

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 1-385-939-968
	)	
	)	
Petitioners.	)	DECISION
_____	)	

(Petitioners) protested the Notice of Deficiency Determination (Notice) dated March 10, 2023. Petitioners disagreed with the Income Tax Audit Bureau’s (Bureau) adjustments resulting from the determination that their businesses were not engaged in for profit. The Tax Commission reviewed the matter and for the reasons stated below upholds the Notice.

**BACKGROUND**

Petitioners filed their 2019, 2020, and 2021 Idaho individual income tax returns, claiming losses from their Schedule C business activities. The Bureau contacted Petitioners to examine their 2019 through 2021 Idaho income tax returns. The Bureau requested information and documentation from Petitioners. Petitioners provided some, but not all of the information the Bureau requested. The Bureau reviewed Petitioners’ information, including their responses to a “Business Activity/Hobby Loss Analysis” questionnaire, and determined that Petitioners did not engage in their businesses, and for profit, but rather conducted their activities as hobbies. The Bureau disallowed Petitioners’ losses claimed on both Schedule Cs. The Bureau sent Petitioners a Notice which Petitioners protested.

The Bureau acknowledged Petitioners’ protest and referred the matter to the Tax Commission’s Appeals Unit (Appeals) for administrative review. Appeals sent Petitioners a letter explaining the options available for redetermining a Notice. Petitioners responded but did not

provide additional information or request an informal hearing. Petitioners submitted a letter to Appeals, stating: “we have never had the luxury of a professional advisor to tell us what we can and cannot deduct” and “we relied on our own interpretations of the questions being asked of us by the software we utilized.” The Tax Commission issues its decision based on the information available.

### ISSUE

The issue on appeal is whether Petitioners met their burden of showing they were engaged in a trade or business for profit during the tax years at issue allowing them to deduct the ordinary and necessary business expenses they claimed on Schedule Cs ( ) and pursuant to Internal Revenue Code (I.R.C.) section 162.

### LAW AND ANALYSIS

#### Deductions for Activities Engaged in For Profit Under IRC section 162.

A taxpayer is allowed a deduction for all ordinary and necessary expenses paid or incurred in carrying on a trade or business pursuant to I.R.C. section 162(a). To qualify for a Section 162 deduction, an item must be:

- (a) paid or incurred during the taxable year,
- (b) for carrying on any trade or business,
- (c) an expense,
- (d) a necessary expense, and
- (e) an ordinary expense.

*Ellis Banking Corp. v. Comm’r*, 688 F.2d 1376, 1378 (11th Cir. 1982).

A trade or business expense is “ordinary” if it is normal or customary within a particular trade, business, or industry. *Hart v. Comm’r*, T.C. Memo. 2013-289, 2013 WL 6800281 at \*2. An expense is “necessary” if it is appropriate and helpful for the development of the taxpayer’s business. *Id.* An expense may only be deducted under Section 162 if it is made primarily in a

furtherance of a bona fide profit motive activity, independent of tax consequences. *Green v. Commissioner*, 507 F.3d 857, 871 (5th Cir. 2007). Expenses of a personal nature are not deductible under Section 162. *Marcello v. C.I.R.*, 380 F.2d 499, 504 (5th Cir. 1967).

The taxpayer must be able to demonstrate that she is carrying on a trade or business for profit to be allowed expenses under Section 162. *Fischer v. United States*, 336 F. Supp. 428, 431 (E.D. Wis. 1971), *aff'd*, 490 F.2d 218 (7th Cir. 1973). Whether a taxpayer is carrying on a trade or business within Section 162 is a question of fact to be inferred from examination of the facts and circumstances of the case. *Id.*

#### Deductions for Activities Not Engaged in For Profit Under IRC section 183

I.R.C. section 183 establishes that if an activity is found to be “not engaged in for profit,” then losses are only deductible to the extent of the income earned by the hobby and cannot be used to offset other income. I.R.C. § 183(a)–(b). Section 183 generally applies to high-earning taxpayers attempting to reduce their tax liability by reporting losses from extravagant “side jobs” without a bona fide profit motive. *Losantiville Country Club v. C.I.R.*, 906 F.3d 468, 473 (6th Cir. 2018). The taxpayer bears the burden of persuasion to show that the activity is for profit, with the taxpayer’s statement of intent given less weight than objective facts of case. *Burger v. C.I.A.*, 809 F.2d 355 (7th Cir. 1987). The following nine factors established by Treasury Regulation section 1.183-2(b) are used to distinguish between for-profit activities eligible for Section 162 deductions, and not-for-profit hobbies limited to deductions under Section 183, with no one factor being determinative.

1. The manner in which the taxpayer carries on the activity;
2. The expertise of the taxpayer or his or her advisers;
3. The time and effort expended by the taxpayer in carrying on the activity;
4. The expectation that the assets used in the activity may appreciate;
5. The success of the taxpayer in carrying on other similar or dissimilar activities;
6. The taxpayer’s history of income or losses with respect to the activity;

7. The amount of occasional profits, if any, which are earned;
8. The financial status of the taxpayer; and
9. Elements of personal pleasure or recreation.

Treas. Reg. § 1.183-2(b).

Taxpayers are required to keep permanent books of accounts or records that are sufficient to allow the Tax Commission to determine the taxpayer's correct amount of income, credits, and deductions, and other matters reported on tax returns. I.R.C. § 6001; Treas. Reg. § 1.6001-1(a). If a taxpayer fails to produce adequate records supporting information shown on a tax return, the deduction or credit is not allowed. *Burnet v. Houston*, 283 US. 223, 51 S.Ct. 413 (1931).

The Tax Commission has reviewed Petitioners' responses to the questionnaire but does not find it persuasive in showing Petitioners engaged in their businesses with the primary motive of making a profit. Neither of Petitioners' businesses, \_\_\_\_\_ or \_\_\_\_\_ generated a profit. Mrs. \_\_\_\_\_ has been reporting her photography business on Schedule C since 2009. Total losses from her \_\_\_\_\_ business since 2009 are over \$400,000, of which \$150,763 is for the tax years 2019 through 2021. Total income from her \_\_\_\_\_ business is \$300. Mr. \_\_\_\_\_ has been reporting his \_\_\_\_\_ business on Schedule C since 2009. Total losses from his \_\_\_\_\_ business since 2009 are over \$300,000, of which \$140,770 is for the tax years 2019 through 2021. Total income from his \_\_\_\_\_ business is \$1,500. Total losses from both businesses are over \$700,000, of which \$291,533 is for the tax years 2019 through 2021. Total income from both businesses is \$1,800. A record of substantial losses with minimal income whatsoever is persuasive evidence that Petitioners did not expect to make a profit from the activity.

Petitioners were asked to explain the time and effort expended by the taxpayer in carrying on the activity. Mrs. \_\_\_\_\_ explained in her response, regarding her \_\_\_\_\_ business, that she "devoted approximately 20-30 hours per individual \_\_\_\_\_ session..." although she did not

specify the number of hours that she spent a day or week, to earn the gross receipts of \$150 for 2019, and \$75 for each of 2020 and 2021. If the price per session was \$75, she would have spent up to 60 hours for the entire year of 2019, and 30 hours for each of 2020 and 2021. Mr.

provided his response for his business and explained that he “devoted on average approximately 10 hours each week towards maintaining my skill, rehearsing, meeting with clientele along with educational courses” to earn total gross receipts of \$1,500 for all three years. Additionally, both Petitioners held wage earning jobs in each tax year that presumably required significant time. In 2019, 2020 and 2021, Petitioners reported \$130,408, \$133,358, \$147,754 for total wages, respectively, and total gross receipts of \$1,800 from both businesses for all three years.

Petitioners were asked to provide business plans, financial projections, or profitability analysis. Petitioners explained that they promoted their businesses via social networking and vehicle stickers for which they spent \$27,676 for Mrs. business and \$23,764 for Mr. business for all three years although they provided no substantiations for the advertising expenses claimed on their Schedule Cs. After experiencing cumulative losses, totaling over \$400,000 since 2009, Mrs. stated in her response: “Because I have experienced losses each year, I no longer do as a business”.

Taking into consideration the relevant factors under Treas. Regs., the Tax Commission concludes that Petitioners did not engage in the Schedule C activities with a bona fide profit objective within the meaning of I.R.C. section 183.

Even if Petitioners Had a Profit Motive, They Did Not Produce Sufficient Records to Substantiate Their Deductions.

If Petitioners had engaged in their activities for profit, the expenses up to the amount of gross receipts would be allowed if adequately substantiated. Petitioners provided some documentation to substantiate the expenses claimed. However, this documentation was not

adequate; it did not list the percentage of business use. Additionally, the information submitted did not match the totals on the return. For most of the expenses, Petitioners did not provide any invoices or receipts.

A Notice issued by the Tax Commission is presumed to be accurate. *Parsons v. Idaho State Tax Commission*, 110 Idaho 572, 574-575 n.2, 716 P.2d 1344, 1346-1347 n.2 (Ct. App. 1986). The burden is on Petitioner to show the deficiency is erroneous. *Albertson's, Inc. v. State, Dept. of Revenue*, 106 Idaho 810, 814, 683 P.2d 846, 850 (1984). Deductions and credits are a matter of legislative grace. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 54 S.Ct. 788 (1934). As with all claimed tax credits, the taxpayer bears the burden of showing that he is entitled to the credit. *United Stationers, Inc. v. United States*, 163 F.3d 440, 443 (7th Cir. 1998) (citing *Interstate Transit Lines v. Commissioner of Internal Revenue*, 319 U.S. 590, 593, 63 S.Ct. 1279 (1943)). The burden to show that claimed deductions come clearly within the scope of the statute rests upon taxpayer. *Int'l Trading Co. v. Comm'r*, 275 F.2d 578, 584 (7th Cir. 1960).

The Tax Commission finds that Petitioners did not meet their burden of proving error in the Notice.

### **CONCLUSION**

The Tax Commission found Petitioners did not engage in their Schedule C activities, and for profit; therefore, the losses claimed on their Schedule C activities are not allowable. 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 April 17, 2024.

THEREFORE, the Tax Commission AFFIRMS the Notice dated March 10, 2023, 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	\$6,881	\$1,012	\$960	\$8,853
2020	6,876	1,032	758	8,666
2021	5,749	862	512	7,123
			TOTAL DUE	<u>\$24,642</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.

---

---