

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

|                                 |   |                  |
|---------------------------------|---|------------------|
| In the Matter of the Protest of | ) |                  |
|                                 | ) | DOCKET NO. 16736 |
| [Redacted]                      | ) |                  |
|                                 | ) | DECISION         |
| Petitioners.                    | ) |                  |
| _____                           | ) |                  |

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the staff of the Idaho State Tax Commission (Commission) dated August 9, 2002, asserting additional liabilities for Idaho income tax and interest in the total amounts of \$1,308, \$1,035, and \$54 for 1998, 1999, and 2000, respectively.

The auditor made several adjustments to the petitioners' income tax returns for the periods here in question. The petitioners contest only two of those adjustments. The first is the proper amount of gain to be reported from the repossession of certain real and personal property. The second is the disallowance of travel expenses of the petitioners.

The petitioners sold, and subsequently reposessed, a restaurant. They reported a gain from this repossession. However, the auditor determined that more gain should have been reported. After the filing of the appeal in this case, the petitioners submitted additional documentation establishing the correctness of their position. Therefore, this issue is decided in favor of the petitioners.

The other issue to be decided is whether the petitioners are entitled to claimed losses with regard to their travel in the amounts of \$6,057 and \$5,182 for 1998 and 1999, respectively. The petitioners claimed these losses indicating that they had a travel business. They deducted the expenses incurred for several trips in these years. One trip was to [Redacted], and another was to [Redacted]. The petitioners reported having received no income from this activity in 1998 and \$15

of income in 1999. The auditor disallowed the claimed losses stating that he found no business purpose. The petitioners bear the burden of proof that they are entitled to the deductions sought, and the Commission finds that they have failed to carry this burden.

It is well established that the allowance of deductions is a matter of legislative grace and that a taxpayer has the burden of establishing his right to the deductions. New Colonial Ice v. Helvering, 292 U.S. 435, 440 (1934); AIA Services Corp. v. Idaho State Tax Commission, 136 Idaho 184, 187 (2001); Potlatch Corp. v. Idaho State Tax Commission, 128 Idaho 387, 389 (1996).

Ordinary and necessary business expenses are deductible. Internal Revenue Code § 162. The phrase “trade or business” presupposes an existing business. Koons v. Commissioner, 35 T.C. 1092, 1101 (1961). The taxpayer must have had an actual and honest objective of making a profit. Capek v. Commissioner, 86 T.C. 14, 36 (1986); Dreicer v. Commissioner, 78 T.C. 642, 645 (1982), affd. without opinion 702 F.2d 1205 (D.C. Cir. 1983). The activity must refer not merely to acts engaged in for profit, but to extensive activity over a substantial period of time during which the taxpayer holds himself out as selling goods or services. McDowell v. Ribicoff, 292 F.2d 174, 178 (3 Cir., 1961).

Section 1.183-2 of the regulations lists the following objective factors which should be considered in determining whether an activity is engaged in for profit: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the success of the taxpayer in carrying on other similar or dissimilar activities; (5) the taxpayer's history of income or losses with respect to the activity; (6) the amount of occasional profits which are earned; (7) the financial status of the taxpayer; and (8) elements of personal pleasure or recreation.

It appears from the record before us that neither of the petitioners has obtained travel agent status with the [Redacted]. The petitioners were asked to provide copies of agreements with airlines, cruise lines, etc. with which they had relationships through which they could obtain fees. None have been provided. The petitioners have not established that they had advertised or had an office where they might generate business. There is no indication that the petitioners had a web site through which they might generate income. Therefore, it appears that there is a serious question of whether they held themselves out as selling goods or services as required. McDowell v. Ribicoff, *supra*.

The petitioners have not established that they have any particular expertise in the travel business. They have failed to show that they committed a significant amount of time over and above the time which they spent traveling (which might simply be considered vacations). Also, as indicated in Regulation § 1.183-2, the extent of personal pleasure should be considered. The travel undertaken by the petitioners would appear to supply significant personal pleasure.

Concerning a similar set of facts, the U. S. Tax Court stated:

For section 183(b)(2) not to apply to limit the deduction of expenses attributed to Ferrell Enterprises, petitioners must prove that they engaged in Ferrell Enterprises with an actual and honest profit objective. Dreicer v. Commissioner, 78 T.C. 642, 644 (1982), *affd.* without opinion 702 F.2d 1205 (D.C. Cir. 1983). The courts have used words such as 'basic,' 'dominant,' 'primary,' 'predominant,' and 'substantial' to describe the requisite profit objective. Lemmen v. Commissioner, 77 T.C. 1326, 1340 (1981). While a reasonable expectation of profit is unnecessary, petitioners' profit objective must be bona fide. Besseney v. Commissioner, 45 T.C. 261, 274 (1965), *affd.* 379 F.2d 252 (2d Cir. 1967), *cert. denied* 389 U.S. 931 (1967). Whether there is an intention to make a profit is a factual issue to be resolved on the basis of all the surrounding facts and circumstances. Finoli v. Commissioner, 86 T.C. 697, 722 (1986). Greater weight is to be given to objective facts than to petitioners' after-the-fact statements of their intent. Thomas v. Commissioner, 84 T.C. 1244, 1269 (1985), *affd.* 792 F.2d 1256 (4th Cir. 1986).

Ferrell v. Commissioner, T.C. Memo. 1987-102, affd. without published opinion 856 F.2d 193 (6th Cir. 1988).

The petitioners provided the names of several organizations, organized similarly to [Redacted], through which they were authorized to arrange travel. Presumably, one of these produced the fifteen dollars of income reported. Given the abundance of Internet based sources of airline tickets, rental cars, hotels, etc., it would appear that the margins would be fairly thin. Therefore, if one were to have any chance of overcoming expenses in amounts such as were claimed by the petitioners, one would need a large volume of customers. Notably absent in this alleged "business" is any expense for advertising, office space, or other means of producing the needed volume of customers to have an honest profit objective.

WHEREFORE, the Notice of Deficiency Determination dated August 9, 2002 is hereby MODIFIED, and as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest (calculated to March 15, 2003):

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u>    |
|-------------|------------|----------------|-----------------|-----------------|
| 1998        | \$ 943     | \$ 47          | \$ 274          | \$ 1,264        |
| 1999        | 779        | 39             | 184             | 1,002           |
| 2000        | 0          | 0              | 0               | <u>0</u>        |
|             |            |                |                 | <u>\$ 2,266</u> |

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2003, 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]

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