STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 86-221
BILLY E. ROBERTS Route 3 Box 239 Deatsville, AL 36022,	§	
Taxpayer.	§	

ORDER

The Revenue Department entered preliminary assessments of income tax against Billy E. Roberts ("Taxpayer") for the years 1983, 1984 and 1985. The Taxpayer appealed to the Administrative Law Division and hearings were conducted on February 19, 1987 and January 14, 1988. The Taxpayer was represented at both hearings by Sandra D. Roberts. Assistant counsel Mark Griffin appeared for the Department. Based on the evidence presented in the case, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

During the years in issue, the Taxpayer was employed as an insurance agent. The Department audited the Taxpayer's returns for 1983, 1984 and 1985 and denied various deductions for car and truck expenses, home office expenses, medical expenses, contributions, and other miscellaneous items. Additional income was also included for 1985. The Department entered preliminary assessments based on the above adjustments and the Taxpayer appealed to the Administrative Law Division.

A hearing was conducted on February 19, 1987 concerning the 1984 assessment, and a subsequent hearing was conducted on January 14, 1988 concerning the 1983 and 1985 liabilities. Additional records were submitted for each of the three years in issue. The Department reviewed the additional records and entered additional adjustments as follows:

(1) Mileage - The Taxpayer claimed business miles traveled of 60,500, 52,000 and 72,600 for the years 1983, 1984 and 1984, respectively. In support of the claimed mileage, the Taxpayer submitted into evidence a composite list of customers, their location, and total miles traveled. The list was not contemporaneously compiled. The Department rejected the claimed mileage and instead allowed a deduction in each year based on an estimate of 20,000 miles per year.

(2) Home Office Expenses - The Department allowed a home office deduction of $404.81 in both 1984 and 1985 based on the amount claimed in 1984.

(3) Telephone Expenses - Deductible telephone expenses of $205.79 were allowed in 1985 based on records provided by the Taxpayer.

(4) Overnight Expenses - Incomplete records were provided by the Taxpayer. Thus, $200.00 was allowed in 1985 as a reasonable amount in lieu of supporting documents.

(5) FICA - The Department disallowed a claimed FICA deduction because the Taxpayer had no wages during the subject years. The

Taxpayer argues that Federal Self-employment tax was inadvertently reported on the line specified for FICA tax, and that the amount should not be denied because of the mistake.

(6) Sales Tax - The Department adjusted the sales tax deduction in each year to conform to the decrease in total income.

(7) Medical Deduction - The medical deduction was increased to the decrease in total income. Also, the Department disallowed medical insurance premiums because they were paid by the Taxpayer's spouse through payroll deduction. The Taxpayer claims that he reimbursed his spouse for the premiums, but no evidence (checks, etc.) was produced in support of the claim, other than the Taxpayer's oral testimony.

(8) Contributions - All unsubstantiated contributions were disallowed. The Taxpayer argues that the claimed contributions are reasonable and should be allowed.

(9) Additional income for 1985 - The Department's original audit included income of $15,549.15 based on a form 1099 wage statement from A. M. Van Arcken. The Taxpayer contends that while that amount was not included as income on the 1985 return, it was reported on Schedule C and thus should not be included again as wages. However, the 1985 return filed by the Taxpayer and audited by the Department did not included a Schedule C.

CONCLUSIONS OF LAW

Code of Ala. 1975, §40-18-15(a)(1) provides a deduction for

all ordinary and necessary expenses incurred in conducting a trade or business. That section is modeled after 26 U.S.C. §162. Accordingly, federal case law and IRS regulations should be followed when interpreting the Alabama statute. See Reg. 810-3-15-.02(5) and Best v. State, Department of Revenue, 417 So.2d 187.

Early case law provided that if a taxpayer incurred deductible business expenses, but could not substantiate the exact amount, then a reasonable approximation would be allowed as a matter of equity. Cohan v. Commissioner, 39 F.2d 540. This so-called Cohan rule has been abolished by the more stringent requirements of 26 U.S.C. §274(d). A brief history and the elements of §274(d) are set out in Berkley Mach. Works and Foundry Company v. C.I.R., 623 F.2d 898, as follows:

> Proper application of §274 requires a consideration of the legislative history accompanying its passage. Support for this section, added to the Code by the Revenue Act of 1962, was generated by a concern that the broad interpretation given the "ordinary and necessary" language of §162, together with the rule of Cohan v. Commissioner allowing deduction of an approximation of travel and entertainment expenses, had led to widespread abuse of the deduction provision. The substantiation requirements of §274(d) were intended to abolish the Cohan rule and require the taxpayer to prove the exact amount and circumstances of the deduction; otherwise it would be disallowed entirely.
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> Section 274(d) of the Code disallows business entertainment expenses altogether "unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense . . . , (B) the time and place of the . . . entertainment . . ., (C) the business purpose of the

> expense . . ., and (D) the business relationship to the taxpayer of persons entertained . . ." The Treasury Regulations relating to this section state that "adequate records" are an account book, diary, statement of expense or similar record . . . and documentary evidence . . . which, in combination, are sufficient to establish each element of an expenditure . . . " §1.274-5(c)(2). Alternatively, if the taxpayer fails to meet the adequate records requirement, he must establish each element "[b]y his own statement, whether written or oral, containing specific information in detail as to such element; and (ii) By other corroborative evidence sufficient to establish such element." §1-274-5(c)(3). These Regulations have been held lawful and obedient to the legislative intent of §274, and applied in Dowell v. United States, 522 F.2d 708, 713 (5th Cir. 1975); Nicholls, North, Buse Co. v. Commissioner, 56 T.C. 1225, 1234 (1971); Sanford v. Commissioner, 50 T.C. 823, 830-32 (1968), aff'd per curiam, 412 F.2d 201 (2d Cir. 1969).

Section 274(d) was amended by the Tax Reform Act of 1984 to require contemporaneous records in all instances. That is, the "sufficient evidence corroborating his own statement" rule which is referred to in the above quote has been eliminated.

In the present case, the Taxpayer submitted a composite list of customers and miles traveled. The list was not contemporaneously maintained as required by the above authorities. Thus, the Department's allowance of 20,000 miles in each year is generous under the circumstances. The entire amount could have been disallowed.

Adequate records must also be maintained concerning all other claimed deductions. U.S. v. Wodtke, 627 F.Supp. 1034. The Taxpayer's oral testimony is insufficient to support a deduction without corroborating records. Berkley Mach. Works, supra, at p.

906.

The Department properly disallowed deductions for utilities and various "overnight expenses" because the records relating thereto were either insufficient or did not establish a business purpose for the expenditure. Contribution deductions were also properly disallowed because no receipts or other supporting evidence was provided.

The sales tax and medical expense deductions were properly adjusted to reflect the decrease in income resulting from the Department's adjustments. Also, the Department properly disallowed certain insurance premiums because they had been paid by the Taxpayer's spouse, and not by the Taxpayer. No evidence was presented, other than the Taxpayer's verbal assertions, indicating that the Taxpayer had reimbursed his spouse for the expense.

The FICA deduction was disallowed because the Taxpayer had no wages during the subject year. However, the claimed deduction was actually for federal self-employment tax which was erroneously claimed on the line allowed for FICA. The Taxpayer should not be penalized because an otherwise deductible item was claimed on the wrong line. Accordingly, the federal self-employment tax should be allowed.

Finally, the Taxpayer's claim that the 1985 income from A. M. Van Arcken was included twice in the audit is unsupported by the evidence. The Taxpayer's original return did not include a

Schedule C which the Taxpayer now claims included the Van Arcken income. Accordingly, the Department auditor properly included the amount shown on the form 1099 as income.

The Department has conducted several re-examinations concerning the Taxpayer's liability for the three years in issue. The Department has allowed additional deductions and thereby reduced the Taxpayer's liability based on additional records provided by the Taxpayer. The adjustments discussed herein resulted from the Department's last review of the Taxpayer's records. The Department is hereby directed to adjust its prior computations as indicated herein, and thereafter make the preliminary assessments final as adjusted.

Done this 2nd day of August, 1988.

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BILL THOMPSON
Chief Administrative Law Judge