BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of [Redacted] Petitioners.	))))))	DOCKET NO. 0-808-251-392 DECISION

[Redacted] (Petitioners) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated March 18, 2014, asserting additional liability for Idaho income tax, penalty, and interest in the total amounts of $3,113 and $3,554 for 2010 and 2011, respectively.

The auditor made the following adjustments:

1. Car and truck expenses were reduced for 2010 and disallowed for 2011,
2. Deduction for insurance was reduced for 2010,
3. Rent expense for rent of machinery and equipment was disallowed for 2011,
4. Travel expense deduction was denied for 2011,
5. Deductions for meals and entertainment was reduced for 2010 and disallowed for 2011,
6. Deduction for insulation deduction was denied for 2010,
7. Deductions for education were disallowed for both 2010 and 2011,
8. Deductible charitable contributions were reduced for 2010, and
9. Machine rent claimed in 2011 was disallowed.

After the NODD was issued, Petitioners filed an amended return for 2010. On this amended return, Petitioners made the following changes:

1. Advertising expense was claimed in the amount of $1,200,
2. Car and truck expenses were increased by $5,360,
3. Supplies expense was increased by $2,257,

4. Travel expense was increased by $2,026,

5. Claimed charitable contributions were increased by $3,254, and

6. Claimed insulation deduction of $8,511 was eliminated.

In Petitioners' letter of protest, they objected to the disallowance of travel and entertainment expenses. They raised no objection to the other adjustments made by the auditor.

CAR AND TRUCK EXPENSES

[Redacted] sold insurance during 2010 and 2011. He contends that he traveled extensively in eastern Idaho and northern Utah. He submitted two different logs for 2010, both having been compiled after the beginning of the audit. He also submitted some credit card information to support his position. There are discrepancies between the logs submitted and the credit card statements, putting him in more than one place at the same time. No documentation was submitted to support the deduction for car and truck expenses for 2011.

Certain expenses may not be estimated because of the strict substantiation requirements of Internal Revenue Code § 274(d). *See Sanford v. Commissioner*, 50 T.C. 823, 827-828 (1992), *aff'd per curiam*, 412 F.2d 201 (2d Cir 1969). Travel expenses, meals and entertainment, and expenses relating to certain listed property are subject to the specific and more stringent substantiation requirements of section 274. To deduct such expenses, the taxpayer must substantiate by adequate records or sufficient evidence to corroborate the taxpayer's own testimony: (1) the amount of the expense; (2) the time and place of the travel or meal expenditure; (3) the business purpose of the expense; and (4) in the case of meals and entertainment, the business relationship between the taxpayer and the persons being entertained. Generally, deductions for expenses subject to the strict substantiation requirements of section 274(d) must be disallowed in full unless the taxpayer satisfies every element of those requirements. *See Sanford v. Commissioner*, 50 T.C. at 827-828. A contemporaneous log is not required, but corroborative evidence used to support a taxpayer's

reconstruction of the expenditure must have a high degree of probative value to elevate such statement to the level of credibility of a contemporaneous record. *See Larson v. Commissioner,* T.C. Memo 2008-187.

Credibility in the documentation offered by the taxpayers is critical. Concerning this, the Tax court stated, in part:

> This evidence does not substantiate the amount of Longino's business mileage for two reasons. First, although Longino testified that his reconstructed routes included travel only to business appointments, we do not find this testimony to be credible. His credit-card statements reveal that on some of the days when he had a business appointment in a particular town, he also made personal purchases in the same town on the same day. This suggests that Longino conducted personal errands while traveling on the reconstructed routes. In addition to personal errands that are evidenced by credit-card statements, we find that Longino made other undocumented personal trips on the reconstructed routes—visiting family and friends, for example.
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> Second, even if we believe that Longino traveled only along the reconstructed routes and made no personal detours, Longino does not articulate how his business miles should be computed. Only for January did Longino supply us with a list of the business miles that he supposedly traveled. For other months, the evidence in the record is insufficient to determine the length of the reconstructed routes. The MapQuest directions he provided give distances between his home offices and the various towns where he had meetings, but he did not testify that he followed the routes described in the MapQuest directions (which are the routes for which the MapQuest directions give a mileage estimate). Furthermore, he did not testify how many miles he drove between his various business appointments [footnote omitted].
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> While we believe that Longino did use his vehicles for some business travel, he failed to substantiate the amount of his business mileage as required by section 274(d). Consequently, we find that he is not entitled to deduct any amount for car-and-truck expenses.

Longino v. Commissioner, T.C. Memo 2013-80.

Petitioners were asked to supply maintenance records for their vehicle or vehicles used in the insurance business to substantiate that they had been driven as many miles as Petitioners are

contending. Petitioners have not provided this information. In such a situation, the U.S. Tax Court stated, in part:

> The rule is well established that the failure of a party to introduce evidence within his possession and which, if true, would be favorable to him, gives rise to the presumption that if produced it would be unfavorable. *Walz v. Fidelity-Phoenix Fire Ins. Co. of New York*, 10 Fed.(2d) 22; certiorari denied, 271 U.S. 665; *Equipment Acceptance Corporation v. Arwood Can Mfg. Co.*, 117 Fed. (2d) 442; *Hann v. Venetian Blind Corporation*, 111 Fed.(2d) 455; *Bomeisler v. Jacobson & Sons Trust*, 118 Fed.(2d) 261; *Sears, Roebuck & Co. v. Peterson*, 76 Fed.(2d) 243. This is especially true where, as here, the party failing to produce the evidence has the burden of proof or the other party to the proceeding has established a prima facie case. *Moore v. Giffen*, 110 Cal.A. 659; 294 Pac. 730; *Indianapolis & Cincinnati Traction Co. v. Montfort*, 80 Ind.A. 639; 139 N.E. 677.

Wichita Terminal Elevator Co. v. Commissioner, 6 T.C. 1158, 1165 (1946), aff'd, 162 F.2d 513 (10th Cir. 1947).

Petitioners have provided a reconstruction for 2010, but not for 2011. Petitioners have not supplied the additional substantiation to support their reconstruction. The Commission finds that Petitioners have failed to meet the documentation requirements of Internal Revenue Code § 274. Accordingly, they are not allowed car and truck expenses for the years here before us in an amount greater than that allowed by the auditor.

INSURANCE EXPENSE

Petitioners claimed deductions for insurance in the amounts of $926 and $836 for 2010 and 2011, respectively. The auditor allowed deductions in the amounts of $826 and $836 for 2010 and 2011, respectively. Petitioners have submitted no additional documentation or authority with regard to this adjustment. Accordingly, the Commission finds that the auditor's adjustment should be affirmed.

RENT EXPENSE

Office rent in the amount of $8,700 was allowed in full for both 2010 and 2011. Rental expense for "Vehicles, Machinery, and Equipment" in the amount of $1,401 was disallowed for 2011 as no documentation was presented by Petitioners to support this deduction either to the auditor or during the administrative appeal. Accordingly, the Commission finds that Petitioners have failed to carry their burden of proof with regard to the deduction for rental expense for "Vehicles, Machinery, and Equipment."

TRAVEL EXPENSE

Travel expense in the amount of $2,058 was disallowed for 2011 as no documentation was presented by Petitioners to support this deduction. In addition, Petitioners claimed additional travel expense on their 2010 amended return which was not claimed on their original return. The auditor requested documentation to support these claimed deductions. None was provided either to the auditor or during the administrative appeal. Accordingly, the Commission finds that Petitioners have failed to carry their burden of proof with regard to this deduction.

MEALS AND ENTERTAINMENT

As was stated above regarding auto expenses, some deductions (including meals and entertainment) fall under the strict record keeping requirements of Internal Revenue Code § 274. As to accepting other than contemporaneous record, the U.S. Tax Court stated, in part:

> In deciding whether a taxpayer has satisfied his or her burden of substantiating a deduction, we are not required to accept the taxpayer's self-serving, undocumented testimony. *Niedringhaus v. Commissioner*, 99 T.C. 202, 219–220, 1992 WL 190129 (1992); *Tokarski v. Commissioner*, 87 T.C. 74, 77, 1986 WL 22155 (1986).
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> To deduct such expenses, the taxpayer must substantiate by adequate records or sufficient evidence to corroborate the taxpayer's own testimony: (1) the amount of the expense; (2) the time and place of the travel or meal expenditure; (3) the business purpose of the expense; and (4) in the case of meals and entertainment, the business

> relationship between the taxpayer and the persons being entertained. Id. Generally, deductions for expenses subject to the strict substantiation requirements of section 274(d) must be disallowed in full unless the taxpayer satisfies every element of those requirements. *Sanford v. Commissioner*, 50 T.C. at 827–828; sec. 1.274–5T(a), Temporary Income Tax Regs., 50 Fed.Reg. 46014 (Nov. 6, 1985).

Cherizol v. Commissioner, T.C. Memo 2014-119.

In addressing another matter regarding the allowance of deductions governed by Internal Revenue Code § 274, the Tax Court stated, in part:

> Mr. Chaganti has not adequately substantiated the remaining meals and entertainment and travel expenses he reported. Section 274(d) requires taxpayers to establish the amount of the expense, the time and the place the expense was incurred, the business purpose of the expense, and the business relationship of the taxpayer to any others benefited by the expense. The Court provided Mr. Chaganti the opportunity to identify records in evidence that would establish this. He failed to do so. The table Mr. Chaganti provided did not refer to any exhibit or provide any information about a specific client matter to show the business purpose of any of his trips. Further, some of the dates and locations that Mr. Chaganti listed on his table were contradicted by the parties' stipulations. Accordingly, because he did not meet his burden of proof, Mr. Chaganti may not deduct any meals and entertainment expenses or travel expenses beyond those that the Commissioner [footnote omitted] conceded were business-related expenses and beyond the per diem amounts for meals and incidentals previously addressed.

*Chaganti v. Commissione*r, T.C. Memo 2016-222, affd. without published opinion. 2018 WL 6587158 (8th Cir. 2018).

Petitioners have failed to meet their burden to establish that they are entitled to a greater deduction than that allowed by the auditor.

INSULATION DEDUCTION

Petitioners claimed a deduction in the amount of $8,511 on their 2010 Idaho income tax return for the insulation of their residence. The auditor denied this deduction in its entirety. Petitioners have not submitted documentation or authority to support their position. Idaho Code §

63-3022B stated, in part:

> Deduction for insulation of residences. For taxable years commencing on and after January 1, 1976, an individual taxpayer may deduct from taxable income an amount actually paid or accrued by the individual taxpayer during the taxable year for the actual installation, but not replacement, of insulation within any existing building in the state of Idaho which serves as a place of residence of the individual taxpayer.

The information in the file indicates that Petitioners' residence was built in 2009. Accordingly, this adjustment made by the auditor is affirmed. Judging by the elimination of this deduction on Petitioners' amended return, we presume that Petitioners concur with this result.

EDUCATION EXPENSE

The auditor disallowed the claimed deductions for education in both 2010 and 2011 in the amounts of $2,039 and $3,567, respectively. After the issuance of the NODD, Petitioners submitted additional documentation substantiating $833 of education expense for 2010. Accordingly, this Petitioners adjustment should be made to the auditor's determination.

ADVERTISING EXPENSE

In the amended 2010 return filed by Petitioners, they claimed $1,200 as advertising expense. They submitted no documentation to support this claimed deduction. However, in a letter received from [Redacted] on March 10, 2015, he states that he is writing in reference to his advertising deduction for 2010. He bases this deduction on his payments to [Redacted] Country Club.

The deduction for club dues is addressed in Internal Revenue Code § 274(a)(3) which states:

> (3) Denial of deduction for club dues.—Notwithstanding the preceding provisions of this subsection, no deduction shall be allowed under this chapter for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

The U. S. Tax Court addressed the matter as follows:

> Section 274(a)(3) operates as a complete and outright ban on any deduction for club membership dues. Pursuant to regulations, this rule applies to "membership in any club organized for business, pleasure, recreation, or other social purpose", which definition includes, but is not limited to, "country clubs, golf and athletic clubs, airline clubs, hotel clubs, and clubs operated to provide meals under circumstances generally considered to be conducive to business discussion." Sec. 1.274–2(a)(2)(iii)(a), Income Tax Regs. Membership dues and related charges paid to the Arizona Club, Gardiner's Resort, and Gainey Ranch are therefore nondeductible.

Deihl v. Commissioner, T.C. Memo 2005-287.

The Commission finds that Petitioners are not entitled to this deduction.

SUPPLIES DEDUCTION

Petitioners claimed $2,388 for supplies expense on their original 2010 income tax return. This amount was allowed, apparently without examination of any documentation. On their amended 2010 return, they claimed $4,645 (an increase of $2,257) for this deduction. Petitioners supplied billings (but not invoices) by an office supply store in 2010 totaling $410.84. To gain an additional deduction for office supplies for 2010, Petitioners would need to document more than the $2,388 which was allowed without review. Accordingly, the auditor's determination with regard to Petitioners' deduction for supplies is affirmed.

MACHINE RENT

Petitioners claimed a deduction for machine rent in the amount of $1,401 for 2011. Petitioners have provided no substantiation for this claimed deduction. Accordingly, the Commission finds that this deduction was properly denied.

CHARITABLE CONTRIBUTIONS

In the amended 2010 Idaho income tax return filed by Petitioners, they claimed charitable contributions in the amount of $12,854. This amount was composed of $12,354 for "gifts by cash

or check" and $500 for "Other than cash or check." The auditor reduced Petitioners' claimed deduction for charitable contributions by $2,157 for 2010 finding that documentation had been provided to verify $10,697 of their claimed $12,354 deduction. The Commission finds that the auditor made the correct determination. Accordingly, this adjustment made by the auditor is affirmed.

PENALTY

The negligence penalty was asserted by the auditor for both 2010 and 2011. The auditor also asserted a penalty for 2011 for the failure of Petitioners to have a valid extension to file their income tax return. The Commission finds that the negligence penalty is appropriate for the failure by Petitioners to maintain proper records. The Commission finds that the penalty for the failure to have a proper extension is not appropriate.

WHEREFORE, the Notice of Deficiency Determination dated March 18, 2014, is hereby MODIFIED, and as so modified is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that Petitioners pay the following tax, penalty, and interest (computed to April 15, 2019):

YEAR	TAX	PENALTY	INTEREST	TOTAL
2010	$2,609	$130	$790	$3,529
2011	2,877	144	756	3,777
			TOTAL DUE	$7,306

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of Petitioners' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2019.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2019, 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.

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