BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
PAUL B. AND MARY E. SCEMID)

Appearances:

For Appellants: Bernard Whitney
Certified Public Accountant

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

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 Paul B. and Mary E. Schmid against a proposed assessment of additional personal income tax in the amount of $2,454.17 for the year 1972.

During 1972, appellants were engaged in several business enterprises. Their 1972 joint personal income tax return reflected the following three business losses:

Schmid Realty	$ 4,536.16
Bay 'N Beach Apartments	65,033.53
TOWMO Co.	28,597.11
Total	$98,166.80

In June 1972, appellants sold Bay 'N Beach Apartments, realizing a gain on the transaction of $396,290.72. Appellants reported this gain and deducted the above business losses along with other deductions which resulted in an adjusted gross income of $79,034.86.

Since the capital gain realized on the sale of the apartments constituted an item of tax preference, appellants were subjected to the tax on preference income pursuant to Revenue and Taxation Code section 17062. In computing this tax appellants deducted from the net recognized capital gain not only the $30,000.00 statutory exclusion, but also the total of the three business losses mentioned above. Respondent determined that only the $30,000 exclusion was allowable and disallowed the claimed business losses in computing the minimum tax on preference income. The resulting proposed assessment gave rise to this appeal;

During 1972, section 17062 of the Revenue and Taxation Code imposed a minimum tax of 2.5 percent on items of tax preference. The tax rate was applied to the balance of any tax preference items after applying the $30,000.00 statutory exclusion and any "net business loss" for the taxable year. Presently, "net business loss" is defined as adjusted gross income less certain deductions for expenses for the production of income, "only if such net amount is a loss." As originally enacted in 1971, the law did not provide a definition of "net business loss." However, the law was amended in 1972 to provide the definition above without the words "only if such net amount is a loss." These words were added by a 1973 amendment which was intended to clarify the current law rather than to impose new or different requirements. (See generally Appeal of Richard C. and Emily A. Biagi, Cal. St. Bd. of Equal., May 4, 1976.)

The sole issue is whether appellants had a "net business loss" in 1972 to be utilized as an offset against their tax preference income.

In Appeal of Richard C. and Emily A. Biagi, supra, we were faced with an identical issue which we resolved adversely to appellants. In Biagi we reviewed the legislative history of the federal and state minimum tax on items of tax preference and determined that the purpose of these legislative acts was to reduce the advantages derived from otherwise tax-free preference income and to insure that those receiving such preferences pay a share of the tax burden. We also noted that the apparent legislative intent was to apply the tax only with respect to those preference items which actually produce a tax benefit; where items of tax preference do not actually produce a tax benefit they are not subject to the minimum tax. (See also Appeal of Harold S. and Winifred L. Voegelin, Cal. St. Bd. of Equal., Feb. 3, 1977.) In construing the phrase "net business loss" in Biagi, we stated:

> [S]ection 17062 was constructed to allow an offset of business losses against preference income only when a taxpayer's total "business" activity for a particular year results in an overall or "net" loss. In that situation, to the extent of the "net business loss," the tax benefit otherwise produced by all or part of a tax preference item is neutralized. We conclude, therefore, that the legislature intended the phrase "net business loss," as used in section 17062, to encompass the total of the taxpayer's "business" activity for the taxable year, and not isolated instances of business loss.

The record on appeal indicates that appellants' gross income, including the $98,166.80 in losses, exceeded $79,000.00. Appellants have not established that their total "business" activity for the year resulted in a "net business loss." Accordingly, we must conclude that appellants' business losses for 1972 were not allowable as an offset against their preference income for purposes of computing the tax imposed by section 17062. Therefore, respondent's action in this matter must be sustained.

Appeal of Paul B. and Mary E. Schmid

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 Paul B. and Mary E. Schmid against a proposed assessment of additional personal income tax in the amount of $2,454.17 for the year 1972, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of April, 1977, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary