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Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **LESLIE BILLINGS AND CAROL BILLINGS**	) OTA Case No. 18011078)) Date Issued: September 18, 2019)))

OPINION

Representing the Parties:

For Appellants:	Leslie Billings
For Respondent:	Bradley Coutinho, Tax Counsel Natasha Page, Tax Counsel IV
For the Office of Tax Appeals:	Andrew Jacobson, Tax Counsel III

T. STANLEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19045, Leslie and Carol Billings (appellants) appeal an action by the Franchise Tax Board (FTB) proposing an assessment of $2,150 in additional tax, plus interest, for the 2012 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Neil Robinson, and Sara A. Hosey held an oral hearing for this matter in Los Angeles, California, on May 23, 2019. At the conclusion of the hearing, appellants requested 45 days to submit additional documents. No documents were submitted, and the record was closed on July 25, 2019.

ISSUE

Have appellants shown that they are entitled to deduct unreimbursed employee business expenses and home office expense deductions disallowed by FTB for the 2012 taxable year?

FACTUAL FINDINGS

1. Appellants timely filed a joint 2012 California Resident Income Tax Return (Form 540), reporting federal and California adjusted gross income (AGI) of $160,439, itemized deductions of $30,796, taxable income of $129,643 and tax of $7,263.[1] After applying exemption and withholding credits, appellants reported an overpayment of $256, which FTB refunded to appellants on May 19, 2013.
2. Appellants included with their federal 2012 tax return a statement entitled "Unreimbursed Expense St." showing total unreimbursed expenses of $31,032 consisting of the following: (1) telephone and internet expenses of $2,360; (2) cell phone expenses of $1,788; (3) business meals (1/2) of $2,614; and (4) auto mileage expenses of $24,270. After deducting the 2 percent of AGI threshold amount ($3,209), appellants claimed total unreimbursed employee business expenses of $28,013.
3. On January 11, 2017, FTB issued a Notice of Proposed Assessment (NPA), stating that appellants failed to provide documentation in support of their claim for unreimbursed employee expenses. The NPA disallowed the entire $28,013 of appellants' claimed California itemized deductions and allowed a standard deduction because it was greater than the remaining balance of appellants' itemized deductions. The NPA proposed an additional tax of $2,150, plus applicable interest.
4. Appellants protested the NPA on the grounds that appellant-husband incurred unreimbursed expenses as a remote field adjuster for an insurance firm for which he examined various types of insurance claims related to commercial, residential and casualty insurance. Appellants stated that:
    - Although appellant-husband's employer had an expense reimbursement policy, "their requirement of submission for reimbursement was difficult and was never explained by trainers."
    - Appellant-husband's employer urged him to "file all expenses with [his] tax preparer," because the process for claiming expenses was so difficult.

[1] Dollar amounts are rounded to the nearest $1.

- Appellant-husband worked out of appellants' home and used a home office with a "simplified tabulation of 300 feet."[2]
- Appellant-husband used his personal vehicle to drive to 334 locations in 2012, to investigate and adjust insurance claims, as required by his employer. Appellant-husband incurred travel mileage in connection with religious institutions.

5. Appellants submitted additional documents to FTB to support their claims. After reviewing these documents, that included an employer expense reimbursement policy, FTB determined that appellants could not claim a deduction for employee business expenses on their 2012 return. FTB determined that appellant-husband's mileage log and expense schedule lacked information regarding the business purpose of these trips, because it did not state the date of travel, the place of origination and the destination, the total mileage, and the purpose of the travel.
6. FTB requested that appellants complete an Internal Revenue Service (IRS) Form 2106, Employee Business Expenses (Form 2106), and an IRS Form 8829, Expenses for Business Use of Your Home (Form 8829). FTB also requested copies of appellant-husband's employer reimbursement policy for the use of a home office, and separate schedules for appellant-husband's business expenses, meals and entertainment expenses, and business telephone expenses.
7. In response, appellants provided copies of: (1) a mileage log showing the miles claimed by appellant-husband in the course of his employment, which included the dates of travel, purpose for the travel, the general destination, and the total miles traveled; and (2) an IRS Publication 587 (2016) Worksheet to Figure the Deduction for Business Use of Your Home showing expenses for business use of the home of $21,790. Appellants did not provide the copies of completed federal Forms 2106 and 8829 requested by FTB.
8. On September 8, 2017, FTB issued a Notice of Action, affirming the NPA. Appellants then filed this timely appeal.
9. A post-hearing order granted appellants 45 days to submit specific documents (a list of 5) in support of their claims. Appellants did not respond, and the record was closed.

[2] This assertion is made for the first time on appeal. No home office expenses were claimed on appellants' federal or state returns.

DISCUSSION

Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) To sustain the burden of proof, a taxpayer must be able to point to an applicable deduction statute and show that the taxpayer came within its terms. (*Appeal of Briglia* (86-SBE-153) 1986 WL 22833.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) A taxpayer's failure to produce evidence that is within his or her 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.)

Taxpayers may deduct unreimbursed employee expenses as ordinary and necessary business expenses under R&TC section 17201; however, taxpayers "shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters . . . ." (Treas. Reg. § 1.6001-1(a).) Moreover, "the books or records . . . shall be kept at all times available . . . and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law." (Treas. Reg. § 1.6001-1(e).)

R&TC section 17201 incorporates Internal Revenue Code (IRC) section 162(a), which authorizes a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ." By contrast, personal, living, or family expenses are generally nondeductible. (IRC, § 262; Treas. Reg. § 1.162-17.) The expenses must be both ordinary and necessary for carrying on a taxpayer's trade or business. (*Deputy v. Du Pont* (1940) 308 U.S. 488, 493-495; Treas. Reg. § 1.162-1(a).)

Reimbursable Expenses

Although the performance of services as an employee constitutes a trade or business, a deduction under IRC section 162(a) is not allowable to the extent that the employee is entitled to reimbursement from an employer for an expenditure related to status as an employee. (*Jetty v. Commissioner*, T.C. Memo. 1982-378; see Treas. Reg. § 1.162-17(a).) "[A]n expense is not [considered] 'necessary' under [IRC section] 162(a) when an employee fails to claim

reimbursement for the expenses, incurred in the course of his employment, when entitled to do so." (*Orvis v. Commissioner* (9th Cir. 1986) 788 F.2d 1406, 1408 (*Orvis*).)

R&TC section 17201 incorporates IRC section 274. The version of IRC section 274(d) that was in effect during 2012 prohibits an IRC section 162 deduction for the following types of expenses unless they are substantiated by adequate records or by sufficient evidence corroborating the taxpayer's own statement: (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) an expense for gifts; or (4) the use of "listed property," as defined in IRC section 280F(d)(4), which includes passenger automobiles. (See *Roberts v. Commissioner*, T.C. Memo. 2012-197.) Claimed deductions must be substantiated 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).) A taxpayer must substantiate each element of an expenditure or use by adequate records or by sufficient evidence corroborating the taxpayer's own statement. (Treas. Reg. § 1.274-5T(c)(2)(i).)

The taxpayer in *Orvis, supra*, was employed by Fresno County as an assistant district attorney. The taxpayer was required to use a personal automobile in the course of employment. The taxpayer was not aware that the County had a policy of fully reimbursing its employees for travel expenses, and thus did not seek reimbursement for these expenses. Instead, the taxpayer deducted $1,275 of travel expenses on a joint tax return. The IRS denied the deduction, and the Tax Court sustained the IRS's denial. The Ninth Circuit affirmed, imposing a bright line rule that prohibits deductions for all reimbursable expenses on the grounds that a reimbursable expense is not "necessary" under IRC section 162(a). In particular, the Ninth Circuit noted that the taxpayer did not dispute that he could have received reimbursement from the employer for automobile expenses had it been requested.

To the extent that any and all claimed unreimbursed expenses were subject to reimbursement by appellant-husband's employer, appellants are not entitled to claim deductions for them, because appellant-husband did not request nor obtain reimbursement for these expenses. With regard to appellants' claim that they incurred expenses in excess of the amounts

allowed by the employer's reimbursement policy, appellants have not submitted evidence to substantiate their entitlement to claim deductions for the reasons discussed below. The failure to provide such evidence that is within appellants' control, after several opportunities to do so, raises the presumption that the evidence would be unfavorable to appellants. (See *Appeal of Cookston, supra*.)

Automobile Mileage Expenses

Taxpayers must maintain "adequate records" combined with supporting documents, which substantiate the required elements of the expense, such as the amount, date, and business purpose of the item. (Treas. Reg. § 1.274-5T(c)(2)(i).) If "adequate records" are not provided under this provision, the taxpayer must establish each element of the expense by his own statement containing specific detail as to each element, and "other corroborative evidence sufficient to establish such element," or other evidence, with respect to each element, possessing "the highest degree of probative value possible under the circumstances . . . ." (*Id.*) Although a contemporaneous log is not required, a record made at or near the time of the expenditure, supported by sufficient documentary evidence, has a high degree of credibility. (Treas. Reg. § 1.274-5T(c)(1).)

In this appeal, appellants have failed to show that their automobile mileage expenses were ordinary and necessary under IRC section 162(a). Appellants did not file a federal Form 2106, although appellants claimed unreimbursed automobile mileage expenses of $24,270 on a statement attached to their 2012 return. Moreover, the Employment Agreement, Section 4(c), as amended on February 1, 2012, provides the following provision with respect to reimbursement of work-related automobile mileage:

> (c) Mileage: Eagle [appellant-husband's employer at the time] shall pay employee 100% of client-allowed billing to each client for mileage incurred in adjusting claims, up to One Dollar and Zero cents ($1.00) per mile, that is, in the discretion of Eagle, billed to an Eagle client.

Appellants contend that the expense reimbursement process was difficult, that the employer never adequately explained it to appellant-husband, and that the employer encouraged appellants to deduct all expenses directly on their tax returns. However, appellant-husband concedes that he was aware of the employer's reimbursement policy but chose not to take advantage of it because of the difficulty of using it. Appellant-husband testified that "they do not

reimburse the employee for that [travel]. They only pay the client-approved mileage, which is restricted by location and how much is charged in a cap." However, difficulty in obtaining reimbursement does not prove that the incurred expenses were ordinary and necessary. Because the employer had a mileage reimbursement policy in place during 2012, appellants must prove that they applied for but did not receive reimbursement if they wish to deduct automobile mileage. Furthermore, in a post-hearing order, appellants were given an opportunity to provide other, specific documents that might have shown whether appellants' actual expenses exceeded the reimbursable expenses. Appellants failed to respond to that request.

Finally, while appellants have provided a mileage log for appellant-husband, this evidence lacks necessary inputs such as the point of origin and the travel destination. (Treas. Reg. § 1.274-5T(c)(2)(i).) Appellants' failure to file a federal Form 2106 means that we lack important information concerning the vehicle used by appellant-husband for his work-related mileage, as well as the proration of the mileage between work and personal use.[3] Therefore, appellants have failed to substantiate any unreimbursed automobile mileage expenses. FTB properly disallowed the claimed automobile mileage expenses deduction.

Travel Expenses and Business Meals Expenses

Appellants claimed costs for hotels and parking of $7,005 on one of their tax statements. However, that statement did not provide a breakdown of each of these expenses, the time and place of the expense, and the business purpose for the expense. Appellants have provided only bank statements from two accounts and a financial summary without any dates for another joint account that appear to commingle both business and personal expenses. Appellants also provided three cancelled checks, which appear to be related to personal family expenses, such as "Kendall – camp" and "tennis and sports camp." Therefore, appellants have failed to satisfy the heightened requirements for substantiating their claimed unreimbursed travel and hotel expenses. FTB properly disallowed the claimed travel expenses deduction.

With respect to business meals, the deduction is generally limited to 50 percent of the amount of each such expense. (IRC, § 274(n).) Specifically, adequate records must be prepared and maintained for each element of a claimed meal expense "at or near the time of the expenditure or use." (Treas. Reg. § 1.274-5T(c)(2)(ii)(A).) In the alternative, each element of a

[3] At protest with FTB, appellants objected to disallowance of "charitable mileage." The claim was not made on appeal, and no documentation in support of such a donation was submitted.

claimed meal expense deduction may be established by the taxpayer's own written or oral statements that contain "specific information in detail as to such element," and which are combined with corroborating evidence. (Treas. Reg. § 1.274-5T(c)(3)(i).) Thus, to qualify as a business deduction, appellant-husband's meal expenses must be directly related to appellant-husband's trade or business and adequately substantiated.

Here, appellants estimated unreimbursed business meal expenses of $5,228, for which they claimed one half of the amount ($2,614) on their 2012 return. However, appellants have provided bank statements and a financial summary that appear to commingle business and personal expenses. To the extent that appellants rely on their 2012 return as evidence in support of their position on appeal, the courts have held that "tax returns are not proof of the statements made therein." (*Bruno v. Commissioner*, T.C. Memo. 1990-109.) Therefore, appellants have failed to prove their claimed unreimbursed business meal expenses. FTB properly disallowed the claimed business meal expenses deduction.

Home Office Expenses

IRC section 280A(c) permits a deduction of home office expenses if a portion of the home is "exclusively used on a regular basis" as the taxpayer's principal place of business "for the convenience of his employer." The term "principal place of business" includes a place of business used by the taxpayer to perform administrative or management activities related to the taxpayer's trade or business if there is "no other fixed location" where substantial administrative or management activities are undertaken. (IRC, § 280A(c)(1).)

In the present appeal, appellants must first show that appellant-husband's home office was his place of business for the convenience of his employer. (IRC, § 280A(c)(1).) Appellants never claimed a home office deduction on their Schedule A, but rather raised this argument for the first time on appeal. Appellants have provided a 2012 Form W-2 and the Employment Agreement, which show that appellant-husband's employer was located in Noblesville, Indiana, while the 2012 List of Closed Claims from RYZE Claim Solutions shows that appellant-husband had 334 closed claims that were spread across various locations throughout California. Therefore, appellants have satisfied their burden of proving that appellant-husband's home office in Bakersfield was a place of business for the convenience of his employer. FTB does not appear to dispute that the home office was appellant-husband's principal place of business.

However, any amount reported as a home office expense incurred in appellants' trade or business must be substantiated, and appellants are required to maintain sufficient records to prove entitlement to the deduction. Appellants did not file (or submit to FTB upon request) a federal Form 8829, nor did they include any home office expenses on the statements they submitted at protest and on appeal. Instead, appellants completed and submitted an IRS Publication 587 (2016) Worksheet to Figure the Deduction for Business Use of Your Home, which reported allowable expenses for business use of their home of $21,790, including rent of $19,200, estimated insurance of $500 and estimated utilities of $1,200. Appellants have provided no evidence such as a lease, insurance documents or utility bills in support of these contentions. Moreover, appellants appear to contend that the office was only 300 square feet (reported as 5.266% of the residence), which would mean that only a fraction of the rent payments would be deductible as office expenses. Appellants also appear to be claiming the entirety of their household expenses. There is insufficient evidence to support appellants' claimed home office deductions.

Telephone, Cellular and Internet Expenses

On a statement submitted to FTB, appellants noted unreimbursed telephone and internet expenses of $2,360 and unreimbursed cell phone expenses of $1,788, which they later modified to claim telephone expenses of $3,127 and internet/email costs of $179 based on a charge of $15 per month. Appellants have provided no bills or receipts, and the bank statements provided have not been correlated to any particular expense. The Employment Agreement allowed reimbursement for cellular telephone expenses of up to $70 and the cost of an internet connection. Appellants are entitled to claim any telephone, cellular or internet expenses not subject to reimbursement if properly substantiated, but appellants have not done so.

The Employment Agreement, Section 4(d), required appellant-husband to submit receipts or invoices to support costs incurred, which should have put appellants on notice that they needed to retain and itemize such documentation. Appellants have not done so, nor have they documented whether any of the claimed costs were reimbursable. Therefore, appellants have failed to establish that they are entitled to deduct telephone, cellular and internet expenses as unreimbursed business expenses.

HOLDING

Appellants have failed to show that they are entitled to deduct unreimbursed employee business expenses and home office deductions disallowed by FTB for the 2012 taxable year.

DISPOSITION

FTB's action is sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Neil Robinson
Administrative Law Judge

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Sara A. Hosey
Administrative Law Judge