

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 19054784  
T. VARDELL AND )  
A. VARDELL )  
\_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellants: Scott B. Snow and Kevin Silva

For Respondent: John E. Yusin, Tax Counsel IV

For Office of Tax Appeals: Andrew Jacobson, Tax Counsel III

D. BRAMHALL, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, T. Vardell and A. Vardell (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing an additional tax of \$66,713, plus applicable interest, for the 2013 tax year.

Appellants waived their right to an oral hearing; therefore, the matter is being decided based on the written record.

**ISSUES**

1. Whether appellants have shown that they are entitled to claim a business loss deduction pursuant to Internal Revenue Code (IRC) section 165 on the sale of real property in 2013.
2. If appellants establish that they are entitled to claim a business loss deduction, whether appellants have supported their claimed adjusted basis in real property that they sold during 2013.

**FACTUAL FINDINGS**

1. On July 20, 2005, appellants purchased a residential property in Pleasanton, California (the property) for \$2,295,000. The property is located on 1.42 acres and consists of a

- 5,192 square-foot French Country style home with seven bedrooms, 5.1 bathrooms, and a guesthouse.
2. Appellants' 2008 California Resident Income Tax Return (Form 540) lists the property as appellants' residential address.
  3. On May 17, 2012, appellants listed the property for sale for an offering price of \$4,400,000, then reduced the price to \$3,495,000, before withdrawing the property from the market in December 2012. Appellants relisted the property for sale on February 13, 2013. The property sold on December 27, 2013, for \$2,680,000.
  4. On their 2012 and 2013 U.S. Individual Tax Returns, Schedules E, filed with their 2012 and 2013 California Forms 540, appellants reported zero rental income received from the property during 2012, despite disclosing 100 fair rental days, and zero rental income received during 2013, despite listing 365 fair rental days. However, appellants did report business expenses associated with the property, which resulted in net rental losses of \$190,209 and \$239,063 for 2012 and 2013, respectively.
  5. On October 13, 2014, appellants filed a 2013 California resident return. As relevant here, with their return, they filed a 2013 Schedule D-1, "Sale of Business Property," and a related attachment, reporting that they sold the property on December 27, 2013, for a gross sales price of \$2,680,000 and an adjusted basis of \$3,597,033 (including claimed depreciation allowed or allowable since acquisition, plus improvements and sale expenses). The sale resulted in a claimed business loss of \$917,033, which they deducted from their California adjusted gross income (AGI).
  6. Following an audit, on March 9, 2018, FTB issued a Notice of Proposed Assessment (NPA), which disallowed the Schedule D-1 loss of \$917,033, itemized deductions of \$70,253,<sup>1</sup> and all exemption credits. The NPA proposed an additional tax of \$66,713, plus applicable interest.
  7. Appellants apparently protested the NPA, but no record of the contents are in the record. However, appellants did provide an appraisal of the property, purporting to establish a fair market value of \$3,550,000, as of September 22, 2012 (the Royer Appraisal).

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<sup>1</sup> The reduced itemized deductions and exemption credits are due to the disallowed business loss, which increased appellants' California AGI. (See R&TC, §§ 17077 and 17054.1.)

8. On April 15, 2019, FTB issued a Notice of Action,<sup>2</sup> affirming the NPA.
9. This timely appeal followed.

### DISCUSSION

Issue 1: Whether appellants have shown that they are entitled to claim a business loss deduction pursuant to IRC section 165 on the sale of real property in 2013.

#### Burden of Proof

FTB's determinations are generally presumed correct, and the taxpayer bears the burden of proving otherwise. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction or credit. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) A taxpayer's failure to produce evidence that is within his or her control gives rise to a presumption that such evidence, if provided, would have been unfavorable to the taxpayer's case. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.) When attempting to establish that personal use property was converted to a business use, the taxpayer bears the burden of establishing that conversion to the requisite business or profit purpose has occurred. (*Murphy v. Comm'r*, T.C. Memo. 1993-292 (*Murphy*); *Redisch v. Comm'r*, T.C. Memo. 2015-95 (*Redisch*)). Such a finding must be based on all the facts and circumstances. (*Ibid.*)

#### Business Loss on Sale of Real Property

In this appeal, appellants argue that the loss at issue of \$917,033 arose in a transaction entered into for profit. They assert that they attempted to rent the property for several months commencing in September 2012, but were unable to do so because of the economy. Further, appellants contend that at no time while the property was held for rent did they use or occupy the property, and that only after several months of unsuccessful rental efforts did they decide to, and ultimately did, sell the property. We note that appellants have provided no evidence of any

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<sup>2</sup> In their appeal letter, appellants did not address the disallowed itemized deductions of \$70,253 or the disallowed exemption credits. However, since appellants have not prevailed in this appeal, we find FTB properly adjusted these items in its proposed assessment.

rental efforts beyond the mere assertion in their appeal. We further note that the property was first listed for sale on May 17, 2012, a date significantly prior to the asserted initial rental efforts and was again listed (this time, continuously) for sale from February 2013, only a few months after the alleged rental efforts, until sold in December 2013.

FTB counters that the sale was of a personal use asset (i.e., appellants' former personal residence) and that the property was never converted to a business use. As factual support, FTB points to the lack of rental income, the absence of documentation of rental efforts, the fact the property was listed for sale prior to the alleged rental efforts, the property's availability for personal use due to its asserted vacancy, and the significant utility costs incurred on the property.

R&TC section 17201(a) incorporates by reference IRC section 165, except as otherwise provided, as of January 1, 2009. IRC section 165(a) allows a deduction for any loss sustained during the tax year that was not compensated for by insurance or otherwise. As relevant to this appeal, IRC section 165(c) restricts IRC section 165(a) deductions for individuals to losses incurred in a "trade or business" or a loss incurred in any "transaction entered into for profit." In general, a "loss sustained on the sale of residential property purchased or constructed by the taxpayer for use as his personal residence and so used by him up to the time of the sale is not deductible under [IRC] section 165(a)." (Treas. Reg. § 1.165-9(a).) However, a taxpayer may deduct a loss from the sale of a taxpayer's former personal residence under IRC section 165(a) if the property is, "prior to its sale, rented or otherwise appropriated to income-producing purposes and is used for such purposes up to the time of its sale . . ." (Treas. Reg. § 1.165-9(b)(1).) If a property has been converted, the amount of loss allowed on the sale of the property is the difference between the amount realized (e.g., selling price) and the *lesser* of either the fair market value of the property at the time of conversion, or the adjusted basis for loss at the time of conversion. (Treas. Reg. § 1.165-9(b)(2)(i)-(ii).)

It is clear from the record that appellants did not actually rent the property even for a single day between their alleged date of conversion of the property and the date of its sale. Therefore, the question is whether they converted the personal property to one held for the production of income. That is a question of fact that "depends on the purpose or intention of the individual, as gleaned from all of the facts and circumstances." (*Grant v. Comm'r* (1985) 84 T.C. 809, 825.) Courts have often employed the following five factors to determine the taxpayer's intent: "(1) the length of time the house was occupied by the individual as his

residence before placing it on the market for sale; (2) whether the individual permanently abandoned all further personal use of the house; (3) the character of the property (recreational or otherwise); (4) offers to rent; and (5) offers to sell.” (*Ibid.*) No one factor is determinative, and all of the facts and circumstances are considered. (*Ibid.*) However, some courts have also held that a former residence that has never been rented “when it is sold is not business property [under IRC section 165(a)] and that the loss occurring on the sale of the property is not a loss in a transaction entered into for profit.” (*McAuley v. Comm’r*, T.C. Memo. 1976-276.) Other courts have held that if the proposed income-producing use of the property is a rental and the property is not actually rented, the taxpayer must show that they made a bona fide attempt to rent the property. (*Redisch, supra.*)

Here, appellants have failed to prove that they converted the property to an income-producing property pursuant to IRC section 165. It is clear from the record that appellants used the property as a personal residence prior to its sale and did not receive any rental income from the property prior to its sale. In *Redisch*, the tax court employed the five-factor analysis, discussed above, and ultimately found that the taxpayers did not make a bona fide effort to rent their property and thus did not convert it to one held for the production of income. We likewise find that appellants have not established that they made a bona fide effort to rent the property after moving out and prior to its ultimate sale.

Appellants have the burden to prove that they converted the property into an income-producing property. (*Murphy, supra.*) However, appellants concede that the property was never rented from September 2012, through December 27, 2013, the date when they sold it. Instead, appellants merely assert that they “listed the Property for rent for several months, beginning in September 2012,” but that they were unable to rent the property “[b]ecause of the economy.”

In this appeal, since appellants acknowledge the property was never rented, they must show that they made a bona fide attempt to rent out the property during the period September 2012, through December 27, 2013. (*Redisch, supra.*) However, appellants have not documented any specific steps taken to rent the property, such as placing advertisements on websites or in newspapers or as broker listings. Further, no offers to rent, at any rental rate, have been provided. The only evidence that appellants have produced in this appeal is the Royer Appraisal, which states that the property had a market value of \$3,550,000 on the valuation date of September 22, 2012. That appraisal also documents the fact that the property was listed for sale

prior to September 2012 and that the listing remained in place until December 2012. But the Royer Appraisal contains no information concerning appellants' alleged attempts to rent the property, although it does reveal a positive outlook on the home resale market, and, presumably, the home rental market in Northern California as of September 22, 2012.

In the absence of any specific evidence as to the steps appellants took to rent the property, the tax court's conclusion in *Redisch* is equally applicable to the present appeal. "It is unsurprising that this minimal effort yielded only minimal interest." (*Redisch, supra.*) We find that appellants did not rent, or make a bona fide attempt to rent, the property and therefore did not convert it to a property held for the production of income. Accordingly, appellants are not entitled to claim a business loss deduction of \$917,033 on the sale of the property pursuant to IRC section 165.

Issue 2: If appellants establish that they are entitled to claim a business loss deduction, whether appellants have supported their claimed adjusted basis in real property that they sold during 2013.

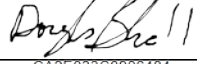
Because appellants have failed to meet their burden of showing that their real property was income-producing property, we need not determine and do not address whether appellants have supported their claimed adjusted basis in the property.

HOLDINGS

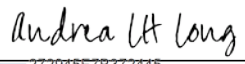
Appellants have failed to show that they are entitled to claim a business loss deduction pursuant to IRC section 165 on the sale of real property. Accordingly, we do not need to address the subsidiary issue of whether appellants have supported their claimed adjusted basis in the property.

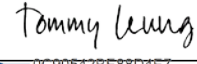
DISPOSITION

FTB’s action is sustained.

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Douglas Bramhall  
Administrative Law Judge

We concur:

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Andrea L.H. Long  
Administrative Law Judge

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Tommy Leung  
Administrative Law Judge

Date Issued: 5/15/2020