MICHAEL E. & ANITA FLYNN 443 SWEETGUM ROAD IDER, AL 35981,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 06-600
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Michael E. and Anita Flynn ("Taxpayers") for 2003 and 2004 income tax. The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on September 8, 2006. The Taxpayers and their tax preparer, Wanda Spillman, attended the hearing. Assistant Counsel Wade Hope represented the Department.

ISSUE

The Taxpayers deducted various fishing-related expenses on their 2003 and 2004 Alabama income tax returns. The issue in this case is whether the expenses were deductible as ordinary and necessary expenses incurred by the Taxpayers in a "trade or business." Code of Ala. 1975, §40-18-15(a)(1).

FACTS

Michael Flynn was employed full-time as a mechanic during the years in issue. Anita Flynn worked full-time as a medical assistant at a hospital. The couple are avid fishermen.

Michael Flynn began fishing in local tournaments in Northeast Alabama in the 1980's. He also operated a fishing guide service a couple of days a week on his off days. He and a friend fished in tournaments in North Alabama and surrounding states until the

early 1990's. The Taxpayers started fishing tournaments together at that time.

The Taxpayers fished in approximately 15 tournaments a year during the two years in issue. They maintained receipts for their gas, food, and other expenses incurred when fishing a tournament. They also maintained a log in which they recorded their fishing activities, i.e., where they fished, the weather, what they fished with, what they caught, etc.

The Taxpayers reported losses on their Alabama returns during the subject years, and for at least the eight years before the years in issue. In 2003 and 2004, they reported income of $10,300 and $1,245, respectively, and expenses of $37,738 and $27,388, respectively. The 2003 income included a $10,000 prize Anita Flynn won in a tournament in North Alabama in the Spring of that year.

The Department audited the Taxpayers for 2003 and 2004 income tax and determined that their fishing-related expenses claimed in those years could not be deducted because the activity was not a business, i.e., was not entered into for profit. The Department examiner concluded that the Taxpayers were not in the fishing business primarily because they had reported substantial losses from the activity in the subject years and also in the prior eight years.[1]

ANALYSIS

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.*

[1] The examiner also disallowed a few Schedule A deductions, which the Taxpayers do not dispute.

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 the circumstances. *Patterson v. U.S.*, 459 F.2d 487 (1972).

Whether the Taxpayers in this case can deduct their fishing-related expenses turns on whether the activity was engaged in for profit. The criteria for determining if an activity is engaged in for profit was discussed in *State v. Lipscomb*, Inc. 92-288 (Admin. Law Div. O.P.O. 3/24/93), as follows:

> An expense can be deducted if the primary purpose for the activity was to make a profit. State, Department of Revenue v. Dawson, 504 So.2d 312, at pg. 313, and federal cases cited therein. The test is whether, from an objective review of all circumstances, the Taxpayer acted with a good faith expectation of making a profit. Dawson, supra, at pg. 313, citing Zell v. CIR, 763 F.2d 1139, at pg. 1142.

> Treas. Reg. §1.183-2(b) sets out a nonexclusive list of nine objective factors to be considered in determining whether an activity is "for profit." Those factors are:
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> (1) The manner in which the taxpayer carries on the activity;
> (2) The expertise of the taxpayer or his advisor;
> (3) The time and effort expended by the taxpayer in carrying on the activity;
> (4) Expectation that assets used in the activity may appreciate in value;
> (5) The success of the taxpayer in carrying on other similar activities;
> (6) The taxpayer's history of income or losses with respect to the activity;
> (7) The amount of occasional profits earned, if any;
> (8) The financial status of the taxpayer; and
> (9) Elements of personal pleasure or recreation.

Lipscomb, Inc. 92-288 at 6.

This is a close and difficult case because the Taxpayers testified openly and honestly at the September 8 hearing about their fishing activities. They also in good faith relied on the advice of their reputable tax preparer when they deducted the fishing-related expenses in issue. Objectively viewing the facts, however, I must find that the Taxpayers' tournament fishing activities were not conducted for the primary purpose of making a profit.

The Taxpayers did keep records of their fishing-related expenses. They are also apparently expert fishermen and spent considerable time competing in tournaments. Those factors tend to indicate that the Taxpayers were operating a business. See, Treas. Reg. §1.183-2(b)(1), (2), and (3). However, the other factors in Reg. §1.183-2 indicate that the Taxpayers should not have reasonably expected to make a profit from their fishing activities.

The assets used by the Taxpayers in the activity, i.e., boats, trailers, vehicles, supplies, etc., certainly did not appreciate in value. The Taxpayers had some limited

success and earned some occasional prize money, but they never realized an overall profit from the activity in any year. The fact that the Taxpayers reported substantial losses from the activity for ten straight years, including the two years in issue, strongly indicates that the activity was not entered into with the reasonable expectation of profit.

The Taxpayers clearly enjoyed and derived personal pleasure from fishing in tournaments. A person can, of course, enjoy his or her chosen profession or job and still be engaged in business. Full-time professional fishermen must surely enjoy their work. But if the individual is otherwise employed full-time, as in this case, the personal enjoyment derived from a part-time recreation or leisure activity such as fishing must be considered.

The facts indicate that the Taxpayers fished in tournaments primarily because they enjoyed fishing and the competition. They clearly took pride in doing well in the tournaments. They were also certainly motivated by the prize money offered, but the money was not their primary motivation. No reasonable person would continue to engage in an activity primarily for the money if they had lost money in the venture for ten straight years. In short, the Taxpayers are no different from the hundreds of other amateur but skilled fishermen in Alabama that regularly fish in organized bass tournaments.

The Department assessed the Taxpayers for a negligence penalty in each year. Those penalties are waived for cause under the circumstances. The final assessments, less the penalties, are affirmed. Judgment is entered against the Taxpayers for 2003 tax and interest of $1,515.94, and 2004 tax and interest of $16.17. Additional interest is also due from the date the final assessments were entered, May 26, 2006.

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

Entered March 22, 2007.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: J. Wade Hope, Esq.
Michael Flynn
Tony Griggs