

ALABAMA TAX TRIBUNAL

ALICE S. MARTIN,	§	
Taxpayer,	§	DOCKET NO. INC. 21-1285-LP
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

OPINION AND PRELIMINARY ORDER

This appeal involves final assessments of individual income tax for years 2014 and 2016. A trial was held on March 21, 2024. The Taxpayer appeared and testified. Warren W. Young represented the Revenue Department, and Cheryl Howard, the Revenue Department’s reviewing auditor, appeared and testified.

The parties agreed that the Taxpayer had paid the 2014 final assessment in full. The Taxpayer stated that she did not contest the 2014 assessment.

With respect to 2016, there are two issues: (1) whether the Taxpayer’s Schedule C business called Quantum Wellness by Design (“Quantum Wellness”) was a for-profit business or a hobby, and (2) whether the expenses for the Taxpayer’s Schedule E rental properties were properly disallowed.

Issue 1: Schedule C Business

“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.

At the trial, the Taxpayer testified that she became interested in Quantum Wellness to help her husband after he had suffered certain medical events. She expended funds to attend workshops to train for the business and purchase equipment. The Taxpayer testified that she developed a clientele from people she knew from her real-estate business. She also advertised on social media. She

testified that she obtained between 25 and 30 clients.

The Taxpayer testified that she lost her previous business, a real-estate business, because she was caring for her husband. Therefore, other than proceeds from an insurance policy, the income from Quantum Wellness was her only income. She testified that the income from Quantum Wellness was low because the business had just begun. According to the Taxpayer, she would have stayed in the business if she had been able to learn more quickly, but she ceased business activity because she was not earning enough money. She testified that she did take great pleasure in the work. The business was only active for two to three years. She testified that she did not have a business license, credit card, or bank account, but she stated that she would have obtained a credit card if the business had continued.

Considering the foregoing evidence, although not all factors weigh in favor of the business being for-profit, I conclude that Taxpayer did have the primary purpose of making a profit from Quantum Wellness. While she did not ultimately make a profit, she had high start-up costs, and the business was short-lived. Moreover, when the business did not become profitable, she ceased business activity. The facts that the Taxpayer took pleasure in the activity and failed to obtain a business license, credit card, or bank account do not outweigh the other evidence of a for-profit motive.

Issue 2: Schedule E Rental Properties

The Taxpayer owned rental properties during the year in question. The Department stated that it did not analyze the Taxpayer's Schedule E substantiating documents because the documents were disorganized, and it was difficult to determine the expenses. However, the documents provided to the Tax Tribunal were

not disorganized or difficult to decipher.

The Revenue Department requested copies of the leases for the rental properties for 2016.

The Taxpayer is directed to submit to the Tax Tribunal, by **April 30, 2024**, lease agreements for her two rental properties.

The Revenue Department is directed to review the Taxpayer's documentation, including the leases and the previously submitted documents, and to contact the Taxpayer with any questions concerning that documentation. The Revenue Department then shall recalculate the Taxpayer's tax liability in light of the documentation submitted and the determination that Quantum Wellness was a for-profit business. The Revenue Department shall notify the Tax Tribunal of its recalculation by **May 30, 2024**.

If the Taxpayer has any questions, the Taxpayer should contact the Tax Tribunal at 334-954-7195. The Tribunal's mailing address is 7515 Halcyon Summit Drive, Suite 103, Montgomery, AL 36117. The Taxpayer also may respond by email to taxtribunal@att.alabama.gov.

Entered April 8, 2024.

/s/ Leslie H. Pitman
LESLIE H. PITMAN
Associate Tax Tribunal Judge

lhp:ac:maj
cc: Alice S. Martin
Warren W. Young, Esq.