

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
)
[Redacted] ,) DOCKET NO. 30808
)
)
) Petitioners.) **DECISION**
)
_____)

This is an individual income tax case, determining whether deductions can be taken for certain horse-related activities.

BACKGROUND

[Redacted] (Petitioners) protested the Notice of Deficiency Determination (NODD) issued by the auditors for the Idaho State Tax Commission (Commission) dated December 4, 2013. The NODD is for taxable years 2010, 2011 and 2012, and asserts additional liability for Idaho income tax, penalty, and interest for those respective years in the total amounts of \$2,905, \$2,801, and \$5,991.

On their tax returns for the taxable years, the Petitioners deducted substantial Schedule F losses related to an activity simply described as “HORSES.” The losses from this horse-related activity were significant. Section 183(a) of the Internal Revenue Code (IRC) generally limits deductions with respect to an activity not engaged in for profit to the gross income reported from the activity. Accordingly, Commission auditors conducted an audit into the profitability of the horse-related activities, including a field visit in October 2013 to the Petitioners’ home and acreage. After the NODD was issued the Petitioners protested their tax liability and an informal hearing was conducted in January of 2016. The Petitioners submitted additional explanation and argument at the hearing and thereafter.

As it relates to the Petitioners' horse-related activity, the record shows the following: Mrs. [Redacted] owns approximately 41 horses. The Petitioners own acreage that includes their personal residence, a horse barn with stalls, a covered barn for storage of the horse trailers, a horse round pen, and a horse riding arena. The Petitioners' horse-related activities involved (1) breeding, (2) raising, (3) training, and (4) showing horses.

Mrs. [Redacted] is more involved with the horse activity than Mr. [Redacted]. The 41 horses are owned by Mrs.[Redacted] and are registered in her name. In fact, during the field visit, Mr.[Redacted] referred to the horses as Mrs. [Redacted] "pets." The auditors found that Mr.[Redacted] only works with the weanlings at first to get them halter broke, but that afterwards, he is not involved. Mrs.[Redacted], however, has been working with horses since she was a teenager. She is a homemaker who receives retirement income. She indicated that she normally works 1-2 hours a day with her horse activities, from springtime through fall each year. During the competition season, she indicated that she takes, at most, two horses at a time to a show, and that she attends six to eight shows per year. The Petitioners' records show that they used multiple trainers with various monthly training rates to help with the horses. The Petitioners' records indicate that she travels south with some of her horses during the winter months and attends shows in Arizona and Nevada.

During the taxable years 2010, 2011 and 2012, the Petitioners operated their horse-related activity with significant losses. Since 2003, the Petitioners have filed a Schedule F with their income tax returns. Each Schedule F for the taxable years (2010, 2011 and 2012) reported a loss. In fact, of the ten years of Schedules F, only one year showed any net income. Minimal gross income was reported during several years, and most of the gross receipts reported were not from horse-related activity but from renting cow pasture. Over the ten years, the Petitioners reported a net loss of \$639,375, or an average yearly loss of almost \$64,000.

The following summarizes what the Petitioners reported over the previous ten years from their horse-related activity (with the years at issue in bold):

HORSE INCOME AND EXPENSES 2003-2012

Year	Schedule F Income	Pasture Rent	Winnings	Net Horse Sales	Other Income	Gross Income	Horse Expenses	Net
[Redacted] *	17,353	10,000			7,353	7,353	60,343	(52,990)
[Redacted] *	10,100	10,000			100	100	68,619	(68,519)
[Redacted] *	12,795	10,000			2,795	2,795	83,397	(80,602)
[Redacted]	30,950	10,797	10,371		9,782	20,153	101,397	(81,244)
[Redacted]	31,590	10,239	13,540	9,590	7,811	30,941	103,310	(72,369)
[Redacted]	35,606	12,332	23,274	7,000	-	30,274	91,232	(60,958)
[Redacted] †	20,328	14,396	5,802	70,907	130	76,839	73,707	3,132
[Redacted]	13,122	12,868	104		150	254	58,441	(58,187)
[Redacted]	19,695	13,756	894		5,045	5,939	78,808	(72,869)
[Redacted]	15,782	13,492	649		1,641	2,290	97,059	(94,769)
	207,321	117,880	54,634	87,497	34,807	176,938	816,313	(639,375)

* The Commission made an estimate of pasture rent in the amount of \$10,000 for these years.

† “[Redacted]” horse was sold as a gross price of \$72,500 (net price \$70,907). This animal was an aberration from the Petitioners’ usual operation. This animal alone was purchased as a foal, raised and sold. She was not from the breeding stock belonging to the Petitioners.

The auditors found for the three taxable years (2010-2012) of concern in this decision, the Petitioners' horse-related activity average income was \$48,599, while average losses totaled \$75,275.

For his part, Mr.[Redacted] is a member of an Idaho limited partnership called [Redacted]. [Redacted] operates a cattle ranch north of [Redacted], Idaho. [Redacted] owns several properties. The Petitioners contend that, because of the vast area and cattle movement, horses are needed for the [Redacted] cattle operations. The Petitioners indicate that their horses are used on the cattle ranch, especially in areas that are difficult to reach by vehicle. The auditors found that the Petitioners allowed [Redacted] to use five of Mrs.[Redacted] horses for no charge. (There is no evidence that [Redacted] used the other 35 horses). The Petitioners also believe that overall horse breeding, training, and selling, in their words, "improves the profitability of [Redacted]," despite the fact that the horses are not owned by or registered to the partnership.

In sum, the Petitioners contend that the horse-related activity is engaged in for profit. They also argue that the horse-related activity is so interrelated with [Redacted], that it should not be analyzed separately, but together with [Redacted], as one business.

LEGAL STANDARD

If an activity engaged in by an individual is not for profit, "no deduction attributable to such activity shall be allowed under this chapter. . . ." Internal Revenue Code § 183 ("IRC"). Under the applicable regulation, "[a]lthough a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into . . . or continued the activity, *with the objective of making a profit.*" Sec. 1.183-2, Income Tax Regs. (emphasis added). In making the determination whether a profit motive exists, more weight must be given to the objective facts than to the taxpayer's mere statements of intent. Section 1.183-2(a), Income

Tax Regs. The Petitioners have the burden of proving that they conducted their activities with the primary, predominant or principal purpose of realizing an economic profit independent of tax savings. *Wolf v. C.I.R.*, 4 F.3d 709, 713 (9th Cir. 1993).

Before applying IRC § 183, however, the particular activity or activities of the taxpayer must first be “ascertained.” Sec. 1.183-1(d)(1), Income Tax Regs. That is because several undertakings may actually constitute one activity. Sec. 1.183-1(d)(1), Income Tax Regs. If an undertaking is a separate activity, then its profitability is to be evaluated separately.

ANALYSIS

There are two issues for decision. First, whether the Petitioners’ horse-related activity should be considered to be one separate activity, or just one part of another undertaking. If the horse-related activity *is* a separate activity, the Commission must then determine whether the Petitioners engaged in their horse-related activity for profit, within the meaning of IRC § 183.

A. The Petitioners may not treat their horse-related activity and [Redacted] cattle operation as one activity.

As stated above, the Petitioners have reported horse-related activity for at least ten years. They listed it on their individual tax returns as “HORSES.” They have deducted a net loss with regard to this activity for each of those ten years, with the exception of one year in which a small profit was reported. Based on an analysis of the profitability of the horse-related activity, auditors for the Commission disallowed the losses for taxable years 2010, 2011 and 2012.

In reporting the horse-related activity, the Petitioners included income from the rental of pasture to a partnership in which Mr. [Redacted] owned a majority interest. On their tax returns the Petitioners did *not* combine the horse-related activity with the reporting of the partnership income. The Petitioners now argue that their horse-related activity listed on their individual tax returns is actually one activity with [Redacted] partnership’s cattle ranch operation. The Commission must

determine whether the activities should be combined or whether each undertaking should be considered by itself.

“In order to determine whether, and to what extent, section 183 and the regulations thereunder apply, the activity or activities of the taxpayer must be *ascertained*.” Sec. 1.183-1(d), Income Tax Regs. (emphasis added). That is, where a taxpayer is engaged in multiple undertakings, “each of these may be a separate activity, or several undertakings may constitute one activity.” Sec. 1.183-1(d). The Commission must take into account all the facts and circumstances of a case when ascertaining the activity or activities of a taxpayer. Sec. 1.183-1(d), Income Tax Regs.

In general, the *most* significant facts and circumstances are:

1. The degree of organizational and economic interrelationship of various undertakings;
2. The business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business or in an investment setting; and
3. The similarity of various undertakings.

Sec. 1.183-1(d).¹

The consequence of all this is that if the Petitioners are engaged in separate activities, “the deductions and income from each separate activity are not aggregated either in determining whether a particular activity is engaged in for profit or in applying section 183.” Sec. 1.183-1(d), Income Tax Regs.²

[Redacted] raises cattle. The partnership sells about 800 head of cattle per year. Mr. [Redacted] owns (directly or indirectly) about 54% of the partnership. The Petitioners assert that because

¹ “Generally, the Commissioner will accept the characterization by the taxpayer of several undertakings either as a single activity or as separate activities. The taxpayer’s characterization will *not* be accepted, however, when it appears that his characterization is artificial and cannot be reasonably supported under the facts and circumstances of the case.” Section 1.183-1(d), Income Tax Regs. (emphasis added).

² In determining whether a taxpayer’s activities should be treated as one activity or more, Tax Courts have also considered these factors: “(a) Whether the undertakings share a close organizational and economic relationship, (b) whether the undertakings are conducted at the same place, (c) whether the undertakings were part of a taxpayer’s efforts to find sources of revenue from his or her land, (d) whether the undertakings were formed as separate businesses, (e) whether one undertaking benefited from the other, (f) whether the taxpayer used one undertaking to advertise the other, (g) the degree to which the undertakings shared management, (h) the degree to which one caretaker oversaw the assets of both undertakings, (i) whether the taxpayers used the same accountant for the undertakings, and (j) the degree to which the undertakings shared books and records. *See, Tobin v. C.I.R.*, 78 T.C.M. (CCH) 517 (T.C. 1999).

they allow the partnership to use their horses without charge, the two activities should be considered one activity for the purposes of Internal Revenue Code § 183. They also argue that the gentle nature of Western Pleasure horses that the Petitioners raise make the best ranch help for day-to-day ranch work (“The [Redacted] have made the determination that pleasure horse attributes are preferable to [Redacted] because it is a better fit for the horse experience of their ranch hands.”)

The Petitioners argue that they only sell horses that were not needed or retained on the ranch. In turn, they state that they “believe that overall horse breeding, training, and selling improves the profitability of [Redacted] and will overall prove to be a profitable decision.” Finally, the Petitioners argue that even though the horse undertaking is accounted separately from [Redacted], “this has been done to understand the expenses and contributory revenue involved and is merely a cost and revenue center rather than a unique activity.”

The Commission will evaluate the above facts and circumstances to determine whether the Petitioners’ horse-related activity and the [Redacted] partnership are similar activities:

(1) The degree of organizational and economic interrelationship of the undertakings

In evaluating the relationship of the two entities, it is apparent that [Redacted] and the Petitioner’s individual horse undertaking do not share a close organizational or economic relationship. Sec. 1.183-1(d), Income Tax Regs. [Redacted] is a partnership, while the Petitioners operated the horse-related activity individually, as sole proprietors. Although there is a commonality between the two in the person of Mr. [Redacted], he did not actively manage the horse-related activities, and there was no other organizational relationship between [Redacted] and the Petitioners’ individual horse-related activities. *See, Rabinowitz v. Commissioner*, 90 T.C.M.

(CCH) 113 (T.C. 2005) (holding that an S-corporation and a sole proprietorship were distinct, even though they shared ownership and both were managed by the same person).

Revenue Ruling 78-22 provides some guidance in relation to analyzing organizationally distinct endeavors. It states that “section 183 of the Code applies to the activities of a partnership, and the provisions of section 183 are applied at the partnership level and reflected in the partners’ distributive shares.” Rev. Rul. 78-22, 1978-1 C.B. 72 (1978) (*citing* Rev. Rul. 77-320, 1977-2 C.B. 78). Therefore, “because section 183 of the Code must be applied at the partnership level with respect to activities engaged in by a partnership and at the individual level with respect to activities engaged in by a sole proprietor, the taxpayer’s activity of racing horses as a sole proprietor and the activity of the partnership racing horses are two separate activities for purposes of section 183.” *Id.*

The Petitioners specifically chose to report the partnership interest and the horse-related activity as separate activities. Mr. [Redacted] had a controlling interest in [Redacted]. Presumably, if Mr. [Redacted] had preferred that Mrs. [Redacted] horse-related activity be an integral part of the partnership, he could have formally compelled this result. He did not do this. Moreover, the Petitioners observed at least some of the formalities of a partnership (as opposed to a sole proprietorship) by keeping separate books for both endeavors. The two undertakings were organizationally distinct.

Because the Petitioners were free to choose the structure and organization of their horse-related activity, the Commission does not agree with the Petitioners argument that the structure

of [Redacted] and their individual horse-related activity should be disregarded. *See Estate of Stangeland v. C.I.R.*, 100 T.C.M. (CCH) 156 (T.C. 2010).³

The Petitioners' arguments rely on *Topping v. Commissioner*, T.C.M. (CCH) 1120 (T.C. 2007). However, *Topping* is easily distinguished on the facts. In that case, the Petitioner built a business of designing horse barns and homes for persons involved in equestrian activities. She planned from the beginning to establish herself as a trusted equestrian peer. The design business was done in a single member limited liability company treated as a disregarded entity. The Petitioner competed in equestrian events to promote her business and obtained the bulk of her business (over 90%) for designing barns and homes from her involvement with the competitive events. Each of the trainers she had worked with had referred at least one design client.

In this case, there is no record of the [Redacted] cattle operation being heavily dependent upon the horse-related activity for the raising or sale of the cattle. In *Topping*, the Petitioners' equestrian activities significantly benefitted her design business, and there was a significant business purpose for combining the undertakings. Further, in *Topping*, the Petitioner was the sole owner of both the horse activity as a proprietorship and the design activity through a single member limited liability company. As a single member limited liability company, all of the income tax aspects were reported on that petitioner's income tax return. In the present matter, the auditors found that the Petitioners allowed [Redacted] to use five of Mrs. [Redacted] horses. At the time of the audit, it was found that only one employee of [Redacted] actually rode any of the horses. (Later, at the informal hearing, the Petitioners indicated that there were, by then, three ranch

³ The Petitioners point to one section of the Income Tax Regulations that provides for allocation of expenses and income where the taxpayer is engaged in multiple activities. Section 1.183-1(d)(2), Income Tax Regs. They argue that, if the Commission considers the cattle ranch and the horse-related activity to be two endeavors, it must perform an after-the-fact allocation of the value of the use of the horses that the cattle ranch used. However, it is not clear that this section applies to allocating *income* when it comes to property; rather, it appears that the Regulation applies only to deductions/expenses. In any case, the Petitioners did not charge the [Redacted] partnership for the use of its five horses. It would be artificial and improper to assign a value to the use of the horses when the Petitioners clearly did not charge the [Redacted] partnership for the use of the horses. The record shows that the Petitioners let the [Redacted] partnership use the horses for no charge. It would be inconsistent to charge the partnership an amount after the fact, when the partnership was able to use the horses for no charge. For these reasons the Petitioners' argument is not accepted by the Commission.

hands riding the horses.) In sum, there is no showing that the Petitioners' individual horse-related activity and [Redacted] partnership share a close economic relationship.

(2) The business purpose which is served by carrying on the two undertakings together

In evaluating the second significant fact, the Commission can see no apparent business purpose which is served by carrying on the various undertakings together. Sec. 1.183-1(d), Income Tax Regs. The Petitioners argue that Western Pleasure horses are a better fit for the horsemanship experience of [Redacted] ranch hands. However, this characterization is without basis since the bulk of the income and expenses of the horse-related activities pertain to breeding, training, showing and selling horses. Mrs. [Redacted] owns more than 40 horses and as represented by the Petitioners, a ranch hand occasionally rides one of Mrs. [Redacted] horses on Mr. [Redacted] cattle ranch. At most, five of Mrs. [Redacted] horses were allowed to be used by [Redacted]. These facts do not support the idea that there is a business purpose which is served by carrying on the undertakings together. Moreover, the value of owning the horses does not actually serve the business purpose of the cattle ranch, as the horses are owned by Mrs. [Redacted] and *not* [Redacted]. Based on these facts the Commission concludes that there is no actual business purpose which could be served by carrying on the two undertakings together. Sec. 1.183-1(d), Income Tax Regs.

(3) The similarity of the horse-related activity and the cattle ranch

The facts in this case indicate that [Redacted] and the Petitioners' horse-related activities are simply not similar undertakings as required in Sec. 1.183-1(d), Income Tax Regs. [Redacted] raises cattle. It runs a cattle ranch. The Petitioners' horse-related activities focus almost entirely on breeding Western Pleasure horses, training, showing, and (occasionally) selling them. There is no appreciable nexus between the day-to-day functioning of [Redacted] cattle ranch operations and the

breeding, training, showing and selling of Western Pleasure horses. These are not similar undertakings.⁴

In the end, the Petitioners made the choice not to combine the horse operation with [Redacted] and treated each enterprise separately both in record-keeping and in filing of their income tax returns. They are organizationally and economically distinct. Moreover, the activities of each are substantially separate. In light of this, and considering all the facts and circumstances of the case, the Commission must conclude that [Redacted] cattle operation and the Petitioners' horse breeding, training and selling were two separate and distinct activities under Section 183, IRC. The Petitioners may not aggregate the two activities to determine the profit motive. Based on this conclusion, the Commission will not look to the profit of [Redacted] in determining whether the horse-related activity was operated for profit.

B. The Petitioners' horse-related activity was not engaged in for profit.

First, the Commission will analyze the Petitioners' argument that they are entitled to the presumption of a profit motive contained in Section 183(d), IRC. In general, under that section, when it comes to horse breeding, training, showing or racing, there is a presumption that if the gross income derived from those activities for two or more of the taxable years in the period of seven consecutive taxable years exceeds the deductions attributable to such activity, then such activity shall be presumed to be an activity engaged in for profit. IRC § 183(d). However, the presumption only applies "with respect to the second profit year and all years *subsequent* to the second profit year." Sec. 1.183-1(c), Income Tax Regs. (emphasis added). In other words, the presumption only applies *after* the final profit year. *Mitchell v. C.I.R.*, 92 T.C.M. (CCH) 17 (T.C. 2006).

⁴ The Petitioners also argue that the pasture rental that they charged to the [Redacted] partnership should be considered to be the same endeavor as their horse-related activity. However, the rental of pasture to the partnership is not at all similar to the Petitioners' horse-related activity. Section 1.183-1(d), Income Tax Regs.

The Petitioners argue that they are entitled to the presumption of profitability because they state that the horse business shows calendar year profits during the tax years of 2009 and 2013. However, year 2013 is outside the audit period and has not been examined by the Commission's audit staff. Moreover, even if the income and expense items are accurately reported for 2013, the presumption would only apply with respect to all years *after* that year. Sec. 1.183-1(c), Income Tax Regs. Therefore, the Petitioners are not entitled to the section 183(d) presumption for 2010, 2011 or 2012.

We next examine the horse-related activity standing alone with regard to profitability under IRC § 183. Section 1.183-2(b), Income Tax Regs., lists the following nine factors that should normally be taken into account in determining whether an activity is engaged in for profit:

- (1) The manner in which the taxpayer carried 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 loss with respect to the activity,
- (7) The amount of occasional profit, if any, which is earned,
- (8) The financial status of the taxpayer, and
- (9) The extent to which elements of personal pleasure or recreation are involved.⁵

In making a determination whether an activity is engaged in for profit, "all facts and circumstances with respect to the activity are to be taken into account." Sec. 1.183-2(b), Income Tax Regs. No single factor is determinative; moreover, the factors provided in the regulation are not exclusive. Sec. 1.183-2(b), Income Tax Regs. A determination is not to be made simply on

⁵ The Petitioners argue that the Commission should rely on the fact that the Internal Revenue Service examined the horse-related activity in 2005 and did not make an adjustment pursuant to IRC § 183. However, just because the IRS declined to do so in 2005 is not controlling on the Tax Commission for years 2010, 2011 and 2012. Year 2005 is not the year at issue in this case. From the information submitted by the Petitioners regarding the audit of their 2005 income tax return, some things are clear; some are not. It is clear that deductions for IRC § 179 expense, itemized deductions, and the allowance for personal exemptions were adjusted. Further, it is clear that the adjustments did not include the disallowance of the horse-related loss. However, it is not clear whether the auditor considered disallowing the horse-related loss pursuant to IRC § 183. In any case, it is an established principle "that each tax year is considered separately." *Sheehy v. C.I.R.*, 72 T.C.M. (CCH) 178 (T.C. 1996) (citing *Harrah's Club v. United States*, 228 Ct.Cl. 650, 661 F.2d 203, 205 (1981)). In addition, the Commission now has more history to consider than was available during the federal audit of the 2005 income tax return.

the basis of whether a majority of factors indicate a profit objective, or vice versa. Sec. 1.183-2(b), Income Tax Regs.

(1) The manner in which the taxpayer carried on the activity

If a taxpayer carries on an activity in a businesslike manner, it may indicate a profit objective. Section 1.183-2(b)(1), Income Tax Regs. In the audit years, the Petitioners' expenses (\$234,308) are more than 27 times the amount of the income (\$8,483). Moreover, the average yearly loss for the period of 2003 – 2012 is \$63,937. Rather than terminate the activity or take measures to lessen the losses, the losses grew in the audit years to an average of \$75,275 per year. Continuing to accrue losses of this size without making changes shows that the Petitioners did not conduct the horse undertaking in a profitable manner. *See, Freed v. C.I.R.*, T.C.M. (RIA) 2004-215 (T.C. 2004).

It appears that there are three avenues for the Petitioners to have made money with the horses. Money can be made by winning at shows. Money can be made by selling horses. And money can be made from stud fees.

In 2008, the winnings from shows peaked at \$23,274. However, in the audit years, the show winnings averaged only \$567 per year while showing fees averaged \$8,394 and training and entry fees averaged \$25,799 per year.

During the audit years, the Petitioners reported no income from the sale of horses. During the audit the Petitioners asserted that they were not selling horses because both the economy and horse markets were bad. However, no evidence was provided that the Petitioners attempted to modify their method of operation, despite the difficult economic conditions. Moreover, rather than sell horses during this time period, the Petitioners allowed the partnership to use some of the horses without charge.

The Petitioners contend that they owned a very desirable stud. However, they reported only \$1,500 from stud fees during the audit years. If the Petitioners had a highly desirable stud and if they intended to make a profit from the horse operation, it would seem that they would have pursued this avenue of business more aggressively. Accordingly, it appears that the Petitioners did not pursue, in a purposeful manner, any of the three courses available to them for making money from the horse-related activity.

During the audit period the Petitioners continued to claim substantial expenses relative to the horse-related activity, sustaining large losses. Expenses far exceeded gross receipts each year from 2010 through 2012, despite the small amount of income received.

Moreover, the Petitioners provided no evidence of significant marketing efforts. The total advertising expense claimed by the Petitioners for the three years was \$45 incurred in 2010. They did not advertise with posted signs, horse journal publications, videos, or online advertising. They marketed horses solely by word-of-mouth and at horse shows.

Last, the Petitioners did not maintain records in a business-like manner. At all relevant times, including during the years at issue, Mrs. [Redacted] did not keep a separate bank account for her horse-related activity. Instead, such expenses were paid from the Petitioners' personal accounts. During the years at issue, Mrs. [Redacted] did not have a written budget for her horse-related activity or have a written business plan that projected, for example, gross receipts and expenses from her horse-related activity or any plans to make the operation profitable.

This factor strongly favors the auditors' position that the horse-related activity was not engaged in for profit.

(2) The expertise of the taxpayer or his advisors

Both of the Petitioners have extensive experience with horses. The Petitioners have engaged multiple trainers for the horses. It is not clear whether either of the Petitioners have any formal equestrian training.

However, it is fairly clear that the Petitioners lack expertise in, or demonstrated lack of interest in making the horse-related activity profitable, nor is there any evidence that the Petitioners sought expert advice on making the horse-related activity profitable. As stated by the U. S. Tax Court in another matter, “[a]lthough petitioner consulted experts on how to generate income from horse activities before she began her horse activity, she does not claim to have consulted with any economic or financial experts during her operations, even when faced with mounting losses. This factor does not indicate a profit objective.” *Hastings v. C.I.R.*, 84 T.C.M. (CCH) 663 (T.C. 2002).

This factor favors the auditors’ position that the petitioners lack the expertise and did not engage business experts to make a profit from the horse-related activity.

(3) The time and effort expended by the taxpayer in carrying on the activity

The Petitioners contend that Mrs. [Redacted] works with the horses every day. In addition, the Petitioners state that Mr.[Redacted] works with the horses both in the breeding process and in foaling. Mr.[Redacted] also works with the weanlings until they are halter broke.

This factor favors the Petitioners’ position.

(4) The expectation that assets used in the activity may appreciate in value

The Petitioners point out that they were able to sell one horse that they purchased for a substantial gain during the prior ten years. However, records indicate that there were no horse sales during the audit years. There is no showing that the horses are appreciating in value as they

age. Likewise, there is no evidence of the value for other property, the pickup and trailer, are appreciating.

This factor favors the auditors' position.

(5) The success of the taxpayer in carrying on other similar or dissimilar activities

Nothing in the record indicates that Mrs. [Redacted] has operated any other business. Accordingly, this is the only business which we have a record of for Mrs. [Redacted]. Mr.[Redacted] is involved in the cattle business as a manager and that business is successful.

This factor is neutral.

(6) The taxpayer's history of income or loss with respect to the activity

Although the undertaking of the horse-related activity predates 2003, we have records for only the last ten years. During those years, the net amount of loss exceeds \$600,000.

This history of loss strongly favors the auditors' position.

(7) The amount of occasional profit, if any, which is earned

In only one year of the 10 years prior to 2013 was a small profit reported (in the amount of \$3,132) and that small profit was directly related to the sale of a horse that was clearly outside of the normal operation of the Petitioners' horse breeding activities. The gain in the one year was produced by the purchase and subsequent sale of a horse (" [Redacted] ") that did not share the blood lines of the horses owned by Mrs. [Redacted]. It was a one-time opportunity. Mrs. [Redacted] did not retain any interest in either the horse or the blood line of [Redacted]. There is no indication that this is a repeatable transaction. Only minimal gross income was reported during several years, and most of the gross receipts reported were not from horses; they were from renting out pasture.

This factor strongly favors the auditors' position.

(8) The financial status of the taxpayer

The Petitioners have significant income from other sources to enable them to afford to incur the losses from Mrs. [Redacted] horse-related activity. This income comes from various sources including pass-through entities, investment income, and retirement income.

The fact that the tax collector may share in the cost of an activity may be a factor in pursuing or continuing an activity. Section 1.183- 2(b)(8), Income Tax Regs., points out that the expectation of being able to arrange to have the tax collector share in the cost of a hobby may often induce an investment in such a hobby which would otherwise not occur. In other words, the government subsidizes the expenses incurred by the Petitioners with regard to this activity.

As addressed by the U.S. Tax Court:

In cases of this kind, the concurrent existence of other income poses the question, rather than answers it. * * * Properly construed, the regulation merely makes the commonsense point that the expectation of being able to arrange to have the tax collector share in the cost of a hobby may often induce an investment in such a hobby which would not otherwise occur. The essential question remains as to whether there was a genuine hope of economic profit. * * *

Hoyle v. C.I.R., 68 T.C.M. (CCH) 1321 (T.C. 1994).

This factor is neutral.

(9) The extent to which elements of personal pleasure or recreation are involved

While there is not much information in the file regarding this element, it appears that Mrs. [Redacted] does take pleasure in raising and showing horses. She has been involved in raising horses since she was a teenager. And during the audit Mr. [Redacted] referred to the horses as Mrs. [Redacted] “pets.” Also, it would appear illogical that over half a million dollars would be put into an activity if it were not pleasing to the Petitioners.

The Commission finds that this element strongly favors the position of the auditors.

CONCLUSION

In summary, after considering all the facts and circumstances of the Petitioners' case, the Commission concludes that the horse-related activity is a separate and distinct activity from [Redacted] cattle ranch, under Section 183, IRC. The deductions and income from the two activities are not to be aggregated in determining whether the horse-related activity is engaged in for profit. Sec. 1.183-1(d), Income Tax Regs.

The Commission analyzed the issue of whether the requisite profit motive exists by reference to "objective standards, taking into account all of the facts and circumstances of [the] case." Sec. 1-183-2(a), Income Tax Regs. In making this determination, more weight must be given to the objective facts than to the taxpayer's characterization of intent. *Baldwin v. C.I.R.*, 83 T.C.M. (CCH) 1915 (T.C. 2002) (*citing* Section 1-183-2(a), Income Tax Regs.).

Therefore, on the record before us, we find that the Petitioners did not engage in the horse-related activity for profit. The facts and circumstances of this case do not indicate that the Petitioners entered into or continued the horse-related activity with the objective of making a profit. Sec. 1.183-2, Income Tax Regs. Therefore, no deduction attributable to such activity shall be allowed, pursuant to IRC § 183.

THEREFORE, the Notice of Deficiency Determination dated December 4, 2013, is hereby APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED that the petitioners pay the following tax, penalty, and interest (computed to November 30, 2016):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2010	\$2,517	\$126	\$542	\$3,185
2011	2,515	126	440	3,081
2012	5,090	764	703	<u>6,557</u>
			TOTAL DUE	<u>\$12,823</u>

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

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

DATED this ____ day of September, 2016.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of September, 2016, 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]

[Redacted]

[Redacted]

[Redacted]