T.C. Summary Opinion 2000-120

UNITED STATES TAX COURT

DAVID B. AND JANICE L. YORKOWITZ, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 14637-98S. Filed May 23, 2000.

David B. Yorkowitz, pro se.

Ric D. Hulshoff, for respondent.

NAMEROFF, Special Trial Judge: This case was heard pursuant to the provisions of section 7463 of the Internal Revenue Code in effect at the time the petition was filed.[1] The decision to be entered is not reviewable by any other court, and this opinion should not be cited as authority.

Respondent determined deficiencies in petitioners' 1995 and 1996 Federal income taxes in the amounts of $4,594 and $4,392,

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[1] Unless otherwise indicated, all subsequent section references are to the Internal Revenue Code in effect for the years at issue.

respectively, and accuracy-related penalties under section 6662(a) of $1,119 and $878, respectively. After concessions,[2] the issues for decision are: (1) Whether section 7605(b) precludes respondent from making the determinations set forth in the notice of deficiency for 1995; (2) whether petitioners are entitled to charitable contribution deductions for both years; (3) whether petitioners are entitled to claim a deduction in 1995 for the use of a computer; and (4) whether petitioners are liable for accuracy-related penalties pursuant to section 6662(a) for both years at issue.

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 Palmdale, California. Both petitioners were employed by the Internal Revenue Service.

Section 7605(b)

Petitioners' 1995 Form 1040, U.S. Individual Income Tax Return, was timely filed with respondent on March 26, 1996. In a

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[2] Petitioners concede that they are not entitled to deductions claimed on Schedule A, Itemized Deductions, for 1995 (if relevant) and 1996 for "protection of income" labor expenses of $16,902 and $14,500, respectively, since they did not incur these expenses.

Petitioners also concede for 1995 that they received $273 in interest income, a State tax refund of $722, and that they are not entitled to a rental loss of $3,851. The deficiency in tax for these three items has been assessed against petitioners.

letter dated April 19, 1996, respondent informed petitioners that, in reviewing their 1995 return, there were certain items that were subject to the alternative minimum tax (AMT). Respondent proposed a correction which increased petitioners' tax by $578 and a penalty under section 6662(b)(1). Petitioners responded on May 18, 1996, agreeing to the increase in tax plus interest but not to the penalty. Attached to this response were two mortgage interest statements reflecting interest petitioners paid in 1995. Petitioners allege that they were told in a telephone call with one of respondent's agents to include the mortgage interest statements. The deficiency of $578 plus interest was subsequently assessed.

On August 29, 1996, petitioners submitted to respondent a Form 1040X, Amended U.S. Individual Income Tax Return, for taxable year 1995, reflecting an overpayment. On May 29, 1997, respondent informed petitioners by letter that their Forms 1040 and 1040X were assigned to Revenue Agent Traci Mooney (Ms. Mooney) for examination. Petitioners met with Ms. Mooney on July 7, 1997, for examination of their books and records. During the ensuing months, the examination continued. Respondent issued the notice of deficiency on July 22, 1998, and petitioners filed their petition with this Court on August 31, 1998.

Petitioners contend that their 1995 return was examined twice in violation of section 7605(b).

Section 7605(b) provides that:

> No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

The purpose of section 7605(b) is to prevent the Commissioner from abusive and unnecessary inspections of a taxpayer's books and records. See United States v. Powell, 379 U.S. 48, 53 (1964). The statute was not meant to restrict the scope of the Commissioner's legitimate power to protect the revenue. See id. at 54-56; Collins v. Commissioner, 61 T.C. 693, 698-699 (1974). Nor is section 7605(b) to be read so broadly as to defeat the Commissioner's power under section 7602 to examine any books, papers, records, or other data that may be relevant or material in ascertaining the correctness of a taxpayer's return. See Grossman v. Commissioner, 74 T.C. 1147, 1155 (1980).

Petitioners contend that when they sent the mortgage interest documents to respondent along with their consent to the computation for AMT, an examination had occurred. Petitioners rely on a letter from respondent dated August 26, 1996, which states: "The change below resulted from an examination of your tax return shown above." The letter provides a statement of account reflecting that petitioners owe $578 plus interest.

Despite the use of the word "examination" in the aforementioned letter, we do not find that respondent examined petitioners' books of account twice. The notice that petitioners received on April 19, 1996, reflected a computational adjustment to petitioners' return; the additional tax had already been determined. There was no examination of books of account conducted at this level. In their response agreeing with the additional tax, petitioners attached two documents which they allege were requested by respondent over the telephone. We do not find this to be an examination of petitioners' books of account. The first and only audit of petitioners' books of account began on July 7, 1997.

If a second examination is made with the knowledge of the taxpayers who raise no objection to that examination at that time, the taxpayers have waived the requirement of written notice even though the Commissioner uses the information obtained for a purpose not anticipated by the taxpayers at the time the second examination was made. See Rife v. Commissioner, 41 T.C. 732, 747 (1964), affd. on this issue 356 F.2d 883 (5th Cir. 1966); Flynn v. Commissioner, 40 T.C. 770, 774 (1963).

Even assuming arguendo that a second examination of petitioners' books and records was made, petitioners received written notice that respondent had selected petitioners' 1995 tax

return for examination.[3] Petitioners did not raise their contention that their records had previously been examined. Petitioners met with Ms. Mooney and, over a period of time, produced books and records for examination and discussed the issues. Petitioners filed a petition with this Court on August 31, 1998, and did not raise the second examination issue at that time. Petitioners did not object to the examination until more than a year and a half after the examination started. Therefore, based on petitioners' actions, we hold that they have not shown that they did not waive the notice requirement of section 7605(b) or that respondent failed to comply with the statute. Accordingly, we conclude that section 7605(b) does not preclude respondent from making the determinations in the notice of deficiency for taxable year 1995.

Charitable Contributions

Petitioners claim that every Sunday they attended Grace Baptist Church to which they made cash contributions. Petitioner testified that in 1995 they contributed $50 each Sunday and in 1996 they contributed $70 each Sunday. Petitioners did not request receipts from the church because they did not want the

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[3] Petitioners had first been notified by telephone, but they requested a written notice. Assuming arguendo that sec. 7605(b) applied at that time, it is arguable that the written notice satisfied the statute's requirement for a second examination.

church to keep track of what petitioners were contributing. Petitioners also contend that they made cash contributions to other various charities during both years, and they did not obtain receipts. Petitioners did not maintain reliable written records of their contributions.[4]

Deductions are strictly a matter of legislative grace. See INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84 (1992); New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934). Taxpayers must substantiate the claimed deductions. See Hradesky v. Commissioner, 65 T.C. 87 (1975), affd. per curiam 540 F.2d 821 (5th Cir. 1976).

Section 170 allows as a deduction any charitable contribution actually paid during the taxable year. See sec. 170(a)(1); sec. 1.170A-1(a), Income Tax Regs. Contributions of money are required to be substantiated by a canceled check, a receipt from the donee charitable organization showing the name

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[4] Petitioners submitted two logs for 1995 and 1996 which contain handwritten notes detailing when contributions were allegedly made. Petitioner testified that he maintained these records contemporaneously. After trial, respondent moved to reopen the record to permit additional evidence as to the authenticity of these logs. In their objection to respondent's motion, petitioners indicated that the testimony as to the contemporaneousness of the entries in the logs was inaccurate and that "some entries were altered or changed" to reflect what allegedly was in another record not presented at trial. If petitioner's testimony had been forthcoming, the logs would not have been received into evidence at trial. Consequently, although we have denied respondent's motion, we have given the logs no weight in our consideration of the issues.

of the donee, the date, and amount of the contribution, or in the absence of a canceled check or receipt, other reliable written records showing the name of the donee, the date, and amount of the contribution. See Thorpe v. Commissioner, T.C. Memo. 1998-123; Schafler v. Commissioner, T.C. Memo. 1998-86; sec. 1.170A-13(a)(1), Income Tax Regs.

Petitioners did not obtain receipts for any of the alleged contributions at issue, nor did they maintain reliable written records to substantiate their claim. Accordingly, respondent is sustained on this issue.

Computer Purchase

In 1995, Mrs. Yorkowitz filed a civil action in Federal District Court, District of Columbia, against her employer, the Department of the Treasury, for employment discrimination. On September 30, 1995, petitioners purchased a Hewlett Packard computer and printer for $2,961.51. Petitioners contend that they used the computer for typing the necessary documents for the court case. On Schedule A for 1995, petitioners claimed a deduction of $2,961 for the computer purchase. Petitioners claim that they used the computer 80 percent for the court case and 20 percent for personal use. The deduction for the cost of the computer was disallowed by respondent. Petitioners contend that they are entitled to the deduction pursuant to section 212.

Section 212(1) allows a deduction for expenses for the

production or collection of income. Taxpayers may not deduct expenses under section 212 that could not be deducted under section 162(a) were the expenses connected to a trade or business. See Trust of Bingham v. Commissioner, 325 U.S. 365, 373-376 (1945) (discussing the predecessors of secs. 212 and 162(a)); Guill v. Commissioner, 112 T.C. 325, 328 (1999). This Court has stated:

> "except for the requirement of being incurred in connection with a trade or business," however, a deduction under section 212 "is subject * * * to all the restrictions and limitations that apply in the case of the deduction under * * * [section 162(a)] of an expense paid or incurred in carrying on any trade or business." [Estate of Davis v. Commissioner, 79 T.C. 503, 507 (1982) (quoting from H. Rept. 2333, 77th Cong., 2d Sess. (1942), 1942-2 C.B. 372, 430; S. Rept. 1631, 77th Cong., 2d Sess. (1942), 1942-2 C.B. 504, 571, the legislative history to the predecessor of section 212)].

Section 274(d) provides certain requirements, which if not satisfied, preclude deductions under sections 162 and 212. As a general rule, section 280F(d)(4) treats any computer or peripheral equipment as "listed property". Sec. 280F(d)(4)(A)(iv). Section 274(d)(4) precludes a taxpayer from claiming a deduction for listed property unless the taxpayer meets the strict substantiation requirements of section 274(d) and the regulations thereunder. Section 274(d) requires substantiation of these expenses either "by adequate records or by sufficient evidence corroborating the taxpayer's own

statement". Petitioners must substantiate the amount of each separate expenditure, the amount of business and total use of the property, the date of use, and the business purpose. See sec. 1.174-5T(b)(6), Temporary Income Tax Regs., 50 Fed. Reg. 46016 (Nov. 6, 1985).

Mr. Yorkowitz (Petitioner) submitted a receipt to establish that he incurred the cost of the computer in 1995. However, petitioners did not maintain any reliable records to satisfy any of the other requirements of section 274(d).[5] Accordingly, petitioners are not entitled to a deduction for the computer.[6]

Accuracy-Related Penalty

Petitioner prepared the 1995 and 1996 returns. From 1972 to 1998, petitioner was employed by the Internal Revenue Service, first as an auditor and then in taxpayer services. Respondent determined that petitioners are liable for accuracy-related penalties for both years at issue.

Section 6662(a) provides that, if it is applicable to any portion of an underpayment in taxes, there shall be added to the tax an amount equal to 20 percent of the portion of the

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[5] Petitioner alleged at trial that the records of the "business" use of the computer were reflected in the logs referred to supra note 4.

[6] Based on our holding on this issue, we need not determine whether petitioners made a valid sec. 179 election or whether the purchase of the computer was for the production of income.

underpayment to which section 6662 applies. Section 6662(b)(1) provides that section 6662 shall apply to any underpayment attributable to negligence or disregard of rules or regulations. "Negligence" is defined as any failure to make a reasonable attempt to comply with the provisions of the Internal Revenue Code, and the term "disregard" includes any careless, reckless, or intentional disregard. Sec. 6662(c). Negligence also includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. See sec. 1.6662-3(b)(1), Income Tax Regs.

Section 6664(c)(1) provides that the penalty under section 6662(a) shall not apply to any portion of an underpayment if it is shown that there was reasonable cause for the taxpayer's position with respect to that portion and that the taxpayer acted in good faith with respect to that portion. The determination of whether a taxpayer acted with reasonable cause and good faith within the meaning of section 6662(c)(1) is made on a case-by-case basis, taking into account all the pertinent facts and circumstances. See sec. 1.6664-4(b)(1), Income Tax Regs.

As an employee for the Internal Revenue Service, petitioner had knowledge of tax laws and the requirements of maintaining records to substantiate deductions. Petitioners claimed deductions of $16,902 and $14,500 for petitioner's personal labor as "protection of labor" expenses, they were unable to

substantiate claimed charitable contribution deductions, they did not satisfy the requirements under section 274(d) for use of a computer, and they conceded a rental loss deduction and the receipt of additional income. On the basis of the entire record, we conclude that petitioners have not established the underpayments were due to reasonable cause and that they acted in good faith. Accordingly, respondent is sustained on this issue.

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

To reflect the foregoing,

Decision will be entered for respondent.