

IN THE MAGISTRATE DIVISION
OF THE OREGON TAX COURT
Income Tax

CHARLES W. BERGMAN and DONNA M.)
BERGMAN,)
)
Plaintiffs,) No. 010385C
)
v.)
)
DEPARTMENT OF REVENUE,)
STATE OF OREGON,)
)
Defendant.) **DECISION**

The issue in this case is whether the Bergmans are precluded, by Internal Revenue Code Section 183, Treasury Reg. 1.183, and ORS 316.048¹ from claiming Schedule F losses from farming operations on their 1996, 1997, and 1998 returns. Mr. Bergman appeared and made their arguments. Jan Hunt, of the Department of Revenue, presented the agency's case.

STATEMENT OF FACTS

The Bergmans farm the 45 acres on which their home is located. Initially they raised cattle. This enterprise failed, so in 1996 the Bergmans began raising, selling, boarding, and breeding horses.

It is the Bergmans' plan to supply their area's need for well-run horse care, with arenas, stables, and riding paths. They now have a barn with a 120 foot by 60 foot riding arena and stable. Stalls rent for \$200 each. In June a pole building will be built, and improvements made to fields.

Both the Bergmans have outside employment. Their plan is that Ms. Bergman will

¹All references to the Oregon Revised Statutes are to 1999.

be able to quit her job and devote all her time to the horse farm. To meet this end she is receiving training in horsemanship and showmanship, and she and her horse have won second place in two shows.

The Bergmans' 2000 tax return in its attached farm schedule showed a \$1400 profit from farm operations. The Department of Revenue observed that the amount of profit may be overstated, suggesting that it may be reduced to levels of a third or lower when sales of firewood are removed, and if car and truck expense and depreciation were more in line with what, in the auditor's estimation, were more typical.

COURT'S ANALYSIS

This is a very close case. There are good reasons for the Department of Revenue to question whether Internal Revenue Code Section 183 precludes deductibility of these losses. However, while it is a difficult decision, the conclusion of the court is that the Bergmans should prevail in their appeal. There are two factors that especially persuade the court that this is the proper conclusion.

The first is the manner in which the Bergmans carried on their farming activities. Most particularly, when it became clear that cattle could not be profitably raised, the Bergmans abandoned that enterprise and substituted operations related to horses. While the Bergmans record-keeping was less than ideal, it does show a greater sophistication over time, and this is a favorable characteristic typical of fledgling businesses. And although the Bergmans business plan is not polished, there is much to recommend it. They have gone from buying horses for resale to breeding horses to boarding horses to the value-added concept of training horses, providing arena services, and instruction. This sequence has produced, and ought to continue to achieve, greater returns over time.

The second factor persuasive to the court is the fact that the farm has generated an

occasional profit in the last year for which returns were filed. While that profit has certainly been a long time coming, this is not surprising when an enterprise changes its operations from cattle to horses. Perhaps the Bergmans have finally turned the corner and begun a trend of profitability; at any rate it does disprove the argument that the farm will never turn a profit.

Other elements also support this conclusion, although not so strongly. The expertise of the Bergmans is important. Mr. Bergman had been a member of Future Farmers of America, and belongs to the Oregon Quarter Horse Association. Ms. Bergman has taken classes on training horses, trains the animals, and is experienced in simple veterinary. While the Bergmans do not have a history of successful farming operations in other venues, the court cannot say that they are naive in what it takes to make a farm successful.

Other factors are more equivocal, however they do not leave the conclusion of the court without support. Both the Bergmans are employed full-time at other jobs, although it is apparent that after funding the farm from their wages they are not using Schedule F losses to support a lavish rural lifestyle, but instead are barely meeting personal and farm-related expenses. It is doubtful that farm assets are likely to significantly appreciate in value, however, it is also true that the appreciation in the value of the home located on the farm, accessed through refinancing, is an important source of funding for expansion. Ms. Bergman has a strong element of personal pleasure from working with horses. While the Internal Revenue Code does not permit the accommodation of a lifestyle by sheltering losses, at the same time a business is more likely to succeed if its proprietors enjoy what they are doing.

Again, it is a close decision. However, a review of the facts of this case leads the court to the conclusion that Internal Revenue Code Section 183 does not preclude the

Bergmans from claiming losses on their 1996, 1997, and 1998 returns.

CONCLUSION

IT IS THE DECISION OF THIS COURT that the appeal shall be granted.

Dated this _____ day of January, 2002.

SCOT A. SIDERAS
PRESIDING MAGISTRATE

IF YOU WANT TO APPEAL THIS DECISION, FILE A COMPLAINT IN THE REGULAR DIVISION OF THE OREGON TAX COURT, FOURTH FLOOR, 1241 STATE ST., SALEM, OR 97301-2563. YOUR COMPLAINT MUST BE SUBMITTED WITHIN 60 DAYS AFTER THE DATE OF THE DECISION OR THIS DECISION BECOMES FINAL AND CANNOT BE CHANGED.

THIS DOCUMENT WAS SIGNED BY MAGISTRATE SIDERAS ON JANUARY 18, 2002. THE COURT FILED THIS DOCUMENT ON THAT SAME DATE.