

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 0-698-713-088
)	
Petitioner.)	DECISION
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The Income Tax Audit Bureau (Bureau) at the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination (Notice) to (Petitioner) an S corporation, for tax years 2017 and 2018. Petitioner filed a timely appeal and petition for redetermination of the Notice. Petitioner participated in an informal hearing and submitted additional information during the appeals process.

The primary issue for decision is whether amounts paid by Petitioner to provide housing, travel, transportation, entertainment, clothing, haircuts, meals, groceries, etc. to its sole shareholder and the shareholder's family members are business expenses or nondeductible personal expenses. The Tax Commission has reviewed the file and hereby issues its decision.

SUMMARY

The Tax Commission affirms the Bureau's determination that Petitioner deducted expenditures which (1) lacked a business purpose; (2) were not ordinary, necessary, or reasonable in amount; and (3) were nondeductible personal, living, and family expenses. Furthermore, the Bureau determined the disallowed expenditures were distributable income to the S corporation's sole shareholder.

Of particular note, Petitioner's bank statements and expense reports showed charges made by individuals who it did not list as shareholders or employees of the business. Petitioner didn't issue these individuals Form W-2s or 1099s.

During the informal hearing, Petitioner indicated most of these individuals were the shareholder's family members. Petitioner explained these family members provided services to the business. Instead of paying the family members wages, it paid for their expenses.

INTRODUCTION

Petitioner claimed business expenses of \$1,266,751 and \$1,707,621 for tax year 2017 and 2018, respectively. The Bureau requested Petitioner provide documentation supporting the deductibility of the expenditures and the amounts. Petitioner provided hundreds of pages of QuickBooks reports and bank statements. The Bureau carefully reviewed the documentation provided and found most of the expenses were nondeductible personal, living and family expenses of its sole shareholder and his family. The Bureau disallowed \$1,162,241 and \$1,622,647 in expenses for tax years 2017 and 2018, respectively.

In short, the Bureau determined Petitioner deducted expenditures which (1) lacked a business purpose; (2) were not ordinary, necessary, or reasonable in amount; and (3) were nondeductible personal, living, and family expenses. Furthermore, the Bureau determined the disallowed expenditures were distributable income to the S corporation's sole shareholder. See Docket No. 1-745-191-936. Petitioner appealed.

STATEMENT OF ISSUES

Issue 1: Another Person's Expense

Whether amounts paid by Petitioner for maintaining a home, meals, entertainment, auto expenses, travel, clothing, etc. for individuals Petitioner didn't list on business filings and tax returns as a shareholder or employee of the business were ordinary and necessary business expenses deductible under IRC section 162 or another person's nondeductible personal, living, and family expenses under IRC section 262.

Issue 2: Expenses for Maintaining a Home

Whether amounts paid by Petitioner for maintaining a home(s) such as rent, utilities, repairs, maintenance, landscaping, pest control, pool maintenance, etc. were ordinary and necessary business expenses deductible under IRC section 162 or the shareholder's nondeductible personal, living, and family expenses under IRC section 262.

Issue 3: Meal Expenses

Whether amounts paid by Petitioner for meal expenses incurred frequently at local restaurants, fast food joints, coffee shops, and grocery stores were ordinary and necessary business expenses deductible under IRC section 162 or the shareholder's nondeductible personal, living, and family expenses under IRC section 262.

Issue 4: Entertainment Expenses

Whether amounts paid by Petitioner for entertainment expenses such as trips to movie theaters, Disneyland, SeaWorld, San Diego Zoo, etc. were ordinary and necessary business expenses deductible under IRC section 162 or the shareholder's nondeductible personal, living, and family expenses under IRC section 262.

Issue 5: Auto Expenses

Whether amounts paid by Petitioner for auto expenses such as leases, fuel, tires, repairs, etc. were ordinary and necessary business expenses deductible under IRC section 162 or the shareholder's nondeductible personal, living, and family expenses under IRC section 262.

Issue 6: Travel Expenses

Whether amounts paid by Petitioner for travel expenses, such as transportation, taxis, lodging and meals, etc. were ordinary and necessary business expenses deductible under IRC

section 162 or the shareholder's nondeductible personal, living, and family expenses under IRC section 262.

Issue 7: Clothing, Haircuts, Eyewear

Whether amounts paid by Petitioner for clothing, haircuts, eyewear, and dry cleaning were ordinary and necessary business expenses deductible under IRC section 162 or the shareholder's nondeductible personal, living, and family expenses under IRC section 262.

Issue 8: Miscellaneous Expenses

Whether amounts paid by Petitioner: (1) for subscriptions to streaming services, online dating services, newspapers; (2) and to various retailers such as Amazon, Best Buy, Lowes, Home Depot, Apple, iTunes, Swiss Knife Shop; Harry and David, etc.; were ordinary and necessary business expenses deductible under IRC section 162 or the shareholder's nondeductible personal, living, and family expenses under IRC section 262.

STATEMENT OF FACTS

Based on the information available, (husband and wife), are related.

He is the sole shareholder and sole employee of

She is also a social media influencer with millions of followers. did not list her as a shareholder or employee on business filings and tax returns.

is a sibling of
appointed him as their attorney-in-fact to represent them and before
the Tax Commission. did not list him as a shareholder or employee on business filings
and tax returns.

is a consulting business. Approximately 90% of income
comes from consulting services to the (a related party),
. Approximately 10% of income comes
from royalties and social media content.

In July 2017, and entered into an Agreement
to Lease and Option to Purchase a mansion on acres located in
Idaho.

In September 2017, his wife, his sister, their family, and extended family
members made the Idaho residence their primary residence. has an office and
in the residence. features the residence in many of her social media videos.

LEGAL PRINCIPLES

Gross Income

IRC code section 61 defines gross income as all income from whatever source derived.
Gross income includes income realized in any form, whether in money, property, or services.
Under Treasury Regulation section 1-61-2(d)(1) when a taxpayer receives goods or services in
exchange for his services, the fair market value of the goods or services received is gross income.

Business Expenses

IRC section 162 allows a deduction for all the ordinary and necessary expenses paid or
incurred during the tax year in carrying on any trade or business. For payments to qualify as

ordinary and necessary business expenses for income tax purposes, they must be appropriate, helpful, and of common or frequent occurrence in the type of business carried on by a taxpayer.¹

Personal Expenses

IRC section 262 provides that most personal, living, and family expenses aren't deductible, except as otherwise expressly provided by the Code. For instance, the cost of a businessman's meal is clearly a personal expense which is therefore not deductible. But if he pays for his meal while traveling away from home on business, this clearly personal expense qualifies as a business expense. Thus, the same kind of personal expense, a meal, may be nondeductible in one situation where it is purely personal, and deductible in another where the personal item takes on the character of a business expense.

Housing Expenses

IRC section 280A provides, in general, taxpayers may not deduct the expenses of their homes. However, home-related deductions allowable without regard to their connection with the taxpayer's trade or business, e.g., mortgage interest and real estate taxes, are permitted. Moreover, home-related expenses are deductible if incurred in the taxpayer's trade or business, and if the home is exclusively used on a regular basis as the taxpayer's principal place of business, as a place of business to meet or deal with patients, clients, or customers, or, in the case of a separate structure used for trade or business purposes.

Meal Expenses

IRC section 274 provides taxpayers may deduct 50% of the costs of meals incurred for a business purpose. The meal expense must be ordinary and necessary expenses of the business and

¹ *Welch v. Helvering*, 290 U.S. 111, 54 S. Ct. 8, 78 L. Ed. 212 (1933).
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not be lavish or extravagant under the circumstances. In addition, to be deductible, meal expenses must be either directly related to or associated with the active conduct of an activity for which the taxpayer has a business purpose.

Entertainment Expenses

IRC section 274 provides taxpayers may deduct 50% of the costs of entertainment expenses incurred for a business purpose. The entertainment expense must be ordinary and necessary expenses of the business and not be lavish or extravagant under the circumstances. In addition, to be deductible, entertainment expenses must be either directly related to or associated with the active conduct of an activity for which the taxpayer has a business purpose.

Auto Expenses

Treasury Reg. section 1.162-1 provides expenditures for the operation and maintenance of an automobile are deductible as a business expense to the extent that they represent the cost of transportation actually required in carrying on the taxpayer's business. If a car is used by the taxpayer for both business and personal purposes, a deduction is allowed for the portion of the costs attributable to business use. Deductions are allowed only for the business expenses and business use of a car which the taxpayer has properly substantiated.

Travel Expenses

IRC section 162(a)(2) provides away-from-home travel (including meals and lodging) costs can qualify as deductible business. But the cost of travel for personal reasons isn't deductible. There are limits on the deductibility of certain costs of combined business and pleasure trips.

Clothing, Haircuts, Eyewear

Under Revenue Ruling 70-474 employees can deduct the cost and maintenance of work clothing and uniforms if both of the following tests are met: (1) if the uniforms are

specifically required as a condition of employment; and (2) the uniforms aren't of a type adaptable to general or continued usage to the extent they take the place of regular clothing. In other words, the cost of a business wardrobe required as a condition of employment is a nondeductible personal expense if the purchased clothing is suitable for general or personal wear.

Substantiation

IRC section 6001 requires taxpayers to maintain records sufficient to document any deductions claimed. When the IRS or the Tax Commission challenges a taxpayer's expense deduction, the taxpayer must prove the deductibility of the expenditure and its amount.

IRC section 274 provides no deduction is allowed for the following expenses, which are deemed particularly susceptible to abuse, unless substantiated by adequate records or sufficient evidence corroborating the taxpayer's own statement: (1) travel expenses (2) entertainment expenses (3) business gifts (4) listed property expenses. The expenses must be substantiated as to: (1) amount; (2) time and place; (3) business purpose; (4) and for entertainment and gift expenses, the business relationship of the person being entertained or receiving the gift must also be substantiated.

PETITIONER'S POSITION

Petitioner appealed contending all the expenditures in question were ordinary and necessary business expenses. on behalf of Petitioner argued that every aspect of the sister's life is recorded, is a performance, and that she is never off the clock. Therefore, it reasoned that every aspect of the sister's life is deductible. For example, during the informal hearing, Petitioner asserted that if the sister went to the grocery store and posted about it online, it was tax deductible (the auto expenses and the groceries). Petitioner provided the following written statement in support of its positions:

As explained during the hearing, part of the property is used strictly as an office for business in relation to the consultancy work done for universities in [redacted]. Another part is a fully operational [redacted] for all our [redacted]. This includes [redacted] as well as all the production that is needed for my sister's internet content.

The reason we moved to North Idaho is that the remoteness and wilderness of where we are provided an excellent opportunity to create content for her social media channels which have proven to be very appealing to her public. You can actually see the property in all her videos as well as her [redacted] space and the [redacted]

This very special niche in her content creations which includes the scenery, remoteness, wildlife has proven to be a very successful tool which has been reflected in the amount of followers she now has...

... There are many influencers all over the world which are competing to create their own following bases on their niche. The remoteness, scenery and log cabin setting has allowed her to go from 30,000 followers in the beginning of 2017 back when we lived in [redacted] to over 14,000,000 followers as of January 2023.

Even though this specific niche has been very advantages to create a massive audience, it has also presented tremendous challenges which required all sorts of investments and upgrades just to be able to operate. The log cabin was in a terrible state of disrepair and our first winter was a big challenge given that our median temperature in the cabin was 47 degrees due to the lack of insulation and problems with the heating system. These upgrades had to include generators, backup generators, miles of high speed internet (fiber optic had to be installed) amongst many other expenses which if not had been done (and will be referred to below) we would have not been able to operate my sister's social media channels (which I have included below) nor the consultancy services of [redacted] of the [redacted] which we built for all of my sister's [redacted] and [redacted] / [redacted]

Additionally, all the work [redacted] does with my sister has proven to be extremely important for the consultancy services provided by [redacted] to schools in [redacted]. Thanks to the expertise and track record developed working with (my sister) we have been able to establish [redacted] as a reputable Consultancy firm in [redacted] developing all the study programs for Bachelor's and Masters Degrees as well as all their marketing and promotional campaigns on the internet...

Petitioner's principal claims on appeal appear to be that most of the expenditures for housing, travel, transportation, entertainment, clothing, haircuts, meals, groceries, etc. were all ordinary and necessary business expenses for the sister's social media content.

DISCUSSION

Issue 1: Another Person's Expense

Treasury Regulation section 1-162-1 disallows deductions for expenses that are not related to a taxpayer's own trade or business or production of income activities. To be deductible, an expenditure must be for the taxpayer's benefit or be a payment of the taxpayer's obligation. A payment of another person's obligation does not result in a tax deduction for either person. The person making a payment cannot deduct an expense that is not related to his or her business because the payment lacks a business purpose.

In this case, Petitioner did not list the sister as an employee or shareholder of the business. However, Petitioner indicated it purchased the Idaho property and incurred many of the expenditures for the sister's social media channels.

The Tax Commission finds many of the expenditures were not related to Petitioner's own trade or business. The Tax Commission further finds the primary purpose of many of the expenditures were not for the consulting business but for the sister's social media content and therefore not deductible under IRC section 162.

Petitioner's bank statements and expense reports showed charges made by individuals who it did not list as shareholders or employees of the business. During the informal hearing, Petitioner indicated most of these individuals were the shareholder's family members. Petitioner explained these family members provided services to the business. Instead of paying the family members wages, it paid for their expenses. Petitioner claimed this was a common industry practice. Therefore, Petitioner reasoned the expenses were ordinary and necessary business expenses.

For example, during the informal hearing, Petitioner explained a vendor would pay the shareholder's sister to sponsor their product on her social media platforms. The vendor would not

pay the shareholder's sister but would pay Petitioner. Petitioner would then pay for the sister's expenses. Petitioner argued the payments were ordinary and necessary business expenses and not the personal, family, and living expenses of the shareholder's family members.

The Tax Commission disagrees. Except for the shareholder's sister, Petitioner has not introduced any evidence to demonstrate what meaningful services the other family members provided to the business. Additionally, Petitioner has failed to prove that the expenditures were anything more than the payment of personal expenses of its shareholder's family members.

Even if the family members did provide meaningful services to the business, Petitioner cannot deduct the family members' personal expenses as business expenses. However, it may have, depending on the facts and circumstances, deducted the payments as compensation to the family members. To do this, Petitioner would have had to file income statements with the Tax Commission and provide copies of the income statements to the family members.

Therefore, the Tax Commission holds the amounts paid by Petitioner for maintaining a home, meals, entertainment, auto expenses, travel, clothing, etc. for people who it didn't list as shareholders or employees of the business were not ordinary and necessary business expenses deductible under IRC section 162.

Issue 2: Expenses for Maintaining a Home

Petitioner argued its expenses for maintaining a home are deductible because it used part of the property strictly as an office for business in relation to the consultancy work. Also, part of the property is a fully operational _____ it uses for _____ and

Additionally, Petitioner argues its expenses for maintaining a home are deductible because the shareholder's sister featured the property in her social media content.

Petitioner cannot deduct expenses with respect to use of a dwelling unit that is also used by the shareholder and his family as a residence regardless of whether Petitioner used part or all of it for business.² During the informal hearing, Petitioner acknowledged the home(s) were used as dwelling units for the shareholder and his family. The fact that the shareholder's sister featured the property in her social media content doesn't change the fact that the home provided personal benefits to the shareholder and his family.

However, a taxpayer who operates a trade or business from home can claim a deduction for expenses related to its business use. Expenses such as rent, real property taxes, insurance, utilities, and repairs can be allocated on a reasonable basis to an area of the home used for a business purpose. This deduction is commonly referred to as the home office deduction. To claim a deduction, strict tests must be satisfied.³

In pertinent part, the home office area must be regularly used as the principal place to conduct a trade or business belonging to the taxpayer or as a place to meet or deal with patients, customers, or clients in the normal course of the trade or business. If these and other tests are met, the taxpayer may deduct expenses related to using part of the home for business.

In this case, Petitioner did not introduce any evidence to demonstrate how much of the expenses of maintaining a home, if any, could be allocated to its business. Additionally, Petitioner offered little evidence that many of the expenses (such as landscaping and masonry) were appropriate or necessary to the maintenance and development of its business.

² Code Sec. 280A(a); *Tobin v. Comm'r*, 78 T.C.M. (CCH) 517 (T.C. 1999).

³ The Tax Cuts and Jobs Act of 2017 eliminate the home office deduction.

Therefore, the Tax Commission holds that Petitioner has not proven that the expenses of maintaining a home or for a home office were ordinary or necessary expenses deductible under IRC section 162.

Issue 3: Meal Expenses

According to bank statements and expense reports, Petitioner deducted meal expenses on nearly a daily basis for expenditures made at local restaurants, fast food joints, coffee shops, and grocery stores. Petitioner argued its shareholder and his family members discussed business during all the disallowed meals. Additionally, Petitioner argued that every aspect of the sister's life is recorded, is a performance, and that she is never off the clock.

Food and beverage expenses are deductible, subject to limitations, if they are ordinary and necessary expenses of a trade or business. Meal expenses aren't deductible if the primary motivation for the meals is social and personal.

For example, the cost of a doctor's regular luncheon meetings with other physicians and nurses wasn't deductible.⁴ The rules that bar the deduction of personal expenses take precedence over the rules allowing the deduction of business expenses. Daily meals are an inherently personal expense, and a taxpayer bears a heavy burden in proving they're routinely deductible. Occasional luncheon meetings with practicing physicians to discuss current treatment techniques may be deductible as a business expense, but expenses for meals eaten three or four times a week, 52 weeks a year, are nondeductible personal expenses.⁵

Similarly, a deduction was denied where an acupuncturist had lunch several times a week with the chiropractor from whom she rented office space. Although office administration and the

⁴ *Bigdeli v. Comm'r*, 105 T.C.M. (CCH) 1854 (T.C. 2013).

⁵ *Id.*

treatment of patients were discussed at the lunches, the meal expenses were primarily personal. The Tax Court found that, because the acupuncturist and the chiropractor alternated paying for meals, in substance each was bearing only the expense of her individual meals. The court also noted that, as the business relationship was well-established, it didn't require the “social lubrication” of a business lunch—at least not as often as several times a week.⁶

In another case, a business deduction for the cost of a medical professional corporation's employees' breakfasts and lunches at a hospital cafeteria was denied. The Tax Court found that there was no substantial business purpose served by payment of the employees' meals. During the meals, the employees discussed patient care problems as well as sports, politics, and other personal matters, or glanced at a newspaper. Although there was some evidence that the doctors conducted business at times during the meals and received patient referrals from other doctors they saw in the cafeteria, this wasn't sufficient to transform inherently personal expenses into deductible business expenses.⁷

The Tax Commission holds that Petitioner has not proven that the meal expenses were ordinary or necessary expenses deductible under IRC section 162. The fact that business may have been discussed during the meals and an aspect of the meal may have been posted online doesn't transform inherently personal expenses into deductible business expenses. Additionally, Petitioner has not shown that it satisfied the strict substantiation requirements of IRC section 274(d).

Issue 4: Entertainment Expenses

Petitioner argued that entertainment expenses such as Disneyland, SeaWorld, San Diego Zoo, movie theaters, Netflix, etc. were expenses necessary to business functions and client

⁶ *Dugan v. Comm'r*, 76 T.C.M. (CCH) 693 (T.C. 1998).

⁷ *Mizell v. Comm'r*, 55 T.C.M. (CCH) 169 (T.C. 1988).

relationships. Although not entirely clear, it appears Petitioner once again argues the expenses were deductible because the shareholder's sister posted the entertainment on her social media sites.

Like meal expenses, entertainment expenses are inherently a personal expense, and the taxpayer bears a heavy burden in proving they are routinely deductible. 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.

The Tax Commission holds that Petitioner has not proven that the entertainment expenses were ordinary or necessary expenses deductible under IRC section 162. Again, the fact that business may have been discussed and the sister may have documented the entertainment online does not transform inherently personal expenses into deductible business expenses. Additionally, Petitioner has not shown that it satisfied the strict substantiation requirements of IRC section 274(d).

Issue 5: Auto Expenses

Petitioner argued its auto expenses are deductible because it used the vehicles for business. Again, Petitioner argues that the expenses are deductible because its shareholder's sister is a social media influencer with millions of followers, that every aspect of her life is recorded, is a performance, and that she is never off the clock. Petitioner's argument is essentially this: everything is deductible if the sister posts about it on her social media platforms.

Expenditures for the operation and maintenance of an automobile are deductible as a business expense to the extent that they represent the cost of transportation actually required in carrying on the taxpayer's business. To the extent the expenses are unrelated to the taxpayer's business they aren't deductible. Deductions are allowed only for the business expenses and business use of a car which the taxpayer has properly substantiated.

In this case, Petitioner did not introduce any evidence to demonstrate how much of the auto expenses, if any, could be allocated to its business. It failed to prove that the auto expenses were anything more than the payment of its shareholder's personal, family, or living expenses. It did not explain how auto expenses for luxury vehicles such as Mercedes-Benz and Porches were ordinary and necessary business expenses.

The Tax Commission holds that Petitioner has not proven that the auto expenses were ordinary or necessary expenses deductible under IRC section 162. Additionally, Petitioner has not shown that it satisfied the strict substantiation requirements of IRC section 274(d).

Issue 6: Travel Expenses

The expenses of a trip that is undertaken primarily for business purposes is deductible, while personal trips are nondeductible. Whether a trip is primarily for business or is primarily personal, is a question of fact. The amount of time spent on business as compared with that spent on personal activities is an important consideration in determining this question. If a taxpayer spends one week at a particular destination on business and five weeks on personal activities, the trip will be considered primarily personal in nature in the absence of a clear showing to the contrary.⁸

No income tax deduction is generally allowed for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying a taxpayer on a business trip unless: (1) the spouse, dependent, or other individual is an employee of the taxpayer;⁹ (2) the travel

⁸ Reg § 1.162-2(b)(2).

⁹ IRC section 274(m)(3)(A); Reg § 1.274-12(a)(4)(iii)(A).

of the spouse, etc., is for a bona fide business purpose of the taxpayer;¹⁰ and (3) the expenses would otherwise be deductible by the spouse, etc.¹¹

Petitioner claims that travel expenses were ordinary and necessary business expenses. However, Petitioner has not explained what the business purposes for the expense or the benefit gained or expected to be gained. Additionally, it has not provided a list of people who traveled. As previously stated, 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.

The Tax Commission holds that Petitioner has not proven that the travel expenses were ordinary or necessary expenses deductible under IRC section 162. Additionally, Petitioner has not shown that it satisfied the strict substantiation requirements of IRC section 274(d). The fact that the sister may have posted about the travel on her social media channels does not change a trip made primarily for a personal purpose to a business trip.

Issue 7: Clothing, Haircuts, Eyewear

Petitioner claims clothing, haircuts, eyewear, dry cleaning, etc. are deductible if used in the sister's social media videos.

A taxpayer who was a rock musician was allowed \$200 in deductions for "flashy" stage clothing not suitable for general wear, but the other \$500 he sought to deduct for items such as underwear, hats, and vests was disallowed.¹²

¹⁰ IRC section (m)(3)(B); Reg § 1.274-12(a)(4)(iii)(B).

¹¹ IRC section. 274(m)(3)(C); Reg § 1.274-12(a)(4)(iii)(C).

¹² *Teschner v. Comm'r*, 74 T.C.M. (CCH) 1108 (T.C. 1997).

A taxpayer who was employed as a television news anchor in Ohio and was required to maintain a specified professional appearance as described in the “Women's Wardrobe Guidelines,” couldn't deduct any of the considerable expenses she incurred for business suits, evening wear, lounge wear, sportswear, active wear, a robe, lingerie, bikini and thong underwear, a Ohio State jersey, running and walking shoes, and jewelry. The Tax Court noted that her clothing wasn't outrageous or unsuitable for everyday personal wear, even if it wasn't so worn.¹³

Similarly, wigs, make-up, skin care and hair care products weren't deductible where the taxpayer didn't prove they were for business rather than personal use. Nor could he deduct laundry and cleaning expenses for clothing that he used in his acting activity, but which was suitable for general and personal wear.¹⁴

The Tax Commission holds Petitioner has not shown that the clothing, etc. was unsuitable for everyday personal wear, even if it wasn't so worn. Petitioner has not proven that the clothing, etc. expenses were ordinary or necessary expenses deductible under IRC section 162. Therefore, no deduction is allowed.

Issue 8: Miscellaneous Expenses

Petitioner claimed various miscellaneous expenses, most of which were categorized as supplies and materials. Some of the expenses were for subscriptions to streaming services, online dating services, newspapers, etc. Retailers included Amazon, Best Buy, Lowes, Home Depot, Apple, iTunes, Swiss Knife Shop, Harry and David, etc. Other expenses include staff physical training and insurance. Petitioner made the same arguments that it had for the other expenses.

¹³ *Hamper v. Comm'r*, No. 22375-09S, 2011 WL 665726 (T.C. Feb. 24, 2011).

¹⁴ *Green v. Comm'r*, 58 T.C.M. (CCH) 606 (T.C. 1989).

Where a taxpayer offered no evidence, or only insufficient evidence, that various expenditures—e.g., legal, and professional fees, rental expenses, the cost of various items of merchandise and services—were paid or incurred in connection with his trade or business activities, he wasn't permitted business expense deductions for those expenditures.¹⁵ The actual character of an expenditure, rather than the name given to it on the taxpayer's books, determines whether it's a business expense.¹⁶

A logbook in which a taxpayer, an actor, casually noted that he purchased supplies, such as make-up and skin and hair care products for his acting, didn't provide substantiation for deduction of the supplies. The notations didn't indicate whether the purchases were for personal or business use, and the Tax Court wasn't in a position to choose one or the other. Further, the supplies appeared to be personal expenses.¹⁷

The Tax Commission holds that Petitioner has not proven that the miscellaneous expenses were ordinary or necessary expenses deductible under IRC section 162. It has failed to prove that the expenses were anything more than the payment of personal, living, and family expenses of its shareholder.

CONCEDED ISSUES

During the informal hearing, Petitioner acknowledged that it didn't maintain adequate books and records. After the informal hearing, Petitioner reluctantly conceded several issues and amounts. For example, Petitioner conceded the miscellaneous expenses and local meal expenses,

¹⁵ *Harris v. Comm'r*, No. 19681-98S, 2001 WL 1893826 (T.C. Mar. 27, 2001).

¹⁶ *Bankers Dairy Credit Corp. v. Comm'r*, 26 B.T.A. 886 (1932); *First Nat. Bank of Skowhegan, Maine v. Comm'r*, 35 B.T.A. 876 (1937).

¹⁷ *Green v. Comm'r*, 58 T.C.M. (CCH) 606 (T.C. 1989).

stating it would not challenge these expenses “although it is reasonable that at least a portion could be considered business related.”

Another example, Petitioner partially conceded clothing and travel expenses and provided an estimate of the allowable expenses. Depending on the item in question, Petitioner estimated 10% – 60% was a business expense. Petitioner didn’t concede other expenses such as the expense for maintaining a home and car expenses, to name a couple.

A taxpayer is required to prove both the deductibility of any business expenses it claims on its return and how the expenses should be allocated. If the taxpayer is unable to substantiate expense deductions through adequate records or other proof, the court may estimate the deductible amount, an approach which is called “the Cohan rule.”¹⁸ However, the Cohan rule does not apply to travel expenses, entertainment expenses, business gifts and listed property expenses.¹⁹

Where the record provides no reasonable basis upon which the court can make a reasonable allocation between the deductible and nondeductible parts of a particular expense, the deduction must be disallowed in full.²⁰ So, the court may refuse to allow any deduction for a lump sum payment covering both expense items and capital expenditures where there's no basis for estimating how much is properly allocable to the expense.²¹

Where a farm lease between a family-owned farm corporation and its shareholder/officer/sole employee (which included the farmhouse at which the shareholder continued to reside) didn't address utilities or telephone use at the farmhouse, and the taxpayer offered no bills, canceled checks, or testimony to identify what, if any, part of expenses related to

¹⁸ *Cohan v. Comm’r*, 39 F.2d 540, 543–44 (2d Cir. 1930).

¹⁹ Reg § 1.274-5T(a); *Shoemaker v. Comm’r*, 31 T.C.M. (CCH) 869 (T.C. 1972).

²⁰ *Pro. Servs. v. Comm’r of Internal Revenue*, 79 T.C. 888 (1982).

²¹ *S. Eng’g & Metal Prod. Corp. v Comm’r*, 9 T.C.M. (CCH) 93 (T.C. 1950); *Battle Creek Food Co. v Comm’r*, 8 T.C.M. (CCH) 207 (T.C. 1949); *Harman v. Comm’r*, 4 T.C. 335 (1944).

the corporation's business, the court had no basis for allocating any of the expenses as deductible business expenses of the corporation.²²

Here, Petitioner has not provided the Tax Commission with a reasonable basis upon which the Tax Commission can make a reasonable allocation between the deductible and nondeductible parts of a particular expense. Additionally, estimates cannot be used for travel expenses, entertainment expenses, business gifts and listed property expenses. Therefore, we disallow the deductions in full.

CONCLUSION

The Tax Commission has carefully examined all of Petitioner's claims, and to the extent not discussed above, finds them unpersuasive and discerns no basis on which to reverse the Bureau's determination. We affirm substantially for the reasons stated in the Notice.

In general, an adjustment to a partnership, S corporation, estate or trust allowed or required by Idaho statute generally is claimed on the income tax returns of the partners, shareholders, or beneficiaries of the entity.²³ In this case, the adjustments to Petitioner's return pass-through to the shareholder. Therefore, Petitioner does not owe any additional tax, penalty, or interest as a result of this decision.

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

DATED this _____ day of _____ 2023.

IDAHO STATE TAX COMMISSION

²² *Weeldreyer v. Comm'r*, 86 T.C.M. (CCH) 622 (T.C. 2003); *Schmidt v. Comm'r*, 86 T.C.M. (CCH) 631 (T.C. 2003); *Tschetter v. Comm'r*, 86 T.C.M. (CCH) 639 (T.C. 2003).

²³ Income Tax Administrative Rule 128.

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.
