

UNITED STATES TAX COURT
WASHINGTON, DC 20217

EARL A. SKARKY,)
Petitioner,) CT
v.) Docket No. 1727-18.
COMMISSIONER OF INTERNAL REVENUE,)
Respondent)

ORDER

Pursuant to Rule 152(b), Tax Court Rules of Practice and Procedure, it is

ORDERED that the Clerk of the Court shall transmit herewith to petitioner and to respondent a copy of the pages of the transcript of the trial in the above case before Judge Michael B. Thornton in Louisville, Kentucky, containing his oral findings of fact and opinion rendered at the trial session at which the case was heard.

In accordance with the oral findings of fact and opinion, a decision will be entered for respondent.

**(Signed) Michael B. Thornton
Judge**

Dated: Washington, D.C.
December 5, 2019

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IN THE UNITED STATES TAX COURT

ALS

In the Matter of:)
EARL A. SKARKY,) Docket No. 1727-18
Petitioner,)
v.)
COMMISSIONER OF INTERNAL REVENUE,)
Respondent.)

Pages: 1 through 17

Place: Louisville, Kentucky

Date: November 13, 2019



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P R O C E E D I N G S

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(2:47 p.m.)

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(Whereupon, a bench opinion was rendered.)

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1 Bench Opinion by Judge Michael B. Thornton

2 November 13, 2019

3 Earl A. Skarky v. Commissioner

4 Docket No. 1727-18

5 THE COURT: The Court has decided to render oral
6 findings of fact and opinion in this case, and the
7 following represents the Court's oral findings of fact and
8 opinion. Except as otherwise provided by Rule 152(c) of
9 the Tax Court Rules of Practice and Procedure, the oral
10 findings of fact and opinion shall not be relied upon as
11 precedent in any other case.

12 This bench opinion is made pursuant to the
13 authority granted by section 7459(b) and Rule 152.

14 Hereinafter in this bench opinion, section references are
15 to the Internal Revenue Code (Code) in effect for the
16 taxable year at issue. All Rule references are to the Tax
17 Court Rules of Practice and Procedure. All monetary
18 amounts are rounded to the nearest dollar.

19 This case was tried on November 13, 2019, in
20 Louisville, Kentucky. Petitioner appeared pro se. Ms.
21 Laura Leigh Bates appeared on behalf of respondent.

22 FINDINGS OF FACT

23 Petitioner is an attorney who commenced
24 practicing law in 1973, when he joined the law firm of
25 Crowe & Dunlevy, PSC, in the firm's Oklahoma City,



1 Oklahoma, office. He practiced law there full-time until
2 July 2014, when, upon reaching mandatory retirement age,
3 he became of counsel to the firm. In that capacity, he
4 would spend about one week a month working at the firm
5 representing a client, the Oklahoma Development Finance
6 Authority, as well as doing some work remotely. In 2016
7 petitioner started his own law firm, but his work still
8 emanates from Oklahoma, where he is licensed to practice
9 law. He is not licensed to practice law in Kentucky.

10 In 2011 petitioner purchased a 55-acre farm,
11 known as Four Winds Farm, in Lexington, Kentucky, for \$2.7
12 million. His intention was to start a horse-breeding
13 business, to breed horses for eventing (rather than for
14 racing). In February 2012 he and his wife moved into a
15 house on the farm. About once a month petitioner would
16 travel from Kentucky to Oklahoma City for his work with
17 Crowe & Dunlevy. Petitioner still retains a residence in
18 Oklahoma City, where he generally stays when he is working
19 in Oklahoma City.

20 In 2013 petitioner renovated an existing tobacco
21 barn at the farm to create nine paddocks and made other
22 improvements. In late 2013 he started work on a 15-stall
23 horse barn that was finished by August 2014.

24 In the fall of 2012 petitioner had acquired 13
25 horses from the Humane Society. He did not intend to sell

1 these horses, and by November 2013 he had disposed of all
2 but one of these horses and had acquired two Tennessee
3 Walkers. At that time he also had five horses that had
4 been retired from his wife's therapy business in
5 Washington State. Of these five horses only one was a
6 potential breeder but because of health issues it had to
7 be gelded. In late 2013 petitioner also bought two mares
8 in foal. These horses foaled in late 2014. In 2015
9 petitioner brought in a trainer to start bridle work on
10 these foals, to make them more desirable for potential
11 eventing. Sometime in mid-2014 petitioner also bought a
12 stallion. In later years petitioner bought additional
13 horses, including some retired geldings from the local
14 police department and two Clydesdales.

15 As of 2014 petitioner had not yet sold any
16 horses from his breeding activity. In fact, as of 2014
17 petitioner was still uncertain what type of horses would
18 be best to breed and was still investigating different
19 possibilities. As of the time of trial, petitioner has
20 not entered into any breeding agreements and has not
21 received any fees for breeding horses. Petitioner
22 testified that he hoped his horse-breeding activity would
23 become operational by 2020.

24 During 2014 petitioner boarded four horses for a
25 neighbor, who ultimately gave him two of the horses and

1 paid him \$3,250 for boarding the two other horses.

2 On February 26, 2016, petitioner filed his Form
3 1040, U.S. Individual Income Tax Return, for taxable year
4 2014, reporting total tax of \$112,745 and claiming a
5 refund of \$286,383. On petitioner's tax return he
6 reported wage income of \$41,739, taxable Individual
7 Retirement Account distributions of \$1,982,083, and a farm
8 loss of \$1,434,160, resulting in adjusted gross income of
9 \$594,654. On the Schedule F, Profit or Loss From Farming,
10 attached to his 2014 return he listed as his principal
11 activity "Horse Breeding". With respect to this activity
12 he reported gross income of \$3,250 from "Sales of
13 livestock, produce, grains, and other products you
14 raised", and claimed deductions totaling \$1,437,410,
15 including depreciation and section 179 expenses of
16 \$1,105,674, resulting in a net loss of \$1,434,160. On
17 Schedule A, Itemized Deductions, attached to his 2014
18 return he claimed a deduction for, among other things,
19 unreimbursed employee business expenses of \$79,901 for
20 travel expenses from Lexington, Kentucky, to attend board
21 meetings at Crowe & Dunlevy in Oklahoma City.

22 By notice of deficiency issued October 27, 2017,
23 respondent disallowed in full petitioner's claimed 2014
24 Schedule F expenses and 2014 Schedule A unreimbursed
25 employee expenses. Additionally, the notice of deficiency



1 determined that the \$3,250 of income reported on
2 petitioner's 2014 Schedule F from the purported sale of
3 livestock should be reclassified as "other income".
4 Respondent also determined that pursuant to section
5 6651(a)(1) petitioner was liable for an addition to tax of
6 \$67,173 for failure to timely file his 2014 tax return, as
7 well as an accuracy-related penalty of \$111,015 pursuant
8 to section 6662(a).

9 Respondent's initial determination to impose the
10 section 6662(a) accuracy-related penalty was personally
11 approved in writing by the examiner's immediate supervisor
12 on May 22, 2017, before the issuance of respondent's
13 Revenue Agent Report on May 23, 2017, which granted
14 petitioner the right to protest the adjustments and
15 penalty determinations.

16 OPINION

17 The Commissioner's determinations in a notice of
18 deficiency are generally presumed correct, and the
19 taxpayer generally bears the burden of proving those
20 determinations erroneous. Rule 142(a); Welch v.
21 Helvering, 290 U.S. 111, 115 (1933). Petitioner has not
22 alleged that the burden of proof should shift to
23 respondent nor shown that he has satisfied the
24 requirements of section 7491 to shift the burden of proof
25 to respondent. Deductions are a matter of legislative

1 grace, and the taxpayer bears the burden of proving
2 entitlement to any deduction or credit claimed. Deputy v.
3 du Pont, 308 U.S. 488, 493 (1940).

4 Unreimbursed Employee Expenses

5 As a general rule, personal living expenses are
6 nondeductible. Sec. 262; secs. 1.162-2(a), 1.262-1(b)(5),
7 Income Tax Regs. Because an employee's trade or business
8 is deemed to consist of the performance of services for an
9 employer, taxpayers may deduct expenses that are: (a)
10 nonreimbursable; (b) related to the employee's trade or
11 business of rendering services to the employer; and (c)
12 ordinary and necessary expenses of such a trade or
13 business. See Lucas v. Commissioner, 79 T.C. 1, 6-7
14 (1982). Traveling expenses, including amounts expended
15 for meals and lodging, may be deducted under section
16 162(a)(2) if they are: (1) ordinary and necessary; (2)
17 incurred while away from home; and (3) incurred in pursuit
18 of a trade or business. Commissioner v. Flowers, 326 U.S.
19 465, 470 (1946).

20 Under section 162, the term "'home' does not
21 have its usual and ordinary meaning." Henderson v.
22 Commissioner, 143 F.3d 497, 499 (9th Cir. 1998), aff'g
23 T.C. Memo. 1995-559. For purposes of section 162(a)(2), a
24 taxpayer's home generally means the vicinity of his
25 principal place of employment. Mitchell v. Commissioner,

1 74 T.C. 578, 581 (1980). As an exception to this general
2 rule, a taxpayer's residence may be treated as the
3 taxpayer's tax home, even though it is outside the
4 vicinity of the principal place of employment, if the
5 taxpayer's employment is "temporary" and not "indefinite".
6 Peurifoy v. Commissioner, 358 U.S. 59, 60 (1958).
7 Employment is "indefinite" rather than "temporary", if
8 "its termination cannot be foreseen within a fixed or
9 reasonably short period of time." Stricker v.
10 Commissioner, 54 T.C. 355, 361 (1970), aff'd, 438 F.2d
11 1216 (6th Cir. 1971).

12 Petitioner has not demonstrated that Lexington,
13 Kentucky, was his "tax home" in 2014. From 1973 until he
14 started his own firm in 2016, petitioner worked
15 continuously for the law firm of Crowe & Dunlevy in
16 Oklahoma City. According to his testimony, in 2014 he
17 worked there full-time until July 2014, when he became of
18 counsel and started coming to the office only about once a
19 month for a week at a time. All of his wage income during
20 2014 came from this work. He still maintains a residence
21 in Oklahoma City, where he stayed when he was working for
22 Crowe & Dunlevy in 2014. Within the meaning of section
23 162(a)(2), petitioner's tax home throughout 2014 was in
24 the vicinity of his place of employment in Oklahoma City,
25 Oklahoma. See Kroll v. Commissioner, 49 T.C. 557 (1968).

1 Accordingly, petitioner's travel expenses between Kentucky
2 and Oklahoma City are personal travel expenses rather than
3 ordinary and necessary business expenses.

4 Schedule F Activity

5 Section 162 generally allows a deduction for
6 "all the ordinary and necessary expenses paid or incurred
7 during the taxable year in carrying on any trade or
8 business". Such expenses, however, must be directly
9 connected with or pertain to the taxpayer's trade or
10 business that is functioning as a business at the time the
11 expenses were incurred. Woody v. Commissioner, T.C. Memo.
12 2009-93, aff'd, 403 F. App'x 519 (D.C. Cir. 2010). Until
13 the activity is functioning as a going concern and
14 performing the activities for which it was organized,
15 expenses related to that activity, including depreciation
16 expenses, are not "ordinary and necessary" expenses
17 currently deductible under section 162 (nor are they
18 deductible under section 212) but rather are "start-up" or
19 "pre-opening" expenses. See Hardy v. Commissioner, 93
20 T.C. 684, 687-688 (1989); Piggly Wiggly Southern, Inc. v.
21 Commissioner, 84 T.C. 739, 745-746 (1985) (citing Richmond
22 Television Corp. v. United States, 345 F.2d 901 (4th Cir.
23 1965), aff'd, 803 F.2d 1572 (11th Cir. 1986)). "Start-up
24 expenditures"--i.e., expenses incurred "before the day on
25 which the active trade or business begins," sec.

1 195(c)(1)(A)(iii)--may be deducted only over time under
2 section 195. The costs of starting up a new trade or
3 business or a new income-producing activity are inherently
4 capital because they are expenses of creating or acquiring
5 a capital asset. See Johnsen v. Commissioner, 794 F.2d
6 1157, 1162 (6th Cir. 1986), rev'd, 83 T.C. 103 (1984).

7 Petitioner has failed to show that his horse-
8 breeding activity was functioning as a going concern in
9 2014. Although petitioner took steps toward establishing
10 a horse-breeding business, his plans were not realized by
11 the end of 2014. In fact, he testified at trial that he
12 hopes for his horse-breeding activity to become
13 operational by 2020. Even as of the time of trial
14 petitioner had not yet sold any horses from his breeding
15 activity. As of 2014 petitioner had not yet finally
16 decided what type of horses would be best to breed. As of
17 the time of trial, petitioner has not entered into any
18 breeding agreements and has not received any fees for
19 breeding horses. In 2014 the farm's only proceeds of
20 \$3,250 came from a neighbor's payment as board for two
21 horses. Petitioner's actions to ready his farm for a
22 horse-breeding business exemplify steps taken to set up a
23 business, not those of a business that had commenced and
24 was presently operating as a going concern in 2014.

25

1 We hold that the amounts reported on
2 petitioner's 2014 Schedule F ~~are~~ start-up expenses and may *MBT*
3 not be deducted pursuant to section 162(a). Consequently,
4 we sustain respondent's determination disallowing
5 petitioner's claimed 2014 Schedule F expenses and also
6 sustain his determination reclassifying the \$3,250 of
7 income reported on petitioner's 2014 Schedule F from the
8 purported sale of livestock as "other income".

9 Section 6651(a)(1) Addition to Tax

10 Respondent determined that petitioner is liable
11 for a section 6651(a)(1) addition to tax for failing to
12 file his 2014 Federal income tax return on time. Section
13 6651(a)(1) provides for an addition to tax for failure to
14 file a return by the date prescribed unless the taxpayer
15 establishes that the failure is due to reasonable cause
16 and not willful neglect. The Commissioner bears the
17 burden of production with respect to whether it is
18 appropriate to impose the section 6651(a)(1) addition to
19 tax, see sec. 7491(c), and the burden of proof is on the
20 taxpayer to establish reasonable cause and the absence of
21 willful neglect, United States v. Boyle, 469 U.S. 241, 245
22 (1985). Reasonable cause exists when a taxpayer exercises
23 ordinary business care and prudence and is nonetheless
24 unable to file his return by the date prescribed by law.
25 Sec. 301.6651-1(c)(1), Proced. & Admin. Regs. Willful

1 neglect connotes "conscious, intentional failure or
2 reckless indifference." Boyle, 469 U.S. at 245.

3 Petitioner's 2014 tax return was due April 15,
4 2015 . He did not file it until February 26, 2016.

5 Respondent has met his burden of production under section
6 7491(c). Petitioner failed to show reasonable cause for
7 not timely filing his 2014 tax return. We sustain the
8 addition to tax under section 6651(a)(1).

9 Section 6662(a) Accuracy-Related Penalty

10 Respondent determined that for taxable year 2014
11 petitioner is liable for a 20% accuracy-related penalty
12 pursuant to section 6662(a). Under section 7491(c),
13 respondent bears the burden of production with respect to
14 the section 6662(a) penalty. Generally, this means that
15 he must come forward with sufficient evidence indicating
16 that it is appropriate to impose the relevant penalty.

17 See Higbee v. Commissioner, 116 T.C. 438, 446 (2001). The
18 Commissioner's burden of production under section 7491(c)
19 includes establishing compliance with the supervisory
20 approval requirement of section 6751(b). Graev v.
21 Commissioner, 149 T.C. 485, 493 (2017), supplementing and
22 overruling in part 147 T.C. 460 (2016). Once the
23 Commissioner has met his burden of production, the burden
24 of proof is upon the taxpayer to show that he is not
25 liable for the penalty. See Higbee v. Commissioner, 116

1 T.C. at 449. The taxpayer may meet this burden by proving
2 that he acted with reasonable cause and in good faith with
3 regard to the underpayment. See sec. 6664(c)(1).

4 Section 6662(a) imposes a penalty of 20% of the
5 portion of any underpayment attributable to, among other
6 things, negligence or disregard of rules or regulations.
7 See sec. 6662(b)(1). Section 6662(a) and (b)(2) imposes
8 the accuracy-related penalty on any portion of a tax
9 underpayment that is attributable to any substantial
10 understatement of income tax, defined in section
11 6662(d)(1)(A) as an understatement that exceeds the
12 greater of 10% of the tax required to be shown on the
13 return or \$5,000.

14 The total tax reported on petitioner's 2014 tax
15 return was \$112,745; the understatement of income tax
16 determined in the notice of deficiency is \$555,075.

17 Therefore, the amount of tax required to be shown on
18 petitioner's 2014 tax return was \$667,820. Petitioner's
19 understatement of tax of \$555,075 exceeds \$66,782, which
20 is 10% of the tax required to be shown on petitioner's
21 2014 tax return. Thus, petitioner's understatement of
22 income tax is substantial for purposes of the section
23 6662(a) and (b)(2) accuracy-related penalty.

24 The record includes a copy of the 30-day letter
25 issued on May 23, 2017, which bears the signature of the

1 examiner's immediate supervisor and includes an
2 examination report proposing a penalty pursuant to section
3 6662(a). This satisfies respondent's burden of production
4 under section 6751(b)(1). See Rose v. Commissioner, T.C.
5 Memo. 2019-73, at *40; cf. Clay v. Commissioner, 152 T.C.
6 ___, ___ (slip op. at 44) (Apr. 24, 2019). We hold that
7 respondent has satisfied his burden of production with
8 respect to the section 6662 accuracy-related penalties for
9 substantial understatement. Consequently, we need not
10 decide whether respondent has also met his burden of
11 production for the accuracy-related penalty for
12 negligence..

13 Reasonable cause requires that the taxpayer
14 exercise ordinary business care and prudence as to the
15 disputed item. Boyle, 469 U.S. at 246. The term "good
16 faith" has no precise definition but connotes, among other
17 things, (1) an honest belief and (2) the intent to perform
18 all lawful obligations. Sampson v. Commissioner, T.C.
19 Memo. 2013-212, at *18. The determination of whether a
20 taxpayer acted with reasonable cause and in good faith is
21 made on a case-by-case basis, taking into account all
22 facts and circumstances. Higbee v. Commissioner, 116 T.C.
23 at 448; sec. 1.6664-4(b)(1), Income Tax Regs. Generally,
24 the most important factor is the extent of the taxpayer's
25 effort to assess the proper tax liability. Sec. 1.6664-

1 4(b)(1), Income Tax Regs. Other circumstances that may
2 indicate reasonable cause and good faith include an honest
3 misunderstanding of fact or law that is reasonable in the
4 light of all of the facts and circumstances, including the
5 experience, knowledge, and education of the taxpayer.

6 Higbee v. Commissioner, 116 T.C. at 449; Sampson v.
7 Commissioner, at *18; sec. 1.6664- 4(b)(1), Income Tax
8 Regs.

9 Petitioner has failed to establish that he acted
10 with reasonable cause and in good faith. Accordingly, we
11 sustain respondent's determination that petitioner is
12 liable for the section 6662(a) penalty for an underpayment
13 attributable to a substantial understatement of his 2014
14 Federal income tax.

15 Consistent with the foregoing, decision will be
16 entered for respondent.

17 This concludes the Court's findings of fact and
18 opinion in this case.

19 (Whereupon, at 3:08 p.m., the above-entitled
20 matter was concluded.)

21

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Earl A. Skarky v. Commissioner

3 DOCKET NO.: 1727-18

4 We, the undersigned, do hereby certify that the
5 foregoing pages, numbers 1 through 17 inclusive, are the
6 true, accurate and complete transcript prepared from the
7 verbal recording made by electronic recording by on
8 November 13, 2019 before the United States Tax Court at
9 its session in Louisville, KY, in accordance with the
10 applicable provisions of the current verbatim reporting
11 contract of the Court and have verified the accuracy of
12 the transcript by comparing the typewritten transcript
13 against the verbal recording.

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Meribeth Ashley, CET-507

11/18/19

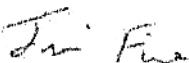
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Transcriber

Date

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Traci Fine, CDLT-169

11/19/19

24

Proofreader

Date

25

