

ALABAMA TAX TRIBUNAL

JONATHAN G. & KAREN L. VUKOVICH,	§	
Taxpayers,	§	DOCKET NO. INC. 17-663-JP
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

OPINION AND PRELIMINARY ORDER

Pursuant to an audit, the Alabama Department of Revenue disallowed certain expenses that had been claimed by Dr. and Mrs. Vuckovich (“Taxpayers”) on Schedules C, E, and F of their Alabama individual income tax returns for years 2012, 2013, and 2014. In response, the Taxpayers supplied documents to the Revenue Department to substantiate the disputed expenses. The Revenue Department agreed to allow certain of those expenses but continued to claim that the Taxpayers had not substantiated others. The entry of final assessments followed, and the Taxpayers appealed those assessments to the Alabama Tax Tribunal.

During the pendency of the appeal before the Tax Tribunal, which is a separate state agency from the Revenue Department, the Taxpayers continued to provide documents for review by the Revenue Department in an attempt to reach an agreement on the remaining issues. A hearing was conducted on January 8, 2019, during which the parties stated that the remaining items in dispute concerned supplies purchased primarily at home improvement stores; days spent working on various rental properties; payments to a family member for labor on a farm; dry cleaning expenses for medical lab coats; and the basis in an airplane. Following the hearing, the appeal was remanded to the Revenue

Department, primarily for the parties to attempt to resolve the issue concerning basis.

In its first Report on Remand, the Revenue Department agreed to the Taxpayers' claims concerning the days spent working on rental properties and concerning dry cleaning expenses. However, the Revenue Department stated that it needed additional information concerning the basis in the airplane, so the remand period was extended. In its second Report on Remand, the Revenue Department reported that the parties were unable to agree on the airplane issue. Therefore, the three issues to be decided involve supplies purchased at home improvement stores, payments for labor on a farm, and the Taxpayers' basis in an airplane.

Supplies

Dr. Vukovich testified that he and his wife owned a beach condominium, a lake condominium, and a lake house that were used for rental purposes during the audit period. They also owned a timber farm on which was located a cabin that was used as part of a hunting club. Obviously, these properties required regular maintenance and repairs from time to time, much of which was done by Dr. Vukovich.

Dr. Vukovich bought supplies in Dothan for the beach property because of the proximity of home improvement stores to his home in Dothan, and he bought supplies in Opelika for the lake properties, because those stores were on his way from his home to Lake Martin. These patterns of purchasing supplies were more efficient than purchasing supplies in the towns where the rental properties were located, because home improvement stores were not as easily accessible in those towns. The transcript also suggested that some supplies may have been purchased online.

To distinguish business purchases from personal purchases, Dr. Vukovich testified

that he used a certain credit card for the purchase of supplies that were used at the rental properties and the timber farm. Specifically, he purchased supplies for the rental properties and the farm with his American Express card and he purchased supplies for his home with his MasterCard or Visa card or with one of his wife's cards. This allowed him to separate his expenditures. Within a few days, he would download his American Express purchases into a Quicken program that categorized those expenses for each of the properties. He kept receipts of business and personal purchases until downloading was complete, in case he needed to identify an occasional personal purchase made using his American Express card. If that happened, he used the receipt to categorize that purchase as personal. He then threw away the receipts. The Quicken program also contained expenses that were paid using his banks' electronic bill-pay systems.

Dr. Vukovich introduced Taxpayers' Exhibit 1, which was a general ledger of categorized expenses for the timber farm for the years in question. He had provided such ledgers to the Revenue Department for each of the properties and for each of the audit years. The Revenue Department allowed expenses for which the Taxpayers provided receipts but disallowed all expenses for which there were no receipts, despite the general ledgers provided by the Taxpayers.

Alabama Code § 40-18-15(a)(1) allows a deduction for "[a]ll ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, as determined in accordance with 26 U.S.C. § 162." The language of Internal Revenue Code § 162(a) is virtually identical, except that the section includes examples of expenses that are deductible.

Here, Dr. Vukovich testified that all of the supplies claimed on Schedules E and F

for the years in question were purchased for use in relation to the Taxpayers' rental properties or the timber farm. And he categorized those expenses by property and by year. As stated, though, the Revenue Department's position is that the supplies are not deductible unless the Taxpayers have receipts for those supplies. Otherwise, the Revenue Department states that it would have no way of knowing whether the purchases were for personal use or business use.

The oft-cited rule is that deductions are matters of legislative grace. *See, e.g., Surtees v. VFJ Ventures, Inc.*, 8 So.3d. 950, 970 (Ala. Civ. App. 2008), *aff'd, Ex Parte VFJ Ventures, Inc.*, 8 So.3d. 983 (Ala. 2008). Thus, the burden of proving the right to a deduction rests with the taxpayer. Also, a final assessment is presumed correct and the burden of proving the assessment incorrect is on the taxpayer. *See* Ala. Code § 40-2A-7(b)(5)c.3.

The Revenue Department's position regarding source documents such as receipts is understandable. Here, however, the Taxpayers have satisfied their burden by tracking business expenses so as to segregate those from personal expenses, initially using receipts and a credit card dedicated to business purchases. They then categorized those expenses by property and by year, and they confirmed their methodology by testimony before the Tax Tribunal. Consequently, the Taxpayers are entitled to deduct the expenses for supplies that were disallowed by the Revenue Department.

Payments for Farm Labor

Dr. Vukovich paid his dad for supplemental work on the timber farm during the audit

years. The work included bush hogging, trimming tree limbs, disking food plots, fertilizing, and planting food plots. The amounts paid for 2012 through 2014 were approximately \$5,175, \$5,000, and \$1,665, respectively. Dr. Vukovich stated that the payments were an attempt to reimburse his dad for travel expenses incurred in traveling from his dad's home in Florida to the farm in Dothan multiple times a year. Sometimes the dad drove, which took twelve hours and required stopping for the night, and other times he flew. The pay decreased in 2014 because of the dad's health issues. Dr. Vukovich noted that the owner of a nearby farm paid his full-time manager \$40,000 per year for comparable tasks performed on a year-round basis.

Dr. Vukovich paid his dad by check and presented canceled checks to the Revenue Department during the audit. The payments also were included by Dr. Vukovich in the general ledgers discussed previously. The Revenue Department disallowed the payments, however, because there were no time sheets that reflected the amount of time worked and because Dr. Vukovich did not issue Forms 1099 to his dad.

Internal Revenue Code § 162(a)(1) specifically authorizes a deduction for “a reasonable allowance for salaries or other compensation for personal services actually rendered.” As noted, that provision is specifically referenced in Ala. Code § 40-18-15(a)(1). Also, Ala. Code § 40-18-15(a)(14) authorizes a “deduction determined in accordance with 26 U.S.C. § 212 for all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income. . .” The language of that section of the Internal Revenue Code is virtually identical.

Here, the question again is whether the Taxpayers have met their burden of proving

that they are entitled to deduct these payments. And, as with the issue concerning supplies, the Taxpayers have met their burden by corroborating the canceled checks and general ledger entries with testimony before the Tax Tribunal that explained the facts concerning the work and the payment of those amounts. Thus, the Taxpayers are allowed to deduct the payments for farm labor.

Basis in an Airplane

Apparently, an 'S' corporation in which Dr. Vukovich was a shareholder sold an airplane in 2013. The Taxpayers reported a loss on Schedule D of their 2013 return from that transaction, but the Revenue Department disallowed the loss because of the lack of substantiation by the Taxpayers of their basis in the property. It seems that the Revenue Department initially attributed a gain to the Taxpayers from the transaction, but it was stated at the hearing that the entry of the gain had been reversed, although it was not clear whether that reversal occurred prior to the entry of the final assessment for that year. The disallowance of the loss remains an issue, however.

The Taxpayers have not presented any evidence to the Tax Tribunal to substantiate their basis in the airplane. Therefore, the Revenue Department's disallowance of the loss from the sale of the plane is upheld. However, the Revenue Department is directed to confirm whether the final assessment for 2013 should be adjusted to reflect that there is no gain from the sale of the airplane.

Conclusion

The Revenue Department is directed to recalculate the final assessments in accordance with the rulings in this Opinion and Preliminary Order and inform the Tax Tribunal of those recalculated amounts no later than **July 31, 2020**. Appropriate action will

then be taken.

Entered May 21, 2020.

/s/ Jeff Patterson

JEFF PATTERSON

Chief Judge

Alabama Tax Tribunal

jp:dr

cc: Jonathan & Karen Vukovich
Hilary Y. Parks, Esq.