ALABAMA TAX TRIBUNAL

JOE C. & MARANDA T. JONES,	§	
Taxpayers,	§	DOCKET NO. INC. 20-687-JP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND FINAL ORDER

This appeal involves final assessments of individual income tax for tax years 2015 through 2017. The case came before the Tax Tribunal for a trial on January 31, 2023. The Taxpayers were present and testified. Ralph Clements represented the Alabama Department of Revenue.

Background

The issue in this appeal involves the Revenue Department's disallowance of expenses for a horse farm that the Taxpayers claimed on their Schedules F. The Revenue Department contends that the horse farm constituted a hobby, not a business, and therefore, that the Taxpayers may claim expenses only to the amount of income generated by the horse farm for each year. The Revenue Department also noted that the Taxpayers must provide documentation to substantiate their expenses. The Revenue Department stated at trial that it agreed to a waiver of the negligence penalties.

The Taxpayers testified at trial concerning the issue of the horse farm. After the trial, the Taxpayers submitted documentation in support of their claimed

expenses, and the Revenue Department was directed to review that documentation. The Revenue Department has recalculated the assessments considering the documentation presented by the Taxpayers.[1] The Taxpayers were given an opportunity to respond to the Revenue Department's recalculations. However, they did not respond.

Discussion

> "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.
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> "Factor (1). The manner in which the taxpayer conducted the activity
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> "Factor (2). The expertise of the taxpayer in carrying on the activity.
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> "Factor (3). The time and effort exerted by the taxpayer in conducting the activity.
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> "Factor (4). The expectation that the assets used in the activity will

[1]The Revenue Department presented alternative calculations for if the horse farm is determined to be a business.

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."

Frank R. and Hazel Willis v. State of Alabama, No. INC. 19-1003-JP (Ala. Tax Tribunal Feb. 27, 2020) (quoting Blankenship v. State of Alabama, No. INC. 06-1215 (Admin. Law Div. 10/16/07), at pp. 3 – 4).

The Taxpayers testified that, for over 20 years, they have engaged in cattle farming as a side business. The Taxpayers stated that their daughter loved horse-barrel racing and that they bought their first horse for their daughter in 2015. According to the Taxpayers, they thought they could generate income buying horses, training them, and then selling the horses for a profit. During the time the Taxpayers engaged in the horse farm activity, they bought several horses. According to the Taxpayers, the most horses they had at one time was six or seven. They sold a total of four horses, and all four sold for a profit.

The Taxpayers testified that their daughter trained the horses as a hobby and was not paid as an employee. They stated that, for a period of time, their daughter spent three or four hours a day for five to six days a week practicing and caring for the horses and that she attended shows every Saturday. The Taxpayers also stated that their daughter currently is in college but still lives with them. Their daughter still rides horses, but she is no longer training for or attending horse shows. The

Taxpayers stated that they have transitioned back to cattle farming, which is, according to the Taxpayers, something with which they can make "actual physical money." The Taxpayers testified that the horses would eventually go with their daughter when she moved out of their home.

According to the Taxpayers, they had expenses for the horse farm such as a horse trailer, fencing, saddles, horse food, veterinary care, and transportation. They also paid competition fees for their daughter to compete, which their daughter enjoyed. According to the Taxpayers, the competitions were also an opportunity to show the horses and to try to sell them. The competitions were the only advertisement the Taxpayers conducted.

Considering the particular facts in this case, the Taxpayers' "primary purpose and intention in engaging in the [horse farm] activity" was not to make a profit, but, instead, to support their daughter's passion for horses. The evidence indicated that the Taxpayers simply decided that they could generate income incidental to supporting their daughter's hobby. As noted, the Taxpayers testified that their daughter enjoyed training horses and barrel racing and that, concerning the horse farm, she acted not as an employee, but as someone who was engaging in an activity for pleasure and not profit. The Taxpayers sold only four horses, albeit at a profit each time, and the Taxpayers concluded their horse farming once their daughter began attending college and no longer competed with the horses. Because the Taxpayers' "primary purpose and intention in engaging in the [horse farming] activity" was not to make a profit, the horse farming activity is treated as a hobby,

not a business, for tax purposes.

Therefore, Revenue Department's recommended adjustments considering the horse farm activity as a hobby are adopted, along with waiving the negligence penalty as agreed to by the Revenue Department at trial.

Accordingly, the final assessment for 2016 is declared void. The Revenue Department states that there is an overpayment for tax year 2016. The Revenue Department is directed to apply that overpayment to the Taxpayers' 2015 liability. The 2015 and 2017 final assessments, as reduced, are affirmed in the following amounts: for 2015, $938.86 (consisting of tax in the amount of $729.00, a late-filing penalty in the amount of $50.00, a late-payment penalty in the amount of $14.58, and pre-final assessment interest in the amount of $145.28); for 2017, $454.36 (consisting of tax in the amount of $399.00, a late-payment penalty in the amount of $7.98, and pre-final assessment interest in the amount of $47.38); plus additional interest that continues to accrue from the date of entry of the final assessments until the liabilities are paid in full.

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

Entered July 25, 2023.

/s/ *Jeff Patterson*
JEFF PATTERSON
Chief Judge
Alabama Tax Tribunal

jp:ac

cc: Joe C. & Maranda T. Jones
Ralph M. Clements, III, Esq.