

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 0-685-016-064
)	
Petitioners.)	DECISION
<hr style="width: 45%; margin-left: 0;"/>)	

(Petitioners) protested a Notice of Deficiency Determination (Notice) dated July 20, 2021, issued by the Income Tax Audit Bureau (Bureau). The Bureau reviewed additional information provided by Petitioners and issued a modified Notice. Petitioners requested to continue their protest and have the case transferred to the Tax Commission’s Appeals Unit (Appeals). The Tax Commission has reviewed the matter and hereby upholds the modified Notice.

BACKGROUND

The Bureau sent Petitioners a letter requesting a comprehensive review of their 2017 through 2019 income tax returns. The Bureau first requested federal and state depreciation schedules and all accounting records for two sole proprietorships reporting on federal Form 1040 Schedule C. The principal businesses stated on the returns were “investment counseling” and “photography.” The Bureau also requested depreciation schedules and all accounting records for a commercial rental reported on federal Form 1040 Schedule E. Petitioners responded by appointing an Attorney in Fact (AIF) to handle the case further.

The AIF provided QuickBooks reports, receipts, and general ledgers for the years in question to the Bureau. After reviewing the documentation provided, the Bureau sent Petitioners a follow-up letter with additional questions regarding the audit. In summary, the Bureau requested the following:

- All accounting records for the commercial property originally requested. No documentation was submitted.
- Journal entries, an explanation on how the income was earned, and how the income for each business was determined.
- Invoices, receipts, or sales contracts for the leasehold improvements on the commercial property and the original purchase of the property.
- An explanation of the business use percentage for a fifth wheel and Freightliner.
- Documentation for auto expenses, travel expenses, and meals and entertainment.

Petitioners did not provide the information requested in a timely manner, so the Bureau issued a Notice based on the information available. In response, Petitioners requested a redetermination of the Notice and objected to numerous items adjusted. Petitioners also submitted three boxes of receipts to support their position. The Bureau reviewed the documentation provided and modified many items, but also upheld items that weren't substantiated. The modified Notice reduced the audit amount from \$64,688 to \$41,884.

Petitioners received the modified Notice and requested the matter be transferred to Appeals. They did not specify the items they disagreed with, but stated they would look at the case in more detail later. Appeals sent Petitioners a letter on July 22, 2022, informing them of their right to schedule a hearing with a commissioner or to submit additional information for consideration. The AIF responded to the letter, proposed a date for an informal hearing, and expressed interest in providing additional information prior to the hearing for the Tax Commission to review. A hearing was scheduled, and Petitioners provided many items of documentation for the years in question. Appeals asked the AIF if any of the documentation just sent was already provided during the audit process. The AIF stated he was unsure but didn't believe so. After reviewing the documentation provided to Appeals, it was clear that most of the items were already provided to the Bureau during the audit.

The informal hearing started with the AIF stating the numbers presented in the Notice did not make sense to him. For example, the AIF explained his disagreement with the leasehold improvements adjustment. He believed the work done on the commercial property was qualified leasehold improvements depreciated as section 179 of the Internal Revenue Code (IRC), including a new roof. Petitioners were owners of the LLC that owned the property, and then paid rent to the LLC, more commonly known as a “self-rental.” Appeals then proceeded to question the AIF if the leasehold improvements were the only item they had a problem with. The AIF stated he had problems with practically every line item on the Notice but admitted he could have done a better job at presenting the information. The hearing ended by Appeals requesting the AIF present a more comprehensive protest with specific line items he had problems with and why. The AIF agreed, and eventually sent a document with items that Petitioners disagreed with. The following section will address the points made in that letter.

LAW AND ANALYSIS

1. Documentation such as invoice, statement, receipt, or contract.

Petitioners disagree with any adjustment made due to lack of sufficient documentation. Specifically, Petitioners state: “Documentation has been shared with receipts to substantiate the expenses disallowed.” A careful review has been done to examine if there was additional documentation shared to reverse the Bureau’s adjustments. After such review, it has been determined that the Bureau’s adjustments are accurate and no substantial information has been shared to prove this portion of the Notice to be incorrect.

2. Proof of Payment

The Bureau disallowed items that were not properly substantiated with proof of payment. Petitioners state the exact phrase mentioned above regarding this issue. After review of the relevant

documentation, it is clear the Bureau made accurate adjustments and Petitioners have not shown this portion of the Notice to be incorrect.

3. Vehicle logbook showing mileage, date, and business purpose.

The Tax Commission has reviewed the mileage logs provided and have found they do not meet the requirements set forth in Internal Revenue Code section 274(d). All the entries describe the business purpose for miles driven as “business.” While the IRC allows the business purpose explanation to be brief, this kind of explanation for each trip says as much as saying nothing at all. Additionally, it appears most of the trips were for driving from their home to their main office, which would be considered commuting, not deductible under the law currently. The Tax Commission deems the disallowance of auto expenses to be appropriate.

4. Business purpose and business use percentages for assets.

In the schedule provided with the Notice, many items were disallowed because there was insufficient explanation in how these items were either used in the business or what percentage of the asset was used for personal purposes. Petitioners argue that the documentation provided should show how each item disallowed was used in the business. This argument is vague in nature and does not point to specific pieces of documentation that would prove this portion of the Notice to be incorrect.

4a. Fifth Wheel and Freightliner

The Bureau disallowed expenses related to the fifth wheel and Freightliner truck as there wasn't sufficient information to determine how these assets were used in the business or how much of the use was personal. During the informal hearing, it was briefly mentioned these assets were used in the photography business to go on trips to take photos. Without a log detailing how much time was spent as personal use for these assets, it is impossible to determine the deductibility.

4b. Utilities/Telephone/Computer and Internet

Petitioners provided documentation from “Cable One” showing phone, internet, and TV services as a utilities package. The Cable One invoice separated the services, but Petitioners claimed the entire amount. No documentation or explanation has been provided during the audit or appeals process to show a business purpose of the Cable One invoice. Without an explanation for the necessity of the Cable One services; the entire expense was disallowed. Statements from “Enhanced Telecommunications” show payments for “add phone, find cable/firewall for Xbox.” No business purpose has been provided for the Xbox. The Tax Commission finds the adjustments made by the Bureau to be accurate.

4c. Office Expense/Supplies

Based on the information provided, the Bureau allowed expenses they could determine a business purpose from the detail on the invoice, statement, or receipt. Petitioners have not provided additional information to allow any additional expenses in this category.

5. Meals and Entertainment diary or logbook

Petitioners provided receipts from restaurants without a logbook detailing the number of days spent away from home, the destination, and business purpose. Receipts from restaurants alone do not provide enough context to determine the deductibility of such expenses. The Tax Commission has determined the adjustments made by the Bureau to be reasonable.

6. Claimed Twice

The Bureau determined there were some of the same expenses that were claimed on both Petitioners’ Schedule Cs. Petitioners argue in their protest: “No such expenses have been claimed twice. Please reference the receipts uploaded.” They did not mention any specific receipts to prove the Notice is incorrect. The section in contention is disallowance of rent expense in 2017. The

Bureau disallowed payments to ICCU because it appeared to be mortgage payments on a commercial loan. It is assumed the “claimed twice” memo line was included because rent expenses were deducted from both Schedule Cs in 2017 but did not continue in later years. Nevertheless, these expenses are not deductible, and the disallowance is deemed accurate.

7. Expense allowed on Schedule E

7a. Property Taxes

Petitioners claim the property taxes claimed on both Schedule E and Schedule C were for different properties. The only documentation the Tax Commission has received were property tax statements from the commercial property reported on Schedule E. Therefore, the adjustment from the Bureau to allow the property taxes on Schedule E is deemed accurate.

7b. Roof repairs and maintenance

Petitioners mention in their protest that repairs and maintenance to a roof for leasehold improvements are 15-year property and are allowed for section 179 depreciation. According to the modified Notice, it appears that the Bureau allowed for depreciation expenses based on the documentation provided. This includes the cost basis of the new roof of \$21,146. The roof cannot be depreciated on both Schedule E and Schedule C.

8. Switch to regular depreciation.

Petitioners conclude their protest with stating: “documentation has been uploaded to support the leasehold improvements to the building.” According to the modified Notice, leasehold improvements which had an invoice and proof of payment were allowed. However, improvements that were claimed on both Schedule E and Schedule C were moved to only Schedule E. It does not appear additional documentation was provided regarding this issue. The Tax Commission finds the modifications to be correct.

CONCLUSION

The Bureau requested documentation for many items related to Petitioners’ Schedule E and Schedule C activities during the audit process. After some documentation was provided, the Bureau modified the original Notice, significantly reducing the amount of tax due. During the appeals process, Petitioners failed to provide any additional information that would show the modified Notice to be incorrect. Many of the items disputed were disputed simply by stating “documentation has been provided.” The Tax Commission has conducted a thorough review of the documentation provided and finds Petitioners’ arguments to be unconvincing. Therefore, the Tax Commission agrees with and upholds the Bureau’s modified 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.

THEREFORE, the Tax Commission AFFIRMS the modified Notice of Deficiency Determination dated March 17, 2022, directed to

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2017	\$12,305	\$615	\$2,557	\$15,477
2018	10,165	508	1,677	12,350
2019	14,037	702	1,559	<u>16,298</u>
			TOTAL DUE	\$44,125

Interest is calculated though October 13, 2023.

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

DATED this _____ day of _____ 2023.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2023,
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.
