CHARLES C. WHATLEY 2202 Old Columbus Road Tuskegee, AL 36083,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. INC. 02-908
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Charles C. Whatley ("Taxpayer") for 1997 Alabama income tax. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on April 24, 2003. CPA William Cox represented the Taxpayer. Assistant Counsel Jeff Patterson represented the Department.

The issue in this case is whether the Taxpayer was in the trade or business of farming from 1988 through 1996. If so, the losses he incurred in those years can be carried over as a net operating loss ("NOL") to the year in issue, 1997.

The Taxpayer is 78 years old. He has lived on a farm in Macon County, Alabama all of his life. The farm currently consists of approximately 1,640 acres. Over one-half of the farm is timberland. The rest is pastureland. The Taxpayer's family has lived on and farmed the land since the mid-1800s. The Taxpayer began farming on the property after he graduated from high school in 1943.

The Taxpayer initially grew crops and raised cattle on the farm. He quit crop farming in 1988 because he consistently lost money. He continued raising cattle on the farm until 1998, when he sold his remaining herd because he was also losing money in the cattle business. The Taxpayer has since sold some timber off his property, but has primarily lived

on his monthly social security checks.

The Taxpayer was not required to file Alabama income tax returns from 1988 through 1996 because he did not have income sufficient to require him to file returns in those years. He had sufficient income in 1997, and thus filed an Alabama return in that year.

In preparing the 1997 return, the Taxpayer's niece, who is an accountant, discovered that the Taxpayer probably had farm losses from 1988 through 1996 that he could carryforward to offset his 1997 income. Consequently, to establish the amount of the losses, she prepared and filed Alabama returns for the Taxpayer for 1988 through 1996 based on his federal returns filed in those years. The Department rejected the Taxpayer's carryover of the prior years' losses to 1997, arguing that his farming activities did not constitute a trade or business. The Taxpayer appealed.

Individuals may carry a net operating loss back two years and forward fifteen years. Code of Ala. 1975, §40-18-15.2. However, deductions not attributable to a trade or business, i.e. nonbusiness deductions, can only be applied to offset nonbusiness income in the year incurred. Section 40-18-15.2(5)(c). Consequently, the Taxpayer in this case can carryover his losses from prior years to 1997 only if he was in the trade or business of farming.

Alabama's NOL deduction is modeled after its federal counterpart at 26 U.S.C. §172. In such cases, federal case law and authority are controlling for Alabama purposes. *Best v. State, Dept. of Revenue*, 417 So.2d 197 (Ala.Civ.App. 1981).

An activity is considered a trade or business if the taxpayer entered into the activity

for profit. “The general test for whether the taxpayer is engaged in a ‘trade or business’ . . . 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, citing *Zell v. Comm. of Internal Revenue*, 763 F.2d 1139, 1142 (10th Cir. 1985). Conversely, nonbusiness “hobby losses” cannot be considered for NOL purposes. See, 26 U.S.C. §183. All facts and circumstances surrounding the activity must be considered in determining if the activity was entered into for profit.

The Taxpayer began farming full-time in 1943. He quit crop farming in the late 1980s because crop prices were depressed and he continued losing money. Likewise, he stopped cattle farming in 1998 because of the depressed cattle market. The fact that he quit raising crops and cattle because he could not make a profit confirms that his primary intent in farming was to make a profit. The fact that the Taxpayer had no other source of income other than farming also shows that his farming activities were not a hobby. A person generally does not rely on a hobby for income to survive.

IRC Reg. §1.183-2 addresses the issue of whether an activity is engaged in for profit. Example (4) in the regulation is analogous to this case.

In the regulation, a taxpayer inherits a family farm from his parents. He continues to operate the farm just as his parents did, and in the same general manner as other farms in the area. The taxpayer’s farm and most other farms in the area had not been profitable for the past 15 years because of rising costs and a decline in farm prices. The regulation concludes that the taxpayer’s farming activities were entered into for profit.

Likewise, the Taxpayer’s farming activities in this case also were engaged in for profit. That finding is supported by the fact that the taxpayer in the above example was

deemed to be in the farming business, even though he had another full-time job from which he earned money to live on. As indicated, the Taxpayer's sole income producing activity was farming, which he primarily depended on to make a living.

The Department does not otherwise dispute that the Taxpayer incurred losses from 1988 through 1996. Consequently, the 1997 final assessment in issue is voided.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered June 13, 2003.