23 T.C. 34 (1954)

The cost of a franchise limited in duration, such as a 10-year operating franchise, is a depreciable asset for tax purposes, and the depreciation should be calculated over the franchise's term.

Summary

Pasadena City Lines, Inc. (petitioner) was granted a 10-year franchise to operate a motor coach system in Pasadena, California. The petitioner was required to purchase the franchise and assets of the existing transportation system. The Commissioner of Internal Revenue disallowed petitioner's depreciation deductions for franchise costs, arguing the franchise was not of limited duration. The United States Tax Court held that because the franchise had a definite 10-year term, the petitioner could depreciate the franchise costs over that period. Furthermore, the court held that the expenses incurred in acquiring the franchise, including payments for the existing operator's franchise and associated assets, were properly included in the franchise's depreciable basis.

Facts

Pasadena City Lines, Inc. was incorporated in 1940 to operate a motor coach transportation system in Pasadena, California. The city granted it a 10-year franchise beginning January 19, 1941. To obtain the franchise, Pasadena City Lines, Inc. acquired the operating rights, facilities, and equipment of the Pacific Electric Railway Company, the existing transportation provider. This included purchasing the existing franchise rights, motor coaches, real property, and other assets. The petitioner also paid the city for the removal of overhead rail facilities. The company capitalized these expenditures and began depreciating them over the 10-year franchise period. The IRS disallowed these depreciation deductions.

Procedural History

The case was heard by the United States Tax Court after the Commissioner of Internal Revenue disallowed the depreciation deductions taken by Pasadena City Lines, Inc. The Tax Court considered the case based on stipulated facts. The Tax Court's decision is the subject of this case brief.

Issue(s)

1. Whether the cost of the franchise to Pasadena City Lines, Inc. was a specific amount that was properly accounted for.

2. Whether the cost of the franchise could be depreciated over a 10-year period.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, because the petitioner properly accounted for the costs associated with the franchise, including payments to the city and the previous operator.

2. Yes, because the franchise had a definite 10-year term, making its cost depreciable over that period.

Court's Reasoning

The court first addressed whether the franchise was depreciable. The court cited Cleveland Railway Co., supra to establish that a franchise limited in duration is depreciable. It reasoned that the 10-year term of the franchise granted to Pasadena City Lines, Inc. clearly made it a depreciable asset, rejecting the IRS's argument that the possibility of renewal rendered the franchise's term indefinite. The court stated, "It is clear that a franchise which is limited in duration is properly depreciable during its term." The court further stated, "The allowance for depreciation is to be determined in accordance with the facts existing at the end of the period for which the return is made."

The court then examined the costs included in the franchise's basis for depreciation. It determined that the filing fee, payment for overhead rail facilities, and payments for the rail and motor coach operating rights acquired from Pacific were all part of the franchise's cost. It found that the amounts paid for operating rights were not payments for goodwill, as these rights were necessary to obtain the new franchise. Legal fees and expenses were also considered, and a portion of these was allocated to the cost of the franchise. The court noted, "the various expenses incurred in acquiring a capital asset are not deductible as business expenses in the year in which they are paid or incurred. Such costs must be capitalized and amortized or depreciated over the life of the asset."

© 2025 SCOTUSreports.com. All rights reserved.