



Audit did not receive any further response and therefore issued the Notice dated September 14, 2023. The Notice denied all expenses claimed on Schedule C for all three years in the audit period, adjusted Petitioners' Idaho residency status from part-year resident to resident, and denied a deduction for energy efficiency upgrades Petitioners claimed on their 2021 Idaho return.

Petitioners exchanged another series of emails with Audit between September and October 2023. Petitioners expressed disagreement with the denial of business expenses, stating that the businesses were legitimate and that the expenses are reasonable.

In this series of emails, Petitioners provided a variety of documents to support the business expenses they claimed. These included order confirmations, copies of billing statements, and receipts. Based on a review of the documents, Audit allowed deductions for some business expenses and issued a modified Notice on January 9, 2024. Audit included in the modified Notice schedules of which expenses were allowed and which were not. Audit also "disallowed" the gross receipts reported on Petitioners' Schedules C.

In addition to the documents mentioned above, Petitioners provided copies of their 2019 through 2021 Oregon state income tax returns, all of which indicated that Petitioners were nonresidents of Oregon. Based on these returns and the other adjustments to Petitioners' Idaho taxable income and income tax, Audit allowed additional credits for income tax paid to other states for all years in the audit period.<sup>1</sup> Audit asked Petitioners to respond to the modified Notice by January 30, 2024, by either withdrawing their protest if they agreed with the updated report or providing an explanation for each item they still disagreed with. Petitioners did not respond by the deadline provided, so Audit began the process of transferring the case to the Tax Commission's

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<sup>1</sup> Petitioners claimed the credit on their 2019 Idaho return but did not claim it on their 2020 or 2021 returns.

Appeals unit (Appeals) for further consideration. On February 7 and 8, 2024, Audit and Petitioners exchanged another round of emails regarding the audit issues, during which Petitioners stated they don't disagree with the conclusion that they needed to file a resident return for 2021.

On March 14, 2024, Appeals sent Petitioners a letter outlining the options available for redetermining a protested Notice. Petitioners and Appeals exchanged a series of emails beginning March 22, 2024. Petitioners explained that the paperwork containing documentation of business expenses has been in a storage unit since May 2022, but they could prove they had the businesses and felt the expenses claimed were not outrageous. They were unaware that documentation was needed for the energy efficiency upgrades deduction. Appeals asked some questions about the deduction. Petitioners said they installed a heat pump that does not operate on solar or geothermal resources. Appeals granted two extensions of time for Petitioners to obtain and organize documentation for their business expenses, but no additional documentation was provided. After the second extension, Petitioners stated they had been unable to find time to go to their storage unit to look for the requested information.

### **Law and Analysis**

Both the original Notice and the modified Notice adjusted Petitioners' residency status for tax year 2021. Petitioners have agreed that they should have filed as residents instead of part-year residents. Therefore, there is no analysis required regarding the issue and it will not be mentioned further in this decision.

During the email exchange beginning March 22, 2024, Petitioners told Appeals they were unaware of any request to provide documentation for the energy efficiency upgrades deduction claimed on their 2021 Idaho return. Petitioners indicated the deduction may have been claimed on a heat pump they installed. After discussion of examples of upgrades that do qualify for the

deduction,<sup>2</sup> Petitioners indicated they were unsure what they claimed the deduction for. In the absence of any documentation showing a qualifying energy efficiency upgrade, the Tax Commission determined that Petitioners are not eligible to claim the deduction.

Internal Revenue Code (IRC) section 162(a) allows taxpayers to claim deductions for “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any business or trade.” 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>3</sup> A necessary expense is one that is appropriate and helpful in the development of the business.<sup>4</sup>

Deductions are a matter of legislative grace, and the taxpayer must prove that he is entitled to each deduction and the amount of the deduction.<sup>5</sup> Taxpayers must substantiate each claimed deduction by maintaining sufficient records to allow the correct determination of their tax liability.<sup>6</sup> If a taxpayer is unable to provide adequate proof of any fact upon which a deduction depends, no deduction is allowed, and that taxpayer must bear his misfortune.<sup>7</sup> A taxpayer’s general statement that expenses were incurred in conducting their business is not sufficient to establish that the expenses had a reasonable direct relationship to the taxpayer’s trade or business.<sup>8</sup>

Both IRC section 6001 and Idaho Code section 63-3042 require taxpayers to maintain books,

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<sup>2</sup> Heat pumps are not among the items that qualify for the energy efficiency upgrades deduction, but they may qualify for a different deduction if certain other conditions are met.

<sup>3</sup> *Deputy v. Du Pont*, 308 U.S. 488, 495 (1940)

<sup>4</sup> *Commissioner v. Heininger*, 320 U.S. 467, 471 (1943)

<sup>5</sup> *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)

<sup>6</sup> *Higbee v. Commissioner*, 116 T.C. 438, 440 (2001)

<sup>7</sup> *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931)

<sup>8</sup> *Ferrer v. Commissioner*, 50 T.C. 177, 185 (1968), *aff’d per curiam*, 409 F.2d 1359 (2nd Cir. 1969); *Near v. Commissioner*, T.C. Memo 2020-10

records, papers, and any other data that might be needed to verify the correctness of a tax return and to provide such items for examination upon request by an authorized party.<sup>9</sup>

The information Petitioners provided to Audit included a 2019 order confirmation for business cards and documentation of agency fees paid during 2019 through 2021. These items showed a clear enough connection to Petitioners' businesses that Audit determined the expenses should be allowed as deductions on Schedule C. The Tax Commission finds no reason to contradict that determination.

Petitioners provided Audit copies of billing statements from Avista (the utility company servicing Petitioners' home). Petitioners claimed electricity payments to Avista as utilities on Schedule C, but electricity was provided to the home in general. There was no indication that a separate meter was used to track utility usage strictly for Petitioners' businesses. As such, the full amount of the utility cannot be a business expense. A portion of the expense could potentially be deductible as part of a deduction for the business use of the home, but Petitioners failed to show that the space used for business was used *exclusively* for business and not also for personal reasons.<sup>10</sup> Therefore, the Tax Commission determined that Petitioners were not eligible to claim such a deduction.

Petitioners provided Audit copies of billing statements from Frontier and Ziply (home phone and internet providers). These statements show charges for "digital phone essentials" and "Broadband ultra." IRC section 262(b) states "any charge (including taxes thereon) for basic local telephone service with respect to the 1st telephone line provided to any residence of the taxpayer shall be treated as a personal expense." IRC section 262(a) reads, "Except as otherwise expressly

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<sup>9</sup> See also *Tax Commission Administration and Enforcement Rule 200* (IDAPA 35.02.01.200)

<sup>10</sup> Refer to IRC section 280A(c)(1).

provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.” Similar to the utilities discussed above, a portion of the charges for broadband service could potentially be deductible as a cost of the business use of the home. The Tax Commission determined Petitioners were not eligible to claim such deduction for the same reasons as above.

Petitioners provided Audit copies of billing statements from Verizon Wireless. Petitioners mentioned in emails that the account was a business account under the name [REDACTED] [REDACTED] [REDACTED] [REDACTED] and they could not understand how the expense was determined to be personal. Petitioners provided complete statements (between 35 and 46 pages) for December 2019 and all 12 months of 2021. Only the front page of each statement was provided for 2020. The complete statements show four lines on the account for all months except March 2021 (five lines) and November and December 2021 (three lines). These statements show one line in the name of [REDACTED] [REDACTED] (the owner of [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] The other lines are in the name of [REDACTED] [REDACTED]. All these statements show hundreds of calls each month between lines on the same account. There is no evidence that Petitioners co-owned any business or that one spouse provided any business service to the other, so the logical conclusion is that these contacts were personal in nature. This does not account for any contact between the lines that were text, picture, or video messages (these are not tracked other than by raw numbers); nor does it take into consideration any data usage that may have been personal in nature. In short, there is no way for the Tax Commission to determine based on available information how much of the phone usage was business-related and how much was personal. Petitioners bear the burden of showing the amount of deduction they are entitled to claim, and they have not done so. Therefore, the Tax Commission determined that Petitioners are not entitled to claim a deduction for amounts paid to Verizon Wireless.

Petitioners provided Audit a receipt from Best Buy showing the purchase of a Sony WiFi BluRay player and a Sony X750 55-inch 4K television. The name of the file containing the scanned receipt was “Office Expense 2020.” There is no indication of the business purpose of the items shown on the receipt, and the business purpose is not obvious, so the Tax Commission determined that no deduction is allowed for the expense.

Petitioners also provided Audit with three items to support travel expenses. Two are receipts from Expedia for the booking of a hotel room. These receipts show that Expedia collected \$0, and \$0 was paid on a Visa card. The third item is a hotel room reservation confirmation from Expedia showing \$236.90 collected by the hotel. Certain categories of business expenses, including travel, carry with them a higher standard of documentation required. To claim a deduction for travel expenses, the documentation must show not only the cost incurred, but also the time and location of the travel, along with the business purpose of the travel and who was present.<sup>11</sup> None of the hotel booking receipts show this additional information required. Therefore, the Tax Commission determined that Petitioners are not allowed a deduction for travel expenses.

Other than what they provided to Audit, and that Audit considered in the preparation of the modified Notice, Petitioners provided no additional documentation during the examination and redetermination process. Based on the information Petitioners did provide, the Tax Commission determined that the Idaho taxable income and resulting tax shown in the modified Notice are accurate.

During the examination of their returns, Petitioners provided Audit with copies of their 2019 through 2021 Oregon state income tax returns. Based on the increased tax liability from

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<sup>11</sup> Refer to IRC section 274(d)

increased Idaho taxable income, Audit calculated credits for income taxes paid to Oregon using the information from those returns. The Tax Commission determined those calculations to be accurate.

As part of the adjustments to Petitioners' 2021 Idaho return, Audit determined that Petitioners were both Idaho residents. Petitioners claimed a partial Idaho Child Tax Credit on their part-year resident return. They reported two children as dependents, a 19-year-old and a 14-year-old. The 14-year-old would qualify for the credit, whereas the 19-year-old would not. Petitioners claimed half of the potential credit because they reported themselves as 6-month residents. Since they were made full-year residents, they would be eligible to claim the maximum Idaho Child Tax Credit. Therefore, the Tax Commission is allowing an additional \$103 credit for 2021.

Similarly, because all four people reported on the 2021 return are now full-year residents, Petitioners would be eligible to claim the Idaho grocery credit for four individuals. There is no evidence to show that any of them would be disqualified from claiming the credit. Therefore, the Tax Commission is allowing an additional \$50 of grocery credit for 2021.

The Bureau added interest and penalty to Petitioner's tax deficiency. The Tax Commission reviewed those additions and finds them to be appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046, respectively.

### **Conclusion**

Audit denied unsubstantiated business expenses Petitioners claimed on Schedule C for tax years 2019, 2020, and 2021. Petitioners have not provided any additional evidence or compelling argument that Audit's determinations are incorrect. The Tax Commission finds that Petitioners are eligible for increases to two Idaho credits for tax year 2021.



THEREFORE, the modified Notice dated January 9, 2024, and directed to [REDACTED]

[REDACTED] is hereby further MODIFIED and MADE FINAL.

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>
2019	\$801	\$40	\$98	\$939
2020	1,856	93	172	2,121
2021	2,475	124	177	2,776
			TOTAL DUE	\$5,836

The Tax Commission DEMANDS immediate payment of this amount. Interest is calculated in accordance with Idaho Code section 63-3045.

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2024.

IDAHO STATE TAX COMMISSION

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2024,  
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.

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