OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **S. RODRIGUEZ**	) OTA Case No. 22029637)))))

OPINION

Representing the Parties:

For Appellant: S. Rodriguez

For Respondent: Eric Yadao, Tax Counsel IV

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, S. Rodriguez (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing an assessment of additional tax of $1,529, plus interest, for the 2016 tax year.

ISSUE

Whether appellant has shown error in FTB's proposed assessment of additional tax based on federal adjustments.

FACTUAL FINDINGS

1. Appellant and his spouse timely filed a 2016 California Resident Income Tax Return (Form 540).[1]
2. FTB received information from the IRS showing that it made two adjustments to amounts reported on their federal tax return: (1) deleted the federal alternative minimum tax, and (2) disallowed $17,957 out of $42,437 of a claimed unreimbursed employee business expense deduction. Appellant requested reconsideration of the adjustments from the IRS, but no further federal adjustments were made.

[1] Appellant's spouse is not a party to this appeal because the appeal letter does not include her signature.

3. Based on the federal adjustments, FTB issued a Notice of Proposed Assessment (NPA) to appellant and his spouse that made changes corresponding to the federal changes. The NPA increased their taxable income by $17,957 for "Sch A-Net Misc Deductions" and proposed additional tax of $1,529, plus interest.
4. Appellant and his spouse protested the NPA, and FTB affirmed the NPA in a Notice of Action.
5. This timely appeal followed.

DISCUSSION

A taxpayer shall concede the accuracy of federal changes to the taxpayer's income or state where the determination is erroneous. (R&TC, § 18622(a).) It is well settled that a deficiency assessment based on a federal audit report is presumptively correct and that a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Bracamonte*, 2021-OTA-156P.)

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 it. (*Appeal of Vardell*, 2020-OTA-190P.) To support a deduction, the taxpayer must establish by credible evidence, other than mere assertions, that the deduction claimed falls within the scope of a statute authorizing the deduction. (*Appeal of Dandridge*, 2019-OTA-458P.) FTB's denials of claimed deductions are presumed correct. (*Appeal of Janke* (80-SBE-059) 1980 WL 4988.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Vardell*, *supra*.)

Internal Revenue Code (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.'" (*Roberts v. Commissioner*, T.C. Memo. 2012-197.)[2] A trade or business expense is ordinary for purposes of IRC section 162 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, supra*.) In contrast, personal, living, or family expenses are generally nondeductible. (*Roberts v. Commissioner, supra*; IRC, § 262.)

[2] IRC sections 162, 262, 274, and 280F are generally incorporated into California law at R&TC sections 17071 and 17201, except as otherwise provided.

In certain circumstances, the taxpayer must meet specific substantiation requirements to be allowed a deduction under IRC section 162. (*Roberts v. Commissioner, supra*; see, e.g., IRC, § 274(d).) 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," as defined in IRC section 280F(d)(4), which includes passenger automobiles. (*Roberts v. Commissioner, supra*.) To qualify for a deduction, the taxpayer must substantiate an 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. (*Roberts v. Commissioner, supra*; IRC, § 274(d).) The tax court has held that "[r]eceipts often fail as proof because they don't show any particular business purpose."[3] (*H & M, Inc. v. Commissioner*, T.C. Memo. 2012-290, at fn. 17.)

An individual performing services as an employee generally may deduct expenses incurred in the performance of such services as itemized deductions on Schedule A. (*Richards v. Commissioner*, T.C. Memo. 2014-88.) However, unreimbursed employee business expenses can be deducted only to the extent those expenses exceed two percent of the taxpayer's AGI under IRC section 67(a).[4] (*Richards v. Commissioner, supra*.) In order to deduct expenses incurred in connection with the performance of services as an employee, a taxpayer must not have the right to reimbursement for such expenses from his employer. (*Ibid*.)

[3] Where the heightened requirements discussed above do not apply, however, a court may allow the deduction of a claimed expense even where the taxpayer is unable to fully substantiate it, if the court has an evidentiary basis for doing so. (*Roberts v. Commissioner*, *supra*, citing *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540, 543-544.) This is called the Cohan rule. (See *Perry v. Commissione*r, T.C. Memo. 2012-237.) The Cohan rule can be summarized as follows: if a taxpayer establishes that he or she paid or incurred a deductible business expense but does not establish the amount, a court may approximate the amount of the allowable deduction, bearing heavily against the taxpayer whose inexactitude is of his or her own making. (*Roberts v. Commissioner*, *supra*.) Appellant has not shown that he is entitled to further deductions or a basis to approximate further deductions.

[4] IRC section 67 is generally incorporated into California law at R&TC section 17076.

Appellant contends that an audit was already completed, and the final amount owed should be $222.25, instead of $12,527.00. However, the $222.25 appears to be the sum of a federal penalty for late payment of tax plus interest charged for late payment, and the $12,527.00 appears to be a refund issued from the IRS, according to the federal account transcript. FTB's proposed assessment is not based on the penalty, interest, or refund amount. FTB based its adjustments on adjustments made by the IRS, including disallowing the unreimbursed employee business expense deduction. FTB obtained a current copy of appellant's federal account transcript for the 2016 tax year, which indicates that the IRS did not revise the original assessment after appellant requested reconsideration of the assessment. Therefore, the federal determination is final. In addition, the IRS data that FTB received indicates that appellant agreed to the federal changes.

The record includes a letter from the IRS requesting that appellant provide a reimbursement policy or a letter from his employer explaining the policy, and states that the IRS will not revise its original assessment of $1,531 in tax without such information. The letter also requests that appellant provide documentation to establish the unreimbursed employee expenses, such as cancelled checks, logs, itineraries, credit card statements, receipts, travel vouchers, or any other supporting documents. The record also includes a letter from one of appellant's employers during a three-month period in 2016 stating that they did not reimburse any of his expenses, and a letter from appellant's union stating that he worked in the area covered by the union's jurisdiction for multiple employers and was not reimbursed his costs for seeking employment in that jurisdiction. It appears the letters were provided to the IRS to explain that he did not receive reimbursements for travel, meals, lodging, tools, and clothing, but does not include supporting documentation such as that requested by the IRS. Appellant's federal account transcript indicates that the assessment amount is $1,531, and that it has not been revised. Therefore, the transcript indicates that the IRS did not make further adjustments after receipt of the letters.

Appellant does not provide any documentation to show that he is entitled to an additional deduction (beyond the $24,440 already allowed) for further unreimbursed employee business expenses beyond those that have already been allowed. Appellant does not provide any information that would allow OTA to determine what was allowed to be deducted by the IRS, and whether the letters in the record are related to expenses previously deducted and allowed.

Furthermore, appellant does not provide any documentation to show what expenses are being claimed or the evidence that meets the heightened substantiation requirements of IRC section 274(d). The burden is on appellant to show error in FTB's determination, and he does not provide any evidence to show the federal adjustment and the proposed assessment is incorrect. Therefore, appellant has not shown error in FTB's proposed assessment of additional tax.

HOLDING

Appellant has not shown error in FTB's proposed assessment of additional tax based on federal adjustments.

DISPOSITION

FTB's action is sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Eddy Y.H. Lam
1EAB8BDA3324477...

Eddy Y.H. Lam
Administrative Law Judge

Date Issued: 9/13/2022