

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 0-751-903-744
)	
Petitioners.)	DECISION
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(Petitioners) protested the Notice of Deficiency Determination (Notice) dated June 7, 2023, for tax years 2019, 2020, and 2021 (audit period). The Tax Commission reviewed the matter and hereby issues its final decision to modify the Notice.

Background

Petitioners filed income tax returns for 2019, 2020, and 2021, claiming income and expenses on federal Schedule C for “personal services.” The Tax Commission’s Income Tax Audit division (Audit) selected these returns for examination. Audit sent letters to Petitioners on February 2, 2023, and _____ – their appointed Representative (Representative) – on February 3, 2023, requesting information about Petitioners’ business reported on Schedule C. Audit asked for Petitioners’ general ledger or other accounting records and a completed business questionnaire. Audit also asked for information about “other income” reported on Schedule C along with substantiation for specific expenses.

Audit did not receive any response to these letters and sent a final request for this information on March 9, 2023, to both Petitioners and Representative. These letters also resulted in no response. Audit issued the Notice on June 7, 2023, denying cost of goods sold and expenses reported on Schedule C for all three years, subtractions claimed on Idaho Form 39R for Idaho net operating loss (NOL) carryforward for all three years, subtractions for bonus depreciation for 2019 and 2020, and allowing additional child tax credit for 2021.

On August 14, 2023, Audit received a protest to the Notice signed by Representative and Petitioners disagreeing with the audit in general. They specifically disputed the adjustments to Schedule C, the disallowance of NOL carryforward, the disallowance of Idaho bonus depreciation subtraction, the changes to the Idaho child tax credit, and penalties.

The protest letter concluded with a request for the case to be transferred to the Tax Commission's Appeals unit (Appeals). Along with the protest letter, Petitioners provided a copy of the Notice, a copy of their protest letter from a previous audit, a copy of the November 25, 2020, letter from the IRS, profit and loss statements for Petitioners' Amway business for the audit period, and 28 receipts, invoices, and other documents showing a total of \$4,434.63 of purchases to substantiate over \$178,000 in cost of goods sold and other business expenses.

On October 26, 2023, Appeals sent letters to Petitioners and Representative outlining the options available for redetermining a protested Notice. Petitioners requested an informal hearing, which was held via telephone on December 20, 2023; Mr. [redacted] and Representative were present on the call. All the main points of the protest were addressed, and Mr. [redacted] and Representative requested another opportunity to provide documentation of business expenses. After the hearing, Appeals provided Representative another copy of Audit's original request for information so that Petitioners would know what specific documentation was required.

Appeals received additional information on January 26, 2024. This decision is based on the Tax Commission's review of all information provided by Petitioners.

Law & Analysis

Petitioners' protest of the Notice in this case opens with this general objection:

As background for the taxpayer's Petition, this is the second time the State of Idaho has audited the taxpayers for the exact same things. While there is no statute to prevent audits from occurring and there are no rule changes on the horizon at this

time, what has changed is Idaho continues to follow its own whims to suit its own purposes for reasons beyond anyone's understanding.

Petitioners were previously issued Notices for tax year 2014 and for tax years 2015 through 2017, which they also protested. The Tax Commission's decision in those cases (Appeals Dockets 1-201-158-144 and 0-664-287-232) modified the Notice for 2014 and upheld the Notice for 2015-2017. It reads in part,

In this matter, Petitioners' records leave much to be desired. The Tax Commission was not given journals or ledgers to support Petitioners' income and expenses. Petitioner did provide large quantities of bank statements, calendars and an overview of the Amway business. However, Petitioners did not show how they arrived at the numbers appearing on their returns or provide any information to distinguish one business from another, or personal expenses from business expenses.

The Tax Commission finds this evidence to be inadequate to substantiate the expenses. Petitioners did not present any evidence that business expenses were in fact incurred. The lack of receipts and their confusing and inconsistent accounting technique, along with the combination of multiple business activities on a single Schedule C gave the Tax Commission no reasonable means of differentiating which of the reported expenses are ordinary and necessary business expenses for the various businesses."

In the second paragraph of Petitioners' protest, they indicate that they have not changed the way they do business, nor have they changed the way that they keep their business records. Their tax preparer has not changed the way that the taxpayers claim the deductions.

While the overall decision in this current case is not contingent upon the results of the previous one, knowledge of the prior audit and protest will help clarify Petitioners' statements, and there are certain details from the prior decision that will be relevant in this case. However, Petitioners can be assured that the decision in this case is based on a review of the information made available during this case and its related audit.

In addition to the above general argument, Petitioners' protest also contained the following statement:

“... on November 25, 2020, the taxpayers received a letter from the Internal Revenue Service which required an Amended Return to be prepared and submitted. The State of Idaho is auditing on an erroneous basis on a return that is no longer correct. This amount is no longer valid and the Auditor should have known that.”

The Tax Commission did not receive an amended Idaho return for tax year 2019 until August 14, 2023, when it was sent with Petitioners’ protest letter. On the amended Idaho return, the only difference was a \$629 deduction on Idaho Form 39R for health insurance premiums. The auditor could not have known about this, because the return was not provided until after the Notice was issued. Petitioners can be assured that the calculation of 2019 Idaho taxable income and subsequent tax liability in the decision includes the additional deduction shown on the amended Idaho return.

Schedule C Profit/Loss

Internal Revenue Code (IRC) section 162(a) allows taxpayers to claim deductions for “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any business or trade.” To qualify as a deduction, an item must be not only an expense, but an ordinary and necessary expense, and it must be incurred or paid during the tax year for which it is claimed, as well as being incurred or paid in the conduct of a trade or business. An ordinary expense is one that is customary or usual within a certain trade or business.¹ A necessary expense is one that is appropriate and helpful in the development of the business.² IRC section 262(a) states that personal, living, and family expenses are generally not deductible.

Deductions are a matter of legislative grace, and the taxpayer must prove that he is entitled to each deduction and the amount of the deduction.³ Taxpayers must substantiate each claimed

¹ *Deputy v. Du Pont*, 308 U.S. 488, 495 (1940)

² *Commissioner v. Heininger*, 320 U.S. 467, 471 (1943)

³ *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)

deduction by maintaining sufficient records to allow the correct determination of his tax liability.⁴ If a taxpayer is unable to provide adequate proof of any fact upon which a deduction depends, no deduction is allowed, and that taxpayer must bear his misfortune.⁵ A taxpayer's general statement that his expenses were incurred in conducting their business is not sufficient to establish that the expenses had a reasonable direct relationship to the taxpayer's trade or business.⁶

Petitioners' protest included this statement about this issue:

"... according to the State of Idaho, taxpayers are not entitled to claim usual and customary expenses for operating a business. ... Federal Tax Code allows for Usual and Customary Expenses, where Idaho says no one can deduct any expense."

Petitioners claimed expenses (not including cost of goods sold) totaling \$51,434; \$12,123; and \$47,580 for 2019, 2020, and 2021 respectively. Audit requested documentation to support specific amounts claimed on Schedule C:

- 2019: cost of goods sold; car and truck expenses; depreciation; repairs and maintenance; travel; other expenses - telephone
- 2020: cost of goods sold; car and truck expenses; depreciation; other expenses - telephone
- 2021: cost of goods sold; car and truck expenses; interest; repairs and maintenance; travel; other expenses - telephone

Petitioners claimed expenses outside these categories each year, but Audit did not request documentation for them.

Petitioners' statements that they are not entitled to expenses and that Idaho says no one can deduct expenses are gross exaggerations. Both IRC section 6001 and Idaho Code section 63-3042 require taxpayers to maintain books, records, papers, and any other data that might be needed to verify the correctness of a tax return and to provide such items for examination upon request by

⁴ *Higbee v. Commissioner*, 116 T.C. 438, 440 (2001)

⁵ *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931)

⁶ *Ferrer v. Commissioner*, 50 T.C. 177, 185 (1968), *aff'd per curiam*, 409 F.2d 1359 (2nd Cir. 1969); *Near v. Commissioner*, T.C. Memo 2020-10

an authorized party.⁷ Audit did not receive responses to letters requesting information and so denied the deductions for which they requested documentation (all those listed above). In the Notice, however, Audit also denied all “other expenses” on Schedule C, not only telephone, which is what was specified. This resulted in Audit denying \$7,118; \$7,296; and \$7,536 of “other expenses” for which they did not request documentation. In the interest of fairness to Petitioners, the Tax Commission will allow these expenses and limit any adjustment of “other expenses” to telephone.

According to Petitioners’ written statements and the statements made during the informal hearing, Petitioners are or were engaged in no less than six separate activities for which they claim expenses on Schedule C – Amway, ETSY, Ebay, personal fitness/training, video production, Loanstar mortgage. They reported all their activities on a single Schedule C each year in the audit period. The IRS requires a separate Schedule C for unrelated businesses conducted by the same person.⁸ During the informal hearing, Representative offered to break down the expenses in each category by business, to which Appeals emphatically agreed. To do so would help ensure that the expense claimed was ordinary and necessary for that business. An ordinary and necessary expense incurred by one business may not be ordinary and necessary for another one. However, the information Appeals received was not broken down as Representative had proposed. With so many intertwined unrelated activities, the Tax Commission finds it impossible to ferret out which expenses apply to which business activity and in what amounts. Additionally, the amounts documented do not match the amounts claimed.

⁷ See also *Tax Commission Administration and Enforcement Rule 200* (IDAPA 35.02.01.200)

⁸ See Instructions for Schedule C (“If you owned more than one business, complete a separate Schedule C for each business.”) and IRS Publication 334, *Tax Guide for Small Businesses* (“If you operated more than one business as a sole proprietorship, you must attach a separate Schedule C for each business” and “If you have more than one business, you must figure your net profit or loss for each business on a separate Schedule C.”).

Two “sets” of documentation were provided. The first accompanied Petitioners’ protest and was minimal (as stated earlier, a total of 28 receipts). The second, provided after the informal hearing, was more extensive. One item included for each year was a summary statement showing Petitioners’ total spending for the year. The hand-written note on one of the statements reads, “Info from Mint.com where I keep track of all my transactions. Each line can be broke [sic] down further if needed.” Petitioners also provided 56 receipts, invoices, and statements from 3rd parties showing costs incurred for 2019, 29 for 2020, and 55 for 2021.

Below, the Tax Commission will discuss documents provided to support claimed expenses and any adjustments needed. Before then, one other general issue should be noted. Petitioners’ protest included the following statement about substantiation:

“The taxpayers [sic] Individual Income Tax Returns that the State Tax Commission receives are substantiation of the figures claimed.”

Substantiating claimed expenses means providing sufficient evidence to prove that the expense was paid or incurred, that it was paid or incurred in the year claimed, that it was incurred as an ordinary and necessary expense of Petitioners’ trade or business, and that the amount paid or incurred matches the amount claimed. Petitioners cannot use the fact that they claimed an expense as proof of the above.

Cost of Goods Sold: Petitioners claimed cost of goods sold on Schedule C. The method they used to calculate cost of goods sold involved adding together: the value of inventory at hand at the beginning of the year; the cost to purchase inventory items less the cost of items withdrawn from inventory for personal use; the cost of labor to produce inventory items; the cost of materials and supplies to create inventory items; and other costs that may be relevant. From this total, the value of inventory left at the end of the year is subtracted. The result is the cost of goods sold.

Audit and Appeals requested documentation to verify the cost of goods sold claimed on Schedule C for each year in the audit period. With their protest, Petitioners did not provide anything that the Tax Commission considers part of cost of goods sold. Following the informal hearing, Petitioners provided annual income summaries for each year from Amway. One of the line items shown in the report is purchases made directly from the company for Petitioners' business (\$28,763 for 2019; \$16,401 for 2020; \$18,142 for 2021). The Tax Commission considers these amounts as elements of cost of goods sold, as it is obvious to which business activity they apply, and they are readily verifiable.

In addition, Petitioners provided three receipts from Sprint for 2020, in the amount of \$496.95 each for a total of \$1,490.85. Petitioners have repeatedly noted that they use Verizon for their cell phone service and that Mr. had a business where he purchased phones from a vendor and resold them. The Tax Commission will give Petitioners the benefit of the doubt and allow these verified charges from Sprint as additional cost of goods sold. Similarly, Petitioner provided a 2021 Verizon billing statement showing ten charges of \$728.27 each for "device payment buyout charge." The hand-written note on this document reads, "Phones purchased as inventory from Verizon." Likewise, the Tax Commission will allow these verified charges from Verizon as additional cost of goods sold.

Therefore, the Tax Commission allows cost of goods sold in the amount of \$28,763 for 2019; \$17,892 for 2020; and \$25,424 for 2021.

Car and Truck Expenses: Petitioners claimed deductions for car and truck expenses for all years in the audit period. Generally, there are two methods to calculate the deduction.

The first method is to multiply the number of miles the particular vehicle is driven for business purposes during the year by the standard business mileage rate provided by the IRS.

Records to keep in order to utilize this method include a mileage log showing beginning and ending destinations, the miles driven for business purposes, and the reason for the drive. A taxpayer must report the business miles driven on his return to use this method. Using this method precludes a taxpayer from claiming a deduction for depreciation or rental/lease payments. The IRS also places other requirements on using the standard mileage method.

The second method to calculate a deduction for car and truck expenses is to claim actual expenses. This would include costs such as gasoline or diesel fuel, repairs and maintenance, oil, insurance, tires, registration, etc., as well as depreciation and rent or lease payments. The deduction is limited to the business use percentage (business miles driven divided by total miles driven) of the costs incurred. For example, if 80% of the miles a taxpayer drives a vehicle are for business purposes, then he may claim 80% of his documented costs as a deduction.

In Petitioners' case, they did not report business miles on their return, so the Tax Commission concludes that they used the actual expenses method of calculating the deduction. They provided receipts showing various expenses including the purchase of unleaded and diesel fuel, parts, oil change services, car washes, registration renewals, and tools.

Since both gasoline and diesel receipts were provided, and the car wash receipts reflect two vehicles, the Tax Commission is left to presume that Petitioners are claiming car and truck expenses for more than one vehicle. On prior returns, however, Petitioners reported only one vehicle used for business purposes. A depreciation schedule provided with Petitioners' amended 2019 federal return shows one asset, a Hummer H2.

Petitioners did not provide any documentation or statement showing the business use percentage of any vehicle, but they appear to be claiming 100% business use for the Hummer. However, the Tax Commission has good reason to believe that the vehicle is also subject to

personal use. Additionally, it is unknown how much the same vehicle is used in each of Petitioners' multiple business activities, and the Tax Commission has no way to determine with any reasonable certainty what the business use percentage might be – a material fact upon which the deduction relies. Therefore, in accordance with *INDOPCO, Inc. v. Commissioner*, the Tax Commission determined that Petitioners are not entitled to any deduction for car and truck expenses.

Depreciation and Section 179 Expense: Petitioners claimed a deduction for depreciation expense on the Hummer on their 2019 and 2020 returns. As stated above, the business use percentage was never established. Therefore, the Tax Commission determined that Petitioners are not entitled to any deduction for depreciation.

Interest: Petitioners claimed a deduction for interest on their 2021 return. No documentation was provided to show where the interest was paid to or for what business purpose it may have been paid. Therefore, the Tax Commission determined that Petitioners are not entitled to any deduction for interest.

Repairs and Maintenance: Petitioners claimed deductions for repairs and maintenance costs on their 2019 and 2021 returns. They provided two receipts from Harbor Freight for tax year 2019 and one for tax year 2021, along with two receipts from Napa Auto Parts and one from Advance Auto Parts for tax year 2021, indicating that the items purchased were for repairs. One of the Harbor Freight receipts (dated February 1, 2021) contains a hand-written note that “All Harbor Freight purchases were for tools for repair or maintenance.” Is this referring to such receipts only from 2021, or does this include all such receipts from the entire audit period? The Tax Commission has no way to be certain with the documentation provided.

All the documents that indicate a purchase for repairs also indicate “auto expense,” but the auto expense category (when using the actual costs method) should include repair and maintenance

costs. It is unclear what other assets might have needed repair or maintenance, but Petitioners clearly wanted to claim repair and maintenance costs for the Hummer. As stated before, Petitioners have not established the business use percentage for any vehicle. In the absence of clear evidence, the Tax Commission determined that Petitioners are not entitled to any deduction for repairs and maintenance costs.

Travel: Petitioners claimed deductions for travel expenses on their 2019 and 2021 returns. IRC section 274 contains strict substantiation rules for travel expenses. To meet these rules, a taxpayer must establish by adequate records: 1) the amount of the expense; 2) the time and place of the travel; and 3) the business purpose. Petitioners submitted three documents for each year 2019 and 2021.

For 2019, this included a receipt for the payment of a balance due to _____ in _____ Texas. The handwritten note states “2019 Travel/Amway.” During the informal hearing, Mr. _____ stated that Amway would hold arena-style training events in places like Las Vegas or Seattle. This receipt does not indicate the business purpose of the travel other than which business activity with which it is associated. There is no indication whether this is for training, for team building, for entertaining potential clients, for recruitment, etc. _____ calls itself “a country club for motoring enthusiasts.”⁹ There is no evidence of a business purpose for this expense, and so Petitioners are not entitled to claim a deduction for it.

Documentation for 2019 also included two receipts from Uber, both dated March 28, 2019, at 12:41 p.m. These appear to be for the same ride, as both show the same trip fare amount, but one shows a tip while the other does not. Both contain an indication that the expense was for

“Travel/ Taxi.” There is no indication where the ride was taken or what the business purpose of the expense was, so Petitioners are not entitled to claim a deduction for it.

Documentation for 2021 includes three receipts, all of which indicate that the expense shown was for travel for Amway training in Las Vegas. All also show dates and amounts, so they meet all the rules listed above, and Petitioners are entitled to a deduction.

Two of the receipts for 2021 were for airfare: 1) from Spokane to Las Vegas on October 14, 2023; and 2) from Las Vegas back to Spokane on October 18, 2023. They show tickets purchased for three people: Petitioners and another person. Research shows that this third person appears to be a business associate. Because of this, Petitioners are allowed to claim the cost for his ticket as well as their own.

The third document is a reservation confirmation for a VRBO property in Paradise, Nevada, just outside Las Vegas. Arrival date is shown as October 14, 2023, and departure is shown as October 18, 2023. This appears to be accommodations for the Las Vegas training. The number of guests listed is six, but there are no names shown on the document. The Tax Commission assumes that three of the people staying at the property are the Petitioners and the other person who travelled with them from Spokane, but there is no indication who the other three are. Because of this, the Tax Commission will allow a deduction of one-half the cost of the VRBO rental as shown on the reservation confirmation.

In summary, Petitioners are not entitled to any deduction for travel expenses for 2019 but are allowed a deduction of \$1,247 for 2021.

Telephone: Petitioners claimed deductions for telephone expenses for all years in the audit period. As documentation, Petitioners provided three or four pages – depending on the year – of a much larger Verizon Wireless billing statement each year. All three years show which line was

Mr. [redacted] and which was Mrs. [redacted]. Two of the three contain a note indicating that the monthly cost for these lines was between \$180 and \$200 per month and a total of approximately \$2,280 per year.

These approximations are not remotely close to the total charges reported on the billing statements. For 2019, the statement provided shows total charges of \$21.14 for Mrs. [redacted] indicated line and \$138.20 for Mr. [redacted]. For 2020, the statement provided shows total charges of \$39.99 for Mrs. [redacted] indicated line and \$87.90 for Mr. [redacted]. For 2021, the statement provided shows total charges of \$737.96 for Mrs. [redacted] indicated line and \$1,153.36 for Mr. [redacted].

The majority of the amounts shown are equipment charges, assumed to be payments for devices and not wireless service.

During the informal hearing, it was agreed that Petitioners would provide a statement with certain documents that showed a consistent monthly charge – something along the lines of “1 of 12 for 2019” or “1 of 36 months”). No such statement was provided.

The Tax Commission has no information to show whether these lines are used only for one business, for all businesses, or even for a mix of business and personal reasons. Because there is no clear way to determine what portion of any amounts charged are ordinary and necessary business expenses, the Tax Commission determined that Petitioners are not entitled to any deduction for telephone expenses.

Schedule C Profit/Loss Conclusion: The Tax Commission finds Petitioners’ records woefully incomplete for the purposes of substantiating legitimate business expenses. It appears that any records they do keep are maintained primarily for the purpose of documenting where they spent money and how much, rather than for truly tracking business expenses with an eye on gauging and improving business performance.

Net Operating Loss (NOL) Carryforward

Audit disallowed deductions of Idaho NOL carryforward in the amounts of \$30,996; \$9,768; and \$5,980 for tax years 2019, 2020, and 2021, respectively. In their protest, Petitioners wrote this regarding NOL carryforward:

“The idea that the State of Idaho can arbitrarily decide that since no adjustments were made to the tax period ending December 31, 2018, that resulted in no additional tax to the taxpayers. While the adjustments from this audit, meaning the NOL carryover from 2018 could be denied is absurd. ... The taxpayers are entitled to the NOL carryover as the returns are correct as they stand.”

This appears to be a direct response to the relevant section of the Notice which reads, “No adjustments have been made to tax year 2018 that would result in additional tax. However, we are disallowing expenses claimed on Schedule C equal to the amount of the NOL carryover from 2018.” No additional explanation or calculations were provided for further clarification.

Audit’s intent in this statement is clear: to give consistent treatment to all years between 2014 and 2021. However, Petitioners’ 2018 return was never audited, and to give Petitioners such short shrift with no opportunity to provide evidence or documentation to support their claim is unfair and not in keeping with the standard practices of the Tax Commission. Therefore, the Tax Commission will not accept the blanket denial of all NOL carryover.

Federal NOLs and Idaho NOLs are calculated differently. An Idaho NOL is the amount by which Idaho taxable income is less than \$0 after adding back certain items included on the Idaho return¹⁰:

- Idaho NOL carryforward or carryback deduction
- Net capital losses
- Idaho capital gains deduction
- Idaho qualified business income deduction (beginning in tax year 2019)
- Standard or itemized deductions, except casualty losses related to Idaho property

¹⁰ See Idaho Code section 63-3021

- Personal exemptions

Idaho Code section 63-3022(b) requires the addback of any NOL carryforward used in calculating federal taxable income (NOL deduction reported on federal Form 1040). Idaho Code section 63-3022(c) allows the deduction of Idaho NOL carryforward from prior years or carryback from subsequent years.

As a result of their prior audit and appeal, Petitioners did not have any Idaho NOL carryover to bring into 2018, so the deduction of \$15,442 for that year is incorrect. Petitioners reported Idaho taxable income of -\$54,996 for 2018, which included the NOL deduction of \$15,442 and the standard deduction amount of \$24,000. They did not report any capital gains or losses, so their NOL incurred in 2018 was \$15,554 ($-\$54,996 + \$15,442 + \$24,000$). The Tax Commission determined that this amount is allowed to carry forward to 2019. Therefore, Petitioners are allowed an NOL carryforward deduction for 2019 in the amount of \$15,554. Because they claimed an NOL carryforward deduction for 2019 in the amount of \$30,996, an adjustment of \$15,442 is required.

The 2018 NOL is completely absorbed by other income in 2019 (as adjusted above), so Petitioners do not have any Idaho NOL carryforward to deduct in tax years 2020 or 2021 and the adjustments for those years will stand.

Bonus Depreciation Subtraction

Audit disallowed subtractions for bonus depreciation on Petitioners' 2019 and 2020 Idaho tax returns. Regarding this issue, Petitioners' protest included the following statement:

“The taxpayers have proven they are engaged in their activity with the intent to make a profit. The Auditor’s disallowance is erroneous as the tax return included a supporting worksheet to make the adjustment being different from Federal.”

IRC section 168(k) allows taxpayers to claim a special depreciation deduction – commonly known as bonus depreciation – on their federal income tax return in the first year certain assets are placed in service in a business. Idaho Code section 63-3022O(1) states:

The adjusted basis of depreciable property, depreciation and gains and losses from sale, exchange or other disposition of depreciable property acquired after September 10, 2001, and before December 31, 2007, shall be computed without regard to subsection (k) of section 168 of the Internal Revenue Code and the adjusted basis of depreciable property, depreciation and gains and losses from sale, exchange or other disposition of depreciable property acquired after December 31, 2009, shall be computed without regard to subsection (k) of section 168 of the Internal Revenue Code, provided that to the extent a taxpayer cannot use the additional depreciation claimed under subsection (k) of section 168 of the Internal Revenue Code in the current year for federal income tax purposes because of loss limitations imposed by sections 465, 469, 704(d) and 1366(d) of the Internal Revenue Code, then such additional depreciation shall not be added back to federal taxable income in order to determine Idaho taxable income.

Claiming bonus depreciation results in a deduction on the federal tax return that is higher than normal in the first year and lower than normal in subsequent years until the asset is fully depreciated. To adjust for this, Idaho Code section 63-3022O requires an addition for the difference between federal depreciation and Idaho depreciation in the year the bonus depreciation is claimed and subtractions for the difference in subsequent years. If the addition is not made, then the subtractions are not allowed.

On their 2015 federal tax return, Petitioners claimed bonus depreciation on a vehicle and made the required addition on their Idaho return. Audit issued a Notice which included the disallowance of the bonus depreciation addition for tax year 2015 and bonus depreciation subtractions for tax years 2016 and 2017. Petitioners protested that Notice. During the Appeals process, “The Tax Commission reviewed the file and issue[d] its decision ... upholding the Notice

for tax years 2015 through 2017.”¹¹ Petitioners did not appeal the Tax Commission’s decision, so it became final. Since the bonus depreciation addition from 2015 was reversed, Petitioners are not entitled to any subsequent subtractions.

Idaho Child Tax Credit

Audit changed the amount of Idaho Child Tax Credit allowed on Petitioners’ Idaho income tax return for tax year 2021. Petitioners’ protest included the following statement regarding the credit:

“The taxpayers are entitled to this credit in its entirety as all adjustments to the taxpayer’s [sic] returns were made in error.”

Idaho Code section 63-3029L allows taxpayers to claim a nonrefundable credit up to \$205 per qualifying child. A nonrefundable credit may only reduce a taxpayer’s tax liability. Therefore, the allowable amount of Idaho Child Tax Credit is limited to the tax liability after other nonrefundable credits are applied first.¹² Petitioners did not claim any other nonrefundable credits on their 2021 Idaho return. When they filed the return, they reported a tax liability (as applicable to the credit) of \$57, so they were able to utilize only \$57 of the \$205 maximum. If all adjustments were made in error, then Petitioners’ tax liability would not change, and they would be ineligible to claim the full amount of the credit.

In the Notice, Audit increased Petitioners’ Idaho taxable income and tax liability to the point where the remaining credit could be utilized and subsequently allowed an additional \$148 of credit ($\$205 - \$57 = \148). As discussed above, the Tax Commission determined that Petitioners’ taxable income and tax liability should be increased but to a lesser degree than that reflected in the

¹¹ Idaho State Tax Commission for Appeals Docket 0-664-287-232.

¹² For tax year 2021, there are 14 nonrefundable credits available to Idaho residents. The Idaho Child Tax Credit is 13th in the line of application. See Idaho Income Tax Administrative Rule 799.02.

Notice. Still, the increase in Petitioners' tax liability for 2021 is enough that the remaining unused Idaho Child Tax Credit is allowed. Therefore, the Tax Commission makes no change to Audit's adjustment for this issue.

Penalty and Interest

Audit added a negligence penalty to Petitioner's tax deficiency. Petitioners' protest included the following statements regarding penalty:

“A Negligence penalty should not be assessed as the taxpayer's [sic] 2019, 2020 and 2021 returns were filed according to current I.R.S. Regulations. The rules were not disregarded and there was no breach of duty or obligation. The income tax returns ... did not contain 'unsubstantiated claims or substantial errors.'”

The State's position of imposing a negligence penalty and a Substantial Understatement Penalty is a misrepresentation of facts as it has not been proven as yet the taxpayers were not engaged in this activity for profit per IRC 183.”

Tax Commission Administration & Enforcement Rule 410.02 describes the following situations that justify the inclusion of a negligence penalty, all of which the Tax Commission determined could apply to Petitioners' current case, but only one of which is needed:

- b. Taxpayer fails to maintain proper records and files returns containing unsubstantiated claims or substantial errors.
- c. Taxpayer makes unsubstantiated or exaggerated claims of deductions or exemptions.
- k. Taxpayer fails to respond to requests to produce records substantiating items shown on the return.

As stated earlier, Petitioners reported income and expenses for multiple unrelated businesses on a single Schedule C each year, while the IRS requires a separate Schedule C for each business. This requirement is not necessarily contained within IRC or Regulations but is well known in the tax preparation community.

Audit did not impose a substantial understatement penalty or indicate any finding that Petitioners were not engaged in their business activities with a genuine profit motive.

Audit also added interest to Petitioners' tax deficiency. The Tax Commission reviewed the addition and finds it to be appropriate and in accordance with Idaho Code section 63-3045.

Conclusion

Petitioners were asked to provide sufficient documentation to support amounts claimed for cost of goods sold and business expenses reported on Schedule C for tax years 2019, 2020, and 2021. The information received left much to be desired.

THEREFORE, the Notice dated June 7, 2023, and directed to is hereby MODIFIED and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2019	\$2,697	\$135	\$329	\$3,161
2020	2,407	120	223	2,750
2021	1,813	91	130	<u>2,034</u>
				<u>\$7,945</u>

The Tax Commission DEMANDS immediate payment of this amount. Interest is calculated through December 31, 2023, and will accrue in accordance with Idaho Code section 63-3045.

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

DATED this _____ day of _____ 2024.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2024,
a copy of the within and foregoing DECISION was served by sending the same by United States
mail, postage prepaid, in an envelope addressed to:

Receipt No.
