

Treas. Reg. Section 1.183-1(c)

Activities not engaged in for profit

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(c) Presumption that activity is engaged in for profit.

(1) In general. If for-

(i) Any 2 of 7 consecutive taxable years, in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses, or

(ii) Any 2 of 5 consecutive taxable years, in the case of any other activity, the gross income derived from an activity exceeds the deductions attributable to such activity which would be allowed or allowable if the activity were engaged in for profit, such activity is presumed, unless the Commissioner establishes to the contrary, to be engaged in for profit. For purposes of this determination the deduction permitted by section 1202 shall not be taken into account. Such presumption applies with respect to the second profit year and all years subsequent to the second profit year within the 5- or 7-year period beginning with the first profit year. This presumption arises only if the activity is substantially the same activity for each of the relevant taxable years, including the taxable year in question. If the taxpayer does not meet the requirements of section 183(d) and this paragraph, no inference that the activity is not engaged in for profit shall arise by reason of the provisions of section 183. For purposes of this paragraph, a net operating loss deduction is not taken into account as a deduction. For purposes of this subparagraph a short taxable year constitutes a taxable year.

(2) Examples. The provisions of subparagraph (1) of this paragraph may be illustrated by the following examples, in each of which it is assumed that the taxpayer has not elected, in accordance with section 183(e), to postpone determination of whether the presumption described in section 183(d) and this paragraph is applicable.

Example (1). For taxable years 1970-74, A, an individual who uses the cash receipts and disbursement method of accounting and the calendar year as the taxable year, is engaged in the activity of farming. In taxable years 1971, 1973, and 1974, A's deductible expenditures with respect to such activity exceed his gross income from the activity. In taxable years 1970 and 1972 A has income from the sale of farm produce of \$30,000 for each year. In each of such years A had expenses for feed for his livestock of \$10,000, depreciation of equipment of \$10,000, and fertilizer cost of \$5,000 which he elects to take as a deduction. A also has a net operating loss carryover to taxable year 1970 of \$6,000. A is presumed, for taxable years 1972, 1973, and 1974, to have engaged in the activity of farming for profit, since for 2 years of a 5-consecutive-year period the gross income from the activity (\$30,000 for each year) exceeded the deductions (computed

without regard to the net operating loss) which are allowable in the case of the activity (\$25,000 for each year).

Example (2). For the taxable years 1970 and 1971, B, an individual who uses the cash receipts and disbursement method of accounting and the calendar year as the taxable year, engaged in raising pure-bred Charolais cattle for breeding purposes. The operation showed a loss during 1970. At the end of 1971, B sold a substantial portion of his herd and the cattle operation showed a profit for that year. For all subsequent relevant taxable years B continued to keep a few Charolais bulls at stud. In 1972, B started to raise Tennessee Walking Horses for breeding and show purposes, utilizing substantially the same pasture land, barns, and (with structural modifications) the same stalls. The Walking Horse operations showed a small profit in 1973 and losses in 1972 and 1974 through 1976.

(i) Assuming that under paragraph (d)(1) of this section the raising of cattle and raising of horses are determined to be separate activities, no presumption that the Walking Horse operation was carried on for profit arises under section 183(d) and this paragraph since this activity was not the same activity that generated the profit in 1971 and there are not, therefore, 2 profit years attributable to the horse activity.

(ii) Assuming the same facts as in (i) above, if there were no stud fees received in 1972 with respect to Charolais bulls, but for 1973 stud fees with respect to such bulls exceed deductions attributable to maintenance of the bulls in that year, the presumption will arise under section 183(d) and this paragraph with respect to the activity of raising and maintaining Charolais cattle for 1973 and for all subsequent years within the 5-year period beginning with taxable year 1971, since the activity of raising and maintaining Charolais cattle is the same activity in 1971 and in 1973, although carried on by B on a much reduced basis and in a different manner. Since it has been assumed that the horse and cattle operations are separate activities, no presumption will arise with respect to the Walking Horse operation because there are not 2 profit years attributable to such horse operation during the period in question.

(iii) Assuming, alternatively, that the raising of cattle and raising of horses would be considered a single activity under paragraph (d)(1) of this section, B would receive the benefit of the presumption beginning in 1973 with respect to both the cattle and horses since there were profits in 1971 and 1973. The presumption would be effective through 1977 (and longer if there is an excess of income over deductions in this activity in 1974, 1975, 1976, or 1977 which would extend the presumption) if, under section 183(d) and subparagraph (3) of this paragraph, it was determined that the activity consists in major part of the breeding, training, showing, or racing of horses. Otherwise, the presumption would be effective only through 1975 (assuming no excess of income over deductions in this activity in 1974 or 1975 which would extend the presumption).

(3) Activity which consists in major part of the breeding, training, showing, or racing of horses. For purposes of this paragraph an activity consists in major part of the breeding, training, showing, or racing of horses for the taxable year if the average of the portion of expenditures attributable to breeding, training, showing, and racing of horses for the 3 taxable years preceding the taxable year (or, in the case of an activity which has not been conducted by the taxpayer for 3 years, for so long as it has been carried on by him) was at least 50 percent of the total expenditures attributable to the activity for such prior taxable years.

(4)Transitional rule. In applying the presumption described in section 183(d) and this paragraph, only taxable years beginning after December 31, 1969, shall be taken into account. Accordingly, in the case of an activity referred to in subparagraph (1)(i) or (ii) of this paragraph, section 183(d) does not apply prior to the second profitable taxable year beginning after December 31, 1969, since taxable years prior to such date are not taken into account.

(5)Cross reference. For rules relating to section 183(e) which permits a taxpayer to elect to postpone determination of whether any activity shall be presumed to be "an activity engaged in for profit" by operation of the presumption described in section 183(d) and this paragraph until after the close of the fourth taxable year (sixth taxable year, in the case of activity which consists in major part of breeding, training, showing, or racing of horses) following the taxable year in which the taxpayer first engages in the activity, see §1.183-3.

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