

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
) DOCKET NO. 22011
[Redacted])
)
Petitioners.)
) DECISION
)
_____)

BACKGROUND

The audit division (Audit) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted] (Petitioners) on April 15, 2009. A request for redetermination (Protest) was timely filed on June 16, 2009 by [Redacted]CPA the designated Power of Attorney (POA) to represent the Petitioners in this matter. An informal hearing was held at the Boise office of the Commission on May 8, 2012. The Petitioners requested more time to submit documents to support their position. A Modified NODD was issued on September 11, 2012 based on the additional documents provided.

ISSUES

1. Flow through adjustments from the S-corporation audit.
2. Rental loss limitations due to the increase in income.
3. Schedule C depreciation.
4. Basis of the covenant not to compete.
5. Unreported gain from installment sale of S-corporation.
6. Penalties.

DISCUSSION

The Petitioners were the sole owners and employees of [Redacted]., an Idaho S-Corporation. The assets of [Redacted]. were sold to [Redacted] on November 30, 2005. The Petitioner went to work for [Redacted] as an employee under a contract from December 1,

2005 through October 12, 2007. Included in the sale of [Redacted] was a non-compete clause. The majority of the audit adjustments are a result of the audit of the corporation and the reporting of the business sale. Being a Subchapter S Corporation¹, the income and expenses flow through to the [Redacted] individual tax returns.

FLOW THROUGH ITEMS

The NODD as Modified and issued to the S-corporation was affirmed. The flow-through items are found to be correct as adjusted by the auditor.

RENTAL LOSS LIMITATIONS

Some of the audit adjustments on the individual returns then become automatic as a result of the adjusted gross income increasing and triggering limitations on the [Redacted] returns like the special loss allowance for rental real estate and the federal itemized deduction limitations. The NODD as Modified was accepted, resulting in the limitation of the rental losses.

SCHEDULE C DEPRECIATION

One of the Petitioners has an accounting business with no employees. Audit did not accept the explanation and substantiation required to claim the depreciation for the 3 vehicles claimed on the Petitioner's Schedule C.

COVENANT NOT TO COMPETE BASIS

The information offered as basis for the "Covenant Not To Compete" agreement consisted of legal expenses occurred in October 2007. Those expenses are personal legal expenses that should be claimed on the Federal Form 1040, Schedule A, Miscellaneous expenses limited by two percent (2%) of adjusted gross income.

¹ A corporation that has elected to be treated as a pass-through entity as defined in Internal Revenue Code section 1361(1).

UNREPORTED GAIN FROM THE SALE OF THE S-CORPORATION

The bank statements provided to the Commission showed deposit amounts that were greater than the income reported. Two of the deposits were confirmed to be transfers from the Petitioners' other personal accounts and removed from the taxable income.

PENALTIES

The NODD included penalties imposed on the tax liabilities based on the following statutes.

Idaho Code sections 63-3046(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.

...

(d) (1) If there is a substantial understatement of tax for any taxable year, there shall be added to the tax an amount equal to ten percent (10%) of the amount of any underpayment attributable to such understatement.

The Commission upholds the penalties in this case.

CONCLUSION

After reviewing the computations made by the auditor, it appears to the Commission that the auditor has properly included the income in the computation of Idaho taxable income. Accordingly, the Commission must affirm the NODD.

THEREFORE, the Notice of Deficiency Determination dated June 11, 2009, Modified September 11, 2012, and directed to the Petitioners, is hereby AFFIRMED by this decision.

<u>YEAR</u>	<u>REFUND CLAIMED</u>	<u>REFUND ALLOWED</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/31/05			\$ 6,156	\$ 923	\$ 2,288	\$ 9,367
12/31/06			6,953	1,043	2,148	10,144
12/31/07			5,491	824	1,313	<u>7,628</u>
					BALANCE DUE	<u>\$ 27,139</u>

Interest is calculated through April 18, 2013, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

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 _____ 2013.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2013, 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.