

## ALABAMA TAX TRIBUNAL

FRANK R. & HAZEL WILLIS,	§	
Taxpayers,	§	DOCKET NO. INC. 19-1003-JP
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

### FINAL ORDER

This appeal involves a 2016 final assessment of individual income tax. A hearing was conducted on February 25, 2020. Wade Cahela represented the Taxpayers, but the Taxpayers did not attend the hearing. Assistant Counsel Keith Maddox represented the Alabama Department of Revenue and examiner Michael Adams testified on behalf of the Revenue Department.

#### Issue

Did the Taxpayers engage in their cattle-farming activities with the objective of making a profit, or did they carry on those activities primarily as a hobby?

#### Facts

On their 2016 Alabama income tax return, the Taxpayers claimed certain expenses, including depreciation, on Schedule F relating to their cattle-farming activities. The Revenue Department took the position, however, that the Taxpayers were not operating the farm primarily with a profit motive. Therefore, the Revenue Department allowed the documented expenses only to the extent necessary to offset farm income and disallowed the remainder of the claimed expenses. This disallowance, and the disallowance of some Schedule A deductions that are not disputed, resulted in the final assessment in issue.

### Analysis

Over the past 35 years, the Tax Tribunal and its predecessor, the Revenue Department's Administrative Law Division ("ALD"), have been called upon on numerous times to decide whether a taxpayer engaged in an activity primarily as a hobby or for profit. Simply put, a taxpayer is allowed to deduct certain expenses incurred in connection with an activity that is engaged in for profit, but is not allowed to deduct expenses associated with an activity engaged in as a hobby or sport or for recreation, except to offset the amount of income from that activity. Of course, any claimed expenses must be documented.

The ALD explained the criteria as follows:

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.

Factor (1). The manner in which the taxpayer conducted the activity.

Factor (2). The expertise of the taxpayer in carrying on the activity.

Factor (3). The time and effort exerted by the taxpayer in conducting the activity.

Factor (4). The expectation that the assets used in the activity will appreciate.

Factor (5). The taxpayer's success in similar or related activities.

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). [Elements of] personal pleasure [or] recreation.

*Blankenship v. State of Alabama*, No. INC. 06-1215 (Admin. Law Div. O.P.O. 10/16/07), at pp. 3 – 4.

Here, Mr. Adams testified that the Taxpayers did not have a separate farm bank account. Instead, the income from the farm was commingled with the Taxpayers' other income in their personal account. They maintained no general accounting ledgers and had no single-entry accounting system. Also, they did not maintain any records concerning their brood stock.

Both Taxpayers worked full-time in 2016 outside of their cattle-farming activities and had significant combined gross income from those jobs. And, for years 2005 through 2017, the Taxpayers reported a net loss for each year from their cattle-farming activities and never reported a profit for any of those years.

A final assessment on appeal is prima facie correct, and the burden is on a taxpayer to prove that the assessment is incorrect. Ala. Code § 40-7A-7(b)(5)c.3. As stated, the Taxpayers did not attend the February 25 hearing. They failed to present any evidence that their cattle business was for-profit and that the expenses should be allowed.

The 2016 final assessment is affirmed. Judgment is entered against the Taxpayers for \$2,286.87. Additional interest is also due from the date the final assessment was entered on July 23, 2019.

This Final Order may be appealed to circuit court within 30 days, pursuant to Ala. Code § 40-2B-2(m).

Entered February 27, 2020.

*/s/ Jeff Patterson*

JEFF PATTERSON

Chief Judge

Alabama Tax Tribunal

jp:dr

cc: Wade Cahela  
Frank & Hazel Willis  
Keith Maddox, Esq.