

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

In the Matter of the Protest of	)	
	)	
<span style="background-color: black; color: black;">[REDACTED]</span> ,	)	DOCKET NOS. 1-201-158-144 AND
	)	0-664-287-232
Petitioners.	)	
<hr style="width: 50%; margin-left: 0;"/>	)	DECISION

[REDACTED] (Petitioners) protested the Notices of Deficiency Determination (Notices) issued by the auditor of the Idaho State Tax Commission (Tax Commission) dated March 20, 2018<sup>1</sup> for tax year 2014 and October 18, 2018, for tax years 2015 through 2017. The Notices asserted liability for Idaho income tax, penalty and interest in the total amounts of \$5,072, \$8,864, \$8,106 and \$5,963 for 2014, 2015, 2016 and 2017, respectively. Petitioners disagreed with the disallowance of business expenses claimed on their income tax returns and the determination their Schedule C business lacked an intent to make a profit. The Tax Commission reviewed the file and issues its decision modifying the Notice for tax year 2014 and upholding the Notice for tax years 2015 through 2017. This means Petitioners need to pay \$29,514 of tax, penalty and interest for tax years 2014 through 2017. The Tax Commission now DEMANDS immediate payment of this amount.

**BACKGROUND**

Petitioners were Idaho residents for the years under review and filed Idaho resident income tax returns. Each year’s return included a Schedule C for “Personal Services.”

The Income Tax Audit Bureau (Audit) selected Petitioners’ 2014 through 2017 returns for examination. Audit informed Petitioners of the examination and requested specific information to

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<sup>1</sup> The original Notice for 2014 was later modified by audit and a copy sent to Petitioners on October 18, 2018.  
DECISION - 1

[REDACTED]

assist with the examination. Petitioners provided Audit with a small portion of the documentation requested. Audit reviewed the limited documentation and issued the Notices.

Petitioners, through their representative, protested the Notices and requested the matter be forwarded to the Tax Commission's Appeals Unit for administrative review. An informal hearing was held on September 10, 2019. On October 18, 2019, Petitioners submitted information for tax year 2017, as none had been provided during the audit. The Tax Commission reviewed all the information contained in the file but could not determine how the numbers on the returns were compiled, both the income and the expenses.

A second telephone conference was held on April 7, 2020. Mr. [REDACTED] attended along with his representative/tax preparer. During this conference, the Tax Commission learned Petitioners' Schedule C for "Personal Services" included income and expenses for as many as four different business activities, including Amway and eBay. At the conclusion of this conference Mr. [REDACTED] stated additional information would be provided to add some clarity and sense to the figures shown on the Schedule Cs. No information has been submitted. Therefore, the Tax Commission decides this matter based upon the information in the file at this time.

The auditor requested Petitioners' financial records for 2014 through 2017 so that Petitioners' business income and expenses might be properly determined. The auditor also requested Petitioners complete a Tax Commission Business Questionnaire to help determine whether the business activities were engaged in for profit.<sup>2</sup> See Internal Revenue Code section 183 and Tres. Reg. section 1.183-2. Petitioners did not supply the financial records and while the questionnaire was returned, it was not complete. The auditor determined Petitioners' "Personal

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<sup>2</sup> Except for tax year 2016, Petitioners reported a Schedule C loss every year since 2008.

Services” business was not an activity engaged in for profit and issued the Notices, disallowing all unsubstantiated expenses.

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. Petitioners 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 determination of whether Petitioners’ activities are engaged in for profit is difficult at best due to the fact that multiple business activities are combined on one Schedule C. While the Tax Commission finds several factors weigh heavily against Petitioners having an intent to make a profit, the Tax Commission will give them the benefit of the doubt, despite their reported losses in all but one year of their “Personal Services” business. Therefore, for the remainder of this decision, the Tax Commission focuses on the substantiation of the expenses claimed by Petitioners on their Schedule Cs.

## **LAW AND ANALYSIS**

### Trade or Business Expenses

Taxpayers operating a trade or business for profit are allowed a deduction for business expenses. Internal Revenue Code (IRC) section 162(a) states in part, that "[T]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." To qualify as a deduction under IRC section 162(a) an item must (a) be paid or incurred during the taxable year, (b) be for carrying on any trade or business, (c) be an expense, (d) be a necessary expense, and (e) be an ordinary expense. An expense is ordinary if it is customary or usual within a particular trade, business, or industry or relates to a

transaction “of common or frequent occurrence in the type of business involved.” *Deputy v. du Pont*, 308 U.S. 488, 495 (1940). An expense is necessary if it is appropriate and helpful for the development of the business. *Commissioner v. Heininger*, 320 U.S. 467, 471(1943). Personal, living, and family expenses are generally not deductible. IRC § 262(a).

Deductions are a matter of legislative grace and the taxpayer must prove that he or she is entitled to each deduction and the amount thereof. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). Taxpayers must substantiate each claimed deduction by maintaining sufficient records to allow the correct determination of the taxpayer’s tax liability. *Higbee v. Commissioner*, 116 T.C. 438, 440 (2001). A taxpayer’s general statement that their expenses were incurred in pursuit of their business is not sufficient to establish that the expenses had a reasonably direct relationship to the taxpayer’s trade or business. *Ferrer v. Commissioner*, 50 T.C. 177, 185 (1968), *aff’d per curiam*, 409 F.2d 1359 (2d Cir. 1969); *Near v. Commissioner*, T.C. Memo 2020-10.

#### Schedule C Expenses-other than car and truck, and travel

In the present matter, to substantiate the expenses claimed on their Schedule C’s, Petitioners provided monthly calendars and copies of credit card statements. The Tax Commission finds this evidence 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 techniques, 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. Therefore, the Tax Commission upholds the Notices with regard to these deductions.

### Expenses Subject to IRC Section 274(d)

IRC section 274 requires strict substantiation rules for travel, meals, and entertainment expenses. To meet these rules, a taxpayer must establish by adequate records or by sufficient evidence corroborating the taxpayer's own statement (1) the amount, (2) the time and place of the travel or use, and (3) the business purpose. The records that section 274 requires may be any document that can establish any of these three elements but are usually an account book, a diary, a log, a statement of expenses, or trip sheets. Temporary Income Tax Regulation § 1.274-5T(c)(2)(i). Credit card and bank statements may be sufficient to show that an expense was paid, but usually are not enough without more to show that it was related to a trade or business because such statements often don't show an expense's purpose. *See Fessey v. Commissioner*, T.C. Memo. 2010-191, 2010.

Petitioners claimed expenses for travel, meals and entertainment on each return under examination. To substantiate these expenses Petitioners provided only a copy of a calendar for each year and credit card statements. They did not provide contemporaneous or near contemporaneous logs for any of their travel, nor did they articulate with specificity the business reasons for each of the travel expenses. The information provided does not show what section 274(d) requires, or even what is needed to distinguish an expense of one business from another. Petitioners are not allowed a deduction for these expenditures.

### Car and truck expenses

A taxpayer may deduct vehicle expenses using either actual cost or the standard mileage rate. *See* Tres. Reg. § 1.274-5(j)(2). Therefore, Petitioners cannot claim deductions for both actual expenses and expenses calculated on the basis of the standard mileage rate.

Petitioners claimed car and truck expenses in each year under review. For tax year 2014

Petitioners claimed a deduction of \$8,960 and provided a mileage log showing 16,187 total miles.<sup>3</sup> Petitioners' log shows a "business detail" column which when compared to Petitioners' calendar adequately substantiates a portion of the claimed business mileage. Therefore, for 2014, the Tax Commission will modify the Notice to allow car and truck expenses of \$4,053 (7,237 miles at the standard mileage rate of .56).

Petitioners' 2015 through 2017 returns show car and truck expenses as well as a depreciation deduction. As outlined above, taxpayers cannot claim both actual expenses and the standard mileage rate. Petitioners provided no mileage logs for tax years 2015 through 2017 nor did they provide any documentation related to the business use percentage of the vehicle being depreciated. Petitioners did not adequately substantiate the car and truck expenses claimed for these years. Accordingly, Petitioners are not allowed a deduction for these expenses.

In this case, Petitioners were asked to substantiate the income and expenses claimed on their schedule C's. Petitioners did not provide adequate documentation to substantiate the items claimed. In addressing such a situation, the U. S. Tax Court stated, in part:

Petitioner has not established the factual allegations in its petition which are material and essential. Respondent was under no obligation to introduce evidence to rebut a fact alleged but not proven by petitioner. *Short v. Philadelphia B. & W. R. Co.*, 23 Del. 108; 76 Atl. 363. The rule is well established that the failure of a party to introduce evidence within his possession and which, if true, would be favorable to him, gives rise to the presumption that if produced it would be unfavorable. *Walz v. Fidelity-Phoenix Fire Ins. Co. of New York*, 10 Fed.(2d) 22; certiorari denied, 271 U.S. 665; *Equipment Acceptance Corporation v. Arwood Can Mfg. Co.*, 117 Fed. (2d) 442; *Hann v. Venetian Blind Corporation*, 111 Fed.(2d) 455; *Bomeisler v. Jacobson & Sons Trust*, 118 Fed.(2d) 261; *Sears, Roebuck & Co. v. Peterson*, 76 Fed.(2d) 243. This is especially true where, as here, the party failing to produce the evidence has the burden of proof or the other party to the proceeding has established a prima facie case. *Moore v. Giffen*, 110 Cal.A. 659; 294 Pac. 730; *Indianapolis & Cincinnati Traction Co. v. Montfort*, 80 Ind.A. 639; 139 N.E. 677.

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<sup>3</sup> The standard mileage rate in 2014 was .56cpm. Petitioners log uses .535cpm, the amount shown on the return reflects .554cpm.

*Wichita Terminal Elevator Co. v. Commissioner*, 6 T.C. 1158, 1165, aff'd, 162 F.2d 513 (10th Cir.1947).

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 misfortune. *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931). For the majority of expenses under review in this matter, Petitioners simply did not provide the necessary receipts and other documentation to substantiate the deduction. Therefore, Petitioners must bear their misfortune and pay the additional tax associated with the disallowed deductions.

Both Notices issued to Petitioners propose the negligence penalty and the Notice covering tax years 2015 through 2017 also proposes the substantial understatement penalty.

Idaho Code section 63-3046(a) states:

If any part of any deficiency is due to negligence or disregard of rules but without intent to defraud, five percent (5%) of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected and paid in the same manner as if it were a deficiency.

Idaho Code section 63-3046(d) states:

(1) If there is a substantial understatement of tax for any taxable year, there shall be added to the tax an amount equal to ten percent (10%) of the amount of any underpayment attributable to such understatement.

(2) For purposes of this subsection, there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of:

- (i) Ten percent (10%) of the tax required to be shown on the return for the taxable year, or
- (ii) Five thousand dollars (\$5,000).

The Tax Commission has reviewed the auditor's application of these penalties and finds both proper.

THEREFORE, the Notice dated March 20, 2018, for tax year 2014, is hereby MODIFIED, and as modified, APPROVED AND MADE FINAL. The Notice dated October 18, 2018, for tax years 2015 through 2017, is APPROVED, AND MADE FINAL.

IT IS ORDERED that Petitioners pay the following tax, penalty, and interest computed to October 2, 2020.

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2014	\$3,985	\$199	\$872	\$5,056
2015	7,104	1,066	1,269	9,439
2016	6,696	1,004	947	8,647
2017	5,063	759	550	<u>6,372</u>
			TOTAL DUE	\$29,514

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2020.

IDAHO STATE TAX COMMISSION



**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2020,  
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.

[REDACTED]

\_\_\_\_\_  
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[REDACTED]

[REDACTED]