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**BOARD OF EQUALIZATION**  
**STATE OF CALIFORNIA**

In the Matter of the Appeals of: ) **HEARING SUMMARY**  
) **PERSONAL INCOME TAX APPEAL**  
) **DONALD R. LEE AND** ) Case No. 513965  
) **DEBRA J. LEE<sup>1</sup>** )

	<u>Year</u>	<u>Proposed Assessment Tax</u>
	2005	\$1,077

Representing the Parties:

For Appellants: Donald R. Lee and Debra J. Lee<sup>2</sup>  
For Franchise Tax Board: Raul A. Escatel, Tax Counsel

QUESTION: Whether appellants have established error in the proposed assessment, which is based on a federal determination.

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<sup>1</sup> Appellants reside in Riverside County.

<sup>2</sup> Appellants filed their own Appeal Letter, Kenneth Yu of the Taxpayers Appeals Assistance Program (TAAP) filed appellants' reply brief, and Joshua Rubel of TAAP subsequently represented appellants. Currently Board's records indicate no TAAP representative or other representative.

1 HEARING SUMMARY

2 Background

3 Appellants filed a timely 2005 California joint return. On the return, appellants claimed  
4 two personal exemption credits and three dependent exemption credits for their three children. They  
5 reported wages of \$116,946, a federal adjusted gross income (AGI) of \$120,662, California  
6 adjustments (subtractions) of \$3,179, California AGI of \$117,483, and, after applying claimed  
7 itemized deductions of \$104,996, they reported taxable income of \$12,487. (Resp. Opening Br.,  
8 exhibit A, p. 1.) On the 2005 Schedule CA (540), appellants calculated their claimed itemized  
9 deductions of \$104,996 based on their total federal itemized deductions of \$111,407 less reported  
10 general sales tax of \$6,411. (*Id.*, exhibit A, p. 4.) On their federal 2005 Schedule A, appellants  
11 claimed total itemized deductions of \$111,407 consisting of the following items: 1) \$62,839 of  
12 medical expenses<sup>3</sup> based on \$71,889 of reported medical expenses less 7.5 percent of appellants'  
13 federal AGI of \$9,050; 2) \$13,452 of paid taxes consisting of \$6,411 of general sales taxes, \$6,648 of  
14 real estate taxes and \$393 of personal property taxes; 3) \$34,516 of home mortgage interest and points  
15 paid; and 4) \$600 of gifts to charity. (*Id.*, exhibit A, p. 5.) Appellants reported a tax liability of zero  
16 (tax of \$125 less exemption credits of \$990). They claimed an income tax withholdings credit of  
17 \$5,466, and a refund of \$5,466. (*Id.*, exhibit A, pp. 1-2.)

18 Respondent subsequently received information indicating the Internal Revenue Service  
19 (IRS) made \$75,898 of income adjustments to appellants' 2005 federal joint return. (Resp. Opening  
20 Br., p. 2, exhibit B, p. 1.) The IRS disallowed \$62,840 of claimed medical deductions<sup>4</sup>, \$6,411 of  
21 Schedule A state and local tax adjustments, and \$6,648 of real estate taxes deductions. (*Id.*, exhibit

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25 <sup>3</sup> For purposes of brevity, staff refers to medical expenses as inclusive of both medical and dental expenses. (See Int. Rev.  
26 Code, § 213(a).)

27 <sup>4</sup> The Fedstar IRS Data Sheet dated November 12, 2009, shows that the IRS disallowed all of the reported medical  
28 expense of \$71,889 of which appellants claimed a medical and dental expenses deduction of \$62,839, which is the amount  
that exceeds 7.5 percent of appellants' federal AGI; staff notes there is a \$1 disparity between the claimed medical  
expenses deductions listed on the federal Schedule A (\$62,839) and the medical expenses deductions listed on the  
November 12, 2009 Fedstar IRS Data Sheet (\$62,840). (Resp. Opening Br., exhibit B. See Int. Rev. Code, § 213(a).)

1 B.)<sup>5</sup> Based on this information, respondent issued a Notice of Proposed Assessment (NPA) dated June  
2 23, 2009, that disallows claimed medical deductions of \$62,840 and real estate taxes deductions of  
3 \$6,648 and allows personal property taxes deduction of \$6,191. The NPA increases appellants'  
4 taxable income from \$12,487 to \$75,784 and proposes additional tax of \$2,090 plus interest. (*Id.*,  
5 exhibit C; Appeal Letter, Attachment.)

6 Appellants filed a timely protest of the NPA. (Resp. Opening Br., p. 2, exhibit D.)  
7 According to respondent, appellant submitted various documents in support of their protest of the  
8 NPA. (*Id.*) Respondent revised the NPA in a Notice of Action (NOA) dated October 2, 2009. The  
9 NOA reduces the proposed assessment from \$2,090 to \$1,077 by allowing \$13,462 of itemized  
10 deductions, which were not reflected in the NPA, in addition to the \$6,191 of personal property taxes  
11 deduction, which were reflected in the NPA. The NOA affirmed the NPA in part by disallowing the  
12 claimed medical deductions of \$62,840 and the claimed real estate taxes of \$6,648. (*Id.*, exhibit E)  
13 Appellants filed this timely appeal.

#### 14 Appellants' Contentions

15 Appellants contend that there is no reason for respondent to disallow their claimed real  
16 property tax deduction of \$6,648.33, because they paid this amount to the Riverside County Treasurer.  
17 Appellants attached to the Appeal Letter copies of their two cancelled checks to the Riverside County  
18 Treasurer amounting to \$6,648.33. (Appeal Letter, p. 1, Attachment; Resp. Opening Br., p. 5.)

19 Appellants contend that on their 2005 return they legitimately deducted out-of-pocket  
20 medical expenses in the amount of \$24,152.09, which consists of \$22,000.00 of unreimbursed medical  
21 expenses paid to their insurance company and \$2,152.09 of miscellaneous medical expenses;  
22 appellants attached to their Appeal Letter a written itemization of the \$24,152.09 of medical expenses.  
23 (Appeal Letter, p. 1, Attachment.) They contend their insurance company denied coverage for  
24 \$67,000 of medical expenses incurred and their attorney wrote a check in the amount of \$22,000 on

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27 <sup>5</sup> Appellants apparently failed to notify respondent of any federal determination for the 2005 tax year.  
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1 their behalf from his clients' trust account to Healthcare Recoveries<sup>6</sup> as their payment to their  
2 insurance company for medical expense reimbursement. (*Id.*) Appellants attached to the Appeal  
3 Letter a copy of an email from David Wilzig to Mr. Lee dated June 24, 2008, which states in part,  
4 "Healthcare Recoveries rcvd my clients trust acct check # 1108 for 22K[.]" Appellants also submitted  
5 a redacted copy of a letter dated August 30, 2005, from Mr. Wilzig to appellants, which states in part,  
6 "Healthcare Recoveries is owed \$22,000.00." (*Id.*, Attachment.) They contend that they enclosed  
7 personal checks for the remaining unreimbursed medical expenses of \$2,152.09 (\$24,152.09 -  
8 \$22,000.00). (*Id.* at p. 1.)

9 In addition, appellants argue that they are entitled to claim a medical expenses  
10 deduction for the costs they incurred in constructing a home spa<sup>7</sup> to alleviate Mrs. Lee's chronic neck  
11 pain and migraine headaches. Appellants contend that Mrs. Lee had neck surgery in December 2004  
12 due to a neck injury she sustained in a serious automobile accident in late 2002. According to  
13 appellants, the automobile accident caused over \$9,000 of damage to Mrs. Lee's 1999 Nissan Maxima  
14 car. (Appeal Letter, p. 2; Apps. Reply Br., p. 1.) Appellants assert that Mrs. Lee's injuries from the  
15 automobile accident were very debilitating in nature, impaired her daily functioning, and prevented her  
16 from working for more than two years. (Apps. Reply Br., p. 1.) Appellants assert, "On December 12,  
17 2002[,] Mrs. Lee's physician prescribed that therapeutic spa treatment would be an indispensable and  
18 effective treatment for her continuing symptoms." (*Id.* at p. 2.) Appellants attached to the Appeal  
19 Letter and their reply brief a copy of a signed prescription form from Community Medical Group of  
20 Riverside, Inc. dated December 12, 2002, which states, "Home spa (for tax purposes)." (*Id.*, exhibit  
21 A.) They also attached to the Appeal Letter a physician's note dated December 12, 2002, which  
22 indicates that the physician recommended a home spa to Mrs. Lee "to help provide long term relief."  
23 (Appeal Letter, Attachment.) Appellants contend that Mrs. Lee "received extensive treatment

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25 <sup>6</sup> It appears that appellants are referring to American Healthcare Recoveries, which provides medical bill collection services.  
26 (<http://americanhealthcarerecoveries.com/>)

27 <sup>7</sup> For clarity's sake, staff has consistently referred to appellants' construction of a home spa, although the record shows that  
28 it is also referred to as a hot tub or simply a spa.

1 throughout the year by an orthopedic surgeon" before having the neck surgery in 2004. (*Id.* at p. 1.)  
2 According to appellants, Mrs. Lee underwent a disectomy and fusion in her cervical spine, which  
3 involved removing a central portion of intervertebral disc and fusing the portion back together in order  
4 to gain mobility and alleviate pain. (*Id.* at pp. 1-2.) Appellants contend that after the surgery, Mrs.  
5 Lee suffered from chronic neck pain, which caused her to suffer debilitating migraine headaches. (*Id.*  
6 at p. 2.)

7           According to appellants, they built the home spa in 2005 pursuant to the December 12,  
8 2002 physician's prescription and recommendation "to primarily help cure and mitigate [Mrs. Lee's]  
9 chronic neck pain and migraines." (Apps. Reply Brief, at p. 2, exhibits A, B.) Appellants assert that  
10 they obtained a second mortgage on their residence in order to build both the home spa and pool.  
11 Appellants contend that they spent months getting several bids for the construction of the home spa  
12 and pool. (Appeal Letter, p. 3.) They contend that they entered into a contract to build the home spa  
13 and pool for a "low estimate of \$55,000" with a contractor who "turned out to be an unlicensed  
14 contractor." (*Id.* at p. 2.) They assert, "The cost was such that a pool and spa combo was only slightly  
15 more than building a spa alone." (*Id.* at p. 3.) Appellants contend they first discovered the contractor  
16 was unlicensed halfway through the construction and the project ultimately cost them twice as much as  
17 the original price. (*Id.*) In their reply brief, appellants state that the entire project of constructing the  
18 home spa and pool ultimately cost them approximately \$100,000 as a result of "unforeseen  
19 circumstances," such as the gas and electrical run (over 300 feet) and the original contractor cancelling  
20 half way through the construction. (Apps. Reply Br., p. 1.)

21           Appellants contend that they claimed 40 percent of the cost of the project as medical  
22 expenses deduction, as recommended by their certified public accountant. (Apps. Reply Br., p. 1.) In  
23 the Appeal Letter, they state, "We deducted 40% of the price since the spa alone would have cost  
24 about 75% of the total expended if we would have not included the pool." (Appeal Letter, p. 3.)  
25 Appellants assert that the fair market value of their residence declined almost 50 percent since they  
26 built the home spa and pool. (*Ibid.*) Appellants contend, "Currently, the IRS has taken our last year  
27 tax return of about \$10,000 leaving us without enough money to pay our expenses and we can no  
28 longer afford to make house payments." (*Id.*) They further contend that they are now in the process of

1 losing their residence to foreclosure and the residence is worth approximately \$150,000 less than the  
2 amount they owe on it. (*Ibid.*) Appellants also contend that Mr. Lee was laid off from his job in  
3 December 2008, which he had for eight years, and, although he was able to find other unidentified  
4 employment, the couple cannot afford another tax assessment. (*Id.*).

5 For the following reasons, appellants argue that Mrs. Lee would have had no other  
6 reasonable way to treat her symptoms:

- 7 • the spa treatment alleviated Mrs. Lee's pain, muscle tension, and migraine headaches in  
8 order for her to be able to proceed through rehabilitative physical therapy (App. Reply Br.,  
9 p. 2.);
- 10 • Mrs. Lee continuously used the home spa on a daily basis, it significantly assisted her in  
11 recovering her mobility, managing her pain, and preventing migraine headaches, and, on  
12 days when Mrs. Lee has been unable to use the home spa, she continues to suffer from neck  
13 pain that sometimes can inhibit her from daily activities (*Id.*);
- 14 • installing a "Whirl Pool Bath Tub" would still be an extremely expensive alternative to a  
15 home spa because a major remodel of the bathroom would be required to install a  
16 comparable spa treatment device, the architecture of the residence created difficulties for  
17 installing gas and electrical lines, and appellants would have to put in trenching and install  
18 appropriate tubing (*Id.*);
- 19 • the home spa made better sense than the whirl pool bath tub because the residential  
20 property encompasses a large portion of open land (*Id.*);
- 21 • close proximity of a spa was an essential factor because Mrs. Lee lives in a very rural part  
22 of Riverside City, it would be impractical for her to travel to a facility with a spa due to her  
23 physical condition, and after the car accident, she was significantly limited in mobility and  
24 was unable to drive herself anywhere, such as a facility with spa treatments (*Id.*);
- 25 • if Mrs. Lee had opted for a facility with spa treatments in lieu of a home spa it would have  
26 involved travel and gym expenses that would eventually exceed the total cost of the home  
27 spa (*Id.*).

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1 Appellants contend they built the home spa as a direct response to Mrs. Lee's injuries  
2 pursuant to her physician's prescription, they did not build it for general health benefits or recreational  
3 use, and they did not build it to increase the value of their residence. Appellants attached to the  
4 Appeal Letter and their reply brief copies of a letter signed by Mrs. Lee's doctor dated June 2, 2009,  
5 which states that Mrs. Lee received care at the clinic, she was last seen for treatment of a chronic  
6 cervical condition on October 7, 2004, and a home spa was prescribed on December 12, 2002, to assist  
7 in the management of Mrs. Lee's chronic neck pain. The letter further states, "It is my understanding  
8 that the spa has been purchased and utilized for the medical condition for which it had been  
9 prescribed." (Appeal Letter, Attachment, Apps. Reply Br., exhibit B.) In their reply brief, appellants  
10 argue that respondent should allow them to deduct a reasonable percentage of the \$100,000 cost for  
11 the construction and installation of their medically-related home spa. (App. Reply Br., p. 2.) They  
12 assert that "a 40 percent deduction would be fair and reasonable." (*Id.* at p. 3.) Appellants cite *Cohan*  
13 *v. Commissioner* (2nd Cir. 1930) 39 F.2d 540, to support their argument that, even if they are not  
14 entitled to deduct the full amount of home spa construction costs they claimed, they should be entitled  
15 to deduct some portion of their out-of-pocket expenditures. (*Ibid.*)

#### 16 Respondent's Contentions

##### 17 Real Property Taxes Deduction

18 Respondent concedes that appellants are entitled to all of their claimed real property  
19 taxes deduction of \$6,648.33. Respondent asserts that it is not clear why the entire amount of claimed  
20 real property taxes deduction of \$6,648.33 was not allowed on the NOA. Respondent concedes that  
21 the NOA incorrectly allowed only \$6,191.00 of real property taxes deduction and appellants are  
22 entitled to an additional \$457.33 of real property taxes deduction (\$6,648.33 - \$6,191.00).

##### 23 Medical Expenses Deduction

24 Respondent argues that it properly disallowed appellants' claimed medical expenses  
25 deduction on their 2005 return because these expenses were not primarily for medical purposes.  
26 Citing *Jacobs v. Commissioner* (1974) 62 T.C. 813, respondent argues that a taxpayer may not deduct  
27 an expenditure as a medical expense unless it is both an essential element of treatment and not  
28 otherwise incurred for nonmedical reasons. Respondent does not dispute that Mrs. Lee's recuperation

1 benefited from the home spa, but it contends that appellants failed to produce sufficient evidence  
2 establishing that the construction of the home spa at their residence was indispensable to Mrs. Lee's  
3 recuperation from her neck condition. According to respondent, the fact that a physician may have  
4 prescribed the home spa or the home spa renders physical comfort does not by itself show that the  
5 couple was entitled to deduct the claimed expenses. Respondent asserts that the note from Mrs. Lee's  
6 doctor indicates that the doctor merely recommended a home spa for long term recovery and it does  
7 not specifically provide that a home spa was essential or the only means available to Mrs. Lee for her  
8 recuperation. Respondent contends that appellants failed to explain why it was necessary to incur the  
9 costs to construct a home spa when there were presumably cheaper alternatives that would provide the  
10 same therapeutic benefits. Respondent relies on *Altman v. Commissioner* (1969) 53 T.C. 487, where  
11 the court denied a medical expenses deduction for transportation costs to and from the golf course  
12 because it found that the taxpayer's golfing was primarily a personal recreational activity, rather than a  
13 medical activity. According to respondent, the construction of the pool, in addition to the home spa,  
14 indicates that the claimed costs were more for personal, rather than medical, purposes. Respondent  
15 thus argues that the present appeal is distinguishable from *Cherry v. Commissioner*, T.C. Memo. 1983-  
16 470, which is discussed below. Respondent argues that appellants failed to prove why \$40,000 of the  
17 \$100,000 amount of expenses incurred for the construction of the pool and home spa was the correct  
18 amount to claim for a medical expenses deduction. Respondent further argues that appellants failed to  
19 show that their residence's market value declined immediately after they constructed the pool and  
20 home spa. Lastly, respondent asserts that there is no need to discuss the issue of the capital nature of  
21 the pool and home spa construction in determining the deductibility of any of appellants' incurred  
22 costs because appellants have not proven that they are entitled to deduct any of these costs as medical  
23 expenses. Respondent does not discuss the claimed medical expenses of \$24,152.09, which comprise  
24 a portion of the \$71,889 of total medical expenses reported on appellants' 2005 federal Schedule A.  
25 (See Resp. Opening Br., exhibit A, p. 5.)

### 26 Applicable Law

#### 27 Assessment Based on Federal Determination

28 Revenue and Taxation Code (R&TC) section 18622, subdivision (a), provides that

1 when the IRS makes a change or correction to a taxpayer's federal account that results in an increase in  
2 the amount of state tax payable, the taxpayer must either concede the accuracy of the federal  
3 determination or state wherein the federal change is erroneous. A state deficiency assessment that is  
4 based on a federal report is presumptively correct and the taxpayer bears the burden of proving error.  
5 (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18, 1986.) Absent uncontradicted,  
6 credible, competent and relevant evidence showing that respondent's determinations are incorrect,  
7 respondent's proposed assessment must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-  
8 SBE-154, Nov. 18, 1980.) An appellant's failure to produce evidence that is within his or her control  
9 gives rise to a presumption that such evidence is unfavorable to his or her case. (*Appeal of Don A.*  
10 *Cookston*, 83-SBE-048, Jan. 3, 1983.)

#### 11 Medical Expenses Deduction

12 R&TC section 17201 incorporates Internal Revenue Code (IRC) section 213, which  
13 allows as a deduction any expenses paid during the taxable year for the "medical care" of the taxpayer,  
14 his/her spouse, and dependents that are not compensated for by insurance or otherwise, but only to the  
15 extent that such medical expenses exceed 7.5 percent of federal AGI. (Int. Rev. Code, § 213(a).) IRC  
16 section 213 has been characterized "as carving out 'a limited exception' to the general rule in [IRC]  
17 section 262 that prohibits the deduction of personal, living, or family expenses." (*Green v.*  
18 *Commissioner*, T.C. Memo 2010-109 (citing *Jacobs v. Commissioner, supra*, 62 T.C. 813, 818.) The  
19 term "medical care" is defined to include the diagnosis, cure, mitigation, treatment, or prevention of  
20 disease. (Treas. Reg. § 1.213-1(e)(1)(i).)

21 The regulations provide that deductions for medical care expenditures are allowable if  
22 they were incurred "primarily for the prevention or alleviation of a physical or mental defect or  
23 illness." (Treas. Reg. § 1.213-1(e)(1)(ii).) The term does not include expenditures for items that are  
24 merely beneficial to the general health of the individual, such as vacation expenses. (Treas. Reg.  
25 § 1.213-1(e)(1)(ii).) The regulations also provide that a deduction is allowable "only with respect to  
26 medical expenses actually paid during the taxable year, regardless of when the incident or event which  
27 occasioned the expenses occurred[.]" (Treas. Reg. § 1.213-1(a)(1).)

28 An expenditure does not qualify for a medical care deduction simply because it is

1 recommended by a physician. (*H. Grant Atkinson v. Commissioner* (1965) 44 T.C. 39.) Not every  
2 expenditure prescribed by a physician is to be catalogued under the term "medical care", nor is every  
3 expense that may be incurred for the physical comfort of an individual a medical expense. (*Haines v.*  
4 *Commissioner* (1979) 71 T.C. 644; *Seymour v. Commissioner* (1950) 14 T.C. 1111.) Generally, even  
5 when recommended by a physician, fees paid to an exercise gym by a taxpayer seeking only general  
6 improvement of his health are not deductible medical expenses. (*Peacock v. Commissioner*, T.C.  
7 Memo 1978-30. See also *Altman v. Commissioner, supra*, 53 T.C. 487 (Expenses incurred while  
8 playing golf on physician's recommendation as a way of obtaining exercise for taxpayer's pulmonary  
9 emphysema were not deductible.))

10 In order for a taxpayer to substantiate medical expenses under IRC section 213, the  
11 taxpayer must furnish the name and address of each person to whom payment was made and the  
12 amount and date of each payment. (Treas. Regs. § 1.213-1(h); see also *Davis v. Commissioner* T.C.  
13 Memo 2006-272.) When a taxpayer fails to provide documentation regarding disallowed medical  
14 expenses, a court is not required to accept the taxpayer's self-serving and uncorroborated testimony in  
15 this regard and may sustain the IRS's determination denying a claimed medical expense deduction.  
16 (See *Davis v. Commissioner*, T.C. Memo. 2006-272; *Lewis v. Commissioner*, T.C. Memo 2000-249;  
17 *Nwachukwu v. Commissioner*, T.C. Memo. 2000-27.)

18 Capital expenditures are generally not deductible. (Int.Rev. Code, § 263; Treas. Reg.  
19 § 1.213-1(e)(1)(iii).) However, a capital expenditure may qualify as a deductible medical expense if it  
20 has as its primary purpose the medical care of the taxpayer or his dependent to the extent that the  
21 expenditure exceeds the increase in the value of the related property. (Treas. Reg. § 1.213-1(e)(1)(iii).  
22 See *Ferris v. Commissioner* (7th Cir. 1978) 582 F.2d 1112; 582 F.2d 1112; *Gerard v. Commissioner*  
23 (1962) 37 T.C. 826.) There is "no ceiling limitation on the amount of deductible medical expenses"  
24 contained in IRC section 213. (*Ferris v. Commissioner, supra*, 582 F.2d at 1115.) However, "[w]here  
25 a taxpayer makes a capital expenditure that would qualify as being 'for medical care,' but does so in a  
26 manner creating additional costs attributable to such personal motivations as architectural or aesthetic  
27 compatibility with the related property, the additional costs incurred are not expenses for medical  
28 care." (*Id.* at p. 1116.) In *Keen v. Commissioner*, T.C. Memo. 1981-313, the court found that the

1 taxpayers installed a health spa primarily on the advice of a doctor and to alleviate the wife's  
2 (unspecified) medical condition, the expenditure was directly related to the wife's medical condition,  
3 and it was not lavish or of a luxury nature. However, the court limited the related medical expenses  
4 deduction for the cost of the health spa because it concluded that it added value to the taxpayers'  
5 residence beyond the value of the removed landscaping. (*Id.*)

6           In *Haines v. Commissioner, supra*, 71 T.C. 644, the court disallowed the expenditure  
7 for a swimming pool, notwithstanding the fact that the taxpayer's physician recommended swimming  
8 to the taxpayer after he broke his leg and had corrective surgery. The court noted that the taxpayer's  
9 need for special therapy for his leg was for a limited period of time during which time there were less  
10 costly means of securing such special therapy, and the swimming pool was suitable for use and was  
11 used by others. The court held, "[T]he examples in the regulations of capital expenditures which are  
12 deductible as medical expenses involve equipment which is not used significantly for any purpose  
13 other than the medical care of the taxpayer; that is, eye glasses, seeing eye dog, artificial teeth and  
14 limbs, wheelchair, crutches, and inclinator or an air conditioner which is detachable from the property  
15 and purchased only for the use of the person in need of medical care." (*Id.* (citing Treas. Reg. § 1.213-  
16 1(e)(1)(iii) and *Estate of Hayne v. Commissioner* (1954) 22 T.C. 113.))

17           Similarly, in *Worden v. Commissioner*, T.C. Memo. 1981-366, the court held that,  
18 although a chiropractor thought swimming would improve the taxpayer's back condition and  
19 swimming may have helped the taxpayer's back problems, the evidence was "insufficient to establish  
20 that the primary purpose for building *his own* swimming pool was related directly to his medical care."  
21 (emphasis original.) The court noted that the taxpayer's pool was suitable for general use by others  
22 and the taxpayer admitted that other members of his family used it. (*Id.*) "Having a swimming pool at  
23 his home certainly made it more convenient for the petitioner to exercise, but an expenditure that  
24 merely serves the convenience of the taxpayer cannot be treated as a medical expense." (*Id.*) Lastly,  
25 the court held that, even if the taxpayers established that they built the pool for the primary purpose of  
26 medical care, they still failed to carry their burden of proving that the claimed deductible amount  
27 "represents only that amount by which the expenditure exceeded the increase in the value of the  
28 related property." (*Id.* (citing Treas. Reg. § 1.213-1(e)(1)(iii).)) The court concluded, "Absent this

1 necessary proof, they cannot prevail." (*Id.* See also *Huff v. Commissioner*, T.C. Memo. 1995-200  
2 (taxpayer did not show the cost incurred for the hot tub, water filtration system, or deck was for the  
3 primary purpose of and/or was directly related to her medical care and she did not show that her  
4 expenditure did not result in increased value to her home.)

5 In *Evanoff v. Commissioner*, T.C. Memo. 1982-600, the taxpayers had valuations done  
6 on their property before and after they installed a pool for physical therapy for their daughter at the  
7 recommendation of her doctor to treat her idiopathic, adolescent scoliosis. The taxpayers selected a  
8 mid-ranged estimate for the construction of the pool and conceded that the pool increased the fair  
9 market value of their property by \$7,500.00, leaving an expenditure of \$8,853.27, which the IRS  
10 disallowed as a deductible medical expense. The court held:

11 We begin by noting that the cost of installing an in-ground residential  
12 swimming pool is not an every-day, garden-variety type of medical  
13 expenditure. While special circumstances may make the costs of a  
14 swimming pool deductible, the strong showing of necessity required by  
*Haines v. Commissioner*, 71 T.C. 644 (1979) is absent herein. Certainly it  
cannot be said on the record before us that the pool was constructed  
primarily for medical reasons.

15 (*Id.*) The court found that there were alternatives community and school pools available that would  
16 have satisfied the taxpayers' daughter's therapeutic needs for much less money than constructing an in-  
17 ground residential pool. The court also found that "if religious convictions, along with other personal  
18 considerations, impelled [the taxpayers] to build the pool, this choice is a personal one rather than a  
19 medical one." (*Id.*) The court further found that the principal reason the taxpayers built the pool was  
20 for personal convenience and satisfaction of the family rather than the daughter's scoliosis, as evident  
21 from the fact that family members and guests used the pool and it was equipped with a diving board,  
22 and other recreational equipment was available. (*Id.*)

23 In contrast, in *Cherry v. Commissioner, supra*, T.C. Memo. 1983-470, the court held  
24 that the costs of operating and maintaining a residential pool were valid medical expense deductions.  
25 The taxpayers installed the pool to treat the husband's severe emphysema and bronchitis at the  
26 recommendation of the husband's doctor. The court found that the primary purpose in maintaining the  
27 pool was to provide the husband with medical care for the following reasons: 1) the taxpayers did not  
28 have a pool prior to the husband's diagnosis of lung problems; 2) the taxpayers investigated other less

1 expensive forms of exercise prior to buying a pool; 3) the husband investigated the possibility of  
2 community swimming pools before investing in a residential pool; 4) the husband used the pool at  
3 least two times every day, all year long; 5) the taxpayers bought a new house and incurred the  
4 additional expense of installing an indoor pool, rather than a purely recreational pool; and 6) the other  
5 family members only used the pool occasionally. The court also found that the lack of additional  
6 equipment was irrelevant here because the husband only needed a swimmable pool to treat his medical  
7 condition. (*Id.*)

8           As a general rule, if there is sufficient evidence indicating the taxpayer incurred a  
9 deductible expense, but the precise amount of the deduction to which he or she is otherwise entitled  
10 could not be determined, a court or other finder of fact may make an approximation of the amount of  
11 the deduction, bearing heavily against the taxpayer whose inexactitude is of his or her own making.  
12 (See *Cohan v. Commissioner, supra*, 39 F.2d at pp. 543-544; *Vanicek v. Commissioner*, 85 T.C. 731,  
13 742-743 (1985); *Sanford v. Commissioner*, 50 T.C. 823, 827-828 (1968), *affd. per curiam* 412 F.2d  
14 201 (2d Cir. 1969); sec. 1.274-5T(a), Temporary Income Tax Regs., 50 Fed. Reg. 46014 (Nov. 6,  
15 1985).) This is known as the *Cohan* rule. In order to estimate the amount of an expense, however,  
16 there must be some basis upon which an estimate may be made. (*Vanicek v. Commissioner, supra*, 85  
17 T.C. at 742-743; *Cherry v. Commissioner, supra*, T.C. Memo. 1983-470.) Without such a basis, any  
18 allowance would amount to unguided largesse. (*Williams v. United States* (5th Cir. 1957) 245 F.2d  
19 559, 560-561.) When taxpayers fail to provide any proper substantiation to support their claimed  
20 deduction for medical expenses, no estimate of any amounts of the claimed deduction can be made  
21 under the *Cohan* rule. (See *Green v. Commissioner, supra*, T.C. Memo 2010-109. But see  
22 *Nwachukwu v. Commissioner*, T.C. Memo. 2000-27 (*Cohan* rule was applied to estimate medical  
23 expenses, though taxpayer provided no documentation other than a computer printout.)

24           The Board discussed the *Cohan* rule in the *Appeal of Henrietta Swimmer, Executrix, et.*  
25 *al.* (63-SBE-138), decided on December 10, 1963, stating: "[T]he *Cohan* rule merely permitted the  
26 deduction of a reasonable portion of substantiated expenses." In the *Appeal of California Steel*  
27 *Industries, Inc.* (2003-SBE-001-A), an opinion on a petition for rehearing decided on July 9, 2003, the  
28 Board further stated, "Our prior discussion of the *Cohan* Rule indicates our reluctance to disturb

1 respondent's determinations involving unsubstantiated amounts without independent facts on which to  
2 base a different finding."

3           In *Cherry v. Commissioner, supra*, T.C. Memo. 1983-470, the court applied the *Cohan*  
4 rule to determine the amount of the deduction to which the taxpayers were entitled for the heating of  
5 the indoor pool and pool room when the taxpayers were unable to substantiate the precise amount of  
6 fuel used for the indoor pool and pool room as opposed to the rest of the house. The court allocated  
7 the total fuel expenditure between the indoor pool and pool room and the rest of the house on a square-  
8 footage basis; the total house area was 6,200 square feet and the indoor pool and pool room occupied  
9 2,200 square feet. The court concluded that the taxpayers were thus entitled to a heating oil deduction  
10 of \$1,024.65 based on the \$2,887.65 the taxpayers spent for heating oil for the entire house (calculated  
11 as \$2,887.65 times 2,200 divided by 6,200).

12           It is well established that deductions from gross income are a matter of legislative  
13 grace, respondent's denials of deductions are presumed correct, and the burden is on appellants to  
14 show by competent evidence that they are entitled to deductions claimed. (*Appeal of Gilbert W.*  
15 *Janke*, 80-SBE-059, May 21, 1980; *Appeal of James C. and Monablanche A. Walshe*, 75-SBE-073,  
16 Oct. 20, 1975; *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435.) In order to carry their burden  
17 of proof, appellants must point to an applicable statute and show by credible evidence that the  
18 deductions they claim come within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.)  
19 Appellants' burden of proof is not overcome by unsupported allegations. (*Appeal of Gilbert W. Janke*,  
20 *supra*.)

## 21 STAFF COMMENTS

### 22 Real Estate Taxes Deduction

23           As discussed above, respondent concedes that appellants are entitled to all of their  
24 claimed real estate taxes deduction in the amount of \$6,648.33. On appeal, respondent is allowing  
25 appellants an additional \$457.33 of real estate taxes deduction in addition to the \$6,191.00 amount  
26 allowed on the NOA. Accordingly, there is no longer any dispute regarding the real estate taxes  
27 deduction issue.

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1                   Medical Expenses Deduction

2                   IRS Determination

3                   Respondent based its proposed assessment on information showing, among other  
4 things, that the IRS disallowed all of appellants' 2005 claimed medical expenses deduction of \$62,840,  
5 which consists of \$71,889 of reported medical expenses less \$9,050, which is 7.5 percent of their  
6 federal AGI. Appellants have not provided any evidence that the federal disallowance of all of  
7 appellants' claimed deduction of medical expenses was reduced. The parties should be prepared to  
8 discuss whether the IRS cancelled or reduced its assessment and whether the federal determination  
9 became final. Appellants may wish to discuss whether they protested the federal disallowance of the  
10 claimed medical expenses deduction of \$62,840 and the outcome of any such protest.

11                   Deductibility of Spa Expenses

12                   The parties should first discuss at the hearing whether the spa is a deductible medical  
13 expense under the case law. As discussed above, the courts have found that more is required than  
14 merely a prescription from a physician to show that the expenditure was for the primary purpose of  
15 medical care. Staff notes that courts considered in this regard whether the capital expenditure is used  
16 for any purpose other than medical care, and whether the medical care was for a limited period of time  
17 during which there were less costly means of obtaining the medical care.

18                   With respect to Mrs. Lee's alleged medical need for a home spa, appellants should be  
19 prepared to explain whether there is any prescription or other written recommendation by a physician  
20 dated *after* her purported December 2004 neck surgery. It appears that the physician's letter dated  
21 June 2, 2009, which is well after the year at issue, was written in direct response to respondent's audit  
22 of this issue. Staff notes that the physician's June 2, 2009 letter does not mention any neck surgery. It  
23 appears that the June 2, 2009 letter from the physician does not provide an independent assessment of  
24 Mrs. Lee's condition or medical need for a home spa.

25                   Appellants should be prepared to discuss their contention that the cost of travel and  
26 membership to a gym that had a spa would exceed the large amount of money appellants purportedly  
27 expended for the construction of the home spa with or without including the cost of the pool  
28 construction. Appellants may wish to be prepared to discuss whether others, such as Mr. Lee,

1 appellants' three children, or guests, used the home spa. Appellants may wish to discuss the distance  
2 from their home to facilities with spas. Appellants may want to discuss whether Mrs. Lee underwent  
3 physical therapy at locations other than her residence following her neck surgery, the frequency and  
4 dates when she went to any such physical therapy, and how she traveled to such physical therapy sites.  
5 Appellants may wish to discuss when, if ever, Mrs. Lee was able to drive following her neck surgery,  
6 and whether Mr. Lee drove Mrs. Lee to any physical therapy session before or after her neck surgery.  
7 According to appellants, Mr. Lee was laid off from his job of eight years in December 2008 but was  
8 able to find other employment.<sup>8</sup>

9 Amount of Spa Expenses (If Deductible)

10 If the Board determines that the spa expenses were deductible, it should then determine  
11 whether appellants have established the amount of any such deduction or a basis for estimating such  
12 amount based on the evidence in the record. Appellants would not be entitled to deduct any claimed  
13 medical expenses to the extent that the aggregate amount does not exceed \$9,050, which is 7.5 percent  
14 of appellants' federal AGI for tax year 2005. (Int. Rev. Code, § 213(a).) Appellants attached to their  
15 Appeal Letter a written itemization of medical bills totaling \$24,152.09 consisting of miscellaneous  
16 medical expenses totaling \$2,152.09 plus the Healthcare Recoveries item of \$22,000.00. (Appeal  
17 Letter, Attachment.) On their federal Schedule A, appellants apparently are attributing the remaining  
18 \$47,736.91 of the \$71,889.00 of reported medical costs (\$71,889.00 - \$24,152.09) to the portion of the  
19 project costs they attribute to the cost of the home spa construction alone. At the hearing, appellants  
20 should be prepared to further explain the cost of the entire project (both the spa and the pool), how the  
21 evidence in the record supports this cost, and how appellants determined that \$40,000 of the costs  
22 were attributable to the spa.<sup>9</sup> Appellants should also be prepared to explain whether they provided  
23 similar evidence and explanation to the IRS prior to its determination. Staff notes appellants hold their  
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26 <sup>8</sup> According to the State Bar of California records dated August 17, 2010, Donald Ray Lee is a California licensed attorney  
on active status and employed at the Riverside law firm, Gilbert Kelley Crowley & Jennett LLP.

27 <sup>9</sup> Staff notes that if appellants attributed 40 percent of the entire project cost to the cost of constructing the home spa and 60  
28 percent of the entire project cost to the cost of constructing the pool, then it appears the entire project would have cost a total  
of \$119,342.27 (\$47,736.91 ÷ 0.40) (i.e., \$47,736.91 is 40 percent of \$119,342.27) and \$71,605.36 of the cost would be  
attributable to the cost of constructing the pool (\$119,342.27 - \$47,736.91).

1 tax professional responsible for determining the percentage of the project cost that should be reported  
2 on the Schedule A as a portion of the reported medical expenses of \$71,889. (*Id.* at p. 1.) Appellants  
3 should be prepared to explain how their tax professional made this determination and what  
4 information they provided to the tax professional in this regard.

5 Appellants may want to produce copies of the several bids for the project they  
6 purportedly received, as well as a copy of the contract, which might indicate the lowest bid for the  
7 project was \$55,000 or the home spa would have cost approximately 75 percent of the total amount  
8 appellants paid for the project had they not included the pool. Based on a review of the invoices and  
9 receipts appellants submitted with the Appeal Letter, it appears that appellants were operating as  
10 owners/builders for purposes of the project. In fact, appellants submitted two unconditional waiver  
11 and release upon final payment forms from Prestige Gunite of Cal., Inc dated July 11, 2005, and  
12 Alonzo Custom Pools dated July 30, 2005, both of which refer to appellants as the "Owner Builder."  
13 (*Id.*, Attachments.) Appellants should be prepared to explain the construction process and provide any  
14 available supporting evidence.

#### 15 Whether Spa Expenses Increased Property Value

16 Appellants have not produced independent evidence supporting their argument that the  
17 value of their residence did not increase due to the construction of a home spa and pool on their  
18 property. In *Worden, supra*, the court explained that even if taxpayers can show that the project in that  
19 case (a pool) "was built for the primary purpose of medical care, it appears they still fail to carry their  
20 burden of proving that the amount sought to be deducted represents only that amount by which the  
21 expenditure exceeded the increase in the value of" appellants' residence. (*Worden v. Commissioner,*  
22 *supra*, T.C. Memo 1981-366 (citing Treas. Reg., § 1.213-1(e)(1)(iii)).) The court stated, "Absent this  
23 necessary proof, they cannot prevail." (*Ibid.*) Accordingly, appellants should be prepared to provide  
24 evidence regarding, and the parties should be prepared to discuss, whether any otherwise deductible  
25 expenses for the spa exceed the amount (if any) by which the expenses increased the value of the  
26 property.

#### 27 Miscellaneous Medical Expenses

28 On appeal, appellants submitted copies of cancelled checks they wrote to medical

1 providers and suppliers in support of their reported \$24,152.09 of incurred miscellaneous medical  
2 expenses. (Appeal Letter, Attachments.) Staff notes that the copies of the checks attached to the  
3 Appeal Letter only substantiate \$1,884.48 of the \$24,152.09 of medical expenses listed on the written  
4 itemization.<sup>10</sup> Moreover, there is no independent documentation that would show the date when  
5 appellants' attorney purportedly paid Healthcare Recoveries on their behalf the sum of \$22,000 for  
6 unreimbursed medical expenses with a check from his clients' trust account. Appellants did not  
7 submit a copy of a cancelled check payable to Healthcare Recoveries in the amount of \$22,000. Staff  
8 notes that the submitted copy of the email apparently sent to Mr. Lee from David Wilzig referring to  
9 the \$22,000 paid on appellants' behalf to Healthcare Recoveries is dated June 24, 2008, which is well  
10 past the 2005 tax year. It appears based on the *redacted* copy of a letter dated August 30, 2005, from  
11 Mr. Wilzig to appellants, which states in part, "Healthcare Recoveries is owed \$22,000.00," that, as of  
12 August 30, 2005, appellants had not yet paid \$22,000 of medical expenses payable to Healthcare  
13 Recoveries. At or prior to the hearing, appellants should be prepared to provide any additional  
14 evidence, such as a cancelled check, indicating that they paid \$22,000 of medical expenses to  
15 Healthcare Recoveries during tax year 2005. Assuming appellants submitted cancelled checks or  
16 other documentary evidence for the \$2,152.09 of miscellaneous medical expenses but failed to submit  
17 evidence showing they paid \$22,000.00 to Healthcare Recoveries during the 2005 tax year, they would  
18 not be entitled to deduct any of the medical expenses unless they were also able to establish they are  
19 entitled to deduct construction costs for the home spa for an amount in excess of \$6,897.91 (\$9,050.00  
20 less \$2,152.09). (Int. Rev. Code, § 213(a).)

#### 21 Submission of Additional Evidence

22 Pursuant to California Code of Regulations, title 18, section 5523.6, if appellants are  
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24 <sup>10</sup> In addition to the \$22,000 item to Healthcare Recoveries, appellants do not have copies of checks for the following items  
25 listed: \$71.41 to Target, \$11.02, \$10.00, \$11.31, and \$10.00 to Spencers, \$53.00 to Unilab, \$13.22 and \$33.88 to Rite Aid,  
26 and \$53.77 to Valley Radiology. Appellants also attached copies of two checks numbered 2613 and 2614 for medical  
27 expenses for \$100 each, which are dated January 30, 2006, and January 28, 2006, respectively; these two items are not  
28 included in the itemization. It appears that appellants would not be entitled to deduct any medical expenses for tax year  
2005 that was not paid for until tax year 2006. (Treas. Reg. § 1.213-1(a)(1).) Appellants inexplicably submitted a copy of  
an estimate dated December 23, 2005, from an automobile paint and body shop for repair work for \$1,124.92 on a 1966 El  
Camino automobile. (Appeal Letter, Attachment.)

1 able to locate any additional evidence supporting their appeal, it should be submitted if possible to the  
2 Board and respondent at least 14 days prior to the hearing date. <sup>11</sup>

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28 <sup>11</sup> Exhibits should be submitted to: Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879  
MIC: 80, Sacramento, CA 94279-0080