



Petitioner deducted expenses related to the shareholder's personal recreational vehicle (RV), e.g., loan payments for the RV purchase, RV "wrapping"<sup>1</sup> expenses, etc., when calculating their ordinary business income. The Bureau determined that these expenses are personal expenses and reclassified them as distributions to the shareholders. The Bureau made these adjustments and issued a Notice.

Petitioner's representative protested the Notice and requested the Bureau discuss the issues with him. During their discussion, the Bureau explained to the representative that they issued the Notice based on the information available to them and could modify the Notice if they receive additional information warranting modifications. The Bureau asked the representative to provide details of the basis calculation, but they received no information. The Bureau acknowledged the protest and referred the matter to the Tax Commission's Appeal's Unit (Appeals) for administrative review.

Appeals sent Petitioner and the representative a letter explaining the options available for redetermining a Notice. The representative responded, provided additional information, and requested an informal hearing, which was held on January 30, 2025. Having reviewed the file, the Tax Commission hereby issues its final decision.

## ISSUES

The issues on appeal are whether the expenses related to the shareholders' personal RV (RV expenses) and the expenses deducted as part of "advertising" are Petitioner's deductible business expenses, and whether the shareholders' cash withdrawals from Petitioner are bona fide loans to the shareholders.

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<sup>1</sup> By using a vinyl wrap, Petitioner put their company name on the side of the shareholders' personal RV. The wrap is applied over the existing paint of the RV and made the RV a moving billboard.

## LAW AND ANALYSIS

Internal Revenue Code (IRC) section 162 provides for the deduction of all the ordinary and necessary expenses paid or incurred in carrying on a trade or business. To qualify as a deduction, an item must be not only an expense, but an ordinary and necessary expense, and it must be incurred or paid during the tax year for which it is claimed, as well as being incurred or paid in the conduct of a trade or business. An ordinary expense is one that is customary or usual within a certain trade or business<sup>2</sup>. A necessary expense is one that is appropriate and helpful in the development of the business<sup>3</sup>. The test for determining whether an expense is ordinary and necessary is whether a “hard-headed” businessperson, under the circumstances, would have incurred the expense. *Union Ganadera Reg'l de Chihuahua, Inc. v. Commissioner*, 80 T.C.M. (CCH) 723, T.C. Memo. 2000-357. “Trade or business” is used often in IRC, but the term is not specifically defined as it relates to section 162. The Tax Court, in its decision, *Comm’r v. Groetzinger*, stated, “... to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit.” Any expenses that have elements of entertainment and recreation require proof of business purpose.

Idaho Code section 63-3042 allows the Tax Commission to examine a taxpayer’s books and records to determine the correctness of an Idaho income tax return. Tax Commission Administration and Enforcement rule IDAPA 35.02.01.201 provides that, “A taxpayer shall maintain all records that are necessary to a determination of the correct tax liability.”

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<sup>2</sup> *Deputy v. Du Pont*, 308 U.S. 488,495 (1940)

<sup>3</sup> *Commissioner v. Heining*, 320 U.S. 467, 471 (1943)

Deductions are a matter of legislative grace, and a taxpayer bears the burden of proving that he is entitled to the deductions claimed. *New Colonial Ice Co., Inc. v. Helvering*, 292 US. 435, 440, 54 S.Ct. 788 (1934). Taxpayers are required to maintain records that are sufficient to enable the determination of their correct tax liability. See IRC § 6001; Treasury Regulation § 1.6001-1(a). The burden rests upon the taxpayer to disclose his or her receipts and claim his or her proper deductions. *United States v. Ballard*, 535 F.2d 400, 404 (1976). If a taxpayer is unable to provide adequate proof of any material fact upon which a deduction depends, no deduction is allowed, and that taxpayer must bear his or her misfortune. *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931). A taxpayer's general statement that his or her expenses were incurred in pursuit of a trade or business is not sufficient to establish that the expenses had a reasonably direct relationship to any such trade or business. *Near v. Commissioner of Internal Revenue*, T.C. Memo. 2020-10 (2020).

In the present case, Petitioner, doing business as [REDACTED] [REDACTED] [REDACTED] provided compliance service, i.e., drug and alcohol testing<sup>4</sup>, to companies that operate commercial vehicles in interstate commerce with an identification number, called "USDOT number"<sup>5</sup>. In addition to the compliance service, Petitioner provided several services, including, but not limited to, assisting drivers with obtaining their commercial licenses, providing training programs, and helping their clients navigate the Unified Carrier Registration Program<sup>6</sup>. During the years under review,

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<sup>4</sup> Petitioner provided random and on demand drug and alcohol testing for pre-employment, post-accident, reasonable suspicion, return to duty, etc. Petitioner partnered with Quest Diagnostics, a nationwide testing facility.

<sup>5</sup> A USDOT number is a unique identifier assigned by the Federal Motor Carrier Safety Administration (FMCSA) and required for a company to operate commercial vehicles, transporting passengers or hauling cargo, in interstate commerce. To obtain a USDOT number, a company must register with the FMCSA and comply with federal regulations.

<sup>6</sup> The Unified Carrier Registration (UCR) program is a system established by federal law where commercial vehicles operating in interstate commerce across multiple states must register and pay an annual fee. The UCR program acts as a single registration point, instead of having to register in each state individually.

Petitioner visited several truck shows<sup>7</sup> to introduce their services to trucking companies and their drivers, fleet managers, and industry vendors. To promote their business, Petitioner “wrapped<sup>8</sup>” the shareholders’ RV with their company logo and stayed at near-by camping sites while visiting the truck shows. Petitioner deducted these expenses related to the RV as business expenses. The Tax Commission reviews whether these RV related expenses are Petitioner’s business expenses or the shareholders’ personal expenses.

### **RV related expenses**

#### Wrapping cost

During Appeals’ review, the representative clarified that the RV was the shareholders’ personal property; therefore, it was not recorded as business property in Petitioner’s books and records. The shareholders purchased the RV in January 2022. At the end of April 2022, Petitioner completed wrapping the shareholders’ personal RV with their company logo to promote/advertise their business. In August 2022, Petitioner started taking the RV to truck shows. Petitioner visited eight (8) truck shows during 2022. In correspondence to Appeals, Petitioner provided a list of the dates, locations, and registrations for each truck show, which indicates that the RV was at those truck shows for almost two and half months, August and September, and the first two weeks of October. Putting a vinyl wrap on the shareholders’ personal RV for business purposes does not automatically make the cost a deductible business expense. Additionally, just because the company logo is always visible to the public, it does not mean Petitioner can deduct entire cost as a business expense. If Petitioner and/or the shareholders used the RV for both personal and business purposes,

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<sup>7</sup> Truck shows are for trucking companies and their drivers, fleet managers, and industry vendors to connect and discuss new products and services. Some shows include seminars and presentations on industry trends, safety regulations, and new technologies.

<sup>8</sup> By using a vinyl wrap, Petitioner put their company name on the side of the shareholders’ personal RV. The wrap is applied over the existing paint of the RV and made the RV a moving billboard.

Petitioner could only deduct the portion of expenses related to business use. During the hearing, the representative argued that the RV was used only for business purposes for the entire year, and when Mr. [REDACTED] the business owner, took the RV to the truck shows, Mrs. [REDACTED] stayed with their children in Idaho. However, Petitioner's information shows that their business usage of the RV was only for two and half months. Petitioner did not record the wrapping cost separately from the RV cost in their general ledger nor did they provide any documentation to substantiate the cost. Without adequate substantiation, the Tax Commission upholds the Bureau's disallowance of the wrapping cost.

#### Loan payments

Petitioner made down payments to purchase the RV for the shareholders and kept making monthly loan payments until the shareholders sold the RV in October 2022<sup>9</sup>. Petitioner recorded these payments<sup>10</sup> in their general ledger and deducted them as part of their advertising expenses for federal purposes. In their general ledger, Petitioner recorded the loan payments as if they were payments of their own debt, instead of the shareholders' debt. As previously mentioned in this decision, the RV was the shareholders' personal property. The payments on the shareholder's personal property are not allowable business expenses. Therefore, the Tax Commission determines that these payments were distributions to the shareholders, and upholds the Bureau's adjustments for the RV loan payments.

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<sup>9</sup> The shareholder sold the RV because of husband's medical condition. He was the only one who could drive the RV, and driving the RV to truck shows was no longer feasible.

<sup>10</sup> Petitioner recorded down payments as "RV Marketing" in their general ledger and deducted as part of "Advertising" for federal purposes.

### Campsite fees

During administrative review, Petitioner provided a timeline of their truck show visits, which started in August 2022, in [REDACTED] Wisconsin, followed by [REDACTED] [REDACTED] Wisconsin, and [REDACTED] [REDACTED] Minnesota. Petitioner visited several more truck shows<sup>11</sup> until the shareholders sold the RV in mid-October 2022<sup>12</sup>. Petitioner deducted campsite fees for [REDACTED] RV Park in August 2022, which appear to be for them to attend the truck shows in [REDACTED] Wisconsin and [REDACTED] [REDACTED] Wisconsin; however, these locations are approximately one hundred forty (140) miles<sup>13</sup> away from [REDACTED] RV Park<sup>14</sup>. It is not clear how Petitioner promoted their business during the truck shows by displaying their company logo on the side of the shareholders' RV while the RV was in the campsite approximately 140 miles away from the truck shows. The Tax Commission determines that the campsite fees Petitioner paid that are outside the timeframe of their truck show visits, along with the campsite fees paid for [REDACTED] RV Park are personal expenses. The Tax Commission determines that all RV travel expenses are personal expenses and therefore, upholds the Bureau's adjustments to the RV travel expenses.

### **Advertising expense**

There were discrepancies in the advertising expense recorded in Petitioner's general ledgers and the amounts reported on their federal returns. The advertising expense account in Petitioner's general ledger contained non-deductible items, such as charitable contributions and

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<sup>11</sup> In September 2022, Petitioner visited three truck shows, held in [REDACTED] Minnesota, [REDACTED] County, Wisconsin, and [REDACTED] [REDACTED] Wisconsin. In October 2022, Petitioner visited two truck shows, held in [REDACTED] Wisconsin, and [REDACTED] California. Petitioner was scheduled to attend the Mid-America Trucking Show, Florida Truck Show, Texas Truck Show after California.

<sup>12</sup> Petitioner decided it was no longer feasible.

<sup>13</sup> Approximately 2.5 hours driving.

<sup>14</sup> [REDACTED] Wisconsin is about 140 miles south from [REDACTED] [REDACTED] RV campground, and [REDACTED] [REDACTED] Wisconsin is about 140 miles west from [REDACTED] [REDACTED] RV campground.

the shareholders' cash withdrawals. Since a charitable contribution is a specific item to be passed through to shareholders, the Tax Commission will review "qualifying<sup>15</sup>" charitable contributions at the shareholders' level.

The shareholders' cash withdrawals Petitioner deducted as part of their advertising expense contained a cash withdrawal to pay off the shareholders' personal credit card debt. Petitioner agreed with the Bureau's adjustment that it was a distribution to the shareholders. The rest of the cash withdrawals include the shareholders' moving expense<sup>16</sup>, RV expenses paid outside the truck show timeframe, etc. The Tax Commission determines that all these cash withdrawals are distributions to the shareholders.

In addition to the shareholders' cash withdrawals deducted as Petitioner's personal expenses, there were multiple cash withdrawals recorded as loans to shareholders<sup>17</sup> in the general ledger. The Tax Commission reviews these cash withdrawals as follows.

### **Shareholders' cash withdrawals**

The determination of whether cash withdrawals from a corporation are loans or distributions depends on whether, at the time of the withdrawals, the shareholder intended to repay the amounts received, and the corporation intended to require payment. It is not enough for a shareholder to declare that he or she intends a cash withdrawal to be a loan. To treat a withdrawal as a loan, instead of a distribution, it must be a bona fide loan. Some of the key factors used to establish a bona fide loan include, but are not limited to:

1. **Documentation:** The presence of a promissory note or other formal evidence of indebtedness is significant, though not conclusive.

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<sup>15</sup> Charitable contributions must be made to a qualifying charity.

<sup>16</sup> There is no evidence that Petitioner's office location changed.

<sup>17</sup> The cash withdrawals treated as loans to shareholders do not include the amounts deducted as expenses.



2. **Intent and expectation of repayment:** Both the lender and borrower must have a bona fide intention and expectation that the debt will be repaid. This includes a good faith intent by the lender to enforce payment.
3. **Terms of the loan:** The loan should have a fixed maturity date, a schedule for repayments, and an interest rate, which are indicative of a debtor-creditor relationship. The presence of security or collateral to ensure repayment is also a factor.
4. **Economic substance:** The transaction must have economic substance beyond its form. Courts often apply the standard of whether an unrelated lender would have entered the transaction on similar terms.
5. **Financial condition of the borrower:** The borrower's solvency and ability to repay the loan at the time the cash withdrawal was made are critical considerations.
6. **Behavior of the parties:** The actions of the parties, such as making demands for repayment and the actual payment of the loan, are relevant in determining the existence of a bona fide debt.

Petitioner's general ledger recorded the shareholders' withdrawals under "[REDACTED] Loan" and "Owner Draws", and the Tax Commission reviews these to determine whether they are loans or distributions to the shareholders:

[REDACTED] Loan

Petitioner entered into two loan agreements with the shareholders, one for tax year 2021<sup>18</sup>, and the other for tax year 2022<sup>19</sup>, in which they specified the terms of payment, and included loan amortization schedules, showing the amount of payment due, i.e., principal<sup>20</sup> plus interest, and its due date. During the years under review, the shareholders made several loan payments indicating an intent to pay principal and interest. Although there was no collateral to secure payments at the time the loan agreements were made, because the shareholders intended to pay the loans and did

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<sup>18</sup> Tax year 2021: \$317,300 is the loan amount. Interest rate is 1.350%, annual compound, which calculates \$63,755.20 of total interest. Annual payment amount is \$12,932.89, and the amount due as of 1/1/2021 includes \$8,649.34 principal and \$4,283.55 interest. Term of loan is 30 years. No late-pay fee/penalty.

<sup>19</sup> Tax year 2022: \$389,551 is the loan amount. Interest rate is 1.820%, annual compound, which calculates \$88,768.51 of total interest. Annual payment amount is \$12,610.65. Term of loan is 30 years. No late-pay fee/penalty.

<sup>20</sup> Petitioner recorded the principals and repayments under "[REDACTED] Loan" in their general ledger.

make some payments, the Tax Commission determines that the shareholders' cash withdrawals are loans, instead of distributions. Therefore, the Tax Commission modifies the Notice, accepting the characterization of the shareholders' cash withdrawals, recorded under "[REDACTED] Loan" in Petitioner's general ledger, as loans to the shareholders.

However, when the shareholders made loan payments, Petitioner recorded the payments towards only the loan principal and did not record interest income in their general ledger nor did they report interest income on their federal returns. Additionally, the interest rates used in the loan agreements were lower than the Applicable Federal Rate (AFR)<sup>21</sup> for both tax years. As provided under Internal Revenue Code section 7872, loans bearing a below-market interest rate should be treated as if they bore interest at the market rate. Therefore, the Tax Commission calculated an imputed interest for tax years 2021<sup>22</sup> and 2022<sup>23</sup> at the AFR and modifies the Notice for the imputed interest.

In addition to "[REDACTED] Loan", Petitioner recorded other cash withdrawals under "Owner Draws"<sup>24</sup> in their general ledger throughout tax years 2021 and 2022. The Tax Commission reviews "Owner Draws" as follows.

#### Owner Draws

It is not clear how Petitioner reported these withdrawals on their federal returns. Petitioner's general ledger shows no payments received from the shareholders, nor does it report

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<sup>21</sup> The Applicable Federal Rates (AFR) <sup>21</sup> rulings provide a long-term AFR 1.90% for tax year 2021 and 4.34% for tax year 2022.

<sup>22</sup> The 2021 loan agreement shows that \$317,300 is total loan balance. With a long-term AFR, 1.90%, the imputed interest is **\$6,028.70** ( $\$317,300 \times 1.90\% \text{ AFR}$ ) for tax year 2021, and after a payment of \$21,000 as of 1/1/2022, the imputed interest is **\$5,629.70** ( $(\$317,300 - \$21,000) \times 1.9\% \text{ AFR}$ ) for tax year 2022.

<sup>23</sup> The 2022 loan agreement shows that \$289,551 is total loan balance. With a long-term AFR, 4.34%, after a payment of \$52,500 in January 2022, the imputed interest is **\$10,288.01** ( $(\$289,511 - \$52,500) \times 4.34\% \text{ AFR}$ ) for tax year 2022.

<sup>24</sup> The shareholders' withdrawals recorded under "Owner Draws" are not part of the "[REDACTED] Loan" previously addressed in this decision.

interest. There is no indication that the shareholders intended to make any payments when they made withdrawals from Petitioner's bank account. There are no documents showing there was a debtor-creditor relation between Petitioner and the shareholders for the amounts recorded under "Owner Draws". The Tax Commission finds that these withdrawals are distributions to the shareholders; therefore, the Tax Commission upholds the Bureau's adjustment.

### CONCLUSION

The Tax Commission found that the Bureau properly disallowed the RV related expenses as personal expenses. As for the Bureau's reclassification of the "[REDACTED] Loan" as distributions to shareholders, the Tax Commission found that the "[REDACTED] Loan" were indeed loans<sup>25</sup>, and as such, require an addition of interest income. As for the "Owner Draws", the Tax Commission found that they are distributions to the shareholders.

THEREFORE, the Tax Commission MODIFIES the Notice dated September 6, 2024, and directed to Petitioner. Since Petitioner is a flow-through entity, the tax owed in addition to the amount described below flowed through to its shareholders.

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

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2021	\$20	\$3	\$23
2022	0	0	0
TOTAL DUE			<u>\$23</u>

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

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<sup>25</sup> Total loan balance is \$533,351 (\$296,300 plus \$237,051) as of 12/31/2022, which is equal to the ending balance of "loans to shareholders" on line 7, federal Form 1120S, Schedule L.

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2025.

IDAHO STATE TAX COMMISSION

## CERTIFICATE OF SERVICE

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_, 2025,  
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:

Receipt No.

[REDACTED]

\_\_\_\_\_  
\_\_\_\_\_

[REDACTED]