

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 19585
[Redacted]	)	
	)	DECISION
Petitioners.	)	
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	)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated June 23, 2006. The Notice of Deficiency Determination asserted additional liabilities for Idaho income tax, penalty, and interest in the total amounts of \$583 and \$786 for 2004 and 2005, respectively.

The auditor made two adjustments to the deductions claimed by the petitioners on each of the returns in question. In addition, the auditor asserted the negligence penalty for each of the years. The petitioners protested each of the adjustments made by the auditor.

For both 2004 and 2005, the auditor disallowed rental losses claimed by the petitioners. For 2004, the auditor disallowed some of the itemized deductions claimed by the petitioners. This reduction in the allowable itemized deductions made it more beneficial for the petitioners to claim the standard deduction than to be allowed the itemized deductions they were able to verify. The auditor allowed the standard deduction for 2004.

For 2005, the petitioners deducted the amount of \$5,230 for health insurance premiums. The auditor felt that, during the audit, she was not provided sufficient documentation to establish that the petitioners were entitled to this deduction. Therefore, she disallowed this deduction.

The auditor made two adjustments to the Schedule A (itemized) deductions claimed by the petitioners. The first of these was to reduce the amount of the allowable deduction as medical expense due to the increase in adjusted gross income from the disallowance of the rental

loss. The second was to entirely disallow the claimed contributions to charitable organizations.

The auditor also asserted the penalty for negligence or disregard of the rules but without intent to defraud.

The petitioners raised several issues on which they disagreed with the auditor's determination:

1. The denial of claimed losses from rental property,
2. The disallowance of a portion of the medical insurance premiums that were disallowed by the auditor,
3. The disallowance of some of the charitable contributions, and
4. The assertion of penalties as a part of the deficiencies referred to above.

The petitioners allege that they held a trailer for rental during the years in question. They reported no income from the property but claimed expenses in the total amounts of \$6,539 and \$4,656 for 2004 and 2005, respectively. The auditor denied the claimed losses and stated:

When an individual owns a dwelling unit and uses it for both personal and rental purposes, deduction of expenses is limited. A dwelling unit is considered to be used as a residence if the individual owner's use of the unit (or a portion of it) for personal purposes exceeds the longer of (1) 14 days, or (2) 10% of the period of rental use. If a dwelling unit is rented for less than 15 days a year, the owner can't deduct any of the rental expenses, but is not taxed on any of the rental income. (IRC § 280A)

The auditor further stated that, "if an activity is not engaged in for profit, then the related deductions are allowed only to the extent of the income from the activity. (IRC § 183)"

The petitioners contend that they did not use the property for personal purposes. On the other hand, [Redacted] had signed a "Homeowner's Exemption Application" in 2000 indicating that he was the owner/occupant and used this property as his primary dwelling place as of January 1 [2000]. Based on his application, the exemption was granted. If the property was not

the petitioners' primary dwelling but instead was rental property, they would not have been entitled to the exemption. However, the petitioners did not ask that the exemption be rescinded. This would indicate that they did live in the property.

Whether the petitioners occupied the property in question as their primary dwelling is not clear from the facts in the file. However, this is not relevant to the Commission's ultimate conclusion that the petitioners are not entitled to the claimed rental losses.

If they used the property as their personal residence, then Internal Revenue Code § 280A(g) precludes the claimed loss:

(g) Special rule for certain rental use. Notwithstanding any other provision of this section or section 183, if a dwelling unit is used during the taxable year by the taxpayer as a residence and such dwelling unit is actually rented for less than 15 days during the taxable year, then –

- (1) no deduction otherwise allowable under this chapter because of the rental use of such dwelling unit shall be allowed, and
- (2) the income derived from such use for the taxable year shall not be included in the gross income of such taxpayer under section 61.

Since the petitioners had no income from the property, none of the deductions would be allowable.

If the petitioners did not use the property as a residence, the Commission finds that the claimed losses are precluded pursuant to Internal Revenue Code § 183. Internal Revenue Code § 183 stated, in pertinent part:

Activities not engaged in for profit.

(a) General rule.

In the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) Deductions allowable.

In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed-

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which should be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable for reason of paragraph (1).

(c) Activity not engaged in for profit defined.

For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212.

Treasury Regulation 1.183-2 sets out factors to be considered in determining whether a particular activity is "an activity not engaged in for profit." In considering these factors, the Commission finds that the petitioners were not engaged in the activity for profit. Of particular concern to the Commission is the lack of advertising of the subject property. The petitioners contend that they had placed a sign or signs indicating that the property was for rent. With regard to the signs, there had been some indication that the property as a whole, or in some part, would not be available for 60 days. The petitioners did not contend that they had listed the property for rent with any agency or that they had purchased ads for the rental of the property in any publication or listed the property with any agent.

In two cases involving the rental of a condominium in [Redacted] by a couple from Oklahoma, the same taxpayers were in court twice concerning losses from the same condominium for different years. The first time involved the taxable years of 1970 and 1971. Edith G. and James R. McKinney v. United States, No. CIV-76-805T (W.D. Okla. November 23, 1977. The second time involved the taxable years of 1974, 1975, and 1976. McKinney v. Commissioner, T.C. Memo 1981-181. In the latter case, the taxpayers prevailed. They

purchased their condominium in Hawaii in November of 1966. The operating results were as follows:

<u>Year</u>	<u>Rental Income</u>	<u>Cash Expenses (Excluding Depreciation)</u>	<u>Total Depreciation</u>	<u>Net Profit (or Loss) (Including Depreciation)</u>
1966	\$ 550.00	\$ 1,529.07	\$1,888.25	(\$2,867.32)
1967	5,375.00	6,330.52	2,506.95	(3,462.47)
1968	4,673.75	8,110.97	2,482.61	(5,919.83)
1969	1,518.80	4,755.45	2,884.27	(6,120.92)
1970	936.00	6,016.65	2,409.94	(7,490.59)
1971	840.00	5,403.14	2,146.56	(6,709.70)
1972	1,091.80	4,480.51	2,128.57	(5,518.08)
1973	2,440.58	6,061.31	4,332.88	(7,953.61)
1974	3,138.30	4,199.84	2,916.44	(3,977.98)
1975	3,098.00	6,518.40	2,689.68	(6,110.08)
1976	6,032.00	5,888.88	2,931.81	(2,788.69)
1977	7,165.00	6,106.62	2,667.90	(1,609.52)
1978	10,085.18	6,678.44	2,731.00	675.74
1979	11,455.00	7,616.29	2,050.78	1,787.93

During substantially all of the period of ownership, the taxpayers had their property listed for rent with one or more agents in Hawaii and advertised in newspapers. They also relied on word-of-mouth publicity. During 1970 and 1971, the property was listed with nine travel agencies in Oklahoma City and with two parties in Hawaii. In 1973, the taxpayers completely remodeled the condominium and purchased a new car for the use of potential lessees. They made an advertising album and began using newspaper advertising with greater frequency. In 1974, 1975, and 1976, they rented the condominium for 49 days, 48 days, and 85 days, respectively. Although the [Redacted] characterized the taxpayers' efforts to obtain rentals of the apartment as spasmodic and half-hearted, the court found that they had engaged in the holding of the condominium for profit.

The Commission finds that the petitioners' efforts to obtain renters for their property fall short and that they have failed to carry their burden of proof that they were engaged in the rental activity for a profit.

The petitioners claimed a deduction in the amount of \$5,230 for medical insurance premiums on their 2005 Idaho income tax return. The auditor disallowed this entire deduction.

After the Notice of Deficiency Determination was issued, the petitioners submitted additional documentation to support their claimed deduction. They contend that they are entitled to a deduction for medical insurance premiums in the amount of \$3,484. The Commission has reviewed the material submitted and agrees that the petitioners are entitled to a deduction in this amount. However, the petitioners did not supply a rational explanation for their claiming a deduction for medical premiums on their original return in the amount of \$5,230.

The next issue concerns the itemized deductions claimed by the petitioners for 2004. The auditor found that the standard deduction was more beneficial to the petitioners than was the allowance of the itemized deductions which were verified by the petitioners.

The petitioners submitted additional documentation regarding some of the disallowed itemized deductions after the issuance of the Notice of Deficiency Determination. They continue to assert that the adjustments made by the auditor disallowing the rental losses are incorrect. However, the Commission has ruled herein that the losses were properly denied by the auditor. The petitioners submitted additional information regarding their claimed deduction for charitable contributions. They contend that, due to this additional documentation, they are entitled to a deduction for charitable contributions in the amount of \$155. The Commission agrees \$155 is deductible. The petitioners did not provide a rational basis for the \$500 deduction claimed on their Idaho income tax return. This additional deduction, however, does not make it more beneficial for the petitioners to claim itemized deductions rather than the standard deduction allowed by the auditor.

The last issue protested by the petitioners is the imposition of the penalty. The auditor asserted the negligence (5%) penalty for each of the years. The authority for the penalty is set out in Idaho Code § 63-3046 which stated in part:

(a) If any part of any deficiency is due to negligence or disregard of rules but without intent to defraud, five percent (5%) of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected and paid in the same manner as if it were a deficiency.

The penalty imposed was for negligence. The Commission finds insufficient cause to justify abatement of the penalty.

WHEREFORE, the Notice of Deficiency Determination dated June 23, 2006, 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 (computed to January 31, 2007):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2004	\$514	\$26	\$54	\$594
2005	481	24	22	<u>527</u>
			TOTAL DUE	<u>\$1,121</u>

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

An explanation of the taxpayers' right to appeal this decision is included with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_, 2006, 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.

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