

July 2016
MPT-2 File:
Nash v. Franklin Department
of Revenue

The Carter Law Firm LLC
1891 Virginia Way
Bristol, Franklin 33800

MEMORANDUM

TO: Examinee
FROM: Sara Carter
DATE: July 26, 2016
RE: Tax Appeal of Joseph and Ellen Nash

Our clients Joseph and Ellen Nash own property in Knox Hollow, on which they raise Christmas trees for sale. For many years, they sold only to friends and neighbors. Five years ago, they started a commercial tree-farming operation and put a lot more money into the farm.

Starting that same year, they began to claim tax deductions for expenses from a trade or business. They had a huge start-up loss to report in the first year. Since then, their income from the farm has gone up, but their expenses have varied. For each of the past five years, they reported a loss on their joint tax return.

Since the Nashes' last tax filing, as the law allows, the Franklin Department of Revenue (FDR) reviewed the Nashes' returns for the years 2011–2015 and denied their claim of full deductions for the farm expenses for those years. The FDR said that the Nashes could only take deductions to offset income they earned from the farm in each of those five years. The Nashes want the full deductions so that they can offset the business losses against their other income.

The FDR also denied the Nashes' claim for a home office deduction.

The FDR assessed the Nashes with additional tax for all five years. To avoid interest and penalties, the Nashes paid the additional tax. Representing themselves, they filed an internal administrative review with the FDR, which was unsuccessful. (See attached Notice of Decision.)

The Nashes then retained us and we filed an appeal to the Franklin Tax Court, which went to hearing last week. We stipulated to the dollar amounts in question, and Mr. Nash testified. I have attached a transcript. The Tax Court has requested post-hearing briefing.

Please draft the legal argument portion of our brief to the Tax Court, following the attached guidelines for drafting persuasive briefs. You should argue that Mr. Nash's testimony establishes the Nashes' right under Franklin law to the full deductions that they claimed. Franklin law uses the federal Internal Revenue Code and regulations to calculate Franklin tax liability.

The Carter Law Firm LLC
1891 Virginia Way
Bristol, Franklin 33800

OFFICE MEMORANDUM

TO: Attorneys
FROM: Sara Carter
DATE: August 18, 2014
RE: Format for Persuasive Briefs

The following guidelines apply to persuasive briefs filed in the Franklin Tax Court.

[Other sections omitted]

...

III. Legal Argument

Your legal argument should be brief and to the point. Make your points clearly and succinctly, citing relevant authority for each legal proposition.

Do not restate the facts as a whole at the beginning of your legal argument. Instead, integrate the facts into your legal argument in a way that makes the strongest case for our client.

Use headings to separate the sections of your argument, and follow the same rule as your argument: do not state abstract conclusions, but integrate factual detail into legal propositions to make them more persuasive. An ineffective heading states only: “The deduction should be allowed.” An effective heading states: “Under the Internal Revenue Code, the appellant may deduct the amount by which the value of the gift exceeds the value of the concert ticket he received.”

The body of your argument should analyze applicable legal authority and persuasively argue how both the facts and the law support our client’s position. Supporting authority should be emphasized, but contrary authority should also be cited, addressed in the argument, and explained or distinguished.

Finally, anticipate and accommodate any weaknesses in your case in the body of your argument. If possible, structure your argument in such a way as to highlight your argument’s strengths and minimize its weaknesses. If necessary, make concessions, but only on points that do not concede essential elements of your claim or defense.

**FRANKLIN DEPARTMENT OF REVENUE
NOTICE OF DECISION — ADMINISTRATIVE REVIEW**

Taxpayers: Joseph Nash and Ellen Nash
Tax Years: 2011–2015

Type: Joint Filing
Date Issued: May 16, 2016

The taxpayers claim that the Franklin Department of Revenue incorrectly denied their claims for (1) deductions for expenses paid or incurred during the taxable year in carrying on a trade or business and (2) deductions related to the business use of their home.

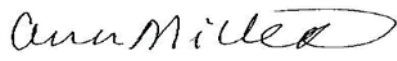
(1) The taxpayers claim certain deductions related to the carrying on of a “Christmas tree farming” business as follows:

| | <i>2011</i> | <i>2012</i> | <i>2013</i> | <i>2014</i> | <i>2015</i> |
|-------------|-------------|-------------|-------------|-------------|-------------|
| Income | \$1,500 | \$2,000 | \$2,000 | \$3,500 | \$5,000 |
| Deductions | \$35,000 | \$9,500 | \$7,000 | \$9,000 | \$12,500 |
| Gain/(Loss) | (\$33,500) | (\$7,500) | (\$5,000) | (\$5,500) | (\$7,500) |

The Department determines that the taxpayers are not engaged in the tree-farming business for profit, due to the lack of a profit motive. Therefore, the taxpayers cannot take full deductions in each year. Instead, they may only deduct annual expenses up to the amount of income earned from the tree-farming activity: \$1,500 in 2011; \$2,000 in 2012; \$2,000 in 2013; \$3,500 in 2014; \$5,000 in 2015. Of the nine factors identified in federal regulation 26 C.F.R. § 1.183–2(b)(1–9), which is controlling in Franklin tax cases, these factors support our conclusion: no profit in the tax years in question; a regular history of losses; no plan to recoup those losses; a history of similar activity without any deductions; and no evidence of operations in a businesslike manner.

(2) The taxpayers may take no deduction attributable to the use of a room in their home because the room was not used exclusively for business purposes. Internal Revenue Code § 280A(c)(1).

The assessment of tax for the years in question is affirmed. The taxpayers have exhausted their internal administrative remedies. They have the right to appeal to the Franklin Tax Court.



Ann Miller, Commissioner of Franklin Department of Revenue

FRANKLIN TAX COURT, SIXTH DISTRICT
Transcript of Testimony of Joseph Nash
July 21, 2016

DIRECT EXAMINATION BY ATTORNEY CARTER

Att’y Carter: State your name for the record.

Joseph Nash: Joseph Nash.

Carter: Where do you live?

Nash: 3150 Old Sawmill Road in Knox Hollow, Franklin.

Carter: How long have you lived there?

Nash: Since we bought it in 1997.

Carter: Describe the land, please.

Nash: It’s 13 acres: an acre for the house and sheds, and another two acres of fields. The rest is forested.

Carter: You started claiming tax deductions in 2011. Please tell the court how you used the land before then.

Nash: Originally, about two acres of the land had Leland cypress, spruce, and pine on it, good for Christmas trees. Soon after we bought it, our daughter and her friends would cut down trees for their own use. After a while, we put up a sign on the road each November and put out a garbage can with saws and twine in it. We charged \$15 for the cypress, \$20 for the pine, and \$25 for the spruce.

Carter: What happened next?

Nash: At some point, we realized that most of the good trees would be gone in a few years. So I researched how to raise Christmas trees in a more orderly way.

Carter: What did you do?

Nash: I read a lot of books on raising trees, Christmas trees in particular. I took a whole series of classes on forest management. Finally, I met a nearby Christmas tree farmer and spent a whole vacation on that farm. I got really interested in it.

Carter: What did you do next?

Nash: First we set apart some of the acreage, cut everything down, and replanted in organized rows, leaving space to plant new seedlings in rotation. When the new trees came in, we’d sell them off, same as before.

Carter: How much did you make?

Nash: Up until five years ago, never more than \$1,000 in any one year.

Carter: Did you report this as income on your tax returns during this period?

Nash: Yes. And up until that point, we claimed no deductions.

Carter: What happened then?

Nash: About five years ago, in 2011, the tree farmer I'd worked with let me know that he was planning to go out of business. And my wife retired from her job with the county. So we had to decide whether to step it up or not. We both liked working in the fields and selling the trees, so we said, "Why not?"

Carter: Then what happened?

Nash: That same year we contacted the farmer's commercial customers, as a target for expansion. Then we invited the farmer over to walk us through what a bigger operation would look like. He showed us how to keep records about the trees and to keep good books. We did exactly what he told us . . . still do.

Carter: You couldn't have sold that many more trees right away.

Nash: No, we didn't. 2011 was a hard year, because we cut down several acres of forest for additional fields and bought new equipment to deal with the additional planting. We couldn't do it by hand, the way we had before. So we bought specialized equipment to trim and shape the trees.

Carter: How do you manage things?

Nash: Starting in 2011, we set aside a room in the house just for this business. We keep the records there, and catalogues and books that we consult. We have a computer that we use just for the business and nothing else. The room has a desk and two chairs, and that's it. Nothing happens there but the business.

Carter: How did things go from then on?

Nash: Well, that first year, we made only \$1,500, including sales to some retailers in the city. We made more each year after that, up until last year when we made \$5,000.

Carter: How much of that was profit?

Nash: None of it. We had a huge loss in 2011. After that, we had to maintain the equipment, and we had to increase the size of each year's planting to

increase our sales five to six years later. For the past two years, we have had to hire people to help us during the harvest; it was just too much for us. And of course, the economy has been bad, and sales haven't been what we thought they would be. It's coming back, though.

Carter: How much time have you and your wife put into this?

Nash: Since 2011, my wife has spent pretty much full time year-round on this. I spend summers and weekends, when I can . . . a lot more time during the harvest. We love it; it's hard work, but it's outdoors and it's satisfying.

Carter: Just to be clear, you've never made a profit?

Nash: That's right.

Carter: Do you plan to make a profit?

Nash: Yes, we will make a profit, once the trees we started planting five years ago are big enough for harvesting. We have reliable customers who want our trees, and we've learned a lot in the past few years about how to keep costs down.

Carter: No further questions.

CROSS-EXAMINATION BY Franklin Dep't of Revenue ATTORNEY SHEPARD

Att'y Shepard: Mr. Nash, you work full-time at Knox County High School as an associate principal, correct?

Joseph Nash: Yes, that's right.

Shepard: Since your wife retired, hasn't she received a pension from the county?

Nash: Yes.

Shepard: You've lived off your salary and her pension the last five years, correct?

Nash: Yes.

Shepard: You've never run a business of your own, have you?

Att'y Carter: Objection. Argumentative.

Shepard: I'll rephrase. Other than this activity on your land, you and your wife have never run a business of your own, have you?

Nash: No.

Shepard: You've never taken a salary for either of you from this activity, have you?

Nash: No.

Shepard: You don't insure your trees, do you?

Nash: No. We do insure the farm equipment.

Shepard: You don't advertise, do you?

Nash: No, not commercially. Our local business is by word of mouth, and we have good connections with our commercial customers.

Shepard: You testified that you set a room aside only for this activity.

Nash: Yes.

Shepard: How did you use the room before?

Nash: We used it as a spare bedroom.

Shepard: You said that there is nothing in that room but a desk and two chairs?

Nash: Yes—we took out the bed.

Shepard: One of those two chairs is a recliner, isn't it? And you have a radio and TV there too, correct?

Nash: Yes. I keep the TV on the Weather Channel, for business reasons.

Shepard: The computer is connected to the Internet.

Nash: By wireless, yes.

Shepard: Your dogs will lie in that room with you while you're there?

Nash: Yes, they will.

Shepard: There's a fireplace in that room too, isn't there?

Nash: Yes.

Shepard: You testified that you love tree farming and are fascinated by it?

Nash: Yes.

Shepard: You enjoy working on the land and making things grow.

Nash: I do.

Shepard: It doesn't really matter to you if this activity makes a profit, does it?

Nash: Maybe not; but we mean to make one anyway. That's part of the fun.

Shepard: No further questions.

