

**Rudolph W. and Abbie A. Steffler v. Commissioner.**  
United States Tax Court - Memorandum Decision  
T.C. Memo. 1995-271

**Memorandum Findings of Fact and Opinion**

Respondent determined deficiencies in, and additions to, petitioners' Federal income taxes as follows:

After concessions by the parties, the issues for decision are:

(1) Whether the parties reached a settlement agreement covering petitioners' investment in International Recovery Inc. (International Recovery). We hold that they did not.

(2) Whether petitioners were engaged in the trade or business of commodities trading during 1985, 1986, and 1987. We hold that they were not.

(3) Whether petitioners may deduct Schedule C option losses of \$1,141 for 1984, and whether petitioners can deduct Schedule C travel and entertainment expenses of \$479 for 1983. Petitioners have conceded these issues.

(4) Whether petitioners are liable for increased interest pursuant to section 6621(c) for 1982 and 1983. We hold that they are to the extent set forth herein.

(5) Whether petitioners are liable for additions to tax for negligence pursuant to section 6653(a)(1) and (2) for their 1982, 1983, and 1984 tax years. We hold that they are to the extent set forth herein.

All section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise indicated.

**Findings of Fact**

Some of the facts are stipulated and are so found. We incorporate by reference the stipulation of facts and attached exhibits.

Petitioners, Rudolph W. Steffler (petitioner) and Abbie A. Steffler (Mrs. Steffler), are husband and wife and resided in Houston, Texas, at the time they filed their petition.

*Settlement of the Tax Shelter* – Excluded as to relevance

*Trader or Investor in Commodities*

Petitioner received his bachelor's degree in business administration from the University of Houston in 1946, and was in the construction business prior to 1982. Mrs. Steffler is a math teacher with a bachelor's degree in mathematics. In 1982, petitioner left the construction business and moved to a home he owned in Galveston, Texas. While in

Galveston, petitioner started looking for "something to keep \* \* \* [him] busy and earn some money with." Petitioner became interested in commodities and studied the commodities markets. Petitioner had no prior education or training in buying or selling commodities, and describes himself as "self-taught". Petitioner purchased stationery and business cards and opened a separate bank account under the name Steffler Enterprises. Petitioner conducted no other activities through Steffler Enterprises.

Petitioner purchased a computer and, with the help of Mrs. Steffler, wrote computer programs to analyze data relevant to the commodities markets. Petitioners had no prior training or education in computer programming. Petitioner purchased 10 years of commodity market data to use in his computer program in addition to entering the daily high, low, and close for the commodities that he tracked. Petitioner opened an account with Lind-Waldock & Co. in Chicago, Illinois, and that firm executed petitioner's orders. Petitioner had approximately \$100,000 of capital available for his commodities activities. Petitioner did not use the services of an investment adviser to decide what commodities to purchase or when to buy or sell; instead, he relied entirely on his computer analysis for investment decisions. Petitioner implemented his investment strategy by choosing 16 "basic" commodities. After analyzing the market data on these 16 commodities, petitioner eliminated seven or eight of them as not suitable investments. Petitioner would run a daily computer analysis on the commodities that he followed.

Petitioner purchased the following commodities contracts:

Petitioner purchased offsetting positions (2 contracts) for hogs with a July 1985 delivery date but the record contains no specific trade dates.

Petitioner did not take delivery on any of the contracts. Petitioner committed 40-60 hours per week to his commodities activities, and he did not pursue any other business activities during this time.

Petitioners reported on Schedule C business losses of \$5,097 in 1985, \$11,489 in 1986, and \$14,961 in 1987 from their commodities activities. Petitioners calculated net operating losses of \$57,841 in 1985, \$48,419 in 1986, and \$9,702 in 1987. Petitioners filed amended returns for 1982, 1983, and 1984 carrying back losses incurred in 1985 to 1982 and 1983, carrying back losses incurred in 1986 to 1983 and 1984, and carrying back losses incurred in 1987 to 1984. Respondent disallowed petitioners' claimed Schedule C expenses for 1985, 1986, and 1987. After these and other adjustments, respondent determined that petitioners had no net operating losses in 1985, 1986, or 1987, and respondent disallowed the net operating loss deductions on the 1982, 1983, and 1984 amended income tax returns.

## **Opinion**

*Settlement of the International Recovery Issues* – Excluded as to relevance

*Trader or Investor in Commodities*

Respondent determined that petitioners' commodities transactions do not constitute a trade or business, and the losses therefrom are properly reported on Schedule D.

Petitioners argue that their commodities trading constitutes a trade or business, and losses therefrom were properly reported on Schedule C. We agree with respondent.

A commodities contract is a commitment to receive or deliver a specified quantity of a commodity during a specified month in the future at a designated price. Each contract is called a "position". A position is "long" if the contract requires the holder to receive the commodity and "short" if the contract requires the holder to deliver the commodity. A position may be offset by acquiring an equal and opposite position to the position previously held. *King v. Commissioner* [Dec. 44,174], 89 T.C. 445, 458 (1987). Petitioners offset each of their positions.

In order to be engaged in carrying on a trade or business, the taxpayer must be involved in the activity with continuity and regularity, and the taxpayer's primary purpose for engaging in the activity must be for income or profit. *Commissioner v. Groetzinger* [87-1 USTC 9191], 480 U.S. 23, 35 (1987); *Juda v. Commissioner* [Dec. 44,855], 90 T.C. 1263, 1287 (1988), *affd.* [89-1 USTC 9367] 877 F.2d 1075 (1st Cir. 1989). In determining whether a taxpayer purchasing and selling securities is engaged in a trade or business, a distinction is drawn between a dealer, a trader, and an investor. The only issue before us is whether petitioner is a trader (one dealing on his own account in securities or commodity futures) who is considered to be engaged in a trade or business or an investor who is not. *Moller v. United States* [83-2 USTC 9698], 721 F.2d 810, 813 (Fed. Cir. 1983); *Paoli v. Commissioner* [Dec. 47,506(M), T.C. Memo. 1991-351].

To qualify as a trader engaged in a trade or business, a taxpayer's activities must be frequent, regular, and continuous. *Commissioner v. Groetzinger, supra* at 35. Activities that are sporadic, in the sense that they are not regular and continuous, do not qualify as a trade or business. *Polakis v. Commissioner* [Dec. 45,078], 91 T.C. 660, 670-672 (1988). A trader engaged in a trade or business must undertake frequent and substantial trading, must seek profit from short term market swings, and receive income principally from trading rather than from dividends, interest, or long-term appreciation. *Commissioner v. Groetzinger, supra*; *Moller v. United States, supra* at 813; *Purvis v. Commissioner* [76-1 USTC ¶ 9270], 530 F.2d 1332, 1334 (9th Cir. 1976), *affg. per curiam* [Dec. 32,652(M)] T.C. Memo. 1974-164. An investor, on the other hand, is never considered to be engaged in a trade or business. The management of one's own investments is not considered a trade or business no matter how extensive or substantial the investment activities might be. *Higgins v. Commissioner* [41-1 USTC ¶ 9233], 312 U.S. 212, 216 (1941); *King v. Commissioner, supra* at 458. Whether petitioners are engaged in a trade or business is a question of fact. *Estate of Yaeger v. Commissioner* [Dec. 44,843(M)], T.C. Memo. 1988-264, *revd. on another issue, affd. in part, and remanded* [89-2 USTC ¶ 9633] 889 F.2d 29 (2d Cir. 1989). Petitioners bear the burden of proving that their commodities activities constitute a trade or business. *Mayer v. Commissioner* [Dec. 49,838(M)], T.C. Memo. 1994-209, *Estate of Yaeger v. Commissioner, supra*.

In *Paoli v. Commissioner, supra*, taxpayer maintained a private telephone line with a stock brokerage house and had frequent conversations with brokers. A machine in the taxpayer's home produced current stock prices, and he also obtained information from periodicals, from reports on companies, and directly from the companies themselves. The taxpayer consummated 326 securities sales during the year at issue involving

approximately \$9 million worth of stocks or options. Between January 12 and February 11, the taxpayer consummated 125 of the 326 sales of stocks made during the year. During January, February, March, and May, the taxpayers reported 233 sales, 71.47 percent of the total sales for the year. We concluded that taxpayers failed to prove that their pattern of buying and selling stocks was sufficiently regular and continuous during the entire year to constitute a trade or business.

Petitioners purchased 16 commodities contracts in 1985, 18 in 1986, and 44 in 1987. Petitioners offset each contract within 2 months of the purchase date. Petitioners purchased five different commodities: Hogs, lumber, pork bellies, sugar, soybean oil. Petitioners traded on 5 to 7 days of the calendar year in 1985, 8 days in 1986, and 12 days in 1987.

Petitioner testified at length on the subjects he studied and incorporated into his market analysis. These include regression theory, Elliot Wave theory, momentum indicators, and moving averages. Petitioners received no investment advice from outside sources, and they knew very little about computers when they began their investment activities. Petitioner testified that he worked at his commodities activities 40-60 hours per week, every week for 3 years, and that he and Mrs. Steffler spent about 2,000 hours over a 2-year period developing the main components of the computer program. Petitioners spent a substantial amount of their time studying, programming, and revising their computerized investment strategy. However, the number of commodities contracts purchased, the number of types of commodities that petitioners purchased, and the number of days that petitioners purchased or sold contracts leads us to conclude that petitioners were investors in commodities and not traders.

While painstaking study and an arduous decision making process may have consumed much of petitioners' time, this does not carry petitioners' burden of showing that their activities on the commodities market constitute a trade or business. *We conclude that petitioners have not shown that their commodities market activity was frequent, regular, and continuous enough to constitute a trade or business.*

#### *Schedule C Option Losses for 1984, and Travel and Entertainment Expense for 1985*

Petitioners make no mention of these issues on brief or reply brief. Thus, we conclude that petitioners have conceded these issues. See *Money v. Commissioner* [Dec. 44,027], 89 T.C. 46, 48 (1987).

#### *Increased Interest*

Respondent determined that petitioners are liable for increased interest under section 6621 with respect to the underpayments for their taxable years 1982 and 1983. Section 6621 provides for an increase in the interest rate to 120 percent of the statutory rate on the underpayments of tax if a substantial understatement is due to a tax-motivated transaction. Respondent argues that the portion of petitioners' underpayments attributable to International Recovery and to their commodities transactions was attributable to tax-motivated transactions subject to section 6621. Petitioners do not argue that section 6621 does not apply to the understatements attributable to International Recovery, and we conclude that petitioners have conceded that issue.

Respondent argues that "petitioners' decision to claim their commodity investing was a trade or business was designed to avoid the limitations on net operating losses" and therefore qualifies as a tax-motivated transaction. Petitioners argue that they intended to make a profit in their commodities trades and that these transactions were not tax motivated. We conclude that petitioners intended to profit from their commodities investments, and these investments were not a sham. Section 6621 is inapplicable to the understatements attributable to petitioners' commodities investments.

#### *Additions to Tax for Negligence*

Respondent determined that petitioners are liable for additions to tax for negligence under section 6653(a)(1) and (2) for their 1982, 1983, and 1984 tax years. Section 6653(a)(1) imposes an addition to tax equal to 5 percent of the underpayment of tax if any part of the underpayment is due to negligence or intentional disregard of rules or regulations. Section 6653(a)(2) imposes an addition to tax equal to 50 percent of the interest due on the portion of the underpayment which is attributable to negligence.

Negligence is defined as the lack of due care or the failure to do what a prudent person would do under the circumstances. *Marcello v. Commissioner* [67-2 USTC 9516], 380 F.2d 499, 506 (5th Cir. 1967), affg. in part and remanding in part [Dec. 27,043] 43 T.C. 168 (1964); *Neely v. Commissioner* [Dec. 42,540], 85 T.C. 934, 937 (1985). Petitioners bear the burden of establishing that the negligence addition to tax does not apply. *Bixby v. Commissioner* [Dec. 31,493], 58 T.C. 757, 791 (1972).

[Portions excluded as to relevance]

Respondent argues that petitioners were also negligent as to the underpayments attributable to their commodities investing that were reported on their 1982, 1983, and 1984 amended returns. Petitioners argue that they reported their commodities activities in good faith, that they reasonably relied on their accountants' advice, and that they made full disclosure on their returns. Petitioner testified that he prepared petitioners' 1979 through 1987 Federal income tax returns without assistance. Nipper prepared petitioners' amended returns for 1982, 1983, and 1984. We conclude that petitioners' position that they were engaged in a trade or business was reasonable under the facts of this case. Given the considerable time that petitioners committed to their commodities investments, prudent persons under similar circumstances could reasonably take the position that their activities constituted a trade or business. We conclude that petitioners were not negligent, for purposes of section 6653(a)(2), as to that portion of the underpayments attributable to their commodities investments.