

**BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA**

TODD and TRINA WILSON,)
)
Appellants,) DOCKET NO.: IT-2007-2
)
-v-)
) FACTUAL BACKGROUND,
) CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE) ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,) FOR JUDICIAL REVIEW
)
Respondent.)
)

STATEMENT OF THE CASE

The DOR adjusted the Wilson's Montana Individual Income Tax returns for tax years 2001 through 2004 based upon an audit of rodeo/horse training activity. The Wilsons seek to reverse the adjustments. At the hearing on July 9, 2007, in Billings, Montana, the Taxpayers, Todd and Trina Wilson, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Tax Counsel Keith Jones, Field Auditor Tina Standish and Field Audit Unit Manager Douglas Peterson, presented testimony in opposition to the appeal. The record remained open for a period of time for the purpose of preparation of the transcript of the hearing before the Office of Dispute Resolution's Hearing Examiner.

ISSUE

The Wilsons were involved in rodeo/horse training during the years of the audit period (tax years 2001-2004). They maintained these activities were engaged in for profit. Therefore, they sought to claim associated losses on their Montana Individual Income Tax Returns during the audit period. **The issue is:** Did the Department of Revenue make a

proper decision that the rodeo/horse training activities are not engaged in for profit?

SUMMARY OF DECISION

Mr. and Mrs. Wilson are the taxpayers in this proceeding and, therefore, have the burden of proof. Based on the evidence and testimony, the Board affirms the decision of the Department of Revenue.

FINDINGS OF FACT

1. The Wilsons live north of Shepherd, Montana. (Todd Wilson testimony).
2. Todd Wilson is employed as a Fixed Operations Director with Incredible Chevrolet in Hardin, Montana. He is responsible for the parts and service departments. (Todd Wilson testimony).
3. Trina Wilson also worked for wages during the audit period. (DOR Exh. 1, p. 22).
4. Todd Wilson is involved in rodeo roping competitions and rides horses he has broken and trained. The entry of his horses in these competitions is the means he uses to advertise his "product", which is a horse trained in arena roping competitions. (Todd Wilson testimony).
5. The Wilsons' Montana individual income tax returns were chosen for audit from a random selection of Schedule F (Profit or Loss from Farming) filers. In a letter dated May 17, 2004, DOR Field Auditor Tina Standish informed the Wilsons the DOR was reviewing their 2003 return. (DOR Exh. 1, p. 39).
6. In a letter dated April 22, 2005, the DOR informed the Wilsons their file had been referred for a field audit. On May 17, 2005, the DOR met with the Wilsons and

reviewed their 2003 Federal Schedule F Profit or Loss from Farming. (DOR Exh. 1, P. 40).

7. The audit initially focused on the Wilsons' 2003 schedule F income or expenses, for which they had reported a loss of \$6,029. (DOR Exh. 1, p. 48).
8. The DOR reviewed the Wilsons' activities and business records to determine whether the activity could be considered a "for profit" business venture under Internal Revenue Code (IRC) Section 183. Based on the Wilsons' responses to a questionnaire (DOR Exh. 1, p. 27-31) and the loss history of the activity, it was determined to be a hobby activity and not a "for profit" business venture. (DOR Exh. 1, p.37).
9. In the written audit findings, the DOR considered nine factors, outlined in IRC Regulation 1.183-2, when deciding whether the Wilsons' rodeo/horse training activities are intended for profit. (DOR Exh. 1, p.21-22).

- 1) **The manner in which the taxpayer carries on the activity.** The Wilsons maintained one checking account which was used both for personal and family living expenses as well as the rodeo activity. There is no formal business plan for the activity. Mr. Wilson maintained a transaction ledger using an Excel spreadsheet he developed in which he recorded deposits of income and checks written for the rodeo activities. The ledger balance for supplies and repairs did not match the amount claimed on the tax return, however since the amount listed on the ledger was more than the amount claimed on the tax return, the amount claimed on the tax return was used. Mr. Wilson did not retain any actual documentation other than cancelled checks. Records for the rodeo income and expenses are separated from personal items by a memo on the check when

it is written.

- 2) **The expertise of the taxpayer or his advisors.** Mr. Wilson has competed in rodeo events for 20 years or since he was 15. Mrs. Wilson has competed in rodeo for 5 years. They currently compete in team roping. The Wilsons are members of the Montana, Wyoming and Northwest Team Ropers Associations. No paid advisors were consulted for the rodeo activity.
- 3) **The time and effort expended by the taxpayer in carrying on the activity.** Both Mr. and Mrs. Wilson are employed full-time. Mr. Wilson is a manager at Incredible Auto Sales. The Wilsons estimate they spend 50 hours weekly related to W2 employment. Weekends and vacation time is [sic] used to provide time to rodeo. The Wilsons estimate spending 10+ hours weekly in rodeo competition, 20+ hours weekly practicing, and 1+ hours weekly in travel time.
- 4) **Expectations that assets used in activity may appreciate in value.** The Wilsons own 5 acres in Yellowstone County where they live and where rodeo horses are stabled. While the Wilsons own the assets used in the rodeo activity (truck, horse trailer, horses, land, saddles & tack) they expect only the horses to appreciate in value. This questionnaire also indicated some of the assets are used personally as well as for rodeo activities. None of the other assets would be expected to appreciate in value under normal circumstances.
- 5) **The success of the taxpayer in carrying on other similar or dissimilar activities.** The Wilsons have no other activities or businesses.
- 6) **The taxpayer's history of income or losses with respect to the activity.** The rodeo activity has never reported a profit. Losses claimed were as follows: 2001-

(\$18,454); 2002-(\$9,133); 2003-(\$6,029);
2004-(\$7,004)

- 7) **The amount of occasional profits, if any, which are earned.** No profits have been reported.
- 8) **The financial status of the taxpayer.** Both Mr. and Mrs. Wilson are employed full time. As indicated on the questionnaire, W2 income supports the rodeo activities. The Wilsons stated the only effort made to increase receipts and minimize expenses was to enter rodeo competitions. Rodeo prizes for 2003 were \$970 and expenses totaled \$12,249. The only other income for 2003 was the sale of two horses raised by the Wilsons. The losses reported by the rodeo activity have offset income from these activities and allowed substantial tax savings to the Wilsons.
- 9) **Elements of personal pleasure or recreation.** Rodeo is a sporting event and by its nature a social activity. The Wilsons acknowledged the rodeo activities provide an element of personal pleasure to them. The Wilsons stated that they intend to continue to rodeo even though they may not be able to deduct losses on their tax returns.
10. Based on the 2003 audit findings, the DOR made an adjustment to the Wilsons' 2004, 2003, 2002 and 2001 tax filings to remove the Federal Schedule F loss amounts claimed and show the gains as hobby income. (DOR Exh. 1, p. 37)
11. The Wilsons had previously reported a net loss of \$44,000 for the four audit years 2001 through 2004. (Standish testimony).
12. DOR notified the Wilsons on October 17, 2005, that they had completed the audit of their 2001 through 2004 Montana Individual Income Tax returns and that

adjustments had been made to their tax liabilities. (DOR Exh. 1, p. 53). Penalties and interest were assessed to the adjusted amount bringing the total amount due to \$6,711.00. (DOR Exh. 1, p. 54).

13. The Wilsons submitted a Request for Informal Review, received by the DOR on November 25, 2005. The Wilsons requested a review stating: "We feel an inaccurate audit - do not feel auditor understood business objective." [sic]. Attached to the form was a two-page statement setting forth the Wilsons' objections in greater detail. (DOR Exh. 1, P. 57).
14. On December 8, 2005, Douglas Peterson, DOR Field Audit Unit Manager, informed the Wilsons he concurred with the adjustments made to their Montana tax return. (DOR Exh. 1, p. 64).
15. The Wilsons disagreed with Mr. Peterson and on April 14, 2006, filed form APLS102F, Notice of Referral to the Office of Dispute Resolution. (DOR Exh. 1, p. 65).
16. The DOR Hearing Examiner heard this matter on August 28, 2006, in Helena, Montana. The Hearing Examiner issued his Findings of Fact, Conclusions of Law, and Order on November 28, 2006, upholding the DOR's disallowance of the claimed losses. (Hearing Examiner's Findings of Fact, Conclusions of Law, and Order dated November 28, 2006).
17. Due to mailing issues, the Wilsons did not receive a copy of the DOR Hearing Examiner's decision until February 6, 2007.
18. The Wilsons appealed the DOR Hearing Examiner's decision to this Board on February 26, 2007. In a one-page letter, they outlined their reasons for the appeal.

PRINCIPLES OF LAW

1. The Montana Department of Revenue is an agency of the executive branch of government, created and existing under the authority of § 2-15-1301, MCA. The Department is charged with the administration and enforcement of Montana Code Annotated (MCA) Title 15, chapter 30 (Individual Income Tax) and ancillary Administrative Rules of Montana (ARM) Title 42, chapter 15.
2. Adjusted gross income for Montana income tax purposes is the taxpayer's federal adjusted gross income as defined in § 62, I.R.C. subject to certain state modifications to income. (See Section 15-30-111, MCA). Therefore, it is appropriate to cite federal income tax authority in applicable state cases pertaining to specific issues. (See, *Magnuson v. Montana State Board of Equalization* (1973), 162 Mont. 393, 395, 513 P.2d 1, 2).
3. If, in the opinion of the Department, a return of a taxpayer is in any essential respect incorrect, the agency may revise the return. The amount of any tax due under a return may be determined by the Department within five years after the return was filed, regardless of whether the return was filed on or after the last day prescribed for filing under authority of § 15-30-145(1)(3), MCA.
4. Taxpayers are required to maintain accurate books and records in support of the various types of income, gains, losses, costs, expenses, and any other items affecting their income tax liability. Such records must be retained for as long as they may be, or become, material for any tax purpose. Generally, records substantiating an item of income or a deduction on a

return should be retained for at least the period of limitation for that particular return. (See Treas. Reg. § 1.6001-1(a)).

5. If an activity is not one engaged in for profit, no deduction attributable to such activity is to be allowed. The term "activity not engaged in for profit" means one other than an enterprise for which deductions are allowable for the tax year under § 162, I.R.C. (*i.e.*, a bona fide trade or business) or § 212(1)(2), I.R.C. (*i.e.*, one involved in the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income). (See Section 183(a)(c), I.R.C.).
6. If gross income derived from an activity for three or more taxable years in a period of five consecutive taxable years exceeds the deductions attributable to the activity, it is presumed to be one engaged in for profit. However, in the case of an activity involving, for the most part, the breeding, training, showing, or racing of horses, the operative period is two out of seven years. (See Section 183(d), I.R.C.).
7. The regulation implementing § 183, I.R.C., makes clear deductions are not allowed under authority of § 162, I.R.C., or § 212, I.R.C., for activities carried out primarily as a sport, hobby, or for recreation. The determination as to whether an activity is engaged in for profit is to be made by reference to objective standards, taking into consideration the facts and circumstances of each case. Such facts and circumstances must indicate a taxpayer entered into, or continued, the activity with the objective of making a profit. In determining whether the activity is one with

the objective of earning a profit, greater weight is to be given to the objective facts than to the taxpayer(s)' statement of intent. (See Section 1.183-2(a), I.R.C.).

8. In ascertaining whether an activity is engaged in for profit, the regulation sets forth nine factors to be applied in making such a determination.

1. Manner in which the taxpayer carries on the activity. The fact that the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books is an indicator.
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 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, which are earned.
8. The financial status of the taxpayer.
9. Elements of personal pleasure or recreation.

However, it cautions no one factor is conclusive in arriving at such a decision. In addition, it notes other factors may be taken into account. The sheer number of factors used, whether recited in the regulation or not, and whether they tend to favor or disfavor the activity as one for profit, is also indicated not to be determinative. (See Section 1.183-2(b), I.R.C.).

9. Direct appeal from department decision to state tax appeal board - hearing. An appeal is made by filing a complaint with the State Tax Appeal Board within 30 days following receipt of notice of the department's final

decision. Section 15-2-302(2)(a), MCA.

BOARD DISCUSSION AND CONCLUSIONS OF LAW

The issue before this Board is whether the Department of Revenue made the proper decision that the Wilson's rodeo/horse training activities are hobby activities and not "for profit" business activities.

Determining whether an activity is a "for profit" business venture for tax purposes, when profits have not yet been realized, is based on federal tax law. The DOR applied those rules as set forth in the written audit file and denied the business losses. (See Finding #9). The Wilsons contend the Department did not properly analyze their business activities and their returns were properly filed.

Testimony shows the Wilsons have invested a great deal in raising and training horses. They used their own money to start the horse training business and did not seek a bank loan. Training horses has allowed the Wilsons to use rodeo as a form of advertising. Rodeo earnings, along with personal income, have kept the horse training activities viable and brought a great deal of personal pleasure to the Wilsons.

The Wilsons acknowledge their rodeo/horse training activity has not yet reported a profit, but it is trending toward profitability. They reduced their losses from \$18,454 in 2001 to \$7,004 in 2004. Mr. Wilson asserts he has yet to see a business turn a profit immediately upon inception.

The DOR contended the Wilson's only means of attempting to increase profitability was to enter more rodeo competitions. The Wilsons asserted the only source of income for this activity, other than selling rodeo livestock, was to compete. In addition, Todd Wilson

testified the only sure way to advertise a rope horse, and to get the horse trainer's name recognized, is for people to see the horse in competition at a rodeo or similar venue. Thus, the rodeo competitions and other venues serve as the only viable means of advertising their rodeo/horse training businesses. The manner in which a horse performs and reacts to different conditions establishes its value.

Based on the sales of rodeo stock the Wilsons reported for years 2001 through 2004, the value of all the Wilsons rodeo assets, if sold, would not cover the losses claimed by the Wilsons on their rodeo/horse training activities.

In supporting their position, Mr. Wilson testified his intent should be of paramount importance. He did not intend to create a tax shelter for his W2 income, nor for his wife's. His only purpose was to establish a bona fide business, though he acknowledged it had been an unprofitable venture during the audit years. He noted, however, from the first to the fourth year, the losses from the activity had decreased significantly.

The Department does not assert that the Wilsons were attempting to improperly reduce their tax liability. The Wilsons have, however, failed to provide adequate records to support their position.

In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the Taxpayer's statement of intent. Treasury Regulation § 1.183-2(a) states, "The determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case". (Finding #8).

The Board considers the Wilson's activities to be horse training. However, their approach to these activities

causes them to be classified as a hobby. The Wilsons have no business plan, no projections, no receipts for expenses, no separate bank account for these activities and do not account for all expenses, *i.e.*, travel, lodging, etc.

Even though the Wilsons have the best intent of making a business from their rodeo/horse training activities, the facts are clear for the years in question that the Wilsons failed to provide adequate records to demonstrate their business intent. Evidence presented indicates a trend toward developing a profitable business venture subsequent to the audit period and nothing in this decision affects the ability of the Wilsons to develop adequate recordkeeping for future tax years.

This Board, given the set of facts presented in this case and the pertinent laws applying to such facts, affirms the decision of the DOR to disallow the losses pursuant to the criteria set forth in § 183, I.R.C., and its ancillary regulations.

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ORDER

IT IS HEREBY ORDERED that the taxes, late pay penalties, and interest due as a result of adjustments made to J. Todd and Trina Wilsons' Montana Individual Income Tax returns for tax years 2001 through 2004, based upon rodeo/horse training activity, are properly due and owing.

Dated this 13th day of September, 2007.

BY ORDER OF THE
STATE TAX APPEAL BOARD

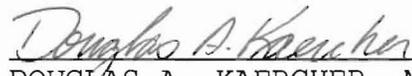
(S E A L)



KAREN E. POWELL, Chairwoman



SUE BARTLETT, Member



DOUGLAS A. KAERCHER, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies on this 13th day of September, 2007, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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