

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of

██████ ██████████

Petitioner.

DOCKET NO. 0-507-208-704

DECISION

The Intrastate Income Tax Audit Bureau (Bureau) sent ████████ ██████████ (Petitioner) a Notice of Deficiency Determination (Notice) for tax years 2020 through 2022. Petitioner protested, disagreeing with the Bureau’s determination that his Schedule C activities were not-for-profit and their application of the fraud penalty. The Tax Commission has reviewed the matter and hereby upholds the Notice issued by the Bureau.

BACKGROUND

Petitioner reported three sole proprietorships on Federal Schedule C during tax years 2020 through 2022. The activities were named: “██████████” “██████████” and “██████████” The Bureau selected Petitioner’s returns for examination and requested documentation for the expenses claimed. The Bureau additionally requested Petitioner complete a questionnaire to better understand his business activities. Petitioner exchanged the requested information and answered clarifying questions about the documentation provided. The Bureau reviewed the information and sent Petitioner a Notice disallowing all the expenses related to his Schedule C activities. For the ██████████ and ██████████ activities, the Bureau concluded they were not operated with a profit motive laid out in Internal Revenue Code (IRC) section 183. The expenses related to the ██████████ activity were disallowed due to a lack of substantiating documentation.

Petitioner protested the Notice with a letter to the Bureau, insisting his ██████████ and ██████████ businesses were operated with a profit motive and his ██████████ expenses should be

recognized due to special circumstances. The Bureau acknowledged his protest and transferred the case to the Tax Commission's Appeals Unit (Appeals) for administrative review. Appeals sent Petitioner a letter explaining the appeals process and his right to a hearing. Petitioner responded by appointing a representative to handle the case for him. The representative communicated with Appeals about how to resolve the case. Appeals provided the representative with the Bureau's response to Petitioner's protest letter and reiterated their right to an informal hearing. Appeals granted Petitioner time to look over the Bureau's arguments and prepare for a potential hearing. Petitioner never responded to Appeals after multiple attempts of contact. With no additional information, the Tax Commission must make its decision on the information available.

LAW AND ANALYSIS

The Bureau analyzed the nine factors established by Treasury Regulation section 1.183-2(b) used to distinguish between activities engaged in for profit and those not engaged in for profit.

These factors are:

1. The manner in which the taxpayer carries on the activity
2. The expertise of the taxpayer or his or her advisers
3. The time and effort expended by the taxpayer in carrying on the activity
4. The expectation that the assets used in the activity may appreciate
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, if any, which are earned
8. The financial status of the taxpayer
9. Elements of personal pleasure or recreation

If the gross income derived from the activity exceeds the deductions for expenses (i.e., if the activity results in a profit) in any three of five consecutive years, then the activity is presumed to be engaged in for profit. None of the activities listed have been operated for five years. However, none of the activities have produced a profit during the years in question.

Each of the nine factors from Treasury Regulation section 1.183-2(b) are discussed in turn below.

(1) The manner in which the taxpayer carries on the activity

If a taxpayer carries on an activity in a business-like manner, it may indicate that he is engaged in it for profit. Operating in a business-like manner can include maintaining complete and accurate books and records, carrying on in a manner similar to profitable activities that are comparable in nature, or changing operating methods, adopting new techniques, or abandoning unprofitable methods in a way that is consistent with an intent to improve profitability.

Activity

The Bureau argued Petitioner did not operate this activity in a business-like manner because he did not keep separate business and personal checking accounts, and he did not provide reliable financial projections. Petitioner argued he is not legally obligated to keep separate bank accounts or to provide a business plan to any regulatory agencies as a sole proprietor. He recognized that having these things would be beneficial to him to carry out his business. However, he argues the Bureau mischaracterized this activity due to the activity being in the beginning stages and the simplicity of his approach.

The Tax Commission has reviewed the arguments laid out by Petitioner and believes they have merit. However, the factor itself does not require compliance with regulatory agencies to raise an activity to a profit motive. The factor examines whether the taxpayer operated with good business practices. Keeping accurate books and records and operating the activity with the intention of making a profit is the focus. When examining Petitioner's operation during the years in question, it is not clear if he made steps to operate the activity in a business-like manner. This factor does not indicate a profit motive.

Activity

The Bureau stated this activity did not indicate a profit motive because he did not have a separate bank account and did not reach his financial projections. Petitioner was an independent contractor for a company where his pay was purely based on sales. He followed the parameters set out for him in his manuals to make the most amount of sales possible. Not reaching his goals does not indicate a lack of profit motive, as the Bureau does not claim it was due to lack of trying. From Petitioner's responses and detailed explanations in his attempts to succeed, this factor indicates a profit motive.

(2) The expertise of the taxpayer or his or her advisers

Preparing for an activity by studying accepted business, economic, and scientific practices (or consulting with experts therein) and carrying on the activity in accordance with those practices may indicate a profit motive. When a person has studied accepted practices or consulted with experts but does not conduct an activity following such guidelines, it may indicate lack of a profit motive.

Activity

The Bureau asserted Petitioner did not have a profit motive for this activity because while he did research and consulted experts in his field, he did not consult with financial experts. Petitioner points out there is no legal requirement to consult with financial experts, even if they would provide helpful information. He goes on to explain his rigorous study and on-site learning to eventually become a licensed Petitioner's study and dedication to learning the craft is undeniable and should be taken into consideration. This factor indicates a profit motive.

Activity

The Bureau believes this factor indicated a profit motive from his proven research and review of disclosure statements. He took classes and consulted with his sponsor to learn the trade. The Tax Commission affirms this position.

(3) The time and effort expended by the taxpayer in carrying on the activity

A person spending much of his or her personal time and effort carrying on an activity, especially one without significant personal or recreational aspects, may indicate that the activity is engaged in for profit. Likewise, if a person leaves another job to devote more time and effort to the activity, it may indicate the same. Spending limited time and effort on an activity does not necessarily show a lack of profit motive when the taxpayer employs qualified, competent people to carry on the activity in his or her absence.

Activity

The Bureau concluded Petitioner was not engaged in this activity for profit because some of the time and effort related to studying, taking classes, and attending trade shows were related to education and not the activity. Petitioner responded by agreeing with the Bureau's assessment, stating he spent 15 to 20 hours a week studying, taking classes, and attending trade shows focused on the industry. Petitioner insists this time should be counted towards his activity, as it was the transitional period between getting his license and learning the trade.

Treasury Regulation section 1.162-5(b)(3) excludes the deduction of expenses for obtaining qualifications for a new trade or business. Petitioner stated obtaining his license would allow him to perform significant tasks on his own without supervision. Analyzing his work as a versus what he would be able to do as a this would

be categorized as a new trade or business, and the expenses related to those activities would not be deductible. It appears Petitioner did not differentiate the time spent on his [REDACTED] activity and obtaining his [REDACTED] license. Therefore, this factor does not indicate a profit motive.

[REDACTED] Activity

Petitioner stated he would spend three hours a day training with an instructor. The Bureau argued this time was spent on learning other opportunities rather than recruiting more clients. Petitioner refutes this assertion, laying out what he would typically accomplish in those three hours. Petitioner demonstrated a clear objective in his response and clearly explained his dedication to becoming better at the activity. This factor indicates a profit motive.

(4) The expectation that the assets used in the activity may appreciate

The term “profit” can include appreciation in the value of assets, such as land, that are used in an activity. So, even though a person may not show periodic profits from the activity, there may be an expectation of an overall profit when the appreciated assets are sold.

[REDACTED] Activities

Petitioner listed a variety of assets for both activities and appeared not to understand the purpose of this factor. All the assets listed decrease in value, not increase. Additionally, it was not part of the business plans for either activity to eventually sell an appreciated asset to offset losses. Possessing investments with the purpose of selling at a future date can indeed indicate a profit motive. However, not having this strategy as part of a taxpayer’s business plan does not necessarily indicate the opposite. Therefore, this factor is considered neutral.

(5) The success of the taxpayer in carrying on other similar or dissimilar activities

If a person has engaged in other activities and turned them from unprofitable to profitable in the past, this may indicate that he or she is engaged in the current activity for profit, even if it is not profitable at the moment.

██████████/██████████ Activities

Petitioner started these activities when he was █████ years old. They also appear to be the first business ventures he has attempted. While the likelihood of him having already turned an unprofitable business into a profitable one is slim, this is just one of the factors. It is a fact that Petitioner has not had prior success in other activities. Therefore, this factor does not indicate a profit motive.

(6) The taxpayer's history of income or losses with respect to the activity

If a person incurs a series of losses during what would normally be considered a start-up period, it would not necessarily be indicative of an activity not engaged in for profit. If, however, the losses continue beyond the initial timeframe typically needed to bring the activity to a profitable status, and those continuing losses are not explainable by normal business risks, it may indicate a lack of profit motive. Losses incurred because of unforeseen circumstances – such as disease, fire, theft, weather, etc. – are not indications that an activity is not engaged in for profit. A series of years where an activity results in net income would be strong evidence that it is engaged in for profit.

██████████ Activity

Petitioner incurred significant losses for this activity. The Bureau asserted that Petitioner did not charge market rate for his █████ services, which contributed to his losses. Petitioner argues he could not charge higher prices for jobs because he was unlicensed and was building his

client base. Petitioner consistently contends that he participated in his [REDACTED] activity to help him become a certified [REDACTED]. While it is most likely accurate that he was not able to charge a higher amount being unlicensed, the goal was to become licensed, which the expenses to do such is not deductible as stated previously. The circumstances to why Petitioner sustained losses as a [REDACTED] are not convincing towards a profit motive.

[REDACTED] Activity:

Petitioner blamed the COVID-19 pandemic for lack of sales. While the Tax Commission empathizes with the challenges of the pandemic and business, the ratio of expenses to income for the years in question was substantial. From 2020 to 2022, Petitioner reported \$125 in gross receipts and claimed \$15,565 in total expenses. This factor does not indicate a profit motive.

(7) The amount of occasional profits, if any, which are earned

Periodic large profits – despite consistent, small losses – may be an indication that an activity is engaged in for profit. Even if the activity generates only losses or small profits, the opportunity for a large ultimate profit could indicate the same. Conversely, an occasional small profit interspersed with consistent losses may indicate that an activity is not engaged in for profit, especially if the person conducting the activity made substantial investments in capital or assets.

[REDACTED] 4 [REDACTED] Activity:

Both of these activities incurred consistent large losses, did not pose opportunities for large profits, and did not make substantial investments in capital assets. Most if not all the expenses claimed on Petitioner's returns were operational in nature, rather than depreciating large assets. This factor does not indicate profit motives for either activity.

(8) The financial status of the taxpayer

If a person does not have another source of significant income or capital, it may be a sign that an activity is engaged in for profit. However, substantial income from other sources – especially if faced with losses from the activity that provides sizable tax benefits – may indicate that an activity is not engaged in for profit. This is particularly true if the activity involves personal or recreational elements.

██████████ 4 ██████████ Activity:

Petitioner received W-2 and 1099 income throughout the years in question that supplemented both activities. Petitioner does not dispute this fact but insists the Tax Commission consider his circumstances that indicate a profit motive. This factor does not indicate a profit motive, as he received significant income from outside sources.

(9) Elements of personal pleasure or recreation

The presence of motives other than earning profit may indicate that an activity is not engaged in for profit, especially when the activity includes personal or recreational elements. Just because an activity has elements of personal satisfaction or recreation does not mean that it is not engaged in for profit. The lack of any personal motives beyond making a profit may indicate that an activity is engaged in for profit, but it is not necessary for an activity to be engaged in solely to earn a profit to rise to the level of “business” over “hobby.” There can be a mix of personal satisfaction or pleasure and profit motive. If other factors indicate profit motive, the elements of personal satisfaction may be downplayed.

██████████ Activity:

While personal pleasure or recreation is not obvious in ██████████ work, it is clear that Petitioner had motives other than profit to continue, as explained earlier. This factor is neutral, as it does not necessarily apply to this line of work.

██████████ Activity:

A large portion of the expenses related to this activity were education trips. To be deductible, these trips need to be carefully documented, as they can be easily exploited. While it is plausible that Petitioner learned to better the activity on these trips, they appeared to be more a benefit towards personal growth. Proper documentation was not provided to substantiate these expenses, and he did not differentiate personal aspects of the trips. Based on the limited information, the travel expenses appeared to be more personal than business related. This factor does not indicate a profit motive.

Treasury Regulation section 183 Conclusion:

Based on all the factors cited, the Tax Commission concludes that Petitioner did not operate either activity with a profit motive. Petitioner did not keep accurate records or operate in a business-like manner, lacked expertise, had extensive operational losses rather than depreciation of large assets, received substantial income from outside sources, and incurred expenses for either personal reasons or to obtain qualifications for a new trade. The Tax Commission therefore upholds the Bureau's decision to disallow expenses related to each activity.

██████████ Activity:

The Bureau requested documentation for the expenses related to this activity rather than doing a section 183 analysis. Petitioner claims to have had a business arrangement with ██████████

██████████ Based on the agreement, Petitioner is responsible for bringing in clients and covering

between 50% and 100% of the associated costs. Since [REDACTED] [REDACTED] was licensed, they operated under the company's [REDACTED] license. Petitioner's objections to the items on the Notice will be listed and analyzed below.

Car and Truck Expenses:

Petitioner provided mileage logs for the years in question. The logs tracked Petitioner traveling from home to his job site and sometimes from the job site to stores to pick up materials. Petitioner argues he is within the law for deducting mileage driving to temporary work locations. Treasury Regulation 1.162-2(e) states: "Commuters' fares are not considered as business expenses and are not deductible." Revenue Rule 99-7, 1999-1 CB 361 explains three exemptions to this rule:

- (1) regular work location exception—i.e., expenses between a taxpayer's residence and temporary work locations, regardless of the distance, are deductible if the taxpayer also has one or more regular work locations away from the taxpayer's residence;
- (2) home office exception—i.e., expenses between a taxpayer's residence and a place of business are deductible if the residence is the taxpayer's principal place of business;
- (3) temporary distant work-site exception—i.e., expenses between a taxpayer's residence and temporary work locations outside of the metropolitan area where the taxpayer lives and normally works are deductible.

Petitioner does not have a regular work location or office. As explained in the rule above, travel after a taxpayer commutes to their work location is deductible, but not to the first location and back home. Additionally, traveling to a place like Home Depot while at a work site would normally be deductible, but Petitioner has not shown receipts from these Home Depot purchases to substantiate the mileage log. Therefore, the Bureau's adjustments to his car and truck expenses are reasonable and accurate.

Legal and Professional Services:

The only documentation provided for these expenses were handwritten notes. These are not adequate to substantiate legal expenses and the Bureau's adjustments are upheld.

Supplies Expense:

Petitioner again pointed to the agreement he had with [REDACTED] [REDACTED] where he would pay 50% of the expenses incurred. He provided some receipts, but the Bureau discovered that they were edited to increase the dollar amounts in the invoices and change the names. The documentation provided to the Bureau was reviewed by the Tax Commission and was found to be unreliable. The Tax Commission upholds the adjustments made by the Bureau.

Utilities:

Petitioner listed a variety of expenses that would classify as utilities and stated he should be able to deduct them. Unfortunately, he never provided documentation for such expenses and therefore these expenses should not be allowed.

Other Expenses:

Petitioner argued that expenses related to obtaining his [REDACTED] license should be deductible because they are under the category of maintaining or improving his skills/trade. Education expenses towards his [REDACTED] [REDACTED] license are not deductible as discussed earlier. Treasury Regulation section 1.162-5(b)(3) excludes the deduction of expenses for obtaining qualifications for a new trade or business. Petitioner did not claim that it was a requirement from his W-2 employer to obtain his license. Rather, it was a requirement to be able to charge higher prices and work independently on a job site. Therefore, obtaining the license would not qualify as maintaining or improving his skills or trade, but obtaining qualifications for a new trade or business.

Petitioner also claimed startup costs under other expenses. He explained he had handwritten notes documenting these expenses and his previous business partner withheld funds from him and did not compensate him correctly. Unfortunately, Petitioner has not provided

adequate documentation for these expenses. Additionally, these expenses would not be considered start-up costs. Start-up expenditures are defined in IRC section 195(c)(1):

- (A) paid or incurred in connection with—
 - (i) investigating the creation or acquisition of an active trade or business, or
 - (ii) creating an active trade or business, or
 - (iii) any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business, and
- (B) which, if paid or incurred in connection with the operation of an existing active trade or business (in the same field as the trade or business referred to in subparagraph (A)), would be allowable as a deduction for the taxable year in which paid or incurred.

The term “start-up expenditure” does not include any amount with respect to which a deduction is allowable under section 163(a), 164, or 174.

Penalties:

The Bureau added 5% negligence penalty for tax years 2020 and 2021. Additionally, a 50% fraud penalty was added to tax year 2022 because Petitioner modified documentation. Petitioner claims it was not his intention to exhibit negligence or fraud, as he had difficulty obtaining documentation from his previous business partner. Petitioner intentionally modified documentation during the Bureau’s examination. Idaho Code section 63-3046(b) states:

If any part of any deficiency is due to fraud with intent to evade tax, then fifty percent (50%) of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid.

Petitioner’s actions display intent to evade tax. Therefore, the application of the fraud penalty by the Bureau is appropriate. The Bureau’s application of the 5% negligence penalty is also appropriate according to Idaho Code section 63-3046(a).

CONCLUSION

The Tax Commission has reviewed all the relevant information and finds Petitioner was not operating his [REDACTED] and [REDACTED] activities with a profit motive. Additionally, Petitioner has not adequately demonstrated how the adjustments made to his [REDACTED] activity were incorrect.

THEREFORE, the Notice of Deficiency Determination dated March 5, 2024, directed to [REDACTED] is hereby AFFIRMED by this decision and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2020	\$1,757	\$88	\$226	\$2,071
2021	2,258	113	243	2,614
2022	4,815	2,408	346	<u>7,569</u>
			TOTAL:	\$12,254

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 _____ 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.
