

8. Taxpayer testified at the hearing that:
 - a. He entered into a [REDACTED] affiliate consultant agreement with [REDACTED].
 - b. [REDACTED] was a [REDACTED] company.
 - c. Taxpayer attended a seminar to become familiar with the activity of selling [REDACTED] services.
 - d. Taxpayer started his activities during tax year 2005.
 - e. Taxpayer's activity during tax year 2006 consisted of contacting businesses and business representatives to become customers of [REDACTED].
 - f. Taxpayer estimated he contacted over a thousand prospective customers in his sales efforts.
 - g. Taxpayer estimated he might work 10 hours in a day in making sales calls and trying to contact prospective customers.
 - h. Taxpayer actively marketed his sales activity by making telephone calls, calling on customers, establishing a website and sending solicitation letters to prospective customers.
 - i. Taxpayer's activities included travel to the prospective customers' business or corporate office locations.
 - j. Taxpayer would receive a commission for each prospective customer that contracted with [REDACTED] for [REDACTED] services.
 - k. The sales of [REDACTED] services was a highly competitive field.
 - l. Taxpayer formed a limited liability company to conduct the activity.
9. Taxpayer was not able to make his activities profitable and stopped pursuing the [REDACTED] business in 2007.
10. [REDACTED] ceased conducting business sometime thereafter.

11. Taxpayers reported gross receipts of \$[REDACTED] and total expenses of \$[REDACTED] on their Schedule C for tax year 2006.
12. Taxpayers reported pension and annuity income of \$[REDACTED] on their federal form 1040.
13. The Section contended that Taxpayer did not carry on the activity in a business like manner, Taxpayer did not present projections of profit and loss or a budget for his activities, the fact Taxpayer attended a seminar did not constitute a showing of expertise, Taxpayer's testimony regarding the number of hours he expended was not sufficient, Taxpayer has not shown success in similar or other endeavors, Taxpayers showed business losses for years 2005 through 2009, Taxpayers had significant other income and there were some recreational elements such as trips to Las Vegas, Aspen and Orlando.
14. Taxpayer maintained expense ledger and expense reports detailing his Schedule C expenses incurred during tax year 2006.
15. A majority of Taxpayer's Schedule C expenses during 2006 was for travel and meals and entertainment to contact and obtain prospective customers.
16. Taxpayer's expenses included golf charges.
17. Taxpayer testified that he used golf as a part of his efforts to obtain customers for the [REDACTED] business.

CONCLUSIONS OF LAW

1. Arizona taxpayers may deduct on their Arizona income tax return itemized deductions calculated under the Internal Revenue Code (I.R.C.). Arizona Revised Statutes (A.R.S.) § 43-1042.
2. I.R.C. § 162(a) provides in pertinent part that "[t]here 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."

3. The activity must have been conducted with an intent to make a profit. See I.R.C. § 183(a); see also *Elliott v. Commissioner*, 90 T.C. 960, 970 (1988), *aff'd*, 899 F.2d 18 (9th Cir. 1990).
4. The burden is on the taxpayer to show he is entitled to a deduction or exemption from tax. See *Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969).
5. I.R.C. § 183(d) provides that if the gross income exceeds the deductions from such activity for three or more of the immediately preceding five years, the activity is presumed to be engaged in for profit and the taxing entity has the burden of proof to rebut this presumption.
6. Taxpayer's gross income did not exceed the deductions from his activity for three or more of the immediately preceding five years.
7. Taxpayers are not entitled to the presumption under I.R.C. § 183(d). Taxpayers bear the burden of proving that they possessed the required profit motive. See *Golanty v. Commissioner*, 72 T.C. 411, 426 (1979).
8. When the activity at issue is a typically profit-oriented enterprise such as a retail store and the taxing entity does not find a particular non-profit motive, the taxpayer must have an easier task of proving a profit motive." *Ranciato v. Commissioner*, 52 F.3d 23, 28 (2d Cir. 1995).
9. While Taxpayers did not operate a retail store, the activity involved the sale of a service, which is a type of enterprises that is typically profit-oriented.
10. The determination of 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).
11. The facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the objective of making a profit. Treas. Reg. § 1.183-2(a).

12. In determining whether a taxpayer entered into or continued an activity for profit, Treas. Reg. § 1.183-2(b) sets forth the following nonexclusive list of objective factors that should normally be taken into account: 1) the manner in which the taxpayer carries on the activity, 2) the expertise of the taxpayer or his advisors, 3) the time and effort expended by the taxpayer in carrying on the activity, 4) the expectation that assets used in the 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) the elements of personal pleasure or recreation involved in the activity.
13. No single factor is conclusive. Rather, determining whether a taxpayer possesses the relevant profit objective is a question of fact to be determined in light of all the facts and circumstances. See Treas. Reg. § 1.183-2(b).
14. Taxpayer seemed to maintain accurate records of his expenses.
15. Taxpayer attended a three-day seminar to learn about the cashflow business and [REDACTED] in particular.
16. The business involved selling a service and Taxpayer believed he would be able to generate a profit from his activities.
17. The purpose of Taxpayer's travel and golf activities was to contact and sign up customers for the [REDACTED] business generating commissions for Taxpayer.
18. These activities seem to indicate that the activity was run in a businesslike manner with efforts to improve profitability.
19. Taxpayer stated that he devoted a great deal of time and effort to the activity, up to ten hours per day. Taxpayer was retired and did not have to devote time to another full-time job.

20. A series of losses sustained beyond the initial start-up period may be an indication that the activity is not engaged in for profit. See Treas. Reg. § 1.183-2(b)(6). Taxpayer here quit the business when he realized that it was unlikely he would be able to make the business profitable.
21. Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved. Treas. Reg. § 1.183-2(b)(8).
22. Taxpayers received substantial pension and annuity income during 2006. Taxpayers were not relying on the business income for their livelihood. However, the loss at issue was fairly minor and did not generate substantial tax benefits.
23. The presence of personal motives in carrying on an activity may indicate that the activity is not engaged in for profit, especially when there are recreational or personal elements involved. Treas. Reg. § 1.183-2(b)(9).
24. 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 other factors indicate that the activity is in fact engaged in for profit. Treas. Reg. § 1.183-2(b)(9).
25. Taxpayer testified that there were some elements of personal pleasure or recreation involved in travelling to various locations to contact prospective customers.
26. However, Taxpayer traveled to these locations because that was the business location of the prospective customer. See *Churchman v. Commissioner*, 68 T.C. 696, 702 (1977).
27. Taxpayer did not seem to be extravagant in his expenses. The activities at issue seem to be of the type that are typically found in a profit-oriented enterprise. See *Ranciato, supra*.

28. Considering all of the facts and circumstances, the Hearing Officer finds that Taxpayer was engaged in the activities at issue during tax year 2006 with the objective of making a profit.
29. Taxpayers are entitled to a deduction of their ordinary and necessary expenses paid or incurred during the taxable year in carrying on the business. I.R.C. § 162(a).
30. The Section's proposed assessment disallowing Taxpayers' Schedule C expenses is reversed.

DISCUSSION

Taxpayers timely filed their 2006 tax year personal income tax return. The Section reviewed Taxpayers' return and issued a proposed assessment disallowing Taxpayers' Schedule C business expenses in excess of Taxpayers' Schedule C income. The basis for the disallowance was that Taxpayer was not engaged in business for a profit.

Whether a taxpayer is engaged in business for a profit depends on the facts and circumstances of each case.¹ Treas. Reg. § 1.183-2(b) considers the following nonexclusive list of factors: 1) the manner in which the taxpayer carries on the activity, 2) the expertise of the taxpayer or his advisors, 3) the time and effort expended by the taxpayer in carrying on the activity, 4) the expectation that assets used in the 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) the elements of personal pleasure or recreation involved in the activity.

¹ Taxpayers are not entitled to a presumption that the activity was engaged in for profit. See Conclusions of Law Nos. 5 through 8. Taxpayers therefore bear the burden of proving that they possessed the required profit motive.

No single factor is conclusive. Rather, determining whether a taxpayer possesses the relevant profit objective is a question of fact to be determined in light of all the facts and circumstances.

Factor (1) *The Manner in Which the Taxpayer Carries on the Activity.*

Taxpayer seemed to carry on his activities in a businesslike manner. Taxpayer seemed to maintain accurate records of his expenses.

Factor (2) *The Expertise of the Taxpayers or Their Advisors.*

Taxpayer attended a seminar relating to the cash flow business, concentrating on the [REDACTED] activity. Taxpayer's function was to solicit customers. Taxpayer would obtain information from the prospective customer and forward the information to the [REDACTED] company for analysis. It was not necessary for Taxpayer to be an expert in [REDACTED]. Taxpayer appeared knowledgeable regarding customer solicitation.

Factors (3), (8) and (9) *The Time and Effort Expended by Taxpayers in Carrying on the Activity, Taxpayers' Financial Status and the Elements of Personal Pleasure or Recreation.*

First, Taxpayer testified that he spent considerable time, up to ten hours per day, trying to obtain business by creating flyers and letters and by calling and personally calling on prospective customers. Taxpayer was retired and did not have other full-time employment. Taxpayer could therefore devote considerable time to his sales activities.

Second, Taxpayer called on customers at their business location. Taxpayer's travel destination was determined by the location of the customer. While Taxpayer engaged in some recreational opportunities available at his travel destinations, there was no indication that his travel destinations were determined by recreation opportunities.

The element of personal pleasure or recreation involved in the activity combined with substantial income from sources, particularly if the activity's losses generate substantial tax benefits, may indicate that the activity is not engaged in for profit. Treas. Reg. § 1.183-2(b)(8). However, rational people do not perform hard work for no reason, and if the possibility that a taxpayer performed this work for pleasure is eliminated the only remaining motivation is profit. *Nickerson v. Comm'r*, 700 F.2d 402, 407 (7th Cir. 1983).

While Taxpayer's efforts did not involve manual labor, sales and soliciting customers is nonetheless work. There would appear to be little or no elements of personal pleasure or recreation involved in the actual sales activity, other than occasionally golfing with prospective customers. Where there are no elements of recreational or personal pleasure involved, courts are more likely to find that the activity was engaged in for profit. Taxpayer's time and effort expended in his solicitation activity tends to demonstrate that it was engaged in for profit.

Third, the tax benefits were relatively small and Taxpayer quit the business when he realized it would not be profitable. This does not seem to be the type of situation where Taxpayers' purpose in having a business was to offset substantial income from other sources. Accordingly, in this case, the fact that Taxpayers receive substantial income from other sources does not indicate that the activity is not engaged in for profit.

Factor (4) *The Expectation That Assets Used in the Activity May Appreciate in Value.*

This criteria is not applicable here. Taxpayer's business did not own appreciating assets such as real estate.

Factor (5) *The Success of the Taxpayers in Carrying On Similar or Dissimilar Activities.*

Taxpayer was a government employee prior to his retirement and had not been involved in soliciting customers for [REDACTED] companies. Taxpayer had not demonstrated a significant ability to succeed in other small business endeavors.

Factors (6) and (7) *The Taxpayers' History of Income or Losses With Respect to the Activity and the Amount of Occasional Profits, If Any, Which Are Earned.*

Taxpayer only engaged in soliciting customers for the [REDACTED] company for a short period. Taxpayer sustained losses during that period. However, Taxpayer quit the business when he realized it would not be profitable. Therefore, Taxpayer's history of income and losses are less indicative of whether Taxpayer had a profit motive than the fact that he quit the activity when he realized his profit objective would not be met.

In weighing the facts and circumstances of this case, the Hearing Officer finds that Taxpayer was engaged in a business with the objective of making a profit.

Based on the foregoing, the proposed assessment issued by the Section for tax year 2006 dated February 23, 2011 is reversed and the Section shall abate the assessment and grant Taxpayers a refund as provided by law.

DATED this 9th day of December, 2011.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[REDACTED]
Hearing Officer

Original of the foregoing sent by
certified mail to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue
Individual Income Tax Audit Section