L. EDWARD & DIXIE C. HICKS 8112 SWEET GUM LANE EQUALITY, AL 36026,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 11-291
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER ON TAXPAYERS' APPLICATION FOR REHEARING

This appeal involves a final assessment of 2007 Alabama income tax and a partially denied 2008 income tax refund involving the above Taxpayers. A Final Order was entered on November 8, 2011 reducing the 2007 final assessment and increasing the 2008 refund. The Taxpayers timely applied for a rehearing. A hearing was conducted on January 17, 2012. The Taxpayers attended the hearing. Assistant Counsel Lionel Williams represented the Department.

The Taxpayers both taught at Faulkner University in Montgomery, Alabama during the years in issue. Dixie Hicks taught history and cultural anthropology. Edward Hicks taught history, bible, and other courses, and was also director of Faulkner's international studies program.

The Department audited the Taxpayers' 2007 and 2008 Alabama returns and disallowed various deductions claimed on the returns. Those adjustments resulted in the 2007 final assessment and the reduced 2008 refund in issue in this case. The Taxpayers dispute the following audit adjustments:

(1) The Department examiner disallowed property taxes paid on certain real property, and also on a vehicle, because one of the Taxpayers' sons was on the deed to

the real property and was listed as owner on the motor vehicle certificate of title.

(2) The examiner disallowed the estimated value of various books donated by the Taxpayers to Faulkner.

(3) The examiner allowed various charitable contributions, but disallowed all contributions for which the Taxpayers failed to provide a receipt from the recipient, including contributions to the United Way, Faulkner University, the Real Island Volunteer Fire Department, and New Harmony Church.

(4) Finally, the examiner disallowed travel-related employee business expenses totaling $36,719 in 2007 and $47,178 in 2008. The expenses related to trips the Taxpayers took to various cities and historic sites in Europe, and also to the States of Oregon, Colorado, Hawaii, and New York. As discussed below, the examiner disallowed the travel expenses because the trips were personal in nature and not a required or necessary part of the Taxpayers' jobs at Faulkner.

Concerning the property taxes paid on the real property and the motor vehicle, the real property and vehicle on which the taxes were paid were at least partly owned by one of the Taxpayers' sons. Those amounts were correctly disallowed because a taxpayer cannot deduct taxes paid that are owed by another person. *Anderson v. State of Alabama*, Docket Inc. 99-525 (Admin. Law Div. 1/20/2000).

Concerning the donated books that were disallowed, the Department claims that the Taxpayers had already depreciated the books in prior years. The Taxpayers argue that the books they donated in the subject years were different from the books they had depreciated in prior years. Specifically, the Taxpayers claim that they had previously depreciated

"encyclopedias and great books of the Western world and this sort of thing, which I still have and have not donated to the school." (T. 10). They also claim that they "have a list from the school of the books (donated each year) and the value of the books." (T. 10).

If the Taxpayers donated books to Faulkner in the subject years that had not been previously depreciated, they could deduct the fair market value of those books. Unfortunately, there is insufficient evidence in the record from which this issue can be decided. The Department should specify what books the Taxpayers depreciated in the years before 2007, and also why it believes that the books deducted in 2007 and 2008 are the same books that were previously depreciated. The Department should also notify the Division if it disagrees with the fair market value of the books as claimed by the Taxpayers, and why.

Concerning the charitable contributions, it is not clear what the Taxpayers submitted in support of their claimed deductions. They testified that they submitted checks in support of the deductions. The Department examiner stated in her audit report, Department Ex. A, that "[a] check book register is not sufficient documentation or proof" for tax purposes. The Taxpayers also testified at one point that some of the charitable contributions were based on estimates. (T. 59).

The Department should notify the Administrative Law Division concerning exactly what records the Taxpayers submitted in support of their charitable deductions. It should also explain why a cancelled check made out to and cashed by a charitable entity is not, by itself, sufficient verification, and also cite authority for its position that a taxpayer must provide a receipt from the recipient of the charitable contribution or donation. Finally, the

Department should explain why a payroll deduction going to the United Way should not be allowed.

Concerning the Taxpayers' travel-related deductions, the Taxpayers argue that part of Mr. Hicks' job as head of Faulkner's international studies program is to periodically take Faulkner students overseas to study. They also claim that they are required to travel and study cultures, history, etc., both in and outside of the United States, for professional development purposes. The disputed trips deducted by the Taxpayers in the subject years are summarized below.

The Taxpayers took a group of Faulkner students on an extended field study trip to Italy in the Fall of 2007. The Taxpayers contend that to adequately prepare and plan for the Fall trip, they traveled to New York City and then to Italy and back in May 2007. Specifically, they flew to New York City on May 10, 2007. They stayed in the New York City area for seven days, during which they toured downtown New York City, the Federal Reserve Museum, the New York City Police Museum, Ellis Island and Liberty Island, and numerous other historic and tourist sites. They deducted $1,836 for food and lodging while in the New York City area. They claim that the New York stay involved professional development. "We had to go through New York to get to Italy. So why not spend some time for professional development." (T. 44).

They flew to Rome on May 17, 2007, where they toured various historic sites for the next three days. They boarded a cruise ship on May 20, 2007, and visited various sites in the Mediterranean over the next nine days. They took the cruise because they and the Faulkner students planned on taking the same cruise in the Fall, "[s]o we went to take that

cruise to be prepared for taking our students in the Fall." (T. 49). They returned to Alabama on May 29, 2007. They deducted $11,451.58 relating to the May 2007 trip.

The Taxpayers also deducted $9,644.97 relating to a trip they took to Hawaii in July and August 2007. The trip included four days in California and seventeen days in Hawaii. While in Hawaii, the Taxpayers visited numerous historical and tourist-related sites. They claim that the trip was for professional development, and that while on the trip they took pictures and developed slide presentations that they could use in teaching.

As indicated, the Taxpayers took some Faulkner students to Italy in the Fall of 2007 as a part of the Faulkner international studies program. Faulkner reimbursed the Taxpayers for their flight to Italy and back, and also for the room and board expenses directly related to their teaching duties while in Italy.

The Taxpayers testified that the group had "free travel time" while in Italy, during which they and the students were free to travel where they wanted. Consequently, from September 26 through December 12, 2007, the Taxpayers took dozens of side trips to various cities and sites in Europe. They traveled to Paris, London, various World War II battlefields and museums, Florence, Vienna, Venice, Munich, Cologne, and numerous other locations. The Taxpayers concede that the above travel was not a required part of the Faulkner international studies program, but that it was necessary for their professional development. Again, the Taxpayers claim that they took pictures and prepared slides that they later used as teaching tools. They deducted $15,163.77 relating to their "free travel time" expenses in Europe in the Fall of 2007.

In April 2008, the Taxpayers took what they describe as a historic research trip to

the Portland, Oregon area. They stayed in Oregon from April 2 to April 6, during which they toured various historical sites in the area, including Fort Clatsop, the Lewis and Clark Expedition site in the area. They deducted $1,127 relating to the Oregon trip.

Ms. Hicks spent 30 days in Israel in May/June 2008. She did field study work at an archeological dig while in Israel, which she needed to obtain her teaching credentials in cultural anthropology. She also toured various other historical sites while in Israel. The Taxpayers deducted $10,303.30 relating to Ms. Hicks's travel to and stay in Israel.

The Taxpayers returned to the Hawaiian Islands in July/August 2008 in what they described as a historical and anthropological research trip to Maui and Oahu. They stayed over two weeks, during which time they toured various historical and tourist sites. The total amount deducted was $11,273.03.

Finally, the Taxpayers took what they described as a historical research trip to the Denver, Colorado area in November 2008. They stayed in Colorado for seven days and visited Pike's Peak, the Royal Gorge Bridge, Buffalo Bill's burial site, the U.S. Air Force Academy in Colorado Springs, and various other sites. The total amount deducted was $1,282.[1]

Code of Ala. 1975, §40-18-15(a)(1) allows a deduction for all ordinary and necessary expenses incurred in carrying on a trade or business to the same extent allowed for federal purposes at 26 U.S.C. §162. Because an employee's job constitutes the employee's trade or business, an employee may deduct all unreimbursed expenses that are ordinarily and necessarily incurred by the employee in performing his or her job duties.

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[1] For a more specific breakdown of where the Taxpayers traveled and what they saw in 2007 and 2008, see Exhibit D attached to Department Exhibit B.

> Section 162(a) allows a taxpayer to deduct all ordinary and necessary business expenses paid or incurred during the taxable year in carrying on any trade or business. To be "ordinary" the transaction which gives rise to the expense must be of a common or frequent occurrence in the type of business involved. *Deputy v. Du Pont*, 308 U.S. 488, 495, 84 L. Ed. 416, 60 S. Ct. 363 (1940). To be "necessary" an expense must be "appropriate and helpful" to the taxpayer's business. *Welch v. Helvering*, supra at 113. Additional, the expenditure must be "directly connected with or pertaining to the taxpayer's trade or business." Sec. 1.162-1(a), Income Tax Regs.

Perry H. Kay, Sr. v. Commissioner of Internal Revenue, T.C. Memo 2002-197, 84 T.C.M. (CCH) 166.

The Taxpayers' trip to Italy with the Faulkner students in the Fall of 2007 as a part of Faulkner's international studies program was a required part of Mr. Hicks' job as head of the program. But the expenses directly relating to the program are not in issue because Faulkner reimbursed the Taxpayers for those job-related expenses. What is disputed are the expenses relating to the Taxpayers' trip to New York and Italy in May 2007, the "free time" travel expenses incurred by the Taxpayers in Europe in the Fall of 2007, the expenses relating to the Taxpayers' travels to Hawaii in 2007 and 2008, the expenses for the Oregon and Colorado trips in 2008, and the expenses incurred during Ms. Hicks' trip to Israel in 2008.

The Taxpayers contend that the above trips were deductible business-related trips because they were primarily for professional development. They claim that they spent most of their time during the trips visiting various historical and cultural sites that enhanced their teaching abilities. Ms. Hicks explained that "[c]ultural anthropology relates to just about everything, everywhere we go. Because it's a different culture." (T. 22). In essence, the Taxpayers assert that anytime they travel to an area and view historical and cultural

sites, the trip is a deductible business-related trip. I disagree.

In *Nichols v. C.I.R.*, T. C. Memo 1984-91; 1984 Tax Ct. Memo LEXIS 584, the taxpayer was a college counselor and sociology professor. She was granted a sabbatical leave by her employer, and thereafter traveled to various locations in Europe, Africa, and Asia over a 227 day period (excluding days in the United States). During her travels, she visited schools and colleges, read work-related materials, traveled with a caravan in Africa, visited historical sites, beaches, and national parks, and mingled with the native peoples in the areas where she visited.

The taxpayer deducted her trip-related expenses as ordinary and necessary business expenses. The IRS disallowed the expenses. The U.S. Tax Court agreed that the travel expenses were nondeductible.

> The sole issue herein is whether petitioner is entitled to a business expense deduction under section 162(a) for travel expenses she incurred during a sabbatical from her employment as a college counselor and instructor.
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> Petitioner claims that the trip maintained or improved her skills as a college counselor and instructor, and that she is therefore entitled to deduct the expenses incurred on such trip. Respondent, on the other hand, contends that the major portion of the activities engaged in by petitioner on the trip did not directly maintain or improve her professional skills, but rather were in the nature of sightseeing, and were therefore nondeductible personal expenditures.
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> Travel expenses incurred for educational purposes are deductible as business expenses “only if the major portion of the activities [during the period of travel] * * * is of a nature which directly maintains or improves skills required by the individual” in her employment. Section 1.162-5(d), Income Tax Regs. Whether the activities engaged in by petitioner were of such nature is a question of fact, as to which she bears the burden of proof. *Adel son v. United States*,342 F.2d 332, 335 (9th Cir. 1965); *Marlin v. Commissioner*, 54 TIC. 560, 564-565 (1970); Rule 142(a).
> In seeking to meet her burden of establishing the business nexus which is requisite to deductibility of her trip expenses, petitioner testified as follows:

> And it's my contention that my travels, having to deal myself with people from other cultures and with backgrounds and ideas different from my own, getting the feeling of being the underdog, the outcast, the minority myself, having difficulties with communicating from time to time, that all of these aided me in my understanding of students who may bring me problems that are different from those that I have directly coped.

The foregoing benefits of her travel, petitioner further testified, not only benefitted her in dealing with foreign students at the college, but transferred as well to her counseling and teaching work at the college with handicapped, minority, and culturally, economically and educationally deprived students. We do not doubt that petitioner benefitted from her travels abroad in each of the ways she has described. As we have aptly noted in another case involving the deductibility of education travel expenses:

> We accept as a major premise that traveling is broadening. It no doubt aids the average traveler in becoming more tolerant or understanding of the habits and customs of others. It enriches culturally. It increases one's ability to communicated with others, an important facility to one whose occupation requires daily communication with [students]. (footnote omitted)
>
> Such benefits, however, do not suffice to establish the deductibility of travel expenses under section 162(a). For that, we must determine whether the benefits bear a sufficiently direct relationship to the traveler's business to convert what are normally personal expenses incurred on a holiday into qualifying business expenses. Based upon our examination of the record herein, we cannot find that such a relationship has been established.

* * *

On these facts, we cannot find that a major portion of petitioner's activities during her trip abroad were of a nature which directly maintained or improved her counseling and teaching skills. Accordingly, petitioner's education travel expenses in 1977 and 1978, as claimed, were personal expenses, nondeductible as such in their entirety.

Nichols at 7 – 10, 13.

The above rationale also applies in this case.

The Taxpayers were not required by their employer, Faulkner University, to take the trips in issue. As did the Tax Court in *Nichols*, I recognize that travel is broadening and generally improves one's ability to communicate with others. Those benefits, however, are not sufficient to establish the deductibility of travel-related expenses. Rather, the benefits derived from the travel must "bear a sufficiently direct relationship to the traveler's business to convert what are normally personal expenses incurred on a holiday into qualifying business expenses." *Nichols* at 10. I find that except for Ms. Hicks' trip to Israel, the trips in issue did not directly or significantly maintain or improve the Taxpayers' teaching abilities, and were primarily for personal pleasure.[2] The expenses relating to the trips were thus nondeductible.

The above conclusion is not altered because the Taxpayers took pictures and prepared slides of the sites they visited, and later used the pictures and slides as teaching aids. In today's high tech world, pictures of all cities, historical sites, landmarks, etc. are available online. The Taxpayers could have, for example, obtained pictures of the various landmarks in Paris without actually traveling to Paris. The trip to Paris and to the other sites/cities were thus not necessary or required.

[2] This is especially true concerning the Mediterranean cruise the Taxpayers took in May 2007. Taking a cruise to "prepare" for later taking the same cruise with others clearly is not an ordinary and necessary business-related trip.

The above conclusion is affirmed by the Tax Court's rationale in *Jorgensen v. C.I.R.*, T.C. Memo 2000-138; 2000 Tax Ct. Memo LEXIS 168. In that case, the taxpayer, a high school teacher, attended university courses in Greece and Southeast Asia to study how legend developed from historical events and how religious traditions shaped cultures. The trips lasted approximately two weeks each.

The taxpayer deducted the expenses relating to the trips. The IRS denied the deductions. In deciding the case, the Tax Court distinguished between travel itself as a form of education, which is nondeductible, and travel related to an activity, i.e., university courses, that gives rise to a business-related education deduction.

> Section 162(a) permits a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Such expenses generally include expenditures for travel, including amounts expended on meals and lodging, while away from home in the pursuit of a trade or business. See sec. 162(a)(2).
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> In contrast, no deductions are allowed for personal, living, or family expenses unless otherwise expressly provided by the Internal Revenue Code. See sec. 262(a). Expenditures made by a taxpayer in obtaining or furthering education are considered personal expenses and are not deductible unless they qualify under section 162 and section 1.162-5, Income Tax Regs., as business expenses. See sec. 1-2611(b)(9), Income Tax Regs. Objective criteria for distinguishing between business expenses and personal expenses are set forth in section 1.162-5, Income Tax Regs. See *Boser v. Commissioner*, 77 T.C. 1124, 1128-1129 (1981), revised 79 T.C. II (1982), affd. Without published opinion (9th Cir., Dec. 22, 1983); *McCulloch v. Commissioner*, T.C. Memo 1988-84.
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> Before 1987, section 1.162-5(d), Income Tax Regs., specifically provided that expenditures for travel as a form of education could properly be deducted under section 162 to the extent the travel was directly related to the duties of the individual in his or her employment or other trade or business. This regulation, however, was expressly overruled for years beginning after 1986 by the enactment of section 274(m)(2). See Tax Reform Act of 1986, Pub. L. 99-514, sec. 142(b), 100 Stat. 2118. Section 274(m)(2) provides that "No deduction shall be allowed under this chapter for expenses for travel as a

form of education."

Although no regulations have yet been promulgated under section 274(m), its legislative history offers insight into congressional intent in enacting section 274(m)(2). In H. Conf. Rept. 99-841 (Vol. 2), at II-30 (1986), 1986-3 C.B. (Vol. 4) 1, 30, the legislation was explained as follows:

> Education travel. – No deduction is allowed for costs of travel that would be deductible only on the ground that the travel itself constitutes a form of education (e.g., where a teacher of French travels to France to maintain general familiarity with the French language and culture, or where a social studies teacher travels to another State to learn about or photograph its people, customs, geography, etc.). This provision overrules Treas. Reg. sec. 1.162(5)(d) to the extent that such regulation allows deductions for travel as a form of education.

While the statute expressly overrules section 1.162-5(d), Income Tax Regs., the report makes no mention of section 1.162-5(e), Income Tax Regs., which provides, in part, for the deductibility of a taxpayer's travel expenses if the primary purpose of the travel is to engage in activities that themselves represent deductible education expenses. A report from the House of Representatives Committee on Ways and Means provides additional insight into the rationale underlying section 274(m)(2) and further indicates that Congress intended to leave intact the provision for deductibility under section 1.162-5(e), Income Tax Regs.:

> The committee is concerned about deductions claimed for travel as a form of "education." The committee believes that any business purpose served by traveling for general educational purposes, in the absence of a specific need such as engaging in research which can only be performed at a particular facility, is at most indirect and insubstantial. By contrast, travel as a form of education may provide substantial personal benefits by permitting some individuals in particular professions to deduct the cost of a vacation, while most individuals must pay for vacation trips out of after-tax dollars, no matter how educationally stimulating the travel may be. Accordingly, the committee bill disallows deductions for travel that can be claimed only on the ground that the travel itself is "educational," but permits deductions for travel that is a necessary adjunct to engaging in an activity that gives rise to a business deduction relating to education. [H.Rept. 99-426, at 122 (1985), 1986-3 C.B. (Vol. 2) 1,122.]

Jorgensen at 7 – 10.

The Tax Court found that the taxpayer's expenses relating to the courses were deductible because they had "focused educational purposes beyond mere travel . . . Unlike the example of a French teacher improving her familiarity with the French language and culture simply through traveling in France," the two courses were structured and had "planned tours of historically and culturally significant sites directly related to the course of study." *Jorgensen* at 9.

This case can be distinguished because the Taxpayers' trips in issue were otherwise unrelated to any educational activity. As stated in the above quote from the House report on §274(m)(2) and Reg. §1.162-5(e) – "Accordingly the committee bill disallows deductions for travel that can be claimed only on the ground that the travel itself is 'educational.'" The Taxpayers' trips in issue clearly fit into that nondeductible category.

The Taxpayers argue that some of the travel should be allowed because the same examiner allowed 80 percent of their claimed travel expenses in an audit of prior years. A prior audit finding or allowance (or disallowance) is not, however, binding on the Department. The Taxpayers were fortunate that the examiner allowed the 80 percent in prior years because none of the travel was allowable, assuming that the trips in the prior years were similar in substance and detail to the above discussed trips in 2007 and 2008.

Concerning Ms. Hicks' 30 day trip to Israel, the Taxpayers explained that the trip was required for Ms. Hicks to be able to teach cultural anthropology.

Education-related expenses cannot be deducted if the education qualifies the person for a new trade or business. See generally, *Ripley v. State of Alabama*, Docket Inc. 00-328

(Admin. Law Div. Final Order on Rehearing 4/3/2001), and federal cases cited therein. Ms. Hicks' trip to Israel qualified her to teach a new course, cultural anthropology, but it did not qualify her for a new trade or business. She was already teaching history at Faulkner when she took the trip, and teaching cultural anthropology is the same general type of work as teaching history. See generally, *Toner v. C.I.R.*, 623 F.2d 315 (3rd Cir. 1980). The expenses relating to Ms. Hicks' trip to Israel should be allowed.

The Department should respond concerning the donated books and the charitable contributions by April 6, 2012. An appropriate Order will then be entered.

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

Entered March 12, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Lionel C. Williams, Esq.
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