

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Estate of Muriel V. Lee :  
AFFIDAVIT OF MAILING  
for Redetermination of a Deficiency or Revision :  
of a Determination or Refund of Personal Income :  
Tax under Article 22 of the Tax Law for the Years :  
1976 - 1978. :  
:

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State of New York :

ss.:

County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 16th day of July, 1985, he served the within notice of Decision by certified mail upon Estate of Muriel V. Lee, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Estate of Muriel V. Lee  
Attn: Garry F. Shultz, Personal Trust Dept.  
Lincoln First Bank, 5 Seneca St.  
Geneva, NY 14456

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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  
16th day of July, 1985.

David Parchuck

Garry F. Shultz  
Authorized to administer oaths  
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

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AFFIDAVIT OF MAILING

State of New York :  
ss.:  
County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 16th day of July, 1985, he served the within notice of Decision by certified mail upon George L. Middleton, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

George L. Middleton  
Nixon, Hargrave, Devans & Doyle  
Lincoln First Tower, P.O. Box 1051  
Rochester, NY 14603

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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  
16th day of July, 1985.

David Parchuck

Muriel A. Heggen  
Authorized to administer oaths  
pursuant to Tax Law section 174

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

July 16, 1985

Estate of Muriel V. Lee  
Attn: Garry F. Shultz, Personal Trust Dept.  
Lincoln First Bank, 5 Seneca St.  
Geneva, NY 14456

To the Executors:

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, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law 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  
Law Bureau - Litigation Unit  
Building #9, State Campus  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
George L. Middleton  
Nixon, Hargrave, Devans & Doyle  
Lincoln First Tower, P.O. Box 1051  
Rochester, NY 14603  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:
	:
of	:
	:
THE ESTATE OF MURIEL V. LEE	:
	:
for Redetermination of a Deficiency or for	:
Refund of Personal Income Tax under Article 22	:
of the Tax Law for the Years 1976, 1977 and	:
1978.	:

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Petitioner, The Estate of Muriel V. Lee, c/o Garry F. Shultz, Personal Trust Department, Lincoln First Bank, 5 Seneca Street, Geneva, New York 14456, 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 1976, 1977 and 1978 (File No. 30313).

On November 15, 1984, petitioner's right to a formal hearing was waived and a request made that the State Tax Commission render its decision based on a stipulation of facts. A stipulation of facts was entered into on December 24, 1984 and all briefs were to be submitted by February 4, 1985. Based on the stipulation of facts and exhibits attached thereto, the State Tax Commission hereby renders the following decision.

ISSUE

Whether the Audit Division properly disallowed, as an activity not engaged in for profit, the losses incurred by Muriel V. Lee from her operation of Leeswood Farm.

FINDINGS OF FACT

On December 24, 1984, the Department of Taxation and Finance and petitioner's representative entered into a stipulation of facts which was prefaced by the following statement:

"The Petitioner, Estate of Muriel V. Lee, and the New York State Department of Taxation and Finance (the "Department") hereby agree and stipulate that the following are the only facts involved in the above matter; that such facts, unless otherwise stated, apply to the entire period from January 1, 1976 through December 31, 1978; and that such facts (and the Exhibits attached to this Stipulation) shall be taken in lieu of testimony and the introduction of exhibits at a formal hearing."

The stipulated facts<sup>1</sup> (1 through 62, infra) are as follows:

1. The Petitioner is the Estate of Muriel V. Lee.
2. Muriel V. Lee died on June 3, 1981, after the petition was filed in this matter.
3. Lincoln First Bank, N.A. is the executor for the Petitioner and administers the Estate through its office at 5 Seneca Street, Geneva, New York 14456. Lincoln First Bank, N.A. is now Chase Lincoln First Bank, N.A., but will be referred to in this Stipulation as Lincoln First Bank, N.A.
4. Lincoln First Bank, N.A. was appointed executor for the Petitioner pursuant to Letters Testamentary.
5. The Notice of Deficiency was sent by the Tax Compliance Bureau of the Department and is dated February 6, 1980.
6. Muriel V. Lee ("Mrs. Lee") filed a Petition on May 5, 1980 in response to the Notice of Deficiency.

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1 The stipulated facts, as shown in this decision, have been edited to delete references to exhibits which were attached to the stipulation of facts, but which are not attached hereto.

7. The State Tax Commission filed an Answer to the Petition on September 8, 1981.

8. The tax article involved is Article 22 of the New York State Tax Law and the type of tax is personal income tax.

9. The taxable years involved are the calendar years 1976, 1977 and 1978. The total amount of tax in controversy is \$48,901.42, distributed as follows:

1976	\$15,378.33
1977	\$16,719.84
1978	\$16,803.25

10. Mrs. Lee was a single individual who timely filed New York State personal income tax returns for the calendar years 1976, 1977 and 1978.

11. Mrs. Lee and her late husband, Cebern Lee, founded a horse farm called Leeswood Farm (the "Farm") in the early 1960's.

12. The Farm was founded to raise, train and sell Tennessee Walking Horses.

13. The Farm is located in Oaks Corner, New York on a tract of 168 acres.

14. An article describing the Farm, its background and operation appeared in the November, 1976 issue of the American Horseman.

15. This article was reprinted in the Walking Horse Report for February 14, 1977.

16. The statements made in the Walking Horse Report article accurately describe the Farm and the Tennessee Walking Horse industry, and the quotations appearing in said article accurately reflect the statements being quoted.

17. The following buildings were used by the Farm: a house in which the trainer, Johnny W. Boyd, lived; a main barn (which had twenty-four stalls, a trophy room, an office, an exercise area, an electric "hot walker", a shower

room, a room for a blacksmith and an attic containing hay); a house trailer in which one or two farm employees lived; and another barn that contained twenty stalls.

18. Just prior to Mrs. Lee's death, the Farm's herd had approximately eighteen horses in it, including two brood mares.

19. Just prior to Mrs. Lee's death, of the eighteen horses in its herd, the Farm owned eight horses itself and boarded the remaining horses for customers. Seven of the eight horses that the Farm owned were Tennessee Walkers and one was an American Saddlebred.

20. The following table sets forth the horses located at the Farm as of December 31 of each year from 1975 through 1978:

<u>Year</u>	<u>Brood Mares</u>	<u>Stallions</u>	<u>Horses Being Boarded</u>	<u>Horses Being Boarded and Trained</u>
1975	6	6	1	3
1976	6	3	5	7
1977	2	2	3	7
1978	2	2	4	6

21. Prior to Mrs. Lee's death, the Farm owned several vehicles including a station wagon, a tractor cab, a 9-horse van, a 2-horse van, a 4-wheel drive truck for plowing snow, a pickup truck, a grain truck, 3 tractors, a baler, hay wagons and other miscellaneous farming equipment.

22. Prior to Mrs. Lee's death, the Farm had three full-time employees, and one part-time employee who worked during the summer.

23. The Farm's professional trainer, Johnny W. Boyd, was hired by the Farm around 1968.

24. As set forth in the article from American Horseman, Mr. Boyd was well qualified to raise and train Tennessee Walking Horses.

25. During the period at issue, Mr. Boyd served as President of the Northeast Walking Horse Trainers Association.

26. The American Horseman article described Mr. Boyd as one of the "most popular figures on the northeast, Virginia and Ohio circuits".

27. Mr. Boyd has trained or shown several world class Walking Horses.

28. The Schedules F, "Farm Income and Expenses", to Mrs. Lee's Forms 1040 for the years 1975 through 1978 reported total gross profits from the Farm of \$113,933.74, an average of almost \$38,000 a year.

29. Each Schedule F accurately reflects the financial results of the Farm for the year covered by that Schedule.

30. The Farm advertised its horses and services.

31. Part of the Farm's advertising occurred in horse show programs or in horse magazines. The total spent by the Farm on this type of advertising during the years at issue was \$2,878.80.

32. In addition, the Farm advertised by participating in horse shows, giving group tours of the Farm and distributing a postcard.

33. During the years at issue the Farm's horses participated in horse shows in both Pennsylvania and New York.

34. There are several sheets listing some of the shows entered and awards won by the Farm during the years at issue.

35. The Farm's success in shows is also described in the American Horseman article.

36. Besides hiring a professional trainer, the Farm used independent veterinarians to treat its horses.

37. The Farm kept detailed records of the medical services performed on its horses.



38. Horse experts were hired from Seneca Castle, New York; Exeter, New Hampshire; and the New York State Veterinary College at Cornell University.

39. The bills for veterinary services were rendered to "Leeswood", the Farm's business name, rather than to Mrs. Lee personally.

40. As part of its operation, the Farm offered training and boarding services to outside horses.

41. During the years at issue, the Farm received \$53,893.91 of income from boarding and training outside horses.

42. The Farm sold tack to customers.

43. The Farm grew most of its own feed for its and its customers' horses.

44. The Farm was able to raise surplus wheat, corn and hay that it sold on the open market. Its sales of these crops totaled \$24,758.65 during the years at issue.

45. Another source of income for the Farm was breeding fees.

46. The Farm used a formal breeding contract.

47. The Farm realized the following amounts of income from the sales of horses in the years at issue:

<u>Year</u>	<u>Amount of Income</u>
1976	\$4,450
1977	6,460
1978	1,375

48. The prices of Tennessee Walking Horses were depressed in the mid-1970's because of the controversy concerning the methods used to train the horses.

49. Cebern Lee, Mrs. Lee's late husband, was for two years President of the American Walking Horse Association and for four years Chairman of the Board, all before the years at issue.

50. Mrs. Lee was named Horsewoman of the Year in 1965 by the American Walking Horse Association.

51. The Farm had a separate checking account into which all income of the Farm was deposited and from which all expenses of the Farm were paid.

52. The Farm maintained a checking account with Security Trust Company of Rochester, New York.

53. The checking account was in the Farm's business name, "Leeswood".

54. The Farm had its own stationery showing the Farm's use of its business name.

55. The financial records of the Farm were kept by a bookkeeper who was employed by the Farm and were kept separate from Mrs. Lee's personal financial records.

56. The Farm's financial records included a payroll book and a ledger.

57. The records so kept were reviewed by the Farm's independent certified public accountants each year.

58. The accountants made sure that the Farm filed all the required employment tax returns, unincorporated business tax returns and other forms required of businesses.

59. During the years at issue, the Farm paid a total of \$2,700 for the services of the outside certified public accountants.

60. Mrs. Lee kept her personal expenses separate from those of the Farm.

61. Mrs. Lee did not use Farm employees to work on her personal residence.

62. The Agent who conducted the audit of Mrs. Lee on behalf of the Department examined the Farm's books but did not disallow any expense on the ground that it was a personal expense of Mrs. Lee.

Findings of Fact 63 through 66, infra, are based on the exhibits attached to the stipulation of facts and the briefs filed by both parties.

63. Federal Schedule F, "Farm Income and Expenses", for the years at issue, reflected the following amounts:

	<u>1976</u>	<u>1977</u>	<u>1978</u>
Gross Profit	\$ 44,690.11	\$ 37,960.78	\$ 31,282.85
Deductions	(134,506.48)	(131,587.25)	(135,832.21)
Depreciation	( 17,313.75)	( 17,839.15)	( 17,463.41)
Net Loss	<u>\$(107,130.12)</u>	<u>\$(111,465.62)</u>	<u>\$(122,012.77)</u>

Included in the deduction figures shown in the above chart were labor expenses. Labor expenses totaled \$73,019.90, \$68,599.49 and \$66,655.20 for 1976, 1977 and 1978, respectively.

64. Gross profit shown in Finding of Fact "63", supra, was comprised of the following items:

	<u>1976</u>	<u>1977</u>	<u>1978</u>
Board & Training	\$25,440.50	\$15,230.41	\$13,223.00
Breeding Fees	400.00	--	--
Grain Sales	12,462.21	8,071.30	4,225.14
Horse Sales	4,450.00	6,460.00	1,375.00
Trucking & Entries	1,832.40	1,153.31	2,623.50
Prizes	105.00	--	--
Tack & Misc.	--	7,045.76	9,836.21
Gross Profit	<u>\$44,690.11</u>	<u>\$37,960.78</u>	<u>\$31,282.85</u>

65. Mrs. Lee, during the years at issue, had substantial amounts of passive income from other sources. The record does not reveal if Mrs. Lee was gainfully employed during the years at issue.

66. Mrs. Lee regularly participated as a rider of the Farm's horses which competed in horse shows. Prize money awarded at said horse shows was nominal, ranging from \$10.00 to \$100.00.

67. Included in petitioner's brief were proposed findings of fact, as to which this Commission makes the following rulings:

a) Proposed findings 1 through 63, 65 and 70 are adopted and are incorporated into this decision.

b) Proposed findings 66, 67 and 69 are rejected as not supported by the evidence.

c) Proposed findings 64, 68 and 71 are rejected as being conclusory in nature.

#### CONCLUSIONS OF LAW

A. That section 689(e) of the Tax Law places the burden of proof on petitioner except in three specifically enumerated instances, none of which are at issue herein. Petitioner has failed to sustain its burden of proof to show that Mrs. Lee operated the Leeswood Farm with the bona fide intention to make a profit. Although there are some facts which might support that petitioner operated the Farm with a bona fide profit motive, said facts are outweighed in that:

(1) during the years at issue, the Farm's substantial net losses steadily increased, while gross profits decreased;

(2) the Farm, established in the early 1960's, cannot be considered in its developmental stages;

(3) the Farm's labor expense alone significantly exceeded gross profit and, in 1978, said labor expense was more than double the gross profit;

(4) the number of horses owned by the Farm decreased from a total of 12 as of December 31, 1975 to a total of 4 as of December 31, 1978;

(5) the record contains no evidence as to what extent the prices of Tennessee Walking Horses were depressed and there is no evidence to support a finding that the Farm could have anticipated a profit had the prices not been depressed;

(6) the record contains no evidence to show that the Farm ever made a profit in all its years of operation;

(7) Mrs. Lee had substantial amounts of passive income from other sources; and

(8) it is undisputed that Mrs. Lee derived personal pleasure and recreation from riding the Farm's horses.

B. That the petition of the Estate of Muriel V. Lee is denied and the Notice of Deficiency dated February 6, 1980 is sustained, together with such additional penalty and interest as may be lawfully due and owing.

DATED: Albany, New York

JUL 16 1985

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER