



1 Trawler for \$160,000. Appellant began investigating yacht charter management companies and  
2 eventually contacted Southwest Florida Yachts, Inc., ("SFY"). SFY provided management, marketing,  
3 chartering and maintenance services to the owners of boats placed in its charter. SFY also acted as a  
4 broker for the buying and selling of yachts, including the one purchased by Appellant. Appellant  
5 ultimately placed his yacht in charter with SFY. Appellant incurred net losses in the years 1997 and 1998  
6 in the amounts of \$28,925 and \$24,275 respectively. Even so, he purchased a second boat, a 1979, 32  
7 ft. yacht which, he also placed in charter with SFY.

#### 8 DISCUSSION

9 The issue before the Board is whether the Department properly disallowed the deductions  
10 claimed.

11 "[T]ax deductions, subtractions, exemptions, and credits are to be strictly construed" against a  
12 taxpayer. *Arizona Dep't of Rev. v. Raby*, 204 Ariz. 509, 522, 65 P.3d 458, 460 (App. 2003) (citing *Ebasco*  
13 *Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P. 719, 724 (1969)).

14 IRC § 162(a) provides, in pertinent part, that "[t]here shall be allowed as a deduction all the  
15 ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or  
16 business . . . ." However, in order for business expenses to be deductible in excess of gross income from  
17 an activity, a taxpayer must have conducted the activity with the intent to make a profit. See IRC §  
18 183(a); see also *Elliott v. Commissioner*, 90 T.C. 960 (1988), aff'd. 899 F.2d 18 (9<sup>th</sup> Cir. 1990). In fact, a  
19 taxpayer's **primary purpose** for engaging in the activity must be for income or profit." *Commissioner v.*  
20 *Groetzinger*, 480 U.S. 23, 35 (1987) (emphasis added).

21 Appellant contends that he DID engage in the activity at issue with the intent of making a profit.  
22 However, "[t]he determination of whether an activity is engaged in for profit is to be made by reference to  
23 objective standards, taking into account all of the facts and circumstances of each case." Treas. Reg. §  
24

1 1.183-2(a). “[G]reater weight is given to objective facts than to the taxpayer’s mere statement of his  
2 intent.” Treas. Reg. § 1.183-2(a). Among the factors that should normally be taken into account are: 1)  
3 the manner in which the taxpayer carries on the activity, 2) the expertise of the taxpayer or his advisors,  
4 3) the time and effort expended by the taxpayer in carrying on the activity, 4) the expectation that assets  
5 used in the activity may appreciate in value, 5) the success of the taxpayer in carrying on other similar or  
6 dissimilar activities, 6) the taxpayer’s history of income or losses with respect to the activity, 7) the amount  
7 of occasional profits, if any, which are earned, 8) the financial status of the taxpayer, and 9) the elements  
8 of personal pleasure or recreation involved in the activity. See Treas. Reg. § 1.183-2(b)

9 A number of factors indicate that Appellant’s primary purpose for engaging in the activity at  
10 question was not for profit. Appellant’s testimony confirms that he has an interest in boats and was first  
11 motivated to purchase one for his own personal use. He had no previous experience chartering boats or  
12 history of success operating any kind of business. There is no evidence that Appellant developed a formal  
13 business plan prior to placing his boats in charter, or that he adequately maintained typical business  
14 records. Even after incurring losses of \$28,925 and \$24,275 in the years 1997 and 1998 respectively,  
15 Appellant purchased a second yacht. Appellant indicates that he relied on advice from SFY before  
16 placing his boats in charter, but the commissions and fees received by SFY from Appellant’s chartering  
17 activities creates a clear conflict of interest that renders such reliance unreasonable. See *Magassy v.*  
18 *Commissioner*, T.C. Memo. 2004-4, 87 T.C.M (CCH) 791 (U.S. Tax Ct. 2004). Finally, Appellant was  
19 employed full time and does not appear to have relied on income from chartering activities for his  
20 economic sustenance. However, the most compelling factors in determining whether Appellant engaged  
21 in boat-chartering activities primarily for a profit motive are those involving the losses at issue.

22 IRC § 183 (d) provides the following presumption:

23 “If the gross income derived from an activity for 3 or more of the taxable years in  
24 the period of 5 consecutive taxable years which ends with the taxable year exceeds the  
25 deductions attributable to such activity (determined without regard to whether or not such

1 activity is engaged in for profit), then, . . . such activity shall be presumed for purposes of  
2 this chapter for such taxable year to be an activity engaged in for profit."

3 On the other hand, as provided, in part, under Treas. Reg. § 1.183-2(b)(6), while

4 "[a] series of losses during the initial or start-up stage of an activity may not necessarily be an  
5 indication that the activity is not engaged in for profit . . . where losses continue to be sustained beyond  
6 the period which customarily is necessary to bring the operation to profitable status such continued  
7 losses, if not explainable, as due to customary business risks or reverses, may be indicative that the  
8 activity is not being engaged in for profit."

9 Appellant did not make a profit at any time up to and including the year at issue. In the first six  
10 years, Appellant reported cumulative losses totaling \$366,889. SFY charged Appellant \$70,906 for  
11 repairs and maintenance on the two boats during 2002. When combined with the \$64,023 of  
12 commissions and fees charged by Southwest Florida Yachts, Inc. that year, the amounts paid to SFY  
13 alone, exceeded Appellant's 2002 revenue by \$25,984. This was before any depreciation or other  
14 expenses were taken into account. Under the circumstances, the likelihood of Appellant ever making a  
15 profit was minimal.

16 Given Appellant's continued significant losses, the evidence indicates that Appellant did not  
17 engage in this activity with the *primary* objective of making a profit. However, the losses generated by  
18 Appellant's activities generated substantial tax benefits. The \$83,187 in related losses for 2002 was used  
19 to offset a significant portion of Appellant' wage income of \$142, 399.50. SFY noted such tax benefits on  
20 its website, stating that there are "tax advantages associated with charter yacht ownership, including  
21 deferral of state sales tax on purchase, and deductions for operating expenses, depreciation, and interest  
22 against your charter revenue. See [http://www.swfyachts.com/webpages/ introduction.htm](http://www.swfyachts.com/webpages/introduction.htm). "Chartering a  
23 yacht to others in order to afford to keep it through tax savings for one's personal enjoyment is not the  
24 same as having a profit objective." *Antonides v. Commissioner*, 91 T.C. 686, 697 (1988), aff'd. 893 F.2d  
25 656 (4<sup>th</sup> Cir. 1990).

1 For the reasons set forth above, the Board finds that Appellant did not engage in the activities at  
2 issue primarily for a profit motive. Therefore, the Department properly disallowed the losses claimed, and  
3 Appellant is liable for the tax assessed. Further, A.R.S. § 42-1123 provides that if the tax "or any portion  
4 of the tax is not paid" when due "the department shall collect, as a part of the tax, interest on the unpaid  
5 amount" until the tax has been paid. Therefore, Appellant is liable for the interest assessed.

6 CONCLUSIONS OF LAW

- 7 1. Appellant is liable for the tax assessed. A.R.S. § 43-102(A)(1) and (4).  
8 2. Because the interest is a part of the tax, it may not be abated. A.R.S. § 42-1123.

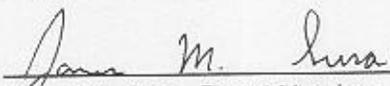
9 ORDER

10 THEREFORE, IT IS HEREBY ORDERED that the appeal is denied and the final order of the  
11 Department is affirmed.

12 This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer,  
13 unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

14 DATED this 13<sup>TH</sup> day of APRIL, 2010.

15 STATE BOARD OF TAX APPEALS

16   
17 James M. Susa, Board Member

18  
19 JMS:ALW

20 CERTIFIED

21 Copies of the foregoing  
Mailed or delivered to:

22 Scot G. Teasdale  
23 Assistant Attorney General  
Civil Division, Tax Section  
24 1275 West Washington Street  
Phoenix, Arizona 85007

Robert H. Feldman  
3550 N. Central Avenue, Suite 1500  
Phoenix, Arizona 85012

1

2

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25