BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Hatter of the Appeal of)
)
DON AND PAT FABER)

Appearances:

For Appellants: Anthony Hess
Enrolled Agent

For Respondent: John R. Akin
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 Don and Pat Faber against proposed assessments of additional personal income tax in the amounts of $482.61, $777.04, $967.57, and $1,393.85 for the years 1973, 19'74, 1975, and 1976, respectively.

Appeal of Don and Pat Faber

The issues presented by this appeal are: (i) whether Don and Pat Faber (hereinafter referred to as "appellant-husband" and "appellant-wife," respectively, and collectively referred to as "appellants") were engaged in the various activities described below primarily for the production of income such that they were entitled to deduct certain expenses incurred with respect thereto; and (ii) whether respondent properly disallowed certain deductions characterized by appellants as employee business expenses.

Appellants are professional educators; appellant-husband is an associate professor of recreation at Lo's Angeles Harbor College, and appellant--wife is a public high school teacher. During the appeal years, appellants were also engaged in a number of activities, purportedly for the purpose of supplementing their income as instructors. For each of the years in issue, appellants filed joint California personal income tax returns on which they claimed numerous trade or business expense 'deductions relating to their positions as educators. Additionally, appellants claimed many Schedule 2 business expenses incurred with respect to their outside activities. The pertinent facts relative to those activities are set forth below.

Yacht Sales

Appellants apparently were the owners of a yacht prior to 1973; a second yacht was purchased in 1976. Appellant-husband was a salesperson for Anchorage Yachts, and received a finder's fee if one of his clients purchased a boat from that firm. In 1976, he entered into a similar arrangement with Sol Sports, the company from which the second yacht had been purchased. As a result of this activity, appellants claimed certain expenditures as business expenses, including football tickets, "gymnastics consulting," and yacht club dues. Appellants' gross income and expenses from this venture were as follows:

Year	Gross Income	Expenses	Net Losses
1973	$667	$1,985	[$1,318]
1974	617	858	[241]
1975	83*	956	[873]
1976	-0-	1,425	[1,425]

* Income received from sailing lessons.

Personal Residence as a Sales Tool

For each of the appeal years, appellants claimed that their personal residence was a sales tool used for the production of income. During 1973 and 1974, appellants referred visitors to their home to R. J. Young Construction Company, which offered appellants two percent of the construction price as a finder's fee if one of their referrals used this company to construct a home. For 1975 and 1976, appellants associated themselves with Goodrich and Associates, a real estate agency, with which they entered into a similar arrangement. On the Schedule C used to report the income and expenses from this activity for 1975, appellants claimed entertainment expenses of $227 and an automobile expense in the amount of $1,980. The other expenses allegedly incurred in 1975 for the display of their home were claimed on the Schedule C for their recreational consulting activity. Among other items, appellants deducted the cost of patio funiture, pool cleaning, trash collection, and liquor as expenses related to the use of their home as a sales tool. Appellants' gross income and expenses from this activity were as follows:

Year	Gross Income	Expenses	Net Losses
1973	$1,200	$3,109	[$1,909]
1974	250	4,231	[3,981]
1975	-0-	2,207	[2,207]
1976	2,235	4,144	[1,909]

Recreational Consultation

Appellant-husband claims to be a consultant for the leisure and travel industry. Purportedly for the purpose of "investigat[ing] the potential of recreation ramifications and to satisfy their need to know what was happening in the private sector," appellants traveled to Nevada, Utah, Idaho, and Wyoming after the 1972-1973 academic year. During their trip to these states, appellants visited Las Vegas, Yellowstone National Park, Jackson Hole, and other tourist attractions. In 1974, appellants traveled to the Virgin Islands; they reported gross income of $170 from this trip for writing a scuba and sail tour report for a travel agency. For the taxable year 1975, appellants deducted $2,224 for expenses incurred in displaying their home on the Schedule C used to report the income

and expenses from the recreational consulting activity. Appellants did not file a Schedule C for the recreational consulting venture in 1976. The gross income a'nd expenses from this activity were as follows:

Year	Gross Income	Expenses	Net Losses
1973	$ 50	$1,241	[$1,191]
1974	170	1,675	[1,505]
1975	250	2,224	[1,974]

Ski Time Realty

As part of their joint personal income tax return for 1973, appellants, the owners of a condominium in Mammoth, California, filed a Schedule C on which they claimed a business expense in the amount of $1,822. This amount represented the'lease and operating costs of an automobile allegedly used by appellant-husband as a salesperson for Ski Time Realty and Reservation, Inc., a company related to R. J. Young Construction Company. By virtue of his ownership of the Mammoth condominium,, appellant-husband claims he felt that he could interest others in vacation property. This activity, which resulted in no sales, was operated by appellant-husband from his yacht in Marina Del Rey.

After conducting an audit of their returns, respondent determined that appellants' above described activities were not activities engaged in for profit. Consequently, respondent disallowed the claimed expenses to the extent they exceeded the limitations imposed by section 17233 of the Revenue and Taxation Code. 1/ Apparently relying upon section 17252, appellants assert, that the losses attributable to the subject activities are fully deductible. In relevant part, these two sections are set forth in the margin. 2/ After carefully reviewing the record on appeal, we are convinced that respondent acted properly.

1/ Hereinafter, all references are to the Revenue and Taxation Code unless otherwise, indicated.

2/ Section 17233:

(a) In the case of an activity engaged in by an individual, if such activity is not

(Cont'd on next page)

2/ (Cont'd)

engaged in for profit, no deduction attributable to such activity shall be allowed under this part except as provided in this section.

(b) In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed--

(1) The deductions which would be allowable under this part for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) A deduction equal to the amount of the deductions which would be allowable under this part for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

(c) For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable ... under subdivision (a) or (b) of Section 17252.

Section 17252:

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year--

(a) For the production or collection of income;

(b) For the management, conservation, or maintenance of property held for the production of income ....

These sections are substantially identical to sections 183 and 212, respectively, of the Internal Revenue Code of 1954. Accordingly, federal case law is highly persuasive in interpreting the California statutes. (Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).)

Ordinary and necessary expenses attributable to an activity not engaged in for profit are deductible only to the extent of gross income derived from such activity less the amount of those deductions which are allowable whether or not the activity is engaged in for profit. (Rev. & Tax. Code, § 17233, subd. (b).) An activity not engaged in for profit is defined in section 17233, subdivision (c), as one for which deductions under section 17202 or under subdivisions (a) or (b) of section 17252 are not allowable.

In deciding whether an activity is described in section 17233, the focus is on the objective with which the taxpayer entered into, and engaged in, the activity. If the taxpayer had a bona fide, even though unreasonable, objective of making a profit, the activity is not described in section 17233. (Edward Jasionowski, 66 T.C. 312, 321 (1976); Margit Sigray Bessenyey, 45 T.C. 261, 274 (1965), affd., 379 F.2d 252 (2d Cir. 1967), cert. den., 389 U.S. 931 [19 L.Ed.2d 283] (1967).) The determination of the taxpayer's 'intent is to be based on "all of the facts and circumstances" with respect to the activity, with greater weight placed on objective facts than on the taxpayer's statement of intent. (Former Cal. Admin. Code, tit. 18, reg. 17233 (b), subd. (a), repealed May 16, 1981; C. West Churchman, 68 T.C. 696, 701 (1977); Francis X. Benz, 63 T.C. 375, 382-384 (1974).) Whether a taxpayer engaged in an activity for the primary purpose of making a profit is a question of fact on which he bears the burden of proof. (Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal., Dec. 15, 1976.)

Nine factors which are normally taken into account were listed in respondent's regulations promulgated pursuant to section 17233, subdivision (b). (Former Cal. Admin. Code, reg. 17233(b), repealed May 16, 1981; see also Treas. Reg. § 1.183-2(b).) our decision in the instant appeal is founded upon a combination of several of these factors. These include consistent and sizable losses, substantial income Erom other sources, the recreational aspect of some of appellants' activities, the limited time and effort which appellants could have devoted to their myriad activities, and commencement and continuation of their activities in a manner which does not reflect business expertise.

From 1973 through 1977, expenses from each of appellants' activities far exceeded gross receipts, resulting in a net loss for each year. The amounts of these net losses ranged from a low of $3,334 in 1976 to a high of $6,240 in 1973. The ratio of average annual expenses to average annual gross receipts ranged from a low of 2.5-to-1 in 1976 to a high of 16-to-1 in 1975. The use of appellants' home as a sales tool, the activity with the best such annual ratio over the appeal period, had a ratio of annual expenses to annual gross receipts of 3.7-to-1. Such an imbalance belies the existence of a profit motive. (Edward Jasionowski, supra.) The record of this appeal discloses no basis for concluding that a period of three to four years is customarily necessary to bring any of the activities in which appellants were engaged to profitable status. Accordingly, the history of uninterrupted losses for each of those activities is a factor which may be indicative of activities not engaged in for profit. (Margit Sigray Bessenyey, supra; Former Cal. Admin. Code, tit. 18, reg. 17233(b), subd. (b)(6), repealed May 16, 1981.)

During the years in issue, income from appellants' salaried positions as instructors ranged from $30,916 in 1973 to $46,914 in 1976. As the amounts of respondent's proposed assessments illustrate, appellants partially recouped losses from their various activities by offsetting those losses against their other income, thereby reducing their tax liability. The combination of losses from the activities in issue and substantial income from other sources may be an indication that the activity is not engaged in for profit, particularly if an activity is one viewed by the taxpayer as recreational. (Former Cal. Admin. Code, tit. 18, reg. 17233(b), subd. (b)(8), repealed May 16, 1981; Edward Jasionowski, supra; Joseph W. Johnson, Jr., 59 T.C. 791, 817 (1973), affd. on another issue, 495 F.2d 1079 (6th Cir. 1974), cert. den., 419 U.S. 1040 [42 L.Ed.2d 317] (1974).) The enjoyment appellants obtained from involvement in their recreational consultation and yacht sales ventures supports our conclusion. (Former Cal. Admin. Code, tit. 18, reg. 17233(b), subd. (b)(9), repealed May 16, 1981; Francis X. Benz, supra.)

A fourth factor is the minimal time and effort expended by appellants on their various activities. (Former Cal. Admin. Code, tit. 18, reg. 17233(b), subd. (b)(3), repealed May 16, 1981.) In view of their full time teaching positions, and the multitude of their

ventures, it is inconceivable that appellants could have devoted sufficient time to any individual activity. Indeed, appellants do not contend that appellant-wife devoted any time whatsoever to Ski Time Realty, the yacht sales enterprise, or the recreational consulting venture.

The manner in which appellants entered into their activities does not reflect any reliance on expertise. The record does not indicate that appellants were experts as to any of the activities in which they engaged, with the possible exception of recreational consulting. The record reveals no more definite knowledge of anticipated expenses. Considering these factors, we cannot conclude that appellants prepared for their activities by extensive study of accepted business practices, within the meaning of former regulation 17233(b), subdivision (b)(2),

Other factors similarly belie appellants' claim that their activities' constituted businesses engaged in for profit. There is no evidence in the record to show that separate bank accounts were maintained, that fictitious name statements were filed,. or that telephone directory listings were acquired., Additionally, advertising and promotional expenses were apparently limited, and there is no indication that insurance coverage was obtained. Finally, in the face of sizable losses and scanty, revenues, appellants apparently did little to alter the operation of their activities, a factor inconsistent with a profit motive. (Former Cal. Admin. Code, tit. 18, reg. 17233(b), subd. (b)(1), repealed May 16, 1981; cf. C. West Churchman, supra.)

The second issue presented by this appeal concerns the propriety of respondent's action in disallowing certain deductions characterized by appellants as employee business expenses. For each of the years in issue, appellants.claimed numerous miscellaneous i terns as trade or business expenses related to their salaried positions as educators. Except for 1973, respondent originally disallowed all of these items. Respondent now concedes that certain of these items were allowable pursuant to section 17202. The following table sets forth the amounts claimed by appellants, amounts now conceded by respondent. as allowable deductions, and the amounts disallowed.

Year	Amounts Claimed	Conceded Amounts	Amounts Disallowed
1973	$3,231*	$420	$2,811
1974	2,259	628	1,631
1975	1,914	811	1,103
1976	5,193	795	4,398

* Net amount originally disallowed by respondent.

It is well settled that income tax deductions are a matter of legislative grace, and the burden is on the taxpayer to show by competent evidence that he is entitled to any deduction claimed. (Deputy v. du Pont, 308 U.S. 488 [84 L.Ed. 416) (1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 13481 (1934).) Appellants claim that the deductions in issue were all "directly related to their [employment] and improve[d] their skills and [allowed them] to maintain their professional standards." Accordingly, they contend that those items were properly deductible under section 17202, which provides, in part:

> (a) There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--
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> * * *
>
> (2) Traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; ...

To the extent research and education expenses fall into this category, a deduction is allowed. During the years in issue, respondent's regulations provided, in part:

> (1) Expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken primarily for the purpose of:
>
> (A) Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or

> (B) Meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status or employment.
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> * * *
>
> (4) If a taxpayer travels away from home primarily to obtain education the expenses of which are deductible under this section, his expenditures for travel, meals, and lodging while away from home are deductible. ... If the taxpayer's travel away from home is primarily personal, the taxpayer's expenditures for travel, meals, and lodging (other than meals and lodging during the time spent in participating in deductible educational pursuits) are not deductible. ... (Former Cal. Admin. Code, tit. 18, reg. 17202(e), repealed March 23, 1979.) (Emphasis added.) 3/

Again, since the subject provisions of section 17202 are virtually identical to those found in Internal Revenue Code section 162, federal case law is highly persuasive in interpreting the California statute. (Rihn v. Franchise Tax Board, supra.)

It is impossible to individually discuss the nearly 200 such items claimed by appellants over the course of the four-year appeal period. Generally, however, these items can be placed into the following broad categories: association and professional dues, clothing, teaching materials and equipment, various trips and events, and miscellaneous' items. The relevant facts and law concerning each of these categories are set forth below.

3/ The federal resulations were liberalized in 1967 by eliminating the subjective "primary purpose" test and permitting a deduction for educational expenses provided they have a direct relationship with the taxpayer's employment or other trade or business. (See Treas. Reg. § 1.162-5(d) (1967); Krist v. Commissioner, 483 F.2d 1345 (2d Cir. 1973).)

Association and Professional Dues

From 1973 through 1976, appellants deducted dues and membership fees paid to a host of organizations. Their 1974 return reveals, for example, that amounts paid to Los Angeles College Teachers Association, Los Angeles College Coaches Association, and The United Federation of Teachers were deducted. While these deductions were originally disallowed, respondent now concedes that these amounts, together with similar such items for the other appeal years, were properly deducted by appellants. Deductions claimed by appellants in 1974 and 1976 for membership in various P.T.A. groups were, however, disallowed. Upon review of respondent's action in this regard, we can only conclude that it acted properly; appellants have not sought to establish that they were required to join any P.T.A. organization for their employment. Accordingly, those payments were personal expenses. (See Arthur S. McKenzie, ¶ 52,126 P-H Memo. T.C. (1952).)

Clothing

For each of the appeal years, appellants claimed deductions for the purchase or repair of clothing or shoes. For example, on their 1973 return, deductions were claimed for the following items: three white "T" shirts, cold weather gloves, snow boots, shorts, socks, and a warm-up suit. Appellants' claim that they are entitled to deduct the cost of these and other similar such items is unmeritorious; they have not established that these items "are required for employment and ... are not suitable for general or persona? wear." (Virginia R. Cinnamon, ¶ 78,118 P-H Memo. T.C. (1978); see Rev. Rul. 70-474, 1970-2 Cum. Bull. 35; cf. Oswald "Ozzie" G. Nelson, ¶ 66,224 P-H Memo. T.C. (1966); George L. Cowarde, Jr., ¶ 68,158 P-H Memo. T.C. (1968).) In fact, it appears that the above referenced items were suitable for personal wear.

Teaching Materials and Equipment

For each of the appeal years, appellants deducted the cost of certain materials and equipment allegedly purchased for use in their classrooms; cameras, bicycles, and racquet balls were some of the items claimed by appellants, but disallowed by respondent.

Section 17202 provides that business expenses deductible from gross income include expenditures directly connected with or pertaining to the taxpayer's

trade or business. The expenditures must be directly or proximately related to the taxpayer's trade or business, and they must also be both ordinary and necessary under the circumstances. (Jack B. Wheatland, ¶ 64,095 P-H Memo. T.C. (1964).) There is nothing in the record of this appeal to indicate that appellants' superiors thought that the purchase of the above referenced items was necessary. Furthermore, even were we to accept the premise that the primary use of these items was in appellants' employment as teachers, it is clear that they were not ordinary expenses of public educators. (Jack B. Wheatland, supra.)

Trips and Events

During the appeal years, appellants deducted the costs incurred for numerous trips and events, including several visits to ski areas, a two-week stay in Hawaii, and tickets to see the Russian Women's Gymnastics Team. In support of their position, appellants maintain that the expenses thereby incurred increased their expertise as recreational and physical education instructors. Appellants claim, for example, that their trip to Hawaii was for the purpose of conducting research in their respective fields.

In the Appeal of Richard T. and Helen P. Glyer, decided on August 16, 1977, we held that deductions cannot be allowed for educators for expenses incurred on trips, even though the taxpayers may enjoy a number of cultural and educational experiences, when their activities did not differ in any substantial way from those of other tourists in the same area; deductions will be allowed, however, where the expenses deducted were incurred on a trip which was part of the school curriculum, and the taxpayers were paid for teaching the travel course. Upon thorough review of the record on appeal, we must conclude that appellants have failed to establish that they were entitled to deduct the costs incurred for the items under discussion. There is no reason to believe that their activities differed substantially from those of the average tourist or spectator. Additionally, appellants were not paid for taking their trips because they did not constitute part of their respective schools' curriculum.

Miscellaneous Items

In addition to the items discussed above,, appellants also claimed deductions for items which do

not fit into the categories previously set forth, including certain automobile expenses allegedly incurred in relation to their positions as teachers. Appellants have not established that the cost of these items were ordinary and necessary expenses of public educators, or that they were incurred primarily for the purpose of maintaining or improving skills required- by their employers as a condition to retention of status or employment. Furthermore, to the extent that the claimed automobile expenses relate to their teaching profession, appellants must establish that they were other than commuting expenses, which are specifically disallowed. (Former Cal. Admin. Code, tit. 18, reg. 17202(b), sub?. (5), repealed Feb. 14, 1981.) Appellants have not carried their burden of proof in this regard.

Appeal of Don and Pat Faber

ORDER

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 Don and Pat Faber against proposed assessments of additional personal income tax in the amounts of $482.61, $777.04, $967.57 and $1,393.85 for the years 1973, 1974, 1975, and 1976, respectively, be and the same is hereby modified in accordance with respondent's concessions regarding the deductibility of certain of appellants' trade or business expenses. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 26th day of July, 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

, Member

, Member