

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
) DOCKET NO. 1-707-104-256
 [Redacted],)
)
 Petitioners.) DECISION
)
 _____)

The Idaho State Tax Commission (Commission) reviewed your case and this is our final decision. We modify the Notice of Deficiency Determination (Notice) dated October 2, 2018. This means **you need to pay \$3,199** of tax, penalty and interest for taxable years 2015, 2016, and 2017. The Commission now DEMANDS immediate payment of this amount.

BACKGROUND

[Redacted] (Petitioners) were Idaho residents for the years under review. For all years under review, Petitioners timely filed their Idaho resident income tax returns. [Redacted] [Redacted] earned wages from the railroad during these years and [Redacted] was a homemaker.

Petitioners' 2015 through 2017 returns were selected for review by the Commission's Income Tax Audit Bureau (Audit) and they were notified in writing of the specific items under examination and the documentation needed. Petitioners, through their appointed representative, responded to the inquiry but did not provide any documentation for several months. After receiving the documentation, Audit reviewed it, but it did not adequately substantiate the expenses claimed. Therefore, Audit issued its Notice.

Petitioners protested the Notice. Audit acknowledged the protest then referred the matter to the Commission's Appeals unit for administrative review. An informal hearing was held on May 28, 2019, after which Petitioners provided more documentation for consideration. The additional documentation, along with the contents of the file have been reviewed as part of the redetermination.

ISSUES

The review of Petitioners' returns centered on the following items:

- Schedule E expenses
- Student loan interest
- Schedule A Unreimbursed Expenses
- Capital Gain
- Idaho Capital Gain Deduction
- Form 4797-Other gains
- Idaho Investment Tax Credit

Audit adjusted each of these items and Petitioners' protest letter provided an objection to each of them along with the imposition of the negligence penalty and the amount of interest asserted. The Commission has reviewed all information available and upholds all adjustments, with the exception of the adjustment to student loan interest, for the reasons that follow.

LAW AND ANALYSIS OF ISSUES

Idaho Code § 63-3042 authorizes the Commission to examine any books, papers, records, or other data necessary to ascertain the correctness of a return. Tax Commission Administrative and Enforcement Rule 201.04(a) authorizes the Commission to disallow claimed deductions if a taxpayer fails to produce records supporting information shown on a tax return.

Schedule E Expenses

For all years under review, Petitioners included with their returns a Schedule E for their rental property, 0.42 acres located in a residential neighborhood in **[Redacted]**, Idaho.

Petitioners' 2015 return claimed a variety of rental expenses most of which were allowed by Audit. However, the deductions for auto/travel and "other" were disallowed by Audit due to lack of substantiation. The mortgage interest expense was adjusted to match the amount reported to the Internal Revenue Service on Form 1098.

Auto/travel expenses and "other" expenses claimed on Petitioners' 2016 Schedule E were

also disallowed by Audit as Petitioners failed to adequately substantiate the amounts claimed.

Petitioners' 2016, as well as their 2017 Schedule E showed a depreciation expense for a backhoe. Audit disallowed the expense, determining the backhoe was not a business asset but rather personal property. Petitioners objected, stating in their protest letter this piece of equipment was purchased to assist in the maintenance of the rental property; to remove stumps and trees that could damage the property if they blew over.

During the administrative review Petitioners were asked to provide more information related to the use of the backhoe and proof of the purchase price. Petitioners provided a handwritten bill of sale to substantiate the purchase price and stated they used the backhoe to replace a sewer system on the rental property. Petitioners also stated there was some personal use of the backhoe (Petitioners' personal residence during the review period was located on 5-acres in [Redacted], 45 miles outside of [Redacted]). While the cost of the equipment was documented, Petitioners did not provide any documentation as to the percentage of business use versus personal use nor did they provide any convincing argument related to the business necessity of the asset. Therefore, the Commission upholds the disallowance of the depreciation expense for both taxable years 2016 and 2017. I.R.C. § 167(a).

Student Loan Interest

Petitioners' 2015 and 2017 returns show a deduction for student loan interest. Petitioners did not provide Audit with any documentation to support this expense during the examination. However, statements from the U.S. Department of Education were provided during the administrative review. Therefore, the Notice is modified to allow the deduction for student loan interest; \$216 in tax year 2015, and \$173 in tax year 2017.

Schedule A Unreimbursed Expenses

On their 2017 return Petitioners claimed unreimbursed employee business expenses related to [Redacted] employment. Audit requested documentation to support the amount claimed but none was provided and the expenses were disallowed. Petitioners protested the adjustment stating:

“[Redacted] works for the railroad. He pays out of his own pocket for his safety gear and any equipment not provided to him by the railroad. He is not reimbursed for these expenses. The amounts claimed should stand as correct.”

Petitioners provided their 2017 bank statements during the administrative review along with a claim from the appointed representative that this information bolsters his position that all expenses claimed on the return were usual and customary expenses. The Commission reviewed the documentation but is unable to identify the safety gear purchases amongst the hundreds of transactions listed. Even if somewhere between the payments to Walmart, Netflix, Hobby Lobby and Northwest Seed and Pet, to name a few, the Commission could identify a payment to a retailer who sells safety gear and equipment, payment alone is not adequate substantiation. Therefore, the Commission upholds the disallowance of all unreimbursed employee business expenses claimed on Petitioners’ return for tax year 2017.

Capital Gain, Idaho Capital Gain Deduction and Other Gains

In July 2017, Petitioners sold their rental property. The gain was reported on their federal return and Petitioners took advantage of the Idaho capital gain deduction on their state return. Petitioners’ federal Form 4797, Sale of Business Property, showed a gross sales price of \$247,500, a cost basis of \$232,848, depreciation of \$18,736, an adjusted basis of \$214,112 and a gain of \$33,388. Petitioners were asked to substantiate the cost basis as the amount reported differed from that claimed for depreciation on Petitioners’ 2015 tax return (\$150,000). Petitioners were unable

to provide the purchase documents to substantiate the higher cost basis shown on the 2017 return. Therefore, Audit re-calculated Petitioners' capital gain and their Idaho capital gain deduction, using the cost basis reported by them in 2015 when the rental property was first placed in service. Petitioners protested the adjustment stating the recomputed amounts were incorrect.

The adjustments were discussed during the informal conference and Petitioners requested more time to try and locate the original purchase agreement for the property. Petitioners did provide some additional information for consideration, but it was not sufficient to substantiate the cost basis shown on the 2017 return. Therefore, the Commission upholds the adjustment to both the capital gain and the related adjustment to the Idaho capital gain deduction.

Audit also made another adjustment to Petitioners' 2017 Form 4797, removing the amount reported as ordinary income. The amount of ordinary income shown on the return is the gain from the sale of the rental property, which Petitioners reported as Section 1245 property.

Section 1245 property includes tangible personal property such as furniture and equipment that is subject to depreciation, or intangible property such as a patent or a license, that is subject to amortization. Section 1250 property is depreciable real property, such as buildings.

In 2017, Petitioners sold a building used as a rental property, they sold Section 1250 property. Petitioners' protest letter seems to agree with this property classification in spite of what is shown on the return as it states, "The Auditor's identification of this property as a Section 1245 property is incorrect. It is a Section 1250 property." The Commission upholds the adjustment to other gains.

Investment Tax Credit

Petitioners' 2016 Idaho individual income tax return included an investment tax credit in the amount of \$150 with the qualifying property being a backhoe. Audit disallowed the credit,

determining the backhoe was personal property rather than property used in a trade or business. Petitioners objected, stating the auditor's assertion that the backhoe must be used in a trade or business is incorrect.

An Idaho Investment Tax Credit is available for qualified investments; property that is eligible for the federal investment tax credit as defined in I.R.C. §§ 46 (c) and 48. *See* Idaho Code § 63-3029B. This property must be Section 38 qualifying property, which by definition is property placed in service in a trade or business. As a matter of law, property must be used in a trade or business to qualify for the investment tax credit. Therefore, the Commission upholds the adjustment denying Petitioners a 2016 investment tax credit.

Interest

Petitioners' protest letter includes an objection to the interest rate schedule included with the Notice. "The Auditor's interest rate schedule covers the tax years 2016, 2017 and 2018. The years covered by the Notice of Deficiency Determination are 2015, 2016 and 2017. The Auditor again states inaccurate facts."

Idaho Code § 63-3045(7)(a) states:

Interest shall apply to deficiencies in tax and refunds of tax. Interest shall not apply to any penalty or to unpaid accrued interest. Interest relating to deficiencies or refunds *accruing after the original due date of the return*, but not including extensions of the date, shall be computed on the net of any underpayments and overpayments of a tax liability required to be shown on the same return. (emphasis added)

The due date for returns made on the basis of a calendar year is the fifteenth day of April following the close of the calendar year. *See* Idaho Code § 63-3032.

In the present matter, Petitioners' 2015, 2016 and 2017 returns were due in 2016, 2017 and 2018, respectively. Interest on a deficiency does not start accruing at the beginning of the year under review, but rather from the due date of the return. The auditor correctly calculated the

amount of interest due.

Penalty

The penalty asserted by Audit was a negligence penalty in accordance with Idaho Code § 63-3046(a), and Tax Commission Administrative and Enforcement Rule 410.01 and 410.02. The penalty assertion was reviewed and found applicable.

CONCLUSION

Deductions are a matter of legislative grace and the taxpayer bears the burden of proof to show that the deduction claimed is within the applicable statute. *New Colonial Ice Co. v. Helvering*, supra. See also *Higgins v. C.I.R.*, T. C. Memo. 1984-330 (1984)). The burden rests upon the taxpayer to disclose his receipts and claim his proper deductions. *United States v. Ballard*, 535 F.2d 400 (1976). If a taxpayer is unable to provide adequate proof of any material fact upon which a deduction depends, no deduction is allowed, and that taxpayer must bear his misfortune. *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931). For the majority of expenses under review in this matter, Petitioners simply did not produce the required receipts and other documentation required for the deduction. Therefore, Petitioners must bear their misfortune and pay the additional tax associated with the disallowed deductions.

Therefore, the Notice dated October 2, 2018, and directed to [Redacted], is hereby MODIFIED and as modified, APPROVED and MADE FINAL.

IT IS ORDERED that Petitioners pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2015	\$318	\$16	\$47	\$381
2016	395	20	44	459
2017	2,090	105	164	2,359
				<u>\$3,199</u>

Interest is calculated through December 31, 2019.

An explanation of Petitioners' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2019.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2019, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]
[Redacted]
[Redacted]

Receipt No.

Copy to:

[Redacted]
[Redacted]
[Redacted]
[Redacted]
[Redacted]