OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **J. BUSS**	OTA Case No. 21078276

OPINION

Representing the Parties:

For Appellant: David J. Cartano, Attorney

For Respondent: David Hunter, Attorney

For Office of Tax Appeals: Nguyen Dang, Attorney

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, J. Buss (appellant) appeals an action by Franchise Tax Board (respondent) denying appellant's refund claims of $106,265 and $75,254 for the 2015 and 2016 taxable years, respectively.

Appellant waived his right to an oral hearing; therefore, this matter is being decided based on the written record.

ISSUE

Whether, at the time of sale, appellant held the properties located at 29, 31, and 33 Shoreline Drive primarily for sale in the ordinary course of a trade or business or as an investor.

FACTUAL FINDINGS

1. In 2013, appellant purchased three contiguous single-family properties at 29, 31, and 33 Shoreline Drive (Shoreline Properties) for $11,904,327.
2. In order to preserve the unobstructed view from the Shoreline Properties, appellant also purchased a vacant lot at 1 Pacific Ridge Place located between the Shoreline Properties and the Pacific Ocean on the same date.

3. In 2016, appellant purchased an adjoining vacant lot at 3 Pacific Ridge Place.
4. Appellant spent $4,121,350 to improve the Shoreline Properties which included demolition and redesign of the existing residence at 29 Shoreline Drive and combining the properties at 31 and 33 Shoreline Drive.
5. From 2013 through 2017, appellant incurred $5,444,777 in interest expenses relating to the acquisition and development of the Shoreline Properties. Appellant took investment interest expense deductions therefor, and did not claim to be a real estate dealer, on his originally filed 2013 through 2016 California tax returns.
6. In 2015, appellant listed the Shoreline Properties for sale.
7. In connection with the sale of the Shoreline Properties, appellant hired a broker to list and sell the Shoreline Properties.
8. Appellant also engaged in a print and digital marketing campaign which included the production of professional marketing materials, full-page advertising in several local publications, postcard mailers, e-mail blasts, pay-per-click advertising, and website and social media advertising.
9. From 2013 through 2017, appellant was vice president and a co-owner of the Los Angeles Lakers professional basketball team (Lakers).
10. In 2017, appellant sold the Shoreline Properties for $10,150,000, realizing a net loss of $11,678,558, which appellant treated as an ordinary loss.
11. Appellant deducted this loss on appellant's 2017 California income tax return (2017 Return), resulting in an overpayment for that year and a net operating loss (NOL) which appellant carried back to the 2015 and 2016 taxable years via the filing of amended returns showing overpayments of $106,265 and $75,254, respectively. This was the first time since acquiring the Shoreline Properties that appellant had reported any business-related income or expenses relating to those properties.
12. Respondent audited appellant's 2017 Return, recharacterizing the claimed loss as a capital loss, and reducing the deductible amount to $3,000, which eliminated appellant's 2017 NOL and resulted in a deficiency assessment for that year.
13. Treating appellant's amended returns for 2015 and 2016 as refund claims, respondent thereafter denied those claims.

DISCUSSION

California generally conforms to the Internal Revenue Code (IRC) provisions governing the treatment of capital gains and losses. (R&TC, § 18151.) To determine the character of the loss, this panel must determine whether the Shoreline Properties are capital assets. (See IRC, § 1221; *Arkansas Best Corp. v. Commissioner* (1988) 485 U.S. 212, 223.) The question of whether the Shoreline Properties are capital assets is a question of fact. (See *Austin v. Commissioner* (9th Cir.1959) 263 F.2d 460, 461.) A capital asset is defined as any property held by the taxpayer but does not include (among other things) property held by the taxpayer primarily for sale in the ordinary course of a trade or business. (IRC, § 1221(a)(1).) The purpose of this exclusion is to "differentiate between gain derived from the everyday operations of a business and gain derived from assets that have appreciated in value over a substantial period of time." (*McManus v. Commissioner* (1975) 65 T.C. 197, 212, citing *Malat v. Riddell* (1966) 383 U.S. 569, 572.) To the extent an individual taxpayer's losses arising from sales or exchanges of capital assets exceed the gain from such sales or exchanges, the taxpayer may deduct the amount of the excess up to $3,000 ($1,500 in the case of a married individual filing a separate return) and carryforward the remainder of the excess, if any, to the succeeding taxable year. (IRC, §§ 1211(b), 1212(b).)

Facts showing that the taxpayer operated a trade or business and held the property in question primarily for sale as part of that trade or business are required for a determination that the property in question is not a capital asset. (See IRC, § 1221(a)(1); *Evans v. Commissioner*, T.C. Memo. 2016-7.) In California, several factors are considered to determine whether property is held primarily for sale to customers in the ordinary course of the taxpayer's trade or business. (See *Redwood Empire Sav. & Loan Ass'n v. Commissioner* (9th Cir.1980) 628 F.2d 516, 517, aff'g 68 T.C. 960 (1977).) These factors include: (1) the nature of the acquisition of the property; (2) the frequency and continuity of property sales over an extended period; (3) the nature and extent of the taxpayer's business; (4) the activities of the seller/taxpayer with respect to the property; and (5) the extent and substantiality of the taxpayer's transactions. The presence of any one or more of these factors may or may not be determinative. (See *Redwood Empire Sav. & Loan Ass'n v. Commissioner*, *supra* at 517; *Evans v. Commissioner*, *supra*.) Thus, while prior opinions may offer some guidance in determining whether property was held for sale in the ordinary course of a trade or business, each case stands on its own and must be decided based on

its own particular facts. (*Biedenharn Realty Co., Inc. v. U.S.* (5th Cir. 1976) 526 F.2d 409, 414-415 [recognizing that the ad-hoc application of these factors has resulted in a large body of case law which is not always reconcilable].)

Appellant argues that the Shoreline Properties were held for sale in the ordinary course of his trade or business as a dealer in real estate. Appellant points to the extensive marketing activities undertaken to sell the Shoreline Properties as conclusive evidence that appellant was a real estate dealer; that is, a person in the business of purchasing real estate with the intent to resell it for a profit. Respondent does not dispute that appellant may have held the Shoreline Properties for sale but argues that appellant did so as an investor; namely, a person who purchases real property to produce income or in the hopes that its value will appreciate over time. Respondent describes appellant's real estate activities as a limited "one-time" venture conducted with insufficient regularity and substantiality to establish that appellant was in fact operating a trade or business.

Respondent makes much of the fact that appellant's sale of the Shoreline Properties was an isolated and non-recurring transaction. Standing alone, this fact is not particularly useful. For instance, courts have found that a single transaction may be sufficient to constitute a trade or business where there is clear and objective evidence that the taxpayer purchased property with the contemporaneous intent to promptly resell it. (*Morley v. Commissioner* (1986) 87 T.C. 1206; see also *S&H, Inc. v. Commissioner* (1982) 78 T.C. 234.) However, appellant has not submitted any evidence or argument regarding his intentions in purchasing the Shoreline Properties. Similarly, appellant has not submitted any evidence on appeal regarding his development activities related to the Shoreline Properties, or any argument regarding how the development activities establish that he held the Shoreline Properties primarily for sale as part of a trade or business.

Appellant submitted only evidence and limited argument on appeal regarding his efforts to market and sell the Shoreline Properties, which appear atypical for an investor of residential real estate, as conclusive evidence that appellant was a real estate dealer. Appellant did not simply plant a for sale sign or list these properties on a local Multiple Listing Service, as the majority of residential home sellers do. Instead, appellant took an earnest role in advertising the Shoreline Properties to potential customers in the United States and abroad across an impressive array of media channels. Appellant also hired professional photographers and created marketing

materials such as brochures and mailers. However, while a majority of residential home sellers do not engage in such comprehensive marketing activities, a majority of residential home sellers also do not sell properties worth more than $10 million dollars. Nevertheless, appellant's marketing activities, standing alone, is not persuasive evidence that appellant primarily held the Shoreline Properties for sale in the ordinary course of his trade or business as a dealer in real estate.

Accordingly, appellant has failed to meet his burden of establishing that respondent's determination was erroneous. (See *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Consequently, these properties were capital assets and the character of appellant's loss resulting from their sale was capital.

HOLDING

Appellant held the Shoreline Properties primarily as an investor, and not primarily for sale in the ordinary course of a trade or business.

DISPOSITION

Respondent's action is sustained.

DocuSigned by:
Tommy Leung
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Tommy Leung
Administrative Law Judge

We concur:

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Ovsep Akopchikyan
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Ovsep Akopchikyan
Administrative Law Judge

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

Date Issued: 2/12/2024