

1 Mai C. Tran
 2 Tax Counsel III
 3 Board of Equalization, Appeals Division
 4 450 N Street, MIC:85
 5 P.O. Box 942879
 6 Sacramento, CA 95814
 7 Tel: (916) 324-8244
 8 Fax: (916) 324-2618

9 Attorney for the Appeals Division

10 **BOARD OF EQUALIZATION**
 11 **STATE OF CALIFORNIA**

12 In the Matter of the Appeal of:

) **HEARING SUMMARY¹**

) **FRANCHISE AND INCOME TAX APPEAL**

13 **JOHN A. MATTSON AND**

) Case No. 816470

14 **TARA L. MATTSON**

<u>Years</u>	<u>Proposed Assessments²</u>
2006	\$ 21,372
2007	\$ 20,195
2008	\$ 34,166
2009	\$ 23,004

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21 ¹ This appeal was originally heard on May 27, 2015, and was deferred pending additional briefing from both parties. After
 22 the completion of additional briefing, this matter was then rescheduled for oral hearing at the Board's March 29-30, 2016
 23 meeting. At appellants' request, this matter was postponed from that calendar due to a scheduling conflict and rescheduled
 24 for oral hearing at the Board's June 14, 2016 meeting. At appellants' request, this matter was again postponed due to a
 25 scheduling conflict and rescheduled for oral hearing at the Board's August 30-31, 2016/September 1, 2016 meeting.

26 ² Appellants owned four rental properties in the years at issue: (1) a Virginia Beach, Virginia condominium; (2) a
 27 Northstar Truckee condominium; (3) a Truckee, California house; and (4) a Devil's Knob Loop, Virginia house (DKL
 28 Property). The proposed assessments are based on the total adjustments for rental losses, home mortgage interest
 deductions, and depreciation expense deductions for these properties. Appellants have conceded the home mortgage interest
 and depreciation expense deductions. It appears that appellants only contest the disallowed rental losses for the Devil's
 Knob Loop house in Wintergreen, Virginia. According to appellants, their Virginia Beach, Virginia and Northstar Truckee
 condominiums and their Truckee, California house were managed by management companies. Appellants state that their
 Truckee, California house had a full-time tenant. As calculated by respondent, the total amount of proposed additional tax
 related to the DKL Property for the all of the years at issue is \$33,494.98. (FTB Exh, pp. 1-2, Exh. A.)

1 Representing the Parties:

2 For Appellants: John A. Mattson and Tara L. Mattson

3 For Franchise Tax Board: Jason Riley, Tax Counsel III

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5 QUESTIONS: (1) Whether appellants have shown error in respondent's determination that appellants'
6 rental real estate activities did not qualify as a trade or business for the years at
7 issue; and

8 (2) Whether respondent erred in determining that appellants' rental real estate activities
9 are passive activities, such that losses from those activities may only offset their
10 passive income for the years at issue.

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12 HEARING SUMMARY

13 Background

14 Overview

15 During the years at issue, appellant-husband was employed full-time by Cisco
16 Technologies, Inc. and was paid wages of \$449,289, \$595,773, \$639,205, and \$357,384 for 2006, 2007,
17 2008, and 2009, respectively. Appellants also owned four vacation properties, including one located on
18 Devil's Knob Loop in Wintergreen, Virginia (DKL Property), and reported losses from those four
19 properties as ordinary losses for the 2006 through 2009 tax years. As to the DKL Property, appellants
20 claimed rental losses of \$89,727, \$106,985, \$113,574, and \$80,800 for 2006, 2007, 2008, and 2009,
21 respectively. Appellants reported these losses under Internal Revenue Code (IRC) section 469(c)(7) as
22 the law applies to rental real estate professionals. Respondent disallowed the claimed rental losses. On
23 appeal, appellants contend that respondent erred in its determination that appellants' rental activities
24 were passive activities with respect to the DKL Property. (ROB, p. 1, Exh. A.)

25 Audit

26 Respondent noted that appellants did not include California Form 3801, *Passive Activity*
27 *Loss Limitations*, with their filed returns. Respondent determined that all of the losses from appellants'
28 rental properties were disallowed as rental losses because California does not conform to IRC section

1 469(c)(7), pursuant to Revenue and Taxation Code (R&TC) section 17561, subdivision (a). In
2 addition, respondent determined that the reported amounts of depreciation were incorrect because the
3 depreciable basis included land. Lastly, respondent determined that appellants incorrectly calculated
4 the amount of the mortgage interest deduction because the reported amounts of interest exceeded the
5 amounts allowed for the first \$1 million of indebtedness. Respondent issued Notices of Proposed
6 Assessment (NPAs) dated March 8, 2011, for the years at issue which proposed additional tax based on
7 the disallowed rental losses, disallowed depreciation expenses, and disallowed mortgage interest
8 deductions.³ (ROB, p. 1, Exh. F; AOB, Atths.)

9 For the 2006 tax year, the NPA reflected that respondent disallowed rental losses of
10 \$204,129, depreciation expenses of \$14,909, and home mortgage interest of \$17,591, which resulted in
11 increasing appellants' taxable income from \$169,780 to \$406,409. The NPA for 2006 proposed
12 additional tax of \$22,759.⁴ (AOB, Atths.)

13 For the 2007 tax year, the NPA reflected that respondent disallowed rental losses of
14 \$186,769, depreciation expenses of \$8,458, and home mortgage interest of \$35,608, which resulted in
15 increasing appellants' taxable income from \$281,378 to \$512,213. The NPA for 2007 proposed
16 additional tax of \$21,468. (AOB, Atths.)

17 For the 2008 tax year, the NPA reflected that respondent disallowed rental losses of
18 \$341,170, depreciation expenses of \$31,293, and home mortgage interest of \$20,431, which resulted in
19 increasing appellants' taxable income from \$161,266 to \$554,160. The NPA for 2008 proposed
20 additional tax of \$37,355. (AOB, Atths.)

21 For the 2009 tax year, the NPA reflected that respondent disallowed rental losses of
22 \$341,538, depreciation expenses of \$22,660, and home mortgage interest of \$15,354, which resulted in
23 increasing appellants' taxable income from negative \$62,120 to \$317,432. The NPA for 2009 proposed
24 additional tax of \$25,383. (AOB, Atths.)

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27 ³ The mortgage interest and depreciation expenses were conceded by appellants in their reply brief. As such, the parties'
28 contentions regarding these items prior to this concession will not be addressed in the hearing summary. (App. Reply Br.,
p. 3.)

⁴ The NPA for 2006 also reflected interest suspension under R&TC section 19116 for the period, April 16, 2010 to
March 22, 2011 (fifteen days after the date of the NPA).

1 Protest

2 Appellants timely protested the NPAs. Appellants indicated that they were unaware of
3 the difference between federal and state law regarding real estate professionals.⁵ Although the losses
4 claimed on the returns related to four different properties, appellants focused their protest on the
5 disallowed losses related to the DKL Property. Appellants abandoned the real estate professional
6 position held at audit, and instead, argued that the DKL Property was not a rental activity, but that it
7 qualified as a trade or business under an exception provided by Treasury Regulation section 1.469-
8 1T(e)(3)(ii)(A). This exception under Treasury Regulation section 1.469-1T(e)(3)(ii)(A) provides that
9 an activity qualifies as a trade or business if the average period of each customer's use is seven days or
10 less during each taxable year. (ROB, p. 2.)

11 Appellants submitted a schedule reflecting that the average period of customer use was
12 seven days or less for each taxable year. Appellants also provided a log that included rental schedules
13 with the tenant's names, arrival and departure dates, the number of days the property was rented, the
14 daily rate, and the deposit amounts. Appellants did not submit any additional documentation such as
15 rental contracts to substantiate their schedules. In addition, appellants provided a schedule estimating
16 the number of hours appellants spent cleaning and performing maintenance on the DKL Property.
17 Appellants did not submit any evidence corroborating the number of hours appellants listed on the
18 schedule. However, appellants provided a schedule of alleged credit card purchases, including food,
19 gas, hotel, airfare, car rental, and airport parking, which appear to demonstrate their physical presence
20 in various locations on specific dates. After review, respondent determined that the DKL Property was
21 considered a rental activity under IRC section 469(c)(2) because appellants did not substantiate that the
22 DKL Property was a trade or business. (ROB, p. 2, Exhs. B, C, D & E.)

23 Respondent issued a position letter dated September 26, 2013, explaining that it
24 disallowed the rental losses for the following reasons: the losses resulted from rental activities which
25 were passive activities; appellants' rental activities did not qualify as a trade or business; and appellants
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27 ⁵ As discussed below, the Internal Revenue Code allows certain real estate professionals to treat their rental activities as
28 non-passive activities. (Int.Rev. Code, § 469(c)(7).) However, the Revenue and Taxation Code specifically excludes this
treatment for California purposes. (Rev. & Tax. Code, § 17561, subd. (a).)

1 did not materially participate in the rental activities. Respondent issued Notices of Action (NOAs)
2 dated April 30, 2014, which took into account the adjustments allowed for the depreciation expenses
3 and the home mortgage interest deductions. The NOAs proposed additional tax of \$21,372, \$20,195,
4 \$34,166, and \$23,004 for the 2006, 2007, 2008, and 2009 tax years, respectively. (ROB, p. 3, Exhs. J,
5 G & H; AOB, Atths.)

6 Appellants then filed this timely appeal.

7 Introduction

8 Generally, passive activity losses may only be used to offset passive activity income.
9 (Int.Rev. Code, § 469; Rev. & Tax. Code, § 17561.) Generally, any “rental activity” is considered to be
10 a passive activity. (Int.Rev. Code, § 469(c)(2).) A “rental activity” is any activity where payments are
11 principally made for the use of tangible property. (Int.Rev. Code, § 469(j)(8).)

12 At the federal level, certain real estate professionals are permitted to treat rental activity
13 losses as non-passive losses. (Int.Rev. Code, § 469(c)(7).) California does not conform with this
14 treatment. (Rev. & Tax. Code, § 17561, subd. (a).) However, California does conform to a federal
15 provision that allows taxpayers to apply up to \$25,000 of rental real estate activity losses to non-passive
16 income. (Int.Rev. Code, § 469(i).) The allowance of this loss deduction completely phases out when
17 taxpayers have a modified adjusted gross income (MAGI) of \$150,000. As discussed below, it appears
18 that, as appellants’ MAGI in the years at issue exceeded \$150,000, they are ineligible for this treatment
19 under IRC section 469(i) (i.e., to apply up to \$25,000 of their rental real estate activity losses to their
20 non-passive income).

21 Nevertheless, if appellants can demonstrate that their activities involved the conduct of a
22 “trade or business” in which they “materially participated”, then their activities will not be considered
23 passive, and they may use the losses from those activities to offset non-passive income. (Int.Rev.
24 Code, § 469(c)(1).) For an activity involving the use of tangible property to be a “trade or business”, a
25 taxpayer must satisfy one of six tests provided under Treasury Regulation section 1.469-1T(e)(3)(ii).
26 Here, the test at issue is whether the average period of customer use is seven days or less. (Treas. Reg.,
27 § 1.469-1T(e)(3)(ii)(A).) In addition, a taxpayer must demonstrate that he materially participated in the
28 activity by satisfying one of seven tests provided under Treasury Regulation section 1.469-5T(a). Here,

1 the test at issue is whether appellants participated in the activity for more than 100 hours during the tax
2 year and whether appellants' participation is not less than the participation by any other individual
3 during the tax year. (Treas. Reg., § 1.469-5T(a).)

4 Contentions

5 Appellants initially disputed the disallowed home mortgage interest and depreciation
6 expense deductions. However, after reviewing respondent's schedules attached to respondent's
7 opening brief, appellants no longer dispute these adjustments.

8 Appellants' Opening Brief

9 Appellants dispute respondent's characterization of their activities relating to the
10 DKL Property as a passive activity. Appellants contend that they actively managed this property
11 during the years at issue. Appellants contend that there was no management company involved during
12 the years at issue and that they did not use the property for personal use for more than 14 days or
13 10 percent of the rental time. Appellants further contend that the DKL Property had an average rental
14 period of seven days or less. Therefore, appellants contend that the losses from the DKL Property
15 should be fully deductible. Appellants assert that, after discussing this with respondent's auditor, the
16 auditor verbally agreed that he would adjust his original analysis accordingly. Appellants contend that
17 they provided the auditor with the requested additional documentation to support their position that the
18 DKL Property was actively managed by them as a business. Appellants contend that, despite providing
19 three different sets of documentation to the auditor, the auditor determined that appellants did not
20 submit sufficient documentation. (Appeal Letter, pp. 1-4, Atths.)

21 Respondent's Opening Brief

22 Respondent contends that appellants are not entitled to deduct any portion of the claimed
23 passive rental losses from their non-passive income because appellants' modified adjusted gross
24 income exceeded \$150,000 in each of the appeal years. Respondent explains that California law
25 generally conforms to IRC section 469 in prohibiting the use of passive losses to reduce non-passive
26 gains, citing R&TC section 17561. Respondent states that losses from passive activities in excess of
27 income from passive activities are suspended and carried forward to future years until the taxpayer has
28 sufficient income from passive activities to offset the loss or until the taxpayer disposes of the entire

1 interest in the activity in a fully taxable transaction, citing IRC sections 469(b) and (g). Respondent
2 notes that California law adopts IRC section 469(c)(2), which provides that rental activities are per se
3 passive. (ROB, pp. 3-4.)

4 Respondent notes that, for federal purposes, IRC section 469(c)(7) provides an
5 exception for qualified real estate professionals who materially participate in a rental real estate
6 activity. Respondent contends that, for those who qualify for this exception, an activity is not treated as
7 passive and the taxpayer is entitled to deduct losses from that activity without limit against non-passive
8 income. Citing R&TC section 17561, subdivision (a), respondent states that California does not
9 conform to the real estate professional exception pursuant to IRC section 469(c)(7). Respondent
10 contends that, for California purposes, all rental activities are considered per se passive activities, and
11 losses from rental real estate passive activities may only be used to offset income from passive
12 activities. (ROB, p. 4.)

13 Respondent further explains that a passive activity includes any trade or business in
14 which the taxpayer does not materially participate and any rental activity regardless of participation,
15 citing IRC sections 469(c)(1) and (2). Respondent notes that there is an exception under IRC section
16 469(i), which allows taxpayers to deduct up to \$25,000 of passive losses against non-passive income,
17 provided the taxpayer is an active participant in the activity. Respondent asserts that this \$25,000 offset
18 is reduced when the taxpayer's MAGI is over \$100,000 and once MAGI exceeds \$150,000, the
19 \$25,000 offset is reduced to zero. (ROB, pp. 4-5.)

20 Respondent notes that appellants claimed rental losses on the DKL Property of \$89,727,
21 \$106,985, \$113,574, and \$80,800 for tax years 2006, 2007, 2008 and 2009, respectively. Respondent
22 contends that appellants' rental losses are per se passive losses which can only be deducted against
23 passive income. Respondent contends that, as appellants did not file California Form 3801 on their
24 2006 to 2009 tax returns, none of the passive losses can be deducted. In addition, respondent notes that
25 appellants' MAGI was \$485,790, \$627,308, \$662,226, and \$395,788 for 2006, 2007, 2008 and 2009,
26 respectively. Noting the Tax Court's decision in *Schetzer v. Comm'r*, T.C. Memo. 1999-252,
27 respondent contends that IRC section 469(i) allows a taxpayer who is a natural person and who actively
28 participates in a rental activity to claim a maximum loss of \$25,000 per year related to rental real estate.

1 Respondent, however, contends that, as appellants' MAGI exceeded \$150,000 for each of the years at
2 issue, appellants were not entitled to claim this offset. Respondent further contends that appellants are
3 not real estate professionals and California does not allow for real estate professionals regardless of
4 whether appellants materially participated in the activity. Accordingly, respondent contends that
5 appellants' rental activity losses must be treated as passive losses and the \$25,000 exception is not
6 available to appellants for any of the years at issue based on appellants' MAGI for each year. (ROB,
7 pp. 5-6, Exh. A.)

8 Respondent next contends that the DKL Property does not qualify as a trade or business,
9 rather than being passive activity losses. Respondent notes that there are six limited exceptions
10 provided under Treasury Regulation section 1.469-1T(e)(ii)(A)-(F) to the general rule that rental real
11 estate activities are per se passive. As to appellants' contention that they qualify under Treasury
12 Regulation section 1.469-1T(e)(ii)(A), respondent notes that this exception excludes from "rental
13 activity" an activity where the average period of customer use is seven days or less. Respondent
14 contends that an activity involving the use of tangible personal property is not a "rental activity" for a
15 taxable year if the average period of customer use for such property is seven days or less in that taxable
16 year, and that activity is not considered a passive activity, citing *Mordkin v. Comm'r*, T.C. Memo.
17 1996-187 and *Scheiner v. Comm'r*, T.C. Memo. 1996-554. Respondent notes that appellants provided
18 several pages from a log book which appear to show the length of customer stays at the DKL Property,
19 but contends that the information was not verifiable because appellants did not provide the contracts or
20 rental agreements that correspond with the entries in the log book. (ROB, pp. 6-7.)

21 Respondent further contends that, "[e]ven if *arguendo* the log entries are correct,"
22 appellants have not shown that they materially participated in the activity as required by IRC section
23 469(c). Respondent notes that Treasury Regulation section 1.469-1T(e)(1) provides that an activity is
24 passive if it is either a rental activity, or a trade or business in which the taxpayer does not materially
25 participate. Respondent argues that, even if the DKL Property activity is not considered a "rental
26 activity," the activity remains passive because appellants did not materially participate in operating the
27 DKL Property. Respondent notes that a taxpayer will not be treated as a material participant unless the
28 involvement is "regular, continuous, and substantial," citing IRC section 469(h). Respondent contends

1 that a taxpayer “materially participates” in a business activity if, and only if, he meets one of the seven
2 tests provided under Treasury Regulation section 1.469-5T(a). Respondent notes that material
3 participation is a year-by-year determination. (ROB, pp. 7-8.)

4 Respondent notes that appellants contend that they materially participate in the
5 DKL Property for the years at issue based on the third test listed under Treasury Regulation section
6 1.469-5T(a). Respondent notes that the third test, on which appellant relies, is satisfied if appellants
7 participate in the activity for more than 100 hours during the taxable year, and such participation in the
8 activity is not less than the participation in the activity by any other individual (including individuals
9 who are not owners in the activity) for such year. Respondent notes that, if appellants spent less than
10 100 hours during a taxable year, they have not materially participated, citing Treasury Regulation
11 section 1.469-5T(b)(2)(iii). Citing Treasury Regulation section 1.469-5T(f)(4), respondent notes that
12 the method of proof that a taxpayer may use to prove that he materially participated in a trade or
13 business include “any reasonable means.” Respondent acknowledges that contemporaneous daily time
14 reports, logs or similar documents are not required if the extent of the participation may be established
15 by other reasonable means. Respondent notes that “reasonable means” may include, but are not limited
16 to, the identification of services performed over a period of time and the approximate number of hours
17 spent performing such services during such period, based on appointment books, calendars, or narrative
18 summaries. Respondent contends that appellants have not provided sufficient substantiation to show
19 that they materially participated during the years at issue. Respondent contends that, while appellants
20 provided a schedule estimating the number of hours they spent cleaning and performing maintenance
21 on the DKL Property, appellants have not provided any evidence to corroborate the number of hours
22 they allegedly spent on these activities. (ROB, pp. 8-9.)

23 Respondent analyzed appellants’ schedule for each year on appeal, using appellants’
24 schedule of alleged credit card purchases. For 2006, respondent notes that appellants allege they
25 worked 126 hours on the DKL Property based on 14 hours a day from December 22 - 31, 2006,
26 including Christmas and New Year holidays. Respondent questions appellants’ claim that they worked
27 14 hours on December 31, 2006, which is also listed as the check-in date for their customer, Kalow.
28 Respondent contends that it is unlikely that Kalow would have rented and used a holiday property for

1 \$550, while appellants intruded on Kalow's use of that property for a 14-hour period. Respondent
2 further contends that appellants have no evidence to support their claim of working 14 hours during this
3 period. Respondent points out that the credit card purchase schedule shows that appellants were
4 purportedly present at the DKL Property, and they dined at restaurants within Wintergreen, Virginia.⁶
5 Respondent points out that the schedule does not show any purchases for supplies. Respondent further
6 questions appellants' claim that they worked 14 hours a day because appellants appeared to have
7 several day trips to neighboring towns approximately 50 miles away.⁷ Respondent further questions
8 appellants' claim that they worked 14 hours a day on Christmas Eve and Christmas Day working on the
9 DKL Property because of their restaurant meals on those days. (ROB, pp. 9-11, Exhs. C & D.)

10 Respondent also contends that the claimed daily average of 14 hours a day of work in
11 2006 is unreasonable in light of their claims that they claimed a daily average of 12 hours of work a day
12 in 2007, 2008, and 2009. Respondent contends that, at most, 12 hours a day is the maximum amount of
13 time appellants could be considered devoting time to the DKL Property in the best case scenario.
14 Respondent contends that it is reasonable and likely that appellants did not work for the entire day, or at
15 all, on the following dates in 2006: December 22, 24, 25, 29, and 31. Based on this analysis,
16 respondent contends that, at most, appellants worked 84 hours on the DKL Property. Respondent
17 contends that appellants did not satisfy their burden of showing that they satisfy the 100-hour
18 requirement for material participation for 2006, citing *Akers v. Comm'r*, T.C. Memo. 2010-85.
19 Respondent further contends that appellants must also show that their participation was more than
20 anyone else. Respondent contends that appellants reportedly paid commissions or management fees on
21 the DKL Property in 2006 which shows that someone else participated in the activity. Respondent
22 contends that it is unlikely that appellants spent more time than anyone else on the property as
23 appellants spent \$5,429 on services on the property.⁸ Respondent accordingly contends that appellants'

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25 ⁶ It appears that appellants spent \$91.42 on December 24, 2006, and \$100.61 on December 25, 2006, at a Wintergreen
26 restaurant.

27 ⁷ It appears that appellants made two trips to Lynchburg, Virginia, on December 22, 2006, and on December 29, 2006.

28 ⁸ Respondent contends that appellants paid \$1,275 in commissions, \$750 in cleaning fees, \$1,500 in repairs, \$984 in
association fees, and \$920 in management fees. (Resp. Op. Br., p. 12; FTB Exhs., Exh. B.)

1 activity at the DKL Property should be treated as passive in 2006. (ROB, pp. 11-12, Exh. K.)

2 For 2007, respondent notes that appellants allege they worked a total of 132 hours on the
3 DKL Property based on 12 hours a day on the following days: January 1 and 2; August 4 to 10; and
4 December 28 to 31. Respondent questions appellants' claim that they had 12 hour meetings with a
5 contractor regarding a window replacement and a tree service company about tree pruning on January 1
6 and 2, 2007, since appellants' customer, Kalow, also occupied the DKL Property on the same dates.
7 Respondent argues that it is hard to believe that their customer would have rented and paid \$1,100 for a
8 holiday property while appellants intruded on his use of that property for two 12 hour days.
9 Respondent further contends that appellants' schedule of credit card purchases show that, on January 2,
10 2007, appellants traveled to Atlanta, Georgia via Lynchburg, Virginia, a journey of at least 8 hours.
11 Respondent further notes that appellants then flew to San Jose, California that same day. Respondent
12 argues that it is unreasonable for appellants to claim a 12-hour meeting with a tree company about tree
13 pruning on January 2, 2007, while simultaneously driving eight hours to Atlanta, and then flying to
14 San Jose, California. Respondent contends that appellants' estimates of time spent on DKL activities
15 are clearly excessive. (ROB, pp. 13-14, Exhs. C & D.)

16 Respondent contends that the second claimed trip from August 4 - 10, 2007, was likely a
17 trip to a different property owned by appellants on Cypress Point Circle in Virginia Beach, Virginia.
18 Respondent points to appellants' credit card purchases that show they dined at restaurants in
19 Virginia Beach and Norfolk on August 4, 5, and 9, 2007. Respondent notes that these restaurants are
20 more than 200 miles and roughly 3.5 hours away from the DKL Property. Respondent contends that
21 these trips were likely spent at the Cypress Point Circle property as the seven hour roundtrip drive
22 would not allow appellants to spend 12 hours a day allegedly spring cleaning and meeting with
23 contractors. With regard to the last claimed trip from December 28 - 31, 2007, respondent questions
24 appellants' alleged work spent at the DKL Property as appellants ate at a restaurant in Norfolk on
25 December 28, 2007 and the property was rented out to Kalow on each of December 30, 2007 and
26 December 31, 2007, for a total of \$1,100. Respondent contends that the best case scenario is that
27 appellants spent zero hours working at the DKL Property in 2007. Respondent further notes that
28 appellants paid commissions or management fees on the DKL Property in 2007 which shows that

1 someone else participated in the activity. Respondent contends that it is unlikely that appellants spent
2 more time than anyone else on the property as appellants spent \$28,805 on services on the property.⁹
3 Respondent accordingly contends that appellants' activity at the DKL Property should be treated as
4 passive in 2007. (ROB, pp. 14-16, Exhs. C & D.)

5 For 2008, respondent notes that appellants allege they worked a total of 156 hours at the
6 DKL Property based on 12 hours a day on the following days: January 1 to 6; July 10 to 13; and
7 August 22 to 26. Respondent questions appellants' claim that they worked 12 hours a day from
8 January 1 - 4, 2008, on spring cleaning and maintenance when their customer, Kalow, rented out the
9 property for \$2,200. Respondent further points out that appellants' schedule of credit card purchases
10 show that, on January 6, 2008, appellants travelled from the DKL Property to Gaffney, South Carolina,
11 a journey of 300 miles and five hours, en route to Atlanta, Georgia, that same day. Respondent notes
12 that the purchases show that appellants remained in Atlanta until January 9, 2008, when they flew to
13 San Jose, California. Respondent contends that it is unreasonable for appellants to claim 12 hours of
14 cleaning and maintaining the DKL Property while simultaneously driving five hours to Gaffney and
15 then another three hours to Atlanta. (ROB, pp. 16 - 17, Exhs. C & D.)

16 As for the second trip on July 10 - 13, 2008, respondent contends that the credit card
17 purchases show that this trip was actually to appellants' property in Virginia Beach. Respondent points
18 out that, on July 10, 2008, appellants were at a hotel in Herndon, Virginia, near Dulles Airport in the
19 Washington D.C. area. Respondent also points out that, on July 12, 2008, appellants dined at a
20 restaurant in Virginia Beach and, on July 13, 2008, appellants dined at a restaurant in Norfolk.
21 Respondent notes that the Dulles airport, Virginia Beach, and Norfolk are all more than three hours
22 away from the DKL Property. Respondent contends that appellants likely spent this trip at the
23 Cypress Point Circle property in Virginia Beach because the seven hour roundtrip would not allow
24 appellants to spend 12 hours a day spring cleaning and maintaining. With regard to the third trip from
25 August 22 - 26, 2008, respondent questions appellants' claim that they worked at the DKL Property for
26 12 hours on August 22, 2008, when their credit card purchases show that appellants dined at a
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28 ⁹ Respondent contends that appellants paid \$500 in commissions, \$500 in cleaning fees, \$26,512 in repairs, \$1,043 in
association fees, and \$250 in management fees. (Resp. Op. Br., p. 16; FTB Exhs., Exh. B.)

1 restaurant in Norfolk that same day. Respondent contends that appellants have not provided any
2 evidence for the period August 23 - 25, 2008. Respondent notes that, on August 26, 2008, appellants
3 appeared to have purchased gas in Greenwood, Virginia, near the DKL Property, but later that day they
4 made a purchase in Norfolk and dined at a restaurant in Virginia Beach. Respondent contends that
5 appellants' credit card purchases to not reasonably allow appellants' claimed 12 hour work days during
6 this trip. Respondent contends that the best case scenario for appellants is that they worked a total of
7 24 hours at the DKL Property in 2008: 12 hours on January 5, 2008 and 12 hours on August 25, 2008.
8 Respondent further contends that appellants paid commissions or management fees on the DKL
9 Property in 2008 which shows that someone else participated in the activity. Respondent contends that
10 it is unlikely that appellants spent more time than anyone else on the property as appellants spent
11 \$25,520 on services on the property.¹⁰ Respondent accordingly contends that appellants' activity at the
12 DKL Property should be treated as passive in 2008. (ROB, pp. 17-20, Exhs. C & D.)

13 For 2009, respondent notes that appellants allege they worked a total of 118 hours at the
14 DKL Property on the following days: May 13 to 17; and August 17 to 22. With regard to the May 13 -
15 17, 2009 trip, respondent contends that there is no evidence appellants made a single credit card
16 purchase in the Wintergreen area during five of the six days where appellants allegedly spent 12 hours a
17 day spring cleaning and maintaining the property. Respondent notes that appellants had a single credit
18 card purchase in Norfolk on May 13, 2009, for a rental car. Respondent further points out that there is
19 an inconsistency in the credit card purchase schedules because this May trip was listed on one of the
20 schedules, but was not listed on the second schedule which was attached to appellants' email dated
21 December 31, 2013. (ROB, pp. 20-21, Exhs. C & D.)

22 As for the August 17 - 22, 2009 trip, respondent contends that appellants' claimed
23 14-hour work days from August 17 - 22, 2009, is unreasonable in light of appellants' claims for the
24 2007, 2008 and 2009 years in which they claimed to have spent a daily average of 12 hours per day
25 cleaning and maintaining the property, as well as their frequent absence from the property's location on
26 days they were allegedly working there. Respondent contends that, at most, it is reasonable that
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28 ¹⁰ Respondent contends that appellants paid \$500 in commissions, \$500 in cleaning fees, \$23,154 in repairs, \$1,116 in
association fees, and \$250 in management fees. (Resp. Op. Br., p. 19; FTB Exhs., Exh. B.)

1 appellants' daily average work time was 12 hours a day. Respondent further contends that appellants'
2 credit card purchases show that appellants spent part of the time claimed in 2009 at the DKL Property
3 in Atlanta, Georgia, and Norfolk, Virginia. Respondent contends that, as the DKL Property is
4 eight hours away from Atlanta, Georgia, it is unlikely that appellants could also work 14 hours on the
5 DKL Property at the same time. Respondent contends that, from August 18 through 21, 2009,
6 appellants made numerous credit card purchases in Charlottesville and Wintergreen, Virginia,
7 demonstrating appellants' likely presence at the DKL Property. However, respondent points out that,
8 on August 22, 2009, appellants made numerous purchases in Norfolk and Virginia Beach, Virginia,
9 which were more than 200 miles and more than three hours away from the DKL Property. As such,
10 respondent contends that it is improbable that appellants could also work 14 hours on the DKL Property
11 on that same day. Respondent contends that the best case scenario for appellants is that they worked a
12 total of 48 hours in 2009, based on working 12 hour days from August 18 - 21, 2009. Respondent
13 further contends that appellants paid commissions or management fees on the DKL Property in 2009
14 which shows that someone else participated in the activity. Respondent contends that it is unlikely that
15 appellants spent more time than anyone else on the property as appellants spent \$4,944 on services on
16 the property.¹¹ Respondent accordingly contends that appellants' activity at the DKL Property should
17 be treated as passive in 2009.¹² (ROB, pp. 21-23, Exhs. C, D & I.)

18 Appellants' Reply Brief

19 Appellant first asserts that, over the course of the original audit and subsequent protest,
20 they provided over 1,000 pages of documentation to respondent, in addition to multiple letters and
21 telephone conversations. Appellants contend that respondent has been aggressive and inappropriate
22 during this process. Appellants assert that respondent conducted a wide ranging investigation in an
23 apparent attempt to maximize revenues, without regard to fairness or accuracy. Appellants contend that
24 respondent "is essentially attempting to pound [appellants] into submission with its relentless series of
25 attacks and accusations." Appellants assert that respondent previously accepted the evidence they
26

27 ¹¹ Respondent contends that appellants paid \$500 in commissions, \$500 in cleaning fees, \$2,500 in repairs, \$1,194 in
28 association fees, and \$250 in management fees. (Resp. Op. Br., p. 23; FTB Exhs., Exh. B.)

¹² The remainder of respondent's opening brief discussed the mortgage interest and depreciation expense deductions.

1 submitted with regard to the hours appellants spent on maintaining the DKL Property, as demonstrated
2 by their telephone conferences and emails to respondent's auditor. (ARB, pp. 1-2; ROB, Exhs. B & L.)

3 Appellants contend that they are not claiming deductions for rental real estate activity on
4 their California returns. Rather, appellants contend that they are claiming that their activities related to
5 the DKL Property should be treated as a trade or business such that the losses are fully deductible.
6 Appellants contend that their activities meet the exception provided in Treasury Regulation section
7 1.469-1T(e)(3)(ii)(A). Appellants contend that they provided respondent with their contemporaneous
8 records of both customer reservations and rental usage. Appellants further contend that they provided
9 summary data showing that the individual customer usage for each tax year and that information agreed
10 with the rental income reported on their Schedule E. Appellants contend that they did not provide
11 copies of rental contracts requested by respondent's auditor after he denied appellants' protest because
12 they are "operating in the twenty-first century" and they conducted their business via email. Appellants
13 assert that they no longer have access to their email records from six-to-nine years ago or they would
14 have already provided them. Appellants assert that the FTB's auditor accepted their evidence that they
15 satisfied the seven-day exception and question respondent's NOAs which state that the information
16 submitted did not verify that the DKL Property was rented for seven days or less. Appellants state that
17 they understand respondent's opening brief to mean that respondent concedes the average rental period
18 argument and respondent instead is concentrating on the material participation argument. Appellants
19 contend that respondent conceded the one point from which respondent denied their protest and,
20 therefore, respondent has acknowledged that the protest should be upheld and the Board should uphold
21 appellants' full deductions for the business use of the DKL Property. (ARB, pp. 3-4.)

22 Appellants further contend that they satisfy the 100-hour test provided in Treasury
23 Regulation section 1.469-5T(a). Appellants contend that, in accordance with acceptable methods of
24 proof provide under Treasury Regulation section 1.469-5T(f)(4), they provided detailed proof,
25 including the identification of services that they performed, the specific dates and hours of service, and
26 documentation substantiating the trips taken to visit the property and perform the services. Appellants
27 contend that, in each of the four tax years, the amount of time they spent physically at the property
28 doing maintenance, repair, and general upkeep was greater than 100 hours for each of the appellants.

1 Appellants state that they did not include travel time to and from the property nor did they account for
2 the fact that their actual hours should have been doubled since both appellant-husband and appellant-
3 wife were present and working on the reported dates. Appellants also contend that in each year they
4 spent approximately two hours per month, in total, working on marketing and customer acquisition
5 related activities, for a total of 24 hours per year. Appellants state that they did not include this time
6 earlier in this process because they had already reported over 100 hours per year. Appellants state that
7 they also spent approximately two hours per customer for each customer stay in a given year. (ARB,
8 pp. 4-5; ROB, Exhs. C & I.)

9 Appellants also contend that respondent used the wrong time and expense schedule to
10 incorrectly contest appellants' reporting. Appellants contend that, in documenting and reporting the
11 time spent at the property working on the various items, they provided detailed credit card statement
12 summaries which substantiate the approximate dates and times they visited the property. Appellants
13 contend that the dates on the credit card statements reflect the processing date, and not the date the
14 charges were made. As such, appellants contend that they made an effort to correct the dates to
15 correspond as closely as possible to the actual dates when the charges were made. In addition,
16 appellants contend that they identified one additional trip to the property taken in May 2009 which was
17 not included in their initial submission. Appellants contend that their revised submission sent to
18 respondent on December 31, 2013, is more accurate and therefore respondent's analysis, based on the
19 previous submission, is incorrect. (ARB, pp. 5-6; ROB, Exhs. D & I.)

20 Appellants also contend that respondent erred in determining that appellants could not
21 stay in the property when a customer was renting the property. Appellants explain that the
22 DKL Property is a four-bedroom house near a mountain top, and due to its location on a slope, it spans
23 four physical levels. Appellants explain that the master suite is on the fourth level, the main living area
24 is on the third level, a second master suite and a large bunkroom is on the second level. Appellants
25 explain that the property includes a completely separate apartment on the first level and that is where
26 appellants stayed while their customer was renting the property. Appellants contend that this was not a
27 problem for their customer. (ARB, p. 6.)

28 Appellants contend that respondent is requiring a standard of proof well in excess of

1 what is required by Treasury Regulation section 1.469-5T(f)(4). Appellants contend that the
2 DKL Property is located in a very isolated location and the nearest towns are Charlottesville and
3 Lynchburg, Virginia. Appellants contend that they made purchases on occasion at the Wintergreen
4 resort, but on most cases, they purchased supplies, gas, and food from Lynchburg and Charlottesville.
5 Appellants contend that, in cases where purchases made in Wintergreen were not reflected in the credit
6 card records, respondent wrongly concluded that there was no evidence to show that appellants were
7 working on the property. Appellants point to their documented trips from their home in California to
8 Virginia and purchases made within 50 miles of the property. Appellants further contend that, even
9 though they cannot document purchases made at the property, they provided documentation in the form
10 of calendars and narrative summaries. Appellants further contend that respondent made incorrect
11 assumptions regarding the amount of time spent working on the property. Appellants contend that they
12 traveled to the property once or twice a year to work on the property. Appellants assert that, based on
13 how the property is situated on a relatively exposed ridge subject to the elements, the property required
14 a great deal of minor repairs and cleaning to maintain the property in a rentable condition. Appellants
15 assert that they have had to repair the windows, fix water leaks, and address the frequent infestation of
16 insects which required extensive cleaning. Appellants assert that, when they were at the property, they
17 worked from 7:00 or 8:00 in the morning to 9:00 or 10:00 in the evening, with breaks for meals, brief
18 rests, and the occasional trip to a nearby town for supplies. Appellants contend that respondent would
19 have appellants subtract every minute they are not engaged in physical labor and questions this
20 approach. Appellants also contend that respondent did not calculate the work hours properly because
21 the estimates appellants submitted were based on only one person's work and since both appellant-
22 husband and appellant-wife worked on the property, every hour previously claimed should be doubled.
23 (ARB, pp. 6-7.)

24 For the 2006 tax year, appellants claim that the actual hours worked were 280 (i.e.,
25 126 per appellant-husband on site + 126 per appellant-wife on site + 24 marketing work + 4 customer
26 coordination). Appellants assert that, contrary to respondent's position that appellants only worked
27 12-hour days, appellants actually worked 14-hour days. With regard to the day trips to Lynchburg,
28 appellants contend that Lynchburg is the closest town and they traveled there to buy supplies, eat a

1 meal, and buy gas. Appellants contend that this time spent also count as hours worked. As for the
2 meals they had on Christmas Eve and Christmas Day, appellants contend that these meals were a treat
3 for the holidays since they sacrificed their time to do necessary work at the property. With regard to
4 New Year's Eve when Kalow checked-in, appellants assert that they worked a full day in preparation of
5 Kalow's evening arrival and later worked in the first level and outside of the house. As to respondent's
6 contention that other individuals worked more than appellants, appellants assert that the fees listed on
7 the Schedule E were paid to different individuals or entities and none of their participation was greater
8 than 10 hours in 2006. Appellants further argue that respondent's estimated hours of 84 hours when
9 doubled to account for both appellant-husband and appellant-wife working on the property is equaled to
10 168 hours. As such, appellants contend that, even based on respondent's lower estimate plus the
11 28 additional hours¹³ for marketing and customer administration, they satisfy the 100-hour test. (ARB,
12 pp. 7-8.)

13 For the 2007 tax year, appellants claim that the actual hours worked were 298 (i.e.,
14 132 per appellant-husband on site + 132 per appellant-wife on site + 24 marketing work + 10 customer
15 coordination). With regard to January 1 and 2, 2007, appellants contend that, even though their
16 customer was in the residence, appellants worked one full day and one partial day on the first level of
17 the property and the outside of the property. With regard to their trip to Atlanta and flight back to
18 California on January 2, 2007, appellants contend that they worked six hours on that day and traveled
19 another eight hours to Atlanta. Appellants assert that they worked 16 hours on January 1, 2007,
20 because they had a lot of work to do before taking their non-refundable flight back to California which
21 brought them back to San Jose at one in the morning the following day. Appellants note that they
22 should have reported their airport parking expense for January 3, 2007. Appellants further contend
23 that, contrary to respondent's interpretation that appellants only met with the tree company and
24 contractor on those two days, appellants actually performed all the stated activities during the entire
25 trip. As to the August 5 - 10, 2007 disallowed hours based on the lack of expenses, appellants contend
26 that it is common to not incur expenses in the immediate area given the isolated nature of the property.
27

28 ¹³ Although appellants referenced 34 additional hours in their reply brief, the correct amount is 28 additional hours claimed
(24 marketing work + 4 customer coordination).

1 Appellants state that they spend two nights, August 3 and 4, 2007, in the Virginia Beach area, where
2 they purchased most of the needed supplies in addition to the supplies they brought from home.
3 Appellants contend that, despite respondent's assertion, they did not visit the Cypress Point Circle
4 property. With regard to December 28 and 29, 2007, appellants assert that they flew to Norfolk to
5 purchase supplies prior to driving to the property. Appellants contend that their claimed 12 hours of
6 work on these days did not include driving time. With regard to December 30 and 31, 2007, appellants
7 again contend that they occupied the first level apartment and worked on the first level and outside the
8 property while their customer was in residence and had approved of the situation. As for other
9 individuals' work on the property, appellants contend that respondent has no proof other than the list of
10 fees. Appellants assert that the fees were paid to different individuals or entities and none of their
11 participation was greater than 30 hours during 2007. Appellants assert that the only party who worked
12 up to 30 hours was the contractor who made repairs to the windows, siding, and other interior repairs.
13 Appellants further argue that their original claimed hours of 132 hours when doubled to account for
14 both appellant-husband and appellant-wife working on the property is equaled to 264 hours. As such,
15 appellants contend that, based on this new claimed amount of hours plus the 34 additional hours for
16 marketing and customer administration, they satisfy the 100-hour test. (ARB, pp. 9-10.)

17 For the 2008 tax year, appellants claim that the actual hours worked were 344 (i.e.,
18 156 per appellant-husband on site + 156 per appellant-wife on site + 24 marketing work + 8 customer
19 coordination). For the period January 1 - 4, 2008, appellants again contend that they occupied the first
20 level apartment and worked on the first level and outside the property while their customer was in
21 residence and had approved of the situation. With regard to January 6, 2008, appellants contend that
22 they worked seven hours, from eight in the morning to three in the afternoon, and then drove six hours
23 to Greenville, South Carolina, where they spent the night. Appellants assert that they previously
24 worked 13 hours a day from January 1 - 5, 2008, for a total of 65 hours. As such, appellants contend
25 that they worked 72 hours total from January 1 to 6, 2008. For the period July 10 - 13, 2008, appellants
26 contend that respondent relied on the incorrect expense worksheet (ROB, Exh. D) versus the more
27 current expense worksheet (ROB, Exh. I) in disallowing the claimed work hours. Appellants contend
28 ///

1 that they flew into Dulles airport in Washington on July 9, 2008,¹⁴ and drove to the property the next
2 morning on July 10, 2008.¹⁵ Appellants assert that they purchased supplies on the way to the property
3 and therefore did not have any expenses in the Wintergreen area. Appellants contend that they left the
4 property on July 13, 2008,¹⁶ to drive to Norfolk. Appellants contend that, contrary to respondent's
5 assertion, they did not visit the Cypress Point Circle. Appellants state that the reported two full 14-hour
6 days on July 11 and 12, 2008,¹⁷ and two partial 4-hour days on July 10 and 13, 2008,¹⁸ for a total of
7 36 hours as reported. With regard to the disallowed hours for the period August 22 - 26, 2008, due to
8 the lack of expenses in the Wintergreen area, appellants contend that they purchased their supplies
9 away from the property. Appellants assert that they flew into Norfolk, and purchased supplies on their
10 way to the property. Appellants contend that a Home Depot expense of \$31.47 reflecting a date of
11 August 26, 2008, was actually incurred on August 22, 2008. Appellants state that the charge was
12 delayed in appearing on their credit card statement. Appellants contend that they actually spent
13 two hours on August 22, 2008, not including drive time. In addition, appellants contend that they
14 actually spent 14 hours per day from August 23 - 25, 2008, and another four hours on August 26, 2008.
15 Therefore, for the period August 22 - 26, 2008, appellants contend that they worked 48 hours. As for
16 other individuals' work on the property, appellants contend that respondent has no proof other than the
17 list of fees. Appellants assert that the fees were paid to different individuals or entities and none of
18 their participation was greater than 30 hours during 2008. Appellants assert that the only party who
19 worked up to 30 hours was the contractor who made repairs to the windows, siding, and other interior
20 repairs. Appellants further argue that their original claimed hours of 156 hours when doubled to
21 account for both appellant-husband and appellant-wife working on the property is equaled to 312 hours.
22 As such, appellants contend that, based on this new claimed amount of hours plus the 32 additional
23

24 ¹⁴ Although appellants referenced the month in this date as August in their reply brief, the correct month is July.

25 ¹⁵ *Id.*

26 ¹⁶ *Id.*

27 ¹⁷ *Id.*

28 ¹⁸ *Id.*

1 hours for marketing and customer administration, they satisfy the 100-hour test. (ARB, pp. 11-12.)

2 For the 2009 tax year, appellants claim that the actual hours worked were 276 (i.e.,
3 118 per appellant-husband on site + 118 per appellant-wife on site + 24 marketing work + 16 customer
4 coordination). For the period, May 13 - 17, 2009, appellants contend that respondent relied on the
5 incorrect expense worksheet (ROB, Exh. D) versus the more current expense worksheet (ROB, Exh. I)
6 in disallowing the claimed work hours. As to the lack of expenses during this period, appellants
7 contend that they flew into Norfolk and purchased supplies in addition to the supplies from home prior
8 to driving to the property on May 13, 2009. Appellants contend that their actual work hours during this
9 period was 14 hours per day on May 14 to May 16, plus two hours on May 13, 2009, and four hours on
10 May 17, 2009, for a total of 48 hours. For the period, August 18 - 21, 2009, appellants argue that their
11 average full work day was 14 hours, not 12 hours as respondent suggests. Appellants contend that
12 many of the 12 hour average days were the result of combining full 14 hour days with partial days. For
13 August 17 and 22, 2009, appellants contend that they did not claim any hours on August 22, 2009.
14 Appellants contend that they worked a full 14 hour day on August 17, 2009, since they arrived very late
15 in the evening of August 16, 2009, based on a Starbuck's charge at the Atlanta airport made on that
16 date. As for other individuals' work on the property, appellants contend that respondent has no proof
17 other than the list of fees. Appellants assert that the fees were paid to different individuals or entities
18 and none of their participation was greater than 10 hours during 2009. Appellants further argue that
19 their original claimed hours of 118 hours when doubled to account for both appellant-husband and
20 appellant-wife working on the property is equaled to 236 hours. As such, appellants contend that,
21 based on this new claimed amount of hours plus the 40 additional hours for marketing and customer
22 administration, they satisfy the 100-hour test. (ARB, pp. 13-15.)

23 Respondent's Reply Brief

24 Respondent contends that appellants have not provided any additional documentation to
25 corroborate the length of any guest occupancy at the DKL Property. Respondent further states that it
26 has not conceded such facts. Respondent contends that, while appellants may have provided hundreds
27 of pages (not thousands, per appellants' assertion), the documentation relating to the DKL Property did
28 not support nor confirm the variety of positions and factual representations appellants made over the

1 course of this dispute. Respondent notes that it requested copies of rental agreements appellants made
2 with each of the potential renters. Respondent notes that, as most of appellants' claimed rentals
3 occurred in the winter, it is worth pointing out that the DKL Property is located in Virginia's Blue
4 Ridge Mountains at the Wintergreen Resort.¹⁹ Respondent notes that, during the winter, the
5 Wintergreen Resort offers 32 trails for skiing and snowboarding, and roughly half of the trails are
6 available for night-skiing and snowboarding. (RRB, pp. 1-2.)

7 As to appellants' contention that they used email instead of written contracts with their
8 customers, respondent contends that appellants have admitted that they no longer have access to their
9 email records from six-to-nine years ago. Respondent contends that, contrary to appellants' assertion,
10 appellants did not provide extensive documentation with respect to the DKL Property. Respondent
11 contends that the email communication would be helpful to determine whether appellants
12 communicated to potential customers, such as Kalow, that appellants would also be occupying the
13 DKL Property, spring cleaning, and performing maintenance work for 14-16 hours per day while
14 Kalow paid \$550 per night to rent the DKL Property. Respondent contends that it is convenient for
15 appellants to claim that the reason no contract exists is because appellants used email while they
16 simultaneously claim that they no longer have the purported email records. Respondent argues that,
17 regardless of whether appellants provide the emails, it remains appellants' burden to prove an
18 entitlement to the claimed deductions. Citing the Board's decision in the *Appeal of Don A. Cookston*
19 (83-SBE-048) decided on January 3, 1983, appellants' failure to introduce evidence that is within their
20 control gives rise to the presumption that the evidence, if provided, would be unfavorable to their
21 position. Respondent contends that appellants provided no emails or rental contracts to show that their
22 average rental period was less than seven days. Respondent further contends that its primary position
23 during this dispute has been, and still is, that the information provided by appellants did not verify that
24 the DKL Property was rented for seven days or less. Respondent states that, at no point, did it concede
25 this issue. (RRB, pp. 2-3.)

26 Respondent further contends that appellants provided no additional documentation to
27

28 ¹⁹ Wintergreen Resort's website may be found at: <http://www.wintergreenresort.com>.

1 corroborate the doubling of their estimate of time spent materially participating in the DKL Property.
2 Respondent contends that appellants' estimates of the time they devoted to spring cleaning and
3 maintenance to be excessive in relation to the vague descriptions of "spring cleaning, general repairs,
4 and maintenance" appellants claim to have performed. Respondent contends that appellants, instead of
5 providing additional evidence to support the original claims of 12-to-14 hours per day, have doubled
6 the amount of time they allegedly spent cleaning and maintaining the DKL Property. Respondent
7 questions why appellants did not provide a "correct" estimate of time participating from the outset.
8 Respondent further contends that it already took into account both appellant-husband and appellant-
9 wife's participation in the DKL Property because appellants' correspondence referred to their activities
10 in the plural form. Respondent contends that appellants' original method of estimating their
11 participation was already not reasonable under the applicable regulation and appellants go even further
12 with their current contention that the hours are doubled since the claimed time is not supported by any
13 authenticating third-party documentation or contemporaneous records. Respondent points out that the
14 burden of proof on this issue lies with appellants and, while the regulation's method of proof is quite
15 lenient, it is well established that this regulation does not require respondent or the Board to believe or
16 rely on a "ballpark guesstimate" of the time spent on different activities. In support, respondent cites
17 various Tax Court decisions including *Lee v. Comm'r*, T.C. Memo. 2006-193; *Carlstedt v. Comm'r*,
18 T.C. Memo. 1997-331 (*Carlstedt*); and *Specks v. Comm'r*, T.C. Memo. 2012-343. Respondent
19 contends that here, as in *Carlstedt*, the documents themselves do not show any objective measure of
20 time for the activities and rather appellants assigned times to activities years later based solely on their
21 judgment and experience as to how long it must have taken him. Respondent contends that, even if
22 such uncorroborated estimates were made in good faith, memories can fade with time, and records can
23 be lost or thrown out. (RRB, pp. 4-5.)

24 Respondent points out that it is particularly questionable that appellants' credit card
25 purchases often place them hundreds of miles away from the DKL Property in Virginia Beach and
26 Norfolk on the very days when appellants claimed to have spent 24 hours a day working at the
27 property. Respondent contends that appellants have not adequately explained how they could incur
28 expenses in Virginia Beach over the course of several days while at the same time transporting

1 themselves back and forth to the DKL Property with adequate time and rest to complete 12-to-14 hour
2 work days at the DKL Property. Respondent acknowledges that, while the documents submitted by
3 appellants show some level of participation, their ballpark guestimates of 12, 14, or 16 hours per day
4 for each appellant is unreasonable. As to the alleged credit card expenditures, respondent contends that
5 it is not necessarily a substantiation issue, rather the evidence appellants provided contradicts their
6 claim of time spent working on the DKL Property. Without some form of participation log, receipts
7 detailing the supplies purchased to account for the 12-to-14 hour days, or some other reasonable form
8 of evidence, respondent contends that appellants' estimates are nothing more than ballpark guestimates.
9 Respondent further contends that it is questionable that appellants increased their time from 14-to-16
10 hours to 28-to-32 hours of spring cleaning and performing maintenance work at the same time their
11 customer was paying \$550 per night to rent and enjoy the DKL Property. (RRB, p. 5.)

12 Respondent further contends that appellants have many of the indicators of a taxpayer
13 that does not materially participate in a rental property, citing the IRS Audit Technique Guide.²⁰
14 Respondent notes that appellants' home in Saratoga, California, is roughly 3,000 miles away from the
15 DKL Property and much of appellants' use of the DKL Property was limited to typical vacation
16 periods. Respondent further notes that appellants have numerous other vacation properties, including a
17 condominium in Virginia Beach, Virginia, a condominium at Northstar Resort in Truckee, California, a
18 mountain ski resort near Lake Tahoe, and a second property in Truckee, California. Respondent further
19 notes that appellants hired a management company, Blue Ridge Getaways, for the 2006 tax year, and
20 had another less significant management arrangement for the 2007 through 2009 tax years at issue.
21 Appellants also paid management fees on the Northstar condo of \$27,042 in 2007, \$30,618 in 2008,
22 and \$19,387 in 2009. Respondent questions appellants' new claim of 24 hours for each year at issue
23 for marketing, including the 2006 tax year when the DKL Property was rented exclusively through
24 Blue Ridge Getaways. Respondent notes that, according to the log, the renters were primarily friends
25 and repeat guests. Respondent contends that appellants did not provide any evidence of the marketing
26

27 ²⁰ Respondent acknowledges that the IRS Audit Technique Guide is not precedential, but it provides guidance in
28 determining the facts germane to passive activity losses. The guide can be found at: <https://www.irs.gov/pub/irs-mssp/pal.pdf>.

1 steps they took to amount to the additional 24 hours claimed for each year. (RRB, pp. 6-7.)

2 Respondent also contends that appellants have not presented evidence establishing that
3 the participation by Blue Ridge Getaways, or any of the contractors, or cleaning crews did not exceed
4 appellants' participation. Respondent points out that, in 2006, appellants paid Blue Ridge Getaways
5 \$625 for maid service which is equaled to roughly 121 hours based on a minimum wage of
6 \$5.15 per hour in Virginia at the time. Respondent also contends that appellants' records show that
7 cleaning crews spent eight days cleaning in 2009 and appellants claimed to have been present at the
8 property for nine days while respondent determined that appellants were present for four days based on
9 the credit card purchases. Respondent contends that appellants claimed significant costs for repairs on
10 the DKL Property for the 2007 and 2008 tax years but appellants have not provided any documentation
11 accounting for the hours spent nor the supplies purchased for those engaged in the alleged repairs.
12 Respondent contends that these examples point to other individuals having spent more time
13 participating in the upkeep of the rental property than appellants, which would disqualify appellants
14 from having the requisite material participation. (RRB, p. 7.)

15 Respondent further notes that appellant-husband had a Form W-2 wage job as a
16 marketing executive with Cisco Technologies during the years at issue, working at least 40 hours a
17 week for which appellant-husband received significant compensation. Respondent questions the extent
18 of appellant-husband's participation in the DKL Property during his vacation breaks from his high-
19 paying job. Respondent further contends that appellants' estimates do not account for breaks for meals,
20 travel, or leisure and holiday time with their minor daughters at the Wintergreen Resort, which is not
21 considered material participation. Respondent contends that its calculations of hours worked as listed
22 in respondent's opening brief are reasonable estimates based on the evidence appellants provided.
23 (ROB, pp. 7-10.)

24 Appellants' Supplemental Brief

25 Appellants maintain that they provided substantial documentation to corroborate the
26 length of each guest occupancy at the DKL Property. Appellants contend that they submitted three
27 separate items of corroborating evidence and attach a fourth set of evidence with their supplemental
28 brief. Appellants contend that they provided: (1) a spreadsheet file titled "Devil's Knob Rentals 2006-

1 2009,” which lists in detail each rental customer in the years at issue; (2) copies of their original and
2 contemporaneous Reservations Book, in which appellants registered and recorded reservations for the
3 property rentals as such reservations came in; and (3) copies of their original and contemporaneous
4 Rentals Book, where appellants recorded the actual property rentals and financial details. In addition,
5 appellants submit as additional proof, their description of the property as being in a four season resort
6 and their experience that the typical rental stays in Wintergreen corresponds to their actual rental.
7 Appellants contend that the average stay at their property for 2006 through 2009 was 4.58 nights.
8 Appellants contend that that it was unusual for guests to stay longer than seven days and that they did
9 not in fact have any stays of that length. (ASB, pp. 1-3.)

10 With regard to the emails, appellants question respondent’s characterization of
11 appellants’ inability to provide the emails as appellants’ attempt to hide evidence detrimental to their
12 case. Appellants contend that this “allegation is patently ridiculous” and the emails, if available, would
13 only further support the documentation already provided. Appellants assert that they changed internet
14 service providers (ISP) during the intervening years and no longer have access to those emails on the
15 old ISP’s email servers. Appellants contend that respondent’s “continuing insistence on obtaining even
16 more evidence is simply a transparent attempt to deny [their] legitimate deduction.” As to appellants’
17 belief that respondent conceded the seven-day rental issue, appellants contend that they relied on page
18 seven of respondent’s opening brief in which respondent stated “Appellants did not provide the
19 contracts or rental agreements that correspond to the entries, so respondent was unable to verify that the
20 log entries were accurate. Even if, *arguendo*, the log entries are correct” Appellants further
21 contend that they did not acknowledge that they could not verify that the property was rented for
22 seven days or less. Appellants contend that they have done just that with their “written and verbal
23 assertions” and the “three independent pieces of evidence” discussed above. Appellants argue that
24 respondent is continuously raising the bar of evidence until appellants cannot satisfy it. Appellants
25 assert that, if they had submitted the emails, respondent would then argue that it was not enough proof
26 to verify that the property was rented for seven days or less. Appellants further question respondent’s
27 contention that its primary position is that appellants failed to demonstrate that they satisfy the seven-
28 day test because appellants assert that, in the majority of respondent’s opening brief, there is no

1 reference to the seven-day test but for two sentences appellants previously noted. Appellants assert that
2 this is “just one more example of the FTB’s ‘shotgun approach’” to this dispute. Appellants assert that
3 respondent is simply following a strategy of “denial and delay” in order to deny appellants the claimed
4 deductions. (ASB, pp. 3-4.)

5 Appellants also maintain that they provided “ample documentation” in accordance with
6 the applicable regulation to support their material participation in the business. Appellants state that, in
7 addition to the “voluminous expense records and narrative summaries of the time [they] spent and work
8 performed,” appellants submit appellant-husband’s calendar records for the time spent working on the
9 property. Appellants contend that none of the information is new and that it is consistent with the
10 previously-submitted evidence. Appellants contend that they provided documentation specifically
11 referenced in Treasury Regulation section 1.469-5T(f)(4), namely the “identification of services
12 performed over a period of time and the approximate number of hours spent performing such services
13 during such period, based on appointment books, calendars or narrative summaries.” Appellants
14 contend that respondent’s insistence on parsing every minute of every hour is inconsistent with the
15 regulation’s use of the word “approximate.” (ASB, p. 4, Exh. 1.)

16 Appellants allege that respondent raised new issues in respondent’s reply brief.
17 Appellants argue that respondent’s discussion regarding the IRS Audit Technique Guide is new and
18 appellants appear to argue that respondent is inconsistent since this dispute arose from the difference
19 between federal and California law. In response to respondent’s arguments, while appellants do not
20 agree that they should be required to respond to these allegations, appellants contend that they do not
21 own numerous other vacation properties. Appellants state that they own several other investment
22 properties which are rented out either on a full-time or part-time basis. Appellants contend that they
23 purchased the DKL Property in 2001 with the intention of using the residence as their future retirement
24 home. Appellants contend that they ended up owning “so much real estate after losing a great deal of
25 money in the stock market, and switching to a strategy of investing in real estate.” Appellants contend
26 that this strategy has not worked out well and, as a result, they hold a number of mortgages and incur
27 other expenses which they offset with rental income. Appellants state that they use management
28 companies to rent their Virginia Beach and Northstar condominiums. Appellants state that they have

1 full-time tenants in the Truckee house. However, appellants were unable to find a suitable management
2 company for the DKL Property and they chose to handle it themselves beginning in the spring of 2006.
3 Appellants contend that, while appellant-husband's salary may appear high, it is insufficient to provide
4 an adequate standard of living on its own in the Bay Area, in light of their high debt load. Appellants
5 state that appellant-husband is entitled to four weeks of paid vacation, and up to seven weeks of reserve
6 vacation. Appellants contend that he has ample time to make the two trips a year to Virginia to care for
7 the DKL Property. Appellants state that they prefer to invest their time and effort in caring for their
8 future retirement home and protecting their investment. Appellants state that they would rather take
9 care of the house themselves than pay another party whom they cannot rely on. (ASB, pp. 5-6.)

10 As to respondent's claims regarding the \$625 paid to Blue Ridge Getaways for maid
11 service, appellants contend that they only had two rentals for that year and they paid approximately
12 \$300 to clean the house. Appellants assert that the typical maid service takes approximately three
13 hours and is performed by two people. As such, appellants further contend that respondent's assertions
14 regarding the eight days of cleaning in 2009 is "patently false" since the total time spent per person for
15 maid service in 2009 was 12 hours. As to the repairs in 2007 and 2008, appellants assert that the vast
16 majority of these expenses were for materials. Appellants state that they had multiple windows blown
17 off the house that needed replacement. In addition, they had extensive siding replaced and interior
18 water damage. Appellants assert that the contractor who performed the services used various
19 individuals and not one individual spent more than 30 hours on the house. As to respondent's reference
20 to the *Carlstedt* case, appellants contend that that case has no bearing on this situation because
21 appellants claim that they have full documentation of where they were and how they spent their time.
22 Appellants further contend that respondent made false statements regarding appellants being hundreds
23 of miles away in Virginia Beach and Norfolk. Appellants also submit an additional copy of the
24 "corrected Expense Summary" previously submitted. (ASB, pp. 6-7, Exh. 2.)

25 Respondent's Exhibits

26 Respondent provides a calculation for the proposed additional tax amount attributable to
27 the rental losses claimed for the DKL Property at issue. For 2006, the amount of the proposed
28 additional tax related to the DKL Property is \$7,580.34. For 2007, the amount of the proposed

1 additional tax related to the DKL Property is \$9,185.24. For 2008, the amount of the proposed
2 additional tax related to the DKL Property is \$9,797.92. For 2009, the amount of the proposed
3 additional tax related to the DKL Property is \$6,931.49. The total amount of the proposed additional
4 tax related to the DKL Property for the years at issue is \$33,494.98. In addition, respondent provides
5 appellants' Schedules E, which reports appellants' rental activities, for each year at issue. (FTB Exh,
6 pp. 1-2, Exhs. A & B.)

7 Appellants' Additional Exhibits

8 Appellants contend that they have submitted over 250 pages of documentation, such as
9 copies of receipts, credit card statements, spreadsheets, page entries from their logbooks, printouts from
10 their calendars, and written descriptions of the work performed by appellants and others on the
11 property. Appellants contend that the materials show that they spent more than 100 hours working on
12 the property in each of the years at issue and that the average rental period was less than seven days.
13 Appellants contend that they have satisfied Treasury Regulation section 1.469-5T(f)(4) in identifying
14 the services performed and the approximate number of hours spent performing such services based on
15 appointment books, calendars and narrative summaries. (AAE, pp. 1-2, Atths.)

16 As for the seven-day rental period, appellants contend they have provided the following
17 to support a finding that the average rental period was seven days or less: copies of their original
18 contemporaneous Reservations Book and Rental Book, and a spreadsheet titled "Devil's Knob Rentals
19 2006-2009." As for the Blue Ridge Getaways, appellants explain that Blue Ridge Getaways did not use
20 rental contracts for short-term rentals either in 2006 or currently. Appellants also state that Blue Ridge
21 Getaways also confirmed that ski season rental rates for the 2006 season were in the range of \$500 per
22 night, and housekeeping rates were about \$300 per clean, which corroborates appellant's earlier
23 statement that the \$5,100 in total rental income resulted from 10 guest nights, divided over two stays,
24 an average rental period of five days per stay. Appellants further contend that the lack of short-term
25 rental contracts is standard practice in the industry. Appellants contend that their typical practice was
26 to contact guests via telephone, text, and email to arrange rentals. Appellants state that they no longer
27 have such email records and their former guests do not have any written records or emails from the
28 period at issue. Appellants state that their customers paid via checks, but they no longer have copies of

1 the bank statements to show the check payments from six to nine years ago as their bank no longer has
2 the statements from this time period. Appellants also state that marketing was done via internet
3 postings and they no longer have any written marketing materials from that period. Appellants contend
4 that tax authorities do not usually ask for such extensive documentation and state that a great amount of
5 effort has been spent producing the documentation provided thus far. Appellants contend that they
6 have shown that the rental stays were shorter than seven days and that this is consistent with their
7 research showing that the average length of a stay in a resort is less than five nights. (AAE, pp. 2-5,
8 Atths.)

9 As for material participation, appellants contend that they have provided the following
10 to support a finding that their participation was more than 100 hours: (1) copies of receipts for
11 purchases made while in route to or from the property or while actively working on the property;
12 (2) copies of credit card statements documenting such purchases; (3) spreadsheets they created to track
13 expenses related to trips to perform work on the property; (4) printouts of their calendar pages for the
14 time periods in question; (5) written descriptions of the work performed during the visits; and
15 (6) written descriptions of the work performed by others at their direction on the property. Appellants
16 contend that their documentation of the hours is not a “ballpark guestimate,” but is based on their
17 documentary evidence of the dates they spent at the property, such as expense receipts and
18 contemporaneous calendar receipts. Appellants further contend that, in their case, unlike cases cited in
19 the Applicable Law section (see below), they have provided contemporaneous calendar records,
20 detailed expense records, and narrative summaries to support their position. As to whether the hours
21 reported were excessive for the tasks described, appellants contend that they have provided additional
22 information to document the specific activities and the time required to complete each activity.
23 Appellants note that they did not include time spent traveling to or from the property and contend that
24 such time is included in other types of expense reporting. Appellants note that they included time spent
25 taking reasonable breaks from work activity which appellants contend is consistent with any time-based
26 wage or compensation system. Appellants note that they included time spent traveling to various
27 nearby locations to purchase supplies and, at times, chose to eat meals while on these trips. Appellants
28 contend that they did not engage in any leisure activities on any of these trips and their children did not

1 accompany them on these trips. Appellants contend that their sole purpose was to restore the home to a
2 pristine condition, both inside and out. (AAE, pp. 5-7.)

3 Appellants further state that their calendar records, while printed on January 15, 2015,
4 were contemporaneous. As for performing work while one of their guests was renting the property,
5 appellants state that they had a separate, downstairs apartment. Appellants state that they spent time
6 prior to the guest's arrival working on the main house and worked on the downstairs apartment and
7 crawl space during the rental. Appellants state that the work included extensive winterization such as
8 caulking and insulating the walls, windows, and pipes under the main structure. Appellants also state
9 that they performed work outside of the house such as weeding the driveway and yard, sweeping, and
10 washing and cleaning the decks and other outside structures. Appellants state that they had a verbal
11 agreement with their guests that appellants would be present on the property in the downstairs
12 apartment and outside areas. (AAE, p. 7.)

13 As for the revised claimed hours of work, appellants explain that the primary revision
14 was to include the hours of both spouses, as initially their count which included more than 100 hours in
15 each of the four years in question was not questioned by respondent prior to this appeal. Appellants
16 note that, in their email to Mr. Cerda of the FTB dated December 31, 2013, appellants indicated that the
17 hours reported were for time they both worked simultaneously, so the actual time spent was double of
18 what they had reported. Appellants state that, at the time, they believed that all they had to do was
19 prove that they spend more than 100 hours per year and, based on their communications with
20 Mr. Cerda, believed that they had done so. Once appellants became aware that the FTB contested this
21 issue, appellants added the time they routinely spent maintaining and marketing the property from a
22 distance, which added an additional 24 hours per year for marketing and two hours per rental for
23 handling rental customers. (AAE, p. 8.)

24 As for the day trips, appellants state that the trips to Lynchburg, Virginia and
25 Charlottesville, Virginia were made to procure supplies. Appellants included the time spent on these
26 trips as part of their work hours. Appellants contend that, even if the Board determines that such trips
27 should not be included, their total time spent would still be in excess of 100 hours. Appellants state
28 that they generally flew into Atlanta, Georgia or Washington DC. Appellants state that they have

1 relatives living in Greenville, South Carolina and Virginia Beach, Virginia and that, on several
2 occasions, their two daughters would accompany them on trips to the east coast and their daughters
3 would either stay with relatives in Greenville, South Carolina or Virginia Beach, Virginia while
4 appellants went to Wintergreen to work on the property. Appellants state that, on the days when they
5 travelled to or from the Wintergreen property and Virginia Beach, Washington DC, or Atlanta, they
6 included the time spent in transit separately from the time spent on working at the property. Appellants
7 state that they did not include 12-14 hour work days on the property on any of these travel days as
8 shown on their calendar records. (AAE, pp. 8-9.)

9 Appellants further state that they would provide the additional credit card statements and
10 some individual receipts that corroborate the information on their schedule of credit card purchases
11 during the periods at issue. As to the contractor, tree service, and maid service, appellants state that the
12 transactions for these services were not formally documented other than by check payment. Appellants
13 state that they were not able to find the invoice from the tree company, but provided records from
14 dealing with their contractor, Nelson Builders, such as emails, invoices, and statements of work. As for
15 the receipts to support their spring cleaning, general repairs, and maintenance activities, appellants state
16 that they have provided the information in the form of limited individual receipts and their credit card
17 statements. Appellants state that other purchases were made by cash or check. As for evidence of the
18 management services, appellants point to the email explanation provided to Mr. Cerda on
19 December 31, 2013. As for Blue Ridge Getaways, appellants provide an excerpt from their current
20 website describing their services, emphasizing the services for short- or long-term leases. Appellants
21 state that the company confirmed that they have no records of any longer term lease for appellants'
22 DKL Property. Appellants also provide "time studies" for the specific activities performed during each
23 visit to further explain their "spring cleaning, general repairs, and maintenance" activities. (AAE,
24 pp. 9-14, Atths.)

25 Appellants' Supplemental Documentation

26 Appellants provide a copy of the current listing of the DKL Property on VRBO.
27 Appellants explain that their current primary rental method is word-of-mouth and repeat business, but
28 they still use VRBO as a supplemental source. Appellants state that, during 2006 to 2009, they relied

1 more on VRBO and had more extensive marketing material and collateral. Appellants further provide
2 an email dated June 9, 2015, from Randy Thompson, who worked with appellants in marketing the
3 DKL Property and interacting with prospective renters and guests. Appellants state that Mr. Thompson
4 is a real estate expert who has been actively involved in the real estate sales and rental market in
5 Wintergreen for over 25 years. Appellants note that the email confirms that Mr. Thompson had direct
6 knowledge of their rentals and the average length of occupancy was two-to-four nights per stay. In
7 addition, appellants provide copies of their bank statements from mid-2008 through 2009 which shows
8 deposits corresponding to their receipt of rental checks. (ASD, pp. 1-2, Atths.)

9 As for material participation, appellants provide copies of relevant pages from the
10 previously referenced credit card statements from American Express, Discover, and Macy's Visa.
11 Appellants note that the statements show expenses for trips to the DKL Property and expenses incurred
12 for the activities at the property. Appellants note that they were unable to locate two monthly
13 statements for August of 2007 and August of 2009 from American Express. However, appellants were
14 able to locate and provide individual receipts for August of 2009. Appellants further point out that the
15 American Express statement for July of 2006 includes a repair expense from Blue Ridge Builders
16 Supply. Appellants state that this expense and a separate receipt provide additional documentation for
17 their "monetary participation" and for some of the repair costs to the property, which largely consisted
18 of material costs. Appellants also provide copies of other individual receipts to support their presence
19 and activity at the DKL Property. Appellants state that the receipt for a new refrigerator for the
20 property in September of 2008 supports their material participation and material costs for the repairs
21 made on the property. Appellants also note that they provided copies of the Form 1099s for the other
22 rental properties showing that they employed third-party management companies for the other rental
23 properties. Appellants also provide a spreadsheet titled "Devil's Knob Time Report" detailing the
24 hours they spent working on the property for each of the trips. Appellants state that these hours are
25 based on the receipts and credit card statements provided. (ASD, pp. 2-4, Atths.)

26 Respondent's Second Reply Brief

27 In response to appellants' supplemental documentation, respondent points out that
28 appellants only provided selective pages of credit card statements, rather than the entire statement.

1 Respondent further points out that, at the prior hearing, it requested that appellants provide statements
2 bookending the period at issue, i.e., the month before and the month following a period in which
3 appellants made purchases related to their Virginia home. Respondent states that appellants did not
4 submit such book-ended statements with their submission, as well as the Discovery card statements for
5 all, but two billing statements. Respondent contends that Congress set a high burden of proof for
6 material participation, citing a 1986 Report of the Senate Finance Committee (S. Rep. 99-313, at 733
7 (1986), 1986-3 C.B. (Vol. 3) 1, 733). Respondent notes that appellants lived 3,000 miles away from
8 the DKL Property and appellants only visited the property a few times a year and spent little time there
9 when they visited. Respondent contends that appellants' records often cast doubt on whether appellants
10 were actually at the DKL Property, or whether they were hours away in the Virginia Beach and Norfolk
11 area. Respondent argues that these are the types of concerns that Congress had with material
12 participation. (R2ndRB, pp. 1-2.)

13 Respondent emphasizes that, as the property was only rented for a small number of days
14 in each of the years at issue, according to the information provided by appellants, the property sat
15 empty for more than 325 days each and every year. Respondent notes that appellants' current VRBO
16 advertisement claims that the DKL Property is currently listed as "unavailable" and "booked" every
17 night through December 2016. Respondent notes that the VRBO advertisement includes three photos
18 and lists the property as a "3 room home" with "2 master bedrooms" plus a bunkroom with 8 beds,
19 which "sleeps up to 12." Respondent contends that property that has little or no advertising and was
20 unrented for many weeks during the year may indicate high personal use, such as use by family
21 members, citing the IRS Passive Activity Loss Audit Technique Guide. Respondent contends that,
22 while appellants claimed to have worked extremely long hours at the property, the documents provided
23 contradict appellants' claimed participation and activities with respect to the rental operation.
24 Respondent contends that appellants' documentation must support their claim of material participation
25 which is difficult for a taxpayer with a full-time, high-salaried job 3,000 miles away from the Virginia
26 home. Respondent contends that the hours claimed by appellants as material participation appears
27 excessive and actually relate, in large part, to their personal activities, and not to the rental operations.
28 Respondent further contends that appellants cannot substantiate that they spent more than 100 hours

1 cleaning and repairing the rental portion of the DKL Property each and every year, and that their
2 participation in the rental activity was not less than anyone else. (R2ndRB, pp. 3-4, Exh. AAA.)

3 Respondent contends that appellants' separate apartment was not part of the rental
4 activity. Respondent notes that the VRBO advertisement does not include the separate apartment for
5 appellants' personal use on the lowest level of the DKL Property. Respondent notes that appellants
6 contend that they spent 60-to-70 hours working on this apartment each year. Respondent notes that
7 appellants stayed in this separate apartment when renters occupied the other portions of the DKL
8 Property available for rent. Respondent maintains that it is unlikely that appellants each worked
9 14 hour days on the rental portion of the DKL Property from December 31, 2006 through January 2,
10 2007, and from December 30, 2007 through January 4, 2008, on days when a renter occupied the
11 property for \$550 per night. Respondent notes that, at the oral hearing, appellants stated that they
12 claimed time spent on their personal separate apartment and questions this assertion in light of the
13 evidence provided by appellants. Respondent notes that "participation" generally means "all work
14 done in an activity by an individual who owns an interest in the activity," citing *Bailey v. Comm'r*
15 (2001) T.C. Memo. 2001-296 and Treasury Regulation section 1.469-5T(f). Respondent contends that,
16 based on the VRBO advertisement and appellants' testimony at the oral hearing, the separate apartment
17 was not for rent, was never for rent, and was not listed in their advertisements, and thus, was not part of
18 the rental activity. As such, respondent contends that the 236 hours claimed for working on the
19 apartment may not count towards appellants' material participation in the rental activity. Respondent
20 further contends that this result is consistent with an analysis of the separate apartment under IRC
21 section 280A, which disallows deductions for expenses with respect to a "dwelling unit" used by a
22 taxpayer as a residence unless an exception applies. Respondent contends that the separate apartment
23 on the DKL Property was not for rent and exclusively occupied by appellants for their personal use and,
24 thus, the separate apartment was not used in carrying on a trade or business. (R2ndRB, pp. 4-6,
25 Exh. BBB.)

26 As for the winterization of the crawl space, respondent contends that, contrary to
27 appellant's position that they performed such work, the invoice from Nelson Builders shows that
28 appellant hired a contractor to perform at least 144 hours of repair and labor on the DKL Property for

1 \$10,414. Respondent notes that this leaves roughly \$15,000 or 216 additional hours in repair work
2 performed by a contractor for 2007. Respondent notes that the invoice provides that Nelson Builders
3 completed the following task: “replace wet crawl insulation w/r-19 fiberglass batts labor/mat. 450.00.”
4 Respondent contends that this document shows that Doug Nelson winterized the crawl space and
5 renovated much of appellants’ personal, separate apartment in 2007. Respondent further contends that
6 a casual observation of the photos in the VRBO advertisement indicate that the terrain upon which the
7 house is built is steep, mountainous and heavily wooded. Respondent argues that, based on the winter
8 conditions during December and January, and the limited daylight hours, it is unlikely that appellants
9 spent much time, if any, working on the outside of the property during these visits. As such,
10 respondent contends that none of alleged 236 hours should be included for material participation.
11 (R2ndRB, pp. 6-8, Exhs. CCC & AAA.)

12 Respondent further contends that appellants’ participation was not more than anyone
13 else. As to appellants’ email from Mr. Thompson, respondent notes that appellants allege that
14 Mr. Thompson worked for appellants for many years in marketing the property and interacting with
15 prospective renters and guests. Respondent points out that Mr. Thompson states that the rentals were
16 more like two-to-three days, in contrast to appellant’s characterization of Mr. Thompson’s email stating
17 that the average length of occupancy was two-to-four nights per stay. Respondent contends that the
18 two night stay is less than the minimum stay of three days advertised on the VRBO listing, and is less
19 than the two, three-night guests that appellants reported on January 26, 2007, and January 30, 2009.
20 Respondent notes that appellant asserts that the average length of renter stays for the period at issue
21 was 4.58 nights. (R2ndRB, p. 8.)

22 Respondent contends that there is no indication from appellants’ documentation
23 regarding the amount of time Mr. Thompson spent on marketing and guest services for the
24 DKL Property or how much appellants paid Mr. Thompson for this work. Respondent notes that
25 appellants also employed Blue Ridge Getaways to manage the property in 2006, hired Doug Nelson as
26 a contractor from 2005 to 2009, and hired a maid service, consisting of a single person, to clean the
27 rental property after each guest stay for the years at issue. Respondent notes that, in *Chapin v.*
28 *Commissioner*, T.C. Memo. 1996-56 (*Chapin*), the Tax Court focused on the participation of the

1 taxpayer not being regular and continuous as to constitute material participation. Respondent argues
2 that, as in *Chapin*, Mr. Thompson, by appellants' own admission, marketed the property and interacted
3 with both the tenants and prospective clients. Appellants further reported that a single cleaning person
4 cleaned the DKL Property on eight occasions. Appellants' documentation shows that Mr. Nelson
5 completed roughly 360 hours of repair work in 2007 and similar hours in 2008. As such, respondent
6 contends that appellants have not shown that no other person's participation exceeded appellants' own
7 participation in the activity. Respondent further argues that, as in *Chapin*, appellants' participation
8 allegedly consisted of "spring cleaning" prior to, and concurrent with, their primary rental season of
9 January. Respondent notes that the Tax Court in *Chapin* was not persuaded that the time supposedly
10 spent cleaning the property was an accurate reflection of what transpired and the Tax Court concluded
11 that most of the time allegedly spent was exaggerated or, if not, was spent primarily for the purpose of
12 avoiding the limitations of IRC section 469. (R2ndRB, pp. 8-9.)

13 Respondent compares the amount of time reported by the taxpayer in *Chapin* to the
14 amount of time claimed by appellants listed in their hearing exhibit.²¹ Respondent notes that, in
15 *Chapin*, the taxpayer reported spending "5 to 6 hours cleaning two bathrooms, 8 hours cleaning a
16 kitchen, and 5 hours 'refreshing' plastic floral arrangements." Respondent notes that appellants' time
17 study reflects 74 hours to clean the first level of the property, which includes "2 bedrooms – 1 with
18 8 bunk beds, 2 bathrooms, family room, storage closet, foyer, stairs." Respondent further notes that
19 appellants claim that they spent 77 hours cleaning the second level, 34 hours cleaning the third level,
20 and 67 hours cleaning the 600 square foot separate apartment which was used only for appellant's
21 personal use. Respondent notes that, in total, appellants estimated that it took "an incredible 252 hours
22 to clean the entire DKL Property." Respondent contends that this is a ballpark estimate on which the
23 Board is not required to rely on. Respondent contends that appellants' estimate of hours spent is not
24 plausible when compared to appellants' own evidence, including their credit card statements.
25 Respondent contends that appellants' claim of time they spent to clean the property is excessive
26 compared to the maid service appellants employed after each guest visit, which only took
27

28 ²¹ Appellant's time study is found on pages 11-14 of appellants' hearing exhibits. (AAE, pp. 11-14.)

1 approximately three hours and was performed by two people (i.e., 6 hours). (R2ndRB, pp. 9-11.)

2 Respondent contends that, if one restricted appellants' estimate of time cleaning the
3 rental portion of the property to those activities performed by a hotel-type maid service (i.e.,
4 vacuuming, spot treatment of carpet stains, cleaning bathrooms, removal, laundering and replacement
5 of all bedding, removal, laundering and replacement of all towels, replenishing toiletries, cleaning
6 kitchen, and cleaning inspection of china, cutlery, and glassware), appellants' estimates of time for each
7 task results in 25 hours to clean the first level, 27 hours to clean the second level, and 14 hours to clean
8 the third level, for a total of 66 hours to clean the DKL Property. Respondent questions why it would
9 take appellants "an incredible *eleven times longer* to clean the house than they alleged it would take a
10 'typical' maid service." (Respondent's emphasis.) Respondent contends that, based on appellants'
11 estimates and the fact that appellants' hired the maid service eight times during 2009, it would have
12 taken the maid service 528 hours to clean the DKL Property in 2009, which demonstrates the
13 unreasonableness and excessiveness of appellants' estimates.²² (R2ndRB, pp. 11-12.)

14 Respondent contends that, even if one was to attribute a reasonable shift for a single
15 cleaning person of eight hours, this would still amount to a total of 64 hours for the 2009 tax year.
16 Respondent contends that the frequency and performance of this cleaning service constituted regular
17 and continuous participation in the rental activity, which is clearly in excess of appellants' rental related
18 hours, after the subtraction of the time spent on the personal use of the separate apartment, and is
19 another factor indicating that appellants did not materially participate in the rental activity. Respondent
20 contends that this illustration shows that appellants' claimed hours were exaggerated or spent primarily
21 for the purposes of avoiding the limitations of IRC section 469. Respondent contends that appellants
22 have not shown that they materially participated in the rental activity and they have not shown that they
23 equaled or exceeded the participation of any other individual, including the Blue Ridge Getaways
24 management in 2006, Mr. Thompson's management services from 2007-2009, Mr. Nelson's repair
25 services in 2007 and 2008, or the maid service in 2009. (R2ndRB, pp. 12-13.)

26
27
28 ²² Respondent notes that appellants claimed to have paid only \$500 in cleaning fees for each of the 2007, 2008 and 2009 tax years, yet they reported that the DKL Property was cleaned five times in 2007, four times in 2008, and 8 times in 2009. (ROB, Exh. B.)

1 As for the credit card statements for December 2006 through January 2007, respondent
2 contends that these statements show that appellants spent \$1,441 on dining at the Wintergreen Resort
3 during the period December 24, 2006 through January 1, 2007. Respondent notes that appellants claim
4 that they did not engage in any leisure activities during the trips at issue. Respondent notes that
5 appellants claim that they each worked 14 hour days from December 22, 2006 through December 31,
6 2006, and 16 hours each on New Year's Day and 8 hours each on January 2, 2007. Respondent
7 contends that eating a meal at a restaurant is not material participation in a rental activity, citing
8 *Pohosky v. Commissioner* (1998) T.C. Memo. 1998-17 and *Merino v. Commissioner* (2103)
9 T.C. Memo. 2013-167. Respondent notes that appellants added time for meals into their estimates of
10 material participation. Respondent contends that appellants' credit card statements indicate that they
11 had substantial, previously unreported dining bills at the Wintergreen Resort²³ and these substantial
12 dining expenses are further evidence that appellants exaggerated their claimed hours of material
13 participation on days when they claimed to have worked from 7:00 am until 9:00 pm. Respondent
14 points out that, despite these large dining bills and the renter occupying the rental portion of the DKL
15 Property on New Year's Eve and New Year's Day, appellants claimed to have spent 14 hours on
16 New Year's Eve, and 16 hours each on New Year's Day working in the personal, separate apartment on
17 the DKL Property. As such, respondent contends that appellants' estimated hours attributable to the
18 rental activity of the three levels of the property are not likely. (R2ndRB, pp. 13-15.)

19 Respondent further notes that appellants only provided the Discover credit card
20 statements for two closing periods during the four years at issue and contends that it is possible that
21 appellants made other purchases during their time in Virginia and have chosen not to disclose those
22 purchases. Respondent contends that the presumption is that the statements are unfavorable to
23 appellants' position. Respondent further contends that appellants' credit card statements indicate that
24 they spent part of their Christmas Eve 2006 on personal shopping and dining. Respondent contends
25 that the statements contradict appellants' claim that they each worked a 14-hour day, from 7:00 am to
26

27
28 ²³ On Christmas Eve, appellants had bills, in addition to the previously reported \$91.42, of \$157.79; on December 28, they
spent \$98.16; on December 29, they spent \$113.19; on New Year's Eve, they spent \$324.00; and had another dining bill of
\$289.79 on New Year's Day, all of which were previously unreported. (R2ndRB, Exh. EEE.)

1 9:00 pm, on Christmas Eve. Respondent points out that appellants made purchases at an art gallery,
2 Black Rock Gallery, for \$29.40 and appellants also purchased \$81.85 worth of goods at a souvenir
3 shop, Logos of Wintergreen, on the same day. Respondent contends that these purchases, and the
4 dining expenses discussed above, are not related to the material participation in the rental activity and
5 demonstrates that appellant did not work on the DKL Property for the hours claimed. Further,
6 respondent contends that the credit card statements contradict appellants' claim that they did not engage
7 in any leisure activities. Respondent notes that, on December 26, 2006, appellants made a purchase at
8 Blue Ridge Mountain Sports, an outdoor clothing store. Respondent notes that, on December 29, 2006,
9 appellants purchased \$36.44 worth of "sporting goods" at the Ski Barn in Roseland, Virginia.
10 Respondent notes that, according to the Ski Barn's website, the company is the "LARGEST Ski &
11 Snowboard Rental Company in the EAST!" Respondent contends that, based on the rental prices for
12 the 2006-2007 ski season, it is possible that the "sporting goods" appellants paid for was a set of rental
13 skis at the holiday and weekend rate. Respondent argues that this type of purchase casts doubt on
14 appellants' claim that they did not engage in any leisure activities while staying at their property, which
15 is located at a mountain ski resort. (R2ndRB, pp. 15-16, Exhs. FFF, DDD, EEE & GGG.)

16 As for December 29, 2006, respondent contends that appellants' credit card statements
17 show that appellants charged a \$27 meal at the Wintergreen Resort, then took a shopping trip to
18 Lynchburg for "supplies," which included a lunch at Logan's Roadhouse, a stop to return unknown
19 items at Target, a stop at Kohl's Department Store, a stop at Lowe's to purchase several table lamps,
20 light bulbs, a screwdriver, and a branch lopper. Respondent notes that appellants each claimed
21 five hours as material participation to purchase supplies. Respondent contends that the verifiable
22 supplies purchased do not support appellants' claim of working 14 hour days on the house. Respondent
23 contends that appellants merely purchased lamps and light bulbs. Respondent further notes that,
24 following this trip, appellants returned to the DKL Property and spent \$113.19 at one of the
25 Wintergreen restaurants. Respondent contends that eating meals and personal shopping errands do not
26 constitute material participation. Citing *Chapin, supra*, respondent contends that there is only a
27 minimal amount of time for changing light bulbs and arranging and plugging in table lamps that could
28 be considered reasonable. Respondent contends that appellants' estimate of 11 hours to perform such

1 activity in the three levels of the rental and another three hours for such activity in the separate
2 apartment is unreasonable. Respondent contends that appellants' purchases and meals do not support
3 the hours claimed. (R2ndRB, pp. 16-17.)

4 As for August of 2007, respondent notes that appellants admit that they did not produce
5 any credit card statements related to the August 2007 trip to Virginia. Respondent further notes that
6 appellants' self-prepared schedules indicate that appellants spent August 2007 in Virginia Beach and
7 Norfolk. Respondent notes that there were no purchases within 3 hours of the DKL Property.
8 Respondent contends that appellants have not provided any evidence to corroborate their assertions and
9 self-prepared schedules. (R2ndRB, p. 18.)

10 As for the December 2007 to January 2008 trip, respondent contends that appellants'
11 credit card statements provide no evidence that appellants were present at the DKL Property for much
12 of the time they alleged to be present. Respondent contends that, while appellants claimed to each
13 work 10 hours and 14 hours on December 28 and 29, appellants' credit card statements place them
14 making a purchase at Sonic Drive-in in Norfolk on December 28, and a previously unreported purchase
15 made at a Virginia Beach Home Depot on December 29, and both locations are 220 miles (i.e., a
16 3 hour, 45 minute drive) away from the DKL Property. Respondent points out that appellants' renter,
17 Kalow, checked in on December 30, 2007, and stayed until January 5, 2008. Respondent contends that,
18 based on the credit card statements, there is no evidence of appellants' presence in the Wintergreen area
19 until January 3, 2008. Respondent note that, on January 3, appellants now claim that they each spent
20 eight hours on a shopping trip to Charlottesville for supplies. Respondent notes that appellants' credit
21 card statements show that they made two purchases of unknown items at Kroger Supermarket on
22 January 3, of \$27.37 and \$35.00. Respondent contends that a trip to the supermarket should not be
23 considered material participation in light of the VRBO advertisement stating that guests must provide
24 their own food. Respondent contends that appellants' records show no other purchases on January 3,
25 and questions what appellants did on their combined 16 hour shopping trip to Charlottesville.
26 Respondent further contends that the credit card statements show that appellants purchased a meal at
27 the Wintergreen resort for \$109.67 on January 4, 2008. Respondent further notes that the credit card
28 statements show that, on January 5, 2008, appellants paid for a meal at the Wintergreen resort, and then

1 at 5:10 pm purchased cleaning supplies at Target; at 6:05 p.m. they purchased two mattresses and a
2 television at Sam's Club; and returned two lamps to Lowe's at 6:18 pm. Appellants also claimed to
3 have each worked 11 hours on the DKL rental and three hours on the separate apartment that day. The
4 credit card statements show that on January 6, 2008, appellants left Wintergreen for Lynchburg,
5 purchasing a meal at Arby's and purchasing gas in Gaffney, South Carolina, five hours and 300 miles
6 away from the DKL Property. Respondent contends that the documentation does not support
7 appellants' claimed hours spent in December 2007 and January 2008 on material participation in the
8 rental activity. Respondent argues that it properly determined that appellants did not materially
9 participate in the rental activity while Kalow was present at the DKL rental property, and where
10 appellants were at least three hours away from the DKL Property in Norfolk and Virginia Beach on
11 December 28 and 29, 2007. (R2ndRB, pp. 18-19.)

12 As for a claimed shopping trip on January 5, 2008, respondent contends that appellants
13 claimed that they spent 8 hours each on the shopping trip for a total of 16 hours is unreasonable.
14 Respondent points out that, based on the receipts, appellants checked out at Target at 5:00 pm; checked
15 out of Sam's Club at 6:00 pm; and Checked out of Lowe's at 6:20 pm. Respondent notes that this is
16 about a two-hour window in which appellants purchased cleaning supplies, two mattresses, a television,
17 and returned two previously purchased lamps. Respondent contends that, since Charlottesville is about
18 an hour away from the property, a reasonable total amount time spent on this activity is four hours.
19 Citing *Jafarpour v. Comm'r*, T.C. Memo. 2012-165, and based on appellants' own receipts and credit
20 card statements, the number of hours reported by appellants appear to be excessive in relation to the
21 task described. Respondent further contends that appellants appear to have exaggerated every routine
22 cleaning activity, shopping trips, and improperly included time spent dining as materially participating
23 in the activity. Respondent contends that the estimates appear to be exaggerated for the purpose of
24 avoiding the limitations of IRC section 469 and that the hours were constructed within an end result in
25 mind so that they would satisfy the requirements of Treasury Regulation section 1.469-5T, citing
26 *Mowafi v. Comm'r*, T.C. Memo. 2001-111. Respondent argues that the time estimates attributable to
27 the qualifying rental activities are implausible when examined together with the evidence appellants
28 provided. Respondent contends that appellants included significant personal time spent on their

1 separate apartment which was not part of the rental activity and may not count towards material
2 participation in the rental activity. Respondent further contends that appellants hired various
3 management companies to perform on-site interactions with renters; a cleaning service consisting of
4 one single person to clean the 2,256 square foot home after each renter vacated the premises; and a
5 contractor, Mr. Nelson, who performed about \$50,000 in repairs to the premises over the tax years at
6 issue. Respondent argues that the manager, maid, and contractor participated on a regular and
7 continuous basis, and appellants have failed to show that they spent more time on the rental activity
8 then the maid and contractor. (R2ndRB, pp. 19-20.)

9 As for the July 2008 trip, respondent contends that the credit card statements contradict
10 the summary of alleged credit and check purchases related to the Virginia home that appellants
11 provided at protest. Respondent notes that the credit card statements place appellants in Norfolk,
12 Virginia on July 10, 2013, a day upon which appellants previously claimed to have been working on
13 the DKL Property. Respondent notes that appellants' American Express statement with a closing date
14 of July 25, 2008, includes a charge for \$67.12 at Max & Erma's, a casual dining chain in Norfolk, on
15 July 10, 2008. Respondent notes that the credit card statement lists both the purchase date and the
16 posting date as July 10, 2008. Respondent notes, however, that on appellants' most recent claim of
17 hours, appellants listed the dining expense as occurring on July 13, 2008, and stated in the notes that
18 the bill states "7/10." Respondent questions appellants' claimed time and purchases. Respondent notes
19 that, on July 13, 2008, appellants claimed to have worked from 7:00 am to 1:00 pm at the
20 DKL Property, then allegedly drove three hours and 45 minutes to Virginia Beach, arriving at 5:45pm.
21 Respondent notes that, while appellants' schedules claimed that they ate at Max & Erma's and paid
22 \$67.12 for dinner, appellants' schedules and credit card statements also claimed three additional meals
23 on July 13, 2008: \$47.61 for a meal at Surf Rider in Virginia Beach; \$20 at Starbucks in Norfolk; and
24 \$21.01 at Panera Bread in Norfolk. Respondent points out that this is a total for \$135.74 for three meals
25 in Norfolk and Virginia Beach, and a trip to Starbucks, all after 6pm on July 13, 2008. Respondent
26 questions appellants' claim and contends that they are not supported by the credit card statements.
27 Respondent contends that a more likely scenario is that the Max & Erma receipt occurred on July 10,
28 2008, as reflected on the credit card statement and appellants were not at the DKL Property on July 10,

1 2008. (R2ndRB, pp. 20-21, Exh. HHH; ROB, Exh. I.)

2 Respondent further contends that appellants could not have logistically worked the hours
3 they claimed and made the purchases shown on their credit card statements for July 10. Respondent
4 notes that appellants' time estimate of working from 1:00 pm to 7:00 pm could not occur because their
5 credit card statements place them at least three hours away from the DKL Property during that time.

6 Respondent contends that appellants checked out of the Homewood Suites in Herndon,
7 Virginia on the morning of July 10; then then dined at Panera Bread in Vienna, Virginia for \$29.94 (a
8 30 minute drive from the hotel) on July 10; and later that day, they dined at Max & Erma's in Norfolk
9 for \$67.12 (a 3 hour 30 minute drive from Vienna). Noting that Norfolk is also 3 hours 45 minutes
10 away from the DKL Property, respondent contends that appellants' credit card statements do not place
11 appellant within three hours of the DKL Property on July 10, 2008. Respondent contends that,
12 similarly, appellants' time estimates for July 13, from 7am to 1pm at the DKL Property, did not occur
13 because numerous purchases from their credit card statements place them in Norfolk and Virginia
14 Beach during that time frame. Respondent maintains that appellants did not spend the time claimed
15 working at the DKL Property in July 2008, and that respondent is supported by appellants' credit card
16 statements. (R2ndRB, pp. 21-22.)

17 As for the August 2008 trip, respondent contends that appellants have logistical
18 problems similar to their July 2008 trip. Respondent contends that appellant's credit card statements
19 contradict appellants' claimed locations and hours spent on the DKL Property. Respondent contends
20 that, contrary to appellants' claim that the American Express statement was incorrect, the credit card
21 statements list both the transaction date and the posting date. Respondent notes that appellants claimed
22 purchases made at OfficeMax and Sonic in Norfolk, Virginia on August 21, 2008, and contends that the
23 credit card statements clearly state that the transactions occurred on August 22, 2008. Respondent
24 argues that it is likely that, on August 23, appellants travelled the 220 miles from Virginia Beach to
25 Charlottesville and on to the DKL Property, as appellants stopped for groceries at Kroger Supermarket
26 in Charlottesville and ate a meal at Ruby Tuesday in Charlottesville. Respondent reiterates that eating
27 a meal and shopping for groceries is not material participation in the rental activity. As such,
28 respondent contends that appellants' claim of each working six hours on August 22, and 14 hours on

1 August 23, is not possible based on their credit card statements. Respondent notes that appellants had
2 meals at a Wintergreen resort restaurant on August 24 and 25. Respondent contends that it is possible
3 that appellants worked on the DKL Property on these dates, but the bifurcation between the rental
4 portion and the separate personal apartment remains unestablished by appellants. Respondent further
5 contends that, while appellants claimed to have worked from 7:00 am to 1:00 pm at the DKL Property
6 on August 26, 2008, this is unlikely as appellants purchased gas in Greenwood, Virginia, at the
7 Skinny Dip in Virginia Beach, shopped at Home Depot in Norfolk, checked-in to the Hilton Beachfront
8 Hotel, and at the Purple Cow restaurant adjacent to the Hilton on this date. Respondent contends that,
9 even if respondent allowed appellants to claim 16 hours total on August 24 and 25,²⁴ it would not be
10 enough to get close to the required 100 hour threshold and it would still not demonstrate that appellants
11 spent more time on the DKL Property than the cleaning service or the contractor. (R2ndRB, pp. 22-24,
12 Exhs. FFF & III.)

13 As for the May 2009 trip, respondent contends that appellants have not provided any
14 credit card statements to verify any purchase that would place them at or near the DKL Property during
15 this time. Respondent points out that appellants only provided page 3 of their six-page American
16 Express statement encompassing their purchases up to May 1, 2009. Respondent notes that the
17 statement covers through the closing date of May 26, 2009. Respondent contends that having a
18 complete statement would have been helpful as appellants claimed to have each worked 14 hour days at
19 the DKL Property from May 13-16, 2009. Respondent argues that it is presumed that the additional
20 pages of the statement had appellants provided it would be unfavorable to appellants' position.
21 (R2ndRB, p. 24.)

22 As for the August 2009 trip, respondent notes that appellants have not provided credit
23 card statements to support their claim that they began work on the DKL Property on August 17, 2009.
24 However, since appellants' receipts do not contradict appellants' self-prepared schedules, respondent
25 will rely on those dates in determining when it was possible for appellants to have spent time at the
26 DKL Property. Respondent contends that several cash receipts corresponding to purchases from
27 August 18, 2009, show that appellants were in Charlottesville, Virginia, an hour's drive from the
28 _____

²⁴ Eight hours each for two days, or 32 hours total aggregate hours. (R2ndRB, p. 24.)

1 property. Respondent notes that appellants claim this stop was made for “supplies” and appellants each
2 claimed five hours material participation for this activity. Respondent contends that, based on
3 appellants’ documentation, there is no evidence that the “supplies” purchased related to material
4 participation, as the receipts were for dining at a Ruby Tuesday and purchasing groceries at
5 Harris Teeter. Respondent contends that these activities relate to personal use food items and not
6 supplies used at the rental property. Respondent further argues that the stop appears to be made
7 en route to a destination, such as the DKL Property, as the property had been vacant prior to August 18,
8 and appellants neither reported nor presented any food purchases prior to the cash register receipts.
9 (R2ndRB, p. 25, Exhs. FFF & JJJ.)

10 As for appellants’ contention that their children did not accompany them to the DKL
11 Property although they traveled to Virginia, respondent notes that appellants’ time schedule also
12 include descriptions of an elaborate network of family and friends driving their children hundreds of
13 miles, and giving the impression that the children never once visited the DKL Property. Respondent
14 questions this assertion as appellants’ supermarket receipts, such as the receipt for the August 18, 2009
15 trip, shows purchases for a 10 pack of Capri Sun juice drink and pepperoni Bagel Bites, which are
16 items typically consumed by children rather than adults. Respondent contends that such purchases give
17 the appearance that the children were present at the DKL property, which, if true, then appellants’ use
18 would be considered personal use.²⁵ (R2ndRB, p. 26.)

19 Respondent notes that appellants previously reported making a purchase at a
20 Wintergreen Resort restaurant of \$92.94 on August 19, 2006. Respondent notes that, on August 20,
21 appellants purchased finishing nails, glue, and light bulbs at Wintergreen Hardware, as well as a pizza
22 at Black Rock Market. Respondent notes that appellants’ receipts show that they purchased \$38.25 in
23 gas on August 21. Respondent notes that appellants claim that they each worked 14 hours per day from
24 August 19-21. Respondent notes that appellants had previously reported that they made purchases in
25 Norfolk on August 22 at a prepared food market, Wawa, lunch at Panera Bread, and dinner at
26 Surf Rider, and stated that those purchases were reflected on their American Express statement with a
27

28 ²⁵ Respondent notes that, if appellants or family members spent more than 14 days at the property, losses generally are not allowed under the rules in IRC section 280A.

1 closing date of August 25, 2009. Respondent notes that appellants removed those purchases from their
2 current time schedule and claimed to have each worked seven hours at the DKL Property. Respondent
3 argues that, as the Norfolk Property is 220 miles from the DKL Property, logistically appellants would
4 have a difficult time eating three meals in Norfolk after 6pm. As such, respondent states that it will
5 reduce appellants' claimed hours on August 18 and August 22 to zero.²⁶ Respondent also contends
6 that, even if appellants worked on August 19, 20, and 21, 2009, these hours do not reach the required
7 100 hour threshold, and appellants did not meet the legal requirements of material participation.
8 (R2ndRB, p. 26; ROB, Exh. I.)

9 As for appellants' claim of "monetary participation" as evidenced by a receipt from
10 Home Depot showing that appellants purchased a refrigerator in California for delivery to the
11 DKL Property and the credit card purchases for building supplies, respondent contends that "monetary
12 participation" is not a legal standard by which a taxpayer's material participation is measured. As such,
13 respondent contends that appellants' monetary participation is irrelevant. Respondent further notes that
14 appellants were not present for the delivery and both the appliance delivery and the repaid supplies
15 demonstrate that someone else, such as the property manager or the contractor, likely participated in
16 that activity. Respondent contends that appellants' credit card statements do not corroborate appellants'
17 assertions of hours spent or their self-prepared schedules of Virginia purchases. Further, respondent
18 contends that appellants' activities relating to their separate personal apartment at the DKL Property do
19 not count towards appellants' material participation in the rental activity, citing *Bailey v. Comm'r*,
20 T.C. Memo. 2001-296. Respondent contends that, while appellants' losses (including those related to
21 personal use) are not currently deductible, the losses are carried forward until appellants either have
22 passive income or they dispose of their vacation property in a fully taxable transaction to an unrelated
23 party. (R2ndRB, pp. 26-28.)

24 Applicable Law

25 Burden of Proof

26 Respondent's determination is presumed correct, and the taxpayer bears the burden of
27 proving that the determination was erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509.)
28

²⁶ Respondent previously allowed six hours per day.

1 Deductions from gross income are a matter of legislative grace and the taxpayer has the burden of
2 proving an entitlement to the deductions claimed; unsupported assertions are not sufficient to satisfy the
3 taxpayer's burden of proof. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of*
4 *James C. and Monablanché A. Walshe*, 75-SBE-073, Oct. 20, 1975.)

5 Passive Activity

6 California incorporates, with some changes, IRC section 469, which generally prohibits
7 the use of passive activity losses to reduce non-passive activity income (e.g., wages, interest, or
8 dividends). (Rev. & Tax. Code, § 17561.) In general, a taxpayer's passive losses can be deducted only
9 to the extent of income from the taxpayer's passive activities. Any unused passive losses are generally
10 suspended and carried forward to future years to offset passive income generated in those years. (*Lowe*
11 *v. Comm'r*, T.C. Memo. 2008-298; see also, *Jafarpour v. Comm'r*, T.C. Memo. 2012-165.) The term
12 "passive activity" includes: (1) any activity which involves the conduct of any trade or business, and in
13 which the taxpayer does not materially participate; and (2) any rental activity. (Int.Rev. Code,
14 §§ 469(c)(1) and (2).) "Rental activity" means any activity where payments are principally for the use
15 of tangible property. (Int.Rev. Code, § 469(j)(8).)

16 Federal Exception for Real Estate Professionals

17 IRC section 469(c)(7) allows taxpayers in the real property business to treat rental
18 activity losses as non-passive losses for federal purposes. However, R&TC section 17561, subdivision
19 (a), states that, "Section 469(c)(7) of the Internal Revenue Code, relating to special rules for taxpayers
20 in [the] real property business, shall not apply." Therefore, for California purposes, rental real estate
21 activities are considered passive activities, and any losses from such activities generally can only be
22 applied to offset passive activity gains. Nevertheless, IRC section 469(i), to which California
23 conforms, allows for up to \$25,000 of rental real estate activity losses to apply to non-passive income.
24 This allowance phases out by 50 percent of the amount in which the AGI of the taxpayer for the taxable
25 year exceeds \$100,000, with a complete phase-out of such loss deductions at an AGI of \$150,000.

26 Trade or Business Exception to Rental Activity

27 An activity involving the use of tangible property is not a "rental activity" for a taxable
28 year if, for such taxable year, one of the following six circumstances are satisfied: (A) the average

1 period of customer use for such property is seven days or less; (B) the average period of customer use
2 for such property is 30 days or less, and significant personal services are provided by or on behalf of
3 the owner of the property in connection with making the property available for use by customers;
4 (C) extraordinary personal services are provided by or on behalf of the owner of the property in
5 connection with making such property available for use by customers (without regard to the average
6 period of customer use); (D) the rental of such property is treated as incidental to a non-rental activity
7 of the taxpayer; (E) the taxpayer customarily makes the property available during defined business
8 hours for nonexclusive use by various customers; or (F) the provision of the property for use in an
9 activity conducted by a partnership, S corporation, or joint venture in which the taxpayer owns an
10 interest is not a rental activity under paragraph (e)(3)(vii) of this section. (Treas. Reg., § 1.469-
11 1T(e)(3)(ii).)

12 Material Participation

13 IRC section 469(h) provides that a taxpayer shall be treated as materially participating in
14 an activity only if the taxpayer is involved in the operations of the activity on a basis which is regular,
15 continuous, and substantial. Material participation is a year-by-year determination. (See Treas. Reg.,
16 § 1.469-5T(a).) A taxpayer materially participates in a trade or business activity if, and only if, he or
17 she meets one of the seven tests provided in Treasury Regulation section 1.469-5T(a). As relevant to
18 this appeal, the third test requires:

19 The individual participates in the activity for more than 100 hours during the taxable
20 year, and such individual's participation in the activity for the taxable year is not less than
21 the participation in the activity of any other individual (including individuals who are not
owners of interests in the activity) for such year.

22 (Treas. Reg., § 1.469-5T(a)(3).)

23 The methods of proof a taxpayer may use to prove that he or she materially participated
24 in an activity:

25 The extent of an individual's participation in an activity may be established by any
26 reasonable means. Contemporaneous daily time reports, logs, or similar documents are
27 not required if the extent of such participation may be established by other reasonable
28 means. Reasonable means for purposes of this paragraph may include but are not limited
to the identification of services performed over a period of time and the approximate
number of hours spent performing such services during such period, based on
appointment books, calendars, or narrative summaries.

1 (Treas. Reg., § 1.469-5T(f)(4).)

2 Tax Courts consistently hold that, while Treasury Regulation section 1.469-5T(f)(4) is
3 somewhat ambivalent concerning the records to be maintained by taxpayers, the provision by no means
4 allow a post-event “ballpark guesstimate.” (*Moss v. Comm’r* (2010) 135 T.C. 365, 369; *Carlstedt v.*
5 *Comm’r, supra* [taxpayer’s diary of activities merely a numerical compilation of hours based on
6 taxpayer’s review of his calendar and uncorroborated estimates not considered a narrative summary];
7 *Lee v. Comm’r, supra* [non-contemporaneous time logs reconstructed based on taxpayer’s personal
8 experience and limited records not credible]; *Mowafi v. Comm’r*, T.C. Memo. 2001-111 [non-
9 contemporaneous logs prepared in connection with taxpayer’s audit and testimony at trial not credible];
10 *Vandegrift v. Comm’r*, T.C. Memo. 2012-14 [honest and forthright testimony of taxpayer’s time
11 estimate suspect because taxpayer was an employee and taxpayer’s subjective estimate lack
12 contemporaneous verification by records or other evidence].) Tax Courts also hold that the credibility
13 of a taxpayer’s records is diminished where the number of hours reported appears excessive in relation
14 to the task described. (*Jafarpour v. Comm’r, supra*, citing *Hill v. Comm’r*, T.C. Memo. 2010-200 and
15 *Bailey v. Comm’r*, T.C. Memo. 2001-296.)

16 In *Chapin, supra*, T.C. Memo. 1996-56, the taxpayer owned a beach condominium that
17 was rented for an average period of seven days or less during the June to September rental season. The
18 taxpayer claimed losses related to the rental were not passive losses subject to IRC section 469. The
19 taxpayer employed a rental agent to handle all leasing arrangements, cleaning between tenants, and
20 routine repairs and maintenance. The taxpayer did not maintain a log or other record of their hours of
21 participation, but provided credit card receipts from restaurants and other commercial enterprises in the
22 vicinity as support. The taxpayer alleged that they spent more than 170 hours during the non-rental
23 season on: cleaning and maintaining the condominium; shopping; repainting; and travel to and from the
24 rental. With regard to the Treasury Regulation section 1.469-5T(a)(3), the Tax Court determined that
25 the taxpayer had not shown that their participation in the activity exceeded anyone else’s participation
26 in the activity, such as the rental agent’s services. The Tax Court also stated that it was not persuaded
27 that the time claimed by the taxpayer was accurate, noting that the taxpayer claimed to have spent
28 five-to-six hours cleaning two bathrooms, eight hours cleaning a kitchen, and five hours “refreshing”

1 plastic floral arrangements.” The Tax Court also determined that the participation of the taxpayer did
2 not constitute participation on a regular, continuous, and substantial basis pursuant to Treasury
3 Regulation section 1.469-5T(a)(7). As such, the Tax Court held that the losses incurred were subject to
4 the passive loss rules of IRC section 469.

5 STAFF COMMENTS

6 Appellants own the DKL Property, which is located in Virginia’s Blue Ridge Mountains
7 at the Wintergreen Resort. Appellant contends that they rented the DKL Property as a trade or
8 business. Appellants claimed rental losses on the DKL Property of \$89,727, \$106,985, \$113,574, and
9 \$80,800 for tax years 2006, 2007, 2008 and 2009, respectively. Respondent disallowed the rental
10 losses as passive losses. According to respondent’s calculations, the proposed additional tax amounts
11 attributable to the rental losses claimed for the DKL Property at issue are: \$7,580.34 for 2006;
12 \$9,185.24 for 2007; \$9,797.92 for 2008; and \$6,931.49 for 2009.

13 The parties dispute whether appellants’ activities at the DKL Property should be treated
14 as a “rental activity” or as a trade or business. Rental activities are per se passive. (Int.Rev. Code,
15 § 469(c)(2).) There is a limited exception for an activity involving the use of tangible property to be
16 considered a trade or business. (Treas. Reg., § 1.469-1T(e)(3)(ii).) The parties will want to discuss
17 whether appellants satisfied the test requiring that the average rental is less than seven days. (Treas.
18 Reg., § 1.469-1T(e)(3)(ii)(A).)

19 In addition, the parties dispute whether the activities at the DKL Property should be
20 considered passive. For the activities to be considered not passive, appellants must demonstrate that
21 they materially participated in the activity. (Int.Rev. Code, § 469(c)(1).) Appellants argue that they
22 satisfy the third test for material participation requiring 100 hours of work on the DKL Property and
23 that no other individual worked more hours in the activity. (Treas. Reg., § 1.469-5T(a).) The parties
24 claim that appellants worked the following hours at the DKL Property²⁷:

25 ///

26 _____
27 ²⁷ The parties will want to clarify whether these hours have changed with their most recent additional briefing submissions.
28 Staff notes that appellant’s hours are based on their additional exhibit entitled “Devil’s Knob Time Report” (R2ndRB, Exh.
FFF.) It does not appear that these amounts include time appellants previously claimed for marketing work and customer
coordination.

	Appellants	Respondent
2006	328	84
2007	260	0
2008	260	24
2009	232	48

Appellants submitted various schedules of credit card purchases created for the audit, protest, and appeal (ROB, Exhs. D & I; ASB, Exh. 2); schedules of estimated hours created for the audit and protest, and appeal (ROB, Exh. C; ASB, Exh. 2); and appellant-husband's calendar during the periods at issue which appears to have been printed out on January 27, 2015 (ASB, Exh. 1). Appellants have also submitted various credit card statements and receipts. (ASD, Atths.) The parties should be prepared to discuss the case law regarding the sufficiency of establishing material participation under Treasury Regulation section 1.469-5T(f)(4). The parties should be prepared to discuss whether appellants have established their material participation by "reasonable means."

The parties should also be prepared to discuss appellants' claimed hours of work in light of appellants' claim that they performed work on the property while guests were renting the property. Staff notes that, in appellants' protest letter dated December 13, 2012, appellants initially stated that the DKL Property "was available for rent 100% of the time during the period from January 1, 2006 to December 31, 2009, except for the occasions when [they] visited to make repairs and maintenance." (AOB, Atths.) Appellants subsequently contend that they stayed in a separate apartment within the property and performed maintenance and repairs on the property during the same time when they rented out the property to one of their customers, Kalow. (ARB, p. 6.) The parties should be prepared to discuss whether the amount of time attributable to cleaning the separate apartment should be included for material participation when, according to the VRBO advertisement, the separate apartment was not available as part of the rental property.

The parties should be prepared to discuss whether appellants' time estimates for cleaning the three levels of the DKL Property are reasonable. (AAE, pp. 11-14; R2ndRB, Exh. FFF.) In addition, the parties should be prepared to discuss whether time spent on appellants' shopping trips, including travel to and from the stores, and taking time for personal meals should be included in the

1 time spent on material participation. In addition, the parties should be prepared to address whether
2 appellants' two minor daughters accompanied them on these visits to the DKL Property. The parties
3 should also be prepared to discuss the amount of time spent by the management person, Mr. Thompson,
4 the contractor, Mr. Nelson, and the maid service employed by appellants for the DKL Property in each
5 of the years at issue.

6 Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has
7 any additional evidence to present, they should provide the evidence to the Board Proceedings Division
8 at least 14 days prior to the oral hearing.²⁸

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²⁸ Evidence exhibits should be sent to: Khaaliq A. Abd'Allah, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.