

stated they cannot stop the state from creating an alternate calculation and assess them an obligation. Petitioners also took exception to the Bureau's determination that their farm was not-for-profit. Petitioners stated the Bureau's determination was based on outright speculation and bits of information gleaned from the internet. Petitioners stated the Bureau's assessment of the examined factors was factually wrong. The Bureau acknowledged Petitioners' protest.

After the Bureau sent Petitioners the Notice of Deficiency Determination on tax years 2015 and 2016, Petitioners filed their 2017 Idaho individual income tax return. Petitioners filed their 2017 return reporting no income even though Petitioners' employer reported Petitioners received wages. Seeing that Petitioners' 2017 income tax return was prepared in the manner as Petitioners' 2016 income tax return, the Bureau sent Petitioners a second Notice of Deficiency Determination stating that Petitioners did receive income in 2017 that was reportable to Idaho.

Since Petitioners' 2017 Idaho income tax return was prepared in the same manner as their 2016 Idaho income tax return and the Bureau's adjustment was the same as to their 2016 income tax return, the Bureau considered the Notice of Deficiency Determination an extension of the audit performed on tax years 2015 and 2016. Therefore, Petitioners' protest of the Notice of Deficiency Determination for tax years 2015 and 2016 was also extended to the Notice of Deficiency Determination for tax year 2017.

The Bureau referred both Notices of Deficiency Determination to the Tax Commission's Appeals Unit (Appeals). Appeals sent Petitioners a letter explaining the options available for redetermining a Notice of Deficiency Determination. Petitioners did not respond. Seeing that Petitioners had opportunity to further their position but chose not to, the Tax Commission decided the matter based on the information provided.

LAW AND ANALYSIS

Internal Revenue Code (IRC) section 183 states that if an activity is not engaged in for profit, no deduction attributable to such activity shall be allowed. IRC section 183 contains a presumption that if the gross income derived from an activity for three or more years of a consecutive five taxable years which ends with the taxable year exceeds the deductions attributable to such activity, then, unless the Secretary establishes to the contrary, such activity shall be presumed for such taxable year to be an activity engaged in for profit.

Treasury Regulations 1.183-2(b) provides a list of relevant factors to be reviewed in determining whether an activity is engaged in for profit; no one factor is determinative in making the determination. The factors include: (1) the manner in which the taxpayer carries on the activity, (2) the expertise of the taxpayer or his advisors, (3) the time and effort expended by the taxpayer in carrying on the activity, (4) expectation that assets used in activity may appreciate in value, (5) the success of the taxpayer in carrying on other similar or dissimilar activities, (6) the taxpayer's history of income or losses with respect to the activity, (7) the amount of occasional profits, (8) the financial status of the taxpayer, and (9) elements of personal pleasure or recreation.

The Bureau reviewed a number of these factors and determined Petitioners' farming activity was not engaged in for profit. The Bureau believed Petitioners had "mixed motives", they did not have a business plan, their books and records were lacking, they had substantial other financial resources, they did not keep separate business records, they had no experience, they did not consult experts, and they did not put the time and effort into the activity to make it profitable.

Petitioners on the other hand argued that they don't see how a few statements on the internet show that they have mixed motives. Petitioners stated they have a passion for clean food, and they want to see their children succeed. Petitioners stated Mr. [REDACTED] grew up in a wheat and cattle

farming family; in a farming community. Petitioners stated they consulted with farming experts and read up on farming. Petitioners stated Mr. [REDACTED] spent 20-40 hours a week in support of their farm. Petitioners stated because they have the financial ability to start a farm is not grounds for deeming the farm a hobby. Petitioners stated all businesses have capital start-up costs. Petitioners stated they may have under estimated the scale of the start-up cost and the demand for their product, but when it became apparent their children showed no interest and Mrs. [REDACTED] had no desire to live on a farm and the fact that they were losing money, Petitioners stopped all farming activities.

Considering the information and documentation before it, the Tax Commission does not find that the evidence is strong enough to support a finding that Petitioners' farming activity was not-for-profit. However, that does not mean Petitioners are entitled to the full amount of the loss claimed in 2015. As Petitioners admitted their record keeping could have been more diligent. Petitioners stated they paid cash for the labor they hired, cash to lease property and buildings, and cash for various other expenses. Petitioners also purchased supplies and other items that lack documentation identifying the purchase.

Deductions are a matter of legislative grace. *New Colonial Ice Co., Inc. v. Helvering*, 292 US. 435, 440, 54 S.Ct. 788 (1934). The taxpayer bears the burden of substantiating the amount and purpose of the claimed deduction. *Higbee v. C.I.R.*, 116 T.C. No. 28 (2001). In general, Petitioners' documentation did not substantiate what was purchased or its purpose. Nevertheless, the Tax Commission did find some deductions that were adequately documented, and those deductions were allowed.

Petitioners purchased capital assets in 2015 that they expensed as IRC section 179 depreciable assets. IRC section 179 allows the taxpayer to write off the full cost of an asset in the year of acquisition. IRC section 179 also provides that if the section 179 property is not used

predominantly in the taxpayer trade or business for the entire recovery period of the property, the taxpayer must recapture any benefit derived from expensing the property. The recapture to be reported in the taxable year the property is not predominately used in the taxpayer's trade or business.

Petitioners stopped their farming activity in 2016. Petitioners expensed as section 179 property in 2015 a Bobcat Skid-Steer loader and a grain grinder. These assets have recovery periods of 7 years and 5 years, respectively. Since Petitioners ceased their farming activity in 2016, Petitioners are required to recapture the benefit derived from expensing the property. Therefore, the Tax Commission adds the recapture to Petitioners' 2016 income tax return.

As for Petitioners not reporting any income in 2016 and 2017, when Mr. [REDACTED] employer reported significant wages paid to him, Petitioners stated their understanding of the definition of wages in Title 26 of the U.S. Code changed and they believed his compensation was not wages. Petitioners did not give any specific references in Title 26 U.S. Code; however, such "causes and beliefs" have repeatedly been rejected by the courts in deciding cases arguing against the income tax. See *Sego v. Commissioner*, 114 T. C. 604 (2000); *Nagy v. Commissioner*, T. C. Memo 1996-24; *Scott v. Dept. of Taxation*, 2008 WL 4542978 (Vt.); *United States v. Jagim*, 978 F.2d 1032, 1036 (8th Cir. 1992). Petitioners have not shown that they did not receive the income, nor have they cited any authority stating that the compensation Mr. [REDACTED] received was not subject to the Idaho income tax.

The Bureau changed Petitioners' 2016 and 2017 filing status and exemptions to married filing joint with four exemptions rather than married filing separate with two exemptions. However, when the Bureau did this it did not give Petitioners the Idaho grocery credit. Considering the reasoning the Bureau used to change Petitioners' filing status and the number of exemptions, the Tax Commission

finds using that same reasoning Petitioners should be allowed the grocery credit. Therefore, the Tax Commission modifies both Notices of Deficiency Determination to allow the grocery credit for each dependent exemption allowed.

The Bureau added the substantial understatement penalty to Petitioners' 2015 tax deficiency. The Tax Commission reviewed that addition and found it inappropriately added. Idaho Code section 63-3046(2) states for the purpose of the substantial understatement penalty a substantial understatement is one that exceeds the greater of ten percent of the tax required to be shown on the return or \$5,000. As determined by the Bureau, Petitioners' 2015 tax deficiency did not exceed \$5,000. And, as modified by this decision, Petitioners' tax deficiency does not exceed \$5,000. Therefore, the substantial understatement penalty is inappropriately added. However, because Petitioners did not keep adequate records to substantiate the deductions claimed, the Tax Commission is adding the negligence penalty to Petitioners' 2015 tax deficiency.

The Bureau added the fraud penalty to Petitioners' 2016 and 2017 tax deficiencies; mislabeled as a negligence penalty for 2016. The Tax Commission reviewed those additions and found them appropriate. Petitioners' claim of no income when they clearly received compensation in the form of wages is an attempt to evade the income tax. Therefore, in accordance with Idaho Code section 63-3046(b) the fraud penalty is upheld. However, for tax year 2017, Petitioners do not have a tax deficiency; therefore, there is no fraud penalty added to tax year 2017.

CONCLUSION

The Tax Commission found Petitioners' farming activity did rise to the level of a for-profit activity; therefore, the Tax Commission allowed the expenses that were adequately documented. Petitioners did receive compensation in 2016 and 2017, and compensation is income. Petitioners have not shown their income is exempt from the income tax. Accordingly, the Tax Commission

modifies the Notice of Deficiency Determination for tax year 2015 and 2016 and upholds the Notice of Deficiency Determination for tax year 2017.

WHEREFORE, the Tax Commission AFFIRMS as MODIFIED the Notice of Deficiency Determination dated October 12, 2018, and AFFIRMS the Notice of Deficiency Determination dated March 12, 2019, directed to [REDACTED].

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

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2015	\$ 806	\$ 40	\$ 139	\$ 985
2016	2,733	1,367	371	4,471
2017	(67)		(7)	(74)
			TOTAL DUE	<u>\$ 5,382</u>

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

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

DATED this _____ day of _____ 2020.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2020,
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.

[REDACTED]