BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of [redacted] Petitioners.	))))))	DOCKET NO. 1-252-480-000 DECISION

[redacted] (Petitioners) protested the Notice of Deficiency Determination (Notice) dated June 6, 2025. The Tax Commission reviewed the matter and for the reasons set forth below upholds the Notice as modified and issued on September 22, 2025.

Background

Petitioners are a married couple who filed joint Idaho income tax returns for tax years 2021, 2022, and 2023 (audit period). They claimed five minor children on these returns:

- [redacted] (JF), born [redacted] 2009
- [redacted] (KF), born [redacted] 2011
- [redacted] (BF), born [redacted] 2015
- [redacted] (FF), born [redacted] 2018
- [redacted] (RF), born [redacted] 2021

The Tax Commission's Income Tax Audit Bureau (Bureau) selected Petitioners' 2023 income tax return for examination. On November 18, 2024, the Bureau sent a letter requesting documentation to substantiate expenses claimed on federal Schedule C for [redacted] ([redacted] Petitioners provided a response on December 5. On December 9, the Bureau sent Petitioners another request for information about [redacted] This letter also expanded the scope of the Bureau's examination to include 2021, 2022, and 2023. Petitioners provided a response on January 16, 2025. The Bureau sent a third letter requesting information about [redacted] on January 27, but Petitioners did not respond to this letter.

The Bureau issued the original Notice on June 6, 2025, and included adjustments for the following: expenses claimed by [redacted] on Schedule C for wages paid to Petitioners' five children; Petitioners' unreported wages and income tax withholding; bonus depreciation; additional income resulting from a separate examination of the 2022 tax return for [redacted] ([redacted] a pass-through entity wholly-owned by Petitioners; a capital gains deduction resulting from the same examination related to [redacted] and the Idaho child tax credit. The Bureau also included penalty and interest.

On August 8, Petitioners' appointed attorney-in-fact (AIF) protested the Notice, indicating disagreement with the Bureau's Schedule C adjustments, the changes related to the [redacted] examination, and the additions of penalty and interest. At the same time, AIF's response indicated agreement with all the other adjustments. AIF provided a significant amount of additional documentation with the protest letter. On August 14, the Bureau sent a letter acknowledging the protest. After resolving the examination of [redacted] the Bureau removed the additional income related to that examination along with the Idaho capital gains deduction. The Bureau issued a modified Notice on September 22, 2025, to reflect these changes.

Petitioners did not respond to the modified Notice, so the Bureau transferred the matter to the Tax Commission's Appeals unit (Appeals). On December 5, Appeals sent Petitioners a letter requesting documentation pertaining to their children's wages and outlining the options available for redetermining a protested Notice. One of those options was to schedule a hearing with a Commissioner. Petitioners did not request a hearing but did provide the additional information Appeals requested in the December 5 letter and in a subsequent email.

As Petitioners did not request a hearing, the Tax Commission must resolve the protest based on the information available.

Issue

All adjustments in the original Notice were either agreed to in the protest letter or resolved in the modified Notice, except the wage expenses claimed on Schedule C and penalty and interest. The agreed-to adjustments will stand. This decision will predominantly focus on the deductions Petitioners claimed for wages paid to their children but will address the addition of penalty and interest as well.

Law & Analysis

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 an ordinary and necessary expense. 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] A deductible expense must also be incurred or paid during the tax year for which it is claimed and be incurred or paid in the conduct of a trade or business. IRC section 262(a) reads, "Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses."

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 deduction by maintaining sufficient records to allow the correct determination of their tax liability.[4] If a taxpayer is unable to provide adequate proof of any fact upon which a deduction

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

depends, no deduction is allowed, and that taxpayer must bear his misfortune.[5] A taxpayer's general statement that 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] 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 an authorized party.[7]

Businesses routinely claim deductions for compensation paid to workers. Wages paid to employees typically fall into that category. However, such compensation is deductible only if it meets three criteria: 1) it is reasonable in amount; 2) it is based on services actually rendered; and 3) it is actually paid or incurred.[8] This type of deduction is allowable even if parents employ their children.[9]

Instances of employment involving familial relationships face greater scrutiny than those not involving such relationships.[10] The baseline assumption is that payments from parents to dependent children are familial support in nature and therefore not deductible under IRC section 262.[11] There must be a bona fide employer-employee relationship between the family members. While all facts and circumstances are considered in determining if an employer-employee relationship exists, there are several facts that will weigh against the deductibility of wages paid by a parent to a dependent child. These include:[12]

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[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
[7] See also *Tax Commission Administration and Enforcement Rule 200* (IDAPA 35.02.01.200)
[8] *O'Connor v. Commissioner*, T.C. Memo. 1986-444. Also Treasury Regulation 1.162-7(a)
[9] *Eller v. Commissioner*, 77 T.C. 934, 962 (1981); *Hamdi v. Commissioner*, T.C. Memo 1993-38.
[10] *Denman v. Commissioner*, 48 T.C. 439, 450 (1967)
[11] *Holtz v. Commissioner*, T.C. Memo. 1982-436.
[12] *Denman v. Commissioner*; *O'Connor v. Commissioner*; *Hable v. Commissioner*, T.C. Memo. 1984-485; *Furmanski v. Commissioner*, T.C. Memo. 1974-47

- Not paying employment taxes or filing informational returns, when required
- Paying a predetermined amount that is not based on services actually performed
- A lack of correlation between the dates and amounts of payments and the hours allegedly worked
- Not maintaining adequate records of hours worked and amounts earned
- Paying the child for completing routine family chores

Petitioners claimed deductions on Schedule C for wages paid in 2021, 2022, and 2023 ($51,117; $61,350; and $62,750, respectively). During the examination, the Bureau requested records to support these deductions. Petitioners revealed that the wages claimed were paid to their five minor children.[13] Within their January 16, 2025, response, Petitioners provided payroll journal reports for 2021 and 2022 (AIF provided reports for 2022 and 2023 with the protest letter). These reports showed monthly records of payments to the children along with a year-end summary. Petitioners also sent a spreadsheet showing various tasks performed by each child in each month of 2021 and 2022 for two of Petitioners' related business entities: the previously mentioned [redacted] and [redacted] ([redacted] Petitioners wrote that in these two businesses, the activities performed by the children represent a substantial part of their "brand." Without the children, they could not show how someone can "grow a business that prioritizes family, wellness, and strong values."

According to the spreadsheet, all the children provided "marketing content" all year (January through December) for both businesses. The three oldest – JF, KF, and BF – completed "office chores" for [redacted] all year and were joined by FF in September through December 2022. The three oldest completed "feeding" for [redacted] all year and were joined by FF in October through December 2022. The two oldest children both provided "day help" for [redacted] in June

[13] At the end of 2021, the children were aged: twelve years, ten months; ten years, eight months; six years, three months; three years, ten months; and nine months.

and July 2021 and 2022, as well as "irrigating" in May through September both years. No such information was provided for 2023.

When the Bureau issued the Notice, several reasons were provided for denying the deduction for the children's wages. The Bureau wrote, "The chores and marketing tasks performed by your children were related to [[redacted] and [[redacted] not your Schedule C activity. The primary focus of your Schedule C is on management, whereas the duties performed by your children, such as feeding cattle, horses, chickens, dogs, and providing day help, are basic household chores. These activities don't have a direct or necessary connection to the management functions of your business." The Bureau noted two children's young ages and the amounts they were paid in 2022 and stated that it was unlikely the youngest children could have provided services justifying their wages. The Bureau stated that the wages claimed were not reasonable for the services they allegedly provided and that the services were provided to entities other than [redacted]

In the protest letter, AIF wrote, "[The] wages paid were ordinary, necessary, bona fide, meaningful, reasonable, customary, based on services rendered, and for carrying on trade or business." He stated that [redacted] is a company that provides "centralized administrative and investment oversight services for the family's holdings, including their LLCs." He indicated that the children were hired as farmstead operations assistants and provided a job description. He stated that the services were documented through time sheets and provided a record for each child. He disagreed with the Bureau's determination that the children's ages prevented them from providing services that justified their wages. AIF described [redacted] as dependent on social media presence to generate revenue and stated that the children were hired from [redacted] as models. He went on to say that the wages the children received were a bargain compared to current rates from SAG-AFTRA[14] (with a daily base rate of $1,204) and backstage.com (postings showing $500 for four hours of modeling). AIF stated that the children's duties as farmstead operations assistants included general labor, irrigation support, livestock care, facility upkeep, and modeling for content creation and that "[t]he compensation structure represents an arm's-length, business-driven decision."

Appeals' initial contact letter to Petitioners[15] included a request for documentation of the arm's-length nature of the children's employment. Petitioners gave Appeals copies of bank records for each child showing deposits matching the timing and amounts of the payroll journal reports Petitioners provided to the Bureau during the examination. Assuming the bank statements are reflective of actual transactions, the Tax Commission determined that criterion 3 for the deductibility of compensation – that it was actually paid or accrued – has been met.

The information for the position of farmstead operations assistant describes it as supporting "the daily functioning of a family-run agricultural property through a diverse range of duties" and typically being filled by a dependent child of the household. The possible categories of duties and example tasks include:

- Marketing and content creation (assisting with social media content; drafting email newsletters and marketing updates; monitoring engagement and flagging messages for adult review)
- Office and facility upkeep (cleaning and organizing the farm office and gym; restocking supplies and disposing of trash; performing light clerical work)
- Livestock and animal care (feeding cattle, horses, chickens, and dogs; refilling water and collecting eggs; monitoring animals and reporting abnormalities)

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[14] Screen Actors Guild – American Federation of Television and Radio Artists, a labor union representing approximately 160,000 media professionals around the world (retrieved March 6, 2026, from *sagaftra.org/about*)
[15] When Petitioners completed Form ID-POA, *Power of Attorney*, they marked a box indicating they did not want copies of notices and communications sent to AIF. For this reason, all communications Appeals had during the administrative review process was directly with Petitioners.

- General day help (assisting with fence repair; hauling supplies; cleanup; supporting seasonal activities like planting and harvesting; running errands; delivering items across the farmstead)
- Irrigation support (moving pipe and checking water flow under supervision; cleaning filters and monitoring sprinkler placement; recording irrigation activity in farm log)

The job description estimates 24-32 hours per week, depending on the season. The starting compensation is listed as $12,200 annually. The Tax Commission has no information indicating when this job description was drafted. It is possible that it was drafted prior to any of the children being hired. However, it is just as likely to have been drafted after the Bureau issued the Notice.

According to the payroll journals provided by AIF, [redacted] paid each of the four oldest children (JF, KF, BF, and FF) $12,200 during 2021 and 2022 and $12,550 during 2023 for working 2,080 hours (full-time) each year. According to the payroll journals, the youngest child (RF) was paid $2,317 for working 32 hours during 2021; $12,550 for working 173.33 hours during 2022; and $12,550 for working 2,080 hours during 2023. In contrast, the farmstead operations assistants' timesheets for 2021, 2022, and 2023 report a far different number of hours worked for every child in every year. The timesheets are broken down by year, child, month, and week (four weeks in every month for a total of 48 weeks). According to these records, the children worked as follows:

Child	2021 hours	2022 hours	2023 hours
JF	1,365	1,357	1,345
KF	1,334	1,353	1,328
BF	1,333	1,332	1,328
FF	1,312	1,350	1,341
RF	1,117	1,367	1,340

For every week reported on the timesheets, each child worked between 24 and 32 hours, precisely as estimated in the job description. When Appeals asked how the children's daily hours were tracked, Mr. [redacted] replied, "I'm not sure where the timesheets came from, because we didn't necessarily track hours, but what it would have cost us to replace what our kids were doing for jobs on the farm and as key roles in the content creation." RF's timesheet for March 2021 included hours in weeks one and two, before he was born. The spreadsheet listing what type of tasks each child performed in each month for 2021 and 2022 shows that RF provided marketing content in January and February 2021, again before he was born. Based on these facts, it appears that Petitioners did not maintain accurate records of the children's hours and tasks completed. This is one of the five "red flags" mentioned earlier regarding determining the deductibility of wages.

Turning to the amount of compensation the children received, the four oldest all received the same amount every month throughout the audit period. According to the payroll records and bank statements, each of the four oldest children received $1,016.67 per month during 2021 and 2022 and $1,045.83 per month during 2023. This amount was paid regardless of how many hours the child worked or what tasks they were assigned. RF received $2,139.67 ($2,317 less employment-related taxes) on December 31, 2021; $11,589.92 ($12,550 less employment-related taxes) on January 31, 2022;[16] and $1,045.83 each month during 2023.

The steady rate of pay is a strong indicator that the amount each child was paid was not tied to the work performed by said child. Rather, the amount they would receive was determined at the beginning of the year and divided equally across 12 months, no matter what type of work they did or how many hours it may have taken them. During those times when additional duties were taken on, there was no adjustment to the child's pay. This is another "red flag."

RF is an exception to this for 2021 and 2022, but according to the records provided, there was no correlation between when he was paid and when he performed whatever "duties" he was

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[16] RF was paid the same amount again on February 28, 2022, but this transaction was reversed shortly after.

assigned. RF was paid lumps sums at the end of 2021 and the beginning of 2022. This represents a third "red flag."

In the Notice, the Bureau determined that the duties performed by the children are basic household chores not directly related to [redacted] The Tax Commission agrees with this determination in part. As defined by Merriam-Webster,[17] chores are "the regular or daily light work of a household or farm" or routine tasks or jobs. Some of the tasks listed as examples in the farmstead operations assistant job description could be considered household or farm chores. This includes activities like cleaning and organizing, restocking supplies, disposing of trash, feeding and watering small animals, monitoring animals for abnormalities, running errands, delivering items across the farmstead, and recording irrigation activity in a log book. Other activities may be outside the "regularity" or "lightness" of chores but still within the realm of tasks necessary for the upkeep of a family farm. Activities such as fence repair, feeding large animals, moving pipes, and cleaning sprinkler filters may fall into this category. While the Tax Commission recognizes that the list of tasks provided in the job description is not exhaustive, the list contains many activities considered chores that are "part of parental training and discipline rather than the services rendered by an employee for an employer."[18] The fact that some activities may fall outside that designation does not negate the fact that the children were paid for completing chores.

One absolutely essential element to being able to deduct compensation as a business expense is an employer-employee relationship. The Tax Commission analyzed the bank statements Mr. [redacted] provided to Appeals. During 2021, 2022, and 2023, deposits to the children's accounts consisted of their monthly payments from [redacted] and interest. With the exception of RF

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[17] Definition retrieved 3/25/2026 from https://www.merriam-webster.com/dictionary/chore.
[18] *Denman v. Commissioner, supra* at 450.

during 2021 and 2022, all deposits from [redacted] were regular and equal. There were no other deposits one might expect on a child's account such as birthday or Christmas gifts. Interest varied based on the balance in each child's account.

In addition to equal deposits, there were also equal transfers out of the children's accounts into other accounts owned by Petitioners. When asked about these accounts, Mr. [redacted] stated that one of them was Petitioners' personal account, and the other was the regular business account for [redacted]

During 2021, each of the four oldest children was paid $12,200, and $11,120 was transferred out of each child's account into the parents' account. When asked what the transfers were for, Mr. [redacted] explained that the children's accounts don't have a debit card or checks, so if a child wanted to purchase something, Petitioners would buy it for them and then reimburse themselves. He said that any transfer to this account would be a reimbursement, which happened once or twice a year. The pattern of these transfers does not support this explanation. During January 2023, $4,300 was moved from each child's account – including the youngest child – to Petitioners' personal account.

Between March and September 2023, eight transfers were made from each of the four oldest children's accounts to the account for [redacted] for a total of $17,765.50 each. During the same period, $8,458 was moved in four transfers from RF's account. The amount transferred on a given day was the same for each child. Each child was paid $12,550 for the year. When asked about these transfers, Mr. [redacted] explained that all the children own cattle in the [redacted] operation, and the money moved to that account was for the purchase of cattle. He then explained that each child owns a share of the herd, not specific animals, and the proceeds from the sale of any animals go back into the business. None of the children are listed as owners of [redacted] Petitioners are the sole shareholders.

The Tax Commission determined that this pattern of payments and transfers does not demonstrate an arm's-length employer-employee relationship between Petitioners and their children. Based on all the above analysis, the Tax Commission determined that the wages Petitioners paid to their children during 2021, 2022, and 2023 are not deductible as Schedule C business expenses.

Penalty and Interest

The modified Notice included two penalties added to Petitioners' tax deficiency for tax year 2021: a 5% negligence penalty; and a 5% delinquency penalty. In the protest letter, AIF wrote, "Upholding the deductions for 2021 results in no further penalties or interest." As detailed above, the Tax Commission determined that the deductions claimed for 2021 are not allowed. The Tax Commission reviewed the penalty additions and finds them to be appropriate and in accordance with Idaho Code section 63-3046. No penalties are included for tax years 2022 or 2023, because applicable penalties are limited to 25% of the tax due on the return.

The modified Notice included interest added to Petitioners' tax deficiency for all years in the audit period. The Tax Commission reviewed those additions and finds them to be appropriate and in accordance with Idaho Code section 63-3045.

Conclusion

Petitioners claimed deductions on Schedule C for wages they paid to their minor children. However, they have not demonstrated that these expenses are properly deductible under IRC section 162. All other adjustments contained in the modified Notice have been agreed to.

THEREFORE, the Notice for tax years 2021 through 2023, directed to [redacted] is hereby UPHELD as modified by the Bureau and MADE FINAL.

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

YEAR	TAX	PENALTY	INTEREST	TOTAL
2021	$3,322	$333	$463	$4,118
2022	5,725	0	593	6,318
2023	3,320	0	168	3,488
				$13,924

The Tax Commission DEMANDS immediate payment of this amount. Interest is calculated in accordance with Idaho Code section 63-3045.

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

DATED this ________ day of ___________________ 2026.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this ________ day of ________________________________ 2026, 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:

[redacted]

Receipt No.

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