



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ROBERT G. W. AND DALE ANN GRACE)

For Appellant: Robert G. W. Grace,
in pro. per.

For Respondent: Jean Harrison Ogrod
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board **on** the protest of Robert G. W. and Dale Ann Grace against a proposed assessment of additional personal income tax in the amount of \$218.21 for the year 1977.

Appeal of Robert G. W. and Dale Ann Grace

The sole question presented by this appeal is whether respondent properly **applied** section 17299 of the Revenue and Taxation Code so as to disallow certain deductions claimed by appellants in their 1977 tax return with respect to rental property owned by them which had been determined to be substandard housing.

Appellants are the owners of residential rental property located at 2040 Strand in Hermosa Beach. In July 1974 they were notified by the Department of Building and Safety of the City of Hermosa Beach that, in violation of the local zoning code, they were renting what the City deemed to be a single family dwelling for multiple family use. Attempts by appellants to obtain approval for multiple family use of their property failed, and on February 4, 1977, after failing to abate such use, they were issued a notice of noncompliance by the City of Hermosa Beach. The notice advised appellants that unless the substandard condition of their rental property was corrected within ten days, or an appeal was filed with the Hermosa Beach City Council within that same period, a copy of the notice of noncompliance would be sent to respondent, pursuant to section 17299 of the Revenue and Taxation Code.' The City also informed appellants of the tax consequences of its being obliged to notify respondent of their noncompliance. After appellant unsuccessfully appealed that notice to the City Council, a copy of the notice of noncompliance was sent to respondent.

Upon examination of appellants' 1977 California personal income tax return, respondent noted that in that year they reported gross rental income in the amount of **\$4,670.00** from the Strand property. In that return they also claimed deductions for interest, taxes, and depreciation relating to the property in the total amount of **\$6,050.00**. Respondent's disallowance of those deductions resulted in the proposed assessment of additional tax here in issue.

Section 17299 provides, in pertinent part., that in the case of a taxpayer who derives rental **income** from substandard housing, no deduction shall be allowed for interest, taxes, depreciation or amortization paid or incurred in the taxable year with respect to such substandard housing. When the period of noncompliance does not cover an entire taxable year, such deductions shall be denied at the rate of one-twelfth for each full

Appeal of Robert G. W. and Dale Ann Grace

month during the period of noncompliance. **Generally, section 17299** defines substandard housing as housing which has been determined by a state or local government regulatory agency to violate state law or local codes dealing with health, safety or building, and which, after written notice of violation by the regulatory agency, has not been brought into compliance within six months after the date of the notice or the time prescribed therein, whichever period is later; or on which good faith efforts for compliance have not been commenced. Subdivision (e) of that section provides, however, that its provisions do not apply to deductions from income derived from property rendered substandard **solely** by reason of a change in applicable state or **Local** housing standards unless such violations cause substantial danger to the occupants of such property, as determined by the regulatory agency which has served notice of violation.

Appellants argue that they are not subject to the provisions of section 17299 because the Strand property was found to be substandard solely by virtue of a change in applicable local housing standards requiring two parking spaces per dwelling unit. Appellants argue that as the government regulatory agency which cited them for violation of local housing standards never determined that their violation of the parking space requirement caused substantial danger to their tenants, respondent improperly disallowed their deductions for depreciation, interest, and taxes.

A review of the record on appeal **reveals** that appellants' reliance on subdivision (e) of section 17299 is misplaced, and that the City of Hermosa Beach did not determine that appellants' rental property was **substandard** solely because of the alleged change in local standards requiring two parking spaces per dwelling unit. As earlier noted,, appellants attempted to obtain approval from the City of Hermosa Beach for **multiple** family use of their property prior to the issue of the notice of noncompliance. During the course of their efforts, appellants appealed unfavorable rulings from both the City Planning Commission and the **Board of** 'Zoning Adjustments to the Hermosa Beach City Council. After a hearing, the City Council accepted the recommendations of the Department of Building and Safety and the City Attorney and denied the **appeal**. Minutes of that April'27, 1976, City Council meeting **note** that the

Appeal of Robert G. W. and Dale Ann Grace

City Attorney presented the Council with a detailed account of the property's history. That history revealed that the Strand **property** had never been legally available for multiple family use. **Additionally**, information supplied to this board by the Department of Building and Safety of Hermosa Beach indicates that the notice of noncompliance was sent to appellants because their property had never been approved for multiple family use since it was located in an area zoned for single family dwellings.

The record reveals that, except as hereinafter noted, respondent did **what** it was required to do under section 17299. It received a copy of the notice of non-compliance dated February 4, 1977, and, as of the end of 1977, it had not been advised by the City of Hermosa Beach that appellants' Strand property had been brought into compliance. Upon examining appellants' 1977 tax return, respondent determined that appellants had derived rental income from that property in 1977, and that they had claimed deductions of interest, taxes, and depreciation relating to the property. Respondent issued a proposed assessment of additional tax disallowing eleven-twelfths of appellants' above-described deductions for 1977. It now concedes, however, that as the period of noncompliance during that year consisted of only ten full months, the proposed assessment should be reduced to disallow only ten-twelfths of the deductions in issue. Consequently, the proper amount of the proposed assessment should have been \$195.20.

