BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
EDWARD P. AND JEANETTE F. FREIDBERG)

Appearances:

For Appellants: Gary L. Conner
Attorney at Law

For Respondent: Michael E. Brownell
Counsel

O P I N I O N

These appeals are made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Edward P. and Jeanette F. Freidberg against proposed assessments of additional personal income tax in the amounts of $18,317.20, $21,717.33 and $72,433.54 for the years 1977, 1978, and 1979, respectively.

The issue presented by these appeals is whether losses incurred in connection with the breeding, raising, and racing of race horses are farm losses and, therefore, subject to tax preference treatment.

Appellants filed joint California personal income tax returns for the years in issue. Mr. Freidberg is an attorney and Mrs. Freidberg, a homemaker.' In 1974, appellants purchased, several mature racehorses, hired trainers, and raced the horses. Two years later, they began breeding the horses they already owned and purchased additional breeding stock. Appellants' involvement in the racehorse business increased substantially during the appeal years. In 1977, appellants owned 41 horses, 16 of which they contend were held for breeding and 25 for racing. In 1978, appellants had increased their holdings to 95 horses, 44 of which were said to be held for breeding and 51 for racing. Although we do not have precise information concerning the number of horses owned in 1979, it appears that appellants' breeding and racing activities continued to increase since, in that year, appellants purchased three properties for use in their horse business at a total cost of $1,726,308. Prior to that year, appellants bred, trained, and stabled their horses on property owned by third parties.

According to appellants, they began breeding horses in an attempt to establish, at minimal expense, an exceptional stable of racehorses. To this end, during the appeal years, they sold only those horses which did not meet appellants' breeding or racing expectations. None of the horses bred by appellants were sold during the appeal years because none had reached the age at which their racing abilities could be assessed. Appellants stated that although they were not breeding horses for sale, they expected to sell 95 percent of the horses they bred since only 5 percent could reasonably be expected to develop into exceptional race horses.

Appellants claimed losses connected with their racehorse business of $237,520, $449,317, and $1,421,806 on their joint California personal income tax returns for years 1977, 1978, and 1979, respectively. Upon examination of the returns, respondent determined that the claimed losses constituted farm net losses, and, to the extent they exceeded $15,000 in 1977 and 1978 and $50,000 in 1979, were items of tax preference, subject to the special tax imposed by section 17062 of the Revenue and

Code.[1] Respondent issued proposed assessments reflecting this determination and, after, considering appellants' protests, affirmed the proposed assessments, giving rise to these appeals. The appeals were consolidated for decision by this board.

In addition to other taxes imposed under 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).)[2] "Farm net loss'" is defined 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' position is that their horse breeding, raising, and racing activities did not constitute the trade or business of farming; therefore, the losses connected with these activities were not "farm net loss" subject to the preference tax.[3]

Since the term "farming" was not defined in section 17064.7, we agree with appellants that the term should be given its ordinary accepted meaning. (Malat v. Riddell, 383 U.S. 569 [16 L.Ed.2d 102] (1966).) However, we do not agree with appellants that the ordinary definition of farming does not encompass any portion of their horse business. On the contrary, we believe that the breeding and raising of horses is clearly within the ordinary definition of farming.

1/ Unless otherwise indicated, all statutory references are to the Revenue and Taxation Code.

2/ 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.

3/ For purposes of the discussion which follows, we will assume, without deciding, that appellants' activities connected with breeding, raising, and racing horses were engaged in for profit and that Revenue and Taxation Code section 17233 is inapplicable.

The business of farming is generally understood to mean the raising of crops or livestock. (Board of Supervisors v. Cothran, 84 Cal.App.2d 679, 682 [191 P.2d 506] (1948); Webster's Third New Internat. Dict. (1971); see also Board of Education v. Board of Revision, 57 Ohio St.2d 62 [386 N.W.2d 1113] (1979) (holding that real property used to raise racehorses was farmland).) Further suport for our conclusion is found i respondent's regulations issued under section 17224,[4] which state that the word "farm" as "used in its ordinary, accepted sense . . . includes stock, dairy, poultry, fruit, and truck farms, and also plantations, ranches, ranges, and orchards." (Former Cal. Admin. Code, tit. 18, reg. 17224(c) (repealer filed Dec. 23, 1981; Register 81, No. 52).) These regulations specifically indicate that the raising of horses is a farming activity. (Former Cal. Admin. Code, tit. 18, reg. 17224(d) (repealer filed Dec. 23, 1981; Register 81, No. 52).)

Appellants submit that although horse breeding and raising may be farming activities when performed with the intention of selling the animals, these activities are not farming when performed with the primary intention of racing the horses. The definitions of "farming" discussed above contain no justification for making such a distinction, and we are not persuaded by either of the cases relied upon by appellants.. Appellants cite the case of McKinley Kirk, 47 T.C. 177 (1966), in which the taxpayer was engaged in the business of breeding, raising, and training horses for the purpose of racing them. The only question involved in that case was whether gain realized by the taxpayer upon the sale of certain horses qualified for capital gains treatment under Internal Revenue Code section 1231(b)(1); the question whether the taxpayer was engaged in the trade or business of farming was not involved. In concluding that the gain was capital gain, the court determined that the taxpayer did not hold the horses primarily for sale since he sold only those

4/ Although section 17224 deals with the deduction of soil and water conservation expenditures, the regulations are relevant to the inquiry before us since the deduction is available only to taxpayers engaged in the business of farming, and the regulations specify that the term "farming" is used in its ordinary, accepted sense. (Former Cal. Admin. Code, tit. 18, § 17224(c).)

horses which.were unsuitable for either racing or breeding. Although this case may support appellants' contention that they did 'not hold horses primarily for sale, it does not suppdrt their conclusion that they were not farmers because they did not hold the horses for sale.

We also believe appellants' reliance on Wint v. Fidelity & Casualty Co., 9 Cal.3d 257 [507 P.2d 1383] (1973), is misplaced. In that case, the court interpreted the term "farming" in connection with an insurance contract. The insured operated a riding club and leased property upon which he pastured horses. The court held that the pasturing of horses was farming but indicated that the operation of the riding club was not. Appellants submit that this case establishes that not every business which uses horses is a farming business. While that may be, the case does not indicate that the raising of horses is not farming. On the contrary, it actually supports our conclusion in that the court recognized that "the broad term 'farming' 'is not limited merely to the cultivation of the soil, but includes, in addition, the raising and grazing of animals." (Wint v. Fidelity & Casualty co., supra, 9 Cal.3d at 262.)

For the reasons discussed above, we conclude that breeding and raising racehorses. constitute farming activities; therefore, one engaged in such activities for profit is engaged in the trade or business of farming. We must now determine whether the racing of horses by one engaged in the breeding and raising of horses also constitutes a farming activity.

We believe that the racing of horses is clearly outside the definitions of the term "farming" discussed above. Respondent has, however, presented policy arguments as to why, for purposes of the preference tax, racing should be treated as farming when performed by a taxpayer who also breeds and raises horses. We must reject respondent's arguments since we believe that the California Legislature has indicated that horse racing is not to be treated as farming for purposes of section 17063, subdivision (h), even when the taxpayer breeds and raises horses.

The statute which enacted the preference tax also repealed section 18220. (Stats. 1975, ch. 1033.) Section 18220, which was substantially similar to Internal Revenue Code section 1251, provided for recapture of certain farm losses' upon the sale of property used in the farming business. We have described the relationship between former section 18220 and section 17063, subdivision (i), (now subdivision (h)), as follows:

> Former section 17063, subdivision (i), was intended as a replacement for former section 18220. While it changed the method of deterring tax motivated farm loss operations, the focus of the new section, i.e., "farm net loss", remained the same as that of the section it replaced. Except for certain provisions not in issue here, section 17064.7 defines "farm net loss" in a manner identical to that of former 18220, subdivision (e).

(Appeal of Harry and Hilda Eisen, Cal. St. Bd. of Equal., Oct. 27, 1981.)

One of the differences between the former statute and the current one is that former section 18220, subdivision (e)(4)(A), provided that "[i]n the case of a taxpayer engaged in the raising of horses, the term 'trade or business of farming' includes the racing of horses." That provision was omitted from the definition of the term "farm net loss". contained in section 17064.7. When a-statute is amended and an express provision removed, it is presumed that the omission signals a change in the law. (Clements v. T. R. Bechtel Co., 43 Cal.2d 227 [273 P.2d 5] (1954).) An omission of a provision has also been held to indicate a different intention "[w]here the Legislature omits a particular provision in a later enactment related to the same subject matter." (Kaiser Steel Corp. v. County of Solano, 90 Cal.App.3d 662, 667 [153 Cal.Rptr. 5461 (1979).) Given the relationship between former section 18220 and section 17063, subdivision (i) (now subdivision (h)), we must conclude that the omission of horse racing from the definition of farming was a deliberate act of the Legislature which signifies, its intention that losses from racing not be subject to the preference tax. Although respondent presents sound policy reasons why this should not be the case, it is not our function to read'into the law a provision which the Legislature intended to remove. (Kaiser Steel Corp. v. County of Solano, supra.) Therefore, we conclude that even where a taxpayer engages in the business of farming by raising racehorses, the racing of horses is not included in the term "trade or business of farming" for purposes of section 17063, subdivision (h).

Finally, appellants contend that even, if some or all of their horse-related activities are farming activities, they could not have been engaged in the business of farming during 1977 and 1978 because during that time they neither owned nor directly managed a farm. We

must reject this argument. It has been generally understood that one can be a farmer for tax purposes without either owning land or being directly involved with the farming activities. (Former Cal. Admin. Code, tit. 18, reg. 17224(c); Maple v. Commissioner, 440 F.2d 1055 (9th Cir. 1971). Since section 17064.7 does not contain any provision indicating that it was intended to apply only to taxpayers who owned land or participated in farming activities directly rather than through hired help, we have no reason to believe that such a limited application was intended.

Since horse racing was not intended to be included in the '"trade or business of farming" for purposes of section 17063, subdivision (h), respondent erred to the extent that it included income and deductions connected with the racing of horses in its calculation of appellants' "farm net loss." Therefore, respondent's action shall be modified in accordance with the foregoing opinion.

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 sof Edward P. and Jeanette F. Freidberg against proposed assessments of additional personal income tax in the amounts of **$18,317.20, $21,717.33 and $72,433.54** for the years 1977, 1978, and 1979, respectively, be and the same is hereby modified in accordance with this opinion. In all other respects, the action **of** the Franchise Ta'x Board is sustained.

Done at Sacramento, California, this 17th day **of** January , 1984, by the State Board of Equalization, with Board Members **Mr. Nevins,Mr.** Dronenburg and Mr. Bennett present.

Richard Nevins , Chairman

Ernest J. Dronenburg, Jr. , Member

William M. Bennett , Member

, Member

, Member