BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 0-293-656-576
	)	
	)	
Petitioners.	)	DECISION
	)	

(Petitioners) protested the Notice of Deficiency Determination dated February 19, 2021. Petitioners disagreed with the Income Tax Audit Bureau's (Bureau) determination that their activity was not for profit. The Tax Commission reviewed the matter and for the reasons stated below upholds the Notice of Deficiency Determination.

BACKGROUND

Petitioners filed their 2016 and 2017 Idaho individual income tax returns reporting losses from a schedule F for Petitioners reported and claimed losses from this activity since at least the early 2000s. The Bureau selected Petitioners' 2016 and 2017 returns to examine Petitioners' schedule F. The Bureau included as part of its examination Petitioners' wholly owned limited liability company, LLC's (schedule F for the tax years 2018 and 2019. Petitioners began including their activity on S-corporation return in 2018.

The Bureau sent Petitioners a letter notifying them of its examination and requesting all their books and records for their activity. Initially, the Bureau did not know Petitioners included the activity on return, so it only inquired about the investment tax credit claimed on their 2018 return and asked if the had been disposed of. The Bureau also asked Petitioners to complete a business activity questionnaire and to sign a waiver of the statute of limitations for tax year 2016. Petitioners' representative (Representative) contacted the Bureau and asked for more time to gather the requested information. Representative agreed to extend the statute

of limitations for 2016 to allow them the time needed. After several emails and other correspondence with Representative and further extending of the statute of limitations, the only documentation Petitioners submitted was an amended return for tax year 2016. The amended return removed Petitioners' schedule C and business from their personal return transferring it to Around the same time, COVID hit which slowed the process even more. As a result of the amended return, the Bureau expanded the audit to include schedule F. (Petitioners transferred their schedule F activity to in 2018.)

After a couple more months with nothing provided from either Petitioners or Representative, the Bureau, running up against the statute deadline, determined it was necessary to protect the state's interests and sent Petitioners a Notice of Deficiency Determination for the tax years 2016 through 2019. The Bureau disallowed Petitioners' activity as being not for profit. The Bureau based its determination on the lack of information Petitioners provided and the fact that since 2006, the earliest tax year the Tax Commission has imaged returns, Petitioners have reported losses from the activity. In addition to the not-for-profit determination, the Bureau stated the expenses of the activity are disallowed because Petitioners provided no documentation to substantiate the expenses claimed. The Bureau adjusted Petitioners' personal income tax returns and the S-corporation returns of Petitioners' pass-through entity,

Petitioners disagreed with the Bureau's determination and protested the Notice of Deficiency Determination. Included with Petitioners' initial protest, Petitioners provided the Bureau's completed business analysis questionnaire, their business plan for the activity, values, a list of capital assets and their values, and Petitioners' QuickBooks records for each year. Petitioners stated they were protesting and providing the documentation in connection with their impending protest to the Notices of Deficiency Determination. (A Notice of Deficiency Determination was also sent to

Petitioners stated they protest the conclusions reached in the Notices of Deficiency Determination and assert that their business is entitled to deduct all its expenses, including deprecation, and to do so in excess of any revenue generated by the business. Petitioners stated the continued insistence on 100% of the records without any reasonable accommodation constitutes an unreasonable use of authority; nevertheless, they acknowledge their obligation to substantiate their expenses and deductions.

The Bureau acknowledged Petitioners' protest and waited for Petitioners' documentation to be provided. However, before any documentation was received, Petitioners sent in a more detailed and explicit protest of the matter. Included in that letter, Petitioners requested an informal hearing to discuss the legal and factual issues raised and that the hearing be in person and recorded. Petitioners requested the hearing be an independent administrative redetermination of the originating division's determination before a commissioner or duly authorized representative of the commission. As a result of Petitioners' requests, the Bureau was advised by the Tax Commission's Deputy Attorney General to acknowledge Petitioners' requests and forward the matter to the Tax Commission's Appeals Unit (Appeals).

Appeals reviewed the matter and sent Representative a letter acknowledging Petitioners' request for a hearing, and asked Representative for a list of dates when he was available for a hearing. Representative responded and a hearing was scheduled. However, during a discussion with Representative prior to the hearing, it was decided that Appeals would review the information and documentation Petitioners provided, make any additional requests for documentation, discuss Appeal's concerns with Representative, and then have a hearing if necessary.

After months of gathering, submitting, reviewing, and discussing Petitioners' information and documentation, Representative and Appeals decided to schedule a hearing for Representative to

present Petitioners' position on the not-for-profit issue. A hearing was scheduled and held on March 5, 2024. In attendance at the hearing was attorney for Petitioners (Representative), and hearing the case were Commissioner Tax Appeals Specialist and Deputy Attorney General

During the hearing Representative went through some relatively undisputed facts regarding Petitioners, the formation of the ownership and use of certain property, the bookkeeping of their businesses, and the use of their children and other notable to showcase their

Representative then began going through the nine factors listed in the Treasury Regulations for determining not-for-profit activities. The discussion included the business-like manner in which the activity was conducted, Petitioners' use of advertising, Petitioners' expertise and the expertise of Petitioners' advisors, the time and effort Petitioners put into the activity, the expectation that the assets used in the activity would appreciate, the ownership of some of the assets, whether Petitioners' businesses constituted separate activities or a single activity, Petitioners' success in other activities, the history of losses and/or occasional profits, other sources of income, and the pleasure or recreational aspects of the activity. In sum, Representative believes the majority of the factors favor Petitioners and that the remaining factors, if looked at using the earnings before interest, taxes, depreciation, and amortization analysis, shows the activity is profitable when unrecognized, appreciated gains are considered. Representative stated the activity is not the same business as what Petitioners reported prior to 2013. The activity is not operated or managed the same and it is different because in 2013 the activity became part of operations, a separate entity.

In support of the argument that the activity should be treated as a single activity with activity, Representative stated the activity derived all their business from the community. Representative stated he could put together a letter regarding the single

activity issue if needed. Appeals asked Representative to provide the letter and allowed Representative time to do so.

The remainder of the hearing was used to discuss the documentation and substantiation Petitioners provided for review. Petitioners' substantiation consisted of QuickBooks printouts, bank statements, check carbons, affidavits, and receipts. Representative and Appeals discussed various accounts and expenses relating to the activity, and where Appeals found the substantiation lacking. Appeals stated it would provide Representative with the detail behind the schedules previously sent to Representative showing the expenses that would be allowed if the activity was found to be for profit. Representative stated he would provide that information to Petitioners so they can fill in the gaps where needed. Some of the problem areas discussed were depreciation not matching the return, livestock sales in cost of goods sold that may have also been depreciated, ownership of the and property, travel, lodging, and meals not meeting the strict substantiation requirements, the claiming and reporting of rents, personal items, and in general no documentation showing business purpose.

Appeals concluded the hearing stating it would provide Representative with the detail to the schedules of allowed expenses, and Representative stated he would submit a letter in support of the position that Petitioners' activity and activity should be considered a single activity under LLC. Representative also stated he would provide additional information on the ownership of the and the property and additional information on the vehicles and equipment purchased and depreciated. The parties agreed to a time frame and the hearing was adjourned.

Both parties provided the additional information to the other. A few days later, Appeals contacted Representative and asked about the amended return Petitioners submitted for tax year 2016. Appeals asked for clarification on what was being amended as it only appeared to be transferring the

business into Representative stated he believed the amended return transferred both the business and the activity into Appeals asked for a copy of 2016 return since it had not been filed with the Tax Commission. Representative provided a copy of return but it only reported the business. When questioned about the activity not being reported on return, Representative provided a letter explaining that an inadvertent and immaterial mistake made by his office failed to amend the schedule F on Petitioners' 2016 income tax return to the return of Representative stated the net tax effect of the mistake is zero and his error should not distort Petitioners' intent nor the facts and circumstances of the case.

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. IRC section 183 states in the case of an activity engaged in by an individual or an S-corporation that is not engaged in for profit (commonly referred to as a hobby), no deduction attributable to such activity shall be allowed. The difference between a hobby and a business can be slight, yet the difference is important because the IRC treats hobbies and businesses differently. Generally, a trade or business is an activity carried on to create a livelihood or to make a profit. A hobby, on the other hand, is an activity pursued because of an interest or for pleasure and its primary purpose is not as an income producing occupation. Whether an activity is a trade or business depends on each situation's facts and circumstances. An activity is engaged in for profit if the taxpayer entertained an actual and honest profit objective in engaging in the activity. *Topping v. C.I.R.*, T.C. Memo. 2007-92 (2007).

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. In the case of an activity which consists in major part of the the number of years is two out of seven.

Treasury Regulation section 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 the 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.

However, before the Tax Commission can address whether Petitioners had the requisite profit motive, it first must address the issue of whether Petitioners', and later business and their activity constitute a single activity for purposes of deciding the requisite profit motive under IRC section 183. This issue was brought up during the hearing and later briefed by Representative. This issue is important because if found to be a single activity, the activity in totality is profitable and section 183 does not apply. *Topping, supra*.

Treasury Regulation section 1.183-1(d)(1) states that in order to determine whether code section 183 applies, the activity or activities must be ascertained.

> In ascertaining the activity or activities of the taxpayer, all the facts and circumstances of the case must be taken into account. Generally, the most significant facts and circumstances in making this determination are the degree of organizational and economic interrelationship of various undertakings, the business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business or in an investment setting, and the similarity of various

> undertakings. Generally, the Commissioner will accept the characterization by the taxpayer of several undertakings either as a single activity or as separate activities. The taxpayer's characterization will not be accepted, however, when it appears that his characterization is artificial and cannot be reasonably supported under the facts and circumstances of the case.
> Treasury Regulation § 1.183-1(d)(1).

Petitioners initially did not assert their business and their activity should be considered a single activity. The single activity issue was brought up in passing in a conversation with Representative before the hearing and brought up as a major point during the hearing. In support of a single activity, Representative provided a letter wherein he discussed the interconnectedness of the activities. Representative stated that the business and business are mutually supportive business enterprises. The business attracts new clients and gives Petitioners a competitive advantage among their peers, and the business helps Petitioners find potential buyers of their and clients for their services. Representative stated Petitioners' characterization of the business and the business as single activity shall be accepted as long as the facts and circumstances indicate that the business and business are sufficiently interconnected. Representative then proceeded to show the interconnectedness of the activities by showing Petitioners' fulfillment of the nine factors used by the courts to evaluate the reasonableness of a taxpayer's characterization. See *Judah v. Commissioner*, (T.C. 2015) 110 T.C.M. 592.

Representative stated the activities were operated from the same location, the activities were brought together and operated by an Idaho limited liability company established on October 25, 2013 to operate both businesses, the activities operate to the mutual benefit of the other, i.e. shared clients, the activities have shared management and ownership, the activities shared assets, employees, caretakers, and professional advisors, and the activities shared books and records. As for the activities efforts to derive revenue from land, Representative referred to other and activities that help to reduce the costs of the and businesses. Representative stated

the Tax Commission did not distinguish between these activities and the and businesses. Nonetheless, the activities' ability to pay rent and maintain and improve the properties not only decreased the costs to carry the real property and improve the property, it also enhanced and increased the properties' perceived and marketable value. Representative stated that each of the facts and circumstances fully satisfy the various factors laid out by the *Judah* court when applying the single factor rule.

In sum, Representative stated Petitioners' and businesses were developed together, are operated together, rely on the same assets, management, employees, caretakers, professional advisors, and books and records. Representative stated the business is the primary source from which Petitioners generate referral business for their business. Likewise, Petitioners' representation of clients to buy or sell puts Petitioners in an exclusive position to acquire and sell as well as discussing and of clients that purchase or are looking for and Representative stated these factors overwhelmingly support the conclusion that Petitioners' decision to characterize their and businesses as a single activity reflects the substantial interconnectedness of the two activities and appears the opposite of unreasonable and artificial.

In the Tax Commission's consideration of the single activity factors, because the issue was first brought up during the hearing or shortly before, the Tax Commission has very little objective facts on which to make a determination. However, based on the information available the Tax Commission makes these observations. Petitioners stated the activities used the same location, that being their primary residence. However, that location for a business is unlikely due to its rural placement. It is more likely that Petitioners had/have an office in town as currently listed on their Facebook page and website to meet with clients.

Petitioners' activity did not use land to generate a profit. Petitioners acquired residential property and but that was acquired through their business and the leased to the activity.

Petitioners have been doing the activity since at least 2006 (Tax Commission records), but as early as 2004 according to Petitioners' history narrative. Petitioners also had a business in 2006 listing as the sole proprietor. Representative stated that with the creation of the businesses changed, and their formation was at the same time. However, the mere fact that Petitioners formally created a business entity to conduct their preexisting businesses does not mean that they commenced their and activities at the same time. See *Judah, supra*.

Representative stated Petitioners' business and business mutually benefited each other. Representative stated nearly all of Petitioners' business originates from clients met while engaging in their business or whose relationship is largely dependent on their attending events where Petitioners' compete. However, in Petitioners' responses to the Bureau's questionnaire, Petitioners stated that nearly 45% of their clients can be traced to their and business activities, with 122 out of 271 transactions directly related to individuals in the industry. Regardless of the statements made, neither can be supported by the record before the Tax Commission. Therefore, based on the fact that Petitioners' business encompasses all aspects of the market, the Tax Commission cannot conclude the degree to which the activities benefited each other. *Ferrer v. Commissioner of Internal Revenue*, 50 T.C. 177 (1968). The Tax Commission is more inclined to believe that the benefits each activity derived from the other were merely incidental and fortuitous. Petitioners' activity did allow them to mingle with prospective clients, but without tangible evidence the Tax Commission is not persuaded that such mingling created a benefit to the level found in *Topping, supra*., for Petitioners'

business. See *Judah, supra*.

Regarding shared advertising, there is no indication Petitioners used one activity to advertise the other. Granted Petitioners likely mentioned the activities in conversation when the opportunity arose, but there was no mention of Petitioners directly advertising their business at the and the Tax Commission found no mention of the activity on the business' website or Facebook page.

The management of the activities is controlled and done by Petitioners. Because management is only in the form of Petitioners, the managerial overlap is insufficient. *Judah, supra*.

Petitioners do oversee and provide some of the care for the However, some of the care of the falls upon Petitioners' and other hired individuals. Other than Petitioners, the and other individuals in the activity are not involved in Petitioners' activities. Therefore, as one would expect, Petitioners are the only overlap of caretakers for both activities.

During the years in question, Petitioners had two accountants/bookkeepers. Petitioners also served as bookkeepers entering their expenses into bookkeeping software. Representative stated Petitioners changed accountants and tax preparers during these years because they noticed things were not reported properly on their income tax returns. Hence the amended return for 2016. However, there is no indication Petitioners used their accountant to analyze the profitability of their businesses or to show where costs could be cut. In addition, there is no crossover of the professional advice received from and to Petitioners' business.

Representative stated Petitioners have a single employee that maintains the records of both businesses and those records are reviewed by the same accounting and tax firm. However, Petitioners' and tax returns report the businesses separately, and for two of the years the businesses are reported on separate income tax returns. Positions taken by a taxpayer in a tax return are treated

as admissions and cannot be overcome without cogent proof that they are erroneous. *Topping, supra*. citing *Mendes v. Commissioner*, 121 T.C. 308, (2003); and *Estate of Hall v. Commissioner*, 92 T.C. 312, (1989). In addition, Petitioners provided no evidence of consolidated financial statements showing unity of the businesses.

After weighing the factors enumerated by the courts, the Tax Commission finds Petitioners' activity was distinct from their business. Representative argued Petitioners operated the and activities as a single undertaking. However, due to the timing of this argument, the Tax Commission believes this was an afterthought and an attempt to qualify for the presumption under IRC section 183(d). Unlike the taxpayer in *Topping, supra*., Petitioners did not show their involvement in the world was the cornerstone of their cultivation of relationships with their clientele. The fact that their at various allowed Petitioners to converse with potential clients is not grounds for finding that the and activities constituted a single undertaking. *Judah, supra*.

Since the Tax Commission has decided Petitioners' activities are separate undertakings, the Tax Commission must now determine whether IRC section 183 applies to Petitioners' activity. As previously stated, Treasury Regulation section 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, nor does the number of factors in favor or against determine the outcome, but rather whether the taxpayer possesses the relevant profit objective determined in light of all the facts and circumstances. *Borsody v. C.I.R.*, T.C. Memo. 1993-534 (1993).

The Bureau's determination was based on a lack of documentation and information. Petitioners' protest responded to each of the nine factors. Petitioners stated they conducted the activity in a businesslike manner. They argued this is supported by the complete and accurate books and

records, conducting their activity in a manner similar to those utilized by successful practitioners, by them changing their operating methods by adopting new techniques/strategies or abandoning unprofitable activities, and by utilizing and adjusting their business plan. Petitioners stated they have maintained adequate and records, have a separate bank account, and utilize accounting software that enables them to evaluate their business decisions. Petitioners stated they consulted with and sought the advice of other successful practitioners and attempted to operate their activity in a similar manner. Petitioners stated they not only made changes to their activity in terms of strategy, but they have also made various operational and improvement changes, for the overall improvement of the activity and to further enhance profitability. Petitioners stated they advertised their activity through a variety of internet web pages and social media accounts, a variety of trade organizations, and other similar marketing activities. Most notably, Petitioners enter their in various competitions where they hoped to increase their notability and enhance the values of the themselves. Petitioners stated they have engaged in multiple efforts to enhance or publicize their business and to increase their ability to market their and services.

Petitioners stated they have extensive experience with and was raised in the local and went on to She trained under numerous professional and and all the she competed on throughout her career. experience was further enhanced by consulting with advisors who have experience in the industry and with these types of Petitioners stated they have also engaged other who are actively competing as and

Petitioners stated they split their time between their business and the activity. Petitioners argued that their business and activity are mutually supportive business enterprises. Therefore, the time they spend pursuing their business has

the effect of furthering their activity. Petitioners stated that together they spend 8-10 hours per day and maintaining the Petitioners stated they also engaged a number of independent contractors to assist with the

Petitioners argued the assets used in the activity have appreciated in value to the extent that the activity is profitable. Petitioners stated their as well as the land and improvements have appreciated to where the unrealized gains will result in an overall profit.

Petitioners stated when they initially engaged in the and business they were not as successful as they had hoped and closed that operation. They later started it up again after consulting with others and had the means to support it through the success of their business. Petitioners point to the success of their business to show that they have past and present successes in other activities.

Petitioners argued that their business has been and continues to be profitable. After excluding certain accelerated depreciation and accounting for unrealized gains in capital assets, Petitioners stated they have consistently increased the value of their business and the assets of the business. Petitioners disagree that the Internal Revenue Code requires that they demonstrate an operating profit to be able to deduct the corresponding expenses for their activity.

Petitioners dispute the existence of occasional profits as well as the implication that profitability is merely a function of operating losses. Petitioners contend that their business as presently constituted began in 2013 and has had limited operational losses under the earnings before interest, taxes, depreciation, and amortization analysis, and under that analysis it shows the activity is profitable when unrecognized, appreciated gains are considered.

Petitioners stated their other income sources come from their rental properties, and their business. Petitioners stated their net rental income is about breakeven each year and their net

business income averages about $200,000 per year over the audit period. Petitioners argue their income comes both from their industry clients and and clients. Petitioners stated they have sold and to and from these types of buyers. Petitioners stated they regularly receive referrals from past clients for the industry, and vice versa.

Petitioners stated they enjoy working for themselves and take pride in being the best at what they do. Petitioners have a passion for and satisfying clients in all areas, whether it's the right or the right Petitioners argued that just because they have an interest in and this does not automatically convert their activity into a hobby. Petitioners stated they do not use their assets for

Treasury Regulation section 1.183-2(a) states,

> The determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case. Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the objective of making a profit. In determining whether such an objective exists, it may be sufficient that there is a small chance of making a large profit. . . . In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the taxpayer's mere statement of his intent.

The Tax Commission reviewed the documentation and information Petitioners provided and how it all fit in a review of the relevant factors for determining if an activity was for profit or not for profit. The following are some of the observations the Tax Commission made from the information provided.

The manner in which the activity is run: Petitioners account for all their expenses utilizing computer software. Petitioners stated they tried to keep personal and business expenses separate, however, this was not apparent on the source documentation provided. Petitioners' source

documentation was not complete and for several accounts no documentation was provided. Petitioners' documentation of ownership showed they were depreciating they did not own. Representative argued that the Petitioners' children owned could not legally be owned by their children because they were minors. However, even if minors cannot own during the audit years and even before, the children were of majority age and are the owners of the Petitioners also set up leases for the activity wherein the activity leased facilities and from Petitioners. Petitioners did account for one of the leases by virtue of a journal entry at year end but did not always include the lease on their income tax returns.

The expertise of Petitioners and their advisors: There is no doubt Petitioners have multiple years of experience in the industry and There is also no doubt Petitioners have access to a wealth of knowledge for and Petitioners stated they modeled their activity after other successful and when they started the activity up again in 2012. It is unknown what all Petitioners did in the activity prior to 2012, but they stated they narrowed their focus to particular types of and i.e. and Petitioners also use current competitors, their children, to help their

Time and effort expended on the activity: Petitioners appear to be involved in all aspects of the activity. Petitioners care for the the and when necessary, compete on the Petitioners attend to showcase their and to scout out to add to their or for Petitioners stated they split their time between their business and the activity.

Assets that appreciate in value: Petitioners' are about the only assets of the activity that could appreciate in value. However, as already mentioned some of the Petitioners

are claiming to have appreciated are not owned by Petitioners. Petitioners provided an estimated fair market value for each of their The estimated to have the highest appreciated value are not owned by Petitioners. In addition to the Petitioners look to the appreciated value of property located at that the activity uses as Petitioners stated that owned the property; however, leased the from Petitioners. If is leasing the property, the question then becomes is this property an asset of the activity. Furthermore, without a written business plan it cannot be determined that Petitioners' plan when purchasing the property was to hold it for its future appreciation. *Allen v. Commissioner of Internal Revenue*, 72 T.C. 28 (1979).

Success in other similar or dissimilar activities: Petitioners are successful in their business and have been very profitable. Petitioners first began their activity in 2004. They ceased the activity for one year in 2011 because it was not successful, and they could not support the losses. Petitioners started the activity again in 2012 and although they have sold some the activity has not reported any net income.

History of income and losses and occasional profits: As stated under Petitioners' successes, the activity began in 2004 and since that time Petitioners have only reported losses from the activity. Petitioners stated they stopped the activity because of the losses and then restarted as a "reconstituted" business as part of a disregarded entity at the time. Nevertheless, even after restarting their activity, Petitioners have never generated net income from the activity.

Other sources of income: Petitioners have another source of income, their business. Petitioners do not need to depend on the success or failure of the activity to survive. In fact, Petitioners have benefited tax wise by the activity's losses. If it were not for their business' income, Petitioners could not have sustained and expanded their activity. There is

little doubt Petitioners intend and believe they can make the activity profitable, but without the success of their business Petitioners would likely have ceased operation like they did in 2011, if everything else remained the same.

Elements of personal pleasure or recreation: Petitioners have a long history of and competing in Petitioners' children compete in and Petitioners use them as for their There is no doubt and requires long hours and at times 24/7 care, and a lot of the work is not pleasurable or easy. Nevertheless, it is apparent that Petitioners take pleasure in and that their children can compete on and do well.

Considering the information and documentation before it, the Tax Commission has difficulty seeing that Petitioners' activity is a for profit trade or business. The overwhelming factor for the Tax Commission is the fact that the activity has not generated a profit since 2005.

The standard for determining whether an individual is carrying on a trade or business is, did the individual engage in the activity with the predominant purpose and intention of making a profit. *Allen v. Commissioner*, *supra*. That purpose may exist even in the face of a history of losses, but the deductibility of those losses must depend upon the taxpayer's proven intention that he sought to realize a profit. *Bessenyey v. C. I. R.*, 45 T.C. 261 (1965). The taxpayer's expectation of profit need not be a reasonable one; it is sufficient if the taxpayer has a good-faith expectation of realizing a profit, regardless of the reasonableness of such expectation. *Golanty v. Commissioner of Internal Revenue*, 72 T.C. 411 (1979). Whether a taxpayer engages in an activity with the requisite intention of making a profit is one of fact to be resolved on the basis of all the surrounding facts and circumstances of the case, and the burden of proving the requisite intention is on the taxpayer. *Golanty v. Commissioner of Internal Revenue, Id*.

A history of unexplained losses over an extended period is persuasive evidence of the absence

of a profit motivation. *Allen v. Commissioner, supra*. A record of large losses over many years is persuasive evidence that the taxpayer did not expect to make a profit, and the unlikelihood of achieving a profitable operation are important factors bearing on the taxpayer's true intention. *Golanty v. Commissioner of Internal Revenue, supra*. However, if the losses occurred in the formative years of a business, which is not the case here, it is not inconsistent with an intention to achieve a later profitable level of operation, bearing in mind that the goal must be to realize a profit on the entire operation, which presupposes not only future net earnings but also sufficient net earnings to recoup the losses which have been sustained in the intervening years. *Bessenyey v. C. I. R., supra*.

Likewise, the fact that taxpayers have other sources of income which permitted them to sustain the losses is not indicative of a profit motive. *Allen v. Commissioner, supra*. Enduring decades of losses is the sort of thing that can be done by a person of means unconcerned with making a profit currently or even ultimately, to say nothing of recouping large losses sustained over a substantial period of years. *Golanty v. Commissioner of Internal Revenue, supra*. Not to say Petitioners were extremely wealthy, but Petitioners' income was sufficient to enable them to maintain a comfortable standard of living notwithstanding the losses from their activity. *Golanty v. Commissioner of Internal Revenue, supra*.

Petitioners initially stated they had no written business plan for the activity but later provided one which basically only stated their goal for the activity. Their plan provided no projections of sales, revenues, or expenses. Petitioners only sought "to obtain through sales or and to sell and compete on."

Petitioners stated that as husband and wife, they had ongoing day-to-day discussions regarding their business goals, strategies, and related business activities, including quarterly meetings during which they discuss the financial performance of the business and annual meetings where they

set annual goals in terms of acquisitions, competitions to attend, development of the facilities, and staffing needs. Petitioners stated none of this is in written form; however, they did use QuickBooks financial statements as an important part of their business planning and strategy. Petitioners stated they used their financial records to create financial projects and conduct ongoing profitability analysis.

Petitioners provided QuickBooks printouts as their books and records on the activity. They also include profit and loss statements for each of the years. However, based on the increasing expenses reported for the activity, there is no indication these records were kept for the purpose of cutting expenses, increasing profits, or evaluating the overall performance of the operation. *Golanty v. Commissioner of Internal Revenue, supra*. In addition, Petitioners books and records were not complete in that they provided limited source documentation for the expenses claimed.

Representative stated the activity was not the same when Petitioners started it up again in 2012. The changing of methods, techniques, species, etc. can indicate a profit motive. *Allen v. Commissioner of Internal Revenue, supra*. However, whatever change Petitioners made did not increase the activity's profitability.

Petitioners argue the appreciated value of assets used in the activity far surpasses their accumulated losses and in fact makes the activity profitable each year. The appreciated assets Petitioners take into account are their and used in the activity. However, of the Petitioners claim to have appreciated, the most valuable according to Petitioners' fair market value estimates, are owned by someone other than Petitioners or Likewise, Petitioners claim the appreciated value of their personal residence, as an appreciated asset. There is no question Petitioners' real property appreciated, however, the activity did not own the property and was in fact leasing the property from Petitioners. Furthermore, there is no

evidence indicating that Petitioners acquired their residential property for the expressed purpose of selling it for a profit so as to defray the costs of operating the activity. *Golanty v. Commissioner of Internal Revenue, supra*. As for the real property claimed to be owned by once again leased the from Petitioners, therefore, drawing question as to who actually owned the property during the years in question.

There is no question that caring, and can entail long hours, hard work, occasional sleepless nights, and unpleasant chores, which equates to not a lot of pleasure or recreation. However, the Tax Commission sees that Petitioners, having a history of life, take pleasure in and competition and watching their succeed, not to mention their children's success.

Taking pleasure in or getting enjoyment from one's work is not inconsistent with a profit motive. Nonetheless, after reviewing the entire record and the facts therein, the Tax Commission is not convinced that Petitioners' activity was operated on a basis which supports a conclusion of a good faith expectation of profitability.

In addition to the not-for-profit determination, the Tax Commission found Petitioners' documentation woefully lacking. 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 35.02.01.200 provides that, "A taxpayer shall maintain all records that are necessary to a determination of the correct tax liability." See also IRC section 6001; Treasury Regulation section 1.6001–1(a).

Deductions are a matter of legislative grace, and the 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). The burden rests upon the taxpayer to disclose his receipts and claim his proper

deductions. *United States v. Ballard*, 535 F.2d 400, 404 (1976). 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 general, taxpayers must establish that a business expense was paid or incurred, and that it relates to a trade or business; has a business purpose. See IRC section 162. Petitioners provided documentation that expenses were paid or incurred but for numerous expenses there was no documentation to show the business purpose of the expense. When examining the documentation provided, the Tax Commission found personal items and/or nondeductible items. Personal items Petitioners claimed as expenses for the activity included clothing such as shoes, jeans, shirts, and jackets, pet food, lawn care programs, water conditioning service, barbeque grilling pellets, plants, mugs, toys, and bulk propane. Petitioners' documentation for travel, meals, and entertainment did not meet the strict substantiation requirements of IRC section 274(d) if they provided documentation at all.

The accuracy of Petitioners' records is also drawn into question because they reported the sale of as a cost of goods sold rather than income as well as depreciating that same In 2018, Petitioners purchased a Class 4 Laser and expensed the payments as interest in both 2018 and 2019. Then in 2019, they began depreciating the laser at the full financed cost. Petitioners also depreciated that are documented as owned by others. In 2017, Petitioners claimed the Idaho investment tax credit on a tractor, a pickup truck, and three at the full cost of the assets. However, they also claimed section 179 depreciation for half the value of the assets for all but one The one does not appear on Petitioners depreciation schedule.

Considering the inadequacy of the documentation, the doubling up of expenses, depreciating

assets not owned, and the improper investment tax credit claimed the Tax Commission finds that if Petitioners' activity was not found to be not for profit, substantial adjustments would be made to the deductions claimed for the activity.

CONCLUSION

Petitioners reported multiple years of losses from their activity. The Bureau determined Petitioners' activity was a not-for-profit activity as defined in IRC section 183. Upon appeal, the Tax Commission reviewed the activity and agreed with the Bureau that Petitioners' activity did not rise to the level of a for-profit activity. The Tax Commission also found the expenses claimed for the activity inadequately documented and in some cases doubled deducted.

Petitioners submitted an amended return for tax year 2016. The amended return moved Petitioners' schedule C business to income tax return. The amended return increased Petitioners' adjusted gross income and also increased their itemized deductions. The Bureau reviewed those changes and incorporated them in the Notice of Deficiency Determination.

The Bureau added interest and penalty to Petitioners' tax liability. The Tax Commission reviewed those additions and found them appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046, respectively.

After reviewing all the facts, the Tax Commission upholds the Notice of Deficiency Determination.

THEREFORE, the Tax Commission AFFIRMS the Notice of Deficiency Determination dated February 19, 2021, directed to

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

YEAR	TAX	PENALTY	INTEREST	TOTAL
2016	$ 4,962	$248	$1,248	$ 6,458
2017	6,776	339	1,482	8,597
2018	17,640	882	3,101	21,623
2019	13,161	431	1,052	14,644
			TOTAL DUE	$51,322
			Refund Held	(4,618)
			BALANCE DUE	$46,704

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.

_____

_____