CHRISTOPHER WIDEMAN & RHONDA R. MCCONATHY 141 MAJESTIC PINES LANE TRUSSVILLE, AL 35173-4207,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 08-503
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Christopher Wideman and Rhonda R. McConathy (jointly "Taxpayers") for 1999, 2000, 2001, 2002, and 2003 Alabama income tax. The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on October 16, 2008. Christopher Wideman (individually "Taxpayer") and his representative, Sam McCord, attended the hearing. Assistant Counsel Lionel Williams represented the Department.

The Taxpayers failed to file Alabama income tax returns for the subject years. The Department received IRS information indicating that the Taxpayers had been required to file Alabama returns for those years. It consequently computed the Taxpayers' liabilities based on the IRS information, and billed the Taxpayers for the tax, penalties, and interest due.

The Taxpayer subsequently filed returns for the years in issue. The 1999 return included expenses relating to the Taxpayer's job as a concrete truck driver. The 2000, 2001, and 2002 returns included Schedule C expenses relating to the Taxpayer's business of pouring and smoothing concrete. A Department examiner requested records verifying the deductions. The Taxpayer provided some Regions Bank checks from 2000, but

explained that his other records had been lost when his wife moved the furniture out of their house pending a divorce.

The Department examiner organized the Regions Bank checks and allowed the Taxpayer various business-related deductions in 2000 based on the check amounts. Specifically, the examiner allowed the Taxpayer $1316 in car and truck expenses; $972 in insurance; $161 in office expenses; $4,488 for vehicles and equipment; $2,089 for supplies; $48 for taxes and licenses; $128,274 for wages; $1,877 for telephone; and $445 for dues, for total Schedule C expenses of $157,659. The Taxpayer had claimed gross income of $298,441 and expenses of $375,127 on the 2000 Schedule C. The examiner disallowed all deductions claimed on the 1999, 2001, 2002, and 2003 returns because the Taxpayer was unable to provide records concerning those years.

The Taxpayer argues that his 1999 income of $84,401 reported by the IRS was his gross income for the year, and that he netted substantially less because his employer, Sherman International, deducted certain expenses from his gross pay. He also claims that he had numerous Schedule C expenses/deductions in 2000, 2001, and 2002 relating to his concrete pouring and smoothing business. The Taxpayer does not dispute the Department's adjustments/calculations concerning 2003.

The Taxpayer testified at the October 16 hearing that he maintained expense records for the subject years, but that the records were lost when his wife moved the furniture out of their house before their divorce. He explained that the records were in a trunk that could not be located after his wife moved out. He attempted to obtain copies of his bank records for all years, but the banks had destroyed/erased the records, except for the Regions Bank checks from 2000. The Taxpayer was thus forced to estimate the

expenses on the 1999 through 2003 returns that he prepared in 2007.

All taxpayers are required to keep adequate books and records from which their correct liability can be computed or verified. See, Code of Ala. 1975, §40-2A-7(a)(1), *Fanning v. State of Alabama*, Inc. 99-395 (Admin. Law Div. 12/7/2000). As a general rule, if a taxpayer fails to provide records verifying a claimed deduction, the deduction must be disallowed. *Fanning*, *supra.* There is, however, an exception to that general rule. If a taxpayer can establish that he or she incurred or is entitled to certain deductions, but is unable to prove the exact amounts due to a lack of records, the taxpayer may reasonably estimate the deductions under the rule established in *Cohan v. Commissioner*, 39 F.2d 540 (1930), i.e., the "Cohan rule."

The Cohan rule has been statutorily abolished concerning business travel, entertainment, and related deductions, see 26 U.S.C. §274. It is still viable, however, relating to other deductions; provided, the taxpayer must present sufficient evidence from which a reasonable estimate of the deductions can be made.

> The rule as announced in Cohan applied to travel and entertainment expenses. In that area, Congress has overruled the result in section 274(d), which imposes a heavy burden of substantiation on a taxpayer claiming deductions under section 162 for travel and entertainment expenses. But the Cohan principle was applied more generally and apparently survives where not legislatively overruled. See, e.g., *Cummings v. Comm'r*, 5 Cir. 1969, 410 F.2d 675, 679; *Green v. Comm'r*, 1980, 74 T.C. 1229, 1237; see generally 4A J. Mertens, Law of Federal Income Taxation s 25.04 (Doheny rev. ed. 1979).
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> > . . . (A) taxpayer would (otherwise) in every case be denied a deduction for otherwise allowable expenses where there was a failure of strict proof on his part. Thus, even though it is quite apparent that because of the nature of the taxpayer's business certain types of ordinary and necessary expenses would have to be incurred and were actually paid, nevertheless, if the taxpayer did not maintain adequate records, no part of such expenses would be allowable because proof of detail or

> itemization was lacking. Fortunately, however, such automatic disallowance has not been the general rule . . .
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> Id.
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> The Cohan rule does not in any way shift the burden of proof. Stated another way, it simply provides that the failure of the taxpayer to establish the exact amount to which he is entitled should not lead the court to ignore that the taxpayer has met his burden of proof on his entitlement to some deduction.

Ellis Banking Corp. v. C.I.R., 688 F.2d 1376, 1383.

Various credible witnesses testified at the October 16 hearing that the Taxpayer was actively engaged in the concrete pouring and smoothing business in 2000, 2001, and 2002. From 7 to 15 individuals helped him on his jobs in those years, depending on the size of the job. He paid those individuals from $13 – $17 per hour. He also performed the concrete work on an 18 story condominium in Florida in 2001/2002. That job lasted for 16 to 18 months. He paid the room, board, and travel expenses for the workers that he used on that job, in addition to their wages.

The Taxpayer clearly had substantial Schedule C expenses in 2000, 2001, and 2002. The issue is whether he has presented sufficient evidence from which the amount of those expenses can be reasonably estimated.

The Taxpayer presented numerous checks relating to his concrete business in 2000. The Department examiner accepted those checks, and thus allowed $157,659 in expenses, or approximately 42.02 percent of the amount claimed. The Taxpayer testified that he operated in substantially the same manner and incurred the same type expenses during the years (2000 – 2002) that he operated his concrete business. Consequently, the Taxpayer should be allowed the same percentage of deductions in 2001 and 2002 that he established he was entitled to in 2000. The Department should thus allow the Taxpayer

$142,033 in expenses in 2001 (42.02 percent of claimed expenses of $338,012 equals $142,033) and $21,587 in expenses in 2002 (42.02 percent of claimed expenses of $51,850 equals $21,587). The Taxpayer cannot be allowed any expenses for 1999 because he failed to present any records from which his expenses as a truck driver could be reasonably estimated. As indicated, the Taxpayer does not dispute the 2003 adjustments.

The Department should recompute the Taxpayers' liabilities as indicated above and notify the Administrative Law Division of the adjusted tax, penalties, and interest due. A Final Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered December 19, 2008.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Lionel C. Williams, Esq.
Samuel R. McCord, Esq.
Tony Griggs