Business Versus Hobby: Determination of Whether a Horse Activity is Engaged in for Profit

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BY TANDY C. PATRICK*

INTRODUCTION

It is well established that the breeding, racing, showing and raising of horses for sale may constitute a "trade or business" for income tax purposes[1] if a taxpayer can prove that he or she has a bona fide intention or expectation of making a profit from it.[2] In order to deduct expenses incurred in connection with an equine business, a taxpayer must demonstrate that the activity is not a hobby, but is "engaged in for profit" within the meaning of section 183 of the Internal Revenue Code (I.R.C. or Code).[3] Subsection (a) of section 183 sets forth the general rule that no deduction attributable to an activity not engaged in for profit shall be allowed, except as further provided in section 183.[4]

Section 183 is a relatively recent addition to the Code. Initially promulgated in December of 1969, it applies to tax years commencing after December 31, 1969.[5] Prior to its enactment taxpayers could look only to various court decisions for guidance as to which factors surrounding a horse activity would be considered significant by the Internal Revenue Service (IRS or Service) in making a business versus hobby determination. The majority of these court decisions are still helpful today, however, since the fundamental tax principles underlying the characteriza-

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[1] *See* Commissioner v. Widener, 33 F.2d 833 (3d Cir. 1929); Wilson v. Eisner, 282 F. 38, 41-42 (2d Cir. 1922).

[2] Imbesi v. Commissioner, 361 F.2d 640, 644-45 (3d Cir. 1966); Godfrey v. Commissioner, 335 F.2d 82, 84 (6th Cir. 1964); Hirsch v. Commissioners, 315 F.2d 731, 736 (9th Cir. 1963); American Properties, Inc. v. Commissioner, 28 T.C. 1100 (1957), *aff'd*, 262 F.2d 150 (9th Cir. 1958).

[3] *See* I.R.C. § 183(a) (1976).

[4] *Id.* § 183(b) (1976).

[5] Benz v. Commissioner, 63 T.C. 375, 382 (1974).

tion of an activity as a hobby were not materially changed by the enactment of section 183,[6] and since relatively few decisions have yet applied section 183.

I. ALLOWABLE DEDUCTIONS FOR A HOBBY ACTIVITY

The Code provides that losses attributable to an activity *not* engaged in for a profit ("hobby losses") are generally deductible *only* to the extent of hobby income.[7] Expenses which are deductible regardless of whether incurred in the pursuit of a hobby, such as taxes, interest and casualty losses also may be deducted.[8] These deductions actually reduce the amount of hobby income against which other hobby expenses can be offset. The Code provides that deductions for hobby expenses are allowed in the following order:

> 1) Amounts allowable without regard to whether the activity was engaged in for profit (e.g., interest; state, local and property taxes; long-term capital gain deductions).
> 2) To the extent that gross income from the hobby activity exceeds the deductions in paragraph one above, amounts which would be deductible if the activity were deemed to be engaged in for profit, so long as these deductions do not result in a basis adjustment.
> 3) To the extent that gross income from the hobby activity exceeds the deductions enumerated in paragraphs one and two above, amounts which would be allowable if the activity were deemed to be engaged in for profit, which result in a basis of adjustment (e.g., depreciation, amortization, partial losses with respect to property, partially worthless debts, amortizable bond premiums).[9]

For purposes of computation, the regulations define gross income from an activity as "the total of all gains from the sale, exchange, or other dispositions of property, and all other gross re-

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[6] *Id.* at 383.
[7] *See* I.R.C. § 183(b)(2) (1976).
[8] *Id.* § 183(b)(1) (1976).
[9] *Id.* § 183(b)(2) (1976); Treas. Reg. § 1.183-1(B)(i)-(iii), T.D. 7198, 1972-2 C.B. 169.

ceipts derived from such activity."[10]

In determining what constitutes an "activity," the Service accepts the taxpayer's own characterization of the activity, so long as it is supported by facts and is not artificial.[11]

II. TWO-OUT-OF-SEVEN PRESUMPTION

In determining whether an activity is engaged in for profit, the essential element required is the presence of a profit objective.[12] The Service uses an objective approach and considers all of the facts and circumstances surrounding an activity in determining whether a profit objective exists.[13] Prior to the enactment of section 183, court decisions involving a business versus hobby determination were based solely upon "facts and circumstances," and the burden of proof in such a determination always rested with the taxpayer. Section 183 does not eliminate the "facts and circumstances" test but does add the "two-out-of-seven presumption," which shifts the burden of proof to the Service in certain cases.

The Code provides that activities involving the breeding, training, showing or racing of horses are presumed *not* to be a hobby if profits result in two out of seven years.[14] An equine business activity which shows two profitable years within a seven-year period is *presumed* to be a business endeavor entitling the taxpayer to deduct all direct and necessary business expenses incurred in connection with the activity. The presumption is nonetheless rebuttable. The Service can still take the position that an activity is a hobby, despite the fact that there were two profitable years in seven; in such a situation, the burden of proof shifts to the Service to show that the activity is a hobby.[15] Fortunately for the equine business taxpayer, no "reverse presumption" exists; the regulations state that an activity will not be presumed to be a hobby simply because it fails to meet the two-out-of-seven presumption.[16]

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[10] Treas. Reg. § 1.183-1, T.D. 7198, 1972-2 C.B. 174.

[11] Treas. Reg. § 1.183-1(d)(1) (1972).

[12] *See* Sabelis v. Commissioner, 37 T.C. 1058, 1062 (1962).

[13] Treas. Reg. § 1.183-2(a), T.D. 7198, 1972-2 C.B. 174.

[14] I.R.C. § 183(d) (1976).

[15] *See* Dunn v. Commissioner, 70 T.C. 715 (1978).

[16] Treas. Reg. § 1.183-1(c)(1)(ii), T.D. 7198, 1972-2 C.B. 172.

The regulations expressly provide that the two-out-of-seven presumption arises only where an activity remains substantially the same in each relevant tax year.[17] If an individual transfers horses to a corporation or partnership, the Service may take the position that a new activity has begun and thus a new seven-year period has started.[18]

For purposes of determining whether the two-out-of-seven presumption applies, all deductions attributable to an equine business activity are taken into account except net operating loss deductions and long-term capital gain deductions.[19] A short tax year will be treated as a full year for purposes of applying the presumption;[20] thus, it may be advisable for a taxpayer whose horse activity commences late in a given calendar year to adopt a fiscal year that varies from the calendar year.[21]

The Code establishes both a "general" presumption and a "special" presumption.[22] A general presumption arises automatically with respect to loss years following two profit years. Thus, it is advantageous for a taxpayer to have two consecutive profit years so as to form the beginning of a seven-year presumption period. A taxpayer may elect to postpone a determination as to whether such a presumption arises.[23] This election raises a special presumption which allows the taxpayer to avoid a determination as to the profit character of his or her activity until the close of the sixth taxable year following the taxable year in which the taxpayer first engages in the activity.[24] A taxpayer should elect this special presumption:

1) Where the activity suffers loss years before its profit years, and the taxpayer wishes to deduct those losses; or

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[17] *Id.*

[18] *See* Rev. Rul. 78-22, 1978-1 C.B. 72.

[19] SENATE COMM. ON FINANCE, TAX REFORM ACT OF 1969 S. REP. No. 552, 91st Cong., 1st Sess. 105 (1969); Treas. Reg. § 1.183-1(c)(1)(ii), T.D. 7198, 1972-2 C.B. 172.

[20] Treas. Reg. § 1.183-1(c)(ii), T.D. 7198, 1972-2 C.B. 172.

[21] Once an individual taxpayer has adopted a calendar year, however, he or she must receive permission from the Internal Revenue Service prior to changing to the fiscal year. *See* Treas. Reg. § 1.441-1(b)(4), T.D. 7767, [1981] STAND. FED. TAX REP. (CCH) ¶ 6446.

[22] *See* I.R.C. § 183(d), (e) (1976).

[23] I.R.C. § 183(e)(2) (1976).

[24] T.D. 7308, 3 Fed. Taxes (P-H) ¶ 16,366.

2) Where one of the required profit years comes between two loss years, and the taxpayer wishes to deduct for both years.

The election for the "special" presumption must be filed within three years after the original due date of the return for the year in which the activity is initially engaged in, but not later than sixty days after receipt of an IRS notice stating that losses are being disallowed as being incurred in an activity not engaged in for profit.[25]

The advantages of opting for the "special" presumption are two-fold: First, the presumption will apply to all years within the seven-year period so long as there are two profit years within the period, and second, once the "special" presumption has been elected by a taxpayer, the IRS must wait until the first seven years of the horse activity are over before auditing the taxpayer's return for the purpose of making a business versus hobby determination.[26] However, a taxpayer should opt for the "special" presumption only if he or she is certain that the horse operation can make two significant profit years during the seven-year period.

The following example demonstrates the difference between the "general" and "special" presumptions:

1970	1971	1972	1973	1974	1975	1976
PROFIT	LOSS	LOSS	LOSS	LOSS	PROFIT	LOSS

Under the "general" presumption, the taxpayer's activity will only be presumed to be a business for years 1975 and 1976. If the taxpayer opts for the "special" presumption, however, the activity is presumed to be a business for years 1970 through 1976.

III. SPECIAL CONSIDERATION: CORPORATIONS

The hobby loss provision states that it applies only to individuals and Subchapter S corporations.[27] However, a 1977 revenue ruling holds that the activities of a partnership are subject to section 183.[28] Corporations, on the other hand, technically are not

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[25] *Id.*

[26] DAVIS, HORSE OWNERS AND BREEDERS TAX MANUAL § 1.04 (1979).

[27] I.R.C. § 183(a) (1976).

[28] Rev. Rul. 77-320, 1977-2 C.B. 78.

subject to section 183, although various courts have uniformly held that losses sustained in a hobby business will not be allowed merely because the hobby is conducted by a corporation.[29]

IV. FACTORS USED IN DETERMINING WHETHER PROFIT OBJECTIVE EXISTS

Treasury Regulations list nine objective factors the Service will consider in making a business versus hobby determination:

1) manner in which the taxpayer conducts his horse activity;
2) expertise of the taxpayer or his advisors;
3) time and effort expended by the taxpayer in carrying on his horse activity;
4) expectation of appreciation in the value of assets used in the horse activity;
5) success of the taxpayer in carrying on other horse activities;
6) history of income or losses in the horse activity;
7) amount of profits earned in the activity;
8) financial status to the taxpayer, and
9) personal pleasure and recreation motives in carrying on the horse activity.[30]

These nine factors are a distillation of holdings in court decisions.[31] The regulations state that no one factor is more important than another;[32] however, various courts seem to emphasize the first four factors. In addition, large and frequent losses incurred in connection with a horse activity often cause the Service to conclude that the activity is a hobby.

A. *The Manner in Which the Taxpayer Carries on Horse Activity*

Numerous courts stress that the horse owner should run his or

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[29] *See* Borge v. Commissioner, 36 T.C.M. (P-H) ¶ 67,173 (1967), *aff'd*, 405 F.2d 673 (2d Cir. 1968), *cert. denied sub nom*, Danica Entpr. Inc. v. Commissioner, 395 U.S. 933 (1969); Black Constr. Co. v. United States, 572 F.2d 820 (Ct. Cl. 1978); DuPont v. United States, 234 F. Supp. 681 (D.C. Del. 1964).

[30] Treas. Reg. § 1.183-2(b)(1)-(9), T.D. 7198, 1972-2 C.B. 175-76.

[31] *See* Benz v. Commissioner, 63 T.C. at 383.

[32] Treas. Reg. § 1.183-2(b), T.D. 7198, 1972-2 C.B. 175.

her horse activity in a businesslike manner, maintaining complete and accurate books and records and generally observing good business practices.[33] In *James and Francia Coe*,[34] the Tax Court, while holding that the petitioners' American Saddlebred horse operation constituted a "trade or business," noted: "[W]e view with favor petitioner's businesslike concern for the economics of the horse venture and her method of accounting for income and expenses."[35] In *Amory v. Commissioner*,[36] the court determined that the petitioner's thoroughbred racing stable was a business enterprise, and observed:

> In the conduct of the stable petitioner gave such personal attention to the same as is usually given to business enterprises. She required her manager and trainer to keep accurate accounts of operations and expenses, and was personally consulted by them in all phases of the same. The attention and attitude of petitioner toward the racing stable was marked by every indicia of a business interest.[37]

Other businesslike practices that may indicate a profit-making motive include the separation of bank accounts,[38] the hiring of professional accountants,[39] and the advertising of a horse operation in programs and periodicals, and exhibiting at horse shows.[40] In *Imbesi*,[41] the court compared the petitioner's poor horse activity records to the meticulous records kept by the petitioner as president, director and partner in the 7-Up Bottling Corporation, stating:

> [W]ith respect . . . to his activities in the breeding and racing of thoroughbred horses . . . [petitioner's] method of bookkeeping, such as it was, was so haphazard by comparison to

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[33] Engdahl v. Commissioner, 72 T.C. 659, 666-67 (1979); Deerman v. Comm'r., 43 T.C.M. (P-H) ¶ 74,084 (1974); Russell, 38 B.T.A. 161 (1938); Tyng v. Commissioner, 37 B.T.A. 21, 35 (1937).

[34] 43 T.C.M. (P-H) ¶ 74,129 (1974).

[35] *Id.*

[36] 22 B.T.A. 1398 (1931).

[37] *Id.* at 1400.

[38] *See* Wegeforth v. Commissioner, 42 B.T.A. 633, 636 (1940).

[39] Farris, 41 T.C.M. (P-H) ¶ 72,165, at 72-862 (1972).

[40] Engdahl v. Commissioner, 72 T.C. at 667; Wegeforth v. Commissioner, 42 B.T.A. at 635.

[41] 33 T.C.M. (P-H) ¶ 64,276 (1964).

> the excellent and accurate method used by him in his activities which were clearly profit motivated that we are forced to conclude that his purpose in carrying on the former was other than his purpose with respect to the latter. Although he maintained separate bank accounts with respect to each corporation and partnership through which his admitted business affairs were conducted, he used his personal bank account as the depository for all receipts from his horse activities. He made no attempt to maintain a system of cost accounting with respect to his horse activities, nor did he, during the years at issue, make any attempt to lessen his costs by the culling of his horses. This is to us inconsistent with the existence of a profit motive on his part.[42]

However, keeping good books and records does not in itself demonstrate a profit motive.[43] While nearly all cases that construe a horse activity as a business note the existence of good books and records, the taxpayer generally also must prove the existence of some other factor(s) in his or her favor.

Several courts have indicated that the horse owner should abandon unprofitable operating methods.[44] A significant factor indicating that an activity is a hobby is a taxpayer's inability to demonstrate how he or she plans to make his horse operation profitable.[45] In holding that the petitioner's thoroughbred operation was a business, the court in *Butler*[46] noted that the petitioner made changes from time to time in an effort to make his breeding farm and racing stable financially successful.

B. *Expertise of the Taxpayer or Advisors*

The Service considers the degree of research and study by taxpayers or their advisors of the economics of conducting horse activity, as well as the use of this information by taxpayers in the actual conduct of their horse activities. In *Deerman*,[47] the court

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[42] *Id.* at 64-1847.

[43] *See* Fisher v. Commissioner, 29 B.T.A. 1041, 1049 (1934).

[44] *See* Wegeforth v. Commissioner, 42 B.T.A. at 636, 638; Thieriot, 9 B.T.A.M. (P-H) ¶ 40,083 (1940).

[45] Dunn v. Commissioner, 70 T.C. at 721; Holderness, 46 T.C.M. (P-H) ¶ 77,005, at 77-17 (1977).

[46] 1 B.T.A.M. (P-H) ¶ 31,167 (1931).

[47] 43 T.C.M. (P-H) at 74-411 to -412.

concluded that the petitioners' thorough preliminary exploration of the type of horse they wished to raise and the potential markets available for this type of horse indicated a genuine profit motive. Similarly, in *Coe*,[48] the court observed that the petitioner's lifelong experience in the horse industry enabled her to realize the great profit potential in raising and breeding American Saddlebred horses.

In *Stoltzfus*,[49] the testimony of three experienced saddle horse trainers was admitted regarding the appropriate steps that an investor should take in order to start and build a profitable saddle horse business. The following steps were suggested, all of which had been performed by the petitioner:

> (a) The investor should employ the services of a person knowledgeable about saddle horses and with a good reputation in the industry for the training and handling of saddle horses.
> (b) The investor should provide adequate facilities, including a stable to house the horses, indoor and outdoor exercise areas for training and showing horses to customers, and pasture land for grazing. There should also be separate barn or stable facilities for housing the operation's brood mares.
> (c) The investor should acquire the highest quality stock available of the following types: (1) quality breeding stock (studs and brood mares) with good blood lines and a record of success in show competition; (2) quality young unfinished horses to train, show and sell; and (3) some finished horses to show for the purpose of putting the business' name before the saddle horse purchasing public and to establish the business' reputation.[50]

C. *Time and Effort Expended by the Taxpayer in Carrying on Horse Activity*

The Service favorably views the devotion of a considerable amount of a taxpayer's time to horse activity,[51] particularly if the activity does not have substantial personal and recreational as-

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[48] *See* 43 T.C.M. (P-H) ¶ 74,129, at 74-555, -557 (1974).
[49] 39 T.C.M. (P-H) ¶ 70,337 (1970).
[50] *Id.* at 70-1775.
[51] *See* Thieriot, 9 B.T.A.M. (P-H) at 40-109; Morton, 40 T.C.M. (P-H) ¶ 71,156, at 706-71 (1971).

pects (activities such as "mucking out" stalls, breeding horses, delivering foals, attending to sick or injured horses and grooming horses do not have the same recreational attraction as attending a horse show).[52] The Service also has favorably viewed a taxpayer's partial or total withdrawal from another occupation to devote more time to horse activity. For example, the court in *Curtis*[53] observed that "[p]etitioner spent more time looking after the horses and attending races in which they were entered than with both her shops."[54] However, if a horse owner employs competent and qualified persons to carry on various activities, the lack of time that the horse owner spends does not necessarily indicate a lack of profit motive.[55]

D. *Expectation that Assets Involved in the Horse Activity May Appreciate in Value*

The regulations specifically note that the term "profit" includes appreciation in the value of assets, including the land used in an activity.[56] Even if gain or profit has not been realized by the horse owner, the value of successful horses can and often does increase.[57] Thus, even if a horse owner shows no profit from current operations, he or she may be able to demonstrate an overall profit motive if the appreciation in the value of the land, horses and other assets is taken into account, together with the current income from his or her activity.

However, the regulations further provide that if land is purchased *primarily* for the purpose of its appreciation in value and is also used for farm activity, the Service may treat the land and farm activity as two separate activities.[58]

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[52] *See* Engdahl v. Commissioner, 72 T.C. at 670-71.

[53] 28 B.T.A. 631 (1933).

[54] *Id.* at 631.

[55] *See* Coe, 43 T.C.M. (P-H) at ¶ 74,129; Stoltzfus, 39 T.C.M. (P-H) at 1786-70; Farris, 41 T.C.M. (P-H) at 862-72; Deerman, 43 T.C.M. (P-H) at 412-74.

[56] Treas. Reg. § 1.183-2(b)(4), T.D. 7198, 1972-2 C.B. 175.

[57] *See* Blake Constr. Co. v. United States, 572 F.2d at 822.

[58] Treas. Reg. § 1.183-1(d)(1), T.D. 7198, 1972-2 C.B. 1973. The Service will ordinarily treat both activities as a single activity if the net cost of holding the land for its appreciation value is reduced by the farming activity. *Id.*

E. *The Success of the Horse Owner in Carrying on Other Similar Activities*

The fact that an individual has engaged in similar activities in the past and converted them into profitable ones may indicate to the Service that the individual is engaged in his or her present activity for profit, despite the fact that at present the activity is not profitable.

F. *The Horse Owner's History of Income or Losses with Respect to the Activity*

The regulations provide that a series of profit years is strong evidence that an activity is engaged in for profit.[59] Conversely, a series of continued losses can indicate that a horse activity is not engaged in for profit, unless the continued losses can somehow be justified. Several courts have found justification for a series of loss years in a horse operation, basing their holdings upon such factors as economic depression,[60] disposition of undesirable stock[61] and inadequate involvement by the taxpayer to build sufficient stock in his or her horse activity.[62]

Losses may result from unforeseen circumstances beyond the horse owner's control. In *Engdahl v. Commissioner*,[63] the court rationalized the petitioner's losses, noting a number of unfortunate factors, namely, a shift in the demand for horses, a great rise in the costs associated with a horse operation, medical problems with some horses, an accident where a horse was hit by a car, failure of the petitioner's trainer to use "best efforts" and the failure of horses purchased for speculation purposes to produce quality offspring.

Various courts have held that a series of loss years during the initial period of operation or "start-up" stage of a horse activity is not unusual and does not necessarily indicate that an operation is not engaged in for profit. In *Engdahl*, the Tax Court of the

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[59] Treas. Reg. § 1.183-2(b)(6), T.D. 7198, 1972-2 C.B. 175.

[60] Tyng, 36 B.T.A. at 35.

[61] *Id.*

[62] Russell, 37 B.T.A.M. (P-H) ¶ 38,094 (1938) ("The business of breeding thoroughbred horses for races takes several year to develop").

[63] 72 T.C. at 664.

United States held that the start-up phase of an American Saddlebred breeding operation is five to ten years.[64] Similarly, in *Stoltzfus*,[65] the court noted:

> It is not unusual to experience losses during the formative years of a saddle horse business. It is estimated to take approximately five to ten years to develop a financially successful saddle horse breeding business. Several years of development are required in order to build a reputation and to produce and develop stock for sale. Colts must not only be produced, but must be started in training in order to show their potential, before it is profitable to sell them.[66]

A series of loss years indicates a hobby if these losses continue beyond the period normally required to make such an operation profitable. Thus, the existence of even one profit year is an important factor, indicating that a profit motive exists, without regard to the two-out-of-seven presumption.

G. *The Amounts of Occasional Profits Which Are Earned by Horse Owners*

The regulations state that "[t]he amount of profits [realized] in relation to the amount of losses incurred, [over a given period,] and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity . . . [are] useful criteria in determining the taxpayer's intent."[67] Thus, an occasional small profit realized from a horse activity which otherwise generates losses does not necessarily indicate to the Service that the activity is a business.[68] Conversely, a substantial profit, though only occasional, may indicate that an activity is "for profit," where the taxpayer's investment and losses are comparatively small.

The regulations further state that: "[A]n opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for

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[64] *Id.* at 669.
[65] 39 T.C.M. (P-H) at ¶ 70,337.
[66] *Id.* at 1774-70 to 70-1775.
[67] Treas. Reg. § 1.183-2(b)(7), T.D. 7198, 1972-2 C.B. 176.
[68] *See* Dunn v. Commissioner, 70 T.C. at 721.

profit even though losses or occasional small profits are actually generated."[69]

H. *Financial Status of the Horse Owner*

If the horse owner has substantial income from sources other than horse activity, the regulations indicate that the Service may determine that the horse activity is not a business.[70] However, the Tax Court has held that the language contained in the regulations cannot be construed as providing a reason to deny a deduction merely because the deduction is usable against other income.[71] In *Engdahl v. Commissioner*, the Tax Court commented on this regulation as follows:

> [T]he concurrent existence of other income poses the question, rather than answers it. If there is no other income, there is no issue. As long as tax rates are less than 100 percent, there is no "benefit" in losing money. Properly construed, the regulation merely makes the common sense point that the expectation of being able to arrange to have the tax collector share in the cost of a hobby may often induce an investment in such a hobby which would not otherwise occur. The essential question remains as to whether there was a genuine hope of economic profit.[72]

In *Bishop v. Commissioner*,[73] the court contrasted the petitioner's relatively modest income with his large expenditures made in connection with his horse operation and noted: "It is difficult to imagine that a person, whose relatively modest income fluctuated greatly, would make large expenditures . . . without having the intention to make a profit."[74]

I. *Elements of Personal Pleasure and Recreation*

The regulations state that personal motives in carrying on an

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[69] Treas. Reg. § 1.183-2(b)(7), T.D. 7198, 1972-2 C.B. 176.

[70] *See* Treas. Reg. § 1.183-2(b)(8), T.D. 7198, 1972-2 C.B. 176. Such a determination is also more likely when the activity involves personal or recreational elements. *Id.*

[71] Engdahl v. Commissioner, 72 T.C. at 679.

[72] *Id.*

[73] 41 T.C.M. (P-H) ¶ 72,167 (1972).

[74] *Id.* at 868-72.

activity may indicate that an activity is not for profit, especially where there are recreational and personal elements involved.[75] However, the fact that a taxpayer derives personal pleasure from engaging in his or her horse activity is not in and of itself sufficient to cause the activity to be classified as a hobby if other factors indicate a profit motive.[76] In *Wilson v. Eisner*,[77] the court observed that "[s]uccess in business is largely obtained by pleasurable interest therein."[78] Also, the availability of a more profitable investment does not indicate that an activity is not engaged in for profit.

CONCLUSION

Whether a horse activity is recognized as a business or a hobby has important tax consequences because the availability of loss deductions is much expanded if the activity can be classified as a business. The key issue, in the view of the IRS, is the presence or absence of a profit motive. This determination requires an objective examination of the facts and circumstances surrounding the activity. The Service is aided in this analysis by recently-enacted section 183, which introduces the two-out-of-seven rule. This rule establishes a presumption, albeit rebuttable, that an activity is not a hobby if it can be shown to have turned a profit for two years out of a seven-year period.

Taxpayers who wish to demonstrate a profit motive in their horse activity should note which factors the IRS and the courts consider particularly relevant. The factors which have proved the most persuasive in showing a profit motive include: 1) the businesslike manner in which the activity is conducted; 2) the expertise of the horse owner and advisors; 3) the time and effort expended by the horse owner in pursuit of the activity, and 4) the realistic expectation that the horse owner's assets may appreciate in value.

Several additional factors also have been considered by some

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[75] Treas. Reg. § 1.183-2(b)(9), T.D. 7198, 1972-2 C.B. 176. *See, e.g.*, Holderness, 46 T.C.M. (P-H) at 18-77; Morton, 40 T.C.M. (P-H) at 706-71.

[76] *See* Bishop, 41 T.C.M. (P-H) at 868-72.

[77] 282 F. at 38.

[78] *Id.* at 42.

courts, though generally accorded less importance by the IRS. These include: 1) the success of the horse owner in carrying on other horse-related activities; 2) the horseowner's history of gains and losses in this activity; 3) the size of profits earned relative to losses sustained; 4) the financial status of the horse owner, and, 5) the extent to which the activity is motivated by personal pleasure and recreation rather than profit.