Alvin E. Keels, Sr. v. Commissioner of Internal Revenue, T. C. Memo. 2020-25 (U. S. Tax Court, 2020)

In a ruling by the U. S. Tax Court, Alvin E. Keels, Sr. faced a mixed outcome regarding his tax deductions and income reporting for 2012-2014. The court upheld the IRS's disallowance of most of Keels' claimed deductions due to insufficient substantiation, except for specific contract labor expenses. Additionally, Keels was not taxed on deferred compensation from State Farm, as the IRS failed to prove these amounts were taxable under Section 409A. The court also confirmed Keels' liability for late filing penalties and accuracy-related penalties for substantial understatements of income tax.

Parties

Alvin E. Keels, Sr. , the Petitioner, represented himself (pro se). The Respondent was the Commissioner of Internal Revenue, represented by Timothy B. Heavner and Robert J. Braxton.

Facts

Alvin E. Keels, Sr. , an independent State Farm agent since 1985, filed tax returns for the years 2012, 2013, and 2014. Keels reported various business expenses on his Schedule C and claimed deductions for these expenses. He also participated in State Farm's nonqualified deferred compensation program, which included termination and extended termination payments. In 2014, Keels used a PayPal account for the Jazz Legacy Foundation (JLF), a non-profit he was involved with, to receive payments for ticket sales to a fundraiser. The IRS issued a notice of deficiency, disallowing most of Keels' claimed deductions and asserting that certain amounts were taxable income, including the yearend balances of his deferred compensation account and payments received via PayPal.

Procedural History

The IRS issued a notice of deficiency to Keels for the tax years 2012, 2013, and 2014, determining deficiencies in income tax and asserting additions to tax and penalties. Keels filed a petition with the U. S. Tax Court contesting the IRS's determinations. The court held a trial, after which it issued its opinion. The IRS conceded some deductions but maintained its position on others, including the tax treatment of Keels' deferred compensation under Section 409A, which was raised for the first time in its posttrial brief. The court applied the de novo standard of review for factual findings and legal conclusions.

Issue(s)

Whether Keels substantiated his claimed deductions beyond those conceded by the IRS?

Whether the yearend values of Keels' termination and extended termination payments from State Farm's deferred compensation program were taxable income for the years at issue?

Whether Keels had $167,223 of income from PayPal, Inc. , for 2014?

Whether Keels is liable for additions to tax for failure to timely file under Section 6651(a)(1) and accuracy-related penalties under Section 6662(a) for the years at issue?

Rule(s) of Law

Section 6001 of the Internal Revenue Code requires taxpayers to maintain records sufficient to establish the amount of any deduction claimed. The burden of proof generally rests with the taxpayer to substantiate deductions (Rule 142(a), Tax Court Rules of Practice and Procedure). Section 409A addresses the tax treatment of nonqualified deferred compensation plans, requiring specific conditions to be met to avoid immediate taxation. Section 6651(a)(1) imposes an addition to tax for failure to timely file a return unless the taxpayer shows reasonable cause. Section 6662(a) and (b)(2) impose an accuracy-related penalty for substantial understatements of income tax, with an exception if the taxpayer acted with reasonable cause and in good faith.

Holding

The court held that Keels substantiated specific contract labor deductions but failed to substantiate most other claimed deductions. The yearend values of Keels' termination and extended termination payments were not taxable income for the years at issue, as the IRS did not meet its burden of proof under Section 409A. The $167,223 received via PayPal in 2014 was not income to Keels, as it belonged to JLF. Keels was liable for additions to tax under Section 6651(a)(1) for late filing and accuracy-related penalties under Section 6662(a) for substantial understatements of income tax.

Reasoning

The court found that Keels did not meet his burden of proof to substantiate most of his claimed deductions, as he failed to provide receipts, invoices, or other documentation showing the purpose of his expenses. His testimony was deemed insufficiently credible. Regarding the deferred compensation, the IRS bore the burden of proof due to its late assertion of Section 409A as a basis for taxation. The IRS failed to provide evidence that the State Farm plan did not meet Section 409A requirements or that there was no substantial risk of forfeiture. The PayPal receipts were not taxable to Keels, as they were for JLF's activities. The court upheld the penalties for late filing and substantial understatements, finding no reasonable cause shown by Keels.

Disposition

The court’s decision was to be entered under Rule 155, reflecting the upheld deficiencies, the disallowed deductions, the nontaxability of the deferred compensation, the non-inclusion of PayPal receipts as income, and the imposition of penalties for late filing and substantial understatements.

Significance/Impact

This case underscores the importance of maintaining thorough records to substantiate tax deductions, as the court strictly applied substantiation requirements. It also highlights the procedural importance of timely raising legal theories in tax litigation, as the IRS’s late assertion of Section 409A led to the court’s finding that it bore the burden of proof, which it failed to meet. The decision reaffirms the application of penalties for late filing and substantial understatements, emphasizing the need for taxpayers to demonstrate reasonable cause to avoid such penalties.

