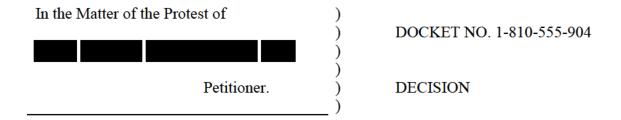
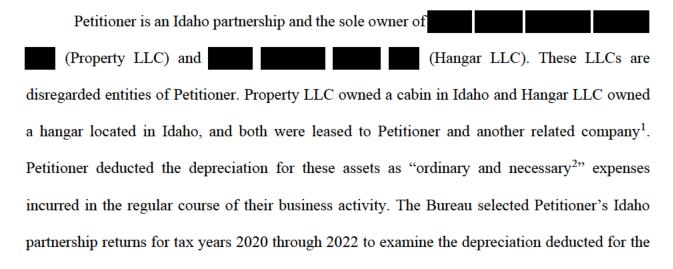
BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO



Determination (Notice) dated May 9, 2024, issued by the Income Tax Audit Bureau (Bureau) for tax years 2020 through 2022. Petitioner disagreed with the Bureau's disallowance of the depreciation for a cabin and a hangar owned by Petitioner. The Idaho State Tax Commission (Tax Commission) reviewed the matter and for the reasons stated below upholds the Notice. Since Petitioner is a flow-through entity, Petitioner's shareholders are liable for any additional tax, penalty, and interest.

BACKGROUND



² Internal Revenue Code (IRC) section 162

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^{1 &}quot;License Agreement" for the cabin between Lease Agreement" for the hangar between liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "License Agreement" is a limited liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability company, managed by two shareholders of Petitioner, and "Hangar liability liability

cabin and the hangar, specifically whether the use of these assets is for business purposes or entertainment/recreational purposes. In a letter to the Bureau, Petitioner explained they purchased the cabin to have "a location to host off-site meetings with customers, key employees, and strategic vendors where relationships could be built beyond those generally established in an office setting." As for the purchase of the hangar, the representative explained that "...it has provided an alternative storage location for the company aircraft and has allowed us to accommodate our guests who would otherwise experience great inconveniences to travel to our relatively remote Idaho headquarters." Based on the information provided by the representative, the Bureau determined that Petitioner did not use the cabin and hangar for business purposes but rather used them for entertainment purposes. Therefore, the Bureau disallowed the federal depreciation deduction taken on the cabin and the hangar, which resulted in the adjustments to Idaho bonus depreciation additions and subtractions.

The Bureau also reviewed the Idaho investment tax credit (ITC) and found that Petitioner claimed ITC on a shop and shed. The Bureau determined these to be non-qualifying assets and disallowed the ITC. After making these adjustments, the Bureau issued a Notice. Petitioner agreed with the Bureau's ITC adjustment; therefore, the Tax Commission will not address it any further in this decision.

In response to the Notice, Petitioner's representative argued that "... the purpose of the purchase and operation of these properties³ meet the criteria of an allowable deduction under Internal Revenue Code (IRC) § 162 as 'ordinary and necessary' and the Treasury Regulation 1.274-2(e)(2) does not apply. Because of the constituted business use, a depreciation deduction is

³ The cabin and the hangar.

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allowable under IRC § 167(1)(1)." In addition to the protest, the representative provided additional information regarding the depreciation of the cabin and the hangar. The Bureau reviewed the information and determined that it didn't warrant any modification to the Notice. The Bureau acknowledged the protest and referred the matter to the Tax Commission's Appeals Unit (Appeals) for administrative review.

Appeals sent Petitioner and the representative a letter explaining the options available for redetermining a Notice. The representative responded and provided more information supporting Petitioner's business use of the cabin and the hangar but did not request an informal hearing. Having reviewed the file, the Tax Commission hereby issues its final decision.

LAW AND ANALYSIS

Internal Revenue Code (IRC) section 162 provides for the deduction of all the ordinary and necessary expenses paid or incurred in carrying on a trade or business. 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 business⁴. A necessary expense is one that is appropriate and helpful in the development of the business⁵. The test for determining whether an expense is ordinary and necessary is whether a "hard-headed" businessperson, under the circumstances, would have incurred the expense. *Union Ganadera Reg'l de Chihuahua, Inc. v. Commissioner*, 80 T.C.M. (CCH) 723, T.C. Memo. 2000-357. "Trade or business" is used often in IRC, but the term is not specifically defined as it relates to section 162. The Tax Court, in its decision, *Comm'r v.*

⁴ Deputy v. Du Pont, 308 U.S. 488,495 (1940)

⁵ Commissioner v. Heininger, 320 U.S. 467, 471 (1943)

Groetzinger, stated, "... to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit."

IRC section 274 imposes two requirements for "entertainment expenses" to be deductible Subsections (A) and (B) of IRC section 274(a)(1) provide that no deduction shall be allowed for:

- (A) Activity With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or
- (B) Facility With respect to a facility used in connection with an activity referred to in subparagraph (A).

Treasury Regulation section 1.274-2(b)(1) in pertinent part provides the following definition of the term "entertainment":

... any activity which is of a type generally considered to constitute entertainment, amusement, or recreation, such as entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips, ...

Treasury Regulation section 1.274-2(e)(2)(i) defines "facilities used in connection with entertainment" in general as follows:

Any item of personal or real property owned, rented, or used by a taxpayer shall ... be considered to constitute a facility used in connection with entertainment if it is used during the taxable year for, or in connection with, entertainment (as defined in paragraph (b)(1) of this section). Examples of facilities which might be used for, or in connection with, entertainment include yachts, hunting lodges, fishing camps, swimming pools, tennis courts, bowling alleys, automobiles, airplanes, apartments, hotel suites, and homes in vacation resorts.

Treasury Regulation section 1.274-2(e)(4)(i) provides "determination of primary use" as:

A facility used in connection with entertainment shall be considered as used primarily for the furtherance of the taxpayer's trade or business only if it is established that the primary use of the facility during the taxable year was for purposes considered ordinary and necessary within the meaning of sections 162 and 212 and the regulations thereunder. All of the facts and circumstances of each case shall be considered in determining the primary use of a facility. Generally, it is the actual use of the facility which establishes the

deductibility of expenditures with respect to the facility; **not its availability for use** and not the taxpayer's principal purpose in acquiring the facility. Objective rather than subjective standards will be determinative... (emphasis added)

...The factors to be considered include the nature of each use, the frequency and duration of use for business purposes as compared with other purposes, and the amount of expenditures incurred during use for business compared with amount of expenditures incurred during use for other purposes. No single standard of comparison, or quantitative measurement, as to the significance of any such factor, however, is necessarily appropriate for all classes or types of facilities...

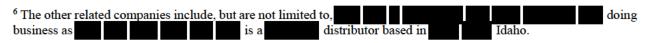
These subsections require the Tax Commission make four determinations with regard to Petitioner's expenses: (1) whether the activity is entertainment; (2) whether the cabin and the hangar are entertainment facilities; (3) whether the facility was used primarily for the furtherance of Petitioner's trade or business; and (4) whether the activity was "directly related" to the active conduct of Petitioner's trade or business, and finally, the Tax Commission must determine whether any of the exceptions provided in IRC section 274(e) are applicable to Petitioner.

Petitioner's federal Form 1065 describes their primary business activities as "building leasing", and the representative explained in a letter that:

The Property LLC and Hangar LLC are acting as cost centers in the enterprise but are an important component in generating sales and income **for other related companies**. When the costs of these properties are spread over the enterprise it makes more sense as to why a "hardheaded" businessperson would invest in such a property. In the period of 2020-2023 the enterprise has seen an increase in topline revenue go from 1.5 billion to 4.3 billion. Some of that increase is due to the vendor events held at this property. (emphasis added)

Petitioner argued that the cabin and the hangar contributed to the furtherance of their related companies' trade or business⁶, which also contributed to Petitioner's "building leasing" business.

To support Petitioner's position, the representative provided a log for the cabin usage (property



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log), showing the dates of stays, a short description of the usage, the number of days for the preparation/clean-up per stay, as well as the number of maintenance days.

	<u>2021</u>	<u>2022</u>	<u>2023</u>
Rental Days	23	35	26
Preparation/Cleanup	23	21	22
Non-billed Business Use	30	30	27
Maintenance	13	21	21
Personal	6	12	8
Total Days Used	95	119	104

The property log describes "Rental Days" as those for retreats (e.g., sales retreat, seasonal executive retreat, etc.) and vendor appreciation events, for which Petitioner received rents from its related companies. "Non-billed Business Use" were for Petitioner's shareholder/board meetings, and "sales events" for the related company. Petitioner spent a day or two for "Preparation/Cleanup" before or after "Rental Days" and "Non-billed Business Use" days. Although the representative provided the property log, it did not explain whether the rental days were for business purposes or entertainment/recreation purposes.

Treasury Regulation section 1.274-2(e)(4)(iii)(b) states in pertinent part,

A facility for employees not falling within the scope of section 274(e)(2)⁸ or (5)⁹ was used primarily for the furtherance of his trade or business if he establishes that more than 50 percent of the total calendar days of use of the facility by, or under authority of, the taxpayer during the taxable year were dates of business use.

Any use of a facility...during one calendar day shall be considered to constitute a "day of business use" if the primary use of the facility on such day was ordinary and necessary within the meaning of section 162 or 212 and the regulations thereunder...

(emphasis added)

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an S-Corp, filed its own Idaho return for tax year 2020. During tax year 2021, another S-Corp., acquired were owned by and several other shareholders who are also the shareholders of Petitioner.

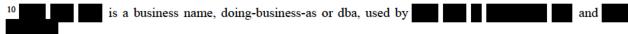
⁸ IRC section 274(e)(2) Expenses treated as compensation.

⁹ IRC section 274(e)(5) Employees, stockholder, etc., business meetings.

The Tax Commission reviewed "Rental Day" and "Non-billed Business Use" to determine whether these days were for Petitioner's "business use", and whether Petitioner's use of the cabin was ordinary and necessary within the meaning of IRC sections 162 or 212.

Rental Days

Appeals requested the representative provide the schedules for several of the "Rental Days" during tax year 2023. The schedules the representative provided do not describe who the participants were, and some of the schedules do not correspond to the dates on the property log. The property log describes that used the cabin for "East Sales Retreat" for four days, but the schedule indicates the stay was only for three days, starting in the afternoon, followed by settling in and dinner at the cabin. The second day of the retreat was for white water rafting in Wyoming, in the morning and "cabin time¹¹" in the afternoon. On the third day, participants departed from the cabin. also used the cabin several times for "vender appreciation" events during 2023. One of the vendor appreciation events was for and The schedules for both events had the identical dates and schedules, the other was for arriving at the cabin in the afternoon of July 24, 2023, settling in and dinner at the cabin, and followed by "enjoy the cabin amenities", such as bowling alley, golf simulator, driving range/putting green, etc. Based on the descriptions provided in the schedules, there is no question that the cabin is an entertainment/recreational facility. It is also clear that



The cabin has movie theater, golf range, golf simulator, training gym, etc. inside, and is surrounded with golf course, putting green, river, walking paths, etc.

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is a company, owns and operates produces and sells and products, and operates products, and operates products, and operates products. It is a producer mostly involved in manufacturing and marketing transportation and other related operations are managed through three main segments:

Petitioner's related companies ¹⁴, rented the cabin from Petitioner primarily for the furtherance of their business. Petitioner did not use the cabin for their own entertainment/recreational purposes; however, for their "building leasing" business to earn income or profit, they rented the cabin out to Therefore, the "Rental Days" where Petitioner rented the cabin to are determined to be for business use. But whether they are entitled to a deduction will be addressed later in this decision.

In addition to renting the cabin to their related entity, Petitioner used the cabin for their "Executive Leadership Retreat" each winter and summer for the years under review, and these executive retreats are listed under "Rental Days". The schedule for August 2023 lists "leadership trainings" for two hours in the morning on the first day; however, there is no training agenda look. The schedule indicates that "trainings" are optional as it describes attire for training as "Professional Dress if attending meetings, lake attire if not." The schedule for the afternoon on the first day includes "Boating on the followed by dinner at the cabin, "The Money Game", and "Enjoy the cabin amenities". The second day's agenda is similar to the first day: "Leadership Training/Floral Arrangement" for two hours in the morning, "Razor Ride" in the afternoon and then "Depart for home". The Tax Commission finds the activities for the retreats constitute entertainment, amusement, or recreation and are therefore the days Petitioner used the cabin for "Executive Leadership Retreat" do not constitute a "day of business use." Therefore, the

and Petitioner are owned by the same shareholders.

The property log shows total 8 days of executive leadership retreats for each tax year.

¹⁶ Generally, a training agenda would consist of a list of topics, action items and activities/subject for discussion, reference material, expected outcomes, etc.

¹⁷ The schedule provides attire: "swimsuit, swim shoes or ones you don't mind getting wet", instructing to pack sunscreen and snacks.

¹⁸ The dress attire for the 2nd day of the "Executive Leadership Retreat" is "Professional dress if attending meetings", and "Comfortable clothes if attending the floral arrangement class."

¹⁹ Razor designs and manufactures manual and electric scooters, bicycles, and personal transporters (i.e., ATV, Gocarts, motorcycles, hoverboards, etc.)

Tax Commission will not include Petitioner's executive leadership retreats as "business use" when determining the percentage of total calendar days Petitioner used the cabin for their business later in this decision.

Non-billed Business Use

The property log shows that Petitioner used the cabin for "Shareholder²⁰/Board²¹ Meeting" several times during the tax years under review. However, there is no agenda or minutes regarding any of the shareholder meetings or the board meetings for tax years 2020-2022. While the representative provided a summary of the topics and discussions that took place on the dates described as "Shareholder/Board Meeting", the summary is not sufficient to prove that Petitioner used the cabin for business purposes. Therefore, the Tax Commission will not include Petitioner's executive leadership retreats as "business use" when determining the percentage of total calendar days Petitioner used the cabin for their business later in this decision.

In addition to the shareholder/board meetings, the "Non-billed Business Use" included days used for "Sales tram", "Sales tram" and "Exec.", which appear to be like the other "Rental Days", except that Petitioner did not bill their related entities for use of the cabin. For the cabin to be considered used primarily for Petitioner's business, Petitioner must engage in the activity for income or profit. Since Petitioner did not bill their related companies for

²⁰ Generally, a shareholder meeting would be held annually, gathering shareholders and board members to discuss business matters, review financial statements, address resolutions, etc. A shareholder meeting agenda should describe all topics for discussion, and all discussions would be recorded in corporate minutes. As for a board meeting, the frequency of board meetings would depend on the needs of the corporation and the preferences of the directors. There is no minimum number of board meetings required by law, but directors should meet often enough to fulfill their

duties. Some boards may meet monthly, while others may meet quarterly or less often.

²¹ Generally, a board meeting agenda would start with a call to order, and followed by opening forum, approval of minutes, reports, discussion of unfinished businesses and new businesses, remarks, announcements, other businesses, etc., and its minutes would describe meeting date, time and location, names and titles of attendees, board approvals, resolutions, acceptance of reports, overview of discussion, etc.

the use of the cabin, the days used for "Sales tram", " and "

Exec.", are not considered business use. Therefore, the Tax Commission will not include these days when determining the percentage of total calendar days Petitioner used the cabin for their business.

Calculation of business use days

Based on the number of the days listed in Petitioner's property log, the Tax Commission calculated the percentage of the days Petitioner used the cabin for their "building leasing" business.

2021 Total Rental Days		23
Less:		
Feb 7-10 Winter Executive Retreat		4
Aug 15-18 Summer Executive Retreat	_	4
Total rental days for business use	a	15
Total days used	b	95
Percentage of rental days for business use	a/b	15.8%
2022 Total Rental Days		35
Less:		
Feb 6-9 Winter Executive Retreat		4
Aug 15-18 Summer Executive Retreat		4
Total rental days for business use	a	27
Total days used	b	119
Percentage of rental days for business use	a/b	22.7%
2023 Total Rental Days		26
Less:		
Feb 5-8 Winter Executive Retreat		4
Aug 14-17 Summer Executive Retreat		4
Total rental days for business use	a	18
Total days used	b	104
Percentage of rental days for business use	a/b	17.3%

In its calculation, the Tax Commission included the days Petitioner rented the cabin out to and excluded the days used for Petitioner's executive retreats, which resulted in less than 50% of the total calendar days of business use of the cabin for each tax year²². Therefore, the Tax Commission finds the deduction of the federal depreciation regarding the cabin is not an allowable business expense.

As for the hangar, the representative provided the lease agreement between and and explained, "[t]he airport and hangar have proven to be an unexpected benefit for the business as it has provided an alternative storage location of the company aircraft and has allowed us to accommodate our guests who would otherwise experience great inconveniences to travel to our relatively remote Idaho headquarters." However, there is no clear and convincing evidence proving that the hangar was used primarily for the furtherance of Petitioner's trade or business or the usage of the hangar is "directly related" to the active conduct of Petitioner's trade or business. Therefore, the Tax Commission determined that the deduction of the federal depreciation for the hangar is not an allowable business expense.

CONCLUSION

The Tax Commission determines that the federal depreciation regarding the cabin and the hangar is not an allowable business expense as the Tax Commission finds the primary use of these assets is not related to Petitioner's trade or business.

²² For tax year 2021, the ratio of 15 Rental Days in 95 total calendar days of use of the cabin is 15.8%. For tax year 2022, the ratio of 27 Rental Days in 119 total calendar days of use of the cabin is 22.7%. For tax year 2023, 18 Rental Days in 104 total calendar days of use of the cabin is 17.3%

THEREFORE, the No	otice dated Ma	ay 9, 2024, and directed to		
is AFFIRMED. Since Pe	etitioner is a flo	w-through entity, the addition	onal tax due f	lows through
to its shareholders. Therefore	, no demand or	r order for payment is neces	sary.	
An explanation of Pet	itioner's right	to appeal this decision is en	closed.	
DATED this	_day of	202	25.	
		IDAHO STATE TAX CO	MMISSION	

CERTIFICATE OF SERVICE

I hereby certify that on this a copy of the within and foregoing DECIS mail, postage prepaid, in an envelope addre	ION was se	rved by sending the same by Unite	2025, d States
		Receipt No.	