

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 21272
[Redacted])	
Petitioners.)	DECISION
)	
)	
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On April 7, 2008, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayers) proposing income tax, penalty, and interest for the taxable years 2004 through 2006 in the total amount of \$7,038.

On June 6, 2008, the taxpayers filed a timely appeal and petition for redetermination. The taxpayers requested a telephone hearing which was held on November 12, 2008. The Tax Commission, having reviewed the file, hereby issues its decision.

The Income Tax Audit Bureau (Bureau) selected the taxpayers 2004, 2005, and 2006 Idaho individual income tax returns for examination. The Bureau contacted the taxpayers and requested the supporting documentation for their schedules A, C, and F for each year. The taxpayers provided their records to the Bureau along with a statement that most of their records were destroyed when their sewer backed up and flooded their basement. The Bureau reviewed the information provided and suggested other methods for substantiating the expenses and deductions claimed. The Bureau received little, if any, further information to support what was claimed on the taxpayers' returns. Consequently, the Bureau adjusted the taxpayers' returns based upon the information available and sent the taxpayers a Notice of Deficiency Determination.

The taxpayers protested the Bureau's determination and provided some additional information and documentation for the Bureau to consider. The Bureau reviewed what the taxpayers provided and modified its deficiency determination. However, the modifications did not change the tax deficiency due to the characterization of the schedule F as not-for-profit and the taxpayers' allowable itemized deductions did not exceed the standard deduction. The Bureau sent the modified report to the taxpayers with an extensive explanation letter, but did not receive a response. Therefore, the Bureau referred the matter for administrative review.

The Tax Commission reviewed the matter and sent the taxpayers a letter that discussed the methods available for redetermining a protested Notice of Deficiency Determination. The taxpayers requested a telephone hearing which was held on November 12, 2008. During the hearing, the Tax Commission obtained additional information about the taxpayers' [Redacted] operation, their [Redacted] business, and their itemized deductions. The taxpayers again stated that virtually all their records were destroyed in a sewer flood and subsequent water break flood.

The Tax Commission told the taxpayers that without documentation of the deductions and expenses claimed, it is impossible to determine whether the deductions and expenses are allowable. The Tax Commission stated that in cases like this, where a taxpayer's books and records are inadequate (or destroyed), other credible evidence may be accepted and, in certain cases, reasonable estimates may be used. Cohan v. Commissioner, 39 F2d 540 (2nd Cir. 1930). The Tax Commission gave the taxpayers suggestions on what they could do to substantiate their deductions and expenses, and allowed them additional time to gather the information.

The taxpayers provided limited additional information, mostly related to their schedule F – [Redacted] operation. The Tax Commission reviewed that information and found that it was sufficient to establish that the taxpayers incurred the expenses for those items in the years in

question. However, since the Bureau determined the taxpayers' [Redacted] operation was not-for-profit, the additional expenses could only be allowed up to the income received from the operation. (Internal Revenue Code section 183.)

Other information the taxpayers provided related to their charitable contributions made in 2006. The taxpayers stated they donated money to the school district[Redacted]. The evidence the taxpayers provided showed an acknowledgement of the taxpayers' donation. The Tax Commission finds that this acknowledgement is sufficient corroborating evidence that the taxpayers made a substantial contribution. Therefore, the Tax Commission allowed the taxpayers' stated contribution.

Internal Revenue Code section 162(a) states, in part, that "[T]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." However, deductions and expenses are a matter of legislative grace, and only as there is clear provision therefor can any particular deduction be allowed. New Colonial Ice Co., Inc. v. Helvering, 292 US. 435, 54 S.Ct. 788 (1934). The petitioner bears the burden of proving that he is entitled to the deduction. 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).

The taxpayers were asked to provide documentation for the expenses and deductions claimed on their schedules A, C, and F. The taxpayers had only a small portion of their documentation to support their expenses and deductions. As previously stated, the taxpayers experienced flooding which destroyed most of their records. Consequently, there were no actual documents the taxpayers could provide.

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). However, a taxpayer can substantiate expenses and deductions by corroborating evidence that supports the expense incurred. The Tax Commission provided the taxpayers with the opportunity to provide such additional information, but only a limited amount of that evidence was provided. Since the taxpayers failed to provide any further information on their expenses, they failed to meet their burden of proof. United States v. Ballard, supra. Therefore, the Tax Commission upholds the balance of the Bureau's adjustments to the taxpayers' 2004, 2005, and 2006 Idaho income tax returns.

The Bureau added a 5 percent negligence penalty to the taxpayers' tax deficiency. The Bureau stated the penalty was for failure to maintain proper records and filing income tax returns that contained unsubstantiated claims or errors. The taxpayers' records were destroyed through no fault of their own. The Tax Commission does not believe this constitutes negligence on the part of the taxpayers. As to whether the taxpayers' returns contained unsubstantiated claims, that determination can only be made if all the taxpayers' records were available. Therefore, the Tax Commission finds the addition of the negligence penalty inappropriate.

WHEREFORE, the Notice of Deficiency Determination dated April 7, 2008, 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, penalty, and interest (computed to November 9, 2009):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2004	\$ 420	\$ 0	\$119	\$ 539
2005	2,981	0	672	3,653
2006	2,140	0	348	<u>2,488</u>
			TOTAL DUE	<u>\$6,680</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.

DATED this _____ day of _____, 2009.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2009, 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]

Receipt No.
