

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 190

October 31, 1956

CAPITAL EXPENDITURES: SUBDIVIDER'S PAYMENTS TO UTILITY COMPANY

Syllabus:

Payments made in order to obtain utility service for a subdivision are capital expenditures if the subdivider might not recover all of the payment under the agreed repayment plan. Colony Inc., 26 T.C., No. 3, followed.

Taxpayer paid substantial sums to two water companies in order to induce them to extend their services to subdivisions being sold by the taxpayer. Under the contract with the water companies the taxpayer was to receive a percentage of gross revenue derived from the sale of water to occupants of these subdivisions. These payments were to continue for fixed periods varying from ten to twenty years or until the entire amounts paid by the taxpayer had been returned, whichever event occurred first. The taxpayer charged these expenditures to construction costs and added them ratably to its basis for the lots in the subdivisions. When amounts were returned by the water companies they were reported by the taxpayer as miscellaneous income. Advice has been requested as to whether the amounts expended by the taxpayer are "pure deposits" which have no tax consequences or whether they are capital expenditures as contended by the taxpayer.

Under facts almost identical to the instant case the Tax Court has decided that the payments should be capitalized. Colony Inc., 26 T.C., No. 3. The only factual difference is that in the Colony case the payments to the taxpayer were not to be based on a percentage of revenue. Rather, the subdivider was to receive a refund of \$75 for each new customer in the subdivision who connected to the company's gas mains. No refund was to be made after ten years from the date of the contract. In allowing the taxpayer to allocate the expenditure to the lots ratably, the Court said:

"The determinative factor is that the petitioner made unconditional payments to the two companies in order to obtain utility service for The Colony, and thereby to attract customers for The Colony lots. The payments were thus closely related to the sale of the lots, and petitioner's income from the sale of the lots will be more clearly reflected if a pro rata portion of the payments in question are included in its basis for gain or loss in each lot which was sold".

This same principle is equally applicable to the instant case. It cannot be said that the taxpayer's payments to the utility companies were mere deposits because there is no certainty that the entire amount expended will be returned.