Joseph Amundsen and Anna Amundsen v. Commissioner of Internal Revenue, T. C. Summary Opinion 2023-30 (United States Tax Court 2023)

In a significant ruling, the U. S. Tax Court upheld the IRS's denial of a certified public accountant's claimed deductions for cost of goods sold and various business expenses, emphasizing stringent substantiation requirements. The court also sustained an accuracy-related penalty, highlighting the importance of proper tax reporting and the consequences of substantial understatements of income tax, particularly for tax professionals.

Parties

Joseph Amundsen and Anna Amundsen, petitioners, filed their case pro se. The respondent was the Commissioner of Internal Revenue, represented by Dillon T. Haskell, Thomas A. Deamus, and Mimi M. Wong.

Facts

Joseph Amundsen, a certified public accountant (CPA) licensed in California and New York, operated a sole proprietorship from his residence in Pennsylvania. His practice primarily involved preparing federal income tax returns. Amundsen was a member of the Yale Club in New York City, where he claimed to meet clients, and maintained a virtual office in downtown New York City for mail and answering services. On their 2015 federal income tax return, the Amundsens reported $66,976 in gross receipts and $69,233 as cost of goods sold, resulting in a reported loss. The IRS disallowed the cost of goods sold and assessed an accuracy-related penalty under section 6662(a).

Procedural History

The IRS issued a notice of deficiency on March 7, 2019, determining a deficiency in the Amundsens' 2015 federal income tax and a section 6662(a) accuracy-related penalty. The case was heard pursuant to section 7463 of the Internal Revenue Code. Anna Amundsen's case was dismissed for lack of prosecution on January 17, 2023, leaving Joseph Amundsen as the sole petitioner. The decision in this case is not reviewable by any other court and is not to be treated as precedent.

Issue(s)

Whether petitioners are entitled to the cost of goods sold reported on their Schedule C for the tax year 2015?

Whether petitioners are entitled to any deductions for trade or business expenses for the tax year 2015?

Whether petitioners are liable for a section 6662(a) accuracy-related penalty for the tax year 2015?

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Rule(s) of Law

The burden of proof in tax cases generally rests with the taxpayer to prove the Commissioner's determinations incorrect (Rule 142(a); Welch v. Helvering, 290 U. S. 111, 115 (1933)). Deductions are a matter of legislative grace, and taxpayers must substantiate their entitlement to any claimed deduction (INDOPCO, Inc. v. Commissioner, 503 U. S. 79, 84 (1992); New Colonial Ice Co. v. Helvering, 292 U. S. 435, 440 (1934)). Section 162(a) allows deductions for ordinary and necessary expenses paid or incurred in carrying on a trade or business. Section 274(d) prescribes stringent substantiation requirements for certain expenses, including travel and entertainment. Section 6662(a) imposes a penalty for substantial understatements of income tax, which can be avoided if the taxpayer shows reasonable cause and good faith (section 6664(c)(1)).

Holding

The court held that petitioners were not entitled to the cost of goods sold reported on their Schedule C, as they failed to establish any basis for such a deduction. The court allowed deductions for substantiated trade or business expenses totaling $6,238, but disallowed all other claimed expenses due to lack of substantiation. The court sustained the section 6662(a) accuracy-related penalty, finding that the petitioners' understatement of income tax was substantial and that they did not act with reasonable cause and good faith.

Reasoning

The court's reasoning centered on the petitioners' failure to meet the burden of proof and substantiation requirements. For the cost of goods sold, the court found that the petitioners did not establish any basis for the deduction. Regarding trade or business expenses, the court applied the Cohan rule (Cohan v. Commissioner, 39 F. 2d 540, 543-44 (2d Cir. 1930)) to estimate allowable deductions where some substantiation was provided, such as for tax preparation software and CPA licensing fees. However, the court denied deductions for travel and home office expenses due to the petitioners' failure to meet the stringent substantiation requirements of section 274(d) and section 280A(c), respectively. The court also upheld the accuracy-related penalty, emphasizing the petitioners' lack of reasonable cause and good faith, particularly given Joseph Amundsen's professional background as a CPA. The court considered the petitioners' misclassification of business expenses as cost of goods sold and their inadequate substantiation efforts as evidence of negligence.

Disposition

The court ordered that a decision be entered under Rule 155, reflecting the disallowance of the cost of goods sold, the allowance of specific trade or business expense deductions, and the imposition of the section 6662(a) accuracy-related penalty.

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Significance/Impact

This case underscores the importance of proper substantiation for tax deductions, particularly for tax professionals. It reaffirms the stringent requirements of sections 274(d) and 280A(c) for travel and home office expenses, respectively. The decision also highlights the consequences of substantial understatements of income tax, emphasizing that even tax professionals are not immune to accuracy-related penalties if they fail to act with reasonable cause and good faith. This case may serve as a cautionary tale for tax practitioners about the importance of meticulous record-keeping and accurate tax reporting.

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