

MELVIN C. & ELSA C. PRICE	§	STATE OF ALABAMA
P.O. BOX 128		DEPARTMENT OF REVENUE
NEWVILLE, AL 36353-0128,	§	ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 13-751
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

FINAL ORDER

The Revenue Department assessed Melvin C. and Elsa C. Price (together “Taxpayers”) for 2009 and 2010 income tax. It also partially denied a refund claimed by the Taxpayers on their 2011 Alabama return. The Taxpayers appealed to the Administrative law Division pursuant to Code of Ala. 1975, §§40-2A-7(b)(5)a. and 40-2A-7(c)(5)a. A hearing was conducted on October 8, 2013. The Taxpayers and their representative, David Johnston, attended the hearing. Assistant Counsel Craig Banks represented the Department.

ISSUE

The Taxpayers bought, raised, and sold goats during the years in issue. The sole issue is whether the Taxpayers can deduct their expenses relating to the goats. That issue turns on whether the activity constituted a trade or business, which in turn depends on whether the activity was entered into for profit.

FACTS

Melvin C. Price (individually “Taxpayer”) retired in 2001 after a long career in the retail battery business. After a year or so, he got bored and began looking for something to do. He has lived on an 80 acre farm in Henry County, Alabama since 1980. He testified at the October 8 hearing that because he already had the land, he thought he would enjoy

and could make some money raising and selling animals. He explained that he needed to earn his own money so that he would not have to ask for money from his wife, who still worked.

The Taxpayer visited the Henry County extension agent's office in Abbeville, Alabama for advice. The agent told him that the cattle business was volatile, that there was no place within 100 miles to sell hogs, and that it would take about \$750,000 to build chicken houses and make a profit growing chickens. The agent also told him, however, that while it might take time, he could eventually make money raising goats.

The Taxpayer took the agent's advice and decided to buy and raise goats. He took out an \$80,000 mortgage on his land so he could get into the business. He bought a tractor for approximately \$15,000, and also fenced his 80 acre farm into sections so that his goats could be moved from section to section. He then bought 30 mixed breed goats in 2002 or 2003.

The Taxpayer sold several of the goats at auction, but soon realized that he could not make money selling mixed breed goats at low prices. Other people that also raised goats told the Taxpayer about boar goats, which are a popular breed of "show" goats. He purchased a few boar goats, but many died because the breed has a low resistance to deadly parasites. The Taxpayer consequently realized that he would also have a hard time making a profit raising and selling boar goats.

The Taxpayer's wife is a college professor. She was invited to speak in Australia in 2006, and she and the Taxpayer subsequently spent several weeks in Australia and New Zealand. While Down Under, the Taxpayer learned about kiko goats, which are a parasite-

resistant breed of goat. He visited the individual in New Zealand that had developed the breed. After talking with the individual, the Taxpayer decided to switch to raising kiko goats when he returned to Alabama.

The Taxpayer purchased five kiko goats in late 2006 or early 2007. His herd has grown, and he currently has approximately 40 breeding female kikos. He testified that when he gets 50 breeding kikos, he will have 80 to 125 kids annually to sell, which should allow him to easily turn a profit.

The Taxpayer concedes that he did not know about raising goats when he bought his first goats in 2002 or 2003. Since that time, however, he has regularly attended seminars and visited Tuskegee University to learn about goats. He also joined and has belonged to the Southeast Kiko Goat Association since 2007, and his wife was the secretary/treasurer of the Association from 2008 until this year.

The Taxpayer has also belonged to the Alabama Farmers Federation ("ALFA") since 1984. He served as chairman of ALFA's Henry County meat, goat, and sheep division for eight years, and served for five years on the State meat, goat, and sheep committee.

The Taxpayer began growing a particular type of hay, sericea lespedeza, in 2008 or 2009 at the suggestion of a professor at Tuskegee University. That type of hay prevents goats from having worms. The Taxpayer testified that only a few of his goats have had worms since he started feeding them the special hay three or four years ago. He has erected two sheds on his farm where he stores the hay, and has also begun selling the hay to other goat farmers.

The Taxpayers' 2009 Schedule F relating to his goats showed that he had goat-related income of \$5,793 and total expenses of \$30,345 in that year. The 2010 Schedule F reported income of \$7,580 and total expenses of \$27,581. The 2011 Schedule F showed income of \$6,231 and total expenses of \$28,658.

The Department audited the Taxpayers for the subject years and determined that the Taxpayer's goat raising activity was not a business entered into for profit. It consequently disallowed the Schedule F expenses that exceeded the goat-related income reported in each year. Those adjustments resulted in the 2009 and 2010 final assessments and the partially denied 2011 refund in issue in this case.

Other relevant facts are stated in the below analysis.

ANALYSIS

The Administrative Law Division has decided numerous cases involving the issue of whether an activity was entered into for profit. In *Blankenship v. State of Alabama*, Docket Inc. 06-1215 (Admin. Law Div. O.P.O. 10/16/2007), the Division explained the criteria to be applied in deciding the issue.

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). The activity was for the taxpayer's personal pleasure and recreation.

Blankenship at 3 – 4.

As in most cases involving this issue, some of the above factors indicate that the activity in question was for profit, while others indicate that it was not. The relevant factors are discussed below.

Concerning factor (1), the Taxpayer conducted his goat farming in a somewhat businesslike manner during the subject years. The Department audit report states that the Taxpayer failed to keep records concerning his truck used in the activity, but there is otherwise no indication that the Taxpayer failed to keep adequate records concerning the

activity. He has also begun advertising in the *Goat Rancher*, a national magazine for goat farmers.

The Taxpayer admittedly had no expertise concerning goats when he started buying and raising them in 2002 or 2003. He has since learned a great deal by attending seminars and taking advice from informed individuals at Tuskegee University. He and his wife have been actively involved in the Southeast Kiko Goat Association. He has also served as chairman of Alfa's Henry County meat, goat, and sheep division, and served for years on the State committee. The Taxpayer has thus attempted to gain knowledge and an expertise relating to raising goats. Factor (2) favors the Taxpayer.

The Department audit report indicates that the Taxpayer spends about three hours a day tending to his goats. He has also attended seminars and goat shows in Alabama and around the country, and spends time growing and harvesting the special hay. That modest amount of time spent on the activity favors neither party. Factor (3) is neutral.

The Taxpayer apparently had a successful career selling batteries, but he has otherwise not engaged in an activity similar to raising goats. Factor (5) is thus irrelevant.

Concerning factors (6) and (7), the Taxpayer does have a consistent history of losses relating to his goats, which weighs against the Taxpayer's position. A large portion of the losses in each year was depreciation, however, so his actual cash losses in each year were not as great. The losses also occurred in part because the Taxpayer initially tried to raise mixed breed goats, which are less desirable, and then boar goats, which are susceptible to parasites. He finally successfully switched to kikos.

The Taxpayer's kiko goat herd has grown since 2007, and the Taxpayer expects to turn a substantial profit in a year or two. He in fact had substantial income from the activity in 2012, and but for depreciation, he nearly turned a profit in that year. Importantly, the fact that the Taxpayer changed his method of operating from mix breed and boar goats in favor of kiko goats is a factor showing an intent to make a profit.

Factor (8) favors the Department because the Taxpayers had substantial income from other sources in the subject years. They could thus afford to lose money on the goats.

Concerning factor (9), the Taxpayer admits that he likes being around goats, and that he got into the business in part to have something to do. But the fact that a taxpayer enjoys an activity does not in itself negate the taxpayer's intent to make a profit. In *Gremmels v. State of Alabama*, Docket Inc. 05-112 (Admin. Law Div. 7/18/2005), the issue was whether a taxpayer's horse breeding activities constituted a trade or business. The Department argued that the activity was a hobby because the taxpayer enjoyed horses. The Division held as follows:

Finally, while the Taxpayer obviously enjoys being around horses, that fact alone does not negate his intent to profit from the activity. As stated in *Engdahl*, "there is no 'benefit' in losing money." *Engdahl*, 72 T.C. at 670. Viewing all of the facts together, the Taxpayers did not engage in their horse breeding activities primarily for pleasure or to create losses to shield other income. (footnote omitted) Rather, they had a genuine hope and expectation that they would be successful and eventually realize a profit. Their related expenses are thus deductible.

Gremmels at 6.

Disputed "hobby loss" cases are difficult to decide because the taxpayer almost always has mixed motives. Understandably, the taxpayer will select an activity that he has

enjoyed in the past or expects to enjoy in the future. For example, a person that was raised around horses may as an adult choose to raise and sell horses, but the fact that the taxpayer may enjoy the activity does not necessarily negate a profit motive if the taxpayer is engaged in the activity with the intent and good faith expectation of making a profit. *Engahl*, 72 T.C. at 666. A professional golfer most certainly enjoys golf, but that does not negate the golfer's intent to make a profit.

In this case, the Taxpayer chose to raise and sell goats in lieu of cattle, horses, or chickens because the County extension agent advised him that he had the best chance of making money raising and selling goats. He knew nothing about goats when he started the activity. He learned the hard way by first unsuccessfully trying to raise mixed breed and then boar goats. He persisted, however, and continued trying to learn more about raising and selling goats by attending seminars, livestock shows, and getting advice at Tuskegee University.

In an effort to improve his chances of making a profit, he switched to kiko goats in 2007. He has substantially increased the size of his herd since that time, and, as indicated, almost made a profit in 2012. And since 2007, he has been actively involved with the Southeast Kiko Goat Association and ALFA's State and Henry County meat, goat, and sheep committees. The above evidences an intent to be involved and make a profit.

If the Taxpayer had wanted goats purely for personal pleasure, he could have purchased a few mixed breed goats and then replaced them as necessary. He clearly went beyond that, and has spent a great deal of time, effort, and money trying to profit from raising and selling goats. As predicted by the County extension agent in 2002, it has taken

time, but the Taxpayer now appears on the cusp of success. Given the above facts, and observing the Taxpayer's believable testimony at the October 8 hearing, I conclude that the Taxpayer did engage in raising goats during the years in issue for the primary purpose of making a profit. The expenses relating to the activity thus constituted deductible ordinary and necessary business-related expenses.

The 2009 and 2010 final assessments are voided. The 2011 refund claimed by the Taxpayers is granted in full. Judgment is entered accordingly.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered December 5, 2013.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Craig A. Banks, Esq.
G. Davis Johnston, Esq.
Brenda Lausane