BEFORE THE STATE BOARD OF TAX APPEALS
STATE OF ARIZONA
100 North 15th Avenue - Suite 140
Phoenix, Arizona 85007
602.364.1102

NICK GEPHART, Appellant, vs. ARIZONA DEPARTMENT OF REVENUE, Appellee.	Docket No. 2014-12-I NOTICE OF DECISION FINDINGS OF FACT AND CONCLUSIONS OF LAW

The State Board of Tax Appeals, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follows:

FINDINGS OF FACT

On his 2006 federal income tax return, Nick Gephart, ("Appellant"), reported a Schedule C business loss in the amount of $11,270[1], and claimed $39,472 in miscellaneous itemized deductions, including $25,803 reported as job expenses, on his Schedule A. Arizona uses the federal adjusted gross income as a starting point for calculating Arizona taxable income. Consequently, the Arizona Department of Revenue ("Department") reviewed Appellant's 2006 federal return, and in a letter dated February 18, 2011 requested information from Appellant to verify the Schedule C expenses and itemized deductions claimed.

Appellant submitted a copy of his Schedule C, federal form 4562 for depreciation and federal form 8829 relating to expenses for the business use of his home as a Vitamark distributor. Further, Appellant stated that his deductions were for household warranties for Terminix, American Home Shield, and J & S Bug Spray, and for amounts paid to National Future Benefit for a living trust and will.

The Department determined that this information failed to substantiate Appellant's claims and issued an assessment, including interest, against Appellant. Appellant protested the assessment and

[1] Appellant reported losses on his Schedule C every year from 2001 through 2009.

the Department subsequently modified the assessment allowing Appellant a deduction for additional real estate taxes in the amount of $729 and mortgage interest in the amount of $7,878.[2] Appellant protested the modified assessment to a Hearing Officer, who upheld the assessment. Appellant then protested to the Director of the Department, who affirmed the Hearing Officer's decision. Appellant now timely appeals to this Board.

DISCUSSION

An individual taxpayer computes Arizona taxable income by starting with federal adjusted gross income, then makes certain additions and subtractions pursuant to A.R.S. § § 43-1021 and 43-1022 and is then allowed certain exemptions and itemized deductions. *See* A.R.S. § 43-1001. The issue before the Board is whether Appellant is entitled to the business loss and itemized deductions claimed.

A right to a deduction or subtraction does not exist absent express statutory authority. *Ariz. Dep't of Rev. v. Transamerica Title Ins. Co.*, 124 Ariz. 417, 420, 604 P.2d 1128, 1131 (1979). The burden is on the taxpayer to show he is entitled to a deduction or exemption from tax. *See Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P. 2d 719, 724 (1969). Accordingly, taxpayers are required to keep records, such as receipts, canceled checks, financial account statements and other documentary evidence and proof of payment to verify deductions. *See* A.R.S. § 42-1105(D); see, also IRS publication 552.

Internal Revenue Code (IRC) § 162(a) provides in pertinent 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, the trade or business activity must have been conducted with the intent to make a profit. *See* IRC § 183(a); *see, also Elliott v. Commissioner*, 90 T.C. 960, 970 (1988), aff'd, 899 F.2d 18 (9th Cir. 1990). If the gross income exceeds the deductions from such activity for three or more of the immediately preceding five years, the activity is presumed to be engaged in for profit and the taxing entity has the burden to rebut this presumption. IRC § 183(d). Appellant's gross income did not

[2] Although Appellant included these deductions as part of the expenses for his business use of the home, the items are deductible whether or not a taxpayer is in business for profit.

exceed his deductions from the activity for three or more of the immediately preceding five years; therefore, he is not entitled to this presumption, and bears the burden of proving that he possessed the required profit motive. *See Golanty v. Commissioner*, 72 T.C. 411, 426 (1979)

Whether an activity is engaged in with the intent to profit is to be determined by reference to objective standards, taking into account all of the facts and circumstances of each case. Treas. Reg. § 1.183-2(a). Factors that should typically be taken into account include: 1) the manner in which the taxpayer carries on the activity, 2) the expertise of the taxpayer or his advisors, 3) the time and effort expended by the taxpayer in carrying on activity, 4) the expectation that assets used in the activity may appreciate in value, 5) the success of the taxpayer in carrying on other similar or dissimilar activities, 6) the taxpayer's history of income or losses with respect to the activity, 7) the amount of occasional profits, if any, which are earned, 8) the financial status of the taxpayer, and 9) the elements of personal pleasure or recreation involved in the activity.

After reviewing all the facts, the Board finds the following to be true: 1) For tax year 2001 to 2009, Appellant claimed $64,325 total in losses and reported total gross income receipts of $2,727, sustaining a series of losses well beyond the initial start-up period; 2) Appellant had substantial income from sources other than the activity at issue, receiving substantial wages and salaries during 2006, indicating that Appellant was not relying on the business income for his livelihood; 3) Losses from the activity generated substantial tax benefits; and, finally, 4) Appellant did not demonstrate the potential for future profit so that losses could be eventually recouped. *See Bessenyey v. Commissioner*, 45 T.C. 261, 275 (1965), aff'd, 379 F.2d 252 (2d Cir. 1967). Appellant has not provided objective evidence demonstrating that the activity was engaged in for profit.

Considering all of the facts and circumstances, the Board finds that Appellant was not shown that he was engaged in the activities at issue with the intent to profit. Therefore, he is not entitled to the business loss and itemized deductions claimed.

A.R.S. § 42-1123(C) provides that if the tax "or any portion of the tax is not paid" when due "the department shall collect, as a part of the tax, interest on the unpaid amount" until the tax has been paid."

CONCLUSIONS OF LAW

1) Appellant has not met the burden of proving that he is entitled to the loss and deductions claimed; therefore, he is liable for the tax assessed. *See Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P. 2d 719, 724 (1969). *See Arizona State Tax Comm'n v. Kieckhefer*, 67 Ariz. 102, 105, 191 P. 2d 729 (1948); *see; also Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969); A.R.S. § 42-1105(D).

2) Appellant is liable for the interest assessed. *See* A.R.S. § 42-1123(C).

ORDER

THEREFORE, IT IS HEREBY ORDERED that the appeal is denied, and the final order of the Department is affirmed.

This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer, unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

DATED this 11th day of March, 2014.

STATE BOARD OF TAX APPEALS

Karen J. Brogdan,
Chairperson

KJB:ALW

CERTIFIED

Copies of the foregoing
Mailed or delivered to:

Nick Gephart
3608 E. Mountain Sky Avenue
Phoenix, Arizona 85044

Kim Cygan
Assistant Attorney General
Civil Division, Tax Section
1275 West Washington Street
Phoenix, Arizona