



Appeal of Thomas M. and Mary H. Caldwell

The issues presented by this appeal are: (1) whether losses incurred in connection with the pasturing, raising, and breeding of livestock are farm losses and, therefore subject to tax preference treatment; and (2) whether appellants were entitled to depreciate the cost of a yacht allegedly used in their trade or business.

Appellant-husband (appellant) is a cattle- and horse auctioneer employed by Thomas M. Caldwell, Inc., of which he owns 50 percent. During the years at issue, on leased ranch land, appellant bred and raised livestock and boarded horses which had been consigned to him to be sold at his auctions. Records kept by appellant maintained separate accounts, denoted as "cattle account," "horse account," and "auction account," for each of these activities. The cattle and horse accounts were shown as farm items while the auction account was shown as a business account on appellant's personal income tax returns for the years at issue. In addition, in 1976, appellant purchased a yacht, named the Hatteras-U for \$118,500, for which he claimed depreciation deductions of \$16,268, \$21,907, and \$17,213 for the years 1976, 1977, and 1978, respectively, contending that he used the yacht in his trade or business,

Upon audit, respondent determined that the losses surrounding the farm items noted above (the "horse account" and "cattle account") constituted farm net losses and, to the extent they exceeded \$15,000 (i.e., 1977, 1978), they were items of tax preference subject to the special tax imposed by section 17062 of the Revenue and Taxation Code as then in effect.^{1/} In addition, respondent disallowed the depreciation deductions for the yacht for the years 1976, 1977, and 1978 contending that the use of the yacht was not directly related to appellant's trade or business. Respondent issued proposed assessments reflecting this determination and, after considering appellant's protest, affirmed the proposed assessments, giving rise to this appeal.

On appeal, appellant contends that the losses surrounding the horse and cattle accounts were so closely integrated with his auction activity that such losses should not be found to be farm net loss but should be found to be ordinary and necessary expenses of his auction activity. Appellant notes that the leased ranch

1/ All statutory references are to the Revenue and Taxation Code as in effect for the years at issue.

Appeal of Thomas M. and Mary H. Caldwell

provided a facility for boarding horses which had been consigned to him for sale from great distances. In addition, appellant states that from time to time, in order to support the price level and to protect the financial interests of owners of animals consigned to him, he would purchase animals at his own sales. This was done, appellant contends, to enhance his reputation as an auctioneer. Again, the leased ranch provided a warehouse to store or maintain the merchandise. In addition, the ranch provided a warehouse for animals that needed further conditioning or medical treatment before sale. Lastly, appellant contends that the ranch provided a physical facility for training assistants in his auction business. Respondent, on the other hand, contends that the expenditures reflected in the horse and cattle account represent expenditures for pasturing, raising, and **breeding of livestock** which are clearly farming activities. Accordingly, respondent concludes that the losses reflected by such activities are net farm losses which are subject to the tax on tax preference items.

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. (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**.) While the term "farming" is not defined in section 17064.7, we have held that the term should be given its ordinary accepted meaning. (Appeals of Edward P. and Jeanette F. Freidberg, Cal. St. Bd. of Equal., Jan. 17, 1984.)

The business of farming is generally understood to mean the **raising of** crops or livestock. (Board of Supervisors v. Cothran, 84 Cal.App.2d 679, 682 [191 P.2d 506] (1948); Webster's Third New Internat. Dict. (1971).) Further support for this conclusion is found in respondent's regulations issued under section 17224, which state that the word "farm" as "used in its ordinary, accepted sense ... includes stock, dairy, poultry, fruit, and truck farms, and also plantations, ranches, ranges, and orchards." (Former Cal. Admin. Code, tit. 18, reg. 17224(c), repealer filed **Dec. 23**, 1981 (Register

Appeal' of Thomas M. and Mary H. Caldwell

81, No. 52).) These regulatibns **specif** ically indicate that the raising of horses or cattle is a farming, activ-
ity. (Former Cal. Admin. Code, tit. 18, reg. 17224(d),
repealer filed Dec. 23, 1981 (Register 81, No. 52).)

Appellant's argument here appears to be a variant of the argument presented by the taxpayers in the Appeals of Edward P. and Jeanette F. Freidberg, supra. In Freidberg, the taxpayers argued that while horse breeding and raising might be farming activities when performed with the intention of selling the animals, these **activites** were not farming when performed with the primary intention of racing the horses. We held there that there was no justification for making such a distinc-
tion based upon ultimate intention or use of the animals. We concluded that the breeding and raising of race horses in Freidberg constituted farming activities. **Accord-
ingly**, we must likewise conclude that the breeding and raising or pasturing of cattle and horses in the instant matter constitute farming **actiy**ties. **Moreover**, we can find no factual-or legal basis^{2/} for excluding any of the activities reflected by the **horse or** cattle accounts from the definition of farming activities; Therefore, respondent's action with respect to this issue must be sustained. We have **also** considered appellant's claim that the Internal Revenue Service compromised the same issue-for 1975 and that respondent should, there-
fore, accept this federal action as proof of the validity of appellant's argument here. However, as respondent notes., no documentation of the settlement has been provided us. Moreover, the fact that proof is available for one taxable year does not mean that **the taxpayer** may simply "transfer" that proof to a different year to support a similar issue. (Appeal of Richard J. and Daphne C. Bertero, Cal. St. Bd. of Equal., Feb. 8, 1979.)

As indicated above, appellant also contends that-the yacht was acquired and used for business purposes and consequently depreciation on it was allow-
able. Respondent, **on the** other hand, contends that appellant has failed to show **that the** use of the yacht was directly connected with appellant's business as required by section 17202, subdivision (a), and that

2/ See, for example, the discussion in Appeals of Edward P. and Jeanette F. Freidberg, supra, which held that based upon statutory analysis racing of horses is outside the definition of farming.

Appeal of Thomas M. and Mary H. Caldwell

appellant has also failed to meet the substantiation requirements of section 17296.

We note first that a determination by respondent that a deduction should be disallowed is presumed correct. (Appeal of Robert V. Erilane, Cal. St. Bd. of Equal., Nov. 12, 1974.) The burden is upon appellant to show that he has fulfilled the statutory requirements for claiming the deduction in question. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 13481 (1934).] **Section 17202**, subdivision (a), noted above, provided for the deductibility of all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. **Section 17208**, subdivision (a), provided for the deduction of depreciation of property used in the trade or business. Both sections required a direct or **primary** relationship between the expenditure and the business enterprise. (Appeal of Richard J. and Daphne C. Bertero, supra; see also Nicholls, North, Buse Co., 56 T.C. 1225, 1233 (1971).) Lastly, **section 17296 required** that all entertainment expenses must be substantiated by adequate records or by sufficient evidence.

Appellant contends that the business relationship was adequately documented by logs of the yacht's use. However, the record contains logs **for only** five trips. While appellant has **also** provided a diary of 33 trips taken (including the 5 for which logs are provided), this **diary** appears to have been prepared at one time which would certainly impugn its authenticity and credibility. Moreover, of those 33 entries covering the 3 years at issue, 7 referred to cruises undergone for maintenance, 2 for family use, 1 for charitable use, and 2 for entertainment of the staff. Of the balance, 7 failed to include the names of the parties present and 12 failed to identify the connection between the excursion and appellant's business. In finding that a yacht failed to qualify as being used in the taxpayer's business, the tax court held "the mere presence of a person with whom business is transacted is not sufficient circumstantial proof that on that **occasion such business was** transacted.*" (Nicholls, North, Buse Co., supra, 56 T.C. at 1236.) Accordingly, based upon the record before us, we must find that appellant has not carried his burden of proving that the yacht was used in his business. Accordingly, respondent's disallowance of the depreciation deduction must be sustained.

Appellant also argues that the Internal Revenue Service accepted his **records for** similar deductions in

Appeal of Thomas M. and Mary H. Caldwell

1975, although for a different boat. As we stated above, the fact that proof of deductions may have been available for one taxable year does not mean that the taxpayer may simply "transfer" that proof to a different year to support similar claimed deductions. (Appeal. of Richard J. and Daphne C. Bertero, supra.)

Accordingly; we **conclude that** respondent's action in this matter must be sustained,

Appeal of Thomas M. and Mary H. Caldwell

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 Thomas M. and Mary H. **Caldwell** against proposed assessments of additional personal income tax in the amounts of **\$2,364.16, \$9,357.75, and \$7,542.02** for the years 1976, 1977, and 1978, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 8th day
of May , 1935, by the State Board of Equalization,
with Board Members Mr. Dronenburg, Mr. Bennett, Mr. **Nevins**
and Mr. Harvey present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

Richard Nevins, Member

Walter Harvey*, Member

, Member

*For Kenneth Cory, per Government Code section 7.9