

8. Taxpayers' 2006 Schedule Cs listed Taxpayers' activities to be photography services and educational services.
9. Taxpayers' educational services related to photography workshops they conducted.
10. Taxpayers formed a limited liability company to carry on their activities.
11. Taxpayers maintained accurate records of their income and expenses and a separate bank account for their activity.
12. Taxpayers testified at the hearing that:
 - a. Both Taxpayers are professional photographers with an emphasis in landscape and wildlife photography.
 - b. Taxpayers initially thought that sales of large frame prints would be profitable.
 - c. Taxpayers realized that before they could command the prices necessary to make the sale of large frame prints profitable, they had to develop a good reputation. Taxpayers' primary efforts have been to build that reputation.
 - d. Taxpayers' efforts to build a reputation have included making [REDACTED] utilizing their photographs, volunteering with [REDACTED] and conducting photography workshops.
 - e. Taxpayers hoped that through volunteering with [REDACTED] they would develop contacts.
 - f. Taxpayers have been asked to judge photo contests at the state fair and at camera clubs.
 - g. Taxpayers have donated their work and time to increase exposure of their photographs and to help build their reputation.
 - h. Taxpayers are trying to find a printer to print their [REDACTED] more cost effectively without sacrificing quality.

- i. Taxpayers have recently had a photograph appear on the [REDACTED] and in the [REDACTED] calendar.
- j. Three of Taxpayers' photographs were selected for display for the [REDACTED].
- k. Taxpayers are also submitting their photographs to other magazines.
- l. Taxpayers have established an internet website to sell their photographs.
- m. Taxpayers have conducted workshops to teach participants photography and as a means of developing contacts and reputation.
- n. As a part of wildlife photography Taxpayer [REDACTED] developed an [REDACTED] box for situations where [REDACTED] are needed and a [REDACTED] for the camera. Taxpayers sell the items to other photographers.
- o. Taxpayers have made significant investment in photography equipment and printing equipment required to produce high quality photographs.
- p. Taxpayers copyright the images they have for sale.
- q. Taxpayer [REDACTED] received his training in photography and in teaching while in the Navy.
- r. Taxpayer [REDACTED] was a photojournalist for a small rural newspaper.
- s. Taxpayers spend a minimum of forty hours per week in their photography related activities which include preparation for and shooting photographs, planning for and conducting workshops, copyrighting pictures, maintaining their website, matting, tagging images with metadata and training.
- t. Taxpayer [REDACTED] was one of the founding members of [REDACTED], a company that developed and built specialized [REDACTED] equipment. [REDACTED] was sold at a substantial enough profit to allow Taxpayers to finance the photography activity while they build their reputation.

- u. After [REDACTED] was sold, Taxpayer [REDACTED] became a director of operations for the Arizona Division of the purchaser for a couple of years before he retired.
 - v. Taxpayers' expenses have been decreasing and their income has been increasing. Taxpayers had approximately \$[REDACTED] in sales in 2011 and about breakeven in expenses and anticipate making a profit in 2012.
 - w. While there may be elements of pleasure in the artistic effort of photography, wildlife photography is hard work. It can involve long hours, carrying heavy equipment and enduring inclement weather. The copyrighting and putting in the metadata information is tedious. Taxpayers enjoy some of the challenges and the teaching aspect of their activities.
13. Taxpayers received investment income of approximately \$[REDACTED] during tax year 2006.
 14. Taxpayers did not have a formal written business plan.

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 an activity for three or more of the immediately preceding five years, such activity is presumed to be engaged in for profit and the taxing entity has the burden of proof to rebut this presumption.
6. Taxpayers' gross income did not exceed the deductions from their activities 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. 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).
9. 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).
10. 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.
11. 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).
 12. A taxpayer's expectation of profit need not be reasonable, but the taxpayer must establish that he continued his activities with a bona fide intention and expectation of making a profit. *Churchman v. Commissioner*, 68 TC 696 (1977).
 13. Taxpayer's business involved wildlife and landscape photography.
 14. Losses should be viewed in the context of the nature of the taxpayer's activity. *Vitale, Ralph Louis Jr.*, TC Memo 1999-131 (1999).
 15. Success in the area of wildlife and landscape photography depends to a large extent on the reputation of the photographer.
 16. The field has the potential to pay large amounts of money to those who succeed in it. *Vitale, Ralph Louis Jr., supra*.
 17. 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 actually generated." *Vitale, Ralph Louis Jr., supra*.
 18. Taxpayers maintained accurate records of their expenses.
 19. Taxpayers pursued their photography activity in a businesslike manner by submitting pictures to magazines, donating pictures to gain exposure, volunteering with [REDACTED], holding workshops, acting as judges and expanding their activities into different but related areas, such as the manufacturing of the [REDACTED].
 20. Taxpayers have had success in having photographs published in [REDACTED] and Calendar and displayed for the [REDACTED].

21. Taxpayers' expenses have been decreasing and their income from the activity has been increasing in the years after the tax year at issue.
22. Years subsequent to the year at issue may be relevant to Treas. Reg. § 1.183 analysis as a part of the examination of all facts and circumstances. See *Grommers v. Commissioner*, T.C. Memo.1992-343 (1992); *N. Joseph Calarco v. Commissioner*, TC Summary Opinion, 2004-94 (2004).
23. 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).
24. Taxpayers received substantial investment income. Taxpayers were not relying on the business income for their livelihood.
25. Taxpayers' losses have generated tax benefits.
26. Taxpayers did not seem to be extravagant in their expenses. Much of Taxpayers' expenses related to investment in quality equipment.
27. The activities at issue seem to be of the type that are typically found in a profit-oriented enterprise. See *Ranciato v. Commissioner*, 52 F.3d 23 (2d Cir. 1995).
28. Considering all of the facts and circumstances, the Hearing Officer finds that Taxpayers were 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 as claimed in Taxpayers' Schedule Cs. I.R.C. § 162(a).
30. The Section's proposed assessment 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. The expenses were disallowed because Taxpayers were not engaged in an activity for 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.

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, including the nature of the activity.

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

Taxpayers seemed to carry on their activities in a businesslike manner. First, Taxpayers maintained accurate records of their expenses. Second, Taxpayers recognized they could not simply sell large frame prints without developing a good reputation. Taxpayers' activities have been focused on developing that reputation through exposure, volunteering with [REDACTED], holding workshops, acting as judges and expanding their activities into different but related areas, such as the manufacturing of the [REDACTED], donating pictures, actually having pictures in [REDACTED] and

¹ Taxpayers are not entitled to a presumption that the activity was engaged in for profit. See Conclusions of Law Nos. 4 through 7. Taxpayers therefore bear the burden of proving that they possessed the required profit motive.

Calendar and displayed for the [REDACTED]. Taxpayers have also sought to reduce the expenses of producing their [REDACTED].

The Section argues that the records were not used by Taxpayers to track expenses to minimize costs and make the business grow. That does not appear relevant here. First, A.R.S. § 42-1105(D) requires Taxpayers to keep and preserve suitable records necessary to determine their tax liability. Second, Taxpayers' expenses were primarily for quality photography equipment and expenses related to wildlife photography on location. The expenses were not comprised of many small expenses that tracking could minimize.

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

Taxpayers demonstrated their expertise. Taxpayer [REDACTED] received training in photography and in teaching while in the Navy. He was also a photojournalist for a small rural newspaper. Taxpayers appeared knowledgeable regarding photography, their equipment and the elements necessary to sell the pictures and have them published in magazines. Taxpayers have held workshops and judged photo contests.

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.

Taxpayers spent considerable time with photography and the related areas. Taxpayers spend a minimum of forty hours per week planning for and shooting photographs, planning for and conducting workshops, copyrighting pictures, maintaining their website, matting, tagging images with metadata and training. Taxpayers are retired and do not have other full-time employment. Taxpayers can therefore devote considerable time to their photography related activities.

While parts of wildlife photography may have elements of personal pleasure, the activity also involves carrying heavy equipment, working long hours preparing for photo

shoots and sometimes enduring inclement weather. There is also a lot of tedious work involved such as copyrighting and meta tagging their pictures. Taxpayers' time and effort expended in their overall activities tend to demonstrate that they were engaged in the activity for profit.

Taxpayers did receive tax benefits. However, most expenses were related to depreciation of their photography equipment, travel and expenses of producing their product. This does not seem to be the type of situation where Taxpayers' purpose in having a business was simply to offset substantial income from other sources. Accordingly, in this case, the fact that Taxpayers received investment income 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.

The Section argues that this criteria is not applicable here because Taxpayers' photography equipment would not be considered appreciating assets.

Taxpayers point out however that their inventory of photographs is their most valuable asset and the value of their photographs will tend to increase as they gain positive reputation. While it may be too early to tell whether the value of Taxpayers' inventory will actually increase, Taxpayers' expectation that the inventory will increase in value appears bona fide.

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

Taxpayer [REDACTED] demonstrated a significant ability to succeed in a dissimilar business endeavor. Taxpayers had not yet had success in their wildlife photography endeavors as of 2006. However, it appears Taxpayers have been achieving some success in both their photography activities and in marketing photography related equipment developed by Taxpayer [REDACTED]. Taxpayers have a bona fide intention and expectation of profit.

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.*

Taxpayers do have a history of losses dating back to 2003. Taxpayers also had losses in years after the tax year at issue. A history of losses may be indicative that Taxpayers did not have a profit motive. However, Taxpayers' history of losses has to be considered with the other facts and circumstances of this case.

First, Taxpayers' activity involves taking and producing wildlife and landscape photographs for publication and sale. As with artists and actors, it can take years for an artistic photographer to be successful, if ever. The artist or photographer must first achieve public acclaim before his serious work can command a price sufficient to provide him with a profit. Success is not guaranteed but success can produce significant income in later years. An opportunity to earn a substantial ultimate profit in a speculative venture tends to indicate that the activity is engaged in for profit.

Second, evidence related to years after 2006 appear to confirm that Taxpayers are becoming recognized in their field. Taxpayers' focus to develop their reputation through exposure of themselves and their work appears to be working.

In weighing the facts and circumstances of this case, the Hearing Officer finds that during the tax year at issue Taxpayers were engaged in a business with the objective of making a profit. Taxpayers had a bona fide intention to be successful and derive a profit from their wildlife and landscape photography. While there are factors indicating the absence of a profit motive, such as losses, that Taxpayers have substantial other income and that Taxpayers did not have a formal written business plan, the other factors listed above indicate a profit motive.

Based on the foregoing, the proposed assessment issued by the Section for tax year 2006 dated April 6, 2011 is reversed. The Section shall abate the assessment.

DATED this 13th day of June, 2012.

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