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LORI HUDSON FLANERY
Secretary

THOMAS B. MILLER
Commissioner

In the matter of:

[redacted] and [redacted]

Contact: [redacted] and [redacted]

FINAL RULING NO. 2011-92
December 7, 2011

Individual Income Tax Assessments
for the 2007, 2008 and 2009 Tax Years

FINAL RULING

The Kentucky Department of Revenue ("the DOR") has issued assessments of tax, interest and penalties to [redacted] and [redacted] for the 2007, 2008 and 2009 tax years. The assessments were the result of a field examination of the [redacted] Kentucky individual income tax returns for those tax years. The following table provides a breakdown of the tax and penalties assessed and the interest that has accrued to date and which will continue to accrue until the assessment is paid:

Period	Tax	Interest	Penalties	Total
2007	$[redacted]	$[redacted]	$[redacted]	$[redacted]
2008	$[redacted]	$[redacted]	$[redacted]	$[redacted]
2009	$[redacted]	$[redacted]	$[redacted]	$[redacted]
Total	$[redacted]	$[redacted]	$[redacted]	$[redacted]

The [redacted] deducted various expenses on their federal income tax return's Schedule C, which reduced their federal adjusted gross income. A deduction of $[redacted] was taken on Schedule C of the 2007 federal return for car and truck expenses, repair and travel. A deduction of $[redacted] was taken on the 2008 Schedule C for car and truck expenses, advertising and utilities by [redacted] and $[redacted] for car and truck expenses, travel, rental of machinery and supplies by [redacted]. The [redacted] Schedule C for 2009 deducted $[redacted] for car and truck expenses, depreciation, supplies, cell phone, internet and storage.

The assessments set forth in the table above are based upon the DOR's disallowance of these deductions. The [redacted] have protested these assessments. For the reasons stated below, this protest is hereby denied and the DOR's assessments upheld.

The Kentucky individual income tax is governed by Chapter 141 of the Kentucky Revised Statutes. This tax is paid annually "by every resident individual upon his entire net income as defined in this chapter." KRS 141.020(1).

"Net income" is defined in KRS 141.010(11) as "adjusted gross income" as defined in KRS 141.010(10), minus various deductions. "Adjusted gross income" is in turn defined in KRS 141.010(10) as "gross income" as defined in KRS 141.0120(9) minus the deductions allowed individuals by Section 62 of the Internal Revenue Code and as modified by KRS 141.0101 and adjusted as set forth in KRS 141.010(10). "Gross income" is defined in KRS 141.010(9) "in the case of taxpayers other than corporations" as "'gross income' as defined in Section 61 of the Internal Revenue Code." "Internal Revenue Code" is defined in KRS 141.010(3) as

> The Internal Revenue Code in effect on December 31, 2006, exclusive of any amendments made subsequent to that date, other than amendments that extend provisions in effect on December 31, 2006, that would otherwise terminate, and as modified by KRS 141.0101, except that for property placed in service after September 10, 2001, only the depreciation and expense deductions allowed under Sections 168 and 179 of the Internal Revenue Code in effect on December 31, 2001, exclusive of any amendments made subsequent to that date, shall be allowed, and including the provisions of the Military Family Tax Relief Act of 2003, Pub. L. No. 108-121, effective on the dates specified in that Act;

It is further provided in KRS 141.050(1) that:

> Except to the extent required by differences between this chapter and its application and the federal income tax law and its application, the administrative and judicial interpretations of the federal income tax law, computations of gross income and deductions therefrom, accounting methods, and accounting procedures, for purposes of this chapter shall be as nearly as practicable identical with those required for federal income tax purposes. Changes to federal income tax law made after the Internal Revenue Code reference date contained in KRS 141.010(3) shall not apply for purposes of this chapter unless adopted by the General Assembly.

The federal courts have held that tax deductions and credits are matters of legislative grace and that a taxpayer must clearly establish his or her entitlement to a tax credit or deduction. United Dairy Farmers v. United States, 267 F.3d 510, 515-16 (6th Cir. 2001); 330 West Hubbard

Restaurant Corp. v. United States, 203 F.3d 990, 997 (7th Cir. 2000); Schiff v. United States, 942 F.2d 348, 352 (6th Cir. 1991). A tax assessment is presumed to be correct and the burden rests upon the taxpayer to establish that the assessment is erroneous. Reynolds v. C.I.R., 296 F.3d 607, 612 (7th Cir. 2002); Delaney v. C.I.R., 99 F.3d 20, 23 (1st Cir. 1996). The Kentucky courts have likewise recognized these well-settled principles of law. Hahn v. Allphin, 282 S.W.2d 824 (Ky. 1955); Bigelow v. Reeves, 285 Ky. 831, 149 S.W.2d 499 (1941).

The [redacted] have failed to prove their entitlement to the deductions claimed or that the assessments in question are erroneous. No records have been provided that would substantiate these deductions for the tax years in question.

It should also be noted that Section 274(d) of the Internal Revenue Code states:

> No deduction or credit shall be allowed –
>
> (1) Under section 162 or 212 for any traveling expense (including meals and lodging while away from home).
>
> * * * * *
>
> Unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement
>
> (a) the amount of such expense or other item,
> (b) the time and place of the travel, entertainment, amusement, recreation, or use of the facility or property, or the date and description of the gift.
> (c) the business purpose of the expense or other item, and
> (d) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. This subsection shall not apply to any qualified non-personal use vehicle (as defined in subsection(i)).

The [redacted] have not substantiated their deductions for these kinds of expenses in accordance with this provision of the Internal Revenue Code. See also, Reynolds v. C.I.R., 296 F.3d 607, 615-18 (7th Cir. 2002).

For each period, the [redacted] were assessed a late pay penalty in accordance with KRS 131.180. Because the [redacted] have failed to timely pay the taxes owed, the aforementioned penalty is a valid penalty assessment in accordance with KRS 131.180 (2), which states:

> Any taxpayer who fails to withhold or collect any tax as required by law, fails to pay the tax computed due on a return or report on or before the due date prescribed for it or the due date as extended by the department or, excluding underpayments determined pursuant to subsections (2) and (3) of KRS 141.990, fails to have timely paid at least seventy-five percent (75%) of the tax determined due by the department shall, unless it is shown to the satisfaction of the department that the failure is due to reasonable cause, pay a penalty equal to two percent (2%) of the tax not withheld, collected, or timely paid for each thirty (30) days or fraction thereof that the withholding, collection, or payment is late. The total penalty levied pursuant to this subsection shall not exceed twenty percent (20%) of the tax not timely withheld, collected, or paid; however, the penalty shall not be less than ten dollars ($10).

The [redacted] have failed to demonstrate why these penalties should not apply or that these penalties should be waived for reasonable cause.

For the reasons stated above, the individual income tax assessments referred to above are correct and legitimate liabilities due the Commonwealth of Kentucky.

This letter is the final ruling of the Kentucky Department of Revenue.

APPEAL

You may appeal this final ruling to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.110, KRS 131.340-131.365, 103 KAR 1:010 and 802 KAR 1:010. If you decide to appeal this final ruling, your petition of appeal must be filed at the principal office of the Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40601-3714, within thirty (30) days from the date of this final ruling. The rules of the Kentucky Board of Tax Appeals, which are set forth in 802 KAR 1:010, require that the petition of appeal must:

1. Be filed in quintuplicate;
2. Contain a brief statement of the law and facts in issue;
3. Contain the petitioner's or appellant's position as to the law and facts; and
4. Include a copy of this final ruling with each copy of the petition of appeal.

The petition of appeal must be in writing and signed by the petitioner or appellant. Filings by facsimile or other electronic means shall not be accepted.

Proceedings before the Kentucky Board of Tax Appeals are conducted in accordance with 103 KAR 1:010, 802 KAR 1:010 and KRS 131.340-131.365 and KRS Chapter 13B. Formal hearings are held by the Board concerning the tax appeals before it, with all testimony and proceedings officially reported. Legal representation of parties to appeals before the Board is governed by the following rules set forth in Section 3 of 802 KAR 1:010:

1. An individual may represent himself in any proceedings before the Board where his individual tax liability is at issue or he may obtain an attorney to represent him in those proceedings;
2. An individual who is not an attorney may not represent any other individual or legal entity in any proceedings before the Board;
3. Any party appealing a final ruling to the Board other than an individual, such as a corporation, limited liability company, partnership, joint venture, estate or other legal entity, shall be represented by an attorney in all proceedings before the Board, including the filing of the petition of appeal; and
4. An attorney who is not licensed to practice in Kentucky may practice before the Board only if he complies with Rule 3.030(2) of the Rules of the Kentucky Supreme Court.

You will be notified by the Clerk of the Board of the date and time set for any hearing.

Sincerely,
FINANCE AND ADMINISTRATION CABINET

E. Jeffrey Mosley

E. Jeffrey Mosley
Interim Executive Director
Office of Legal Services for Revenue

CERTIFIED MAIL
RETURN RECEIPT REQUESTED