

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
RICHARD H. AND JOANNE ROBERTS)

For Appellants: Daniel M. **McGilloway, Sr.**
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 Richard H. and Joanne Roberts against a proposed assessment of additional personal income tax in the amount of **\$1,061.65** for the year **1977.**

Appeal of Richard H. and Joanne Roberts

The issue presented by this appeal is whether losses incurred in connection with the breeding of horses are farm losses subject to tax preference treatment.

Appellants purchased a brood mare in 1977 with the purpose of producing foals for sale. The mare was located in New Hampshire and cared for by a management company. Appellants were not directly involved in the care of the horse. The management company guaranteed appellants that the mare would produce income of \$6,000 per year.

On their 1977 joint California personal income tax return, appellants claimed a business loss of \$36,000 in connection with the brood mare. They did not treat that **loss** as an item of tax preference. Upon audit respondent determined that the claimed loss was a farm loss subject to preference tax. Respondent issued a proposed assessment reflecting this determination, which was affirmed after appellants' protest. This timely appeal followed.

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. (i) (now subdivision (h)).) "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 activities did not constitute the trade or business of farming: therefore, the loss connected with these activities was not "farm net loss" subject to the preference tax. They also contend that they are not engaged in the business of farming because they raised no crops, owned no land in connection with their horse activities, and were not directly involved with the **care** of their horse.

The Appeal of Edward P. and Jeanette F. Freidberg, decided by this board on January 17, 1984, presented essentially the same issues as this appeal. In that case, we concluded that the term "trade or business

Appeal of Richard H. and Joanne Roberts

of farming" as used in section 17063, subdivision (i), encompasses the breeding and raising of horses. We further concluded that one can be a farmer for tax purposes without either owning land or **being** directly involved with the farming activities. On the basis of our decision in the Freidberg appeal, we must reject appellants' contentions that they are not engaged in farming since they only raise horses and were not directly **involved** in the horse breeding activities.

Appellants' final argument is based upon Treasury regulation section 1.175-3 which states that "a taxpayer who receives a fixed rental (**without reference** to production) is engaged in the business of farming only if he participates to a material extent in the operation or management of the farm." Appellants contend that they receive a fixed' return without reference to production, but we cannot agree. Although the management company guaranteed appellants that they would receive income of \$6,000 per **year**, this merely established the minimum amount of income appellants would receive. If the foal produced was worth more than \$6,000, appellants would be entitled to a greater return. Therefore, appellants did not receive a fixed return, and the regulation relied upon by them is inapplicable.

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

Appeal of Richard H. and Joanne Roberts

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 Richard H. and Joanne Roberts against a proposed assessment of additional personal income tax in the amount of **\$1,061.65** for the year 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of April , 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Bennett and Mr. -Harvey present.

Richard Nevins _____, Chairman
 Ernest J. Dronenburg, Jr., _____, Member
William M. Bennett _____, Member
 Walter Harvey* _____, **Member**
 _____, Member

*For Kenneth Cory, per Government Code section 7.9