AMERICAN HORSE COUNCIL'S
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Tax Bulletin No. 387

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Horse Industry Faces New Tax Landscape in 2018

Following President Trump's signing of the new tax law on December 22, federal policy makers began immediately to discuss the likelihood of moving legislation in 2018 to address technical changes and clarifications to the 1100 page law. While AHC takes a deeper dive into the tax law to address in more detail those provisions having a direct impact on the horse industry, please see the below highlights that will impact your tax filing for Fiscal Year 2018:

Business Provisions

- Corporate Taxes: The new tax law reduces the corporate income tax rate from 35% to 21% and takes effect January 1. AHC members filing as "C corporations," which are generally identified by the suffix, "Inc.," will see an immediate reduction in their official, or statutory tax rate. AHC members filing as "C corporations" would include racetracks, makers of pharmaceuticals and agricultural equipment, and large breeding operations governed by officers and a board of directors, among others. While many policy experts believe that the new tax code will be easier to navigate from a business perspective, corporate taxpayers' effective liability will vary to the extent they are able to utilize the new code's remaining deductions, some of which are outlined below.
- Small Business, "Pass-Through" Deduction: The Tax Cut and Jobs Act establishes a 20% deduction for the first $315,000 of joint income, or $157,500 for individual filers, from "pass-through" entities such as partnerships, sole proprietorships and S corporations. This new provision could benefit small businesses that generally report incomes at or near the new threshold level. While various types of "pass-throughs" constitute the fastest growing segment of AHC members, they also include the majority of U.S. farms. According to Department of Agriculture data, 85% of domestic agriculture production comes from "pass through" entities.
- Bonus Depreciation of Equipment: The House and Senate conference report includes 100% bonus depreciation – an increase from the current 50% rate - through December 31, 2022, for property placed in service after September 27, 2017. Beginning in 2023, bonus depreciation is reduced from 100%, to 80% in 2024, then falls by 20% increments each year through 2026. Farm equipment used in a business operation, breeding stock and according to a preliminary reviews of the final language, race horses will benefit from the robust deduction.
- Losses at the Racetracks: The final law preserves the deduction of losses "sustained … on wagering transactions to the extent of the gains" realized "during the taxable year." However, the law clarifies that the "limitation on losses from wagering transactions applies not only to the actual costs of the wages, but to other expenses incurred by the individual in connection with the conduct of that individual's gambling activity." For example, the law subjects the deduction for travel expenses to

and from a racetrack to the cap established by the amount of the gains. Like many of the deductions in the bill, the provision sunsets after 2025.

- Alternative Minimum Tax (AMT): The new law repeals the corporate AMT, ending the need to calculate tax liability twice for a single filing.

Individual Provisions

- Estate Tax: The final law ultimately preserves the estate tax, but doubles the current exemptions of $5.49 million for individuals and $10.98 million for married couples. Raising the statutory threshold will reduce the number of farms and family businesses subject to the tax. It will also spare many family-run businesses from jumping over accounting hurdles to avoid the tax altogether.
- State and Local Taxes (SALT) – The tax law includes a significantly downsized, itemized deduction for up to $10,000 of state and local property taxes. This provision – which eliminates the unlimited, longstanding deduction for state, sales and local property taxes - may pose challenges for AHC members who file returns in high-tax states next year. High tax states such as New Jersey are already considering revenue measures, including possible tax cuts, to mitigate the impact of the $10,000 cap on this popular deduction.

Looking Ahead

In addition to new legislation from Congress to clarify technical issues, the Internal Revenue Service (IRS) will begin a years-long process of promulgating regulations to implement the new law. AHC recommends that members consult their accountants or other tax professionals to begin assessing the new tax landscape for 2018 and beyond. To view a 550-page copy of an explanation of the final conference report of the bill, please click here: http://docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf. For more information related to the new tax law and next steps, including technical corrections and implementation, please contact Bryan Brendle, Director of Policy and Legislative Affairs, at bbrendle@horsecouncil.org.

Tax Court Rules Owner Did Not Operate Horse Activity as a Business for Profit

By Thomas A. Davis, Esq., Davis & Harman, LLP

Since childhood, the taxpayer has been an amateur horsewoman. In 2005, she started Big Dog Farms (BDF) for the purpose of breeding, selling, and showing horses. Operations at BDF ceased in 2011.

She also practiced medicine as an independent contractor from January 2004 through 2010, but did not renew her medical license when it expired in 2011.

During the period 2005-2011, the taxpayer reported BDF losses every year which totaled $581,919 for the seven year period. She reported expenses related to BDF for tax years 2008-11 which totaled $445,181 and gross receipts in 2008 and 2010 which totaled $1,370.

The IRS audited the taxpayer's tax returns for the tax years 2008-2012. They concluded that the taxpayer did not operate BDF as a business for profit and therefore expenses related to BDF were not deductible. They also assessed penalties. The taxpayer disagreed with the IRS findings and took the dispute to the U.S. Tax Court.

Judge Kerrigan decided the case for the Court. The Judge pointed to several key factors in reaching the court's decision: No evidence that the taxpayer maintained books and records or conducted BDF in a manner similar to that of a profitable horse farm; No evidence regarding the assets held by BDF and whether these assets are expected to appreciate; BDF had substantial losses all of its years of operation; Taxpayer is a medical doctor who had significant income during the tax years at issue, and the losses from BDF generated substantial tax benefits for her.

Based on the above factors, the Court concluded that the taxpayer "did not operate BDF with the actual and honest objective of making a profit." The Court also found the taxpayer was liable for the fraud penalty for years 2011-2012 and accuracy-related penalties for tax years 2008-2010.

[**Margaret Knowles v. Commissioner,** TC Memo 2017-152]

Tax Bulletin No. 387

Horse Owners Ability to Utilize a Section 179 Deduction Against Income from Multiple Active Trades or Businesses

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While the Internal Revenue Code ("the Code") allows taxpayers to deduct from taxable income all ordinary and necessary expenses incurred in carrying out an active trade or business[1], generally, when purchasing tangible business assets with a useful life greater than a taxable year, the asset must be capitalized rather than deducted from business income for the year the property is placed in service. Under the Code, taxpayers are generally allowed to take an annual depreciation deduction for the wear, tear, and deterioration of their capitalized tangible property used in an active trade or business over an applicable recovery period[2]. For race horses, the current applicable recovery period is 3-years from the time the horse is placed in service (i.e., begins training). For broodmares and stallions, the current applicable recovery period is 7-years[3].

Section 168 of the Code also provides taxpayers with ability to take a depreciation deduction for qualified property equal to 50% of the adjusted basis of the property in the year it is placed in service[4]. This is known as Bonus Depreciation. Bonus Depreciation, however, is limited to original use property or new property[5]. As such, a taxpayer purchasing a race horse after the horse has been placed in training will not have the benefits of Bonus Depreciation available to them[6]. Additionally, if a horse ceases racing prior to deducting the full costs through depreciation, a taxpayer will no longer be able to take depreciation deductions on the horse[7].

Section 179 of the Code, however, provides another avenue for taxpayers to accelerate the deduction of capital purchases that, in many cases, will be more beneficial to taxpayers than Bonus Depreciation. Section 179 of the Code allows taxpayers to treat otherwise capital purchases as deductible expenses in the taxable year of purchase, subject to certain limitations. Section 179 will apply to the purchase of a race horse used in an active trade or business.

A recent case from the 7th Circuit U.S. Court of Appeals, Roberts v. Commissioner, 820 F.3d 247 (7th Cir. 2016), provided a beneficial ruling for a race horse owner challenging the disallowance of a deduction for startup costs related to the taxpayer's horse racing business. Although Section 179 was not at issue in the Roberts decision, as the Hobby Loss rules impact Section 179, the decision provides guidance on what horse racing activities will qualify for a Section 179 expense deduction.

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1 IRC § 162(a)
2 IRC § 167
3 IRC § 168(e)(3); note: horses over 12 years of age will have a recovery period of 3-years when placed in service.
4 IRC § 168(k)
5 *Id*.
6 See Toby, Milt, "Cracking the Tax Code," April 13, 2016, < http://www.thehorse.com/articles/35597/cracking-the-tax-code> accessed October 12, 2017
7 See IRS Publication 946 (2015)

This article will provide an overview of the Section 179 rules and limitations as well as a discussion of the Hobby Loss rules discussed in the Roberts case. Additionally, this article will provide an example to show how the Section 179 and the Roberts decision will apply to a taxpayer starting a horse racing and breeding business venture.

I. Overview of IRC 179

Section 179 of the Code allows a taxpayer to treat the cost of specified property as an expense which can be deducted, up to a certain limit, in the tax year of purchase. This allows taxpayers to deduct the entire purchase price of the property, up to a certain amount, that would otherwise be depreciable. Property for which a Section 179 election is available includes all property that may be depreciated under Sections 167 and 168 of the Code[1]. For 2017, the Code allows taxpayers to expense up to $510,000 of the aggregate cost of Section 179 property purchased in a single tax year. If a taxpayer has purchased more than $2,030,000 of Section 179 property in a single tax year, however, the $510,000 limit will be reduced, but not below zero, by the amount of the aggregate Section 179 purchases exceeding $2,030,000 in that year[2].

A Section 179 expense can be taken against income from any trade or business conducted by a taxpayer, regardless of the active trade or business that purchased the Section 179 property. An active trade or business income in which Section 179 expenses may be taken against will include pass-through entity distributions as long as the pass-through entity is an active trade or business and the taxpayer meaningfully participates in the business. Income from an active trade or business in which a Section 179 expense may be taken against also includes employee wages, salaries, tips and other compensation that a taxpayer receives as an employee[3].

A. Limitations

In addition to the annual $510,000 limitation, other Section 179 limitations exist. The total section 179 deduction is limited to the aggregate amount of all taxable income derived by the taxpayer from active trades or businesses in the taxable year. Therefore, a Section 179 limitation cannot take a taxpayer into a loss position in any taxable year. Any excess Section 179 exclusion amounts may be carried over for an unlimited number of years and used against active trade or business income in future years[4]. In the case of married taxpayers, regardless of whether they file jointly or separately, the income limitations are applied against the total aggregate income of both spouses[5].

B. Making the election

To take a Section 179 expense deduction in a taxable year, a separate election must be made for year the Section 179 deduction is claimed[6]. The election is made by filing a Form 4562 along with a taxpayer's federal income tax return for the year in which the deduction is claimed[7]. The election may also be made on an amended income tax return, as long as the amended return is timely filed[8]. The election must specify the items of Section 179 property to which the election applies and the portion of the purchase cost of each item that will be taken as an expense deduction in that tax year[9]. If a pass-through entity is taking a Section 179 expense deduction, the election must be made at the entity level and not by the partners or shareholders[10].

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1 IRC § 179(d)

2 See IRS Publication 946, < https://www.irs.gov/publications/p946#en_US_2016_publink100053768> accessed October 11, 2017

3 Treas. Reg. § 1.179-2(c)

4 IRC § 179(b)(3)

5 IRC § 179(b)(4)

6 IRC § 179(c); Treas. Reg. § 1.179-5(a); Treas. Reg. § 1.179-5(c)

7 Treas. Reg. § 1.179-5(a)

8 Treas. Reg. § 1.179-5(c)

9 IRC §179(c)

10 Treas. Reg. §1.179-1(h)(1)

II. Active Trade or Business and Hobby Loss Limitations

Often the biggest hurdle in the ability to utilize Section 179 is the requirement that the expense must be paid or incurred in carrying on active conduct of a trade or business that is engaged in for profit by the taxpayer. The regulations to Section 179 state that the meaning of trade or business for purposes of Section 179 has the same meaning as in Section 162 of the Code, which provides for trade or business expense deductions that are ordinary and necessary in conducting the trade or business[1]. The regulations further state that any property used in an activity that falls under the Hobby Loss rules of Section 183 of the Code, which limit Section 162 deductions for activities not engaged in for profit, will not qualify for a Section 179 expense deduction[2]. Additionally, income from an activity that is deemed not engaged in for profit under the Hobby Loss rules will not be included in the calculation of active trade or business income for the purposes of the Section 179 income limitation[3].

While the purchase of a horse for the purposes of a horse racing or breeding venture would certainly seem to be ordinary and necessary for a horse racing trade or business, the Hobby Loss rules may provide a roadblock in the ability to utilize a Section 179 expense deduction. The IRS has specifically identified horse racing and breeding as a potential activity not engaged in for profit[4]. The Code presumes that horse racing activity is engaged in for profit if the gross income derived from an activity exceeds the deductions attributable to the activity in two (2) of the previous seven (7) taxable years[5]. If this is the case, although the IRS may rebut this presumption, a Section 179 deduction will likely be available. If the horse racing activity does not fall under this presumption, a facts and circumstances analysis test will be applied to determine if the activity is engaged in for profit, allowing a section 179 deduction, or not.

A. Factors used to determine if an activity is engaged in for profit

The regulations of Section 183 identify nine (9) factors to be used in determining whether an activity is engaged in for profit. These factors include: (1) the extent to which the taxpayer carries on the activity in a businesslike manner; (2) the taxpayer's expertise or reliance on the advice of experts; (3) the time and effort the taxpayer expends in carrying on the activity; (4) the expectation that the assets used in the activity may appreciate in value; (5) the taxpayer's success in similar activities; (6) the taxpayer's history of income or loss from the activity; (7) the amount of occasional profits, if any; (8) the taxpayer's financial status; and (9) the elements of personal pleasure or recreation. A court will consider all factors and no single factor is determinative[6].

Treas. Reg. § 183-2(b) provides an explanation of how each factor may indicate a profit motive:

1) The extent to which the taxpayer carries on the activity in a businesslike manner – Maintaining accurate books and records consistent with profitable horse activities and adoption of business techniques and methods with an intent to improve profitability may indicate a profit motive.
2) The expertise of the taxpayer or his advisors – Extensive study of the accepted business techniques and practices of horse racing and breeding or consultation of an expert in those techniques and practices may indicate a profit motive if the techniques and practices are utilized in the horse racing or breeding operation.
3) The time and effort the taxpayer expends in carrying on the activity – Devoting personal time and effort to carrying on an activity may indicate an intention to derive a profit. If the taxpayer employs competent and qualified persons to carry on such activity, the fact that the taxpayer devotes a limited amount of time to an activity does not necessarily indicate a lack of profit motive.

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1 Treas. Reg. §1.179-2(c)(6)
2 *Id*.
3 *Id*.
4 IRC §183: Activities Not Engaged in For Profit (ATG) (Audit Guide Rev. 6/09), <http://www.irs.gov/pub/irs-utl/irc183activitiesnotengagedinforprofit.pdf.> accessed October 11, 2017
5 IRC § 183(d)
6 Treas. Reg. § 183-2(b)

4) **The expectation that the assets used in the activity may appreciate in value –** If the taxpayer expects the horses or other property (e.g., horse farm) utilized in the racing or breeding operation to appreciate in value to the point they would exceed the costs of the operation, it may indicate the activity is engaged for profit.
5) **The taxpayer's success in similar activities –** If the taxpayer has engaged in similar activities and converted them into profitable enterprises, it may indicate the activity is engaged in for profit.
6) **The taxpayer's history of income or loss from the activity –** A history that includes profit in the activity may indicate that the activity is engaged in for profit.
7) **The amount of occasional profits, if any –** Having substantial profits, even if only occasional, may indicate an activity is engaged in for profit.
8) **The financial status of the taxpayer -** The fact that the taxpayer does not have substantial income or capital from sources other than the activity may indicate that an activity is engaged in for profit.
9) **The elements of personal pleasure or recreation –** A profit motivation may be indicated where an activity lacks any appeal other than profit. However, 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 the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.

B. Roberts v. Commissioner

Mr. Roberts was a successful owner of bars, restaurants and nightclubs in Indianapolis for 30 years. In the mid 90's Mr. Roberts began selling his businesses to his adult children, but remained a paid consultant. In 1999 he bought his first two race horses for $1,000 each and netted $18,000 in earnings from racing them in the first year. Following his initial success, he built a horse track on his land and eventually increased his horse ownership to 10 horses and a breeding stallion. In addition, Mr. Roberts obtained an Indiana state license as a horse trainer.

In 2005 Mr. Roberts decided to upgrade his horse training facilities, but following the opposition of the city of Indianapolis, he purchased a new property outside of the city and invested in new training facilities in 2006. Mr. Roberts trained his horses himself and stated that he spent approximately 8 hours a day with his horses and longer on race days. Additionally, Mr. Roberts became active in lobbying for the horse racing industry in Indiana and served on the board of several industry associations.

For the tax years 2005-2008 Mr. Roberts derived losses from his racing activities, totaling $574,163, and deducted the losses from his real estate and consulting income. The IRS disallowed his deductions related to his horse racing and breeding operations for the 2005-2008 years, declaring them activities not engaged in for profit. In 2014, the Tax Court held that his horse racing breeding activities did not become an activity engaged to for profit until 2007, when Mr. Roberts moved his horse operations to the new property he purchased. Finding for the IRS for the years 2005 and 2006 and for the taxpayer in years 2007 and 2008.

On appeal, the 7th Circuit Court of Appeals addressed the 2005 and 2006 tax years. The Court of Appeals completed an analysis of the nine (9) factors discussed previously and determined the facts to be sufficient to finding that the taxpayer was engaged in an activity for profit for these years. These facts included, obtaining a training license, the substantial amount of time devoted to the business, the lobbying to increase purses and horse association activities, purchase of property with an expectation for the property to appreciate in value, and past income derived from the activity. The most important takeaways from the Court of Appeals decision are the discussion of startup costs in a horse racing and breeding operation, the discussion of the ninth factor, the element of pleasure, and the general discussion of the factor test.

The Court of Appeals concluded that Mr. Robert planning related to the expansion and improvement of his racing operation in 2005 and purchase of a new property in 2006 indicated a profit motive, even though he did not move his operations to the new property until 2007, analogizing the activities in 2005 and 2006 to normal business startup costs. In discussing the ninth factor, the Court of Appeals stated that, "[horse racing] may have been a fun business, but fun doesn't convert a business to a hobby. If it did, Facebook would be a hobby, Microsoft and Apple would be hobbies." In the opinion, the Court of Appeals made it clear that the fun and social aspects of the horse racing and breeding business should not prevent the venture from having a profit motive. As for the nine (9) factors test, the Court of Appeals indicated that the rigid factor test does not have to be applied in each case and that additional factors may be utilized as long as it is explained why the normal factors are insufficient and other factors should be used. This opens the door for the ability to argue a profit motive outside of the nine (9) factors listed in the regulation, providing taxpayers with the ability to introduce other reasons a profit motive exists.

III. Benefit of utilizing Section 179 expense deduction where the taxpayer has multiple active trades or businesses

A taxpayer that derives income from multiple trades or businesses may be able to utilize Section 179 expense deductions against income from other business. The IRS provides such an example to illustrate this in Publication 225[1]. The following example illustrates how a taxpayer who derives income from one trade or business may be able to conduct their horse racing and breeding activities in a manner that will allow them to deduct the cost of horse purchases, via a Section 179 election, against income from other trades or businesses.

IV. Example

A Taxpayer has operated a successful real estate business for many years. As the Taxpayer's children have recently joined his business and assumed some of the day to day management of the company, the Taxpayer has more time available for other business ventures. The Taxpayer has previously participated in racing syndicates and currently owns a successfully mare that is nearing the end of its racing career. The Taxpayer has devised a plan to retire the mare and purchase several additional broodmares to begin a breeding and racing operation. The Taxpayer plans to use his current trainer and veterinarian as consultants in selecting the additional broodmares and stallions with which to breed, training the race horses and advising him on his horse operation. The Taxpayer also currently has an option to buy a small horse farm that he will upgrade with current industry standard facilities for breeding.

In year one, the Taxpayer purchases the property and begins to upgrade to the facilities. The Taxpayer also retires his racing mare following a graded stakes win, purchases two broodmares for $150,000 apiece and breeds the three broodmares. In year two, the three broodmares are moved to the property and each foal a colt. The Taxpayer also purchases an additional two broodmares for $150,000 apiece in year two and breeds the mares. The Taxpayer sells two yearlings in year three for substantial profit and places the other yearling in training.

1 In 2016, Partnership P placed in service section 179 property with a total cost of $2,110,000. P must reduce its dollar limit by $100,000 ($2,110,000 – $2,010,000). Its maximum section 179 expense deduction is $400,000 ($500,000 – $100,000), and it elects to expense that amount. Because P's taxable income from the active conduct of all its trades or businesses for the year was $1,000,000, it can deduct the full $400,000. P allocates $100,000 of its section 179 expense deduction and $250,000 of its taxable income to John, one of its partners.

John also conducts a business as a sole proprietor and in 2016, placed in service in that business, section 179 property costing $600,000. John's taxable income from that business was $100,000. In addition to the $100,000 allocated from P, he elects to expense the $300,000 of his sole proprietorship's section 179 costs. However, John's deduction is limited to his business taxable income of $350,000 ($250,000 from P plus $100,000 from his sole proprietorship). He carries over $50,000 ($400,000 – $350,000) of the elected section 179 costs to 2017. IRS Publication 225, Pg. 40.

In year one, the Taxpayer has $300,000 of income from the real estate business and $100,000 of loss from the racing and breeding operations. The Taxpayer decides to make a Section 179 expense election on the broodmares purchased for $300,000. While the $300,000 is less than the annual Section 179 limit, the Taxpayer will be limited to a $200,000 deduction, the total aggregate income from the Taxpayer's active trades or businesses. The additional $100,000 will carry over for use in additional years. By utilizing the Section 179 expense deduction, the Taxpayer is able to eliminate all taxable income from trades or businesses in year one.

In year two, the Taxpayer has $700,000 of income from the real estate business and $150,000 in losses from the horse racing and breeding venture. The Taxpayer again elects to take a Section 179 expense deduction on the purchase of the broodmares in year two. As he has $550,000 in trade or business income in year two, the Section 179 expense deduction is not limited. Additionally, he will be able to utilize his $100,000 carry over Section 179 expense deduction amount from the previous year. After the Section 179 deductions, the Taxpayer will have $150,000 of taxable trade or business income.

The benefits of the Section 179 deduction rely heavily on the finding that the Taxpayer's horse racing and breeding venture is a trade or business entered into for profit. Based on the Section 183 regulations and the Roberts case, we analyze what facts would help the taxpayer establish his horse venture is entered into for profit and what additional facts may be needed to establish a profit motive.

1) **The extent to which the taxpayer carries on the activity in a businesslike manner –**The fact that the Taxpayer has upgraded his facilities to industry standard operations will show a profit method. The Taxpayer must maintain accurate books and records consistent with profitable horse activities as well as ensure that business decisions are generally made to improve profitability. In Roberts, the fact that Mr. Roberts conducted his horse venture in a businesslike manner led the Court of Appeals to find this factor in his favor.
2) **The expertise of the taxpayer or his advisors –** The Taxpayer has hired a trainer and veterinarian as consultants, which indicates a profit motive. If the Taxpayer can also show extensive study of the accepted business techniques and practices of horse racing, this will be a positive fact for the taxpayer. In Roberts, the fact that Mr. Roberts obtained a training license led the Court of Appeals to find this factor in his favor.
3) **The time and effort the taxpayer expends in carrying on the activity –** As the Taxpayer now has more time to devote outside of the real estate business, devoting substantial personal time and effort to carrying on the horse racing and breeding may indicate an intention to derive a profit. However, if this is not possible, the Taxpayer should employ a competent and qualified farm manager to find in his favor. In Roberts, Mr. Roberts devoted most of his time to his horse operation, which led the Court of Appeals to find this factor in his favor.
4) **The expectation that the assets used in the activity may appreciate in value –** The Taxpayers purchase of a farm, making valuable upgrades to the farm and the purchase of income producing property, the broodmares, should all be positive facts for the taxpayer. If the Taxpayer can show the expectation and planning to make a profit from breeding and racing, this will also be a positive fact for this factor. In Roberts, Mr. Roberts expectation of an eventual profit as well as the appreciation of the value of his horse farm led the Court of Appeals to find this factor in his favor.
5) **The taxpayer's success in similar activities –** The Taxpayer's success in the real estate business will be a positive fact for this factor, especially if the taxpayer was able to grow the business after initial losses in the early years. Any other successful business venture would be additional positive facts for this factor. In Roberts, Mr. Robert's past success after initial setbacks in his restaurant and bar businesses led the Court of Appeals to find this factor in his favor.

6) **The taxpayer's history of income or loss from the activity –** The Taxpayer's losses in the first two years of his expanded business should not be a negative factor based on the Roberts decision. In Roberts, the Court of Appeals stated, "[a] series of losses during the initial or start-up stage of the activity may not necessarily be an indication that the activity is not engaged in for profit."[1]

7) **The amount of occasional profits, if any –** The Taxpayer's profit from the stakes win in year one as well as the sale of the yearlings in year three were substantial amounts. These will be positive facts for this factor. In Roberts, the Court of Appeals found this factor in Mr. Roberts' favor because of his initial profits in horse racing and the fact that one of his horses was nominated to run in a triple crown race.

8) **The financial status of the taxpayer –** Although the Taxpayer has income from his real estate business, the Roberts opinion stated, "we believe the existence of other income has little weight when many other factors indicate a profit objective."[2] As such, if other factors show a profit motive, this factor should not weigh against the Taxpayer.

9) **The elements of personal pleasure or recreation –**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 show the activity is in fact engaged in for profit. The Roberts opinion states that social and recreation aspects of the business should have no bearing on whether or not it is engaged in for profit. Therefore, if other factors show a profit motive, this factor should not weigh against the Taxpayer. However, if the Taxpayer can show that they are engaged in non-pleasurable activities related to the horse business (e.g., mucking stalls and farm upkeep), this may help show a profit motive.

V. Conclusion

As explained in this article and illustrated in the above example, Section 179 of the Code provides taxpayers an election to deduct the full purchase price of a racing or breeding horse in the tax year of purchase from all trade or business taxable income, subject to the limitations discussed in this article, regardless of the horse's prior use. If a taxpayer can arrange their horse racing or breeding business venture in a manner consistent with a business engaged in for profit under the Hobby Loss rules and regulations discussed in this article and demonstrated in the Roberts case and the example, a Section 179 election may provide a greater tax deduction with fewer limitations than the deductions provided under the Bonus Depreciation rules and regulations. Race horse owners and breeders, therefore, should take the Section 179 expense deduction into consideration if the election under that Section is available to them, especially if the owner or breeder has additional trade or business income streams to utilize the deduction against.

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As each taxpayer's circumstances will vary significantly based on all facts and circumstances, readers should consult with an attorney or an accountant before taking action based upon any information provided in this article.

For more information, or for a response to any questions you may have, please call Joel B. Turner at (502)568-0392, email him at jturner@fbtlaw.com, call Nelson D. Rodes IV at (502) 779-8716 or email him at nrodes@fbtlaw.com. For additional information about the full range of services offered by the Frost Brown Todd LLC Equine and Tax Section attorneys, and links to other articles of interest, you should visit www.frostbrowntodd.com and follow the link to the Equine or Tax Group under Practice Areas. Thanks to Nelson D. Rodes IV of Frost Brown Todd LLC's Tax Group for his significant contributions to this article.

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1 *Roberts*, 820 F.3d at 253

2 *Id*.

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