T.C. Summary Opinion 1998-94

UNITED STATES TAX COURT

FRANCESCO AND LOU-ANN GUARNA, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 6126-96S. Filed May 11, 1998.

Francesco Guarna, pro se.

Jason M. Silver, for respondent.

NAMEROFF, Special Trial Judge: This case was heard pursuant to the provisions of section 7463.[1] The decision to be entered is not reviewable by any other court, and this opinion should not be cited as authority. Respondent determined a deficiency in petitioners' 1992 Federal income tax in the amount of $1,823 and

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the year at issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

an accuracy-related penalty under section 6662(a) in the amount of $365. References to petitioner are to Francesco Guarna.

After concessions, the issues for decision are: (1) Whether petitioner failed to report tip income; (2) whether petitioner is entitled to a deduction for meals and entertainment expenses; (3) whether certain expense deductions should be claimed on Schedule A or Schedule C; and (4) whether petitioners are liable for the accuracy-related penalty.

Some of the facts have been stipulated, and they are so found. The stipulation of facts and the attached exhibits are incorporated herein by this reference. At the time they filed their petition, petitioners resided in Sierra Madre, California. Petitioner earned income in 1992 as an actor and as a waiter.

Unreported Tip Income

Beginning in 1991, petitioner worked part-time as a waiter in a restaurant called the Georgian Room (the GR), which was located in the Ritz Carlton Hotel (Ritz Carlton) in Pasadena, California. The GR served only evening meals. Petitioner worked there until the GR closed at the end of 1992.

When he worked as a waiter, petitioner was scheduled to begin between 4:00 and 6:00 p.m. and finish between 12:00 and 2:00 a.m. He was paid $5 per hour plus tips. The GR personnel pooled all tips, which were distributed, after "tip-outs" to nonservers such as busboys, bartenders, and maitre d's, on a pro rata basis to those food servers on shift. During 1991, about 18

waiters and waitresses worked for the GR. By the time the GR closed, only 6 or 7 of them remained.

Often, petitioner was not permitted to work as a waiter in GR, even though he was scheduled to do so, because the GR had insufficient business. When this occurred, petitioner was given the option of either leaving or working in another capacity at the Ritz Carlton, such as a banquet hall waiter or as a restaurant doorman. When petitioner elected to leave, he was paid for 4 hours of work at his standard $5 per hour rate, but received no tips. As a banquet hall waiter, petitioner received $5 per hour plus tips. From time to time, petitioner was asked to "work the door" instead of waiting on tables. When he worked the door, he would greet and seat customers, acting as a maitre d. As such, petitioner did not receive a pro rata share of tips, but was tipped out like the other nonservers. Petitioner also testified that occasionally he was assigned to assist "important customers" for which he did not receive any tips. Petitioner did not describe his activities when he was assisting such customers, other than stating that he was showing them around the hotel complex.

Petitioner submitted a 1992 calender on which he wrote, allegedly contemporaneously, where he worked (i.e., the GR, banquet hall, restaurant door, or went home), the amount of hours he worked, and the daily amount of tips he received during 1992. For example, the entry for January 15, 1992, showed "wk door hr 7.5 tip 10.00" indicating that petitioner worked the door for 7.5

hours and received tips totaling $10. Similarly, the entry for January 25, 1992, showed "slow gone home wk 0 hr 4 tip 0", indicating that petitioner went home early, but was paid for 4 hours and received no tips. The calender indicates that petitioner earned tip income of $2,357.87 during 1992. Petitioner stated that he recorded the information daily, although sometimes he waited "a couple of days" to record it.

On his 1992 joint return, inter alia, petitioner reported wages, salaries, and tips from the Ritz Carlton in the amount of $8,713.74 as set forth in Box 10 of the Form W-2 issued by the Ritz-Carlton. Petitioner, however, did not report the allocated tip amount of $8,631.25 listed in Box 7. In the notice of deficiency, respondent, inter alia, determined that petitioner failed to report $11,965 of tip income.

Unreported Tip Income. Tip income is includable in gross income under section 61(a). Meneguzzo v. Commissioner, 43 T.C. 824 (1965). Taxpayers are required to maintain sufficient records to establish the exact amount of any tip income received. Sec. 6001; sec. 1.6001-1(a), Income Tax Regs. Where taxpayers fail to keep any records or fail to keep accurate records of their income, the Commissioner is authorized to reconstruct the income by any means the Secretary deems reasonable. Sec. 446; Meneguzzo v. Commissioner, supra. The Commissioner's income reconstruction need not be exact, but need only be substantially correct. Anson v. Commissioner, 328 F.2d 703, 705 (10th Cir. 1964), affg. Basset v. Commissioner, T.C. Memo. 1963-10. The

taxpayer, however, may point out areas or specific instances in which the method used by the Commissioner fails to reflect his true income. Miller v. Commissioner, 237 F.2d 830 (5th Cir. 1956), affg. in part, revg. in part and remanding T.C. Memo. 1955-112.

Petitioner asserts that, while he worked for the Ritz Carlton for a total of 1,179 hours during 1992, only 204 of those hours were in the capacity as a food server either in the GR or in the banquet hall. Of the remainder, petitioner asserts that 739 hours were spent working as a host at the restaurant door (where he earned between $5 and $15 in tips per shift), 123 hours were nontip hours assisting "important clients", and 112 hours were hours in which petitioner came to work, signed in, and left because there was insufficient business.

Respondent, on the other hand, determined that petitioner had at least $11,965 of unreported tip income. Respondent made a survey of the employees of the Ritz Carlton to determine a tip rate for the various areas of service in the hotel.[2] Apparently by dividing the amount of allocated tips on petitioner's Form W-2

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[2] Several documents were offered by respondent to support the determination--the report of the tip income project at the Ritz Carlton, a computation under the "McQuatter's formula" prepared by a revenue agent, and a Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips. Petitioner objected to the receipt of these documents, and respondent offered no testimony in their support. These documents are clearly inadmissible hearsay, and we sustain petitioner's objections to their receipt in evidence as to the truth of their contents. We do receive them for the limited purpose of describing how respondent arrived at his determination.

($8,631.25) by 8 percent, respondent determined that petitioner had gross sales of $107,890.63. This amount was then determined to consist of cash sales of $6,473.49 and charge sales of $101,417.19. Tip rates of 12 percent and 17 percent, respectively, were multiplied by these sales less adjustments for "stiff rate" and tipouts to arrive at determined tips for petitioner of $15,282.06. Finally, the amount listed as allocated tips on the Form W-2 was deducted to arrive at an understatement of tip income of $6,650.81. We note that this amount is substantially different from what was determined in the notice of deficiency. Respondent, however, provided no explanation for the discrepancy.

Respondent's determinations are presumed correct, and petitioner has the burden of proof to show that they are incorrect. Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933). In this case, petitioner, through his credible testimony and calendar, has overcome that presumption. It is clear that respondent's determination, without further explanation or rebuttal, has failed to take into consideration the unusual procedures at the GR, whereby an employee might be permitted to go home without working and be paid for 4 hours of time. Respondent's determination also reflects the conclusion that petitioner was a full-time food server, when the evidence shows that he was often working the door as maitre d.

While petitioner's calendar record may not be 100 percent accurate, it is the better measure of petitioner's tip income

than respondent's reliance on a survey. We hold that petitioner reported income from the GR in the amount of $8,713.74, of which $2,357.87 represents tip income. Accordingly, petitioners did not have any unreported tip income.

Meals & Entertainment Expenses. Petitioner is also an actor. During 1992, petitioner earned approximately $6,500 for his work on commercials, television shows, and movies. Forms W-2 included with petitioners' 1992 income tax return show that petitioner, under the stage name Frank Isles, performed acting jobs for production companies and was paid wages, from which various withholdings were made.

Petitioner was not represented by any one agent or manager. To promote himself, petitioner occasionally treated various agents and managers to lunch or dinner. For example, petitioner frequently dined with one agent, Charles De Silva (Mr. De Silva), who let petitioner "into the breakdown" about acting jobs that were available in the Los Angeles and New York area. Petitioner believed that these meetings were necessary for him to become aware of the acting opportunities.

At trial, petitioner claimed a deduction for meals and entertainment expenditures of $5,206, which had not been claimed on petitioners' tax return. Respondent disputes their deductibility. Petitioner submitted 33 restaurant and cafeteria receipts indicating that he spent $5,176.52 on meals and entertainment during 1992. The amount of the receipts ranged from 60 cents for coffee/milk to as much as $667.53 for a meal.

Petitioner also submitted a mileage log, which entries were consistent with some of the information listed on the restaurant receipts.

Section 162(a) permits the deduction of "ordinary and necessary" expenses paid or incurred during the taxable year in carrying on any trade or business. Meals and entertainment expenses are deductible if they are ordinary and necessary to a taxpayer's business. Section 274(d), however, provides that no deduction will be allowed for any activity which is generally considered to constitute entertainment unless the taxpayer maintained records sufficient to establish: (1) The amount of each expense; (2) the time and place of the activity; (3) the business purpose of the activity; and (4) the business relationship to the taxpayer of persons entertained. Sec. 274(d). Meals in a restaurant are generally considered to be "entertainment" and governed by section 274(d). See, e.g., Matlock v. Commissioner, T.C. Memo. 1992-324. Section 274(d) prohibits the estimation of these expenses by the Court. Sanford v. Commissioner, 50 T.C. 823, 827-828 (1968), affd. per curiam 412 F.2d 201 (2d Cir. 1969); sec. 1.274-5T(a), Temporary Income Tax Regs., 50 Fed. Reg. 46014 (Nov. 6, 1985).

Upon examination of the receipts and mileage log, we hold that petitioners are not entitled to a meals and entertainment expense deduction. First, petitioner failed to submit documentation, such as canceled checks or credit card receipts, to verify that he actually paid the amounts indicated by the

receipts. In addition, petitioner's substantiation falls far short of the stringent requirements of section 274(d). For example, for 15 of the 33 restaurant receipts, the locations of the purported meetings were not disclosed. As to the remaining items, petitioner's records failed to adequately explain, in specific detail, the business purpose of each meeting and the business relationship of the persons entertained. Petitioner, at trial, proffered only general statements about the importance of these meetings. Moreover, the receipts and log also contain general statements, such as "business lunch", "publicity blitz", "media exposure", and "networking". We do not believe that the above explanations are sufficient to satisfy the statutory requirement of section 274(d). Finally, with the exception of Mr. De Silva, petitioner failed to explain the business relationship he had with the persons listed on the receipts. For the above reasons, we deny petitioners a meals and entertainment deduction.

Schedule A v. Schedule C Deduction. At trial, respondent conceded that petitioner is entitled to a deduction of $10,621 for business expenses incurred as an actor. Of this amount, $3,934 had been claimed on petitioner's Schedule C and not disallowed in the notice of deficiency. The remaining amount, $6,687, was claimed by petitioner during these proceedings. While conceding that the remaining amount is deductible, respondent disputes that it is deductible from gross income on Schedule C, rather than from adjusted gross income (AGI) on

Schedule A and subject to a limitation of 2 percent of AGI. See sec. 67. Petitioner asserts that these expenditures relate to his independent contractor work as an actor and that, therefore, he is entitled to deduct these expenditures on his Schedule C.

Section 62(a)(1) states the general rule that trade or business deductions (i.e., Schedule C deductions) are allowed "if such trade or business does not consist of the performance of services by the taxpayer as an employee". Consequently, for employed individuals, section 162 trade or business deductions are ordinarily itemized Schedule A deductions. Secs. 161 and 162; see Alexander v. Commissioner, T.C. Memo. 1995-51, affd. 72 F.3d 938 (1st Cir. 1995).

Nevertheless, even if an individual is an employee for the taxable year, he may deduct unreimbursed employee business expenses from gross income if he is a "qualified performing artist" performing services in the performing arts. Sec. 62(a)(2)(B). A "qualified performing artist," however, must meet the requirements of section 62(b). In order for an employee to be a qualified performing artist under section 62(b): (1) The individual must have performed services in the performing arts as an employee during the taxable year for at least 2 employers; (2) the aggregate amount allowable as a deduction under section 62 in connection with the performance of such services must exceed 10 percent of such individual's gross income attributable to the performance of such services; and (3) the adjusted gross income of such individual for the taxable year (determined without

regard to subsection (a)(2)(B)) may not exceed $16,000. The record reflects that in the year before the Court, petitioner's adjusted gross income determined without regard to subsection (a)(2)(B) of section 62, exceeded $16,000. Accordingly, petitioner is not a qualified performing artist, and therefore is not entitled to deduct business expenses from gross income. He must deduct his business expenses from adjusted gross income.

There is no evidence that petitioner is an independent contractor as an actor. When he secures a job, he becomes an employee of the producer of the film, play, or commercial. Between jobs, he is looking for work as an employee. While it is true that petitioner's product is himself and his acting skill, there is no evidence that petitioner earned any income as an independent contractor. All of the expenses incurred by petitioner pertain to the securing of employment as an employee or to the performance of such services. Accordingly, we hold for respondent on this issue. Consequently, petitioners may only deduct the expenses at issue on their Schedule A as a miscellaneous itemized deduction subject to the 2-percent floor imposed by section 67(a).

In view of our holdings herein, there will not be any deficiency or underpayment; more likely there will be an overpayment. Accordingly, inasmuch as an accuracy-related penalty under section 6662 is imposed on an underpayment, the issue of whether petitioners are liable for the penalty is moot.

Reviewed and adopted as the report of the Small Tax Case Division.

To reflect the foregoing,

Decision will be entered under Rule 155.