BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
GEORGE D. AND CATHERINE C. BUCCOLA)

For Appellants: *Robert G.* Starrett
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

PeterS. Pierson
Associate Tax Counsel

O 3 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 George D. and Catherine C. Euccola against proposed assessments of additional personal income tax in the amounts of $263.04, $955.06, and $5,788.72 for the years 1958, 1959, and 1960, respectively.

Appellant Catherine C. Buccola appears as a -party herein only by virtue of the filing of a joint income tax *return,* Ker husband, George D. Buccola, will be referred to hereafter as "appellant."

On October 23, 1956, appellant entered into an agreement of limited partnership with ten individuals, The partnership was formed for the stated purpose of acquiring certain described real property consisting of approximately 11 acres and constructing commercial and industrial buildings thereon . *Tile* character *of the* business to be carried on by the partnership was described *in the agreement as* follows:

> The business of the partnership shall be to acquire approximately eleven (11) acres of unimproved real property in the County of Orange, and to develop and/or sell all or any part thereof in such a manner as in the judgment of the General Partner seems to be in the best interest of the Partnership.

The limited partners collectively contributed capital in the total sum of $25,000 which was used to acquire the property. Appellant was not required to contribute funds but by the terms of the agreement was obligated to "contribute services by way of acquiring the above described real property, the construction of commercial buildings thereon, and the leasing of the same to the general public.",

Appellant was entitled to receive 70 percent of partnership profits and the limited partners were to receive the remaining 30 percent. As general partner, appellant was vested with the sole authority to manage and control the business of the partnership, and to distribute profits,

During the period under consideration, appellant was an executive and controlling shareholder in corporations engaged in subdividing, improving, and selling real property but did not participate in such activities in his individual capacity.

The property was never listed with a broker for sale and no advertising or other sales activity was undertaken to sell the property. Although a subdivision map had been filed by a previous owner of the purchased land, no development occurred. No improvements were erected on the land during the period it was held by the partnership. After holding the property for approximately one year, the partnership sold the entire eleven acres in separate parcels to five different buyers. Four of the sales were completed during the year 1958 and the final sale occurred in 1959.

Appellant reported his share of income derived from the partnership land sales as gain from the sale of a "capital asset" taxable as "capital gain." (Rev. & Tax. Code, § 18151.) Respondent concluded that the land was not a capital asset and denied capital gains treatment. Thus, the question for the years 1958 and 1959 turns upon whether the land sold by the partnership was a capital asset.

Section 18161 of the Revenue and Taxation Code defines a "capital asset" as property held by the taxpayer (whether or not connected with his trade or business), but

excludes "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." An identical exclusion may be found in section 1221 of the Internal Revenue Code of 1954 which defines the term "capital asset" for federal-income tax purposes,

In support of his contention that the partnership land was a capital asset, appellant has executed an affidavit which recites that the property was acquired by the partnership for the purpose of developing it as a shopping center or motel and that it was expected that the developed property would produce substantial rental income. The property was subsequently sold to unsolicited buyers when anticipated commercial development of the surrounding area did not occur.

Respondent relies heavily on that part of the partnership agreement which states that the business of the partnership was to "develop and/or sell" the land, as indicating that the property was held primarily for sale,-

Determination of the primary purpose for which property is held is essentially a question of fact. (Curtis Co., 23 T.C. 740; Arthur E. Wood, 25 T.C. 468.) Although each case is controlled by its particular circumstances, certain recognized criteria have been developed to assist in making the factual determination. Among the matters to be inquired into are the reasons for acquisition and disposal of the property; the amount and continuity of sales activity; the extent to which the taxpayer engaged in developing or improving the property for sale and the number and frequency of the sales, (Home Co. v. Commissioner, 212 F.2d ,637; Broughton v. Commissioner, 333 F.2d 492; James G. Hoover, 32 T.C. 618.)

An important aid in statutory construction has been provided by a recent decision of the United States Supreme court . *In* Malat v. Riddell, 383 U.S. 569 [16 L. Ed. 2d 102], the Court defined the term "primarily' in ruling on a taxpayer's application for capital gains treatment under the aforementioned section 1221 of the-Internal Revenue, Code. The Court held that "primarily" means "of first importance' or "principally," Although it was clear from the evidence before the Court that sale of the property was one of the alternatives considered by the taxpayer at the time of the purchase of the property, the case was remanded to the lower court to determine- the primary purpose for which the property was held prior to sale. The Court thus rejected a line of authority holding that property is held primarily for sale if sale is one of the essential, although not necessarily the dominant purpose for which it is held.

We are satisfied that at the time of acquisition the partnership intended to hold the property for the primary purpose of development as rental property. Appellant's sworn declaration to this effect is supported by provisions of the partnership agreement which disclose that the partnership contemplated the construction of commercial buildings on the land and the leasing of the property to the general public.

A review of sales and development activity does not indicate that the partnership deviated from its original intent to hold the property for development as rental property. It did not advertise or post 'For Sale" signs and no agents were employed to obtain buyers. No improvements were erected to enhance the marketability of the property. The five sales were made in parcels selected by the buyers whose offers were not solicited by the partnership. 'Such facts *strongly* indicate that the property was not held primarily for sale to customers. (South Texas Properties Co., 16 T.C. 1003.) Under these circumstances, the number and frequency of the sales likewise do not support an inference that the sales were made as a result of business activity.- (Frieda E. J. Farley, 7 T.C. 198; Carl E. Metz, T.C. Memo., Dkt. Nos. 37524, 37525, Nov. 8, 1955.)

Appellant 's activities in connection with other corporations engaged in ***real estate sales*** activity cannot be attributed to the partnership in the absence of evidence that the. other. *corporations* actually *engaged in* business activity on behalf of the partnership, (Municipal Bond Corn. v. Commissioner, 341 F.2d 683.) The information contained in the record does not warrant a finding that appellant solicited customers in any representative capacity. -Although appellant's connections in the real estate business could have reduced any need for active solicitation, that fact does not compel a conclusion that the property in question was held for sale to customers in the ordinary course of business. (Lobell0 v. Dunlap, 210 F.2d 465.)

For the reasons stated, we conclude that the property was acquired and held as a capital asset: Since the partnership did not in the course of disposing of the property engage in such business activity as to constitute a business of selling real estate, the property was not held primarily 'for sale in the ordinary course of a trade or business, We, therefore, ***reverse*** respondent's determination that the income derived by appellant from the sales was *not* entitled to be taxed as capital gains.

An additional issue, which related to the year 1960, has been Settled, Appellant and respondent have stipulated that the appeal for that year is to be dismissed.

Appeal of George D. and Catherine C. Buccola

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 George D. and Catherine C. Buccola against proposed assessments of additional personal income tax in the amounts of $263.04 and $955.06 for the years 1958 and 1959, be and the same is hereby reversed.

IT IS FURTHER ORDERED that the Appeal of George D. and Catherine C. Buccola from the action of the Franchise Tax Board on their protest against a proposed assessment of additional personal income tax in the amount of $5,788.72 for the year 1960, be and the same is hereby dismissed.

Done at Sacramento, Califprnia, this 15th day of December 1966, by the State Board of Equalization.

_____, Chairman

Paul R. Leake, Member

John W. Lynch, Member

_____, Member

_____, Member

Attest: _____, Secretary