



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
DARR AND PATRICIA JOBE )

Appearances:

For Appellants: H. A. Sherda  
Certified Public Accountant

For Respondent: Peter S. Pierson  
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Darr and Patricia Jobe against proposed assessments of additional personal income tax in the amounts of \$84.72, \$112.67, and \$366.55 for the years 1960, 1961, and 1962, respectively. After this appeal was filed respondent Franchise Tax Board conceded two issues relating to the year 1962, thereby reducing the proposed additional assessment for 1962 to \$195.74.

Mr. Jobe (hereafter referred to as "appellant") is primarily engaged in the practice of veterinary medicine. In the mid-1950's he purchased real estate in Temple City, California, on which he planned to erect an apartment house. Construction of that building was commenced in 1957 and completed in 1958. During 1959 appellant built a duplex on the rear portion of the same lot, and in 1962 he placed a 9-unit apartment complex on the remaining vacant land.

Appellant experienced some difficulty in renting these various apartment units. In 1959 the vacancy factor was 16 percent. It rose to as high as 62 percent in 1962 after the second apartment complex was completed, and it

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finally stabilized at about 27 percent in 1963. Appellant's rental properties produced gross rental income during the years in question of \$15,289 in 1960, \$13,441.54 in 1961, and \$18,220.20 in 1962. In his California personal income tax returns for those years appellant reported the following net losses from his rental properties: \$2,420.94 in 1960, \$8,139.33 in 1961, and \$11,752.67 in 1962.

The first question raised by this appeal concerns whether appellant properly computed annual depreciation on these rental properties.

**Section 17208 of the Revenue and Taxation Code** allows as a depreciation deduction "a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) -- ... (2) Of property held for the production of income, " The annual allowance for depreciation of such property is based in part on an estimate of the property's useful life, i.e., the period over which the asset may be useful to the taxpayer in the production of his income. (Cal. Admin. Code, 'tit, 18, reg. 17208(a), subd. (2) .)

In computing depreciation on his rental properties appellant estimated the useful lives of the original apartment building, the duplex, and the 9-unit apartment complex to be 25 years, 20 years, and 25 years, respectively.

Respondent's auditor increased appellant's estimates of useful life to 33 1/3 years for the first apartment building and the duplex, and 35 years for the 9-unit apartment complex. This action was taken in reliance on Bulletin F of the Internal Revenue Service (Bulletin F, "Estimated Useful Lives and Depreciation Rates" (Revised, Jan., 1942)), which supplied the federal authorities with guideline estimates of useful lives for various types of depreciable property. In that publication 33 1/3 years was designated as a reasonable estimated useful life for a cheaply constructed apartment building, when the building and its components were depreciated on a composite rate basis, as was the case here.

As a result of respondent's downward adjustments in the allowable depreciation deductions, the net losses reported by appellant to have been incurred in the operation of his rental properties were reduced to \$618.36 in 1960, \$6,448.55 in 1961, and \$9,355.68 in 1962.

Appellant contends that respondent's extension of the estimated useful lives of appellant's rental properties was unreasonable because it completely ignored the functional

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and economic obsolescence factor which prevailed. Appellant supports his use of lower estimated useful life figures by the following contentions:

(1) A substantial number of apartment buildings have gone up in the Temple City area since appellant built his rental properties. Many of those newer buildings are more modern in styling and more luxuriously constructed than appellant's, yet their units are in the same rental price range as appellant's. As a result of this increased competition and a general overbuilding of apartments in the area, it has become increasingly difficult for appellant to find tenants and to keep his units occupied, as is evidenced by the high vacancy factor prevailing in his apartments. On occasion appellant has found it necessary to lower rents in order to compete.

(2) At the same time, taxes, insurance and wages have continued to rise steadily, making it more and more unprofitable to own and maintain the rental units.

(3) Although appellant's gross rental income has increased during the years on appeal, this is due to the nine additional units which were added in 1962. Each year, moreover, there has been a net loss,

(4) This economic obsolescence is not likely to end since in 1964 the property surrounding appellant's was rezoned for more multi-residence structures.

In a recent case (Appeal of Continental Lodge, Cal. St. Bd. of Equal., May 10, 1967) we had to determine, as we must here, whether the appellant had submitted evidence sufficient to overcome the presumption of correctness which attaches to respondent's determination as to the proper depreciation allowance. (Appeal of Frank Miratti, Inc., Cal. St. Bd. of Equal., July 23, 1953; Appeal of Address Unknown, Inc., Cal. St. Bd. of Equal., May 5, 1953.) In the Continental Lodge appeal, as here, respondent had increased the estimated useful life of the taxpayer's building on the basis of the guideline figures contained in Bulletin F. The bulk of the evidence introduced by Continental Lodge in its attempt to prove respondent's determination wrong consisted of its own unsupported statements of its contentions and its opinion about conditions which were likely to exist at some indefinite future time. On that record we held that Continental Lodge had not sustained its burden of proving respondent's action to have been incorrect.

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In the instant case also, appellant's evidence of his contentions consists mainly of his own unsupported statements of those contentions. Moreover, the obsolescence which appellant contends has shortened the useful lives of his rental properties is not proven by a mere showing of competition, decreases in revenue, or even net losses. (Detroit & Windsor Ferry Co. v. Woodworth, 115 F.2d 795, cert. denied, 312 U.S. 692 [85 L. Ed. 1128]; Southeastern Bldg. Corp. v. Commissioner, 143 F.2d 879, cert. denied, 326 U.S. 740 [90 L. Ed. 442]; Anna J. Cotton, 25 B.T.A. 1158.) Appellant's case for obsolescence is particularly weak in view of the fact that during the years on appeal construction of his properties had only recently been completed. At that point in time the existence of net losses did not necessarily establish a trend, nor did it prove that the economic conditions then prevailing would continue. Even more debilitating to appellant's claim is the fact that in 1962 he constructed a new rental property, in the face of the very conditions that he claims establish obsolescence. The case of Occidental Loan Co. v. United States, 235 F. Supp. 519, relied on by appellant, is not controlling for in that case the reasonableness of the estimated useful life which the taxpayer used in computing depreciation on his rental properties was not in issue.

In our opinion appellant has failed to introduce evidence sufficient to overturn respondent's determination as to the appropriate estimated useful lives of appellant's rental properties.

The second issue which must be resolved is whether appellant properly deducted the cost of an X-ray cable as a business expense and, if not, what the estimated useful life of that cable was for purposes of computing depreciation.

In 1962 appellant purchased an X-ray machine and X-ray cable for use in his small animal hospital. For tax purposes appellant treated the cost of the X-ray machine as a capital expenditure and he computed his annual depreciation deductions on the machine on the basis of an estimated useful life of eight years. Appellant deducted \$832, the cost of the X-ray cable, as a business expense incurred in 1962. Respondent has determined that the cost of the X-ray cable was also a capital expenditure and has computed appellant's annual depreciation deduction on the cable on the basis of an estimated useful life of eight years.

Section 17202 of the Revenue and Taxation Code provides for the deduction from gross income of ordinary and necessary business expenses paid or incurred by the

taxpayer during the taxable year. Section 17283 of that code prohibits the deduction of capital expenditures. An example of a nondeductible capital expenditure is "the cost of acquisition... of machinery and equipment, ... having a useful life substantially beyond the taxable year." (Cal. Admin. Code, tit. 18, reg. 17283(b), subd. (1).)

In support of his treatment of the cost of the X-ray cable as a deductible expense, appellant argues that: (1) the useful life of this high-voltage cable is unrelated to the life of the X-ray machine; (2) upon inquiry the X-ray companies refused to give an estimate of the useful life of this cable, but they indicated that the cable could last one year or it might last as long as four years or even more; and (3) the manufacturer's warranty on this cable is one year in duration. If it be concluded that the cost of the X-ray cable was a nondeductible capital expenditure, then appellant contends that at most the X-ray cable should be assigned an estimated useful life of three years for purposes of computing annual depreciation.

We cannot agree with appellant that if the X-ray cable was guaranteed by its manufacturer for only one year and if in some instances those cables might last for only one year, then the cost of the cable was a deductible business expense. On the contrary, those facts, if established by competent evidence, would indicate that the probable useful life was more than one year and therefore that the cable was a capital asset. The cable was acquired by appellant at the same time as the X-ray machine and was necessary to the operation of that machine. We do not believe that the cost of the cable was in the nature of a repair or other deductible business expense, but rather that the purchase price represented the cost of a capital asset, the same as the cost of the X-ray machine.

Since we have concluded that the X-ray cable was a capital asset, it is necessary to determine whether respondent properly computed depreciation on that cable on the basis of an estimated useful life of eight years. This was appellant's own estimate of the useful life of the X-ray machine.

As was stated in connection with the first issue in this appeal, respondent's determination as to the proper depreciation allowance carries with it a presumption of correctness and the burden is on appellant to prove that determination incorrect. Here, as with the first issue, the only evidence offered by appellant is his own unsupported statement that an appropriate estimate of useful life for the X-ray cable was three years. Although he refers to statements

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allegedly made by X-ray companies to the effect that the cable could last for three or four years or longer, no documentary evidence of those statements appears in the record. In any event, such statements would be inconclusive.

Under these circumstances we do not believe appellant has produced evidence sufficient to overturn respondent's determination that the X-ray cable should be depreciated along with the X-ray machine on the basis of an estimated useful life of eight years.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Darr and Patricia Jobe against proposed assessments of additional personal income tax in the amounts of \$84.72, \$112.67, and \$366.55 for the years 1960, 1961, and 1962, respectively, be and the same is hereby modified in that the assessment for 1962 shall be reduced to \$195.74, in accordance with the concessions made by the Franchise Tax Board. In all other respects the action of the Franchise Tax Board is sustained.

-Done at Sacramento, California, this 7th day of July, 1967, by the State Board of Equalization,

Paul R. Leake, Chairman  
John W. Lynch, Member  
Richard Lee, Member  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member

ATTEST: [Signature], Secretary