



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
VIRGINIA R. WITHINGTON)

Appearances:

For Appellant: William D. Phillips
 Certified Public Accountant

For Respondent: Michael E. **Brownell**
 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 Virginia R. Withington against proposed assessments of additional personal income tax in the amounts of **\$1,085.49**, **\$2,432.27**, and **\$2,015.07** for the years 1974, 1976, and 1977, respectively.

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The issue presented for decision is whether respondent properly disallowed the appellant's trade or business **expense deductions** for the years 1974, 1976, and 1977.

Appellant filed personal income tax returns for the years 1974, 1975, 1976, and 1977. In those returns, appellant reported income from two trusts in the respective aggregate amounts of \$35,757, \$71,413, \$68,531, and \$77,955, and also claimed deductions for net expenses incurred in the operation of a **kennel**. The gross receipts, total expenses, and net expenses of the **kennel for** the above mentioned years were as follows:

<u>Year</u>	<u>Gross Receipts</u>	<u>Total Expenses</u>	<u>Net Expenses</u>
1974	\$2,573	\$12,063	\$ 9,490
1975	\$2,750	\$23,782	\$21,032
1976	\$ 3 , 1 2 0	\$24,046	\$20,926
1977	\$6,193	\$23,977	\$17,784

During the years in issue, appellant's kennel was located on **1-1/2** acres adjacent to her personal residence in an exclusive neighborhood. Appellant's husband apparently started to operate a kennel in **the 1940's**, and after his marriage to appellant in 1952, they jointly operated the kennel. Throughout their marriage, appellant's husband managed the financial affairs of the kennel and made all of the policy decisions. Appellant's husband died in 1973, at which time appellant took over the operation of the kennel. **By** the year 1979, appellant had increased the number of dogs she owned to thirty from the ten she owned in 1973. The record does not provide us with the number of dogs owned by appellant in the years being appealed.

After an audit of appellant's kennel records, respondent determined that appellant's operation of a dog kennel was an activity not engaged in for profit. Consequently, it disallowed the claimed business expense deductions and issued notices of proposed **assessment** for the years 1974 through 1977. Appellant protested this action. After due consideration of appellant's protest, respondent affirmed the assessments,+ According to respondent's records, appellant was sent notices of action affirming the proposed assessments for the years 1974 through 1977. Appellant appealed respondent's action only for the years 1974, 1976, and 1977.

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Appellant contends that the expenditures she made relating to the operation of the dog kennel were deductible under Revenue and Taxation Code section 17202 as expenses paid in connection with a trade or business. Respondent contends that appellant's activities did not constitute a trade or business, but were "activities not engaged in for profit" as defined by Revenue and Taxation Code section 17233. Expenses in connection with an activity not engaged in for profit are not deductible, except in certain limited situations which are not present here. Section 17233 and section 17202, cited above, are interrelated. Section 17233, subdivision (c), defines an activity not engaged in for profit as

any activity other than one with respect to which deductions are allowable for the taxable year under Section 17202 [dealing with expenses of a trade or business] or under subdivision (a) or (b) of Section 17252 [dealing with expenses for production or collection of income].
(Emphasis added.)

Revenue and Taxation Code sections 17202 and 17233 and the regulations thereunder (in effect for the years in issue) are based on Internal Revenue Code sections 162 and 1.83, **respectively**, and their regulations. Therefore, it is appropriate to consider the federal case law construing Internal Revenue Code sections 162 and 183 as very persuasive in the interpretation and application of the corresponding California sections. (Holmes v. McCoigan, 17 Cal.2d 426 [110 P.2d 428], cert. den., 314 U.S. 636 [86 L.Ed. 510] (1941); Appeal of Paul J. Wiener, Cal. St. Bd. of Equal., Aug. 1, 1980.)

The disposition of this appeal turns on the question of whether appellant's operation of the dog kennel was an activity engaged in for profit. (Rev. & Tax. Code, § 17233, subd. (c).) In order to prevail, appellant must establish that she operated the dog kennel primarily for profit-seeking purposes, and not primarily for personal, recreational, or other nonprofit purposes. (Joseph W. Johnson, Jr., 59 T.C. 791 (1973); Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal., Dec. 15, 1976.) Whether property is held primarily for profit-seeking motives is a question of fact on which the taxpayer bears the burden of proof. (Appeal of Clifford R. and Jean G. Barbee, supra.) The taxpayer's expressions of intent, **while relevant**, are not controlling. Rather, the taxpayer's motives must be determined from all the surrounding facts and circumstances. (Joseph W. Johnson, Jr., supra.)

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The record does not indicate that the enterprise ever had a profitable year. From 1974 through 1977, the expenses incurred to operate the kennel were more than five times as great as the income produced by the activity. We have previously held that large and continued losses justify an inference that appellant never had a good faith intention of realizing a profit from the activity in question. (Appeal of Clifford R. and Jean G. Barbee, supra.) In spite of the continued losses, there is no indication that appellant changed the operation of the kennel in order to make it a profitable venture. This board has previously held that the failure to take any action to convert the losses to profits makes a consistent pattern of losses even more significant evidence of a lack of profit motive. (Appeal of Walter E. and Gladys M. Sherbondy, Cal. St. Bd. of Equal., April 10, 1979.)

Appellant argues that her dogs have appreciated in value and that by not selling them she has deferred the profits. However, "the goal must be to realize a profit on the entire operation, which presupposes not only future net earnings but also sufficient [future] net earnings to recoup losses which have meanwhile been sustained in the intervening years." (Francis X. Benz, 63 T.C. 375, 384 (1974).) Despite a request from this board, appellant has not shown us that she had this goal, and we must conclude, therefore, that she did not.

The history of large and continuous losses from the kennel operation, appellant's failure to take action to convert the losses to profits, and the absence of an expectation of realizing a sufficient profit on the operation to recoup past losses may not be individually conclusive. However, when considered together and coupled with the necessity of overcoming the burden of proof, they lead us to the conclusion that appellant did not operate the dog kennel primarily for profit-seeking purposes. (White v. Commissioner, 227 F.2d 779 (6th Cir. 1955).)

Accordingly, on the basis of the record before us, respondent's action in this matter must be sustained.

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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 Virginia R. Withington against proposed assessments of additional personal income tax in the amounts of **\$1,085.49, \$2,432.27, and \$2,015.07** for the years 1974, 1976, and 1977, respectively, be and the same is hereby **sustained**.

Done at **Sacramento, California**, this 4th day of May, ~~1983~~, by the State Board of Equalization, with Board **Members** Mr. Bennett, Mr. **Collis**, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett _____, Chairman
Conway H. Collis _____, Member
Ernest J. Dronenburg, Jr. _____, Member
Richard Nevins _____, **Member**
_____, Member