



Appeal of Joseph A. and Lora J. Duffel

The issue presented by this appeal is whether losses incurred in connection with the breeding, raising, and racing of horses are farm losses subject to tax preference treatment.

Appellants are engaged in the business of breeding, raising, and racing horses. On their joint California personal income tax returns for the appeal years, they claimed business losses in connection with their horse activities, but they did not include those losses in calculating their items of tax preference. Upon audit respondent determined that the claimed losses were part of appellants' farm net losses and should have been taken into account in calculating the amount of preference tax owed by appellants. Respondent issued proposed assessments reflecting this determination, which were affirmed after appellants' protest. This timely appeal followed.

In addition to other taxes imposed under the Personal Income Tax Law (Rev. & Tax. Code, §§ 17001-19452), section 17062 imposes a tax on the amount by which the taxpayer's items of tax preference exceed his net business loss. Included in the items of tax preference is the amount of "net farm loss" in excess of a specified amount which is deducted from **nonfarm** income. (Rev. & Tax. Code, § 17063, subd. (i) (now subd. (h)).) "Farm net loss" is defined 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." (Rev. & Tax. Code, § 17064.7.)

Appellants' position is that their horse breeding, raising, and racing activities did not constitute the trade or business of farming; therefore, the losses connected with these activities were not part of their "farm net loss" subject to the preference tax.

The Appeal of Edward P. and Jeanette F. Freidberg, decided by this board on January 17, 1984, presented essentially the same issue as this appeal. In that case, we concluded that the term "trade or business of farming" as used in section 17063, subdivision (i), does encompass the breeding and raising of race horses. However, we further concluded that the California Legislature did not intend that horse racing be included in that term, even when the taxpayer also breeds and raises horses.

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Since horse racing was not intended to be included in the "trade or business of farming" for purposes of section 17063, subdivision (i), respondent erred to the extent it included income and deductions connected with the racing of horses in its calculation of appellants' "farm net loss." Respondent's action, therefore, shall be modified in accordance with the foregoing opinion.

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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 A. and Lora J. Duffel against proposed assessments of additional personal income tax in the amounts of \$387 and \$2,870 for the years 1976 and 1977, respectively, be and the same is hereby modified in accordance with the foregoing opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 28th day of February , 1984, by the State Board of Equalization, with Board Members **Mr. Nevins**, **Mr. Dronenburg**, **Mr. Collis**, **Mr. Bennett** and Mr. Harvey present.

Richard Nevins , Chairman  
Ernest J. Dronenburg, Jr. , Member  
Conway H. Collis , Member  
William M. Bennett , Member  
Walter Harvey\* , Member

\*For Kenneth Cory, per Government Code section 7.9