STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 88-161
ELIZABETH C. HUTCHINSON P.O. Box 2483 Opelika, AL 36803-2483,	§	
Taxpayer.	§	

ORDER

The Revenue Department assessed income tax against Elizabeth C. Hutchinson ("Taxpayer") for the calendar year 1985. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on September 29, 1988. The Taxpayer's representative, Mr. Jimmy A. LaFoy, was notified of the hearing by certified mail on August 29, 1988. However, the Taxpayer failed to appear at the time and location set for the hearing. The hearing proceeded, with assistant counsel Sam Clenney representing the Department. Based on the evidence presented by the Department, the following findings of fact and conclusions are hereby made and entered.

FINDINGS OF FACT

The Taxpayer and her husband filed joint Alabama income tax returns for the years 1980, 1981 and 1982. The couple was divorced in 1983 and the Taxpayer subsequently filed individual returns for 1983, 1984 and 1985.

Expenses were claimed in each of the years 1980 through 1985 relating to the Taxpayer's breeding and show horse operation, "Hobby Horse Farms". Specific deductions were for breeding fees,

feed, gasoline, veterinarian fees and other related expenses. The resulting losses totaled $2,302.53, $9,818.97, $9,292.77, $3,768.00, $4,731.13 and $5,174.00 for 1980 through 1985, respectively. No income was reported from the horse operation for any of the subject years except $191.00 in 1981 and $128.00 in 1984.

The Department audited the subject returns and disallowed the expenses relating to the horse operation. As a result, the Department reduced the refunds due the Taxpayers or Taxpayer for 1980 through 1984 and entered the preliminary assessment in issue against the Taxpayer for 1985.

The Department's position is that the horse operation was not entered into for profit. Accordingly, the expenses relating thereto can be deducted only to the extent of income generated by the activity. Presumably, the Taxpayer's position is that the activity was entered into for profit and that the expenses relating thereto should be fully deductible.

CONCLUSIONS OF LAW

All taxpayers are allowed to deduct ordinary and necessary business expenses, see Code of Ala. 1975, §40-18-15(a)(1). Further, all non-business losses are allowed if incurred in a transaction entered into for profit, see Code of Ala. 1975 §40-18-15(a)(5). Personal or "hobby" losses cannot be deducted. The above sections are modeled in substance after federal sections 26 U.S.C.

§162 (ordinary and necessary business expenses) and 26 U.S.C. §§165 and 212 (non-business losses or expenses), respectively.

The issue in dispute is whether the Taxpayer's horse farm operation was entered into for profit. 26 U.S.C. §183 governs that question for federal purposes. Thus, because the relevant Alabama statutes cited above are modeled after federal law, §183 and related regulations and case law should also be followed in Alabama.

Basically, §183 creates a presumption that the activity is engaged then for profit if the taxpayer reports a net gain in at least three of the five years immediately preceding the subject tax year. In the case of breeding, training, racing or showing horses, a profit must be shown in only two out of seven years. However, the Department can rebut the presumption by presenting adequate

proof that the activity was in fact not entered into for profit.[1]

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[1]Numerous factors must be considered in deciding if an activity is entered into for profit. The primary factors as set out in Tres. Reg. §1.183-2(b) are as follows:

(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 expanded by the taxpayer in carrying on the activities;
(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) The elements of personal pleasure or recreation.

Conversely, if a profit is not recognized in three out of five or two out of seven years, there is no negative presumption that the activity is not for profit, see Tres. Reg. §1.183-1. But as with all other deductions, the taxpayer has the burden of proving his right to the deduction, and in the absence of such proof the deduction must be denied. U.S. v. Wodtke, 627 F.Supp. 1034. That is, the burden is on the taxpayer to show that the activity was entered into with a profit motive.

In the present case, the Taxpayer did not report a profit in any of the years 1980 through 1985. Thus, there is no §183 presumption that the horse farm was entered into for profit. Further, the Taxpayer failed to provide any affirmative evidence indicating that the operation was in fact entered into for profit. To the contrary, the Taxpayer reported only $319.00 as income during the years 1980 through 1985, while declaring losses totaling over $37,000.00 for the same period. Such a disparity in income versus expenses is strong evidence that the operation was not intended as a business or to make a profit.

The above considered, the expenses claimed by the Taxpayer relating to the horse operation were personal in nature and thus were properly denied by the Department. The assessment is correct as entered and should be made final by the Department, with interest as required by statute.

Entered this the 5th day of October, 1988.

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BILL THOMPSON
Chief Administrative Law Judge