OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18011188
	)	
STEVE MOSHI AND	)	Date Issued: August 9, 2018
	)	
FIORELLA MOSHI	)	
	)	

OPINION

Representing the Parties:

For Appellants:	Jorge A. Lopez, Esq. and Richard A. Jorgensen, Esq.
For Respondent:	Mira Patel, Tax Counsel
For Office of Tax Appeals:	Tom Hudson, Tax Counsel III

A. ROSAS, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19045,[1] Steve Moshi and Fiorella Moshi ("Appellants") appealed an action by the Franchise Tax Board ("FTB" or "Respondent") assessing additional tax of $2,605, plus interest, for the 2010 tax year. Respondent based the assessment on federal adjustments made by the Internal Revenue Service (IRS).

Appellants waived their right to an oral hearing, and therefore we decide this matter based on the written record.

ISSUE

Did Appellants establish error in Respondent's assessment, which was based on a federal assessment?

[1] Statutory references are to the California Revenue and Taxation Code, unless otherwise noted.

FACTUAL FINDINGS

1. In 2010, Appellants, a married couple, resided in California. United Parcel Service, Inc. employed Mr. Moshi, and he earned wages of $2,480. He also earned wages of $121 from Aetna Life Insurance Co.
2. During 2010, Mr. Moshi also competed in body building competitions and offered services as a personal trainer. He reported $9,700 of income from this self-described "body building" business.
3. In early 2011, Appellants went to Elias Arteaga and Laurie Arteaga to prepare and file their 2010 federal and state tax returns. On behalf of Appellants, the Arteagas filed a timely 2010 California resident income tax return (Form 540). Schedule C of Appellants' return claimed a total of $45,315 in business expenses.[2]
4. The IRS audited Appellants' 2010 federal tax return (Form 1040) and made a federal determination on or about June 22, 2013. The IRS disallowed $41,600 listed as "other expenses," including the following: medical ($25,000), office equipment ($7,000), computer expense ($3,100), laptop ($2,800), and cell phone ($1,200).[3]
5. On September 20, 2013, FTB received notice of the federal adjustments. The federal information indicated the IRS disallowed $41,600 in "other expenses" reported on Appellants' Schedule C. The IRS assessed a federal tax deficiency of $7,693, plus penalties and interest.
6. IRS records indicate that, on or about October 1, 2013, Appellants filed a claim for refund with the IRS for the 2010 year.[4] In early 2014, the IRS denied the claim for refund.
7. On September 4, 2014, Appellants filed a civil action against their tax preparers.[5] Appellants' civil action accused the Arteagas of professional negligence.

[2] The total of $45,315 in business expenses included (from greatest to least) medical expenses ($25,000), office equipment ($7,000), computer expense ($3,100), laptop ($2,800), job education ($2,500), advertising ($1,890), cell phone ($1,200), insurance ($960), and office expense ($865).

[3] The IRS also disallowed a $2,500 job education expense but that expense is not at issue in this appeal.

[4] Although the record is not clear, it appears this refund claim was made on an amended federal tax return, dated September 20, 2013. During later protest proceedings with Respondent, Appellants provided a copy of an amended federal tax return, dated September 20, 2013, and Appellants provided a copy of this amended return on appeal.

[5] *Moshi v. Arteaga*, Superior Court of California, County of Orange, Case No. 30-2014-0074328-CL-PN-CJC.

8. On May 27, 2015, Respondent issued a Notice of Proposed Assessment (NPA), based on the IRS audit adjustments. The NPA disallowed $41,600 of "other expenses" listed on Schedule C. The NPA proposed to assess additional tax of $2,605, plus interest.

9. On July 24, 2015, Appellants protested the NPA. With their protest, Appellants included an amended federal return, dated September 20, 2013. The amended federal return states that the return was amended to move claimed body building medical expenses from Schedule C to Schedule A. On the revised Schedule A, Appellants reported medical expenses of $34,316. Appellants also provided a revised Schedule C that claimed business expenses of $11,398, including the following relevant business expenses: computer, laptop, and office equipment expenses ($5,402); additional claimed advertising expenses ($1,401); cell phone expenses ($1,152); and automobile expenses ($784).

10. In a letter dated January 21, 2016, Respondent acknowledged receipt of Appellants' protest. Respondent gave Appellants until February 22, 2016, to provide any revised IRS information.

11. Appellants did not provide Respondent with any revised IRS information by the due date. Respondent issued a Notice of Action affirming its assessment of additional tax of $2,605, plus interest.

12. On March 31, 2016, Appellants filed this timely appeal.[6]

DISCUSSION

A. Federal Assessments

Section 18622(a) provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. Unless a taxpayer offers documentation or other evidence to establish an error in the federal adjustment or change, FTB's assessment based on the federal adjustments is presumed correct. (*Appeal of Freemon and Dorothy Thorpe*, 87-SBE-072, Oct. 6, 1987.)

[6] Appellants mailed this appeal to the Office of Tax Appeals' predecessor-in-interest, State Board of Equalization.

B. Burden of Proof

Income tax deductions are a matter of legislative grace, and the taxpayer bears the burden of establishing entitlement to the deductions claimed. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) To meet this burden, a taxpayer must point to an applicable statute and show by credible evidence that the transactions in question come within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.) The failure to produce evidence within a taxpayer's control gives rise to a presumption that such evidence, if provided, would be unfavorable to the taxpayer's case. (*Appeal of Don S. Cookston*, 83-SBE-048, Jan. 3, 1983.)

C. Appellants' Civil Litigation

The Superior Court of California found that Appellants' tax preparers negligently prepared their 2010 tax returns and did not properly assist and/or advise Appellants on how to respond to the IRS notice of deficiency.[7] Appellants' reliance on the Superior Court case is misplaced; they cannot use the decision in *Moshi v. Arteaga* as proof or substantiation of the claimed deductions because the decision did not revise the amount of tax due. Appellants must substantiate their assertions and prove entitlement to the claimed deductions.

D. Medical Expenses Claimed on Schedule A

Internal Revenue Code (IRC) section 213(a) defines the medical expense tax deduction as "the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent. . . ." California conforms to this provision per section 17201.

As noted previously, on their original federal and California tax returns, Appellants reported $25,000 of medical expenses on Schedule C for the body building business. The IRS disallowed these medical expenses in their entirety. Appellants concede it was erroneous to report the $25,000 of purported expenses on the original Schedule C but argue that the medical expenses of $34,315.56 were properly reported on Schedule A of their amended return as itemized deductions.

[7] *Moshi v. Arteaga*, Superior Court of California, County of Orange, Case No. 30-2014-0074328-CL-PN-CJC. Minute Order dated December 7, 2015. Neither the IRS nor FTB was a party to the litigation. Moreover, notwithstanding the Superior Court's finding that Appellants' tax preparers were negligent, Appellants' were still required to pay $9,937.07 to the IRS for the additional taxes, interest, and accuracy penalty due.

Appellants' primary support for these claimed expenses is a Patient Prescription Record from CVS Pharmacy. The Patient Prescription Record lists approximately thirty-eight (38) different prescriptions from January 15, 2010, through June 27, 2010, for a combined "total price" of approximately $34,315.56. However, there is no evidence or information in the record to show whether the "total price" listed on the Patient Prescription Record is the actual price paid by Appellants or whether insurance covered the prescription drug expenses.

Appellants provide JPMorgan Chase Bank, N.A. ("JPMorgan") statements for the period from March 23, 2010, through June 22, 2010. These statements show Appellants used a bank card at CVS and CVS Pharmacy for purchases totaling less than $300. By comparison, the Patient Prescription Record lists approximately $19,400 of prescriptions filled during this same period. Thus, the JPMorgan statements do not show that Appellants paid CVS Pharmacy anywhere near $19,400 during this three-month period.

Appellants' failure to offer complete bank records weighs against them. As noted above, the failure to produce evidence within a taxpayer's control gives rise to a presumption that such evidence, if provided, would be unfavorable to the taxpayer's case. (*Appeal of Don S. Cookston*, *supra*.)

Appellants did not offer any receipts or cancelled checks showing the actual amounts they paid for the prescription drugs. Appellants did not substantiate that they paid approximately $34,315.60 to CVS Pharmacy during 2010 or that they paid any lesser amount that would entitle them to a medical expense deduction.[8] As a result, Appellants did not establish error in Respondent's disallowance of the claimed medical expense deduction.[9]

E. Business Expenses on Schedule C

IRC section 162 states, "[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 . . . ." California law conforms through section 17201. To qualify as an allowable business deduction, an item must (1) be paid or incurred during the taxable year, (2) be for

[8] As noted previously, medical expenses are only deductible to the extent they exceed 7.5 percent of a taxpayer's adjusted gross income for the year. (R&TC § 17201; IRC, § 213.) Here, the IRS determined an adjusted gross income of $113,420. Therefore, Appellants could not obtain a medical expense deduction unless they incurred qualifying expenses exceeding $8,506.50 (i.e., 7.5% of $113,420).

[9] Because Appellants did not substantiate that they incurred the claimed expenses, the issue of whether the expenses would qualify as a Schedule A medical expense is not discussed.

carrying on any trade or business, (3) be an expense, (4) be a necessary expense, and (5) be an ordinary expense. (*Commissioner v. Lincoln Savings & Loan Assn*. (1971) 403 U.S. 345, 352.)

A taxpayer must provide documentation proving a particular deduction or business expense occurred. (*Appeal of James C. and Monablanche A. Walshe,* 75-SBE-073, Oct. 20, 1975.) Moreover, it is insufficient to show simply that expenditures were made, without showing their direct relation to a business purpose. (*Appeal of Harold J. and Jo Ann Gibson*, 76-SBE-090, Oct. 6, 1976.)

1. Computer, Laptop, and Office Equipment

Appellants originally reported a computer expense of $3,100, a laptop expense of $2,800, and an office equipment expense of $7,000. The IRS disallowed these claimed expense amounts. Subsequently, Respondent disallowed them based on the federal adjustment. In their revised Schedule C, Appellants claimed a combined total of $5,402 for "computer, laptop, and office equipment." Appellants offered receipts from the Apple Store totaling $5,402.46 for an iPod Touch, a MacBook, and two (2) iPads.

There is nothing in the record to establish Appellants are entitled to these deductions. Appellants did not show that these expenses constituted business expenses incurred in the body building business, as opposed to personal expenditures. There is no evidence to show that Appellants used these devices in a body building trade or business and, if they were used in that business, the percentage of business use as compared to personal use.[10] Therefore, Appellants did not prove entitlement to any business deduction for these items.

2. Advertising Expenses

In their original federal and California returns, Appellants reported $1,890 in advertising expenses on Schedule C for the body building business. Both the IRS and Respondent allowed these advertising expenses. Appellants then provided an amended return claiming that their advertising expenses were higher: a total of $3,291. In support, Appellants offered three (3) invoices, each for $1,097, dated February 12, 2010, May 7, 2010, and September 21, 2010. The

[10] Generally, these types of items, if used for a business, would have to be depreciated over the useful life of the equipment, per IRC section 179. California conforms, with certain exceptions, under sections 17201, 17255, and 17268. However, a discussion of the depreciation rules is unnecessary because Appellants did not meet the threshold requirement of proving that these items constituted business expenses.

invoices are virtually identical, have little in the way of description,[11] and do not list an address or phone number for the individual listed as the sender of the invoices. The invoices state they were "paid in full by cash."

These invoices lack credibility. Other than the statement on the face of the invoices, there is no evidence to show that Appellants paid the amounts shown on the invoices. As noted previously, Appellants only offered bank records for the period of March 23, 2010 through June 22, 2010. While the records do show various cash withdrawals, the records do not show any payments or withdrawals approximating the $1,097 amount shown on the May 7, 2010 invoice. As noted previously, Appellants' failure to offer complete banking records weighs against them. (*Appeal of Don S. Cookston, supra*.)

In addition to the lack of evidence to corroborate payment of the invoices, there is no evidence related to whether or how the invoices related to Mr. Moshi's trade or business. The $1,890 of advertising expenses already allowed shall remain undisturbed. But, there is not sufficient evidence in the record to find that Appellants are entitled to any additional deduction for advertising expenses.

3. Cell Phone Expenses

Appellants did not establish entitlement to any business deduction for cell phone expenses. Appellants reported $1,200 in cell phone expenses on their original Schedule C. The IRS disallowed this amount, and Respondent also disallowed it based on the IRS adjustment. In their revised Schedule C, Appellants claimed $1,152 in cell phone expenses. Appellants did not offer any invoices or receipts to support the expenses claimed. There is nothing in the record to indicate Appellants are entitled to a $1,152 cell phone business deduction.[12]

4. Office Expenses

Appellants originally reported $865 for office expenses, and neither the IRS nor Respondent disallowed the expense in their respective assessments. In the revised Schedule C, Appellants did not claim any amount for office expenses. Appellants did not submit any

[11] Each of the three (3) invoices included a line item for "HAND BILL FLYERS (copy)" for $247.00 and a line item for "LABOR (distribute)" for $850.00.

[12] The JPMorgan statements for the period from March 23, 2010, through June 22, 2010, showed three (3) payments made to Verizon Wireless: $177.81 on April 7, 2010; $166.94 on May 13, 2010; and $149.72 on June 8, 2010. However, there is no evidence to show the cell phones were used in the business or, if they were used in business, the percentage of business use as compared to personal use.

evidence regarding the office expense claimed in their original returns. However, because this issue does not relate to a change made by the IRS, the four-year statute of limitations bars Respondent from disallowing this deduction. (See §§ 19057, 19059(a), 19060(b), and 19065.)

5. Automobile Expenses

In their original returns, Appellants did not report any vehicle expenses, but they claim $784 as "actual car expenses" on their revised Schedule C. Appellants said Mr. Moshi used his 2005 Honda Accord 80% of the time for his body building business. In support, Appellants submitted a repair invoice dated June 11, 2010, showing a "total invoice" price of $530.22.[13] At appeal, Respondent agreed to allow a deduction of $424.18 for automobile expenses (80% of the "total invoice" price of $530.22). Appellants did not show that they are entitled to any additional deduction.[14]

6. Insurance Expenses

Appellants originally claimed an insurance expense deduction of $960 on their Schedule C, and neither the IRS nor Respondent disallowed the expense in their respective assessments. On appeal, in their revised Schedule C, Appellants reported $769 for insurance, although Appellants have not shown an entitlement to any insurance deduction greater than $615.45.[15] However, because this issue does not relate to a change made by the IRS, the four-year statute of limitations bars Respondent from disallowing the $960 deduction. (See §§ 19057, 19059(a), 19060(b), and 19065.)

HOLDING

Respondent agrees to reduce its assessment by $32.51. Appellants did not establish error in Respondent's assessment, as modified by Respondent on appeal. Appellants did not meet their burden of substantiating any additional deductions.

[13] From a review of the invoice, it is unclear how Appellants arrived at a subtotal of $979.66, to which they applied 80% for the business use, to arrive at a total of $783.72. The invoice is four (4) pages, but Appellants only submitted three (3) pages. They added a line item from page 1 ($349.66), added a line item from page 3 ($100), and added the "total invoice" on page 4 ($530.22) to arrive at $979.66. Considering the invoice included numerous labor discounts, it is unclear why Appellants used an amount higher than the "total invoice" as a starting base amount. There appears to be no reason for why the base expense amount should be higher than $530.22.

[14] The additional deduction in the amount of $424.18 resulted in a tax assessment reduction of $32.51.

[15] Appellants offered invoices from Allstate Insurance for the 2005 Honda Accord. Respondent contended that Appellants should reduce the $769 amount to $615 because Appellants' position is that the 2005 Honda Accord was used 80% of the time for business purposes.

DISPOSITION

We sustain Respondent's action, which was based on federal adjustments, subject to the reduction of $32.51 as agreed by Respondent.

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Alberto T. Rosas
Administrative Law Judge

We concur:

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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
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Michael F. Geary
Administrative Law Judge