BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GEORGE F, AND AIDA R. AYMANN)

For Appellants: George F. Aymann, in pro. per.

For Respondent: Crawford H. Thomas
Chief Counsel

Karl F. Munz
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of George F. and Aida R. Aymann against proposed assessments of additional personal income tax in the

amounts of $214. 12 and $580.85 for the years 1964 and 1965, respectively. Aida R. Aymann is involved in this appeal only because joint returns were filed during the years in question. Therefore George F. Aymann will hereinafter be referred to as appellant.

The principal issue is whether respondent properly disallowed claimed deductions for capital gains and losses on certain sales of real property.

Appellant holds a general contractor's license from the State of California. Since 1960 he has apparently earned his living by purchasing parcels of real estate, constructing new homes and related improvements on some of the property, and then reselling both improved and unimproved lots. While some sales are allegedly handled by brokers, it appears that appellant personally engages in sales activity and solicits customers for much of the property. His turnover is quite rapid, and none of the lots sold during the years in question had been held by appellant for more than two years prior to resale. Appellant does not have a license to sell real estate.

On his state and federal personal income tax returns for the years in question, appellant listed his occupation variously as "real estate" or "real estate investor. " The returns indicate that he derived almost all his income in those years from sales of real property. Appellant claimed deductions for a number of expenses which were apparently, incurred in connection with his real estate sales, including advertising, business gifts, and entertainment expenses. He reported the net gain from such sales as a capital gain.

In 1969 the Internal Revenue Service audited appellant's federal income tax returns for the years 1963 through 1967. The Service found that appellant had made a total of twenty-two bona fide real estate sales during 1.964 and 1965. An additional transaction, a purported sale of certain property to appellant's brother-in-law, was determined to be a sham, and a loss claimed on that sale was therefore disallowed. The Service also concluded that appellant

was engaged in the trade or business of selling real estate, and accordingly treated the net gain from all but five of the bona fide sales as ordinary income.[1/] The conference auditor's report states that appellant agreed to these and various other adjustments.

Appellant did not notify respondent of the changes which the Internal Revenue Service had made to his federal returns. Respondent obtained copies of the federal audit reports, however, and relying entirely on those reports, it issued the proposed assessments in question on April 15, 1971. Appellant protested, and this appeal followed.

Initially, appellant contends that the proposed assessments are barred by the statute of limitations. Revenue and Taxation Code section 18586.2 provides, however, that where a taxpayer fails to report a change or correction made by the federal authorities, a notice of a proposed deficiency resulting from the change may be mailed to the taxpayer within four years after the change is filed with the federal government. Since appellant did not notify respondent of the results of the federal audit, the four year period applies, and the proposed assessments in question were therefore timely. (Appeal of Mary R. Encell, Cal. St. Bd. of Equal., April 21, 1959.)

Appellant next argues that one-half of the loss claimed on the sale to his brother-in-law should have been allowed. While he apparently feels that the transaction was not a sham, he has neither cited authority nor offered evidence to support his contention. Where, as here, respondent has made a determination on the basis of a federal audit report, that determination is presumed correct, and the burden is on the taxpayer to show wherein it is erroneous.

1/ The record contains both a preliminary revenue agent's report and a conference auditor's report. The preliminary report disallowed capital gains treatment on all sales during 1964 and 1965. The conference report allowed such treatment on the sales of the properties designated as "Devonshire Land," "Carmichael Land," "2513 Carmelita," "Lot 39-40 Block 50," and "Teza Land." Gain from the sale of an additional parcel, "Lots 52 & 53 Block 50," was also treated as a capital gain in the conference report, but the auditor determined that that sale had actually occured in 1963.

(Appeal of Shedrick I. Barnes, Cal. St. Bd. of Equal. , Jan. 7, 1975.) Appellant has not met that burden, and we must therefore conclude that respondent correctly disallowed the claimed loss.

Finally, appellant contends that he is entitled to capital gains treatment on the sales of unimproved land. Relying on the federal action, respondent determined that proceeds from the sales of the five lots mentioned in footnote 1, supra, were capital gains. The net gain from the sales of the remaining parcels was treated as ordinary income, also on the basis of the federal audit report, on the ground that those parcels were not capital assets when they were sold by appellant. For the reasons expressed below, we agree with respondent's determination.

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 the taxpayer primarily for sale to customers in the ordinary course of his trade or business. "

Whether property is held primarily for sale to customers in the ordinary course of a trade or business is essentially a question of fact, to be determined from the totality of circumstances in each individual case. (Brown v. Commissioner, 448 F. 2d 514, 516; Appeals of Ben F. and Emily Moore, Cal. St. Bd. of Equal., Jan. 4, 1966.) The relevant factors include the purpose for which the property was acquired; the frequency, continuity, and size of the sales; whether the taxpayer or his agents engaged in selling activities or developed and improved the property for sale; and the proximity of sale to purchase. (Robert W. Pointer, 48 T. C. 906, 915916; Appeal of James H. and Eula G. Arthur, Cal. St. Bd. of Equal., Aug. 3, 1960.) No one factor is conclusive, and each case must rest upon its own particular facts. (Scheuber v. Commissioner, 371 F. 2d 996, 998.)

In this case, while appellant sold only twenty-two parcels during the appeal years, the record discloses that those sales were part of a continuous pattern of real estate transactions. Appellant's primary source of income was the sale of real property. He constructed extensive improvements on much of the property in order to make it more attractive to buyers, and he actively took part in selling activities. In addition, all of the parcels sold during the years in question were sold within two years of acquisition. These factors indicate to our satisfaction that appellant's dealings in real estate constituted a trade or business. (Appeal of James H. and Eula G. Arthur, supra.) The case of Auda C. Brodnax, T. C. Memo., June 22 1970, upon which appellant relies, is distinguishable on its facts. There the taxpayer, an architect, had not made substantial improvements to nor actively attempted to sell the property in question.

Appellant argues, however, that he held certain unimproved lots for "investment. " It is true that a taxpayer in the business of selling real estate may nonetheless hold some property for investment purposes, rather than for sale to customers. In such a case he may be entitled to capital gains treatment on the disposition of the investment property. (Municipal Bond Corporation v. Commissioner, 341 F. 2d 683, 689-690; Westchester Development Co., 63 T. C. 198. The burden of proving investment purpose is on the taxpayer, however (Myers v. United States, 345 F. Supp. 197, 206, aff'd, 469 F. 2d 1393), and mere allegations do not satisfy this burden. (Harlan 0. Carlson, T. C. Memo., Dec. 24, 1959, aff'd, 288 F. 2d 228.) Appellant in this case was allowed capital gains treatment on the sales of the five lots mentioned in footnote 1, supra, and there is nothing in the record to indicate that any of the remaining parcels were held for investment purposes. On the basis of the facts presented, we conclude that those remaining parcels were held primarily for sale to customers in the ordinary course of appellant's real estate business.

For the above reasons, we sustain respondent's action.

Appeal of George F. and Aida R. Aymann

ORDER

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 George F. and Aida R. Aymann against proposed assessments of additional personal income tax in the amounts of $214.12 and $580.85 for the years 1964 and 1965, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of May, 1976, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary