

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18093708
OTTO VARELA)
) Date Issued: November 14, 2019
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OPINION

Representing the Parties:

For Appellant: Otto Varela

For Respondent: Desiree Macedo, Tax Counsel

For Office of Tax Appeals: Andrew Jacobson, Tax Counsel III

N. ROBINSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Otto Varela (appellant) appeals an action by the Franchise Tax Board (FTB) proposing an additional tax of \$2,074, plus applicable interest, for the 2012 tax year.

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

ISSUE

Whether appellant has shown error in FTB’s disallowance of his claimed unreimbursed business expense deductions.

FACTUAL FINDINGS

1. In 2012, Continental Data Graphics (CDG) employed appellant as a senior system engineer in Long Beach, California.
2. On February 10, 2013, appellant filed a timely 2012 California Resident Income Tax Return (Form 540), on which he reported a California AGI of \$119,934 and itemized deductions of \$58,373, including \$25,278 in deductions for unreimbursed employee business expenses.

3. The job expenses and certain miscellaneous deductions consist of unreimbursed employee expenses of \$25,636 and other expenses of \$2,164,¹ totaling \$27,800. Appellant subtracted 2 percent of his federal AGI (\$126,115) from the total expenses (\$27,800) in computing the claimed miscellaneous deductions of \$25,278 ($\$126,115 \times .02 = \$2,522$; $\$27,800 - \$2,522 = \$25,278$).
4. On a federal Form 2106, entitled Employee Business Expenses, appellant claimed expenses (other than meals and entertainment) of \$18,449 consisting of vehicle expenses of \$14,652 and \$3,797 for computer expenses. Appellant also claimed meals and entertainment expenses of \$14,374, which he reduced by 50 percent, resulting in claimed meals and entertainment deductions of \$7,187. Appellant thus claimed total unreimbursed employee expenses of \$25,636 ($\$14,652 + \$3,797 + \$7,187$).
5. In a letter dated July 26, 2016, FTB notified appellant that it was examining his 2012 return and requested that he provide documentation to support claimed unreimbursed employee business expenses of \$25,278, because his 2012 federal return did not provide sufficient information to substantiate the deducted expenses.
6. On March 27, 2017, FTB issued a Notice of Proposed Assessment (NPA) that increased appellant's taxable income from \$70,916 to \$96,194, an increase of \$25,278. The NPA stated that FTB was denying the claimed job expenses and certain miscellaneous deductions of \$25,278 because appellant's employer's reimbursement policy showed that appellant's claimed expenses were reimbursable. The NPA proposed an additional tax of \$2,353, plus applicable interest.
7. In a letter dated May 30, 2017, appellant protested the NPA on the grounds that CDG's procedures and guidelines substantiated appellant's position. Appellant attached copies of the following documents: (1) CDG's General Travel Expenses Guidelines (Guidelines) with an effective date of October 14, 2010; (2) a report supporting claimed 2012 digital subscriber line (DSL) expenses of \$1,740; (3) a report supporting claimed 2012 travel and lodging expenses of \$10,899.68, all of which are categorized as "Vacation" expenses; (4) a report supporting claimed 2012 computer expenses of \$3,797.39; (5) a report supporting claimed 2012 dry-cleaning expenses of \$424.71; (6) a

¹ Appellant claimed on Schedule A that he had other expenses in the amount of \$2,164 that included \$1,740 for DSL and \$424 in dry cleaning.

- report supporting claimed 2012 meal expenses of \$8,718; and (7) a 2012 mileage log report showing the dates, destinations and mileage for vehicle expenses.
8. In a position letter dated March 29, 2018, FTB informed appellant that it had reviewed appellant's submissions and determined that most of the claimed unreimbursed employee business expenses should still be disallowed. FTB indicated that it agreed to allow the claimed computer expenses of \$3,797 and the claimed DSL expenses of \$1,740 because CDG did not have a reimbursement policy in effect for these items. FTB also indicated that it continued to deny the remaining claimed business expense deductions of \$22,263, because CDG's reimbursement policy encompassed these items.
 9. On July 5, 2018, FTB issued a Notice of Action (NOA) that revised the NPA by reducing the disallowed itemized deductions from \$25,278 to \$22,263. The NOA proposed a revised additional tax of \$2,074, plus applicable interest.
 10. Appellant filed the instant appeal.

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 entitlement to that deduction. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435.) To sustain the burden of proof, a taxpayer must be able to point to an applicable deduction statute and present evidence to satisfy any requirements within the statute. (*Appeal of Donald D. Briglia* (86-SBE-153) 1986 WL 22833.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise 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 Don A. Cookston* (83-SBE-048) 1983 WL 15434.)

A taxpayer may deduct unreimbursed employee expenses as ordinary and necessary business expenses under R&TC section 17201, which incorporates by reference Internal Revenue Code (IRC) section 162. 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." (See *Roberts v. Comm'r*, T.C. Memo. 2012-197.) By contrast, personal, living, or family expenses are generally nondeductible. (IRC, § 262.) The expenses must be ordinary and necessary business expenditures directly related to the taxpayer's trade or business. (*Deputy v.*

Du Pont (1940) 308 U.S. 488, 493-495; Treas. Reg. § 1.162-1(a).) The performance of services as an employee constitutes a trade or business. (See Treas. Reg. § 1.162-17.)

An unreimbursed trade or business deduction under IRC section 162(a) is not allowable to an employee to the extent that the employee is entitled to reimbursement from an employer for an expenditure related to the employee's status. (*Jetty v. Comm'r*, T.C. Memo. 1982-378.) An expense is not "necessary" under IRC section 162(a) when an employee fails to claim reimbursement for the expenses when the employee is entitled to do so. (*Orvis v. Comm'r* (9th Cir. 1986) 788 F.2d 1406, 1408 (*Orvis*); *Coplon v. Comm'r* (6th Cir. 1960) 277 F.2d 534, 535; *Heidt v. Comm'r* (7th Cir. 1959) 274 F.2d 25, 28; *Stolk v. Comm'r* (1963) 40 T.C. 345, 356, affd. (2d Cir. 1964) 326 F.2d 760.)

R&TC section 17201 incorporates IRC section 274. IRC section 274(d) prohibits an IRC section 162 deduction for employment-related meal, travel and lodging expenses unless they are substantiated by adequate records or by sufficient evidence corroborating appellant's 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 benefit where applicable.

CDG's Guidelines show that there was a travel and lodging expense reimbursement process in effect during 2012. Section 2 states that the policy applies to all employees who travel on behalf of CDG. Section 3 states, "[t]his Policy/Procedure of . . . CDG [is to] ensure [that] individuals are reimbursed for all properly authorized, reasonable, and necessary business expenses." Section 6.2 provides that CDG reimburses employees for actual travel expenses that are reasonable and necessary. Section 6.2.4.1 provides that CDG employees shall be reimbursed for "reasonable actual lodging costs." Section 4.3 provides that "travel related expenses are reported and reimbursed via this specific [Business and Travel Expense Report Form]." Section 3.7 provides that "[a] bill, receipt, or justification shall be submitted for all expenses to be reimbursed."

Business Meal Expenses

IRC section 274(n) limits a deduction for meal expenses to 50 percent of the amount of each such expense. 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 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).)

Guidelines section 6.2.5.1 provides that meals and other incidental actual expenses will be reimbursed on a reasonable basis. Any single meal of more than \$25 (including tax and tip) requires a receipt to be submitted with the Business and Travel Expense Report Form. Guidelines section 6.2.5.9.1 provides that meal costs determined excessive by management may result in the employee becoming responsible for all or part of the costs. Guidelines section 6.1.7.4 provides that employees will not be reimbursed for meals within the local area (up to 75 miles) except when the employee is on travel status and is authorized to incur lodging and related travel expenses.

Appellant has failed to show that he requested but did not receive reimbursement from CDG for business meal expenses or that his claimed meal expenses were incurred in carrying on his trade or business as a CDG employee pursuant to IRC section 162(a). Moreover, appellant has not produced any receipts, which are necessary to satisfy his burden of proof pursuant to the heightened requirements of IRC section 274(d).

Furthermore, on his federal Form 2106, appellant reported total meal expenses of \$14,374, which were reduced by 50 percent pursuant to the requirements of IRC section 274(n), resulting in claimed meals and entertainment deductions of \$7,187. Appellant provided a meal expense report which lists 2012 meal expenses of \$8,718 without reducing them by 50 percent, as required by IRC section 274(n). While appellant claimed total meal expenses of \$14,374 on his 2012 return and then reduced that amount by one half to \$7,187, appellant's meal expense schedule only shows meal expenses of \$8,718, one half of which is \$4,359. Therefore, the evidence shows that appellant's meal expenses were less than those claimed on the Form 2106.

For these reasons, FTB properly disallowed the claimed business meal expenses as unreimbursed business expense deductions.

Travel and Lodging Expenses

Appellant submitted a schedule showing travel and lodging expenses in the total amount of \$10,899.68.² Appellant's documentation is specific with regard to the date of travel or lodging and the travel destinations. However, the documentation fails to explain the business purpose of each of these travel expenses. Also, we do not have evidence showing appellant requested or received reimbursement or that claimed reimbursements were denied by his employer.

By failing to provide evidence about the business purpose of his travel or lodging, appellant has clearly failed to comply with all of the requirements specified in IRC section 274(d). Furthermore, because we do not have evidence that appellant submitted the claimed travel and lodging expenses to his employer pursuant to employer's guidelines, appellant may not deduct these expenses. (*Orvis, supra*, 788 F.2d at 1408.)

Automobile Mileage Expenses

Appellant's employer allowed employees to be reimbursed for business mileage. Guidelines section 6.1.1 provides that "[m]ileage from a privately-owned automobile for business travel within the local area is reimbursed at the prevailing mileage rate. Local area travel miles can be calculated by using the odometer reading." Guidelines section 6.1.2 provides that employees must file a mileage reimbursement form if no Business and Travel Expense Report has been filed.

Appellant claimed vehicle expenses of \$14,652 on his Form 2106. Appellant provided a 2012 mileage log schedule, listing the dates, destination and mileage for vehicle expenses. Appellant has failed to show that he requested and was denied reimbursement from CDG for his claimed travel and lodging expenses or that his claimed automobile mileage expenses were incurred in carrying on his trade or business as a CDG employee. Once again, appellant has failed to provide a breakdown of mileage expenses that were reimbursed by CDG, as well as any cancelled reimbursement checks or expense statements.

²This schedule also labels each travel or lodging entry as "vacation," however these expenses are being offered as documentation of unreimbursed travel or lodging expenses. We have no evidence in this record to explain the meaning of the word "vacation" and choose to treat this schedule as documentation of unreimbursed business expenses.

Finally, while appellant provided a mileage log, this evidence lacks necessary information, such as the point of origin, the travel destination and the purpose of the trip. (Treas. Reg. § 1.274-5T(c)(2)(i).) Therefore, appellant has failed to substantiate any unreimbursed automobile mileage expenses. For these reasons, FTB properly disallowed the claimed automobile mileage expenses as unreimbursed business expense deductions.

Dry-Cleaning Expenses

As stated above, a taxpayer may only deduct unreimbursed employee expenses as ordinary and necessary business expenses under IRC section 162(a). By contrast, personal, living, or family expenses are generally nondeductible. (IRC, § 262.) To claim an unreimbursed business expense deduction for clothing, a taxpayer must show the following: (1) the items were required or essential for employment; and (2) that they were not suitable for ordinary use. (*Fausner v. Comm’r*, T.C. Memo. 1971-277, affd. 472 F.2d 561 (5th Cir. 1973), affd. (1973) 413 U.S. 838; *Donnelly v. Comm’r* (2d Cir. 1959) 262 F.2d 411.) The Internal Revenue Service (IRS) has concluded that the cost of acquisition and maintenance of uniforms in the case of police officers, firefighters, letter carriers, nurses, bus drivers, and railway employees “who are required to wear distinctive types of uniforms while at work and which are not suitable for ordinary wear” is deductible under IRC section 162(a). (Rev. Rul. 70-474, 1970-2 C.B. 34.) However, the IRS also concluded that the fact that “a uniform might be required as a condition of employment is not, of itself, sufficient to allow a deduction, as in the case of military apparel which replaces regular clothing.” (*Ibid.*)

Appellant claimed dry-cleaning expenses of \$424.71. Guidelines section 6.2.11 provides that CDG employees may receive reimbursement for actual and reasonable laundry and dry-cleaning expenses if their business travel involves at least four consecutive nights of lodging or on trips of lesser duration in the case of extenuating circumstances. Appellant has failed to show that he requested and was denied reimbursement for these claimed expenses.

Furthermore, appellant has failed to provide any evidence showing that his claimed dry-cleaning expenses were incurred in pursuit of his trade or business as a senior system engineer employed at CDG’s corporate headquarters. (IRC, § 162(a).) There is no evidence that appellant was required as a condition of his employment to wear a special uniform that would not be suitable for ordinary use outside of his workplace. Thus, FTB properly disallowed appellant’s claimed dry-cleaning expenses deduction.

HOLDING

Appellant has failed to show error in FTB’s disallowance of his remaining claimed Schedule A unreimbursed business expense deductions.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:

Neil Robinson

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Neil Robinson
Administrative Law Judge

We concur:

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Jeffrey I. Margolis

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Jeffrey I. Margolis
Administrative Law Judge

DocuSigned by:

Suzanne B. Brown

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Suzanne B. Brown
Administrative Law Judge