

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 0-796-804-096
	)	
	)	
Petitioners.	)	DECISION
_____	)	

(Petitioners) protested the Notice of Deficiency Determination (Notice) dated October 25, 2022. Petitioners disagreed with the adjustments the Income Tax Audit Bureau (Bureau) made to their 2019, 2020 and 2021 Idaho individual income tax returns. The Tax Commission reviewed the matter and for the reason stated below upholds the Notice.

**BACKGROUND**

The Bureau selected Petitioners’ 2019, 2020 and 2021 Idaho income tax returns for examination; specifically, the Schedule C activities (C1: \_\_\_\_\_ and C2: Consulting), and the subtraction of bonus depreciation. The Bureau notified Petitioners of the examination and requested they provide an explanation of the Schedule C activities as well as receipts and/or invoices to substantiate the expenses claimed.

Petitioners responded, describing \_\_\_\_\_ as “the company to run \_\_\_\_\_ consulting services through. Originally, \_\_\_\_\_ consulted on \_\_\_\_\_ ... and has transitioned to her advising \_\_\_\_\_ . Petitioners did not provide any descriptions for the Consulting business<sup>1</sup>.

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<sup>1</sup> The 2019 tax year is the only year that the Bureau addressed Consulting in the Notice as Petitioners did not file Schedule C for Consulting for tax years 2020 and 2021.

In regard to the request for receipts and invoices, Petitioners provided some documentation but not all that the Bureau requested. Petitioners stated that \_\_\_\_\_ did not have a “formal accounting system” and “just tracked with receipts.” None of the Petitioners’ documentation provided to the Bureau clearly identifies whether it is for their Schedule C1 or C2. The Bureau reviewed Petitioners’ documentation, determined the allowable expenses and deductions, and sent them a Notice. Petitioners, through their appointed representative, protested the Notice arguing two points; (1) stipulation to claim expenses as Petitioners are independent contractors by referring to *Butts v. Commissioner*<sup>2</sup>, and (2) disallowance of expenses incurred due to the right to deduct expense in the year included based on the method of accounting used by both \_\_\_\_\_ and \_\_\_\_\_ Consulting with references to Internal Revenue Code (IRC) section 280F(d)(4)(A)<sup>3</sup> and 26 CFR § 1.446-1(c)(1)(i)<sup>4</sup>.

The Bureau reviewed the information in Petitioners’ protest but determined it did not warrant any modifications to the Notice. The Bureau acknowledged the protest and referred the matter to the Tax Commission’s Appeals Unit (Appeals).

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<sup>2</sup> In the protest, the representative states; “Butts v Commissioner – It was determined that while Butts received a W2 he was in fact an independent contractor. Based on key issues related to how he was compensated, his exposure to risk of loss, how he went about securing clients, and who was responsible for his expenses it was determined he was an independent contractor. Therefore, he was required to file income and expenses on a schedule C even though his earnings were reported on a W2.”

<sup>3</sup> Internal Revenue Code (IRC) section 280F – Limitation on depreciation for luxury automobiles; limitation where certain property used for personal purposes. (d) Definition and special rules. For purposes of this section – (4) Listed property (A) In general. Except as provided in subparagraph (B), the term “listed property” means – (i) any passenger automobile, (ii) any other property used as a means of transportation, (iii) any property of a type generally used for purposes of entertainment, recreation, or amusement, and (iv) any other property of a type specified by the Secretary by regulations.

<sup>4</sup> 26 CFR § 1.446-1 – General rule for methods of accounting. (c) Permissible methods – (1) In general. Subject to the provisions of paragraphs (a) and (b) of this section, a taxpayer may compute his taxable income under any of the following methods of accounting: (i) Cash receipts and disbursements method. Generally, under the cash receipts and disbursements method in the computation of taxable income, all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made.

Appeals sent Petitioners and their representative a letter explaining the options available for redetermining a Notice. The representative responded but did not request an informal hearing. Instead, he provided information for the Tax Commission's consideration, some new and some duplicates of what was provided to the Bureau. The Tax Commission has reviewed all information provided and hereby issues its decision on the matter.

### **ISSUES**

The two arguments brought up in the protest: Petitioners' stipulation to claim expenses and method of accounting, were not questioned or addressed by the Bureau. The issues are whether the claimed expenses are adequately substantiated and had business purposes or not.

### **LAW AND ANALYSIS**

IRC section 162 provides for the deduction of all the ordinary and necessary expenses paid or incurred in carrying on of a trade or business. Idaho Code section 63-3042 allows the Tax Commission to examine a taxpayer's books and records to determine the correctness of an Idaho income tax return. Tax Commission Administration and Enforcement rule IDAPA 35.02.01.201 provides that, "A taxpayer shall maintain all records that are necessary to a determination of the correct tax liability."

Deductions are a matter of legislative grace, and a taxpayer bears the burden of proving that he is entitled to the deductions claimed. *New Colonial Ice Co., Inc. v. Helvering*, 292 US. 435, 440, 54 S.Ct. 788 (1934). Taxpayers are required to maintain records that are sufficient to enable the determination of their correct tax liability. *See* IRC § 6001; Treasury Regulation § 1.6001-1(a). The burden rests upon the taxpayer to disclose his receipts and claim his proper deductions. *United States v. Ballard*, 535 F.2d 400, 404 (1976). If a taxpayer is unable to provide adequate proof of any material fact upon which a deduction depends, no deduction is allowed, and that

taxpayer must bear his or her misfortune. *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931).

A taxpayer's general statement that his or her expenses were incurred in pursuit of a trade or business is not sufficient to establish that the expenses had a reasonably direct relationship to any such trade or business. *Near v. Commissioner of Internal Revenue*, T.C. Memo. 2020-10 (2020).

In the present matter, Petitioners were asked to substantiate the following expenses claimed on their Schedule C1 and C2:

<u>Schedule C1:</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Car and truck expenses	102	0	0
Depreciation	4,689	15,652	26,259
Office expense	10,071	0	0
Supplies	987	950	450
Travel	4,000	0	0
Other expenses	0	1,700	1,700
Total expenses	19,849	18,302	28,409

<u>Schedule C2: Consulting</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Depreciation	13,417		
Office expense	1,288		
Supplies	100		
Total expenses	14,805	0	0

Petitioners provided some receipts, but the total of these receipts did not match any of the amount claimed on either Schedule C1 or C2. Additionally, none of these receipts are clearly marked whether it is for Schedule C1 or C2.

#### Car and truck expenses

In the administrative review, Appeals received the “vehicle maintenance reports” and “schedules.” However, these are duplicates of the receipts/invoices that Petitioners provided to the Bureau and are not organized in any way of regular accounting compilation.

For automobiles that are used for more than one purpose, Treasury Regulation section 1.280F-6 provides that the taxpayer allocates the use of the property based on mileage. To do this,

a logbook of business miles to total miles is generally required. *See* IRC section 274(d). Petitioners failed to provide a mileage logbook, and the business use percentage of any of the vehicles. They have not met the substantiation requirement.

#### Depreciation

One of the few items of documentation Petitioners provided is a federal asset report, calculating depreciation on a recreational vehicle (RV). Petitioners stated that they used the RV to travel to remote locations within and outside Idaho to meet with clients for their business. Petitioners failed to provide a mileage logbook, and the business use percentage of the RV. There is no proof that the RV was used for either one of the Schedule C activities.

Petitioners' federal asset report also lists two vehicles for Consulting: Schedule C2. Petitioners failed to provide a mileage logbook, and the business use percentage of these vehicles. Therefore, no deduction is allowed.

#### Office expenses

One piece of "new" information Appeals received is the "layout of their home" that Petitioners provided to substantiate the office expenses for their home office; however, they did not provide any corresponding calculation for the amount deducted on their Schedule C1 and C2. Without adequate substantiation, no deduction is allowed.

#### Supplies

Petitioners provided some receipts marked that are for the supplies; however, the total of these receipts did not match the amount claimed on either Schedule C1 or C2. Without adequate substantiation, no deduction is allowed.

## Travel

Another new piece of information Appeals received is the “expense summary”, listing their travel expenses for tax year 2019<sup>5</sup>. The “expense summary” shows a brief description of the expenses and the reasoning for each expenditure, but the totals do not match any of the amounts claimed on their Schedule C1<sup>6</sup>.

Early in 2019, Petitioners and their dependents traveled to an amusement park in California. They claimed the full amount of purchase price paid for a vacation package as a travel expense and described that is for “Annual Meeting.” IRC section 274(d) requires strict substantiation for travel expenses to be claimed as a business deduction. It includes establishing the amount, date, and business purpose of each expenditure. Additionally, IRC section 162(a)(2)<sup>7</sup> defines that before a travel expense can be deducted, such an expense must be necessary or appropriate to the development and pursuit of the business or trade. The Tax Commission struggles to find a direct connection between the vacation package Petitioners spent with their dependents in California and the carrying on of either one of their Schedule C activities.

## Other expenses

Appeals received the “expense summary” of the other expenses for tax year 2021<sup>8</sup>, describing the expenses as for their cell phone and cable/internet usage. Petitioners provided cell phone and cable/internet bills to substantiate their expenses. While Petitioners may have used cell

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<sup>5</sup> Petitioners did not provide an “expense summary” of the travel expenses for tax years 2020 and 2021.

<sup>6</sup> No travel expense was claimed on Schedule C2: Consulting, for any tax year.

<sup>7</sup> IRC section 162(a)(2):

1. The expense must be reasonable and necessary traveling expense, as that term is generally understood. This includes such items as transportation fares and food and lodging expenses incurred while traveling.
2. The expense must be incurred ‘while away from home.’
3. The expense must be incurred in pursuit of business. This means that there must be a direct connection between the expenditure and the carrying on of the trade or business of the taxpayer or of his employer. Moreover, such an expenditure must be necessary or appropriate to the development and pursuit of the business or trade.

<sup>8</sup> Petitioners did not provide an “expense summary” of other expenses for tax years 2019 and 2020.

phones and internet for business, they did not provide sufficient documentation to substantiate the amounts shown on the return. There is no information showing the number of phones included on the monthly bill, how the internet was used for their business or the business use percentages. The cable/internet bills do not break out the amount by service: cable and internet<sup>9</sup>. Therefore, the total amount that Petitioners paid for the internet service is unknown.

None of the expenses claimed on their Schedule C1 and C2 are adequately substantiated. Furthermore, Petitioners failed to prove that there is a direct connection between any of the expenses and the carrying on of the trade or business of Petitioners.

In the imposition of a tax, the general rule is that there is a strict presumption against the taxing authority. See *Tandy Leather Company v. United States*, 347 F.2d 693 (5<sup>th</sup> Cir. 1965). However, in this case Petitioners are claiming deductions to reduce its tax owed and the burden is clearly on Petitioners. Petitioners did not meet the burden in that they did not provide source documentation for most of the deductions claimed. Petitioners did not prove their case.

## **CONCLUSION**

The Tax Commission reviewed the Bureau's adjustments and the additional documentation received in the administrative review. The Tax Commission finds that the Bureau's adjustments to the Schedule C1 and C2 activities are appropriate and in accordance with Idaho law. Therefore, the Tax Commission upholds the Notice.

The Bureau added interest and penalty to Petitioners' Idaho tax. The Tax Commission reviewed those additions and found them appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046. Interest is computed to July 20, 2023.

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<sup>9</sup> The service provider sells internet, phone, and cable TV services.

THEREFORE, the Tax Commission AFFIRMS the Notice dated October 25, 2022,  
directed to

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	\$3,278	\$164	\$325	\$3,767
2020	2,213	111	158	2,482
2021	3,188	159	156	3,503
			TOTAL DUE	<u>\$9,752</u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

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.

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