

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18011225
JAMES L. SNELL AND MAGDA SNELL)
) Date Issued: July 23, 2019
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OPINION

Representing the Parties:

For Appellants: James L. Snell and Magda Snell

For Respondent: Mira Patel, Tax Counsel

For Office of Tax Appeals: Tom Hudson, Tax Counsel III

S. HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19045, James L. Snell and Magda Snell (appellants) appeal from the action of respondent Franchise Tax Board (FTB) on their protest against FTB’s proposed assessment of additional tax of \$636 for 2008, \$4,145 for 2009, and \$4,409 for 2010, plus applicable interest.¹

Appellants waived their right to an oral hearing and therefore the matter is being decided on the basis of the written record.

ISSUE

Did appellants establish errors in the proposed assessments for tax years 2008, 2009, and 2010, which are based on a final federal determination?

¹ In its appeal briefs dated April 20, 2018, and October 23, 2018, FTB indicated that it will reduce its proposed assessments in response to the additional materials submitted by appellants on appeal. FTB indicated that the revised amounts that are now at issue in this appeal are \$636 in additional tax for 2008 (no change), \$3,379 for 2009 (a decrease of \$766 from the original Notice of Action), and \$4,347 for 2010 (a decrease of \$62 from the original Notice of Action), plus applicable interest.

FACTUAL FINDINGS

1. For 2008, appellants filed a timely income tax return (Form 540), reporting federal adjusted gross income (AGI) of \$54,345, California AGI of \$54,634, and taxable income of \$12,056. Appellants reported tax of \$121, exemption credits of \$1,434, zero tax liability, and zero payments. Subsequently, the Internal Revenue Service (IRS) audited appellants' federal return and made adjustments that increased appellant's federal taxable income by \$61,130. Appellants did not report these federal audit adjustments to FTB, but the IRS eventually reported the adjustments to FTB by means of a FEDSTAR IRS Data Sheet on December 20, 2012. Based on this IRS information, FTB issued a Notice of Proposed Assessment (NPA) dated October 8, 2013, which included Schedule C gross receipts of \$39,414, disallowed Schedule C car and truck expenses of \$13,941, disallowed Schedule C supply expenses of \$4,229, and allowed an adjustment to income of \$3,546 for one-half of the self-employment tax. The NPA proposed to assess \$636 in additional taxes, plus applicable interest.
2. For 2009, appellants filed a timely income tax return (Form 540), reporting federal and California AGI of \$48,608, and taxable income of \$13,326. Appellants reported tax of \$166, exemption credits of \$588, zero tax liability, and zero payments. Subsequently, the IRS audited appellants' federal return and made numerous adjustments that increased appellant's federal taxable income by \$83,731. Appellants did not report these federal audit adjustments to FTB, but the IRS eventually reported the adjustments to FTB by means of a FEDSTAR IRS Data Sheet on December 20, 2012. Based on this IRS information, FTB issued an NPA that included the federal adjustments, proposing additional tax of \$4,145, plus applicable interest.
3. For 2010, appellants filed a timely income tax return (Form 540), reporting federal and California AGI of \$53,474, and taxable income of \$16,354. Appellants reported tax of \$227, exemption credits of \$495, zero tax liability, and zero payments. Subsequently, the IRS audited appellants' federal return and made numerous adjustments that increased appellant's federal taxable income by \$83,992. Appellants did not report these federal audit adjustments to FTB, but the IRS eventually reported the adjustments to FTB by means of a FEDSTAR IRS Data Sheet on December 20, 2012. Based on this IRS

information, FTB issued an NPA that included the federal adjustments, proposing additional tax of \$4,409, plus applicable interest.

4. Appellants protested all of the NPAs by a letter dated October 10, 2013, arguing that the IRS auditor made various mistakes, such as taxing the income shown on a Form 1099-MISC and taxing the cash deposits of that same income. FTB asked appellants to provide additional information and documentation by May 9, 2014. When there was no response, FTB issued a Notice of Action for each tax year that affirmed the NPA for each year. Appellants then filed this timely appeal.
5. On November 3, 2016, the Board of Equalization (the predecessor agency to the Office of Tax Appeals) issued a request for additional briefing to the parties. The letter requested documentation and information from appellants to show the errors, if any, in the IRS audit on which FTB's proposed assessments were based. The letter explained that none of the records provided to the IRS during the federal audit process were available for this appeal, so appellants would need to provide them if they wished to have them considered in this appeal. Appellants requested several extensions of time to respond to the additional briefing letter and each request was granted.
6. On or about April 18, 2017, appellants provided 239 pages of additional evidence and information, including "reconstructed" tax returns, receipts (some illegible), adding machine tapes and spreadsheets, reconstructed mileage information, receipts for donations to charities, bank statements, and other records. Appellants submitted a letter signed by Marcus Kasparian stating that he had borrowed \$500 from appellant-husband and paid him back in 2010.
7. On April 20, 2018, FTB replied to appellants' additional briefing materials. FTB asserted that it had reviewed all the documents provided by appellants and made four adjustments to the proposed assessments by allowing the following deductions: (1) \$8,020 for charitable contributions for 2009; (2) \$1,260 for Schedule C telephone expenses for 2009 (\$630 for each of two Schedule C businesses); (3) \$34.58 for Schedule C supply expenses for 2010; and (4) \$2,933 for business use of appellants' home for a Schedule C business for 2010. FTB asserted that additional adjustments were not warranted by the evidence provided. FTB indicated that, as a result of these adjustments, the proposed tax deficiency for 2008 would remain the same (\$636), the additional tax for 2009 would

increase to \$4,555 from \$4,145, and the additional tax for 2010 would decrease to \$4,347 from \$4,409.

8. On September 25, 2018, the Office of Tax Appeals issued a request for additional briefing asking FTB to explain the mathematical computations for the revised deficiency computed for 2009 in FTB's April 20, 2018 submission. On October 23, 2018, FTB replied and stated that its revised computation in the letter dated April 20, 2018, contained a mathematical error and the correct amount of its revised proposed tax deficiency for 2009 is \$3,379, which is a decrease of \$766 from the originally proposed tax deficiency of \$4,145. FTB explained that this decreased assessment reflected its decision to allow a deduction of \$8,020 for charitable contributions and a deduction of \$1,260 for telephone expenses for 2009.

DISCUSSION

Federal Assessment

R&TC section 18622(a), provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. A deficiency determination based on a federal audit report is presumptively correct and the taxpayer bears the burden of proving that the determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Sheldon I. and Helen E. Brockett* (86-SBE-109) 1986 WL 22731; *Appeal of Freemon and Dorothy Thorpe* (87-SBE-072) 1987 WL 50200.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to an assessment based on a federal action. (*Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.) In the absence of credible, competent, and relevant evidence showing error in FTB's determinations, such determinations must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer* (80-SBE-154) 1980 WL 5068.) A taxpayer's failure to produce evidence that is within his 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) 1983 WL 15434.)

Deductions from gross income are a matter of legislative grace and a taxpayer has the burden of proving entitlement to all of the deductions claimed. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440; *Appeal of James C. and Monablanche A. Walshe* (75-SBE-73) 1975 WL 3557.) To carry the burden of proof, a taxpayer must point to an applicable

statute and show by credible evidence that the deductions claimed come within its terms. (*Appeal of Robert R. Telles* (86-SBE-061) 1982 WL 11930.)

Gross Receipts

Appellants argue that the gross receipts that form the basis of the proposed assessments were incorrectly calculated by the IRS. For example, appellants argue that the IRS twice included in their income \$15,406.75 earned in 2010 from Owl Intervention Services by including certain cash deposits as income in addition to the same amount shown on the Form 1099-MISC issued by that company. To establish the correct amount of their gross receipts, appellants provided summaries, written assertions, copies of adding machine tapes, spreadsheets listing deposits by date and amount, revised income tax returns, etc. Appellants also provided the following monthly bank statements:

- Tri Counties Bank statements for the period from January 19, 2009, to January 19, 2010, showing deposits and credits of \$107,106.10 for that period;
- Golden 1 Credit Union statements for the period from January 1, 2009, to December 31, 2009 (omitting the month of September 2009), showing deposits and credits of \$22,421.90;
- Tri Counties Bank statements for the period from December 20, 2009, to January 19, 2011 (omitting the two monthly periods ending on April 19, 2010 and on December 19, 2010), showing deposits and credits of \$114,189.14 for that period; and,
- Golden 1 Credit Union statements for the period from January 1, 2010, to December 31, 2010, showing deposits and credits of \$29,365.10.

Appellants provided just one Form 1099-MISC, showing \$17,708 earned in 2010 by appellant-husband from William H. Graf as nonemployee compensation.

The documentation provided by appellants is not sufficient to overturn FTB's determination of appellants' gross receipts for any of the tax years on appeal. We do not have normal business records to review, such as invoices, contracts, receipts for payments received, deposit slips, ledgers, business journals, checkbook registers, accounting reports, etc. We do not have sufficient information about appellants' two businesses to make any estimates of appellants' income. We do not have Forms 1099-MISC for any tax year, except the one from

William H. Graf. The bank statements provided by appellants are incomplete and they have little probative value in the absence of business records, especially with regard to a business that appellants claim routinely received cash payments that may not have been deposited into a bank account. In sum, we do not have a sufficient evidentiary basis to overturn FTB's proposed assessments, which were based on an IRS determination.

Appellants argue that the IRS incorrectly included the repayment of a \$500 loan by Markus Kasparian in appellants' gross receipts for 2010. We do not have evidence showing that this \$500 payment was included in the gross receipts determined by the IRS auditor. Appellants provided a letter dated February 14, 2016, apparently signed by Markus Kasparian, as evidence of this loan repayment. The letter explains that Mr. Kasparian borrowed \$500 from appellant-husband in 2010, then repaid the same amount to appellant-husband by check number 6964744-0 on March 8, 2010. Appellants did not provide any other proof of the loan, such as a cancelled check or loan agreement. We do not have sufficient evidence to reduce appellants' gross receipts for 2010 on the basis of Mr. Kasparian's letter because we cannot determine if this \$500 loan repayment was included in gross receipts by the IRS or FTB. As previously explained, we do not have sufficient evidence to determine whether this loan repayment was excluded from income.

Business Expense Deductions

Internal Revenue Code (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 R&TC section 17201. To qualify as an allowable business deduction, an item must: (1) be paid or incurred during the taxable year; (2) be for 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 Monablance A. Walshe, supra*, 1975 WL 3557.) 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) 1976 WL 4106.)

As a preliminary matter, appellants did not provide basic information or documentation about the nature of their two businesses. Because these fundamental issues were not addressed by appellants, we have insufficient information to determine what sort of business expenses might be considered ordinary and necessary in connection with their businesses, even if documentation for those expenses were provided. Appellants failed to meet their burden of proof because they did not present evidence to support their business expense deductions. Appellants provided lists and summaries of income and expenses, but in most cases, the supporting documentation and substantiation were not provided to us.

Mileage and Travel Deductions

IRC section 274(d) generally prohibits taxpayers from deducting travel expenses *unless* the taxpayer “substantiates by adequate records or by sufficient evidence” the amount, time and place, and business purpose of the expense. IRC section 274 is incorporated into California law by reference in R&TC section 17201. The substantiation requirements for compliance with IRC section 274 are stricter than those required for other kinds of deductions, particularly the deduction for ordinary and necessary expenses found in IRC section 162. (*D. A. Foster Trenching Co. v. United States* (Ct. Cl. 1973) 473 F.2d 1398.) The U.S. 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.) Expenses related to other kinds of deductions can sometimes be estimated under the “*Cohan rule*” (see *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540), but such estimation is not consistent with the more stringent requirements for deductions under IRC section 274. Furthermore, the cost of commuting to a regular place of business or employment is treated as a personal expense and is not deductible. (Treas. Reg. § 1.262-1(b)(5).)

Here, appellants contend that “mileage logs were given to the auditor, but disappeared.” Appellants provided notes and summaries that they say were “recreated from appointment books.” For example, appellants state, “1 Business Trip to Sacramento 5/10/2008 = 468 miles.” This statement, which is typical of the information provided, does not include an explanation or even a hint about the business purpose for the trip, does not include the odometer readings for the beginning or ending of the trip, does not include the addresses or specific locations to which appellant travelled, and does not include receipts, documentation, or “sufficient evidence corroborating the taxpayer’s own statement” as required in IRC section 274 (d)(3). The

information that appellants have provided is too vague and incomplete to meet the strict substantiation requirements for a business mileage deduction. We do not have a sufficient evidentiary basis in this area to overturn FTB's proposed assessment.

Business Supplies, Repairs, Maintenance, and Office Expenses

Appellants provided various summaries of expenses for business supplies, repairs, maintenance, and office expenses. For example, for the 2009 tax year, appellants state,

Receipts for supplies are voluminous and difficult to copy. An adding machine tape was made of the total and a copy of that is enclosed (marked as item 10). No clothing or personal items were included in the adding machine tape. Sales tax is included on receipts for which the total was for supplies, but not on individual items picked from receipts with non-supply items included. Thus, the total for supplies is understated by the amount of sales tax. Some receipts are copied and enclosed. All receipts can be copied and provided if necessary, but many will not copy well due to the paper used.

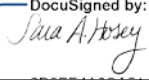
While we understand the difficulty involved in producing individual receipts for business expenses, appellants did not provide sufficient documentation to allow us to overturn FTB's proposed assessment. Adding machine tapes and summaries are insufficient to meet the substantiation requirements for such deductions. We have no information about the nature of appellants' businesses and no information about what sort of expenses might have been ordinary and necessary. Accordingly, we are unable to determine whether any amounts in excess of those allowed by the IRS should be allowed.

HOLDING

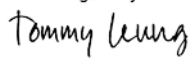
Appellants did not establish any errors in the proposed assessments for tax years 2008, 2009, and 2010, except as conceded on appeal by FTB.

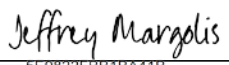
DISPOSITION

FTB's proposed assessments are modified, as conceded by FTB on appeal.² Otherwise, FTB's proposed assessments are sustained.

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Sara A. Hosey
Administrative Law Judge

We concur:

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Tommy Leung
Administrative Law Judge

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Jeffrey I. Margolis
Administrative Law Judge

² See fn. 1.