

they claim and providing records upon request, and that not providing requested information may result in denial of claimed deductions. Audit indicated that all the deductions for business expenses on Petitioners' 2021, 2022, and 2023 Schedule C were being denied because Petitioners did not provide all the records Audit requested.

In response to the Notice, Petitioners provided additional documents Audit had requested along with responses to questions Audit had asked via email. Audit reviewed these and replied to Petitioners' email indicating no change to the determination in the Notice. Audit acknowledged receipt of the additional information and then commented on Mrs. [REDACTED] employment with [REDACTED] [REDACTED] [REDACTED] [REDACTED] ([REDACTED] [REDACTED]). Audit stated that [REDACTED] [REDACTED] issued her a W-2 , but the statutory employee box was not checked. Audit also stated that the expenses claimed on Schedule C were incurred for her job and were unreimbursed employee expenses which are currently deductible only to a few select categories of employees. Mrs. [REDACTED] does not fall into any of the described groups and is therefore not eligible to claim unreimbursed employee expenses.

Petitioners and AIF sent formal written protests, stating that they provided documentation as requested and that Mrs. [REDACTED] status as a statutory employee was reviewed by the IRS in 2009, after which review the IRS granted the request to be allowed to file as a statutory employee even though [REDACTED] [REDACTED] will not check the appropriate box on her W-2. They requested a redetermination by a "higher power" at the Tax Commission.

Audit sent letters acknowledging the protest and indicating that the matter was being forwarded to the Tax Commission's Appeals unit (Appeals). Appeals sent AIF and Petitioners letters outlining the options available for redetermining a protested Notice but received no response. Appeals sent a follow-up email to AIF and Petitioners, again receiving no response. The Tax Commission must therefore make a decision based on the information currently available.

Issues

The issues in this case are: What is Mrs. [REDACTED] status as a worker; is Mrs. [REDACTED] eligible to claim deductions for business expenses; and if so, how much?

Law & Analysis

Generally, an individual receiving compensation for providing services to a company or business can fall into one of three categories: independent contractor, common-law employee, or statutory employee.

A statutory employee is an independent contractor who is treated as an employee for certain tax purposes. The payor is required to withhold Social Security and Medicare taxes but is not required to withhold income taxes. Statutory employees may or may not participate in benefit programs like insurance and retirement programs, depending on the preferences of the payor. Only an individual who falls into one of four roles and meets three additional conditions can be considered a statutory employee¹. Those roles are:

- A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is the employer's agent or is paid on commission.
- A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- An individual who works at home on materials or goods that the employer supplies and that must be returned to the employer or an agent if the employer also furnishes specifications for the work to be done.
- A full-time traveling or city salesperson who works on the employer's behalf and turns in orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed must be the salesperson's principal business activity.

¹ See Internal Revenue Code section 3121(d)(3) and Treasury Regulations section 31.3121(d)-1

The three other conditions to be met are:

- The service contract implies or states that the worker will perform the services himself.
- The worker does not have significant investment in equipment or property used for the job, except transportation.
- The services are performed on a consistent basis for the same employer.

Mrs. [REDACTED] is a salesperson for [REDACTED] [REDACTED] a company which sells supplies, equipment, services, and software to dental and orthodontic offices. She covers a region that includes much of southwestern Idaho and extends into eastern Oregon. She works full-time and only for [REDACTED] [REDACTED] and she has no other significant income. She completes the work herself and the only significant investment in equipment, etc., is her car. The Tax Commission has determined therefore, that Mrs. [REDACTED] meets the criteria to be a statutory employee, even though her W-2 does not indicate that status.

In 2009, the IRS examined deductions claimed for business expenses on Petitioners' 2006 Schedule C. That year, and every year since 2006, Petitioners have reported Mrs. [REDACTED] wages on the appropriate line on Form 1040 and claimed deductions on Schedule C against the wages reported on Form W-2. The results of that federal audit were a reduction in total deductions, but not an outright denial. From this information, the Tax Commission concluded that the IRS also determined that Mrs. [REDACTED] met the criteria to be considered a statutory employee. Audit requested a copy of the IRS determination, but Petitioners were unable to locate it. This does not come as a surprise, as the determination was issued over 15 years ago.

Statutory employees can claim ordinary and necessary business expenses on Schedule C against the compensation (wages) they receive from the employer. For a statutory employee, these are not "unreimbursed employee expenses" as Audit suggested. Statutory employees are self-employed contractors who are treated as employees for certain employment taxes. Statutory

employees report income as wages and then are allowed to claim ordinary and necessary business expenses on Schedule C. As a statutory employee, Mrs. [REDACTED] is allowed to claim deductions on Schedule C for such business expenses.

After reviewing the business expenses Petitioners reported on Schedule C, the Tax Commission finds the amounts reported for tax years 2021, 2022, and 2023 to be reasonable and consistent with prior years with one exception. For tax year 2021, under shipping expenses, Petitioners reported a deduction of \$22,962. Based on documents AIF provided, this represents the full amount of shipping costs Mrs. [REDACTED] paid in connection with her work. In other years, Mrs. [REDACTED] reported a deduction equal to 25% of her total shipping costs. The Tax Commission determined that the deduction should be \$5,741 to be consistent with other years. In correspondence with Audit, Mrs. [REDACTED] agreed with that amount.

Audit added interest to Petitioners' tax deficiency. The Tax Commission reviewed this addition and finds it to be appropriate and in accordance with Idaho Code section 63-3045.

Audit also added a negligence penalty to Petitioners' tax deficiency because the returns in question contained unsubstantiated claims and/or substantial errors. The Tax Commission reviewed this addition and finds that enough information exists to substantiate Petitioners' eligibility to claim the deductions that were the subject of the adjustments in the Notice and that the remaining error is not substantial enough to warrant a negligence penalty. Therefore, the Tax Commission removed the penalty.

Conclusion

Mrs. [REDACTED] is a statutory employee eligible to deduct ordinary and necessary business expenses on Schedule C. The Tax Commission found the deduction reported for shipping expenses on Petitioners' 2021 Schedule C to be excessive but all others to be reasonable.

THEREFORE, the Notice dated February 10, 2025, and directed to [REDACTED] is hereby MODIFIED for tax year 2021, CANCELLED for tax years 2022 and 2023, and MADE FINAL.

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>
2021	\$1,119	\$0	\$144	\$1,263

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 _____ 2025.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2025,
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.

[REDACTED]