59 T.C. 312 (1972)

To deduct expenses as business expenses under Section 162 of the Internal Revenue Code, a taxpayer's activity must constitute a 'trade or business,' meaning it must be undertaken with the primary intention of making a profit, although the expectation of profit need not be reasonable, only genuine.

Summary

Thomas W. Jackson sought to deduct expenses and depreciation related to his yacht, Thane, arguing it was used in the trade or business of chartering. The Tax Court considered whether Jackson's yacht chartering activities constituted a 'trade or business' under Section 162 of the Internal Revenue Code, allowing for deduction of ordinary and necessary business expenses. The court held that Jackson's chartering activities did constitute a trade or business because he demonstrated a genuine intention to profit, despite losses in the tax year in question due to unforeseen circumstances. Therefore, he was entitled to deduct related expenses and depreciation.

Facts

Petitioner Thomas W. Jackson purchased a 65-foot yacht in 1958 and invested in extensive repairs and improvements. By 1964, he decided to enter the chartering business in the Virgin Islands. He advertised the yacht, secured charters, including a high-profile charter with Hugh Downs, and in 1965, the yacht generated $30,000 in gross revenues and a small profit. However, in 1966, due to delays and damages during a return voyage from Tahiti, most charters were canceled, resulting in significantly reduced revenue and a net loss for the year. Jackson sought to deduct expenses and depreciation related to the yacht for 1966.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Jackson's federal income tax for 1966, disallowing deductions related to the yacht chartering activity and imposing a negligence penalty. Jackson petitioned the Tax Court to contest this determination.

Issue(s)

1. Whether the petitioner's yacht chartering activities during 1966 constituted a 'trade or business' under Section 162(a) and 167(a)(1) of the Internal Revenue Code, thus allowing for the deduction of ordinary and necessary business expenses and depreciation.
2. Whether any portion of the tax deficiency was due to negligence or intentional disregard of rules and regulations, justifying the imposition of a penalty under Section 6653(a).

Holding

1. Yes, because the petitioner demonstrated a genuine intention to profit from the yacht chartering activities, thus constituting a 'trade or business' despite the losses incurred in 1966.
2. No, because the petitioner maintained records of expenses, albeit not in a formal bookkeeping system, and thus did not demonstrate negligence or intentional disregard of rules and regulations.

Court's Reasoning

The Tax Court reasoned that to qualify as a 'trade or business,' the activity must be undertaken with the purpose of making a profit. Citing *Lamont v. Commissioner*, the court emphasized that the taxpayer's intention is the key factual question. The court found that Jackson had a genuine profit motive based on several factors: his investigation of the chartering business, efforts to market and improve the yacht, success in generating revenue in 1965, and the fact that the losses in 1966 were due to unforeseen circumstances (delays and damages at sea). The court noted, "The expectation of profit need not be reasonable, only genuine," citing *Margit Sigray Bessenyey*. The court distinguished this case from hobby loss cases, noting Jackson's limited personal use of the yacht and modest income, suggesting a genuine business pursuit rather than a tax shelter. Regarding the negligence penalty, the court found that while Jackson's record-keeping was informal, it was sufficient to demonstrate a reasonable effort to track expenses, thus negating negligence. The court quoted *Wilson v. Eisner*, stating, "Success in business is largely obtained by pleasurable interest therein," to counter the idea that enjoyment of the activity negates a profit motive.

Practical Implications

Jackson v. Commissioner provides a practical illustration of how to determine whether an activity constitutes a 'trade or business' for tax purposes, particularly when personal enjoyment is involved. It clarifies that the primary factor is the taxpayer's genuine intention to make a profit, evidenced by business-like activities, even if profits are not immediately realized or consistently achieved. This case is frequently cited in disputes involving hobby loss rules and helps legal professionals advise clients on structuring activities to qualify as a business for tax deduction purposes. It emphasizes that temporary setbacks and imperfect record-keeping do not automatically disqualify an activity as a business, as long as a genuine profit motive and reasonable substantiation of expenses exist. Later cases have applied this 'genuine profit motive' standard in various contexts, from farming to art, consistently looking at the taxpayer's intent and actions rather than solely on profitability in a given tax year.