

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

RONALD J. AND CONSTANCE K.)	
STROH)	DOCKET NO.: IT-2005-1
)	
Appellants,)	
)	FACTUAL BACKGROUND,
-vs-)	CONCLUSIONS OF LAW,
)	ORDER AND OPPORTUNITY
THE DEPARTMENT OF REVENUE)	<u>FOR JUDICIAL REVIEW</u>
OF THE STATE OF MONTANA,)	
)	
Respondent.)	

The above-entitled appeal was heard on November 2, 2005, in the City of Glendive, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was given as required by law.

James W. Lenhardt, Certified Public Accountant, represented the taxpayers, Ronald J. and Constance K. Stroh. Derek R. Bell, Tax Counsel, and Sharon Myran, Field Auditor, Billings, represented the Department of Revenue (DOR). In addition to testimony from Mr. Lenhardt and Ms. Myran, exhibits were received in evidence. Mr. and Mrs. Stroh are the appellants in this proceeding and, therefore, have the burden of proof. Based on the evidence, this Board finds as follows:

STATEMENT OF THE ISSUE

The primary issue in this matter is whether Mr. Stroh is required to provide substantiation for the lodging costs deducted as employee business expenses or whether he may use a per diem method to substantiate the lodging deduction. Other issues include the substantiation required for cell phone costs and for Mrs. Stroh's mileage expense and whether they are eligible to deduct the costs of certain clothing as work clothing.

FACTUAL BACKGROUND

1. The Strohs work for a construction company and travel away from home to pursue their occupations. The parties agree that the Strohs are entitled to some deduction for the employee business expenses they incur while traveling away from home.

2. In May 2004, Sharon Myran, Field Auditor for the DOR, initiated a field audit of the Strohs' employee business expenses for 2003. (Exhibit K)

3. Based on the results of the 2003 audit, the DOR opened the years 1999 through 2002 to audit the Strohs' employee business expenses. (Exhibit E, Page 59)

4. In February 2005, the DOR notified the Strohs of new assessments based on the audit results. The new assessments totaled \$8672.24 (Exhibit E, Pages 136 through 144)

5. The Strohs filed a Notice of Referral to request a review by the DOR's Office of Dispute Resolution. That Office held a hearing on this matter on June 3, 2005. The Hearing Examiner issued an Order denying the Strohs' appeal on July 11, 2005. (Hearing Examiner's Findings of Fact, Conclusions of Law, and Order in the Matter of the Montana State Individual Income Tax Liability of Ronald and Constance K. Stroh for Tax Years 1999 through 2003)

6. As provided in Section 15-2-302, Montana Code Annotated, the Strohs appealed the DOR's decision to this Board, contesting "all issues related to the review of taxpayers [sic] returns for the years 1999 through 2003." (July 26, 2005 Letter from James W. Lenhardt to the Board)

7. The Board heard this appeal on November 2, 2005, in Glendive, Montana. Mr. Lenhardt presented testimony and exhibits in support of the appeal. Ms. Myran presented testimony and the DOR introduced exhibits in opposition to the appeal. At the outset of the hearing, the Board clarified with Mr. Lenhardt that the Strohs are appealing the decisions affecting Mr. Stroh's returns for the years 1999 through 2003 and Mrs. Stroh's returns for the years 2000 through 2003.

TAXPAYERS' CONTENTIONS

The Strohs contend that Mr. Stroh's employer reimburses him for away from home expenses under a nonaccountable plan. They

cite an April 1, 2005, letter from the CEO of Century Companies Inc. to Mr. Stroh which states:

In your case, however, we have agreed to pay a slightly higher-than-scale wage with the understanding that all expenses are to be paid for by you out of your wages. . . (Exhibit 11)

An October 28, 2005, letter from the Controller of Century Companies Inc. to Mr. Stroh adds:

This method of reimbursement for away from home expenses would be classified as a non accountable plan as we do not require receipts. (Exhibit 12)

All of Mr. Stroh's compensation is reported as wages on his W-2 form and he is taxed on the total amount. (Lenhardt Testimony)

Mr. Stroh asserts that this method of compensating him for his away from home expenses constitutes a nonaccountable plan (Exhibits 6 and 7) and he is, therefore, eligible to use a per diem amount as the basis for his lodging expense deduction. (Exhibit 5) The per diem amount used by Mr. Stroh is called a high-low rate, in which a taxpayer may deduct a specified amount in certain high-cost locations in the United States and a different amount for all other U.S. locations. (Exhibit 4) The taxpayer must substantiate days away from home and the business purpose for the travel, which Mr. Stroh maintains he has done. The taxpayer is not required to document specific lodging costs because the per diem is treated as substantiation of the amount

of the expense. The per diem amount for lodging deducted by Mr. Stroh is \$90 per day.

The Strohs both worked at the same locations when they were away from home but frequently found it necessary for each of them to have a vehicle at their work location. They do not believe that sufficient mileage was credited to Mrs. Stroh's expenses for the times she took her own vehicle to the work location.

The Strohs obtained a cell phone because their employer needed to be able to reach them when they were at a job site. (Exhibit E, Page 52) DOR has asked for records that break out the amount of business use and the amount of personal use of the cell phone. The Strohs maintain that DOR is requiring excessive documentation of their cell phone calls over a five-year period before allowing them to deduct the full amount that the cell phone costs them.

Finally, the Strohs believe that the coveralls their work requires are not a type of clothing that should be considered appropriate for general use, particularly for Mrs. Stroh. They feel that they should be able to deduct the cost of such clothing as an employee expense.

Although these latter items were appealed, the issue that really matters, according to the Strohs, is that the method Century Companies uses to compensate Mr. Stroh for his travel

expenses constitutes a nonaccountable reimbursement plan. (Testimony of Mr. Lenhardt) They insist that Mr. Stroh has appropriately deducted a per diem amount for lodging as part of his employee expenses because he is reimbursed under a nonaccountable plan.

DOR CONTENTIONS

The DOR agrees that the Strohs are entitled to deduct their employee business expenses, including their lodging, meals, and incidental expenses for the days they work away from home. However, DOR maintains that the Strohs must adequately substantiate their deductions for these expenses and they have failed to do so.

According to the DOR, the Century Companies' practice of paying a "slightly higher-than-scale wage" and requiring Mr. Stroh to pay for all of his own expenses does not constitute a "reimbursement or other expense allowance arrangement". Thus, the DOR does not agree that this arrangement is a nonaccountable plan under the Internal Revenue Code and the Treasury Regulations governing employee business expenses. The DOR noted that, even if the compensation arrangement between Mr. Stroh and his employer were considered a nonaccountable plan, it would make no difference. According to DOR, Mr. Stroh would have to substantiate his lodging expenses with receipts whether he was under a nonaccountable plan or no reimbursement plan.

(Testimony of Ms. Myran) DOR maintains that the Strohs could use a per diem amount for their meals but not for lodging expenses. (Exhibits A, B and D)

When working away from home, the Strohs used a travel trailer for lodging. The DOR has allowed the total amount of travel trailer expenses that the Strohs were able to substantiate with receipts. DOR allocated all of the substantiated lodging expense to Mr. Stroh. If this deduction had been split between Mr. and Mrs. Stroh, the additional amount due in tax would have been higher. (Exhibit E, Page 125, and Testimony of Ms. Myran)

For meals, the DOR stated that the Strohs claimed a per diem amount, which they are allowed to do. It appeared to the DOR that the Strohs each claimed \$36 a day for meals. However, the per diem rate for meals allowed by the Internal Revenue Service was \$30 per day for 1990 through most of 2003. The rate then went up to \$31 a day. (Exhibit E, Page 143, and Testimony of Ms. Myran)

The DOR originally disallowed all the mileage expense claimed by Mrs. Stroh because Mrs. Stroh's mileage log and her husband's mileage log were identical. In a subsequent conversation, Mrs. Stroh indicated that she drove a separate vehicle approximately 50% of the time. The DOR then accepted a deduction of 50% of the mileage claimed on the logs originally

submitted by Mrs. Stroh. (Exhibit E, Page 166, and Testimony of Ms. Myran)

In regard to the cell phone the Strohs used, the DOR accepted that the phone was an employee business expense. However, the Strohs only provided a total monthly bill to substantiate the cell phone expense and did not give the DOR any itemization that identified the costs associated with the business use of the phone versus any personal use. According to the DOR, the Strohs' cell phone bill in months that they were not working was sometimes higher than the lowest monthly bill in the year. (Testimony of Ms. Myran) Without further itemization, the DOR limited the deduction to \$30 a month for the cell phone, based on cell phone plans that charge this amount as the minimum charge for having a cell phone. (Exhibit E, Page 74, and Testimony of Ms. Myran)

In regard to the claimed deduction of clothing expenses, the DOR asserts that the type of clothing indicated on the receipts submitted by the Strohs is clothing that is appropriate for use as general apparel. Therefore, the clothing does not qualify as an employee business expense. (Exhibit E, Page 143, and Testimony of Ms. Myran)

BOARD DISCUSSION

The major issue in this appeal is whether the Strohs' lodging costs must be substantiated or whether they may use a

per diem amount for their lodging deduction. The Taxpayers maintain that their employer's practice of paying Mr. Stroh a slightly higher-than-scale wage out of which he must pay all of his expenses constitutes a nonaccountable plan for reimbursing expenses. The DOR maintains that there is no reimbursement occurring. Mr. Stroh's wage is simply that - a wage, not a wage plus reimbursement for expenses.

As both parties noted in their testimony, much of Montana's income tax regulation refers to and is governed by the federal Internal Revenue Code and Treasury Regulations. The Board has reviewed all pertinent portions of the Code and Regulations as well as the Internal Revenue Service's Publication 463, "Travel, Entertainment, Gift, and Car Expenses." Both the Taxpayers and the DOR introduced Exhibits containing portions of Publication 463 (Taxpayers' Exhibit 4 and DOR Exhibits D, E and H) However, the clearest statement of whether Mr. Stroh is covered by a reimbursement plan or not is in Part 6 of Publication 463, which neither party to this appeal included in their Exhibits. A subsection in Part 6, Publication 463 provides:

No reimbursement. You are not reimbursed or given an allowance for your expenses if you are paid a salary or commission with the understanding that you will pay your own expenses. In this situation, you have no reimbursement or allowance arrangement . . . (Board Exhibit I)

This portion of Publication 463 appears to describe exactly the understanding Mr. Stroh has with his employer and it makes clear that Mr. Stroh has no reimbursement or other expense allowance arrangement as those terms are used in regard to employee business expenses. Consequently, Mr. Stroh is not eligible to calculate his deduction for lodging expenses using a per diem amount and he must substantiate his lodging expenses with adequate records.

The Strohs must also limit the amount of their deductions for meal expenses to the standard meal allowance authorized, unless they can substantiate higher costs with adequate records.

Mrs. Stroh is required to document the times she used a separate vehicle for work purposes in order to deduct the appropriate mileage. She has had the opportunity to do so and appears to prefer to estimate her business mileage at a level that the DOR has accepted. Thus, her mileage deduction is limited to the level accepted by the DOR.

The documentation required by the DOR to determine the business use of the Strohs' cell phone seems excessive to the Taxpayers. Without such documentation for at least a sampling of months, however, the DOR has no way to determine the extent to which the Strohs used their cell phone for personal calls. Given the extent to which the Strohs' employment takes them away from home, the Board is unwilling to believe that they have not

used the cell phone for personal calls as well as for business calls. The DOR has acknowledged the business necessity of the Strohs' cell phone and accepted a deduction at a reasonable level for the phone.

Finally, the Taxpayers have not introduced any evidence to persuade the Board that the work clothing purchased by the Strohs cannot be worn at times when they are not working.

CONCLUSIONS OF LAW

1. The State Tax Appeal Board has jurisdiction over this matter. §15-2-302, Montana Code Annotated.
2. Adjusted gross income - trade and business deductions of employees. §62(a)(2)(A), IRC.
3. Adjusted gross income - arrangements not treated as reimbursement arrangements. §62(c), IRC.
4. Certain expenses - substantiation required. §274(d), IRC.
5. Substantiation requirements. 26 CFR 1.274-5 and 26 CFR 1.274-5A.
6. Internal Revenue Service Publication 463 (2003), Travel, Entertainment, Gift, and Car Expenses.
7. The appeal of the Taxpayers is denied and the decision of the Department of Revenue is upheld.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the tax and interest assessed by the DOR are properly due and owing for tax years 1999 through 2003.

DATED this 5th day of January 2006.

BY ORDER OF THE
STATE TAX APPEAL BOARD

GREGORY A. THORNQUIST, Chairman

(S E A L)

JOE ROBERTS, Member

SUE BARTLETT, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 5th day of January, 2006, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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