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Larry's Tax Law

Hobby Loss Rules Revisited

By Larry Brant on 4.22.25 | Posted in Internal Revenue Code, Tax Laws, Tax Planning

With the Corporate Transparency Act hopefully in our rearview mirrors, I decided to take a brief break from my ongoing series on Subchapter S and report on a different topic. In the last few weeks, the Magistrate Division of the Oregon Tax Court issued two important decisions,[i] both of which center on a singular issue – whether the taxpayer had engaged in an activity for profit and was thus able to deduct its losses under IRC Section 162. These battles, commonly referred to as "hobby-loss" cases, have existed among the Internal Revenue Service and/or the state departments of revenue, and taxpayers for decades. I suspect, with the anticipated significant reduction in staffing at the Internal Revenue Service, we will see more audit activity at the state level throughout the United States. Among the audit activity may be hobby-loss cases.

In Oregon, the department of revenue (the "ODOR") has recently made the hobby-loss issue a mainstay in its audits of activities where losses result. I suspect it is not earth shattering that activities such as horse breeding, racing and training; wineries and vineyards; automobile racing; airplane rentals; and llama breeding and sales have been under fire by the ODOR as hobbies rather than activities engaged in for profit. Interestingly, the ODOR appears to have added other activities to the list, expanding its hobby-loss exams to include traditional farming and other related activities.

Background

The "hobby loss" rules were originally contained in Code Section 270 of the Internal Revenue Code of 1954. In 1969, Congress repealed that provision of the tax code and enacted Code Section 183.

The impetus for enacting Code Section 183 is Congress's desire to create objective standards to determine whether a taxpayer was engaged in an activity for making a profit or simply creating losses that could be used to offset unrelated income. Additionally, the legislative intent behind Code Section 183 is to require that a taxpayer must have a true objective to make a profit rather than a reasonable expectation of making a profit.

Code Section 183 disallows deductions attributable to activities "not engaged in for profit" (more commonly called "hobbies" by tax practitioners). Under Code Section 183(c), an activity is not engaged in for profit unless it is an activity for which deductions are allowable under Code Section 162 (trade or business expenses) or Code Sections 212(1) or (2) (expenses for the

production of income).

A taxpayer must demonstrate a sufficient profit motive for entering into an activity, or it may be considered a hobby, subject to the limitations of Code Section 183. *See Cannon v. Comm'r*, TC Memo 1990-148, *aff'd*, 949 F.2d 345 (10th Cir. 1991). The taxpayer bears the burden of proof to show any given activity was entered into with a profit motive. *See, e.g., Golanty v. Comm'r*, 72 T.C. 411, 426 (1979), *aff'd*, 647 F.2d 170 (9th Cir. 1981).

The Nine Factors Applicable to Code Section 183

Whether an activity is engaged in for profit involves a facts-and-circumstances analysis based upon factors set forth in the applicable Treasury Regulations and case law. *See* Treas. Reg. § 1.183-2(a).

The following nine factors, discussed in more detail below, are to be considered in determining whether a profit motive exists:

1. The manner in which the taxpayer conducts the activity;
2. The expertise of the taxpayer or his/her advisors;
3. The time and effort spent by the taxpayer 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;
8. The financial status of the taxpayer; and
9. Elements of personal satisfaction or recreation.

See Treas. Reg. § 1.183-2(b).

Additionally, the regulations set forth several analytical principles to guide any analysis under these nine factors.

First, taxpayers are not required to have a reasonable expectation of making a profit. *See* Treas. Reg. § 1.183-2(a). Rather, the facts and circumstances must indicate that the taxpayer entered into the activity with an actual and honest objective of making a profit. *Id.*; *Schwartz v. Comm'r,* TC Memo 2003-86. A small chance of making a large profit may be sufficient. *See* Treas. Reg. § 1.183-2(a). The regulations further elaborate on this principle by providing an example of an investor in a "wildcat" oil well who incurs substantial expenditures even though the expectation of profit is so slim as to be considered unreasonable. *See id.*

In this manner, the regulations establish a standard that focuses on the taxpayer's subjective intent—i.e., whether the taxpayer has an actual profit motive. The standard is not an objective "reasonableness" standard—e.g., how a reasonable businessman would have acted. *See*, *e.g., Cornfeld v. Comm'r*, 797 F.2d 1049 (DC Cir. 1986).

Second, in analyzing the various factors, no one factor is determinative. *See* Treas. Reg. § 1.183-2(b). The analysis is also not predicated upon whether more factors indicate profit motive or a lack thereof; rather, all facts and circumstances must be considered. *Id.*

Third, in determining whether a profit motive exists, greater weight is given to objective facts than to the taxpayer's statement of intent. *See* Treas. Reg. § 1.183-2(a).

Each of the nine factors is discussed in more detail below.

Factor 1: Manner in which Taxpayer Conducts the Activity. The fact that a taxpayer carries on an activity in a "businesslike manner and maintains complete and accurate books and records" is indicative of a profit motive. Treas. Reg. § 1.183-2(b)(1). Use of books and records to improve operations is an indication of profit motive. *See id.*; *Golanty*, 72 T.C. 411. However, a written financial or business plan is not required where the plan is evidenced by the taxpayer's actions. *See Golanty*, 72 T.C. 411; *Strickland v. Comm'r,* TC Memo 2000-309.

A change of operating methods, adoption of new techniques or abandonment of unprofitable methods in a manner consistent with an intent to improve profitability may also indicate a profit motive. *See* Treas. Reg. § 1.183-2(b)(1). Similar "businesslike" actions may include: (a) drafting a written business plan; (b) attending conferences and industry events relating to the business; (c) maintaining a business calendar; and/or (d) establishing separate business bank accounts.

Factor 2: Expertise of Taxpayer or Advisors. Expertise in a given area, extensive study, and/or consultation of experts may be evidence of the taxpayer's profit motive when the taxpayer then operates in accordance with the experts' recommendations. *See* Treas. Reg. § 1.183-2(b)(2). A lack of profit motive may be indicated if a taxpayer prepares a plan based upon advice or receives advice, and the taxpayer then ignores or does not operate in accordance with such advice or plan. *Id.* This factor does not necessarily require formal study. Informal discussions with industry experts and professionals can be evidence of a profit motive. *See Engdahl v. Comm'r*, 72 T.C. 659 (1979), *acq.*, 1979-2 C.B. 1.

Factor 3: Time and Effort Spent by the Taxpayer. The fact that a taxpayer invests substantial personal time and effort into an activity may indicate a profit motive. This is especially the case if the activity does not include substantial personal or recreational elements. *See* Treas. Reg. § 1.183-2(b)(3).

Factor 4: Expectation that Assets may Appreciate in Value. Expectation of profit includes the potential appreciation in value of the assets used in the activity, not just profits from current operations of the business activity. *See* Treas. Reg. § 1.183-2(b)(4). A bona fide belief that assets

will appreciate may be all that is necessary. *See Engdahl v. Comm'r*, 72 T.C. 659 (1979), *acq.*, 1979-2 C.B. 1.

This can include an expectation of appreciation of land used in the activity. A taxpayer "may intend to derive a profit from the operation of the activity, and may also intend that, even if no profit from current operations is derived, an overall profit will result when appreciation in the value of land used in the activity is realized since income from the activity together with the appreciation of land will exceed expenses of operation." Treas. Reg. § 1.183-2(b)(4).

Treas. Reg. § 1.183-1(d) states in part that when the taxpayer is engaged in several undertakings (such as land ownership and farming), each undertaking may be a separate activity or they may all constitute one activity. How to characterize them depends on the facts and circumstances.

Generally, the most significant facts and circumstances in making this determination are the degree of organizational and economic interrelationship of various undertakings, the business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business or in an investment setting, and the similarity of various undertakings. Importantly, the regulations state that the IRS will accept the taxpayer's characterization of multiple undertakings as a single activity or separate activities unless the taxpayer's characterization is artificial and cannot be reasonably supported. *See* Treas. Reg. § 1.183-1(d)(1).

In the context of land ownership and farming, the regulations offer more specific guidance. If land is purchased or held primarily with the intent to profit from an increase in its value, and the taxpayer also engages in farming on the land, the farming and the land holding are ordinarily considered a single activity only if the farming activity reduces the net cost of carrying the land for its appreciation in value. *See* Treas. Reg. § 1.183-1(d)(1). "Thus, the farming and holding of the land will be considered a single activity only if the income derived from farming exceeds the deductions attributable to the farming activity which are not directly attributable to the holding of the land. . . ." Treas. Reg. § 1.183-1(d)(1). This test looks to the primary motive for purchasing the land and prevents a taxpayer who purchased land primarily for appreciation from aggregating the land with another lossmaking activity.

Under this framework, when a taxpayer purchases land for reasons primarily related to farming operations (such that profit from the land's appreciation was a secondary consideration), then the ownership of the land and farming operations are looked at under the standard test, which allows the taxpayer to consider them a single activity for these purposes based upon their organizational and economic interrelationship, which in the case of a farm is virtually certain. *See, e.g.*, Treas. Reg. § 1.183-1(d)(1); *McKeever v. Comm'r,* TC Memo 2000-288; *Engdahl v. Comm'r*, 72 T.C. at 668 n.4.

***Factor 5: Success of Taxpayer in Carrying on Similar or Dissimilar Activities*.** If a taxpayer has engaged in similar activities in the past and converted the past activities from unprofitable to profitable status, it may indicate a profit motive if the current activity is unprofitable. *See* Treas. Reg. § 1.183-2(b)(5). For example, in *Arrington v. Comm'r*, 47 T.C.M. 270 (1983), the taxpayer previously owned and operated a successful cattle ranch. As a result, the court was persuaded that the taxpayer was knowledgeable about cattle and likely had the necessary profit motive.

This factor may be less important to courts than others, as many cases do not mention this factor at all, and courts have tended not to place much significance on the similarity between the activities. For example, in *Ellis v. Comm'r*, TC Memo 1984-50, the Tax Court noted that the taxpayer who was operating a horse farm had been actively involved in many other profitable ventures, and was the managing partner of his own very successful accounting firm. These other ventures were cited as support for his profit motive. *See also Eisenman v. Comm'r*, TC Memo 1988-467.

The Tax Court has also noted that activities that were "fundamentally different" are "not particularly helpful" in aiding a determination of whether a taxpayer engaged in an activity for profit and that the lack of taxpayer experience does not necessarily indicate that the activity was not engaged in for profit, such that this factor may be neutral. *See, e.g., Smith v. Comm'r*, TC Memo 1997-503; *Brown v. Comm'r*, TC Sum. Op. 2001-184.

***Factor 6: History of Income or Losses with Respect to the Activity*.** While a history of income may indicate a profit motive, a history of losses does not prevent a taxpayer from establishing a profit motive. Courts have found taxpayers involved in activities with a long-term string of losses to have a profit motive even when the taxpayer's efforts and objectives may have been objectively unreasonable. *See Helmick v. Comm'r*, TC Memo 2009-220. In *Snyder v. Comm'r*, 54 T.C.M 953 (1985), the court found a taxpayer to have a genuine, but unrealistic, profit motive in breeding and racing horses even though she incurred six years of losses. The taxpayer's activities and business-like manner reflected a profit motive. *Id.*

A long history of startup losses is customary in the process of building some profitable businesses. Treas. Reg. § 1.183-2(b)(6); *Palmer v. Comm'r*, TC Memo 1981-354 (land fertilization and improvement). This is particularly true for farming and animal breeding: "[I]f losses, or even repeated losses, were the only criterion by which farming is to be judged, then a large proportion of the farmers of the country would be outside the pale." *Riker v. Comm'r*, 6 B.T.A. 890, 893 (1927). Courts have recognized longer startup periods for breeding and for market volatility, which often can cause losses. *See, e.g., Engdahl v. Comm'r*, 72 T.C. at 669 (startup phase between five to 10 years for horse-breeding activity); *Fields v. Comm'r*, TC Memo 1981-550 (losses in third, fourth and fifth years of cattle breeding operation found to occur during startup phase).

Additionally, some startup periods may be longer than expected for fact-specific reasons. In *Nickerson v. Comm'r*, 700 F.2d 402 (7th Cir. 1983), the Seventh Circuit Court of Appeals found that the taxpayer, who was midway through a 10-year plan to change careers from advertising to dairy farming, had a legitimate profit expectation even though he projected losses throughout the transition. These losses were largely from renovation costs incurred in the early years of owning the farm. Similarly, in *Burrus v. Comm'r*, TC Memo 2003-285, the taxpayer's losses in the first six years of operations were consistent with his stated business plan of expanding his herd of productive cows and not expecting to cover his losses until the herd reached a certain size. Importantly, in *Burrus*, the Tax Court disagreed with the IRS's reasoning that the taxpayer's history of unprofitability indicated a lack of a profit motive. The Tax Court treated that fact as neutral—neither determining nor ruling out a profit motive.

Furthermore, when losses are sustained because of customary business risks or unforeseen or fortuitous circumstances that are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damages, other involuntary conversions or depressed market conditions, such losses are not an indication of a lack of profit motive. *See* Treas. Reg. § 1.183-2(b)(6); *see also Taras v. Comm'r*, TC Memo 1997-553.

Finally, as discussed below with respect to Factor 7, there is a line of cases with respect to the proper analysis of whether a taxpayer must recoup a history of losses. This line of cases is sometimes discussed in the context of an analysis of the amount of occasional profits (Factor 7) or an analysis of the appreciation potential of land or other assets used in the activity (Factor 4).

***Factor 7: Amount of Occasional Profits*.** The seventh factor suggests that a taxpayer may demonstrate a profit motive if his or her occasional profits are large, or if he or she has an opportunity to earn a substantial ultimate profit—even in a highly speculative venture. Treas. Reg. § 1.183-2(b)(7). Similarly, a taxpayer who demonstrates that his or her expectation of ultimate profit outweighs his or her cumulative losses is likely to establish a profit motive. *Eisenman v. Comm'r,* 56 T.C.M. 330 (1988) (potential ultimate profit from horse breeding activity outweighed loss history).

In *Helmick v. Comm'r,* TC Memo 2009-220, the taxpayers had a 17-year string of losses in their equestrian activities. At one juncture, the taxpayers were involved in a zoning dispute over their land and equestrian operations. In 1997, after winning the zoning lawsuit, they significantly started expanding their equestrian operations as a means of lowering their costs and improving profitability.

In analyzing the IRS's position, the Tax Court stated that the IRS "seems to assume that the requisite profit motive as of any given year must involve an expectation that even all past losses will be recouped, so that the activity will have generated a net profit over its entire course. *This position distorts the notion of profit motive for purposes of section 183.*" *Helmick v. Comm'r,* TC Memo 2009-220 at 1651 (emphasis added).

After making this statement, the Tax Court used the following insightful example to provide additional clarity and nuance:

"If a natural disaster caused the death of 90 percent of a rancher's herd and resulted in a catastrophic loss that could never be recouped, but the rancher thereafter expected to generate an overall prospective profit by breeding and selling the remaining portion of his herd . . .then he could not be said to lack a profit objective merely because he could never recoup the prior loss." *Id.* at 1652.

Turning to the facts of the Helmick dispute, the Tax Court then stated that "even assuming arguendo that even if the Helmicks could never recoup their losses from years prior to 1997 [the year in which they significantly started expanding their equestrian operations as the result of winning the zoning dispute], then they cannot be said to lack a profit objective with respect to those later years merely because they could never recoup their losses from years prior to 1997." *Id.* at 1652.

In this manner, the Tax Court did away with the notion that taxpayers must recoup all prior losses because it recognized that recouping all prior losses might not be possible in some circumstances and could lead to absurd results.

Rather, it reframed the loss recoupment concept in a forward-looking manner, stating that taxpayers meet their burden "as to any year for which they show that they expected to eventually recoup losses sustained in the 'intervening years' between the current year and the hoped-for profitable future." *Id.* Thus, the appropriate test is "whether the Helmicks expected their horse activity to generate an overall profit between that year and the time at which future profits were expected." *Id.*

In this manner, the Tax Court reframed the loss recoupment concept. Rather than a backwards-focused test that looks at whether a taxpayer could ever recoup all prior losses, the appropriate test is forward-looking and focuses on whether, as to each relevant year, the net earnings and appreciation are sufficient to recoup the losses sustained in the "intervening years" between a given tax year and the future year in which profits are expected. *See id.* at 1651; *see also Metz v. Comm'r*, TC Memo 2015-54 (affirming the forward-looking approach from *Helmick* and determining that, with respect to Factor 6, a taxpayer with a history of $20 million of losses still had a requisite profit motive, such that Factor 6 (history of profits or losses) was "neutral").

***Factor 8: Financial Status of the Taxpayer*.** The fact that the taxpayer does not have substantial income or capital from another source may indicate that the activity is entered into for profit. *See* Treas. Reg. § 1.183-2(b)(8). Substantial income from other sources (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit, particularly where personal or recreational elements are involved. *Id.*

The legislative history cites "the case of a poor person engaged in what appears to be an inefficient farming operation" as an example of full-time activity that should not be subject to the gross income limits of Code Section 183. *See* S. Rep. No. 552, 91st Cong., 1st Sess. 102-105 (1969).

What constitutes "substantial income" is not clearly defined. In *Ellis v. Comm'r*, TC Memo 1984-50, the Tax Court stated that the "concurrent existence" of other income merely raises the question, but does not answer it. In *Engdahl v. Comm'r*, 72 T.C. 659 (1979), the Tax Court was satisfied that a wealthy retired orthodontist nevertheless engaged in horse breeding for profit. The court actually criticized the idea that a loss should be denied simply because it could offset other income, stating that there would be no issue if the taxpayer had no other income. So long as tax rates are less than 100 percent, the court reasoned, there is no benefit in losing money. *See id.*

***Factor 9: Elements of Personal Satisfaction or Recreation*.** Elements of personal recreation, satisfaction or similar motives present in the activity may indicate that the activity is not engaged in for profit. *See* Treas. Reg. § 1.183-2(b)(9). Conversely, a profit motive may be indicated if the activity lacks any appeal other than profit. *Id.*

There is significant nuance in the appropriate application of this factor. A taxpayer may have personal motivations for engaging in an activity other than solely to make a profit and not be deemed to lack a profit motive. *Id.* Likewise, a taxpayer will not be deemed to lack a profit motive merely because the taxpayer derives personal pleasure from the activity when the activity is, in fact, engaged in for profit as evidenced by other factors. *Id.*

Farming and animal breeding activities are often difficult to analyze under these criteria because many taxpayers are often motivated in part by personal enjoyment involving working with animals. Several cases and examples from the Treasury Regulations shed some light on this factor:

- Taxpayers who enjoy living on a farm rather than the business of farming, or who raise and show animals more for the social "prestige" and the attendant social and recreational activities rather than the profit potential run the risk of failing this factor. *See* Reg. § 1.183-2 (c), Examples 1 and 3.
- In *Prieto v. Comm'r,* TC Memo 2001-266, a physician's family was heavily involved in training horses because the mother and two daughters were very interested in horses. The activity started when the daughters were in school, but the activity terminated as soon as the girls left the house for college. The court found that the taxpayers derived "substantial amounts of pleasure" from the horse activity and concluded that this factor weighed against the taxpayers.

- In *Engdahl*, the Tax Court noted that, although the taxpayers received personal pleasure and recreational benefits from their equestrian activities, they did the "unpleasant work" themselves—caring for the animals, cleaning stalls, and maintaining the facilities. *Engdahl,* 72 T.C. at 670-71.

Two Recent Oregon Decisions

Two hobby-loss cases were recently adjudicated before the Magistrate Division of the Oregon Tax Court. If anything, these cases illustrate that the hobby-loss issue is still a matter that taxpayers and their advisers need to keep their eyes on as the issue remains ripe for dispute.

Propst et. al. v. Oregon Department of Revenue

The first case, *Propst et. al.,* v. *Oregon Department of Revenue*, ORTC No. TC – MD 240002R (March 25, 2025), is a bit unique as the activity at issue was not one of the traditional activities that one would normally think would garner the hobby-loss scrutiny of the tax authorities.

In *Propst*, taxpayers, husband and wife, operated a snow removal activity. The ODOR challenged the taxpayers' deduction of expenses under Code Section 162 on the grounds that the activity was not entered into for profit and thus under Code Section 183 was subject to the hobby-loss rules. Additionally, the ODOR asserted, regardless of the application of Code Section 183, that the taxpayers did not have the requisite substantiation to deduct expenses under Code Section 162.

The facts of the case are interesting. The husband worked as a crane operator for more than 40 years. Upon retirement, he purchased an existing snow removal business. Anticipating that he could grow the business, he purchased additional equipment, aggregating approximately $650,000 in equipment. Mr. Propst grew the business from 40 customers at the time of purchase to roughly 135 customers at the time of trial.

In this not-so-glamorous business, Mr. Propst put in eight-and-a-half-hour grueling days during the winter season. Gross annual revenues ranged from $50,000 to $80,000. Mrs. Propst, who has a bachelor's degree in business administration and a master's degree in counseling, managed the bookkeeping function of the business. Initially, the business had no separate bank account or credit card but obtained both shortly before the audit. There was no formal business plan, and no financial forecasting was ever undertaken. The Propsts did not maintain complete business records and failed keep their personal expenses separate and apart from business expenses.

In analyzing the case, the Oregon Tax Court proclaimed three core principles of Oregon law applicable to the case: (i) in general, the Oregon personal tax laws mirror the Internal Revenue Code and the regulations promulgated thereunder; (ii) the party seeking affirmative relief has the burden of proof by a preponderance of the evidence; and (iii) the person claiming allowable deductions bears the burden of substantiating the deduction.

With respect to the hobby-loss issue, the court looked at the nine factors discussed above. It ultimately concluded, despite several years of losses, that the taxpayers entered into the activity with the intent to make a profit. Therefore, Code Section 183 is inapplicable. It stated:

Plaintiffs provided persuasive testimony that Steven operated his snowplowing business professionally, working long hours and in harsh winter conditions. Steven had been a successful equipment operator for over 40 years, a profession with heavy maintenance work needed similar to snow removal activities. Plaintiffs demonstrated that the machinery used in the snowplow business was expected to increase in value with proper maintenance. The evidence confirms that Steven invested significant time and money in maintaining his equipment. Additionally, Plaintiffs recounted receiving an offer to purchase the business and one snow blower for $450,000, supporting their expectation of increased value.

Although Plaintiffs incurred many years of net business losses, they credibly explained that these losses resulted from reinvesting revenue into equipment. In later years, reinvestment declined, and net profits increased. While Steven acknowledged that he enjoyed the work, this is not disqualifying; many people enjoy their jobs. Ultimately, the court is persuaded that Plaintiffs engaged in the snow removal business with a genuine intent to make a profit. Therefore, the court allows the expenses stipulated by the parties and must now consider the disputed expenses.

Unfortunately, the Propsts failed to produce itemized receipts to support all of the business expenses. Many of the expenses, such as telephone bills, fuel receipts, vehicle maintenance and repair receipts, and credit card statements were intertwined with personal expenses, making it difficult, if not impossible, to distinguish between business and personal expenses. Accordingly, many of the expenses they claimed as business related were denied.

The moral to the story is simple – keeping separate and reasonably detailed records of business expenses is required!

Houston Vineyards, Inc. v. Oregon Department of Revenue

The second case, *Houston Vineyards, Inc. v. Oregon Department of Revenue*, ORTC No. TC – MD 220486G (March 24, 2025), involved an activity that we generally think of being vulnerable to a hobby-loss inquiry by the taxing authorities when losses are incurred on a multi-year basis – the operation of a vineyard.

For over 40 years, the taxpayer owned and operated a vineyard on 20 acres of land in Oregon. Steve Houston and Doris Roberts live in a home located on the vineyard property. While the court ruling was not totally clear, it appears that the home and the property are owned by Mr. Houston and Ms. Roberts outside of the corporation.

Mr. Houston has substantial experience in the wine growing activity and has a college degree in agriculture. He began working full time at the vineyard upon retirement from a job with a railroad. The corporation has a written business plan. Recordkeeping, however, is poor. The corporation may have tracked expenses, but it did not track revenue (i.e., losses). The corporation sustained losses averaging over $100,000 per year from 2010 to 2021, and there are no signs of improvement or visible steps taken to achieve profitability.

Mr. Houston testified at trial that the gain from the ultimate sale of the property at retirement would make up for the losses. However, most of the potential gain from the property (which appears to be owned outside of the corporation) is in the value of the personal residence located on the property rather than the vineyard itself. On that issue, the court concluded, citing Treas. Reg. § 1.183-1(d), in this instance the farming and the holding of the land are two distinct activities, and that the land's appreciation cannot be weighed against the farming losses. If the farming activities, however, were the cause of the increase in the land's value, such appreciation would be considered. Again, in the instant case, it appears the increase in the value of the land is due to the non-farming improvements on the property (i.e., the personal residence); not the farming improvements (i.e., the vineyard).

After reviewing the nine factors discussed above, the court ultimately concluded that the long record of losses, with no sign of improvement or effort to improve the economics and the lack of recordkeeping, pointed to a lack of intent to engage in the activity for profit. The plaintiffs were unable to present evidence to overcome that conclusion. Accordingly, the losses were disallowed under Code Section 183.

Conclusion

The saga of the taxpayers in these two state tax court cases may not be over. In Oregon, the losing party has a direct appeal right to the Oregon Supreme Court. Nevertheless, even though hobby-loss disputes with taxing authorities have existed for decades, it is clear from these cases that the battles continue to rage today.

For taxpayers and tax advisers that have clients with sustained business losses, a good review of the hobby-loss rules is in order. It is not just the Internal Revenue Service that may be on the prowl. As illustrated by the *Propst* and *Houston* cases, the state departments of revenue in jurisdictions that have an income tax may also be on the attack.

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[i] *Houston Vineyards, Inc. v. Oregon Department of Revenue*, ORTC No. TC – MD 220486G (March 24, 2025); and *Propst et. al.,* v. *Oregon Department of Revenue*, ORTC No. TC – MD 240002R (March 25, 2025).

Tags: Code Section 183, hobby loss rules, income tax, Oregon, Oregon Department of Revenue, Oregon Tax Court, Taxpayer