



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
  )  
HAROLD A. AND DORIS C. ROCKWELL )

For Appellants: Harold A. Rockwell,  
  in pro. per.  
  
For Respondent: Kendall E. Kinyon  
  Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Harold A. and Doris C. Rockwell against a proposed assessment of additional personal income tax in the amount of \$3,017.15 for the year 1976. Appellants have paid \$2,608.15 of the proposed assessment; therefore, only \$409.00 remains in dispute.

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The issue presented is whether respondent properly computed appellants' tax on preference items for the year in issue,

Appellants, husband and wife, filed a joint return for taxable year 1976. Their return reflected negative taxable income of \$2,931.45, but indicated a preference tax liability of \$489.85 on the excluded portion of their long-term capital gains. Upon receipt of appellants' return! respondent recomputed appellants' tax on preference income by including, as an item of tax preference, appellants' net farm loss in excess of \$15,000.

Appellants, while acknowledging that their net farm loss was properly included as an item of tax **preference**, protested the proposed assessment contending that their net farm loss preference income should be adjusted by an amount equal to their **allowable** itemized personal deductions and exemption credits. Pursuant to this belief, appellants calculated their net farm loss preference income at \$48,582.00 and paid the tax thereon. The \$409.00 in dispute represents preference tax at the rate of 5-1/2 percent on \$7,431.00, the difference between \$56,013.00, the net farm loss preference income determined by respondent, and the \$48,582.00 calculated by appellants to be their net farm loss preference income. Respondent, after reviewing appellants' protest, reaffirmed its proposed assessment. Appellants' disagreement with respondent's determination has resulted in this appeal.

Sections 17062-17062.2 of the Revenue and Taxation Code impose a tax on the sum of the **items** of tax preference in excess of the amount of "net business loss" for the taxable year. Section 17063,<sup>1/</sup> subdivision (i), as it existed for the year in issue,<sup>2/</sup> included as an item of tax preference, for years beginning after December 31, 1975, "[t]he amount of net farm loss in excess of fifteen thousand dollars (\$15,000) which is deducted from **nonfarm** income." The term "net business loss" is defined in section 17064.6 as "adjusted gross income (as defined in Section 17072) less the deductions

<sup>1/</sup> Hereinafter, all references are to the Revenue and Taxation Code.

<sup>2/</sup> AB 93 (Stats. 1979, Ch. 1168), operative **for** taxable years beginning on or after January 1, 1979, rewrote subdivision (**i**) of section 17063 as subdivision (h) and increased the excluded amounts thereunder.

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allowed by Section 17252 (relating to expenses 'for production of income), only if such net amount is a **loss.**"

Appellants argue that the term "**nonfarm** income," as used in former subdivision (i) of section 17063, should be interpreted as referring to a taxpayer's **nonfarm** income after allowance for statutory deductions and exemption credits. In essence, appellants contend that their personal deductions and exemption credits are "net business loss" and, accordingly, may be used to offset their tax preference income for the year 1976. To do otherwise, they argue, would be to assess a tax on that portion of the net farm loss from which they 'derived no tax benefit.

Appellants' argument involves the proper method of computing their "net business loss" pursuant to section 17064.6. The definition of "net business loss" set forth in section 17064.6 was designed to identify the portion of a taxpayer's items of tax preference **which** do not produce an actual tax benefit. (Appeal of Richard C. and Emily A. Biagi, Cal. St. Bd. of Equal., **May 4**, 1976; Appeal of James R. and Jane M. Bancroft, Cal. St. Bd. of Equal., Jan. **11, 1978.**) The Legislature achieved this result by defining "net business loss" in terms of adjusted gross income as reduced by the deductions allowed by section 17252 (relating to expenses for production of income). The purpose for defining "net business loss" in this manner was to place taxpayers engaged in activities for the production of income on an equal footing, for purposes of the tax on preference income, with taxpayers engaged in a trade or business. (Appeal of Paul and Melba Abrams, Cal. St. Bd. of Equal., Jan. 11, 1978.) **This purpose** would be frustrated by construing the phrase "net business loss" to include personal deductions and exemptions credits.

It is significant that the deductions allowed in computing adjusted gross income, as well as the deductions allowed by section 17252 which relate to the production of income, are, for the most part; directly related to business or income producing activities. However, the deductions and exemptions allowed in computing "\*taxable income" include items of a personal nature which have no direct connection with business or income producing activities. (Compare Rev. & Tax. Code, **§§** 17072 and 17201-17240 with Rev. & Tax. Code, **§§** 17253-17256.) Accordingly, we believe that by defining "net business loss" in terms of adjusted gross income, rather than taxable income, the Legislature

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intended to eliminate from consideration, in ascertaining the extent to which items of tax preference produce a tax benefit, personal deductions and exemptions which have no relationship to the production of tax preference income. (Appeal of James R. and Jane M. Bancroft, supra.) For these reasons, we must conclude that appellants are not entitled to offset against tax preference income an amount equal to their personal exemptions and exemption credits in computing the tax imposed by sections **17062-17062 .2.**

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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 protest of Harold A. and Doris C. Rockwell against a proposed assessment of additional personal income tax in the amount of **\$3,017.15** for the year 1976, be and the same is hereby sustained.

Done at Sacramento, California, this 30th day of March , 1931, by the State Board of Equalization, with Members Dronenburg, Bennett and Nevins present.

<u>Ernest J. Dronenburg, Jr.</u>	, Chairman
<u>William PC. Bennett</u>	, Member
<u>Richard Nevins</u>	, Member
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