

# United States Tax Court

T.C. Summary Opinion 2022-4

CHERI L. RAU,  
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent

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Docket No. 23074-19S.

Filed March 7, 2022.

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*Charles C. Black*, for petitioner.

*Huiwen Audrey Xi, John W. Sheffield, and John T. Arthur*, for respondent.

## SUMMARY OPINION

GUY, *Special Trial Judge*: This case for the redetermination of a deficiency was heard pursuant to the provisions of section 7463 of the Internal Revenue Code in effect when the petition was filed.<sup>1</sup> Pursuant to section 7463(b), the decision to be entered is not reviewable by any other court, and this opinion shall not be treated as precedent for any other case.

Respondent determined a deficiency of \$21,768 in petitioner's federal income tax for the taxable year 2016 (year in issue) and an accuracy-related penalty under section 6662(a) of \$4,354. Petitioner

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<sup>1</sup> Unless otherwise indicated, all statutory references are to the Internal Revenue Code, Title 26 U.S.C., in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure. We round all monetary amounts to the nearest dollar.

**Served 03/07/22**

filed a timely petition for redetermination with the Court. She resided in Georgia when the petition was filed.

After concessions, the issues remaining for decision are whether petitioner is entitled to various deductions that she claimed for the year in issue on (1) Schedule A, Itemized Deductions; (2) Schedule C, Profit or Loss From Business; and (3) Schedule E, Supplemental Income and Loss.<sup>2</sup>

### *Background*<sup>3</sup>

#### I. *Petitioner's Employment and Related Activities*

During the year in issue petitioner was employed as a mortgage broker, worked as a freelance real estate agent, and owned and managed three residential rental properties.

##### A. *Mortgage Broker*

Petitioner was employed as a manager in the mortgage brokerage division of Westmoore Group, LLC (Westmoore). Her duties included selling mortgage loans, prospecting, meeting with account executives, clients, and real estate agents, attending real estate closings, and maintaining professional education requirements. Westmoore did not have a reimbursement policy for employee business expenses, and, except for company-related technology subscriptions, petitioner was not reimbursed for work-related expenses.

##### B. *Real Estate Agent*

As a freelance real estate agent, petitioner met with clients, toured properties for sale (alone and with her clients), and submitted purchase offers to sellers on behalf of her clients.

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<sup>2</sup> The parties agree that petitioner is (1) not entitled to a deduction for medical and dental expenses of \$9,775 (Schedule A), (2) not entitled to a deduction for "other" expenses of \$2,346 (Schedule C), and (3) is entitled to a deduction for utility expenses of \$550 (Schedule C). Respondent concedes that petitioner is not liable for an accuracy-related penalty under section 6662(a) for the year in issue. For clarity, additional concessions are noted in the text below.

<sup>3</sup> Some of the facts have been stipulated.

### C. *Rental Real Estate Activities*

Petitioner owned and managed three residential rental properties. One of the properties, referred to herein as the Castleair Drive house, had been rented to college students for several years and had fallen into considerable disrepair.

During the year in issue, petitioner hired contractors to make substantial renovations to the Castleair Drive house, including roof repairs, flooring and drywall work, replacement of the garage door, siding, and gutters, remodeling of the kitchen and bathrooms, and landscaping improvements. Petitioner purchased the materials needed for the renovation work, delivered the materials to the house, and oversaw much of the work.

## II. *Petitioner's 2016 Tax Return*

Petitioner filed Form 1040, U.S. Individual Income Tax Return, for the year in issue reporting wages of \$104,679, offset by Schedule A itemized deductions of \$59,650, a Schedule C loss of \$8,696, and a Schedule E loss of \$25,000.

### A. *Schedule A*

Petitioner claimed and respondent disallowed deductions for noncash charitable contributions and unreimbursed employee business expenses as summarized below.

#### 1. *Noncash Charitable Contributions*

Petitioner cleaned out the Castleair Drive house before it was renovated and donated various household items to Goodwill. She attached Form 8283, Noncash Charitable Contributions, to her return reporting noncash charitable donations of \$9,010.

At trial petitioner provided a list of the items that she had donated, including kitchen items, glassware, furniture, bedding, pictures, appliances, and lawn equipment. Petitioner valued the items at \$11,050, a figure that she determined after visiting Goodwill and taking note of the prices that the shop was asking for items similar to those that she had donated.

Respondent concedes that petitioner is entitled to a deduction of \$500 for noncash charitable contributions.

## 2. *Unreimbursed Employee Business Expenses*

Petitioner reported unreimbursed employee business expenses of \$44,727 (\$43,307 after the 2% limitation of section 67(a)), comprising vehicle expenses, meals and entertainment expenses, and “other” expenses.

### a. *Vehicle Expenses*

Petitioner reported vehicle expenses of \$22,345 using the standard mileage rate of 54 cents per mile. Although petitioner maintains that she contemporaneously recorded all of her business-related trips and expenses in a notebook that she kept in her car, she did not offer the notebook as evidence. Instead, she offered a mileage log prepared in advance of trial and purportedly derived from information in the notebook. Most of the entries in the mileage log were limited to a short statement of the number of miles petitioner drove on a given day, a reference to the person(s) she met with, and/or the name of the city, town, or general location that she visited (e.g., “[m]et w/Connie potential client Duluth”).

Respondent concedes that petitioner is entitled to a deduction of \$3,780 for vehicle expenses.

### b. *Meals and Entertainment Expenses*

Petitioner reported meals and entertainment expenses of \$3,665 (\$1,833 after the 50% limitation of section 274(n)(1)). Petitioner produced numerous restaurant receipts, some of which were illegible, to substantiate these expenses.

Respondent maintains that petitioner is not entitled to a deduction for meals and entertainment expenses.

### c. *Other Business Expenses*

Petitioner reported “other” expenses of \$20,549. While there is no schedule or other record attached to petitioner’s return itemizing these expenses, she offered a log that combines “other” expenses that she reported on Schedule A with similar “office” expenses reported on Schedule C (discussed below). The log, which includes expenses for

advertising, office space, supplies, and meals, does not distinguish between Schedule A and Schedule C expenses.

Respondent concedes that petitioner is entitled to a deduction of \$5,532 for “other” unreimbursed employee business expenses.

#### B. *Schedule C*

With regard to her work as a real estate agent, petitioner reported gross receipts of \$3,761 on Schedule C, offset by various expenses that resulted in a loss of \$8,696. As is relevant here, petitioner reported (1) vehicle expenses of \$3,299 (computed using the standard mileage rate of 54 cents per mile); (2) meals and entertainment expenses of \$2,314 (\$1,157 after the 50% limitation of section 274(n)(1)); and (3) office expenses of \$2,665.

Petitioner offered a mileage log purportedly derived from information in the notebook that she failed to produce. Most of the entries in the mileage log provided limited information about petitioner’s activities (e.g., “2/1/2016 9 houses Wendy Kitchen Douglasville area 143 [miles]”).

As mentioned above, petitioner also offered a log combining the “other” expenses that she reported on Schedule A with the “office” expenses (including meals expenses) that she reported on Schedule C.

Respondent disallowed deductions for all of the aforementioned expenses.

#### C. *Schedule E*

With regard to her rental properties, petitioner reported rents received of \$25,900, completely offset by various expenses, and a loss of \$25,000 related to the activity.

##### 1. *Vehicle Expenses*

Petitioner reported vehicle expenses of \$3,178 (using the standard mileage rate of 54 cents per mile) and offered two mileage logs to substantiate the expenses. The first log was purportedly derived from information in the previously mentioned notebook, while the second revised log was based in large part on petitioner’s review of Home Depot receipts. The second log provided detailed information about

petitioner's trips between her home, the Castleair Drive house, and Home Depot, and the business purpose for each trip.

Respondent concedes that petitioner is entitled to a deduction of \$270 for vehicle expenses.

### 2. *Supply Expenses*

Petitioner reported supply expenses of \$9,365 in connection with the renovation work at the Castleair Drive house. At trial petitioner offered Home Depot receipts and credit card records and asserted that her supply expenses actually exceeded \$13,000.

Respondent concedes that petitioner is entitled to a deduction of \$555 for supply expenses.

### 3. *"Other" Expenses*

Petitioner claimed "other"/labor expenses of \$20,050 for renovation work performed at the Castleair Drive house. She offered invoices and bank records to substantiate about one-half of the labor expenses and explained that she had paid the remaining labor expenses in cash. Petitioner reported that some of the cash payments went to teenagers who did not maintain bank accounts and that she was unable to obtain statements from other contractors who she paid in cash.

Respondent concedes that petitioner is entitled to a deduction of \$10,400 for labor expenses.

### *Discussion*

As a general rule, the Commissioner's determination of a taxpayer's liability in a notice of deficiency is presumed correct, and the taxpayer bears the burden of proving that the determination is incorrect.<sup>4</sup> Rule 142(a); *Welch v. Helvering*, 290 U.S. 111, 115 (1933). Deductions are a matter of legislative grace, and the taxpayer generally bears the burden of proving entitlement to any deduction claimed. Rule 142(a); *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934).

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<sup>4</sup> Petitioner contends, without elaboration, that the burden of proof should shift to respondent under section 7491(a). Because we have concluded that petitioner failed to introduce credible evidence to substantiate the items in dispute, the burden of proof is not shifted to respondent under section 7491.

Under section 162(a), a deduction is allowed for ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. A taxpayer must substantiate deductions claimed by keeping and producing adequate records that enable the Commissioner to determine the taxpayer's correct tax liability. § 6001; *Hradesky v. Commissioner*, 65 T.C. 87, 89–90 (1975), *aff'd per curiam*, 540 F.2d 821 (5th Cir. 1976).

When a taxpayer establishes that he or she paid or incurred a deductible expense but fails to establish the amount of the deduction, the Court may sometimes estimate the amount allowable as a deduction. *Cohan v. Commissioner*, 39 F.2d 540, 543–44 (2d Cir. 1930); *Vanicek v. Commissioner*, 85 T.C. 731, 742–43 (1985). There must be sufficient evidence in the record to permit the Court to conclude that a deductible expense was paid or incurred in at least the amount allowed. *Williams v. United States*, 245 F.2d 559, 560 (5th Cir. 1957).

Section 274(d) prescribes more stringent substantiation requirements to be met before a taxpayer may deduct certain categories of expenses, including meals and vehicle expenses. Temp. Treas. Reg. § 1.274-5T(a); *see Balyan v. Commissioner*, T.C. Memo. 2017-140, at \*7. To satisfy the requirements of section 274(d), a taxpayer generally must maintain adequate records or produce sufficient evidence corroborating her own statement, which, in combination, are sufficient to establish the amount, time and place, and business purpose for each expenditure. Temp. Treas. Reg. § 1.274-5T(b)(2), (6), (c)(1). Temporary Treasury Regulation § 1.274-5T(c)(2) provides in relevant part that “adequate records” generally consist of an account book, a diary, a log, a statement of expense, trip sheets, or a similar record, made at or near the time of the expenditure or use, along with supporting documentary evidence. The Court may not use the *Cohan* doctrine to estimate expenses covered by section 274(d). *See Boyd v. Commissioner*, 122 T.C. 305, 320 (2004); Temp. Treas. Reg. § 1.274-5T(a).

#### I. *Vehicle Expenses*

As noted above, petitioner reported vehicle expenses on Schedules A, C, and E. Vehicle expenses are subject to the strict substantiation requirements of section 274(d).

The mileage logs that petitioner offered to substantiate the vehicle expenses that she reported on Schedules A and C are inadequate to satisfy the heightened requirements of section 274(d). In sum, the

logs are not reliable because they purportedly reflect information that petitioner drew from a notebook that is not part of the evidentiary record and the log entries often lack necessary information such as the location where petitioner started a particular trip, her precise destination, and the business purpose for the trip. Under the circumstances, petitioner is not entitled to deductions for vehicle expenses reported on Schedules A and C in excess of the amounts that respondent conceded.

Petitioner provided a more detailed mileage log in support of the vehicle expenses that she reported on Schedule E. Considering the various records that petitioner provided and her role in overseeing the renovation work at the Castleair Drive house, including purchasing and delivering the materials needed to complete that work, she adequately substantiated and is entitled to a deduction of \$3,178 for vehicle expenses reported on Schedule E.

## II. *Meals and Entertainment Expenses*

Petitioner reported meals and entertainment expenses on Schedules A and C. Meals and entertainment expenses are subject to the strict substantiation requirements of section 274(d).

Petitioner testified that she often purchased meals while working with clients in completing mortgage loan applications or when she was showing homes for sale to her clients. She offered a log, credit card statements, and restaurant receipts to substantiate meals expenses.

The records that petitioner offered to substantiate meals expenses are inadequate to satisfy the heightened requirements of section 274(d). The logs were not prepared contemporaneously, some of the receipts were illegible, and she failed to identify a business purpose for any meal. *See Alexander v. Commissioner*, T.C. Memo. 2016-214, at \*20–21 (concluding that a ledger with no explanations regarding the business purpose of reported meals or the taxpayer's relationship to alleged dining companions was insufficient under section 274(d)). Respondent's disallowance of the deductions that petitioner claimed for meals and entertainment expenses reported on Schedules A and C is sustained.



### III. *Additional Schedule A Deductions*

#### A. *“Other” Employee Expenses*

Respondent concedes that petitioner is entitled to deduct \$5,532 of “other” expenses totaling \$20,549 that she reported on Schedule A. The items that respondent conceded included various fees (realtor, supra key, NMLS, and Blackstone), office rent and fees, Zillow marketing charges, and postage fees.

Petitioner offered a log and credit card statements to substantiate these expenses. Although the expenses in question are subject to the *Cohan* rule, there is insufficient evidence to permit the Court to estimate the amount of an allowable deduction greater than the amount respondent conceded. Respondent’s determination is sustained.

#### B. *Noncash Charitable Contributions*

Petitioner claimed a deduction for noncash charitable contributions of \$9,010 on her return, and she asserted at trial that the deduction should be increased to \$11,050. Respondent concedes that petitioner is entitled to a deduction for noncash charitable contributions of \$500.

Section 170 allows as a deduction any charitable contribution made within the taxable year to specified entities. *See* § 170(a)(1), (c)(2). Charitable contributions are deductible only if verified in accordance with regulations prescribed by the Secretary. *See* § 170(a)(1); *Van Dusen v. Commissioner*, 136 T.C. 515, 530 (2011).

As is relevant here, no deduction is allowed for “any contribution of clothing or a household item” unless such property is “in good used condition or better.” § 170(f)(16)(A). “The term ‘household items’ includes furniture, furnishings, electronics, appliances, linens, and other similar items.” § 170(f)(16)(D)(i). The items that petitioner donated during the year in issue were household items within the meaning of the statute.

Petitioner failed to present objective and credible evidence that the items she donated were “in good used condition or better.” *See Kunkel v. Commissioner*, T.C. Memo. 2015-71, at \*12. Any suggestion that the donated items were in good used condition is undermined by petitioner’s testimony regarding the state of considerable disrepair at

the Castleair Drive house before the items were removed. Respondent's determination that petitioner is limited to a deduction of \$500 for noncash charitable contributions is sustained.

#### IV. *Additional Schedule C Deductions*

Petitioner reported office expenses of \$2,665 on Schedule C and offered a log and credit card statements as substantiation. Although the expenses in question are subject to the *Cohan* rule, there is insufficient evidence to permit the Court to estimate the amount of an allowable deduction. Respondent's determination disallowing a deduction for office expenses reported on Schedule C is sustained.

#### V. *Schedule E*

##### A. *Supply Expenses*

Respondent concedes that petitioner is entitled to deduct \$555 of \$9,365 of supply expense that she reported on Schedule E. Petitioner offered receipts and credit card statements demonstrating that she purchased most if not all of the materials and some of the tools needed for the renovation work at the Castleair Drive house.

As a general rule, incidental repairs to an investment property may be deducted under section 162 by a cash basis taxpayer when paid, while capital improvements are added to the investment property's basis and recovered upon the sale of the property under section 263. *See, e.g., Schroeder v. Commissioner*, T.C. Memo. 1996-336. The record reflects that roughly half of the renovation work at the Castleair Drive house constituted incidental repairs and routine maintenance, while the other half comprised capital improvements. Considering all of the facts and circumstances, and bearing heavily against petitioner and her own inexactitude, we conclude that she is entitled to a total deduction of \$4,000 for supplies.

##### B. *"Other" Expenses*

Respondent concedes that petitioner is entitled to deduct \$10,400 of \$20,050 of "other" expenses that she reported on Schedule E. Petitioner offered testimony and a spreadsheet to substantiate labor expenses in excess of the amount respondent conceded.

Considering all of the facts and circumstances and bearing heavily against petitioner and her own poor recordkeeping, we conclude

that she is entitled to a total deduction of \$12,000 for “other” (labor) expenses.

To reflect the foregoing,

*Decision will be entered under Rule 155.*