BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
WING EDWIN AND FAYE LEW )

For Appellants: Wing Edwin Lew,
in pro. per.

For Respondent: Crawford H. Thomas
Chief Counsel

Gary M. Jerrit
Counsel

O P I N I O N

This appeal is made pursuant to section 13594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Wing Edwin and Baye Lew against proposed assessments of additional personal income tax and penalties in the total amounts of $357.50, $589.72, and $585.72 for the years 1966, 1967, and 1968, respectively, and against a proposed assessment of additional personal income tax in the amount of $636.43 for the year 1969.

The questions presented are: (1) whether certain itemized personal and business expense deductions claimed by appellants in their California personal income tax returns for the years 1966, 1967, 1968, and 1969, were properly disallowed by respondent due to lack of substantiation: and (2) whether the penalties proposed for failure to file timely returns for 1966, 1967, and 1968, and for failure to file a return upon notice and demand for 1966, were proper,

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During the years on appeal appellants resided in San Francisco. Appellant Wing Lew was an engineer for the State of California and Mrs. Lew was employed as an accountant by the federal government. In addition to these full-time jobs, appellants worked part time in two businesses of their own: marketing Christmas trees and operating a college women's rooming house. Roth businesses have consistently lost money and appellant has stated that he expected this trend to continue. Altruistic purpose was the prime motivation cited for having remained in these losing enterprises. Inflation and insufficient time to devote to the businesses were the main factors mentioned by appellant to explain the continued losses.

In 1363 respondent was advised by the Internal Revenue Service that appellants had filed a joint federal income tax return for 1966. Upon receipt of this information, respondent searched its records but could find- no evidence of any California personal income tax return filed in appellants' names for 1966. On July 29, 1968, respondent notified appellants that a return had not been filed for 1966 and demanded that one be filed. When appellants failed to respond to this demand or to subsequent demands, a proposed assessment was made.

On May 2, 1969, October 16, 1970, and November 16, 1970, returns for 1966, 1968,and 1967, respectively, were submitted in response to respondent's demands. Appellants' 1969 return was timely filed. Appellant stated that all returns for the years in question had been submitted on time and that the returns forwarded to respondent were "file copies" of the originals. However, respondent could find no record of any original returns filed by appellants for 1966, 1367, or 1365.

In September 1370, respondent began an audit of appellants' returns for the years 1966 through 1969. Appellants were asked to substantiate a number of items appearing in the returns, including itemized personal and business expense deductions, and the amount of gross income.

In response to this request appellant stated that production of primary substantiation records was impossible since they had been lost durinq cleanup operations following a theft and vandalism incident which occurred on appellants' business premises a few months after commencement of the audit. Appellant's only attempt to substantiate the deductions was made by writing numerous confusing letters to members of respondent's staff.

On March 26, 1971, respondent concluded its audit of appellants' returns for the years 1966 through 1969. It was determined that, due to lack of substantiation, itemized personal deductions would be disallowed and itemized business expense deductions would be permitted only to the extent that they offset gross rental income. In addition, respondent proposed a 25 percent penalty for failure to file a return upon notice and demand for 1966, as well as a 5 percent negligence penalty and 25 percent penalties for failure to file timely returns and failure to furnish information for 1966, 1967, and 1963. (Rev. & Tax. Code, §§ 18682, 18684, 18681, subd. (a), and 18683.)

After a protest hearing in September 1971, respondent withdrew the penalties for negligence and failure to furnish information. However, the penalties for failure to file timely returns and failure to file a return upon notice and demand were retained.

Respondent's disallowance of the itemized personal and business expense deductions for the years 1966 throuqh 1969 and the imposition of penalties for failure to file timely returns for 1966, 1967, and 1968, and for failure to file a return upon notice and demand for 1966, gave rise to this appeal,

In deciding whether or not respondent properly disallowed appellants' deductions for lack of substantiation, it must be kept in mind that deductions are a matter of legislative grace and the burden of proving the right to a deduction is upon the taxpayer. (New

Colonial Ice Co. v. Iielvering, 292 U.S. 435 [78 L. Ed. 1348]; Deputy v. du Pont, 308 U.S. 488 [84 L. Ed. 416]; Appeal of James M. Denny, Cal. St. Bd. of Equal., May 17 1962.) Despite this well-settled principle, appellants contend that the alleged loss of their records made substantiation difficult and that the burden of gathering information in support of the deductions should therefore be on respondent. We do not agree. Respondent has no duty to substantiate a taxpayer's claim to deductions. The burden of proving his deduction is on the taxpayer and the mere fact that evidence is difficult if not impossible to obtain does not relieve him of this burden. (Burnet v. Houston, 283 U.S. 223 [75 L. Ed. 991].)

In the instant case, appellants have made no attempt to carry their burden of proof. By their own admission, substantiation in support of their claimed deductions existed in the form of the records in the hands of third parties. Nevertheless, they made no attempt to produce that substantiation. Instead they have offered only their uncorroborated assertions that the figures appearing in their income tax returns were accurate. In previous cases where substantiating evidence was available but not produced by the taxpayer the courts and this board have held that a taxpayer's uncorroborated assertions are inadequate proof of his right to the claimed deductions. (Birnbaum v. Commissioner, 117 F.2d 395; Watab Paper Co., 27 B.T.A. 488; Appeal or Nake M. Kamrany, Cal. St. Bd. of Equal., Feb. 15, 1972.) Accordingly, we sustain respondent's disallowance of appellants' deductions.

With respect to the penalties assessed by respondent, appellant contends initially that all penalties were canceled at the protest hearing held on September 22, 1971. This contention is based in part on what appellant allegedly was told by respondent's hearing officer, and in part on an October 14, 1971, letter from the Governor's executive secretary indicating that he also had been told by respondent's officials that the penalties had been canceled. Regardless of what appellant and the Governor's Office may have been told, however, respondent in fact did not cancel all of the penalties when it issued its Notice of Action on Taxpayer's Protest dated November 22, 1971. Under Revenue and Taxation Code section 18593, that document constitutes the official notice to the taxpayer of the action taken on his protest, and also forms the

jurisdictional basis for a **taxpayer's** appeal to this board. Accordingly, in determining this appeal, we must take the "notice of action" as we find it and rule on its **merits,** at least in the absence of some estoppel against respondent. Since no such estoppel would appear to lie under these circumstances (see George H. Baker, 24 T.C. **1021),** we are obliged to determine the propriety of the penalties asserted in the "notice of action."

Section 18681, subdivision (a), of the Revenue and Taxation Code pertains to the penalty for failure to file a timely return. It provides:

> If any taxpayer fails to make and file a return required by this part on or before the due date of the return or the due date as extended by the Franchise Tax Board, then, unless it is shown that the failure is due to reasonable cause and not due to willful neglect, 5 percent of the, tax shall be added to the tax for each month or fraction thereof elapsing between the due date of the return and the date on which filed, but the total penalty shall not exceed 25 percent of the tax. The penalty so added to the tax shall be due and payable upon notice and demand from the Franchise Tax Board.

Appellants allege that they filed timely returns and paid the taxes when due. However, this claim is unsubstantiated by any independent evidence of payment such as canceled checks. Under these circumstances, and in view of the fact that respondent could find no record of any returns filed for the years in question, we must conclude that no returns were filed. (See Anthony J. Petrone, T.C. Memo., Sept. 22, 1959.) It follows that the penalties imposed by respondent for failure to fiie timely returns for the years 1966, 1967, and 1968 were proper.

The penalty for failure to file a return upon notice and demand is authorized by section 18682 of the California Revenue and Taxation Code. It states:

> If any taxpayer, upon notice and demand by the Franchise Tax Board, fails or refuses to make and file a return (other than a declaration of estimated tax required under Sections 18414, 18414.5, and 18415) required by this part, the Franchise Tax Board, notwithstanding the provisions of Section 18648, may estimate the net income and compute and levy the amounts of the tax due from any available information. In such case 25 percent of the tax, in addition to the penalty added under Section 18681, shall be added to the tax and shall be due and payable upon notice and demand from the Franchise Tax Board.

The facts show that on July 28, 1968, respondent, pursuant to section 18682, notified appellants that no return had been filed for 1966 and demanded that one be filed. No filing date was specified; and appellants did not file a return until May 2, 1969, approximately nine months after the demand was made.

In Appeal of J. H. Hoeppel, Cal. St. Bd. of Equal., Feb. 26, 1962, we held that, when the demand fails to specify a date within which the return must be filed, the regulations imply that a reasonable time will be allowed for filing the return. We further held a six-month delay in filing to be unreasonable. In the instant case, appellants delayed filing for nine months. This, too, was an unreasonable delay. Consequently, we sustain respondent's imposition of the penalty.

In accordance with the views expressed herein, we sustain respondent's determinations, both with respect to the disallowance of appellants' claimed deductions and the imposition of penalties.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS **HEREBY ORDERED, ADJUDGED AND DECREED,** pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Wing Edwin and Faye Lew against proposed assessments of additional personal income tax and penalties in the total amounts of $357.50, $539.72, and $585.72 for the years 1966, 1967, and 1968, respectively, and against a proposed assessment of additional personal income tax in the amount of $636.43 for the year 1969, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of September, 1973, by the State Board of **Equalization.**

_____, **Chairman**

_____, **Member**

_____, **Member**

_____, **Member**

_____, Member

**ATTEST:** _____, Secretary