



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 )  
 ARTHUR L. AND GERMAYNE CARVER )

Appearances:

For Appellants: David R. Hickey  
Certified Public Accountant

For Respondent: Michael R. Kelly  
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 Arthur L. and Germaine Carver against proposed assessments of additional personal income tax in the amounts of \$500, \$575.63, and \$1,007 for the years 1977, 1978, and 1979, respectively.

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The issue before us is whether respondent properly determined that appellants' ranching operation was not an activity engaged in for profit.

During the years at issue, Arthur's primary activity was owning and operating a contracting business while Germaine described herself in her California personal income tax return as a homemaker. Their California joint personal income tax returns indicate that Arthur earned \$28,700 from his **construction business** in 1977, \$41,500 in 1978, and \$59,800 ~~in 1979~~. In 1967, Germaine's father had died, leaving one-third of his approximately **1440-acre** ranch to Germaine and two-thirds of that ranch to her brother, Jim Stallings. In 1977, appellants purchased Jim's interest in the ranch for \$313,000, while contemplating raising cattle and also growing hay and renting pasture land. On their tax returns, appellants deducted losses generated from the ranching operations as follows: \$6,773 in 1977; \$12,055 in 1978; and \$35,327 in 1979.

Upon audit, respondent concluded that appellants' activities with respect to the ranch were activities "not engaged in for profit" within the meaning of Revenue and Taxation Code section 17233. Section 17233 provides, in relevant part, that if an **individual's** activity is "not engaged in for profit," only those deductions allowable regardless of a profit objective (**e.g.**, taxes or interest) may be taken.

Accordingly, the disputed deductions are allowable only if appellants had an actual profit objective for buying the ranch. (Appeal of Paul-J. and Rosemary Henneberry, Cal. St. Bd. of Equal., May **21, 1980**; Appeal of F. Seth and Lee J. Brown, Cal. St. Bd. of Equal., Aug. 16, 1979.) The taxpayer's expectation of profit need not be a reasonable-one, but there must be a good faith objective of making a profit. (**Truett E. Allen**, 72 T.C. 28 (1979).) Of course, whether **the property is held** primarily for such profit-seeking motives is a question of fact upon which the taxpayer has the burden of proof. (Appeal of Du Dorothy Hatfield, Cal. St. Bd. of Equal., Aug. **1, 1980**; Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal., Dec. **15, 1976**.)

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The regulations<sup>1/</sup> provide a list of factors relevant in determining whether a taxpayer has the requisite profit motive. While all facts **and** circumstances with respect to the activity are to be taken into account, no one factor is determinative in making this determination. (Treas. Reg. § 1.183-2(b).) Among the factors which normally should be taken into consideration are the **following**: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the **taxpayer's** history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation. After reviewing the facts and circumstances involved **here**, we are convinced that appellants possessed the requisite profit motive with respect to the operation of the ranch so that the disputed deductions are allowable,

The record indicates that appellants operated their ranch in a businesslike manner. On appeal, appellants submitted to this board copies of complete and, apparently, accurate records of the ranch operations during the period at issue. In addition, the records indicate that appellants utilized new techniques in order to increase or create a profit. Inferior cattle were culled and superior **bulls** were purchased in order to improve the quality of the **herd**. In addition, new fences and irrigation pipes were installed. All of these facts would indicate that appellants operated the ranch in a **businesslike** manner and possessed the requisite profit motive.

In addition, both appellants were born on or near ranches and worked on ranches during their formative years, indicating that they had some background or

<sup>1/</sup> As section 17233 conforms to **Internal Revenue Code** section 183 and since there are now no regulations of the Franchise Tax Board in this **area**, the regulations under section 183 of the Internal Revenue Code govern the interpretation of section 17233. (Cal. Admin., Code, tit. 18, **reg.**, 19253.1)

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**experience** regarding this enterprise. In operating the ranch, appellants also relied upon the advice of experts in the area. One expert, Arthur Carver's brother Ronald Carver, had an extensive background in cattle ranching and would visit the farm at least weekly. Another expert, Germaïne Carver's brother, Jim Stallings, who had sold appellants his share of the **ranch**, continuously made himself available to appellants for advice with respect to the operation of the ranch. In addition, appellants employed their son as a full-time manager of the subject ranch. Again, these facts indicate that appellants consulted with those who had extensive expertise in operating ranches and carried out their operations in 'accordance with their advice.

**While there** appears to be some dispute as to the amount of time that appellants expended in carrying on the activity, it appears that Germaïne spent at least three months a year on the ranch and that Arthur, the president of a 'successful construction company, spent somewhat less time on the ranch itself. Nevertheless, as indicated- above, appellants employed competent and qualified persons to carry on such activity in their absence. In such circumstances, the fact that appellants devoted a limited amount of time to the ranch does not necessarily indicate a lack of profit motive. Moreover, appellants' involvement in the ranch is clearly more extensive and more significant than the more typical situation before this board where, for example, the taxpayer spends an occasional weekend fishing. (**E.g., Appeal of Robert Harold and Darlene B. Sousa**, Cal. St. Bd. of Equal., Sept. 15, 1983.)

Appellants have also established that the purchase of the ranch from Jim Stallings, when added to the ranch interest which they had previously owned, enhanced the profit potential of the entire operations. In essence, appellants argue that they anticipated that the profitability of the whole would be greater than **the** sum of the parts. Clearly, appellants expected that the purchase of the Stallings' interest in the ranch would lead to an appreciation in the value of their holdings and this expectation indicates that appellants possessed the requisite profit motive. Moreover, Arthur, the owner of a successful construction business, appears to have the kind of business acumen that should lead to eventual success in this activity. Like the taxpayer in William G. Daugherty, ¶ 83,188 P-H Memo. T.C. (1983), he appears to have exhibited the **dilligence**, initiative, and foresight that generally lead to success. Again, these abilities

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appear to be of some significance in establishing appellants' profit motive with respect to the subject venture.

Regarding the history of profits and losses and the amount of occasional profits earned, appellants argue that losses in the years at issue are a result of the introduction of new techniques of operation and renovation of the existing operations. Extensive repairs were made to the irrigation system. In addition, the unanticipated drop in beef prices prevented appellants from realizing any profit during the years at issue. When losses result from circumstances (e.g., depressed market conditions) beyond the control of the taxpayer, such losses do not indicate that the activity is not engaged in for profit. (Treas. Reg. § 1.183-2(b)(6).) In addition, while appellant owned a successful construction **business**, the amount of his income does not suggest that the ranch was operated for personal or recreational purposes rather than for profit. (As indicated above, Arthur earned \$28,700 in 1977, \$41,500 in 1978, and \$59,800 in 1979 from the construction business.) Compared to a more typical case involving the higher incomes of physicians (e.g., Appeal of Ivan S. and Judith A. Fucilla, Cal. St. Bd. of Equal., March 2, 1977); appellants' income appears to be modest and not of **such magnitude** that would indicate that the subject ranch activity **was** engaged in without thought of its profitability.

Lastly, there appear to be few, if any, of the usual recreational aspects involved in appellants' ranch operation. Unlike the taxpayer in the appeal of Guy E. and Dorothy Hatfield, supra, (involving an avid horse enthusiast) no personal recreational activity appears to be involved. (Compare Appeal of F. Seth and Lee J. Brown, supra (fishing); Appeal of Robert Harold and Darleen B. Sousa, supra (fishing).) Instead, all the evidence presented indicates that **appellants'** operations involved a working ranch. This, of course, indicates that these activities were engaged in for profit and not pleasure.

As indicated above, based on all of the factors listed above, we find that appellants have established that they engaged in the subject ranch activities "for profit" and that the disputed deductions are allowable. Accordingly, we must reverse respondent's action in this matter.

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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 Arthur L. and Germaine Carver against proposed assessments of additional personal income tax in the amounts of \$500, \$575.63, and \$1,007 for the years 1977, 1978, and 1979, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 13th day of December, 1984, by the State Board of Equalization & with Board Members Mr. Nevins, Mr. Dronenburg, **Mr. Collis**, Mr. Bennett and Mr. Harvey present.

<u>Richard Nevins</u>	, Chairman
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Conway H. <b>Collis</b></u>	, Member
<u>William M. Bennett</u>	, Member
<u>Walter Harvey*</u>	, Member

\*For Kenneth Cory, per Government Code section 7.9