William J. Stafford
Tax Counsel III
Board of Equalization, Appeals Division
450 N Street, MIC:85
PO Box 942879
Sacramento, CA 95814
Tel: (916) 206-0166
Fax: (916) 324-2618

Attorney for the Appeals Division

BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**[2]
	PERSONAL INCOME TAX APPEAL
ILONA FOYER[1]	Case No. 569037

Years	Proposed Assessments[3] Additional Tax	Penalties[4]
2001	$24,296.00	$6,401.74
2002	$13,731.00	$3,544.67

Representing the Parties:

For Appellant: Solis Cooperson, Esq.

[1] Appellant currently lists an address in Las Vegas, Nevada. It appears to be undisputed that appellant was residing in California for the tax years at issue.

[2] This appeal was originally scheduled for the Board's February 26-28, 2013 oral hearing calendar. It was removed from that calendar pursuant to a request of the Appeals Division to conduct additional briefing. Subsequently, this appeal was rescheduled for the Board's October 29-31, 2013 oral hearing calendar. Afterwards, the Appeals Division received a Board Member Inquiry as to the amount of unreported income for the 2001 tax year and appellant provided various documents, totaling hundreds of pages, shortly before the scheduled oral hearing. Based on the foregoing, this appeal was removed from the Board's October 29-31, 2013 oral hearing calendar pursuant to a request of the Appeals Division to conduct additional briefing. Later, this appeal was rescheduled for the Board's June 24-26, 2014 oral hearing calendar.

[3] Respondent states, in its memorandum dated February 4, 2014, that the tax amounts remaining at issue after its concessions are $3,151 of tax for 2001 and $10,608 of tax for 2002.

[4] The penalty amounts consist of the following: For 2001, an accuracy-related penalty of $4,859.00 and a proposed post-amnesty penalty of $1,542.74. For 2002, an accuracy-related penalty of $2,746.00 and a proposed post-amnesty penalty of $798.67. On appeal, appellant has not directly disputed the penalties, though the penalties would be removed if appellant prevailed with respect to the assessed additional taxes.

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For Franchise Tax Board: Maria Brosterhous, Tax Counsel

QUESTIONS: (1) Whether appellant can substantiate her Schedule C cost of goods sold amounts for 2001 and 2002.

(2) Whether appellant can substantiate her business expense deductions for 2001 and 2002.

(3) Whether appellant omitted gross income in excess of 25 percent for 2002 (and if so, by what amount), such that the extended six-year statute of limitations applies for the FTB to issue the Notice of Proposed Assessment (NPA) dated August 25, 2008, which assesses additional tax for omitted gross income.

HEARING SUMMARY

Background

Appellant filed her 2001 and 2002 California personal income tax returns on September 23, 2002 and October 27, 2003, respectively. (FTB OB, p. 1.) The returns list California taxable income amounts of -$45,621 for 2001 and -$174,054 for 2002 (which appellant reported as "zero" taxable income on her returns). (*Id*., Exhs. A & B.) The returns contain Schedule Cs (*id*., Exhs. C & D) that list gross receipts or sales totaling $80,763 for 2001 and $89,785 for 2002. The Schedule Cs also list cost of goods sold amounts totaling $50,871 for 2001 and $13,346 for 2002 as follows:

2001	
Cost of goods sold-purchases	$33,097
Cost of goods sold-labor	$17,774
Cost of goods sold-materials	$0
TOTAL	$50,871

2002	
Cost of goods sold-purchases	$0
Cost of goods sold-labor	$10,423
Cost of goods sold-materials	$2,923
TOTAL	$13,346

In addition, the Schedule Cs list business expense deductions totaling $86,013 for 2001 and $254,167 for 2002. (*Id*., Exhs. C & D.) The Schedule C for 2001 lists the business name "Cyberdressforms, Co.," and the Schedule C for 2002 lists the business name "Shapely Shadow." (*Id*.)

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In a letter dated December 1, 2005, the FTB first notified appellant that her 2001 and 2002 tax returns were being examined. (*Id*., p. 2.) That letter was returned by the Postal Service as undelivered. (*Id*.) Afterwards, the FTB sent appellant another letter dated December 21, 2005 (to an updated address), requesting that appellant provide supporting documents. (*Id*.) When appellant failed to respond to the letter dated December 21, 2005, the FTB sent appellant another letter dated January 23, 2006. In response, appellant provided the FTB with copies of various documents, which the FTB generally describes in its opening brief as "mortgage interest statements, cancelled checks, and invoices." (*Id*.)

After examining those documents, the FTB issued NPAs dated April 7, 2006, which (1) denied appellant's cost of goods sold amounts totaling $50,871 for 2001 and $13,346 for 2002, and (2) denied appellant's claimed business expense deductions totaling $86,013 for 2001 and $254,157 for 2002. (A copy of the 2001 NPA is attached as an unlettered exhibit to the FTB's additional brief dated October 21, 2013; a copy of the 2002 NPA is attached as Exhibit F to the FTB OB.)

Appellant filed timely protests, asserting that her accountant accidently overstated her income for the tax years at issue. (FTB OB, Ex. G.) During protest, the FTB made numerous requests for further documentation and examined the issue of whether appellant had unreported income for 2001 and 2002. (*Id*. pp. 2-4.)

In response, appellant provided, among other things, a schedule of bank deposits, copies of cashier's checks, a schedule of advances, a promissory note for a loan, documents regarding the issuance of common stock for Cyberdressforms, and a copy of the complaint from litigation pertaining to Cyberdressforms. (*Id*., p. 4.) Appellant also filed amended California returns for 2001 and 2002 that included amended Schedule Cs, which report (1) cost of goods sold amounts totaling $55,266 for 2001 and $8,490 for 2002, and (2) business expense deductions totaling $96,340 for 2001 and $255,943 for 2002. (*Id*., Exhs. H at p. 7 & I at p. 10.) The specific cost of goods sold amounts, as set forth in the amended Schedule Cs, are as follows:

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2001	
Cost of goods sold-purchases	$43,243
Cost of goods sold-labor	$12,023
Cost of goods sold-materials	$0
TOTAL	$55,266

2002	
Cost of goods sold-purchases	$0
Cost of goods sold-labor	$8,490
Cost of goods sold-materials	$0
TOTAL	$8,490

The amended Schedule C for 2001 lists the business name of "Ilona Foyer & Associates"; similarly, the amended Schedule C for 2002 lists the business name of "Ilona Foyer & Associates." (*Id*.)

On August 25, 2008, the FTB issued additional NPAs, asserting that appellant had unreported income in the amounts of $545,141 for 2001 and $366,320 for 2002. (*Id*., Exhs. J & K.)

On October 24, 2013, following a Board Member Inquiry, the FTB withdrew its proposed assessment of unreported income for the 2001 tax year, conceding on appeal that this proposed assessment, for unreported income, was untimely. Therefore, with regard to unreported income, only the August 25, 2008 NPA for the 2002 tax year remains at issue.

In response to the NPAs dated August 25, 2008, appellant filed timely protests, asserting that (i) the statute of limitations had expired before the FTB made the assessments of unreported income on August 25, 2008, (ii) the alleged unreported funds were not income, but were loans secured by her home, and (iii) she was ousted from Cyberdressforms on or about May 2001, was not in control of the income from that company after that date, and the FTB should have gone after Cyberdressforms rather than her. (*Id*., Ex. L.)

After reviewing the documents appellant provided during protest, the FTB reduced appellant's unreported income for 2002 from $366,320 to $146,827.[5] As noted previously, the FTB no longer asserts any unreported income for 2001.

Later, the FTB issued NOAs dated February 28, 2011 (FTB OB, Exhs. M & N), which

[5] The FTB states that it agreed to make this adjustment to account for (i) $194,323 attributable to a refinance agreement, and (ii) $25,170 of federal income tax refunds.

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affirmed the NPAs dated April 7, 2006, with the modification that the FTB allowed the following business expense deductions for 2001 and 2002:

- For 2001, (i) utilities of $2,267 and (ii) accounting expenses of $4,086.
- For 2002, (i) Schedule A interest of $17,143, (ii) utilities of $4,277, (iii) legal expenses of $11,477, and (iv) mortgage interest of $11,514.

For 2002, the FTB also issued an NOA dated March 11, 2011, which affirmed its NPA dated August 25, 2008, with the above-referenced adjustments to cost of goods sold and expense deductions, and affirmed its determination of unreported income of $146,827 for 2002. (FTB OB, Exhs. O and P.) Appellant then filed this timely appeal.

Summary of Concessions

During the appeal, appellant asserted that she incurred various costs and expenses during the 2001 and 2002 tax years. (App. Reply Br., Exs. 8 & 9.) Appellant's recent assertions in her appeal schedules (see App. Reply Br., Exs. 8 & 9) and the FTB's concessions to date,[6] are reproduced in Tables 1-2 below:

Table 1
Costs of Goods Sold

	Amounts claimed in latest appeal schedules (See App. Reply Br. Exs. 8 & 9.)	Amounts allowed at protest, as reflected in the NOAs	Amounts allowed by FTB on appeal	Amount still at issue at the Board Hearing
Costs of Goods Sold-Purchases 2001	$43,112.83	$0	$0	$43,112.83
Costs of Goods Sold-Purchases 2002	$0	$0	$0	$0

[6] As mentioned above, respondent states, in its memorandum dated February 4, 2014, that the tax amounts remaining at issue after its concessions are $3,151 of tax for 2001 and $10,608 of tax for 2002.

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Costs of Goods Sold-Labor 2001	$12,022.24	$0	$1,400	$10,622.24
Costs of Goods Sold-Labor 2002	$8,489.79	$0	$0	$8,489.79
Costs of Goods Sold-Materials 2001	$0	$0	$0	$0
Costs of Goods Sold-Materials 2002	$0	$0	$0	$0

Table 2
Expenses

	Amounts claimed on latest appeal schedules (See App. Reply Br. Exs. 8 & 9)	Amounts allowed at protest, as reflected in the NOAs	Amounts allowed by FTB on appeal	Amount still at issue at the Board Hearing
Automobile Expenses 2001	$4,988.00	$0	$0	$4,988.00
Automobile Expenses 2002	$4,065.47	$0	$0	$4,065.47
Travel Expenses 2001	$15,272.26	$0	$14,338.00	$934.26
Travel Expenses 2002	$11,875.92	$0	$11,876.00	$0
Meals & Entertainment 2001	$17,149.08	$0	$5,570.00	$11,579.08

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Meals & Entertainment 2002	$10,976.41	$0	$5,478.00	$5,498.41
Depreciation 2001	$31,377.00	$0	$0	$31,377.00
Depreciation 2002	$37,238.00	$0	$0	$37,238.00
Interest and/or Rent 2001	See detailed discussion below			
Interest and/or Rent 2002	See detailed discussion below			
Legal & Professional 2001	$7,976.38	$0	$5,917.00	$2,059.38
Legal & Professional 2002	$80,281.05	$11,477.00	$1,249.00	$67,555.05
Accounting Expenses 2001	$4,086.00	$4,086	$0	$0
Accounting Expenses 2002	$1,591.00	$0	$0	$1,591.00
Utilities (gas, etc.) 2001	$2,292.90	$0	$2,267.00	$25.90
Utilities (gas, etc.) 2002	No schedule provided	$4,277.00	$0	$0
Office	$3,942.56	$0	$3,078.00	$864.56

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Expenses 2001				
Office Expenses 2002	$1,675.59	$0	$1,676.00	$0
Postage 2001	$310.00	$0	$0	$310.00
Postage 2002	$0	$0	$0	$0
Rentals of Vehicles, etc. 2001	$254.00	$0	$0	$254.00
Rental of Vehicles, etc. 2002	$31,800.00	$0	$0	$31,800.00
Repairs 2001	$278.24	$0	$0	$278.24
Repairs 2002	$0	$0	$0	$0
Telephone 2001	$4,554.05	$0	$0	$4,554.05
Telephone 2002	$4,174.50	$0	$0	$4,174.50

On appeal, the unreported income of $146,827 for the 2002 tax year is still in dispute, as set forth in table 3 below. This is addressed in question/issue 3 below.

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Table 3 Unreported Income				
	Amount claimed on NPA dated Aug. 25, 2008	Amounts adjusted at protest, as reflected in the NOA	Amounts adjusted by FTB on appeal	Amount still at issue at the Board Hearing
Unreported Income 2002	$366,320	$219,493	$0	$146,827

Additional Submissions

At various points in the hearing summary below, Board staff makes requests for additional documents/evidence from appellant. As noted previously, this appeal was recalendared from the October 2013 calendar due in in large part due to hundreds of pages of documents submitted by appellant less than ten days prior to the hearing, and it has been the subject of extensive additional briefing in which appellant was provided an additional opportunity to provide evidence. In order to avoid any further delay, and to ensure a productive oral hearing that can resolve this matter, pursuant to California Code of Regulations, title 18, section 5523.6, any additional evidence or information should be provided *no later than* June 10, 2014, and should be clearly indexed and tabbed to facilitate review.[7] Board staff also requests that any further submissions by the FTB likewise meet this deadline.

Question No. 1: Whether appellant can substantiate her Schedule C cost of goods sold amounts for 2001 and 2002.

Applicable Law—Cost of Goods Sold

In general, a taxpayer takes gross receipts and then subtracts cost of goods sold to arrive at gross income/gross loss. (*Kazhukauskas v. Commissioner*, T.C. Memo 2012-191.) Afterwards, the taxpayer will subtract business expenses to arrive at net profit/net loss. (*Id.*) Thus, the calculation of net profit (or net loss) can generally be stated as follows:

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[7] Any new evidence exhibits should be sent to: Khaaliq Abd'Allah, Associate Governmental Program Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879, MIC:80, Sacramento, California, 94279-0080.

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Gross Receipts
(Cost of Goods Sold)
= **Gross Income/Gross Loss**
(Business Expenses)
= **Net Profit/Net Loss**

(See *Kazhukauskas v. Commissioner*, *supra*.)

The FTB's determinations are presumed correct and a taxpayer bears the burden of proving that the determinations are erroneous. (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.)[8] Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) Furthermore, "tax returns are not proof of the statements made therein." (*Bruno v. Commissioner*, T.C. Memo 1990-109.)

Contentions and Staff Comments

Cost of goods sold-purchases

As indicated above, appellant's amended Schedule Cs list cost of goods sold-purchases totaling $43,243 for 2001. (FTB OB, Ex. H.) On appeal, appellant provides cancelled checks (issued from the account of Ilona Foyer & Associates) totaling $43,112.83 for 2001, which appellant argues represent cost of goods sold-purchases. (App. Reply Br., Ex. 8.) Those checks show the following payments:

2001	
Costco	$777.69
Bay Cities	60.00
Sears	39.37
JC Taylor	141.00
Cantoni	2,400.00
Rappaport	2,208.60
Bay Cities	790.65
Finish First	375.00
Kyle Masonry	3,137.65
Kyle Masonry	2,690.26
Kyle Masonry	1,500.00
Eur. & Am. Cabinets	5,000.00
Portosan	299.43
Koonz Hardware	100.61
Neiman Marcus	1,314.07
Good Guys	3,000.00
Good Guys	15,551.92

[8] Board of Equalization cases are generally available for viewing on the Board's website (www.boe.ca.gov).

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Waterside Beauty	192.35
Finish First	400.00
Carlton	40.00
Sears	2,324.57
Standard Cement	769.66
TOTAL	$43,112.83

Appellant's amended Schedule C for 2002 lists costs of goods sold-purchases of "zero" and she has provided no checks for 2002.

2002	
N/A	$0

The FTB argues that appellant has not shown that her alleged cost of goods sold-purchases for 2001 served business purposes. (FTB OB, pp. 5 & 12.)

Staff Comments

For 2001, the FTB allows no cost of goods sold-purchases. For 2002, appellant is not claiming any cost of goods sold-purchases. Thus, the only year at issue in relation to costs of goods sold-purchases is 2001.

In a declaration dated October 21, 2013, appellant provided a list of the above-listed expenses for 2001, along with appellant's handwritten notations indicating why each of the above-listed expenses served a business purpose. (See App. Add. Br. dated Oct. 2013.) For example, appellant indicated that (1) the charges of $15,551.92 and $3,000.00 to Good Guys are for a "wiring system" and "computer & TV"; (2) the charges of $3,137.65, $2,690.26, and $1,500 to Kyle Masonry were for a "cement foundation" and a "new factory-wall"; and (3) the charge of $5,000 to "Eur & Am. Cabinets" was for "Tables-Counters."

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, questioning whether appellant had any documents (e.g., invoices, receipts, contracts, third-party declarations, etc.) that might *independently* verify appellant's assertions that the changes totaling $43,112.83 were made for business purposes (as opposed to personal purposes) for the 2001 tax year.

In reply, appellant asserted in an additional brief dated March 18, 2013, that her declaration, bank statements, and cancelled checks (issued from the account of Ilona Foyer and

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sssociates) were proof of the business purposes.[9] In this respect, appellant argued that (i) she did not comingle nonbusiness expenses with business expenses, (ii) starting in 2002, she operated Ilona Foyer and Associates from her personal residence, (iii) she had separate rooms set aside for business use, and (iv) she had to furnish the designated office space because clients would come to her home for business.

At the oral hearing, appellant should be prepared to substantiate that the above-listed payments (issued in 2001 and totaling $43,112.83) were issued for business purposes (as opposed to personal purposes). Staff notes that, even though appellant asserts in her declaration dated October 21, 2013, that she did not comingle business expenses and personal expenses, copies of her bank statements (under the name of Ilona Foyer and Associates) contain appellant's handwritten notations indicating that only certain expenses therein were for business purposes—and other expenses were for personal purposes.[10] In short, appellant's handwritten notations on her bank statements seem to conflict with appellant's assertion in her declaration that she did not comingle business and personal expenses.

Cost of goods sold-labor

As indicated above, appellant's amended Schedule Cs list cost of goods sold-labor totaling $12,023 for 2001 and $8,490 for 2002. (FTB OB, Exhs. H & I.) On appeal, appellant provides cancelled checks (issued from the account of Ilona Foyer & Associates) totaling $12,022.24 for 2001 and $8,489.79 for 2002, which appellant argues represent cost of goods sold-labor. (App. Reply Br., Exhs. 8 & 9.) Those cancelled checks show the following payments:

2001	
Robert Wenlo	$375.00
Rebecca Foyer	2,000.00
Monique Duenas	500.00
Maurice Electric	2,000.00
Erin Andres	1,350.00
Erin Andres	225.00
Greg Losman	175.00

[9] In addition, appellant stated (incorrectly) that the 2001 tax year was not at issue. Staff notes that the FTB only conceded its assessment of *unreported income* for the 2001 tax year—the FTB did not concede *cost of goods sold* or *expenses* for the 2001 tax year.

[10] Appellant lists some of the expenses with the heading of "me," apparently indicating that those expenses were for personal use (and not business use).

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F. Smith	500.00
Robert Hultzen	200.00
F. Smith	500.00
John Bravo	250.00
Bruce Smith	210.00
Guadalupe Zavala	1,400.00
Bruce Smith	482.24
Brazadzionis	55.00
Lee Holloway	175.00
Rebecca Foyer	600.00
Juan Bravo	160.00
Gary Kyle	400.00
Lee Holloway	175.00
Benny's Piano	120.00
No name	170.00
TOTAL	$12,022.24

2002	
Erin F.	$200.00
Wade Lawson	140.00
Carl Lane	3,000.00
Gary Halvorson	479.91
No name	150.00
Maurice Electric	2,000.00
Hugo Hernandez	150.00
Sarah M.	500.00
Hugo Hernandez	150.00
Juan Rodriguez	80.00
Ami Lauber	125.00
Patrice Lehman	864.88
Gary Kyle	300.00
Darrell Burge	350.00
TOTAL	$8,489.79

On appeal, the FTB states that it will allow cost of goods sold-labor of $1,400 for 2001 and costs of goods sold-labor of zero for 2002. (FTB Add. Br. dated Feb. 4, 2014, pp. 2-3.) Other than the aforementioned allowance of $1,400 for 2001, the FTB argues that appellant has not shown that the above-listed payments for 2001 and 2002 served business purposes. (*Id*. & FTB OB, pp. 5 & 12.)

Staff Comments

As noted above, on appeal the FTB states that it will allow cost of goods sold-labor of $1,400 for 2001 and costs of goods sold-labor of zero for 2002.

In a declaration dated October 21, 2013, appellant provided a list of the above-listed expenses for the 2001 and 2002 tax years, along with appellant's handwritten notations indicating why each of the above-listed expenses served a business purpose. (See App. Add. Br. dated October 2013.)

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For example, appellant indicated that (1) the charge of $2,000 to Rebecca Foyer in 2001 was for "web design," (2) the charge for $2,000 to Maurice Electric in 2001 was for "plans for lighting," (3) the charge for $1,350 to Erin Andrews in 2001 was for "sales," (4) the charge for $175 to Lee Holloway in 2001 was for "consulting," (5) the charge for $3,000 to Carl Lane in 2002 was in relation to "lawyer – incorporated," and (6) the charge for $300 to Gary Kyle in 2002 was for "consulting."

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, questioning whether appellant had any documents (e.g., invoices, receipts, contracts, third-party declarations, etc.) that might *independently* verify appellant's assertions that the changes totaling $12,022.24 in 2001 and $8,489.79 in 2002 were made for business purposes (as opposed to personal purposes).

In reply, appellant asserted in an additional brief dated March 18, 2013, that her declaration, bank statements and cancelled checks (issued from the account of Ilona Foyer and Associates) were proof of the business purposes. In this respect, appellant argued that (i) she did not comingle nonbusiness expenses with business expenses, (ii) starting in 2002, she operated Ilona Foyer and Associates from her personal residence, (iii) she had separate rooms set aside in her home for business use, and (iv) she had to furnish the designated office space because clients would come to her home for business.

At the oral hearing, appellant should be prepared to substantiate that the above-listed payments for 2001 and 2002 were issued for business purposes (as opposed to personal purposes), and that she is entitled to a greater cost of goods sold for labor than the $1,400 allowed by the FTB for 2001 and that she is entitled the cost of goods sold for labor claimed for 2002. Among the type of evidence that appellant might present are declarations under penalty of perjury and/or invoices from the payees (many of whom appear to be individuals), substantiating that those payees provided services that should be classified as cost of goods sold-labor and did not constitute personal expenses. Staff notes that, even though appellant asserts in her declaration dated October 21, 2013, that she did not comingle business expenses and personal expenses, copies of her bank statements (under the name of Ilona Foyer and Associates) contain appellant's handwritten notations indicating that only certain expenses therein were for business purposes—and other expenses were for personal purposes. In short, appellant's

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handwritten notations on her bank statements seem to conflict with appellant's assertion in her declaration that she did not comingle business and personal expenses. Appellant should be prepared to clarify this matter at the oral hearing. In turn, the FTB should be prepared to address how it determined to allow costs of goods sold-labor of $1,400 for 2001.

Cost of goods sold-materials

As indicated above, appellant's amended Schedule Cs list cost of goods sold-materials totaling "zero" for 2001 and "zero" for 2002. (FTB OB, Exhs. H & I.) On appeal, appellant does not provide any evidence (or arguments) regarding cost of goods sold-materials.

Question No. 2: Whether appellant can substantiate her business expense deductions for 2001 and 2002.

Applicable Law

Internal Revenue Code (IRC) section 162(a) authorizes a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."[11] (*Roberts v. Commissioner*, T.C. Memo 2012-197.) A trade or business expense is ordinary for purposes of IRC section 162 if it is normal or customary within the particular trade, business, or industry, and is necessary if it is appropriate and helpful for the development of the business. (*Roberts v. Commissioner, supra*.) In contrast, personal, living, or family expenses are generally nondeductible. (*Id*.; Int.Rev. Code, § 262.)

The distinction between deductible trade or business expenses on the one hand, and nondeductible personal expenses on the other, is based on a weighing and balancing of the facts and circumstances of each case. (*Irwin v. Commissioner*, T.C. Memo 1996-490.) With respect to deductions under IRC section 162, the taxpayer bears the burden of proving that an expense was incurred for business, rather than personal reasons. (*Id*.) Specifically, taxpayers must show that the expense was incurred primarily to benefit their business, and there must have been a proximate, rather than remote or incidental, relationship between the claimed expense and the taxpayer's business. (*Id*.) The Tax Court has recognized that some expenditures are so "inherently personal" that they are never

[11] IRC sections 162, 262, 274, and 280F are generally incorporated into California law at R&TC sections 17071 and 17201.

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deductible, regardless of the relative importance of the expenditures in connection with a taxpayer's trade or business. (*Id*.) As an example, the Tax Court in *Bakewell v. Commissioner* (1955) 23 T.C. 803, 805, held that a taxpayer could not deduct the cost of a hearing aid:

> We believe that a hearing aid is so personal as to come within the meaning of section 24(a)(1). Even if it is used in petitioner's business . . . the device is so personal as to preclude it from being a business expense. A businessman's suit, a saleslady's dress, the accountant's glasses are necessary for their businesses but the necessity does not overcome the personal nature of these items and make them a deductible expense.

In certain circumstances, the taxpayer must meet specific additional substantiation requirements to be allowed a deduction under IRC section 162. (*Roberts v. Commissioner, supra*; e.g., Int.Rev. Code, § 274(d).) IRC section 274(d) requires that the following types of expenses must be substantiated by adequate records or sufficient corroborating evidence: (1) any travel expense, including meals and lodging away from home; (2) any item with respect to an activity in the nature of entertainment, amusement, or recreation; (3) an expense for gifts; or (4) the use of "listed property," as defined in IRC section 280F(d)(4), which includes passenger automobiles. (*Roberts v. Commissioner, supra*.) To qualify for a deduction, the taxpayer must substantiate that expense with adequate records or sufficient evidence to corroborate the taxpayer's own statement as to: (1) the amount of the expense or other item; (2) the time and place of the travel, entertainment, amusement, recreation, or use of the property, or the date and description of the gift; (3) the business purpose of the expense or other item; and (4) the business relationship to the taxpayer of the persons entertained or receiving the gift. (*Id*.; Int.Rev. Code, § 274(d).) The Tax Court has held that "[r]eceipts often fail as proof because they don't show any particular business purpose." (*H & M, Inc. v. Commissioner*, T.C. Memo 2012-290, at fn. 17.)

To satisfy the adequate records requirement of IRC section 274, a taxpayer must maintain records and documentary evidence that in combination are sufficient to establish each element of an expenditure or use. (*Roberts v. Commissioner, supra*.) Although a contemporaneous log is not required, corroborative evidence to support a taxpayer's reconstruction "of the elements . . . of the expenditure or use must have a high degree of probative value to elevate such statement" to the level of credibility of a contemporaneous record. (*Id*., citing Treas. Reg. § 1.274-5T(c)(1).)

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Where the heightened requirements discussed above do not apply, however, a court may allow the deduction of a claimed expense even where the taxpayer is unable to fully substantiate it, *if* the court has an evidentiary basis for doing so. (*Roberts v. Commissioner, supra*, citing to *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540, 543-544.) This is called the Cohan rule. (See *Perry v. Commissioner*, T.C. Memo 2012-237.) The Cohan rule can be summarized as follows: If a taxpayer establishes that he or she paid or incurred a deductible business expense but does not establish the amount, a court may approximate the amount of the allowable deduction, bearing heavily against the taxpayer whose inexactitude is of his or her own making. (*Id*., citing to *Cohan v. Commissioner, supra*.)

IRC section 274(n) generally limits a deduction for meals and entertainment to 50 percent of the amount of each such expense. As noted above, unsupported assertions cannot satisfy the taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow, supra*.) Furthermore, "tax returns are not proof of the statements made therein." (*Bruno v. Commissioner, supra*.)

Contentions and Staff Comments

For sake of convenience, we shall analyze each expense category separately.

Automobile Expenses

Appellant provides bank statements (in the name of Ilona Foyer dba Ilona Foyer & Associates) totaling $4,988.00[12] for 2001 and $4,065.47 for 2002, which appellant argues represent automobile expenses. (App. Reply Br., Exs. 8 & 9.) Those banks statements show the following payments for 2001 and 2002:

2001		
Union 76	$28.93	1/4/01
Union 76	18.79	3/5/01
Mobil	43.23	3/14/01
Chevron	37.71	5/23/01
Chevron	30.34	5/25/01
ExxonMobil	24.91	6/25/01
Exxon	25.03	6/27/01
ExxonMobil	20.03	7/2/01
Chevron	37.01	7/16/01
Union 76	46.47	7/23/01

[12] Appellant asserts that the alleged automobile expenses for 2001 total $4,867.03; however, it appears to staff that the expenses total $4,988.00.

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Mobil	30.00	8/6/01
Chevron	24.94	8/6/01
Union 76	30.51	8/14/01
Texaco	40.35	8/21/01
Chevron	40.00	8/24/01
ExxonMobil	23.68	9/21/01
Chevron	20.00	10/22/01
Chevron	18.83	10/23/01
Ryder	241.88	1/19/01
Enterprise	150.00	4/11/01
Enterprise	150.00	4/26/01
Enterprise	234.30	5/25/01
Alamo	580.65	6/20/01
Gemstar	220.84	8/13/01
Gemstar	1,202.05	8/16/01
Gemstar	100.40	9/24/01
Ryder	171.16	11/13/01
Auto Ins.	387.00	10/22/01
Car Payment	725.96	10/19/01
Membership AAA	71.00	11/1/01
Membership AAA	71.00	11/1/01
Auto Ins.	141.00	11/30/01
TOTAL	$4,988.00	

2002		
Alamo	$186.41	1/18/02
Chevron	34.45	1/23/02
Chevron	29.71	1/23/02
USA Express Tires	888.88	2/19/02
Mobil	184.14	2/13/02
Chevron	530.03	2/13/02
DMV	284.00	2/20/02
DMV	115.00	3/1/02
Gas	198.70	3/4/02
Gemstar Limousine	415.88	3/25/02
Enterprise	150.00	5/8/02
Enterprise	(6.08)	5/15/02
Gemstar Limousine	125.50	8/8/02
Gemstar Limousine	125.50	8/9/02
Union 76	9.40	8/13/02
Gemstar Limousine	112.95	12/17/02
Mercury Ins.	681.00	4/30/02
TOTAL	$4,065.47	

The NOAs for 2001 and 2002 dated February 28, 2011, allow no automobile expenses. (FTB OB, Exhs. M & N.) The FTB asserts that appellant failed to substantiate the date, amount, and business purpose for each alleged automobile expense because (i) appellant provided documents (i.e., bank statements) that included personal expenses, and (ii) appellant failed to provide any information

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substantiating business purposes for the above-listed expenses. (See FTB OB, pp. 9-10.) In addition, the FTB asserts that a number of the alleged automobile expenses were or might have been reported as corporate expenses in Shapely Shadow's general ledger.[13] (*Id*., p. 10.)

Staff Comments

The FTB is allowing no automobile expenses for 2001 and 2002.

In appellant's declaration dated October 21, 2013, appellant states the following regarding her alleged automobile expenses for 2001 and 2002:

> The Board questions automobile expenses and lists various car payments, gasoline bills, etc. The reality is that for 2001 and 2002, I drove an excess of 25,000 business miles per year for legitimate business purposes. At the allotted per mile rate for these years, my mileage would exceed the list of actual expenses. 2001 will be $8,625.00 and 2002 will be $9,125.00. I drove around every day for business purposes, including but not limited to, sales calls, product inception and development, purchasing of Cost of Goods Sold and other expenses. My Schedule C business was a one person business and I did everything.

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, requesting that appellant explain how the evidence submitted with regard to automobile expenses satisfied the requirements of IRC section 274(d) that a taxpayer must substantiate, among other things, a business purposes of each such expense by "adequate records" or "sufficient evidence corroborating the taxpayer's own statement."

In reply, appellant asserts in an additional brief dated March 18, 2013, that (1) "[t]he business purposes were the same for all the business expenses which were meetings with clients and/or potential clients regarding business", and (2) "[a]ppellant's business is in sales and meeting and entertaining clients is the main source and way business is conducted."

As noted above, IRC section 274(d) adds strict substantiation requirements for automobile expenses, in that, among other things, a taxpayer must substantiate a business purpose for each such expense by "adequate records" or "sufficient evidence corroborating the taxpayer's own statement." Furthermore, the Tax Court has held that "[r]eceipts often fail as proof because they don't show any particular business purpose." (*H & M, Inc. v. Commissioner*, *supra*, at fn. 17.)

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[13] The FTB might have intended to refer to the general ledger of "Cyberdressforms, Inc." rather than Shapely Shadow.

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At the oral hearing, appellant should be prepared to show that the evidence provided substantiates a business purpose (as opposed to a personal purpose) for each of the above-listed claimed automobile expenses. In addition, appellant should substantiate that the above-listed claimed automobile expenses were not deducted (and/or were not properly deductible) by the business named Cyberdressforms, Inc.[14]

Travel Expenses (including certain meals when traveling) for 2001

Appellant provides a partial schedule, bank statements (in the name of Ilona Foyer dba Ilona Foyer & Associates), and receipts that appellant asserts represent travel expenses (including certain meals when traveling) totaling $15,272.26 for 2001. (App. Reply Br., Ex. 8.)

The NOA for 2001 dated February 28, 2011, allows no deductions for travel expenses. (FTB OB, Ex. M.) However, on appeal, the FTB states that it will allow travel expenses totaling $14,338 for 2001. (FTB Add. Br. Dated Feb. 4, 2014, p. 2.)

Staff Comments

On appeal, the FTB states that it will allow travel expenses totaling $14,338 for 2001.

In appellant's declaration dated October 21, 2013, appellant does not itemize travel expenses for 2001.

In an additional briefing letter dated December 13, 2013, the Appeals Division requested that appellant explain how the evidence submitted with regard to travel expenses for 2001 satisfies the requirements of IRC section 274(d) that a taxpayer must substantiate, among other things, a business purposes of each such expense by "adequate records" or "sufficient evidence corroborating the taxpayer's own statement."

In reply, appellant asserted in an additional brief dated March 18, 2013, that (1) "[t]he business purposes were the same for all the business expenses which were meetings with clients and/or potential clients regarding business", and (2) "[a]ppellant's business is in sales and meeting and entertaining clients is the main source and way business is conducted."

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[14] In exhibit C of the FTB's opening brief, appellant provides Schedule Cs (*Profit of Loss from Sole Proprietorship*) of Cyberdressforms for the tax year ending December 31, 2001 and Shapley Shadow for the tax year ending December 31, 2002. In comparison, in appellant's exhibits dated October 22, 2013, appellant provides unsigned copies of the state and federal corporate income tax returns for Cyberdressforms, Inc. for the fiscal year May 1, 2001 through April 30, 2002.

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As noted above, IRC section 274(d) adds strict substantiation requirements for travel expenses, in that, among other things, a taxpayer must substantiate a business purpose for each such expense by "adequate records" or "sufficient evidence corroborating the taxpayer's own statement." (*Roberts v. Commissioner*, *supra*.)

At the oral hearing, appellant should be prepared to substantiate the dates, amounts, and business purposes for travel expenses greater than the $14,338 in travel expenses that the FTB is allowing on appeal for the 2001 tax year. At the hearing, the FTB should be prepared to address how it determined to allow travel expenses in the amount of $14,338 for 2001.

Travel Expenses (including certain meals when traveling) for 2002

On appeal, appellant claimed, and the FTB allowed, all the following travel expenses for 2002. Therefore, these expenses are no longer at issue.

2002		
NWA Air	$211.50	1/9/02
NWA Air	211.50	1/9/02
Alamo	186.41	1/18/02
Enterprise	150.00	5/8/02
Gemstar Limo	125.50	8/8/02
Gemstar Limo	125.50	8/9/02
Air Canada	419.88	12/16/02
Host Int'l	29.50	1/18/02
Host Int'l	15.02	1/22/02
Molly O'Briens	15.02	1/22/02
Arlington Hotel	90.00	1/22/02
Harrah's Hotel LV	65.40	2/19/02
Manhattan of LV	160.47	2/21/02
Pino Brasserie	39.80	2/22/02
Paris Boulangerie	47.47	2/22/02
Harrah's Hotel LV	70.85	2/22/02
Bellagio Hotel	485.05	2/22/02
Enterprise	55.88	3/28/02
La Serena Inn	108.90	4/8/02
United Air	183.44	6/10/02
United Air	183.44	6/10/02
Banff Springs Hotel	541.56	6/17/02
Fairmont	983.06	6/21/02
Fairmont	28.27	6/24/02
Fairmont	108.84	6/24/02
Banff Springs Hotel	2,519.15	6/24/02
Chateau Lake Louis	1,062.71	6/26/02
Thrifty Car Rental	64.98	6/27/02
Sheraton Suits Calg.	214.53	6/27/02
Thrifty Car Rental	498.38	6/27/02
Passport	62.59	7/17/02
Sassafraz, Toranto	96.41	9/27/02

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Dfs USA – LAX	320.00	9/27/02
Rernys Toranto	20.13	9/30/02
Holt Refrew	219.22	9/30/02
Stillwater Park Hy	256.22	10/1/02
Coffee Mill	88.65	10/2/02
United Air	256.50	10/28/02
United Air	256.50	10/28/02
Benedict's Rest	22.08	11/18/02
Papertree	64.14	11/18/02
Chamberlain's	102.08	11/18/02
Fogo De Chao	106.47	11/19/02
Chamberlain's	189.02	11/19/02
CA Pizza Kitchen	18.98	11/20/02
Patrizio Highland	38.83	11/20/02
Budget Rent A Car	164.82	11/21/02
Inter-Continental	529.44	11/22/02
Passport	61.83	12/20/02
TOTAL	$11,875.92	

Staff Comments

As noted above, the FTB now states that it will allow all of the above-listed travel expenses totaling $11,875.92 for 2002. (FTB Add. Br. dated Feb. 4, 2014, p. 3.)

Meals and Entertainment for 2001 (other than certain meals when traveling)

Appellant provides a schedule and bank statements (in the name of Ilona Foyer dba Ilona Foyer & Associates) showing alleged meals and entertainment expenses (other than certain meals when traveling) totaling $17,149.08 for 2001. (App. Reply Br., Ex. 8.) Those bank statements show the following expenditures:

2001		
Nichols Restaurant	$27.63	1/1/01
House of Blues	50.00	1/2/01
Geary's	1,906.28	1/3/01
Magic Castle	112.40	1/3/01
Beachside Bar	40.02	1/4/01
Factory	159.03	1/4/01
Duke's Malibu	38.84	1/5/01
Nichols Restaurant	25.30	1/8/01
Nichols Restaurant	27.98	1/8/01
Nichols Restaurant	26.90	1/8/01
Mi Place	73.26	1/8/01
Nicholas Restaurant	25.73	1/8/01
Spruzzo Pizzeria	51.05	1/8/01
Marie Callender's	90.05	1/8/01
Marie Callender's	13.00	1/8/01
Jerry's Famous	69.90	1/9/01
Coogies Beach Café	32.75	1/9/01
Jerry's Famous	57.32	1/10/01
Acapulco	23.33	1/16/01

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Maxicali	12.50	1/16/01
Aleio Pesto	35.37	1/16/01
Café Del Rey	12.00	1/17/01
Asakuma Sushi	64.73	1/18/01
Mambos Café	25.27	1/18/01
Engine Co No 28	52.78	1/19/01
Mambo's Café	21.89	1/19/01
George Petrelli	90.49	1/22/01
Nichols Restaurant	43.07	1/23/01
Black Angus	79.09	1/29/01
Café Roma	92.12	1/29/01
Mi Place	69.32	1/29/01
Black Angus	24.00	1/31/01
Mi Place	24.82	1/31/01
House of Blues	142.00	1/31/01
Nichols Restaurant	28.54	2/2/01
Nichols Restaurant	27.14	2/5/01
Jerry's Famous	34.79	2/5/01
Café Metropol	26.99	2/5/01
Mi Place	35.13	2/7/01
Nichols Restaurant	22.87	2/13/01
MCS	33.75	2/15/01
Authentic Café	75.42	2/20/01
Paul Addi Salon	290.00	2/20/01
Café Metropol	53.44	2/21/01
Burbank Gindl	72.00	2/21/01
Chin Chin	40.45	2/22/01
CA Pizza Kitchen	42.86	2/23/01
Nichols Restaurant	19.69	2/26/01
Café Roma	54.49	2/26/01
Islands	26.28	2/27/01
Jerry's Famous	42.44	2/28/01
Glass Act	211.67	3/2/01
Mama's Original	55.03	3/2/01
Mambos Café	33.08	3/2/01
House of Blues	118.00	3/5/01
House of Blues	633.60	3/5/01
CA Pizza Kitchen	41.93	3/5/01
House of Blues	94.00	3/5/01
Mama's Original	34.13	3/7/01
Mambos Café	27.15	3/8/01
Black Angus	44.45	3/12/01
BJ's Restaurant	23.63	3/12/01
Take Out Taxi	59.77	3/12/01
Cheesecake Factory	55.14	3/12/01
Cheesecake Factory	22.66	3/12/01
Black Angus	13.34	3/12/01
Ocean Park Om.	22.01	3/12/01
Host Int'l	20.58	3/16/01
Ruby's	16.30	3/20/01
Aleio's Pesto	32.64	3/21/01
Chan Darette	55.06	3/21/01
Il Treno	47.37	3/22/01
Room Svc	63.97	3/26/01

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Broadway Deli	38.20	3/27/01
Black Angus	36.46	3/29/01
FN Ristorante	70.64	4/2/01
House of Blues	100.50	4/2/01
Cravings	60.27	4/2/01
Nichols Restaurant	30.14	4/2/01
Tam O'Shanter Inn	22.44	4/2/01
Tam O'Shanter Inn	60.38	4/2/01
Nichols Restaurant	25.75	4/3/01
Jerry's Famous	47.63	4/4/01
George Petreili	104.53	4/9/01
Pacific Fining Car	60.89	4/9/01
Flints	28.00	4/9/01
Jerry's Famous	46.00	4/10/01
Cheesecake Factory	193.71	4/10/01
Elephant Bar	20.72	4/13/01
Tam O'Shanter Inn	188.80	4/16/01
BB Kings	39.50	4/16/01
Nichols Restaurant	20.71	4/16/01
Hamburger Hamlet	29.33	4/16/01
Mi Place	89.92	4/20/01
Papa Cristo's	19.18	4/23/01
Islands	21.27	4/23/01
Elephant Bar	28.85	4/23/01
Mambos Café	31.90	4/25/01
Cheesecake Factory	90.22	4/26/01
BJ's Restaurant	88.84	4/27/01
Chan Darette	36.79	4/30/01
El Torito	26.42	4/30/01
El Torito	12.52	4/30/01
Nichols Restaurant	24.76	5/2/01
BJ's Restaurant	34.43	5/7/01
Shanghai Red's	10.95	5/8/01
The Fish Market	56.06	5/9/01
Mambo's Café	24.27	5/17/01
Mambo's Café	34.61	5/18/01
Market City Caffe	40.24	5/21/01
Mi Place	42.75	5/23/01
Jerry's Famous	31.02	5/23/01
The Bistro Garden	57.57	5/23/01
BJ Restaurant	24.63	5/25/01
Nichols Restaurant	36.73	5/29/01
Mi Place	36.73	5/29/01
C&O Trattoria	38.28	5/31/01
Starbucks	9.30	5/31/01
Mi Place	116.66	5/31/01
Acapulco	49.60	6/4/01
The Galley	80.04	6/4/01
BJ's Restaurant	86.30	6/4/01
Jerry's Famous	56.05	6/5/01
CA Pizza Kitchen	34.71	6/6/01
Nichols Restaurant	24.60	6/6/01
Wallys Liquors	411.35	6/6/01
Mi Place	63.30	6/11/01

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Nichols Restaurant	23.47	6/11/01
Islands	23.48	6/11/01
Jerry's Famous	50.48	6/11/01
OO	123.03	6/11/01
26 Beach Rest	45.80	6/11/01
Morton's	537.49	6/13/01
Mambos Café	22.33	6/13/01
Pico Party Rental	188.89	6/18/01
Pico Party Rental	41.96	6/18/01
BJ's Restaurant	267.72	6/18/01
Baja Fresh	150.98	6/18/01
Papa John's	24.51	6/18/01
Pacific Dining Car	70.48	6/18/01
George Petrelli	62.97	6/19/01
Kenneth George	96.39	6/19/01
CA Pizza Kitchen	49.25	6/21/01
Cheshire Crab Rest	37.82	6/22/01
Pusser's Co.	40.95	6/25/01
Pusser's Co.	37.82	6/25/01
Cheshire Crab Rest	102.47	7/2/01
Cheesecake Factory	44.23	7/5/01
El Torito	50.09	7/5/01
The Ritz Carlton	90.00	7/6/01
The Ritz Carlton	118.95	7/10/01
The Fish Co.	63.79	7/13/01
Jerry's Famous	50.00	7/17/01
Jerry's Famous	35.98	7/17/01
Pacific Dining Car	72.61	7/18/01
Cheesecake Factory	42.75	7/19/01
Acapulco	98.21	7/20/01
The Ritz Carlton	304.20	7/20/01
IHOP	19.60	7/23/01
Aleio's Pesto	43.47	7/26/01
Mambos Café	35.89	7/26/01
Elephant Bar	21.26	7/27/01
Jerry's Famous	69.17	7/30/01
Café Del Rey	109.91	7/30/01
Jerry's Famous	43.62	7/30/01
Mambos Café	33.46	7/30/01
Take Out Taxi	41.63	8/2/01
Engine Co No 28	19.80	8/3/01
Engine Co No 28	62.05	8/3/01
Mi Place	54.14	8/8/01
Black Angus	44.53	8/10/01
Johnnie's NY Pizza	41.58	8/10/01
Islands	70.91	8/13/01
Dinah's Family	37.80	8/14/01
Levy Rests	26.50	8/20/01
The Fish Co.	125.63	8/24/01
Mambos Café	32.46	8/24/01
CA Pizza Kitchen	50.51	8/27/01
Nichols Restaurant	24.76	9/5/01
Buchanan Arms	61.00	9/6/01
Mambos Café	36.48	9/10/01

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Aleio's Pesto	13.77	9/12/01
Nichols Restaurant	22.60	9/13/01
Joes Rest	41.18	9/18/01
Chan Darette	39.13	9/19/01
Hanna's Candle	261.75	9/24/01
Mambos Café	28.76	10/1/01
Mambos Café	28.26	10/4/01
Sierras Spanish	33.89	10/9/01
New Moon Rest	40.72	10/12/01
Cheesecake Factory	96.49	10/15/01
Champagne French	18.60	10/16/01
Cheesecake Factory	101.59	10/17/01
Zono Sushi	23.67	10/19/01
Ahwahnee Rest	60.48	10/22/01
Engine Co No 28	132.77	10/26/01
Nichols Restaurant	22.76	10/29/01
CA Pizza Kitchen	23.80	10/29/01
Granada	21.37	10/29/01
Mambos Café	25.57	11/6/01
Don Diego Mex	28.32	11/9/01
Mambos Café	39.99	11/9/01
Champagne French	67.05	11/15/01
Nichols Restaurant	45.42	11/20/01
Elephant Bar	33.04	11/23/01
CA Pizza Kitchen	33.44	11/23/01
Olympic Spa	360.00	11/26/01
Café Del Rey	122.30	11/27/01
Jerry's Famous	48.78	11/30/01
Aoba Japanese	52.60	11/30/01
Benihana	127.70	12/4/01
Nichols Restaurant	22.62	12/11/01
El Cholo	28.56	12/13/01
Hama Restaurant	94.84	12/17/01
Nichols Restaurant	32.26	8/1/01
Mambos Café	22.33	8/2/01
Juniors Rest	33.57	8/27/01
Clancy's Crab	170.82	9/4/01
Pacific Dining Car	46.93	9/17/01
Smoke House	48.02	9/17/01
Pinot Hollywood	84.52	9/17/01
Fred's Hickory	60.02	9/20/01
Cool Water Village	52.42	9/24/01
Dixie Café	27.94	9/24/01
Ocean Park Omle	27.77	10/1/01
Black Angus	42.60	10/1/01
Rose Café	26.13	10/2/01
Market City Caffe	28.76	10/3/01
Aoba Japanese	136.40	10/10/01
Cheesecake Factory	98.13	11/13/01
Cheesecake Factory	41.07	11/29/01
L'eggs Hanes Bali	149.83	12/5/01
Jerry's Famous	62.15	12/10/01
Emeril's NO Fish	72.41	12/10/01
CA Pizza Kitchen	43.19	12/17/01

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Casablanca Rest	28.75	12/19/01
Chan Darette	32.70	12/24/01
Maria's Cucina	46.18	12/24/01
TOTAL	$17,149.08	

The NOA for 2001 dated February 28, 2011, allows no deductions for meals and entertainment expenses. (FTB OB, Ex. M.) On appeal, the FTB states that it will allow "meals and entertainment" expenses totaling $5,570 for 2001. (FTB Add. Br. dated Feb. 4, 2014, p. 2.)

Staff Comments

Appellant claims "meals and entertainment" of $17,149.08 for 2001. On appeal, the FTB states that it will allow "meals and entertainment" totaling $5,570 for 2001.

In a declaration dated October 21, 2013, appellant provided a list of the above-listed expenses, along with appellant's handwritten notations indicating why each of the above-listed expenses served a business purpose. (See App. Add. Br. dated October 2013.) For example, appellant indicated that (1) the charge of $25.30 to Nichols Restaurant on January 8, 2001, was for a business meeting/meal with "Christy Fabito," (2) the charge for $23.63 to BJ's Restaurant on March 12, 2001, was for a business meeting/meal with "Justin Summers," (3) the charge for $50.48 to Jerry's Famous on June 11, 2001, was for a business meeting/meal with "Tim Curren," and (4) the charge for $33.04 to the Elephant Bar on November 23, 2001, was for a business meeting/meal with "Keith Crisco."

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, asking appellant how she could remember all of the names of the individuals she allegedly entertained over 10 years ago. In addition, the Appeals Division stated that, if appellant were relying on business journal to refresh her memory, she should provide copies of that journal.

In reply, appellant asserted in an additional brief dated March 18, 2013, that she was not senile and she questioned why the Appeals Division was inquiring about her ability to remember facts that happened over 10 years ago:

> The Board questions how the Appellant can remember. A reciprocal question can be posed as to how she would not remember. Appellant is neither senile nor does she suffer from dementia. In fact, Appellant is a very astute business person with a Masters Degree in business . . . .

As noted above, IRC section 274(d) adds strict substantiation requirements for travel

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expenses, in that, among other things, a taxpayer must substantiate a business purpose for each such expense by "adequate records" or "sufficient evidence corroborating the taxpayer's own statement." In addition, IRC section 274(n) generally limits a deduction for meals and entertainment to 50 percent of the amount of each such expense.

At the oral hearing, appellant should be prepared to substantiate business purposes for "meals and entertainment" expenses greater than the $5,570 that the FTB is allowing on appeal for the 2001 tax year. In turn, at the hearing, the FTB should be prepared to explain how it determined to allow $5,570 of expenses.

Meals and Entertainment for 2002 (other than certain meals when traveling)

Appellant provides a schedule and bank statements (in the name of Ilona Foyer dba Ilona Foyer & Associates) showing alleged meals and entertainment expenses (other than certain meals when traveling) totaling $10,976.41 for 2002. (App. Reply Br., Ex. 9.) Those bank statements show the following purchases:

2002		
The Galley Rest	$137.93	1/7/02
Versailles	36.00	2/4/02
Dom	43.20	2/11/02
La Scala Presto	25.62	2/12/02
Cheesecake Factory	37.80	2/12/02
Bettina Duncan	167.79	2/13/02
Hama Rest	163.81	2/14/02
Drago Restaurant	156.24	2/25/02
La Scala Presto	64.21	2/28/02
26 Beach Café	47.89	3/20/02
Café Del Rey	54.09	4/4/02
Nichols Rest	19.71	4/8/02
The Mandarin	69.62	4/12/02
Houston's	63.58	4/19/02
26 Beach Café	33.12	4/19/02
RL Silver	40.00	4/22/02
George Petrellis	108.56	4/22/02
26 Beach Café	35.63	4/22/02
Pasta Factory	53.19	4/22/02
Nichols Rest	34.39	4/24/02
Café Del Rey	46.05	5/6/02
Nichols Rest	24.68	5/9/02
Nichols Rest	23.68	5/16/02
Daily Grill	34.66	5/17/02
Nichols Rest	32.90	5/20/02
Café Del Rey	114.45	6/10/02
Houston's	173.83	6/18/02
LA Phil/Hollywood	245.00	7/26/02

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SY8 French	12.00	7/29/02
Marina Del Rey Liq	22.75	7/29/02
Café Del Rey	35.40	7/29/02
Nichols Rest	22.56	8/8/02
Int'l Coffee Bean	9.25	8/13/02
Chart House	170.83	8/14/02
Café Del Rey	220.26	8/15/02
Cheesecake Factory	68.46	8/16/02
Cheesecake Factory	11.96	8/16/02
Aleio's Pesto	25.00	8/19/02
Hama Rest	143.53	8/19/02
Hilton LAX Café	75.44	8/19/02
Broadway Deli	27.80	8/20/02
Engine Co No 28	77.04	8/21/02
Johnnies NY Pizza	21.43	8/22/02
CA Pizza Kitchen	37.06	8/23/02
Pacos Tacos	34.38	8/26/02
Islands	26.59	8/26/02
Natalie Thai	71.54	8/26/02
Pasta Factory	43.90	8/28/02
Ristorante	29.22	8/30/02
Cugini	43.84	9/3/02
Hamburger Hamlet	26.81	9/3/02
Aqua	372.50	9/3/02
The Lobster	155.69	9/9/02
Il Cielo	138.55	9/9/02
Tradinoi	54.09	9/9/02
La Scala Presto	51.87	9/10/02
Hamburger Hamlet	48.38	9/13/02
Schmid Dieter	157.35	9/13/02
Cheesecake Factory	28.25	9/13/02
Taveria Tony	87.23	12/3/02
Jerry's Famous	48.56	12/9/02
Asakuma Sushi	77.53	12/9/02
Islands	68.09	1/11/02
The French Garden	37.50	1/14/02
Nichols Rest	37.31	1/23/02
Dukes	27.68	1/28/02
Nichols Rest	22.51	1/29/02
Ocean Park Ome.	31.45	2/19/02
Cooke's Family Mar	79.55	2/19/02
Chan Darette	30.14	2/27/02
Ritz Carlton	67.00	3/11/02
Ritz Carlton	115.00	3/11/02
Ritz Carlton	115.00	3/11/02
Ritz Carlton	130.00	3/11/02
Dagwoods Pizza	26.17	3/12/02
Tradinoi Malibu	114.59	3/19/02
New Moon Rest	31.20	3/25/02
CA Pizza Kitchen	35.07	3/27/02
Rest Hakata	109.70	3/29/02
Teuscher Chocolate	166.00	3/29/02
Nichols Rest	25.52	5/7/02
Christine Valmy	78.44	5/9/02

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DnpsAt Tenaya	64.03	5/10/02
Saddle Peak Lodge	163.25	5/15/02
C&O Trattoria	39.70	5/28/02
Cheesecake Factory	44.95	5/29/02
Chili's	24.02	5/30/02
26 Beach Café	34.07	5/30/02
Sierra Spanish	45.84	5/31/02
Islands	28.41	6/3/02
John O Groats	25.68	6/4/02
Nichols Rest	37.96	6/4/02
Asakuma Sushi	77.86	6/4/02
Engine Co No 28	98.25	6/6/02
Mercedes Cuban	38.39	6/10/02
New Moon Rest	52.33	6/10/02
Typhoon Rest	227.46	6/10/02
Elephant Bar	27.59	7/1/02
Aleio's Pesto	12.80	7/3/02
Islands	15.27	7/3/02
Nichols Rest	22.38	7/3/02
Grill	24.54	7/3/02
Café Pinot	33.63	7/5/02
12 Washington Rest	38.50	7/8/02
PF Changs	79.34	7/8/02
Ritz Carlton	146.99	7/8/02
Jerry's Famous	38.41	7/9/02
Mercedes Cuban	48.59	7/9/02
Edies Diner	14.96	7/10/02
Pacifico's	46.38	7/12/02
Dukes	30.09	7/15/02
Musso & Frank	32.69	7/15/02
Rio Rocks	148.98	7/17/02
Sidewalk Café	20.54	7/18/02
Nichols Rest	16.18	7/19/02
Plum Tree Inn	16.83	7/19/02
Morton's	17.43	7/22/02
Musso & Frank	44.43	8/22/02
Marmalade Café	27.38	8/29/02
Castillos Mex	18.25	9/16/02
The Forks	145.00	9/16/02
Carrows	34.72	9/17/02
Morton's	59.96	9/18/02
Taveriva Tony	41.50	9/19/02
Planet Blue	162.92	9/19/02
La Dijonaise	23.45	9/23/02
Ocean Park Ome	24.97	9/23/02
Bay Cities Italian	58.13	9/23/02
Hama Rest	99.14	9/23/02
La Scala Presto	71.10	9/27/02
The Lobster	77.10	10/3/02
Islands	27.45	10/7/02
Café Del Rey	104.77	10/8/02
Marmalade Café	34.88	10/11/02
La Scala Presto	25.65	10/15/02
Moustache Café	43.89	10/28/02

Pasta Factory	51.79	10/28/02
Johnnies NY Pizza	40.10	11/5/02
Koo Koo Roo	27.63	11/6/02
Lillys	40.13	11/6/02
Moustache Café	42.89	11/12/02
Hama Rest	116.88	11/12/02
Hal's Bar & Grill	48.22	11/13/02
Lilly's	114.72	11/25/02
CA Pizza Kitchen	18.76	11/29/02
The French Garden	91.30	12/3/02
Islands	24.17	12/6/02
Engine Co No 28	36.74	12/6/02
Bay Cities Italian	100.94	12/6/02
La Scala Presto	38.26	12/9/02
Whole Foods	135.00	12/9/02
Stats Floral	550.22	12/9/02
Mi Place	52.76	12/10/02
CA Pizza Kitchen	18.98	12/11/02
Granita Malibu	258.14	12/13/02
Jerry's Famous	37.65	12/16/02
Akbar Cuisine	43.41	12/16/02
Jerry's Famous	51.99	12/16/02
Les Deux Cafes	59.62	12/26/02
Saisai Rest	33.69	12/30/02
Chin Chin	39.83	12/30/02
Starbucks	10.20	12/31/02
TOTAL	10,976.41	

The NOA for 2002 dated February 28, 2011, allows no deductions for meals and entertainment expenses. (FTB OB, Ex. N.) On appeal, however, the FTB states that it will allow "meals and entertainment" expenses totaling $5,478 for 2002. (FTB Add. Br. dated Feb. 4, 2014, p. 3.)

Staff Comments

Appellant claims "meals and entertainment" of $10,976.41 for 2002. On appeal, the FTB states that it will allow "meals and entertainment" totaling $5,478 for 2002.

In a declaration dated October 21, 2013, appellant provided a list of the above-listed expenses, along with appellant's handwritten notations indicating why each of the above-listed expenses served a business purpose. (See App. Add. Br. dated October 2013.) For example, appellant indicated that (1) the charge of $137.93 to The Galley Restaurant on January 7, 2002, was for a business meeting/meal with "Tony Troung," (2) the charge for $64.21 to La Scala Presto on February 28, 2002, was for a business meeting/meal with "Bill Burke," (3) the charge for $22.56 to Nichols Restaurant on August 8, 2002, was for a business meeting/meal with "Lee Thompson," and (4) the

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charge for $43.90 to the Pasta Factory on August 28, 2002, was for a business meeting/meal with "Kamila Bohls."

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, asking appellant how she could remember all of the names of the individuals she allegedly entertained over 10 years ago. In addition, the Appeals Division stated that, if appellant were relying on business journal to refresh her memory, she should provide copies of that journal.

In reply, appellant asserted in an additional brief dated March 18, 2013, that she was not senile and she questioned why the Appeals Division was inquiring about her ability to remember facts that happened over 10 years ago:

> The Board questions how the Appellant can remember. A reciprocal question can be posed as to how she would not remember. Appellant is neither senile nor does she suffer from dementia. In fact, Appellant is a very astute business person with a Masters Degree in business . . . .

As noted above, IRC section 274(d) adds strict substantiation requirements for travel expenses, in that, among other things, a taxpayer must substantiate a business purpose for each such expense by "adequate records" or "sufficient evidence corroborating the taxpayer's own statement." In addition, IRC section 274(n) generally limits a deduction for meals and entertainment to 50 percent of the amount of each such expense.

At the oral hearing, appellant should be prepared to substantiate <u>business purposes</u> for "meals and entertainment" expenses greater than the $5,478 that the FTB is allowing on appeal for the 2002 tax year. In turn, the hearing, the FTB should be prepared to explain how it determined to allow $5,478 of expenses.

<u>Depreciation Expenses</u>

Appellant is asserting depreciation amounts of $31,377 for 2001 and $37,238 for 2002. (FTB OB, Exhs. C, D, H & I.) In support, appellant provides Depreciation Reports (Forms 4562). (App. Reply Br., Exhs. 8 & 9.) The FTB is allowing no depreciation for 2001 and 2002.

Staff Comments

The FTB is allowing no depreciation for 2001 and 2002.

In appellant's declaration dated October 21, 2013, appellant states that all of the claimed

depreciation for the 2001 and 2002 tax years was carried forward from the 2000 tax year. Appellant contends that the FTB did not audit appellant's 2000 California tax return and, thus, such an audit would now be beyond the statute of limitations. Based on the foregoing, appellant asserts that the FTB cannot dispute the depreciation amounts claimed on appellant's 2001 and 2002 tax returns, which allegedly were carried over from appellant's 2000 California tax return.

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, asserting, for purposes of discussion, that (1) the FTB may examine facts from prior closed years in order to determine the correct tax in the year at issue, citing *Graffia v. Commissioner*, T.C. Memo 2013-211, and (2) the filing of a tax form (i.e., a depreciation report or schedule, such as a Form 4562) does not itself establish the truth of the assertions listed therein, citing *Sparkman v. Commissioner* (9th Cir. 2007) 509 F.3d 1149, 1157.

In reply, appellant simply cites to her depreciation schedules as evidence of her right to take depreciation deductions of $31,377 for 2001 and $37,238 for 2002.

On appeal, the FTB asserts that (1) the FTB may examine facts from prior closed years in order to determine the correct tax in the year at issue, (2) appellant's Depreciation Reports (Forms 4562) are not proof of the statements made therein, and (3) appellant's Depreciation Reports simply refer to general classifications, such as "equipment" or "program," without providing enough detail to show that the "equipment" and "programs" had business purposes. (FTB OB, p. 10; FTB Add. Br. dated Mar. 4, 2014, pp. 4-5.)

As noted above, (1) the FTB may examine facts from prior closed years in order to determine the correct tax in the year at issue (see *Graffia v. Commissioner*, *supra*), and (2) the filing of a tax form (i.e., a depreciation report or schedule, such as a Form 4562) does not itself establish the truth of the assertions listed therein (see *Sparkman v. Commissioner*, *supra*).

At the oral hearing, appellant should be prepared to (1) identify each particular depreciation item in detail, (2) substantiate each depreciation item amount, and (3) show that each depreciation item had a business purpose. In this respect, appellant might provide evidence (e.g., invoices, receipts, cancelled checks, a declaration, etc.) showing (a) when items were purchased, (b) who purchased the items, (c) the cost of the items, (d) why the items related to a particular business,

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and (e) that the items are subject to depreciation under the Internal Revenue Code.

Interest (including mortgage interest and/or points) and/or Rent

On appeal, appellant provides spreadsheets and mortgage and/or loan servicing statements allegedly showing the years and amounts of bank interest (including mortgage interest and/or points) totaling $25,297.49 for 2001 and $64,724.15 for 2002. (See App. Reply Br., Exhs. 8 & 9.) Appellant's spreadsheet listing, alleged interest expenses for the 2002 tax year (see App. Reply Br. Ex. 9), has a notation asserting that appellant used 69 percent of a home (apparently a home located on Howard Street in Marina Del Ray, California) as office space for a deduction of $28,631. In short, appellant seems to be asserting that she incurred a home office rental expense of $28,631 for the 2002 tax year. However, it is unclear as to what documents appellant is relying upon to substantiate the alleged rental expense of $28,631 for the 2002 tax year. (Staff notes that appellant's spreadsheet for alleged interest expenses in 2001 does not list any home office expenses.)

For 2001, the FTB's NOA dated February 28, 2011, does not list any interest deductions (including mortgage interest and/or points). (FTB OB, Ex. M.)

For 2002, the FTB's NOA dated February 28, 2011, lists deductions for Schedule A interest of $17,143 and mortgage interest of $11,514. (*Id.*, Ex. N.)

Staff Comments

In an additional briefing letter dated December 13, 2013, the Appeals Division requested that the FTB clarify its arguments regarding disallowed interest, including mortgage interest and points, for the 2001 and 2002 tax years.

In response, the FTB stated the following for the 2001 tax year:

> Respondent would like to clarify that during the protest respondent allowed $28,902 of Schedule A mortgage interest expense for the 2001 tax year. Appellant also reported an additional $32,902 of Schedule C mortgage deductions per her correspondence of April 22, 2009. The protest officer determined appellant substantiated the above referenced $28,902 of mortgage interest expenses for her personal residence, but was unable to substantiate the additional $32,902 in mortgage expenses for purposes of the Schedule C deduction. Appellant also reported $6,000 in Schedule A mortgage points on her amended 2001 return. She has been unable to substantiate this deduction. (FTB Add. Br. dated Feb. 4, 2014, p. 8.)

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For the 2002 tax year, the FTB stated:

> For the 2002 tax year, respondent determined appellant substantiated $17,143 of Schedule A mortgage interest deduction during the audit and an additional $11,514 of Schedule A mortgage deductions during the protest. Appellant also reported $32,362 of Schedule C mortgage expenses deductions per her April 22, 2009 letter. During the protest, appellant provided documents indicating Shapely Shadow paid $24,876 in mortgage interest. This amount was not allowed because it was not paid by appellant. (FTB Add. Br. dated Feb. 4, 2014, p. 8.)

Next, in the additional briefing letter dated December 13, 2013, the Appeals Division requested that appellant provide evidence (or identify specific evidence in the appeal record) demonstrating that appellant is entitled to further interest deductions, other than those allowed by the FTB.

In response, appellant stated as follows:

> Regarding interest expenses there is a detailed schedule which was submitted as part of Exhibit 9. The interest expense is documented with 2 Forms 1098 and other explained interest.

The Appeals Division also requested that appellant clarify whether she was alleging home office expenses totaling $28,631 for the 2002 tax year and, if so, what documents she was relying upon to substantiate those home office expenses.

In response, appellant stated as follows:

> There was an office in the home during this period. Appellant had presented a chart regarding the allocation of the expense and how it was derived in Exhibit 9.

Tax Year 2001: As noted above, the FTB states that during protest its protest officer allowed $28,902 of Schedule A mortgage interest for 2001. Staff notes, however, that the 2001 NOA dated February 28, 2011 (a copy of which is attached as Exhibit N to the FTB's opening brief) allowed interest expenses of only $28,657 for 2001—i.e., (i) Schedule A interest of $17,143, and (ii) mortgage interest of $11,514. Accordingly, at the oral hearing, the FTB should clarify whether its protest officer allowed $28,902 of Schedule A mortgage interest during protest, as the FTB asserts. In turn, appellant should clarify and substantiate all interest expenses and/or home office expenses she is asserting for the 2001 tax year.

Tax Year 2002: As noted above, the FTB states that during protest, appellant provided

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documents indicating Shapley Shadow paid $24,876 in mortgage interest for 2002 but the FTB's protest officer disallowed that amount because it was not paid by appellant. Staff notes, however, that in Issue No. 3 (see below), the FTB is allocating income to appellant for the 2002 tax year based, in part, on bank deposits of Shapley Shadow. Since the FTB is allocating income to appellant from Shapely Shadow, the FTB should be prepared to explain why it is not also allowing mortgage interest evidently paid by Shapely Shadow. In turn, appellant should substantiate that she is entitled to further interest expense deductions, other than those allowed by the FTB. Also, appellant should clarify whether she is alleging home office expenses totaling $28,631 for the 2002 tax year and, if so, she should substantiate those home office expenses, including appellant's assertion that she used 69 percent of her home for business purposes.

Legal and Professional Expenses (other than Accounting)

2001 Tax Year: On her amended Schedule C for 2001, appellant claims "legal and professional" expenses of $7,976. (FTB OB, Ex. H, p. 7.) On appeal, appellant provides a spreadsheet (that she or her representative prepared) for alleged "legal and professional" expenses in 2001, along with checks totaling $7,976.38 to various individuals. (App. Reply Br., Ex. 8.) Those checks show the following payments:

2001		
Julio D'Aqua	$3,000.00	4/17/01
Joseph M Cobert	488.00	2/5/01
Answering Svcs	109.00	11/25/01
Prime Protection	2,000.00	1/24/01
Alba Dominguez	1,100.00	7/26/01
Jan Labbu/G Czavala	1,279.38	1/5/01
TOTAL	$7,976.38	

2002 Tax Year: On her amended Schedule C for 2002, appellant claims "legal and professional" expenses of $135,000. (FTB OB, Ex. I, p. 10.) On appeal, appellant provides a spreadsheet (that she or her legal representative prepared) for alleged "legal and professional" expenses, along with documents (invoices, checks), which appellant asserts add up to $80,281.05. Staff cannot verify (from the face of the documents) that these documents represent legal expenses in the amounts appellant asserts. Appellant's spreadsheet lists the following alleged expenses for 2002:

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2002		
American Arbitration	$3,250.00	12/5/02
American Arbitration	750.00	12/5/02
American Arbitration	400.00	12/5/02
American Arbitration	800.00	12/5/02
American Arbitration	1,600.00	12/5/02
American Arbitration	3,600.00	12/5/02
Cohen & Bartlett	8,623.12	9/10/02
Cohen & Bartlett	708.75	9/10/02
Cohen & Bartlett	10,000.00	4/25/02
Cohen & Bartlett	9,767.72	11/30/02
Robert Wenke	1,487.00	11/30/02
CA Muni Tech.	30,000.00	10/21/02
American Arbitration	400.00	5/13/02
Robert Wenke	368.50	5/13/02
American Arbitration	4,000.00	2/11/02
Cohen & Bartlett	4,525.96	11/12/02
TOTAL	$80,281.05	

The NOA for 2001 dated February 28, 2011, allows no legal and professional expenses (Note: Accounting expenses are analyzed separately below in this Hearing Summary.) (FTB OB, Ex. M.) The NOA for 2002 dated February 28, 2011, allows legal expenses totaling $11,477. (*Id*., Ex. N.) The FTB asserts that appellant has not provided evidence substantiating any further amounts for legal/professional expenses, as (i) appellant has not provided business purposes for those expenses, (ii) it is not clear that the checks provided correspond with the expense amounts claimed, and (iii) a number of those expenses (although the FTB does not specify which ones) were (or might have been) reported as corporate expenses by Shapely Shadow. (FTB OB, p. 11.)

Staff Comments

On appeal, the FTB states that it will allow "legal and professional" expenses of $5,917 for 2001. For 2002, the NOA allows legal expenses of $11,477—and on appeal, the FTB does not concede any further legal expenses for 2002.

In appellant's declaration dated October 21, 2013, appellant states the following regarding her alleged legal expenses for 2001 and 2002:

> All of these costs were in relation to the lawsuits going on between myself and the other shareholders of Cyberdressforms, Inc. I also paid some settlement fees to California Municipal Technologies as part of the restitution.

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, requesting that appellant (i) provide or identify any evidence corroborating a

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business purpose for each claimed expense, (ii) substantiate that appellant paid more than $11,477 for legal/professional expenses in 2002, as this amount has already been allowed by the FTB, (iii) identify which checks or other documentation corresponded to each claimed expense, and (iv) substantiate that appellant's legal and professional expenses were not reported as corporate expenses.

In reply, appellant asserted in an additional brief dated March 18, 2013, that "[t]he legal expenses have been detailed with copies of cancelled checks and invoices" as evidenced in appellant's schedules.

At the oral hearing, appellant should be prepared to substantiate the dates, amounts, and business purposes for legal and professional expenses greater than the $5,917 that the FTB is allowing on appeal for 2001 and the $11,477 that the FTB allowed in the NOA for 2002.

For 2002, staff is unable to confirm that appellant made payments totaling $80,281.05 for legal/professional services, as she asserts. In fact, some of the alleged charges for "legal services" appear to represent disbursements to an entity named California Municipal Technologies, Inc., possibly in relation to appellant's alleged settlement. Thus, appellant might want to provide invoices/declarations from her attorneys/professionals that clearly show the total payments appellant made in 2002 for legal/professional services in 2002 (i.e., excluding settlement amounts) and a business purpose. Furthermore, appellant should substantiate the deductibility of any amounts paid to California Municipal Technologies, Inc.

Accounting Expenses

For 2001, appellant provides a cancelled check in the amount of $4,086 to AAA, Inc.—i.e., the American Accounting Association, Inc. (see App. Reply Br., Ex. 8.), and the FTB's NOA for the 2001 tax year allows the full amount of those expenses. (FTB OB, Ex. M.) Thus, accounting expenses for the 2001 tax year are not at issue.

For 2002, appellant provides a spreadsheet, wherein appellant alleges that she (or her business) incurred accounting expenses of $1,591 in 2002. However, appellant does not provide any supporting checks, invoices, bank statements, etc. (*Id.*, Ex. 9.) The FTB is not allowing any accounting expenses for the 2002 tax year. (FTB OB, p. 11.)

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Staff Comments

For 2001, the NOA allows all of the accounting expenses claimed (i.e., $4,086). Thus, accounting expenses for the 2001 tax year are not at issue. The FTB is allowing no accounting expenses for 2002.

In an additional briefing letter dated December 13, 2013, the Appeals Division requested that appellant "identify evidence (i.e., cancelled checks, invoices, bank statements, declarations, etc.) substantiating the amounts and business purposes for the alleged accounting expenses totaling $1,591 for 2002."

In response, appellant simply asserted in an additional brief dated March 18, 2013, that "[a] schedule of the accounting expenses has been previously submitted."

Despite the Appeals Division's request for supporting documentation for the 2002 tax year, appellant has not provided any supporting checks, invoices, bank statements, etc. in relation to her alleged accounting expenses of $1,591 for 2002. Appellant should provide evidence (i.e., cancelled checks, invoices, bank statements, third-party declarations, etc.) substantiating the amounts and business purposes for her alleged accounting expenses totaling $1,591 for 2002.

Utilities (gas, water, electric)

For 2001, appellant provides various cancelled checks and bank statements in support of utility expenses totaling $2,292.90 for 2001. (See App. Reply Br., Ex. 8.) Those checks and/or banks statements show the following utility payments for 2001:

2001		
The Gas Co.	$30.60	10/25/01
The Gas Co.	148.81	3/29/01
The Gas Co.	92.97	4/30/01
The Gas Co.	91.94	5/21/01
The Gas Co.	47.74	7/1/01
The Gas Co.	43.40	8/18/01
The Gas Co.	37.90	8/23/01
The Gas Co.	41.60	11/10/01
So. Cal. Edison	2.75	3/29/01
DWP	26.46	5/8/01
The Gas Co.	188.67	2/19/01
So. Cal Edison	364.69	2/19/01
DWP	28.33	2/5/01
DWP	40.00	4/5/01
DWP	26.46	5/11/01
DWP	183.13	6/5/01
DWP	268.14	8/3/01

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DWP	135.49	10/3/01
DWP	105.60	11/16/01
DWP	387.65	12/6/01
TOTAL	$2,292.90	

For 2002, appellant does not provide any supporting documents on appeal (i.e., spreadsheets and/or cancelled checks) for which appellant claims "utilities." (See *id*., Ex. 9.)

The NOAs dated February 28, 2011, allow deductions for utilities totaling $2,267 for 2001 and $4,277 for 2002. (FTB OB, Exhs. M & N.) The FTB asserts that appellant has not provided evidence substantiating any further amounts for utilities expenses (gas, water, electric). (*Id.*, p. 12.)

Staff Comments

For 2001, the FTB is allowing on appeal all of the claimed utility expenses except for $25.90. For 2002, the NOA allows utilities of $4,277—as noted above, appellant does not provide any supporting documents (i.e., spreadsheets and/or cancelled checks) regarding "utilities" for the 2002 tax year.

Office Expenses

On appeal, appellant provides bank statements in an effort to substantiate what she labels as "office expenses" of $3,942.56 for 2001 and $1,675.59 for 2002. (App. Reply Br., Exhs. 8 & 9.) Those bank statements show the following payments:

2001		
Good Guys	191.99	4/9/01
DirectTV	93.97	4/9/01
Network Solutions	63.00	4/11/01
Panasonic	83.22	4/19/01
Earthlink	19.95	5/9/01
DirectTV	93.97	5/9/01
Highlights Lighting	226.80	6/4/01
DirectTV	99.29	7/2/01
DirectTV	137.05	7/9/01
Wherehouse Music	127.99	7/9/01
DirectTV	180.99	8/9/01
Intuit	187.81	8/28/01
DirectTV	113.11	9/10/01
Ikea	179.94	10/29/01
Unlimited Check Or.	48.50	11/1/01
DirectTV	169.32	11/9/01
DirectTV	172.04	12/10/01
Earthlink	19.95	7/9/01
Earthlink	19.95	7/9/01
Earthlink	21.95	8/13/01
Beverly Hills Whsle	258.12	8/14/01

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Costco	204.05	8/27/01
Homelife Furniture	64.79	9/5/01
Earthlink	43.90	10/19/01
Costco	903.82	11/1/01
Costco	137.69	11/13/01
Costco	79.40	12/20/01
TOTAL	$3,942.56	

2002		
Barnes & Noble	43.96	2/4/02
Fry's Electronics	993.93	5/16/02
Barnes & Noble	38.92	7/29/02
Image Print USA	86.60	9/13/02
Costco	106.82	1/22/02
Earthlink	61.85	2/27/02
Staples	25.69	2/28/02
Verisign	12.00	3/25/02
Staples	193.38	4/18/02
Earthlink	38.90	4/25/02
Kinko's	23.99	4/29/02
Verisign	69.99	8/28/02
Myfonts.com	19.95	10/28/02
Kinko's	3.57	11/18/02
TOTAL	$1,675.59	

On appeal, the FTB states that it will allow office expenses of $3,078 for 2001 and the full amount of claimed office expenses for 2002. (FTB Add. Br. dated Feb 4, 2014, p. 2-3.)

Staff Comments

On appeal, the FTB states that it will allow office expenses of $3,078 for 2001 and the full amount (i.e., $1,676) of claimed office expenses for 2002. Thus, office expenses for the 2002 tax year are not at issue.

In a declaration dated October 21, 2013, appellant provided a list of the above-listed office expenses for 2001, along with appellant's handwritten notations indicating why each of the above-listed expenses served a business purpose. (See App. Add. Br. dated Oct. 2013.) For example, appellant asserted that (1) the charge of $127.99 to Wherehouse Music on July 9, 2001, was for a "VCR", (2) the charge for $204.00 to Costco on August 27, 2001, was for a desk, and (3) the charge for $187.81 to Intuit on August 28, 2001, was for a "router."

In response, the Appeals Division sent appellant an additional briefing letter dated December 13, 2013, requesting that appellant (1) identify evidence substantiating a business purpose

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for each alleged office expense, and (2) substantiate that the expenses were not already deducted as corporate expenses (possibly by Cyberdressforms, Inc. and/or Shapely Shadow).[15] In response, appellant filed an additional brief dated March 18, 2013, asserting:

> Shapley Shadows, Inc. had its own location and operated a warehouse and factory. These expenses are not the same as those included in Schedule C.

At the oral hearing, appellant should be prepared to demonstrate that she is entitled to a greater amount of office expenses for 2001 than the $3,078 that FTB has stated it will allow. In this respect, appellant should be prepared to substantiate that the above-listed payments for 2001 were for business purposes (as opposed to personal purposes) and were not already deducted (and/or were not properly deductible) as corporate expenses, possibly by Cyberdressforms, Inc. on its corporate tax return for the fiscal year of May 2, 2001 through April 30, 2002. (App. Ex. 12 of appellant's exhibits submission dated Oct. 22, 2013.) In turn, the FTB should be prepared to explain how it determined to allow office expenses of $3,078 for 2001.

Postage

In relation to postage expenses for 2001, appellant provides one check to Alcala Delivery (in the amount of $90) and one check to Westwood Mail Service (in the amount of $220). (App. Reply Br., Ex. 8.) Appellant does not provide any documents for postage in 2002. (*Id*., Ex. 9.)

The FTB argues that appellant failed to substantiate a business purpose for each payment.

Staff Comments

The FTB allows no postage expenses for 2001 and 2002. At the oral hearing, appellant should substantiate a business purpose for each of the two payments provided for the 2001 tax year. If appellant wants to claim any postage expenses for 2002, she should provide supporting documents (i.e., cancelled checks, invoices, declarations, etc.) substantiating the amounts paid and the business purposes for those amounts.

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[15] In exhibit C of the FTB's opening brief, appellant provides Schedule Cs (*Profit of Loss from Sole Proprietorship*) of Cyberdressforms for the tax year ending December 31, 2001, and Shapley Shadow for the tax year ending December 31, 2002. In comparison, in Exhibit 12 of appellant's exhibits submission dated October 22, 2013, appellant provides unsigned copies of the state and federal corporate income tax returns for Cyberdressforms, Inc. for the fiscal year May 1, 2001 through April 30, 2002.

Rental of Vehicles, Machinery, and/or Equipment

On her 2001 and 2002 amended Schedule Cs, appellant lists rentals of "vehicles, machinery, and equipment" totaling $254 for 2001 and $31,800 for 2002. (FTB OB, Exhs. H at p. 7 & I at p. 10.) On appeal, appellant does not provide a spreadsheet specifically titled "vehicles, machinery, and equipment," which is the classification listed in her amended Schedule Cs.[16]

The FTB argues that appellant failed to provide evidence showing the dates, amounts, and business purposes for rentals of any "vehicle, machinery, and/or equipment." (See *Id*., at pp. 11-12.) Moreover, the FTB argues that a number of these expenses (although the FTB does not specify which ones) were (or might have been) reported as corporate expenses in Shapely Shadow's general ledger.[17] (*Id*., p. 12.)

Staff Comments

The FTB allows no deductions for "rentals of vehicles, machinery and/or equipment" for 2001 and 2002.

In an additional briefing letter dated December 13, 2013, the Appeals Division requested that appellant identify evidence substantiating (i) appellant's claimed rentals of vehicle/machinery expenses totaling $254 for 2001 and $31,800 for 2002, (2) the nature of the equipment rented and business purposes thereof, and (3) that the expenses were not already deducted as corporate expenses.

In response, appellant filed an additional brief dated March 18, 2013, asserting that a portion (although appellant does not state such portion) of the expenses for vehicles, machinery and/or equipment, was part of appellant's claimed home office expenses.

At the oral hearing, appellant should clarify her arguments and substantiate the date, amount, and business purpose for each alleged rental of "vehicles, machinery, and equipment," as set forth in her amended Schedule Cs for the 2001 and 2002 tax years (i.e., $254 for 2001 and $31,800 for 2002). Also, appellant should substantiate that any alleged expenses were not already deducted (and/or

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[16] Staff notes, however, that for the 2001 tax year (but not for the 2002 tax year) appellant provides a spreadsheet titled "rent" wherein appellant lists an equipment rental charge of $254 but admits that she does not have a document (such as a cancelled check, etc.) to support that charge. (App. Reply Br. Ex. 8.)

[17] It is possible that the FTB intended to refer to the general ledger of Cyberdressforms, Inc.

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are not properly deductible) as corporate expenses, possibly by Cyberdressforms, Inc. on its corporate tax return for the fiscal year of May 2, 2001 through April 30, 2002. (See App. Ex. 12 of appellant's exhibits submission dated Oct. 22, 2013.)

Repairs

In relation to alleged repairs for 2001, appellant provides one check to American Deck Systems (in the amount of $165.00) and one check to Oakley Lock Key Service (in the amount of $113.24). (App. Reply Br., Ex. 8.) For 2002, appellant provides no documents summarized as "repairs." (*Id*., Ex. 9.)

The FTB argues that appellant has not established business purposes for the above-listed checks for the 2001 tax year. (See FTB OB, pp. 11-12.) Moreover, the FTB argues, in general, that those expenses were or might have been reported as corporate expenses in Shapely Shadow's general ledger.[18] (*Id*., p. 12.)

Staff Comments

The FTB allows no repair expenses for 2001 and 2002. At the oral hearing, appellant should substantiate business purposes (as opposed to personal purposes) for the check to American Deck Systems in the amount of $165.00 and the check to Oakley Lock Key Service in the amount of $113.24. In addition, appellant should substantiate repairs (if any) for the 2002 tax year. Also, appellant should substantiate that any alleged expenses were not already deducted (and/or are not properly deductible) as corporate expenses, possibly by Cyberdressforms, Inc. on its corporate tax return for the fiscal year of May 2, 2001 through April 30, 2002. (See App. Ex. 12 of appellant's exhibits submission dated Oct. 22, 2013.)

Telephone

On appeal, appellant provides cancelled checks and/or telephone bills to substantiate telephone expenses of $4,554.05 in 2001 and $4,174.50 in 2002. (See App. Reply Br., Exhs. 8 & 9.) Those cancelled checks and/or telephone bills show the following payments:

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[18] It is possible that the FTB intended to refer to the general ledger of Cyberdressforms, Inc.

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2001		
Cingular	626.92	11/20/01
Verizon	14.88	11/20/01
Verizon	335.10	12/30/01
Verizon	187.56	1/25/01
Verizon	228.85	8/23/01
Verizon	402.62	10/11/01
Verizon	346.29	5/21/01
Cingular	116.52	7/25/01
Cingular	35.00	7/25/01
AT&T	111.12	1/11/01
Verizon	545.60	5/4/01
AT&T	172.34	5/21/01
Verizon	266.38	3/19/01
AT&T	7.25	3/29/01
AT&T	86.17	5/29/01
Verizon	208.91	2/19/01
Verizon	86.29	2/19/01
Verizon	111.15	2/20/01
AT&T	53.10	2/20/01
AT&T	57.61	2/19/01
Verizon	138.16	2/19/01
Cingular	416.23	12/20/01
TOTAL	$4,554.05	

2002		
Verizon	621.84	2/4/02
AT&T	72.87	2/4/02
Cingular	866.38	5/27/02
Cingular	381.16	1/27/02
Cingular	850.66	4/27/02
Cingular	829.84	1/26/02
Cingular	256.73	2/27/02
Charter Comm	134.89	2/7/02
Charter Comm	95.57	12/4/02
Charter Comm	64.56	2/13/02
TOTAL	$4,174.50	

The FTB argues that appellant has not substantiated business purposes for the above-listed telephone expenses. (FTB OB, p. 12.) In addition, the FTB argues that some of those telephone expenses (although the FTB does not specify which ones) were (or might have been) reported as corporate expenses in Shapely Shadow's general ledger.[19] (*Id.*)

Staff Comments

The FTB allows no telephone expenses for 2001 and 2002. At the oral hearing,

[19] It is possible that the FTB intended to refer to the general ledger of Cyberdressforms, Inc.

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appellant should substantiate a business purpose for each alleged telephone expense. Also, appellant should substantiate that any alleged expenses were not already deducted (and/or are not properly deductible) as corporate expenses, possibly by Cyberdressforms, Inc. on its corporate tax return for the fiscal year of May 2, 2001 through April 30, 2002. (See App. Ex. 12 of appellant's exhibits submission dated Oct. 22, 2013.)

Question No. 3: Whether appellant omitted gross income in excess of 25 percent for 2002 (and if so, by what amount), such that the extended six-year statute of limitations applies for the FTB to issue the NPA dated August 25, 2008, which assesses additional tax for omitted gross income.

Concession

As noted above, in addition to issuing *timely* NPAs dated April 7, 2006 (which denied various amounts related to cost of goods sold and expenses for the 2001 and 2002 tax years), the FTB issued NPAs dated August 25, 2008, which assessed additional taxes for alleged omitted gross income for the tax years 2001 and 2002. On appeal, the FTB concedes that the NPA dated August 25, 2008, which assessed additional tax for alleged omitted gross income for the tax year 2001, was *untimely*; thus, the remaining issue is whether the NPA dated August 25, 2008, which assessed additional tax for alleged omitted gross income for the tax year 2002, was timely.

Contentions

Appellant

Appellant contends that the 2002 NPA dated August 25, 2008 (see FTB OB, Ex. K) was issued untimely and, thus, the FTB cannot assess alleged unreported income for the 2002 tax year. (App. Reply Br., p.1; Appellant's Supplemental Brief (App. Supp. Br.), pp. 1-2.) As noted below, the FTB generally has four years from the date a taxpayer files a return to issue an NPA, but if the taxpayer omits more than 25 percent of his or her gross income, that time period is extended to six years. (Rev. & Tax. Code, §§ 19057, subd. (a), and 19058, subd. (a).) Appellant argues that the FTB failed to issue the NPA dated August 25, 2008, in a timely manner because the FTB issued that NPA (which was for the 2002 tax year) beyond four years from the date appellant filed the applicable return (on October 27, 2003) and the FTB has not shown that appellant omitted gross income by more than 25 percent for the

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taxable year. (App. Reply Br., p.1; App. Supp. Br., pp. 1-2.) Appellant asserts that she did not have any unreported income for 2002. (App. Reply Br. pp. 2-3.) In fact, in her additional brief dated March 18, 2014, appellant asserts that deposits of $383,037.51 were not income but, rather, represent amounts related to (1) tax refunds, (2) loan repayments from an individual named Irene Washer, (3) a home refinance, (4) amounts due to/from shareholders, and (5) bank transfers. (Each of the five categories is discussed below in staff comments).

The FTB

The FTB argues that it issued the NPA dated August 25, 2008, in a timely manner because appellant understated her income by more than 25 percent for 2002, such that the FTB had six years to issue the NPA pursuant to R&TC section 19058. (FTB Reply Br. pp. 1-2.) In short, the FTB argues that it properly performed a bank deposit analysis and determined (as reduced during protest) that appellant had unreported income of $146,827 for 2002, as set forth in the NOA dated March 11, 2011. (FTB OB, p. 4; FTB Reply Br., pp. 1-2.) In its additional briefing, the FTB describes in greater detail how it determined that appellant had unreported income of $146,827 for 2002:

> During the audit state of this matter respondent determined deposits were made into appellant's bank accounts as follows: $345,187 in the Shapely Shadow, Inc. bank account, $288,600 in the Ilona Foyer and Associates bank account, and $122,747 into her personal bank account. Respondent deducted $34,764 of Schedule C expense and costs from this amount as well as the $355,450 of expenses reported by Shapely Shadow on its 2002 Form 100. During the audit, respondent therefore determined the remaining amount of unreported income to be $366,320. During the protest state of this matter, appellant provided substantiation indicating she received $25,170 of tax refunds during 2002 and an escrow refinance check from Love Escrow in the amount of $194,323. Thus, the remaining amount of unreported income is $146,827.

In summary, the FTB asserts that it properly determined that appellant has unreported income of $146,827 for 2002 (as set forth in the NOA dated March 11, 2011), and it issued the NPA dated August 25, 2008, in a timely manner because appellant "understated her income" by more than 25 percent for 2002. (FTB OB, p. 4; FTB Reply Br. pp. 1-2.)

Applicable Law

Statute of Limitations for the FTB to Issue an NPA

The FTB generally has four years from the date a taxpayer files a return to issue an

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NPA, but if the taxpayer omits more than 25 percent of his or her gross income, that time period is extended to six years. (Rev. & Tax. Code, §§ 19057, subd. (a), and 19058, subd. (a).)

R&TC section 19058 provides as follows:

> (a) If the taxpayer omits from gross income an amount properly includable therein which is in excess of 25 percent of the amount of gross income stated in the return, a notice of proposed deficiency assessment may be mailed to the taxpayer within six years after the return was filed. . . .
>
> (b) For purposes of this section both of the following shall apply:
>
> (1) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if the amounts are required to be shown on the return) prior to diminution by the cost of the sales or service.
>
> (2) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if the amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Franchise Tax Board of the nature and amount of the item. (Rev. & Tax Code § 19058.)

Bank Deposits

If the FTB makes a tax assessment based on an estimate of unreported income, the FTB's initial burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers, supra*.) Once the FTB's initial burden is satisfied, a presumption of correctness arises. (See *Appeal of Michael E. Myers, supra*.) Courts have long recognized that using bank deposits is a permissible method for reconstructing taxable income. (*Kazhukauskas v. Commissioner, supra*; *DiLeo v. Commissioner* (1991) 96 T.C. 858, 867, *aff'd*, (2d Cir. 1992) 959 F.2d 16.) A taxpayer bears the burden of establishing that bank deposits originate from nontaxable sources. (*Kazhukauskas v. Commissioner, supra*.)

STAFF COMMENTS

At the oral hearing, the parties should be prepared to discuss whether appellant omitted more than 25 percent of appellant's gross income for the 2002 tax year, such that the six-year statute of limitations applied for the FTB to issue the NPA dated August 25, 2008. That NPA proposed unreported income of $366,320 for 2002, which the FTB reduced during protest to unreported income

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of $146,827, as set forth in the NOA dated March 11, 2011. (See FTB OB, Ex. P.) Appellant's 2002 California return reported California gross income of -$171,050.[20] (FTB OB, Ex. B.) In addition, appellant's 2002 Schedule C reported gross receipts or sales totaling $89,785. (FTB OB, Ex. D.) As such, it appears to Board staff that appellant must establish that there is less than $22,446 of unreported income (i.e., $89,785 x 25%) in 2002, to avoid the application of the extended statute of limitations to this tax year.

At the oral hearing, the parties should be prepared to address, among other things, the following topics:

1. Appellant should be prepared to address whether she exercised control over the bank accounts into which deposits were made and wrote checks from the accounts for her personal use.

2. Appellant asserts in her additional brief dated March 18, 2014, that deposits totaling $29,090.80 in 2002 were not income to appellant but were tax refund amounts. Appellant should provide copies of all tax refund checks and/or other evidence showing that deposits of $29,090.80 in 2002 represent tax refund amounts. Staff notes that, in the FTB's additional brief dated February 4, 2014, the FTB states that appellant was given credit for tax refund amounts totaling $25,170 for the 2002 tax year.

3. Appellant asserts in her additional brief dated March 18, 2014, that deposits totaling $57,410 in 2002 were not income to appellant but were repayments proceeds of a loan that appellant made to an individual named Irene Washer. Appellant might provide a declaration from Ms. Washer, under penalty of perjury, stating that Ms. Washer made repayments to appellant totaling $57,410 in 2002, or perhaps supporting correspondence from the time period at issue, including a copy of a promissory note between the parties. In turn, the FTB should be prepared to address whether its estimation of unreported income for the 2002 tax year takes into account the alleged repayments of $57,410 from Ms. Washer to appellant.

4. Appellant asserts in her additional brief dated March 18, 2014, that deposits totaling $194,323.28 in 2002 were not income to appellant but, rather, represent funds from an escrow refinance. Staff notes that the FTB's additional brief dated February 4, 2014, states that appellant was

[20] Appellant's 2002 federal return reported gross income of -$175,406.

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given credit of $194,323 in relation to an escrow refinance check from Love Escrow, which reduced appellant's alleged 2002 unreported gross income.

5. Appellant asserts in her additional brief dated March 18, 2014, that deposits totaling $90,329.23 in 2002 were not income to appellant but were "amounts due to/from shareholder" (i.e., "Due To/From Shrhldr"). Appellant should further explain this argument; also, appellant should provide copies of all checks in support thereof. In turn, the FTB should be prepared to address whether its estimation of unreported income for the 2002 tax year takes into account the *alleged* "amounts due to/from shareholder" totaling $90,329.23.

6. Appellant asserts in her additional brief dated March 18, 2014, that deposits totaling $11,884.20 in 2002 were not income to appellant but were bank transfers. Appellant should provide copies of all bank documents (including routing information, if possible) substantiating that deposits of $11,884.20 in 2002 represent bank transfers. In turn, the FTB should be prepared to address whether its proposed assessment of unreported income for the 2002 tax year takes into account the *alleged* bank transfers totaling $11,884.20.

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Foyer, Ilona_wjs

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