

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 2-119-874-560
)	
)	
Petitioners.)	DECISION
_____)	

This case arises from a timely protest of a Notice of Deficiency Determination (Notice) issued to _____ (Petitioners) for taxable years 2017 and 2018. The Idaho State Tax Commission (Commission) after a review of the matter modifies the Notice issued to Petitioners.

THEREFORE, the Notice dated July 20, 2021, and directed to Petitioners is AFFIRMED as modified for the reasons discussed below.

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>
2017	\$2,714	\$136	\$527	\$3,377
2018	7,515	376	1,137	<u>9,028</u>
				<u>\$12,405</u>

Interest is computed through July 6, 2023.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

BACKGROUND

The Income Tax Audit Bureau's (Audit) selection of Petitioners' returns was based on adjustments to _____ a pass-through entity in which Mr. _____ has a 50% ownership interest. Audit issued a Notice to Petitioners that passed audit adjustments to Mr. _____ for tax years 2017 and 2018.

Petitioners protested the Notice via their representative stating in part that they disagree with the disallowance of business expenses, they disagree with the disallowance of all

depreciation, and they disagree with the inclusion, in income, of the full sale price of three assets sold in tax year 2018. Audit accepted Petitioners' protest and transferred the matter to the Commission's Tax Appeals Unit (Appeals) for administrative review.

Appeals sent Petitioners' representative a letter containing two methods for redetermining a protested Notice. Petitioners' representative requested an informal hearing where Petitioners' disagreements were presented by their representative. The informal hearing ended with Petitioners' representative agreeing to provide documentation that would substantiate their position. Petitioners subsequently provided additional information regarding four assets through their representative. Appeals reviewed the additional information and modified the Notice allowing depreciation for the 2004 International Water Truck, but the remaining assets were found to be either personal assets or assets of another entity. The Commission decided the matter based upon available information.

LAW AND ANALYSIS

Idaho Code section 63-3002 adopts the provisions of the Federal Internal Revenue Code relating to the measurement of taxable income. Internal Revenue Code section 162(a) states, in part, that "[T]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." However, deductions/expenses are a matter of legislative grace and only as there is clear provision therefore can any particular deduction be allowed. *New Colonial Ice Co., Inc. v. Helvering*, 292 U.S. 435, 54 S.Ct. 788 (1934). The taxpayer bears the burden of proving that he is entitled to the deduction. *Higgins v. C.I.R.*, T.C. Memo. 1984-330 (1984). The burden rests upon the taxpayer to disclose his receipts and claim his proper deductions. *United States v. Ballard*, 535 F.2d 400 (1976).

Idaho Code section 63-3042 states that for the purpose of ascertaining the correctness of any return and determining the liability of any person for any tax payable, that the state tax

commission or its duly authorized deputy is authorized to examine any books, papers, records, or other data which may be relevant or material to such inquiry. Moreover, it is well established that the Tax Commission is not required to accept self-serving testimony in the absence of corroborating evidence. *Niedring v. Commissioner*, 99 T.C. 202, 212 (1992); *Tokarski v. Commissioner*, 87 T.C. 74, 77 (1986). 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. *Burnet v. Houston*, 283 U.S. 223, 51 S.Ct. 413 (1931).

Petitioners stated in their protest that they disagreed with three things; the disallowance of certain business expenses, the disallowance of depreciation, and the addition of the full sale price of assets sold in 2018 in income. However, the Notice issued to Petitioners only adjusted depreciation and business expenses.

This case is a lack of substantiation case where Petitioners did not provide adequate documentation for the depreciation claimed and the business expenses claimed on their Idaho individual income tax returns. Internal Revenue Code section 6001 states in part that the taxpayer must keep “adequate records” to justify the claimed business deductions. In *Reinke Est. v. Com’r*, 46 F.3d 760 (8th Cir. 1995), the court stated that in cases where the taxpayer fails to present any evidence from which the court can make an estimate, the taxpayer’s claimed deductions will not be upheld.

For evidence to be adequate, Petitioners must either provide primary or, in some cases, secondary evidence that they actually incurred the expenses associated with the claimed business deductions. Primary evidence is documentary proof created contemporaneously with the expense demonstrating the date, amount, and purpose of the expense. *See Boyd v. Comm’r*, 122 T.C. 305, 320 (2004). Secondary evidence is reconstructed evidence not created contemporaneously with the expense, such as testimonial evidence. *Id.* To be persuasive, secondary evidence must establish

the same facts as primary evidence: the date, amount, and purpose of the expense. *Id.* Secondary evidence may only be presented in lieu of primary evidence when “the taxpayer establishes that the failure to produce adequate records is due to the loss of such records through circumstances beyond the taxpayer’s control.” Such circumstances include “destruction by fire, flood, earthquake, or other casualty.” *Id.*

After numerous requests for documentation, Petitioners only provided adequate documentation for the purchase of a 2004 International Water Truck. Petitioners failed to provide adequate documentation for the purchase of the other business assets. In addition, Petitioners have not shown the lack of documentation was due to circumstances beyond their control. Petitioners have not provided the necessary documentation for the deductions claimed on their Idaho individual income tax returns for taxable years 2017 and 2018.

CONCLUSION

Petitioners’ Idaho individual income tax returns were adjusted for flow-through deductions from Audit adjusted Petitioners’ returns because adequate documentation was not provided for depreciation and other business expenses. During the appeal, Petitioners provided some additional documentation. The Commission found a portion of the depreciation documentation acceptable and modified that adjustment. However, since Petitioners failed to substantiate the other deductions, the Commission upholds those adjustments. Therefore, the Commission modifies the Notice dated July 20, 2021.

Audit added both penalty and interest to Petitioners’ income tax liability. The Commission reviewed these additions and found them appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

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.

cc: