

Appeal of Paul W. and Joanne B. Clopper

The sole issue is whether profit was appellants' primary motivation for operating a summer camp on their property in Canada., .

Appellants are both **teachers** in public schools in the Los Angeles area. Both teach at nine-month schools, which leaves their summers free. In 1955, appellants purchased an island on Lake of the Woods at Sioux Narrows, Ontario, Canada. Appellants' drama students expressed desires to perform summer productions for tourists in the many resorts of the area. Appellants then purchased six acres on the shore of Lake of the Woods in the resort area and built a lodge and dormitory cabins for students, using the money appellants had earned teaching. Appellants homesteaded the land, obligating themselves to build in order to obtain title. Appellants paid more for the property because they intended to use it **commercially**. In 1966, they began taking four paying students and two counselors, which filled their camp facilities to capacity. The four students paid \$750 each for the five week stay. The fees covered their food, lodging, and **transportation** to and from the camp. The "counselors" did not pay. Advertising for students was mainly by word of mouth where appellants taught.

Because appellants needed several weeks in early summer to clean and repair the camp and make it ready for the students and also needed several weeks after the students left to close the camp for the winter, they were limited to one five-week student session each summer.

The student group presented plays, which were advertised locally by brochures and fliers. The sale of tickets provided appellants with a small amount of additional income. Ticket sales in 1978 were \$250 and in 1979 were \$710. In 1980, appellants discontinued presenting plays and the sole income from **the** property was provided by the students' fees.

The depreciation deductions for camp fixtures and equipment, which appellants claimed during the years. at issue, roughly equaled the gross receipts from the student fees and theatrical ticket sales during those years. In fact, the camp has never shown a profit. Respondent issued notices of proposed assessment disallowing the property depreciation deductions for 1978 and 1979. Appellants protested. Respondent affirmed its proposed assessments, and this appeal followed.

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It is, of course, well settled that income tax deductions are a matter of legislative grace and the burden of proving the right thereto is upon the taxpayer. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Deputy v. du Pont, 308 U.S. 488 [84 L.Ed. 416] (1940).) In order to sustain that burden, the taxpayer **must be** able to point to an applicable deduction statute and show that he comes within its terms.

The relevant sections of the Revenue and Taxation Code are section 17202, which states, in part that "There shall be allowed as **a deduction** all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any **trade** or business," and section 17233, which states, in part:

(a) In the case of an activity engaged in by an individual, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this part except as provided in this section.

(b) In the case of an **activity** not engaged in for profit to which subsection (a) applies, there shall be allowed--

(1) The deductions which would be allowable under this part for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) A deduction equal to the amount of the deductions which would be allowable under this part for the taxable year only if such activity were engaged in for profit, but only to the extent that the **gross** income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

(c) For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under Section 17202

Certain expenses, such as taxes, are **deductible** whether or not an activity is engaged in for profit. (Rev. & Tax. Code, § 17233, subd. (b).) However, deduction of other expenses, such as the property depreciation

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here at issue, is permitted only if the activity is engaged in for profit. (Rev. & Tax. Code, § 17233, subd. (c); Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal., Dec. 15, 1976.) The disposition of this issue, involving section 17233, subdivision (c), turns on whether appellants' camp, of which **that** property was a part, constituted an activity in which appellants were engaged in primarily for profit. (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 applicable regulation in effect during the years on appeal stated, in part:

In determining whether an activity is engaged in for profit, all facts and circumstances with respect to the activity are to be taken into account. No one factor is determinative in making this determination. In addition, it is not intended that **only** the factors described in this section are to be taken into account in making the determination, or that a determination is to be made on the basis that the number of factors (whether or not listed in this section) indicating a lack of profit objective exceeds the number of factors indicating a profit objective, or vice versa.

(Former Cal. Admin. Code, tit. 18, reg. 17233(b), repealer filed April 16, 1981 (Register 81, No. 16).)

One factor suggesting that an operation is conducted for profit is whether appellants carried on the activity in a businesslike manner maintaining complete and accurate books and records. In this instance, appellants' records were limited to the retention of receipts for money expended on camp supplies, and the books of account were limited to the depreciation schedule from which appellants drew the claimed camp property depreciation amounts for their tax return.

Another factor suggesting a profit motive is whether the operating methods were changed over time in attempts to turn unprofitable operating methods into profitable ones. Here, the method of engaging students and operating a summer theater was unchanged from the start of the student operation in 1967 until it was abandoned in 1980. In explanation, appellants state that

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they could not increase their gross receipts from the student fees by increasing the number of students per session because **the limited** camp facilities could not accommodate more students, and they could not have more 'than a single student session per summer because their own 'summer **vacations were** too short to allow them to ready the camp before the students arrived and to close the camp after the students left and also to permit more than one session of students each summer.

An additional factor suggesting a **profit-seeking** activity is whether the managers either had expertise or engaged expert advice on the procedures which would result in a profitable operation. Here, appellants apparently had no expertise in operating summer camps or **summer theatrical camps**, and, apparently, they did not seek expert counsel.

Yet another factor to consider in determining the existence of a profit objective is the relative amount of time and effort appellants expended on the activity. Here appellants' main occupations were their school teaching jobs; and the camp activity was pursued only with the time and effort which was not devoted to teaching.

. Of interest also is the possibility that the property would appreciate in value sufficiently so that an overall profit would eventually result although no profit from the activity's current operation was available. Here, however, 'we have no evidence of the property's potential for appreciating in value', and we have no way of estimating whether such a prospect was possible, much less reasonably expectable.

Another factor **suggesting a primary profit** motive is whether occasional substantial profits were earned in an activity subject to cyclical variations in profitability,. Thus, losses during years under examination might be attributable to more adverse conditions and the activity yet maintained with the hope that profits will be made in the future when conditions change. Here, however, we have no evidence that the summer theatre camp had such a prospect. Thus, we must conclude that since the camp operated at a loss in its early years, it will continue to sustain losses in the future if its operations are not **drastically** changed.

.A final factor for consideration **is whether the** activity has elements of personal pleasure or recreation,

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so that the personal motivation for pleasure or recreation might be determined to outweigh that of profit in maintaining an activity. Although respondent characterizes the camp activities as a vacation, appellants take the position that the activity of preparing a camp for the student session, cooking, cleaning, supervising the students in residence, and then cleaning and closing the camp after the students have left cannot reasonably be regarded as a pleasurable or recreational endeavor.

Notwithstanding appellants' protestations that operating the camp was no vacation, when we take into account all the known facts and circumstances, we cannot find that appellants have demonstrated that the activity in question was operated for profit by objective standards and that, therefore, the respondent's determination was in **error**. Accordingly, we must sustain respondent's action.

