BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
DONALD AND NADA SCHRAMM)

For Appellants: William E. Chaltraw

For Respondent: Kathleen M. Morris
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Donald and Nada Schramm for refund of personal income tax in the amount of $2,350 for the year 1978.

The issue presented by this appeal is whether interest received in connection with the sale of farm assets is farm income for purposes of the preference tax.

On their joint personal income tax return for 1978, appellants claimed a net loss of $97,409 from the operation of their farm, but they did not compute or pay any preference tax. Respondent determined that appellants' farm net loss was an item of tax preference, calculated the preference tax, and issued a proposed assessment of additional tax in that amount. Appellants paid the assessment and, on July 27, 1981, filed an amended return claiming a refund in the amount of the preference tax. Appellants claim that certain income received during 1978 was farm income which should have been included in the calculation of their farm net loss, with the result that they owed no preference tax. This income was of two types: wages paid to appellants by their family corporation which was engaged in the business of farming, and interest income which resulted from the sale of farm assets. Respondent treated the amended return as a claim for refund and denied it, giving rise to this appeal.

In addition to other taxes imposed by the Personal Income Tax Law (Rev. & Tax. Code, §§ 17001-19452), section 17062 imposes a tax on the amount by which the taxpayer's items of tax preference exceed his net business loss. Included in the items of tax preference is the amount of net farm loss in excess of a specified amount which is deducted from nonfarm income. (Rev. & Tax. Code, § 17063, subd. (h).) The specified amount in effect for the year in issue was $15,000. (Rev. & Tax. Code, § 17063, subd. (i) (now subd. (h)).) Farm net loss is defined in Revenue and Taxation Code section 17064.7 as "the amount by which the deductions allowed by this part which are directly connected with the carrying on of the trade or business of farming exceed the gross income derived from such trade or business." (Rev. & Tax. Code, § 17064.7.)

Appellants now concede that wages received by an employee of a farming corporation do not constitute farm income. Therefore, the sole question remaining is whether appellants' interest income from a note received in exchange for farm assets is derived from the trade or business of farming. Appellants contend that the interest is farm income because it was earned as a result of the sale of farm assets.

This board has heard an argument substantially similar to that advanced by appellants and concluded that it was without merit. (Appeal of Ernest R. and Dorothy A. Larsen, Opinion on Petition for Rehearing, June 21, 1983.) In that opinion we noted that, regardless of whether or not gain from the sale of farm property is farm income for purposes of section 17064.7, the interest received as a result of the sale is not income from the trade or business of farming. This is because interest is payment for the use of money, rather than proceeds of the sale. (See Rosen v. United States, 288 F.2d 658 (3d Cir. 1961); Lloyd v. Commissioner, 154 F.2d 643 (3rd Cir. 1946).) Appellants have presented no reason for us to alter our opinion. The cases relied upon by appellants deal only with the question of whether certain litigation expenses are capital expenditures or deductible expenses; they set forth no general principle that the character of income is determined by reference to the type of assets involved in the original transaction. (See Woodward v. Commissioner, 397 U.S. 572 [25 L.Ed.2d 577] (1970); William Wagner, 78 T.C. 910 (1982).) Therefore, we conclude that the interest received by appellant was properly characterized as nonfarm income and that respondent correctly calculated the preference tax owed by appellants.

For the above reasons, respondent's action must be sustained.

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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Donald and Nada Schramm for refund of personal income tax in the amount of $2,350 for the year 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 13th day of December, 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