



Petitioner appointed another individual (Representative) to represent him in matters with the Tax Commission. Representative sent an email, stating that Petitioner was working with the IRS. Audit requested additional information. Petitioner provided a statement indicating he was working with the IRS to resolve the federal audit issues. He also provided a copy of a letter from the IRS stating that correspondence from Petitioner was being forwarded to a different office for processing.

Audit sent a letter on November 4, 2022, acknowledging the protest and requesting copies of all documentation provided to the IRS, along with regular updates at least every 40 days. No additional documentation was provided. One update was provided in February 2023 after Audit initiated contact. Another update was requested in April 2023, but Petitioner and Representative did not respond.

Audit transferred Petitioner's file to the Tax Commission's Appeals unit (Appeals) in August 2023. On October 24, 2023, Appeals sent Petitioner and Representative letters outlining the options available for redetermining a protested Notice. Representative responded by telephone on October 30, 2023. He explained that he had documentation supporting Petitioner's claim to his dependent children. He stated that it was never provided to the IRS, which is why the federal audit was closed. He was attempting to have the IRS redetermine the audit results.

Appeals requested and received from Representative copies of this documentation and determined that it was sufficient to support Petitioner's claim of two dependent children on his returns, as well as qualify him for the Head of Household filing status. Appeals subsequently requested and received from Representative a copy of the IRS Revenue Agent Report<sup>1</sup> and

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<sup>1</sup> A detailed document describing an IRS examiner's findings. Form 4549 shows any adjustments to income, deductions, tax, credits, other payments, etc. Form 886-A contains written explanations of the changes made to the taxpayer's federal return.

documentation of business expenses. The documentation received does not match the amounts claimed on Petitioner's Schedule C, so Appeals requested specific additional information to consider in redetermining the protested Notice. No additional response was received. Therefore, the Tax Commission renders its decision based on the information provided.

### **Law & Analysis**

Idaho Code section 63-3002 states that Idaho taxable income is to be identical to federal taxable income, except for modifications required or allowed by Idaho law. The IRS changed Petitioner's federal taxable income by disallowing his claim to two dependent children and disallowing business expenses claimed on Schedule C.

Petitioner stated he was contesting the IRS adjustments to his federal return and asked the Tax Commission to wait until the matter was fully settled with the IRS before making any adjustments to his Idaho return.

Generally, the Tax Commission follows a final federal determination whenever a change is made to a taxpayer's federal income tax return. However, in the recent past, due to the COVID pandemic, the Tax Commission has found it more expeditious to make its own determination on certain contested federal audits. This is one of those cases. The Tax Commission's decision to review Petitioner's documentation arose from the initial conversation between Representative and Appeals.

#### *Dependents*

During the conversation mentioned above, Representative stated that he could provide documentation proving that the dependents claimed on Petitioner's returns were his and that they lived with him during 2019. Representative submitted to Appeals two letters from the Nampa School District, one for each child. Each letter included the child's name, the name of the school

and the dates the child was enrolled during 2019, the address of record for the child, and the name of the parent or guardian on record. According to the documentation provided by Representative, this is the information that the IRS needed to verify that the children were Petitioner's qualifying children. Therefore, the Tax Commission determined that Petitioner is eligible to claim the children as dependents.

#### *Filing status*

To claim Head of Household filing status, a taxpayer must meet three criteria: they must be or be considered unmarried; they must have paid more than half of the cost of maintaining a household for the year; and they must have maintained a household for a qualifying person. Prior to tax year 2019, Petitioner had never filed an Idaho return with any indication that he was married; there is no indication that he was married in 2019. There is no indication that another person paid any of the costs to maintain the household, let alone more than half the cost. A qualifying child is a qualifying person, and Petitioner has two. Therefore, the Tax Commission determined that Petitioner is eligible for the Head of Household filing status.

Petitioner claimed the standard deduction amount for the Head of Household filing status on his 2019 return when he filed (\$18,350). The Tax Commission will also allow the same.

#### *Business income*

As is relevant to Petitioner's Schedule C activity, IRC section 1402 defines self-employment income as gross income derived from an individual's trade or business minus allowable deductions for expenses attributable to the trade or business. IRC section 162 allows taxpayers to claim a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business. A trade or business expense is "ordinary" if it is normal or customary within a particular trade, business, or industry, and "necessary" if it is appropriate and helpful for the

development of the taxpayer's business<sup>2</sup>. Expenses of a personal nature are not deductible under IRC section 162.<sup>3</sup>

On his 2019 Schedule C, Petitioner reported \$62,492 of gross receipts and the following deductions for expenses: \$14,874 for car and truck expenses; \$7,431 for depreciation and section 179 expense; \$8,772 for equipment; \$2,009 for other property; \$3,402 for supplies; and \$625 for fuel. He reported a net profit of \$25,379.

According to the IRS Revenue Agent Report Form 886-A, the examiner reviewed bank deposits related to Petitioner's landscaping business and verified eleven deposits ranging from \$4,290 to \$6,608 for a total of \$57,266.33. The examiner states, "we determined that the activity described on your Schedule C does not meet the guidelines of carrying on a trade or business within the meaning of IRC 162." Therefore, all business expenses were disallowed, and Petitioner's self-employment income was increased from \$25,379 to \$57,266.

"Trade or business" is used often in IRC, but the term is not specifically defined as it relates to section 162. In its decision in *Comm'r v. Groetzinger*<sup>4</sup>, the Supreme Court 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." In Petitioner's case, he began reporting income and expenses on Schedule C for his landscaping business in tax year 2015 and has claimed a net profit every year through tax year 2022, ranging from \$22,751 to \$43,838. Tax year 2019 has been the only year subject to IRS examination to date. Based on Petitioner's filing history, the Tax Commission determined that he

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<sup>2</sup> *Hart v. Comm'r*, T.C. Memo. 2013-289, citing *Deputy v. du Pont*, 308 U.S. 488, 495 [23 AFTR 808] (1940).

<sup>3</sup> *Marcello v. C.I.R.*, 380 F.2d 499, 504 (5<sup>th</sup> Cir. 1967)

<sup>4</sup> 59 AFTR 2d 87-532 (107 S.Ct. 980)

is engaged in a trade or business and is entitled to claim deductions for business expenses under IRC section 162.

Petitioner and Representative did not provide to Audit or Appeals copies of the information showing gross receipts that was provided to the IRS during the federal audit. Based on Petitioner's filing history, the gross receipts he reported for tax year 2019 are reasonable. It is not outside the realm of possibility that the IRS may have missed a deposit for Petitioner's landscaping business. The average of the eleven deposits accounted for is \$5,206. If that amount is added to the \$57,266 total verified by the IRS, the result is \$62,472, only \$20 less than the gross receipts Petitioner reported on his Schedule C. Therefore, in determining his net profit, the Tax Commission will use the \$62,492 gross receipts as reported on Schedule C.

As stated earlier, an individual engaged in a trade or business is entitled to claim ordinary and necessary business expenses. However, deductions are a matter of legislative grace, and the taxpayer bears the burden of proving that he is entitled to the deductions claimed<sup>5</sup>. Taxpayers are required to maintain records that are sufficient to enable the determination of their correct tax liability<sup>6</sup>. The burden rests upon the taxpayer to disclose his receipts and claim his proper deductions<sup>7</sup>. If a taxpayer is unable to provide adequate proof of any material fact upon which a deduction depends, no deduction is allowed, and that taxpayer must bear his misfortune<sup>8</sup>.

Representative provided Appeals with 85 separate legible receipts showing expenditures that could reasonably be related to Petitioner's landscaping business in tax year 2019. These included 6 receipts for parts and services related to a Ford F250 with a diesel engine, 23 diesel fuel

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<sup>5</sup> *New Colonial Ice Co., v. Helvering*, 292 US. 435, 440, 54 S.Ct. 788 (1934)

<sup>6</sup> IRC section 6001; Treasury Regulation section 1.6001-1(a)

<sup>7</sup> *United States v. Ballard*, 535 F.2d 400, 404 (1976)

<sup>8</sup> *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931)

receipts, 16 unleaded fuel receipts, and 40 receipts for other various items including lumber, plants, seeds, tools, equipment, and other supplies.

On his Schedule C, Petitioner reported that he drove 25,645 miles for business reasons (47.22%) and 28,659 miles for personal reasons (52.78%) in his Ford F250 during 2019. This indicates that he used the standard mileage rate of 58 cents per business mile. Appeals requested, but did not receive, information to verify the business and personal mileage accumulated during the year. In the absence of a mileage log or other documentation to verify the amount claimed, the Tax Commission turns to the receipts for actual expenses, namely truck parts and services and diesel fuel. In the absence of a better estimate of the percentage of business use, the Tax Commission allowed 47.22% of the documented expenses related to the Ford F250, a total of \$1,679.

Based on the receipts provided, the Tax Commission also allowed \$429 for fuel expenses and \$5,377 for all other expenses. Combined with car and truck expenses, this provides a total of \$7,485. Subtracting this total from gross receipts gives a net profit of \$55,007 – an increase of \$29,628.

#### *Self-employment tax deduction*

IRC section 1401 requires a separate tax on individuals' self-employment income. IRC section 164(f)(1) allows individuals to deduct from gross income an amount equal to one-half of the self-employment tax required by section 1401. Based on a net profit of \$25,379, Petitioner reported self-employment tax of \$3,586 and a deduction of \$1,793. The IRS increased Petitioner's net profit to \$57,266, his self-employment tax to \$8,091, and the resulting deduction to \$4,046. The Tax Commission determined that Petitioner's self-employment income was \$55,007, which

results in self-employment tax of \$7,772 and a deduction of \$3,886. This is an increase of \$2,093 to the deduction.

*Qualified business income deduction*

IRC section 199A allows a taxpayer to deduct from adjusted gross income an amount based on that taxpayer's qualified business income (QBI). Petitioner claimed a deduction of \$1,047 based on QBI of \$23,586<sup>9</sup>. The IRS increased the deduction to \$8,091 based on QBI of \$53,219. Using the same calculations as Petitioner and the IRS, the Tax Commission determined that Petitioner is entitled to a deduction of \$6,554 based on QBI of \$51,121. This is an increase of \$5,507 to the deduction.

*Idaho child tax credit*

Idaho Code section 63-3029L allows a non-refundable credit against Idaho tax of \$205 for each qualifying child of the taxpayer. Because the credit is non-refundable, it is limited by the amount of income tax on the return. Petitioner claimed a credit of \$195 on his 2019 Idaho return, because his income tax liability was \$195. He was unable to utilize the full amount of the credit available to him.

Since Petitioner had two qualifying children he could claim on his 2019 Idaho tax return, the maximum Idaho child tax credit he is entitled to is \$410. The adjustment to his taxable income increases his tax above \$410, so he is eligible for the maximum credit. Since he claimed \$195, he is therefore allowed an additional \$215 credit.

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<sup>9</sup> \$25,379 net profit minus \$1,793 deduction for self-employment tax

*Grocery credit*

Under Idaho Code section 63-3024A, Idaho residents who file a return when required and are not otherwise disqualified are allowed a credit of \$100 for the taxpayer, a spouse, and each dependent claimed on the return. Petitioner is eligible to claim three people on his return and is therefore allowed a \$300 credit. Since this is the amount he claimed, there is no adjustment for grocery credit.

*Interest and penalty*

The Bureau added interest and penalty to Petitioner's tax deficiency. The Tax Commission reviewed those additions and finds them to be appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046, respectively.

**Conclusion**

The IRS adjusted Petitioner's federal income tax return for 2019, disallowing Schedule C expenses, changing his filing status, and removing dependents. Petitioner stated he was requesting the IRS revisit the adjustments and provided the Tax Commission with documentation supporting his federal return as filed. The Tax Commission reviewed this information and determined that Petitioner had two qualifying children living with him during 2019, thereby allowing him to claim dependents and the Head of Household status. The Tax Commission allowed ordinary and necessary business expenses that Petitioner was able to document.

THEREFORE, the Notice dated August 25, 2022, and directed to \_\_\_\_\_ is hereby MODIFIED and MADE FINAL.

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

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|--------------|
| 2019        | \$1,131    | \$57           | \$138           | \$1,326      |

The Tax Commission DEMANDS immediate payment of this amount. Interest is calculated through December 31, 2023, and will accrue in accordance with Idaho Code section 63-3045.

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2024.

IDAHO STATE TAX COMMISSION

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2024,  
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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