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7 **BOARD OF EQUALIZATION**
 8 **STATE OF CALIFORNIA**

9
 10 In the Matter of the Appeal of:) **HEARING SUMMARY**
 11) **PERSONAL INCOME TAX APPEAL**
 12 **RANDOLPH C. READ**¹) Case No. 354399

Year	Proposed Assessment ²	Tax ³	Penalties ⁴
2000	\$360,210.00	\$ 32,227.00	\$90,052.50
2001	\$ 8,056.75		

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 17 Representing the Parties:

18 For Appellant: Michael C. Cohen, Esq.
 19 For Franchise Tax Board: John Penfield, Tax Counsel IV

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22
 23 ¹ Appellant resided in Los Angeles County, California, during the years at issue. Appellant apparently now resides in the
 24 State of Illinois.

25 ² Respondent should be prepared to provide the accrued interest amounts at the time of the oral hearing.

26 ³ As discussed below, respondent now concedes the first audit item in full. Accordingly, respondent should be prepared to
 27 provide the amount of tax allegedly still due at the time of the oral hearing.

28 ⁴ This amount is comprised of a \$90,052.50 notice and demand penalty for the 2000 tax year and an \$8,056.75 notice and
 demand penalty for the 2001 tax year. As discussed below, respondent now concedes the first audit item in full.
 Accordingly, respondent should be prepared to provide the amount of penalties allegedly still due at the time of the oral
 hearing.

Appeal of Randolph C. Read

NOT TO BE CITED AS PRECEDENT - Document prepared for Board
 review. It does not represent the Board's decision or opinion.

- 1 QUESTIONS: (1) Whether appellant has demonstrated that he is entitled to the claimed alimony
2 deductions of \$143,840 and \$286,084 for the 2000 and 2001 tax years,
3 respectively.
- 4 (2) Whether appellant has demonstrated that he is entitled to the claimed business
5 expense deductions of \$167,369 and \$371,600 for the 2000 and 2001 tax years,
6 respectively.
- 7 (3) Whether appellant is entitled to relief from the notice and demand penalties for
8 the 2000 and 2001 tax years, respectively.

9 HEARING SUMMARY

10 Background

11 Appellant is a Certified Public Accountant and holds an MBA from the Wharton
12 Graduate School of the University of Pennsylvania. The Franchise Tax Board (FTB or respondent)
13 audited appellant's 2000 and 2001 California resident tax returns, focusing on three audit items. The
14 first audit item relates to appellant's claim for the 2000 tax year that he is entitled to exclude
15 \$1,058,458.85 in compensation reported on a Form W-2 from his former employer, Stone Corporation,
16 and that he is entitled to exclude \$2,395,878.70 in receipts reported on a Form 1099B. The second audit
17 item involved appellant's claimed alimony deductions of \$143,840 and \$286,084 for the 2000 and 2001
18 tax years, respectively. The third audit item involved appellant's claimed Schedule C business expense
19 deductions for the activity of a sole proprietorship, "Read & Company," in the amounts of \$167,369 and
20 \$371,600 for the 2000 and 2001 tax years, respectively.

21 During the audit stage of the proceedings, respondent issued numerous specific requests
22 for information in relation to the three audit items listed above. Specifically, in Exhibit A of its Reply
23 Brief, respondent lists the following Correspondence of Events:

24

<u>Date</u>	<u>Correspondence of Events</u>
02/03/04	Initial Contact Letter sent
02/19/04	Initial Contact Letter Follow Up sent
03/08/04	Initial Contact Letter Follow Up #2 sent via Certified Mail.

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1		Return receipt was received by the FTB on 03/12/04.
2	03/08/04	Information Document Request #1 sent via Certified Mail. Return receipt was received by the FTB on 03/12/04.
3		
4	03/30/04	Received taxpayer's letter dated March 22, 2004. Taxpayer indicated he is in process of gathering information pursuant to Information Document Request #1. The taxpayer's letter indicated his address is . . . [address redacted pursuant to Board policy of not publishing addresses].
5		
6		
7	03/30/04	Information Document Request #2 sent via Certified Mail. Return receipt was received by the FTB on 04/03/04.
8		
9	04/14/04	Information Document Request #1 & #2 Follow Up sent via Certified Mail. United State (sic) Post Office website confirmed the letter was delivered on 04/15/04.
10		
11	05/03/04	Information Document Request #1 & #2 Follow Up #2 sent via Certified Mail. United States Post Office website confirmed the letter was delivered on 05/04/04.
12		
13	05/19/04	Called taxpayer and left voice message regarding examination.
14		
15	05/25/04	Taxpayer called and left voice message indicating he received voice message and that he knows he needs to provide documentation and will get to it.
16		
17	06/03/04	Information Document Request #1 & #2 Follow Up letter that was sent on 04/14/04 is returned to the FTB by the United States Post Office because the letter was unclaimed.
18		
19	06/11/04	FTB received information that the holder of PO Box [address redacted pursuant to Board policy of not publishing addresses] is Randolph Read and the holder's address is [address redacted pursuant to Board policy of not publishing addresses].
20		
21	06/14/04	Demand Letter Follow up sent via Certified Mail to PO Box 49-455. United States Post Office website confirmed the letter was delivered on 06/15/04. A copy of Demand Letter is also sent via Certified Mail to [address redacted pursuant to Board policy of not publishing addresses].
22		
23		
24	06/22/04	The copy of the Demand Letter Follow Up letter sent to [address redacted pursuant to Board policy of not publishing addresses] is returned to the FTB by the United States Post Office because it was undelivered to the address.
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27
28 Next, in Exhibit A of its Reply Brief, respondent asserts that the following items were requested (but never provided by appellant) during the audit:

1 of 2000, he did not actually become a California resident until February 21, 2000; thus, appellant argued
2 that the income, even if attributable to appellant, was not subject to taxation in California. In relation to
3 the second and third audit items, appellant continued to challenge respondent's denial of his alimony
4 deductions and his business expense deductions.

5 Even though appellant timely protested the NPAs, respondent asserts that appellant failed
6 to provide any documents during the protest stage of the proceedings to support his arguments in
7 relation to the three audit items.⁵ On March 13, 2006, respondent issued Notices of Action (NOAs)
8 sustaining the NPAs. Appellant then filed this timely appeal.

9 Contentions

10 First Audit Item – W-2 and 1099B Income

11 On appeal, appellant provided sufficient documents to substantiate his claims in relation
12 to the first audit item (i.e., W-2 and 1099B income); thus, respondent now concedes the first audit item
13 in full. Specifically, respondent concedes that for the 2000 tax year appellant is entitled to exclude the
14 \$1,058,458.85 in compensation reported on a Form W-2 and \$2,395,878.70 in receipts reported on a
15 Form 1099B. Accordingly, since the first audit item has been conceded by respondent, we will not
16 analyze it further; however, we note that respondent should be prepared to provide the amount of tax,
17 interest, and penalties allegedly still due at the time of the oral hearing, given the fact that the first audit
18 item has been conceded.

19 Second Audit Item – Alimony Deductions

20 In relation to the second audit item (i.e., appellant's claimed alimony deductions for 2000
21 and 2001), appellant supplied copies of four documents in his opening brief, and appellant contends that
22 he made the alleged alimony payments to his wife pursuant to the terms of these four documents. The
23 first document is a one-sentence agreement dated August 24, 2000, which is signed by both appellant
24 and his wife, and which provides that appellant and his wife are "separated" "though . . . living under the
25 same roof." The agreement, however, does not make reference to any alimony or spousal support
26 payments. The agreement provides as follows:

27 _____

28 ⁵ During the oral hearing before the Board, appellant should be prepared to explain whether he responded to any of
respondent's information requests and in what manner he made his responses.

1 We, Lindsey D. Read and Randolph C. Read, hereby agree that even though we are
2 living under the same roof, we have separated consistent with the mandates of
California Family Code Section 717(a).

3 The additional three documents that appellant supplied in support of his claimed alimony
4 deductions are (1) an unsigned and unstamped “temporary support order” dated March 23, 2001, (2) the
5 judge’s⁶ notes in relation to the temporary support order, and (3) a tentative agreement dated June 1,
6 2001 (allegedly modifying the “temporary support order”). In summary, appellant contends that he
7 made alimony payments pursuant to the terms of the four documents listed above and, therefore, the
8 claimed alimony payments for 2000 and 2001 should be allowed.

9 Respondent makes the following arguments: respondent first notes that appellant’s only
10 support for his claimed alimony deduction for the 2000 taxable year is the one sentence agreement dated
11 August 24, 2000, which provides that he and his wife are “separated” “though . . . living under the same
12 roof.” Respondent states that this agreement does not require, nor does it make any reference to, any
13 alimony or spousal support payments, and thus, respondent argues that the agreement utterly fails to
14 meet the legal requirements to support an alimony deduction. Furthermore, respondent notes that the
15 agreement states that appellant and his wife are “living under the same roof,” and respondent argues that
16 because appellant and his wife resided in the same house, appellant is disqualified from taking a
17 deduction for any payment made as alimony, or in lieu thereof.

18 Next, respondent notes that appellant made the following statement in his Opening Brief:

19 Between August 24, 2000, and March 23, 2001, taxpayer and Lindsey entered into
20 various agreements for her support. The support provided to Lindsey included
21 transfers of cash, checks issued to Lindsey, expenses paid on Lindsey’s behalf and
22 allowing Lindsey to continue living in the Pacific Palisades home, effectively
23 providing her one-half of the rental value of the house. . . . Taxpayer hasn’t been able
24 to locate the records used in computing the alimony deduction reported on the return,
but his best recollection (which he will testify to at the hearing) is that, based on
information available at the time, he computed the rental value of the house, which
had been purchased in January 2000 for \$3.8 million, to be \$30,735 per month, with
Lindsey’s share being \$15,367.50.) The remaining amount of the alimony deduction
was attributable to actual payments to Lindsey or on her behalf.

25 In relation to the above statement, respondent notes that appellant never provided copies of the alleged
26 “various agreements” mentioned above, and respondent asserts that oral agreements are not legally
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⁶ The Honorable Jill S. Robbins, Commissioner (Retired).

1 sufficient to support the claimed alimony deductions. Respondent also states that the only specific item
2 referred to by appellant in the statement above is an alleged rental payment to his wife for \$15,367.50
3 per month; however, respondent argues that appellant is not entitled to deduct a “rental” payment for a
4 property in which he has an ownership interest.

5 Next, respondent notes that appellant never provided any receipts or cancelled checks in
6 relation to any of the alleged alimony payments. In addition, respondent argues that appellant is not
7 entitled to deductions for the alleged alimony payments because appellant had two minor children in
8 2000-2001, and there is no evidence or accounting for the likely possibility that a significant portion of
9 any payments were non-deductible child support.

10 Respondent also notes that appellant’s former spouse filed separately as a California
11 resident for the entire 2000 tax year, but she did not report any income from the alleged alimony
12 payments in 2000, nor did she report any income in 2001; thus, respondent argues that her failure to
13 report any income is consistent with the absence of actual payment.

14 Next, respondent notes that in appellant’s Opening Brief appellant described the terms of
15 the “temporary support order” and the tentative agreement dated June 1, 2001 (allegedly modifying the
16 “temporary support order”) as follows:

17 On March 23, 2001, the prior agreements were replaced with a court order [i.e. the
18 temporary support order]. (Taxpayer cannot locate a signed copy of the order, but an
19 unsigned copy along with the judge’s “notes” of the order are attached.) Spousal
20 support under the order was \$11,000 per month. On June 1, 2001, taxpayer and
Lindsey entered into a modification of the order under which taxpayer was obligated
to pay monthly family support of \$13,500 (copy attached).

21 Respondent states that the “temporary support order” is unsigned and unstamped; thus,
22 respondent argues that the “temporary support order” is not significant evidence of an actual court order.
23 Respondent also argues that even if the problems with the legal sufficiency of the unsigned and
24 unstamped “temporary support order” are overcome, the terms of the “temporary support order” are
25 vague and confusing, and are not legally sufficient to support deductions of \$11,000 per month in
26 alimony payments. Specifically, respondent notes that as an element of spousal support, the temporary
27 support order includes “\$3,000 per month as unallocated housing expense” and that the Judge’s notes
28 apparently refer to this item as a “3000 contribution to rent”; however, respondent asserts that appellant

1 may not deduct as spousal support, rental or mortgage payments for property in which he has an
2 ownership interest.

3 Respondent contends that another problem with the sufficiency of the “temporary support
4 order” is that it commingles items and confuses the categories of spousal support as opposed to child
5 support. For example, respondent notes that the portion of the “temporary support order” that provides
6 for “\$1,000 per month for expenses of the children” is listed under the category of “spousal support” and
7 another category of expenses is listed as “Child/Spousal Support”; thus, respondent argues that spousal
8 support has been commingled with non-deductible child support. Respondent also argues that the
9 “temporary support order” requires that the “Child/Spousal Support” category of expenses be monitored
10 and “adjusted on a monthly basis”; however, respondent notes that appellant has not provided any record
11 of these alleged expenses, which were subject to adjustment on a monthly basis.

12 In addition, respondent notes that the “temporary support order” refers to the “family
13 home,” and respondent again argues that spousal support/alimony payments are not deductible when a
14 “separated” couple still resides under the same roof.

15 In addition, respondent notes that even assuming for the sake of argument that appellant
16 had a legal obligation to pay \$11,000 per month in “spousal support,” the spousal support payments
17 would total only \$99,000 for the months subsequent to the “temporary support order,” far less than the
18 \$286,084 claimed as an alimony deduction in 2001. Furthermore, respondent notes that appellant has
19 not provided any proof of actual payments, or any evidence necessary to allocate such alleged payments
20 between deductible and non-deductible items.

21 Next, respondent argues that the tentative agreement dated June 1, 2001, which allegedly
22 modifies the “temporary support order,” is deficient as both a legally enforceable document and as
23 evidence of actual deductible alimony because, by its terms, it is only a “tentative agreement in
24 principal” and is “[s]ubject to documentation and execution of a definitive agreement and appropriate
25 court orders to that effect . . .” However, respondent notes that no “definitive agreement” or subsequent
26 “court orders” have been provided to respondent, and therefore, respondent asserts that appellant has
27 failed to show that he was under an enforceable, legal obligation to pay spousal support.

28 Accordingly, for the reasons set forth above, respondent argues that appellant has failed

1 to prove that he is entitled to any portion of the claimed alimony deductions for 2000 and 2001.

2 In reply, appellant makes the following arguments: First, appellant asserts that he and his
3 wife entered into a written separation agreement on August 24, 2000, and while it is true that the written
4 separation agreement does not specifically state any requirement for any alimony payments, the
5 practicality was that, because appellant's wife did not have the financial ability to support herself,
6 appellant was required to make alimony payments to his wife. In that sense, appellant argues that any
7 payments appellant made from August 24, 2000 through March 23, 2001, were made "under" the
8 written separation agreement and, therefore, qualify as alimony payments.

9 Second, appellant contends that respondent's assertion that appellant's alimony
10 deductions are barred simply because appellant and his wife continued to live in the same house while
11 the divorce proceedings was pending is erroneous. Appellant cites to Treasury Regulation 1.71-1T(b)
12 for the proposition that if parties are not divorced or legally separated under a decree of divorce or
13 separate maintenance, payments made pursuant to a written separation agreement (or a decree other than
14 a decree of divorce or separate maintenance) may qualify as alimony, even if the parties reside under the
15 same roof when the payments are made.

16 Third, appellant states that the temporary support order and the subsequent modification
17 call for the payment of spousal support, and therefore, appellant argues that it is irrelevant if the judge's
18 notes compute the spousal support amount by reference to a "contribution to rent," because all that
19 matters is that the temporary support order (and the modification thereto) require the payment of spousal
20 support.

21 Fourth, appellant asserts that he paid all support payments required under the written
22 separation agreement dated August 24, 2000, and the later court order(s); and as proof of payment,
23 appellant asserts that notwithstanding an extraordinary number of motions filed by his wife in the
24 divorce proceedings (allegedly more than 200), his wife did not file a single motion alleging that the
25 support payments for 2000 and 2001 were not made in a timely manner. Thus, appellant asserts that the
26 fact his wife never brought a motion for nonpayment of support is proof that he made all of the required
27 support payments.

28 Finally, appellant contends that just because his former spouse did not include any

1 alimony in her income tax returns for 2000 and 2001 should not have any bearing in this case.
2 Appellant asserts that if appellant and his former spouse took inconsistent positions with respect to
3 alimony, respondent had ample time to protect its interests by issuing protective NPAs to the former
4 spouse for the income that she failed to report.

5 Third Audit Item – Business Expense Deductions for Read & Company

6 Appellant states that as a result of the divorce proceedings, his records relating to his
7 Schedule C business expense deductions for Read & Company in 2000 and 2001 can no longer be
8 located. However, appellant asserts that he will testify concerning those deductions at the oral hearing
9 “so that an appropriate allowance can be made under the *Cohan* rule.”⁷

10 Respondent indicates that appellant never provided any documents supporting his
11 claimed Schedule C business deductions for the activity of his sole proprietorship, “Read & Company,”
12 in the amounts of \$167,369 and \$371,600 for the 2000 and 2001 tax years, respectively. Thus,
13 respondent asserts that appellant has not proven that he is entitled to the alleged business deductions.

14 Notice and Demand Penalties

15 Appellant asserts that he was preoccupied with his divorce proceeding and, accordingly,
16 had reasonable cause for any failure to produce documents or other information that respondent may
17 have requested during the course of the administrative proceedings in this case. Appellant also asserts
18 that respondent has not set forth with any particularity the records that taxpayer failed to produce, and
19 therefore, it is difficult for appellant to defend against the penalties by showing specific reasons why
20 particular documents may not have been produced.

21 Respondent asserts that appellant did not provide any information or supporting
22 documents as requested pursuant to two document requests, multiple follow-up letters, and a formal
23 demand letter. Thus, respondent argues that the notice and demand penalties were properly imposed for
24 the 2000 and 2001 tax years. Furthermore, respondent asserts that appellant failed to provide
25 information throughout the protest period. Finally, respondent asserts that appellant has failed to offer
26 any evidence showing that his failure to respond was due to reasonable cause and not due to willful
27

28 ⁷ Staff presumes that appellant is referring to *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540; if this is not so, appellant should so clarify at the oral hearing.

1 neglect. Thus, respondent contends that the notice and demand penalties were properly imposed for the
2 2000 and 2001 tax years.

3 Applicable Law

4 Second Audit Item – Alimony Deductions

5 Alimony payments are deductible by an individual under Internal Revenue Code (IRC)
6 section 215 if they are taxable to the recipient spouse under the provisions of IRC section 71.⁸ Thus,
7 whether appellant’s payments qualify for deduction hinges on their meeting the definition of “alimony”
8 contained in IRC section 71(b)(1).

9 IRC section 71(b)(1) defines the term “alimony or separate maintenance payment” as
10 follows:

11 In general—The term ‘alimony or separate maintenance payment’ means any
12 payment in cash if—

13 (A) such payment is received by (or on behalf of) a spouse under a divorce or
14 separation instrument,

15 (B) the divorce or separation instrument does not designate such payment as a
16 payment which is not includible in gross income under this section and not
17 allowable as a deduction under section 215,

18 (C) in the case of an individual legally separated from his spouse under a decree of
19 divorce or of separate maintenance, the payee spouse and the payor spouse are not
20 members of the same household at the time such payment is made, and

21 (D) there is no liability to make any such payment for any period after the death of the
22 payee spouse and there is no liability to make any payment (in cash or property)
23 as a substitute for such payments after the death of the payee spouse.

24 Thus, a payment may be “alimony” if it is a cash payment “under a divorce or separation
25 instrument.” (Int.Rev. Code § 71(b)(1)(A).) A divorce or separation instrument can be any of three
26 types: (1) a decree of divorce or separate maintenance; (2) a written separation agreement; or (3) a
27 decree requiring payments for support or maintenance, other than a decree of divorce or separate
28 maintenance. (See Int.Rev. Code § 71(b)(2).)

Generally, a payment made at the time when the payor and payee spouses are members of
the same household cannot qualify as an alimony or separate maintenance payment if the spouses are
legally separated under a decree of divorce or of separate maintenance. (Treas. Reg. § 1.71-1T(b), Q
&A-9.) However, if the spouses are not legally separated under a decree of divorce or separate

⁸ California conforms to IRC sections 215 and 71 at California Revenue and Taxation Code sections 17201 and 17081.

1 maintenance, a payment under a written separation agreement (or a decree other than a decree of divorce
2 or separate maintenance) may qualify as an alimony or separate maintenance payment notwithstanding
3 that the payor and payee are members of the same household at the time the payment is made. (Treas.
4 Reg. § 1.71-1T(b), Q & A-9; *Benham v. Commissioner*, T.C. Memo. 2000-165 [deduction of for alimony
5 allowed where taxpayers continued to reside in same household after executing separation agreement
6 providing for temporary support.])

7 The term “written separation agreement” is not defined by the Internal Revenue Code, the
8 legislative history, or applicable regulations. (*Benham v. Commissioner, supra; Leventhal v.*
9 *Commissioner*, T.C. Memo 2000-92.) However, in *Benham v. Commissioner, supra*, the court defined a
10 “written separation agreement” as follows:

11 [A] written separation agreement is a clear, written statement of the terms of support
12 for separated parties. See *Bogard v. Commissioner*, 59 T.C. 97, 101 (1972). It must
13 be a writing that constitutes an agreement. See *Grant v. Commissioner*, 84 T.C. 809,
14 823 (1985), affd. per curiam without published opinion 800 F.2d 260 (4th Cir. 1986).
15 An agreement requires mutual assent or a meeting of the minds. See *Kronish v.*
16 *Commissioner*, 90 T.C. 684, 693 (1988). But a written [separation] agreement does
17 not have to be legally enforceable. See *Richardson v. Commissioner*, T.C. Memo
18 1995-554, affd. 125 F.3d 551, 554 (7th Cir. 1997). It is sufficient that it was entered
19 “in contemplation of a separation status” and includes a statement of the terms of
20 support.

21 Revenue Ruling 73-409, 1973-2 C.B. states that a written separation agreement “must contain a definite
22 statement as to the amount of the wife’s support.”

23 Support payments made pursuant to an oral agreement and not pursuant to a written
24 separation agreement or judicial decree are not deductible as alimony. (*Jachym v. Commissioner*, T.C.
25 Memo. 1984-181.) In addition, payments that the terms of the decree, instrument, or agreement fix as
26 support for the payor’s children are not alimony but, rather, are non-deductible child support. (Int.Rev.
27 Code § 71(b); Treas. Reg. 1.71-1T; *Commissioner v. Lester* (1961) 366 U.S. 299.) Generally, if a
28 divorce decree or separation instrument provides for “family support” payments, and no amounts are
fixed as child support, then the “family support” payments are includable in the recipient’s income as
alimony and are deductible to the payor spouse. (*Neu-Kramer v. Commissioner*, T.C. Memo. 1986-
412.) However, any payments to maintain property owned by the payor spouse and used by the payee
spouse (including mortgage payments) are not alimony even if those payments are made pursuant to the

1 terms of the divorce or separation instrument. (*H.W. Tseng v. Commissioner*, T.C. Memo. 1994-126.)

2 The inclusion of payments within the income of the recipient is irrelevant to the
3 determination of whether the payments were alimony because their inclusion is not mandated by law
4 prior to the divorce decree. (*James J. Klobuchar v. Commissioner*, T.C. Memo. 1981-482.)

5 The burden is on the taxpayer to show by competent evidence that he is entitled to the
6 claimed alimony deductions. (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of*
7 *Gilbert W. Janke*, 80-SBE-059, May 21, 1980; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31,
8 2001.)⁹

9 Third Audit Item – Business Expense Deductions for Read & Company

10 In general, there shall be allowed as a deduction all the ordinary and necessary expenses
11 paid or incurred during the taxable year in carrying on any trade or business. (Int.Rev. Code § 162(a).)¹⁰
12 It is well settled that income tax deductions are a matter of legislative grace, and a taxpayer who claims
13 a deduction has the burden of proving by competent evidence that the he is entitled to that deduction.
14 (See *New Colonial Ice Co. v. Helvering*, *supra*; *Appeal of Michael E. Myers*, *supra*.)

15 In *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540, the court held that George M.
16 Cohan, a famous actor and producer, could deduct certain expenses based on estimated expenses, rather
17 than having to produce detailed records of each expenditure. The holding in this case became known as
18 the “Cohan rule.” In the *Appeal of Henrietta Swimmer* (63-SBE-138), decided on December 10, 1963,
19 the Board discussed the *Cohan* case and stated that “the Cohan rule merely permitted the deduction of a
20 reasonable portion of unsubstantiated expenses.” Even though the Cohan rule is often cited by taxpayers
21 on appeal, the Board has indicated its reluctance to disturb respondent’s determinations involving
22 unsubstantiated amounts without independent facts in which to base a different finding. (*Appeal of*
23 *California Steele Industries, Inc.*, 2003-SBE-001-A, July 9, 2003; see also *Appeal of Henrietta*
24 *Swimmer*, *supra*.)

25 Notice and Demand Penalties

26
27 ⁹ Board of Equalization cases are generally available for viewing on our website (www.boe.ca.gov).

28 ¹⁰ California conforms to IRC section 162 at R&TC section 17201.

1 R&TC section 19133 provides that respondent may impose a penalty when a taxpayer
2 fails or refuses to furnish information requested by respondent in writing. The notice and demand
3 penalty is computed at 25 percent of the amount of the taxpayer's total tax liability, which is determined
4 without regard to payments. (*Appeal of Elmer R. and Barbars Malakoff*, 83-SBE-140, June 21, 1983.)
5 This penalty may be abated if the taxpayer's failure to respond is due to reasonable cause and not willful
6 neglect. (*Ibid.*) The burden is on the taxpayer to prove that reasonable cause prevented him from
7 responding to the notice and demand. (*Appeal of Kerry and Cheryl James*, 83-SBE-009, Jan. 3, 1983.)
8 To establish reasonable cause, a taxpayer must show that the failure to reply to the notice and demand or
9 request for information occurred despite the exercise of ordinary business care and prudence. (*Appeal of*
10 *Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.) A taxpayer's reason for failing to respond to the
11 notice and demand or request for information must be such that an ordinary intelligent and prudent
12 businessperson would have acted similarly under the circumstances. (*Appeal of Joseph W. and Elsie M.*
13 *Cummings*, 60-SBE-40, December 13, 1960; *Appeal of J.B. Ferguson*, 58-SBE-024, September 15,
14 1958.)

15 STAFF COMMENTS

16 Second Audit Item – Alimony Deductions

17 At the hearing, the parties should be prepared to discuss whether appellant is entitled to
18 any alimony deductions, considering the fact that appellant has not provided any receipts or cancelled
19 checks in relation to the alleged alimony payments.

20 Also, the parties should be prepared to discuss whether the one sentence agreement dated
21 August 24, 2000 qualifies as a "written separation agreement," such that payments made under the terms
22 of that agreement might qualify as alimony. As stated above, in *Benham v. Commissioner, supra*, a
23 "written separation agreement" is a "clear, written statement of the terms of support." Revenue Ruling
24 73-409, 1973-2 C.B. states that a written separation agreement "must contain a definite statement as to
25 the amount of the wife's support." Here, the agreement dated August 24, 2000, does not contain a
26 definite statement as to the amount of the wife's support; thus, appellant should be prepared to discuss
27 how the agreement dated August 24, 2000 can qualify as a written separation agreement.

28 In addition, the parties should be prepared to discuss whether the undated and unstamped

1 “temporary support order,” the Judge’s notes in relation to the “temporary support order,” and the
2 tentative agreement dated June 1, 2001 (allegedly modifying the “temporary support order”) are legally
3 enforceable documents that qualify as evidence of actual deductible alimony payments.

4 When discussing the above-listed documents, the parties should take note of the fact that
5 a payment of rent for property in which appellant has an ownership interest cannot qualify as alimony.
6 Moreover, fixed child support payments cannot qualify as alimony.

7 Third Audit Item – Business Expense Deductions for Read & Company

8 The parties should be prepared to discuss any appropriate application of the “Cohan rule” here,
9 as appellant has yet to provide any evidence that he incurred any business expenses related to his
10 Schedule C business, such that the Cohan rule should be applied. Appellant should provide his evidence
11 (if any) to the Board Proceedings Division at least 14 days prior to the oral hearing.¹¹ (Cal. Code Regs.,
12 tit. 18, § 5523.6.) When discussing the alleged business expenses, the parties should take note of the
13 fact that business expense deductions are often limited by the provisions of IRC section 274, as
14 incorporated in part by R&TC section 17201.

15 Notice and Demand Penalties

16 The parties should be prepared to discuss whether reasonable cause exists for relief from
17 the notice and demand penalties for the 2000 and 2001 tax years. Appellant should be prepared to
18 explain whether he responded to any of respondent’s information requests and in what manner he made
19 his responses.

20 As stated above, respondent now concedes the first audit item in full, and since the notice
21 and demand penalty is computed at 25 percent of the amount of the taxpayer’s total tax liability,
22 respondent should be prepared to provide the notice and demand penalty amounts allegedly still due at
23 the time of the oral hearing, taking into account that respondent has conceded the first audit item.

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¹¹ Evidence exhibits should be sent to: Mira Tonis, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879, Sacramento, California, 94279-0081.