

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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|--|---|---------------------------------|
| In the Matter of the Petition | : | |
| of | : | |
| STEVE AND LINDA HORN | : | |
| for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2004 through 2009. | : | DETERMINATION DTA NO. 825333 |

Petitioners, Steve and Linda Horn, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2004 through 2009.

A hearing was held before Barbara J. Russo, Administrative Law Judge, at the offices of the Division of Tax Appeals, New York, New York, on July 16, 2014 at 10:30 A.M. and continued on July 17, 2014 at 9:30 A.M., with all briefs to be submitted by February 5, 2015, which date began the six-month period for the issuance of this determination. Petitioners appeared by Roberts & Holland LLP (Joseph Lipari, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis A. Warren, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly determined that the activities of Steve and Linda Horn, Inc., an S corporation, were not engaged in for profit and that therefore petitioners, as owners of the S corporation, were not entitled to a deduction for the claimed losses for the years in issue.

FINDINGS OF FACT¹

1. Steve and Linda Horn (petitioners) are married individuals with an address in Ossining, New York.

2. During the years 2004 through 2009 (the tax years at issue), petitioners filed joint federal (forms 1040) and New York (forms IT-201) personal income tax returns.

3. During the tax years at issue Steve and Linda Horn, Inc. (the Company) was an S corporation for both federal and New York State income tax purposes. All of the stock of the Company is owned by petitioner Linda Horn. All of the income and losses of the Company passed through for income tax purposes to petitioners and was reported on their joint personal income tax returns.

4. On September 16, 2011, the Division of Taxation (Division) issued a Notice of Deficiency, Notice Number L-036622577-5, to petitioners for the years at issue. The notice assessed tax as follows:

| Year | Tax | Interest | Penalty | Current Balance Due |
|------|----------------|--------------|--------------|---------------------|
| 2004 | \$134,337.00 | \$86,348.16 | \$13,433.00 | \$234,118.16 |
| 2005 | \$1,157,264.00 | \$605,801.83 | \$115,726.00 | \$1,878,791.83 |
| 2006 | \$374,685.00 | \$148,102.34 | \$37,468.00 | \$560,255.34 |
| 2007 | \$261,861.00 | \$73,162.49 | \$26,186.00 | \$361,209.49 |
| 2008 | \$365,914.00 | \$72,786.49 | \$36,591.00 | \$475,291.49 |
| 2009 | \$179,974.00 | \$20,210.72 | \$17,997.00 | \$218,181.70 |

5. Petitioners timely protested the Notice of Deficiency by means of a request for a conciliation conference filed on November 18, 2011.

¹ The parties executed and submitted a Stipulation of Facts setting forth 13 numbered stipulated facts and including 27 agreed-upon exhibits. The stipulated facts are incorporated herein, with the exception of stipulated fact 13, which is merely a recitation of the agreed exhibits that have been accepted into the record. The stipulated facts are set forth herein as Findings of Fact numbered 1 through 12.

6. A conciliation conference was held before the Bureau of Conciliation and Mediation Services (BCMS) on April 18, 2012.

7. BCMS issued a conciliation order dated August 17, 2012, sustaining the Notice of Deficiency.

8. Petitioners timely filed a petition, which was received by the Division of Tax Appeals on November 5, 2012.

9. The Division filed an answer dated January 16, 2013.

10. The tax amount reflected in the Notice of Deficiency was calculated by disallowing all of the Company losses for the years at issue and by disallowing net operating loss carryforwards and carrybacks.

11. The 2005 tax liability on the Notice of Deficiency also includes the disallowance of an Internal Revenue Code (IRC) § 1031 like-kind exchange entered into by the Company in 2005. However, the section 1031 like-kind exchange issue is no longer being pursued by the Division due to the Company's sale of the property located at 930 Ocean Boulevard, Palm Beach, Florida (the Ocean Property) in 2011 and its reporting of the capital gain recognized on that sale in its tax return for that year.

12. The parties have agreed that following the issuance of a determination in this matter, the liability for each tax year will be recalculated to reflect the resolution of the like-kind exchange issue and the resolution of the remaining issues as set forth in the determination.

Background

13. Steve Horn went to an art and music high school, after which he received a scholarship to the Pratt Institute, where he majored in advertising. He then studied at Columbia University, where he received a Bachelor of Arts degree in Fine Arts and worked towards a master's degree.

14. After school, Mr. Horn worked as a commercial photographer, eventually partnering with another photographer to form a firm, Horn/Griner.

15. Linda Horn initially worked as an assistant to a fashion photographer. A few years later, she worked at Avon Products (Avon). Mrs. Horn worked her way up the corporate ladder to become the beauty and fashion director at Avon. In this position, she would travel throughout the country to develop an understanding of Avon's mass market appeal, in order to determine the look of the Avon catalogues and what consumers wanted.

16. In 1970, while at Avon, Mrs. Horn was responsible for the first commercial that Avon produced, called "Field Flowers." During that production, Mrs. Horn first met Mr. Horn, who worked on the commercial shoot.

17. After Avon, Mrs. Horn was hired to become executive editor at Vogue Patterns (Vogue), and became editor-in-chief six months later. As editor-in-chief, she was responsible for the entire editorial production of the magazine.

18. In 1973, Mr. and Mrs. Horn married.

19. In 1974, Mr. Horn had a dispute with the other partners of Horn/Griner and left the firm. Mrs. Horn, with the knowledge and blessing of Vogue, continued to give Mr. Horn work as a photographer.

20. After the breakup of Horn/Griner, Mr. Horn was locked out of the partnership's building and had significant personal debt. Only two Horn/Griner employees, a cleaning man and a receptionist, left the partnership with Mr. Horn.

21. The Horns then went into business together. They created the Company, an S corporation. Under the original certificate of incorporation, filed on July 12, 1974, the S corporation's name was Steve Horn, Inc. On September 5, 1991, the name of the S corporation

was changed to Steve & Linda Horn, Inc. The certificate of incorporation states, in part, the following purposes for which the corporation was formed:

“(a) To engage in the general business of still photography for advertising agencies, print media, and all other persons, firms or corporations, and on its own behalf, and of film production of every type, nature and description, including but not limited to the filming of commercials for TV viewing, and the production of motion picture films, and to engage in all business and activities in furtherance thereof, or incidental or related to said business, for others or on its own behalf.

(b) To lease, rent, purchase or otherwise acquire, outfit, develop and maintain studios, equipments, materials and supplies, and all the articles and things necessary or convenient in pursuing the business of the corporation.

(c) To purchase, sell, rent, lease, sub-let, hold and exchange real property, improved and unimproved, to build, re-build, construct, demolish, alter and improve buildings and stores thereon, fixtures and personal property including or incidental thereto and connected therewith, and real property generally.

(d) To purchase, acquire, hold, sell, exchange . . . or otherwise dispose of or deal in, the stocks, notes, bonds, debentures or other evidences of indebtedness and obligations of any private, public, quasi-public, or municipal corporation . . .

(e) To purchase, lease, or otherwise acquire . . . the business, goodwill, rights, franchises and property of every kind, and to undertake the whole or any part of the assets or liabilities of any person, firm, association, or corporation engaged in or authorized to conduct any business similar to any business authorized to be conducted by this corporation, or owning any property necessary, desirable or suitable for its purposes . . .

(f) To acquire . . . and to hold or dispose of stocks, bonds, and any other obligations of any corporation formed for or engaged in or pursuing any one or more of the kind or kinds of business, purposes, objects or operations above indicated . . .

(g) To borrow or raise money for the purposes of the corporation, to mortgage and charge all or part of the present or hereafter acquire property, rights and franchises of the corporation, and to issue and sell stocks, bonds, debentures and other evidence of indebtedness.

(h) To purchase, hold and re-issue shares of its capital stock . . .

(i) To do all, and everything necessary, suitable, proper, and/or convenient for the accomplishment of the purposes . . . herein set forth”

22. Due to Mr. Horn's financial difficulties, the Company was formed with funds from Mrs. Horn, who owned, and continues to own, 100% of the stock of the Company. The Company initially operated out of petitioners' apartment. The Company eventually engaged in the production of television commercials.

23. Mr. and Mrs. Horn both worked for the Company. Mrs. Horn worked as a producer, scouting locations, casting and clothing actors, and deciding where to shoot a commercial, whether in a studio or at a location. She also made bids on behalf of the Company to advertising agencies for particular jobs.

24. Mr. Horn directed the commercials, worked on storyboards and did camera and lighting work.

25. Petitioners worked long hours during the commercial production business, but took weekends off to spend time with their young children. As their children grew older, petitioners would do some work on weekends.

26. In addition to petitioners, the Company has always had some long-term employees, including Alayne Baxter, Thomas Drohan, Cheryl Baxter, Katherine Horn and Efleda Danao. Mrs. Horn felt that each of these employees could do the work of two or three people.

27. Cheryl Baxter has been with the Company since the year it was created. She began doing billing for the print photography business and answering telephones.

28. Later, Cheryl Baxter began to work as a coordinating producer, hiring crews, stylists, and set decorators and designers, renting props, creating schedules and arranging logistics for the commercial shoots, including location scouting, travel arrangements and catering.

29. During the commercial production business, Cheryl Baxter's job required working 10-12 hours per day, 5 days a week, and would require working as many as 14 hours a day when they were shooting a commercial.

30. Alayne Baxter, Mrs. Horn's sister, worked after college as an editor at Mademoiselle Magazine.

31. Alayne Baxter started working for the Company in the 1970s, where she learned the entire film business. She eventually became the Company's "rep," acting as the salesperson who obtained new commercial production jobs for the Company.

32. Katherine Horn, petitioners' daughter, initially worked as an assistant buyer for a women's clothing store, Putumayo, eventually becoming a buyer and creative director there. In the 1990s, she began to work for the Company as a stylist, dealing with costumes and wardrobe.

33. Mr. Drohan had been involved in theatrical and film production since he finished school, working as a "grip" (i.e., a lighting, electrical and rigging technician). Through a recommendation, he was hired by the Company.

34. Mr. Drohan eventually became assistant director, booking equipment, contacting the crew, assisting on lighting and shoot decisions, and working on timesheets and production reports. He would typically work 12 to 14 hours per day when the Company was shooting commercials.

35. Ms. Danao started with the Company in 1994 as an assistant bookkeeper. Since 1997, she has served as the Company's bookkeeper. Ms. Danao has an accounting degree from the Philippines.

36. Over the years, the Company employed a number of full-time and freelance employees for the television commercial production business who were independent contractors. At times

they would have multiple jobs in the house at the same time and would employ the independent contractors for three or four months.

37. In 1981, the Company purchased 435 East 83rd Street, New York, New York (the Studio), which it used and still uses as the headquarters for all of its activities.

38. The Horns felt it was important for the success of their business to create a brand. The Horns' approach to commercials included creating "little mini movies and little stories." This approach carried over to their antique business, where they felt it was important to create a brand under the Linda Horn name and would create vignettes for the store displays to tell a story about the items they were selling.

39. Petitioners' commercial production business became well known in the advertising world and received accolades such as Mr. Horn's induction into the Art Directors Club Hall of Fame. In 1981, Michael J. Arlen wrote a book, *Thirty Seconds*, about petitioners and the Company's commercial production business, in which Mr. Horn was described as one of "the top men in business." In 1985, *Advertising Age* named Mr. Horn "Television Commercial Director of the Year."

40. The Company created commercials for AT&T, G.E., McDonald's, Coke and Pepsi, as well as the "I Love New York" commercials. The Museum of Modern Art inducted into its collections a reel of the Company's commercials.

41. Petitioners have also had a long-standing antiques and decorative items business (the antiques business), which they began in the early 1980s.

42. The idea for an antiques business came to Mrs. Horn during her travels with the Company to shoot television commercials in Europe. For example, while in the Netherlands for a shoot for Pan American airlines, she decided to buy antiques for resale and ship them back to

the United States. Mrs. Horn felt that it was a good buying time because the prices were good and the dollar was strong. Furthermore, by buying pieces when the Company was otherwise working in Europe, petitioners could eliminate the middleman and avoid markups on the items.

43. Mr. Horn would accompany Mrs. Horn on trips to acquire antiques, act as a courier and note taker, make recommendations and take photographs of pieces. He prepared the shipping invoices to ship the items to New York. Mr. Horn would also take professional photographs of purchased antiques once they were added to the store's inventory.

44. Mrs. Horn described the antiques business's initial concept as "not a big money-making thing, but it was something that would pay for itself." She explained that when they began the antiques business they intended to make it work for itself and break even with the potential to make more money. During the antiques business's start-up, petitioners had the strength and income from both the commercial production business and the real estate activity. As the commercial production business declined in 2004 and 2005, petitioners focused on the antiques business and intended to grow it into a mass market business by increasing their appeal to a wider audience.

45. Mrs. Horn made all purchase decisions with respect to the antiques business.

46. Mrs. Horn's knowledge of the fashion business was informed by influences such as Donna Karan, Ralph Lauren and Calvin Klein and their creation of branded lines such as DKNY, RL, Lauren and CK. Mrs. Horn had previously, about 15 years earlier, been offered a job with Donna Karan to run DKNY, and Mary Wells, the head of advertising agency Wells Rich Greene, had offered her a job to run a division. However, Mrs. Horn preferred to stay with the Company.

47. The Company originally purchased a property in the early 1980s in Valhalla, New York, to serve as an antiques store. The store was initially run by Mrs. Horn's sister, Mary

Donahue. The Valhalla property was used for the antiques store up to about four or five years prior to the years at issue. Petitioners subsequently operated an antiques store on Madison Avenue in Manhattan. The Valhalla store was operated simultaneously with the Madison Avenue store for a period prior to the years at issue. Petitioners then tried to sell the Valhalla property, but were unable to sell it until 2013. From 2004 to 2009, the Valhalla property was vacant with a “for sale” sign posted. The property was sold in 2013, resulting in a capital gain.

48. In approximately 1984, the Company opened a store in Manhattan in a space leased by Murray Mondschein, professionally known as Fred Leighton. Mr. Leighton was an expert in the jewelry antiques world and supported Mrs. Horn in her development of the antiques store. Mr. Leighton provided the store for no rent, on the condition that the store be called “Linda Horn at Fred Leighton.” Mrs. Horn obtained advice from Mr. Leighton on running the antiques store.

49. After Mr. Leighton’s lease ran out, the store moved to its own space on 79th Street and Madison Avenue in Manhattan. The store operated at the 79th Street location until approximately 2005, when it moved to its current location on Madison Avenue and 93rd Street.

50. In addition to the television commercial business and the antiques business, the Company, as well as Mr. and Mrs. Horn, through other entities, has bought and sold real estate for investment purposes during, prior and subsequent to the years at issue.

51. In 1980, the Company purchased, for \$775,000.00, property located at 166 East 73rd Street, New York, New York (the Church). The Church was originally purchased to become the headquarters for the Company, but the neighborhood block association would not allow a television production company on the premises. The building was then used for storage for the commercial business and the antiques store.

52. In 2005, the Church was sold for \$12,000,000.00, resulting in a profit in excess of \$11,000,000.00.

53. In 1981, the Company purchased property located at 435 East 83rd Street, New York, New York (the Studio) for \$525,000.00. The Studio had five floors, with 2,500 square feet per floor, plus a full basement, a high ceiling and skylight. The Studio has a curb cut so that a car can be driven into a car elevator. Mrs. Horn testified that she has no idea what the property is worth, but believes it is worth more than the purchase price. The Studio was used as a photography studio during the operation of the commercial production business and had housed the wardrobe used for various television commercials petitioners filmed. During the years at issue, the Studio was used as the main office headquarters for the Company.

54. In 1999, Woodland Farms, LLC, of which petitioners were 100% owners, purchased and renovated property at 120 Woodside Avenue, Briarcliff Manor, New York (the Creamery). In 2001, Woodland Farms, LLC, purchased and renovated property at 104 Woodside Avenue, Briarcliff Manor, New York (the Warehouse). The Company stores inventory that is not at the antiques store at the Warehouse and Creamery and used the properties for receiving merchandise. The Company pays rent to Woodland Farms, LLC, for use of the properties.

55. Mrs. Horn testified that in 1999, petitioners purchased property at 52-62 Cooper Square, New York, New York, for \$14,000,000.00 and sold it in 2000 for \$21,000,000.00. She could not remember whether they owned the property individually or through the Company.

56. In early 2004 to 2005, the Company's television commercial business declined and came to an end. The decline happened for a number of reasons, including a change in the commercial business from the use of film, which petitioners used, to digital, creating an increase in competitors who could produce commercials at a lower price.

57. After discontinuing the production of television commercials, petitioners decided to remain in business and continue working. Petitioners decided to devote their time to expanding the existing antiques business and real estate business.

58. Recognizing the change in the Company's business resulting from the winding down of the commercial business, petitioners realized they had to cut overhead. Petitioners gradually reduced the total number of Company employees, from 20 in 2005 to 14 in 2009, and ceased working with various independent contractors.

59. With respect to the antiques business, Mrs. Horn's business plan was to have a brand that is known by many people and to take the brand to a mass market level. Mrs. Horn's plan emulated what she saw from designers such as Calvin Klein, Donna Karan and Ralph Lauren, opining that "all the moneys that [these designers] made were not on the designer lines. They were all in [mass market brands such as] DKNY, RL, Lauren, CK."

60. Mrs. Horn felt that it was necessary to move from the smaller antiques store on 79th Street and Madison Avenue to a larger store in order to create a larger impact and have a better showcase so that her brand name would be more widespread.

61. After scouting locations all over New York City, the Company found a location at 1327 Madison Avenue, on 93rd Street and Madison Avenue (the 93rd Street Store), which the Company rented in December 2005, effective February 1, 2006.

62. The 93rd Street Store was previously a children's clothing store. The space required a complete renovation before it could be used as a store. Mrs. Horn designed the renovation, and the physical work was overseen by Thomas Drohan and Cheryl Baxter.

63. Mr. Drohan worked as a project manager/general contractor for the renovation, supervising the installation of lighting (including installation of a chandelier), electrical work,

painting, and the installation of carpeting, sheet rock, and tile. The work required Mr. Drohan to work 8 to 10 hours a day and took approximately 6 to 8 months to complete.

64. Cheryl Baxter was also involved in finding contractors to construct, and materials to be used in, the renovations. Together with Mr. Drohan, she hired contractors, electricians and plumbers, and purchased lights and materials. Ms. Baxter testified that her work on the renovations was much like her work in the production business, bringing in similar scene workers and set designers to do the scene work, set builders to do the construction, and using prop people who she knew to obtain materials.

65. The Creamery and the Warehouse also required significant renovation before they could be used by petitioners. The Creamery required new floors, walls, sprinkler system, doors and a roof. The Warehouse required walls, floors, a loading dock, heating and air conditioning and a new roof.

66. Mr. Drohan acted as general contractor on the renovations for the Creamery and the Warehouse, dealing with subcontractors and business inspectors. Mr. Drohan was also involved in moving the store inventory from the 79th Street location to the warehouses until the store relocated several months later to the 93rd Street location.

67. With respect to all of the renovations, petitioners' goal was to get the best price possible. Cheryl Baxter negotiated deals on items and used companies such as SceniX, that they knew from their work in the television commercial business.

68. Post-renovation, the 93rd Street Store has 50 feet of show windows facing Madison Avenue. The store is on two levels, with between 3,500 to 4,500 square feet of space.

69. The 93rd Street Store has significantly more space than the prior store, allowing for the display of more items. It also has double doors that allow for inventory such as furniture to be brought in for display.

70. The store is open to the public from 10:00 A.M. to 6:00 P.M., Monday through Saturday. However, the store would never turn customers away and is known for opening early, closing late, and reopening after hours in order to accommodate customers.

71. The inventory is roughly 60% to 70% antiques, which are defined as items that are at least 100 years old. The rest of the inventory includes pieces from the 1950s through the 1970s, petitioners' famous photography, a small amount of jewelry, and new recreations (reproductions). During the tax years at issue, the inventory at cost ranged from \$8,199,654.00 at the end of 2004 to \$10,006,457.00 at the end of 2009.

72. Mrs. Horn expects the inventory items to appreciate in value. Although a formal appraisal of the inventory had been done previously, she could not recall when and testified that it was probably done ten years ago. During the market crash, petitioners' accountant suggested they appraise the inventory and then offer work for sale at a lower price and take a loss. Mrs. Horn would not consider the suggestion of taking a possible write down for tax purposes.

73. Petitioners purchased some items of inventory to be sold as collections, such as Majolica collections.

74. For the tax years at issue, the Company's cost for purchases of new inventory items for the antiques business was as follows: \$638,417.00 in 2004; \$1,118,844.00 in 2005; \$1,396,156.00 in 2006; \$703,581.00 in 2007; \$199,431.00 in 2008; and \$165,888.00 in 2009.

75. Mr. and Mrs. Horn both do work for the antiques business. Mrs. Horn is responsible for the overall conception of the antiques business. She makes the final decision with respect to

items purchased for the store's inventory and sets the prices. Mrs. Horn estimated she would spend between two to four hours or more working between the antiques store, the Creamery, the Warehouse and the Studio. Mrs. Horn testified that when she is not physically present at the store, warehouses or Studio, she is "constantly" on the phone with Alayne Baxter regarding the store.

76. Utilizing his background in art and photography, Mr. Horn takes photographs of every item of inventory for the antiques business's website database and designs all of the advertisements for the business. During the audit period, petitioners placed advertisements for the antiques store in Architectural Digest, Rosewood Magazine, Veranda, Quest Magazine, Avenue Magazine, Palm Beach Cottage Gardens Magazine, NY Spaces, Elle Decor, and Platinum Publications, which publishes magazines for New York hotels. Petitioners also advertized through holiday mailers and emails to clients for special occasions and discounts.

77. With their launch of an expanded antiques business, petitioners relied on long-term employees Alayne Baxter, Thomas Drohan, Cheryl Baxter, Katherine Horn and Efleda Danao.

78. Mrs. Horn asked her sister, Alayne Baxter, to take over running the store because Mrs. Horn felt that Ms. Baxter, whose background was in sales, would be an excellent salesperson. Petitioners wanted Ms. Baxter to take her experience in sales from the film industry and use it to turn the store around. Ms. Baxter's primary job is to sell. Ms. Baxter works in the store five days a week, from at least 10:00 A.M. to 6:00 P.M., and takes calls from the person running the store on the days she is not on the premises. On Sundays, Ms. Baxter usually meets with Mrs. Horn to discuss the store.

79. Alayne Baxter changes the store's window displays every couple of months for holidays and changes of seasons, or to display a new collection, and updates the displays more

frequently as needed to fill a hole when items in the display are sold. The store is locally famous for its Christmas windows, which feature Parisian animated polar bears.

80. Ms. Baxter is also responsible for changing the layout of the store displays, moving items in the store daily and rotating inventory from the warehouses in order to keep the store looking new for regular clients.

81. Mr. Drohan loads and moves the inventory as it rotates between the store and the Warehouse or Creamery.

82. Mrs. Horn and Ms. Baxter conceived of the store's display as a series of little vignettes, where multiple pieces come together to form a collection that tells a story. Mrs. Horn developed this same concept during her years in the film business. Katherine Horn dressed mannequins for her work in wardrobe, and would come up with a theme to create a collection.

83. The store uses sales diaries, which petitioners refer to as the Madison Diaries. The Madison Diaries allow Ms. Baxter and her salespeople to keep track of the contact information and sales history of every customer who has come into the store. The store's sales people write down the names of customers who come in, what items they are interested in, if the customer was given a special price, and customer contact information. They then use the diaries as a sales technique to follow-up with customers and contact customers when they find an item for which the customer was looking. Other antiques stores have copied the Company's sales diary technique.

84. Ms. Baxter, along with Katherine Horn and Ms. Danao, have implemented a "tear sheet" system. Ms. Baxter came up with the idea based on her background work in magazines. Katherine Horn created the information database to store information in a manner that could easily print out on the tear sheets.

85. The tear sheets have several functions. Ms. Baxter and her sales staff print out from the database “short” one-page tear sheets, which display, for an individual item, a photograph, measurements, and a description. Depending on the customer, the tear sheets may or may not show a price. The staff can quickly produce tear sheets to give to customers and decorators, so that potential customers remember their favorite items after they leave and can call back to purchase the item. A decorator may walk out of the store with multiple tear sheets at a time to show a client.

86. There is also a “long” version of the tear sheets for Ms. Baxter’s use, which provides vendor information, financial reports, purchase price information, and customer information. Ms. Baxter can access the long form tear sheet in order to determine what price to offer for an item and to access information about past customer purchases. Using the tear sheets, Ms. Baxter knows when she can offer a discount of anywhere from 10% to 20% on an item. The staff can quickly toggle between “short” and “long” versions of the tear sheets on the computer screen to make sure that customers do not see internal store information.

87. Ms. Baxter can also access from her store computer the sales reports generated by Ms. Danao to see how much the store has sold for the day, and can check year-to-date sales for the current and prior years. Ms. Baxter uses the sales history garnered from the reports to set current sales goals.

88. Katherine Horn uses the product area and vendor section of the database to enter information from purchase orders and assign a SKU, similar to a bar code, to each item. The items are categorized by the SKU to identify antiques, recreations and limited edition items.

89. Mr. Horn takes the inventory photographs for the tear sheet database and website.

90. Around 2002 or 2003 Katherine Horn became in charge of the Company's computers and database. She found that although the Company had a website, it did not have email or internet sales. She encouraged petitioners to increase their online presence and create a program that would combine the database, website and sales. The Company required a customized program containing pictures of different views and other information. Ms. Horn interviewed companies for the project, but they were too expensive and she worked to combine the database and website herself. In approximately 2003 or 2004 the store had a working system with a combined customized point of sale, database and website. The Company's combined system has evolved and been upgraded over the years from its creation through today. For example, views on the system increased from one to four. Ms. Horn has also worked to increase the Company's use of social media, such as Facebook, Twitter, Instagram and Pinterest and maintains the Company's database.

91. As the database and website manager, Ms. Horn typically works from 8:30 or 9:00 A.M. until 6:00 P.M., but can stay up late at night updating the database as additional inventory is acquired, uploading pictures onto the website and database.

92. Petitioners redesigned labels for the antiques store's items and created stickers to place on store items that identified "Linda Horn Collection" items. They also created unique packaging designs to appeal to customers.

93. In February 2008, the Company entered into a sales arrangement with 1stdibs.com (1stdibs), which Alayne Baxter characterized as "the number one online site in the world for selling antiques." The Company updated its 1stdibs inventory monthly. The site is the Company's major online selling tool and Ms. Baxter testified that over half of the items listed get sold.

94. 1stdibs considers petitioners' store to be a major dealer, and the store is often featured in a place of prominence on the website and picked for feature stories. The antiques business posts new items on 1stdibs monthly. Both the former and current chairman of 1stdibs have come to the antiques store. Ms. Baxter has met with 1stdibs' current chairman, David Rosenblatt, two or three times and discussed ideas.

95. In order to appeal to the mass market, the antiques business started selling recreations or reproductions of antiques, wherein petitioners reproduce an antique so that it is more affordable. Through reproductions, petitioners create high demand items at a lower price point, described by Mrs. Horn as somewhere between Pottery Barn and Ralph Lauren. Petitioners started to produce a small amount of reproductions during the audit years 2004 - 2009, and produced approximately a dozen seahorse lamps and 14 swans, all of which sold. Subsequent to the audit period, petitioners made connections with manufacturers to produce a larger quantity of reproductions and plan to increase sales through an increase in reproductions. Petitioners have tried to find sources within the country to produce the reproductions so that they can sell them to the mass market.

96. Mrs. Horn is in contact with manufacturers in North Carolina and South Carolina for the production of recreations.

97. The Company's gross receipts, as reported on the S corporation income tax returns, increased from 2005 to 2007 to wit: in 2005 the Company reported \$872,659.00 in gross receipts; in 2006 the Company reported \$1,026,583.00; and in 2007 the Company reported \$1,222,103.00. For 2008 and 2009, the Company reported gross receipts in the amount of \$805,738.00 and \$834,742.00, respectively.

A breakdown of the gross receipts pertaining to the antiques business only, as stated in the antiques business's trial balances and monthly accounting reports, are as follows: \$461,594.18 in 2004; \$473,800.51 in 2005; \$1,026,349.82 (\$492,257.68 in sales from Steve and Linda Horn, Inc., d/b/a Linda Horn Antiques and \$534,092.14 in sales from Linda Horn LLC) in 2006; \$1,177,806.30 in 2007; \$796,468.00 in 2008; and \$779,952.04 in 2009.²

98. The Company maintained detailed records of the purchase price and sales price for items in the antiques business inventory. An annual comparison of the Company's purchase price versus the amount for which the items were sold is as follows:

| Year | Selling Price | Cost of Goods Sold |
|-------------|----------------------|---------------------------|
| 2004 | \$461,595.00 | \$202,683.00 |
| 2005 | \$473,801.00 | \$181,778.00 |
| 2006 | \$1,026,350.00 | \$379,198.00 |
| 2007 | \$1,177,806.00 | \$459,672.00 |
| 2008 | \$796,468.00 | \$298,766.00 |
| 2009 | \$831,791.00 | \$351,440.00 |

99. In conversations with another antiques dealer, Mrs. Horn was told to use her eye to find unique and interesting items.

100. The Company has provided items from the antiques store for use in store window displays of Bergdorf Goodman and Ralph Lauren. Every time an object is used from the antiques store in those stores' windows, the name of Linda Horn Antiques is written on the window, which provides publicity for the antiques store.

² The following discrepancies are noted between the monthly accounting report and trial balances: November 2008, sales per monthly report are \$89,877.00 and sales per trial balance are \$88,900.00. For October 2008, sales per monthly report are \$65,444.10 and sales per trial balance are \$65,235.00. For April 2008, sales per monthly report are \$81,050.00 and sales per trial balance are \$80,700.00. For March 2008 sales per monthly report are \$50,675.00 and sales per trial balance are \$47,175.00. For 2009, the total gross receipts, including consignment sales as reported in the monthly accounting report is \$831,791.00. There was no explanation for the discrepancy.

101. In 2008, the financial crisis hit, depressing the market for high-end items.

102. As a result of the decline in sales in 2008 and 2009, the store took steps to reduce costs, including getting rid of the store's security guard and replacing him with Alayne Baxter's dog.

103. The Company also reduced salaries from 2004 to 2009 as follows:

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Commercial Business | \$681,194 | \$665,108 | \$475,527 | \$445,442 | \$317,062 | \$271,204 |
| Antiques Business | \$642,210 | \$932,814 | \$992,367 | \$974,763 | \$987,570 | \$841,200 |

104. Additionally, Ms. Baxter negotiated with the landlord of the antiques store, and the lease was amended in May 2014 to reduce the rent, forgive unpaid back rent, and renew the lease at a favorable rate.

105. Travel expenses for the antiques business were also reduced from 2004 to 2009 as follows:

| 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|-------------|-------------|-------------|-------------|-------------|-------------|
| \$66,104.00 | \$89,880.00 | \$62,430.00 | \$58,169.00 | \$32,806.00 | \$23,599.00 |

106. The antiques business also reduced purchases of new inventory in 2008 and 2009 (*see* Finding of Fact 74).

107. Subsequent to the audit period, media executive Barry Diller and 1stdibs selected the antiques store to feature in a television show for Mr. Diller's wife, Diane von Furstenberg.

108. After the audit period, the Company planned to increase the strength of the "Linda Horn" brand through the advertisement of its collection of Majolica, a type of pottery created in England in the mid-1800s. The collection has been acquired over 40 years and sold in the store.

109. After the audit period, Mr. and Mrs. Horn have been designing a book together featuring the Majolica collection. Mr. Horn is taking the photographs of the pieces and doing the layouts. Cheryl Baxter is helping petitioners with the research and photographs. Petitioners plan to publish the book and then conduct a large sale of the collection at an auction house such as Christie's.

110. Petitioners have considered selling or franchising the Linda Horn brand subsequent to the audit period.

111. The Company's accountant, Michael Hecht, counseled petitioners on structuring real estate purchases. In regard to petitioners' real estate activities, Mr. Hecht stated that petitioners would "buy opportunistically." In 2004, Mr. Hecht recommended the Company sell the Church in a like-kind exchange pursuant to Internal Revenue Code (IRC) § 1031. Petitioners were interested in expanding to the Palm Beach, Florida, area, and had advertised there for the antiques store during winters to gain exposure with visiting New Yorkers. In April 2004, the Company purchased property at 260 Via Bellaria, Palm Beach, Florida (the Lake House) for \$9,850,000.00 with money advanced to the Company by petitioners, individually, as part of an intended IRC § 1031 like-kind exchange with the Church. However, petitioners did not complete a timely like-kind exchange and the Lake House was subsequently transferred out of the Company to petitioners' limited liability company, 260 Via Bellaria, LLC, to satisfy the debt of petitioners' loan for the property. The actual date of transfer of the property to 260 Via Bellaria, LLC, is unclear from the record.

112. Mrs. Horn testified that she planned to make a profit from the Lake House by renovating and then selling the property. Petitioners used recognized designers that designed buildings from the 1920s and 1930s and renovated the Lake House property to its original look.

Petitioners renovated the property in an art deco style and gained press coverage for the renovation.

113. Cheryl Baxter helped Mrs. Horn with the design of the Lake House, researching the items that Mrs. Horn wanted, with the goal of finding the items at the best price possible.

114. Mr. Drohan acted as a project manager/general contractor to the work on the Lake House, and described the work as a “total gut job.” Mr. Drohan supervised a contractor in Florida and reviewed pricing and payroll. When the Florida contractor left the project early, Mr. Drohan personally went to Florida to supervise and perform work on the elevator, cabinetry, and small electrical items.

115. In August and September 2004, Hurricanes Charley, Frances, Ivan and Jeanne hit Florida, with Hurricanes Frances and Jeanne directly impacting the Palm Beach area.

116. In April 2005, the Company sold the Church, which it purchased for \$775,000.00, for approximately \$12,000,000.00. The Company reported the sale as an IRC § 1031 like-kind exchange on its 2005 tax return, acquiring 930 South Ocean Boulevard, Palm Beach, Florida (the Ocean Property) in May 2005 and 353 Peruvian Avenue, Palm Beach, Florida (the Peruvian Ave. property) in June 2005. The Company reported a fair market value of the like-kind property received of \$15,443,000.00 on its 2005 return.

117. The Ocean Property was a residential property acquired for renovation and investment. Despite the Florida hurricanes, it was in relatively good condition at the time of purchase. The property did sustain some hurricane damage to roof tiles and a balustrade. Additionally, petitioners constructed a new terrace and patio, landscaping and lighting. Mr. Drohan dealt with the contractors involved in this renovation work, receiving estimates and discussing the scope of work.

118. The Peruvian Avenue property was a strip mall on Peruvian Avenue and Coconut Row, a block from the main street in Palm Beach. It was purchased with the idea of opening a Linda Horn Antiques store in Palm Beach. The Company also considered renting a portion of the Peruvian Avenue property.

119. Petitioners' son Christopher Horn, a real estate agent in Palm Beach, managed the Company's real estate holdings. He moved into a garage apartment at the Ocean Property after his apartment was damaged by a hurricane to allow him to supervise construction and show the real estate.

120. In October 2005, Hurricane Wilma hit Florida and caused significant property damage in the state. The widespread damage from multiple hurricanes within a short time span delayed renovations throughout the community. For example, the Palm Beach area was devoid of landscaping and nursery stock and the Company had to wait a long time to purchase replacement landscaping for the Florida properties.

121. At some point, Mrs. Horn was diagnosed with Lyme disease and Mr. Horn had a quadruple bypass. As a result, petitioners decided not to extend themselves further and the Company eventually abandoned plans to open an antiques store in Palm Beach. In February 2008, the Company entered into a sale listing agreement with a real estate broker, Linda A. Gary Real Estate, Inc. (the listing agent), to list the Peruvian Avenue property for sale. The property was advertised by the listing agent.

122. The Lake House and Ocean Property were also advertised for sale by the listing agent.

123. The 2008 financial crisis depressed the real estate and consumer market.

124. On December 11, 2008, Bernard Madoff was arrested for running a Ponzi scheme. Because many Palm Beach residents had invested money with Mr. Madoff, the resulting collapse of the Ponzi scheme had a significant negative effect on the local economy.

125. In 2011, the Company sold the Ocean Property for \$11,500,000.00, reporting a gain of \$7,388,713.00 on its 2011 federal income tax return for an S Corporation.

126. In 2013, 260 Via Bellaria, LLC, sold the Lake House for \$15,000,000.00, more than its original cost but less than the \$25,000,000.00 for which it was valued before the financial crisis started.

127. The Peruvian Avenue property is still currently on the market.

128. Mrs. Horn enjoys the antiques business and finds it fascinating. Alayne Baxter, who runs the antiques store, loves the work and wants to do it.

129. The Division's auditor, Summer Mann, testified at trial that she believes Mrs. Horn is an honest woman who works very hard. Ms. Mann also believes that Mrs. Horn derives personal pleasure from the antiques business rather than possessing an actual profit objective.

130. The Company's administrative and executive office for all of its businesses is at the Studio.

131. Ms. Danao, as the Company's bookkeeper, pays all of the Company's bills, keeps track of expenses, and generates sales reports. Ms. Danao uses the accounting software Sage, and formerly used the accounting software Peachtree, to maintain general ledgers and trial balances for the Company. Separate trial balances and general ledgers are maintained for the antiques store. Sales reports for the antiques store are generated from store invoices which are entered into the system by store employees. Ms. Danao prints sales reports at the end of every month and reviews the reports against the invoices. James Moirano at Hecht and Company, P.C.

(Hecht and Co.), petitioners' accountants, testified that Ms. Danao's records are adequate and professional. The records are used by Mr. Moirano to prepare the Company's and petitioners' tax returns, which are then reviewed by Fred Slomovic of Hecht and Co.

132. Ms. Danao reviews all expenditures and separates out personal expenditures of Mr. and Mrs. Horn. These expenses are not deducted but are offset against loans made by the Horns to the Company.

133. From 2004 to 2006, the antiques business was a division of the Company known as Steve and Linda Horn, Inc., d/b/a Linda Horn Antiques. In 2006, the antiques business was transferred to a limited liability company, Linda Horn, LLC, which was wholly owned by the Company.

134. Separate bank accounts are maintained for the Company, Linda Horn, LLC, Woodland Farms LLC, and petitioners personally.

135. The Company did not provide a separate breakdown of income for the television commercial business, the antiques business, or the real estate business during the audit. The Company did not provide a separate breakdown of expenses for the three businesses during the audit. A schedule partially breaking down the expenses was prepared after the conciliation conference. During the hearing, separate trial balances and general ledgers for the Company, Steve and Linda Horn, Inc., d/b/a Linda Horn Antiques, and Linda Horn, LLC, were submitted into the record. Separate sales reports for Steve and Linda Horn, Inc., d/b/a Linda Horn Antiques, and Linda Horn, LLC, were submitted into the record.

136. The trial balances indicate if income or receipts are from the television commercial business or the antiques business. The trial balances do not include receipts or income from the Florida real estate. While certain expenses of the Company can be apportioned solely to the

antiques business on its trial balances, some of the expenses listed on the general ledgers of the Company are allocable to all of the Company's business activities. For example, Ms. Danao is the bookkeeper for all of the Company's business lines, but her salary is listed only on the books of the Company. Professional fees and the costs of maintaining the Studio, which is used as the administrative office for the antiques store, are also on the books of the Company.

137. Over the years, petitioners have loaned money to the Company. Petitioners have lent over \$31,000,000.00 to the Company over the audit period. The Company pays interest to petitioners on the loans. Any personal expenses of petitioners incurred by the Company are charged against the loans.

138. The Company has employed the services of an outside accounting firm, Hecht and Co., since its creation. Hecht and Co. prepares the Company's tax returns, in consultation with Ms. Danao.

139. Michael Hecht, a principal at Hecht and Co. and a certified public accountant, has known and advised petitioners for 40 years. He described the Horns as tremendously optimistic and only seeing the possibilities and benefits with respect to their work.

140. Mr. Hecht testified that because petitioners were hard-working individuals, he could only meet with them after 6:00 or 6:30 P.M. and could not meet with them during the normal working day.

141. On March 11, 2008, the Company's and petitioners' cases were assigned for audit for the period 2004 through 2006 to the Rochester, New York, district office of the Division. On March 14, 2008, internal audit logs were created by the Division's auditor.

142. On March 17, 2008, the Division's auditor sent a letter to the Company advising that its New York State tax returns for the period 2004 to 2006 were selected for audit. The letter

requested that the Company provide, in part, the following: details of the like kind exchange; workpapers detailing the balances in the loans from shareholders account and copies of the loan agreement documents detailing the interest rate, payment terms and note holders; workpapers detailing the note receivable from HD Antiques & Collectables, LLC, and copies of the loan agreement documents; and copies of all insurance policies used for the business. The letter further stated that in addition to the aforementioned documents, the Division may require the following documents as the audit continues: federal unemployment reports; information regarding interests in a partnership, LLP, LLC or S Corporation; a written description of the business activities or the taxpayer both within and without New York State, including a description of the places of business and activities performed at each location, the number of employees, and whether the location is owned or leased; all books, records, worksheets, schedules, and other documents pertinent to the preparation of the Company's tax returns, including general ledger, purchase disbursements, and sales/receipts journals, payroll ledger, and year end adjusting entries; accountant's workpapers reconciling the books to the tax returns; names, addresses, and social security numbers of all officers/shareholders/partners, including duties and responsibilities; board of directors meeting minutes; chart of accounts; an organizational chart identifying parent, subsidiary, brother or sister entities as well as a detailed descriptions of their business activity inside and outside of New York; copies of the Consolidated Form 1120-S, U.S. Income Tax Return, including schedules and attachments; copies of the filed Article 9-A Corporation Franchise tax returns, MTA surcharge returns, and Forms NYS-45 and NYS- 45-ATT, Quarterly Combined Withholding, Wage Reporting and Unemployment Insurance Return and Attachment; copies of audited financial statements, annual reports, annual statements, and SEC 10-K reports; documentation and details to support New York State and

federal net operating loss, rent expense deducted on federal returns, interest expense per the federal return, including principal amount, interest paid and purpose of each loan; bad debt deduction for federal, New York State and IBF purposes; workpapers used to compute the interest expense deduction for federal purposes and for the IBF; copies of federal personal income tax forms for the shareholders for the audit years; and W-2 wage statement for the audit period.

143. In an entry dated March 17, 2008, Division's audit log pertaining to the Company described the audit issues as "analyzing the like kind exchange" and "analyze the loans from shareholders."

144. On April 3, 2008 the Division received a power of attorney from Ephraim Slomovic, a certified public accountant and tax manager at Hecht and Co., who has worked as petitioners' accountant for over 15 years. Mr. Slomovic notified the Division that he was the Company's representative for the audit.

145. An entry in the Division's field audit log dated June 17, 2008 notes that the auditor conducted research on IRC § 1031.

146. Over the course of the audit from June 17, 2008 through September 29, 2008, the Division requested and the Company provided information in relation to the like-kind exchange issue.

147. On December 1, 2008, the Division's auditor sent the Company a letter requesting details regarding the use and occupancy of each of the two replacement properties in Florida and copies of leases in effect for the audit period if the properties were being held for investment purposes.

148. In response, the Company's representative sent a letter dated January 28, 2009, stating that the Company purchased the Ocean Property as an investment with the expectation of appreciation, but had been unsuccessful in selling the property, and that the Peruvian Avenue property was a commercial property purchased in part to extend the antiques store to Florida, and to rent out the remaining space. The letter further indicates that due to the difficult real estate market, the Company had been unable to launch the Florida store, rent the retail space or sell the property.

149. In response to additional inquiries from the Division, the Company's representative sent a letter stating that the real estate properties suffered significant hurricane damage, which made them uninhabitable, and referenced newspaper and real estate broker listings.

150. On May 1, 2009, the auditor requested additional information with respect to the like-kind exchange, including, in part, the date and name of the hurricane mentioned in the representative's prior correspondence, copies of invoices substantiating the dollar amounts spent in rehabilitating the properties, the name and address of the employee supervising the renovation, real estate tax bills, floor plans, leases and rent receipts.

151. On June 23, 2009, in response to the Division's request, the Company sent a letter and documents, including invoices detailing amounts spent on the Florida properties, real estate tax bills, a list of employees who supervised property renovations, and a floor plan of the Peruvian Avenue property. Said documents referenced in the letter were not included in the record as attachments to the letter. The Company further noted in the letter that Hurricane Wilma was responsible for the damage to the properties.

152. An entry in the Division's field audit log dated September 11, 2009 notes, in part, the Division's question of whether the Company's business is a viable business and indicates that the auditor needs to conduct research regarding the activities not engaged in for profit.

153. On October 16, 2009, after transfer to a new auditor, the Division's auditor sent a letter to the Company's representative requesting additional information with respect to the like-kind exchange. The letter also requested a full description of the business activities of the Company, including the locations where all business is conducted and the number of employees at each location, substantiation of the Company's shareholder, stock and loan basis, copies of loan agreements, and substantiation as to where petitioners stay when they are in Florida, including details of their travel account and record for travel expenses. The letter did not reference IRC § 183.

154. In response to the Division's request, the Company's representative sent correspondence dated December 14, 2009, stating, "[e]nclosed is the documentation requested in your letter of October 16th." The referenced enclosures are not included in the record.

155. On April 27, 2010, the Division's auditor sent a letter requesting a full description of the business activities for the Company, including the locations where all business is conducted and the number of employees at each location; income statements and trial balances for each business entity conducted under the Company; insurance policies for all the Florida property under the Company; substantiation as to where petitioners stay when they are in Florida; and the realtor listing for the Ocean Property. The auditor also questioned the validity of the like-kind exchange. The auditor did not mention IRC § 183.

156. On June 29, 2010, the Company's representative sent a letter in response to the Division's request, stating, in part, "I am enclosing copies of the following: 1. "Quiet Open

Listing” dated December 5, 2008 listing the property for sale, or rental; 2: Realtor Listing Service Agreement between Steve and Linda Horn and Linda A. Gray real Estate Inc. dated December 17, 2009.” Said enclosures were not attached to the letter in the record. The letter also noted that “due to significant hurricane damage the taxpayer was unable to list the property for either sale or rent immediately after its purchase.”

157. An entry in the Division’s field audit log dated October 4, 2010 notes, in part, that Mr. Slomovic spoke with the auditor and stated that the Company’s businesses are commercials and antiques, and that the company had been phasing out the commercial business.

158. On October 27, 2010, the Company’s representative sent another letter in response to the Division’s April 27, 2010 letter, stating, in part that the Company was engaged in the business of selling antiques and in the business of television commercial production. The letter also notes that the administrative and executive office of both businesses were located at the 435 E. 83rd Street (the Studio).

159. The Division’s audit log notes that on November 24, 2010, November 26, 2010, December 23, 2010, December 24, 2010 and January 12, 2011, the Division’s auditor conducted research in IRC § 183.

160. An entry in the Division’s field audit log dated January 13, 2011 notes, in part, that the Division’s auditor contacted the Company’s representative and requested the Company’s articles of incorporation. The entry further notes that the auditor informed Mr. Slomovic that the Division was reviewing the section 1031 exchange and whether it qualified for nonrecognition of gain. The entry does not indicate that the auditor referenced IRC § 183.

161. On February 10, 2011, the Division’s auditor sent a letter to the Company’s representative updating the audit period to include tax years 2007, 2008 and 2009. The letter

further stated that the Division determined that the Ocean Property obtained during the tax year 2005 like-kind exchange does not qualify for deferred gain treatment. The letter also stated that after reviewing IRC § 183, Activities Not Engaged in for Profit, the Division determined that the Company is not a business that is engaged in for profit, based on the following:

- “1. The shareholder does not depend on the income from the business.
2. The business has not made a profit in at least the last eight years of operation.
3. The losses were not due to circumstances beyond their control and they did not occur in the start-up phase of their business.
4. The business has not changed their methods of operation to improve profitability.”

162. On April 11, 2011, Roberts & Holland LLP (R&H) submitted a power of attorney and took over the representation of the Company and petitioners with respect to the audit. On May 10, 2011, R&H sent a letter in response to the Division’s February 11, 2011 letter, arguing that the like-kind exchange was valid and that the Company’s activity was engaged in for a profit, noting, among other things, that the Company earned substantial sums on the sale of the Church property in 2005.

163. An entry in the Division’s field audit log dated May 20, 2011, notes, in part, with respect to the IRC § 183 issue, “[t]he business made a profit when they sold the NY building, but the gain was deferred. They did not go into any details to defend or support how the business intends to make a profit.”

164. As noted in an entry in the Division’s field audit log dated July 28, 2011, during a conversation with the Company’s representative the auditor requested a breakdown of income for each business segment. The representative informed the auditor that the business is one entity and they do not separate the income and expenses.

165. On September 16, 2011, the Division issued a Notice of Deficiency to petitioners for the years 2004 through 2009 (*see* Finding of Fact 4). The tax amount for each year was

calculated by disallowing all of the Company's losses for the year and by disallowing any net operating loss carryforwards and carrybacks from other tax years.

166. Prior to making its determination, the Division never asked to visit the Studio, the Warehouse, the Creamery, or the antiques store. During the audit, the Division did not know that the antiques store changed its location in 2005. The Division's auditor was also not aware that the antiques store had expanded its internet presence during the audit period.

167. On April 28, 2012, a conciliation conference was held before the Bureau of Conciliation and Mediation services (BCMS). On August 17, 2012, a conciliation order was issued sustaining the statutory notice.

168. The Division does not dispute that the Company's commercial production business was engaged in for profit.

169. The Division's audit report states, "Based on review of returns and discussion with taxpayers there are no indications of any tax shelter activity."

170. Petitioners submitted 202 proposed findings of fact. In accordance with State Administrative Procedure Act (SAPA) § 307(1), proposed findings of fact 1, 2, 5 - 11, 13 - 22, 24, 26, 30 - 33, 35, 37, 39, 41 - 43, 46, 47, 53, 56, 58 - 61, 64, 66 - 70, 73 - 75, 78, 79, 84 - 87, 90, 94, 95, 99 - 101, 108 - 111, 116 - 118, 120, 122, 126, 131, 133, 134, 136 - 138, 140, 142, 143, 145, 146, 150, 152, 154, 155, 161, 167, 170, 173 - 176, 178, 180 - 182, 184, 187, 190, 191 and 195 are supported by the record and have been substantially incorporated in the foregoing Findings of Fact.³ Proposed findings of fact 3, 4, 12, 23, 25, 28, 29, 36, 38, 40, 44, 45, 48, 50 - 52, 54, 55, 57, 62, 65, 71, 72, 76, 77, 83, 88, 89, 91 - 93, 96, 102, 104, 106, 107, 112 - 114, 119,

³ Many of the proposed facts as presented by petitioners have been condensed and renumbered as incorporated in the Findings of Fact set forth above.

121, 123 - 125, 127 - 130, 139, 141, 147, 151, 153, 162, 164 - 166, 168, 169, 171, 172 and 179 have been modified to more accurately reflect the record, delete information not relevant and material to this determination, and remove direct quotes, which are not proper findings of fact. Proposed finding of fact 27 has been rejected as not relevant and material to this determination. Proposed finding of fact 34 has been rejected as setting forth an ultimate fact thus constituting a conclusion of law. Proposed findings of fact 49, 63, 135, 144, 183, and 185 are repetitive of earlier proposed or stipulated facts previously incorporated herein. The first sentence of proposed finding of fact 80 has been accepted; the remainder of 80 has been modified to remove the direct quote, which is not a proper finding of fact but merely a quote of opinion testimony. Proposed finding of fact 81 has been rejected as it is not a proper finding of fact because it states a conclusion and is merely a quote of testimony offering opinion and hyperbole. The second and third sentences of proposed finding of fact 82 have been generally incorporated herein; the first sentence is rejected as a conclusion; the remainder is rejected as not a proper finding of fact but merely a quote of testimony. Proposed finding of fact 97 has been modified to remove conclusory statements and transcript quotes. Proposed findings of fact 98, 103, 132, 148, 149 are rejected as conclusions. Proposed findings of fact 105 and 193 are rejected as not supported by the record. The first sentence of proposed finding of fact 115 is rejected as a conclusion; the remainder of 115 is generally incorporated herein. Proposed findings of fact 156 - 160 and 163 have been condensed and portions not probative or necessary in reaching the ultimate conclusions of law herein have been omitted. Proposed finding of fact 177 has been modified to delete argumentative portions; the remainder has been generally incorporated herein. Proposed findings of fact 186, 188, 189 and 192 have been rejected as argumentative. Proposed findings of fact numbered 194 and 196 through 202 have not been incorporated because they set forth

undisputed procedural matters whose recitation is unnecessary for purposes of resolving the issues presented.

CONCLUSIONS OF LAW

A. As a preliminary matter, in order to determine whether Internal Revenue Code (IRC) § 183 and the regulations thereunder apply, the activity or activities of the taxpayer must be ascertained (Treas Reg § 1.183-1[d][1]). Where, as here, a taxpayer is engaged in several undertakings, each undertaking may be a separate activity, or several undertakings may constitute one activity (*id.*). If the taxpayer engages in two or more separate activities, deductions and income from each separate activity are not aggregated either in determining whether a particular activity is engaged in for profit or in applying section 183 (*id.*). In ascertaining the taxpayer's activities, all facts and circumstances of the case must be taken into account. "Generally, the most significant facts and circumstances in making this determination are the degree of organizational and economic interrelationship of various undertakings, the business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business or in an investment setting, and the similarity of the various undertakings" (*id.*). A taxpayer's characterization of two or more undertakings as one activity is generally accepted unless it is artificial or unreasonable (*id.*). Petitioners argue that the Company's television commercial production business, antiques business, and real estate investments should be treated as one activity. The Division, on the other hand, does not specifically address whether the various undertakings should be treated as one or multiple activities, but instead argues that the

television commercial production business ended at the beginning of the audit period and that petitioners were not engaged in real estate activity.⁴

Courts have applied various factors in deciding whether a taxpayer's characterization of several undertakings as one activity is unreasonable for purposes of IRC § 183, including:

- “(1) whether the undertakings are conducted at the same place;
- (2) whether the undertakings were part of a taxpayer's efforts to find sources of revenue from his or her land;
- (3) whether the undertakings were formed as separate activities;
- (4) whether one undertaking benefitted from the other;
- (5) whether the taxpayer used one undertaking to advertise the other;
- (6) the degree to which the undertakings shared management;
- (7) the degree to which one caretaker oversaw the assets of both undertakings;
- (8) whether the taxpayer used the same accountant for the undertakings; and
- (9) the degree to which the undertakings shared books and records.” (*Price v. Commissioner*, TC Memo 2014-253 [2014], citing *Mitchell v. Commissioner*, TC Memo 2006-145 [2006]).

I examine these factors, as applied to the facts of this case, as follows:

Location of Activities

⁴ In regard to the Division's contention that petitioners were not engaged in real estate activity, the Division argues the Company purchased only four properties since 1981 and sold only one of those properties during the audit period. The Division further argues that petitioner's son lived at the Ocean Property “for a time” and that the Studio and Church properties were both purchased and used by the Company for a headquarters and storage facility. The Division contends, therefore, that petitioners were not in the real estate business because they did not purchase and sell multiple properties. However, contrary to the Division's argument, IRC § 212 does not require that a specific number of properties be bought or sold in order for a taxpayer to be allowed an expense deduction. Rather, it allows a deduction of all ordinary and necessary expenses for, among other things, the management, conservation, or maintenance of property held for the production of income. The question is not the number of properties, but whether the properties were held for the production of income. This question will be addressed below, in the discussion of whether petitioners were engaged in the activities for profit.

The activities were generally conducted at different locations, although they shared one location for administrative functions. The television commercial production business (commercial business) ceased bringing in new business around the beginning of 2005, although it continued to carry overhead expenses from maintaining its administrative location at the Studio. During the years at issue, any remaining functions for the commercial business were conducted at the Studio. Prior to 2004 or 2005, when the commercial business was still active, its functions were conducted at both the Studio and various field locations as required for commercial shoots. The antiques business was carried on at the storefront, located first in Valhalla, New York, then at a store called “Linda Horn at Fred Leighton” on Madison Avenue in Manhattan, then at 79th Street and Madison Avenue, and finally at the 93rd Street store. However, the bookkeeping for the antiques business was done at the Studio, and photographs of the antiques were taken at the Studio. The real estate activities were conducted primarily at the various real property locations in Florida, where petitioners renovated the Ocean Property and Lake House, and listed the Peruvian property with a Florida real estate agent, although some administrative functions and bookkeeping for the real estate were conducted at the Studio. Based on these facts, I find the shared location for administrative purposes to be incidental and this factor weighs against aggregating the activities.

The Activities as Efforts to Derive Revenue From Land

For an activity to be deemed as having been created to derive revenue from the land, the land or assets must exist before the start of activity (*Price v. Commissioner, citing Estate of Stangeland v. Commissioner*, TC Memo 2010-185 [2010]). The commercial business began in July 1974, before the Company acquired the various properties (the Church in 1980, the Studio in 1981, the Lake House in 2004, the Ocean Property and Peruvian Avenue property in 2005). As

such, the commercial business could not have been created to derive revenue from petitioners' property. Similarly, the antiques business began in the early 1980s, prior to the purchase of any of the Florida properties, and thus could not have been created to derive revenue from those properties. Additionally, the antiques business was not created to find sources of revenue for the Church or the Studio, as those properties were initially acquired to act as the headquarters for the commercial production business.

Whether the Undertakings Were Formed as Separate Activities

The activities were not formed at the same time. The Company was formed as an S Corporation in 1974. Its certificate of incorporation lists among its purposes engaging in photography for advertising, film production, filming of television commercials and motion picture production. Although the certificate of incorporation also lists purchasing and selling real estate as a purpose of the Company, the real estate activities did not begin until years after the formation of the commercial business. Additionally, some of the real estate activities were conducted by separately formed entities, such as the purchase of the Creamery and Warehouse properties, which were owned by Woodland Farms, LLC, and the Lake House, which was transferred to 260 Via Bellaria, LLC. The antiques business activities are not mentioned in the certificate of incorporation and the antiques business was not formed at the same time as the other activities. Moreover, the antiques business was originally formed as the Company "doing business as" Linda Horn Antiques, and subsequently as Linda Horn, LLC.

Each Activity's Benefit to the Other Activity

The commercial business did not benefit from the real estate activities involving the Florida properties, and vice versa, since the commercial business had generally ceased operations before the Florida properties were purchased. There is no evidence that the commercial business,

antiques store and the real estate activities shared a client base or that one activity generated clients or sales for the other (*see Price v. Commissioner; cf. Topping v. Commissioner*, TC Memo 2007-92 [2007] [treating taxpayer's interior design and equestrian activity as a single activity for purposes of § 183, where taxpayer generated more than 90% of her interior design client base through equestrian activity contacts]). While petitioners argue that the skills of the various employees that were developed in one undertaking proved beneficial for use in the other undertakings, there is no evidence that expenses were reduced by using the same employees for each activity or that they were unable to find outside skilled employees for the various activities.

Cross-Advertising

Petitioners argue that Mr. Horn's expertise in photography and film were used to create the Company's advertisements in-house. However, there is no evidence of cross-advertising between the undertakings; there is no evidence that any advertisements covered the commercial business, antiques business and real estate business together. The advertisements presented into the record are limited to the antiques business and make no mention of the other activities. Further, there is no evidence that the antiques store's website mentions the real estate activities or advertises any of the Company's real estate for sale or rent (*see Price v. Commissioner*). Additionally, although petitioners argue that "all of the undertakings serve as an advertisement of the 'Linda Horn' brand," there is no mention in the real estate listings presented in the record of the "Linda Horn" brand and there is no evidence that the real estate listings advertised the antiques business.

Shared Management

The undertakings shared management in the form of Linda Horn. However, Alayne Baxter is the antiques store manager and is not involved in the real estate activities.

Shared Caretaker

Petitioners argue that they satisfy this factor in that “Tommy Drohan and Cheryl Baxter managed sets for the commercials and oversaw the development of the real properties. Tommy manages the inventory in the warehouses and newly purchased items as they are delivered or moved. Cheryl oversees the operation of the Studio.” Contrary to petitioners’ argument, Mr. Drohan’s and Ms. Baxter’s descriptions of their duties do not appear to be that of a caretaker. The general definition of a caretaker is “one that takes care of the house or land of an owner who may be absent” (*Price v. Commissioner, citing* Webster’s Ninth New Collegiate Dictionary 208 [1985]). Mr. Drohan worked as an assistant director for the commercial business and did not oversee that business’s assets. For the antiques business, Mr. Drohan worked as the general contractor for the construction of the new store and was also responsible for receiving inventory at the warehouse and transporting merchandise between the store and warehouse. He was not involved as a “caretaker” of the assets at the antiques store. If anyone qualifies as a caretaker of the antiques business, it would more appropriately be Alayne Baxter, the store manager, who looked after the store’s inventory on a daily basis. For the real estate activities, again Mr. Drohan’s primary role was that of a general contractor, overseeing the subcontractors involved in the real properties’ rehabilitation work. There is no evidence that once the construction was completed, Mr. Drohan continued to oversee the properties and act as a caretaker. To the contrary, it appears that petitioners’ son, Christopher acted more as the caretaker of the real estate activities related to the Florida properties. As petitioners’ witness, Mr. Hecht explained, Christopher Horn, the listing agent for the Florida real estate, moved into a garage apartment of the Ocean Property after his apartment was damaged by a hurricane, to oversee construction on the house and later show the real estate. With regard to Cheryl Baxter, her testimony reveals that

she was not a caretaker who oversaw the assets of all the undertakings. Ms. Baxter testified that prior to 2004 or 2005, when the commercial business was active, she did not work with the antiques business. In 2005, when the antiques store moved to the 93rd Street location, she was involved in bringing in builders, scene designers, electricians and plumbers. She was also involved in conducting research for the antiques business to find manufacturers and resources, and placed advertisements for the store. Ms. Baxter's job duties as described are not one of a caretaker of the antiques business's assets. Ms. Baxter's description of her duties for the Florida properties, which included finding items, materials and workers Mrs. Horn needed for the real property restoration projects, likewise does not fall within the definition of a caretaker.

Shared Accountants

This factor favors petitioners' argument, in that petitioners use the accounting firm of Hecht & Company, P.C., for all of the undertakings. Petitioners' bookkeeper, Ms. Danao, maintained the books for all of the undertakings.

Shared Books and Records

As noted above, Ms. Danao maintained the books for all of the undertakings. Separate trial balances and general ledgers are maintained for the separate activities. The trial balances indicate from which activity the income or receipts are generated. Contrary to petitioners' argument that the books and records are so intertwined that no one can completely segregate the finances of each activity, petitioners' accountant, Mr. Moirano, presented a breakdown of expenses for the antiques business, the real estate business and the commercial business and testified that the trial balances are broken down for each business.

Based on the foregoing factors and a review of the relevant facts and circumstances, it is determined that the various undertakings were separate activities. As such, each activity must be

reviewed separately for purposes of IRC § 183, and deductions and income from each separate activity are not aggregated either in determining whether a particular activity is engaged in for profit or in applying IRC § 183. Additionally, where the taxpayer is engaged in more than one activity, an item of deduction or income may be allocated between two or more of these activities. Where property is used in several activities, and one or more of such activities is determined not to be engaged in for profit, deductions relating to such property must be allocated between the various activities on a reasonable and consistently applied basis (Treas Reg § 1.183-1[d][2]).

B. The Division does not dispute that petitioners' commercial production activity was engaged in for profit. Although the commercial business was winding down by the beginning of 2005 and did not have any income during the audit years, a taxpayer does not lack a profit motive merely because he takes a reasonable time to unwind an unprofitable business and minimize his losses (*Bailey v. Commissioner*, TC Memo 2012-96 [2012], *affd Bailey v. IRS*, 2014 WL 1422580 [1st Cir 2014]). Moreover, the commercial business was profitable in earlier years prior to the audit period. Since it is not contested that the commercial business was engaged in for profit, expenses attributable to that activity are deductible. While the Regulations call for an allocation of deductions among the separate activities, it is not necessary to specifically attribute the expenses to the separate activities herein, as the ultimate conclusion, discussed below, is that each separate activity was engaged in for profit, so that all of the expenses claimed by the Company are determined to be deductible.

C. With regard to the remaining activities, a deduction is allowed by IRC § 162(a) for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying out any trade or business." Deductions are also allowed pursuant to IRC § 212 for expenses incurred "for

the management, conservation, or maintenance of property held for the production of income.” The test as to whether property is held for the “production of income” within the meaning of IRC § 212 is whether the taxpayer’s primary, good faith purpose and intention in engaging in the activity was to make a profit (*Zell v. Commissioner*, 763 F.2d 1139, 1142 n.3 [10th Cir 1985]; *Snyder v. United States*, 674 F.2d 1359, 1362 [10th Cir 1982]; *Lowry v. United States*, 384 F Supp 257, 261 [1974]). IRC § 183 supplies the same ultimate test.

Petitioners are entitled to a deduction for ordinary and necessary expenses of the antiques business and real estate activities if petitioners engaged in the activities with an actual and honest objective of making a profit (*see Annuzzi v. Commissioner*, TC Memo 2014-233 [2014]). If an activity is “not engaged in for profit,” deductions are allowable only to the extent of income from such activity (IRC § 183[b][2]; *Matter of Temple*, Tax Appeals Tribunal, July 8, 2004). Resolution of the issue of whether petitioners’ activities were engaged in for profit is properly determined based on a review of all of the surrounding facts and circumstances and in consideration of the nine factors set forth in Treas Reg § 1.183-2[b] (*see Hoag v. Commissioner*, TC Memo 1993-348 [1993]). In resolving the factual question, greater weight is given to the objective facts than to the taxpayer’s statements of intention (*id.*).

D. The nine factors listed in the regulations to help determine whether a taxpayer has engaged in an activity for profit are as follows: (1) the 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, that are earned, (8) the financial status of the taxpayer, and

(9) elements of personal pleasure or recreation (Treas Reg § 1.183-2[b]). The factors listed above are intended as guidelines and are nonexclusive. Accordingly, no single factor or combination of factors is conclusive in indicating a profit objective (*see Ranciato v. Commissioner*, 52 F3d 23 [2d Cir 1995]). Additionally, as stated by the court in *Metz v. Commissioner*, “[w]hile we organize our analysis by the nine factors listed in the regulation [citation omitted] we don’t use a reasonable-person standard or substitute our own business judgment for what the [taxpayers] could have done better. Our focus is instead on the [taxpayers’] subjective intent and we use the factors to establish that intent.” (*Metz v. Commissioner*, TC Memo 2015-54 [2015], *citing Wolf v. Commissioner*, 4 F3d 709 [9th Cir 1993]).

E. The factors enumerated above, as applied to each activity, in turn, are as follows:

The Manner in Which the Taxpayer Carries on the Activity

The first factor considers whether the taxpayer engaged in the activity in a businesslike manner (Treas Reg § 1.183-2[b][1]). In determining whether the taxpayer conducted the activity in a businesslike manner, the courts have considered whether accurate books were kept, whether the activity was conducted in a manner similar to other comparable businesses and whether changes were attempted in order to make a profit (*Dodge v. Commissioner*, TC Memo 1998-89 [1998], *affd* 188 F3d 507 [6th Cir 1999]). A review of the record shows that there are many objective criteria indicating the Company engaged in the antiques business and real estate activities in a businesslike manner.

The Company kept thorough and accurate records of both the antiques business and the real estate activities. The Company’s bookkeeper maintained trial balances and general ledgers reflecting the income and expenses of the various activities of the Company. For the antiques

business, the Company's bookkeeper also generated monthly sales reports based on invoices entered into the database by the store's salespeople and reviewed the reports against the actual invoices. The store's sales manager accessed the sales reports to view sales per day, year to date, and prior years' sales history, in order to set current sales goals. Petitioners maintained separate accounts for their business undertakings and personal matters. Petitioners used a professional outside accounting firm to prepare the Company's tax returns each year. In preparation of the Company's returns, the accountants consulted with the Company's bookkeeper and reviewed the Company's trial balances, bank statements and other books and records. The accountants testified that the Company's books and records were kept in a professional manner.

In addition to the detailed records of income and expenses maintained in the trial balances and ledgers, the Company used sales diaries in the antiques store, which petitioners refer to as the Madison Diaries. The Madison Diaries allow the store manager and salespeople to keep track of the contact information and sales history of every customer that has come into the store. The store's salespeople write down the names of customers who come in, what items they are interested in, if the customer was given a special price, and customer contact information. Petitioners utilize these records as a sales technique to follow-up and contact customers when they find an item for which the customer was looking. Petitioners also maintain a detailed database of the antiques store's inventory and use tear sheets in the store, both to keep track of inventory and to encourage sales by giving the tear sheets to customers and decorators, so that potential customers remember their favorite items after they leave the store and can call back to purchase the item. The use of such thorough records in the antiques business favors petitioners' argument that the business was run with a profit motive (*see Elliott v. Commissioner*, 90 TC

960, 970 [1988], *affd* 899 F2d 18 [9th Cir 1990]; *Metz v. Commissioner* [noting taxpayer's use of customer prospects and contact lists as a factor in favor of a profit motive]).

Petitioners invested substantial personal funds into the Company for both the antiques business and purchase of real estate investments. A loan account is maintained for the Company and interest is charged based on advice obtained from petitioners' accountants. Petitioners' personal expenses are not included in deductions taken by the Company but are charged to petitioners against their loan account. The interest the Company pays to petitioners is reported on their personal income tax returns. This factor likewise shows that the activities were conducted in a businesslike manner.

The Division argues that the absence of a written business plan and formal budget shows that petitioners did not act in a businesslike manner. However, a written business plan is not required where the plan was evidenced by the taxpayers actions (*see Annuzzi v. Commissioner; Dishal v. Commissioner*, TC Memo 1998-397 [1998]; *Estate of Brockenbrough v. Commissioner*, TC Memo 1998-454 [1998]; *Phillips v. Commissioner*, TC Memo 1997-128 [1997]). Although petitioners did not have a written business plan, they had an unwritten business plan of creating the "Linda Horn" brand for the antiques business and pursued it consistently. Petitioners developed their business plan based on their experience in the commercial business, where they produced commercial advertisements for various highly successful brand-names. Petitioners' development of their business plan was also based on Mrs. Horn's familiarity with fashion designer brand lines, such as Donna Karen's "DKNY" line and Calvin Klein's "CK" brand. With a plan to emulate these business models, Mrs. Horn credibly testified that her plan was to create a brand, make the brand name well known, and develop reproductions under her brand name that would be more affordable than original antiques and

appeal to the mass market, in addition to selling original antiques. In pursuit of the plan to mass produce the reproductions, petitioners sought out manufacturers to make the items at a favorable price. To further the brand name, petitioners redesigned the labels, created a sticker to place on items that read “Linda Horn Collection” and created unique packaging designs for items in the antiques store with an eye toward promoting the brand. Petitioners also furthered recognition of their brand by showing their antiques and decorative items in window displays of well-known Manhattan stores such as Bergdorf Goodman and Ralph Lauren, and received store-name credits on those displays.

Petitioners’ pursuit of their business plan can also be seen in the progression of the store. Their antiques business began as a small store in Valhalla, New York, in the early 1980s, where petitioners’ hope was to at least break even.⁵ Petitioners then decided to expand into the Manhattan market, and upon consultation with Fred Leighton, an expert in the jewelry antiques world, petitioners opened their first Manhattan antiques store known as “Linda Horn at Fred Leighton,” in space leased by Mr. Leighton on Madison Avenue. After the lease ran out, the Company moved to its own storefront, obtaining a lease on 79th Street and Madison Avenue in Manhattan and operated at that location until approximately 2005. With the decrease in the commercial business around 2004 and 2005, petitioners decided to focus more on their antiques business. As petitioners looked to grow the antiques business, they decided the 79th Street store was not big enough. In an effort to increase the business, they looked for a larger space where they could display and sell more antiques as well as the growing reproduction line, and have a larger, more visible impact. After searching for the appropriate location, the Company found the

⁵ It should be noted that Mrs. Horn’s testimony that, when she first conceived of the antiques business her hope was to have the business work for itself and break even, and “if we do more money, great,” is not contrary to a profit motive (*See Estate of Brockenbrough v. Commissioner*).

93rd Street property, a two-story, 3,500 - 4,500 square foot store with 50-foot display windows facing Madison Avenue, and entered into a lease for the space, effective February 1, 2006.

Petitioners then expended much time, effort and expense renovating the 93rd Street site to create the appropriate atmosphere for the antiques store.

Another factor showing that petitioners ran the antiques business in a businesslike manner was their use of advertising and promotions. In addition to the publicity petitioners gained through the Bergdorf and Lauren window displays, petitioners also placed advertisements for the antiques business in various magazines, sent holiday mailers promoting the store, and sent emails to customers for special occasions and discounts. Petitioners also promoted the antiques business's goods by giving potential customers and decorators tear sheets with information for items of interest to encourage sales following a visit to the store. The store has an attractive website displaying its inventory, as well as a listing of its goods on the 1stdibs website, both key tools in marketing. Petitioners' extensive advertising campaign is indicative of their desire to promote the Linda Horn brand and further demonstrates that they conducted the activity in a business like manner (*see Metz v. Commissioner; Jackson v. Commissioner*, 59 TC 312 [1972][determining that taxpayer's boat charter business was conducted for profit, where the taxpayer staged a thorough advertising campaign, including preparing and mailing brochures and contacting charter brokers and travel agents]).

The Division argues that the Company's advertising for the antiques business was inconsistent and intermittent, and as such should weigh against a finding of a profit objective. I disagree. First, I find that the Division mischaracterizes Cheryl Baxter's testimony by stating that "[t]he Company advertised in a few publications from one to a couple of times a year." Contrary to the Division's assertion, Ms. Baxter testified that the company placed ads a couple of times a

year in Architectural Digest. She also testified that advertisements were placed in a number of other publications and the determination of when to place the ads was based on the focus of the magazine for a specific issue. In this way, petitioners were able to gear the advertising to the appropriate audience, such as those focused on New York design or Palm Beach editions. Moreover, the documentary evidence shows multiple advertisements for the antiques business in various monthly publications each year during the audit period. Second, the Division's argument that the Company's advertising costs in relation to the total costs for the activity indicates that the Company had minimal advertising is misleading. Looking at only the costs is deceptive, because the Company was able to save advertising expenses since Mr. Horn, a professional photographer with vast experience in the advertising world, was able to photograph and design all of the advertisements for the Company. Also, the Division is using the total costs of all the activities in its calculation, but the advertising expenses are only attributable to the antiques business; the real estate activities were advertised through the listing agencies and the commercial business was not advertised during the audit period. As such, when comparing advertising expenses to total costs, the total costs should only be those attributable to the antiques business, not total costs for the Company, as shown in the breakdown of expenses prepared by petitioners' accountant (*see* Finding of Fact 135). Finally, the Division's argument ignores the free publicity the antiques business gained by having its items displayed in the windows of Bergdorf Goodman and Ralph Lauren, as well as its use of promotions through holiday mailers, emails to customers, the use of tear sheets, its elaborate website and social media campaign, and its listing on 1stdibs.

Another factor courts consider in determining if an activity is conducted in a businesslike manner is whether a taxpayer made changes in operating methods and adopted new techniques (*see Metz v. Commissioner; Annuzzi v. Commissioner*; Treas Reg § 1.183-2[b][1]). In addition

to growing the antiques business, petitioners made several changes to the Company's operations in a manner consistent with an intent to improve profitability. By growing their line of reproductions, petitioners hoped to expand the antiques business's customer base to a wider, younger crowd. To further this goal, the Company modernized its marketing techniques to include social media and entered into a contract with 1stdibs, a premier website for antiques sales. The Company also created a website for the antiques business, where items could be purchased directly online.

The Company also reduced expenses in an attempt to improve profitability. As the Company transitioned away from the commercial business and increased its focus on the antiques business, the distribution of employees' salaries followed suit. For the commercial business, salaries were reduced from \$681,194.00 in 2004 to \$271,204.00 in 2009 and positions such as casting director and production manager were eliminated. For the antiques business, the salary history is reflective of the progression of the business. As petitioners tried to expand the antiques business and moved into the new larger store on 93rd Street, salaries correspondingly increased (from \$642,210.00 in 2004 to \$932,814.00 in 2005 and \$992,367.00 in 2006). Subsequently, petitioners reduced salaries for the antiques business in order to bring down expenses, lowering total salaries to \$841,200.00 in 2009. Petitioners also decreased travel in an effort to reduce the antiques business's expenses, lowering these costs from \$66,104.00 in 2004 down to \$23,599.00 in 2009. Another step petitioners took to reduce expenses for the antiques business was slowing the purchase of new inventory and moving more items from the warehouse to the store in order to sell from the existing inventory. In 2005 and 2006, when petitioners were working to grow the antiques business and moved into the new storefront, new inventory purchases totaled \$1,118,844.00 and \$1,396,156.00 respectively. By 2009, new purchases had

significantly decreased to \$165,888.00. Finally, Alayne Baxter renegotiated the Company's lease for the antiques store and the lease was amended in May 2014 to reduce the rent and forgive unpaid back rent.⁶

The Division argues that petitioners' cost-cutting measures were not enough. However, as noted by the court in *Metz*, "We shouldn't turn what the Commissioner may think a better strategy for cutting costs into a requirement that taxpayers must show they meet before we can find they intended to make a profit. . . . The records the Metzses kept did allow them to assess SMF's economic performance and identify strategies to reduce its costs. And we won't use those records to second-guess what they could've done better; we use them only to determine whether what the Metzses did do at SMF shows they had a profit motive" (*Metz v. Commissioner*, at 36, 37). While petitioners may have operated the business more efficiently, "that's not what this factor asks. Rather, by looking at criteria such as business plans, advertising, records and response to losses, we must determine whether [petitioners] operated [the business] in a businesslike manner." (*Id.*) Based on a review of the record, I find that they have, and therefore, this factor weighs in their favor.

Regarding the real estate investment activities, I find that these activities, too, were carried on in a businesslike manner. In addition to maintaining accurate books and records, as noted above, the renovations on the Florida properties were conducted professionally, with petitioners hiring skilled contractors to repair and renovate the properties (*see Vandeyacht v. Commissioner*, TC Memo 1994-148 [1994])[finding petitioner's hiring of a caretaker and condominium association to make repairs to their investment property was a factor in favor of

⁶ Although the reduction in rent is subsequent to the years at issue, evidence from years after the years in issue is relevant to the extent it creates inference regarding the taxpayer's requisite profit objective in earlier years (*see Foster v. Commissioner*, TC Memo 2012-207 [2012]; *Bronson v. Commissioner*, TC Memo 2012-17 [2012] *affd without published opinion* 591 Fed Appx 625 [9th Cir 2015]).

their profit motive]). Petitioners listed the Florida properties with a real estate professional and entered into a listing agreement with a real estate agency in an effort to sell the properties.

Petitioners also had an unwritten business plan for their real estate activities, as reflected by their actions. Simply put, their plan for real estate was to purchase properties in desirable locations at favorable prices, renovate the properties, and sell them for a profit. The record evidences that petitioners exhibited a common entrepreneurial pattern with their real estate investments, wherein they would locate a property, discuss a purchase with their accountant, Michael Hecht, who would counsel them on structuring the real estate purchase, and then, as described by Mr. Hecht, “buy opportunistically” (*see Holmes v. Commissioner*, 184 F3d 536 [6th Cir 1999] [finding that taxpayers’ activity was engaged in for profit where they exhibited a “common entrepreneurial pattern” of identifying a potentially lucrative business, investigating that business by consulting experts and self-study and making informed property acquisition and investment decisions that typically proved profitable]). The record shows a history of petitioners’ real estate activities, including their purchase of the Valhalla property, which was initially used as the antiques store’s original location, and was sold years later for a capital gain, after the store moved to Manhattan. In 1999 petitioners, either individually or through one of their entities, purchased the Cooper Square property for \$14,000,000.00, which they sold a year later for \$21,000,000.00.⁷ The Company purchased two additional properties in Manhattan, the Church and the Studio, with the dual purpose of using these properties for the Company’s business and for investment, expecting the properties to appreciate in value. While the Company still owns the Studio and uses it for administrative offices, it sold the Church for a substantial

⁷ Although some properties were owned by petitioners individually and not by the Company, the overall pattern of activity by petitioners through their various closely held entities demonstrates that they held real estate for investment purposes.

profit. Petitioners consulted with their accountants regarding the real estate activities, and Mr. Hecht advised them to sell the Church in a like-kind exchange pursuant to IRC § 1031. Petitioners were interested in expanding into Florida for both real estate investments and an extension of the antiques business and investigated the Palm Springs area. Following Mr. Hecht's advice, the Company first purchased the Lake House for \$9,850,000.00 with money advanced from petitioners. Petitioners intended to renovate the Lake House and then sell it for a profit. When they were unable to timely complete the like-kind exchange with the Lake House, the Company transferred the property to petitioners' limited liability company, 260 Via Bellaria, LLC, to satisfy the debt of petitioners' loan for the property. The Lake House was eventually sold for \$15,000,000.00.

To complete the like-kind exchange as suggested by Mr. Hecht, the Company then purchased the Ocean Property and the Peruvian Avenue property. The Company purchased the Ocean Property for investment purposes, with petitioners intending to renovate and sell it for a profit. The Peruvian Avenue property was purchased with the idea of opening a Linda Horn Antiques store in Palm Beach. The Company also considered renting a portion of the Peruvian Avenue property. The Company eventually sold the Ocean Property in 2011, reporting a gain of \$7,388,713.00.

While the Division argues that petitioners were not engaged in real estate activity because the Company bought only four properties and sold only one during the years at issue, such contention is without merit. IRC § 212 does not require that a specific number of properties be bought and sold, but only that the property be held for the production of income (*see Vandeyacht v. Commissioner* [finding a profit objective in petitioner's purchase of two residences]). The pattern of real estate activities described above, indicating that petitioners purchased properties

for investment purposes, is a strong factor in favor of petitioners' argument. The Division also argues that petitioners' son lived at the Ocean Property "for a time." However, the Division's speculation does not negate petitioners' investment interest in the property. Petitioners' witness, Mr. Hecht, credibly explained that Christopher Horn, who was an employee of the Company and a licensed real estate broker, moved into the garage apartment at the Ocean Property in order to oversee the construction and show the property. Contrary to the Division's argument, the use of a caretaker to oversee repairs and show the property indicates the businesslike manner in which petitioners conducted their real estate activities (*see Vandeyacht v. Commissioner*).

Each of the elements discussed above indicates that petitioners conducted both the antiques business and the real estate activities in a businesslike manner. As such, this factor supports petitioners' position that they had a profit objective.

Expertise of the Taxpayers or their Advisors

A taxpayer's "consultation with those who are expert" in a particular activity may indicate a profit motive (Treas Reg § 1.183-2[b][2]). The record shows that Mrs. Horn consulted with antiques jewelry expert Fred Leighton before moving the antiques business into the Manhattan market. Indeed, the store's first venture in Manhattan was at a storefront leased by Mr. Leighton, using the name "Linda Horn at Fred Leighton." Additionally, the antiques store's manager consulted with the owner and chairman of Istdibs in relation to the store's online selling with that company. Petitioners used a professional accounting firm during all of the years at issue and employed a bookkeeper with an accounting degree to maintain the Company's books and records.

The Division argues that petitioners did not follow their accountant's advice by not appraising the antiques business's inventory during the recession and then offering the items for a

lower price. This advice, however, was not how to make a profit. To the contrary, following this advice would not have resulted in a profit, but a loss that would have been taken as a “write down” as suggested by Mr. Hecht.

As far as marketing the antiques business and the Linda Horn brand, petitioners relied primarily on their own expertise, garnered from their years of experience in the advertising industry. The record shows that petitioners were knowledgeable in the field of brand marketing, having produced commercial advertisements for various well-known brand names such as Pepsi, Coke and AT&T, to name a few. Mr. Horn, a professional and renowned photographer, put his experience to use photographing the store’s items for the website, database, and advertisements.

With regard to the real estate, petitioners consulted with their accountants before purchasing the Florida properties, hired professional contractors to complete the renovations, and hired a professional real estate agency to list and market the properties. Based on the foregoing, it is concluded that this factor supports petitioners’ position for both activities.

Taxpayer’s Time and Effort

Employing substantial time and effort to an activity may be indicative of a profit motive (Treas Reg § 1.183-2[b][3]; *see Annuzzi v. Commissioner*). “In some instances, devoting two to four hours daily and more time on weekends may be sufficient to demonstrate a profit objective (*Annuzzi v. Commissioner, citing Givens v. Commissioner*, TC Memo 1989-529). Even where a taxpayer himself devotes limited time to an activity, a profit motive may be indicated if he “employs competent and qualified persons to carry on the activity” (Treas Reg 1.183-2[b][3]).

While Mrs. Horn testified that she was in and out of the store and could not give an exact amount of time that she spent in the antiques store, she estimated spending two to four hours in the store, in addition to spending time working for the antiques business in the Studio and the

warehouses. When not present in the store, Mrs. Horn was available by telephone to discuss matters with the store manager. She designed the layout of the new store, and the Company hired professional contractors to completely renovate the new store based on Mrs. Horn's direction. The Company also renovated two warehouses to house excess inventory for the antiques business. Mrs. Horn does all of the buying for the antiques business, priced all of the items in the business's inventory, and discussed the window designs with the store manager. She also traveled to Europe during the audit period to make purchases for the store once or twice a year. Mr. Horn accompanied Mrs. Horn on the business trips, photographing the items purchased and preparing shipping invoices to have the items shipped to the Company's warehouse. Mr. Horn spent time photographing every item of inventory for the database and website.⁸ He produced the advertisements for the antiques business and designed mailers for special sales.

The Company also employed a number of competent and qualified employees to carry on the antiques business activities. The antiques store's hours of operation during the audit period were Monday through Saturday, 10:00 AM - 6:00 PM, and the Company employed sales people to man the store daily. Alayne Baxter was employed as the store's full-time manager, working in the store five days a week from at least 10:00 AM to 6:00 PM, and taking calls from the person running the store on the days she was not on the premises. On Sundays, Ms. Baxter usually met with Mrs. Horn to discuss the store. Ms. Baxter worked for the Company since approximately 1976, and worked as the sales representative for the commercial business prior to her work for the antiques business, obtaining commercial jobs for the Company. When the commercial

⁸ Although the number of items in the inventory during the audit period is not disclosed in the record, the record indicates that in addition to the inventory that filled the 93rd Street store, additional inventory was stored at the two warehouses in Briarcliff Manor, New York. The inventory at cost ranged from \$8,199,654.00 at the end of 2004 to \$10,006,457.00 at the end of 2009. Based on a review of the evidence in the record, I conclude that the antiques business's inventory was substantial, and that pricing and photographing each item would require significant time and effort by petitioners.

business began slowing down and petitioners increased their focus on the antiques business, they asked Ms. Baxter to manage the antiques business full time. They felt she was the appropriate choice based on her prior experience in sales with the commercial business. Ms. Baxter also had prior experience from the commercial business with “propping the environment” for commercial shoots, which served well for her work of setting up displays in the antiques store. As with the commercial business, both Mrs. Horn and Ms. Baxter had an eye for telling a story about the items they were selling by setting up a series of little vignettes, where multiple pieces come together to form a collection that tells a story. Ms. Baxter devoted much time and effort into setting up the displays for the store in order to attract customers. Additionally, Ms. Baxter’s efforts in sales is evidenced by the store’s gross sales receipts as indicated in the trial balances and monthly accounting reports for the years at issue. In 2004, the antiques business brought in gross sales of \$461,594.18; in 2005, \$473,800.51; in 2006, \$1,026,349.82 (\$492,257.68 in sales from Steve and Linda Horn, Inc., d/b/a Linda Horn Antiques and \$534,092.14 in sales from Linda Horn LLC); in 2007, \$1,177,806.30; in 2008, \$796,468.00; and in 2009, \$779,952.04 (\$831,791.00 including consignment sales).

Given the commitment that was obviously required in order to achieve the level of sales that was reached (notwithstanding the fact that expenses were greater), it is clear that the Company expended substantial time and effort in the antiques business.

The Company also employed other competent individuals, including Ms. Danao, a full-time bookkeeper with an accounting degree who maintained the company’s books and records, and Katherine Horn who was in charge of the antiques business’s computers and database. Ms. Horn increased the business’s online presence and created a program that combined the antique’s store’s database with the website and sales. Ms. Horn has also worked to increase the business’s

use of social media, such as Facebook, Twitter, Instagram and Pinterest. Ms. Horn devoted significant time to the business, typically working from 8:30 or 9:00 A.M. until 6:00 P.M., but sometimes also working late at night updating the database as additional inventory was acquired, uploading pictures onto the website and database.

The Company also expended significant time and effort in the real estate activities. Mrs. Horn spent time on the design and renovation of the properties. The Company hired professional contractors to perform work on the Florida real estate and hired a real estate broker to list the properties. The Company employed Mr. Drohan, who acted as the general contractor for the various Florida real property renovations. Mr. Drohan had prior experience with the Company working as the assistant director for the commercial business, where he was involved in hiring, timekeeping, reviewing timesheets, production reports and equipment rental. Mr. Drohan also had previous experience working as an electrician for various other production companies. This experience served as an asset to Mr. Drohan's work for the Company as general contractor and project manager of the Florida real estate renovations. Mr. Drohan described the work required for the Lake House as "a total gut job." While the Ocean Property did not require as much work as the Lake House, it required the construction of a new terrace and patio, as well as landscaping and lighting. Petitioners hired professional contractors to conduct the renovations, and Mr. Drohan met with the contractors, reviewed the scope of the projects, received weekly reports from the contractors, reviewed the hours worked by the construction crew, reviewed and okayed the payroll for the workers, and reviewed the pricing on the contractor's purchases weekly.

Another Company employee, Cheryl Baxter, also devoted time and effort to the real estate activities. With her vast experience in procurement, she expended time and effort finding items,

materials and workers Mrs. Horn needed for the real property restoration projects. Overall, I find that this factor favors petitioners' argument.

Expectation that Assets May Appreciate

An expectation that assets used in the activity may appreciate in value may indicate a profit motive (Treas Reg § 1.183-2[b][4]). “ Such an expectation becomes less speculative when a taxpayer shows successes that could plausibly lead to appreciation” (*Annuzzi v. Commissioner*). In the case of the antiques business, the assets to consider are the antique and decorative items in the business's inventory. For the real estate activity, the assets to consider are the real properties. Petitioners credibly testified that they expected both the inventory of the antiques business and the real estate to appreciate.

For the antiques inventory, petitioners kept detailed records of the their purchase price for each item. A review of the monthly sales reports and trial balances shows that, for every month during the years at issue, the price for which the items were sold was significantly greater than the Company's purchase price for the items (*see* Finding of Fact 98). The gross profits over the costs of goods evidences a plausible expectation of appreciation.

Petitioners likewise had an honest expectation that the real properties would appreciate in value. The plausibility of this expectation becomes apparent in the Company's sale of the Church. Both the Church and the Studio were purchased for the dual purpose of using these properties for the Company's business and for investment. When the Company was unable to use the Church as originally intended for the commercial business's headquarters, it was used for storage and held for investment. When petitioners decided to expand the Company's real estate investments into the Palm Beach, Florida, area, their accountant suggested selling the Church in IRC § 1031 like-kind exchange. Following this advice, the Company sold the Church for a

substantial profit of over \$11,000,000.00. Petitioners credibly testified that they then purchased the Ocean Property with the intent to renovate it and sell it for a profit. I also find credible their testimony that they expected the Peruvian Avenue property to appreciate in value, in addition to their hope that they would earn income from renting out some the shops on this property.

The Division argues that petitioners' expectation that the inventory and the Studio will appreciate in value is purely speculative. This argument is without merit. The Studio is a five-floor, 2,500 square-foot, per-floor, building on the Upper East Side of Manhattan that the Company purchased for \$525,000.00 in 1981. Petitioners' expectation that the value will appreciate above its purchase price is clearly plausible, and is supported by the fact that the Company sold the Church for a profit of over \$11,000,000.00 and sold the Ocean Property in 2011, reporting a gain of \$7,388,713.00. Additionally, petitioners are not required to prove that the assets have actually appreciated by providing an appraisal as argued by the Division (*see Holmes v. Commissioner*). In *Holmes*, the court reversed the lower court, finding that it had erred in concluding that petitioners did not prove that at the time that they acquired the subject property, they had actually and honestly expected that property to appreciate, because they did not prove that their farming endeavors and land had actually appreciated:

“To the contrary, the taxpayers needed only to prove a contemporaneous actual and honest expectation of value appreciation; they were not required to prove that a profit expectation was reasonably realistic at the time they acquired their land, and thus a fortiori did not need to prove that the fortunes of time ultimately vindicated their prognostication” (*Holmes v. Commissioner* at 546).

The Division's argument that any appreciation in value must exceed the accumulated losses of prior years in order to infer a profit motive is likewise rejected. In *Metz v. Commissioner*, the Tax Court noted that while appreciation in the taxpayer's assets “may not be enough to make up for the losses that the Metzses have already suffered, as the Commissioner

argues . . . that’s not the point. This factor is on the list because taxpayers who buy or grow assets that they actually and honestly think (and especially if they reasonably think) will increase in value are more likely to have the subjective profit motive that we have to look for” (TC Memo 2015-54 at 51). The Tax Court further disagreed with the Commissioner’s argument that petitioners’ activity could only be considered to be a for-profit activity if they have a bona fide expectation that the amount of the future profit will more than offset the \$20 million of losses incurred from inception to date. Rejecting the Commissioner’s position, the Tax Court found that “this argument distorts the notion of profit motive for purposes of section 183” and explained that “if a taxpayer can expect to generate an overall profit from the current year onward, then it can’t be said that he lacks a profit objective simply because he will never generate an overall profit over the lifetime of the activity.” (*Id.* at 55; *see also Helnick v. Commissioner*, TC Memo 2009-220 [2009] [after a “catastrophic loss that could never be recouped,” a taxpayer who “thereafter expected to generate an overall prospective profit . . . could not be said to lack a profit objective after the disaster merely because he would never recoup the prior loss”].)

Petitioners have met their burden of proving that they expected the assets of both the antiques business and the real estate activities to appreciate in value. This factor therefore weighs in petitioners’ favor.

Taxpayer’s Success in Other Activities

This factor looks at the taxpayers success in carrying on other activities (Treas Reg § 1.183-2(b)(5) and “the regulation unequivocally encompasses both ‘other similar or dissimilar activities’” (*Holmes v. Commissioner*). As such, although dissimilar to the antiques and real estate business, petitioners’ commercial production business can be considered for this factor.

Although petitioners were successful in the commercial business prior to 1999, in the early 2000s, as commercials moved away from film and petitioners' commercial business declined, the Company sustained losses. On this basis alone, this factor would be neutral.

What is more telling for this factor is petitioners' success in similar real estate ventures. Mrs. Horn testified to her earlier success in the sale of the Cooper Square building, which resulted in a \$7,000,000.00 profit. Although it is unclear from the record whether petitioners owned the Cooper Square property individually, through the Company, or through one of their other entities, the profit they garnered from the sale nevertheless indicates their prior success in flipping property for a profit. Accordingly, this factor shifts in petitioners' favor.

The Taxpayer's History of Income or Loss

This was the criterion that prompted the Division to issue the Notice of Deficiency (in addition to the like-kind exchange issue that the Division subsequently dropped) and which the Division stresses in its brief. Courts have recognized that a series of losses which extend beyond the startup period may display a lack of a profit motive (*Annuzzi v. Commissioner*; Treas Reg § 1.183-2[b][6]). Nevertheless, "If [the] losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damages, or other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit" (Treas Reg § 1.183-2[b][6]).

In this instance, the Company unquestionably sustained a series of losses. However, this is not where the inquiry ends. Rather, the Regulation also requires an examination of the reason for the losses. In this instance, petitioners have established that the business losses were due, in part,

to increased expenses from the store's expansion, as well as due, in part, to circumstances beyond their control.

The antiques business's expansion and move into a new, bigger storefront in 2005 is analogous to a startup period, during which losses are expected (*see Annuzzi v. Commissioner* [finding that petitioner's shift to a new level of horse breeding, that would increase current expenses while deferring income, was analogous to a startup period, during which losses are expected]). The Company incurred significant expenses from remodeling and designing the new store. The space required a complete renovation before it could be used for the antiques business, requiring the installation of lighting, electrical work, painting, and the installation of carpeting, sheet rock, and tile. The Company incurred additional expenses moving the inventory from the old store into the warehouses until the new store was ready and then moving the items to the new store. The Company also incurred more expenses by increasing its purchase of new inventory in 2005 and 2006 to fill the new, larger store.

The record shows that while the antiques business's expenses grew during this expansion phase, its gross receipts likewise grew in 2005, 2006 and 2007. Then, in 2008, the store's gross receipts declined, due in large part to the decline in the economy. Contrary to the Division's argument that "a downturn in the economy and an accompanying decreased demand for antiques is not an unforeseeable circumstance," the Regulation specifically provides that "depressed market conditions" are an example of a condition beyond the taxpayer's control, and that losses sustained due to such condition "would not be an indication that the activity is not engaged in for profit" (Treas Reg § 1.183-2[b][6]). In *Metz v. Commissioner*, the Tax Court specifically recognized the effect of the market crash on luxury goods: "[t]he bottom fell out of the economy that fall [of 2008], and the Great Recession depressed the demand for luxury goods worldwide."

Petitioners credibly testified that both the antiques business and the real estate business were negatively impacted by the 2008 market crash. Petitioners' Florida real estate activity was met with a series of unfortunate events. The Company purchased the Florida real estate in May and June 2005, right around the peak of real estate bubble (*see e.g.* Robert Johnson, *Is There a Bubble in Florida Waiting to Burst?*, NY Times, May 29, 2005; Les Christie, *Real Estate: Busts Don't Follow Booms*, available at http://money.cnn.com/2005/05/03/real_estate/financing/boom_bust/, May 4, 2005; *The global housing boom: In come the waves*, The Economist, June 16, 2005). In October 2005, shortly after the Company purchased the Florida properties, Hurricane Wilma hit Florida, causing a delay in renovations due to the demand for building supplies and landscaping stock, as well as some damage to the Ocean Property. Then the real estate bubble burst depressing real estate sales nationwide, with Florida real estate taking a significant hit (*see Report: Florida hit hardest by real estate bubble*, South Florida Business Journal, March 19, 2010). Petitioners testified that despite their efforts, they were unable to sell the Ocean Property until 2011. Additionally, due to the downturn in the economy, they were unable to complete their plans of expanding the antiques business to the Peruvian Avenue property.

While the Division argues that the Company incurred losses for years before the hurricanes and the market collapse, the Division refers to the total losses of the Company, including the commercial business, the antiques business and the real estate activities. Yet, the Division has conceded that the commercial business was engaged in for profit. Petitioners credibly explained the earlier losses, due in part to the decline in the commercial business as the industry moved away from film commercials. Petitioners showed that they attempted to respond to those losses by first expanding the antiques business and real estate activities, and then changing their

operating methods to appeal to a wider market. As such, while the Company's losses during the years at issue do not weigh in their favor, petitioners have a reasonable explanation and show that they tried to respond to the losses. Under the circumstances, it is found that this factor is neutral.

Amount of Occasional Profit

“A taxpayer's derivation of some profits from an otherwise money-losing venture may support the existence of a profit motive” (*Annuzzi v. Commissioner* at 29). Petitioners point to the sale of the Church, which was sold for a profit of over \$11,000,000.00. Petitioners reported the sale as a like-kind exchange and deferred the gain until the sale of the Ocean Property in 2011. The Division, on the other hand, contends that the sale of the Church does not turn this factor in petitioners' favor because “it represents the sale of an extraordinary item and not a recurring occurrence. . . .”

The Regulation provides that “an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are actually generated” (Treas Reg § 1.183-2[b][7]). While real estate sales may not be considered a highly speculative activity, the opportunity to earn a substantial ultimate profit exists, as demonstrated by the gain the Company reported in 2011 as a result of the sale and like-kind exchange of the Church and sale of the Ocean Property. Accordingly, this factor is not detrimental to petitioners' argument as far as the real estate activity is concerned.

For the antiques business, petitioners have not shown any occasional profits. As such, this factor weighs against petitioners for that activity.

The Financial Status of the Taxpayer

The Treasury Regulations provide that an indication of a profit motive may be discerned when a taxpayer does not have substantial income or capital from sources unrelated to the activity (Treas Reg § 1.183-2[b][8]). Petitioners had substantial wealth, derived from earlier years in the commercial business and investments. However, this is not necessarily detrimental to petitioners' position because,

“the existence of independent sources of wealth for the taxpayers will not automatically gainsay an otherwise proved actual and honest capitalistic motivation underlying a mercantile activity which in fact failed to yield economic gains for the taxpayers, especially if, as here, the taxpayers suffered actual out of pocket monetary losses in that undertaking, rather than mere paper losses manufactured to shelter unrelated income” (*Holmes v. Commissioner, citing Ranciato v. Commissioner*, 52 F3d 23 [2d Cir 1995]).

While petitioners were able to write off the losses against other income, the Division does not contend that the activity was created merely as a tax shelter (*see* Finding of Fact 169).

Additionally, as the Tax Court in *Engdahl v. Commissioner* notes,

“the language [of the Regulation] cannot be construed as providing an additional reason to deny a deduction merely because the deduction is useable against other income. In cases of this kind, the concurrent existence of other income poses the question, rather than answers it. If there is no other income, there is no issue. As long as tax rates are less than 100 percent, there is no ‘benefit’ in losing money. Properly construed, the Regulation merely makes the commonsense point that the expectation of being able to arrange to have the tax collector share in the cost of a hobby may often induce an investment in such a hobby which would not otherwise occur. The essential question remains whether there was a genuine hope of economic profit” (*Engdahl v. Commissioner*, 72 TC 659 [1979]).

Based on a review of the record as a whole, I find that there was a genuine hope of economic profit and find this factor neutral.

Elements of Personal Pleasure or Recreation

The Treasury Regulations provide that the presence of recreational or personal pleasure may suggest that the activity may not be engaged in for profit (Treas Reg § 1.183-2[b][9]).

While Mrs. Horn admits that she enjoys the antiques business and finds it fascinating, “gratification received from an activity is insufficient in itself to cause the activity to be considered not engaged in for profit” (*Faulconer v. Commissioner*, 748 F2d 890, 901 [4th Cir 1984]); *see also Jackson v. Commissioner* [“a business will not be turned into a hobby merely because the owner finds it pleasurable; suffering has never been made a prerequisite to deductibility”]). Mrs. Horn’s enjoyment of the activity does not outweigh the factors discussed above that indicate the business was engaged in with a profit motive. Most significantly, although she enjoyed the activity, the business was run in a professional manner and is distinguishable from the stereotypical hobby cases where a taxpayer “runs a real business during the week - with business records, income projections, accountability to banks and investors and so on - and owns a ‘gentleman’s farm’ as a weekend retreat where he keeps horses for the recreation of himself and his family and friends” and has no expectation of making a profit (*Helmick v. Commissioner* at 23). This case is also unlike other cases that have dealt with antiques collectors, who maintained their collections in their homes for their personal enjoyment and rarely sold items from their collections (*see e.g. Stanley v. Commissioner*, TC Memo 1980-217 [1980]; *Barcus v. Commissioner*, TC Memo 1973-138 [1973], *affd* 492 F2d 1237 [1974]). Unlike those cases, the antiques business here had all the makings of a professional business. There was not a small inventory maintained at petitioners’ home for their own use and enjoyment, but instead a sizeable inventory displayed for sale in an elaborate store and two warehouses, as well as listed for sale on the business’s website. Also unlike those cases, petitioners here made every effort to sell items from the antiques business’s inventory, through advertising and other marketing as discussed above, and did in fact have significant gross sales.

Regarding the real estate business, petitioners did not use the Florida properties for their personal enjoyment. Petitioners did not use the properties as a vacation home. Mrs. Horn testified that the renovations ended up being far more extensive than what petitioners were led to believe at the time of purchase, the cost became incredibly high, and they had to address landmark issues. She found it difficult to deal with historical properties in a different state. Any enjoyment Mrs. Horn garners from her real estate activities seems to come when the Company is able to sell a property for profit, as was evidenced by her enthusiastic testimony regarding the sale of the Church and the Cooper Square property.

Based on the foregoing, this factor is neutral with regard to both activities.

F. With the above factors considered, the weight of the evidence supports petitioners' position that both the antiques business and the real estate activities were engaged in for profit and not as a hobby.

G. The petition of Steve and Linda Horn is granted and the notice of deficiency dated September 16, 2011 is cancelled.

DATED: Albany, New York
July 2, 2015

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE