

Horse Breeding Was a Hobby Despite Expertise of Taxpayers

Cross References

- *Schumacher*, TC Memo 2026-47

The taxpayers lived on a 50-acre parcel of land. They owned horses for many years, culminating an interest in breeding and raising horses. The taxpayers reported losses for each year at issue in this case from their horse breeding activity on Schedule F, while reporting significant income from W-2 wages and nonpassive passthrough income on Schedule E from other sources of income. The IRS disallowed the losses reported on Schedule F under IRC section 183, claiming the activity was not operated with the intent to make a profit. The Tax Court applied the nine factors listed in the Treasury Regulations to determine whether the taxpayers operated their horse breeding activity for profit.

1) Manner in which the taxpayers conducted the activity. Carrying on an activity in a business-like manner indicates a profit motive. Maintaining complete and accurate books and records, conducting the activity in a manner substantially like comparable businesses which are profitable, and making changes in operations to improve profitability suggest that a taxpayer conducted an activity for profit.

The taxpayers failed to keep complete and accurate records. Though they kept handwritten notes and some receipts, they did so for tax reporting and not for profit-making purposes. They did maintain a separate business checking account for the activity. However, the court stated it functioned as an extension of their personal checking account. Many horse-related expenses were paid from their personal checking account. When the business account ran low, the taxpayers replenished it from their personal checking account.

The taxpayers had no written business plan. Any changes they made to their operation benefited their success in horse competitions that had no correlative increase in profitability. There is no indication that they attempted to reduce their expenses to increase profits in any of the years at issue.

The court stated this factor favors the IRS.

2) The taxpayer's expertise. Efforts to gain experience, a willingness to follow expert advice, and preparation for an activity by extensive study of its practices may indicate that a taxpayer has a profit motive.

Both of the taxpayers have extensive experience training horses before establishing their horse breeding activity. The husband had been around horses from a young age and has owned horses for most of his entire adult life. He is a licensed veterinarian and has practiced veterinary medicine since 1986. In 2019, he enrolled in the 12-week Clinton Anderson Method Ambassador horse training course. And he regularly discussed horse breeding with other breeders at horse shows and competitions.

The wife has also been exposed to horses from a young age. She has competed in barrel racing, roping, and showing events. She likewise has trained horses. It was her responsibility to feed the horses and take them trail riding.

The court stated this factor favors the taxpayers.

3) The taxpayer's time and effort. The taxpayer's devotion of much of his or her personal time and effort to carrying on an activity may indicate a profit motive, particularly if the activity does not involve substantial personal or recreational enjoyment.

Despite their demanding professional and family obligations, the taxpayers still devoted substantial time to their activity. The husband spent two to four hours each day training and caring for the horses, while the wife devoted substantially more time. Their construction of a hoop barn supports the taxpayer's contention that they performed these activities consistently throughout the year.

The court stated this factor favors the taxpayers.

4) Expectation that property used in the activity would appreciate in value. A taxpayer may intend to make an overall profit when he or she expects appreciation in the value of assets used in the activity to exceed losses.

Other than a headcount estimate during the trial, the taxpayers provided no evidence of their horse inventory during the years at issue or that they even recorded such information. As a result, the court stated it had no way of determining the herd's value at that time or what its future value might have been.

The court stated this factor favors the IRS.

5) The taxpayer's success in other activities. The fact that a taxpayer has previously and profitably engaged in similar activities may show that the taxpayer has a profit objective. The taxpayers have been successful in other ventures, including the husband's veterinary practice, but none bears a similarity to their horse breeding activity.

The court stated this factor is neutral.

6) The taxpayer's history of income or losses. A history of substantial losses may indicate that the taxpayer did not conduct the activity for profit. However, losses during the startup period of an activity do not necessarily indicate that it is not conducted for profit.

The taxpayers began their horse breeding activity in 2001, and it has not turned a profit since its inception. The activity experienced net losses ranging from \$51,028 to \$210,148 between 2010 and 2019. Their history of continuous and significant losses indicates a lack of a profit motive.

The court stated this factor favors the IRS.

7) Amounts of occasional profits, if any. The amounts of occasional profits the taxpayer earned from the activity may show that the taxpayer had a profit motive. The taxpayer's horse breeding activity has never turned a profit since its inception in 2001, a trend that continued through the years at issue.

The court stated this factor favors the IRS.

8) The taxpayer's financial status. The receipt of a substantial amount of income from sources other than the activity may indicate the taxpayer does not intend to conduct the activity for profit. The taxpayers reported substantial income from sources other than their horse breeding activity during the years at issue. This suggests they had the ability to absorb the losses and would benefit from them insofar as they sheltered income from other sources.

The court stated this factor favors the IRS.

9) Elements of personal pleasure. The presence of recreational or personal motives in conducting an activity may indicate that the taxpayer is not conducting the activity for profit. However, a taxpayer's enjoyment of an activity does not show that the taxpayer lacks a profit objective if the activity is conducted for profit as shown by other factors.

The taxpayers derived substantial pleasure from breeding, raising, training, racing, and showing horses. The court stated their review of the other factors indicates the taxpayers did not have a profit motive.

The court stated this factor favors the IRS.

Conclusion. Of the nine factors listed in the Treasury Regulations, six favor the IRS, two favor the taxpayers, and one is neutral. After consideration of these factors and the facts and circumstances of this case, the court ruled the taxpayers did not have an actual and honest objective to operate their horse breeding activity for profit during the years at issue.