

Letter of Findings Number: 09-0593
Individual Income Tax
For the Years 2005-2007

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Individual Income Tax—Income Determination.

Authority: IC § 6-8.1-5-1; I.R.C. § 183; Treas. Reg. § 1.183-1; Treas. Reg. § 1.183-2; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the redetermination of his income.

STATEMENT OF FACTS

Taxpayer is an individual. Taxpayer filed federal adjusted gross income tax returns that included Schedule Cs reporting activities from selling antique dolls. Taxpayer's Schedule Cs reported a \$7,117 loss for 2005, a \$4,234 loss for 2006, and a \$4,099 loss for 2007. After an investigation, the Indiana Department of Revenue ("Department") redetermined Taxpayer's adjusted gross income and assessed additional adjusted gross income tax, interest, and penalties for the 2005, 2006, and 2007 tax years. The Department disallowed Taxpayer's Schedule C expense deductions claimed for the doll selling activities to the extent the expenses exceeded the income Taxpayer received from the doll selling activities. The Department determined that the expense deductions were disallowed under I.R.C. § 183 "hobby loss rules." Taxpayer protested the assessment. The Department conducted an administrative hearing, and this Letter of Findings results.

I. Individual Income Tax—Income Determination.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Taxpayer protests the Department's redetermination of his income based upon the federal "hobby loss rules." The Department disallowed Taxpayer's antique doll selling Schedule C expense deductions to the extent that Taxpayer's Schedule C expenses exceeded the income from this activity. The Department determined that the expense deductions were disallowed under I.R.C. § 183 "hobby loss rules."

For a taxpayer's Schedule C expenses to qualify as allowable deductions, the taxpayer must demonstrate that the activity is an activity engaged in for profit. See I.R.C. § 183. Generally, "no deductions are allowable for expenses incurred in connection with activities which are not engaged in for profit"—i.e., "for activities which are carried on primarily as a sport, hobby, or for recreation." Treas. Reg. § 1.183-2(a). To meet a rebuttable presumption that an activity is engaged in for profit, a taxpayer must show that "the gross income derived from an activity for 3 or more of the taxable years in the period of 5 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity...." I.R.C. § 183(d). In regards to the doll selling activity, Taxpayer reported on his Schedule Cs the following:

	Receipts	Cost of Goods Sold	Gross Earnings	Expenses	Losses
2001	\$355	\$67	\$288	\$9,354	\$(9,066)
2002	\$147	\$128	\$19	\$6,755	\$(6,736)
2003	0	0	0	\$2,606	\$(2,606)
2004	0	\$1	\$(1)	\$4,540	\$(4,541)
2005	0	\$113	\$(113)	\$7,004	\$(7,117)
2006	0	0	0	\$4,234	\$(4,234)
2007	\$31	\$9	\$22	\$4,121	\$(4,099)
Totals	\$533	\$318	\$215	\$38,614	\$(38,399)

In the seven years from 2001 to 2007, Taxpayer reported gross earnings of \$215 and losses for seven consecutive years totaling over \$38,000. Since Taxpayer reported seven consecutive years of losses, Taxpayer's activities do not meet the presumption that his activities were engaged in for profit. I.R.C. § 183(d). Therefore, for Taxpayer to deduct the expenses in excess of the income reported, Taxpayer must be able to demonstrate that his activities were engaged in for profit. Treas. Reg. § 1.183-1 & 1.183-2.

Treas. Reg. § 1.183-2(a) states that "[t]he 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."

Treas. Reg. § 1.183-2(a), states that "in determining whether an activity is engaged in for profit, greater weight is given to objective facts than to taxpayer's mere statement of his intent." Treas. Reg. § 1.183-2(b) provides a list of relevant factors for demonstrating a profit objective that should normally be considered. These factors include, but are not limited to whether a taxpayer has a businesslike manner maintaining complete books and records, is an expert or has expertise advisors, expends a great amount of time on the activity, generates a relative amount of profits and losses, has another source of income, and is personally motivated receiving mainly personal pleasure from the activity. Id.

In the seven years from 2001 to 2007, Taxpayer never reported a profit and reported losses of over \$38,000. Additionally, even if Taxpayer sold the remainder of his inventory, Taxpayer's gross earnings—based on a projection from his past results—would be \$15,868 [inventory of \$23,470 multiplied by his .676 inventory earnings percentage (gross earnings of \$215 / \$318 of cost of goods sold = .676 inventory earnings percentage) equals \$15,868]. Since Taxpayer has already reported over \$38,000 of losses, Taxpayer could have no reasonable expectation of recognizing future profits from this activity as Taxpayer would never recoup these reported past losses. Especially, in light of the fact that this \$15,868 of future gross earnings does not take into account Taxpayer's average yearly expenditures of \$5,516 [expenditures of \$38,614 divided by 7 years equals \$5,516 of average yearly expenditures], which would reduce Taxpayer's potential profit by \$5,516 for each year it takes Taxpayer to sell this inventory.

Nonetheless, Taxpayer maintains that the "hobby loss rules" do not apply to his doll selling activities. However, Taxpayer has not demonstrated facts or presented evidence to support his protest. Therefore, Taxpayer has not only failed to meet his burden of demonstrating that the Department's determination was not correct under IC § 6-8.1-5-1(c), Taxpayer has also failed to meet his burden under Treas. Reg. § 1.183-2.

FINDING

Taxpayer's protest is denied.

Posted: 02/24/2010 by Legislative Services Agency
An [html](#) version of this document.