Individual taxation research paper-arlene case

Facts * As a result of a bitter divorce, Arlene had no means of support. * Forced to lead a living for herself, she established a business (and LLC) that integrated equestrian activities with a home and barn design activity. * Arlene competed in horse shows and then contacted directly with potential clients at the shows. She didn't use advertising media. She used her knowledge of the idiosyncrasies of her client's horses to design home and barn for clients. * Arlene's overall business produced substantial profits in six of the seven years. For the loss year, the amount of the loss was small. Issues * Whether equestrian activity and design activity could be considered an integrated activity? * Was the integrated activity for profit? * Whether expenses related to equestrian activity should be considered personal expenses or expenses incurred in the integrated business? Conclusion Arlene's equestrian activity and home and barn design activity could be treated as a single integrated activity, and the single integrated activity was held for profit. Meanwhile, equestrian-related expenses should be considered expenses incurred in the integrated business rather than personal expenses. Therefore, Arlene's position of reporting two activities on a single Schedule C is correct. Rationale * The first issue to be addressed is whether equestrian and design undertakings could be considered a single integrated activity. Topping, Tracey, (2007) TC Memo 2007-92 has very similar facts with those for Arlene. This court case shows that " Equestrian was entitled for Code Sec. 183 purposes to treat loss-generating horse activity and profitable home and barn design business as single, profitable activity: although reported on separate Schedules C, activities were sufficiently interconnected organizationally and economically to be treated as single activity. " Between the equestrian and design undertakings, supported by the facts of this case, there was a close organizational and economic relationship. First, as a successful equestrian competitor, Arlene used her reputation in equestrian competition to attract clients and to create a good goodwill for her design activity. Second, she used her knowledge of the idiosyncrasies of each of her client's horses to help herself conduct design activity. All these show that equestrian activity contributed the success of design activity, so equestrian and design undertakings were interconnected and they could be considered an integrated activity. * In the integrated activity, one part was horse activity and one part was not. Ordinary activity is profit seeking if it shows profit 3 years out of 5, but horse activity is profit seeking if it shows profit 2 years out of 7 [See Section 183(d)]. The integrated activity produced substantial profits in six of seven years. Although the integrated activity had half-half characteristic, it should be considered profit seeking no matter based on the ordinary activity rule or the horse activity rule. Therefore, the integrated activity was an integrated business. * Equestrian activity was part of the integrated business and necessary to its success and building of client base [See Topping, Tracey, (2007) TC Memo 2007-92]. Therefore, equestrian-related expenses were not personal expense but necessary expenses in the integrated business. The equestrian-related expenses were also ordinary expenses to make sure the success of design business. The fact that the integrated business produced substantial profits in six of seven years shows that the equestrian-related expenses were reasonable. The ordinary, necessary and reasonable equestrian-related expenses were deductible in the integrated business [See Section 162(a)].