

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 0-067-052-544
)	
Petitioners.)	DECISION
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The Intrastate Income Tax Bureau (Bureau) sent (Petitioners) a Notice of Deficiency Determination (Notice) for tax years 2020 through 2022. Petitioners protested, disagreeing with the Bureau’s determination that their farm activity was a not-for-profit activity. The Tax Commission has reviewed the matter and for the reasons stated below upholds the Notice issued by the Bureau.

BACKGROUND

Petitioners filed federal and Idaho income tax returns jointly for tax years 2020, 2021, and 2022. On each year’s federal return, they claimed a net loss on a Schedule F farming activity. Petitioners mainly raised cattle and pigs for auction sale. The Bureau selected these returns for review.

The Bureau sent Petitioners a letter requesting information regarding the farming activity reported on Schedule F for 2020, 2021, and 2022. Specifically, the Bureau asked for a completed Business Activity Analysis questionnaire, documentation for farming expenses, and depreciation schedules. Petitioners completed the questionnaire and provided receipts, depreciation schedules, and documentation regarding the expenses claimed on the returns previously mentioned.

The Bureau reviewed the documentation and questionnaire provided and sent Petitioners a Notice denying all claimed farming expenses based on Internal Revenue Code (IRC) section 183, “Activities not engaged in for profit.” Petitioners protested with a letter to the Bureau refuting the

points referenced in the Notice, insisting the farming activity was engaged in for profit. The Bureau acknowledged their protest and transferred the matter to the Tax Commission's Appeals Unit (Appeals).

Appeals sent Petitioners a letter outlining the available options for redetermining a protested Notice. Petitioners responded to the letter by requesting a telephonic informal hearing with Appeals. An informal hearing was conducted with Petitioners' representatives and Appeals where they discussed in depth the reasons for their protest. During the hearing, Petitioners admitted to ceasing the farming activity after the audit was conducted. The reasons for why the activity was abandoned were not entirely explained. The representatives simply stated they had a conversation with Petitioners about their feelings regarding the activity and they felt it was the appropriate time to liquidate. The hearing concluded, and Appeals sent Petitioners additional questions that their representatives could not answer during the hearing. The Tax Commission has reviewed the information available and hereby makes its decision on the following analysis.

LAW AND ANALYSIS

The Bureau analyzed the nine factors established by Treasury Regulation section 1.183-2(b) and used to distinguish between engaged in for profit and those not engaged in for profit.

These factors are:

1. The manner in which the taxpayer carries on the activity
2. The expertise of the taxpayer or his or her advisers
3. The time and effort expended by the taxpayer in carrying on the activity
4. The expectation that the assets used in the activity may appreciate
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. Elements of personal pleasure or recreation

If the gross income derived from the activity exceeds the deductions for expenses (i.e., if the activity results in a profit) in any three of five consecutive years, then the activity is presumed to be engaged in for profit. In this case, Petitioners do not meet the criteria for such a safe harbor presumption. Petitioners have been claiming farm losses for the past 14 years.

Each of the nine factors from *Treas. Reg. section 1.138-2(b)* are discussed in turn below.

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

If a taxpayer carries on an activity in a business-like manner, it may indicate that he is engaged in it for profit. Operating in a business-like manner can include maintaining complete and accurate books and records, carrying on in a manner similar to profitable activities that are comparable in nature, or changing operating methods, adopting new techniques, or abandoning unprofitable methods in a way that is consistent with an intent to improve profitability.

Petitioners claim this factor should be weighed favorably because they provided handwritten sheets that list the itemized income received and expenses incurred. Also, having a separate bank account for the operation is not a legal requirement by the IRS, only a recommendation.

In the Tax Commission's analysis of the documentation provided, it is clear Petitioners mix personal and business expenses. Petitioners did not keep mileage logs for their trucks claimed on the returns showing personal and business use. Under the "professional dues/fees" expense on their Schedule F, Petitioners claimed receipts associated with their W-2 wage job, not related to farming. Petitioners also admitted to not having a business plan, financial projections, or profitability analysis regarding the activity. Additionally, during the informal hearing, Appeals inquired as to why Petitioners would some years claim expenses regarding property tax and water and other years completely leave it out. Their representatives did not have a clear answer, only that they complete Petitioners' tax return with the information they are given. In review of the

information provided, the Tax Commission finds that Petitioners do not conduct the activity in a business-like manner. This factor weighs against a profit motive.

(2) The expertise of the taxpayer or his or her advisers

Preparing for an activity by studying accepted business, economic, and scientific practices (or consulting with experts therein) and carrying on the activity in accordance with those practices may indicate a profit motive. When a person has studied accepted practices or consulted with experts but does not conduct an activity following such guidelines, it may indicate lack of a profit motive.

Petitioners state they had sought out the advice of family and friends to start and develop the business. Additionally, they sought advice from a CPA regarding the reporting of the profits and expenses of the business. In the completed questionnaire, Petitioners argue their expertise comes from growing up on a dairy farm.

Petitioners' experience living on a farm should be considered. However, it is the Tax Commission's understanding that Petitioners lived on a dairy farm, which was not the activity they engaged in on their property. It is understandable that some aspects of raising cattle and dairy can be transferrable, but they are still different activities. While Petitioners do not show signs of absolutely no experience in cattle production, the explanation of their expertise is vague and limited. This factor doesn't weigh for or against a profit motive.

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

A person spending much of his or her personal time and effort carrying on an activity, especially one without significant personal or recreational aspects, may indicate that the activity is engaged in for profit. Likewise, if a person leaves another job to devote more time and effort to the activity, it may indicate the same. Spending limited time and effort on an activity does not

necessarily show a lack of profit motive when the taxpayer employs qualified, competent people to carry on the activity in his or her absence.

Petitioners claim they spend 500-750 hours a year devoted to the activity. They have paid their children to help with the daily tasks of operating the farm because of the time constraints of having full-time jobs. Their representative is quoted here in this section: “The fact that livestock is bought and sold each year is an indication that the taxpayer plans for such items and is not casual in his decisions regarding such items.”

Petitioners do not argue that having full-time off farm jobs limits the amount of time they can dedicate to the activity. While hiring their children can be a cheaper option for labor, they typically are inexperienced. 500-750 hours a year is around 9-15 hours a week on average. The number of hours dedicated to this activity is the definition of part-time work. This factor weighs against a profit motive.

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

The term “profit” can include appreciation in the value of assets, such as land, that are used in an activity. So, even though a person may not show periodic profits from the activity, there may be an expectation of an overall profit when the appreciated assets are sold.

Petitioners own 80 acres of pasture. According to research conducted by the USDA, the value of pastureland per acre has increased from \$1,610 in 2020 to \$1,700 in 2021 and \$1,970 in 2022. Petitioners also argue they have incurred costs in the form of seed and irrigation improvements to make the ground more fertile and desirable, thus increasing its value.

Petitioners have reported \$11,209 of income from the activity and \$125,873 in expenses resulting in \$114,664 in loss since 2009. While it is true that the sale of 80 acres of pastureland at current prices would eliminate all losses, it is not part of the business plan presented by Petitioners.

All they have presented is the potential value of the land if sold, not the planned intention of the sale. Such cases have been presented in the past, such as *Kaehn v. Commissioner TC Memo 1987-608*. In this case, Tax Court was not satisfied with the argument that the expectation of increased land value suggests a profit motive:

“We think that petitioners expected the property to increase in value but such an unsupported expectation is not sufficient to support a profit objective. Moreover, between 1970 and 1984, petitioners made no effort to determine whether that expectancy was bearing fruit. Finally, even if such an expectation existed, we are not satisfied that it should be considered a significant element in this case, where petitioners acquired the farm to live and work on—an objective obviously inconsistent with the ultimate sale of the property at a profit.”

As Petitioners showed no interest or expectation to ultimately sell the property any time in the future, it cannot be considered an indication of a profit motive. This factor doesn't weigh for or against a profit motive.

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

If a person has engaged in other activities and turned them from unprofitable to profitable in the past, this may indicate that he or she is engaged in the current activity for profit, even if it is not profitable at the moment.

Petitioners have not shown or argued this to be the case. Rather, Petitioners attempted to explain rising costs, inflation, and factors not in their control as reasons for long periods of losses. While these are relevant points of discussion in general, they are not relevant for this factor. Ultimately, Petitioners do not have successful experience in carrying out other similar or dissimilar activities. This factor weighs against a profit motive.

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

If a person incurs a series of losses during what would normally be considered a start-up period, it would not necessarily be indicative of an activity not engaged in for profit. If, however,

the losses continue beyond the initial timeframe typically needed to bring the activity to a profitable status, and those continuing losses are not explainable by normal business risks, it may indicate a lack of profit motive. Losses incurred because of unforeseen circumstances – such as disease, fire, theft, weather, etc. – are not indications that an activity is not engaged in for profit. A series of years where an activity results in net income would be strong evidence that it is engaged in for profit.

Petitioners argue that professional judgement was used in determining if the expenses were both ordinary and necessary. Increased costs for feed and supplies were outside of the control of the taxpayer.

Losses have been reported on Petitioners' tax returns for the past 14 years. Increased costs for feed, supplies, and inflation were only in the last few years and do not explain the losses in years prior. This amount of time is beyond the initial start-up phase of any business. There was one year in 2016 where the farm experienced a small profit, but otherwise the expenses greatly outweigh any income. This factor weighs against a profit motive.

(7) The amount of occasional profits, if any, which are earned

Periodic large profits – despite consistent, small losses – may be an indication that an activity is engaged in for profit. Even if the activity generates only losses or small profits, the opportunity for a large ultimate profit could indicate the same. Conversely, an occasional small profit interspersed with consistent losses may indicate that an activity is not engaged in for profit, especially if the person conducting the activity made substantial investments in capital or assets.

Petitioner has never experienced large profits or anticipated any opportunity for a large profit. They have however, experienced a small profit in 2016 interspersed with consistent losses. Additionally, there has been no evidence provided that Petitioners made substantial investments

in capital or assets in order to incur a large occasional profit. This factor weighs against a profit motive.

(8) The financial status of the taxpayer

If a person does not have another source of significant income or capital, it may be a sign that an activity is engaged in for profit. However, substantial income from other sources – especially if faced with losses from the activity that provides sizable tax benefits – may indicate that an activity is not engaged in for profit. This is particularly true if the activity involves personal or recreational elements.

Petitioners are working professionals with jobs off the farm. They reported wages of over \$100,000 in the years in question. It is apparent that the losses generated from the farm provided substantial tax benefits during the years in question. This factor weighs against a profit motive.

(9) Elements of personal pleasure or recreation

The presence of motives other than earning profit may indicate that an activity is not engaged in for profit, especially when the activity includes personal or recreational elements. Just because an activity has elements of personal satisfaction or recreation does not mean that it is not engaged in for profit. The lack of any personal motives beyond making a profit may indicate that an activity is engaged in for profit, but it is not necessary for an activity to be engaged in solely to earn a profit to rise to the level of “business” over “hobby.” There can be a mix of personal satisfaction or pleasure and profit motive. If other factors indicate profit motive, the elements of personal satisfaction may be downplayed.

During the informal hearing, Petitioners’ representatives insisted there was no element of personal pleasure due to the hard work of farming. While it is reasonable to recognize the hard work associated with farming, Petitioners state on the questionnaire that the main reason for

continuing the activity was for their kids, as it is a good activity for them. Working with animals, gardening, and working the land is obviously difficult, but it creates large amounts of personal satisfaction. Petitioners have also indicated that at least a portion of the 14 years in the activity, they would participate in 4-H and slaughter their animals for personal consumption. This factor weighs against a profit motive.

CONCLUSION

In review of all the nine factors set out in the IRC, the Tax Commission concludes that Petitioners have failed to substantiate a profit motive for their farming activity. Petitioners’ lack of business-like practices, hours spent on the activity, no success in similar or dissimilar activities, history of losses, substantial income from other sources, and elements of personal pleasure all indicate a not-for-profit activity.

THEREFORE, the Notice dated September 5, 2023, a directed to _____ is hereby UPHeld and MADE FINAL.

IT IS ORDERED that Petitioners pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2020	\$1,351	\$68	\$125	\$1,544
2021	2,080	104	149	2,333
2022	1,232	62	44	1,338
			TOTAL DUE	<u>\$5,215</u>

Interest is calculated through December 31, 2023.

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

DATED this _____ day of _____ 2024.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2024,
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:

Receipt No.
