

Appeal of Russell Q. and Thyra N. Fellows

The sole issue to be resolved in this appeal is whether respondent properly computed appellants' net farm loss for the purpose of calculating the tax on tax preference items.

Appellants filed a joint California personal income tax return for the taxable year 1977, reporting a net farm loss of \$31,059 and a capital gain in the amount of \$106,695 from the sale of 28 acres of unimproved property.

According to information submitted by appellants, they purchased the land in question in 1960 for investment or agricultural use and sold it in 1977 to an individual who planned to use it for an investment. Although appellants have submitted no records, they state that the land was farmed intermittently by a tenant farmer who paid no rent. At no time did appellants farm the land themselves. (Resp. Ex. E.) Appellants did not compute a preference tax on the net farm loss because they treated the gain from the sale of this land as farm income sufficient to offset the net farm loss. Respondent examined appellants' return and determined that the gain from the sale of the land was not farm income because it resulted from the sale of an asset not used in the trade or business of farming. Pursuant to section 17063, subdivision (i)^{1/} of the Revenue and Taxation Code, respondent determined that appellants had an item of net farm loss preference in the amount of \$16,059 (\$31,059 less the \$15,000 exclusion) and issued a proposed assessment. Appellants protested contending that the capital gain was in fact farm income. After due consideration, respondent affirmed its determination and this timely appeal followed.

Section 17062 of the Revenue and Taxation Code imposes a tax on the amount by which a 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 non-farm income. (Rev. & Tax. Code, §17063, subd. (i).) The

^{1/} All references to Revenue and Taxation Code section 17063, subdivision (i), whether or not so stated are to former section 1.7063, subdivision (i), in effect during the appeal year. Assembly Bill 93 (Stats. 1979, ch. 1168), operative for taxable years beginning on or after January 1, 1979, rewrote subdivision (i) of section 17063 as subdivision, (h) and increased the excluded amounts thereunder.

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specified amount for the year in issue was \$15,000. (Id.) Farm net loss is defined in Revenue and Taxation Code section 17064.7 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." Thus, under section 17064.7, if the land sold by appellants was related to the trade or business of farming, the resulting gain could be considered farm income sufficient to offset their net farm loss.

The business of farming is defined in Treasury regulation section 1.175-3² as:

A taxpayer is engaged in the business of farming if he cultivates, operates, or manages a farm for gain or profit, either as owner or tenant. For the purposes of [IRC] section 175, a taxpayer who receives a rental (either in cash or in kind) which is based upon farm production is engaged in the business of farming. However, a taxpayer who receives a fixed rental (without reference to production) is engaged in the business of farming only if he participates to a material extent in the operation or management of the farm.

The question we are left to resolve is essentially a factual one of whether the land sold by appellants was in fact farm land or whether it was unrelated to appellants' business of farming. We must conclude that, under the facts presented here, appellants were not engaged in the business of farming the land in question since they presented no evidence that they cultivated, operated, or managed the land in question either as an owner or tenant. Although appellants have made vague references to an occasional tenant who cultivated the land, this sort of activity does not constitute the business of farming because appellants did not receive any rent from their tenant. Accordingly, the gain from the sale of this land cannot be used to offset farm net loss under the terms of section 17064.7 of the Revenue and Taxation Code. As such, we

^{2/} In accordance with respondent's regulation 19253 (Cal. Admin. Code, tit. 18, reg. 19253) regulations adopted under conforming Internal Revenue Code provisions are applicable for interpreting the Personal Income Tax Law.

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conclude that respondent properly computed appellants' farm net loss without regard to the **gain** from the sale of land unrelated to the trade or business of farming.. For the reasons stated above, respondent's **position** in this matter will be sustained.

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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 Russell Q. and Thyra N. Fellows against a proposed assessment of additional personal income tax in the amount of \$883.12 for the year 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of August, 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 Ii. Collis, Member
William M. Bennett, Member
Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9