OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **WILLIAM A. STRACHAN**	OTA Case No. 18011028 Date Issued: December 27, 2018

OPINION

Representing the Parties:

For Appellant: Maria Lopez, TAAP[1]

For Respondent: Eric R. Brown, Tax Counsel III

For Office of Tax Appeals: William Stafford, Tax Counsel III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045,[2] William A. Strachan (appellant)[3] appeals an action by the Franchise Tax Board (FTB or respondent) proposing $4,872 of additional tax for the 2010 taxable year, and $1,644 of additional tax for the 2011 taxable year.

Appellant waived his right to an oral hearing; therefore, we decide this matter based on the written record.

[1] Appellant filed his opening brief on his own behalf. Subsequent representation was provided by the Tax Appeals Assistance Program (TAAP)

[2] Unless otherwise indicated, all "section" or "§" references are to sections of the California Revenue and Taxation Code.

[3] Although appellant filed joint tax returns with his spouse for 2010 and 2011, appellant's spouse did not sign the appeal, so we refer only to Mr. Strachan as appellant.

ISSUE

Has appellant shown he is entitled to deduct employee business expenses[4] for 2010 and 2011, that were disallowed by the Internal Revenue Service (IRS) following an examination conducted by the IRS?

FACTUAL FINDINGS

1. Appellant filed a timely 2010 joint California Resident Income Tax Return (Form 540). As relevant to this appeal, on that return, appellant claimed unreimbursed employee business expenses of $61,805 ($50,406 for a chemical services sales position – on Form 2106; and $11,399 for a funeral arranger position – on Form 2016-EZ). The claimed expenses included $33,369 in vehicle expense for appellant's chemical services sales position, and $8,210 in vehicle expense for his funeral arranger position (based on the standard mileage rate deduction).
2. Appellant filed a timely 2011 joint California Resident Income Tax Return (Form 540). As relevant to this appeal, on that return, appellant claimed unreimbursed employee business expenses of $33,830. The claimed expenses included $21,103 in vehicle expenses (based on standard mileage rate deduction).
3. On July 15, 2014, FTB received a notice from the IRS (FEDSTAR IRS Data Sheet) indicating that the IRS had conducted an examination of appellant's federal tax return and adjusted his 2010 federal tax liability. Of the $61,805 appellant claimed for unreimbursed employee business expenses (using Schedule A of appellant's 1040 federal return), the IRS disallowed $50,793, leaving a post-examination deduction allowed of $11,012.[5] Appellant did not notify respondent of these federal changes.
4. Respondent issued a Notice of Proposed Assessment (NPA) for 2010, adjusting appellant's liability based on the IRS adjustments, on February 6, 2015. The adjustments resulted in a proposed additional tax liability of $4,872, plus interest.

[4] The term "employee business expenses," as used herein, includes deductions claimed by appellant on Schedule A of federal Form 1040 for employee-related meals, travel, lodging, and miscellaneous expenses attributable to appellant's employment. It specifically excludes business expenses related to any Schedule C trade or business of appellant or his wife.

[5] The IRS also allowed a deduction of $79 for tax preparation fees, so the allowed deductions on the examination total $11,091.

5. On July 15, 2014, FTB received a notice from the IRS (FEDSTAR IRS Data Sheet) indicating that the IRS had conducted an examination of appellant's federal tax return and adjusted his 2011 federal tax liability. Of the $33,830 appellant claimed as unreimbursed employee business expenses, the IRS reduced the amount by $18,696, leaving a post-examination deduction allowed of $15,134. As with the 2010 taxable year, appellant did not notify respondent of these federal changes.
6. Respondent issued a Notice of Proposed Assessment (NPA) for 2011, adjusting appellant's liability based on the IRS adjustments, on February 6, 2015. The adjustments resulted in a proposed additional tax liability of $1,644, plus interest.
7. Appellant protested the proposed assessments for both 2010 and 2011 taxable years.
8. In response to appellant's protest, respondent wrote to appellant on March 11, 2016, and explained that in order to cancel or reduce the assessments, appellant must resolve the matter with the IRS and send to respondent a revised IRS report and/or account transcript reflecting the resolution.
9. Appellant did not provide respondent with evidence of the IRS having changed its position with respect to appellant's 2011 tax liability.
10. Respondent issued a Notice of Action (NOA) for each of the 2010 and 2011 taxable years, on May 9, 2016, which affirmed the NPAs for those years.
11. Respondent received Income Tax Discrepancy Adjustment forms (IRS Form 4549-A) from the IRS for the taxable period ending December 31, 2010, and for the taxable period ending December 31, 2011, both on August 9, 2016. The contents of the forms reflect the adjustments reported to respondent on the FEDSTAR IRS Data Sheets.
12. IRS Account Transcripts, dated February 2, 2017, show the adjustments to appellant's 2010 and 2011 accounts following the IRS examination of his return. They also show that appellant entered into Installment Agreements with the IRS on June 21, 2014, and on August 3, 2015. The IRS made no further changes to appellant's 2010 or 2011 unreimbursed employee business expenses or to his tax liability after its initial examination determination.

DISCUSSION

An individual taxpayer is required to report federal changes to income or deductions to the FTB within six months of the date the federal changes become final when those changes

increase the California tax liability. (§ 18622(a).) The taxpayer must concede the accuracy of the federal changes or prove that those changes, and any California deficiency assessment based thereon, are erroneous. (*Ibid*.; *Appeal of Brockett*, 86-SBE-109, June 18, 1986.)[6] Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Magidow*, 82-SBE-274, Nov. 17, 1982.) A taxpayer's failure to produce evidence that is within his control gives rise to a presumption that such evidence, if provided, would have been unfavorable to the taxpayer's case. (*Appeal of Cookston*, 83-SBE-048, Jan. 3, 1983.)

An individual performing services as an employee generally may deduct expenses incurred in the performance of such services as itemized deductions on Schedule A. (*Feaster v. Commissioner*, T.C. Memo. 2010-157; *Richards v. Commissioner*, T.C. Memo. 2014-88.) Schedule A deductions are subject to various limitations. (*Ibid*.) For example, employee business expenses can be deducted only to the extent those expenses exceed two percent of the taxpayer's adjusted gross income under Internal Revenue Code (IRC) section 67(a). (*Ibid*.) In addition, to deduct expenses incurred in connection with the performance of services as an employee, a taxpayer must not have the right to reimbursement for such expenses from his employer. (*Ibid*.)

IRC section 162(a) authorizes a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."[7] (*Roberts v. Commissioner*, T.C. Memo. 2012-197; Treas. Reg. § 1.162-1(a).) A trade or business expense is ordinary for purposes of IRC section 162 if it is normal or customary within the particular trade, business, or industry, and is necessary if it is appropriate and helpful for the development of the business. (*Roberts v. Commissioner, supra*.) In contrast, personal, living, or family expenses are generally nondeductible. (*Ibid*.; IRC, § 262.) Deductions from gross income are a matter of legislative grace, and a taxpayer must prove entitlement to claimed deductions. (*Appeal of Walshe*, 75-SBE-073, Oct. 20, 1975.)

The distinction between deductible trade or business expenses on the one hand, and nondeductible personal expenses on the other, is based on a weighing and balancing of the facts and circumstances of each case. (*Irwin v. Commissioner*, T.C. Memo. 1996-490.) With respect

[6] Precedential opinions of the State Board of Equalization (BOE) are available for viewing on the BOE's website: <http://www.boe.ca.gov/legal/legalopcont.htm>.

[7] IRC section 162 is generally incorporated into California law by section 17201.

to deductions under IRC section 162, the taxpayer bears the burden of proving that an expense was incurred for business, rather than personal reasons. (*Ibid*.) Specifically, taxpayers must show that the expense was incurred primarily to benefit their business, and there must have been a proximate, rather than remote or incidental, relationship between the claimed expense and the taxpayer's business. (*Ibid*.)

In certain circumstances, the taxpayer must meet specific substantiation requirements to be allowed a deduction under IRC section 162. (*Roberts v. Commissioner, supra*; see e.g., IRC, § 274(d).) IRC section 274(d) requires that the following types of expenses must be substantiated by adequate records or sufficient corroborating evidence: (1) any travel expense, including meals and lodging away from home; (2) any item with respect to an activity in the nature of entertainment, amusement, or recreation; (3) expense for gifts; or (4) the use of "listed property," as defined in IRC section 280F(d)(4), which includes passenger automobiles. (*Roberts v. Commissioner, supra*.) To qualify for a deduction, the taxpayer must substantiate these types of expenses with adequate records or sufficient evidence to corroborate the taxpayer's own statement as to: (1) the amount of the expense or other item; (2) the time and place of the travel, entertainment, amusement, recreation, or use of the property, or the date and description of the gift; (3) the business purpose of the expense or other item; and (4) the business relationship to the taxpayer of the persons entertained or receiving the gift. (IRC, § 274(d).) Adequate records must be made "at or near the time of the expenditure." (Treas. Reg. § 1.274-5A(c)(2)(ii)(a).) The tax court has held that "[r]eceipts often fail as proof because they don't show any particular business purpose." (*H & M, Inc. v. Commissioner*, T.C. Memo. 2012-290, at fn. 17.)

To satisfy the adequate records requirement of IRC section 274(d), a taxpayer must maintain records and documentary evidence that in combination are sufficient to establish each element of an expenditure or use. (*Roberts v. Commissioner, supra*.) Although a contemporaneous log is not required to substantiate nonpersonal use vehicle miles, corroborative evidence to support a taxpayer's reconstruction "of the elements . . . of the expenditure or use must have a high degree of probative value to elevate such statement" to the level of credibility of a contemporaneous record. (*Ibid*., citing Treas. Reg. § 1.274-5T(c)(1).)

For business expense deductions where the heightened requirements of IRC section 274(d) do not apply, a claimed expense may be allowed even where the taxpayer is unable to

fully substantiate it, if there is an evidentiary basis for doing so. (*Roberts v. Commissioner*, *supra*, citing *Cohan v. Commissioner* (1930) 39 F.2d 540.) This is called the "*Cohan* rule." (See *Perry v. Commissioner*, T.C. Memo. 2012-237.) Most of the claimed deductions at issue in this appeal may not be estimated because IRC section 274(d) specifies the substantiation requirements, and estimates are insufficient to support a claimed deduction.

Appellant's claims herein are that the IRS erroneously excluded claimed unreimbursed employee business expenses for 1) business mileage, 2) unreimbursed travel meals, 3) unreimbursed lodging, and 4) additional miscellaneous expenses, such as cell phone expense.

Business Mileage

As discussed above, IRC section 274(d) requires substantiation for expenses for use of a passenger automobile. In order to substantiate use of a passenger vehicle for business purposes, appellant must establish the amount, time, and business purpose for the use. (Treas. Reg. § 1.274-5T(b)(6)(i)-(iii).) Appellant asserts that he traveled between 20,000 and 25,000 miles per year for business. In support of his mileage claims, appellant provided a "travel expenses log" for 2011. No similar report was submitted for 2010. The log appears to have been prepared for purposes of this appeal, and is not a contemporaneous log kept by appellant during the course of the year at issue.[8] Even if we were to accept the submitted log, it only appears to corroborate that appellant allegedly traveled for business 43 days in 2011, not the "25 days per month, and 35,620 business miles during 2011" he claims.

Appellant's only evidence of business mileage for 2010 are his statement that he drove 21,252 miles that year, and his tax return, which claims he drove 45,408 miles in one vehicle and 21,330 in the second vehicle, and used both vehicles 100 percent for his "chemical services sales" position. Appellant's Form 2106-EZ for 2010 shows miles totaling 11,399 for a "funeral arranger" position. On that form, appellant alleged that the vehicle was used 100% for business. No fraction of that mileage is substantiated by the evidence appellant submitted in this appeal.

Unreimbursed Travel Meals and Lodging

With respect to appellant's travel, food, and/or entertainment expenses, such expenses must be substantiated with adequate records or sufficient evidence to corroborate the taxpayer's

[8] A mileage log is more probative when it is prepared close in time to the expenditure or use. (Treas. Reg. § 1.274-5T(b)(6)(c).)

own statement. (IRC § 274(d).) These types of expenses are not eligible for estimation under the *Cohan* rule. (*Roberts v. Commissioner*, *supra.*) For 2010, appellant claimed $1,786 in non-mileage travel expenses, and $454 in meals and entertainment expenses. His claim is not supported by any documentary evidence. For 2011, appellant claimed $5,118 in non-mileage travel expenses, and $5,321 in meals and entertainment expenses. For support, appellant submitted a "travel expenses log" and some receipts. The log appears to have been prepared for purposes of this appeal, and appellant alleges that he turned his substantiating documents over to the IRS and did not retain copies. Appellant's own log, however, only totals $1,679.88 for all 2011 travel and meal expenses. Further evidence was submitted in the form of receipts that do not substantiate what is in appellant's log. For example, he included several "meal" receipts from establishments that are in Vacaville, which is appellant's home town. Appellant has not substantiated that he was entitled to more non-mileage meal and travel expenses than what the IRS allowed for both 2010 and 2011.

Miscellaneous expenses

Appellant listed some miscellaneous expenses for 2010 in one of his declarations, but did not offer evidence of any miscellaneous expenses for 2011. The IRS performed audits for the two taxable years at issue, and made adjustments based on statutes and rules that are the same under California law as under federal law. Appellant has not shown, and the evidence does not support, that the IRS made any adjustments to appellant's claimed business deductions, other than those upon which respondent made its proposed assessments.

Because appellant has not provided documentation showing that the IRS erred in disallowing some of his claimed business deductions for 2010 and 2011, he has not met his burden to show that respondent's proposed assessments based on the federal determination are erroneous.

HOLDING

Appellant has not shown that respondent's proposed assessments, which are based on federal adjustments, are erroneous.

DISPOSITION

Respondent's proposed assessments for taxable years 2010 and 2011 are sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Kenneth Gast
Administrative Law Judge

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Tommy Leung
Administrative Law Judge