

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:
A. ARENAS

) OTA Case No. 19044660
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OPINION

Representing the Parties:

For Appellant: A. Arenas

For Respondent: Desiree Macedo, Tax Counsel
Sonia Woodruff, Tax Counsel IV

R. TAY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, A. Arenas (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing \$3,024 of additional tax, plus applicable interest, for the 2012 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Douglas Bramhall, Nguyen Dang, and Richard Tay held an oral hearing for this matter in Cerritos, California, on February 19, 2020. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

ISSUE

Whether appellant has shown that FTB erred in disallowing his Job Expenses and Certain Miscellaneous Deductions for the 2012 tax year.

FACTUAL FINDINGS

1. In 2012, appellant was the District Sales Manager for Luitpold Pharmaceuticals, Inc., a company based in Shirley, New York. Appellant worked remotely full-time in California.
2. Appellant filed a timely 2012 California income tax return, and claimed \$29,196 in unreimbursed employee expenses. After taking into account the 2 percent limitation for

- miscellaneous itemized deductions, appellant's total deduction under the Job Expenses and Certain Miscellaneous Deductions category reported on line 27 of Schedule A of his federal income tax return was \$26,915.¹
3. On IRS Form 2106, Appellant listed specific expenses that comprised his unreimbursed employee expenses: \$19,199 in business expenses; \$7,358 in meals and entertainment expenses; \$5,940 in travel expenses; and \$378 in parking fees.² Appellant's business expenses specifically included \$2,545 for "business phone/data/etc.," \$2,628 for "business supplies, postage, etc.," \$3,754 for continuing education/trade show, \$6,552 for client/assoc. marketing expenses, and \$3,720 for home office expenses.
 4. FTB audited appellant's 2012 income tax return and during the audit, appellant provided bank statements and receipts to substantiate his unreimbursed employee expenses. However, FTB issued a Notice of Proposed Assessment (NPA) proposing to assess additional tax of \$3,024, plus interest. The NPA disallowed, among other adjustments, the \$26,915 deduction because appellant failed to provide his employer's expense reimbursement policy or contract, a description of the activity and business purpose of appellant's unreimbursed expenses, a detailed transportation log, and a description of appellant's job.
 5. Appellant protested the NPA and provided additional documents including a copy of his employer's expense reimbursement policy.³ FTB affirmed its NPA by issuing a Notice of Action. This timely appeal followed.

DISCUSSION

A taxpayer may deduct unreimbursed employee expenses as an ordinary and necessary business expense under R&TC section 17201, which incorporates by reference Internal Revenue code (IRC) section 162.⁴ (See also *Lucas v. Commissioner* (1982) 79 T.C. 1, 6.) For purposes of

¹ Appellant also reported a deduction for tax preparation fees in the amount of \$350, which is not at issue in this appeal and does not exceed the 2 percent limitation on its own.

² \$19,199 + \$3,679 (\$7,358 x 50% [Meals and entertainment expenses are subject to a 50 percent limitation]) + \$5,940 + \$378 = \$29,196.

³ Appellant also provided proof of employment and a schedule listing his expenses.

⁴ California generally conforms to federal law regarding unreimbursed employee expenses. (R&TC, § 17201.)

IRC section 162, a trade or business expense is “ordinary” if it is normal or customary within the particular trade, business, or industry, and is “necessary” if it is appropriate and helpful for the development of the business. (*Roberts v. Commissioner*, T.C. Memo. 2012-197.) The expenses must be directly or proximately related to the taxpayer’s trade or business. (*Weaver v. Commissioner*, T.C. Memo. 2004-108; *Deputy v. Du Pont* (1940) 308 U.S. 488, 493-495; Treas. Reg. § 1.162-1(a).)

Courts have held that an expense is not “necessary” when an employee has a right to reimbursement for expenditures related to his or her status as an employee but fails to claim such reimbursement. (*Orvis v. Commissioner* (9th Cir. 1986) 788 F.2d 1406, 1408; *Coplon v. Commissioner* (6th Cir. 1960) 277 F.2d 534 (*Coplon*).) In *Coplon*, the court stated that “[s]imply by failing to seek reimbursement, [the taxpayer] cannot convert business expenses of the corporation into his own business expenses.” (*Coplon, supra*, at p. 535.)

In certain circumstances, a taxpayer must meet specific additional substantiation requirements to be allowed a deduction under IRC section 162. (*Roberts v. Commissioner, supra*.) Specifically, IRC section 274(d) requires that the following types of expenses must be substantiated by adequate records or sufficient corroborating evidence: (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,” which includes passenger automobiles. To qualify for this deduction, a taxpayer must substantiate that 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).)

Deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving that he or she is entitled to that deduction. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) FTB’s determination that a particular deduction should be disallowed is presumed correct. (*Appeal of Janke* (80-SBE-059) 1980 WL 4988.) It is well established that a taxpayer who claims a deduction must keep sufficient records to substantiate the claimed deduction. (*Sparkman v. Commissioner* (9th Cir. 2007) 509 F.3d 1149, 1159.)

Appellant provided numerous receipts, invoices, and bank statements to show that he paid for travel, meals and entertainment, and parking expenses in 2012. However, appellant's evidence does not show he is entitled to a deduction for unreimbursed employee expenses under the law. Specifically, the record shows that appellant's expenses fail the "necessary" requirement of IRC section 162 because appellant could have sought reimbursement from his employer, but did not. (*Orvis v. Commissioner, supra*, 788 F.2d 1406.)⁵ Appellant provided his employer's reimbursement policy, which allowed appellant to submit reimbursements for the expenses underlying the deductions he claimed, and which included provisions for miscellaneous expenses, and expenses that are "out-of-policy"; that is, for amounts in excess of policy limits. Appellant admits that he did not request reimbursement from his employer for any of the expenses at issue in this appeal. Thus, appellant's expenses are not deductible.

Additionally, appellant has not shown that the expenses had a business purpose, as required by IRC section 274(d). Appellant's handwritten notes of names and dates provide no explanation as to the business purpose of the meals and entertainment, parking and travel expenses. Appellant provided no additional evidence to corroborate his testimony that these had a business purpose, and we cannot rely solely on his unsupported assertions. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) It is also noteworthy that some of appellant's expenses appear to be personal in nature, such as international trips and visits to amusement parks, and although appellant had the opportunity to provide information and evidence, appellant has not made a sufficient showing to support a business purpose for such expenses.

Appellant also claims that he incurred a portion of his expenses as part of his real estate business. However, appellant did not file a Schedule C, provided no evidence of his real estate business activity, and provided no reason or evidence to show he is entitled to a trade or business expense deduction under IRC section 162 (or any other statutory provision) for any such expenses.

Finally, appellant claimed a substantial amount of home office expenses, and provided statements from his home internet service provider. However, appellant's expenses do not qualify under the rules for the home office deduction. As he testified to at the hearing, appellant

⁵ Various copies of appellant's employer expense reimbursement policies were offered into evidence. We base our decision on the full Corporate Expense Reimbursement Policy (version 13.0) of appellant's employer, Luitpold Pharmaceuticals Inc., and the Expense Policy of Regency Therapeutics that appellant testified was the most recent policy. We find the policies do not materially conflict.

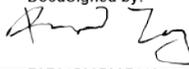
regularly used his home office space for personal use, and thus, failed the regular and exclusive use requirement under IRC section 280A.⁶ Indeed, the “[p]ersonal use of a room or segregated area precludes claiming deductions for business use of that same space” (*Sievers v. Commissioner* (2014) T.C. Memo. 2014-115.) For all other business expenses not addressed above, appellant has not provided any substantiation to support his position. Without evidence showing error, we must sustain FTB’s proposed assessment.

HOLDING

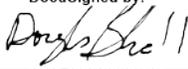
Appellant has not shown that FTB erred in disallowing appellant’s Job Expenses and Certain Miscellaneous Deductions for the 2012 tax year.

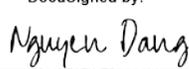
DISPOSITION

FTB’s proposed assessment is sustained.

DocuSigned by:

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Richard Tay
Administrative Law Judge

We concur:

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Douglas Bramhall
Administrative Law Judge

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Nguyen Dang
Administrative Law Judge

Date Issued: 4/17/2020

⁶ California conforms to IRC section 280A pursuant to R&TC section 17201.