BOBBY N. & DORIS N. DUCK 2066 BUTTSTON ROAD DADEVILLE, AL 36853-3521,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. INC. 09-645
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department partially denied a refund of 2001 income tax requested by Bobby N. and Doris N. Duck (together "Taxpayers"). The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on December 7, 2010. Bobby Duck (individually "Taxpayer") and his attorney, Jim Sizemore, attended the hearing. Assistant Counsel Billy Young represented the Department.

The Taxpayers claimed various deductions on their 2001 Alabama return. The Department audited the return and disallowed or reduced some of the amounts claimed. It subsequently assessed the Taxpayers for the additional tax due. The Taxpayers paid the assessed amount and then petitioned for a $1,745 refund. The Department reduced the refund claim to $1,296.81. This appeal followed.

The Taxpayer and his wife operated a truck hauling business in 2001. The wife owned the truck and maintained the business's records at a room in the Taxpayers' home. The Taxpayer drove the truck.

The Taxpayer hauled pulpwood exclusively for Arthur Caldwell Logging in 2001. He was paid $2 per loaded mile during the year, and received a total of $31,414 from Caldwell for the year. The Taxpayers reported that amount as income on their 2001 return.

The Taxpayers initially claimed a fuel expense of $14,073.48 on their 2001 return. They also claimed a home office expense of $1,979, contract labor of $3,614.40, and business-related liability insurance of $2,448. The Department per its audit allowed one-half of the fuel cost, or $7,036.74. It also disallowed the home office deduction, the contract labor, and the insurance expense in full for lack of substantiation.

The Taxpayer concedes that he does not have complete records of the deductions claimed on the 2001 return because his house and its contents, including his business records, were completely destroyed by fire in 2007. He contends, however, that the disputed fuel, home office, contract labor, and insurance deductions should be allowed in the amounts claimed based on reasonable estimates. The four disputed deductions are discussed below.

(1) The Fuel Expense.

As indicated, the Taxpayer initially claimed a fuel expense of $14,073.48. The Department allowed one-half of that amount, or $7,036.74. The Taxpayer now contends that the correct allowance is $8,795.92, or $1,759.18 more than allowed by the Department.

The Taxpayer estimated the fuel allowance by dividing his 2001 income of $31,414 by 2 to reflect the $2 per loaded mile he was paid in that year. The Taxpayer thus contends that he traveled 15,707 loaded miles in the year. He also assumes that he traveled an equal distance of unloaded miles to arrive at a total of 31,414 miles traveled.

He estimated that his truck averaged five miles per gallon. Dividing the 31,414 miles traveled by 5 resulted in the use of 6,282.8 gallons in 2001. Per the internet, the Taxpayer determined that the average diesel fuel price per gallon in 2001 was $1.4039. Multiplying

the 6,282.8 gallons used by the cost of $1,4039 per gallon, the Taxpayer concluded that his 2001 fuel expense was $8,795.92.

(2) The Home Office Expense.

The Taxpayer testified that he and his wife used a 12 by 16 foot room in their house exclusively as a business office in 2001. His wife used a computer and stored their business-related records in the room. The Taxpayers claimed a home office deduction of $1,979 on both their 2001 federal and State returns. The IRS allowed the deduction.

(3) The Contract Labor.

The Taxpayer explained at the December 7 hearing that in 2001, he sometimes hired a friend, Melvin Kelly, to use his truck to haul goods for Caldwell Logging when he was unable to do so. He paid Kelly 30 percent of the amount paid to him by Caldwell.

The Taxpayer's records relating to his payments to Kelly were destroyed in the 2007 house fire. The Taxpayer did, however, obtain a few handwritten records from his tax preparer showing some amounts paid to Kelly in 2001 that totaled $3,614.40. See, Taxpayers' Ex. 23 – 26. He claims that at least that amount should be allowed.

(4) The Commercial Insurance.

All commercial truck drivers are required to maintain liability insurance. The Taxpayer testified that he obtained and carried liability insurance in 2001, and that Caldwell Logging required him to provide proof of such insurance before allowing him to haul for the company.

The Taxpayer submitted a December 1, 2010 letter from Liberty Truck Insurance, Inc., indicating that "[g]enerally speaking, in the year 2001, the premium on an Auto Liability policy with a limit of $1,000,000 could run between $4,500 and $5,500 annually. . . ."

Taxpayers' Ex. E.

The Taxpayer testified that he estimated his 2001 insurance premium to be $2,448. He explained that he had paid considerably more than that amount, but that because his records had been burned, he made a conservative estimate.

All taxpayers are required to keep adequate books and records from which their correct liability can be computed or verified. See, Code of Ala. 1975, §40-2A-7(a)(1), *Fanning v. State of Alabama*, Inc. 99-395 (Admin. Law Div. 12/7/2000). As a general rule, if a taxpayer fails to provide records verifying a claimed deduction, the deduction must be disallowed. *Fanning*, *supra.* There is, however, an exception to that general rule. If a taxpayer can establish that he or she incurred or is entitled to certain deductions, but is unable to prove the exact amounts due to a lack of records, the taxpayer may reasonably estimate the deductions under the rule established in *Cohan v. Commissioner*, 39 F.2d 540 (1930), i.e., the "Cohan rule."

The Cohan rule was discussed in *Ellis Banking Corp. v. C.I.R.*, 688 F.2d 1376 (1982), as follows:

> The rule as announced in Cohan applied to travel and entertainment expenses. In that area, Congress has overruled the result in section 274(d), which imposes a heavy burden of substantiation on a taxpayer claiming deductions under section 162 for travel and entertainment expenses. But the Cohan principle was applied more generally and apparently survives where not legislatively overruled. See, e.g., *Cummings v. Comm'r*, 5 Cir. 1969, 410 F.2d 675, 679; *Green v. Comm'r*, 1980, 74 T.C. 1229, 1237; see generally 4A J. Mertens, Law of Federal Income Taxation s 25.04 (Doheny rev. ed. 1979).
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>> . . . (A) taxpayer would (otherwise) in every case be denied a deduction for otherwise allowable expenses where there was a failure of strict proof on his part. Thus, even though it is quite apparent that because of the nature of the taxpayer's business certain types of ordinary and necessary expenses would have to be incurred and were actually paid, nevertheless, if the

> taxpayer did not maintain adequate records, no part of such expenses would be allowable because proof of detail or itemization was lacking. Fortunately, however, such automatic disallowance has not been the general rule . . .
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> Id.
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> The Cohan rule does not in any way shift the burden of proof. Stated another way, it simply provides that the failure of the taxpayer to establish the exact amount to which he is entitled should not lead the court to ignore that the taxpayer has met his burden of proof on his entitlement to some deduction.

Ellis Banking Corp. v. C.I.R., 688 F.2d 1376, 1383.

Courts have also held that where a taxpayer's records are destroyed or otherwise made unavailable through no fault of the taxpayer, the taxpayer should be able to estimate the amount of an otherwise allowable deduction using reasonable information or other evidence.

> As with all deductions, taxpayers are generally required to establish by adequate records that they are entitled to a casualty loss. However, if a taxpayer's records are destroyed by fire, storm, or otherwise through no fault of the taxpayer, the taxpayer may reasonably reconstruct such records. *Hentges v. C.I.R.*, T.C. Memo 1998-244 (U.S. Tax Court 1998). Further, the rule established in *Cohan v. Commissioner*, 39 F.2d 540 (2nd Cir. 1930) is that if a taxpayer is entitled to a deduction, but is unable to prove the exact amount of the deduction, the taxpayer may reconstruct the amount using reasonable evidence.

Alexander v. State of Alabama, Inc. 02-145 (Admin. Law Div. O.P.O. 5/23/2002).

The Taxpayer initially claimed a fuel expense of $14,073.48, but now contends that he should be allowed $8,795.92. The Department allowed one-half of the original amount claimed, or $7,036.74.

The Taxpayer calculated the $8,795.92 by first assuming that he drove the truck at least the same distance loaded as he did unloaded. He then estimated the miles per

gallon, and also estimated the price per gallon for fuel. The Taxpayer's estimates of his fuel costs are not sufficient to invoke the Cohan rule. The Department's allowance of $7,036.74 is reasonable, and is affirmed.

The Taxpayer presented an appraisal of his home which shows a room that the Taxpayer claims was used as a home office. The Taxpayer testified that he and his wife used the room exclusively for their trucking business in 2001. The Taxpayers also claimed the room as a home office on their 2001 federal return, which was allowed. Under the circumstances, the home office deduction of $1,979 should be allowed.

The Taxpayer testified that he paid Melvin Kelly to haul logs for Caldwell Logging in 2001 when he was unable to do so. He claimed that he paid Kelly $3,614.40 in the subject year. He submitted handwritten notes that, according to the Taxpayer, show some amounts paid to Kelly. He also provided a copy of an April 6, 2001 check payable to "Melvin Kelly" for $322.19.

The handwritten notes are not sufficient to show that the amounts on the notes were actually paid to Kelly to haul for the Taxpayer. The Taxpayer also testified that he paid Kelly 30 percent of what he received from Caldwell Logging. In that case, the $3,614.40 that the Taxpayer claims he paid Kelly in 2001 would represent over $12,000 received by the Taxpayer from Caldwell Logging, or well over one-third of the amount received by the Taxpayer for the full year. That relatively large amount is inconsistent with the Taxpayer's testimony that "I didn't think I was going to use him (Kelly) but a week or two, . . ." (T. 45)

Under the circumstances, the check for $322.19 payable to Kelly is all that should be allowed for labor.

Finally, the Taxpayer deducted liability insurance of $2,448. The evidence is

undisputed that the Taxpayer was required to have liability insurance to be able to haul logs for Caldwell Logging, or any other company. There is also evidence that in 2001, a motor vehicle liability policy would cost between $4,500 and $5,500 annually, more or less, depending on age, expense, driving record, and other factors. Under the circumstances, the $2,448 insurance premium claimed by the Taxpayer is reasonable, and is allowed.

The Department is directed to recompute the Taxpayer's 2001 liability as indicated above. An appropriate Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered May 4, 2011.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Warren W. Young, Esq.
James M. Sizemore, Jr., Esq.
Kim Peterson