OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18083680
PAUL C. SMITH	)
	) Date Issued: June 19, 2019
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Paul Smith, Taxpayer
For Respondent:	Brian Miller, Tax Counsel III
For Office of Tax Appeals (OTA):	William J. Stafford, Tax Counsel III

A. KWEE, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19045, Paul C. Smith (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying his protest of a proposed assessment of $3,414 in additional tax, plus applicable interest, for the 2012 tax year. This appeal is being decided based on the written record because appellant waived the right to an oral hearing.

ISSUES

1. Whether appellant established that the claimed miscellaneous itemized expenses are deductible.
2. Whether appellant is entitled to interest abatement.

FACTUAL FINDINGS

1. Appellant and Diane Smith (appellant's wife)[1] jointly filed a 2012 California income tax return reporting federal adjusted gross income (AGI) of $128,117, and federal itemized deductions of $59,976. Appellant was employed as a construction manager at a

[1] Appellant's wife passed away prior to the appeal at issue.

construction management firm during 2012, and had to perform work at various construction job sites as part of his employment. Appellant's wife worked as a medical billing and collection agent.

2. On both the state and federal income tax returns for 2012, appellant claimed itemized deductions of $42,228 for miscellaneous expenses.[2] Of this amount, $20,317 was for unspecified unreimbursed employee business expenses incurred by appellant's wife. These expenses were claimed on a federal Form 2106, Employee Business Expenses, that she completed in connection with her job performing medical billing. The remainder purportedly related to appellant's job as a construction manager. On his federal Form 2106, appellant claimed $15,450 in unspecified unreimbursed employee business expenses, $2,320 in parking, tolls, and transportation (not related to overnight travel), and $6,460 in meals and entertainment expenses.

3. On December 16, 2015, FTB notified appellant that it was examining his 2012 California income tax return, and requested documentation to substantiate the claimed $42,228 of itemized deductions for unreimbursed employee business expenses.

4. On March 20, 2017, FTB issued a Notice of Proposed Assessment (NPA) disallowing the $42,228 of itemized deductions, and making no other changes.

5. Appellant protested the NPA on March 23, 2017, on the basis that it was an undue hardship to find or obtain tax records from 2012. Additionally, appellant contends that his wife teleworked for a doctor in Las Vegas, Nevada, and her job responsibilities included calling health insurance companies for billing purposes. Additionally, appellant contends that he travelled for his job and purchased equipment to perform his job.

6. On May 8, 2018, FTB requested documentation from appellant to support the claimed expenses, including a detailed schedule with supporting documentation for each individual unreimbursed employee expense claimed, including date, place, amount, description, purpose, and business relationship.

7. By letter dated July 11, 2018, appellant provided FTB a general summary of the nature of his job, his wife's job, and a general description of how they would typically incur expenses. Appellant contends he purchased protective gear for his work at construction

[2] Appellant claimed miscellaneous expenses of $44,790, on his federal Schedule A, Itemized Deductions, line 24. The deduction was less than this amount because these expenses are only deductible to the extent they exceed 2 percent of AGI.

job sites, and in order to perform his job he needed to purchase and maintain a cell phone, a computer, and special computer software. For example, appellant contends he would use software, such as Microsoft Project, to create construction schedules for clients. In support, appellant attached an email from his employer, stating that if a cell phone is required, then a cell phone allowance will be included in the employee's salary and listed in the offer letter at the time of hiring.[3]

8. On July 30, 2018, FTB issued a Notice of Action (NOA) denying the protest. This timely appeal followed. On appeal, FTB submitted a copy of appellant's wife's Form W-2 for the 2012 tax year, issued by Advanstaff Inc., which FTB contends is a staffing agency.

9. Appellant timely appealed the NOA on August 25, 2018. Attached to his appeal, appellant included a partial payment (tax deposit)[4] of $1,707, which he indicated demonstrates a good faith attempt to resolve this matter, and requested that OTA delete the remaining balance due on his account, including taxes and interest. In addition, appellant contended that because his wife teleworked, there would be home office expenses including rent, electricity, internet, and equipment for the home office such as computers, furniture, fax machines, software, and printers.

10. On August 31, 2018, OTA forwarded the tax deposit to FTB.

DISCUSSION

1. Itemized Deductions

Gross income means all income from whatever source derived, unless specifically excluded. (R&TC, §§ 17071, 17085; IRC, §§ 61(a)(8)-(10), 72, 408(d).) The law allows an itemized deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. (R&TC, § 17201(a) [incorporating IRC, § 162(a)].) The term "ordinary and necessary business expenses" means only those expenses which are ordinary and necessary in the conduct of the taxpayer's business and are directly

[3] It appears appellant may have also provided FTB a copy of meeting notes with a couple of his clients, proof of insurance, a copy of an email to a client, a schedule created using MS Project software, his employer's timekeeping policy, and his resume. These documents are not a part of the written record in this appeal because they were not submitted to OTA.

[4] A payment made to stop the running of interest on a proposed deficiency assessment that has not become final is generally regarded as a "tax deposit" that stops the running of interest. (R&TC, § 19041.5; Int. Rev. Code (IRC), § 6603(b).)

attributable to such business. (Treas. Reg. § 1.162–17(a).) The term does not include personal, living or family expenses, which are generally nondeductible. (*Ibid*; IRC, § 262(a).)

California law generally conforms to federal law with respect to itemized deductions for miscellaneous itemized expenses. (See R&TC, §§ 17071, 17201.) IRC section 67 provides, in pertinent part that, "the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income." (R&TC, § 17076 [incorporating IRC section 67]; IRC, § 67(a) (2012).) The taxpayer bears the burden of establishing entitlement to any deductions claimed. (*Appeal of Janke* (80-SBE-059) 1980 WL 4988; *Appeal of Walshe* (75-SBE-073) 1975 WL 3557.)

To support a deduction, the taxpayer must establish by credible evidence, other than mere assertions, that the deduction claimed falls within the scope of a statute authorizing the deduction. (*New Colonial Ice Co., Inc. v. Helvering* (1934) 292 U.S. 435, 440; *Appeal of Telles* (86-SBE-061) 1982 WL 11930; *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) A taxpayer's failure to produce evidence that is within the taxpayer's 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) 1983 WL 15434.)

In certain circumstances, the taxpayer must meet specific substantiation requirements to be allowed a deduction for ordinary and necessary business expenses. (*Roberts v. Commissioner* (2012) T.C. Memo. 2012-197; see, e.g., IRC, § 274(d).) Heightened substantiation requirements apply to any travelling, entertainment, amusement, recreation or gift expense claimed as a deduction. (IRC, § 274(d)(1).) To qualify for such a deduction of such items, the taxpayer must substantiate each expense 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); *Roberts v. Commissioner, supra*.)

Specific reporting and substantiation requirements also apply to any unreimbursed business expense claimed as an itemized deduction by an employee. (Treas. Reg. § 1.162–17(b)(3), (c).) Taxpayers may be called upon to substantiate expense account information, and must maintain adequate and detailed records of travel, transportation, entertainment, and similar

business expenses, and the burden of proof is upon the taxpayer to show that such expenses were paid and are ordinary and necessary business expenses. (Treas. Reg. § 1.162–17(d)(1)(ii), (2).) One method for substantiating expenses incurred by an employee in connection with his or her employment is through the contemporaneous preparation of a daily diary or record of expenditures, maintained in sufficient detail to enable the taxpayer to readily identify the amount and nature of any expenditure, and the preservation of supporting documents, especially in connection with large or exceptional expenditures. (Treas. Reg. § 1.162–17(d)(2).)

Generally, expenses of maintaining a household, including amounts paid for rent, water, utilities, and similar expenses, are not deductible. (Treas. Reg. § 1.262-1(b)(3).) As an exception, a deduction for home office expenses is permitted if a portion of the home is exclusively used on a regular basis as the principal place of business for any trade or business of the taxpayer. (IRC, § 280A(c)(1).) Additionally, in the case of an employee, a deduction is only allowed if the exclusive use is for the convenience of the employer. (*Ibid*.)

Here, appellant failed to provide anything in the nature of a daily diary or record of expenditures for 2012. Appellant did not identify the exact dollar amount and date of any expenses allegedly paid during 2012. Furthermore, appellant has not provided copies of any source documentation, such as receipts or cancelled checks, to support any alleged expense for items such as computers, software, equipment, or furnishings. Finally, appellant also has failed to introduce any contemporaneous evidence regarding the business use (as opposed to personal use) of any item of alleged business expense. Even if we were to accept that appellant's wife used a portion of their home for business purposes during the 2012 tax year, and that appellant incurred expenses in relation thereto, appellant has failed to introduce any credible evidence to show that his wife used that portion exclusively for business purposes, and that such use was for the convenience of her employer. Therefore, we find that appellant failed to meet his burden to show (1) the amount of any unreimbursed employee business expenses incurred during 2012, and (2) that he was entitled to deduct any 2012 expenses as an itemized deduction.

2. Interest Abatement

The assessment of interest on a tax deficiency is mandatory and there is no reasonable cause exception to the imposition of interest. (R&TC, § 19101(a); *Appeal of Yamachi* (77-SBE-095) 1977 WL 3905.) Interest is not a penalty but is simply compensation for a taxpayer's use of money. (*Appeal of Jaegle* (76-SBE-070) 1976 WL 4086.) FTB may abate interest related to a

proposed deficiency to the extent the interest is attributable in whole or in part to: (1) an unreasonable error or delay (2) by an officer or employee of FTB (3) in performing a ministerial or managerial act (4) which occurred after FTB contacted the taxpayer in writing regarding the proposed assessment, and provided no significant aspect of that error or delay is attributable to the taxpayer. (R&TC, § 19104(a)(1), (b)(1); *Appeal of Michael and Sonia Kishner* (99-SBE-007) 1999 WL 1080250.) OTA has jurisdiction to determine whether a failure by FTB to abate interest under R&TC section 19104 was an abuse of discretion, and OTA has the authority to abate interest in such cases. (R&TC, § 19104(b)(2)(B).)

The Revenue and Taxation Code does not define what is meant by an "unreasonable error or delay." (R&TC, § 19104(a)(1).) R&TC section 19104(a)(1), California's interest abatement provision for unreasonable error or delay, applies the same standard and uses substantially identical language as IRC section 6404(e), which is the comparable federal statute authorizing interest abatement for unreasonable error or delay. Therefore, it is appropriate to look to federal authority for guidance. (*Douglas v. State* (1948) 48 Cal.App.2d 835, 838; *Appeal of Michael and Sophia Kishner*, *supra*.) Congress only intended abatement of interest in circumstances where the failure to do so would be widely perceived as grossly unfair. (*Franklin v. Commissioner* (2008) T.C. Memo. 2008-13 [citing H. Rept. 99–426, at 844 (1985), 1986–3 C.B. (Vol. 2) 1, 844; S. Rept. 99–313, at 208 (1986), 1986–3 C.B. (Vol. 3) 1, 208].) Thus, the mere passage of time does not establish an unreasonable error or delay. (*Ibrahim v. Commissioner* (2011) T.C. Memo. 2011-215.)

Here, appellant asks that OTA delete all accrued interest, and contends that it took FTB too long to contact him regarding the proposed assessment. Nevertheless, interest abatement is not applicable prior December 16, 2015, the date FTB first contacted appellant, because R&TC section 19104 limits interest abatement to periods *after* FTB initiates contact in writing with the taxpayer regarding the proposed assessment. (R&TC, § 19104(b)(1).) The March 20, 2017 NPA explains that it was being issued because, as of that date, appellant failed to provide any documentation to support the deduction claimed, despite being afforded extensions of time to respond. Subsequently, appellant protested the NPA on March 23, 2017, and FTB proposed denying his protest on May 18, 2018, unless appellant provided supporting documentation. Appellant's response, dated July 11, 2018, did not provide the documents or substantiation requested by FTB, and FTB denied the protest on July 30, 2018. This timely appeal followed.

Based on the above, the record shows that any delay after FTB's initial contact letter can be attributed in whole or part to appellant's failure to provide the supporting documentation requested by FTB. To date, appellant still has not provided supporting documentation. Therefore, we conclude that interest abatement is inapplicable under the facts of this case.[5]

Appellant separately asks OTA to delete the balance of FTB's proposed tax liability, based on his having made a good faith payment of $1,707 at the time of filing his appeal. Nevertheless, OTA must determine the legally correct amount of the tax liability and we lack authority to make discretionary adjustments to the amount of a tax assessment that has been correctly determined. (*Appeal of Luebbert* (71-SBE-028) 1971 WL 2708.)

HOLDINGS

1. Appellant failed to show that he incurred any deductible business expenses during 2012.
2. Appellant is not entitled to interest abatement.

DISPOSITION

FTB's action is sustained.

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge

DocuSigned by:
Jeffrey Margolis
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Jeffrey I. Margolis
Administrative Law Judge

[5] Based on our finding that interest abatement is inapplicable we do not address whether appellant's request to delete interest in his appeal letter constitutes a qualifying request for interest abatement in the form and manner required by FTB, or whether FTB's opening brief, requesting that the action be sustained, constitutes an action on a qualifying request for interest abatement, as provided in R&TC section 19104(b)(4).