

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :

of

Ralph R. & Anna Hartel :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of
Personal Income Tax :
under Article 22 of the Tax Law
for the Years 1972, 1973 & 1974. :

State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 13th day of March, 1981, he served the within notice of Decision by certified mail upon Ralph R. & Anna Hartel, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Ralph R. & Anna Hartel
Route #3, Box 209B
Idaho Falls, ID

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
13th day of March, 1981.

Annice G. Hagelund

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION

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Personal Income Tax :

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for the Years 1972, 1973 & 1974. :

State of New York

County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 13th day of March, 1981, he served the within notice of Decision by certified mail upon Peter L. Faber the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Mr. Peter L. Faber
Harter, Secrest & Emery
700 Midtown Tower
Rochester, NY 14604

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
13th day of March, 1981.

Cornelia A. Hagelund

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

March 13, 1981

Ralph R. & Anna Hartel
Route #3, Box 209B
Idaho Falls, ID

Dear Mr. & Mrs. Hartel:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 690 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Deputy Commissioner and Counsel
Albany, New York 12227
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Peter L. Faber
Harter, Secrest & Emery
700 Midtown Tower
Rochester, NY 14604
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
RALPH R. and ANNA HARTEL	:	DECISION
for Redetermination of a Deficiency or	:	
for Refund of Personal Income Tax under	:	
Article 22 of the Tax Law for the Years	:	
1972, 1973 and 1974.	:	

Petitioners, Ralph R. and Anna Hartel, Route 3, Box 209B, Idaho Falls, Idaho, 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 1972, 1973 and 1974 (File No. 18771).

A small claims hearing was held before Carl P. Wright, Hearing Officer, at the offices of the State Tax Commission, One Marine Midland Plaza, Rochester, New York, on July 19, 1979 at 9:15 A.M. Petitioner Ralph R. Hartel appeared with Peter L. Faber, Esq. The Audit Division appeared by Peter Crotty, Esq. (Kathy L. Sanderson, Esq., of counsel).

ISSUE

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

FINDINGS OF FACT

1. Petitioners, Ralph R. and Anna Hartel, filed New York State income tax resident returns for 1972, 1973 and 1974, on which they reported business losses of \$9,196.00, \$10,337.00 and \$8,337.00, respectively.

2. Petitioners executed a Consent Extending the Period of Limitation for 1972 from April 15, 1976 to April 15, 1977.

3. On February 28, 1977, the Audit Division issued a Notice of Deficiency for 1972, 1973 and 1974, holding that the business deductions above the business income were not deductible since the activity was not engaged in for profit under the provisions of Internal Revenue Code section 183. However, the Audit Division did allow an additional sales tax deduction per the sales tax tables due to the increase in adjusted gross income. The Audit Division accordingly asserted additional personal income tax of \$4,228.70, plus interest of \$944.41, for a total due of \$5,173.11.

4. In the Fall of 1970, petitioner Ralph R. Hartel accepted a position as a corporate executive with The R. T. French Company and moved to the Rochester, New York area. During the years 1972, 1973 and 1974, petitioner Ralph R. Hartel earned wages from The R. T. French Company of \$68,521.01, \$66,790.81 and \$62,775.43, respectively.

When Mr. Hartel decided to take the job with The R. T. French Company, petitioners looked for a place in the country to live because they had been residing in a suburb of Chicago, Illinois and had experienced problems with their children. They were anxious to escape from the hazards of urban living to the more sheltered atmosphere of rural life.

5. Petitioners had seven children, who were approaching college age, and they decided to start a business that would make enough money to defray the substantial college expenses they anticipated incurring. After considering several alternatives, the petitioners decided to establish a horse boarding business, in particular, only because the business was one which could be run in a country setting. They had no prior connection with horses, either in a recreational or a business context. Mr. Hartel, himself, had no interest in horses and did not ride horses. Mrs. Hartel was afraid of horses and, at that

time, none of the seven Hartel children rode horses (although one of the children, the nine-year old, later learned to ride after the Hartels moved to Marion, New York).

Mr. Hartel read several books on the subject. The petitioners also investigated the operations of other local operators and projected that they could charge \$80.00 to \$90.00 per month board for each stall. They anticipated that with 12 stalls there would be potential income of \$1,000.00 per month. They estimated that they could break even even if only 75 percent of the stalls were actually occupied.

6. When the petitioners began the business in 1970, in order to reduce costs, Mrs. Hartel and the Hartel children did the day-to-day work on the stalls and horses, which included cleaning the stalls, feeding and exercising the horses. The children did not enjoy either the stall work or the horses and Mr. Hartel felt that it was necessary to pay them an hourly rate. He also hired other young people, at the same wage, to do some of the work. Mr. Hartel managed the business, did repairs, and mowed the lawn during his free time from his regular job at The R. T. French Company.

7. In 1971, the petitioners decided to hire someone to manage the business. Thereafter, the manager (Mr. Laties) and the children did the work of running the stalls.

Mr. Laties was active in the promotion of horse shows, being well known in the area as a showman. Mr. Laties had approached Mr. Hartel at one point and said that he felt he could build up petitioners' business if petitioners would let him use their stalls and give him a concession to run shows and other events, thereby attracting people to the facility.

Petitioners agreed that Mr. Laties was to receive all rentals above \$.40 per day, per horse, on transient boarders who were there for a day or

two. A specific exemption was made for two long-term boarders, from whom petitioners would receive all the income. The fact was clearly understood that if Mr. Hartel could bring in long-term boarders, the transient boarders for which Mr. Laties was receiving his commission (rentals) would have to leave the stalls. Although Mr. Laties could not work full-time, it was understood that he would be there to feed the animals and clean the stalls. He was also expected to deal with prospective boarders.

8. Petitioners ran their horse boarding enterprise in a business-like manner. They developed a form rental agreement for horse boarding, and they kept records of their business transactions by carefully recording expenses and by retaining cancelled checks. Duplicates of receipts for their business expenditures were kept and, on the advice of their accountant, a separate bank account was maintained for the business.

9. Petitioners attempted to get public exposure for the business by advertising their boarding facilities in local newspapers. In addition, they allowed the local 4-H Club to use the facility for horse shows in order to acquaint members of the community with the type of facilities petitioners had to offer potential boarders.

10. During 1972 and 1973, petitioners made improvements in order to upgrade the stall facilities and to attract horse shows. These included: (a) resurfacing the indoor training arena with six inches of specially washed sand at a cost of \$80.00 for materials, excluding labor costs; (b) adding new fences and repairing old fencing for all the pastures, fencing paddocks and constructing gates, resurfacing the floors and rebuilding the doors and walls of all 12 stalls, painting the exterior of the barn and tack shop, constructing a food concession booth to be used at horse shows, building shelves and cabinets for the tack shop, repairing the roof of the tack shop and the barn

doors, and building trash bins and feed bins for the feed room at an aggregate cost of \$2,410.12; (c) replacing the doors on the training arena at a cost of \$159.13; (d) resurfacing the driveway and parking apron near the barn and tack shop at a cost of \$900.00; (e) replacing the pipeline to the water trough behind the paddock and the electrical wiring under the hay barn at a cost of \$246.07; (f) repairing the hay barn shed at a cost of \$95.97; and (g) purchasing various materials for the above jobs at a cost of \$539.25.

11. At one time in 1971, the petitioners had 6 stalls leased at an average of \$65.00 per stall per month. After 1971, the low revenue-to-expense ratio was due to depressed market conditions. In 1972, feed cost doubled and some supply costs tripled. Improvements to the facilities were made at significant costs.

12. The business losses they sustained in 1972, 1973 and 1974 were actual cash losses and not merely "paper losses" attributable to depreciation. For example, in 1972 petitioners had business expenses of \$10,641.00, which included depreciation of \$4,992.00. In 1973, expenses were \$11,365.00 which included depreciation of \$4,876.00. In 1974, business expenses were \$8,412.00 which included depreciation of \$5,145.00.

The gross receipts in the years at issue were \$1,445.00, \$1,028.00 and \$75.00, respectively. Accordingly, they abandoned the business in 1974. After they abandoned the business, the petitioners tried to lease the barns and pasture to cover fixed expenses for utilities.

13. The cost of the depreciable assets used in the activity was approximately \$40,000.00 for each of the years in issue.

CONCLUSIONS OF LAW

A. That the test for determining whether an individual is carrying on a trade or business so that his expenses are deductible under section 162 of Internal Revenue Code is whether the individual's primary purpose and intention in engaging in the activity is to make a profit. In determining whether an expenditure comes within this section of the Code, it becomes necessary to look at the origin and nature of the activity itself. The purpose to derive a gain must be the principal or primary one, Arata v. Comm., 277 F.2d 576. To state the proposition differently, each taxpayer is entitled to conceive and embark upon his own business enterprise, no matter how impractical, idiosyncratic or questionable of success the business may seem to others (Wright v. U.S., 249 F. Supp. 508). Therefore, before a loss or a business expense deduction will be allowed, the taxpayer must show that he had a real purpose to operate a profitable business, Henry P. White, 23 TC 90, affd 227 F.2d 779.

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 taxpayer 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.

In determining whether an activity is engaged in for profit, the petitioners' intent is considered, but greater weight is given to the objective facts.

While losses often occur during the formative years of a business and particularly when the venture involves animals, "...the goal must be to realize a profit on the entire operation, which presupposes not only future net earnings but also sufficient net earnings to recoup the losses which have meanwhile been sustained in the intervening years." Besseney v. Comm., 45 TC 261, affd 379 F.2d 252.

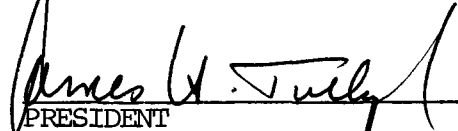
C. Although a reasonable expectation of profit may not have been immediately anticipated, an analysis of the petitioners' operation confirms that there was a profit motive, and the circumstances indicate that the petitioners both entered into and continued this activity with the objective of making such profit.

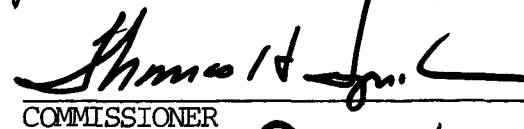
D. That the petition of Ralph R. and Anna Hartel is granted, and the Notice of Deficiency issued on February 28, 1977 is cancelled.

DATED: Albany, New York

MAR 13 1981

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER