

Appeal of Joe J. and Elvira Correia

On their joint California personal income -tax **return** -for 1978, appellants reported on Schedule F ("Farm Income and Expenses") a farm loss of \$127,566. None of that loss was reported as an item of tax preference. (See Rev. & Tax. Code, § 17063.) Upon audit, respondent recalculated appellants' tax on preference items by including the farm loss as reported and issued a resulting proposed assessment for \$4,249. Appellants protested respondent's action, arguing that rental payment receipts from the sublease of part of their farmland -more than offset the reported farm loss so that no such loss existed and, **therefore**, no tax on preference items **was** actually due.

In reply, respondent argued that the amount appellants received in fixed rent for such sublease, i.e., \$114,370, was not income derived from the trade or business of farming and that such amount could not, therefore, offset the reported farm loss. Upon further review, respondent, however, noted that the amount that appellants paid for the lease of the subject 'farmland, i.e., ~~\$56,630~~, which had been subsequently subleased, had **been reported** by appellants as part of their farm expenses thereby serving to increase their reported farm loss. Respondent now concedes that this rental payment by appellants was not a farm expense and its removal from such category reduces appellants' net tax preference items from \$92,251 to \$35,621 and appellants' tax on tax preference items from \$4,249 to **\$1,126.15**.

Revenue and Taxation Code section 17063, subdi-vision (i), ^{1/} as it existed for the year in issue, ^{2/} included as an item of tax preference "[t]he amount of net farm loss in excess of fifteen thousand dollars (\$15,000) which is deducted from **nonfarm** income." The term "farm net loss" is defined by 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

1/ Hereinafter, all references are to the Revenue and Taxation Code unless otherwise indicated.

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.

Appeal of Joe J. and Elvira Correia

business of farming, exceed the gross income derived from such trade or business. (Emphasis added.)

In essence, appellants maintain that appellant-husband had only one trade or business which is farming and that his decisions to farm the land himself or to sublease it are both integral parts of that trade or business. Accordingly, appellants argue that the fixed payments received from the sublease of the subject land were directly connected with the carrying on of his trade or business of farming.

Former section 17063, subdivision (i), and section 17064.7 were intended as replacements for former section 18220. While changing 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 section 18220, **subdivision** (e). Pursuant to respondent's **regulation 19253,^{3/}** regulations adopted pursuant to Internal Revenue Code section 1251 (after which former section 18220 was patterned) governed the interpretation of the term "farm net loss" under former section 18220, subdivision (e). Given the successor relationship between section 17064.7 and former section 18220, subdivision (e), the Treasury regulations promulgated pursuant to section 1251 of the Internal Revenue Code are applicable for purposes of interpreting the term "**farm** net loss" as it appears in section 17064.7.

Treasury regulation section 1.1251-3(e), as relevant, defines the term "trade or business of farming" to include "any trade or business with respect to which the taxpayer may ... make an election under section

3/ In pertinent part, this regulation provides as follows:

In the absence of regulations of the Franchise Tax Board and unless otherwise specifically provided, in cases where the Personal Income Tax Law conforms to the Internal Revenue Code, regulations under the Internal Revenue Code shall, insofar as possible, govern the interpretation of conforming state statutes

Appeal of Joe J. and Elvira Correia

175" Treasury regulation section 1.175-3, in return, defines "the business of farming" as follows:

A taxpayer is engaged in the business of farming if he cultivates, operates, or manages a farm for gain **or** profit, either as **owner or** tenant. For the purpose of section 175, a taxpayer who receives a rental (either in cash or in kind) which is based upon farm production is engaged in the business of farming. However, 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.

Since the record establishes that appellants received a fixed rental from the sublease of the subject farmland and there is no indication that appellant-husband participated in the operation or management of such subleased land, we must conclude the rent derived is "not farm income." Moreover, since it is well settled that a taxpayer may have more than one trade **or** business (see Woodrow L. Wroblewski, ¶ 73,037 P-H Memo. T.C. (1973)), appellants' allegation that appellant-husband --engaged in but one **business** cannot be maintained. Accordingly, we must sustain respondent's action subject to its concession noted above.

Appeal of Joe J. and Elvira Correia

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 Joe J. and Elvira Correia against a proposed assessment of additional personal income tax in the amount of \$4,249 for the year 1978, be and the same is hereby modified in accordance with the concession of the Franchise Tax **Board**. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 10th day Of October 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

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

*For Kenneth Cory, per Government Code section 7.9