

ALABAMA TAX TRIBUNAL

LARRY E. & KIMBERLY P. LEE,	§	
Taxpayers,	§	DOCKET NO. INC. 18-371-CE
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

FINAL ORDER

Larry E. and Kimberly P. Lee (“Taxpayers”) submitted an Alabama income tax return for tax year 2016 requesting a refund of tax paid in the amount of \$1,722. The Revenue Department adjusted the Taxpayers’ return to disallow certain Schedule A and Schedule C expenses claimed by the Taxpayers. After adjustment, the Department determined that the Taxpayers were due a refund in the amount of \$204 and notified the Taxpayers of the refund denial by letter dated October 3, 2017. On April 13, 2018, the Taxpayers appealed the Department’s partial denial of their refund request to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on July 9, 2018. Assistant Attorney General David Folmar represented the Department. Mr. Lee attended the hearing and offered testimony.

The Taxpayers claimed Schedule A and Schedule C expenses on their 2016 Alabama income tax returns. The Schedule C expenses are expenses for hunting and travel related to Mr. Lee’s operation of Loggerhead Productions, which specializes in the filming and production of hunting videos.

The Department audited the Taxpayers for the subject years and requested records verifying the claimed expenses. The Taxpayers submitted some records. The Department

determined that the Taxpayers failed to substantiate a significant amount of their expenses, and it determined that Mr. Lee's filming activity was not a business, i.e., was not entered into for profit. Consequently, the Department disallowed those expenses.

Mr. Lee is a retired mining engineer and former golf course manager. He is an avid hunter and has been for most of his adult life. Upon retirement, Mr. Lee began traveling around the United States filming his hunting experiences, which he edits and posts to social media and YouTube. He explained that his activities would be profitable if he could procure clients to advertise in his videos. However, he further testified that he has not spent a lot of time attempting to procure advertisers.

Deductions are a matter of legislative grace, and the burden is on a taxpayer to maintain records showing that a deduction should be allowed. *Hentges v. C.I.R.*, T.C. Memo. 1998-244 (U.S. Tax Ct., 1998). If a taxpayer fails to verify a deduction with complete and accurate records, the deduction must be disallowed. *McDonald v. C.I.R.*, 114 F.3d 1194 (1997); *Jones v. C.I.R.*, 903 F.2d 1301 (1990); *Doyal v. C.I.R.*, 616 F.2d 1191 (1980). The examiner in this case thus correctly disallowed the Schedule A and Schedule C deductions for which the Taxpayers failed to provide verifying records.

The burden was also on the Taxpayers to establish that their film production activities constituted a trade or business or was entered into for profit. Code of Ala. 1975, §40-18-15(a)(1).

Section 40-18-15(a)(1) allows a deduction for all ordinary and necessary expenses incurred in a trade or business. The statute is modeled after its federal counterpart, 26 U.S.C. §§162. Consequently, federal case law interpreting the federal statutes should be

followed in interpreting the similar Alabama statutes. *Best v. Dept. of Revenue*, 417 So.2d 197 (Ala. Civ. App. 1981).

Whether an activity constitutes a trade or business for purposes of section 162 depends on whether a taxpayer engaged in the venture with the predominant purpose and intention of making a profit. *Allen v. Commissioner*, 72 T.C. 28 (1979); *Dunn v. Commissioner*, 70 T.C. 715, 720 (1978); *Churchman v. Commissioner*, 68 T.C. 696, 701 (1977); *Jasionowski v. Commissioner*, 66 T.C. 312, 319 (1976); *Benz v. Commissioner*, 63 T.C. 375, 383 (1974). Reasonableness is not a requirement, but a taxpayer must show that he continued the activities with a bona fide intention and good-faith expectation of making a profit. Sec. 1.183-2(a), *Allen v. Commissioner, supra* at 33; *Jasionowski v. Commissioner, supra* at 321; *Benz v. Commissioner, supra* at 383; *Besseney v. Commissioner*, 45 T.C. 261 (1965), *aff'd*. 379 F.2d 252 (2d Cir. 1967).

Section 1.183-2(b), Income Tax Regs., lists some of the relevant factors to be considered in determining whether an activity is engaged in for profit. These factors include: (1) The manner in which the taxpayer carried on the activity; (2) the expertise of the taxpayer or his advisers; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or loss with respect to the activity; (7) the amount of occasional profit, if any, which is earned; (8) the financial status of the taxpayer; and (9) whether elements of personal pleasure or recreation are involved.

Not any one factor is controlling; the issue is one of fact to be determined based on all the facts and circumstances. Sec. 1.183-2(b), Income Tax Regs. Greater weight is to be given to objective facts than to a taxpayer's mere statement of their intent. Sect. 1.183-2(a), Income Tax Regs.

Applying the nine factors listed in Reg. 1.183-2(b), I conclude that the Taxpayers have failed to prove that they carried on the activity in a businesslike manner.

The Taxpayers failed to maintain complete and accurate books and records, they did not maintain a mileage log, and they paid hunting and travel expenses from personal credit cards and bank accounts used for personal finances and expenses. Additionally, the Taxpayers have never applied for or been granted a business license.

The Taxpayers reported a loss in the subject year, and for at least the eight years before the year at issue. Since 2007, the Taxpayers have sustained losses, claiming over \$406,594 in hunting and travel related expenses and reporting only \$7,218 of income. Not only have the Taxpayers failed to show that the opportunity exists to make a profit, they have no real plan regarding how they intend to bring the operation to profitable status. The Taxpayers have never realized an overall profit from their activities in any year. The fact that they reported substantial losses for nine straight years, including the year at issue, and that they have no real plan to make the activity profitable, strongly indicates that the activity was not entered into with the reasonable expectation of profit.

The assets used in the Taxpayers' activity, i.e., vehicles, cameras, production equipment, supplies, etc., certainly did not appreciate in value.

Mr. Lee has been an avid hunter for most of his life. He testified that many times his grandson accompanied him to states such as Montana, Kansas, and Texas to hunt with

him. Mr. Lee clearly enjoys and derives personal pleasure from his hunting activities. A person can, of course, enjoy his or her chosen profession or job and still be engaged in business to earn a profit, and professional hunters surely enjoy their work. But the personal enjoyment derived by a retired taxpayer from part-time recreation or leisure activity, such as hunting, must be considered – especially when the taxpayer is a life-long, avid hunter with no substantial plan to generate profit from his activities.

No reasonable person would continue to engage in an activity primarily to make money if they had lost substantial money in the venture for nine straight years and made very minimal money. Applying the nine factors set forth in Reg. 1-183-2, and viewing all the facts and circumstances objectively, the evidence indicates that the Taxpayers' hunting and filming activities were not conducted for the primary purpose of making a profit or, at the very least, indicate that the Taxpayers should not have reasonably expected to make a profit from Mr. Lee's hunting and filming activities. Consequently, the related expenses were correctly disallowed.

The Department's partial denial of the Taxpayers' request for refund is affirmed. Judgment is entered accordingly.

This Final Order may be appealed to circuit court within 30 days from the date of this Order pursuant to Code of Ala. 1975, §40-2B-2(m).

Entered January 14, 2019.

/s/ C. O. Edwards

CHRISTY O. EDWARDS
Associate Tax Tribunal Judge

cc: Larry Lee
David M. Folmar, Esq.