

Appeal of John A. and Betty. M. Bidart

There are two issues presented for decision. They are: (1) whether the salary paid by a corporation engaged solely in the business of farming is income from the business of farming for purposes of computing net farm loss as an item of tax preference; and (2) whether interest earned on certificates of deposit owned by a partnership engaged solely in the business of farming is income from the business of farming for purposes of computing net farm loss as an item of tax preference.

Appellants filed joint personal income tax returns for the appeal years reporting Mr. Bidart's wages as their only earned income. During the years in question, Mr. Bidart received an annual salary of \$125,006 from Bidart Brothers, a corporation engaged in farming and owned by appellants and their children. He also received an \$8,000 annual salary during 1976 and 1977 from Saco Ginning Company, a corporation engaged in cotton ginning that was wholly owned by Bidart Brothers. In addition, appellants reported income from two farming partnerships and reported losses from a cattle feeding operation which they operated as a sole proprietorship.

In calculating the amount of their tax preference income, appellants reported the wages Mr. Bidart received from Bidart Brothers and Saco Ginning Company as income from the business of farming. Appellants also reported as farm income their entire distributive share of income, including the interest on certificates of deposit, from Wheeler Farms, one of the partnerships.

Respondent determined that the corporate salaries and appellants' share of the partnership's interest income were not income from the trade or business of farming. This determination resulted in an increase in appellants' net farm loss and the imposition of preference tax.

Appellants contend that they are engaged solely in the business of farming, even though the farming business is conducted through multiple entities. When the profits and losses of all the entities which comprise appellants' farming business are aggregated, there is a net farm profit rather than a net farm loss. Appellants argue that if all of their farming operations were conducted through a single entity such as a proprietorship, no net farm loss would have been sustained, and, therefore, no preference tax imposed. Thus, appellants argue that the multiple entity form of their farming business and the fact that the income in question was received by

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Mr. Bidart in the form of corporate salaries, should be disregarded for the purpose of computing net farm loss as an item of tax preference. Second, appellants argue that the intent of the California Legislature in enacting Revenue and Taxation Code section 17063, subdivision (h), which designates net farm loss as a tax preference item, was to prohibit the use of farm losses to offset or shelter income from non-farm sources. Appellants contend that the preference tax should be imposed upon net farm losses only when the losses in question have the effect of sheltering income' from non-farm sources.

During the years in issue, Revenue and Taxation Code section 17063, subdivision (i), provided that the amount of net farm loss in excess of \$15,000 which is deducted from non-farm income is a tax preference item. The term "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." In the Appeal of Harry and Hilda Eisen, decided by this board on October 27, 1981, we were presented with the issue of whether a corporate salary paid to an owner constituted income from the business of farming. The appellant in Eisen was a partner in a farming partnership and the chief operating officer and 50-percent owner of a farming corporation. Prior to its incorporation, the appellant had owned and operated the farming corporation as a sole proprietorship. In the Eisen appeal, we decided that a salary paid an employee who was also an owner, by a corporation engaged in the business of farming, did not constitute income from farming.

Appellants argue that if the income in question had been derived from a sole proprietorship rather than as salaries from corporations, it would have been considered farm income for the purposes of computing the net farm loss. We considered a similar argument in the Eisen appeal. We stated:

1/ Statutes 1979, chapter 1168, page 4415, 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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At the oral hearing on this matter, appellant argued that **the** salary, bonus, and dividend income in issue would have been considered 'gross income from farming had it not been for the incorporation of Norco and that the mere change -in form **of** ownership should not have the effect of changing the nature of such income from farm income to non-farm income. We cannot agree. **While** it is true that in matters of tax liability substance is generally to be preferred to form, it is not correct to say that the form which a transaction takes is unimportant **from the** standpoint of tax liability. Indeed, in many instances, the form of a transaction is determinative of tax consequences. If a taxpayer, having a choice of methods for accomplishing an **economic** or business result, pursues a particular means to accomplish his ends, he must abide by the tax consequences resulting from his choice of methods, even though had he made another choice the tax consequences **would have** been less severe or even nonexistent. (United States v. Cumberland Public Service Company; 338 U.S. 451 [94 L.Ed. 251] (1950); Freeman v. Commissioner, 303 F.2d 580 (8th Cir. 1962); Barber v. United States, 215 F.2d 663 (8th Cir. 1954).)

Appellants also argue that the legislative intent in enacting section 17063 of the Revenue and Taxation Code was to impose preference tax upon net farm losses only when the losses have the effect of sheltering income from non-farm sources. In the Appeal of Dorsey H. and Barbara D. McLaughlin, decided by this board on October 27, 1981, we stated the following with respect 'to the legislative history behind enactment of the minimum tax on tax preference items:

Section 17062, the section setting forth the minimum tax on tax preference items, was enacted as part of a comprehensive legislative plan designed to conform California income tax law to the federal reforms enacted by the Tax Reform Act of 1969. (See Assemb. Corn. on Rev. and Tax. Tax Reform: 1971; Detailed Explanation of AB 1215-1219 and ACA 44, As Amended May 20, 1971, p. 85.) The federal counterpart of section 17062, section 56 of the Internal Revenue Code of 1952, imposes a minimum tax on tax preference items. It was enacted to reduce the advantages

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derived from otherwise tax-free preference income and to insure that those receiving such preferences pay a share of the tax burden. (1969 U.S. Code Cong. and Ad. News 2143.)

The issue presented in Eisen is identical to the issue presented in this case; therefore, we sustain respondent's determination that the corporate salaries paid to Mr. Bidart do not constitute farm income.

We now turn to the issue of whether appellants' distributive share of the Wheeler Farms partnership interest income is income from the trade or business of farming.

Interest is compensation for the use or forbearance of money. (Rosen v. United States, 286 F.2d 658, 660 (3rd Cir. 1961).) Income received in the form of interest has no connection with the trade or business of farming. The fact that the funds which earned such interest had their source in profits from farming is not relevant. Once the farming activity from which these funds have been generated has been completed, the funds cannot be termed "farm income," regardless of the use to which they are subsequently put. Accordingly, interest derived from the profits from previous farming activities is not farm income.

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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 18535 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of John A. and Betty M. Bidart against proposed assessments of additional personal income tax in the amounts of \$174.84, \$5,626.65, and \$1,387.80 for the years 1976, 1977, and 1978, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of October, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

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| Richard Nevins | , Chairman |
| William M. Bennett | , Member |
| Walter' Harvey* | , Member |
| | , Member |
| | Member |

*For Kenneth Cory, per Government Code section 7.9