BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) NO. 82R-1652-MW
THEODORE R. AND AIDA NASSAR)

For Appellants: Richard L. Braddy
Certified Public-Accountant

For Respondent: Donald C. McKenzie
Counsel

OPINION

This appeal is made pursuant to section 19057, subdivision (a),.[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Theodore R. and Aida Nassar for refund of personal income tax in the amounts of $951.19, $1,636.04, and $1,029.83 for the years 1978, 1979, and 1980, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

The question presented by this appeal is whether appellants have shown that their pecan growing activities were engaged in for profit.

Appellant Theodore Nassar is a physician. In 1978, appellants purchased property which included a 6-acre pecan orchard. During the years 1978 through 1980, appellants had income from the orchard, but the expenses of the orchard exceeded the income each year and appellants claimed the farm losses on their joint returns for those years. The Franchise Tax Board determined that appellants' pecan growing activities were not engaged in for profit and disallowed all of appellants' deductions except those for taxes and interest. Appellants apparently paid the resulting deficiency assessment and filed a claim for refund, which was denied.

Section 17233[2/] provided that if an activity is not engaged in for profit, only the following deductions are 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
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> (2) A deduction equal to the amount of 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).

(Rev. & Tax. Code, § 17233, subd. (b).)

Deductions other than those listed in subdivision (b) of section 17233 are allowable only if the taxpayer's primary intention and motivation in engaging

2/ Section 17233 was substantially identical to section 183 of the Internal Revenue Code. Therefore, the federal interpretations of Internal Revenue Code section 183 are very persuasive authority in the interpretation and application of section 17233. (Holmes-v. McColgan, 17 Cal.2d 426 [110 P.2d 428], cert. den., 314 U.S. 636 [86 L.Ed. 510] (1941); Appeal of Paul J. Wiener, Cal. St. Bd. of Equal,, Aug. 1, 1980,)

in the activity was to make a profit. (Jasionowski v. Commissioner, 66 T.C. 312, 319 (1976).) The taxpayer's expectation of profit need not be reasonable, but it must be a good-faith expectation. (Allen v. Commissioner, 72 T.C. 28, 33 (1979).) The issue is one of fact and the burden of proving the requisite intention is on the taxpayer. (Allen v. Commissioner, supra, 72 T.C. at 34.) The taxpayer's expression of intent, while relevant, is not controlling; the taxpayer's motives must be determined from all the surrounding facts and circumstances. (Appeal of Virginia R. Withington, Cal. St. Bd. of Equal., May 4, 1983.)

The regulations under Internal Revenue Code section 183 list a number of factors which normally should be considered when determining whether the taxpayer has the requisite profit motive: (1) manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) an expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation. (Treas. Reg. § 1.183-2(b).)

Appellants indicate that their production was adversely affected by weather conditions, that they produced an average yield according to industry standards, and that their costs were not out of line with industry standards when inflation was accounted for. They also state that they consistently made improvements to the land and that they expected production to increase enough to eventually make a profit. While these factors may justify appellants' losses, they do not prove that appellants' primary intention was to make a profit.

The record is notably lacking in any information on most of the relevant factors listed in the regulations. Therefore, we have no information which might offset the inference of a lack of profit motive which arises from large and continued losses from the activity. (Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal., Dec. 15, 1976.) The only factor listed in the regulations about which we have information, besides the history of losses, is that of appellants' financial

status. They appeared to have substantial income from Dr. **Nassar's** medical practice, which made the losses a valuable tax benefit. This is a factor which may indicate that the activity is not engaged in for profit. (Treas. Reg. **§ 1.183-2(b)(8).)**

With the scant information we have about appellants' pecan growing activities, we cannot conclude that they have carried their burden of showing that their primary purpose was to make a profit. Therefore, their deductions must be limited by the provisions of section 17233.

Ordinarily, we would simply sustain respondent's action at this point. However, the schedule of income and expenses attached to appellants' brief indicates that, at least for 1978 and **1979,** appellants' income from this activity **exceeded** their expenses for interest and taxes. If this is the case, respondent's action must be modified to allow appellants' other deductions to the extent of their income from the activity less the taxes and interest already allowed, in accordance with subdivision (b)(2) of section 17233.

Appeal of Theodore R. and Aida Nassar

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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Theodore R. and Aida Nassar for refund of personal income tax in the amounts of $951.19, $1,636.04, and $1,029.83 for the years 1978, 1979, and 1980, respectively, be and the same is hereby modified in accordance with the foregoing opinion.

Done at Sacramento, California, this 6th day of May, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9