

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 38947
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated March 18, 2014. The Notice of Deficiency Determination (NODD) asserted additional liability for Idaho income tax, penalty, and interest in the total amounts of \$10,067, \$13,181, and \$16,365 for 2010, 2011, and 2012, respectively.

The petitioners, at all times relevant to this matter, resided at [Redacted], Idaho. The auditor made the following adjustments to the returns filed by the petitioners:

1. Disallowed amounts claimed for personal exemptions in the amounts of \$25,550, \$29,700, and \$15,200 for 2010, 2011, and 2012, respectively with a corresponding change to the grocery credit claimed,
2. Included unreported pension income in the amount of \$32,250 for 2012,
3. Increased income from [Redacted] business in the amounts of \$40,967, \$58,807, and \$63,089 for 2010, 2011, and 2012, respectively,
4. Decreased a rental loss claimed in 2012 by \$8,556,
5. Increased itemized deductions claimed by \$387 for 2011 and decreased claimed itemized deductions by \$5,379 for 2013,
6. Decreased claimed health insurance premium deductions by \$4,000, \$1,491, and \$12,500 for 2010, 2011, and 2012, respectively,

7. Decreased claimed insulation deductions by \$1,200 and \$3,980 for 2010 and 2011, respectively,
8. Denied a deduction claimed for an [Redacted] device by \$1,280 for 2011,
9. Decreased a deduction claimed for long term health insurance by \$589 for 2011,
10. Denied credits for a charitable donation to an Idaho [Redacted] for both 2010 and 2011,
11. Denied credits for maintaining a [Redacted] for both 2010 and 2011, and
12. Asserted both the substantial understatement penalty and the fraud penalty.

PERSONAL EXEMPTIONS

The petitioners claimed numerous people as their dependents. The auditor invited them to show that the individuals qualified as their dependents. The petitioners failed to demonstrate that the claimed individuals qualified as dependents. Therefore, for each of the years here in question, the auditor limited the petitioners to two personal exemptions.

PENSION INCOME

For 2012, the 1099-Rs received by the petitioners indicated that the pension income received by the petitioners was in the amount of \$71,691. The petitioners reported \$39,441. Accordingly, the auditor increased the pension income includable in the computation of their Idaho taxable income by \$32,250.

[Redacted] BUSINESS

There appear to be adjustments in four areas with regard to the [Redacted] business. The first is the gross income. The second is the amount claimed for an office in the home. The third is for cell phone and internet use. The last is for travel and entertainment.

The petitioners had clients' refunds deposited in their bank account. After having received the refunds from the government, the petitioners would issue a check to their clients for a lesser amount. Accordingly, the auditor included this difference in the petitioners income. The petitioners contend that they gave some cash to their clients. However, they failed to present any documentation to show this. Accordingly, the auditor correctly used the information available.

For 2010 business use of the petitioners' home, the petitioners claimed 600 square feet of their 1300 square foot house. For 2011, the petitioners claimed 800 square feet of their 1700 square foot house. The petitioners had the burden of establishing that they used an area of their home exclusively and on a regular basis for their business. The auditor found that they had failed to do so. Accordingly, she allowed them 100 square feet as qualifying area in their home.

The petitioners deducted the cost of their cell phone use and their internet use. The petitioners did not provide proper documentation for the business use of these assets. The auditor disallowed a portion of these expenses.

The petitioners deducted expenses for travel and entertainment with regard to the tax preparation business. However, the petitioners did not submit the necessary documentation required by Regulation 1.274-5 properly documenting that the expenses were business related. Accordingly, the auditor disallowed all such deductions.

RENTAL LOSS

The petitioners reported rental income for 2012 and claimed numerous related expenses. The auditor limited the allowable deductions to those which the petitioners could demonstrate that they incurred.

ITEMIZED DEDUCTIONS

Deductible medical expenses were claimed for both 2010 and 2011. Upon examining the documentation presented by the petitioners, the auditor found that the petitioners' medical expenses had not exceeded seven and one half percent of their adjusted gross income for either year. Accordingly, all of the claimed deductible medical expenses were denied for both years.

The petitioners claimed mortgage insurance premiums in the amount of \$447 for 2011. The petitioners did not produce documentation showing that they were entitled to this deduction.

The petitioners claimed deductions for gifts to charities, however, the documentation presented to the auditor did not show that the petitioners had donated as much as they claimed. Accordingly, the auditor disallowed the amount by which their claimed deductions exceeded the amount documented.

HEALTH INSURANCE PREMIUM DEDUCTIONS

Idaho Code § 63-3022P allows a deduction for health insurance premiums not allowed elsewhere. The petitioners paid insurance premiums through an employer with pretax funds and deducted these. Since payment of such expenses with pretax funds is not deductible, the auditor denied these deductions.

INSULATION DEDUCTION

Idaho Code § 63-3022B allows for a deduction for expenditures for some energy conservation measures. The petitioners claimed deductions for having taken such measures in

both 2010 and 2011. They produced no documentation to support their claim. Accordingly, the auditor disallowed these deductions.

[Redacted] Idaho Code § 63-3022C allows a deduction for the installation of certain [Redacted]. The petitioners installed a heater. Upon examination of the documentation describing the heater, the auditor determined that expenditures for the installation of this device did not qualify for this deduction.

LONG TERM HEALTH INSURANCE

Idaho Code § 63-3022Q provides for a deduction for the cost of long term health insurance. The petitioners claimed a deduction for paying for such premiums in 2011. However, the petitioners did not provide documentation to establish that they had paid such premiums.

CREDIT FOR CHARITABLE DONATIONS

The petitioners claimed credits for charitable contributions to [Redacted] in the amounts of \$125 and \$200 for 2010 and 2011, respectively. The auditor denied the credit for both 2010 and 2011 due to lack of substantiation.

CREDIT FOR MAINTAINING A [Redacted]

The petitioners claimed a credit in the amount of \$100 for both 2010 and 2011. The auditor denied this credit due to the petitioners not having provided a [Redacted].

The vast majority of the adjustments made by the auditor are in the nature of disallowing deductions. The burden of proof with regard to deductions is squarely upon the taxpayer. The U. S. Supreme Court stated, in part:

Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.

* * *

Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.

New Colonial Ice Co., Inc. v. Helvering, 292 U. S. 435, 440 (1934).

This concept is further strengthened by a decision of the U. S. Tax Court in which the court stated, in part:

Petitioners have the burden of proving that the cost of the lunches for the medical technologists are allowable deductions. Welch v. Helvering, 290 U.S. 111, 115 (1933); Rule 142 (a). Furthermore, deductions are a matter of legislative grace and each statutory requirement must be satisfied before the deduction can be allowed. New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934).

Section 162 allows a deduction for reasonable business expenses which are both ordinary and necessary. Deductible business expenses include 'ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business.' Sec. 1.162-1(a), Income Tax Regs. Whether an expense is ordinary and necessary is a question of fact. Commissioner v. Heininger, 320 U.S. 467, 475 (1943); Walliser v. Commissioner, 72 T.C. 433, 437 (1979).

Magruder v. Commissioner, T.C. Memo 1989-169.

Credits are also a matter of legislative grace:

Petitioners bear the burden of proof on all pertinent items. See Rule 142(a); Welch v. Helvering, 290 U.S. 111 (1933). All claimed deductions and credits are matters of legislative grace and must have a basis in the statute. New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934). We are not required to find that petitioner Abraham Weiss' self-serving testimony meets that burden. Tokarski v. Commissioner, 87 T.C. 74, 77 (1986). Even if respondent does not present contradictory evidence, we may still find, on the basis of the record, that petitioners' evidence falls short of meeting their burden of proof. Fleischer v. Commissioner, 403 F.2d 403, 406 (2d Cir.1968), affg. T.C. Memo.1967-85.

Weiss v. Commissioner, T.C. Memo 1999-17

The petitioners have failed to demonstrate that the auditor's computations are incorrect.

Accordingly, the adjustments to income and the denial of the credits must be affirmed.

PENALTIES

The authority for both the substantial understatement penalty and the fraud penalty are provided in Idaho Code § 63-3046 which stated, in part:

(b) If any part of any deficiency is due to fraud with intent to evade tax, then fifty percent (50%) of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid.

* * *

(2) In the event the return required by this chapter is filed but the tax shown thereon to be due is not paid, there may be collected a penalty of one-half percent (0.5%) of the tax due on such return for each month elapsing after the later of the due date of such return or the date the return was filed until the tax is paid.

(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.

(2) For purposes of this subsection, there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of:

- (i) Ten percent (10%) of the tax required to be shown on the return for the taxable year, or
- (ii) Five thousand dollars (\$5,000).

The petitioners reported Idaho income tax in the amounts of \$874, \$1,461, and \$8 for 2010, 2011, and 2012, respectively. Accordingly, the criteria for the imposition of the substantial understatement penalty are present.

With respect to the fraud issue, the Commission has the burden of proving, by clear and convincing evidence, that there was an underpayment of tax and that some part of the underpayment was due to fraud with the intent to evade tax. Idaho Code § 63-3046(b). This burden is met if it is shown that the taxpayer intended to conceal, mislead, or otherwise prevent the collection of such taxes. Spies v. United States, 317 U.S. 492, 499 (1943); United States v. Conforte, 624 F.2d 869 (9th Cir. 1980). The existence of fraud is a fact which must be determined on the basis of all facts and circumstances. Estate of Pittard v. Commissioner,

69 T.C. 391 (1977). Since direct proof of a taxpayer's fraud is rarely available, circumstantial evidence may be utilized to prove fraud. Rowlee v. Commissioner, 80 T.C. 1111, 1119-22 (1983). The taxpayer's entire course of conduct may establish the requisite fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971); Otuski v. Commissioner, 53 T.C. 96, 105-106 (1969).

In this case, there is clear and convincing evidence that petitioners acted with fraudulent intent. The petitioners did not include all of their income from their [Redacted] business. Omitted from the reported income was income from the direct deposit of clients' refunds deposited to the petitioners' bank account, from which a portion was paid to their clients. Also omitted were payments to the petitioners from [Redacted]. The petitioners also claimed both deductions and credits for which they had no credible argument. In 2012, the petitioners claimed a repair expense deduction for a payment to [Redacted] When the auditor received a copy of the same canceled check from the petitioners' bank, the check was made payable to [Redacted]

THEREFORE, the Notice of Deficiency Determination dated March 18, 2014, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest (computed to February 28, 2015):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2010	\$5,875	\$3,525	\$827	\$10,227
2011	7,875	4,725	799	13,399
2012	9,999	5,999	646	<u>16,644</u>
			AMOUNT PAID	(\$10,000)
			TOTAL DUE	<u>\$30,270</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 _____ 2014.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2014, 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.
