BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 83R-1287-KP
OAKLEY W. AND FERN A. PORTER)

Appearances:

For Appellants: David E. Cox
Certified Public Accountant

For Respondent: Grace Lawson
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 Oakley W. and Fern A. Porter for refund of personal income tax in the amount of $4,194 for the year 1977.

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

The issue on appeal is whether respondent properly excluded gain realized from the sale of grazing land from the computation of 'farm net loss" for tax preference purposes for the year at issue.[2/]

During the year at issue, appellants were in the business of raising and selling cattle. In 1975, appellants purchased 6,000 acres in Modoc County together with a lease-option to purchase an additional 2,500 acres of grazing land. Thereafter, appellants discovered that they were financially unable to exercise the option by themselves. Although the events are somewhat in doubt, appellants apparently exercised the option on December 13, 1977, receiving title to the land in fee simple, and, during the same escrow, sold that property to an unrelated third party, realizing a gain from the latter transaction. Appellants continued their ranching operation on the land for the following two years,

Respondent audited appellants' return for 1977 and determined that they failed to pay preference tax based upon a "farm net loss" for 1977. Appellants paid the additional assessed tax, but filed a claim for refund based on the contention that the gain from the sale of the Land should *have* been applied as farm income to reduce the amount of farm loss, and, thereby, the gteference tax otherwise due. Respondent denied the claim on the basis that appellants were in the business of ranching and that their-purchase of the option was a form of speculation. Therefore, according to respondent, even though appellants may have owned the land in fee simple for one day, the transaction was not an integral part of their farming operation. This appeal foliowed,

Section 17062 imposes a tax on the amount by which items of tax preference exceed net business loss. *One* item of tax preference is "farm net loss," defined in section 17064.7 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."

2/ While this appeal was prepared on the basis that 1978 Gas the year at issue, the parties now appear to agree that 1977 is the proper year at issue.

In previous appeals where we have had to decide the parameters of the trade or business of farming, we have looked to the definition found in Treasury Regulation section 1.175-3. (Appeal of James A. and Carol A. Collins, Cal. St. Bd. of Equal,, Apr. 9, 1986.) The regulation states, in pertinent part, that: "[a] taxpayer is engaged in the business of farming if he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant." Consequently, we are called upon to decide if appellants were engaged in the business of farming when they sold the farm land in question.[3]

We 'nave been faced with the question of whether a loss sustained in a sale of farm land should be included in the computation of a "farm net loss" in two previous appeals under slightly altered sets of facts In the Appeal of Russell Q. and Thyra N. Fellows, decided August 1, 1984, the taxpayers owned a large piece of property which they claimed to be farm land. In determining that the loss sustained by the taxpayers on the sale of their property could not be considered part of the taxpayers' 'farm net loss" for preference tax purposes, we found that the taxpayers failed to provide evidence that the land was used as a farm by either themselves or their tenants.

In the Appeal of James A. and Carol A. Collins, supra, the taxpayers were farmers who sold their property and retired from the business, In ruling that the loss sustained by the taxpayers on the sale of their farm property could not be included in the determination of the taxpayers' "farm net loss" for preference tax purposes, we reasoned that:

> We believe that this boss does dot come within the language of section 17064.7 because it arose from the sale af appellants.'

3/ As stated earlier, there is some dispute whether appellant sold an option to purchase property or sold actual title to the land in question.. Respondent seizes upon the fact of the option as evidence that appellants were speculating in land. Respondent's argument is without merit. As explained infra, since we find that the underlying sale was an integral. part of appellants' farm business for the year at issue, we necessarily find that appellants were not speculating in the land. Consequently, whether they sold the land itself or only an option to buy it does not affect the result.

> farm, not from the carrying on of the trade or business of farming. The term "trade or 'business" itself does not encompass ail activities which may produce a profit, but is used "in the sense of a going trade or business." (Citation.) *Here, the* loss *does* not arise from the carrying on of a going trade or business, but from the cessation of that business. ... The sale of a farm is not the same as the cultivation, operation, *or* management of a farm. We must conclude that the sale of a farm is not directly connected with the carrying on of the trade or business of farming. (Footnote omitted.) (Emphasis in the original,)

(Appeal of James A. and Carol A. Collins, supra.)

We find that neither of these cases compels respondent's present determination as both are distinguishable from the appeal 'oefore us. Unlike Fellows, there appears to be no doubt that appellants were farmers operating a ranch on the property in question. Unlike the taxpayer in Collins, appellants ran cattle on the land both prior to and after the third party purchased title to the property. There was no cessation or interruption *in* appellants' farming operation, The sale was a one--time event involving specific Land used, at all times, *by* appellants as farm land. These circumstances indicate that appellants were not speculating in the land but fully intended to purchase the farm land as an integral part of their farming operation had they had the money.

Finally, the argument that appellants were not in the business of buying and selling farm Land and, therefore, the gain they realized is not part of their: farming business, is not persuasive in the present situation. (Cf. Appeal of Andre and Suzanne Andresian, Cal. St. Bd. of Equal., Feb. 4, 1986.) When assets are acquired and disposed of in the course of an ongoing business and for business purposes, the gains and Losses from such transactions would seem to be *income* from carrying on that business, whether it is farming. or some other endeavor. Here, there is no evidence that appellants acquired and sold this property for some extraneous, nonbusiness purpose such as Land speculation. Under these circumstances, we must conclude that the gain in question wa.5 properly includible in appellants' "farm net loss."

Appeal of Oakley W. and Fern A. Porter

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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Oakley W. and Fern A. Porter for refund of personal income tax in the amount of $4,194 for the year 1977, be and the same is hereby reversed..

Done 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. 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