

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 24383
[Redacted],)	
)	
Petitioners.)	DECISION
)	
)	
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[Redacted] (petitioners) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated September 20, 2010, asserting additional liabilities for Idaho income tax and interest in the total amount of \$3,493 for 2006.

Mr. [Redacted] is a [Redacted] from [Redacted], Idaho. On the petitioners' 2006 income tax return, they reported (on Schedule C) that they were also operating a [Redacted]. Their Schedule C for the [Redacted] showed sales of \$178,978 and expenses such that they reported a net loss of \$13,989. The petitioners deducted this loss in the computation of their Idaho taxable income.

When it was found that the [Redacted] had a liability for sales tax, the petitioners stated that the business was not theirs and that, therefore, they were not liable for the sales tax liability. They then stated that they had loaned funds to their son and that he was the owner of the business. They amended their tax return to show that the [Redacted] business was not theirs and claimed a deduction for "guaranteed payments" with regard to Mr. [Redacted] business in the amount of \$67,381 relating to their having advanced their son funds to purchase and operate the [Redacted]. They also claimed an additional \$1,444 of car and truck expenses on their amended 2006 income tax return and reported an additional \$150 of miscellaneous income. The auditor disallowed both the "guaranteed payment" deduction and the car and truck expense and the auto

expense stating that it appeared to relate to the petitioners' son's business and not to the [Redacted] business of Mr. [Redacted].

Following the issuance of the Notice of Deficiency Determination, the petitioners again amended their 2006 Idaho income tax return. This amended return was dated by the petitioners on October 21, 2010. This time, they reported on a Schedule C (Profit or Loss From Business) that they had rented equipment for \$7,875 and incurred a loss of \$71,339. The auditor requested invoices and other documentation to establish the basis for the assets. The petitioners failed to supply this documentation. Accordingly, the loss claimed with regard to the renting of equipment was denied. The Commission concurs with this disallowance.

The auditor disallowed the deduction for "guaranteed payments" stating that it was not an ordinary and necessary business expense of Mr. [Redacted] business. The Commission finds that the alleged loss from advances to or for the use of the business or businesses of the petitioners' son is not properly considered to be a business expense for the dentistry business.

While the petitioners have not advanced the argument, one might consider whether the funds advanced to the petitioners' son might be deductible as a bad debt. In making such a determination, several relevant facts need to be considered. In making their advance in the amount of \$225,000 for the purchase of [Redacted], the petitioners submitted a memorandum dated June 24, 2009, stating the following:

To whom it may concern: This letter is written for the purpose of stating that [Redacted] loaned money to [Redacted] for the purpose of buying "[Redacted]" Stores for the price of \$225,000. Our agreement [sic] was that there was no interest on the loan and as loaner of the money we would have no business interest in [Redacted] of \$10,000 / month starting Sept 201?¹, we would receive \$2,000 / month as long as we lived.

The memorandum was signed by [Redacted].

¹ The last digit of the year was not legible.

In reviewing the memorandum above, the Commission finds the agreement less than clear. There were two stores. Was the \$2,000 per month to begin when [Redacted] produced a profit of \$10,000 per month or when both together produced a profit of \$10,000 per month? If the \$10,000 standard had been established in one month, but the next month it was not met, was the \$2,000 per month to be paid? Would the income in question include gains or losses from the sale of capital assets? What if one or both stores were sold?

In determining whether a transaction possesses objective indicia of economic substance, we examine whether the transaction was conducted at arm's length. Helba v. Commissioner, 87 T.C. 983, 1005 (1986), affd. without published opinion 860 F.2d 1075 (3d Cir.1988). Where a transaction occurs between related parties, the transaction is carefully scrutinized “ ‘because the control element suggests the opportunity to contrive a fictional * * * [transaction] .’ ” Geftman v. Commissioner, 154 F.3d 61, 68 (3d Cir.1998) (quoting United States v. Uneco, Inc., 532 F.2d 1204, 1207 (8th Cir.1976)), revg. in part and vacating in part T.C. Memo.1996-447; see also Schering-Plough Corp. v. United States, 651 F.Supp.2d 219, 244 (D.N.J.2009), affd. sub nom. Merck & Co. v. United States, 652 F.3d 475 (3d Cir., June 20, 2011).

In reviewing the material in the file, we find no notes executed at the time of the advance of the funds. We find no security pledged by anyone. What we have indicates that there was no interest due from any party, and we have no unconditional commitment by anyone to repay the funds to the petitioners. In addressing such a situation, the U.S. Tax Court stated, in part:

Absent an unconditional obligation by the borrower to repay an advance, the amount cannot be reasonably considered to be an indebtedness. Hoguet Real Estate Corporation, 30 T.C. 580, 601 (1958); Diamond Bros. Company v. Commissioner, 322 F.2d 725 (C.A. 3, 1963), affirming a Memorandum Opinion of this Court; and Ludwig Baumann & Co. v. Commissioner, 312 F.2d 557 (C.A. 2, 1963), affirming a Memorandum Opinion of this Court.

Southeastern Aviation Underwriters, Inc., T.C. Memo 1966-75.

Based upon this, the Commission finds that the petitioners have failed to establish that there existed a legitimate debt. Petitioners, of course, bear the burden of proving that the debt (should it be found that one existed) became worthless during the year in which the debt is claimed. Perry v. Commissioner, 22 T.C. 968, 973 (1954). The Commission lacks any such proof. Further, even if there was such a debt, the petitioners have failed to show that they made a legitimate effort to collect on the debt. A. Finkenberg's Sons, Inc. v. Commissioner, 17 T.C. 973, 984 (1951). Therefore, there is no available deduction for either a business or nonbusiness bad debt.

WHEREFORE, the Notice of Deficiency Determination dated September 20, 2010, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax and interest (computed to March 15, 2012):

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2006	\$2,876	\$771	\$3,647

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 _____ 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.
