

WILLIAM GARY & KAREN TERRY BRACKIN §  
6765 COUNTY ROAD 150  
COURTLAND, AL 35618, §

Taxpayers, §

v. §

STATE OF ALABAMA §  
DEPARTMENT OF REVENUE.

STATE OF ALABAMA  
ALABAMA TAX TRIBUNAL

DOCKET NO. INC. 17-444

### **OPINION AND PRELIMINARY ORDER**

This appeal involves assessments of individual income tax for years 2013 and 2014 and a refund for 2015 that was applied to those assessments. A hearing was conducted in Hoover, Alabama, on August 31, 2017. Mr. and Mrs. Brackin (“Taxpayers”) represented themselves at the hearing, and the Department was represented by Deputy Counsel David Avery.

### **ISSUE**

Did the Taxpayers engage in their cattle-farming activities with the objective of making a profit, or did they carry on those activities primarily as a hobby?

### **PROCEDURAL FACTS**

On their 2013 through 2015 Alabama income tax returns, the Taxpayers claimed losses on Schedule F relating to their cattle-farming activities. For all three years, the Taxpayers also claimed losses on Schedule E relating to their rental of a single-family home. And for years 2013 and 2014, the Taxpayers reported payouts from a pension as “other income.” Each return requested a refund, and refunds were paid to the Taxpayers for years 2013 and 2014.

In an audit, the Department determined that the rental losses were generated by the rental of the real estate to family members at a below-market rate. The Department’s

adjustments to this item apparently are not disputed. Also, it was determined that the pension receipts originally reported by the Taxpayers as income were exempt from taxation, so those amounts were removed from the Department's calculations of liabilities. Concerning the farm losses, the Department took the position that the Taxpayers failed to prove that they operated the farm with a profit motive, so the Department disallowed the losses.

The Department entered preliminary assessments for 2013 and 2014, and increased the refund amount claimed by the Taxpayers for 2015. That refund was applied to the preliminary assessments for 2013 and 2014, and a final assessment for 2014 was entered for the balance of the assessment that was not satisfied by the application of the refund. The Taxpayers paid the 2014 final assessment, and the only issue before the Tribunal is the disallowance of the farm losses for all three years.

### **ANALYSIS**

Over the past 35 years, the Tax Tribunal and its predecessor, the Revenue Department's Administrative Law Division ("ALD"), have been called upon on numerous times to decide whether a taxpayer engaged in an activity primarily as a hobby or for profit. Simply put, a taxpayer is allowed to deduct certain expenses incurred in connection with an activity that is engaged in for profit, but is not allowed to deduct expenses associated with an activity engaged in as a hobby or sport or for recreation.

The ALD explained the criteria as follows:

The general test for whether a taxpayer is engaged in a "trade or business," and thus entitled to deduct all ordinary and necessary business expenses, is "whether the taxpayer's primary purpose and intention in engaging in the activity is to make a profit." *State of Alabama v. Dawson*, 504 So.2d 312,

313 (Ala. Civ. App. 1987), quoting *Zell v. Commissioner of Revenue*, 763 F.2d 1139, 1142 (10th Cir. 1985). To be deductible, the activity must be engaged in “with a good faith expectation of making a profit.” *Zell*, 763 F.2d at 1142. As stated by the U.S. Supreme Court – “We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer’s primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.” *Commissioner v. Groetzinger*, 107 S. Ct. 980, 987 (1987). But a taxpayer’s expectation of a profit need not be reasonable. Rather, the taxpayer must only have a good faith expectation of realizing an eventual profit. *Allen v. Commissioner*, 72 T.C. 28, 33 (1979). Whether the taxpayer had an intent to make a profit must be determined on a case-by-case basis from all the circumstances. *Patterson v. U.S.*, 459 F.2d 487 (1972).

Treas. Reg. §1.183-2 specifies nine factors that should be considered in determining if an activity was entered into for profit.

Factor (1). The manner in which the taxpayer conducted the activity.

Factor (2). The expertise of the taxpayer in carrying on the activity.

Factor (3). The time and effort exerted by the taxpayer in conducting the activity.

Factor (4). The expectation that the assets used in the activity will appreciate.

Factor (5). The taxpayer’s success in similar or related activities.

Factors (6) and (7). The taxpayer’s history of profits and losses, and the amounts of any occasional profits.

Factor (8). The taxpayer’s financial status.

Factor (9). [Elements of] personal pleasure [or] recreation.

*Blankenship v. State of Alabama*, No. INC. 06-1215 (Admin. Law Div. O.P.O. 10/16/07), at pp. 3 – 4.

Here, the Taxpayers testified that they had first been in the cattle business in the mid-1990s, which was prior to the years in question. In approximately 1995, they bought a

few cows and kept them for four or five years. But, during that time, both Taxpayers were working other, full-time jobs, and were caring for Mrs. Brackin's ill mother who was living with them. Because the Taxpayers did not have sufficient time or opportunity to tend to the cattle, they sold them in 1999 and decided to wait for a better opportunity to undertake cattle farming.

In 2011, the Taxpayers bought ten young heifers (less than one year old), with the intent to grow their cattle farm slowly, and to "do it better" than they had in the 1990s. According to Mr. Brackin, it would take approximately three years from the purchase of such young livestock in 2011 to start making money from the sale of calves. Throughout the Taxpayers' testimony, they emphasized that their intent was to operate the farm in a first-class manner and to build the business on a solid foundation for the long term.

In early 2014, the paper mill where Mr. Brackin had worked for many years closed, so the Taxpayers decided to grow their cattle business at a faster rate than previously planned. This decision required the Taxpayers to invest more money by buying more cows and equipment. Those investments were paid for, in part, by money that Mr. Brackin received as severance pay from the mill closing.

One problem that the Taxpayers faced early on in their business was finding quality hay to feed their cattle. The hay that they had been purchasing from an outside source was discovered to be of such poor quality that it had no nutritional value. As a result, two of the Taxpayers' cows died one winter.

Therefore, the Taxpayers decided to grow their own hay, so that they could control its quality. To do so, the Taxpayers bought 27 additional acres, which were full of weeds and briars, and spent two years preparing the land to the point where it would produce

high-quality hay. That acreage was across the road from their farm. Also, the Taxpayers bought the necessary equipment to grow and harvest the hay, such as tractors, mowers, and rollers. The Taxpayers also fertilized the land and sprayed for weeds.

Also, the Taxpayers decided to operate in seed stock, which involves registered Angus cattle. Currently, the Taxpayers have seven registered cows, and the Taxpayers testified that a good registered calf could be worth three times as much as a regular calf. Their plan is to also have registered bulls that would average costing \$4000 to \$5000 each. In fact, they recently had a calf born from a bull that had sold for \$600,000. Mr. Brackin stated that the calf could be worth a lot of money in a few years, although he acknowledged that there is no guarantee of that. But he testified that the possibility of greater value is why he got into the seed-stock business. "It is a lot more profitable in the long run." Also, the Taxpayers bought a bull this year that cost \$3500. Although that was a higher price than they had paid in the past, Mr. Brackin said that they are getting calves from that bull that are more valuable than calves from previous, less-expensive bulls.

The Department's auditor's report stated that Mr. Brackin gave no indication of having consulted with experts for advice on running the Taxpayers' cattle farm. Mr. Brackin disagreed, however, and testified that he consulted (and still consults) with his county agent about improving his land, and with the Alabama Cattlemen's Association and the American Angus Association. For example, with the Cattlemen's Association, Mr. Brackin has learned to cross-fence his pastures and rotate his cows so that they do not eat the grass too close to the ground in any one area. And the American Angus Association provides dollar-value information that seed-stock producers use in deciding which bulls to breed with their cows. Other services utilized by Mr. Brackin involve taking a gene sample

from cows to determine traits relating to milking and the tenderness and marbling of meat. The information concerning tenderness and marbling is instrumental in qualifying to sell certified Angus beef. Mr. Brackin has begun adhering to these standards. (In performing the audit, the auditor did not visit the farm.)

The auditor's report stated that the Taxpayers did not keep a separate farm bank account and that their business records were "minimal." Mr. Brackin admitted that there was no separate business banking account, but he expressed his intent to establish an account solely for the farm once the farm produces enough profit to sustain itself. He emphasized, though, that he entered farm income and expenses each week in a Microsoft Money program so that he knew exactly how much was being spent. "I knew we were spending a lot of money, but I knew there was a long-term goal for that money." And the auditor acknowledged that the Taxpayers' records were sufficient to track income and expenses.

Mr. Brackin also testified that, although he enjoys raising cows, it is a lot of physical work which he no longer is able to perform because of a back injury in 2014 that caused permanent nerve damage in his right leg. That injury makes it very difficult for him to get on a tractor. Therefore, his son and son-in-law perform most of the labor and, without their work, the Taxpayers would be out of the cattle business. Thus, Mr. Brackin stated, the Taxpayers do not perform these activities for recreational purposes.

Concerning the amount of expenses incurred during the audit period, the Taxpayers emphasized that they spent money on equipment, livestock, and other items that should make the farm more profitable in the long run. In short, they made decisions and spent money to have and maintain a high-quality farm, instead of opting for a lower-cost (and

lower-quality) farm that would have had less up-front expenses. For example, Mr. Brackin testified that he spent \$20,000 on a barn in which he could store his hay and farm equipment. According to Mr. Brackin, storing hay outside causes it to lose about 30% of its value, so Mr. Brackin calculated that the barn would pay for itself in eight or nine years. He also stated that, when he realized that the paper mill was closing, he believed he would not be able to find other employment because of his health, so he invested more money in the farm for its long-term profitability. And Mrs. Brackin testified that they used some of their farm equipment to dig out ponds so that the cows would have good water to drink. (Both Taxpayers seem to have a very strong work ethic. Mr. Brackin worked 39 years in the same plant, and missed only one day of work during that time. Mrs. Brackin has worked for 40 years, and she currently is employed.)

After observing the witnesses and considering the evidence, the Tribunal finds that the Taxpayers engaged in their cattle-farming activities with the objective of making a profit, as opposed to carrying on those activities as a hobby. Thus, the Taxpayers were legally entitled to claim the losses in question, and the Department's disallowance of those losses was erroneous.

Therefore, the Department is directed to recalculate the Taxpayers' tax liabilities in light of this ruling and to make all necessary adjustments or allowances. Specifically, to the extent that any assessment entered by the Department against the Taxpayers for the audit period was based on the disallowance of the farm losses, those assessments are voided. The Department also is directed to refund to the Taxpayers all amounts, plus applicable interest, that result from the allowance of the losses in question. The Department is

directed to make any other adjustments or allowances that are necessary to conform to this ruling.

The Department is directed to then notify the Tribunal of the amounts and effects of the Department's recalculations and adjustments, including, among other things, any amounts to be refunded to the Taxpayers.

It is so ordered.

This Opinion and Preliminary Order is not an appealable order.

Entered November 22, 2017.

---

JEFF PATTERSON  
Chief Judge  
Alabama Tax Tribunal

jp:dr

cc: William Gary & Karen Terry Brackin  
David E. Avery, III, Esq.