OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **S. RAIEN AND** **T. TARVERDYAN**[1]	) OTA Case No. 20086420)))))

OPINION

Representing the Parties:

For Appellants: S. Raien

For Respondent: John Yusin, Tax Counsel IV

For Office of Tax Appeals: Michelle Huh, Tax Counsel

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, S. Raien and T. Tarverdyan (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of $38,836, and applicable interest, for the 2015 tax year.

Appellants waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUE

Whether appellants have established error in FTB's proposed assessment.

[1] For the 2015 tax year, appellant-wife filed with the surname "Tarverdyan," and the Notice of Action (NOA) listed appellant-wife's surname as "Tarverdyan." On appeal, appellant-wife stated that she changed her surname from "Tarverdyan" to "Avetisyan" on January 21, 2020.

FACTUAL FINDINGS

1. On April 16, 2016, appellants filed a joint California resident income tax return (California return) for the 2015 tax year. Appellants' California return included income from gambling winnings totaling $857,850.[2] Appellant-husband's also claimed deductions for gambling losses of $730,555. After applying income tax withholdings, estimated tax payments, and an underpayment of an estimated tax penalty of $73, appellants reported a balance due of $3,651.
2. FTB audited appellants' 2015 California return. During the audit, appellant-husband submitted a list of his gambling winnings and losses for the 2015 tax year. The approximated gambling losses consisted of $450,000 from casino games,[3] $85,000 from lottery and scratch-offs, $170,000 from sports betting, and $25,555 from horse racing.
3. During the audit of $730,555 appellant-husband's provided copies of the following: (1) a letter from IGT congratulating him on his Mega Jackpot win and stating that he could elect to receive a discounted single cash payment of $793,844.73, in addition to the $56,655.14 he received on the date of his original jackpot; (2) played scratchers and receipts for super lotto, sports betting, and horse betting; (3) win/loss statements for losses incurred from casino games; and (4) bank statements from his personal, joint, and business accounts showing a total of $193,695 of withdrawals.[4]
4. In an Audit Issue Presentation Sheet dated June 8, 2018, FTB stated that appellants reported the correct gambling winnings of $857,850 based on the 2015 Forms W-2G. FTB allowed appellants the full amount of gambling losses reported on the loss schedule for lottery, scratch-offs, and horse betting, because appellant-husband submitted played lottery and scratch-off receipts, and horse betting receipts that totaled the same amounts. FTB also allowed $12,415 of the claimed $170,000 of sports betting losses because that was the amount recorded on appellant-husband's sports betting receipts.
5. With respect to the casino games losses of $450,000, FTB noted that appellant-husband

[2] The majority of appellant-husband's gambling income came from a Mega Jackpot slot machine win in January 2015.

[3] This amount consists of losses including: $50,000 from slot machines; $130,000 from poker; $150,000 from blackjack; and $120,000 from roulette.

[4] During this appeal, OTA received partial business bank account statements as exhibits. Neither appellants nor FTB provided copies of appellants' personal bank account statements or their win/loss statements.

alleged that "he used to tally his losses by tracking in a diary [of] how much he would go to the casino with and how much he would come back with." FTB also noted that on December 21, 2017, appellant-husband indicated that he lost the diary that tracked his gambling activities from 2015. FTB concluded that although appellant-husband "had no contemporaneous diary of his casino gambling losses and the statements provided from the casinos only reported total losses of $18,814, in an effort to be reasonable, $193,695 of cash and verifiable check withdrawals will be allowed as substantiation for the casino game wagering losses." In total, FTB allowed a gambling loss deduction of $316,665.

6. On September 14, 2018, FTB issued to appellants' a Notice of Proposed Assessment (NPA), which increased appellants' reported taxable income by $413,890 (i.e., the disallowed gambling loss deduction) and proposed an additional tax of $38,836, plus interest.

7. Appellants protested the NPA. During protest, appellant-husband sent FTB a letter, stating that he was not able to locate his diary and two missing boxes of betting receipts, but there were two additional boxes of lottery tickets in his garage that he could bring to FTB for examination.

8. In a letter dated September 27, 2019, appellants stated "under oath" that they never had a gambling diary for the 2015 tax year. Appellants also stated that the cash used for appellant-husband's gambling activities was deposited in a Union Bank safe deposit box, and the cash stored in the safe deposit box was from a home loan in the amount of $400,000 that appellants obtained from East West Bank in the 2011 tax year. Appellants further stated that they previously provided FTB copies of their receipts for the Union Bank safe deposit box for the 2014 and 2015 tax years.

9. In a letter to FTB dated November 21, 2019, appellants stated that appellant-husband. never had a specific day-by-day detail diary of his gambling activities for the 2015 tax year and appellant-wife was not involved in any of appellant-husband's gambling activities in the 2015 tax year. The representative further stated that appellant-husband was new to gambling when he won the Mega Jackpot in the 2015 tax year, and he did not know the proper way of record keeping. The representative requested that FTB consider the amount of $170,000 (from the alleged 2011 home loan) that appellant-husband had in the Union Bank safe deposit box as a portion of appellant-husband's gambling losses.

10. On June 29, 2020, FTB issued a Notice of Action to appellants, affirming the NPA.

11. This timely appeal followed.

DISCUSSION

Income tax deductions are a matter of legislative grace, and the taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction or credit. (*Appeal of Vardell*, 2020-OTA-190P; *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) To meet that burden, a taxpayer must point to an applicable statute and show by credible evidence that the transactions in question come within its terms. (*Appeal of Jindal*, 2019-OTA-372.) FTB's denials of claimed deductions are presumed correct until the taxpayer has proven his or her entitlement. (*Appeal of Janke* (80-SBE-059) 1980 WL 4988.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Vardell*, *supra*.)

Gross income includes all income from whatever source derived, including gambling winnings. (See Internal Revenue Code (IRC), § 61; R&TC, § 17071; *United States v. Maginnis* (9th Cir. 2004) 356 F.3d 1179, 1183; *McClanahan v. United States* (5th Cir. 1961) 292 F.2d 630, 631-632, cert. denied (1961) 368 U.S. 913.) In computing taxable income, gambling losses shall be allowed as a deduction by a taxpayer "only to the extent of the gains from such transactions." (IRC, § 165(d);[5] see also Treas. Regs. § 1.165-10.) For federal income tax purposes, "if [a taxpayer's] gambling activity did not constitute a trade or business, his [or her] gambling losses would be deductible as an itemized deduction in arriving at taxable income on Schedule A, Itemized Deductions." (*Torpie v. Commissioner,* T.C. Memo. 2000-168; see also *Coleman v. Commissioner*, T.C. Memo. 2020-146, fn. 3; IRC, § 62(a).)

"The question of the amount of losses sustained by a taxpayer is a question of fact to be determined from the facts of each case, established by the taxpayer's evidence, and the credibility of the taxpayer and supporting witnesses." (*Norgaard v. Commissioner* (9th Cir. 1991) 939 F.2d 874, 878.) In the event that a taxpayer establishes that a deductible expense has been paid but is unable to substantiate the precise amount, the amount of the deductible expense may generally be estimated if there is an evidentiary basis for doing so. (*Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540, 543-544.) This is the *Cohan* rule. When applying the *Cohan* rule, a court may consider evidence of a taxpayer's lifestyle or financial position to approximate

[5] R&TC section 17201(a) incorporates by reference IRC section 165, except as otherwise provided.

unsubstantiated gambling losses. (See *Doffin v. Commissioner*, T.C. Memo. 1991-114.) However, the taxpayer must produce sufficient evidence to corroborate his or her story and provide a satisfactory basis for the estimation. (See *Jones v. Commissioner*, T.C. Memo. 2011-77 [stating that the taxpayer did not provide any evidence to corroborate his story and thus the court would not apply the *Cohan* rule]; *Schooler v. Commissioner* (1977) 68 T.C. 867, 871 [stating that the evidence presented by the married taxpayers did not provide a satisfactory basis for estimating the amount of the taxpayer-husband's winnings or losses, or support the fact that his losses exceeded his unreported gain].)

In *Metas v. Commissioner*, T.C. Memo. 1982-36, the Internal Revenue Service IRS disallowed married taxpayers' claimed gambling losses and increased the net gambling income from $200 to $23,000. At trial, the taxpayers testified that the taxpayer-husband kept all his gambling funds in a single strongbox and would fill out a "minus" slip showing the amount removed. (*Ibid*.) They also testified that if the taxpayer-husband won more than he wagered, he would tear up the minus slip and substitute another slip containing his net gain from the gambling transaction; but "[i]f he had won nothing, he left the minus slip in the box." (*Ibid*.) The court did not find the taxpayers' strongbox method to be credible because the taxpayer-husband did not present original records, such as the plus and minus slips kept in the strongbox, and the taxpayer-husband's testimony was "incomplete in specifying what procedures he used to insure [*sic*] accurate computations of amounts won and lost." (*Ibid*.) The court stated that the "trustworthiness and reliability of [the taxpayer-husband's] recordkeeping system can rise no higher than the credibility of his testimony, especially because he has submitted no actual original records." (*Ibid*.) When the taxpayers requested that the court estimate and allow them to deduct some amounts of gambling losses under the *Cohan* rule, the Tax Court held that it was unable to apply the *Cohan* rule because it had no rational basis for doing so and that there was no evidence as to what the taxpayers' actual losses were. (*Ibid*.) Citing *Plisco v. U.S.* (D.C. Cir. 1962) 306 F.2d 784, 787, the court concluded that "there [were] no reliable figures from which to calculate or extrapolate a reasonable estimate of [taxpayers'] losses," and sustained the IRS's disallowance of the taxpayers' claimed gambling losses. (*Metas v. Commissioner*, *supra*, T.C. Memo. 1982-36.)

In another gambling loss deduction case, *Jackson v. Commissioner*, T.C. Memo. 2007-373, the taxpayer was a recreational gambler who played slot machines regularly and did

not keep a diary, log, or record of any kind of her gambling winnings and losses. The IRS disallowed $223,693 of the taxpayer's claimed gambling losses due to a lack of substantiation. (*Ibid*.) At trial, the IRS conceded that the taxpayer presented sufficient documentation to substantiate $127,165 in gambling losses by providing "casino ATM receipts, canceled checks made payable to casinos, carbon copies of checks made payable to casinos, and credit card statements stating that cash was advanced at the casinos." (*Id*. at fn. 2.) Citing *Cohan v. Commissioner, supra*, 39 F.2d at pp. 543-544 and other cases, the court noted that "[a]s a general rule, if the trial record provides sufficient evidence that the taxpayer has incurred a deductible expense, but the taxpayer is unable to substantiate adequately the precise amount of the deduction to which he or she is otherwise entitled, the Court may estimate the amount of the deductible expense, and allow the deduction to that extent…, bearing heavily against the taxpayer whose inexactitude is of his or her own making." (*Jackson v. Commissioner*, *supra*, T.C. Memo. 2007-373.) The court reiterated that the estimated amount of the deductible expense must have some basis from which an estimate may be made. (*Ibid*., citing *Vanicek v. Commissioner*, *supra*, 85 T.C. at pp. 742-43.) The court found that the evidence did not provide a satisfactory basis for estimating the taxpayer's gambling losses and the taxpayer failed to produce any evidence to corroborate her story. (*Id*. at p. *2.)

In Revenue Procedure 77-29, the IRS provides guidelines to assist taxpayers in establishing their gambling gains and deductible gambling losses. (Rev. Proc. 77-29, 1977-2 C.B. 538; see also IRS Pub. 529 (Miscellaneous Deductions) (Rev. Jan. 2021), at p. *14.) Revenue Procedure 77-29 states that taxpayers should regularly maintain an accurate diary or similar record, supplemented by verifiable documentation, to substantiate wagering winnings and losses. According to Revenue Procedure 77-29, the diary should contain at least the following information: (1) the date and type of specific wager or wagering activity; (2) the name and address of the gaming establishment; (3) the names of other person(s) (if any) present with the taxpayer at the gaming establishment; and (4) the amount(s) won or lost. Revenue Procedure 77-29 also states that verifiable documentation includes but is not limited to Forms W-2G, Forms 5754, Statement by Person Receiving Gambling Winnings, wagering tickets, canceled checks, credit records, bank withdrawals, and statements of actual winnings or payment slips provided by the gambling establishment.

Here, there is no dispute that appellant-husband received gambling winnings of $857,850

during the 2015 tax year. Therefore, appellants are entitled to gambling loss deductions to the extent of their winnings *if* appellants can substantiate such a deduction. (IRC, § 165(d); *Norgaard v. Commissioner*, *supra*.) On appeal, appellants argue that they are entitled to additional gambling loss deductions of $170,000.[6] Appellants assert that this amount consisted of loan proceeds, which appellant-husband kept in a safe-deposit box. Appellants assert that appellant-husband withdrew this amount from the safe-deposit box for gambling purposes, making 17 trips to the safe deposit box during 2015, and allegedly removing $10,000 cash each time.[7] We note that appellants have not provided any evidence of the alleged home loan.

Our review of appellant-husband's safe deposit box receipts revealed no persuasive evidence to substantiate any gambling losses. Unlike a bank account statement or a credit card statement, the safe deposit box receipts did not provide any discernible information on what appellant-husband withdrew from the safe deposit box or how much he withdrew on each trip. The only information shown on each safe deposit box receipt is appellant-husband's signature to access the safe deposit box and the time stamp of his access. Furthermore, appellants did not supplement the safe deposit box receipts with another original, verifiable documentation to prove that they are entitled to additional gambling losses. (See *Metas v. Commissioner*, *supra*, T.C. Memo. 1982-36.)

As for an estimation of appellants' request for additional gambling losses on appeal, we find that FTB already provided a reasonable estimation of appellant-husband's gambling losses during the audit to the extent that appellant-husband corroborated his losses using played scratchers, gambling receipts, win/loss statements, and bank statements. Despite a large discrepancy between appellants' win/loss statements and appellants' bank statements, FTB estimated and allowed casino game wagering losses of $193,695.

Moreover, appellants' lifestyle and financial position for the 2015 tax year do not support

[6] On appeal, appellants only contend that they are entitled to an additional gambling loss deduction of $170,000, even though FTB disallowed a claimed gambling loss deduction of $413,890. We find that, because appellants do not contest, or provide substantiation for, the remaining disallowed gambling losses of $243,890, appellants concede the remaining amount and the only amount at issue in this appeal is $170,000 of disallowed claimed gambling losses, which is the same amount appellants attributed to sports betting losses at audit.

[7] Two of appellants' safe-deposit box receipts are dated in December 2014. We note that if appellant-husband withdrew funds in 2014 for the purpose of gambling, he also could have lost those funds in 2014. However, as discussed above, it is impossible to determine if or when appellant-husband lost money withdrawn from his safe-deposit box. As such, we need not discuss appellants' alleged 2014 withdrawals separately from appellants' alleged 2015 safe-deposit box withdrawals.

the amount of gambling losses claimed by appellants for the 2015 tax year. For example, appellant-husband's business bank statements for the 2015 tax year show payments to Lawyers Title Company in excess of the federal adjusted gross income AGI that appellants reported on their returns for the purchase of two properties. Factoring the purchase of the two properties in the 2015 tax year, appellants' financial position does not support any additional amounts of gambling losses for the 2015 tax year.

Therefore, because the record provides no satisfactory basis for estimating additional gambling losses in favor of appellants, we find that the application of the *Cohan* rule is not warranted. Thus, appellants have not met their burden of showing that they are entitled to an additional amount of gambling losses for the 2015 tax year.[8]

HOLDING

Appellants have not established error in FTB's proposed assessment.

DISPOSITION

FTB's action is sustained.

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Keith T. Long
Administrative Law Judge

We concur:

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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
0C90542BE88D4E7...
Tommy Leung
Administrative Law Judge

Date Issued: 12/6/2021

[8] It is not clear whether appellants are arguing on appeal that appellant-wife should not be liable for the proposed additional tax because she was not involved in any of appellant-husband's gambling activities during the 2015 tax year, and they had filed for divorce and were living separately before appellant-husband won the Mega Jackpot. However, when a joint return is filed, each spouse is jointly and severally liable for the entire tax due for that tax year. (IRC, § 6013(d)(3); R&TC, § 19006(b).) Here, appellants jointly filed a 2015 California return. There is no evidence on the record showing that appellant-wife filed an innocent spouse relief claim for the 2015 year. Thus, appellant-wife would still be liable for the proposed additional tax of $38,836, plus interest, for the 2015 tax year at the conclusion of this appeal.