

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 25156
[Redacted],)	
)	
Petitioners.)	DECISION
)	
_____)	

[Redacted] (Petitioners) protested the Notice of Deficiency Determination dated June 13, 2012, asserting income tax and interest for taxable years 2010 and 2011 in the total amount of \$4,736. Petitioners disagreed with the disallowance of legal and professional expenses claimed, and the corresponding net operating loss carryover. The Tax Commission, having reviewed the file, hereby issues its decision.

BACKGROUND

Petitioners filed their 2010 Idaho individual income tax return claiming a deduction for legal and professional fees as the only entry on a schedule C for Investments. The Income Tax Audit Bureau (Bureau) selected Petitioners’ return to verify the deduction claimed. The Bureau requested information from Petitioners to support the deduction for the legal and professional fees. Petitioners provided documentation showing the transfer of stock for the payment of services to “[Redacted]” and sustain the public’s interest in [Redacted] stock. The Bureau reviewed the documentation and determined the documentation did not support the deduction as being an ordinary and necessary business expense of Petitioners. The Bureau disallowed the deduction which changed Petitioners’ 2010 income tax return from a loss to one having taxable income. As a result of the adjustment to Petitioners’ 2010 Idaho income tax return, the Petitioners’ 2011 Idaho income tax return required adjusting due to the net operating loss carry

forward from 2010 that was eliminated. After adjusting Petitioners' returns, the Bureau sent Petitioners a Notice of Deficiency Determination, which Petitioners protested.

Petitioners provided copies of a stock certificate issued to [Redacted] shares of [Redacted] stock, and an order transferring [Redacted] shares of [Redacted] from [Redacted] on behalf [Redacted]. Petitioners stated the transfer of shares to [Redacted] was to protect their investment in [Redacted]. The Bureau reviewed the additional information Petitioners provided, acknowledged Petitioners' protest, and referred the matter for administrative review.

The Tax Commission reviewed the matter and sent Petitioners a letter that discussed the methods available for redetermining a protested Notice of Deficiency Determination. Petitioners replied stating the payment to [Redacted] was a business expense. Petitioners stated they were working with [Redacted] supporting the company by paying for many of the company's expenses, some that were reimbursed and some that were not. Petitioners stated the payment to [Redacted] was not reimbursed by [Redacted]

Petitioners provided a copy of a contract between [Redacted] [Redacted]), an Idaho corporation 100 percent owned by [Redacted], for professional consulting. Petitioners stated [Redacted] rather than himself personally because others were asking to borrow money from him. Petitioners stated [Redacted] never received payment on the contract. Petitioners also provided a copy of a [Redacted] journal entry showing [Redacted] expenses as a loan to [Redacted].

The Tax Commission reviewed Petitioners' information, and determined additional information was needed to clarify the business purposes of the transactions. The Tax Commission asked Petitioners to provide additional information based upon assumptions the Tax Commission was making regarding Petitioners' relationship with [Redacted] and [Redacted].

Petitioners responded to the Tax Commission's request with the following information and documentation.

The Tax Commission asked how Petitioners acquired [Redacted] stock. Petitioners stated the stock was purchased through a series of transactions wherein Petitioners received the stock for satisfying outstanding debt incurred by [Redacted] for legal, accounting, and operating expenses. The total outstanding debt paid by Petitioners was \$157,000. Petitioners provided a portion of a document from [Redacted] and a document from [Redacted] stock clearinghouse, authorizing and issuing the stock for the payment of outstanding debt.

All prior documentation regarding [Redacted] services were proposals and letters to [Redacted] stating what [Redacted] could do to bolster [Redacted] stock in the open market. The Tax Commission asked Petitioners to provide a billing statement or contract showing the amount due and the terms of the contract. Petitioners provided two copies of a contract between [Redacted]. The contracts provided for different quantities of free-trading [Redacted] stock as payment for [Redacted] services, and the named parties to both contracts were [Redacted] and [Redacted]. Petitioners stated [Redacted] and the CEO of [Redacted] met with [Redacted] on October 28, 2010, wherein [Redacted] name was substituted for [Redacted] on the contract dated September 20, 2010. However, Petitioners did not provide a copy of that contract.

LAW AND ANALYSIS

Internal Revenue Code section 162 allows for the deduction of all ordinary and necessary expenses incurred in a trade or business of the taxpayer. Petitioners claimed a deduction for the professional services [Redacted] provided [Redacted]. Petitioners argued payment of the [Redacted] expense protected their investment [Redacted] and therefore is deductible as a business expense. Petitioners stated [Redacted] asked Petitioners to put up [Redacted] shares of

their [Redacted] stock, since [Redacted] rejected [Redacted] payment of restricted stock (the first contract).

In reviewing Petitioners' history with [Redacted], it is apparent Petitioners took an active interest in the profitability of [Redacted]. In 2009, Petitioners acquired [Redacted] stock and sold it for a substantial gain. Petitioners then acquired [Redacted] shares of [Redacted] stock in exchange for paying outstanding [Redacted] debt. Petitioners provided other documentation that showed Petitioners paid other [Redacted] expenses that were treated as a loan from [Redacted] wholly owned corporation.

Considering Petitioners' relationship with [Redacted], the payment of Petitioners' [Redacted] shares of [Redacted] stock to [Redacted] seems to be just one in a series of transactions where Petitioners paid for the business expenses [Redacted]. This being the case, Petitioners cannot deduct [Redacted] services as their business expense. Only [Redacted] has the ability to deduct [Redacted] services as a business expense. Simply put one taxpayer cannot deduct the expenses of another taxpayer.

If, as Petitioners argue, [Redacted] was hired by them to protect their investment in [Redacted], Petitioners entered into a barter transaction or a non like-kind exchange with [Redacted]. If this is the case, Petitioners failed to report the gain on the transaction. Petitioners traded stock with a basis of \$78,500 for services valued at \$197,000 producing a gain for the taxpayers of \$118,500. Under this scenario Petitioners not only do not get a deduction for [Redacted] services (sale or exchange of stock); Petitioners have additional income of \$118,500 to report on their 2010 income tax return.

CONCLUSION

Petitioners' claim of a business expense for the professional services of [Redacted] does not fit the requirement of an ordinary and necessary business expense for a trade or business of Petitioners. Petitioners were not engaged in a business wherein [Redacted] services were an ordinary or necessary business expense. The business expense for [Redacted], in both substance and form, were directed and contracted by [Redacted]. Therefore, the Tax Commission finds the legal and professional expenses Petitioners reported on their 2010 income tax return were not expenses of Petitioners but of [Redacted] and therefore not deductible by Petitioners.

Petitioners reported a net operating loss on their 2010 return which they carried forward to taxable year 2011. However, because the Tax Commission disallowed the claimed legal and professional expenses, Petitioners no longer have a net operating loss for taxable year 2010. Consequently, Petitioners have no net operating loss to carry forward to taxable year 2011.

The Bureau added interest to Petitioners' tax. The Tax Commission reviewed the addition and found it appropriate and in accordance with Idaho Code section 63-3045.

THEREFORE, the Notice of Deficiency Determination dated June 13, 2012, and directed to [Redacted] is AFFIRMED.

IT IS ORDERED that the taxpayers pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2010	\$4,490	\$393	\$4,883
2011	0	0	<u>0</u>
		BALANCE DUE	<u>\$4,883</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 _____ 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.
