

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF **CALIFORNIA**

In the Matter of the Appeal of)
RICHARD A. AND DIANA S. VOHNE)

For Appellants: Thomas W. Shumate
Certified Public Accountant

For Respondent: Eric J. Coffill
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 A. and Diana S. Vorne against a proposed assessment of additional personal income tax in the amount of \$217.95 for the year 1979.

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The sole issue presented in this appeal is whether the loss realized by appellants from the sale of a house in Santa Cruz should be treated for tax purposes as a capital loss.

Appellant Richard Vorne during the year in question was an engineer with Lockheed Missiles & Space Company, Inc., and appellant Diana Vorne's business allegedly was real estate sales. On March 1, 1978, appellants purchased a house at 519 Escalona Drive in Santa Cruz. They made improvements to the property; however, they never occupied or rented the house. On March 30, 1979, the house was sold for a loss of \$12,294, which appellants claimed on their 1979 tax return as an ordinary loss.

On October 19, 1981, respondent issued a notice of proposed assessment of \$217.95 in additional tax. This action was based upon respondent's disallowance of the loss as an ordinary loss and recharacterization of the loss as a capital loss. Appellants dispute this recharacterization of the loss and contend that they purchased the property with the intent to resell. They state that this intent is evidenced by the fact that they took no depreciation on the property; they capitalized, remodeling costs, interest, and taxes incurred on holding the property; and they financed the acquisition of the property with a mortgage due in one year.

Revenue and Taxation Code section 18161, which defines the term "capital asset," is substantially similar to section 1221 of the Internal Revenue Code of 1954. Both statutes define "capital asset" by exclusion, that is, by enumerating certain classes of property which are not capital assets. In relevant part, they provide that the term "capital asset" does not include "property held by a taxpayer primarily for sale to customers in the ordinary course of his trade or business." It is well settled in California that when state statutes, are patterned after federal legislation on the same subject, the interpretation and effect given the federal provisions by the federal courts and administrative bodies are relevant in determining the proper construction of the California statutes. (Andrews v. Franchise Tax Board, 275 Cal.App.2d 653, 658 [80 Cal.Rptr.403] (1969); Appeal of Horace C. and Mary M. Jenkins, Cal. St. Bd. of Equal., April 5, 1983.)

Whether at the time of the sale the property constitutes a capital asset held for investment purposes

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or constitutes a sale in the ordinary course of a business is a question of fact. (W. T. Thrift, Sr., 15 T.C. 366 (1950); Appeals of Ben F. and Emily Moore, Cal. St. Bd. of Equal., Jan. 4, 1966.) Thus, if the house sold by appellants was held by them primarily for sale to customers in the ordinary course of business, then its sale in 1979 was not a sale of a capital asset, and the loss realized on the sale will be an ordinary loss. In determining whether the property should be classified as a capital asset, the following factors have been considered relevant: (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity, and substantiality of sales; (4) the extent of developing and advertising to increase sales; (5) the use of a business office for the sale of the property; and (6) the time and effort devoted to the sale. (Edward I. Newman, ¶ 82,061 P-H Memo. T.C. (1982).)

An analysis of these factors answers the three-fold inquiry required by Revenue and Taxation Code section 18161 of whether: (1) the taxpayer was engaged in a trade or business and, if so, what business; (2) the taxpayer was holding the property primarily for sale in that business; and (3) the sale contemplated by the taxpayer was "ordinary" in the course of business. (See Suburban Realty Co. v. United States, 615 F.2d 171 (5th Cir. 1980).)

The first inquiry is whether either of appellants was engaged in a trade or business and, if so, what business. Richard Vorne listed his occupation on their 1979 return as an engineer, and Diane Vorne's occupation was listed as real estate sales. Diana's sales activities, however, appear to be the **activities** of a commissioned agent as her net profit for 1979 was only \$3,279. There is no evidence that she had personally purchased and resold any real estate other than the Santa Cruz house. The court in Biedenharn Realty Co., Inc. v. United States, 526 F.2d 409 (5th Cir. 1976), held that when deciding whether there is an existence of a trade or business, the most important factor to consider is the frequency and substantiality of sales. In this case, appellants have made only one sale of real property which they have owned. A single sale of property is not enough to establish the existence of a business.

Furthermore, as to the existence of a real estate business, the court in Suburban Realty stated that if a taxpayer is also engaged in extensive activities

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other than real estate sales, the presence of this other business may make it less likely that he will be found to be in the real estate business. (Suburban Realty Co. v. United States, **615 F.2d** 171, 179 n. 24 (5th Cir. 1980).) In this case, \$33,884 of appellants' total income of \$39,768 came from Richard Vorne's job as an engineer.

There is also no evidence that appellants maintained a sales office for their real estate sales activities, that they advertised the property for sale, or that they hired a broker to help them sell the property. While these factors by themselves are not conclusive evidence, they may be considered in determining the existence of a business.

The frequency and substantiality of appellants' sales go not only to the existence of a trade or business but also to the holding purpose. A **single** isolated sale does not indicate that appellants intended to sell the property as their business. Rather, it is evidence that the property was purchased for investment. (See Suburban Realty Co. v. United States, supra.)

Finally, as to the question of whether the sale was "ordinary" in the course of business, the court in United States v. Winthrop, 417 **F.2d** 905, 912 (5th Cir. 1969), held that the concept of normalcy requires for its application a chronology and a history to determine if the sales to customers were the usual or a departure from the norm. Again, the fact that there was only one sale is indicative of an investment or a sale of a capital asset.

Based on the findings above, we conclude that the loss associated with the sale of the Santa Cruz property was a capital loss. Respondent's action in this matter, therefore, must be sustained.

