



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MILLAR FARMS CORPORATION)

For Appellant: Kendal Cornell
Attorney at Law
For Respondent: Kathleen M. Morris
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Millar Farms Corporation against proposed assessments of additional franchise tax in the amounts of \$2,306.98, \$644.29, and \$235.42 for the income years ended October 31, 1975, 1976, and 1977, respectively.

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Appellant's predecessor, Millar Brothers, a California partnership composed of two partners, Robert P. and Thomas B. Millar, entered into a written agreement (hereinafter referred to as "the Agreement") with the partners' parents on August 1, 1972. Pursuant to the terms of the Agreement, certain real property and the improvements thereon were conveyed to Millar Brothers in consideration for a private annuity to pay the partners' parents \$1,000 a month for the remainder of their lives, so long as either of them should live. The market value of the property transferred to Millar Brothers pursuant to the expressed terms of the Agreement was appraised at \$160,750 as of September 1, 1972. On October 16, 1972, Millar Brothers incorporated as "Millar Farms Corporation" (appellant); the latter began doing business on January 1, 1973.

During an audit of appellant's franchise tax returns for the years in issue, respondent noted that appellant's depreciation schedule for each year contained an item labelled "various equipment" with a reported basis of \$45,648. In response to a request for substantiation as to the basis of the subject equipment, appellant stated that it had been acquired in partial consideration for the annuity. When appellant failed to provide any documentation substantiating its contention, respondent disallowed the claimed depreciation. Respondent also made an adjustment to appellant's return for the 1975 income year with respect to its income from walnut sales; no objection has been raised with regard to the latter adjustment. The subject proposed assessments were subsequently issued.

Appellant protested respondent's issuance of the proposed assessments. To support its claimed depreciation of the subject equipment, it supplied an appraisal of "all the personal property ... involved in the Millar transfer." That appraisal valued certain items of farm machinery conveyed to Millar Brothers, apparently in partial consideration for the annuity, at \$15,125 as of November 28, 1972. Respondent concluded that this appraisal did not substantiate the \$45,648 basis which appellant had attributed to the equipment in issue and affirmed the proposed assessments, thereby resulting in this appeal.

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In that appellant has not protested respondent's adjustment to its 1975 return with regard to its income from the sale of walnuts, the sole issue presented by this appeal is whether respondent properly disallowed appellant's claimed depreciation on the subject equipment for the years in issue,

Respondent argues that the proposed assessments should be sustained because appellant has failed to establish that its predecessor, Millar Brothers, acquired the equipment in issue in partial consideration for the annuity. Should appellant substantiate that Millar Brothers acquired the equipment pursuant to the Agreement, respondent asserts that its action in this matter should be sustained for either of the following reasons: (i) appellant has not substantiated that it actually obtained the equipment from Millar Brothers; and (ii) appellant has not shown how it established the basis of the equipment.

It is well settled that deductions are a matter of legislative grace and that the burden of proving the right to a deduction is upon the taxpayer. (Deputy v. du Pont, 308 U.S. 488 [84 L.Ed. 4161 (1940)]; New Colonial Ice Company v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of Robert J. and Margaret A. Wirsing, Cal. St. Bd. of Equal., Aug. 1, 1974; Appeal of James M. Denny, Cal. St. Bd. of Equal., May 17, 1962.) Given that each of respondent's three objections to appellant's claimed depreciation is independently sufficient to sustain the proposed assessments, the first question presented for our determination is whether appellant has established that Millar Brothers acquired the equipment in issue in partial consideration for the annuity. We need only discuss respondent's other objections if the answer to the initial inquiry is affirmative.

Appellant originally maintained that Millar Brothers acquired real property and improvements worth approximately \$112,000, as well as approximately \$45,000 in equipment (including the farm machinery listed in the November 28, 1972 appraisal), in consideration for an annuity worth \$158,000. Appellant has apparently altered its original position and now contends that its predecessor obtained real property and improvements valued at approximately \$98,000, plus equipment worth approximately \$62,000, in exchange for the annuity,

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which it now claims was worth \$160,000. ^{1/} Moreover, whereas appellant originally stated that the farm machinery appraised as of November 28, 1972 constituted a portion of the subject equipment, it now contends that the farm machinery was specifically appraised for the purpose of acquiring financing and did not constitute part of the equipment in discussion here. Appellant maintains that the \$45,648 basis it attributed to the subject equipment can be substantiated by eliminating the \$15,125 in appraised farm machinery from the approximately \$62,000 in equipment its predecessor purportedly received in partial consideration for the annuity.

Appellant acknowledges that the expressed terms of the Agreement do not support its contention that Millar Brothers received the equipment in issue in partial consideration for the annuity. However, it argues that extrinsic evidence may be used to support that assertion. While it is true that the Agreement's terms may be explained or supplemented by course of performance of the parties thereto (Code Civ. Proc., § 1856, subd. (c)), we conclude, upon careful review of the record on appeal, that appellant has failed to provide any such evidence.

The record of this appeal actually refutes, rather than supports, appellant's contention that it received the equipment in issue in partial consideration for the annuity. Documentation provided by appellant indicates that the only personal property acquired by **Millar Brothers in partial consideration for the annuity** was the farm machinery valued in the November 28, 1972 appraisal. That appraisal stated that the farm machinery listed therein constituted "all the personal property ... involved in the Millar transfer..." (Emphasis added). Appellant, however, has stated that the appraised farm machinery does not constitute part of

^{1/} While appellant states that the value of the annuity was a "mechanical computation based upon the [then] present value of the annuity at the time the [Agreement] was entered into," it has not provided any documentation demonstrating how that computation was made. Additionally, appellant has failed to explain why it originally maintained that the value of the annuity was \$158,000 but now claims that "it is clear that the value of the private annuity was \$160,000."

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the equipment in issue. Furthermore, appellant has provided no substantiation for its contradictory claims as to the value of the annuity; consequently, those unsupported claims are of no assistance to appellant's position here.

Under the circumstances described above, we conclude that appellant has failed to establish that its predecessor acquired any personal property, other than that mentioned in the above referenced November 28, 1972 appraisal, in consideration for the annuity. Accordingly, respondent's action in this matter must be sustained.

