OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **T. BLEDSOE AND** **L. BLEDSOE**	OTA Case No. 220410118

OPINION

Representing the Parties:

For Appellant: T. Bledsoe
L. Bledsoe

For Respondent: Brian Werking, Attorney

E. LAM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, T. Bledsoe and L. Bledsoe (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of $3,227, and applicable interest for the 2015 tax year.

Appellants elected to have this appeal determined pursuant to the procedures of the Small Case Program. Those procedures require the assignment of a single administrative law judge. (Cal. Code Regs., tit. 18, § 30209.1.) Appellants waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides this matter based on the written record.

ISSUE

Whether appellants have shown error in FTB's proposed assessment of additional tax, which is based upon a final federal determination.

FACTUAL FINDINGS

1. Appellants timely filed a joint 2015 California Resident Income Tax Return (Form 540). Appellants reported a loss from appellant L. Bledsoe's Schedule C real estate business.

2. The IRS examined appellants' federal tax return. The IRS made adjustments to appellant L. Bledsoe's Schedule C business income that increased appellants' taxable income and assessed additional tax.
3. Appellants did not report these federal changes to FTB. Based upon the federal information, FTB issued a Notice of Proposed Assessment (NPA) to appellants for the 2015 tax year, which stated that FTB adjusted appellants' Form 540 based on information provided by the IRS.
4. Appellants protested the NPA, indicating that appellants were challenging the federal adjustments with the IRS. FTB placed appellants' protest on hold, pending the IRS's review and requested appellants to provide a copy of the final tax examination changes upon the conclusion of the IRS's review.
5. FTB received a letter from appellants indicating the IRS revised its federal adjustments of appellants' 2015 tax year federal adjusted gross income (AGI). The IRS revised its prior adjustments, resulting in a total net increase to appellants' federal AGI of $44,159. As relevant to this appeal, the IRS disallowed: $55 of car and truck expense, $5,589 of travel expense, $639 of meals and entertainment expense, and $33,767 of other expenses.
6. FTB issued a revised position letter reducing its proposed adjustment based on the revised final federal determination. FTB's letter also gave appellants 30 days to provide additional documentation if they disagreed with the revised assessment, but appellants did not respond.
7. FTB then issued a Notice of Action (NOA) to affirm the 2015 revised proposed deficiency assessment.
8. This timely appeal followed.
9. On appeal, appellants submitted: (1) a mileage log covering the period from January 5, 2015, to August 9, 2015, totaling 3,539.60 miles, and (2) a summary of expenses without any specificity as to an itemized breakdown for the 2015 tax year. The summary of expenses also indicated that L. Bledsoe had driven 19,069 miles.
10. The summary of expenses itemized the following expenditures, which OTA categorized into the following four categories:

a. Car and Truck Expenses: $5,287 for gas, $1,926.82 for car repairs and maintenance, $2,648 for car insurance, $696 for DMV fees, and $461 for parking.
b. Travel Expenses: $858.08 for car rentals and $2,422.30 for travel meals.
c. Meals and Entertainment Expenses: $3,184.02 for gifts for clients and entertainment and $4,908.12 for meals with clients.
d. Other Business Expenses: $21,000 for rent for home (living room and bathroom used for office), $3,283.38 for "SCE," $274.60 for trash, $531.05 for So Cal Gas, $998.49 for office and internet and land line, $3,740.93 for work wireless, $355.75 for renters insurance, $148 for PO Box rental, $453.01 for postage and delivery, $400 for computer repairs, $424.09 for advertising, $427.20 for office equipment, $1,229.55 for office supplies, $1,107.40 for L. Bledsoe work clothes, $683.35 for office lunches, $3,036.57 for relocation and upgrade of new office, and $25 for office rekey.

DISCUSSION

When the IRS makes a final federal determination, taxpayers must concede the accuracy of the federal changes to a taxpayer's income or state where the changes are erroneous. (R&TC, § 18622(a).) It is well settled that a deficiency assessment based on a federal adjustment to income is presumed to be correct and taxpayers bear the burden of proving that FTB's determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Valenti*, 2021-OTA-093P.) The applicable burden of proof standard is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of Cal., Inc. v. Construction Laborers Pension Trust for So. Cal.* (1993) 508 U.S. 602, 622.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of Valenti*, *supra*.) Taxpayers' failure to introduce evidence that is within their control gives rise to the presumption that the evidence, if provided, would be unfavorable to the taxpayers' position. (*Appeal of Bindley*, 2019-OTA-179P.)

Here, FTB received information from the IRS indicating that it revised its federal adjustments, resulting in an increase of appellants' federal taxable income by $44,159 for the 2015 tax year in a final federal determination. FTB obtained appellants' 2015 federal account

information, which indicated that the IRS revised its adjustments in a final federal determination and disallowed the following Schedule C business deductions: $55 car and truck expense deduction, $5,589 of travel expense, $639 of meals and entertainment expenses, $33,767 of other expenses, and $4,109 of claimed depreciation. As the final federal determination has not undergone further revisions or cancellations, appellants must show error in the final federal adjustments upon which FTB based its proposed assessment.

Income tax deductions are a matter of legislative grace, and taxpayers who claim a deduction have the burden of proving by competent evidence that they are entitled to that deduction. (*Appeal of Vardell*, 2020-OTA-190P.) To sustain that burden of proof, taxpayers must be able to point to an applicable deduction statute and show that they came within its terms. (*Appeal of Briglia* (86-SBE-153) 1986 WL 22833; see *Appeal of Dandridge*, 2019-OTA-458P.) Unsupported assertions cannot satisfy the taxpayers' burden of proof. (*Appeal of Magidow*, (82-SBE-274) 1982 WL 11930.)

As relevant to this appeal, 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."[1] (*Roberts v. Commissioner*, T.C. Memo. 2012-197.) 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. (*Ibid*.) In contrast, personal, living, and family expenses are generally not deductible. (IRC, § 262(a).)

Certain kinds of expenses are not deductible unless the taxpayer provides specific documentation and substantiation, in accordance with IRC section 274(d). As applicable here, these heightened substantiation requirements apply to deductions for travel expenses, meals and entertainment, and "listed property" as defined by IRC section 280F(d)(4), which includes passenger automobiles. (IRC, § 274(d)(1); see Treas. Reg. § 1.274-5T(a).) To qualify for a deduction, a taxpayer must substantiate "by adequate records or by sufficient evidence corroborating the taxpayer's own statement: (A) the amount of such expense or other item, (B) the time and place of the travel . . . or use of the facility or property, (C) the business purpose of

[1] This Opinion makes reference to the IRC and its relevant regulations pertinent to the 2015 tax year. IRC sections 162, 262, 274, and 280F are generally incorporated into California law at R&TC section 17201.

the expense or other item, and (D) the business relationship to the taxpayer of persons . . . using the facility or property . . ." (IRC, § 274(d); see also *Roberts v. Commissioner*, *supra*.)

The substantiation requirements for compliance with IRC section 274 are stricter than those required for other kinds of deductions, particularly the deduction of the ordinary and necessary expenses found in IRC section 162. (*D.A. Foster Trenching Co. v. United States* (Ct. Cl. 1973) 473 F.2d 1398.) "General or vague proof, whether offered by testimony or documentary evidence, will not suffice. Specificity is imperative." (*Goldberger v. Commissioner* (1987) 88 T.C. 1532, 1558.) While expenses related to other kinds of deductions can sometimes be estimated under the "*Cohan* rule" that was announced in *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540, such estimation is superseded by the more stringent requirements for deductions under IRC section 274. (Treas. Reg. § 1.274-5T(a)(4).)

On appeal, appellants indicated that the final federal determination was incorrect. Appellants asserted that they did not have the opportunity to present their documentation with FTB and that they do not think that after seven years the tax should be owed.[2] It appears that appellants contend they are entitled to Schedule C deductions more than those allowed by the IRS and appellants provided those two documents in support.

In this appeal, appellants submitted to OTA: (1) a mileage log covering the period from January 5, 2015, to August 9, 2015, totaling 3,539.60 miles, and (2) a summary of expenses without any specificity as to an itemized breakdown for the 2015 tax year, totaling $60,510.21. The summary of expenses also indicated that L. Bledsoe had driven 19,069 miles, but it did not assign an actual cost amount to those miles or provide details on how those miles were recorded. Accordingly, OTA determines that appellants have not supported that their claimed business deductions were substantiated with "adequate records" or by sufficient "corroborating evidence." Each of the items is discussed separately below.

Car and Truck Expenses

Appellants reported $11,020 in car and truck expenses. FTB allowed a revised deduction of $10,965 for these expenses, consistent with the IRS's revised final federal determination. From appellants' summary of expenses, it is discerned from appellants that the car and truck

[2] On December 23, 2021, appellants informed FTB about the IRS's revised assessment. On January 13, 2022, FTB indicated that it had adjusted its assessment based on the IRS's final determination. Appellants were given 30 days to provide further information if they disagreed, but appellants did not respond. FTB subsequently issued an NOA.

expenses totaled $11,019.32, comprising of the following: $5,287 for gas, $1,926.82 for car repairs and maintenance, $2,648 for car insurance, $696 for DMV fees; and $461.50 for parking. Furthermore, the summary of expenses indicated that L. Bledsoe had driven 19,069 miles without any specifics regarding how these miles were recorded. But here, appellants only presented a mileage log documenting a total of 3,539.60 miles driven to various companies between January 4, 2015, and August 9, 2015.

As noted above, deductions for passenger automobiles are subject to the strict substantiation requirements of IRC section 274(d). (Treas. Reg. § 1.274-5T(a)(4); see IRC, § 280F(d)(4).) With respect to listed property such as passenger automobiles, the federal regulations provide that taxpayers will have maintained "adequate records" if they maintain an account book, diary, log, statement of expense, trip sheets, or similar record combined with supporting documents, which substantiate the required elements of the expenses, such as the amount, time, place, business purpose of the expenditure, and business relationship. (Treas. Reg. § 1.274-5T(c)(2)(ii).) If adequate records (such as maintaining an account book, diary, log, statement of expense, trip sheets, or similar record.) are not provided under this provision, taxpayers must establish each element of the expense by their own statement containing specific details as to each element, and provide "other corroborative evidence sufficient to establish such element." (Treas. Reg. § 1.274-5T(c)(3); see IRC, § 274(d)(1).)

However, appellants did not provide any "adequate records" or "corroborative evidence" to substantiate the heightened substantiation requirements as required by IRC section 274(d). (See Treas. Reg. § 1.274-5T(c)(2) & (3).) Here, appellants furnished only a general summary of expenses without offering specific details as to each individual occurrence to substantiate the required elements of the expenses, such as the amount, time, place, business purpose of the expenditure, and business relationship. (Treas. Reg. § 1.274-5T(c)(2)(ii).) Also, there was no other documentary or "corroborative evidence" (i.e., documentary evidence such as invoices, receipts, or bank statements, or similar documents) to substantiate any of the required elements of expenses. Furthermore, while appellants provided a mileage log showing 3,539.60 miles driven, this contradicts the claim made in the summary of expenses showing that L. Bledsoe drove 19,069 miles. Additionally, although the mileage log records each instance of the 3,539.60 mileage driven, including dates and destinations, it fails to show the business purpose for these journeys. (IRC, § 274(d); Treas. Reg. § 1.274-5T(c)(2)(ii).) Therefore, there is no

basis to determine that any additional amount of the car and truck expenses beyond the amount already allowed are deductible.

Travel Expenses

Appellants reported $7,213 in travel expenses. FTB allowed a deduction of $1,624, consistent with the IRS's revised final federal determination. From appellant's summary of expenses, it is discerned that the travel expenses totaled $3,280.38, comprising of the following: $858.08 for car rentals and $2,422.30 for travel meals.

Here, deductions for travel expenses are subject to the strict substantiation requirements of IRC section 274(d). (See Treas. Reg. § 1.274-5T(a)(1), (c).) To reiterate, appellants furnished only a general summary of expenses without offering specific details as to each individual occurrence to substantiate the required elements of the travel expenses, such as the amount, time, place, and business purpose of the expenditure. (See Treas. Reg. § 1.274-5T(b)(2).) For the same reasons as described above, appellants did not provide "adequate records" or "corroborative evidence" to substantiate the heightened substantiation requirements as required by IRC section 274(d). (Treas. Reg. § 1.274-5T(c)(2) & (3).) Therefore, there is no basis to determine that any of these expenses beyond what was already allowed are deductible.

Meals and Entertainment Expenses

Appellants reported $2,795 in travel expenses. FTB allowed a revised deduction of $2,639 consistent with the IRS's revised final federal determination. From appellant's summary of expenses, it is discerned that the meals and entertainment expenses totaled $8,092.14, comprising of the following: $3,184.02 for gifts for clients and entertainment and $4,908.12 for meals with clients.

Here, deductions for business meal and entertainment expenses and gift expenses are subject to the strict substantiation requirements of IRC section 274(d).[3] (See Treas. Reg. § 1.274-5T(a)(2) & (3).) To reiterate, appellants furnished only a general summary of expenses without offering specific details as to each individual occurrence to substantiate the required elements of expenditure, such as the amount, time, place, business purpose of the expenditure,

[3] As in effect for the 2015 tax year, only 50 percent of unreimbursed business meal and entertainment expenses are deductible when incurred if directly connected with a taxpayer's trade or business. (IRC, § 274(a) & (n).)

and or business relationship. (Treas. Reg. § 1.274-5T(b)(3) & (4).) Additionally, when it comes to expenditures relating to gifts, a description of the gift would be another requisite element. (Treas. Reg. § 1.274-5T(b)(5)(iii).) For the same reasons as described above, appellants did not provide any "adequate records" or "corroborative evidence" to substantiate the heightened substantiation requirements as required by IRC section 274(d). (*Ibid*.) Therefore, there is no basis to determine that any of the gift expenses and business meal and entertainment expenses are deductible.

Other Business Expenses

Appellants reported $37,089 in other business expenses. The FTB allowed a deduction of $3,322 consistent with the IRS's revised final federal determination. From appellant's summary of expenses, it is discerned that the other expenses totaled $38,118.37, comprising of the following: $21,000 for rent for home (living room and bathroom used for office), $3,283.38 for SCE, $274.60 for trash, $531.05 for So Cal Gas, $998.49 for office and internet and land line, $3,740.93 for work wireless, $355.75 for renters insurance, $148.00 for PO Box rental, $453.01 for postage and delivery, $400 for computer repairs, $424.09 for advertising, $427.20 for office equipment, $1,229.55 for office supplies, $1,107.40 for L. Bledsoe work clothes, $683.35 for office lunches, $3,036.57 for relocation and upgrade of new office, and $25.00 for office rekey.

As previously noted, 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." Taxpayers are required to keep books and records sufficient to establish matters reported on a return. (*Higbee v. Commissioner* (2001) 116 T.C. 438, 440.) However, appellants have not provided any explanation for how these other business expenses are related to their business or provided any substantiating documents to support the expenses, such as receipts, invoices, bank or credit card statements. Without any evidence or support, OTA cannot determine whether any of the disallowed business expenses constitute ordinary and necessary expenses paid or incurred during the tax year of appellants' business. (IRC, § 162(a).) For example, OTA cannot determine whether the home living room and bathroom used for office were used exclusively for business purposes. Appellants have not provided credible support for their claimed business deductions or any information or support. Accordingly, appellants have not demonstrated error in FTB's proposed assessment based on a final federal determination.

HOLDING

Appellants have not shown error in FTB's proposed assessment of additional tax, which is based upon a final federal determination.

DISPOSITION

FTB's action is sustained in full.

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Eddy Y.H. Lam
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Eddy Y.H. Lam
Administrative Law Judge

Date Issued: 11/13/2023