



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
EMIL AND ROSE **GAYNOR** ) No. **84R-477-MW**

Appearances:

For Appellant: Emil **Gaynor**,  
in pro. per.

For Respondent: B. S. Heir  
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a), 17 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Emil and Rose **Gaynor** for refund of personal income tax in the amounts of \$2,403 and \$2,598 for the years 1977 and 1978.

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

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The question presented by this appeal is whether appellants' charter-boat operation was an activity engaged in for profit. "Appellant" herein shall refer to Emil **Gaynor**.

During the years in issue, appellant was employed full time as an engineer. He was also a shipwright and had been involved with boating for many years. Appellants had chartered boats for 12 years prior to 1977, but had never produced a profit. In 1977, they purchased a **45.5-foot** boat which they then used in their charter-boat activity. The boat was chartered for 32 days in 1977 and 19 days in 1978. All charters were on weekends or during appellants' vacations. Appellant skippered all of these charters except one, when a certified captain was skipper. Appellant always had available an alternate skipper for times when he might be unable to skipper the boat himself.

On their 1977 and 1978 California personal income tax returns, appellants reported income of \$4,480 and \$2,670, respectively, and claimed losses of \$14,606 and \$26,156, respectively, in connection with their charter-boat activity. During an audit of those returns, the Franchise Tax Board determined that appellants' charter-boat activity was not engaged in for profit. The Franchise Tax Board recomputed appellants' tax liability for those years, **disallowing their** claimed deductions to the extent that they exceeded income from the activity. Appellants paid the additional tax liability which resulted and filed a claim for refund which was denied, **leading** to this appeal.

Section 17202 allowed the deduction of **"all** the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ." However, section 17233 prohibited deductions **attributable** to activities not engaged in for profit, except for certain limited deductions enumerated in subdivision (b) of section 17233 which are not involved in this appeal.

Internal-Revenue Code sections 162 and 183 correspond to sections 17202 and 17233, respectively. Therefore, interpretations of those federal statutes are highly persuasive in determining the proper application of sections 17202 and 17233. (Meanley v. McColgan, 49 **Cal.App.2d** 203, 209 [121 P.2d 45] (1942).)

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Deductions, other than those listed in subdivision (b) of section 17233, are allowable only if the taxpayer's primary intention and motivation in engaging in the activity was to make a profit. (Jasionowski v. Commissioner, 66 T.C. 312, 319 (1976).) The taxpayer's expectation of profit need not be reasonable, but it must be a good-faith expectation. (Allen v. Commissioner, 72 T.C. 28, 33 (1979).) The issue is one of fact and the burden of proving the requisite intention is on the taxpayer. (Allen v. Commissioner, supra, 72 T.C. at 34.) The taxpayer's expression of intent, while relevant, is not controlling; the taxpayer's motives must be determined from all the surrounding facts and circumstances. (Appeal of Virginia R. Withington, Cal. St. Bd. of Equal., May 4, 1983.)

The regulations under Internal Revenue Code section 183 list a number of factors which normally should be considered when determining whether the taxpayer has the requisite profit motive: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) an expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation. (Treas. Reg. § 1.183-2(b).) All the facts and circumstances regarding the activity are to be taken into account: no one factor is determinative. (Treas. Reg. § 1.183-2(b).) Our evaluation of the entire record convinces us that appellants' 1977 and 1978 boat-chartering activity was an activity engaged in for profit.

It appears that appellants maintained adequate books and records, retaining an accountant to prepare their tax returns and a financial plan for their chartering activity. The Franchise Tax Board contends that their activity was not conducted in a manner substantially similar to profitable chartering operations because it was usually engaged in only on weekends, while profit-seeking operations are conducted full time. We cannot agree with the Franchise Tax Board's implication that a chartering enterprise must be conducted full time in order to be considered a profit-motivated activity.

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In any case, although **most** of appellant's charters were done on weekends, appellant has stated that he had sufficient flexibility in his employment to take a leave of absence so that he could skipper a charter and that an alternate skipper was also **available to** operate a charter whenever required. Appellant has also stated that he has refused only two charters and these were refused for reasons unrelated to appellant's availability as a skipper. The fact that most charters were on weekends, therefore, seems to reflect the fact that most people wanted to charter appellant's boat on weekends, not that the boat-chartering activity was only conducted part of the time. In addition, appellant has stated that he took several courses that enabled him to reduce his insurance and repair costs, which indicates an intent to improve profitability.

There is no question raised **of** appellant's expertise. He became a licensed shipwright at 16 years of age and was a skipper during the summers while attending college. In addition, appellant has taken navigation courses to improve his skills.

The Franchise Tax Board has argued that appellant devoted a limited amount of time to boat charters because of his employment as an engineer, again citing the fact that most of the charters were on weekends. While appellant's time spent as a skipper may not have been great, skippering is not the only aspect of the activity. Appellant also devoted time to courses to improve his skills and reduce his costs, and spent time maintaining the boat as well. Although the regulations state that withdrawal from another occupation to devote energies to the subject activity may be evidence that the activity was engaged in for profit (Treas. Reg. § 1.183-2(b)(3)), we do not believe that appellant's failure to leave his job as an engineer indicates that he lacked a profit motive.

The "profit" referred to by the regulations includes appreciation in the value of the assets used in the business. Although the market value of appellants' boat decreased in the years after 1983, when the boat was purchased in 1977 and the financial plan for the activity was drawn up, appellants clearly anticipated that the boat would appreciate in value in an amount more than sufficient to offset their anticipated losses in the first several years of its operation.

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A profit motive may be indicated when a taxpayer has previously engaged in a similar activity and converted it from an unprofitable to a profitable activity. Appellant was apparently engaged in chartering, as a sole proprietor and as a partner, for the 12 years preceding 1977. In none of those years did he make a profit. This long history of losses in similar activities certainly does weigh against appellants; although, since we know nothing about the circumstances of these previous operations, we are hesitant to ascribe too great a weight to this situation.

The Franchise Tax Board points out that appellants produced no profit in either 1977 or 1978. However, the regulations state that losses attributable to unforeseen or fortuitous circumstances do not indicate that the activity lacks a profit motive. (Treas. Reg. § 1.183-2(b)(6).) Appellant has stated that his chartering endeavors were adversely affected by the advent of tax-shelter bare-boat chartering companies which could offer charters at a much lower rate than could appellant. The Franchise Tax Board has not refuted appellant's statement and we find it to be a reasonable explanation for at least part of the losses sustained by appellants.

The Franchise Tax Board contends that the "tremendous losses" (Resp. Br. at 8) appellants incurred indicate a lack of profit motive because they offset appellants' income of more than \$60,000 from other sources. While the losses undoubtedly provided some tax benefit, the after-tax cost of the activity would still have represented a significant amount to appellant. That appellants did not invest in the boat with the primary intent of tax benefits is shown by the relatively small losses which they anticipated in their accountant's financial projection.

Finally, although appellants enjoyed sailing, they have made the uncontested statement that the only personal use made of their boat was limited to maintaining it in readiness for chartering. This is in distinct contrast to the extensive personal use found in other cases where operation of a boat was held not be an activity engaged in for profit. (See e.g., Martin v. Commissioner, 50 T.C. 341 (1968); Rand v. Commissioner, 34 T.C. 1146 (1960); Blake v. Commissioner, ¶ 81,579 T.C.M. (P-H) (1981).)

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Based on the record as a whole, we are convinced that, in 1977 and 1978, appellants had a good-faith expectation of making a profit from their boat-chartering activities. Therefore, the action of the Franchise Tax Board must be reversed.

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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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Emil and Rose **Gaynor** for refund of personal income tax in the amounts of \$2,403 and \$2,598 for the years 1977 and 1978, be and the same is hereby reversed.

Done at Sacramento, California, this 6th day of **January** , 1987, by the State Board of Equalization, with Boar? **Members** Mr. Collis, Mr. Dronenburg, Mr. Bennett, Mr. Carpenter and Ms. **Baker** present.

Conway I!. Collis , Chairman  
Ernest J. Dronenburg, Jr. , Member  
William M. Bennett , Member  
Paul Carpenter , Member  
Anne Baker\* , Member

\*For Gray Cavis, Per Government Code section 7.9