

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 231214989
G. BARRAZA)	
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)	

OPINION

Representing the Parties:

For Appellant:	Jesse Ryu, Tax Appeals Assistance Program (TAAP) ¹
For Respondent:	Vivian Ho, Attorney

L. KATAGIHARA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, G. Barraza (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$8,120 and applicable interest for the 2018 tax year.

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, section 30209(a).

ISSUE

Whether appellant has shown error in FTB's proposed assessment, which is based on a federal determination.

FACTUAL FINDINGS

1. Appellant operates a business selling items online through eBay.
2. PayPal issued appellant a 1099-K (PayPal 1099-K) reporting \$100,638 of merchant income for the 2018 tax year.
3. Appellant did not report the \$100,638 as income on his 2018 federal or California income tax returns.

¹ Appellant filed his opening brief. Josh Bishop Alfonso of TAAP filed appellant's reply brief, and Jesse Ryu of TAAP filed appellant's supplemental reply brief.

4. The IRS increased appellant's adjusted gross income (AGI) for the 2018 tax year to account for the unreported 1099-K income, and as a result, assessed additional tax.²
5. FTB was informed of the IRS's assessment and therefore made corresponding adjustments to appellant's California AGI. As a result of those adjustments, on December 28, 2022, FTB issued to appellant a Notice of Proposed Assessment (NPA) for additional tax of \$8,120 and applicable interest for the 2018 tax year.
6. Subsequent to FTB's issuance of the NPA, appellant petitioned the 2018 tax year federal assessment to the United States Tax Court (Tax Court).³ During the pendency of the petition, the IRS removed its assessed tax in accordance with Internal Revenue Code (IRC) section 6213. After the Tax Court dismissed appellant's petition for lack of jurisdiction, the IRS re-assessed the tax on June 12, 2023, and it became a final federal determination.
7. On November 28, 2023, after appellant failed to provide substantiation to FTB that the IRS reduced or cancelled its assessment, FTB issued a Notice of Action, affirming the NPA.
8. This timely appeal followed.
9. On appeal, FTB submits an IRS Account Transcript reflecting that, as of February 15, 2024, the IRS had not cancelled or reduced the amount of its adjustment to appellant's income for the 2018 tax year.
10. Appellant submits documents claiming to support a reduction of the assessed tax. Such documents include, but are not limited to, invoices from eBay, PayPal's fee structure, emails from eBay regarding certain orders, emails between appellant and one of his purported suppliers, one purchase invoice, redacted bank statements from April 2018 to December 2018, a redacted credit card statement reflecting a charge by Cricket Wireless on February 23, 2018, and a Microsoft Excel workbook (workbook) with

² The IRS assessment also made adjustments to appellant's self-employment tax deduction and student loan interest deduction, but appellant has not disputed these adjustments. Accordingly, OTA does not discuss these adjustments further.

³ An IRS Account Transcript submitted by FTB on appeal reflects that, subsequent to filing the Tax Court petition, appellant filed an amended 2018 federal return (amended return) reporting the additional income (and claiming deductions) on a federal Schedule C. On appeal, appellant provides a copy of the amended return. It appears from the account transcript, however, that the IRS did not accept the amended return because the IRS did not make any adjustments to appellant's tax liability after receipt of the amended return.

spreadsheets titled: “1099K_Reconciliation_2019_New” (1099-K spreadsheet)⁴; “Payment Refunds”; “Ebay Sale Fees”; “Ebay Non-Sale Fees”; “Austin Payments”; “Supplier Orders”; and “Adjusted Totals.”

DISCUSSION

R&TC section 18622(a) provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment based on a federal adjustment is presumptively correct and that the taxpayer bears the burden of proving that FTB’s determination is erroneous. (*Appeal of Valenti*, 2021-OTA-093P.) In the absence of credible, competent, and relevant evidence showing that FTB’s determination is incorrect, it must be upheld. (*Ibid.*) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof with respect to an assessment based on a federal action. (*Appeal of Gorin*, 2020-OTA-018P.)

IRC section 162, which is incorporated into California law by R&TC section 17201, allows taxpayers to deduct ordinary and necessary business expenses paid or incurred during the tax year in carrying on any trade or business. The expenses must be directly connected with or pertain to the taxpayer’s trade or business. (Treas. Reg. § 1.162-1(a).) 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.) The taxpayer must establish by credible evidence, not mere assertions, that the deduction claimed falls within the scope of a statute authorizing the deduction. (*Appeal of Dandridge*, 2019-OTA-458P.) A taxpayer’s failure to produce evidence that is within his or her control gives rise to a presumption that such evidence, if provided, would have been unfavorable to the taxpayer’s case. (*Appeal of Vardell*, *supra*.)

Here, FTB received information that the IRS increased appellant’s 2018 federal AGI due to the unreported income reflected on the PayPal 1099-K. FTB therefore made conforming adjustments to appellant’s 2018 California income, which resulted in \$8,120 of additional tax, plus applicable interest. According to the February 15, 2024 IRS Account Transcript, the IRS did not make subsequent adjustments to appellant’s federal AGI. Because FTB’s assessment was based on federal adjustments, it is presumed correct, and appellant has the burden to show that FTB’s assessment was erroneous. (*Appeal of Valenti*, *supra*.)

⁴ Despite the title, all of the entries in the 1099-K spreadsheet relate to 2018, not 2019. The spreadsheet includes the date, item description, purchase price, sale price, profit amount, and other details of approximately 200 purported transactions from the 2018 tax year, totaling \$100,698.33.

Appellant asserts that FTB's proposed assessment is erroneous because the IRS and FTB both fail to account for appellant's expenses, such as cellular phone charges, various fees, refunds provided, and his cost of goods sold (COGS). Appellant asserts that his expenses amount to \$97,264.26, resulting in a net profit of only \$3,374. OTA addresses each category in turn.

Cellular Phone Expense

A taxpayer claiming a cellular phone expense must provide some credible evidence as to the extent of business use. (*Parker v. Commissioner*, T.C. Memo. 2016-194, fn. 5.) If there is no reasonable basis to differentiate between business and personal use, there is no need to determine whether taxpayer paid for such cellular phone service. (*Haskins v. Commissioner*, T.C. Memo. 2019-87.)

Appellant's workbook reflects a cellular phone expense of \$624. In support of this deduction, appellant has provided a single credit card statement that includes one \$52 cellular phone charge. Appellant has not provided any evidence that the credit card statement was paid, or that the remaining \$572 was charged and paid. Moreover, appellant has not provided any evidence from which OTA can determine the amount of appellant's use that was attributable to business, rather than personal, use. Consequently, appellant has not shown he is entitled to a deduction for his cellular phone expense.

Fees

Appellant claims he incurred and paid approximately \$6,668 in fees to PayPal, eBay, and Bonanza. Appellant asserts that some of the fees are substantiated by various spreadsheets in his workbook, and that he is entitled to deduct the remaining fees under what is commonly referred to as "the Cohan Rule." (See *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d. 540, 543-544.) Under the Cohan Rule, when there is sufficient evidence indicating a taxpayer incurred a deductible expense, but the precise amount cannot be determined, a fact finder may approximate the amount of the deduction, bearing heavily against a taxpayer whose inexactitude is of his or her own making. (*Ibid.*) A court may estimate some expenses, but only if the taxpayer provides at least some evidence to support an estimate, and the court is convinced that the taxpayer incurred them. (*Id.* at p. 544.)

Appellant has not provided any evidence of his sales using Bonanza, Bonanza's fee structure, or that such fees were incurred or paid. In regard to the PayPal fees, appellant submits a copy of PayPal's fee structure, which reflects a 2.99 percent charge for sending and receiving money for goods and services. However, appellant fails to provide any reliable

evidence of the fees actually incurred and paid to PayPal. There is also no evidence indicating whether PayPal deducted the fees prior to transferring funds to appellant, so the PayPal 1099-K could potentially be net of fees. Although appellant relies on the workbook as proof of his incurred fees, none of the entries in the workbook (related to fees or not) can be verified with the limited contemporaneous documents appellant provides in this appeal. Consequently, OTA finds the workbook and the various spreadsheets therein lack credibility. Because appellant has not provided credible evidence to support that he incurred fees from Bonanza or PayPal for which he would be entitled to a deduction, the Cohan Rule does not apply.

With respect to the eBay fees, appellant argues that there are both “sale fees” and “non-sale fees” that he is entitled to deduct. Appellant’s evidence includes invoices from eBay, but the invoices do not specifically differentiate the fees between “sale fees” and “non-sale fees.” The eBay invoices do, however, reflect payments for fees totaling \$4,002.77 for the period January 1, 2018, through December 15, 2018. As such, appellant is entitled to a deduction of \$4,002.77 for his eBay fees. OTA notes that a December 31, 2018 invoice reflects a charge of \$32.98, but appellant has not provided documentation to substantiate payment of that invoice, or that appellant paid that invoice in 2018 (rather than in 2019).⁵

To the extent that appellant argues there are “non-sale fees” not included in the eBay invoices referenced above, appellant has not provided any evidence to support those fees and is thus not entitled to any additional deduction for them. Without more, appellant cannot meet his burden of proving his entitlement to a deduction. (See *Appeal of Vardell, supra*; *Appeal of Dandridge, supra* [deductions must be supported by credible evidence, not mere assertions].)

Refunds

Appellant asserts that his income should be reduced by \$23,853.07 to account for refunds provided to customers. In support of these alleged refunds, appellant provides four emails from eBay, three of which reference a cancelled order and one that references a refund (each email references a single cancelled or refunded order). The four emails together represent only \$5,177.96 of the alleged \$23,853.07 in refunds, and two reveal same-day cancellations. Appellant also relies on his workbook and several emails he exchanged with his purported supplier regarding cancelled or refunded orders.

As stated earlier, the workbook is not credible evidence. Specifically, appellant’s 1099-K spreadsheet (which does not make any reductions for refunds and includes non-PayPal sales)

⁵ The eBay invoice reflects that an automatic payment would be made between January 15, 2019, and January 17, 2019, but the invoice also includes a link to change the payment method.

reflects sales totaling \$100,698.33 for 2018, but the eBay invoices alone reflect total sales of \$125,561.80. Therefore, it seems appellant failed to report an additional \$24,923.80 (\$125,561.80 - \$100,638⁶) in sales. Another explanation of the difference between the total sales in the eBay invoices and the PayPal 1099-K is that PayPal accounted for appellant's refunded transactions prior to issuing its 1099-K. Therefore, without further evidence, a reduction of appellant's \$100,638 income by an additional \$23,853.07 could result in a duplicative deduction of the refunds.

Appellant has not produced a single sales invoice to substantiate his 1099-K spreadsheet despite having made these sales online using an eBay account. It is within appellant's control to produce the invoices that would definitively prove whether the refunds were accounted for in the PayPal 1099-K and his failure to do so gives rise to the presumption that such evidence, if provided, would have been unfavorable to his appeal. (*Appeal of Vardell, supra.*) Therefore, OTA finds that appellant has not met his burden of proving that he is entitled to a deduction for the alleged refunds.

COGS

COGS is an adjustment to gross income. (Treas. Reg. § 1.162-1(a); *Hultquist v. Commissioner*, T.C. Memo. 2011-17.) Gross income means all income from whatever source derived, including gross income derived from business. (IRC, § 61(a)(2).)⁷ For merchandising businesses, gross income is calculated by subtracting the COGS from gross receipts and adding any income from investments and from incidental or outside operations or sources. (Treas. Reg. § 1.61-3(a).) COGS include the cost of items acquired for resale, and the costs of producing items for resale, with proper adjustment for opening and closing inventories. (Treas. Reg. § 1.162-1(a).) The taxpayer bears the burden of substantiating the amount claimed as COGS. (*Sawyer v. Commissioner*, T.C. Memo. 2015-55.)

When there is sufficient evidence indicating a taxpayer incurred a deductible expense, but the precise amount cannot be determined, a fact finder may estimate the amount of expenses under the Cohan rule. (*Cohan v. Commissioner, supra*, 39 F.2d at pp. 543-44; *Sawyer v. Commissioner, supra.*) The fact finder's estimation may bear heavily against taxpayers whose inexactitude is of their own making. (*Ibid.*) There must be sufficient evidence

⁶ This represents the amount reflected in the PayPal 1099-K and the amount of sales appellant attempted to report in the federal Schedule C accompanying his amended federal return.

⁷ Pursuant to R&TC section 17071, California conforms to section 61 of the IRC relating to gross income, except as otherwise provided.

that the estimated amount was in fact spent or incurred for the stated purpose, or the allowance would amount to unguided generosity. (*Williams v. U.S.* (5th Cir. 1957) 245 F.2d 559, 560; *Jabari v. Commissioner*, T.C. Memo. 2017-238.)

Appellant claims his COGS totaled \$72,437.77 and is therefore entitled to an adjustment of his unreported gross income by that amount.⁸ In support of this adjustment, appellant relies on the workbook, heavily redacted bank statements reflecting debits to an individual he identifies as his supplier, and some emails he exchanged with said supplier.

Again, appellant has not provided any credible evidence to support the specific entries in the workbook. For example, appellant provides only one purchase invoice (in the amount of \$10.48) to support over 200 purported transactions, and no sales invoices. Although the purchase invoice supports a finding that appellant incurred a cost for at least one good he sold, it does not prove that his sale of that particular item was included in the PayPal 1099-K. In fact, appellant's purchase is not even included in his 1099-K spreadsheet.⁹

Appellant's bank statements and emails are equally unsupported. The bank statements show transfers of funds but do not provide any detail as to the specific items purchased or the individual cost of the items. One email exchange between appellant and his purported supplier references payments and inventory of certain goods, but there are no purchase invoices, confirmations of receipt of payment for those goods, or corresponding sales invoices. As such, OTA has no means of verifying that any goods appellant purchased were sold during the 2018 tax year and included in the PayPal 1099-K.

Based on the foregoing, appellant has not provided credible evidence or otherwise sufficiently proven that he incurred COGS attributable to the PayPal 1099-K. Similarly, appellant has not provided documentation from which OTA could estimate the amount of appellant's COGS under the Cohan rule. For OTA to estimate the amount of the offset under the Cohan rule, it must have some basis upon which an estimate may be made. (*Cohan v. Commissioner*, *supra*, 39 F.2d at pp. 543-44; *Sawyer v. Commissioner*, *supra*; *Williams v. U.S.*, *supra*, 245 F.2d at p. 560; *Jabari v. Commissioner*, *supra*.) Without such a basis, any allowance would amount to unguided generosity. (*Williams v. U.S.*, *supra*, 245 F.2d at p. 560; *Jabari v.*

⁸ Appellant asserted this amount in his reply brief, but appellant's federal Schedule C included with his amended return reflects COGS of \$66,119.

⁹ OTA searched for the transaction in the 1099-K spreadsheet by the supplier transaction ID (which corresponds to the confirmation number on the purchase invoice). Although there are multiple entries in the 1099-K spreadsheet purporting to reflect that appellant sold the same type of good on multiple occasions, none of those entries match the supplier transaction ID/confirmation number on the one purchase invoice provides on appeal.

Commissioner, supra.) Consequently, OTA finds that appellant is not entitled to a reduction of his gross income by the asserted COGS.

In sum, appellant has not met his burden of proving that he is entitled to an offset for COGS, or a deduction for cellular phone expenses, refunds, or fees paid to PayPal or Bonanza. Appellant has, however, established with sufficient evidence that he is entitled to a deduction of \$4,002.77 for fees paid to eBay.

HOLDING

Appellant has shown partial error in FTB's proposed assessment because he has established he is entitled to a deduction of \$4,002.77 for fees paid to eBay, but appellant has not shown he is entitled to any additional deductions.

DISPOSITION

FTB's proposed assessment is modified and shall be reduced to take into account that appellant is entitled to a deduction of \$4,002.77 for fees paid to eBay. FTB's action is otherwise sustained.

Signed by:

Lauren Katagihara

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Lauren Katagihara
Administrative Law Judge

We concur:

DocuSigned by:

Erica Parker

Erica Parker
Hearing Officer

DocuSigned by:

Phyllis Mallard

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Kim Wilson
Hearing Officer

For

Date Issued: 4/25/2025