BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 81A-1104-SW
KURT WILLE ELECTRIC, INC.)

Appearances:

For Appellant: John L. Burghardt
Attorney at Law

For Respondent: Jon Jensen
Counsel

O P I N I O N

This appeal is made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Kurt Wille Electric, Inc., against proposed assessments of additional franchise tax in the amounts of $1,347, $803, $480, and $312 for the income years ended October 31, 1976, October 31, 1977, October 31, 1978, and October 31, 1979, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

Appeal of Kurt Wille Electric, Inc.

The issue presented in this appeal is whether the expenses of operating and of traveling to and from a ranch in Crescent Mills, California, are the business expenses of appellant or the personal expenses of its owners.

Appellant is a corporation owned by Kurt and Elise Wille. Prior to incorporating the business in 1975, Mr. Wille operated his electrical contracting business as a sole proprietorship. His business was in the Los Angeles area and was operated out of his personal residence in Palos Verdes.

In 1972, the Willes purchased a 215-acre ranch in Crescent Mills, California, which is almost 600 miles from Los Angeles. The ranch is situated predominantly on mountainous terrain with only 15 acres of usable pasture. At the time of purchase, the house was the only improvement on the land. Subsequently, the ranch house was remodeled, the pasture was fenced, and an animal and storage barn was constructed.

In June of 1977, Mr. and Mrs. Wille transferred title in the ranch to the corporation via a quitclaim deed. There is no evidence what type of consideration was given for the tranfer and there are no corporate minutes that indicate why the corporation acquired the ranch. In April of 1979, the Willes sold their Palos Verdes home and made the ranch their permanent. residence.

During the period in issue, appellant deducted the expenses of operating the ranch and the expenses of traveling to and from the ranch, contending that they are proper business expenses. Respondent's position is that these expenses are the personal expenses of Mr. and Mrs. Wille, the sole shareholders of appellant, and that these expenses should be attributed to the Willes individually as income in the form of constructive dividends. Respondent issued assessments which reflect this position and appellant made a timely appeal.

The first question to be answered is whether the corporation was engaged in the business of farming or ranching so as to properly deduct the expenses of operating the ranch. Section 24343, subdivision (a), provide's that there 'shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the income year in carrying on any trade or business. The provisions of section 24343, subdivision (a), are similar to Internal Revenue Code section 162(a). It is

well settled in California that when state statutes are patterned after federal legislation on the same subject, the interpretation and effect given the federal provisions by the federal courts and administrative bodies are relevant in determining the proper construction of the California statutes. (Andrews v. Franchise Tax Board, 275 Cal.App.2d 653, 658 [80 Cal.Rptr. 403] (1969).)

Before an activity can be considered to be an activity constituting the carrying on of a trade or a business, such activity must be entered into in good faith with the dominant hope and intent of realizing a profit therefrom. (Hirsch v. Commissioner, 315 F.2d 731, 736 (9th Cir. 1963).) Whether a taxpayer possesses the required profit motive or intent for his activity to constitute a trade or business is a question of fact to be decided from all the evidence In each particular case. (Jasionowski v. Commissioner, 66 T.C. 312, 321 (1976).) In making this factual determination, more weight must be given to the objective facts than to the mere statements of the parties. (Engdahl v. Commissioner, 72 T.C. 659, 666 (1979).) Furthermore, the burden of proof rests with appellant. (Forster Mfg. Co., Inc. v. Commissioner, ¶ 72,138 T.C.M. (P-H) (1972).) Of further significance is the fact that, as in the Forster case, this case involves a corporation taking deductions on a home of its dominant shareholders. In such circumstances, the proof should be very clear and very certain that the expenses charged to the corporation were legitimate business expenses of the corporation. (Greenspon v. Commissioner, 23 T.C. 138 (1954).)

In this case, the facts reveal that the ranch was first purchased by Mr. and Mrs. Wille in 1972. After purchasing the property, they began to remodel the house and improve the property. Five years after purchasing the property, the Willes transferred the ranch to appellant. In 1979, the Willes sold their home in Palos Verdes and moved into the house located on the ranch.

Appellant contends that the deductions are proper business expense deductions because Mr. Wille had experience operating a farm when he was a child. Appellant further contends that Mr. and Mrs. Wille did not raise the cattle for their own consumption or operate the ranch for their personal enjoyment.

Respondent asserts that at the protest level, Mr.and Mrs. Wille told respondent's representative that the entire ranch had no irrigation and was too hilly and

cold to be an operating ranch. Respondent further asserts that only eight cattle were purchased and there was no gross income of any sort from the ranch operations. Mr. and Mrs. Wille allegedly did have a garden on the ranch and did consume its produce.

Given the facts presented, we must conclude that appellant was not engaged in a farming activity that could be considered to constitute a trade or business. First, we note that the corporate minutes do not indicate that the ranch was purchased or for what particular purpose it was purchased. In other words, there is no indication in the corporate minutes that appellant intended to enter into the farming or ranching busines for a profit. In the first seven years of ownership, either by Mr. and Mrs. Wille or by appellant, the ranch showed nc profit or even any gross income. Secondly, there is no evidence that the ranch had any history of being a successful cattle ranch. (See Metcalf v. Commissioner, ¶ 63,277 T.C.M. (P-H) (1963).) When Mr. and Mrs. Wille purchased the ranch, the only improvement on the property was the house. Furthermore, there is no -evidence that the Willes consulted- with experts in the area of the ranch who could advise them on the chances of success in their farming activities.

The facts further indicate that there were only eight cattle on the ranch. Given this small number of cattle, a logical conclusion would be that appellant may have been considering entering into the commercial cattle business *at* some future time but that it did not intend to do so immediately. (See Stoltzfus v. Commissioner, ¶ 70,337 T.C.M. (P-H) (1970).)

The record also shows that Mr. Wille's parents may have resided on the ranch. There is no evidence that appellant hired any experienced farm workers to manage the ranch. Likewise, Mr. and Mrs. Wille lived over 600 miles away from the ranch and could not themselves have participated in the daily chores associated with raising animals. (See Mahr v. Commissioner, ¶ 82,297 T.C.M. (P-H) (1982).)

The physical layout of the ranch also supports our findings. A commercial cattle operation cannot be successfully conducted on only 15 acres of irrigated land. While the ranch had over 200 acres, the record establishes that only 15 acres of it was pasture land and the remaining_ land was forest.

Finally, we note that the house was eventually used by Mr. and Mrs. Wille as their personal residence. We cannot conclude that expenses incurred in repairing a house so as to prepare it for personal occupancy are proper business expenses. (See Appeal of Trevor Whayne and Florence Eisenman, Cal. St. Bd. of Equal., July 10, 1962.)

Based on the record as a whole, we conclude that appellant was not engaged in the ranching or farming activities during the period in issue with any profit motive. For this reason, we conclude that the deductions taken relating to this farming activity are not allowable under section 24343, subdivision (a).

Appellant's second contention is that the expenses of operating the ranch and the transportation and costs of equipment are fully justified deductions as they are integrally related to the corporation's primary economic activity of electrical contracting.

Since purchasing the ranch in 1972, Mr. and Mrs. Wille have made numerous trips to the property. Many of these trips were made in corporate-owned vehicles. The majority of, the facts involving these trips remain in dispute.

Appellant contends that when Mr. and Mrs. Wille went to the ranch, they did not spend much time there. Rather, they used the barn at the ranch to store equipment and corporate vehicles. Appellant has stated that it was difficult to rent a storage facility in the Los Angeles area which could provide the space and the security necessary to house its expensive equipment. When a large job was in progress, the eight corporate vehicles would be left on the job site. But when the job was completed, the vehicles would be moved to the ranch. Appellant contends that even with the costs of transporting the vehicles over 600 miles to the ranch, the cost was still less than renting a storage facility in the Los Angeles area. Mr. and Mrs. Wille allegedly used the ranch to store business vehicles even prior to incorporating the business in 1975'.

Respondent's position' is that it makes no economic sense to store vehicles over 600 miles from potential job sites. It points out that no evidence has been presented to show what equipment was stored at the ranch; how often it was transported back and forth; or what it would cost to rent storage space in the Los

Angeles area. The pictures submitted of items stored at the ranch show only smaller items such as pipes and fittings. Respondent finally contends that Mr. and Mrs. Wille traveled to the ranch to do the electrical improvements on the property and to enjoy the ranch. Mr. and Mrs. Wille allegedly told respondent that they stayed at the ranch about one week a month to work on ranch improvements.

As was stated above, it is appellant's burden to prove that the expenses are ordinary and necessary expenses. We do not think that this burden has been met. No evidence has been presented, other than the testimony of Mr. and Mrs. Wille, to support appellant's contentions that corporate vehicles were stored on the ranch. The corporate minutes do not reflect any decision to utilize the ranch for storing company vehicles and the pictures presented do not show the storage of any large equipment or vehicles. Likewise, there are no other records or documents which verify appellant's contentions. Rather, the facts support a finding that the Willes improved the property so that it could be ultimately used as their personal residence. Trips made to the ranch were made primarily for this personal purpose.

In sum, we conclude that the expenses of operating the ranch and the expenses of traveling to and from the ranch are not business expenses which can be deducted by appellant. The action of respondent 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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Kurt Wille Electric, Inc., against proposed assessments of additional franchise tax in the amounts of $1,347, $803, $480, and $312 for the income years ended October 31, 1976, October 31, 1977, October 31, 1978, and October 31, 1979, respectively, be and the same is hereby sustained.

Done at Sacramento, Califcrnia, this 9th day of April , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins , Chairman

Conway H. Collis , Member

William M. Bennett , Member

Walter Harvey* , Member

, Member

*For Kenneth Cory, per Government Code section 7.9