

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of
John K. & Rose G. Schemmer :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or for Refund :
of New York State and New York City Personal Income :
Taxes under Articles 22 and 30 of the Tax Law and :
Chapter 46, Title T of the Administrative Code of :
the City of New York for the Years 1976, 1977, :
1978, 1979 and 1980. :

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 21st day of August, 1985, he served the within notice of Decision by certified mail upon John K. & Rose G. Schemmer, the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:


John K. & Rose G. Schemmer
S. Quaker Hill Rd.
RR 1, Box 345
Pawling, NY 12564

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
21st day of August, 1985.




Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of
John K. & Rose G. Schemmer :

AFFIDAVIT OF MAILING

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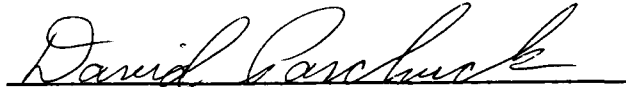
David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 21st day of August, 1985, he served the within notice of Decision by certified mail upon William T. McCallum, the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

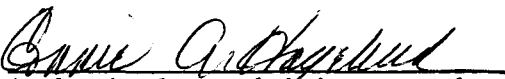
William T. McCallum
32 E. 57th St.
New York, NY 10022

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
21st day of August, 1985.




Authorized to administer oaths
pursuant to Tax Law section 174

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

August 21, 1985

John K. & Rose G. Schemmer
S. Quaker Hill Rd.
RR 1, Box 345
Pawling, NY 12564

Dear Mr. & Mrs. Schemmer:

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 & 1312 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York, 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
William T. McCallum
32 E. 57th St.
New York, NY 10022
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
JOHN K. SCHEMMER AND ROSE G. SCHEMMER	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of New York State and New York City	:	
Personal Income Taxes under Articles 22 and	:	
30 of the Tax Law and Chapter 46, Title T of	:	
the Administrative Code of the City of New York :	:	
for the Years 1976, 1977, 1978, 1979 and 1980.	:	

Petitioners, John K. Schemmer and Rose G. Schemmer, South Quaker Hill Road, RR 1, Box 345, Pawling, New York 12564, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Articles 22 and 30 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York for the years 1976, 1977, 1978, 1979 and 1980 (File Nos. 36931, 37121 and 37122).

A formal hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on November 2, 1984 at 10:30 A.M., with all briefs to be submitted by January 28, 1985. Petitioners appeared by William T. McCallum, CPA. The Audit Division appeared by John P. Dugan, Esq. (Anne Murphy, Esq., of counsel).

ISSUES

I. Whether petitioners' activity with respect to the breeding, training and showing of Morgan horses was an activity engaged in for profit.

II. Whether petitioners' 1976 claim for refund should be denied.

FINDINGS OF FACT

1. Petitioners, John K. Schemmer and Rose G. Schemmer, timely filed a joint New York State Income Tax Resident Return (with City of New York Personal Income Tax) for each of the years 1976, 1977, 1978, 1979 and 1980 whereon John K. Schemmer reported his occupation as "Attorney" and Rose G. Schemmer reported her occupation as "Housewife". On each of said returns petitioners reported a substantial farm loss from Quaker Hill Morgan Farm located at South Quaker Hill, Pawling, New York.

2. On October 5, 1981, the Audit Division issued three (3) statements of personal income tax audit changes to petitioners wherein the farm losses claimed with respect to Quaker Hill Morgan Farm (hereinafter "the Morgan Farm") for the years 1976 through 1980 inclusive, were disallowed based on the following explanation:

"Your activities involving Morgan horses are not considered to be a bona fide business venture and as such the losses incurred are not allowed."

Accordingly, on January 22, 1982, three (3) notices of deficiency were issued against petitioners. One notice asserted additional New York State and City personal income taxes of \$22,390.87 for the years 1976 and 1977, plus interest of \$8,609.46, for a total due of \$31,000.33. The second notice asserted additional New York State and City personal income taxes of \$19,745.52 for the year 1978, plus interest of \$10,281.10, for a total due of \$30,026.62. The third notice asserted additional New York State and City personal income taxes of \$17,175.24 for the years 1979 and 1980, plus interest of \$1,999.18, for a total due of \$19,174.42.

3. On December 10, 1979, petitioners executed a consent form which extended the period of limitation upon assessment of 1976 personal income tax

to any time on or before April 15, 1981. Subsequently, on January 14, 1981, they executed a second consent form which extended the period of limitation upon assessment of 1976 and 1977 personal income tax to any time on or before April 15, 1982.

4. The gross profit, deductions and loss claimed each year at issue with respect to the Morgan Farm were as follows:

<u>Year</u>	<u>Gross Profit</u>	<u>Deductions</u>	<u>Loss</u>
1976	\$ 520.00	\$ 62,593.99	(\$ 62,073.99)
1977	\$2,312.00	\$ 61,047.00	(\$ 58,735.00)
1978	\$3,006.00	\$112,551.00	(\$109,545.00)
1979	\$1,022.00	\$ 82,332.00	(\$ 81,310.00)
1980	\$2,334.00	\$ 74,657.00	(\$ 72,323.00)

5. The aforesaid gross profit derived from the Morgan Farm for each year at issue was comprised of the following income:

<u>Nature of Income</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Show Winnings	\$315.00	\$ 375.00	\$ 665.00	\$ 495.00	\$ 885.00
Stud Fees	100.00	425.00	275.00		400.00
Miscellaneous	105.00				20.00
Board & Training		1,512.00	862.00	146.00	1,029.00
Other			24.00		
Horse Transportation			1,180.00		
Miscellaneous Refund				381.00	
Total Income (Gross Profit)	<u>\$520.00</u>	<u>\$2,312.00</u>	<u>\$3,006.00</u>	<u>\$1,022.00</u>	<u>\$2,334.00</u>

6. The deductions claimed for each year at issue with respect to the Morgan Farm included, inter alia, the following:

<u>Deduction</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Labor Hired	\$10,519.33	\$11,405.00	\$ 7,460.00	\$12,560.00	\$14,816.00
Feed Purchased	5,724.48	6,176.00	9,201.00	6,403.00	4,913.00
Supplies Purchased	3,765.63	2,396.00	5,266.00	4,750.00	3,746.00
Board & Training	5,712.62	5,524.00	8,675.00	9,025.00	7,200.00
Transportation	1,771.35	1,157.00	3,401.00	500.00	-0-
Horse Show Expense	4,022.25	2,131.00	15,424.00	2,413.00	764.00
Advertising & Photography	594.75	1,164.00	4,710.00	3,395.00	267.00
Miscellaneous	259.93	65.00	669.00	153.00	20.00

Depreciation	21,255.42	15,756.00	28,796.00	26,507.00	28,356.00
Rental of Farm					
Pasture	600.00	1,200.00	700.00	-0-	-0-
Appraisal Fee	-0-	1,250.00	-0-	-0-	-0-
Blacksmith	-0-	2,158.00	3,649.00	2,979.00	2,319.00
Veterinary Fees,					
Medicine	1,739.05	3,229.00	2,827.00	2,273.00	2,241.00
Security	-0-	-0-	14,010.00	-0-	-0-

7. The Morgan Farm was located in Pawling, New York. All documents constituting the hearing record show petitioners' address during the years at issue herein as "South Quaker Hill Road, RR 1, Box 345, Pawling, New York". Although on their New York returns their county of residence was reported to be "Dutchess", petitioners filed as full year residents of the City of New York and paid the New York City taxes computed to be due on each return filed for the years at issue. No explanation was furnished for this apparent contradiction.

8. The Morgan Farm commenced operations in 1975 and has sustained a loss every year to the date of hearing.

9. Petitioners alleged that the Morgan Farm's "primary source of income is from the sale of Morgan horses". Review of petitioners' Federal tax returns for the years at issue reveals the following information with respect to the sale of horses:

- a. During 1976 petitioners sold one (1) horse for a gain of \$350.00. A second horse, which was disposed of, yielded a loss of \$680.74.
- b. During 1977 petitioners sold one (1) horse for a gain of \$4,813.00.
- c. During 1978 petitioners sold two (2) horses for a total net loss of \$3,148.00.
- d. During 1979 petitioners sold five (5) horses for a total net gain of \$7,982.00.
- e. During 1980 no horses were sold by petitioners.

All of the aforesated gains and losses attributed to the sale of horses were personally reported by petitioners each year on Federal form 4797, Supplemental Schedule of Gains and Losses.

10. During the years at issue the Morgan Farm owned (according to the depreciation schedules) between nine (9) and sixteen (16) horses.

11. In addition to the Morgan Farm, which commenced operations in 1975, petitioners also operated a cattle farm in Pawling, New York known as the "Quaker Hill Stock Farm" (hereinafter "the Stock Farm"). Petitioners owned and operated the Stock Farm from approximately 1960 through 1978, when said farm was sold.

12. Pursuant to petitioners' tax returns, the gross profit, deductions and net profit or loss claimed for the years 1976 through 1978 with respect to the Stock Farm were as follows:

<u>Year</u>	<u>Gross Profit</u>	<u>Deductions</u>	<u>Net Profit or (Loss)</u>
1976	\$15,522.85	\$26,981.08	(\$11,458.23)
1977	\$13,808.00	\$23,945.00	(\$10,137.00)
1978	(\$ 1,356.00)	\$14,697.00	(\$16,053.00)

13. According to a schedule prepared by petitioners, the net profits and losses attributable to the Stock Farm for the years 1971 through 1975 were as follows:

<u>Year</u>	<u>Net Profit or (Loss)</u>
1971	(\$13,707.00)
1972	\$ 1,595.00
1973	(\$ 4,665.00)
1974	\$ 216.00
1975	\$ 1,982.00

14. Separate, adequate books and records were kept by petitioners for the Morgan Farm and the Stock Farm.

15. The operation of the Stock Farm was deemed to be an activity engaged in for profit. Accordingly, the losses sustained with respect thereto were not disallowed for the years 1976, 1977 and 1978.

16. Petitioner John K. Schemmer derived substantial income from other sources during each of the years at issue. His federal adjusted gross income reported each year at issue (inclusive of the substantial farm losses claimed) was as follows:

<u>Year</u>	<u>Federal Adjusted Gross Income</u>
1976	\$218,283.65
1977	\$ 82,624.00
1978	\$340,082.00
1979	\$ 26,203.00 ¹
1980	\$140,603.00 ¹

Petitioner John K. Schemmer's Federal adjusted gross income for each of the aforesaid years was comprised, inter alia, of the following:

<u>Source of Income</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Dividends	\$ 42,467.06	\$44,919.00	\$ 48,976.00	\$53,354.00	\$ 58,192.00
Capital Gains	\$ 86,077.51	\$ 2,757.00	\$342,171.00	\$ 3,130.00	\$ 2.00
Receiver Fee	\$112,550.92	\$49,593.00	\$ 59,040.00	\$ -0-	
Partnership Income	\$ 51,651.17	\$52,887.00	\$ -0-	\$ -0-	
Legal Fees				\$13,469.00	
Other Income					\$148,402.00 ¹

17. During the years 1976 and 1977 petitioner John K. Schemmer was a partner in the law partnership Carter, Ledyard & Milburn. In 1978 he sold his interest in the partnership; however, he continued to practice law in subsequent years as an individual.

18. Petitioners did not personally appear at the hearing. Their representative argued that the losses sustained by the Morgan Farm during the years at issue should properly be allowable on the basis that said farm was an activity engaged in for profit. He claimed in the petition that the following factors support his argument:

¹ The record does not contain a 1980 Federal return. These amounts were taken from petitioners' 1980 New York State return.

a. "Good records and businesslike concern for the economics of the Morgan Farm."

b. "Qualified professionals are utilized for technical advise, (sic) i.e., trainor (sic), accountants, etc."

c. "Prior to operating the Morgan Farm, the taxpayer was involved in a Stock Farm which was deemed to be a business."

d. "Potential for appreciation of assests, (sic) i.e., horses and land, is great especially in view of the significant 1978 (Stock Farm) land sale." (With respect to appreciation of the land, petitioners' representative claimed that petitioners are currently offering the Morgan Farm land for sale. He claims that the asking price of \$1,333,000.00 would offset all prior year losses and give rise to a substantial capital gain.)

e. "The current recession coupled with high interest rates has hindered the development of the farm."

f. "Normally, it takes a good eight to twelve years to establish a quality inventory of Morgan Horses. However, the taxpayer's Morgan Farm has only been in existence since 1976, or approximately six years."

g. "The examining agents feel that due to the taxpayer's substantial outside income, that the farm was nothing more than a tax shelter. However, they fail to realize that as long as the tax rates are less than 100 percent, there is no "benefit" in losing money. More importantly, the taxpayer, with his impressive legal background, could have easily invested in any real estate, movie or oil and gas tax shelter and obtained the same write-offs without requiring substantial physical and financial energies in which to 'shelter' a portion of his income."

h. "Taxpayer advertises his horses for sale in the Morgan Horse Magazine."

19. It was claimed that the following additional factors support petitioners' position that the Morgan Farm was an activity engaged in for profit:

a. That the Morgan Farm sustained a casualty (fire) loss in 1978 which damaged the entire breeding program.

b. That petitioner John K. Schemmer has devoted substantially all of his energies to the Morgan Farm since his retirement from the aforestated law partnership in 1978.

c. That petitioner John K. Schemmer "has been around horses and farming all his life".

20. The trainer petitioners used did not render services exclusively for petitioners. The record herein is devoid of information with respect to the trainer's credentials.

21. The record herein is devoid of factual information with respect to the amount of personal time and effort expended by petitioners in the operation of the Morgan Farm. Furthermore, the record does not establish that petitioner John K. Schemmer has, in fact, "been around horses and farming all his life".

22. On October 28, 1980, petitioners filed a Claim for Credit or Refund of Personal Income Tax, Form IT-113X, wherein they claimed a 1976 refund of \$3,326.43 based on the carrying back to said year of a 1979 net operating loss resulting from the Morgan Farm loss of \$81,310.00 claimed on their 1979 return. The Audit Division's position is that the 1979 farm loss is not deductible and accordingly, a net operating loss was not sustained in 1979.

CONCLUSIONS OF LAW

A. That section 183 of the Internal Revenue Code provides that:

"(a) GENERAL RULE - In the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) DEDUCTIONS ALLOWABLE - In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed -

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the

extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1)."

B. That section 183(d) of the Internal Revenue Code provides that an activity which consists in major part of the breeding, training, showing or racing of horses shall be presumed to be an activity engaged in for profit if the gross income derived from such activity exceeds the deductions attributable to such activity for 2 or more of the taxable years in a period of 7 consecutive taxable years. Since the Morgan Farm has sustained losses each year from its inception to date, the aforesaid presumption is inapplicable in the instant case.

C. That I.R.C. Regulation Section 1.183-2(a) provides, in pertinent part that:

"In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the taxpayer's mere statement of his intent."

D. That I.R.C. Regulation Section 1.183-2.(b) provides relevant factors in determining whether an activity is engaged in for profit. Such factors are as follows:

- (1) Manner in which the taxpayer carries 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) 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 losses with respect to the activity.
- (7) The amount of occasional profits, if any, which are earned.

(8) The financial status of the taxpayer.

(9) Elements of personal pleasure or recreation.

E. That considering the aforestated relevant factors prescribed under I.R.C. Regulation Section 1.183-2(b) and other relevant facts enumerated herein, it is hereby concluded that petitioners' activities with respect to the Morgan Farm were not engaged in for profit. Accordingly, the farm losses claimed for the years 1976 through 1980, inclusive, with respect thereto are disallowed.

F. That based on the above, petitioners' claim for refund with respect to taxable year 1976 is denied in full (See Finding of Fact "22", supra).


G. That the petition of John K. Schemmer and Rose G. Schemmer is denied and the three (3) notices of deficiency issued January 22, 1982 are sustained together with such additional interest as may be lawfully owing.


DATED: Albany, New York

STATE TAX COMMISSION

AUG 21 1985


PRESIDENT


COMMISSIONER


COMMISSIONER