

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
) DOCKET NO. 21288
[Redacted])
)
Petitioner.) DECISION
)
)
_____)

The petitioner protests the Notice of Deficiency Determination dated March 28, 2008, asserting additional Idaho income tax, penalty, and interest in the total amounts of \$1,292 and \$8,519 for 2005 and 2006, respectively.

The petitioner initially filed his 2005 Idaho income tax return as a resident of Idaho. Upon receiving additional information from the petitioner’s representatives, it was found that he was a part-year resident having moved into Idaho on June 22, 2005. The petitioner properly filed as an Idaho resident for 2006.

The petitioner was employed as a mining engineer during the years in question. From this employment, the petitioner reported compensation in the total amounts of \$174,187 and \$284,935 for 2005 and 2006, respectively. The petitioner claimed farm losses for both 2005 and 2006 in the amounts of \$7,235 and \$82,787, respectively. The auditor denied these losses asserting that the activity was not engaged in for profit. The petitioner has conceded the loss in 2005 and has revised the amount of loss that he feels should be allowed for the 2006 from \$82,787 to \$32,316.

For 2006, the record indicates that the petitioner purchased [Redacted] for \$690 each, butchered one for personal use, and sold one for \$810.39. The record indicates that the disposition of another of the [Redacted] was to be sold to an individual that the petitioner did not know and who was from “out-of-the-area.” Without having been paid for this animal, Mr. [Redacted] had a butcher pick up the animal. The “purchaser” left the state without paying the butcher or picking up

the cut and wrapped meat. The petitioner resorted to paying the butcher and picking up the meat to protect his investment. The last of the [Redacted] was sold in a later year.

The test for determining whether an individual is carrying on an activity for profit is whether the taxpayer's actual and honest objective in engaging in the activity is to make a profit. See Osteen v. Commissioner, 62 F.3d 356, 358 (11th Cir.1995), affg. in part and revg. in part T.C. Memo.1993-519; Surloff v. Commissioner, 81 T.C. 210, 233 (1983); Dreicer v. Commissioner, 78 T.C. 642, 645 (1982), affd. without published opinion 702 F.2d 1205 (D.C.Cir.1983); sec. 1.183-2(a), Income Tax Regs. While a taxpayer's expectation of profit need not be reasonable, there must be a good-faith expectation of making a profit. See Allen v. Commissioner, 72 T.C. 28, 33 (1979); sec. 1.183-2(a), Income Tax Regs.

The petitioner has submitted additional information regarding his 2007 and 2008 income tax returns. On those returns, it appears that the petitioner had *gross profit* from sales in the amounts of \$3,506 and \$3,970 for 2007 and 2008, respectively. The petitioner reported net losses from the farm operations for 2007 and 2008 in the amounts of \$8,906 and \$3,687, respectively. Notably, certain expenses were missing in the 2007 and 2008 farm schedules. While the petitioner claimed \$5,735 of car and truck expense in the return he filed for 2006, there was no expense claimed for car and truck expense for either 2007 or 2008.

The taxpayer bears the burden of establishing the requisite profit objective. Keanini v. Commissioner, 94 T.C. 41, 46 (1990); Golanty v. Commissioner, 72 T.C. 411, 426 (1979), affd. without published opinion 647 F.2d 170 (9th Cir.1981). However, greater weight is accorded to objective facts and circumstances than to a taxpayer's mere statement of intent. Dreicer v. Commissioner, 78 T.C. 642, sec. 1.183-2(a), Income Tax Regs.

In determining whether an activity is engaged in for profit, Treasury Regulation § 1.183-2

(b) sets out nine criteria to be considered:

- (1) The manner in which the taxpayer carries on the activity.
- (2) The expertise of the taxpayer or his advisors.
- (3) The time and effort expended by the taxpayer in carrying on the activity.
- (4) The expectation that assets used in the activity may appreciate in value.
- (5) The success of the taxpayer in carrying on other similar or dissimilar activities.
- (6) The taxpayer's history of income or losses with respect to the activity.
- (7) The amount of occasional profits, if any, which are earned.
- (8) The financial status of the taxpayer.
- (9) The elements of personal pleasure or recreation.

These factors are not applicable or appropriate in every case. Abramson v. Commissioner, 86 T.C. 360, 371 (1986). In determining whether petitioners were engaged in the activity with the requisite intent to make a profit, all of the facts and circumstances of their situation must be taken into account. Golanty v. Commissioner, *supra* at 426; sec. 1.183 2(a) and (b), Income Tax Regs. No single factor is controlling, nor is the existence of a majority of factors favoring or disfavoring a profit objective necessarily controlling. Hendricks v. Commissioner, 32 F.3d 94, 98 (4th Cir.1994), *affg.* T.C. Memo. 1993-396; sec. 1.183 2(b), Income Tax Regs. In this case, the Commission finds that most of the factors do not weigh heavily on either side.

The petitioner sold or attempted to sell two of the animals during 2006. One of these sales is of some interest. The record indicates that the petitioner agreed to sell this animal to a person not known to him and allowed a butcher to take the animal away without the petitioner having been paid. This seems to come short of a businesslike manner of making a “sale.”

The petitioner wishes to deduct as an expense pursuant to Internal Revenue Code § 179, the following:

Used Backhoe	\$ 6,000
Tool Set	5,225
New Motorcycle	5,684
Engine Repair for New Motorcycle	2,601
Water Pressure Tank	1,124
Fencing	<u>3,335</u>
Total	<u>\$23,969</u>

It is of some interest that the new motorcycle was purchased on May 12, 2006, and that on July 29, 2006, documentation submitted by the petitioner indicated that the new motorcycle's engine had seized requiring the \$2,601 repair bill. The expenses claimed by the petitioner also include other expenses for motorcycle and ATV repairs. The total claimed repair expenses for motorcycles and ATVs totaled \$3,816 for 2006. The petitioner also claimed depreciation for a garage built for \$43,238 as being 100 percent used for the livestock operation.

The petitioner wrote that "organic beef" sells for \$3,000 to \$9,000 per animal. However, answering further questions, the petitioner admitted that he did not have the necessary certification for the sale of "organic beef." The petitioner's subsequent submission showed sales of animals for \$1,000 per animal. In the 2008 return, the petitioner reflects that he sold 10 animals for \$1,000 each producing a gross profit of \$3,970 and a net loss of \$3,687.

The petitioner contends that the land is expected to appreciate in value. The last sentence of section 1.183-2(b)(4), Income Tax Regs., cross-refers to paragraph (d) of section 1.183-1, Income Tax Regs., for a definition of an activity in this connection. Section 1.183-1(d)(1), Income Tax Regs., provides:

Where land is purchased or held primarily with the intent to profit from increase in its value, and the taxpayer also engages in farming on such land, the farming and the holding of the land will ordinarily be considered a single activity only if the farming activity reduces the net cost of carrying the land for its appreciation in value. Thus,

the farming and holding of the land will be considered a single activity only if the income derived from farming exceeds the deductions attributable to the farming activity which are not directly attributable to the holding of the land (that is, deductions other than those directly attributable to the holding of the land such as interest on a mortgage secured by the land, annual property taxes attributable to the land and improvements, and depreciation of improvements to the land).

It is clear from the petitioner's Schedules F that the costs attributed to the [Redacted] activity (apart from those directly attributable to the holding of the land) substantially exceed the income from the [Redacted] sales. Thus, the petitioner does not satisfy the test set forth in section 1.183-1(d), Income Tax Regs., for combining his farming activity with his holding of the land into a single profit-motivated activity. We find that this factor weighs against the petitioner.

The lack of substantial income from sources other than the activity in question may indicate the existence of a profit objective. See sec. 1.183-2(b)(8), Income Tax Regs. The rationale for this rule is that a taxpayer with substantial income unrelated to the activity can more easily afford to operate the activity as a hobby. In 2006, the petitioner received \$284,935 in compensation. The petitioner had substantial income unrelated to the cattle activity. Accordingly, this factor does not favor the petitioner.

In summary, the petitioner was feeding three animals for sale. He originally claimed a loss of \$82,787 with regard to this activity. Of this amount, the detail for \$58,051 was never provided to the staff of the Commission. Only after the auditor had begun the audit did the petitioner offer to lower the amount of the claimed loss to \$32,316. The nature of the "business" is that the petitioner would purchase a few animals for \$600 - \$700, feed them for a relatively short time, and sell them for about \$1,000. The petitioner contends that the grain to feed the animals would cost less than \$50 per animal. If there were no unpleasant events such as the need for a veterinarian or supplies for which the petitioner would need not only the cost of the supplies, but also the cost of travel to retrieve such, he could expect the gross profit to be about \$300 per animal. With the three animals

which the petitioner held for sale, the maximum that might have been expected would be about \$900. The Commission finds that there was not a good-faith expectation of making a profit. In one of the letters from the petitioner's representative, it was stated that, "Mr. [Redacted] had originally intended to raise beef for his personal consumption." This appears to be the nature of this activity. Accordingly, the Commission finds that, pursuant to Internal Revenue Code § 183, the petitioner is not allowed to deduct the loss from this activity

The auditor included in the computation of the liability asserted for 2005 unreported income in the amount of \$1,632. After the issuance of the Notice of Deficiency Determination, the auditor subsequently determined that this income was not Idaho source income. This adjustment needs to be made to the liability asserted.

For 2006, in the auditor's modified report, it was noted that the petitioner had made a \$1,000 charitable contribution to the Idaho Youth Ranch. The auditor cited Idaho Code § 63-3029 stating that the maximum *credit* allowable was \$100. The auditor allowed a *deduction* in the amount of \$100. We find that the \$100 deduction allowed by the auditor should be restored to the computation of Idaho taxable income and that a credit against the tax in the amount of \$100 should be allowed.

WHEREFORE, Notice of Deficiency Determination dated March 28, 2008, is hereby MODIFIED, and as so modified is hereby APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax, penalty, and interest (computed to December 31, 2009):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2005	\$ 975	\$ 0	\$ 226	\$1,201
2006	6,816	682	1,158	<u>8,656</u>
			TOTAL DUE	<u>\$9,857</u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioner's right to appeal this decision is enclosed.

DATED this _____ day of _____, 2009.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2009, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.

[Redacted]