

IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Income Tax

MARK L. ROBERTS)	
and THERESA A. ROBERTS,)	
)	
Plaintiffs,)	TC-MD 060783E
)	
v.)	
)	
DEPARTMENT OF REVENUE,)	
State of Oregon,)	
)	
Defendant.)	DECISION

Plaintiffs appeal Defendant’s conference decision finding Plaintiffs’ fishing activities lacked a profit objective for tax years 2002, 2003, and 2004. A trial in the matter was held in the courtroom of the Oregon Tax Court October 10, 1007. Kevin O’Connell and Katherine de la Forest, Attorneys with Hagen O’Connell LLP, appeared on behalf of Plaintiffs. James C. Wallace, Assistant Attorney General, appeared on behalf of Defendant.

I. STATEMENT OF FACTS

Mark L. Roberts (Roberts) has been involved with ocean fishing for many years. His father engaged in commercial fishing on a part-time basis and owned more than one boat. Roberts fished one of those boats out of Pacific City for many years. Roberts’ father died in a fishing accident. After his father’s death, Roberts continued to fish and considers himself to have been involved in a commercial fishing business since the 1970s. Originally, Roberts fished off a dory named Shark Bait out of Pacific City. He registered the Shark Bait with the Marine Board as a pleasure fishing boat. The Shark Bait fished primarily for bottom fish, *i.e.*, rock fish and lingcod. Roberts replaced Shark Bait with another dory called the Fish Assassin, which he

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registered as a commercial vessel and also fished out of Pacific City. He continued to fish primarily for bottom fish with the Fish Assassin.

Roberts worked 22 years full-time for Intel Corporation as a technician until his eventual retirement in 2005. Plaintiffs lived in their primary residence in Newberg, Oregon, and owned a second residence in Pacific City.¹ In 1999, Plaintiffs decided to make fishing their primary profession. In 2000, they contracted to build a bigger boat that could carry more product and gear and that could go farther out to sea. The boat cost \$190,000. Through his job at Intel, Roberts had acquired stock and stock options. In 2000, he began selling stock and received enough money to pay for half of the boat. Plaintiffs financed the remainder of the boat by taking out a second mortgage on their home. Plaintiffs intended to retire and exercise additional stock options to pay off the loan by 2002. Roberts testified that stock prices dropped in 2001 and, as a result, he was financially unable to retire. He was also unable to exercise the additional stock options to pay off the remaining balance on the boat. Plaintiffs received the new boat in August 2001.

Plaintiffs named the new boat the Pacific Mistress. As part of Plaintiffs' focus on making fishing their primary business, Plaintiffs began fishing out of Depoe Bay, whereas before they had always fished out of Pacific City. The new waters offered more opportunities for the new boat. Roberts testified that, in 2002, he planned to fish for tuna, coho salmon, and lingcod. Roberts testified that Oregon had discussed easing restrictions on coho salmon and so they were positioning themselves for the turnaround in 2002. Unfortunately, those restrictions did not ease and tuna had generally gone "off shore" approximately 100 miles. Roberts testified he does not
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¹ Plaintiffs sold their Newberg residence in 2005. (Def's Ex C at 10.)

fish the Pacific Mistress 50 miles beyond the shore. In 2002, he also fished for rockfish and chinook salmon.

Defendant submitted landings records for Depoe Bay from the Oregon Department of Fish and Wildlife for 2002 to 2004. (*See* Def's Ex D at 9-11.) A "landing" occurs when a boat brings in fish off the waters. A review of the documents shows that lingcod were primarily landed during the months of May through September. The information on black rockfish varied from 2002 to 2004, with 2002 showing landings in March, April, June, July, August, and September; 2003 landings occurring in May, June, July, and August; and 2004 landings occurring in January and March through September. (*Id.*) Chinook salmon are primarily landed March through October. (*Id.*)

Landings records for the Pacific Mistress in 2002 show the Pacific Mistress landed lingcod, chinook salmon, rockfish, and tuna. (*Id.* at 12.) The Pacific Mistress landings began May 4, 2002, and concluded October 27, 2002, with a total of 29 days with fish landed. (*Id.*) The records show a total of 5,256 pounds of fish landed in 2002. (*Id.* at 13.) In 2003, the records show the Pacific Mistress again landed lingcod, chinook salmon, rockfish, and tuna. (*Id.* at 14-16.) The Pacific Mistress began landings March 30, 2003, and concluded October 5, 2003, with a total of 32 days with fish landed bringing in a total of 6,843 pounds of fish. (*Id.*) In 2004, Roberts purchased a crab permit for \$15,000 in an effort to expand his product. (*See* Ptf's Ex 40 at 8.) The landings records show the Pacific Mistress landed blue shark, chinook salmon, pacific mackerel, tuna, rockfish, shortspine thornyhead, lingcod, cabezon, halibut, and dungeness crab. (Def's Ex D at 17-19.) In 2004, the Pacific Mistress began landings March 28, 2004, and concluded October 16, 2004, with a total of 38 days with fish landed. (*Id.* at 17, 18.) That year, the Pacific Mistress landed 7,234 pounds of fish. (*Id.* at 19.)

Roberts testified that, although landings records are useful to show what was caught and when, it is not reflective of time spent on the ocean because it does not show days where he fished and failed to catch anything, or days where he intended to fish but weather prohibited him from doing so. In addition, in April and May 2004, the Pacific Mistress was out six weeks due to engine failure. Roberts also testified that landings do not reflect the time he puts in getting ready to fish. He testified he spent his evenings in Newberg on the internet researching the business, evaluating weather patterns, tying ropes, and preparing gear for fishing.

In 2002 and 2003, Plaintiffs sold their product to wholesale and retail fish markets. They were the main product supplier for Neptune's Choice out of Depoe Bay and the only live lingcod supplier to Ocean Brite Seafoods. (Def's Ex D at 22.) In 2004, Roberts purchased a permit allowing Plaintiffs to sell their product off their boat directly to consumers.

During the years at issue, Plaintiffs purchased a yacht insurance policy for the Pacific Mistress with a commercial rider.² In 2002, the commercial rider covered the boat for 30 days of fishing. In 2003 and 2004, the rider covered the boat for 90 days of fishing. (*See, e.g.*, Ptf's Ex 68.) Roberts testified that he is aware of no law that requires commercial insurance. In addition, the limit of days on the rider does not prohibit him from fishing more than those days, there would just be no coverage.

For 2002, Plaintiffs filed a Schedule C reporting gross receipts from the fishing business of \$6,840. (Ptf's Ex 42 at 5.) They reported total expenses of \$63,591, for a total loss of \$56,751. (*Id.*) Roberts points out that \$43,934 of the expenses is related to depreciation with the largest depreciating asset being the boat. (*Id.* at 5, 7.) In 2003, Plaintiffs' Schedule C reported

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² In 2006, Plaintiffs purchased a commercial fishing boat policy.

gross receipts of \$9,281 and total expenses of \$57,403, for a net loss of \$48,122. (Ptf's' Ex 41 at 5.) Roberts again points out the large depreciation expense of \$31,256 and the large repair expense of \$9,748 resulting from repairs to the bottom of the boat due to scraping. (*Id.* at 5, 7.) For 2004, Plaintiffs reported gross receipts from their fishing business of \$11,071, total expenses of \$49,627, for a net loss of \$38,556. (Ptf's' Ex 40 at 5.) For 2004, Plaintiffs reported depreciation of \$21,658 and repairs of \$7,629, due in large part to the new engine. (*Id.* 5, 7.)

For the years at issue, Plaintiffs failed to maintain a separate checking account for the fishing business. Roberts testified that, because the business was a sole proprietorship, he did not think it was necessary to maintain separate accounts.³ Further, Roberts testified that he has "fish tickets" that document every sale. (*See* Ptf's' Exs 30 to 36.) Those fish tickets identify the income attributable to fish sales.

Defendant audited Plaintiffs' 2002, 2003, and 2004 returns and concluded Plaintiffs' fishing activities lacked a profit objective. As a result, Defendant denied Plaintiffs' fishing related expenses. Plaintiffs appeal claiming they are engaging in the business to make a profit. They argue they are taking steps in that direction and are making changes to their business to become more profitable. Plaintiffs also point out that the Internal Revenue Service audited their 2003, 2004, and 2005 returns and concluded they were sufficient, finding they were "heading in the right direction." (*See, e.g.*, Ptf's' Ex 55.)

II. ANALYSIS

The Oregon income tax system is connected to the federal income tax system. *See* ORS 316.007.⁴ As a result, the Oregon Legislature adopted by reference the federal definitions

³ In 2005, Plaintiffs opened and maintained a separate account for the Pacific Mistress based on Defendant's advice.

⁴ All references to the Oregon Revised Statutes (ORS) are to 2003.

for income and deductions, including Internal Revenue Code (IRC) section 183.⁵ Section 183 provides that when an activity is not engaged in for profit, deductions for expenses related to that activity are limited. In this case, Plaintiffs argue their fishing activity was engaged in for the purpose of obtaining a profit and, as a result, the deduction for their expenses should not be limited.

Federal cases set forth the standards a court must use when reviewing whether an activity is engaged in for profit. In *Briggs v. CIR*, the United States Tax Court stated:

“In determining whether an activity is engaged in for profit, the taxpayer must show that he or she engaged in the activity with an actual and honest objective of making a profit. The taxpayer’s expectation need not be reasonable, but he or she must have a good faith objective of making a profit.

“The determination of whether an activity is engaged in for profit is to [be] made by reference to all the facts and circumstances. We give greater weight to objective facts than to a taxpayer’s mere statement of intent.”

67 TCM (CCH) 2484 (1994), 1994 WL 97731 at *12 (case citations omitted); *see also* Treas Reg § 1.183-2(a).

The Treasury Regulations (Regulations) set forth nine factors for the courts to consider when determining whether a taxpayer has engaged in an activity for profit. *See* Treas Reg § 1.183-2(b). Those factors are (1) the manner in which the taxpayer carries on the activity, (2) the expertise of the taxpayer or his advisors, (3) the time and effort expended by the taxpayer in carrying on the activity, (4) the expectation that assets used in the activity may appreciate in value, (5) the success of the taxpayer in carrying on other similar or dissimilar activities, (6) the taxpayer’s history of income or losses with respect to the activity, (7) the amount of occasional profits, if any, which are earned, (8) the financial status of the taxpayer, and (9) elements of personal pleasure or recreation. *Id.* The Regulations further state that:

⁵ All references to the Internal Revenue Code (IRC) are to 2003.

“[n]o one factor is determinative in making this determination. In addition, it is not intended that only the factors described in this paragraph are to be taken into account * * * or that a determination is to be made on the basis that the number of factors * * * indicating a lack of profit objective exceeds the number of factors indicating a profit objective, or vice versa.”

Id.

A. *Manner in which Plaintiffs carried on the activity*

Defendant argues that, because Plaintiffs failed to maintain a separate bank account for the Pacific Mistress, they did not carry on the activity in a businesslike manner. Although they maintained a single account, the court observes that Plaintiffs kept detailed records of the fish sales for the three years at issue, allowing them to easily trace funds related to the fishing activity. (See Ptf's Exs 30-36.)

In addition, Plaintiffs entered the business expecting to fish primarily for coho salmon, lingcod, and tuna. Finding restrictions did not ease for coho salmon and that limits were imposed for lingcod, Plaintiffs evaluated other alternatives. In 2004, they decided to pursue crabbing as their primary catch and invested \$15,000 for a crab permit, in addition to large expenditures for crab pots and crab equipment. The Regulations point out that changing operating methods by abandoning unprofitable methods is a fact indicating a profit motive. Treas Reg § 1.183-2(b)(1).

B. *The expertise of Plaintiffs*

Roberts has ocean fished for decades and has, therefore, a level of expertise. In addition, Roberts testified he is continually educating himself on new fishing methods, and when he changed ports in 2001, he educated himself on the local markets.

C. *The time and effort expended by Plaintiffs in carrying on the activity*

Roberts spent most of his time away from Intel on the ocean fishing. He used his sabbatical, vacation time, and weekends to fish. In addition, Roberts testified that he spent many

evenings preparing for his next fishing trip. Landings records show Roberts landed fish 29 days in 2002, 32 days in 2003, and 38 days in 2004. As explained by Roberts, those records do not fully reflect his efforts because they do not show the days he fished with no catch or days he intended to fish but was unable to due to weather. In addition, a review of the records shows that the fishing season is limited.

The Regulations state that if a taxpayer withdraws from another occupation to devote more time to the activity, it may be evidence of a profit objective. *Id.* at § 1.183-2(b)(3). Roberts testified he intended to retire in 2002 and devote all his time and energy to commercial fishing. Due to the market, he testified he had to postpone his retirement plans until 2005. When he did eventually retire, he sold his Newberg residence and made his home at the coast his primary residence.

D. *Expectation that assets used in activity may appreciate in value*

The Regulations provide that “[t]he term profit encompasses appreciation in the value of assets[.]” *Id.* at § 1.183-2(4). Plaintiffs’ largest asset is the boat, which cost \$190,000. No appraisal evidence was offered to demonstrate appreciation of the boat, but Roberts testified that someone approached him in 2006 and offered to buy the boat for \$150,000, which shows no appreciation. Roberts testified, however, that his fishing permits have value. The number of permits allowed in the state for certain species is limited, which creates value for those permits. Crab permits are limited and, therefore, he believes the crab permit he paid \$15,000 for would be worth substantially more. Roberts also testified that lingcod is going limited entry and, if that occurs, his lingcod permit will increase in value.

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E. *Success of Plaintiffs in carrying on similar or dissimilar activities*

Plaintiffs have filed Schedule Cs related to their commercial fishing for nearly 20 years. For the period from 1996 to 2006, Plaintiffs reported losses.⁶ (*See* Ptf's Exs 38-48.) The court observes that during the period before the Pacific Mistress, *i.e.*, 1996 to 2000, the losses reported were substantially less, ranging from \$1,053 to \$8,079. (Ptf's Exs 44-48.) That was due to there being no large depreciation deduction for the Pacific Mistress.

Although they have a history of losses, Roberts testified that, with the acquisition of the Pacific Mistress in August 2001, Plaintiffs' focus on fishing shifted. They intended commercial fishing to become their primary occupation and placed more emphasis on making it a profitable endeavor. They switched ports and began to fish for a broader array of species. They also bought a permit allowing them to sell their product off their boat in 2004.

F. *History of income or losses*

As mentioned above, Plaintiffs have a history of losses related to commercial fishing. Defendant points out that Plaintiffs have filed Schedule Cs for decades and never reported a profit. The court acknowledges Defendant's point, but also agrees with Plaintiffs that, in 2001, their focus shifted. They made changes from their prior operations and showed a renewed intensity with fishing. Investing in a new boat, new species, new water, and new methods demonstrates Plaintiffs were approaching the business in a different manner.

For the period at issue, however, Plaintiffs reported large losses. As previously stated, the losses were due, for the most part, to the depreciation deductions taken for the new boat. Further, reviewing the returns shows that Plaintiffs' income is increasing and losses are

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⁶ Returns for years prior to 1996 were not provided to the court.

decreasing, suggesting a shift towards profitability. Plaintiffs reported gross receipts and losses as follows:

<u>Year</u>	<u>Gross Receipts</u>	<u>Net Loss</u>
2002	\$6,840	\$56,751
2003	\$9,281	\$48,122
2004	\$11,071	\$38,556
2005	\$20,525	\$25,690
2006	\$40,239	\$14,753 (of which \$15,204 was depreciation)

(Ptfs' Exs 38-42.)

The Regulations state that “[a] series of losses during the initial or start-up stage of an activity may not necessarily be an indication that the activity is not engaged in for profit.”

Treas Reg § 1.183-2(6). Defendant would argue the years at issue were not part of any start-up stage. The court disagrees, finding Roberts’ testimony that, with the purchase of the Pacific Mistress and change in port, Plaintiffs were, in essence, “restarting” their business.

G. *Amount of occasional profits*

Plaintiffs have not recognized any profits.

H. *Financial status of Plaintiffs*

The Regulations state that, if a taxpayer does not have substantial income from other sources, it is indicative of the activity being engaged in for profit. *Id.* at § 1.183-2(8). In 2002, 2003, and 2004, Roberts continued to work for Intel and earn substantial income. Roberts testified that he had intended to retire in 2002 but, given the market, it made sense financially to wait until 2005, when he did take early retirement to focus on fishing.

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I. *Elements of personal pleasure or recreation*

The Regulations state:

“The presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved. On the other hand, a profit motivation may be indicated where an activity lacks any appeal other than profit. It is not, however, necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits. * * * An activity will not be treated as not engaged in for profit merely because the taxpayer has purposes or motivations other than solely to make a profit. Also, 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.”

Id. at § 1.183-2(9).

Fishing certainly has elements of recreation and personal pleasure. Ocean fishing has been a lifelong endeavor of Roberts. As the Regulations make clear, however, simply because Plaintiffs derive pleasure from the activity does not mean they are not pursuing the activity for profit.

The court has carefully considered the above factors, the exhibits, and testimony. The fact that Plaintiffs experienced losses in 2002 through 2006 suggests they pursued commercial fishing without the requisite intent of making a profit. However, the Regulations are clear that factors beyond profit yields must be considered and that all factors must be balanced. The parties submitted various federal cases with decisions on fishing activities. Cases were decided in both directions, making clear that the facts of the case control the outcome.

After careful consideration, the court is persuaded that Plaintiffs pursued commercial fishing with a profit objective during the subject years. Roberts proved to be a credible witness and testified matter-of-factly about the pleasures and stresses of fishing. It is an ever changing occupation that needs flexibility and requires constant reassessment. The court was persuaded by the testimony and evidence showing that, in 2000, Plaintiffs’ focus on fishing did indeed shift,

with their intention that it become their primary source of income. It is true Roberts did not retire from Intel until 2005, but it is also true Plaintiffs were taking steps to pursue their business before then by expanding to crabbing, obtaining permits to market their product off their boat, and changing ports to allow them to fish bigger oceans. The court finds, therefore, that Plaintiffs' deductions related to fishing should not be limited.

A side issue raised by Defendant was the mileage expenses claimed by Plaintiffs. Plaintiffs claimed mileage when traveling from their home in Newberg to their home in Pacific City. They also claimed mileage from Pacific City to Depoe Bay on the days they fished. Some of Plaintiffs' mileage logs were provided. (*See*, Def's Ex D at 36-38.) The court agrees that Plaintiffs' traveling expenses between homes, and from their home in Pacific City to Depoe Bay, were nondeductible personal commuting expenses. (*See* Def's Ex I at 2.) Plaintiffs did, however, claim miles that were deductible. For example, trips to take the boat for repairs would be deductible and trips to obtain supplies would be deductible. The parties did not, however, provide enough information for the court to accurately separate the mileage expense claimed between deductible and nondeductible. Reviewing the information before it, however, the court finds that reducing the mileage expense claimed by 75 percent is a reasonable adjustment. The mileage adjustment would be:

<u>Tax Year</u>	<u>Miles Claimed⁷</u>	<u>Deduction Claimed</u>		<u>Deduction Allowed by Court</u>
2002	7,570	\$2,763	x .25	\$691
2003	10,386	\$3,739	x .25	\$935
2004	10,197	\$3,824	x .25	\$956

III. CONCLUSION

⁷ See Defendant's Exhibit I for the number of miles claimed.

It is the conclusion of the court that Plaintiffs engaged in their commercial fishing activity with an intent of making a profit during the relevant tax years. As a result, their deductions related to the activity are not limited. The court further concludes, however, that the mileage expenses claimed by Plaintiffs should be reduced. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiffs' appeal is granted, in part; and

IT IS FURTHER DECIDED that Defendant shall adjust Plaintiffs' account for the years 2002, 2003, and 2004 to reflect the above Decision.

Dated this _____ day of December 2007.

COYREEN R. WEIDNER
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 Magistrate Coyreen R. Weidner on December 28, 2007. The Court filed and entered this document on December 28, 2007.