

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 24246
[Redacted],)	
)	
Petitioners.)	DECISION
)	
)	
_____)	

On June 7, 2011, the Income Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted](taxpayers) proposing income tax and interest for taxable years 2008, 2009, and 2010 in the total amount of \$8,213.

On August 1, 2011, the taxpayers filed a timely protest and petition for redetermination. Substantial additional information was submitted for the Commission’s consideration. An informal hearing was held October 18, 2011. [Redacted]. The Commission, having reviewed the file, hereby issues its decision based on the information in the file.

The taxpayers filed Idaho individual income tax returns jointly during the audit period. In 2008 and 2009, both taxpayers claimed to be Idaho residents. In 2010, [Redacted] changed his residency for Idaho purposes to part-year and allocated his income accordingly on Idaho Form 43. [Redacted] state of residence was reported as [Redacted] for 2010.

During the three-year audit period, the taxpayers claimed that [Redacted] was a real estate professional. [Redacted] worked full-time and did not contribute her time to the rental properties. The federal Schedule E filed by the taxpayers reported residential rental property [Redacted] and residential rental property [Redacted]. The [Redacted] property was inherited in 2008 and was reported as a rental property on the 2008 and 2009 income tax returns only.

The taxpayers claimed rental losses on their Idaho returns as follows:

2008 - \$49,597

2009 - \$44,358

2010 - \$1,774 (farmland only)

At the auditor's written request, the taxpayer provided a handwritten log of activities relating to the real estate rentals.

The taxpayer did not make the election as outlined in Internal Revenue Code (IRC) section 469(c)(7)(A) to treat all interests in rental real estate as a single real estate activity; therefore, the reported rentals were treated as separate activities. As such, the material participation requirements of the real estate professional as outlined in IRC section 469(c)(7)(B) must be met with respect to each interest in rental real estate.

The taxpayer submitted a letter on May 18, 2011, stating the [Redacted] farmland was not part of [Redacted] rental activities and was therefore deemed to be a passive activity. The residential rentals [Redacted] were the two properties claimed to be involved in the professional real estate activities.

The taxpayers' activity log was examined, and various entries were disallowed as being personal or investment activities rather than direct material participation in rental real estate. All activities for the [Redacted] residential rental property did not exceed the 750 hours required by the federal tax code and was therefore deemed to be a passive activity.

The taxpayers appealed the auditor's claim that [Redacted] is not a real estate professional. The taxpayers claim the time disallowed in computing material participation for a real estate professional qualifies as direct rental activities. Those specific disallowed activities were travel between the taxpayers' home and the rental [Redacted], time spent shopping for furniture for the

rental and planning upgrades to the rental, researching furniture, and tax return preparation. The taxpayers did not provide any citations or authority to support their claim.

As outlined in IRC section 469(c)(7)(B), in order to qualify as a real estate professional, the following conditions must be met:

- (i) More than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and
- (ii) Such taxpayer performs more than 750 hours of service during the taxable year in real property trades or businesses in which the taxpayer materially participates.

The total hours of activities directly related to the [Redacted] rental combined with the hours of activities deemed not integral to operations does not total the 750 hours necessary to qualify as a real estate professional. The deciding factor then becomes the travel time from the taxpayers' home to the [Redacted] rental. The time allocated to travel was not considered in computing the hourly tests for material participation for the following reasons. IRC section 469(h) requires regular, continuous and substantial participation in the operation of the activity. In Goshorn, T.C. Memo 1993-578, the Court held that travel was nothing but an investment related activity and refused to consider travel time. Travel time is analogous to personal commuting. It is well established that the expenses for commuting from home to work are personal and not deductible under IRC section 162. According to Treasury Regulation 1.262-1(b)(5), the taxpayers' costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible business expenses. Reg. 1.162-2(e) provides that commuters' fares are not considered as business expenses and are not deductible. "Commuting is an inherently personal activity and as such does not constitute "work" in connection with a trade or business." See Fausner v. Commissioner, 413 U.S. 838, 839 (1973). "A taxpayer's choice to live at a distance from his place of business is personal, and a taxpayer's

costs of commuting to his place of business or employment are personal.” See Commissioner v. Flowers, 326 U.S. 465 (1946). Similarly, in computing the hourly tests for participation (i.e. work) in an activity under IRC section 469, travel time from a personal residence are inherently personal hours that do not represent participation in a business. IRC section 1.469-5(f)(1) defines participation as “any work done by an individual in connection with an activity in which he owns an interest at the time the work is done”.

IRC section 469(h)(1) defines material participation as involvement in the operations of the activity on a basis which is regular, continuous, and substantial. In order to treat rental real estate as non-passive, material participation is necessary according to IRC section 469(h)(1). The fact that Mr. [Redacted] is not on-site and must travel to and from the activity is an indication he is not materially participating. Furthermore, it also raises questions as to whether Mr. [Redacted] meets the regular and continuous requirements of IRC section 469(h) for material participation. Legislative history further provides that “services must be integral to operation.” First, it is somewhat difficult to construe that travel constitutes “services” or “participation” as contemplated by the Regulations. Secondly, travel is not integral to operations in most cases. Generally, an owner who is materially participating in operations is on-site and does not have to expend large amounts of the time allocated to his business in traveling to and from it.

The taxpayers have provided nothing that would dissuade the Commission from accepting the Bureau’s determination of Idaho income and Idaho income tax for taxable years 2008, 2009, and 2010.

THEREFORE, the Notice of Deficiency Determination dated June 7, 2011, and directed to [Redacted] is APPROVED.

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>
2008	\$3,857	\$529	\$4,386
2009	\$3,460	\$301	\$3,761
2010	\$ 263	\$ 10	\$ 273
		TOTAL DUE	<u>\$8,420</u>

Interest is calculated through April 15, 2012 .

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

An explanation of the taxpayers' 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.
