UNITED STATES TAX COURT

MILES RAYMOND and MAYA RAYMOND,	)	
Petitioners,	)	
	)	Docket No. 24680-15
v.	)	
	)	Filed Electronically
COMMISSIONER OF THE INTERNAL REVENUE SERVICE	)	
Respondent.	)	

PRETRIAL MEMORANDUM FOR PETITIONER

Trial Calendar: Houston, Texas
Date: March 6, 2015

NAME OF CASE: | **DOCKET NO.**

MILES AND MAYA RAYMOND, v. COMMISSIONER OF INTERNAL REVENUE | 24680-15

ATTORNEYS:

Petitioners:
Elliot McCardle
(281) 900-9186

Respondent:
William Wilkins
(202) 317-3300

AMOUNTS IN DISPUTE:

Year	Deficiency	I.R.C. § 6662(a) Penalty
2008	$150,127.00	$30,025.40
2009	$172,490.00	$34,498.00
2010	$206,386.00	$41,277.20
2011	$210,550.00	$42,110.00

STATUS OF CASE:

Probable Settlement __ Probable Trial __ Definite Trial _X_

CURRENT ESTIMATE OF TRIAL TIME: 3 hours

STATUS OF STIPULATION OF FACTS: Completed _X_ In Process __

The parties have completed the process of preparing the stipulation of facts.

ISSUES

1. Whether petitioner was engaged in the vineyard activity (as reported on his Schedule C) for profit pursuant to I.R.C. § 183.

2. Whether petitioner is entitled to deduct ordinary losses claimed with respect to that activity in the amounts of $125,952, $147,262, $181,158 and $185,322 in tax years 2008, 2009, 2010 and 2011, respectively.

3. Whether petitioner is entitled to deduct depreciation expenses with respect to that activity in the amounts of $24,175, $25,228, $25,228 and $25,228 in tax years 2008, 2009, 2010 and 2011, respectively.

4. Whether petitioner is liable for the accuracy related penalty under I.R.C. § 6662(a), in the amounts of $30,025.40, $34,498.00, $41,277.20 and $42,110.00 for tax years 2008, 2009, 2010 and 2011, respectively.

WITNESSES PETITIONER EXPECTS TO CALL

1. Miles Raymond.

2. Maya Raymond.

3. Jack Lopate.

4. Petitioner reserves the right to call any other witnesses called by the respondent.

5. Petitioner further reserves the right to call any witnesses whose testimony becomes relevant as a result of the petitioner's examination of documents produced or testimony provided by respondent after the date of this memorandum.

SUMMARY OF FACTS

During the years 2008, 2009, 2010 and 2011, Mr. Raymond operated a vineyard with two others, Maya Raymond (spouse) and Jack Lopate, under the business name of "Miles and Jack Vineyards, Inc." hereafter "Vineyard". Vineyard was formed in 2006 as an S Corporation domiciled in California. Each partner held equal interests in Vineyard.

In 2006, Vineyard purchased unimproved land in the Santa Ynez Valley upon which it planned to conduct winemaking activities. Over the years, Vineyard constructed several buildings, a wine cave and roads necessary to Vineyard's operations. Additionally, Vineyard planted vines over two-acres of the property.

Petitioner has been actively engaged in Vineyard operations. His involvement includes activities such as overseeing construction efforts, marketing of wine products and meetings with industry experts, among other things. At all times, petitioner has maintained a business plan, which includes plans for a future expansion on winemaking capabilities.

Petitioners claimed losses relating to their Schedule C activity in the amounts of $125,952.00, $147,262.00, $181,158.00 and $185,322.00 in the taxable years 2008, 2009, 2010 and 2011, respectively. Additionally, petitioner has claimed amounts equaling $24,175.00, $25,228.00, $25,228.00 and $25,228.00 for depreciation expenses in the taxable years 2008, 2009, 2010 and 2011, respectively. The respondent has disallowed all of these amounts.

As a result of the disallowances, the respondent has assessed petitioner with accuracy-related penalties equaling $30,025.40, $34,498.00, $41,277.20 and $42,110.00 for the taxable years 2008, 2009, 2010 and 2011, respectively.

BRIEF SYNOPSIS OF LEGAL AUTHORITIES

Burden of Proof

The examination commenced in this case after July 22, 1998, which is the effective date of I.R.C. § 7491. Therefore, I.R.C. § 7491 is applicable to this case. Under I.R.C. § 7491, the petitioner has the burden of proof with respect to the deficiency in income tax for the tax years 2008, 2009, 2010 and 2011, related to the I.R.C. § 183 issue. Welch v. Helvering, 290 U.S. 111 (1933); Reese V. Commissioner, 615 F.2d 226, 233 (5th Cir. 1980); Pham v. Commissioner, T.C. Memo. 2002-101; T.C. Rule 142(a). The petitioner can meet his burden of proof with evidence, and has maintained adequate records to substantiate claimed expenses. See Wood Corporation of Delaware v. Commissioner, 63 F.2d 1023 (6th Cir. 1933); I.R.C. § 6001.

Under I.R.C. § 7491(c), the respondent has the evidentiary burden of production with respect to the additions to tax because the examination in this case was begun after July 22, 1998. Petitioner has provided credible evidence to justify all positions taken on his Schedule C.

Issue 1. Whether Petitioner's Schedule C Activity Relating to the Vineyard Was "For Profit"

Respondent's determination is generally presumed correct. T.C. Rule 142(a); Welch v. Helvering, 290 U.S. 111 (1933); Elliott v. Commissioner, 90 T.C. 960, 971 (1988). Taxpayers have no inherent right to deductions; they are matters of legislative

grace. Interstate Transit Lines v. Commissioner, 319 U.S. 590, 593 (1943); New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934). As a result, taxpayers must substantiate any deductions claimed, and they must keep records sufficient to establish their entitlement to the deductions. I.R.C. § 6001; Treas. Reg. § 31.6001-1(a); Hradesky v. Commissioner, 65 T.C. 87, 90 (1975), aff'd per curiam 540 F.2d 821 (5th Cir. 1976).

Section 183 provides that, if an activity is not engaged in for profit, then no deduction attributable to the activity shall be allowed except to the extent of gross income derived from an activity. I.R.C. § 183(a), (b). Section 183(c) defines an activity not engaged in for profit as any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212. Deductions are allowable under section 162 or under section 212 (1) or (2) if the taxpayer is engaged in the activity with the actual and honest objective of making a profit. Ronnen v. Commissioner, 90 T.C. 74, 91 (1988); Dreicer v. Commissioner, 78 T.C. 642, 645 (1982), aff'd without op., 702 F.2d 1205 (D.C. Cir. 1983).

The existence of the requisite profit objective is a question of fact that must be decided on the basis of the entire record. See Benz v. Commissioner, 63 T.C. 375, 382 (1974). In resolving this factual question, greater weight is accorded objective facts than a taxpayer's statement of intent. See Westbrook v. Commissioner, 68 F.3d 868, 875-876 (5th Cir. 1995), aff'g T.C. Memo. 1993-634; Treas. Reg. § 1.183-2(a). For purposes of deciding whether the taxpayer has the requisite profit objective, profit means economic profit, independent of tax savings. See Surloff v. Commissioner, 81 T.C. 210, 233 (1983).

The regulations set forth a non-exhaustive list of factors that may be considered in deciding whether a profit objective exists. These 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 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, which are earned; (8) the financial status of the taxpayer; and (9) any elements indicating personal pleasure or recreation. See Treas. Reg. § 1.183-2(b).

No single factor, nor even the existence of a majority of factors favoring or disfavoring the existence of a profit objective, is controlling. See id. Rather, the relevant facts and circumstances of the case are determinative. See Golanty v. Commissioner, 72 T.C. 411, 426 (1979), aff'd without published op., 647 F.2d 170 (9th Cir. 1981). After application of the factors to this case, it is strikingly apparent that petitioners had the requisite profit motive during all tax years at issue.

A. Manner in Which Petitioner Carries On the Activity

The fact that a taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate a profit objective. Treas. Reg. § 1.183-2(b)(1). During the tax years at issue, petitioners had a business plan for the vineyard activity. The fact that the plan itself is not in written form is not pivotal in weighing application of this factor. See Phillips v. Commissioner, T.C. Memo 1997–128 (holding that a business plan need not be in written form and can be evidenced by the taxpayer's actions).

Since the initial land purchase, the petitioners have taken actions consistent with a winemaking business. These actions include, but are not limited to, the following: 1)

formation of a valid S Corporation, 2) development of a marketing plan for the product, and 3) consultation with other industry leaders on vineyard operations.

All of these facts support a conclusion that this factor weighs in favor of the petitioner that the activity is engaged in for profit.

B. Expertise of Petitioner and His Advisers

A taxpayer's expertise, research, and study of an activity, as well as his consultation with experts, may be indicative of a profit intent. Treas. Reg. § 1.183-2(b)(2). Petitioners have a vast knowledge of fine wines built upon his years as an oenophile. In addition to the petitioner's personal knowledge, a vineyard management company, Stephanie's Vineyard Management Company, was hired to provide expert advice on the vineyard's operations. These facts weigh strongly in favor of the activity as one engaged in for profit.

C. Time and Effort Expended by Petitioner

The fact that the taxpayer devotes much of his personal time and effort to carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate an intention to derive a profit. Treas. Reg. § 1.183-2(b)(3). Petitioner has devoted a substantial amount of time and effort to the activity. He travels to the vineyard for at least three weeks each month in order to oversee vineyard operations. A taxpayer's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. Id. Prior to beginning the vineyard, petitioner had a career as a teacher, author and a rental property owner. Since beginning the vineyard, the vast majority of his time is spent at the

vineyard, which takes away from the other activities. As such, this factor strongly favors the petitioner that the activity is engaged in with a profit motive.

D. Appreciation of Assets

The term profit encompasses appreciation in the value of assets, such as land, used in the activity. Treas. Reg. § 1.183-2(b)(4). The petitioner purchased unimproved land in Santa Ynez valley. Since the original purchase, the petitioner has made several improvements to the land. It is highly likely that the land has (and will further) appreciate in value. Accordingly, this factor weighs in favor of the petitioner and supports a finding that the petitioner has the requisite profit motive for the activity.

E. Success of Petitioner in Carrying On Other Activities

The fact that the taxpayer has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may indicate that he is engaged in the present activity for profit, even though the activity is presently unprofitable. Treas. Reg. § 1.183-2(b)(5). Petitioner is a successful businessperson. The court has recognized that a taxpayer's success in other business activities may indicate a profit objective. Schwartz v. Commissioner, T.C. Memo 2003-86 (T.C. 2003). Petitioner has had prior successes in business in regards to his rental activities. While those activities are dissimilar to a vineyard, that fact alone is not dispositive. See Hoyle v. Commissioner, T.C. Memo 1994-592 (holding that a dissimilar activity is relevant to the extent it measures petitioner's willingness to take risks and his devotion to nurturing a new endeavor). Here, the same may be said of petitioner’s devotion to the vineyard. Correspondingly, this factor weighs in favor of the petitioner in finding that the activity was engaged in for profit.

F. History of Income or Losses

Petitioner concedes that he has sustained several years of losses. However, 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(b)(5). On several occasions, the Tax Court has held that extended periods have not precluded an activity as having a profit motive. See Engdahl v. Commissioner, 72 T.C. 659 (holding that an twelve years of losses did not preclude taxpayer's horse-breeding activity from having a profit motive); See Allen v. Commissioner, 72 T.C. 28 (1979) (holding that losses for eleven years in a ski lodge did not preclude activity from having a profit motive). While the vineyard has not been profitable to date, petitioner has taken steps to ensure the future profitability of the business venture. The fact that he has had losses in the first several years does not disprove a profit motive for petitioner and as such, this factor favors the petitioner.

In light of the factors just discussed, it is overwhelmingly apparent that the vineyard activity was one engaged in for profit during the tax years at issue. As such, the court should uphold the position of the petitioner.

Issue 2. Whether Petitioner is Entitled to Deduct Ordinary Losses as Reported on Petitioner's Schedule C.

I.R.C. § 162 provides in pertinent part that the ordinary and necessary expenses of carrying on a trade or business, that are paid or incurred in the taxable year, are deductible from gross income. I.R.C. § 162(a).

A. Trade or Business

Though, the term "trade or business" is not defined within the code or a regulation, focus generally falls upon specific factors in determining whether a trade or business is carried on. Commissioner v. Groetzinger, 480 U.S. 23 (1987).

First, the taxpayer must be actively involved in the activity with regularity. Gajewski v. Commissioner, 723 F.2d 1062, 1065 (2nd Cir. 1983). As noted above, petitioner is actively involved with the vineyard. He travels to the vineyard three weeks each month to carry on business activities, e.g. overseeing construction, various meetings with industry members, etc. Thus, the first requirement is met.

Second, the Service requires that the taxpayer have an expectation of a obtaining a profit from the activity. Bessenyey v. Commissioner, 379 F.2d 252, 255-56 (2nd Cir.), cert. denied, 389 U.S. 931, 88 S.Ct. 293, 19 L.Ed.2d 283 (1967). As discussed in detail above, the petitioner has a profit motive. Thus, the second requirement has been met.

B. Ordinary and Necessary

An expense is ordinary under section 162 if it bears a reasonably proximate relationship to the operation of the taxpayer's business, and is one that is common and accepted in a particular business activity. See Deputy v. du Pont, 308 U.S. 488, 495-496 (1940); Gill v. Commissioner, T.C. Memo. 1994-92, aff'd without published opinion, 76 F.3d 378 (6th Cir. 1996). An expense is necessary if it is helpful and appropriate in promoting and maintaining the taxpayer's business. Carbine v. Commissioner, 83 T.C. 356, 363 (1984), aff'd, 777 F.2d 662 (11th Cir. 1985).

Here, the petitioner has provided the Service with a log of expenses related to the vineyard operations titled "Analysis of Costs and Expenses;" which documents many of the claimed deductions. Additionally, petitioner has provided the Service with a

checkbook showing the actual payments for business expenses. All expenses were ordinary and necessary to the vineyard operations. As such, the court should uphold the determinations of the petitioner and allow all deductions.

Issue 3. Whether Petitioner is Entitled to Deduct Depreciation Expenses as Reported on Petitioner's Schedule C.

I.R.C. § 167 provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business, or of property held for the production of income. I.R.C. § 167(a). Petitioner claimed $24,175.00, $25,228.00, $25,228.00 and $25,228.00 for depreciation expenses in the taxable years 2008, 2009, 2010 and 2011, respectively. During examination, Petitioner provided a depreciation schedule, titled "Federal Depreciation Report for 4562", to the Service which claimed deductions for various assets (including buildings, equipment and the vineyard). These assets are exactly what is meant to be depreciated under section 167. Therefore, the Court should uphold the determinations of the petitioner and allow this deduction.

Issue 4. Whether Petitioner is Liable for the Accuracy Related Penalties Pursuant to I.R.C. § 6662(a)

I.R.C. § 6662(a) provides a penalty in an amount equal to 20 percent of the portion of the underpayment which is attributable to negligence, disregard of rules or regulations, or any substantial understatement of income tax. I.R.C. §§ 6662(b)(1) and (b)(2). The penalties asserted in this case are in the amount of $30,025.40, $34,498.00, $41,277.20 and $42,110.00 for the taxable years 2008, 2009, 2010 and 2011, respectively, in regard to the notice of deficiency.

Negligence is the lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances. Neely v. Commissioner, 85 T.C. 934, 947 (1985). Negligence includes a failure to make a reasonable attempt to comply with internal revenue laws or to exercise ordinary and reasonable care in preparing a tax return. I.R.C. § 6662(c).

The term "disregard" includes any careless, reckless, or intentional disregard. I.R.C. § 6662(c). The accuracy-related penalty does not apply to any part of an underpayment to the extent the taxpayer shows that he had reasonable cause and acted in good faith. I.R.C. § 6664(c)(1).

The petitioner has provided substantiation for the tax years at issue. See I.R.C. § 6001; Treas. Reg. § 1.6001-1(a). Further, the petitioner did what a reasonable and ordinarily prudent person would do under the circumstances. Neely v. Commissioner, 85 T.C. 934, 947 (1985); see also Diesel Country Truck Stop, Inc. v. Commissioner, T.C. Memo. 2000-317.

At trial, petitioner will provide evidence relieving them from liability for the penalty in this case based on its provided business records. See Varica v. Commissioner, 444 F.2d 770 (3rd Cir. 1971), aff'g on this point 52 T.C. 986 (1969). The petitioner can establish reasonable cause for the underpayments; should the Court find that they are liable for the accuracy-related penalty under section 6662(a) for the years 2008, 2009, 2010 and 2011.

Further, the petitioner is not liable for the penalty under section 6662(a) because the underpayment resulted from the good faith reliance on his return preparer. While reliance on advice may provide a defense, the petitioners must establish that the person

rendering the advice was competent to give that advice and that they provided him with accurate and complete information. See Freytag v. Commissioner, 89 T.C. 849, 888 (1987), aff'd 904 F.2d. 1011 (5th Cir. 1990), aff'd on other issues, 501 U.S. 868 (1991). Here, petitioner relied on information provided by his CPA, which the court should consider both accurate and competent.

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Date: March 15, 2015 By: Elliot W. McCardle

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CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing PRETRIAL MEMORANDUM FOR PETITIONER was served on each counsel for respondent by mailing the same to their counsel on _____ in a postage paid wrapper addressed as follows:

Attorney Name
123 Main Street
Houston, TX 77469

Date: March 15, 2015

_____
Attorney Name