

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

DONALD A. MAXWELL AND JULIE A. MAXWELL

DECISION

for Redetermination of a Deficiency or for
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Years 1977 through 1979.

Petitioners, Donald A. Maxwell and Julie A. Maxwell, P.O. Box 1052, 887 Sundial Circle, Sisters, Oregon 97759, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1977 through 1979 (File No. 33901).

A hearing was held before Arthur Bray, Hearing Officer, at the offices of the State Tax Commission, 333 East Washington Street, Syracuse, New York, on October 8, 1985 at 9:15 A.M., with all briefs to be filed by December 20, 1985. Petitioners appeared by Robert J. Trenga. The Audit Division appeared by John P. Dugan, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether petitioners' horse breeding business was an activity engaged in for profit within the meaning of section 183 of the Internal Revenue Code.

FINDINGS OF FACT

1. Petitioners, Donald A. Maxwell and Julie A. Maxwell, filed separately, on one return, a New York State Income Tax Resident Return for the year 1977. On this return, Donald Maxwell reported a farm loss of \$16,292.97. A schedule of Farm Income and Expenses was not attached to this return.

2. Petitioners filed jointly a New York State Income Tax Resident Return

Expenses, which was attached to this return, a gross profit of \$19,024.23. This gross profit consisted of income from, among other things, horse boarding of \$13,037.88, horse training of \$3,387.43, breeding fees of \$1,150.00, show income of \$788.00 and income from the sale of a filly of \$508.25. The return also reported total deductions of \$34,374.75 which included depreciation of \$5,969.60. The foregoing resulted in a net loss of \$15,350.52.

3. Petitioners filed jointly a New York State Income Tax Resident Return for the year 1979. The schedule of Farm Income and Expenses disclosed that the business had a gross income of \$18,819.14 consisting, in part, of income from boarding horses of \$11,812.73, training horses of \$6,131.00 and show income of \$617.00. However, the business had total deductions of \$37,214.06, including depreciation of \$9,261.48, resulting in a net **loss** of \$18,394.92.

4. On March 11, 1981, the Audit Division issued three notices of deficiency. The first Notice of Deficiency was issued to Julie A. Maxwell for the year 1977 and asserted personal income tax due of \$16.52, plus interest of \$4.52, for a balance due of \$21.04. The second Notice of Deficiency was issued to Donald A. Maxwell for the year 1977 and asserted personal income tax due of \$1,782.35, plus interest of \$487.13, for a total amount due of \$2,269.48. The third Notice of Deficiency was issued to Donald A. Maxwell for the years 1978 and 1979 asserting a deficiency of personal income tax in the amount of \$4,517.58, plus interest of \$647.65, for a total amount due of \$5,165.23. To the extent at issue herein, the notices of deficiency were premised upon the Audit Division's position that petitioners' activities of breeding, training, showing and racing horses were not engaged in for profit.

5. Prior to the commencement of the audit which led to the notices at issue herein, the Internal Revenue Service audited petitioners' tax returns for the years 1977 and 1978. The Internal Revenue Service required an asset, which had been expensed, to be capitalized and adjusted the depreciation on another asset. No consideration was given as to whether petitioners were engaged in a business for profit. Since the Internal Revenue Service had examined petitioners' income and expenses for 1977 and 1978, the Audit Division concentrated on petitioners' income and expenses for 1979.

6. During the years in issue, Mr. Maxwell operated a sole proprietorship known as Top View Arabians ("Top View") in Port Byron, New York. The business activity consisted of the boarding, training, breeding and showing of horses.

7. The business premises were located across the road from the taxpayers' residence and consisted of one hundred thirty-six acres of semi-wooded land containing a sixty foot by one hundred twenty foot stable built in 1972 and a thirty foot by sixty foot stable built in 1974. Top View had two barns providing for a total of sixteen stalls. During the busy season, January through September a seventeenth stall could be created through the use of a partition. It was petitioners' practice to keep their two or three horses in the stalls as well as provide boarding for other people's horses.

8. Mr. Maxwell started the horse breeding business in 1966. From the inception of the business until 1979, the business consistently reported net losses. In or about 1980 or 1981, the business began to reduce its expenses by growing its own corn and grain which was used for feed. The portion of the corn and grain crop which exceeded the business' own needs was sold. As a result, the business started showing a profit in 1981 and continued to report a profit in 1982 and 1983.

9. Petitioners maintained complete records of their income and expenses through the use of a single entry record keeping system. These records included entries for both personal and business expenses. However, it was possible to distinguish the entries for personal expenses from business expenses. Petitioners maintained one checking account for both personal expenses and business expenses.

10. Mr. Maxwell was employed full time for Chrysler Corporation throughout the years in issue. Mrs. Maxwell was employed full time for General Electric during the year 1977. Nevertheless, petitioners expended substantial time and effort conducting the business activities of Top View. During the year Mrs. Maxwell worked full time for General Electric, she worked for the business during evenings and on her days off. In 1978 and 1979, she worked on the farm approximately fourteen hours a day. During the years in issue, Mr. Maxwell worked a minimum of five hours a day for the business. Petitioners' activities included training, cooling, grooming and feeding horses. They would also oil the track, clean the aisles, clip and transport horses. Mr. Maxwell also spent time in transporting feed and bedding, spreading manure, leveling and wetting the riding ring, driving horses and helping with hard to handle horses. Mrs. Maxwell spent time giving riding lessons.

11. Mr. Maxwell paid his children \$10.00 a week for their services. In addition, two other individuals assisted with the maintenance of the business in exchange for the training of their respective horses.

12. Since the inception of the business, petitioners have consulted with a number of individuals who are knowledgeable in the horse breeding and showing business.

CONCLUSIONS OF LAW

A. That in order to determine whether an individual **is** carrying on a trade or business, one must examine whether the individual's primary purpose and intention in engaging in the activity was to make a profit (Matter of Ralph R. and Anna Hartel, State Tax Commission, March 13, 1981).

B. That section 1.183-2(b), Income Tax Regulations, sets forth some of the relevant factors derived principally from prior case law, which are to be considered in determining whether an activity is engaged in for profit. Such factors include: (1) the manner in which the taxpayers carried on the activity; (2) the expertise of the taxpayer or his advisors; (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.

C. That in determining whether an activity is engaged in for profit, the petitioner's intent is considered, but greater weight **is** given to the objective facts (Treas. Reg. §1-183-2(a)).

D. That upon all the facts and circumstances presented herein, it is concluded that Top View was operated with the objective **of** realizing a profit. The manner of Top View's operation, including the maintenance of complete records disclosing all of the business's income and expenses, the consultation with experts concerning Top View's operation, the time **and** effort expended by ~~petitioners in carrying on Top View's activities~~

petitioners' horses would appreciate in value, all evidence a good faith effort to generate a profit. Accordingly, the limitation on the deductibility of losses arising from activities not engaged in for profit, as provided for in section **183** of the Internal Revenue Code, is inapplicable and the net losses of Top View are deductible in full.

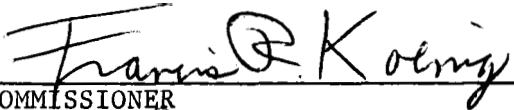
E. That the petition of Donald A. Maxwell and Julie A. Maxwell **is** granted to the extent **of** Conclusion of Law "D" and the notices of deficiency are to be modified accordingly; as modified, the notices **of** deficiency are sustained.


DATED: Albany, New York

STATE TAX COMMISSION

SEP 15 1986


PRESIDENT


COMMISSIONER


COMMISSIONER

