87-SBE-015

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BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 85A-995-KP
JOSEPH W. FERREBEE	)	

For Appellant: Joseph W. Ferrebee, in pro per.

For Respondent: John A. Stilwell, Jr. 'Counsel

O P I N I O N

This appeal is made pursuant to section 18593[1]/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Joseph W. Ferrebee against a proposed assessment of additional personal income tax in the amount of $1,870 for the year 1981.

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 issues presented by this appeal are (1) whether appellant has established his entitlement to an interest expense deduction, and (2) whether appellant has established his entitlement to a business loss deduction for the year in question.

On May 7, 1981, appellant allegedly entered into a contract to purchase a parcel of Virginia real property owned by his daughter for $300,000. The contract for sale was handwritten and provided that appellant would gay $75,000 as down payment and his daughter would take back a note for the balance at 12-percent interest. The note was due May 1, 1986, but it did not specify any payment schedule. On October 25, 1981, appellant forwarded $13,500 to his daughter which he alleged to be six month's interest pursuant to the contract. On January 2, 1982, appellant's daughter sent him a letter releasing him from the agreement. In the same letter, appellant's daughter promised to repay the $75,000 deposit on demand at no interest. On March 24, 1982, appellant wrote to his daughter and requested that she give him *an* option to purchase the property. At a later date, the option was apparently exercised, although the terms of the sale are unknown,

For six decades, appellant has been interested in, and has apparently owned, horses. In February 1981, appellant arranged to purchase a horse from an acquaintance for $3,000. Appellant contends he did not purchase the horse for himself, but that he knew several women whom he thought would be interested in the animal. Appellant purchased the horse, sight unseen, with the assurance that the horse was sound. Upon taking possession of the horse, a dispute arose between appellant and the seller as to whether the horse was lame. Appellant returned the horse to Idaho but the seller refused to refund the $3,000. Appellant did not pursue the matter any further, and has stated that he felt that the use of legal remedies would have damaged his relationships with various Idaho horse sellers.

On his tax return for the year in question, appellant deducted as an interest expense the $13,500 he paid to his daughter. Appellant also deducted the $3,000 he paid for the horse by claiming it as an ordinary and necessary business expense, Respondent audited appellant's return and determined that appellant did not enter into a transaction to buy the property but rather used the alleged sale as a means of disguising a gift to his daughter. Furthermore, respondent determined that

appellant was not in the business of buying and selling horses. Therefore, respondent disallowed both deductions. The appropriate assessment was issued, appellant protested, his protest.was denied, and this appeal followed.

The United States Supreme Court clarified the general rule regarding deductions in New Colonial Ice co: v. Helvering, 292 U.S. 435, 440 [78 L.Ed. 1348, 13521 (1934), wherein it stated:

> 'Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.
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> * * *
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> Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.

Respondent's determination that a deduction should be disallowed is presumed to be correct and the taxpayer bears the burden of proving that he is entitled to the claimed deduction. (Appeal of J. T. and Mildred Bellew, Cal. St. Bd. of Equal., Aug. 20, 1985; Appeal of James C. and Monablanche A. Walshe, Cal. St. Bd. of Equal., Oct. 20, 1975.) An unsupported assertion that respondent is incorrect in its determination does not satisfy the taxpayer's burden. (Appeal of James C. and Monablanche A. Walshe, supra.) Deductions arising from intrafamily transactions are subject to particularly rigid scrutiny. (Appeal of Robert E. and Beth B. Hadady, Cal. St. Bd. of Equal., June 10, 1986; Appeal of Konstantyn and Rose Baruch, Cal. St. Bd. of Equal., June 10, 1986.)

To allow the $13,500 payment to be deducted as an interest expense, appellant must prove that payment occurred in accordance with the terms of a legitimate obligation. (Appeal of Georgia Cassebarth, Cal. St. Bd. of Equal., Feb. 4, 7986.) Appellant has provided this board with copies of handwritten letters describing the transactions, the "contract," and two cancelled check as evidence of the proported "sale" between appellant and his daughter. We note, however, that appellant has failed to produce more objective evidence that this

transaction was more than what respondent determined it to be. Appellant has failed to produce a deed, recorded lien, or other document passing title to the property. There is no evidence that either the seller or the buyer took a security interest in the property. Furthermore, the payment schedule left a great deal of discretion to the buyer. In short, none of the steps normally taken by parties operating at arms length in the sale of property are present. The fact that the sale eventually occurred under different circumstances and by the terms of a different agreement a few years later does not support a conclusion that an "installment sale" occurred during the year at issue. As stated above, due to the intimate nature of intrafamily relations, transactions must be strictly scrutinized to ensure that the transaction occurred as claimed and was not an attempt to avoid taxes that would otherwise be owed. (See Appeal of Robert E. and Beth B. Hadady, supra.) As described above, we find that appellant has not produced the evidence necessary to show that respondent was incorrect in determining that the alleged sale was simply a gift of money to appellant's daughter.

With regard to the issue of whether the payment for the horse is deductible, section 17202 provides, in pertinent part, 'that "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." The concept of a trade or business does not encompass all activities engaged in for profit, but is used in the realistic and practical sense of a-going trade or businsss. (Appeal of Richard W. and Hazel R. Hill, Cal. St. Bd. of Equal., May 19, 1981.) In order to prevail on this issue, appellant has the burden of connecting the expenditures-in issue to an existing trade or business. (Appeal of Richard W. and Hazel R. Hill, supra.)

Appellant's argument that the loss incurred in the purchase of the horse should be deductible as a business expense fails because appellant has not established that trading horses was his trade or business. We begin by noting that appellant has established that he is a doctor, and as horse trading cannot be considered a regular activity in the practice of medicine, the $3,000 cannot be deductible as an expense of his medical profession. (Cf. Appeal of Sherwood C. and Ethel 3. Chillingworth, Cal. St. Bd. of Equal., July 26, 1978,) Therefore, for the purchase of the horse to be viewed as an expense appellant incurred in his trade or business,

appellant must show that he was actively engaged in the trade or business of buying and selling horses. (Appeal of Sherwood C. and Ethel J. Chillingworth, supra.) Appellant has not, however, demonstrated that he spent any time, other than this one transaction, organizing or operating his alleged activity. Furthermore, no business plan or business records for appellant's alleged "business" have been produced. Consequently, appellant has failed to satisfy his burden of proving that he was in the trade or business of buying or selling horses.

For the above-stated reasons, respondent's action in this matter must be sustained.

Appeal of Joseph W. Ferrebee

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Joseph W. Ferrehee against a proposed assessment of additional personal income tax in the amount of $1,870 for the year 1981, he and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of March, 1987 by the State Board of Equalization, with Board Members Mr. Collis, Mr. Bennett, Mr. Carpenter and Ms. Baker present.

Conway H. Collis, Chairman

William M. Bennett, Member

Paul Carpenter, Member

Anne Baker*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9