BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
LOGAN R. AND DELLA M. COTTON)

Appearances:

For Appellants: Logan R. Cotton, in propria persona

For Respondent: Burl D. Lack, Chief 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 Logan R. and Della M. Cotton to proposed assessments of additional personal income tax in the amount of $8.08 against each of them for the year 1952.

Appellants are husband and wife. Hereafter, Logan R. Cotton will alone be referred to as the Appellant.

Appellant has been a public accountant for approximately 25 years. His professional activities have centered in the vicinity of Redondo Beach and Hermosa Beach, California. From time to time he audited the governmental accounts of both cities.

In the course of such activities he learned of a group of lots, already platted and subdivided, which had been sold by one of the cities for delinquent taxes. He thereupon proposed to Karl R. Anderson, an insurance agent and real estate broker, that they jointly purchase the lots. In September, 1947, title to the lots was taken in the name of Anderson. It was agreed, however, that Appellant held a one-half interest in the lots and would take one half of the proceeds from sales. Appellant states that he entered into the purchase of the lots as an investment.

Neither Anderson nor Appellant solicited sales of the lots and there were no "for sale" signs placed on any of the lots. Nevertheless, persons who wished to buy the lots occasionally contacted Appellant and Anderson. Two lots were sold in 1948, one in 1949, six in 1951, nine in 1952, one in 1954 and three in 1956. The gross amounts received on the sales varied from $978.90 to $9,400.00 in each of the years in which sales were made. The gain on the sales prior to the division between Anderson and Cotton was between $552.18 and $5,700.07 in each of those years. Not more than three separate transactions occurred in any single year. Appellant and Anderson did not subdivide or

in any way improve the lots. Anderson was engaged in selling real estate on his own behalf during these years. Appellant has engaged in no other real estate activities.

Appellant and Anderson filed partnership returns with respect to the lot sales. For the year in question, 1952, the return described their relationship as a joint venture in real estate. The partnership returns for other years described the relationship variously as a partnership, joint venture and joint ownership in real estate, except that for the year 1954 the only description on the return was "Accounting and Real Estate Broker." No partnership return was filed for 1956.

In filing their individual returns for 1952, Appellant and Anderson each reported as capital gain his share of the net proceeds from sales of the lots jointly owned by them. The Franchise Tax Board has determined that the profit on the sales constituted ordinary income rather than capital gain.

Appellant's gain is taxable as ordinary income if the lots were held primarily for sale to customers in the ordinary course of trade or business. (Section 17711 of the Revenue and Taxation Code, effective for the year in question.) This provision is substantially the same as that in Section 117(a)(1) of the United States Internal Revenue Code of 1939. Factors to be considered 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.)

We are here impressed by the lack of sales activity and the sporadic and minimal nature of the sales over a period of nine years. No sales at all were made in three of those years. Appellant and Anderson did not acquire additional lots after their original purchase. They did not subdivide or improve the lots or promote the sales in any manner. The buyers were the moving parties in the transactions.

Whether the arrangement between Appellant and Anderson was a partnership, a joint venture or merely joint ownership of property, it must be held that the disposition of the lots in question was a passive liquidation and did not constitute a trade or business under the judicially established tests. (See Houston Deepwater Land Co. v. Scofield, 110 Fed. Supp. 394; Boomhower v. United States, 74 Fed. Supp. 997; Wellesley A. Ayling, 32 T. C. 704; James G. Hoover, 32 T. C. 618; South Texas Properties Co., 16 T. C. 1003; Thomas E. Wood, 16 T. C. 213.)

It is our conclusion that Appellant derived capital gain rather than ordinary income from the sales.

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 Logan R. and Della M. Cotton to proposed assessments of additional personal income tax in the amount of $8.08 against each of them for the year 1952 be and the same is hereby reversed.

Done at Los Angeles, California, this 19th day of October, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

George R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary