

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of  
JAMES H. AND EULA G. ARTHUR

Appearances:

For Appellants: James H. Arthur, in pro. per.

For Respondent: Burl D. Lack, Chief Counsel;  
Jack Rubin, Assistant 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 James H. and Eula G. Arthur to proposed assessments of additional personal income tax in the amount of \$344.38 against them jointly for the year 1950 and in the amount of \$42.96 against each of them for the year 1951.

Arthur Bros. is a family partnership now composed of Appellant James H. Arthur and his brother, Noel L. Arthur. The partnership is in the general contracting business and has apparently held itself out to the public as a real estate firm. Neither partner has been licensed to deal in real estate, but a licensed real estate broker has been employed by the partnership and during the year 1951 it received commission income from real estate transactions not in question in this appeal.

In 1945 Arthur Bros. entered into a "land development agreement" with Lang Bros., a partnership engaged in the business of real estate development and sales, wherein they jointly acquired a subdivision of 51 lots together with some additional acreage in a hilly district of San Francisco. The composition of the Lang firm was later altered by the addition of another partner and in October, 1949, there was a substitute agreement between the two firms. This agreement stated that the interests of the Arthur and Lang partnerships in the acquired lots and acreage were "equal, undivided and co-existent" and that "from and after the date of this contract, said property will be mutually managed and administered for the benefit of both parties equally, and any sale of said property, and any transaction of any other type resulting

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in a profit from said real estate, shall be a joint transaction and the sale price or profits shall be equally divided between the parties hereto." In 1950 the two partnerships entered into a third agreement which severed their joint ownership of most of the property. Each partnership then became the sole owner of designated parcels, excepting three lots which continued to be held in joint ownership.

When the aforesaid property was acquired, sewerage facilities and sidewalks for the subdivided portion of the property had been installed and a billboard advertising lots for sale already was standing at the entrance to the subdivision. The sale of one lot completed in 1946, was then pending. Shortly after acquisition, plans were drawn and estimates were made for the construction of residences on the property. Appellants state that these plans and estimates were not intended for construction by the joint owners prior to sales, but served merely to show prospective buyers how feasible it would be to build homes on the lots.

Before and during the years on appeal payments were made to an outdoor advertising company for maintenance of the billboard. Moreover, various repairs, replacements and improvements were made on the property. These consisted of clearing lots, removing trees, repairing and paving streets, and installing curbs, sewers and **electroliers**. According to Appellants, all of this work was "due to the poor way in which this property was originally developed by the Lang Realty Co." and was necessary to bring the lots up to an acceptable standard for sale and construction; much of the work was required by the City of San Francisco; and none of the work pertained to sale of the acreage.

During 1950 Arthur Bros. sold 11 acres of unimproved property in two transactions and 4-1/2 lots in five transactions. In 1951 the firm sold 4 acres in one transaction and 4 lots in another transaction. Although the lots were listed for sale with other brokers, Lang Bros. handled most of the sales and received a fee for sales of lots separately owned by Arthur Bros. Other brokers were allowed to retain whatever in excess of stated prices they obtained on sales. Arthur Bros.' receipts from all sales in 1950 and 1951 were \$68,889.98. Commissions earned from other, unrelated real estate transactions in San Mateo were \$4,202.98.

Appellants contend that the gain realized by them on sales of the residential lots and acreage in San Francisco

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is taxable as capital gain rather than as ordinary income. The Franchise Tax Board in applying Section 17711 (now 18161) of the Revenue and Taxation Code, has determined that the property sold should not be classified as "capital assets" and hence the gain from sales should not be taxed as capital gain. The material provisions of Section 17711 are as follows:

"Capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include ... property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . .

The Internal Revenue Code of 1939 has substantially the same provisions in Section 117(a). Factors to be considered in determining whether property is held primarily for sale in the ordinary course of business are the purpose of the taxpayer's acquisition and disposal of the property, the continuity of sales or sales related activity over a period of time, the number, frequency and substantiality of sales, and the extent to which the owner or his agents engaged in sales activities by developing or improving the property, soliciting customers and advertising (W. T. Thrift, Sr., 15 T. C. 366).

Upon acquiring the property in question Appellants allied themselves with real estate developers and brokers, had plans and estimates made to sell lots for home construction, maintained a billboard to attract customers, and did the developmental work required to make the lots satisfactory to customers. Although no improvements were made to the undivided acreage, there is no evidence before us that this portion of the property was acquired, held or sold in any manner different from the way in which the lots were handled. (Compare John E. Sadler, T. C. Memo. Op., Dkt. No. 3378, Nov. 30, 1944.) None of the property was producing income. During the years on appeal, the receipts from sales of lots and acreage was substantial. It appears that the partnership was in the business of selling real estate in San Francisco as well as dealing in real estate in San Mateo. Even though sales of the property in question were few, they were in accordance with a sales-development plan formulated with Lang Bros. (See George J. Wibbelsman, 12 T. C. 1022; James E. Kesicki, 34 T. C. No. 70; Harlan O. Carlson, T. C. Memo. Op., Dkt. No. 65856, December 24, 1959.) The evidence shows that the lots and acreage were held primarily for sale to customers in the ordinary course of business.

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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 James H. and Eula G. Arthur to proposed assessments of additional personal income tax in the amount of ~~\$344.38~~ against them jointly for the year 1950 and in the amount of \$42.96 against each of them for the year 1951, be and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of August, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

George R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

                    , Member

ATTEST: Dixwell L. Pierce, Secretary