

The Bureau received information from the representative [Redacted]. The Bureau noted the adjustments and identified some minor adjustments that carried over into the taxable years 1999 and 2000. It was shortly after the Bureau received this information that the taxpayers died. The Bureau continued the examination with the representative requesting specific expense categories to be documented. The Bureau made the requests in writing but received no response from the representative. Since the expenses questioned were not documented, the Bureau disallowed a determined percentage of the expenses and issued a Notice of Deficiency Determination.

The representative protested the Bureau's determination [Redacted]. He stated the adjustments made to the 2000 return were arbitrary, capricious, an abuse of discretion, and all without basis or merit. The Bureau acknowledged the representative's protest and, upon contacting the representative, scheduled a meeting to go through the taxpayers' documentation.

The Bureau examined the documentation the representative provided and modified its deficiency determination. The Bureau determined that three of the four selected expense categories were verifiable and allowable as deductions. However, the fourth, cleaning/maintenance, was too convoluted to trace the expenses to the amounts claimed on the taxpayers' returns. Since the representative was not available to offer any assistance, the Bureau stood firm with its adjustment to the cleaning/maintenance expenses.

The representative continued his protest of the Bureau's determination, so the Bureau referred the matter for administrative review. The Tax Commission sent the representative a letter giving him two options for having the Notice of Deficiency Determination redetermined. The representative requested a hearing before a Commissioner, which was granted and held on November 13, 2003.

The representative explained the relationship between the taxpayers' businesses and the taxpayers' returns. The taxpayers' rental properties were owned through partnerships and solely owned by the taxpayers. All the rental properties were managed through a corporation the taxpayers created. The corporation was a fiscal year corporation and it paid all the expenses of the taxpayers' rentals. The taxpayers then reimbursed the corporation for the rental expenses. The taxpayers also paid a management fee to the corporation for managing the properties. The reason for the confusion in tying amounts to the taxpayers' returns was the fiscal year accounting of the corporation.

The representative provided all the rental records for the Tax Commission to review. The Tax Commission determined that the only expenses it would examine were those for cleaning and maintenance. (The Bureau had already determined the other questioned expenses were allowable.) The Tax Commission selected specific cleaning and maintenance expenses for verification and to determine whether they were deductible. The Tax Commission found all the amounts could be verified. However, the Tax Commission questioned the expensing of expenditures that were capital in nature.

The representative stated that, because of the nature of the taxpayers' business--renting to college students--the apartments needed regular extensive repairs. This included replacing carpet, vinyl, windows, doors, appliances, and paint. The representative also said the taxpayers had to replace some vinyl siding that had been destroyed in a windstorm. The representative identified expenditures from certain vendors that the taxpayers always bought materials in bulk to make the repairs. In addition to the representative's statements, the representative provided the Tax Commission with an affidavit from the taxpayers' son and co-personal representative. The taxpayers' son stated that he, his father, and his brother worked on the apartments in the fall of

1997 through 1998 installing vinyl siding and replacing aluminum windows with vinyl windows. He said the installation of the siding and windows were all completed by the spring of 1999 and all the costs of the renovation were incurred prior to 1999.

The Tax Commission questioned the expenditures for 1999 because the records did not necessarily agree with the representative's or the son's statements. The records showed substantial window purchases into the middle of 1999 and substantial materials purchased from the siding and roofing vendor throughout 1999. The Tax Commission's review of the supporting documentation showed the materials purchased were roofing material, vinyl siding, doors, vinyl windows, and vinyl patio doors.

The Tax Commission requested information on the date and damage the windstorm was to have caused, any insurance claims for the damage caused, and an explanation as to why the expenditures to these vendors virtually disappear after 1999 if they are recurring expenses. The Tax Commission put its request in writing and followed up with telephone calls to the representative but did not receive a response. Therefore, the Tax Commission issues its decision based upon the information available.

Internal Revenue Code (IRC) section 263(a)(2) stated no deduction shall be allowed for, “Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.”

The taxpayers' son stated that the taxpayers installed vinyl siding and replaced aluminum windows with vinyl windows. [Redacted] The expenditures made in 1999 were the same as those claimed in 1998. The question the Tax Commission must decide is whether the expenditures were of a sufficient enough nature to require the taxpayers to capitalized them.

The representative and the taxpayers' son both stated the expenses were in the ordinary course of the taxpayers' business. The representative also stated the repairs were due to damage caused by a severe windstorm. However, nothing was provided to show what damage was caused by the storm or that the same level of repairs/maintenance were made in succeeding years. Additionally, the taxpayers expended over \$28,000 for insurance in 1999. If there was damage caused by a windstorm, one would reasonably assume an insurance claim would have been made to cover the cost of the damage.

The expenditures made (carpet, vinyl, doors, patio doors, windows, roofing and siding materials) are all of the nature of capital expenditures under IRC section 263. Each of these expenditures prolongs the useful life of the property or restores the exhaustion of the property. An expense that represents "incidental" repair or maintenance is currently deductible and is not a capital expenditure. However, if the repair is an improvement or replacement or if it increases the property's value or substantially prolongs its useful life, it is capital in nature and is not currently deductible. Wolfsen Land & Cattle Co. v. Commissioner, 72 T.C. 1, 14 (1979).

Section 263(a)(2) and the regulations thereunder deny deductibility of amounts expended in restoring property in which an allowance is, or has been, made in the form of a depreciation deduction. Sec. 1.263(a)-1(a)(2), Income Tax Regs. Joseph J. Otis v. Commissioner, 73 T.C. 671 (1980). Accordingly, when the taxpayers were required to capitalize the expenditures for the siding and replacement windows in 1998, it follows those same expenditures should be capitalized and depreciated in 1999. The taxpayers simply expended funds "in making good the exhaustion" on their property upon which an allowance for depreciation had been allowed. The replacement assets all had a useful life in excess of one year and represented the replacement or

restoration of depreciated assets. Therefore, replacement of these assets was more than mere incidental repair or maintenance of the property. Joseph J. Otis v. Commissioner, id.

The representative presented little or no support for expensing the expenditures for carpeting, vinyl flooring, windows, patio doors, interior doors, roofing material, vinyl siding, and the labor to install them. He did not meet his burden of proof. Albertson's, Inc. v. State, Dept. of Revenue, State Tax Com'n, 106 Idaho 810, 683 P.2d 846 (1984). Therefore, the Tax Commission finds the expenditures for carpeting, vinyl flooring, windows, patio doors, interior doors, roofing material, vinyl siding, and the labor should be capitalized and depreciated in accordance with the attached schedules.

WHEREFORE, the Notice of Deficiency Determination dated April 11, 2003, is hereby MODIFIED, in accordance with the provisions of this decision and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
1999	\$15,834	\$4,513	\$20,347
2000	3,557	729	<u>4,286</u>
		TOTAL DUE	<u>\$24,633</u>

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

An explanation of the taxpayers' rights to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2004.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2004, 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]

Receipt No.
