



The Bureau requested Petitioners provide documentation supporting the rental income and expenses, including documentation for purchase of the rental properties, rental agreements, and an explanation of how they used certain assets in the rental activities. Petitioners provided profit and loss statements for the rental activities, but none of the other requested information. Therefore, the Bureau disallowed the rental expenses and issued a Notice.

Petitioners appealed and provided a few receipts for some of the expenditures. The Bureau reviewed the information submitted and found it did not support Petitioners' claims. In pertinent part, the documentation provided showed Petitioners didn't pay for the expenses referenced by the receipts. Instead, Petitioners' family paid for the expenses. For example, a garage door apparently for the \_\_\_\_\_ property was billed to \_\_\_\_\_ and a washer and dryer was billed to \_\_\_\_\_. Additionally, Petitioners didn't provide documentation for purchase of the rental properties, rental agreements, or an explanation of how they used certain assets in the rental activities.

### **LAW AND ANALYSIS**

Taxpayers can deduct from gross income certain business expenses. Internal Revenue Code (IRC) section 162. Expenditures may only be deducted under IRC 162 if the facts and circumstances indicate that the taxpayer made them 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).

The tax law specifically disallows deductions for personal, living, and family expenses. IRC section 262. A payment of another person's obligation does not result in a tax deduction for either person. The person making the payment cannot deduct expenses that are not related to his

or her business or production of income activities because the payment lacks a business purpose. Reg. section 1-162-1.

In reaching this decision, the Tax Commission notes the following: (1) There is evidence to suggest Petitioners rented one the properties to a family member at below market rent; (2) Petitioners may own one or more of the rental properties in conjunction with family members or family trusts; and (3) Petitioners may have converted one or more of the properties from a rental to personal use or vice versa.

In seeking to pay the minimum amount of tax, taxpayers often structure transactions that may not reflect economic reality. In many such cases, the transaction is not given any tax effect, because the transaction is deemed not to conform with the arm's length transaction concept. An arm's length transaction is one in which all parties have bargained in good faith and for their individual benefits, not for the benefits of the transaction group. Transactions that are not made at arm's length are generally not given any tax effect or not given the intended tax effect. Transactions that are not made at arm's length generally involve an element of self-dealing. The tax law has formally incorporated the notion of self-dealing through a set of related party provisions. IRC section 267.

In general, the Tax Commission's determination of a taxpayer's liability in a notice of deficiency is presumed correct, and the taxpayer bears the burden of proving that the determination is incorrect. *Welch v. Helvering*, 290 U.S. 111, 115 [12 AFTR 1456] (1933). Deductions are a matter of legislative grace, and the taxpayer generally bears the burden of proving entitlement to any deduction claimed. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 [13 AFTR 1180] (1934). A taxpayer must substantiate deductions claimed by keeping and producing adequate

records that enable the Tax Commission to determine the taxpayer's correct tax liability. Idaho Code section 63-3024.

In the current case, the Tax Commission requires Petitioners to provide the following: (1) Receipts, lease agreements and other records showing total amount of rents received; (2) Explanation if rental units were occupied rent-free or below rental value during the year; (3) Total number of days rented and number of days used for personal purposes, including use by immediate and extended family members; (4) Evidence to verify ownership of the property; and (5) Canceled checks, credit card statements, and receipts to verify all expenses claimed. Petitioners have not provided the requested information. Therefore, the Tax Commission finds no basis on which to reverse the Bureau's determination.

The Bureau added interest and penalty to the income tax deficiency. The Tax Commission has reviewed those additions, found both to be appropriate per Idaho Code sections 63-3045 and 63-3046, and has updated interest accordingly. Interest is calculated through April 25, 2023 and will continue to accrue at the rate set forth in Idaho Code section 63-3045(6) until paid.

THEREFORE, the Notice of Deficiency Determination dated June 22, 2022 is hereby APPROVED, in accordance with the provisions of this decision, and is AFFIRMED 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>
2019	\$1,563	\$78	\$147	\$1,736
2020	3,807	190	228	4,118
				<u>\$6,013</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.

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Receipt No.

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