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A Horse Owner's Tax Checklist (/full-blog/2014/04/a-horse-owners-tax-checklist.html)

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By: Matthew Doane, Staff Member

With tax day upon us, horse owners must be cautious if they are attempting to deduct business expenses related to their horse activity. Section 183(a) of the Internal Revenue Code states, “[i]n the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.”[i] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) If an activity is not “engaged in for profit,” provision (b) of section 183 allows deductions only to the extent of gross income derived from the activity.[ii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) Deemed the “hobby loss rules,”[iii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) this means that if an individual's horse activity does not rise to the level of “engaged in for profit,” but is simply a hobby, then that individual will only be able to deduct allowable expenses up to the threshold of income they have received relating to the activity.[iv] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) This can lead to serious tax implications if a taxpayer was planning on horse-related expenses being deductible, primarily larger tax liability, or in the case of previous tax year where a taxpayer included the deductions, an audit by the IRS. In 2011, this exact situation occurred, leading to a Tax Court opinion that provides some guidance to horse owners and the deductibility of horse-related expenses. [v] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner)

In *Blackwell v. Comm'r.*, the petitioners, Mark and Patti Blackwell, were seeking a redetermination of tax deficiencies on their 2005 and 2006 federal income tax returns, relating to the deductibility of business expenses related to their horse-breeding operation, Fresh Horses Farm.[vi] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) The main issue in the case, as laid out by Judge Swift, was “whether petitioners' horse breeding activity constituted an activity carried on for profit under section 183.”[vii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) The court relied upon Section 1.183-2(b) of the Income Tax Regulations, which sets forth a nonexclusive

list of nine factors that are to be considered when deciding whether an activity has an “actual and honest profit objective.”^[viii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) The nine factors considered in the case include: 1) Manner in Which the Activity Is Carried On; 2) Expertise of the Taxpayer; 3) Time and Effort Expended in Carrying On the Activity; 4) Expectation That the Horses May Appreciate in Value; 5) Success in Other Activities; 6) History of Income or Losses; 7) Amount of Occasional Profits; 8) Financial Status; and 9) Elements of Personal Pleasure.^[ix] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner)

In *Blackwell*, the court, after examining all nine factors, held that the “petitioners’ motive, efforts, and investment in carrying on their FHF horse activity during the years in issue” was indicative of a “profit objective.”^[x] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) The court’s holding centered around such facts as the petitioners’ substantial preparation and education associated with entering the horse business, the considerable amount of time and energy invested in the horse activity, and their dedication to proper business planning and book keeping procedures related to their horse activity.^[xi] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) While the outcome in *Blackwell* was a positive one for Mark and Patti Blackwell, horse owners this tax season must still be mindful of the nine factor checklist set out in 1.183-2(b) of the Income Tax Regulations and examined in *Blackwell v. Comm’r.* to properly deduct expenses relating to their horse activity.

[i] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) 26 I.R.C. § 183(a) (2014).

[ii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) See id. § 183(b).

[iii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) Peter Rilly, Horse Breeders Win in Tax Court, *Forbes* (Aug. 13, 2011),

<http://www.forbes.com/sites/peterjilly/2011/08/13/horse-breeders-win-in-tax-court/> (<http://www.forbes.com/sites/peterjilly/2011/08/13/horse-breeders-win-in-tax-court/>).

[iv] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) See 26 I.R.C. § 183(a)-(b) (2014).

[v] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) See generally *Blackwell v. Comm’r.*, No. 29287-09, T.C. Memo. 2011-188 (2011).

[vi] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) See id. at *6.

[vii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) Id. at *1.

[viii] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) Id. (citing *Dreier v. Comm’r.*, 78 T.C. 642, 645 (1982)).

[ix] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) See id. at *6-8.

[x] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) Id. at *8.

[xi] (file:///C:/Users/Laken/Downloads/A%20Horse%20Owner) See id. at *6-8.

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