

2018 US Tax Court Judicial Conference  
Panel on Schedule C Income and Expense

**Problem # 1 of 2**

**Substantiation of Expenses/Settlement Offer**

**Facts:**

In 2016, Ms. Lucy Blake worked as a nurse's aide for Apex Assisted Living in Tarrytown, New York. Her position included 2 types of work, 12-hour shifts in the facility where patients are cared for in rehabilitation and long-term care settings and 8-hour shifts in patient's homes. After rehabilitation patients are released from the facility, they are normally assigned a home aide for one, two or three 8-hour shifts per day. Apex assigns nurse's aides to cover all of the in-home care.

Ms. Blake was born in the Philippines in 1981. After moving to the United States in 2007, she received training and became licensed as a Home Health Aide in NY State. She began working at Apex Assisted Living in 2014. Her position required her to work three 12-hour shifts in the facility and at least two 8-hour shifts in patient's homes, although she was permitted to work up to four 8-hour shifts per week in addition to her 36-hour full-time work in the facility. She left Apex in 2017 after she noticed some questionable practices which in her opinion compromised patient safety.

In 2014 and 2015, Apex issued Ms. Blake a Form W-2 for her work in the facility and a Form 1099 for her work in the patient's homes. Apex instructed her that she could deduct all of her expenses related to her shifts in the patients home, such as commuting, supplies, uniforms, licensing fees, training courses and meals. She provided her tax preparer with all of the receipts and documents for these expenses and he claimed all of them as Schedule C deductions.

In 2016, Apex issued her, as usual, a Form W-2 for \$40,000 for her work in the facility and a Form 1099 for \$15,000 for her shifts in the patient's home. However, she also received a second Form 1099 for \$32,000. When she asked about the second Form 1099, the payroll people at Apex told her to ignore it, explaining that it was a mistake. When she went to her tax preparer, she didn't tell him about the second Form 1099 because she assumed that Apex had taken care of the error.

In late 2017, the IRS issued a correspondence audit letter to Ms. Blake which added the \$32,000 from the second Apex Form 1099 to her income and disallowed all of her claimed Schedule C expenses.

### **Substantiation:**

Ms. Blake sent the following documents to the Appeals Officer:

- A letter dated 2014 from Apex Assisted Living to Ms. Blake regarding her new position at the company which explained that she would be paid a salary while providing services within the company's facilities and that she would not be reimbursed for her expenses for her work at the patient's homes. The letter further explains that to stay eligible for her full-time position in the facility, she must work at least two 8-hour shifts per week (although more are permitted) in patient homes. Nurse's aides are not permitted to work only in the facility.
- Ms. Blake provided receipts and documentation for deductions of **\$14,156**.
  - Credit card statements and receipts for uniform expenses of **\$3,524**.
  - Credit card statements and receipts for supplies of **\$1,640.00**.
  - Receipts from taxi cabs for **\$3,137**.
  - Receipts for meals totaling **\$4,270**.
  - Receipts and certificates from licensing support and training courses for **\$1,500**.
  - Licensing Fee receipt for **\$85**.
- Ms. Blake also provided an affidavit explaining that -
  - she only earned \$15,000 for her work in patient's homes;
  - when she asked her employer about the second Form 1099, that they told her it was a mistake;
  - she has not been able to get any further information from Apex as she no longer works for the company; and

that she learned from a friend who still works at Apex that the company is under federal investigation for Medicare fraud.

### **Settlement Offer:**

- The Appeals Officer has offered a settlement which relies on the fact that the \$15,000 of income reported on the Schedule C represents 27% of the total \$55,000 of income from Apex. The offer -
  - allows 27% of the travel expenses;
  - allows 27% of the meals expenses; and
  - allows 27% of the remaining expenses on the Schedule C and moves the other 73% to Ms. Blakes Schedule A as unreimbursed employee expenses.
- Ms. Blake claimed the standard deduction, so the Appeals Officer has also allowed her state and local income taxes paid in 2016 of \$2,015.
- The settlement adds \$32,000 to Ms. Blake's income and imposes self-employment income on the entire \$32,000.
- The settlement offer asserts the section 6662 substantial understatement penalty.

### **Issues:**

- How can Ms. Blake prove that the expenses claimed on her Schedule C relate only to her Schedule C income and not to her Form W-2 income?
- How can Ms. Blake prove that she did not receive an additional \$32,000 from Apex in 2016? (Corrected Form 1099?)
- How can Ms. Blake challenge the section 6662 penalty? Who has the burden of proving managerial approval?

**Problem # 2 of 2**  
**Overstated Income/Substantiation**

**Facts:**

Mr. Ramos is an independent carpet installer. He works on contract for Government Carpet Contractors, Inc. (“GCC”). GCC has a number of government contracts with various U.S. agencies to install carpet. Mr. Ramos works with a team of colleagues, all Spanish speakers, who hail from the same area of Mexico and who travel from job to job together.

During 2014, GCC heard rumors that the federal personnel in charge of contracting were concerned about the use of undocumented subcontractors by those with federal contracts. In 2014, GCC told Mr. Ramos, a green card holder, that his leadership skills on the installation team were impressive and they told him that, beginning in 2015, they would like him to be a team leader. He would be responsible for bringing his team to a job and GCC would pay him for the entire job. He would be responsible for paying his teammates. In 2015, GCC duly paid Ramos for all jobs the team performed and furnished him a Form 1099.

Mr. Ramos went to a tax return preparer with the Form 1099 in January of 2016. The tax return preparer explained that if Ramos paid others, he must give each of them a Form 1099. Ramos had some papers showing how much he paid each teammate per job. He paid all in cash. Ramos filled out Forms 1099 by hand and mailed them to each teammate at the apartment complex where they shared several apartments.

Mr. Ramos filed his 2015 return showing the full amount received from GCC on Schedule C. He claimed as deductions his 2015 expenses as follows:

- The expense of compensation he paid his teammates
- The expense of travel to and from various jobs for GCC throughout the mid-Atlantic states
- Car expense for himself
- The expense of a cell phone he used to communicate with GCC and his teammates.

The IRS examined Mr. Ramos’ 2015 return and disallowed all claimed deductions. As it turned out, many of the 2015 team were getting nervous about immigration talk in the country during 2016 returned to their native country. The IRS said no one reported income that was reported to them on a Form 1099 from Mr. Ramos.

The IRS also found Mr. Ramos’ travel and cell expenses wanting for adequate substantiation.

**Issues:**

- Can Mr. Ramos challenge the amount reported on the Form 1099 is his income? When does the burden of proof shift under section 6201(d)?
- What evidence can Mr. Ramos introduce to support that he paid his teammates? Testimony? Documentary?
- What documents can he get from the IRS?
  - i.e. Proof of filing/reporting by teammates?
- Will noncontemporaneous evidence regarding Mr. Ramos’ travel be enough to support the deduction?
- Challenging the section 6662 penalty.