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Appeal of Clifford R. and Jean G. Barbee

Appellants Clifford R. and Jean G. Barbee reside in West Los Angeles, California. During the appeal years Clifford worked as a sales manager for the Coca-Cola Company. More recently he has been engaged in the real estate development business.

On January 9, 1967, appellants purchased a three-bedroom vacation home at Lake Arrowhead, California. Their initial capital outlay for the property was approximately \$20,000, of which about \$11,000 was spent for "furniture and inventory." It appears that appellant's accountant had advised them to purchase this home because he believed it had superior earning potential as a rental.

During 1967 and the first part of 1968, appellants listed the Arrowhead house for rent through the Lake Arrowhead Realty Board. According to appellants, the Realty Board "did a fair job of renting" the property. The Arrowhead area allegedly suffered an economic slump towards the end of 1968, however, and appellants at that time transferred their exclusive rental agreement to a private realty company. Throughout these years the prime rental periods for vacation homes at Lake Arrowhead totaled about 17 weeks per year, mostly during the summer, but the record does not reveal how many weeks appellants' property was actually rented. The record is also silent as to whether appellants, the Realty Board, or the private realty company ever attempted to advertise the property for rent.

Although appellants listed the Arrowhead house as a rental, they retained the right to vacation there whenever they so desired, provided that they would quit the premises upon twenty-four hours notice if the house were rented. Appellants admit that they did in fact use the property for personal recreational purposes during the years at issue. They apparently kept no records of their personal occupancy, however, and the record does not reveal the dates or length of such use.

On their California personal income tax returns for the years 1967 through 1972, appellants reported income

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from and claimed deductions for expenses on the Arrowhead property in the following amounts:

<u>Year</u>	<u>Income</u>	<u>Expenses</u>
1967	\$1,870.52	\$10,613.62
1968	-0-	10,282.51
1969	320.00	9,701.46
1970	1,350.00	13,055.00
1971	1,275.00	13,288.61
1972 (through September)	3,670.00	7,190.00
TOTALS	\$8,485.52	\$64,131.20

After an audit of the returns for 1967 and 1968, respondent determined that appellants were entitled to deductions for interest and taxes on the property in the total amounts of \$3,527.80 for 1967 and \$3,169.25 for 1968. Respondent also allowed an additional deduction for 1967 equal to the amount of income reported from the property for that year, \$1,870.52. The remainder of the claimed deductions for 1967 and 1968, consisting principally of depreciation, were disallowed.

The issue presented is whether appellants are entitled to deductions for expenses and depreciation on the Arrowhead property under sections 17202, 17208 and 17252 of the Revenue and Taxation Code. In relevant part, these sections are set forth in the margin.^{1/} Resolution of this issue in favor

1/ Section 17202:

(a) There 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....

Section 17208:

(a) There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) --
(1) Of property used in the trade or business; or
(2) Of property held for the production of income.

Section 17252:

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year --

(b) For the management, conservation, or maintenance of property held for the production of income....

These sections are substantially identical to sections 162, 167, and 212, respectively, of the Internal Revenue Code of 1954.

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of appellants requires a finding either that their holding of the Arrowhead property constituted a "trade or business" or that the property was "held for the production of income" within the meaning of the above statutes. In order to secure such findings, appellants must establish that they acquired and held the Arrowhead property for the primary purpose of making a profit, and not primarily for personal recreational purposes or other nonprofit motives. (Joseph W. Johnson, Jr., 59 T.C. 791, 813-815 (1973).)

Whether property is held primarily for profit-seeking motives is a question of fact on which the taxpayer bears the burden of proof. The taxpayer's expressions of intent, while relevant, are not controlling. Rather, the taxpayer's motives must be determined from all the surrounding facts and circumstances. (Joseph W. Johnson, Jr., *supra.*)

Appellants have made little attempt to meet their burden of proof. Indeed, they do not even allege that they hoped to secure a profit from renting the Arrowhead property. They merely point out that they spent large amounts of money to acquire and furnish the house and that they listed the property for rent. While these circumstances certainly indicate an intention to rent the property, an intention to rent is not necessarily an intention to earn a profit, since appellants may have sought only to earn sufficient rental income to minimize the cost of owning a vacation home. (Appeal of John E. and Amet Z. Newland, Cal. St. Bd. of Equal., Sept. 17, 1975.) And the renovations and furnishings which made the property suitable for rental could also have been intended to satisfy appellants' personal tastes and comfort while they occupied the property. (Carkhuff v. Commissioner, 425 F.2d 1400, 1405 (6th Cir. 1970).)

On the other side of the coin, there is substantial evidence in the record to indicate that appellants did not own the property primarily to make a profit. For example, the expenses they incurred to maintain the property from 1967 through September 1972 were more than seven times as great as the income returned from the property. Some of this loss during the earlier years may have been caused by an economic slump in the Arrowhead area, but the disparity between income and expenses is so great even in the later

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years as to suggest something more than a mere bad investment. Such large and continued losses warrant an inference that appellants, who were advised by an accountant, never had a good faith intention of realizing a profit from renting the property. (Cecil v. Commissioner, 100 F.2d 896, 899 (4th Cir. 1939).) Furthermore, the Arrowhead house was available for appellants' personal use with only limited restrictions. Appellants did use the house themselves at various times during the years in question, and they did not keep accurate records of such personal use. (Joseph W. Johnson, Jr., supra, 59 T.C. at 816.)

Considering the record as a whole, we conclude that appellants have failed to establish that they had a profit-seeking motive for holding the Arrowhead house. While the evidence is somewhat meager, it appears that appellants owned the property primarily for personal recreational purposes and sought only to offset the resulting expense by renting the property for part of the year. We therefore sustain respondent's action. [Joseph W. Johnson, Jr., supra; Appeal of John E. and Amet Z. Newland, supra.]

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,

