

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 23032
[Redacted],)	
)	
Petitioner.)	DECISION
_____)	

[Redacted] (petitioner) protests the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated April 19, 2010, asserting an additional liability for Idaho income tax, penalty, and interest in the total amount of \$8,132 for 2007.

The petitioner filed her 2007 income tax return with the filing status of married filing separately. The return, as filed, reported Idaho taxable income in the amount of \$58,965. The auditor first determined that the starting Idaho taxable income was \$6,961. The auditor then made four adjustments to the petitioner's income. They were as follows:

1. He added back half of a business loss initially claimed on the petitioner's husband's return,
2. He disallowed half of a loss from the disposition of the [Redacted] property,
3. He included a computed gain from the disposition of the [Redacted] property, and
4. He allowed the capital gains deduction with regard to the gain from the sale of the [Redacted] property.

BUSINESS LOSS

The petitioner's husband ([Redacted]) claimed a business loss in the amount of \$118,000. The return reflected total sales in the amount of \$826 and a cost of goods sold in the amount of \$95,000 made up from \$75,000 in beginning inventory, \$40,000 of purchases, \$20,000 as labor, \$10,000 as other expenses, and an ending inventory of \$50,000. Other expenses in the total amount of \$23,826 were also claimed. Ignoring the other expenses, [Redacted] reports that he sold \$65,000 of merchandise ($\$75,000 + \$40,000 - \$50,000$) for \$826.

Insufficient documentation was submitted to support the expenses claimed. The reason given for the lack of documentation was that [Redacted] had substance abuse problems and that the business, therefore, incurred large expenses and was not successful. While some expenses were documented, the Commission finds that, as the auditor determined, no part of the loss is deductible.

Counsel for the petitioner contends that his clients are being discriminated against due to [Redacted] substance abuse problems. No authority was cited for this position and no different standard was set forth for the taxation of those with substance abuse issues than for those without such issues.

It was represented to the Commission staff that the nature of the "business" was to sell supplies and equipment to [Redacted] businesses. The records submitted do not substantiate the kind of business that was represented. Some of the expenses would have been incurred in such a business, but many of the claimed deductions appear to show little or no relation to such a business.

In notes made by the auditor for July 6, 2009, was the following:

Mrs. [Redacted] admitted that it wasn't really a business.

In notes made by the auditor for August 20, 2009, was the following:

During prior conversations taxpayer admitted that due to his drug/alcohol habit he sold most of his inventory to pawn shops and in on the street sales. Has [sic] admitted that a business never really existed but will not put that in writing because he is afraid he will be charged for fraud as it relates to the SBA loan he received.

Internal Revenue Code (IRC) section 162(a) allows deductions for all ordinary and necessary expenses paid or incurred during a taxable year in carrying on a trade or business. In the case of an activity not engaged in for profit, IRC section 183 generally limits allowable deductions attributable to the activity to the extent of gross income generated by the activity. Sec. 183(b).

The test for determining whether a taxpayer is carrying on an activity for profit is whether the taxpayer's actual and honest objective in engaging in the activity is to make a profit. *See Dreicer v. Commissioner*, 78 T.C. 642, 645 (1982), *affd.* without published opinion 702 F.2d 1205 (D.C. Cir. 1983). Although the taxpayer's expectation of profit need not be reasonable, it must be a good-faith expectation. *See Allen v. Commissioner*, 72 T.C. 28, 33 (1979); sec. 1.183-2(a), Income Tax Regs. Greater weight is to be given to objective facts than to a taxpayer's statement of intent. *See Dreicer v. Commissioner*, *supra* at 645; sec. 1.183-2(a), Income Tax Regs.

The records submitted to the Commission indicate that some receipts were kept, but no organized set of books or records was presented. Given the information in the file, it is difficult to imagine that [Redacted] could be characterized as having pursued this activity with an honest

objective to make a profit. The record supports this indicating that both spouses stated that there was no business. Accordingly, the Commission finds that the loss in question is not allowable.

[Redacted] STREET PROPERTY – [Redacted]

The petitioner lived in the [Redacted] area; but she purchased another house in the [Redacted] area. The petitioner purchased the property in a rather poor condition, put a substantial amount of money into the property, and sold the property at a substantial loss which she deducted and which loss the auditor disallowed. The petitioner set out her intent regarding the property as follows:

I purchased the home with the intend [sic] of the second home in the area as my business required me to spend a lot of time in the [Redacted].

Treasury Regulation 1.165-9(a) states:

Losses not allowed. A loss sustained on the sale of residential property purchased or constructed by the taxpayer for use as his personal residence and so used by him up to the time of the sale is not deductible under section 165(a).

The property was purchased as a personal residence for the petitioner, and the record contains no record of the property having been put to any other use. Accordingly, the loss sustained is not deductible.

[Redacted] PROPERTY

The petitioner did not report a gain from the sale of the [Redacted] property. The record indicates that this property was purchased on [Redacted] (at which time the petitioner was single) and sold on [Redacted]. It appears that the auditor computed the gain on the property to have been \$2,798 (\$6,995 less 60 percent capital gains deduction). Additionally, it appears that the auditor allowed the capital gains deduction a second time in the amount of \$1,679 (\$2,798 x 60 percent). Upon review, the Commission finds that the taxable gain from the disposition of the property was \$5,345. The record indicates that the property was sold for \$55,000. The property

was purchased for \$46,247. The cost of the sale was \$3,408 (brokerage fees of \$3,300 plus an escrow closing fee of \$108). The gain from the sale of this property also was not eligible for the Idaho capital gains deduction. The authority for this deduction was provided by Idaho Code § 63-3022H which stated, in part:

Deduction of capital gains. (1) If an individual taxpayer reports capital gain net income in determining taxable income, eighty percent (80%) in taxable year 2001 and sixty percent (60%) in taxable years thereafter of the capital gain net income from the sale or exchange of qualified property shall be a deduction in determining Idaho taxable income.

(2) The deduction provided in this section is limited to the amount of the capital gain net income from all property included in taxable income. Gains treated as ordinary income by the Internal Revenue Code do not qualify for the deduction allowed in this section. The deduction otherwise allowable under this section shall be reduced by the amount of any federal capital gains deduction relating to such property, but not below zero.

(3) As used in this section “qualified property” means the following property having an Idaho situs at the time of sale:

(a) Real property held at least twelve (12) months; . . . (Underlining added.)

Clearly, the holding period was not met. Therefore, the taxable gain from the sale should be increased by \$4,226 from that computed by the auditor.

Although not raised by the petitioner, her counsel, or the auditor, the income attributed to the petitioner from the community property division performed earlier was partially incorrect. The Idaho taxable income previously attributed to the petitioner (before the audit adjustments addressed in this decision) was \$6,961. The amount should have been (\$11,163). Accordingly, the Commission finds that the petitioner’s Idaho taxable income should be reduced by \$18,124 due to this error.

THEREFORE, the Notice of Deficiency Determination dated April 19, 2010, is hereby MODIFIED, and AS SO MODIFIED is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax, penalty, and interest (computed to November 30, 2011):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2007	\$5,803	\$290	\$1,081	\$7,174

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

An explanation of the petitioner's right to appeal this decision is enclosed.

DATED this _____ day of _____ 2011.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2011, 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.
