

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 25315
)
)
Petitioners.) DECISION
)
_____)

BACKGROUND

The Income Tax Audit Bureau (Audit) issued a Notice of Deficiency Determination to [Redacted] (Petitioners), dated August 20, 2012, asserting income tax and interest in the total amount of \$13,948 for taxable years 2009 and 2010. The Petitioners protested the Notice of Deficiency Determination on October 17, 2012. On November 21, 2012, the Commission sent a letter to the Petitioner explaining the Redetermination process and their rights to a hearing and the right to provide additional information to be considered.

ISSUE

1. Whether the Petitioners are entitled to claim a bad debt deduction for various amounts expended to help [Redacted] employer’s business.

DISCUSSION

The Petitioner operated a counseling service as [Redacted], an LLC from 2006 through 2011. The Petitioner’s LLC shared office space with [Redacted], Inc. owned by [Redacted]. [Redacted] received wages from [Redacted] corporation beginning in 2003 through 2009. Having the same names and addresses makes it difficult to distinguish the entities involved. The information provided during the audit and during the protest process consists of copies of cleared checks from 2005, 2007, and 2008. There are also some statements signed by co-workers and

employees of [Redacted] after the fact, attesting to [Redacted] having advanced funds to cover payroll and other expenses of [Redacted] failing business.

There is no actual loan document that shows who loaned money to whom, the amount that was loaned, any promise to repay the money, or the date that the money is due. Without written evidence, we are not able to determine whether the money was loaned or gifted to [Redacted] personally, to his corporation, or anyone else. [Redacted] filed a personal bankruptcy in taxable year 2005. The Petitioner was not named as a creditor at that time. There are no invoices or other receipts showing what is being paid for, or who received the goods or services being paid for. A number of the checks are written from “[Redacted]” to “[Redacted]” or “[Redacted]”, apparently for cash. There is no way of determining the purpose of the checks or if they were simply cashed.

LAW AND ANALYSIS

Treasury Regulation 1.166-1(c) says in part;

“Bona fide debt required. Only a bona fide debt qualifies for purposes of Internal Revenue Code Section 166, Bad Debts. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. A debt arising out of the receivables of an accrual method taxpayer is deemed to be an enforceable obligation for purposes of the preceding sentence to the extent that the income such debt represents have been included in the return of income for the year for which the deduction as a bad debt is claimed or for a prior taxable year...”

Treasury Regulation 1.461-1(a) says in part;

“Taxpayer using cash receipts and disbursements method. Under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid...”

The Petitioners use the cash receipts and disbursements method.

Idaho Tax Commission Administration and Enforcement Rule 200.01 says in part;

“In General. a. A taxpayer shall maintain all records that are necessary to a determination of the correct tax liability. Required records must be made available on request by the Tax Commission or its authorized representatives...”

It appears that the Petitioner may have been trying to help a colleague that was having financial problems; however the Internal Revenue Code and the Treasury Regulations are very clear about the requirements for taking a “Bad Debt” deduction. One of the essential requirements is that there is a valid and enforceable obligation to pay. In addition, the Idaho Tax Administration Rules are clear about the recordkeeping requirements.

In the present case there is no evidence that a loan existed, to whom funds were advanced or if they were expected to be repaid. In the case of the checks that were cashed, we cannot even determine that any funds changed hands.

With the close working relationship and sharing of office space, there may have been expenses, like advertising, that might have been at least partially deductible by the Petitioner, but under Treasury Regulation 1.461, the expenses would have to have been claimed in the year paid. Those years are now closed by the statute of limitations. Expenses cannot be claimed four and five years later.

CONCLUSION

The Petitioner did not have the essential evidence required to claim a business bad debt. THEREFORE, the Notice of Deficiency Determination dated August 20, 2012, and directed to [Redacted] is AFFIRMED by this decision.

IT IS ORDERED that the Petitioners pay the following tax, penalty, and interest:

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|---------------|
| 12/31/2009 | 6,197 | 0 | 766 | 6,963 |
| 12/31/2010 | 6,668 | 0 | 508 | <u>7,176</u> |
| | | | | <u>14,139</u> |

The Commission updated the interest through March 31, 2013, on the Petitioners' tax liability.

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.