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Montana Tax Appeal Board

EDWARDS & EDWARDS DBA,

Appellant,

v.

STATE OF MONTANA,
DEPARTMENT OF REVENUE,

Respondent.

CASE №: IT-2022-1

**FINDINGS OF FACT,
CONCLUSIONS OF LAW, ORDER,
AND OPPORTUNITY FOR
JUDICIAL REVIEW****STATEMENT OF THE CASE**

This is an appeal of a final decision of the Department of Revenue (DOR) which assessed additional tax, interest, and penalties on the 2014-2017 income tax filings of Edwards & Edwards DBA and its partners, Paul and Helen Edwards (Taxpayer). After the final audit determination resulting in tax due, the Taxpayer bypassed the DOR's Office of Dispute Resolution (ODR) and appealed to the Montana Tax Appeal Board (MTAB) on January 3, 2022. The only issue before this Board is whether Paul Edwards was engaged in the activity of writing with the intent to earn a profit during the years at issue for purposes of 26 U.S.C. § 183¹ and 26 C.F.R. § 1.183-2.² We reverse the DOR's determination and find that Mr. Edwards was engaged in the activity of writing with the intent to earn a profit during the 2014-2017 tax years (Audit Period).

ISSUE TO BE DECIDED

Whether Paul Edwards was engaged in the activity of writing with the intent to earn a profit for purposes of 26 U.S.C. § 183 and 26 C.F.R. § 1.183-2 during the Audit Period.

¹ Also referred to as Internal Revenue Code § 183.

² Also referred to as Treasury Regulation § 1.183-2.

EXHIBIT LIST

The following evidence was submitted at the hearing:

Taxpayer Exhibits:

1. List of Taxpayer's film scripts and productions
2. 2014 Form 1099-Misc from Writers Guild of America
3. 2014 Form W-2 from Walt Disney Pictures
4. 2014 Form 1099-R from Writers Guild of America
5. 2014 Form W-2 from MGM and UA Services Company
6. 2015 Form 1099-MISC from Writers Guild of America
7. 2015 Form W-2 from MGM and UA Services Company, 2015 Form W-2 from Walt Disney Pictures, 2015 Form W-2 from WB Studio Enterprises, Inc., 2015 Form 1099-Misc from Writers Guild of America.
8. 2015 Form 1099-R from Writers Guild of America, 2015 Form W-2 from WB Studio Enterprises Inc., 2015 Form from Walt Disney Pictures, 2015 Form W-2 from MGM and UA Services Company, two Direct Deposit Confirmation documents from Writers Guild of America Pension Plan dated 01/01/2016 and 11/01/2015
9. 2016 Form 1099-MISC from Writers Guild of America
10. 2016 Form 1099-MISC from Writers Guild of America
11. 2016 Form W-2 from Walt Disney Pictures
12. 2016 Form 1099-R from Writers Guild of America, two Direct Deposit Confirmation documents from Writers Guild of America Pension Plan dated 12/01/2016
13. 2017 Form 1099-MISC from Writers Guild of America
14. 2017 Form 1099-MISC from Writers Guild of America
15. 2017 Form W-2 from MGM and UA Services Company, 2017 Form W-2 from WB Studio Enterprises, Inc., 2017 Form W-2 from Walt Disney Pictures

DOR Exhibits:

- A. Audit Determination Letter July 31, 2019 – Entity

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- B. Audit Determination Letter July 31, 2019 – Individual
- C. Extension Agreement September 6, 2019
- D. Audit Determination Letter April 23, 2021 – Entity
- E. Audit Determination Letter April 23, 2021 – Individual
- F. Request for Informal Review May 2021
- G. Informal Review Response September 30, 2021
- H. 2014 Form 2 – Montana Individual Tax Return
- I. 2015 Form 2 – Montana Individual Tax Return
- J. 2016 Form 2 – Montana Individual Tax Return
- K. 2017 Form 2 – Montana Individual Tax Return
- L. 2014 Form PR-1 – Montana Partnership Tax Return
- M. 2015 Form PR-1 – Montana Partnership Tax Return
- N. 2016 Form PR-1 – Montana Partnership Tax Return
- O. 2017 Form PR-1 – Montana Partnership Tax Return
- P. Worksheet VIII – Taxable Social Security Benefits for Form 2 – 2014
- Q. Worksheet VIII – Taxable Social Security Benefits for Form 2 – 2015
- R. Worksheet VIII – Taxable Social Security Benefits for Form 2 – 2016
- S. Worksheet VIII – Taxable Social Security Benefits for Form 2 – 2017

PROCEDURAL HISTORY

The DOR sent an initial audit determination letter dated July 31, 2019, to Edwards & Edwards, DBA disallowing several deductions claimed on the partnership tax returns during the Audit Period, citing Internal Revenue Code § 183 (Activities Not Engaged in for Profit), sometimes referred to as the “hobby loss rule.” *Ex. A.* The DOR sent a corresponding audit determination letter dated July 31, 2019, to Paul and Helen Edwards assessing additional tax, penalties, and interest on their individual income tax returns as a result of the denial of the deductions on their partnership tax returns. *Ex. B.* After Edwards and Edwards DBA filed an objection letter in response, the DOR sent a letter to Edwards and Edwards DBA dated September 6, 2019, requesting additional information related to the partnership and individual tax returns filed for the years of the Audit Period. *Ex. C.* The DOR sent a second audit

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determination letter to Edwards and Edwards DBA dated April 23, 2021, detailing its audit results and disallowing several deductions based on its determination that Paul Edwards was not engaged in the activity of writing with the intent to earn a profit. *Ex. D.* The DOR sent a corresponding audit determination letter dated April 23, 2021, to Paul and Helen Edwards confirming its assessment of additional tax, penalties, and interest on their personal income tax returns as a result of the denial of the deductions on their partnership tax returns. Edwards and Edwards DBA sent a letter dated May 11, 2021 to the DOR detailing its objections to the DOR's determination. *Ex. F.* The DOR responded in a letter dated September 30, 2021, reaffirming its previous determination. *Ex. G.* On December 7, 2021, Edwards and Edwards DBA elected to bypass the Office of Dispute Resolution, and a final determination letter was mailed to the Edwards and Edwards DBA dated December 7, 2021. *MTAB Dkt 1.* Edwards and Edwards DBA appealed to MTAB on January 3, 2022, requesting a reversal of the DOR's audit determination.

The MTAB hearing was conducted in Helena on November 10, 2022. At the hearing, the parties stated they had come to an agreement on their dispute regarding the Augusta rental property income and expenses, as well as the dispute regarding substantiation of expenses claimed as deductions on the tax returns. The only issue remaining for the Board to decide is whether Paul Edwards was engaged in the activity of writing with the intent to earn a profit during the Audit Period.

The MTAB hearing was conducted in Helena on November 10, 2022, at which the following were present:

- a. Paul Edwards, Taxpayer; Sean Morrison, Taxpayer Counsel; and
- b. Teresa Whitney, DOR Counsel; Febe Gemlich, DOR Tax Examiner, Business and Income Tax Division; and David Merrian, DOR Unit Manager, Business and Income Tax Division.

The record includes the ODR record, all materials submitted to MTAB with the appeal, and additional exhibits submitted by the parties prior to the MTAB hearing.

FINDINGS OF FACT

1. To whatever extent the following findings of fact may be construed as conclusions of law, they are incorporated accordingly.
2. The Taxpayer, Paul Edwards,³ has been a professional writer and member of the Writers' Guild of America from 1969 up to and including the time of the hearing. Writing has been his only occupation and main source of income since 1969. He currently receives a pension from the Writers' Guild of America, as well as residual and royalty income from his previous work. *MTAB Hrg Tr. 5:15-6:19, 9:15-11:2.*
3. After submitting a screenplay for the television series *Gunsmoke*, the Taxpayer was hired into his first salaried position as an assistant story consultant for *Gunsmoke*. *MTAB Hrg Tr. 10:12-11:2.* He testified that he worked for *Gunsmoke* for three or four seasons, and he continues to receive residuals and royalty income from that work. *Id.*
4. The Taxpayer wrote 45 full-length scripts and screenplays for films over the course of his career, all of which he was paid for. *Ex. 1; MTAB Hrg Tr. 11:5-20.* He testified that four or five of them were made into movies. *Id.*
5. In addition to his work on *Gunsmoke*, the Taxpayer wrote episodes for other television shows. *MTAB Hrg Tr. 11:8-11.* He also wrote a pilot for the movie *I, Robot* for Walt Disney Pictures. *Id.*
6. After the Taxpayer left the staff of *Gunsmoke*, he was on staff for about 15 different television shows as a story consultant or producer. *MTAB Hrg Tr. 12:5-10.* He directed television shows and eventually produced the television series *Buck James* on ABC, which ran for one year. *Id.*

³ Because the only issue presented to the Board is whether Paul Edwards was engaged in the activity of writing for a profit, the term "Taxpayer" as it relates to the issue before this Board will refer to Mr. Edwards in this opinion.

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7. After working in television for several years, the Taxpayer decided to leave television to focus on writing scripts and screenplays for films. *MTAB Hrg Tr. 12:10-24*. He started writing movies in about 1970, continuing to the early 2000s. *Id.* He wrote some scripts on his own initiative without being paid, but most of the time, he was hired by studios that already had basic material, such as a novel, and needed someone to write a screenplay for it. *Id.*
8. The last screenplay the Taxpayer was paid for was *In the Spirit of Crazy Horse*, which he worked on with Oliver Stone in the 1990s. *MTAB Hrg Tr. 21:19-22:8*. The deal for the movie fell through before it was made. *Id.*
9. He has not yet sold any of the scripts he wrote on his initiative, although he testified he has come close at times. *MTAB Hrg Tr. 12:24-13:16*. He has actively worked to sell his scripts in Los Angeles over the years, including during the Audit Period. *Id.*
10. When the Taxpayer was approximately 65 years of age, he lost his television agent and film agent when the agency they worked for went through a merger. *MTAB Hrg Tr. 13:19-14:24*. After that, he experienced what he perceived to be age discrimination in the industry which led him to participate in a successful class action lawsuit with approximately 80-100 older writers against the networks and studios. *Id.* Although the lawsuit was successful, the Taxpayer continued to experience the same issues. *Id.*
11. After the lawsuit, the Taxpayer experienced difficulty in finding an agent so he had to rely on his own professional connections to sell his work. *MTAB Hrg Tr. 14:24-15:11*. He tried to sell his own scripts through those connections during the Audit Period, but by that time he was in his 70s and many of his connections had since died. *Id.*
12. During the Audit Period, the Taxpayer wrote, produced, and filmed the documentary *American Inspiration Wilderness* which he attempted to sell to

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PBS and HBO. *MTAB Hrg Tr. 15:14-19:22*. He received an offer from a distribution company but did not agree to the terms. *Id.* He also made a series of short video documentaries that he attempted to sell. *Id.* When he was not able to sell these videos, he posted them on his YouTube site. *Id.* If YouTube advertises on his site, he can get a small amount of income. *Id.* During that time, he also wrote content for several internet sites, but found that activity did not make much money. *Id.*

13. The Taxpayer is currently writing a book with the hope of selling it. *MTAB Hrg Tr. 21:4-7*.
14. While the Taxpayer did not always keep meticulous and detailed records of his expenses, he did keep track of his efforts to sell his scripts in daybooks at the advice of his accountant. *MTAB Hrg Tr. 23:6-24:18*. He tracked his efforts through these daybooks, which included receipts and notes, the same way for 40 years. *Id.* He would provide the daybooks to his accountant in what he referred to as “raw” form to prepare his tax returns. *Id.*
15. In 2004, the Taxpayer began reporting his income and expenses on a partnership tax return, along with his late wife’s income and expenses from her work as an artist. *MTAB Hrg Tr. 24:19-25:22*.
16. The Taxpayer provided his daybook from the Audit Period to the DOR to copy and review while they were conducting the audit. *MTAB Hrg Tr. 23:6-8, 56:1-7*.
17. Although the DOR acknowledged the Taxpayer had previous success in carrying out similar activities, it determined the Taxpayer was not engaged in the activity of writing with the intent to earn a profit, in part, because the partnership tax returns for the Audit Period reported losses, and there was little to no income reported for several years prior. *MTAB Hrg Tr. 48:8-49:11, 74:4-10*. The DOR also argued that the Taxpayer was not engaged in the activity of

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writing with the intent to earn a profit based on their analysis of the factors set forth in 26 C.F.R. § 1.182-2(b) (discussed below). The DOR primarily based its opinion on the history of losses the Taxpayer claimed on his tax returns, as well as its determination that the Taxpayer did not keep records in a businesslike manner, that he received pension income and was not financially dependent on earning income from current writing projects, and that there could be some element of pleasure in writing. *MTAB Hrg Tr. 51:23-52:6, 54:6-55:21.*

JURISDICTION AND STANDARD OF REVIEW

18. The Montana Tax Appeal Board is an independent agency not affiliated with the Montana Department of Revenue. *Mont. Const., Art. VIII § 7; Mont. Code Ann. § 15-2-101.* The Taxpayer filed a timely appeal of the DOR's decision to the MTAB. Therefore, this Board maintains jurisdiction to hear and decide this matter. *Mont. Code Ann. § 15-2-302.*
19. This Board may hear appeals de novo. *Dept. of Revenue v. Burlington N.*, 169 Mont. 202, 213-14, 545 P.2d 1083 (1976). "A trial de novo means trying the matter anew, the same as if it had not been heard before and as if no decision had been previously rendered." *McDunn v. Arnold*, 2013 MT 138, ¶ 22, 370 Mont. 270, 275, 303 P.3d 1279, 1282.
20. The Board's order is final and binding upon all parties unless changed by judicial review. *Mont. Code Ann. § 15-2-302(6).*

CONCLUSIONS OF LAW

21. To whatever extent the following conclusions of law may be construed as findings of fact, they are incorporated accordingly.
22. "The Montana board shall conduct the appeal in accordance with the contested case provisions of the Montana Administrative Procedure Act." *Mont. Code Ann. § 15-2-302(5).*

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23. The DOR is an agency of the executive branch of government created and existing under the authority of Mont. Code Ann. § 2-15-13. The DOR is charged with the administration and enforcement of the Montana Code Annotated, Title 15, Chapter 20 (Individual Income Tax) and the ancillary Administrative Rules of Montana Title 42, Chapter 15.
24. “If, in the opinion of the department, any return of a taxpayer is in any essential respect incorrect, it may revise the return.” *Mont. Code Ann. §15-30-2605(1)*.
25. “Taxable income’ means the adjusted gross income of a taxpayer less the deductions and exemptions provided for in this chapter.” *Mont. Code Ann. §15-30-2101(32)*.
26. “[G]ross income means all income from whatever source derived, including (but not limited to) ... [c]ompensation for services, including fees, commissions ...” *26 U.S.C. § 61*.
27. “[A]djusted gross income is the taxpayer’s federal adjusted gross income as defined in section 62 of the Internal Revenue Code, 26 U.S.C. 62,” and includes certain additions. *Mont. Code Ann. §15-30-2110(1)*.
28. “Under Montana law, in computing net income, deductions are generally those permitted by 26 U.S.C. §161 and 211. Mont. Code Ann. § 15-30-2131(1)(a).” *Robinson v. DOR.*, 2012 MT 145, ¶ 3, 365 Mont. 336, 336, 281 P.3d 218, 218.
29. “Tax deductions are a matter of legislative grace, and it is the taxpayer’s burden to clearly demonstrate the right to the claimed deduction.” *Robinson*, ¶ 12 (Quoting *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84, 112 S. Ct. 1039, 117 L. Ed. 2d 226 (1992)).

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30. The taxpayer bears the burden of proving the error of DOR's decision. *Farmers Union Cent. Exch., Inc. v. Dep't of Revenue of State of Mont.*, 272 Mont. 471, 476, 901 P.2d 561, 564 (1995); *Western Air Lines, Inc. v. Michunovich*, 149 Mont. 347, 353, 428 P.2d 3, 7 (1967).
31. DOR is entitled to a "presumption of correctness if its decisions are pursuant to an administrative rule or regulation, and the rule or regulation is not arbitrary, capricious or otherwise unlawful." *Dep't of Revenue v. Burlington N. Inc.*, 169 Mont. 202, 214, 545 P.2d 1083, 1090 (1976). However, DOR cannot rely entirely on the presumption in its favor and must present a modicum of evidence showing the propriety of their action. *Western Air Lines*, 149 Mont. at 353, 428 P.2d at 7.
32. "When faced with a problem of statutory construction great deference must be shown to the interpretation given the statute by the officers or agency charged with its administration." *Dep't of Revenue v. Puget Sound Power & Light Co.*, 179 Mont. 255, 262, 587 P.2d 1282, 1286 (1978) (citing *Udall v. Tallman*, 380 U.S. 1, 16 (1965)).
33. "[T]ax statutes are to be strictly construed against the taxing authority and in favor of the taxpayer." *Western Energy Co. v. Dep't of Revenue*, 1999 MT 289, ¶ 10, 297 Mont. 55, 58, 990 P.2d 767, 769.
34. "In general. There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business..." 26 U.S.C. § 162.
35. "In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

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(1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income...”
26 U.S.C. 212(1)-(2).

36. In general, 26 U.S.C. § 183(a)-(b) disallows or limits deductions if an activity is not engaged in for profit. 26 U.S.C. § 183(c) defines “activity not engaged in for profit” as any activity other than one in which deductions are allowed under 26 U.S.C. § 162 or 26 U.S.C. § 212(1) or (2). In other words, § 183 disallows or limits deductions when an activity is not carried on as a trade or business but is instead carried on as a sport, hobby, or recreation.
37. In general, 26 U.S.C. § 183(d) provides a presumption that an activity is engaged in for profit if the gross income derived from that activity exceeds the deductions for that activity for three or more of five consecutive tax years. There are exceptions to that presumption that are not at issue in this case and are not further discussed in this opinion.
38. If a taxpayer does not derive net income from an activity for three or more of five consecutive years and therefore does not meet the presumption set forth in 26 U.S.C. § 183(d) that the activity is engaged in for profit, then the analysis turns to 26 C.F.R 1.183-2 and the factors set forth in its subsection (b) (hereinafter referred to as “Factors”) to make that determination. No one Factor is determinative, and factors other than those listed in the regulation may also be considered. The Factors set forth in the regulation are: (1) the manner in which the taxpayer carries on the activity, (2) the expertise of the taxpayer or his/her advisors, (3) the time and effort expended by the taxpayer in carrying on the activity, (4) the expectation that assets used in 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 losses with respect to the activity, (7) the amount of occasional profits, if any, which are earned, (8) the

financial status of the taxpayer, and (9) elements of personal pleasure or recreation.

DISCUSSION

39. In the course of auditing the Taxpayer's returns, the DOR determined the Taxpayer was not engaged in the activity of writing with the intent to earn a profit for purposes of Internal Revenue Code § 183. In other words, this meant the DOR determined the Taxpayer's writing activities did not amount to an occupation or profession but were more comparable to a hobby or a recreational activity. The Taxpayer did not report a profit from his writing activities in at least three of five consecutive years, which meant that he did not benefit from the presumption that his intent was to earn a profit. However, the Taxpayer still had an opportunity to prove that his intent was to earn a profit by demonstrating how the factors set forth in § 1.183-2(b) apply to him. The DOR requested additional information from the Taxpayer and after working with the Taxpayer and his CPA, the DOR determined the information presented did not convince them that the Taxpayer's intent was to earn a profit with his writing.

40. The DOR's determination that the Taxpayer was not engaged in the activity of writing with the intent to earn a profit was based on its conclusion that the Taxpayer did not carry on the activity in a businesslike manner (Factor 1), the history of losses he claimed with respect to the activity (Factor 6), his financial status (Factor 8), and elements of personal pleasure (Factor 9). The Taxpayer argued that he was engaged in the activity of writing with the intent to make a profit as demonstrated by his expertise in professional writing (Factor 2), the time and effort he spent in carrying on the activity (Factor 3), his previous success in carrying out similar activities (Factor 5), and his history of earning income as a writer (Factor 6).

41. After reviewing the evidence and hearing testimony from both the Taxpayer and the DOR, this Board determined the Taxpayer is engaged in the activity of

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writing with the intent to earn a profit, and the limitations on deductions under § 183, or the “hobby loss rule”, do not apply. The Board analyzed the Factors set forth in Treasury Regulation 1.183-2(b) as they relate to the facts presented in this case. The reasons for the Board’s determination are as follows.

42. Factor 1: the manner in which the taxpayer carries on the activity. While both parties agreed that the Taxpayer’s method of tracking his expenses could have been improved, he did keep track of his expenses in daybooks at the instruction of his long-time accountant. The DOR argued that many of the entries in the daybook and many of the expenses claimed as deductions on the tax returns appeared to be personal in nature and would not have been deductible as ordinary and necessary business expenses under 26 U.S.C. § 162. Nor would they be deductible as expenses incurred in the production of income under 26 U.S.C. § 212. The DOR argued that this showed a lack of care in how the Taxpayer carried on the activity, and thus could be seen as proof that he did not carry on the activity in a businesslike manner. The DOR also argued that some of the income and expenses were also reported incorrectly on the tax forms. This Board notes that issues such as incorrect reporting, improper deductions, and lack of substantiation for deductions are separate issues that do not necessarily prove that the Taxpayer did not intend to profit from his writing, but that he was instead using expenses generated from a hobby or recreational activity to reduce his overall taxable income. If the Taxpayer claimed deductions he was not entitled to under § 162 or §212, the DOR could have denied those deductions. However, that issue was not before this Board. The DOR advanced this argument to show the Taxpayer did not carry on his writing activities in a businesslike manner and therefore § 183 should apply. This Board disagrees. The first sentence of § 1.183-2(b)(1) states: “The fact that the taxpayer carries on the activity in a businesslike manner and maintains compete and accurate books and records *may* indicate that the activity is engaged in for profit.” [*Emphasis added.*] Some taxpayers keep better records than others. Taxpayers are responsible for the information they provide to

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federal and state tax authorities, and taxpayers who do not substantiate their expenses run the risk of a deduction being disallowed. This is a separate argument from the one advanced by the DOR that the Taxpayer's method of tracking his expenses demonstrates he did not intend to make a profit from his writing, but that his intent was instead to use expenses generated from that activity to offset other income. Because the issue of substantiation was not before the Board, the Board makes no determination on the adequacy of the Taxpayer's record keeping method. The Board simply disagrees with the DOR that the Taxpayer's method of recordkeeping, whether adequate or inadequate to substantiate deductions, somehow proves the Taxpayer was not trying to earn profits from writing.

43. Factor 2: the expertise of the taxpayer or his/her advisors. Both parties acknowledged that the Taxpayer has expertise in professional writing based on his long history of commercial success, so the Board determines this Factor weighs in favor of the Taxpayer.

44. Factor 3: the time and effort expended by the taxpayer in carrying on the activity. This Board determines this Factor weighs in favor of the Taxpayer. This Factor might have weighed differently had the Taxpayer been actively engaged in another profession while spending some time on the side writing. However, this was not the case here. The Taxpayer's testimony convinced this Board that writing has always been his main profession and main source of income even if he spends less time on those activities now than he did at the beginning of his over 50-year career. During the Audit Period, the Taxpayer wrote, produced, and filmed the documentary *American Inspiration Wilderness*, along with other short documentaries which he ended up posting on his YouTube channel after being unable to sell them for an agreeable price. The Taxpayer presented credible evidence and testimony that he spends enough time and effort on his writing activities that this Factor weighs in his favor

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based on the work he did during the Audit Period and because it is and has been his only occupation since 1969.

45. Factor 4: the expectation that assets used in activity may appreciate in value. Neither party relied on this Factor, and the Board determines it is not relevant in this matter.

46. Factor 5: the success of the taxpayer in carrying on other similar or dissimilar activities. The Board determines this Factor weighs in favor of the Taxpayer. Both parties acknowledged the Taxpayer has had a long career as a writer. The Taxpayer presented credible testimony regarding the work he has done and the considerable money he has made over the years. In fact, the Taxpayer's primary source of income currently is his pension from the Writers' Guild of America which is based on his previous work as a writer. Additionally, the Taxpayer still receives residual and royalty income from his previous work. The Board finds that the Taxpayer's career history and these continued sources of income from previous work weigh in the Taxpayer's favor with regard to previous success in similar activities.

47. Factor 6: the taxpayer's history of income or losses with respect to the activity. The DOR argued that this Factor weighed against the Taxpayer because the tax returns showed losses over the course of several years. However, this Board disagrees. As discussed under Factor 5, the Taxpayer presented credible evidence that his writing activities have generated significant income in the past so that his only occupation since 1969, and his main source of income since then, has come from his writing activities. To reiterate, the issue of substantiation of deductions was not before this Board, so the Board is unable to determine if the history of losses claimed would have been the same if the DOR had denied deductions, either in full or in part, that were not permissible under § 162 and §212. Additionally, as discussed in relation to other Factors, sustained losses do not automatically mean the Taxpayer does not have a profit motive if those losses can be explained. As such, this Board was not convinced

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that the history of losses in and of itself means the Taxpayer did not have the intent to earn a profit with his writing activities but was otherwise engaged in writing as a hobby or recreational activity.

48. Factor 7: the amount of occasional profits, if any, which are earned. While neither party argued specifically for or against this Factor, the Board finds this Factor weighs somewhat in favor of the Taxpayer based on the testimony and evidence presented. The final sentence of §1.183-2(b)(7) states: "...an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are generated." The Taxpayer still owns some scripts that he has not yet sold, and he is currently writing a book with the intent to sell it. Based on his past success in earning a profit from his scripts, it is not unreasonable to believe the Taxpayer could have comparable success in the future, either from selling an existing script or from selling newly created work.
49. Factor 8: the financial status of the taxpayer. The DOR argued that this Factor weighed against the Taxpayer based on the history of losses shown on the tax returns over the course of several years. The DOR pointed to an example in Treasury Regulation § 1.183-2(b)(c) that illustrates a situation in which a certain individual engaged in writing activities is deemed to be engaged in those activities for reasons other than to earn a profit. The DOR argued that example was comparable to the Taxpayer's situation. This Board notes that Example 3 of the regulation discusses a wealthy individual who generates losses from a writing activity which are used to offset his primary source of income which comes from passive sources. This Board disagrees that this example is similar to the Taxpayer's situation. The individual in the example offsets passive income with losses incurred in an activity that he does not rely on financially which could presumably be considered a hobby. Here, the Taxpayer has a long career as a professional writer with a history of losses reported on his tax returns. The DOR argued that the deductions the Taxpayer

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claimed with regard to his writing activities were generated from a “not for profit activity” to offset his pension income. However, this Board disagrees that the Taxpayer’s purpose in writing, or for claiming deductions for expenses incurred in his writing activities, was to reduce his taxable income. As discussed in relation to other Factors, if the Taxpayer claimed deductions that were not permissible, either in full or in part, the DOR could have disallowed those deductions rather than argue that the purpose of the Taxpayer’s writing activities was to generate losses to offset his pension income. The DOR also argued that the Taxpayer is not financially dependent on the successful sale of a script or other writing project because he receives his pension and Social Security income, and therefore this Factor weighs against him. The Board disagrees with the DOR’s conclusion. The Taxpayer is not financially dependent on the sale of a script precisely because he has a history of success as a professional writer and continues to receive income stemming from those activities.

50. Factor 9: elements of personal pleasure or recreation. The DOR also argued this Factor weighed against the Taxpayer. The last sentence in § 1.183-2(b)(9) states: “...the fact that the taxpayer derives personal pleasure from engaging in the activity is not sufficient to cause the activity to be classified as not engaged in for profit if the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.” While it may be easy to assume the Taxpayer derives personal pleasure from writing, the Taxpayer never actually testified to that. The Taxpayer did testify to some aspects of working in Hollywood that may not be enjoyable to everyone, including himself. If the Taxpayer does in fact derive personal pleasure from writing, which may be the case, this Board would not find this Factor necessarily weighs against him. People can enjoy their job and still have a profit motive. In this instance, the Taxpayer’s past writing activities, which he might have enjoyed a great deal, have been used to make a profit for himself and for other individuals and

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businesses in the pursuit of entertaining others. As such, this Board does not agree with the DOR that this Factor weighs against the Taxpayer.

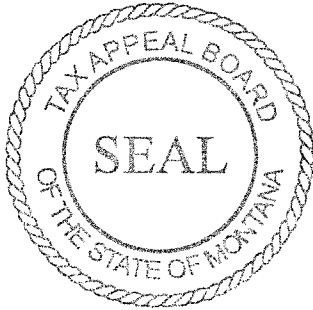
51. Overall, this Board was not convinced by the DOR's arguments that the Taxpayer was not engaged in writing activities and in attempts to sell his existing scripts with the intent to earn a profit such that the limitations of § 183 should be applied. The Taxpayer continued writing through the Audit Period and up to the time of the hearing. Additionally, he continued to try to sell the scripts he had already written during that time. These scripts remain his assets, and the Taxpayer could potentially sell them in the future. The Board was convinced that the Taxpayer engaged in his writing and related activities with the intent to earn a profit, and not for another reason, such as for recreation or as a hobby. Whether or not the deductions the Taxpayer claimed were permissible under the Internal Revenue Code and Montana Code Annotated was not before this Board. Whether the Taxpayer substantiated permissible deductions to the DOR's satisfaction was likewise not before this Board. The only issue before this Board, per agreement between the parties, was whether or not the limitations of § 183 should apply to the Taxpayer. The Taxpayer presented credible evidence and testimony to convince this Board that he is engaged in the activity of writing with the intent to earn a profit. Thus, this Board reverses the DOR's determination that the limitations of § 183 apply in this matter.

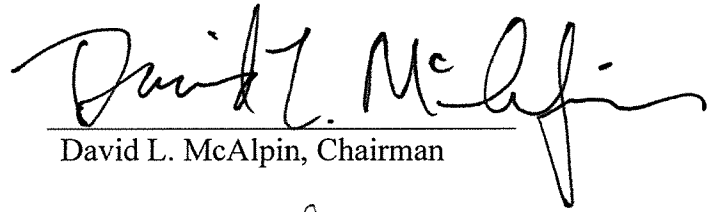
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ORDER


52. The DOR's determination that the limitations of Internal Revenue Code § 183 apply because the Taxpayer was not engaged in the activity of writing with the intent to earn a profit is reversed.

Dated this 6th day of January 2023.





David L. McAlpin, Chairman



Amie Zendron, Member

Notice: You are entitled to judicial review of this Order by filing a petition in district court within 60 days of the service of this Order. The Department of Revenue shall promptly notify this Board of any judicial review to facilitate the timely transmission of the record to the reviewing court. *Mont. Code Ann. §15-2-303(2)*.

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Certificate of Service

I certify that I caused a true and correct copy of the foregoing Findings of Facts and Conclusions of Law to be sent by email and United States Mail via Print & Mail Services Bureau of the State of Montana on January 6, 2023, to:

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