BRADLEY A. & MARY JO CORL 1216 CAMELLIA WOODS COURT PRATTVILLE, AL 36067-2724,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 08-377
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Bradley A. and Mary Jo Corl ("Taxpayers") for 2004, 2005, and 2006 Alabama 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 August 13, 2008. The Taxpayers were notified of the hearing by certified mail, but failed to appear. Assistant Counsel Keith Maddox represented the Department.

The Taxpayers claimed Schedule A and Schedule C expenses on their Alabama returns for the subject years. The Schedule C expenses related to an embroidery business and a horse breeding operation.

The Department audited the Taxpayers for the subject years and requested records verifying the claimed expenses. The Taxpayers submitted some records. The Department examiner allowed the Schedule A and embroidery business deductions that were verified, but disallowed those that were not. The examiner also determined that the Taxpayers' horse breeding activity was not a business, i.e., was not entered into for profit. Those expenses were consequently disallowed.

Deductions are a matter of legislative grace, and the burden is on a taxpayer to maintain records showing that a deduction should be allowed. *Hentges v. C.I.R.*, T.C.

Memo. 1998-244 (U.S. Tax Ct., 1998). If a taxpayer fails to verify a deduction with complete and accurate records, the deduction must be disallowed. *McDonald v. C.I.R.*, 114 F.3d 1194 (1997); *Jones v. C.I.R.*, 903 F.2d 1301 (1990); *Doyal v. C.I.R.*, 616 F.2d 1191 (1980). The examiner in this case thus correctly disallowed the Schedule A and embroidery-related deductions for which the Taxpayers failed to provide verifying records.

The burden was also on the Taxpayers to establish that their horse breeding activities constituted a trade or business or was entered into for profit. Code of Ala. 1975, §40-18-15(a)(1).

Section 40-18-15(a)(1) allows a deduction for all ordinary and necessary expenses incurred in a trade or business. Section 40-18-15(a)(5) also allows a deduction for nonbusiness losses incurred in a transaction entered into for profit. Both statutes are modeled after their federal counterparts, 26 U.S.C. §§162 and 212, respectively. Consequently, federal case law interpreting the federal statutes should be followed in interpreting the similar Alabama statutes. *Best v. Dept. of Revenue*, 417 So.2d 197 (Ala. Civ. App. 1981).

In *Engdahl v. Commissioner of Internal Revenue*, 72 T.C. 659, 1979 WL 3705 (U.S. Tax Ct. 1980), the U.S. Tax Court addressed the issue of whether the taxpayer's horse breeding activities constituted a trade of business. The Tax Court opined as follows:

> Breeding and raising horses for sale may constitute a trade or business for purposes of section 162. *Commissioner v. Widener*, 33 F.2d 833 (3d Cir. 1929). Whether it does or not, depends on whether petitioners engaged in the venture with the predominant purpose and intention of making a profit. *Allen v. Commissioner*, 72 T.C. 28 (1979); *Dunn v. Commissioner*, 70 T.C. 715, 720 (1978); *Churchman v. Commissioner*, 68 T.C. 696, 701 (1977);

> *Jasionowski v. Commissioner*, 66 T.C. 312, 319 (1976); *Benz v. Commissioner*, 63 T.C. 375, 383 (1974). Petitioners' expectation of profit need not be reasonable, but petitioners must establish that they continued their activities with a bona fide intention and good-faith expectation of making a profit. Sec. 1.183-2(a), *Allen v. Commissioner*, *supra* at 33; *Jasionowski v. Commissioner*, *supra* at 321; *Benz v. Commissioner*, *supra* at 383; *Bessenyey v. Commissioner*, 45 T.C. 261 (1965), aff'd. 379 F.2d 252 (2d Cir. 1967). Section 1.183-2(b), Income Tax Regs., lists some of the relevant factors to be considered in determining whether an activity is engaged in for profit. These factors include: (1) The manner in which the taxpayer carried on the activity; (2) the expertise of the taxpayer or his advisers; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or loss with respect to the activity; (7) the amount of occasional profit, if any, which is earned; (8) the financial status of the taxpayer; and (9) whether elements of personal pleasure or recreation are involved.
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> The issue is one of fact to be resolved not on the basis of any one factor but on the basis of all the facts and circumstances. Sec. 1.183-2(b), Income Tax Regs.; *Allen v. Commissioner*, *supra* at 34. See *Boyer v. Commissioner*, 69 T.C. 521 (1977), on appeal (7th Cir., July 7, 1978). Greater weight is to be given to objective facts than to petitioners' mere statement of their intent. Sect. 1.183-2(a), Income Tax Regs.; *Churchman v. Commissioner*, *supra* at 701.

Engdahl 72 T.C. at 665, 666.

Applying the nine factors listed in Reg. 1.183-2(b), the Tax Court concluded in *Engdahl* that the taxpayers intended to derive a profit from their horse-related activities. The related expenses were thus allowed.

Unlike *Engdahl*, the Taxpayers in this case have failed to establish an intent to make a profit from their horse breeding activities. The Taxpayers have claimed over $192,000 in horse breeding-related expenses since 2001. They have failed, however, to report any income from the activity in those years. That is strong evidence that the activity is not a business or for profit. The Taxpayers also failed to maintain complete records relating to the activity. Based on those facts, and the Taxpayers' failure to

attend the August 13 hearing or otherwise present evidence that the activity was entered into for profit, I must find that the activity was a hobby. The related expenses were thus correctly disallowed.

The final assessments are affirmed. Judgment is entered against the Taxpayers for 2004 tax, penalty, and interest of $3,178.21; 2005 tax, penalty, and interest of $3,194.18; and 2006 tax, penalty, and interest of $599. Additional interest is also due from the date the final assessments were entered, March 25, 2008.

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

Entered August 18, 2008.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Keith Maddox, Esq.
Mary Jo Corl
Tony Griggs