
**PURSUANT TO INTERNAL REVENUE CODE
SECTION 7463(b), THIS OPINION MAY NOT
BE TREATED AS PRECEDENT FOR ANY
OTHER CASE.**

T.C. Summary Opinion 2014-108

UNITED STATES TAX COURT

TORY M. WATSON, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 26032-11S.

Filed December 8, 2014.

E. Rhett Buck, Jr., for petitioner.

Portia Neomi Rose, for respondent.

SUMMARY OPINION

MORRISON, Judge: This case was heard pursuant to section 7463 of the Internal Revenue Code in effect when the petition was filed. Pursuant to section

7463(b), the decision to be entered is not reviewable by any other court, and this opinion shall not be treated as precedent for any other case.¹

The respondent (referred to here as the “IRS”) issued a notice of deficiency to the petitioner, Tory M. Watson (referred to here as “Watson”), for the 2005 and 2006 tax years determining: (1) income-tax deficiencies of \$2,282² for 2005 and \$26,257 for 2006; (2) additions to tax for 2006 of \$5,633 under section 6651(a)(1) and \$6,259 under section 6651(a)(2); and (3) an accuracy-related penalty for 2006 of \$5,251 under section 6662(a).

After trial the parties settled many of the issues. The remaining issues to be resolved involve the tax treatment of certain business expenses of LLCs Watson owned. Specifically, the remaining issues are:

- (1) The amount of the rental-expense deduction for Skyline Motion Pictures, LLC, for 2005. We hold that the amount is \$16,605.
- (2) The amount of the contract-labor-expense deduction for Skyline Motion Pictures, LLC, for 2005. We hold that the amount is \$75,153.

¹All subsequent section references are to the Internal Revenue Code in effect for the years at issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

²All dollar amounts are rounded to the nearest dollar.

- (3) The amount of the contract-labor-expense deduction for Skyline Movement, LLC, for 2006. We hold that the amount is \$14,778.
- (4) The amount of the contract-labor-expense deduction for Liberation Financial, LLC, for 2006. We hold that the amount is \$8,900.

Background

The stipulated facts and the supplemental stipulation of facts are incorporated by this reference. Watson resided in Texas at the time he filed the petition.

From 2002 through 2006 Watson was an employee in the mortgage industry. During 2005 Watson was employed by DSG Mortgage, LLC, and First Capital Mortgage Corp. as a loan originator. During 2006 Watson was employed by First Capital Mortgage Corp. as a loan originator.

Watson prepared his own federal-income-tax returns for 2005 and 2006. He filed these returns late. Watson's 2005 return included Schedules C, "Profit or Loss From Business," for two LLCs that he owned and operated: Britt and Skyline Motion Pictures. Through Britt, Watson engaged in the business of making and selling clothing. Through Skyline Motion Pictures, Watson engaged in the business of producing films and other entertainment.

During 2006 Watson abandoned Skyline Motion Pictures' business of producing films and other entertainment. He changed the name of the LLC to Skyline Movement. Through Skyline Movement, Watson engaged in website design and other consulting services. On his 2006 return he included a Schedule C for Skyline Movement. He also included a Schedule C for Liberation Financial, LLC, another LLC that he owned and operated. Through Liberation Financial, Watson advised mortgage companies on improving their overall performance and the performance of their loan officers. All three LLCs (Skyline Motion Pictures/Skyline Movement, Britt, and Liberation Financial) were disregarded entities for federal tax purposes. Therefore, Watson is treated for federal tax purposes as if he operated the LLCs as sole proprietorships. The IRS does not challenge the existence of the businesses the LLCs conducted or that the businesses were operated for profit.

On the Schedule C for Skyline Motion Pictures for 2005 Watson claimed business-expense deductions of \$291,558. On the Schedule C for Britt for 2005 Watson claimed business-expense deductions of \$10,839. Watson reported that neither business had gross income for 2005. On the Schedule C for Skyline Movement for 2006 Watson claimed business-expense deductions of \$152,940. On the Schedule C for Liberation Financial for 2006 Watson claimed business-

expense deductions of \$208,426. Watson reported gross income for both Skyline Movement and Liberation Financial for 2006.

On August 9, 2011, the IRS mailed a notice of deficiency to Watson for both 2005 and 2006. In the notice of deficiency, the IRS disallowed:

- all business-expense deductions that Watson claimed on the Schedule C for Skyline Motion Pictures for 2005,
- all business-expense deductions that Watson claimed on the Schedule C for Britt for 2005,
- \$70,016 of the business-expense deductions that Watson claimed on the Schedule C for Skyline Movement for 2006, and
- \$97,973 of the business-expense deductions that Watson claimed on the Schedule C for Liberation Financial for 2006.

The IRS also determined that for 2005 Watson had earned \$67 in interest and received \$1,376 attributable to a refund from the State of Illinois Revenue Department. The IRS also made computational adjustments for both years to Watson's self-employment taxes, adjusted gross income, itemized deductions, and net operating losses. The IRS determined: (1) income-tax deficiencies of \$2,282 for 2005 and \$26,257 for 2006; (2) additions to tax for 2006 of \$5,633 under

section 6651(a)(1) and \$6,259 under section 6651(a)(2); and (3) an accuracy-related penalty for 2006 of \$5,251 under section 6662(a).

The case was tried in Houston, Texas. After trial the parties reached a partial settlement. The parties agreed that: (1) Watson's income for 2005 is increased by \$67 for interest and \$1,376 for the refund from the State of Illinois Revenue Department; (2) any adjustments to Watson's self-employment taxes, adjusted gross income, itemized deductions, and net operating losses for 2005 and 2006 are computational; and (3) for 2006 Watson is liable for additions to tax under section 6651(a)(1) and (2) and a penalty under section 6662(a) for any underpayment that is determined. As for the Schedule-C adjustments, it appears to us that the settlement agreement resolved all Schedule-C adjustments except for the following four categories:

- a rental-expense deduction for Skyline Motion Pictures for 2005,
- a contract-labor-expense deduction for Skyline Motion Pictures for 2005,
- a contract-labor-expense deduction for Skyline Movement for 2006,
and
- a contract-labor-expense deduction for Liberation Financial for 2006.

The following tables summarize: (1) the categories of Schedule-C expenses that Watson reported; (2) the amounts Watson claimed on his returns for each category; (3) the amounts allowed in the notice of deficiency for each category; and (4) the parties' positions regarding the deductible amounts for each category, as reflected in the pleadings, the concessions made at trial, the settlement agreement, and the briefs.

<u>Skyline Motion Pictures (2005)</u>			
<u>Item</u>	<u>Amount per return</u>	<u>Amount allowed in notice of deficiency</u>	<u>Parties' positions</u>
Advertising	\$20,734	-0-	\$20,565 (as settled)
Business use of home	16,877	-0-	-0- (as settled)
Car and truck expenses	8,489	-0-	2,430 (as settled)
Contract labor	85,843	-0-	¹ 78,861 (Watson) -0- (IRS)
Depreciation	8,621	-0-	4,625 (as settled)
Legal & professional services	15,822	-0-	8,480 (as settled)
Office expense	2,901	-0-	11,767 (as settled)
Rent or lease of "[o]ther business property"	22,769	-0-	23,055 (Watson) -0- (IRS)
Supplies	15,392	-0-	² -0-
Travel	26,491	-0-	² -0-
Meals and entertainment	12,287	-0-	² -0-
Utilities	10,035	-0-	794 (as settled)

“Other expenses”	45,297	-0-	15,431 (as settled)
Total	291,558	-0-	64,092 (settled as deductible) plus 101,916 (still sought by Watson)

¹This amount is explained infra Discussion part 2.a.

²Watson did not argue for any deduction at trial or on brief. These are deemed conceded. See, e.g., Hedrick v. Commissioner, 63 T.C. 395, 396-397 (1974).

<u>Britt (2005)</u>			
<u>Item</u>	<u>Amount per return</u>	<u>Amount allowed in notice of deficiency</u>	<u>Parties’ positions</u>
Supplies	\$421	-0-	\$5,420 (as settled)
“Other expenses”	10,418	-0-	-0- (as settled)
Total	10,839	-0-	5,420 (settled as deductible)

<u>Skyline Movement (2006)</u>			
<u>Item</u>	<u>Amount per return</u>	<u>Amount allowed in notice of deficiency</u>	<u>Parties’ positions</u>
Advertising	\$1,643	\$1,643	¹ \$1,643
Car and truck expenses	33,225	33,225	¹ 33,225
Contract labor	26,870	-0-	² \$14,778 (Watson) -0- (IRS)
Depreciation	13,056	13,056	¹ 13,056
Legal & professional services	4,350	4,350	¹ 4,350
Rent or lease of “[o]ther business property”	2,100	2,100	¹ 2,100

Supplies	9,235	9,235	¹ 9,235
Travel	6,912	5,169	1,237 (as settled)
Meals and entertainment	26,135	1,565	486 (as settled)
Utilities	6,289	6,289	¹ 6,289
“Other expenses”	23,125	6,292	8,617 (as settled)
Total	152,940	82,924	³ 80,238 plus 14,778 (still sought by Watson)

¹Neither party sought an amount different than the amount allowed in the notice of deficiency.

²This amount is explained infra Discussion part 2.b.

³This consists of: (1) amounts agreed to in settlement and (2) amounts determined in notice of deficiency in categories for which neither party sought an amount different than the amount allowed in the notice of deficiency.

<u>Liberation Financial (2006)</u>			
<u>Item</u>	<u>Amount per return</u>	<u>Amount allowed in notice of deficiency</u>	<u>Parties' positions</u>
Advertising	\$27,125	\$27,125	¹ \$27,125
Contract labor	45,548	-0-	260,582 (Watson) -0- (IRS)
Legal & professional services	3,875	3,875	¹ 3,875
Office expenses	36,030	36,030	¹ 36,030
Supplies	13,516	13,516	¹ 13,516
Taxes and licenses	1,350	1,350	¹ 1,350
Travel	4,291	552	2,480 (as settled)
Meals and entertainment	38,513	3,779	2,672 (as settled)
Utilities	18,393	18,393	¹ 18,393

“Other expenses”	19,785	5,833	7,111 (as settled)
Total	208,426	110,453	³ 112,552 plus 60,582 (still sought by Watson)

¹Neither party sought an amount different than the amount allowed in the notice of deficiency.

²This amount is explained infra Discussion part 2.c.

³This consists of: (1) amounts agreed to in settlement and (2) amounts determined in notice of deficiency in categories for which neither party sought an amount different than the amount allowed in the notice of deficiency.

Discussion

Generally, the taxpayer bears the burden of proving, by a preponderance of the evidence, that the determinations in the notice of deficiency are erroneous. Rule 142(a)(1); Welch v. Helvering, 290 U.S. 111, 115 (1933). Section 7491(a) imposes the burden of proof on the IRS with respect to fact issues for which the taxpayer: (1) complied with the substantiation requirements of the Internal Revenue Code; (2) maintained all records required under the Internal Revenue Code; (3) cooperated with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews; and (4) introduced credible evidence. Credible evidence is the quality of evidence which the Court would find sufficient upon which to base a decision on the issue in the taxpayer’s favor, absent any contrary evidence. See, e.g., Higbee v. Commissioner, 116 T.C. 438, 442 (2001). Watson argues that he has satisfied the conditions required to impose

the burden of proof on the IRS. We need not decide whether section 7491(a) imposes the burden of proof on the IRS. This is because our findings are supported by the preponderance of the evidence. See Knudsen v. Commissioner, 131 T.C. 185, 189 (2008).

Section 162(a) authorizes a deduction for ordinary and necessary expenses that were paid or incurred during the taxable year in carrying on the taxpayer's trade or business, including rental payments, section 1.162-1(a), Income Tax Regs., and payments for services, section 1.162-7(a), Income Tax Regs. An expense is "ordinary" if either it is customary or usual within the particular trade, business, or industry or it relates to a transaction "of common or frequent occurrence in the type of business involved." Deputy v. du Pont, 308 U.S. 488, 495 (1940). An expense is "necessary" if it is both appropriate and helpful to the taxpayer's trade or business, see, e.g., Welch v. Helvering, 290 U.S. at 113, and it is directly connected with or pertains directly to the taxpayer's trade or business, sec. 1.162-1(a), Income Tax Regs. Being an employee is considered a trade or business, and thus the ordinary and necessary expenses of employment are deductible under section 162(a), provided, however, that the employee cannot seek reimbursement of the expenses from the employer. See, e.g., Benson v. Commissioner, T.C. Memo. 2007-113, 93 T.C.M. (CCH) 1199, 1201 (2007)

(citing Podems v. Commissioner, 24 T.C. 21, 23 (1955)). Personal, family, and living expenses are generally not deductible. Sec. 262(a).

If the taxpayer establishes that the taxpayer paid or incurred a deductible expense but does not establish the amount of the expense, then the court may estimate the amount of the allowable deduction if there is sufficient evidence in the record to provide a rational basis for the estimate. Cohan v. Commissioner, 39 F.2d 540, 542-544 (2d Cir. 1930); Vanicek v. Commissioner, 85 T.C. 731, 742-743 (1985). If the evidence in the record does not provide a rational basis for the estimate, the claimed deduction must be disallowed. Vanicek v. Commissioner, 85 T.C. 731 at 742-743.

1. Rental-expense deduction for 2005

Watson claimed a rental-expense deduction of \$22,769 on the Schedule C for Skyline Motion Pictures for 2005. In the notice of deficiency, the IRS disallowed that deduction. At trial and on brief Watson asserted that he is entitled to a rental-expense deduction of \$23,055 for Skyline Motion Pictures for 2005 consisting of:

- \$4,500 that Watson allegedly paid to Gerry Licea to rent a unit in an unidentified building as an office for Skyline Motion Pictures for February, March, and April 2005,

- \$15,605 that Watson allegedly paid to Sarah Bajwa to rent Unit 711 as an office for Skyline Motion Pictures for June through December 2005, and
- \$2,950 that Watson allegedly paid to lease a house in Los Angeles for one week for business meetings for Skyline Motion Pictures.

The IRS disputes the deductibility of any rental expense for Skyline Motion Pictures for 2005.

As discussed more fully below, we hold that Watson is entitled to a total rental-expense deduction of \$16,605 for Skyline Motion Pictures for 2005, which consists of:

- Zero of the \$4,500 allegedly paid to Gerry Licea,
 - \$13,655 of the \$15,605 allegedly paid as rent for Unit 711, and
 - \$2,950 of the \$2,950 paid to lease the house in Los Angeles.
- a. Rental-expense deductions for rental of an office from Gerry Licea

Watson testified that he paid \$4,500 to Gerry Licea to lease “a unit in a different building” (i.e., different from 125 East 13th Street, Chicago, Illinois, which was the office of Skyline Motion Pictures beginning in June 2005) at the rate of \$1,500 per month for February, March, and April 2005. The documentary evidence confirms that Watson made one \$1,500 payment to Gerry Licea.

However, Watson's testimony about the alleged office was vague and tentative. He did not tell us the address of the "different building". He supplied no other details about the office or what he used it for. No documents in the record corroborate Watson's testimony. His vague, uncorroborated testimony was too weak to be credible on this point. Consequently, Watson is not entitled to any deduction for rental payments to Gerry Licea for an office for Skyline Motion Pictures for 2005.

b. Rental-expense deduction for rental of Unit 711

Unit 711 was a condominium loft with a kitchen and a bedroom in a residential building at 125 East 13th Street, Chicago, Illinois. During 2005, Watson owned and lived in Unit 1406, also at 125 East 13th Street, Chicago, Illinois.

Watson explained in detail how he used Unit 711: He kept audiovisual equipment in the unit, he wrote movie scripts in the unit, and he met there with Skyline Motion Pictures' contractors. Watson's testimony was credible. We hold that the rent payments for Unit 711 were an ordinary and necessary business expense.

To prove the amount of rent he paid for Unit 711, Watson provided a copy of the signed lease agreement for Unit 711. The agreement required Watson to

pay a monthly rent of \$1,950 per month and \$50 per month for a parking space.

The term of the lease was from June 4, 2005, to June 4, 2006. Watson also provided copies of these checks and cleared-check images written on Skyline Motion Picture's bank account, written to Sarah Bajwa:

- a check dated May 26, 2005, for \$1,950 for "deposit" for "Unit 1406",
- a check dated May 26, 2005, for \$1,755 for "June 2005 rent",
- a check dated July 18, 2005, for \$1,950 for "July Rent #711",
- a check dated August 1, 2005, for \$1,950 for "August Rent #711",
- a check dated September 2, 2005, for \$2,000 for "Sept '05 Rent and Parking", and
- a check dated October 4, 2005, for \$2,000 for "Oct Rent - Apt #711".

Watson testified that the first check, which was noted as "deposit" for "Unit 1406", actually related to Unit 711, not Unit 1406. We take this to be true.

However, the check appears to be a payment of a security deposit, not rent.

Security deposits are not deductible, if at all, until the year actually forfeited.

Williams v. Commissioner, T.C. Memo. 1998-93, 75 T.C.M. (CCH) 1933, 1938 (1998).

On the basis of Watson's testimony, copies of checks and cleared-check images, and the signed lease agreement, we find that Watson paid \$1,755 for rent for June 2005, \$1,950 for rent for July 2005, \$1,950 for rent for August 2005, \$2,000 for rent for September 2005, and \$2,000 for rent for October 2005.

Watson testified that he paid rent for November and December 2005, but he could not find checks or other documents to substantiate the payments. We found his testimony credible. We find that he paid \$2,000 for rent for each of these two months. Consequently, Watson is entitled to deduct \$13,655 for renting Unit 711 for Skyline Motion Pictures for 2005.

c. Rental-expense deduction for lease of a house in Los Angeles

Watson claimed a rental-expense deduction for Skyline Motion Pictures for a \$2,950 payment made in 2005. At trial Watson testified that the purpose of the payment was to lease a furnished, single-family house for Skyline Motion Pictures to be used for one week of business meetings while he attended the Los Angeles International Film Festival. We found Watson's testimony credible. Consequently, Watson is entitled to deduct the \$2,950 payment as a rental expense for Skyline Motion Pictures for 2005.³

³Watson testified that he stayed at the house during the week. Thus, the expense could arguably be a "lodging" expense subject to the "strict-

(continued...)

2. Contract-labor-expense deductions for 2005 and 2006

As discussed more fully below, we hold that Watson is entitled to contract-labor-expense deductions of:

- \$75,153 for Skyline Motion Pictures for 2005,
- \$14,778 for Skyline Movement for 2006, and
- \$8,900 for Liberation Financial for 2006.

a. Contract-labor-expense deduction for Skyline Motion Pictures for 2005

Watson claimed a contract-labor-expense deduction of \$85,843 on the Schedule C for Skyline Motion Pictures for 2005. The IRS disallowed the deduction in full. At trial and on brief Watson asserted that he is entitled to a contract-labor expense deduction of \$81,767 for Skyline Motion Pictures for 2005. However, during trial Watson conceded that four expenses included in the \$81,767 totaling \$2,906 are not deductible. These expenses included: (1) a check dated January 4, 2005, written to Ben Goldhirsh for \$353; (2) a check dated April 10, 2005, written to Commercial Edison for \$141; (3) a check dated October 11, 2005, written to A B Chicagoland for \$500; and (4) a check dated June 22, 2005, written

³(...continued)
substantiation” requirements of sec. 274(d)(1) and sec. 1.274-5T(b)(2), Temporary Income Tax Regs., 50 Fed. Reg. 46014 (Nov. 6, 1985). However, the IRS did not challenge the deduction on this ground.

to Duo Consulting for \$1,912, which was counted twice in the \$81,767 total. We therefore consider that it is Watson's position that the deductible amount of this category of expenses is \$81,767 minus \$2,906, or \$78,861. The IRS disputes the deductibility of any contract-labor expenses for Skyline Motion Pictures for 2005.

To document those expenses Watson provided numerous copies of checks, cleared-check images, partial bank statements, and a few invoices. Watson also provided copies of the non-disclosure agreements that he entered into with some of the contract laborers for Skyline Motion Pictures. The copies of checks, cleared-check images, bank statements, and invoices that Watson provided substantiate the amounts he paid as contract-labor expenses for Skyline Motion Pictures for 2005. Furthermore, Watson credibly testified to the business purpose for nearly all of the contract-labor expenses for Skyline Motion Pictures for 2005 for which he seeks a deduction; only a few of the expenses reported for Skyline Motion Pictures appear to be nondeductible.

On the basis of Watson's credible testimony and the corroborating documentary evidence, we hold that he is entitled to a contract-labor-expense deduction of \$75,153 for Skyline Motion Pictures for 2005. The following table summarizes the deductibility of the contract-labor expenses for Skyline Motion Pictures for 2005:

<u>Skyline Motion Pictures (2005)</u> <u>Contract-labor expenses</u> <u>(\$81,767 claimed on brief)</u>			
<u>Payee</u>	<u>Amount claimed on brief</u>	<u>Amount deductible</u>	<u>Reasoning</u>
A B Chicagoland	\$500	-0-	Watson conceded at trial
Ben Goldhirsh	353	-0-	Watson conceded at trial
Brian Bubser	1,750	\$1,750	Expense of designing Skyline's website
Com Ed	141	-0-	Watson conceded at trial
Design 4 U	585	-0-	Watson testified that the expense was to install 17 curtains in Unit 1406, which was his personal residence at the time. This is a non-deductible personal expense. ¹
Duo Consulting	3,824	1,913	Expense was included twice
Jelena Zanko	27,575	27,575	Consulting, promotional, marketing, creative, and writing services
Jelena Zanko	104	104	Reimbursement to Jelena Zanko for her payment of Skyline Motion Pictures' business expenses
Jonathan Jacobs	4	-0-	Watson could not remember purpose
M W Design	600	600	Design services and print coordination
Mike Laha	5,084	5,084	Consulting services; provided advice on the film industry, including production, budgeting, and screenwriting
Mike Laha	170	170	Reimbursement to Mike Laha for his payment of Skyline Motion Pictures' business expenses
Nicole Cavallo	21,025	21,025	Consulting services
Nicole Cavallo	20	20	Reimbursement to Nicole Cavallo for her payment of Skyline Motion Pictures' business expenses

Patrick Loughman	1,250	1,250	Consulting service for the film industry
Patrick Loughman	1,500	-0-	The memo line on the check reads “Personal loan” and Watson did not present evidence sufficient to overcome the implication that this is not deductible. ¹
Paul Niemeyer of Niemeyer Illustrations	5,750	5,750	Artwork services, designed a movie poster
Proline Mechanical Inc.	158	158	Service call to balance the bulb in a projector Watson used for business presentations
Quist Interactive	7,500	7,500	Web design and development services
SPOT Animation	1,000	1,000	Animation services; created a marketing trailer
Tony Gonzalez	1,620	-0-	Watson testified that this expenses was for electrical work done in Unit 1406, which was his personal residence at the time. This is a non-deductible personal expense. ¹
Tony Gonzalez	1,255	1,255	Electrical work for communications in Unit 711, which was Watson’s office at the time.
Total	81,767	75,153	

¹See sec. 262(a).

b. Contract-labor-expense deduction for Skyline Movement for 2006

Watson claimed a contract-labor-expense deduction of \$26,870 on the Schedule C for Skyline Movement for 2006. The IRS disallowed the deduction in full. At trial and on brief Watson contended that he is entitled to a contract-labor expense deduction of only \$14,778 for Skyline Movement for 2006. The IRS

disputes the deductibility of any contract-labor expenses for Skyline Movement for 2006.

To document the contract-labor expenses for Skyline Movement for 2006, Watson submitted numerous copies of checks, cleared-check images, and bank statements from his personal bank account. These substantiate the amounts Watson paid as contract-labor expenses for Skyline Movement for 2006. Furthermore, Watson credibly testified to the business purpose for all of the contract-labor expenses for Skyline Movement for 2006 for which he seeks a deduction.

On the basis of Watson's credible testimony and the corroborating documentary evidence, we hold that Watson is entitled to a contract-labor-expense deduction of \$14,778 for Skyline Movement for 2006. The following table summarizes the deductibility of the contract-labor expenses for Skyline Movement for 2006:

<u>Skyline Movement (2006)</u> <u>Contract-labor expenses</u> <u>(\$14,778 claimed on brief)</u>			
<u>Payee</u>	<u>Amount claimed on brief</u>	<u>Amount deductible</u>	<u>Reasoning</u>
Jacob Watson	\$630	\$630	Business artwork services; creation of artwork for She Beads, which was a business Watson consulted for in 2005.

Jelena Zanko	13,425	13,425	Business marketing, writing, and consulting services
Kurt Kroeck	400	400	Business artwork services
Nicole Cavallo	323	323	Business marketing and consulting services
Total	14,778	14,778	

c. Contract-labor-expense deduction for Liberation Financial for 2006

Watson claimed a contract-labor-expense deduction of \$45,548 on the Schedule C for Liberation Financial for 2006. The IRS disallowed the deduction in full. At trial and on brief Watson contended that he is entitled to a contract-labor-expense deduction of \$60,582 for Liberation Financial for 2006. The IRS disputes the deductibility of any contract-labor expenses for Liberation Financial for 2006.

To document the contract-labor expenses for Liberation Financial for 2006, Watson provided numerous copies of checks, cleared-check images, and bank statements. These substantiate some of the amounts that Watson claims he paid as contract-labor expenses for Liberation Financial for 2006. Furthermore, Watson credibly testified to the business purpose for some of the contract-labor expenses for Liberation Financial for 2006 for which he seeks a deduction.

However, for many of the contract-labor expenses that Watson reported for Liberation Financial for 2006, it appears to us, on the basis of his testimony and

the memorandum lines on several of the checks that he provided as proof of payment, that all the payments he made to Melissa DeSitter, Ben Goldhirsh, Dominic Garner, Jonathan Jones, Reginald Ray, and Tony Gonzalez are related to his employment. In 2006 Watson was employed as a loan originator by First Capital Mortgage. Liberation Financial was in the business of management consulting and advised primarily mortgage companies, including First Capital Mortgage, in order to help improve the overall performance of each company and its loan officers. Watson asserted that none of the expenses he claims as deductions for Liberation Financial were related to his employment as a loan originator for First Capital Mortgage. The payments that Watson made to Melissa DeSitter, Ben Goldhirsh, Dominic Garner, Jonathan Jones, Reginald Ray, and Tony Gonzalez all appear to be for services these individuals performed in connection with his employment as a loan originator. These expenses are deductible only if Watson could not seek reimbursement from his employer. See Podems v. Commissioner, 24 T.C. at 23. The record does not support the proposition that Watson could not seek reimbursement for these expenses. Therefore they are not deductible.

On the basis of Watson's credible testimony with respect to some of these expenses and corroborating documentary evidence, we hold that he is entitled to a

contract-labor-expense deduction of \$8,900 for Liberation Financial for 2006.

The following table summarizes the deductibility of the contract-labor expenses that Watson reported for Liberation Financial for 2006:

<u>Liberation Financial (2006)</u> <u>Contract-labor expenses</u> <u>(\$60,582 claimed on brief)</u>			
<u>Payee</u>	<u>Amount claimed on brief</u>	<u>Amount deductible</u>	<u>Reasoning</u>
Ben Goldhirsh	\$663	-0-	Watson testified that Ben Goldhirsh provided loan-processing services in the mortgage loan business and that expenses paid to Goldhirsh were incurred on behalf of his employer. These expenses appear to be related to Watson's employment as a loan originator and not his Schedule-C business of management consulting.
Brian Bubser	2,000	\$2,000	Website and graphic design
Dominic Garner	14,650	-0-	Watson testified that Dominic Garner performed "[l]ead generation, communication with borrowers, going and getting applications signed, picking up documents". The memo lines on all the checks read "Advance". These expenses appear to be related to Watson's employment as a loan originator and not his Schedule-C business of management consulting.
Holly Bartle	250	250	Promotional work
Jacob Watson	1,200	1,200	Marketing, design, and artwork services
Jelena Zanko	3,000	3,000	Marketing and writing services
Jennifer McCullah	250	250	Promotional work
Jonathan Jones	8,065	-0-	Watson testified that Jonathan Jones performed services that were "very similar to Dominic Garner". The memo lines on the checks read

			either “Commissions” or “advance”. These expenses appear to be related to Watson’s employment as a loan originator and not his Schedule-C business of management consulting.
Kurt Kroeck	1,700	1,700	Marketing, design, and artwork services
Leticia Winn	250	250	Promotional work
Melissa DeSitter	26,554	-0-	Watson testified that Melissa DeSitter was like an executive assistant for his consulting business and that she “sent out and confirmed that lead mailing campaigns were going out, dealt with borrowers, dealt with lead companies” and “communicat[ed] with borrowers, lenders, title companies, prospects, closing agents in the mortgage consulting business”. The few memo lines available read “[Month] Bonus”. These expenses appear to be related to Watson’s employment as a loan originator and not his Schedule-C business of management consulting.
Nicole Cavallo	500	-0-	The memo line on this check reads “repayment of loan”. This suggests that the payment was the repayment of loan principal, which is nondeductible. Watson did not testify what this payment was for.
Reginald Ray	350	-0-	Watson testified that Reginald Ray “provided some sort of closing activities with a borrower”. These expenses appear to be related to Watson’s employment as a loan originator and not his Schedule-C business of management consulting.
Satin Grable	250	250	Promotional work
Tony Gonzalez	900	-0-	Watson testified that this expense was to have electrical work done, but he could not remember where it was done; the work may have been done at Unit 711 or at his employer’s office. These expenses appear to be expenses Watson paid on behalf of his employer.
Total	60,582	8,900	

In reaching our holdings, we have considered all arguments made, and, to the extent not mentioned, we conclude that they are moot, irrelevant, or without merit.

To reflect the foregoing,

Decision will be entered under Rule

155.