RICHARD E. & SUE S. CRIBBS 1059 10TH STREET PLEASANT GROVE, AL 35127-2230,	§	STATE OF ALABAMA ALABAMA TAX TRIBUNAL DOCKET NO. INC. 15-529
Taxpayers,	§	
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Richard E. and Sue S. Cribbs (together "Taxpayers") for 2010 and 2011 Alabama income tax. The Taxpayers appealed to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on October 20, 2015. The Taxpayers and their attorney, Sam McCord, attended the hearing. Assistant Counsel Margaret McNeill represented the Revenue Department.

The Taxpayers lived in Gardendale, Alabama during the years in issue. Richard Cribbs (individually "Taxpayer") worked in the Birmingham, Alabama area until the late 1990's, when he retired.

The Taxpayer and another individual purchased approximately 1,800 acres in Wilcox County, Alabama in 1988. The Taxpayer explained at the October 20 hearing that he and the co-owner intended to grow timber and hunt deer on the property. The Taxpayer and the co-owner subsequently divided the property, with the Taxpayer getting 747 fenced-in acres and the rest going to the co-owner.

The Taxpayer began genetically engineering the deer on his 747 acres in the late 1990's or early 2000's. In 2005, the Taxpayer started Mossy Oak Commercial Hunting. He testified that his intent at the time was to genetically engineer large trophy deer that individuals would pay to hunt and kill.

The Taxpayer has four small two and one-half acre pens on the property where he keeps the genetically engineered deer that have been bred. Each deer born on the property must be given a Department of Conservation-required birth certificate. The Taxpayer obtained an Alabama game breeder's license from the Conservation Department, and during the years in issue, followed that Department's guidelines concerning the tagging of his newly-born deer, health inspections, etc. Specifically, when a deer is released into the general deer population on the 747 acres, the Taxpayer must notify Conservation and provide the deer's birth certificate. If a deer dies naturally, the Taxpayer must send the head to the Conservation lab in Montgomery so that it can be tested for various diseases. The Conservation Department visits the farm twice a year to count and check on the deer, the condition of the farm, etc.

As indicated, the Taxpayer has been retired since the late 1990's. Since at least 2005, he has worked almost full-time at maintaining his farm and raising/caring for his deer herd. He generally travels 130 miles from his home in Gardendale to his farm in Wilcox County early Wednesday, and back the 130 miles to Gardendale on Sunday evening.

The Taxpayer had less than ten deer on his farm when he started Mossy Oak in 2005. He now has approximately 100 whitetail deer, 50 red deer, and approximately 50 axis or fowler deer in total on the property. He also owns and cares for approximately 50 buffalo.

The farm includes a house where the Taxpayer's customers stay during a hunt. The Taxpayer personally cooks breakfast, lunch, and dinner for the customers. Customers are required to pay a non-redeemable $500 booking fee. They thereafter pay for each animal they kill. During the years in issue, customers paid $2,000 for each deer they killed, and

$3,500 for each buffalo. The Taxpayer indicated that his prices will go up as the quality and size of his deer increases over time.

The Taxpayers' children and grandchildren hunted on the farm four times total during the two years in issue. They were allowed to shoot only "cull deer," which are inferior deer that a paying customer would not want to shoot.

The Taxpayer has kept detailed records since 2005 concerning the expenditures incurred on the farm. Specifically, he has 64 accounting codes that he uses for the different type expenses he incurs on the farm. He also has organized canceled checks concerning the expenses.

The Taxpayers reported income from the hunting activity of $9,952 and $20,240 on their 2011 and 2012 Alabama returns, respectively. They also reported net losses of $45,897 and $59,846 from the activity in those years. The Department audited the Taxpayers and disallowed the losses because it determined that the activity was not entered into for profit. Important factors in that finding were the Department examiner's understanding that the Taxpayer's family primarily hunted on the property, and that the Taxpayer stated to her that he did not intend to make a profit on the activity. This appeal followed.

Code of Ala. 1975, §40-18-15(a)(1) allows a deduction for all ordinary and necessary expenses incurred in a trade or business. That deduction is modeled after its federal counterpart, 26 U.S.C. §162. Consequently, federal case law interpreting the federal statute should be followed in interpreting the similar Alabama statute. *Best v. Dept. of Revenue*, 417 So.2d 197 (Ala. Civ. App. 1981).

The general test for whether a taxpayer is engaged in a "trade or business," and thus entitled to deduct all ordinary and necessary business expenses, is "whether the taxpayer's primary purpose and intention in engaging in the activity is to make a profit." *State of Alabama v. Dawson*, 504 So.2d 312, 313 (Ala. Civ. App. 1987), quoting *Zell v. Commissioner of Revenue*, 763 F.2d 1139, 1142 (10th Cir. 1985). To be deductible, the activity must be engaged in "with a good faith expectation of making a profit." *Zell*, 763 F.2d at 1142. As stated by the U.S. Supreme Court – "We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify." *Commissioner v. Groetzinger*, 107 S. Ct. 980, 987 (1987). Whether the taxpayer had an intent to make a profit must be determined on a case-by-case basis from all facts and circumstances. *Patterson v. U.S.*, 459 F.2d 487 (1972).

The Revenue Department's Administrative Law Division, now the Tax Tribunal, has decided numerous cases involving the issue of whether an activity was entered into for profit. In *Blankenship v. State of Alabama*, Docket Inc. 06-1215 (Admin. Law Div. O.P.O. 10/16/2007), the Division explained the criteria to be applied in deciding the issue.

> The general test for whether a taxpayer is engaged in a "trade or business," and thus entitled to deduct all ordinary and necessary business expenses, is "whether the taxpayer's primary purpose and intention in engaging in the activity is to make a profit." *State of Alabama v. Dawson*, 504 So.2d 312, 313 (Ala. Civ. App. 1987), quoting *Zell v. Commissioner of Revenue*, 763 F.2d 1139, 1142 (10th Cir. 1985). To be deductible, the activity must be engaged in "with a good faith expectation of making a profit." *Zell*, 763 F.2d at 1142. As stated by the U.S. Supreme Court – "We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose

> for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify." *Commissioner v. Groetzinger*, 107 S. Ct. 980, 987 (1987). But a taxpayer's expectation of a profit need not be reasonable. Rather, the taxpayer must only have a good faith expectation of realizing an eventual profit. *Allen v. Commissioner*, 72 T.C. 28, 33 (1979). Whether the taxpayer had an intent to make a profit must be determined on a case-by-case basis from all the circumstances. *Patterson v. U.S.*, 459 F.2d 487 (1972).
> Treas. Reg. §1.183-2 specifies nine factors that should be considered in determining if an activity was entered into for profit.
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> Factor (1). The manner in which the taxpayer conducted the activity.
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> Factor (2). The expertise of the taxpayer in carrying on the activity.
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> Factor (3). The time and effort exerted by the taxpayer in conducting the activity.
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> Factor (4). The expectation that the assets used in the activity will appreciate.
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> Factor (5). The taxpayer's success in similar or related activities.
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> Factors (6) and (7). The taxpayer's history of profits and losses, and the amounts of any occasional profits.
>
> Factor (8). The taxpayer's financial status.
>
> Factor (9). The activity was for the taxpayer's personal pleasure and recreation.

Blankenship at 3 – 4.

"Hobby loss" cases are almost always difficult to decide because in most cases some of the above nine factors will indicate that the activity was for profit, while other factors will suggest that it was a hobby. Even if the activity was a hobby, the taxpayer would still want to profit from the activity, if possible. Conversely, taking pride in and enjoying a business activity does not make the activity a hobby. "A person can obviously take pride in a profit-motivated venture." *Blankenship*, supra at 6.

This case is also difficult because, once again, some of the nine factors support the Taxpayers' position, and some support the Department.

The first three factors favor the Taxpayers. The Taxpayer has always kept complete and detailed books and records concerning the activity in a businesslike manner. He also keeps detailed records concerning the breeding of his deer, which he shares with the Department of Conservation. He has also gained an expertise as to how to breed the deer. He works on the farm at least four days a week feeding the animals, doing chores, mending fences, and otherwise maintaining the farm. That is, he spends considerable time and effort to make the activity successful, and thus profitable.

The equipment the Taxpayer uses to operate the farm will not appreciate, but the deer, which are the primary "assets" of the activity, will appreciate in value in time as the Taxpayer is able to produce larger deer with prized racks. Factor four thus also supports the Taxpayers.

Factor five is neutral because the Taxpayer had not previously conducted a similar or related activity. He has, however, always been successful at his other businesses.

> A. I've made money in every business I ever started and went into, and I didn't go into this one – if I went into it to be a gentleman farmer, I'm a sure enough dumb man sitting right here in Alabama.
>
> Q. And did you reasonably expect that you're going to be profitable.
>
> A. Yes.

(T. 65 – 66).

Factors six and seven clearly favor the Department because the Taxpayers lost money in the venture from when they started in 2005 through the years in issue. But a primary reason for the losses was that the Taxpayers incurred one-time, up-front costs

buying equipment and otherwise getting the venture started. The Taxpayers also reported a profit from the business in 2014, which shows that the Taxpayers may have turned the financial corner in the activity.

Factor eight is problematic because there is no evidence showing the Taxpayers' overall financial condition. The Taxpayer did testify, however, that he has had to borrow money on occasion to pay the farm-related expenses.

Factor nine is probably mixed. The Taxpayer enjoys hunting, but it appears that the Taxpayer does little or no hunting on his property, and when he does hunt, he does not kill the large, multi-tined bucks that he has raised for his paying customers. As stated above, the Taxpayer testified that "if I went into it to be a gentleman farmer, I'm a sure enough dumb man sitting here in Alabama." And caring for the land and animals appears to be an onerous, full-time job that would not qualify as a relaxing hobby.

As indicated, the examiner's decision to find that the activity was not entered into for profit was her understanding that the Taxpayer's family members were the ones that primarily hunted on the farm, and that the Taxpayer indicated that he did not intend to profit from the activity. The Taxpayer testified, however, that his family hunted only four times on the farm for cull deer during the two years in issue, and that he never indicated that he did not intend to profit from the activity. The examiner did not testify.

When viewed together, the above factors show that the Taxpayer entered into the activity for profit. The well-documented farm-related expenses claimed by the Taxpayers in the subject years should be allowed. The Department should recompute the Taxpayers' liabilities accordingly and notify the Tax Tribunal of the adjusted amount due. A Final Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2B-2(m).

Entered February 18, 2016.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Warren W. Young, Esq.
Samuel R. McCord, Esq.