BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 85R-519
WALDRIP C. EDWARDS, JR.)

For Appellant: Joseph D. Seckelman
Attorney at Law

For Respondent.: Kathleen M. Morris
Counsel

O P I N I O N

This appeal is made pursuant to section 18646[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Waldrip C. Edwards, Jr. for reassessment of jeapardy assessments of personal income tax in the amounts of $577, $544, $925, $1,131, and $1,050 for the years 1979, 1980, 1981, 7982, and 1983, respectively. After the filing of this appeal, appellant paid the jeopardy assessments in full. Accordingly, pursuant to section 19061.1, this appeal is treated as an appeal: from the denial of claims for refund.

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 appellant has shown that his automobile conversion and repair activities were engaged in for profit.

Appellant, a design engineer and former naval chief engine man, was employed full time by Lancea Corporation during the appeal period and earned from about $25,000 to almost $50,000 during those years. Appellant apparently was also an automobile racing enthusiast and he had often converted or rebuilt automobile. eng-ines for his. own use. In 1979, appellant alleges that he began doing automobile engine conversions for others, i.e., putting modern engines into older classic. automobiles, under the name "Edwards Conversions." Appellant and his son apparently- did the engine conversions at night and on weekends. Appellant alleges that he and his son each spent an average of 35 hours per week on the conversions, He states that later he began doing general repair and body work as well as engine conversions. Appellant reported net losses for Edwards Conversions during each of the five years on appeal, ranging from $6,621 to $70,943. The only gross receipts he reported from Edwards Conversions were for 1983, in the amount of $942, Appellant has alleged that he had gross income from Edwards Conversions during the years. 1979 through 1982, but has provided no proof of either the amount or the existence of this alleged income.

The Franchise Tax Board (FTB) conducted an audit and determined that appellant was not engaged in an activity for profit. Appellant's claimed Losses for Edwards Conversions were disallowed and personal income tax jeopardy assessments were issued. Appellant's petition for reassessment was denied, Leading to this appeal,

Section 17202 allowed the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business," Internal Revenue Code (IRC) section 162, applicable for 1983 (Rev.. & Tax, Code, § 172011, allowed the same trade or business expense deduction. However, in the case of an activity not engaged in for profit., section 17233 (and IRC section 183), prohibited deductions attributable to such activities, except for 'certain Limited deductions, enumerated in subdivision (b) of section 17233 which are not involved in this appeal,

Deductions other than those listed in subdivision (b) of section 17233 are allowable only if the taxpayer's primary intention and motivation in engaging 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 he 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).) After reviewing the facts as set forth in the record, we find that appellant has not met his burden of proving that his primary motivation in engaging in this activity was to make a profit,.

Although no one factor is determinative of the taxpayer's intention to make a profit, the absence of reported income from appellant's activity, coupled with large claimed deductions, suggests strongly that the generation of tax deductions, which could be offset against appellant's income from his regular employment, was more important than the generation of any profit. (Alcala v. Commissioner, ¶ 84,664 T.C.M. (P-H) (1984).) There is little in this record to refute or negate this strong suggestion.

Appellant contends that the additional repair and body work which he began doing after the first year

was undertaken with an intent to improve profitabiiity. Whatever changes appellant made in his operation, they obviously did not increase profitability, since he reported no income at al.1 until 1983, minimal income in that year, no profit in any year, and large losses every year. For at least four years, we have no evidence that appellant worked on any cars for anyone else, Appellant also states that he tried to promote his business, but he has not given us any evidence of how, when, or where this was done.

Appellant's background indicates that he had expertise with engines. However, there is no evidence that he had any expertise with body and fender work or in running a small business, Nor does he allege that he consulted with any experts in either of these areas. The record lacks any proof of the time appellant spent on his activity and appellant alleges only that he and his-son each spent an average of 35 hours a week "when work was available," (App. Br. at 5.) Since we have little indication that work was available during these five years, we must assume that appellant's time spent on this activity was minimal,

The regulations state that "substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved," (Treas. Beg. § 1.183-2(b)(8).) Although, as appellant points out, his income may not be as high as- that of some people in cases such as this one, it was substantial enough to realize a tax benefit from the large losses and, apparently; to provide adequate support for him in spite of the large cash outlays for Edwards Conversions. In addition, there clearly were elements of personal pleasure involved in appellant's engine work.

We believe that the factors mentioned hy appellant as indicating a'profit motive are too few and too unsupported to carry appellant's burden of proof in light of the history of losses, virtually no income, a relatively substantial income from other courses, lack of businesslike conduct, and the personal or recreational elements of the activity. Therefore, the FTB's action must be sustained.

was undertaken with an intent to improve profitability, Whatever changes appellant made in his operation, they obviously did not increase profitability, since he reported no income at all until 1983, min-imal income in that year, no profit in any year, and large losses every year. For at least four years, we have no evidence that appellant worked on any cars for anyone else, Appellant also states that he tried to promote his business, but he has not given us any evidence of how, when, or where this was done.

Appellant's background indicates that he had expertise with engines. However, there is no evidence that he had any expertise with body and fender work or in running a small business. Nor does he allege that he consulted with any experts in either of these areas, The record lacks any proof of the time appellant. spent on his activity and appellant alleges only that he and his son each spent an average of 32 hours a week "when work was available." (App. Br. at 5.) Since we have. little indication that work was available during these five years, we must assume that appellant's time spent on this activity was minimal,

The regulations state that "substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved." (Treas. Reg. § 1.183-2(b)(8).) Although, as appellant points out, his income may not be as high as that of some people in cases such as this one, it was substantial enough to realize a tax benefit from the large losses and, apparently, to provide adequate support for him in spite of the large cash outlays for Edwards Conversions. In addition, there clearly were elements of personal pleasure involved in appellant's engine work.

We believe that the factors mentioned by appellant as indicating a profit motive are too few and too unsupported to carry appellant's burden of proof in light of the history of losses, virtually no income, a relatively substantial income from other courses, lack of businesslike conduct, and the personal or recreational elements of the activity. Therefore, the FTB's action must be sustained.

Appeal of Waldrip C. Edwards, Jr.

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 claims of Waldrip C. Edwards, Jr. for refund of personal income tax in the amounts of $577, $5'44, $925, $1,131, and $1,050 for the years 1979, 1980, 1981, 1982, and 1983, respectively, be and the same is hereby sustained,

Dane at Sacramento, California, this 19th day of November, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Hakvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburq, Jr. Member

Walter Harvey*, Member

*For Kenneth Cory, per Government.Code section 7.9