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I. Real Estate Tax Matters

1.01 In *Alta Wind 1 v. United States*, 897 *F.3d* 1365 there was a great deal of discussion about expert witnesses, their qualifications and other items not relevant to our analysis. The germane point in this case related to the allocation of a purchase price when one acquires assets which constitute a trade or business. Section 338 proposes a waterfall method of purchase price allocations. In this case, the plaintiffs bought a functioning wind farm. They applied for credits from the federal government which were granted in 2009 as incentives by Congress for amounts expended for tangible personal property acquired for renewal energy development. In this case, the plaintiffs purchased a completed wind farm (actually seven different wind farms) six of which had not yet begun business. The credit could not be granted for real estate or other buildings or transmission equipment and therefore the plaintiffs excluded those assets in the computation of the acquisition price and applied the balance of the purchase price to tangible personal property. The government argued that in this type of acquisition the purchase price would have to be allocated among intangible property, contract rights and going conserve value and goodwill. Normally at an acquisition, a purchaser might attempt to minimize the value allocated toward real estate (especially non-depreciable real estate) and more towards tangible assets which could be depreciable. In this case the court overruled a Court of Claims decision and held that the purchase price had to be allocated using the waterfall method and assets other than tangible property could not be excluded in computing the basis allocation.

1.02. In *Perkins v. United States*, 2018 *BL* 262956, there was a question about the taxability of revenue derived from Indian lands. In this case the taxpayer, a member of the Seneca Nation of Indians owned a trucking and land construction business. There evidently was highway construction in the area in which plaintiff operated her sole proprietorship business and plaintiff entered into a deal with the Seneca Nation to extract gravel from a pit located on Seneca Nation land and deliver this gravel to the highway construction area. The Plaintiff claimed she was exempt from taxation on the gravel sales. The Internal Revenue Code does tax all individuals on all income unless an exemption applies. In this case, the plaintiff was relying on language from treaties and by case law relating to the definition of what is income from the land. Plaintiff stated she did not attempt to exclude from income any trucking charges or delivery charges but only income from the sale of gravel. The case discussed a variety of irrelevant matters relating to this but the court did consider whether the gravel sale income was exempt. Cases have also recognized that income realized by an Indian land holder from the operation of a motel, restaurant or gift shop is not income derived from the land and thus is not immune from federal income taxes simply because businesses and buildings are physically located on the tax exempt land. Cases have also held that income generated by farming operations on Indian land is exempt but dividends from the casino built on land are not. Oil and gas revenues from Indian land are exempt whereas rent from a commercial improvement on

land such as an apartment complex or shopping center is not. The court also noted that in attempting to analyze treaties with Indian nations the benefit of doubt belongs to the Indians rather than the Internal Revenue Service. In this case, the treaty allowed Indians free use and enjoyment of their land. This did not require them to ignore technological changes which spared them from having to extract gravel by themselves by hand. Thus, though there is a considerable question as to books and records and proper reporting of income, the court did hold that the income from the sale of gravel was exempt from federal income taxes.

1.03. In *Havener v. Commissioner*, *Tax Court Summary Opinion* 2018-17, the taxpayer was attempting to deduct expenditures he incurred in traveling to and from a house he was attempting to renovate and sell for a profit. The house ("Salem House") was approximately 250 miles from taxpayer's permanent residence and during 2013 taxpayer would travel to the Salem House during the work week spending from three to five days renovating the residence. During this time plaintiff was retired and did not engage in any other entrepreneurial activities other than remodeling the Salem house. The main question is whether taxpayer was engaged in the trade or business of remodeling this house or whether his expenditures were capital in nature and had to be added to the cost basis of the house. In making this determination, courts have considered the taxpayer's purpose of acquiring the property, the taxpayer's everyday business in relationship of income from the property, the frequency, continuity and substantiality of sales from the property and the time and effort the taxpayer habitually devoted to his property and the sale thereof. The court noted that the Code does not define the term "trade or business" but cases have held the management of personal investments, no matter how extensive is not a trade or business. The court noted that the various improvements made to the Salem house were part of a plan of capital rehabilitation or improvement. The house when purchased was uninhabitable and thus the improvements to make the property habitable and to increase its value for eventual resale were eligible for treatment only as capital expenditures. Thus, the taxpayer cannot currently deduct any of the expenses paid or incurred on the house remodeling as a trade or business expense and thus travel to incur these expenses was also a capital expenditure and can only be added to the taxpayer's basis in the property.

1.04. *Welch v. Commissioner*, 114 *T.C.M.* 578 is another Section 183 matter dealing with ranching activities conducted by the taxpayer. Taxpayer had a multifaceted career. He was an economics professor and was sought after as an expert witness in civil litigation cases. Taxpayer had suffered from an automobile accident in high school and has been confined to a wheelchair ever since. The significant factor in this case is the vast amount of activity conducted by the taxpayer in connection with farming and ranching activities. Taxpayer had initially purchased 130 acres of land near Centerville, Texas which grew during the years at issue to 8,700 acres. Taxpayer had income from oil and gas royalties, rental real estate, royalties, partnerships, S corporations, estates and trusts included on his return. The business activities that occurred on the 8,700 acre ranch created work for 25 full-time employees as well as various part-time ranch hands. Taxpayer has fired employees for nonperformance or inappropriate behavior. Taxpayer owned multiple 18-wheeler trucks that were used to move hay and cattle around the ranch and to transport cattle when they were purchased and sold. He also leased the trucks to move the cattle and hay to others and charged third parties per load hauled. Taxpayer was initially involved in a cow-calf operation but after a short period of operating the petitioner decided that it would not be profitable because the prices were too low.

Petitioner then attempted to move into a purebred beef cattle operation relating to Maine Anjou cattle. Unfortunately, this breed of cattle proved not well suited to the hot and humid client around Centerville, Texas and therefore taxpayer changed his operation to raising Brangus cattle. This ranch operation utilized artificial insemination for breeding purposes which required constant care and supervision. This proved to be too time intensive for petitioner's ranch hands and therefore he sold his entire purebred heard in 2006 and fired the purebred cattle manager and began raising commercial cattle for a cow-calf operation. Taxpayer also raised hay, much of which was used on his own ranch but approximately two-thirds of the square bales produced on taxpayer's land was sold to third parties as a cash crop.

In 1999, petitioner entered into cutting horse competitions and in attempting to train the cutting horses on his ranch petition constructed a horse center which comprised seven buildings, a residence for a horse trainer, special barns for stallions, 55 stalls, an arena for training cutting horses, exercise lots, a walker, an exercise machine, fenced paddocks, a 200-acre pasture for recipient mares and a 35-acre pasture for other mares. All of these structures were utilitarian work structures. Petitioner intended that the horse operation would be profitable from both a breeding program and for the showing of cutting horses. It was noted that it would take five to six years before credible information about a stallion's breeding capability and his ability to pass on the vital cutting horse traits to his progeny would become known. A stallion stud fee will increase over time. One stallion purchased by petitioner had lifetime cutting horse competition earnings of over $340,000, yet he was unproven for a breeding program and thus his stud fee was no more than $1,500. His initial stud fee of $1,500 grew over time and at the date of trial the stallion's progeny had generated prize winnings of over $500,000 and thus his stud fee had increased and should continue to be realized until the stallion was in his mid-twenties. The tax court analyzed the nine factors generally used to determine whether an activity is carried on with an objective of realizing a profit. The manner by which the taxpayer carried on the activity, the expertise of taxpayer and his advisor and the amount and time expended on the activity were all found in favor of the taxpayer. The court noted that the taxpayer did have substantial wealth and financial resources but wealth not associated with the activity at issue is not a bar to the activities being engaged in for profit. The factors coupled with the fact that the injury petitioner sustained in an automobile accident substantially restricted his ability to derive personal pleasure from ranch outdoor operations, and he performed no manual labor on the ranch, did not ride the ranch's horses and only did a little hunting in the late 1980's. This led to the court's opinion that the ranching activities were carried on with the objective of making a profit and not for elements of personal pleasure or recreation.