IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Income Tax

STEVEN E. ELLISON and STACY S. ELLISON, Plaintiffs,	)	TC-MD 041142D
v.	)	
DEPARTMENT OF REVENUE, State of Oregon, Defendant.	)	**DECISION**

Plaintiffs appeal Defendant's Notices of Tax Assessment, dated September 23, 2004, for tax years 1999, 2000, and 2001. A trial was held at the Oregon Department of Revenue's field office located at 6405 SW Rosewood Street, Suite A, Lake Oswego, Oregon, on Friday, July 8, 2005. Steven E. Ellison (Ellison) appeared on behalf of Plaintiffs. Greg Weddle (Weddle), Tax Auditor, appeared on behalf of Defendant.

I. STATEMENT OF FACTS

Plaintiffs appeal Defendant's limitation of deductions they claimed related to their car and truck leasing operation for tax years 1999, 2000, and 2001. Based on its audit of Plaintiffs' records, Defendant concluded that Plaintiffs' leasing operation was not engaged in for profit as the primary objective.

In response to Defendant's determination, Ellison testified that the auditor incorrectly concluded that the business activity for tax years 1993 through 1998 was the same as the business activity for 1999 through 2001. Ellison testified that prior to 1999 he did not "have a plan for his business venture." For tax years 1993 through 1996, Ellison testified that Plaintiffs took one of their personal vehicles and offered it "for hire." (Ptfs' Ex E-1; Ptfs' Ex A-1BE.) Plaintiffs added

another vehicle for hire in 1997 and 1998. (Ptfs' Ex A-1BE.) From 1993 to 1998, gross revenue collected ranged from a low of $1,200 to $2,950. (*Id.*) For the first two years (1993 and 1994), Plaintiffs did not claim depreciation on the vehicle rented to others. (*Id.*) However, expenses claimed were substantially in excess of the reported gross revenue. (*Id.*) For tax years 1995 through 1998, Plaintiffs claimed depreciation and other expenses in excess of reported revenue. (*Id.*)

Ellison testified that in 1999 he formulated a plan that is reflected in his mission statement: "Make a profit on each vehicle placed in service and for rent in a long term or short term scenario. Select vehicles that will last and hold their values even beyond the standard depreciation period. Procure vehicles with low repair experience to keep repair costs to a minimum for the renters." (Ptfs' Ex A-6.) Ellison testified that, as a leasing operator, first he looked for a client, and then acquired a vehicle to match the needs of the client. He targeted two groups of individuals: remodeling construction business owners and workers, and young college graduates. He incurred no advertising costs to offer his vehicles for lease. Ellison testified that he relied on an informal network of contacts developed from his association with his current full-time employer, and that through his business associate network he found clients in the local area and in other states, including North Carolina and California.

With reference to the portion of the mission statement concerning selection and procurement of vehicles, Ellison testified that during 1999 Plaintiffs made a substantial capital outlay in the amount of $115,000 to add six vehicles to their vehicle inventory. (Ptfs' Ex A-1BE.) In 2000, Plaintiffs sold one of the vehicles purchased in 1999 and replaced it with another vehicle (cost: $32,500). (*Id.*) In 2001, Plaintiffs sold one vehicle and purchased four more, resulting in a capital outlay of $83,800. (*Id.*) Over three years, Plaintiffs invested $231,300 in their vehicle

inventory. Ellison testified that the vehicles he purchased will have "high resale value." For example, the Ford F350 he purchased for $28,000 in 1999 will only decrease in value $7,000 in seven years. (Ptfs' Ex A-2a.) Contrary to his mission statement, Ellison admitted that the 1998 Mercedes 320E purchased in 2001 for $36,300 recently sold for $19,000.

For the three years under appeal, Ellison failed to "[m]ake a profit on each vehicle placed in service and for rent * * *." (Ptfs' Ex A-6.) In 1999, the average annual rent collected per vehicle was under $1,000. (Ptfs' Ex A-1BE.) Expenses claimed, excluding the depreciation deduction, almost matched gross revenue. (*Id.*) In 2000, the average rent collected increased to over $1,500 per vehicle. (*Id.*) Expenses claimed, excluding a depreciation deduction, were approximately $2,700 less than gross revenue collected. (*Id.*) In 2001, the number of vehicles available for lease jumped to 12, but the gross revenue dipped to less than $1,200 per vehicle. (*Id.*) Expenses claimed, excluding a depreciation deduction, exceeded gross revenue by almost $1,500. (*Id.*) Ellison testified that the expenses claimed were so "high" because he was carrying his own insurance on the leased vehicles and paying for maintenance and repairs. He testified that he "helped people get started" in their business and did not pass those costs (*i.e.*, insurance, repairs, and maintenance) through to his lessees. Ellison testified that in order to keep his customers in the face of a "recession" he "worked with them" to "keep the rent coming in." He stated that, in one case, he allowed the person who was in real estate sales to make a lease payment after she received her commission from the sale of a house.

Ellison testified that he has modified his business plan to reduce costs. He no longer carries insurance on the vehicles or pays the maintenance and repair costs; those costs are now borne by the lessees. Rather than short term rental agreements, he now offers long term leases of five years with the option to renew for another five years. Weddle testified that, based on his

research, it is an "unrealistic assumption" that someone will keep leasing a vehicle for 10 years. Ellison testified that all of his vehicle inventory is leased and he has "kept" his clients because he developed "good business relationships by being accommodating" when he started his business.

Defendant determined that Plaintiffs' business activity of leasing cars and trucks began in 1993 and, because each year from 1993 through 2001 the business generated a tax loss, there is no presumption that the activity is engaged in for profit. Weddle testified that, after reviewing the nine factors found in the Treasury Regulation section 1.183-2(b)(2003), his conclusion was that Plaintiffs' business was not an activity engaged in for profit, but rather a hobby. Beginning with the first factor, he stated that Plaintiffs have failed to operate the "activity in a businesslike manner" because their record keeping was inadequate. For example, on their state income tax returns, Weddle testified that Plaintiffs claimed some expenses twice, incorrectly computed the allowable tax depreciation, and incorrectly claimed a Section 179 deduction. Weddle and Ellison agreed that the auditor allowed certain deductions even though there was inadequate substantiation. Weddle testified that Plaintiffs "carried insurance for their clients" and paid for the repair and maintenance without passing those costs through to their lessees. In addition, he testified that Plaintiffs' method of collecting rent by allowing their clients to delay payment pending the collection of income from their own business was not "businesslike." In response, Ellison testified that he wanted to differentiate his leasing business from the "customary leasing company." His goals were to "retain clients, keep the vehicles rented, and keep things moving."

With respect to expertise and consultation, Weddle questioned Ellison about his choice of consulting at no charge with business associates he met through his full-time employer. Weddle noted that Ellison failed to provide any documentation to support his assertion that he held discussions with those individuals he identified as experts. (Ptfs' Ex A-7.) Ellison testified that

he “gleaned useful information” from his discussion with the individuals he identified as experts who are in the business of leasing.

Weddle challenged the time and effort Ellison put into his leasing business. Both Plaintiffs are employed outside the home. (Def’s Ex M-1, M-2.) Weddle stated that, for tax year 1999, Plaintiffs reported 90 trades of call options on their income tax return, and for tax year 2000 Plaintiffs reported 48 trades. (Def’s J-1, J-2.). Ellison testified that he no longer trades call options. Weddle stated that Plaintiffs had at least two rental properties in 2000 and added another rental property in 2001. Ellison acknowledged that, for a period of time, he visited one of the rentals during 2000 at least three times a week, and made two trips to California to handle matters related to Plaintiffs’ duplex rental. Ellison testified that his rental properties are now profitable. In 2001, Ellison worked as office manager a couple of days a week plus four hours on Saturday during the time he had funds invested in a partnership, Fauvelle Construction. He testified that he is no longer in that partnership. Ellison acknowledged at trial that, during the years under appeal, he was involved in “a lot of start up activities” and took time away from his full-time employment to participate in all of those activities.

Considering appreciation in value, Weddle challenged Plaintiffs’ assumptions that the inventory of cars and trucks would “hold their value.” Weddle stated that vehicles, in contrast to land, are subject to “wear and exhaustion.” The tax depreciation life of a vehicle is short, five years according to Weddle, because vehicles used for business or leased by others are usually driven many miles and the drivers “live in them.” Weddle stated that “plaintiff’s expectation that the vehicles used in the rental/leasing activity will have an outstanding resale value that will recoup the cumulative losses from operations is unrealistic.” (Def’s Ex A-7.) In response, Ellison referred to a recent article in Automotive News, which stated that Toyota and Honda have “good

residual values." In response, Weddle commented that Plaintiffs' vehicle inventory does not include any Toyota vehicles and only one Honda.

Weddle testified that Plaintiffs have shown no success in prior activities. He testified that Plaintiffs incurred losses from their other activities, including call options trades and rental properties. Weddle stated that he "disagrees that the plaintiff operated different or separate activities that somehow changed or are different between 1995-1998 and 1999-2001." (Def's Ex A-8.) He explained that "since 1993 the plaintiff filed a federal Schedule C - Profit or Loss from Business using the industry code 8813; which applies to automobile rental and leasing." (*Id.*)

Weddle disputed Ellison's assertion that the leasing business will generate a profit in the future. According to Weddle, the profits and losses of the business, and the history of income or losses, show that "expenses have exceeded income by $151,597" from 1993 through 2001. (Def's Ex A-8, 9.) Weddle testified that with respect to the leasing activity, Plaintiffs have never made a profit and have not "demonstrated to be successful." Ellison disagreed with Weddle, testifying that 2005 will be a "breakeven year." He testified that he has modified his leasing agreements to transfer costs to the lessees, thereby reducing the operating costs. Further, Ellison testified that if he sold all of his vehicle inventory today, he would net $108,000. He concluded that by "going forward" it will "work great" with rental revenue of "$6,000 to $7,000 per month."

Weddle testified that, based on his review of Plaintiffs' projections, breakeven will not come until 2010. He stated that "while depreciation expenses will decline the costs associated with repairs and maintenance will increase." (*Id.*) Further, Weddle expressed his opinion that Plaintiffs will need to replace vehicles, which will allow the "costs of depreciation" to "again increase" and the residual value of rental vehicles will "dramatically decrease * * * over time."

(Def's Ex A-8,9.) Weddle concluded that "there is no evidence to support the potential for a one-time profit or windfall that would allow the plaintiff to recoup the sustained losses incurred year after year." (Def's Ex A-10.)

Another factor, Taxpayer's Financial Status, looks at the incentive of a taxpayer to spend its financial resources on an activity that produces a loss to reduce total taxable income. Weddle stated that both Plaintiffs are "employed and earn income from wages." (*Id.*) Ellison's gross salary was $130,334 in 1999, $134,949 in 2000, and $117,443 in 2001. (Def's Ex M-1, 2, 3.) Ellison's wife worked part time and her gross salary was $6,094 in 1999, $6,564 in 2000, and $6,773 in 2001. (*Id.*) Weddle concluded that because "plaintiff has income from other sources to finance the automotive rental/leasing business and has received a substantial tax benefit[] annually; both factors weigh against the plaintiffs profit motive." (Def 's Ex A-10.) Ellison testified that during the start up years, 1999, 2000 and 2001, the "tax benefit" was "needed" to keep the business going. He testified in the future, there "won't be a benefit" to him, but rather to the "state of Oregon."

Weddle concluded that the elements of recreation or personal pleasure are present because Ellison "enjoys cars and trucks." Ellison disputed Weddle's conclusion that cars and trucks are his hobby. He testified that he is a design development engineer and is not interested in "hanging around" cars and trucks. Ellison testified that all of his vehicles are leased. Suggesting that Plaintiffs claimed personal pleasure expenses as business, Weddle stated that Plaintiffs deducted meetings between the two of them at off-site locations even though they had a home office where all their books and records were within easy access. In addition, Plaintiffs deducted personal meals and the cost of rounds of golf even though they did not maintain receipts to substantiate

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those expenses as business rather than pleasure. Ellison testified that during the rounds of golf he "really did talk about his business plan" in an effort to recruit those individuals as clients.

Weddle concluded his testimony by stating that the start-up period for Plaintiffs' business was not 1999, 2000, and 2001. He testified that Plaintiffs have been "operating" on the same "premise" since 1993 with the only difference being the number of vehicles available for lease. Weddle testified that Plaintiffs have not meet the Internal Revenue Code criteria and the primary objective of their leasing activity is not for profit.

II. ANALYSIS

Defendant "suspended" Plaintiffs' reported operating losses from its car and truck leasing business because it concluded that for tax years 1999, 2000, and 2001, Plaintiffs' business was not in the start-up or early stages of the activity. (Def's Ex A-1.) Defendant concluded that Plaintiffs' business had been in operation since 1993, and from 1993 through 2001, Plaintiffs did not make a profit. As a result, Defendant concluded that Plaintiffs could only deduct expenses to the extent of the gross revenue collected and the "suspended losses" would be available to "reduce the income earned in" future years when "the plaintiff generates profits." (Def's Ex A-12.)

The parties dispute whether Plaintiffs' car and truck leasing operation began in 1993 or 1999. In reporting those losses from 1993 through 2001, Plaintiffs used the industry code 8813, which Defendant states "applies to automobile rental and leasing." (Def's Ex A-1.) For Defendant, Plaintiffs' continued use of the same industry code and goal "to earn additional income through the rent and lease of those vehicles" has not changed since 1993 when Plaintiffs offered their personal vehicles for rent. Plaintiffs disagree, stating that before 1999, their activity "was not business like in nature. There was no business plan, no invested capital, no books and only a trial based activity." (Ptfs' Ex E-1.)

The year Plaintiffs began their leasing operation is important because it determines the number of years and related activities the court will consider in evaluating whether profit is, or is not, the primary motivating factor for Plaintiffs.[1] In order to determine the year, it is necessary to review the history of Plaintiffs' car and truck renting and leasing activity. There is no dispute that, from 1993 through 1996, Plaintiffs rented one of their personal vehicles, a Mercedes 300E, "to friends from time to time." (Ptfs' Ex E-3.) In the first two years, 1993 and 1994, operating expenses substantially exceeded reported gross revenues. (Ptfs' Ex A-1BE.) Depreciation was deducted in 1995 and 1996, resulting in an overall tax loss for both years. (*Id.*)

In 1997, Plaintiffs offered a second vehicle, a Mercury 190C, for rent. (*Id.*) Gross revenue decreased from the prior year even though there were two vehicles available to lease. (*Id.*) Expenses were significantly reduced from the prior years. (*Id.*) However, once again, Plaintiffs reported a loss on their personal income tax return because tax depreciation was deducted. (*Id.*) In 1998, a third vehicle, a Monterro, was added to the vehicle inventory. Gross revenue more than doubled from the prior year, operating expenses were comparable to those reported in 1995 and 1996, and tax depreciation was taken on three vehicles. (*Id.*) Another tax loss was reported. (*Id.*)

In contrast to prior years, when Plaintiffs offered their personal vehicle for rent and purchased two others for rent, over the next three years, 1999, 2000 and 2001, Plaintiffs acquired 11 vehicles and sold one. (Ptfs' Ex A-1.) The cost of those vehicles was $231,300. Plaintiffs continued to report substantial tax losses, with operating expenses close to the gross revenue collected. The tax depreciation deduction generated significant tax losses in each year.

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[1] Internal Revenue Code (IRC) §183(d) provides a presumption that an activity is engaged in for profit if the activity is profitable for three years of a consecutive five year period. In the time period 1993 through 2001, Plaintiffs never generated a profit from their leasing business. Under that section, there is no presumption that Plaintiffs' leasing activity was "engaged in for profit."

Looking first to Plaintiffs' activities for tax years 1993 through 1998, the court concludes that Plaintiffs lacked the requisite intent to make a profit. In Ellison's own words, there was no business plan, little gross revenue, no long term leases, and no efforts to improve profitability. However, in 1999, Plaintiffs moved from renting their personal vehicles to leasing vehicles specifically acquired to meet the needs of their clients. With the acquisition of their vehicle inventory, Plaintiffs made a significant financial commitment to their leasing business. The court agrees with Plaintiffs that in 1999 they entered the automobile leasing business. Tax years 1999, 2000, and 2001 will be evaluated considering all the facts and circumstances to determine if Plaintiffs' activity was conducted primarily for profit.

The Oregon Legislature intended to make Oregon personal income tax law identical to the Internal Revenue Code (IRC) for purposes of determining Oregon taxable income, subject to adjustments and modifications specified in Oregon law. ORS 316.007.[2] As a result, the legislature adopted, by reference, the federal definition for deductions, including IRC section 183, providing that when an activity is not engaged in for profit, deductions for expenses of the activity are allowed only to the extent of the profit generated. It is worth noting that profit in this context "means economic profit, independent of tax savings." *Antonides v. Commissioner*, 91 TC 686, 694 (1988), *aff'd*. 893 F2d 656 (4th Cir. 1990). Treas Reg Section 1.183-2(b) "sets forth a nonexclusive list of nine factors to guide courts in analyzing a taxpayer's profit objective. * * * The nine factors are: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisers; (3) the time and effort expended by the taxpayer in carrying on the

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[2] References to the Oregon Revised Statutes (ORS) are to year 1997 for tax year 1999, and to year 1999 for the balance of tax year 1999 (effective October 23, 1999), 2000, and 2001. A change, if any, in the language of the referenced statute will be noted.

activity; (4) the expectation that the 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, that are earned; (8) the financial status of the taxpayer; and (9) the elements of personal pleasure or recreation involved in the activity." *Routon v. Commissioner*, 83 TCM (CCH) 1062 (2002). The determination of whether the requisite profit objective exists is based on all the surrounding facts and circumstances. (*See Golanty v. Commissioner*, 72 TC 411, 426, 1979 WL 3683 (1979), *aff'd* without published opinion 647 F2d 170 (9th Cir 1981.)

The following discussion of the factors supports the court's conclusion that Plaintiffs did not engage in their leasing activity to make a profit.

A. *Businesslike manner*

Plaintiffs failed to operate their leasing activity in a businesslike manner. Plaintiffs allege that they had a business plan beginning in 1999. However, their "records, forecasts, financial analysis and spreadsheets" were all destroyed in December 2002 during "a house/office fire." (Ptfs' Ex E-3.) Plaintiffs re-created their business plan for the court. The plan submitted to the court was filled with words, but lacked supporting documentation, including copies of vehicle leases for the tax years under audit, a customer list, and an analysis with explanations showing how Plaintiffs planned to make a profit. There is no evidence Plaintiffs maintained a separate checking account for their business.

Plaintiffs failed to present evidence showing that they conducted their leasing activity in a manner substantially similar to other comparable vehicle leasing businesses that are profitable. Although Plaintiffs made substantial capital contributions in years 1999 and 2000 in the form of purchasing vehicles to lease, they failed to set rental rates with "cost pass through" requirements

for maintenance and repair and insurance sufficient to generate a profit. "Cost pass throughs" for insurance and repairs are standard terms found in most lease agreements. For the tax years before the court, there were small increases in gross revenue year-to-year. Even though Plaintiffs had nine vehicles available for lease in 1999, 63 percent of the gross revenue reported came from one vehicle leased to CCI Construction. (Def's Ex K-1.) In 2001, Plaintiffs had 12 vehicles available for lease. However, gross revenue was comparable to that reported for 2000 when nine vehicles were available for lease. (Ptfs' Ex A-1.) In each of the tax years, expenses before the deduction for tax depreciation almost matched the gross revenue. Plaintiffs made no timely efforts to improve profitability by adjusting the lease rental rates or reducing operating expenses to generate a profit.[3]

Because all Plaintiffs' records were destroyed in their house fire, there is no evidence to support the operating expenses claimed as business deductions. With respect to some of the expenses, Plaintiffs' actions were not conducted in a businesslike manner. For example, in 2001, Plaintiffs' insurance records show that the vehicle inventory was insured on their personal policy, stating that all vehicles were for "pleasure driving." (Def's Ex G-1.) In 2000, meals expenses of over $2,000 and golf fees of over $1,700 were claimed as business expenses with no required documentation stating date, name(s) of individuals, location and business purpose.[4] (Def's Ex I-1, 2.) IRC section 274 imposes stringent substantiation requirements for travel,

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[3] In the fourth year of operating their leasing business, Plaintiffs changed the terms of their lease agreements to require the lessee to carry insurance on the leased vehicle. (Ptfs' Ex A-16.) It appears from the evidence that Plaintiffs incurred maintenance and repair costs for the leased vehicles until the fifth year. (*Id.*)

[4] Many of the meal expenses claimed were for the same dollar amount at the same eating establishment, including a charge incurred on New Year's Day. Ellison states that claiming those expenses were "mistakes" and he was following the practice of his current employer who allows its employees to claim meal expenses while on travel status. (Ptfs' Ex E-12.)

meals and entertainment, gifts, and with respect to any listed property as defined in section 280F (d)(4). *See* IRC §Sec 274(d). Even though Ellison testified that his records were destroyed during a fire, he offered no specific details to show how those expenditures for meals and golf promoted the business activity and resulted in new lessees.

B. *Expertise of the taxpayer or his advisors*

Ellison earned a Masters in Business Administration (MBA) in May 1990. Ellison stated that with his MBA, and the "experts" he "consulted in the field and information * * * mined on the internet and other places," he gained the expertise he needed to own and operate his leasing business. Further, Ellison stated that he "has worked in the automotive and transportation industry for 25 years." (Ptfs' Ex E-9,11.)

Plaintiffs failed to distinguish between an understanding of the automotive and transportation industry and expertise in the business and economic practices relating to a successful leasing business. Even though Ellison had a longstanding interest in cars and trucks, the evidence does not establish that he has an expertise in the economics or business of leasing vehicles. Plaintiffs, to their detriment, relied on their own abilities rather than retaining the services of business and financial advisors, including an accountant. Plaintiffs submitted a small number of business cards to support their testimony that they sought the advice of consultants. However, there is no evidence those individuals gave advice or that Plaintiffs followed their advice designed to aid them in making their business profitable.

C. *Time devoted to the activity*

During tax years at issue, Plaintiffs were employed by others. Ellison stated that his current employment at Freightliner LLC "is not demanding or time consuming" and "allows for freedom and mobility and multitasking." (Ptfs' Ex E-9.) He described in detail the time he spent

planning, looking for and bidding on vehicles, reading about the business in "books, magazines and internet articles" and communicating with others. (Ptfs' Ex E-10.)

In addition to working full time, Ellison engaged in other activities, specifically the trading of options, and acquiring and renting residential property located in Oregon and California. During 2000, Ellison traveled twice to California to handle rental issues, and three times a week he spent time at an Oregon rental property. In 2001, Ellison was involved in a construction partnership, working a couple of days a week and every Saturday. In addition, Ellison and his wife were actively involved in raising three sons.

Even though Ellison testified that he devoted substantial amount of time to the leasing operation, it appears that the time he found to allocate to the business was spent acquiring vehicles. There is little evidence showing that Ellison spent time and effort to enhance profitability.

D. *Expectation that assets may appreciate*

Ellison's expectation that the vehicle inventory will appreciate or "hold value" is not supported by actual experience. For example, the 1998 Mercedes S320 that was purchased in 2001 for $36,300 recently sold for $19,000. (Ptfs' Ex A-1BE.) Plaintiffs allege "that the vehicles used in this business will substantially exceed the useful life of other more average vehicle." (Ptfs' Ex E-10.) However, Plaintiffs have donated two vehicles to charity, resulting in additional deductions, not income. Further, two vehicles have been "wrecked" with no net value to the business. (Ptfs' Ex A-1.)

Ellison estimated that the gross revenue generated from the lease of the vehicles and the sale of the vehicles at the end of 2005 would net a profit of $108,975, before offsetting the operating expenses and recapturing the depreciation deduction previously claimed. (Ptfs' Ex A-2.)

The United States Tax Court held that when the property's appreciation in value is independent of the claimed business activity, the gain from sale of the property is not taken into account in evaluating the profits and losses of the activity in question. *See Ruben v. Commissioner*, 51 TCM (CCH) 1268 (1986.) In this case before the court, the appreciation, if any, of the vehicles "is independent of" Plaintiffs' leasing activity and the gain, if any, "from sale of the" automobiles cannot be "taken into account in evaluating" Plaintiffs' profit making motive. *Id.*

E. *Success in similar or dissimilar activities*

Plaintiffs have no history of operating a profitable business of a similar activity. Their six years (1993-1998) of renting automobiles to others provides no evidence that they learned from their prior experiences how to generate a profit from an automobile leasing business. Plaintiffs refer to that time period as a "trial and error period." (Ptfs' Ex E-11.) Ellison wrote that "[t]his provided an understanding of what would work and what would not work." (Ptfs' Ex E-9.) Unfortunately, there is no evidence to show how they applied the lessons learned from the "trial and error period" to their current leasing operation to make it profitable.

Ellison testified that he has been and is currently "successful in this automotive, truck manufacture, truck sales and leasing and support business with Freightliner LLC for many years." (Ptfs' Ex E-11.) The court agrees that he appears to be successful as an employee. However, there is no evidence to show that Plaintiffs are successful in owning and operating their own leasing business.

F. *History of income and losses*

Generally, the profit objective test looks for a profit on the entire activity, including profits to recoup losses from prior years. *Golanty v. Commissioner*, 72 TC 411, 427, 1979 WL 3683 (1979), *aff'd* without published opinion 647 F2d 170 (9th Cir 1981) (citing *Bessenyey v.*

Commissioner, 45 TC 261, 274 (1965), WL 1317 (1965), *aff'd*. 379 F2d 252 (2d Cir 1967.) There have been consistent substantial losses from Plaintiffs' leasing activity. There is no evidence to show that Plaintiffs made any serious effort to analyze the economic viability of their leasing activity. With respect to future profitability, Plaintiffs' expectation that there will be no need to acquire replacement vehicles through 2011 is not persuasive given the model year of the vehicles available for lease and the history of vehicle donations and "wrecks." (Ptfs' Ex A-1.) Further, Plaintiffs forecast that operating expenses will substantially decrease with no costs incurred to maintain their vehicle inventory does not follow from an aging vehicle inventory. The record of uninterrupted substantial losses realized by Plaintiffs in their leasing activity over many years is indicative of a lack of profit objective. The court is unable to conclude that the losses should be attributed to some measure of poor business judgment by Plaintiffs rather than a lack of a profit motive.

G. Amount of profits

Plaintiffs' ability to generate a profit based on the average monthly lease rates is unlikely. Plaintiffs project a gross revenue increase of 39 percent from 2004 to 2005, without a change in the number and age of vehicles available for rent. In addition, Plaintiffs project another 13 percent increase in gross revenue from 2005 to 2006, with no change in vehicle inventory. There was no explanation provided to the court as to how those gross revenue increases would be accepted by lessees.

H. *Taxpayers' financial status*

During the tax years at issue, Ellison was employed by Freightliner LLC and is currently the Director of Customer Support for Freightliner LLC. During the tax years at issue, he earned more than $130,000 in 1999 and 2000, and $117,000 in 2001. Case law supports the conclusion

that, although another additional source of significant income does not create a presumption of a lack of profit motive, it is an important factor. *See Jackson v. Commissioner*, 59 TC 312, 317, WL 2449 (Nov. 27, 1972). This is particularly significant when the losses generated by a business are primarily generated by depreciation, which is not a cash expense, but instead, used to offset earned income.

For the tax years under appeal, Plaintiffs claimed tax losses totaling $130,495. (Def's Ex A-9.) In each year, operating expenses before the deduction for tax depreciation slightly exceeded gross revenue. The net losses were primarily generated by the tax depreciation deduction. Clearly, Plaintiffs received tax benefits each year. Ellison testified that he "needed" the "tax benefit" to keep the business going. He concluded that "in the future" there would be no tax benefit to him, but rather, he would pay state income taxes. Based on the evidence submitted, the court is not persuaded that the tax benefit would end as Plaintiffs state.

I. *Personal pleasure or recreation*

Ellison stated that he "does not find pleasure in losing a great deal of money" (Ptfs' Ex E-12.) The factor, an element of personal pleasure or recreation involved in the activity, does not focus on the outcome of the activity, but rather, deriving personal pleasure or enjoyment from the activity. Ellison purchased all the vehicles available for lease, but did not drive the vehicles for pleasure or personal recreation. The level of personal pleasure Ellison derived from the leasing activity is not significant.

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III. CONCLUSION

After carefully reviewing the testimony and evidence, the court concludes that Plaintiffs' leasing activity is not an activity engaged in for profit under Internal Revenue Code (IRC) section 183. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiffs' appeal is denied and the losses relating to Plaintiffs' leasing business are disallowed for tax years 1999, 2000, and 2001.

Dated this _____ day of September 2005.

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JILL A. TANNER
PRESIDING MAGISTRATE

If you want to appeal this Decision, file a Complaint in the Regular Division of the Oregon Tax Court, by mailing to: 1163 State Street, Salem, OR 97301-2563; or by hand delivery to: Fourth Floor, 1241 State Street, Salem, OR.

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 Presiding Magistrate Jill A. Tanner on September 23, 2005. The Court filed this document September 23, 2005.