

"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. 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) used to distinguish between activities 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 20 years.

Each of the nine factors from Treas. Reg. section 1.183-2(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 argue that the Bureau exceeded their scope of authority by claiming their efforts in marketing and revenue generation were unreasonable. They insist that the Bureau failed to objectively analyze all the facts and circumstances related to these criteria. Petitioners claim they never let their business become stagnant, trying new ways to become profitable year after year. This point was also echoed during the informal hearing. During the hearing, Petitioners mentioned recently they have been exploring ideas on how to reduce their feed costs, namely grazing their herd on private land during the warmer months. Additionally, Petitioners are currently looking into selling [REDACTED] [REDACTED] [REDACTED] [REDACTED] to diversify their revenue streams.

While the Tax Commission recognizes the attempts to reduce feed costs and diversify revenue streams, these activities appear to be recent additions to the business plan and not constant changes over the 20 years in question. Additionally, no financial projections for how much they would sell the [REDACTED] [REDACTED] [REDACTED] for or even if there is a market. While Petitioners are hopeful they would eventually become profitable, they provided no concrete projections for when that might happen or how they would get there.

Petitioners did not contest the Bureau's criticism of their record keeping. In the Notice, the Bureau stated that Petitioners needed extensions to provide the documentation requested and many of their spreadsheets included personal expenses with business expenses. Petitioners are also two

years behind on their income tax filings. While the audit only covered tax years 2017 through 2020, 2021 through 2023 will also report extreme losses. During the appeals process, Petitioners did not have their income to expense numbers available for 2022 and 2023. Reviewing all the facts at hand, Petitioners appear to not have carried out the activity in a business-like manner for the majority of the 20 years. 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.

The Bureau asserted that this factor weighs against a profit motive because they did not have direct experience in the business aspect of farming. The Bureau recognized Petitioners' extensive experience with animal science, but argued the expertise was academic in nature and did not transfer to the business world of farming. Petitioners refute this point, arguing that farming and animal science is their main expertise and list more than a full page of Petitioners' education, experience, professional affiliations, etc.

In the Notice, the Bureau listed Petitioners' qualifications:

- [REDACTED] - Born and raised on an [REDACTED] farm where she had extensive day to day, hands-on experience with food animals – predominantly cattle (dairy and beef), hogs, and poultry.
- [REDACTED] – Born and raised on [REDACTED] cattle ranch where he had extensive cattle experience.
- [REDACTED] – Acquired a degree in Ag Business with minors in Animal Science and Agronomy from [REDACTED]
- [REDACTED] - Managed an [REDACTED] farm for 22 years.
- [REDACTED] - handled and hauled livestock (predominantly cattle) for 21 years.

- [REDACTED] – Acquired a Bachelor of Science and Master of Science in Animal Sciences at [REDACTED]
- [REDACTED] - Doctor of Philosophy (PhD) in [REDACTED] Nutrition ([REDACTED] [REDACTED] and [REDACTED] are [REDACTED])
- [REDACTED] - Assistant and Associate Professor of Animal Nutrition at [REDACTED] – responsible for over 20 semesters of teaching [REDACTED] [REDACTED] [REDACTED] ([REDACTED] [REDACTED] for food animals as well as many other nutrition and husbandry classes. The final semester there (2016), she taught [REDACTED] Production Management.
- [REDACTED] - Multiple trips to [REDACTED] including an Ag tour focused on [REDACTED] [REDACTED] and then a Sabbatical.
- [REDACTED] - Serving as a Faculty Advisor for [REDACTED] students at [REDACTED] [REDACTED] in [REDACTED] where she taught the “[REDACTED]” approach to food animals focusing on [REDACTED]
- [REDACTED] - [REDACTED] [REDACTED] at the [REDACTED] [REDACTED] from 1991-2013 with primary emphasis on animal nutrition, husbandry and management. This included exotic species of dietary strategies including herbivores, carnivores and omnivores.

The Bureau argued that even though Petitioners obtained this experience, it was in pursuit of teaching rather than operating a farm. While it is true that Petitioners acquired this experience in pursuit of education, it is unreasonable to assume this experience cannot be applied in multiple contexts. It is clear that Petitioners’ education is extremely valuable to them in pursuit of this activity. In review of Petitioners’ expertise background laid out during the audit, the Tax Commission believes this factor weighs towards 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.

[REDACTED] is employed full-time at [REDACTED] [REDACTED] [REDACTED] and part-time at [REDACTED] [REDACTED] [REDACTED] as a professor. Due to over full-time employment for W-2 outside farm jobs, it is

not possible to attribute adequate amounts of time to sustain profitability on the farm. Petitioners admit to this during the informal hearing. They state that once [REDACTED] retires, she will have much more time to dedicate to the activity. Even though their outside employment restricts their time spent on the activity, they insist this factor should weigh favorably towards a profit motive. Petitioners argue that a significant amount of time is dedicated to the activity and they have hired assistance when available/necessary.

While Petitioners claim they hired assistance when necessary, records indicate most of this help was students that [REDACTED] taught. The Bureau argued that since these were students, it is assumed that they would need to work under supervision. The treasury regulation states that they should hire “competent people to carry on the activity in his or her absence” to be considered operating with a profit motive.

The Tax Commission recognizes that while Petitioners have full-time jobs outside of the activity, they credibly maintain they spend many hours towards the activity and performed much of the necessary and unpleasant labor themselves. In the treasury regulations however, the time and effort are somewhat discounted as a factor when the activity has substantial recreational aspects. In the case *Commissioner v. James L. Sullivan, et ux.*, *TC Memo 1998-367*, a horse farm, the tax court argued: “the unpleasant tasks associated with caring for horses are required regardless of whether the activity is pursued as a hobby or business.” Although the Tax Commission believes Petitioners put considerable amount of effort into the activity, this factor is not dispositive.

(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 argue this factor should be at the most neutral, as there is “nowhere in the regulations or case law is there an indication that lack of a taxpayer’s expectation that assets values will appreciate will weigh against the taxpayer.” This statement is incorrect. Many instances in case law have weighed against the taxpayer if they fail in this factor¹. While no one factor weighs disproportionately than any others, all factors must be taken into consideration. Petitioners have reported immense losses over the last 20 years. Without assets expecting to appreciate in value to potentially offset these losses, it again points towards a not-for-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.

It is recognized that █████ operated a successful trucking and hunting guide business in a prior marriage. Petitioners argue his experience operating a profitable business should be weighed positively towards a profit motive. Also, Petitioners believe that █████ success in her teaching career should also weigh positively.

The tax courts have stated that success in both similar and dissimilar activities can weigh towards a profit motive. However, the tax courts have consistently stated that taxpayers must demonstrate how the success in prior activities translate to the activity in question. For example, in the case *Charles M. Steiner v. Commissioner, TC Memo 2019-25*, while the taxpayer had past success in other business ventures, they failed to demonstrate how they used the past experience in the activity in question. The Tax Commission has reviewed the information available and believes Petitioners

¹ See in cases: *James C. Dodge, et ux. v. Commissioner, TC Memo 1998-89* and *Rodney W. Taras, et ux. v. Commissioner, TC Memo 1997-553*

have also failed to demonstrate how they have used the experience in successful dissimilar activities in the activity in question. Additionally, ██████ “success” in her academic career does not necessarily translate into a successful sole proprietor business venture. Success in W-2 employment is vastly different than success in running your own business. 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 admit that in the history of the activity, they have never made a profit. However, they argue this was not due to a lack of trying. They argue that moving to a different state in 2017, COVID-19, and disease in their ██████ contributed to the consistent losses. The Tax Commission does not have access to all of Petitioners’ tax returns while they participated in the activity. However, during the years 2013 through 2020, Petitioners have reported \$267,847 in gross income and \$1,299,180 in total expenses, resulting in a net loss of \$1,031,333. Analyzing their income and expenses further, Petitioners’ expenses exceeded five times their gross income on average. Additionally, there were no years reported where their income could even cover their feed costs. The tax courts have been more understanding of consistent losses if a large majority of the

operating expenses can be covered by the income generated by the activity. This is not the case for Petitioners. In every year evaluated, a considerable amount of outside income had to be contributed in order for the activity to continue operating. 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.

Petitioners have not demonstrated success in any of the examples laid out in treasury regulations for this factor. They have never had a profit, let alone a large profit despite consistent losses. Their losses also have not been small, as stated in the previous section. Additionally, the opportunity of an eventual large profit was never cited or expected. Petitioners have recognized these facts but insist that because they have invested a large portion of their net worth into the activity, it should weigh favorably towards a profit motive.

The tax courts have consistently weighed against a profit motive when expenses and income have large disparities². When large investments for an activity is cited in tax court, it usually is referring to depreciation expense. When analyzing Petitioners' tax returns, most of the expenses are operational rather than depreciation of large investments. This factor weighs against a profit motive.

² See in cases: *Deborah Joyce Windisch v. Commissioner, TC Memo 1996-369* and *Melissa S. Spranger v. Commissioner, TC Memo 1999-93*

(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 have significant income from other sources and the losses from the activity have provided significant tax benefits. For tax years 2017 through 2020, Petitioners have reported the following income and losses:

- 2017 wages of \$85,070, retirement of \$374,319, royalty income of \$101, and Schedule C income of \$5,778. Losses of \$171,112 on Schedule F.
- 2018 wages of \$109,606, interest of \$1,012, retirement of \$47,063, royalty income of \$194, and Schedule C income of \$56,713. Losses of \$150,966 on Schedule F.
- 2019 wages of \$92,283, interest of \$1,954, royalty income of \$317, and Schedule C income of \$35,531. Losses of \$112,985 on Schedule F.

Losses from the activity from 2017 through 2020 total \$435,063. This resulted in a tax benefit of \$25,233 for Idaho alone. Based on the limited information available, it is clear Petitioners benefited from tax reduction through this activity. 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.

Through Petitioners' correspondence during the audit and appeals process, it is clear that Petitioners are passionate about raising [REDACTED]. The treasury regulations state that if other factors indicate a profit motive, this factor may be downplayed. Unfortunately, most of the nine factors do not indicate a profit motive. During the informal hearing, it was made clear that Petitioners' main objective for continuing the farming activity was to educate the youth. While this is a commendable goal and objective, this behavior does not indicate a profit motive. This appears to be the main reason for continuing such an unprofitable activity for so many years. When asked if Petitioners knew of any other [REDACTED] operations that were profitable, they indicated that "most everyone are having the same problems we are." The response appeared to be apathetic towards a profit expectation or an afterthought. This factor weighs against a profit motive.

CONCLUSION

Petitioners have been operating a [REDACTED] activity for 20 years. During those years, Petitioners have never made a profit. From the outset, Petitioners may have intended and continue to believe the activity can be profitable. However, based on the information available, the Tax Commission does not believe Petitioners operated the activity in a manner where profit was the motive. This conclusion primarily was derived from the recordkeeping, consistent and substantial losses, income from other sources, and strong recreational components of the activity. The Tax Commission is not convinced that Petitioners operated the activity with a profit motive.

THEREFORE, the Tax Commission AFFIRMS the Bureau's determination that Petitioners' [REDACTED] activity was not-for-profit.

The Bureau added interest and penalty to Petitioners' tax deficiency. The Tax Commission reviewed those additions and finds them to be appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046, respectively.

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>
2017	\$17,372	\$2,606	\$4,066	\$24,044
2018	11,581	1,737	2,214	15,532
2019	7,632	1,145	1,048	9,825
2020	6,335	950	684	<u>7,969</u>
			TOTAL:	\$57,370

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.



