Case No._____

IN THE
Supreme Court of the United States

NAREN CHAGANTI

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR A WRIT OF CERTIORARI

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Plaintiff pro se

QUESTIONS PRESENTED

1) Whether stipulations filed under Tax Court Rule 91(a) & (e) are binding on the parties and the Tax Court.

2) Whether statements in a court order in one case may be used for their truth in a different case over a hearsay objection.

3) Whether litigation sanctions ordered by a district court and paid to an opposing party are "fines" or "penalties" "paid to a government" under Internal Revenue Code § 162(f) (2006), in light of the change to the code section enacted in the Tax Cuts & Jobs Act of 2017.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Naren Chaganti hereby respectfully petitions for a writ of certiorari to review the judgment in this case by the United States Court of Appeals for the Eighth Circuit in Appendix A and B.

I. OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit (App.3 *infra*, B) is unreported. The opinion of the United States Tax Court is reported at 2013 T.C.M. 285 (App.33-43 F) as ordered (App.31, E) and 2016 T.C.M. 222 (App. 5-30 D), as ordered April 19, 2017 (App. 4, C)

II. JURISDICTION

The Commissioner's Notice of Determination of Deficiency was dated January 12, 2012. A timely Petition to the Tax Court was mailed on March 14, 2012 and filed on March 19, 2012. The Tax Court entered its final judgment on December 7. 2016. Plaintiff filed a timely notice of appeal from that decision to the Ninth Circuit Court of Appeals on March 6, 2017 alleging that he resided in California. On challenge to the venue by the Commissioner, the Ninth Circuit transferred the case to the Eighth Circuit in the interests of justice. The Eighth Circuit entered its decision on December 14, 2018. (App.3. B) A timely motion for rehearing was filed on January 14, 2019, which motion was denied on February 12, 2019. (App.1-2, A) The Tax Court's jurisdiction was predicated under 26 U.S.C § 7442. The Court of Appeals had jurisdiction under 26

U.S.C. § 7482. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

III. RULES AND STATUTORY PROVISIONS

Tax Court Rule 91 subds. (a) & (e) provide, in relevant part:

RULE 91. STIPULATIONS FOR TRIAL

(a) Stipulations Required: (1) *General:* The parties are required to stipulate …, regardless of whether such matters involve fact or opinion or the application of law to fact.

(e) Binding Effect: A stipulation shall be treated, to the extent of its terms, as a conclusive admission by the parties to the stipulation, unless otherwise permitted by the Court or agreed upon by those parties. ....

Fed. R. Evid. 802 provides,

Rule 802. The Rule Against Hearsay

Hearsay is not admissible unless any of the following provides otherwise:

- a federal statute;
- these rules; or
- other rules prescribed by the Supreme Court.

(As amended Apr. 26, 2011, eff. Dec. 1, 2011.)

26 U.S.C. § 162(f) (as amended by The Tax Cuts and Jobs Act of 2017) provides, in part:

> 162(f) Fines, Penalties, and Other Amounts.--

> (3) EXCEPTION FOR AMOUNTS PAID OR INCURRED AS THE RESULT OF CERTAIN COURT ORDERS.—Paragraph (1) shall not apply to any amount paid or incurred by reason of any order of a court in a suit in which no government or governmental entity is a party.

See Pub. L. 115-97; reported in Cong. Rec. H10280 2017-12-20 (full text)

IV. STATEMENT OF THE CASE

In tax year 2006 Petitioner paid court-ordered litigation sanctions under 28 U.S.C. § 1927 and took deduction for the amount as ordinary and necessary in the practice of law, or alternatively as losses incurred in a trade or business.

The Commissioner for Internal Revenue denied the deductions, and the tax court, relying solely on the statements made in the district court order, characterized the imposition as not "ordinary" or "necessary" under IRC § 162(a)[1] and also stated that the mere fact that a court imposed the sanctions made it nondeductible "fine" or "penalty" paid to "a government" under § 162(f). It also invoked "public policy" in disallowing deduction under § 165(c).

When the parties filed cross-motions for partial summary judgment, Petitioner objected to the use of the statements in the district court order for the

[1] IRC stands for the Internal Revenue Code. Unless otherwise indicated section references are to the Internal Revenue Code as applicable to the tax years at issue.

truth of the matters asserted therein. In open court, Petitioner and the Commissioner entered into a written stipulation pursuant to Tax Court Rule 91 that the district court order was "to be used to establish business purpose and not for the truth of the matter asserted."

The Tax Court nevertheless relied on the court order and affirmed the Commissioner. On appeal, the Eighth Circuit Court of Appeals affirmed the Tax Court, stated that the "mere fact" that a district judge ordered sanctions did not make them nondeductible, but ignored the binding nature of the stipulation and relied on the contents of the district court's order.

This created a split in the circuits as to both the binding nature of Rule 91 stipulations and use of another court order for the truth of the matter therein over a hearsay objection.

Another issue is whether court-ordered sanctions against an attorney and paid to an opposing party are deductible as ordinary and necessary trade expenses under IRC § 162(a). The Tax Court applied § 162(f) and equated such payment "fine" or "penalty" paid to a government, reasoning that a payment paid at the direction of a court is tantamount to being "paid to a government" under the code section. This code section has been recently amended in 2017 to clarify that such nondeductibility of fines and penalties applies only if the government or a government entity is a party to the proceeding.

REASONS TO GRANT THE PETITION

A. Tax Court stipulations are binding

The importance of stipulations in tax cases has been acknowledged for many years by almost every circuit court of appeal. *See, e.g., Shah v. C.I.R.*, 790 F.3d 767, 770 (7th Cir. 2015); *Shami v. C.I.R.*, 741 F.3d 560, 574 (5th Cir. 2014); *Farrell v. C.I.R.*, 136 F.3d 889, 897 (2d Cir. 1998) [Stipulations are uniquely important to the Tax Court.]; *Bail Bonds by Marvin Nelson, Inc. v. C.I.R.*, 820 F.2d 1543, 1547-48 (9th Cir. 1987);

The parties and the Tax Court entered into a written stipulation in open court that an order by a district court from another case was not to be used for the truth of the statements made therein, but only to establish "business purpose" to assess whether litigation sanctions paid pursuant to the order were "ordinary and necessary" under § 162(a), which is a threshold requirement for deducting expenses incurred in a trade or business.

The stipulation was binding on the Commissioner. And yet, the Commissioner breached this stipulation, and the Tax Court as well as the Eighth Circuit ignored the breach, which should not be permitted.

Even in non-tax situations, this Court has held repeatedly that stipulations are binding and conclusive. See *Standard Fire Ins. Co. v. Knowles*, 568 U.S. 588, 592 (2013); *Christian Legal Soc. Chapter v. Martinez*, 561 U.S. 661, 677 (2010) [holding that stipulations are "binding and conclusive" ..., and "not subject to subsequent variation."] "Litigants, … "[a]re entitled to have [their] case tried upon the assumption that ... facts,

stipulated into the record, were established." (*Id.*, at 676)(citations).

The Eighth Circuit not only conflicted with other circuit courts of appeal, but also departed from this Court's binding precedent. This warrants grant of certiorari to resolve the conflicts between the circuits. Alternatively, the Court is requested to enter a GVR order. See *Thomas v. Am. Home Prods Inc.*, 519 U.S. 913 (1996) (Scalia, J.)

B. Statements in court orders are hearsay

Many circuits held that statements made in court orders are inadmissible hearsay if used for the truth of the matters asserted. See *Nipper v. Snipes*, 7 F.3d 415, 417 (4th Cir. 1993); *United States v. Jones*, 29 F.3d 1549, 1554 (11th Cir. 1994); *Herrick v. Garvey*, 298 F.3d 1184, 1191-92 (10th Cir. 2002); *United States v. Boulware*, 384 F.3d 794, 806 (9th Cir. 2004); *United States v. Sine*, 483 F.3d 990, 993 (9th Cir. 2007).

In contrast to the other circuits, the Eighth Circuit relied solely on statements made in a court order for their truth and held that a judge's statements made in an order imposing litigation sanction against an attorney (to pay the opposing side's legal fees) is sufficient to characterize the payment as nondeductible fine or penalty paid to a government under § 162(f). This created a split in the circuits.

C. COURT ORDERED SANCTIONS PAID TO AN OPPOSING PARTY ARE NOT FINES OR PENALTIES PAID TO A GOVERNMENT.

In the recently enacted Tax Cuts & Jobs Act of 2017, Congress has amended § 162(f) to state that a government must be a party to the action in order for the sanction to be non-deductible.

The Government characterized the issue of deductibility of court-ordered sanctions under §§ 162(a) and 162(f)/165(c) as an issue of first impression. The Tax Court took it axiomatic that any judicial imposition of a sanction was a "fine" and thereon ruled that it was not "ordinary" or "necessary" for the practice of law.

The Eighth Circuit, in a terse statement, stated that § 162(a) did not apply to this case, but did not explicate why §§ 162(f) or 165(c) would apply, though the Tax Court relied *only* on § 162(a) as basis to apply §§ 162(f) or 165(c).

The Tax Court's view was based on its view of "public policy," which according to the Tax Court must deny deductions for litigation sanctions. However, such pronunciation of "public policy" is the sole prerogative of Congress and the Tax Court appears to have "usurped the legislative function by carving out this special group of expenses and making them nondeductible." *Textile Mills Sec. Corp. v. Comm'r*, 314 U.S. 326, 338 (1941).

Because Congress did not create a "public policy" rationale to disallow deduction of court-ordered payments as trade or business expenses or losses in trade or business, neither the government nor the courts are empowered to determine national policy based on insufficiently developed facts or arguments

from a single case. Such wresting of Congressional power violates the separation of powers doctrine. *New Colonial Ice Co., Inc. v. Helvering*, 292 U.S. 435, 440 (1934) ["whether and to what extent deductions shall be allowed depends on legislative grace…."]

In *Commissioner v. Heininger*, 320 U.S. 467 (1943) this Court allowed deduction of an expense—incurred as attorney's fees by a mail order dentist in unsuccessfully resisting a charge of fraud by the Postmaster General—stating that disallowing an otherwise ordinary and necessary business expense was proper only when allowance would "frustrate sharply defined national or state policies proscribing particular types of conduct." *Id.*, at 473.

In *Lilly v. Commissioner*, 343 U.S. 90 (1952), this Court allowed an optician to deduct kickbacks paid to an ophthalmologist for referring patients because no applicable state statute made such payments illegal, and no identified "public policy" existed barring such payments and thus there was no frustration of sharply defined public policy. (*Id.*, 96-97). Importantly, both Heininger & Lilly found the expenses to be "ordinary and necessary."

And in *Commissioner v. Tellier*, 383 U.S. 687, 691 (1966), this Court allowed deduction of legal fees incurred by a securities dealer who was convicted of securities fraud, stating that income tax is not a morality based punishment for wrongdoing. "Only where the allowance of a deduction would "frustrate sharply defined national or state policies proscribing particular types of conduct" have we upheld its disallowance." *Id.*, at 694 (quoting *Commissioner v. Heininger*, 320 U.S. 467, 473 (1943)).

After the Tax Reform Act of 1969 was enacted, this Court invented no "public policy" that was not legislatively defined. Congress has jealously guarded its prerogative to enact deductions. See S. Rep. No. 92-437, 92nd Cong. 1st Sess. at 72 ["The Committee continues to believe that the determination of when a deduction should be denied should remain under the control of Congress"].

The Tax Court's decision circumvented the legislature's right to decide deductibility (or denial of deductibility) of punitive damages, fines, penalties etc.

V. CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

Dated: May 9, 2019

s/
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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No: 17-3804

Naren Chaganti

Appellant

v.

Commissioner of Internal Revenue

Appellee

Appeal from The United States Tax Court
(7344-12)

ORDER

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

February 12, 2019

Order Entered at the Direction of the Court:
Clerk, U.S. Court of Appeals, Eighth Circuit.

/s/ Michael E. Gans

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No: 17-3804

Naren Chaganti

Appellant

v.

Commissioner of Internal Revenue

Appellee

Appeal from The United States Tax Court
(7344-12)

Submitted: October 29, 2018
Filed: December 14, 2018
[Unpublished]

Before LOKEN, BENTON, SHEPHERD, Circuit Judges.

PER CURIAM.

Naren Chaganti appeals from a tax court decision upholding the Commissioner's determination finding him liable for income tax deficiencies and penalties related to his 2006 and 2007 taxes.

Following a careful review, see *DKD Enter.v. C.I.R.*, 685 F.3d 730, 734 (8th Cir. 2012) (tax court's legal conclusions are reviewed de novo and its factual findings for clear error; unless claimed deductions come clearly within scope of statute, they are not to be allowed); see also *Parrish v. C.I.R.*, 168 F.3d 1098, 1102 (8th Cir. 1999) (tax court's finding that taxpayer is liable for accuracy-related penalties under 26 U.S.C. § 6662 is reviewed for clear error). Although we do not affirm the tax court's conclusion that the mere fact that petitioner was ordered to pay opposing counsel attorney's fees under [28 U.S.C.] § 1927, demonstrates that those amounts were not ordinary and necessary to the practice of law, for reasons explained by the tax court we conclude that the Commissioner's determination of income tax deficiencies and penalties was correct. Critically, the district judge's sanctions order details the facts in this case which show that the payments are not deductible under the Internal Revenue Code §§ 162(f) and 165(a). See *Katoch v. Mediq/PRN Life Support Services, Inc.*, 2007 WL2434052 at *6-10 (E.D. Mo. 2007), affd, 330 Fed.Appx. 626 (8th Cir. 2009). Accordingly, we affirm. See 8th Cir. R. 47B. Agreeing with the district court, for the reasons stated, we affirm the judgment of the district court.

APPENDIX C

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UNITED STATES TAX COURT

NAREN CHAGANTI,)
Petitioner,) SD
v.) Docket No. 7344-12
)
COMMISSIONER OF)
INTERNAL REVENUE,) Lodged Electronically
Respondent.)

DECISION

Pursuant to the opinion of the Court filed December 7, 2016, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax due from petitioner for the taxable years 2006 and 2007 in the amounts of $8,892.00 and $21,492.00, respectively;

That there are additions to tax due from petitioner for the taxable years 2006 and 2007, under the provisions of I.R.C. § 6651(a)(1), in the amount of $1,992.00 an $5,081.25, respectively; and

That there are penalties due from petitioner for the taxable years 2006 and 2007, under the provisions of I.R.C. § 6662(a), in the amounts of $1,778.40 and $4,298.40, respectively.

(Signed) Ronald L. Buch
Judge

Entered: APR 19 2017

SERVED **APR 19 2017**

APPENDIX D

T.C. Memo. 2016-222

UNITED STATES TAX COURT

NAREN CHAGANTI, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 7344-12. Filed December 7, 2016.

Naren Chaganti, pro se[1]. Jessica R. Nolen, Karen O. Myrick, and Stephen A. Haller, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

BUCH, Judge: Naren Chaganti is an attorney with clients in both Missouri and California. Mr. Chaganti deducted expenses associated with his legal services business for 2006 and 2007 and a net operating loss (NOL) carryforward from prior years to offset his taxable income for 2007. The Commissioner determined that Mr. Chaganti was not entitled to deductions for many of the expenses or to a foreign tax credit he claimed, that he was not entitled to deduct the NOL carryforward, that he owed additional self-employment tax, and that he

[1] Although Mr. Chaganti filed an entry of appearance with the Court to represent himself, his status as an attorney does not change the fact that he is appearing "pro se", which translates to "for oneself".

was liable for section 6651(a)(1) additions to tax and section 6662(a) accuracy-related penalties for those years.[2] Mr. Chaganti did not keep adequate records to substantiate many of the expenses he reported, and he failed to prove that he had any NOL to carry forward. He also filed his tax returns late for the years in issue. Accordingly, because of failure of proof, neither is Mr. Chaganti entitled to deductions for many of the expenses and to the claimed foreign tax credit, nor is he entitled to deduct an NOL carryforward. He is also liable for the section 6651(a)(1) additions to tax for failure to file returns and the section 6662(a) accuracy-related penalties.

FINDINGS OF FACT[3]

Mr. Chaganti is a self-employed attorney who practices in Missouri and California. During the years in issue 12 of his docketed cases with activity were in St. Louis, Missouri, 1 was in Kansas City, Kansas, 2 were in Los Angeles, California, and 2 were in the San Francisco Bay area.[4]

Mr. Chaganti used two different addresses, one in St. Louis, Missouri, and one in Los Angeles,

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[2] Unless otherwise indicated, all section references are to the Internal Revenue Code (Code) in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. All monetary amounts are rounded to the nearest dollar.

[3] We issued a previous opinion in this case. *Chaganti v. Commissioner*, T.C. Memo. 2013-285. We incorporate the findings of fact in that opinion by this reference.

[4] We reserved ruling on Exhibit 29-P. That exhibit was offered by Mr. Chaganti, but he did not cite it in his proposed findings of fact. In contrast, the Commissioner objected to Exhibit 29-P but relied on it in his answering brief. Thus, we will treat his objection as withdrawn and admit Exhibit 29-P.

California, but had closer ties to St. Louis. He maintained a Missouri driver's license and had family ties to St. Louis during the years in issue. Accordingly, his principal residence was in St. Louis, Missouri.

Mr. Chaganti traveled from Missouri to California. Mr. Chaganti provided Southwest Airlines confirmations for some of the flights that he took during the years in issue. Most of the Southwest Airlines confirmations show that he paid less than $10 for each of the tickets. Mr. Chaganti explained that he purchased Southwest Airlines travel coupons or vouchers from Southwest Airlines patrons or employees and used them to purchase round trip tickets for himself at a cost of approximately $325 per round trip; however, Mr. Chaganti did not provide any proof of payment.

I. Tax Returns

A. Prior Years

For tax year 2002[5] Mr. Chaganti filed his Form 1040, U.S. Individual Income Tax Return, and reported $25,218 in adjusted gross income.

For tax year 2003 Mr. Chaganti filed his Form 1040 and reported negative adjusted gross income of $18,048. He did not elect to forgo the NOL carryback requirement for that year. He attached a Schedule C, Profit or Loss From Business, to his 2003 return for his legal services business, reporting gross receipts of $31,568 and expenses of $50,360, resulting in a net loss of $18,792.

For tax year 2004 Mr. Chaganti filed his Form 1040 reporting negative adjusted gross income of

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[5] Neither party offered evidence into the record about Mr. Chaganti's tax reporting for tax years before 2002.

$60,061. Mr. Chaganti did not elect to forgo the NOL carryback for that year. The negative adjusted gross income of $60,061[6] is attributable in part to Mr. Chaganti's Schedule C legal services business. On his Schedule C he reported gross receipts of $30,255 and total expenses of $89,598, which yields a net loss of $59,343. Included in the total expenses were contract labor expenses of $55,000. Mr. Chaganti provided substantiation for approximately $23,600 of these expenses, $7,500 of which is for contract labor.[7]

For tax year 2005 Mr. Chaganti filed his Form 1040 and reported negative adjusted gross income of $29,104. Mr. Chaganti did not elect to forgo the NOL carryback for that year. The negative adjusted gross income of $29,104 is attributable in part to Mr. Chaganti's Schedule C legal services business. On his Schedule C he reported gross receipts of $71,200 and total expenses of $106,589, which yields a net loss of $31,968. Included in the total expenses were contract labor expenses of $55,000. Mr. Chaganti did not substantiate these expenses. The only evidence Mr. Chaganti offered to substantiate these expenses was

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[6] Mr. Chaganti reported a Schedule C business loss of $59,343 but erroneously reported this amount as a passive activity loss. Mr. Chaganti also reported negative adjusted gross income of $19,510, which included a net loss of $18,792 from his 2003 Schedule C on line 21 of his Form 1040 that he characterized as an NOL. His negative adjusted gross income of $19,510 should not include the $18,792 but should include the Schedule C loss of $59,343. This would result in a negative adjusted gross income of $60,061.

[7] The Commissioner disputes that Mr. Chaganti has shown that certain of these expenses were business related.

statements that he requested per diem reimbursements from his brother's business.[8]

B. Years in Issue--2006 and 2007

Mr. Chaganti filed his Form 1040 for tax year 2006 late, and the Commissioner received his return on June 8, 2010. On his Schedule C Mr. Chaganti reported gross receipts of $43,200, travel expenses of $3,695, meals and entertainment expenses of $1,245, and other expenses of $40,000, which he described as "Prior years travel and per diem expense", in addition to other expenses. Overall, he reported a net business loss of $13,048. He attached a Form 8582, Passive Activity Loss Limitations, to his return and listed a prior year's unallowed passive loss of $59,343 described as "LEGAL SERVICES".

Mr. Chaganti filed his Form 1040 for tax year 2007 late, and the Commissioner received his return on May 28, 2010. On his Schedule C Mr. Chaganti reported gross receipts of $80,397, travel expenses of $3,463, meals and entertainment expenses of $2,226, and other expenses of $43,535, which comprised "Prior years travel and per diem expense" of $22,200, "Court ordered payments" of $20,425, and "Filing [f]ees for appeals, writs" of $910, in addition to other expenses. He attached a Form 8582 to his return and listed a prior year's unallowed passive loss of $59,343 described as "LEGAL SERVICES" and used $17,208 of the loss to offset $17,208 in legal services income from his Schedule C business, leaving an overall net business profit of zero. He also claimed a foreign tax credit of $6.

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[8] The reimbursement statements that are dated 2005 show that Mr. Chaganti requested $16,240. However, there are no underlying documents such as receipts or canceled checks to show that Mr. Chaganti actually paid any expenses.

II. Notice of Deficiency

On January 6, 2012, the Commissioner issued a notice of deficiency determining the following deficiencies, additions to tax, and penalties with respect to Mr. Chaganti's Federal income tax for years 2006 and 2007:

Year	Deficiency	Addition to tax sec.6651(a)(1)	Penalty sec. 6662(a)
2006	9,332	2,102	1,866
2007	21,936	5,192	4,387

The Commissioner determined that Mr. Chaganti was not entitled to deduct the travel expenses, meals and entertainment, and other expenses[9] that he reported for those years on his Schedules C. The Commissioner determined that he was liable for additional self-employment tax because of his increased net earnings but could take a corresponding deduction. For 2007 the Commissioner determined that Mr. Chaganti could not deduct an NOL carryforward of $17,208 and that he was not entitled to a foreign tax credit of $6.

III. Tax Court Case

While residing in Missouri, Mr. Chaganti timely filed a petition for redetermination.

Mr. Chaganti moved for partial summary judgment on whether he could deduct (1) business expenses he had paid in previous years and (2) the

[9] For 2006 the Commissioner disallowed the entire $40,000 Mr. Chaganti deducted for other expenses on Schedule C. For 2007 the Commissioner allowed $910 of the $43,535 total other expenses he deducted on Schedule C.

Court-ordered payments of $20,687 that he made in 2007. The Commissioner filed a cross-motion for partial summary judgment on the same issues. On December 17, 2013, the Court issued an opinion on these motions. *Chaganti v. Commissioner*, T.C. Memo. 2013-285.

With respect to the first issue, the Court found that Mr. Chaganti had received $40,000 and $22,200 in 2006 and 2007, respectively, from his brother's business as reimbursement for expenses paid in 2001 through 2005. Id. at *4, *8. The Court explained that Mr. Chaganti "was not entitled to deductions for tax years 2006 and 2007 for reimbursements related to business expenses paid in prior years." Id. at *8. However, the Court did not determine the "veracity of the expenses themselves." Id. at *8 n.6. Because Mr. Chaganti had not shown whether he included those expenses in the NOLs he reported for 2003, 2004, and 2005, the Court did not decide this issue. Id. at *9.

With respect to the issue involving the deductibility of the Court-ordered payments totaling $20,687, the Court decided that issue in part. The Court held that Mr. Chaganti was barred under section 162(f) from deducting the $2,300 he paid in 2007. Id. at *10. The Court did not address the deductibility of the $262 sanction that Mr. Chaganti paid to opposing counsel as reimbursement for deposition fees. Id. at *10-*11. However, the Commissioner later conceded that Mr. Chaganti could deduct this amount. Finally, although the Court held that Mr. Chaganti could not deduct the $18,125 sanction imposed against him under 28 U.S.C. sec. 1927 (2006) because it was not an ordinary and necessary business expense under

section 162, the Court left open the question of whether he could deduct this payment under a different theory. Id. at *12-*13.

Later, the Court held trial on the remaining issues in St. Louis, Missouri. At the close of trial we instructed Mr. Chaganti to prepare a chart or table that tied his claimed travel expenses to a trip. We explained:

> So, for example, if you say I was in Los Angeles on March 13th of 2007. And you can direct me to a docket sheet and you can direct me to a Southwest voucher. Then what you can do in your brief, maybe it's a table, maybe it's a chart, but you can include in your brief, you know, travel to L.A., Southwest voucher this date, duration of travel, three days.

As part of his brief, Mr. Chaganti provided a table that purported to detail when he traveled during the years in issue. Mr. Chaganti prefaced the table with this disclaimer:

> Petitioner presents the following table with the number of days spent at each location based on his best information and recollection. It is respectfully suggested that there may be slight discrepancies between this table and other records.

The table had the following information: start date, end date, place, and number of days. The table did not include any citations of any documents in the record.

Overall, a myriad of issues remains for us to decide. The Commissioner conceded that a portion of Mr. Chaganti's travel was business related, that he was entitled to deduct a portion of his reported travel expenses,[10] and that he could deduct the $262 sanction he paid to opposing counsel in 2007. After these concessions, the remaining issues we must decide are: (1) whether the burden of proof shifts to the Commissioner; (2) whether Mr. Chaganti is entitled to deduct the remaining travel and meals and entertainment expenses he reported; (3) whether Mr. Chaganti can offset net business profit with an NOL he carried forward from prior years; (4) whether Mr. Chaganti can reduce the gross receipts he reported; (5) whether Mr. Chaganti can deduct the $18,125 sanction he paid pursuant to a Court order under 28 U.S.C. sec. 1927; (6) whether Mr. Chaganti is entitled to a foreign tax credit of $6 for 2007; (7) whether Mr. Chaganti is liable for additional self-employment tax but entitled to a corresponding deduction; (8) whether Mr. Chaganti is liable for section 6651(a)(1) failure to file additions to tax; and (9) whether Mr. Chaganti is liable for section 6662(a) accuracy-related penalties. We will take each issue in turn.

OPINION

I. Burden of Proof

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[10] The Commissioner conceded $529 in travel expenses for 2006 and $507 in travel expenses for 2007.

For various business related trips, the Court finds that Mr. Chaganti was away from his tax home for a total of 25 days in 2006 and 15 days in 2007.

The Commissioner's determinations in the notice of deficiency are generally presumed correct, and taxpayers bear the burden of proving otherwise.[11] The burden with respect to a factual issue may shift to the Commissioner under section 7491(a) if the taxpayer has introduced credible evidence regarding the issue, has complied with the necessary substantiation requirements, has maintained all records, and has cooperated with reasonable requests by the Commissioner for witnesses, information, documents, meetings, and interviews. Mr. Chaganti argues that the burden of proof should shift; however, he has not met the statutory requirements to shift the burden because he failed to substantiate many of the expenses he reported. Accordingly, the burden of proof remains on him.

II. Deductions

The Code allows a deduction for "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business".[12] Taxpayers are not allowed a deduction for personal, living, or family expenses except where specifically allowed in the Code.[13] Deductions are a "matter of legislative grace",[14] and taxpayers must maintain sufficient records to establish their claimed deductions.[15] These records must be retained for as long as the contents may become material and must be kept available for inspection.[16]

A. Strict Substantiation

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[11] Rule 142(a); *Welch v. Helvering*, 290 U.S. 111, 115 (1933).

[12] Sec. 162(a).

[13] Sec. 262(a).

[14] INDOPCO, *Inc. v. Commissioner,* 503 U.S. 79, 84 (1992).

[15] Sec. 6001; sec. 1.6001-1(a), Income Tax Regs.

[16] Sec. 1.6001-1(e), Income Tax Regs.

Certain expenses are subject to strict substantiation rules under section 274(d). Such expenses include those relating to travel, meals and entertainment, gifts, and listed property under section 280F(d)(4).[17] For the years in issue listed property included passenger automobiles, any other property used as a means of transportation, any property of a type generally used for purposes of entertainment, recreation, or amusement, computers, and cellular telephones.[18] To comply with the strict substantiation rules, the taxpayer must have adequate records or sufficient evidence corroborating the amount of the expense, the time and the place the expense was incurred, the business purpose of the expense, and the business relationship of the taxpayer to any others benefited by the expense.[19] To substantiate by adequate records, the taxpayer must maintain an account book, a log, a diary, or a similar record and documentary evidence to establish each element of an expenditure.[20]

In some instances the Court may approximate the amount if the taxpayer can establish a deductible expense but cannot substantiate the precise amount.[21]

However, the taxpayer must provide some basis for that estimate.[22] And the Court is precluded from making estimates with regard to expenses that are

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[17] Sec. 274(d).

[18] Sec. 280F(d)(4).

[19] Sec. 274(d).

[20] Sec. 1.274-5T(c)(2)(i), Temporary Income Tax Regs., 50 Fed. Reg. 46017 (Nov. 6, 1985).

[21] *Cohan v. Commissioner*, 39 F.2d 540, 543-544 (2d Cir. 1930).

[22] *Vanicek v. Commissioner*, 85 T.C. 731, 742-743 (1985).

subject to the strict substantiation requirements under section 274(d).[23]

B. Per Diem Expense Deduction

As discussed above, section 162(a) allows a deduction for "the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business".[24] Taxpayers are also allowed to deduct traveling expenses "while away from home in the pursuit of a trade or business". The term "away from home" is not defined in the Code. Accordingly, the Commissioner adopted the "sleep or rest rule", which was first articulated by the U.S. Court of Appeals for the Fifth Circuit in *Williams v. Patterson*, 286 F.2d 333, 340 (5th Cir. 1961):[25]

> If the nature of the taxpayer's employment is such that when away from home, during released time, it is reasonable for him to need and to obtain sleep or rest in order to meet the exigencies of his employment or the business demands of his employment, his expenditures (including incidental expenses, such as tips) for the purpose of obtaining sleep or rest are deductible traveling expenses under Section 162(a)(2) of the 1954 Code.

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[23] *Deely v. Commissioner*, 73 T.C. 1081, 1101 (1980); sec. 1.274-5T(a), Temporary Income Tax Regs., 50 Fed. Reg. 46014 (Nov. 6, 1985).

[24] Sec. 162(a)(2).

[25] See Rev. Rul. 61-221, 1961-2 C.B. 34 (adopting the "sleep or rest rule").

The Supreme Court has acknowledged this rule as achieving "not only ease and certainty of application but also substantial fairness".[26]

Although traveling expenses may be deducted under section 162, they are subject to the strict substantiation requirements of section 274(d)(1). Pursuant to section 1.274-5(g), Income Tax Regs., the Commissioner may prescribe alternative methods of substantiating certain expenses, including per diem allowances. Accordingly, the Commissioner provides an optional method by which, in certain circumstances, employees and self-employed individuals who pay or incur business-related meal and incidental expenses may use an amount computed at the Federal meals and incidental expenses rate for the locality of travel for each calendar day that the individual is away from home.[27] These expenses are deemed substantiated for purposes of section 274(d) if the individual can substantiate the time, place, and business purpose of the travel in accordance with the regulations.[28] Again, to substantiate an expense a taxpayer must offer sufficient evidence to corroborate the taxpayer's statements or adequate records;[29] and to substantiate by adequate records, the taxpayer must maintain an account book, a log, a diary, or a similar

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[26] *United States v. Correll*, 389 U.S. 299, 303 (1967).

[27] Rev. Proc. 2007-63, 2007-2 C.B. 809; Rev. Proc. 2006-41, 2006-2 C.B. 777; Rev. Proc. 2005-67, 2005-2 C.B. 729.

[28] Rev. Proc. 2007-63, sec. 4.03, 2007-2 C.B. at 811-812; Rev. Proc. 2006-41, sec. 4.03, 2006-2 C.B. at 780; Rev. Proc. 2005-67, sec. 4.03, 2005-2 C.B. at 732.

[29] Sec. 274(d).

record and documentary evidence to establish each element of an expenditure.[30]

When determining a taxpayer's "tax home" we have previously held that as a general rule, a taxpayer's tax home is defined as the taxpayer's principal place of business.[31] Conversely, "[a]n employee without a principal place of business may treat a permanent place of residence at which he incurs substantial continuing living expenses as his tax home."[32] And if a taxpayer does not have a principal place of business or a permanent residence, then the taxpayer's home is "wherever he happens to be."[33]

Taxpayers have the burden of proof to show that they had a tax home, and this inquiry is a factual question.[34] We have previously explained that "[w]hile the subjective intent of the taxpayer is to be considered in determining whether he has a tax home, for purposes of section 162(a)(2), this Court and others consistently have held that objective

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[30] Sec. 1.274-5T(c)(2)(i), Temporary Income Tax Regs., supra.

[31] *Daly v. Commissioner*, 72 T.C. 190, 195 (1979), aff'd, 662 F.2d 253 (4th Cir. 1981); Kroll v. Commissioner, 49 T.C. 557, 562 (1968).

[32] *Barone v. Commissioner*, 85 T.C. 462, 465 (1985) (relying on *Sapson v. Commissioner*, 49 T.C. 636, 640 (1968)), aff'd, 807 F.2d 177 (9th Cir. 1986).

[33] *James v. United States*, 308 F.2d 204 (9th Cir. 1962); *Barone v. Commissioner*, 85 T.C. at 465 (relying on *Brandl v. Commissioner,* 513 F.2d 697, 699 (6th Cir. 1975), aff'g T.C. Memo. 1974-160, and Rosenspan v. United States, 438 F.2d 905, 912 (2d Cir. 1971)).

[34] *Rambo v. Commissioner*, 69 T.C. 920, 924-925 (1978).

financial criteria bear a closer relationship to the underlying purpose of the deduction."[35]

Mr. Chaganti's principal place of business during the years in issue was St. Louis, Missouri. Twelve of his seventeen docketed cases during those years were in St. Louis. Mr. Chaganti argued that this breakdown did not provide the full picture because the California cases represented higher potential revenue. However, he did not offer records to show a closer connection between his business and California. Accordingly, Mr. Chaganti's principal place of business was St. Louis, and his tax home was St. Louis.

As previously explained, travel expenses are subject to strict substantiation. Beyond the travel expense deductions that the Commissioner conceded, we hold that Mr. Chaganti is entitled to deduct only per diem amounts for meal expenses for those trips that the Commissioner conceded were business-related travel when Mr. Chaganti was away from his tax home of St. Louis, Missouri. The exact per diem amounts for meals and incidental expenses, computed at the Federal meals and incidental expenses rate for the locality of travel for each calendar day that Mr. Chaganti was away from home, will be determined under Rule 155.[36]

Although Mr. Chaganti argued that he is entitled to use per diem amounts for lodging because he had a contract for reimbursement from his brother's business, he is mistaken. Self-employed individuals are not eligible to use per diem amounts for

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[35] *Barone v. Commissioner*, 85 T.C. at 465.

[36] See Rev. Proc. 2007-63, sec. 4.03, 2007-2 C.B. at 811-812; Rev. Proc. 2006-41, sec. 4.03, 2006-2 C.B. at 780; Rev. Proc. 2005-67, sec. 4.03, 2005-2 C.B. at 732.

lodging.[37] Further, Mr. Chaganti has not provided evidence to show he incurred actual lodging expenses.

Mr. Chaganti has not adequately substantiated the remaining meals and entertainment and travel expenses he reported. Section 274(d) requires taxpayers to establish the amount of the expense, the time and the place the expense was incurred, the business purpose of the expense, and the business relationship of the taxpayer to any others benefited by the expense. The Court provided Mr. Chaganti the opportunity to identify records in evidence that would establish this. He failed to do so. The table Mr. Chaganti provided did not refer to any exhibit or provide any information about a specific client matter to show the business purpose of any of his trips. Further, some of the dates and locations that Mr. Chaganti listed on his table were contradicted by the parties' stipulations. Accordingly, because he did not meet his burden of proof, Mr. Chaganti may not deduct any meals and entertainment expenses or travel expenses beyond those that the Commissioner conceded were business-related expenses and beyond the per diem amounts for meals and incidentals previously addressed.

III. Net Operating Loss Carryforward

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[37] See Rev. Proc. 2007-63, sec. 4.03, 2007-2 C.B. at 811-812; Rev. Proc. 2006-41, sec. 4.03, 2006-2 C.B. at 780; Rev. Proc. 2005-67, sec. 4.03, 2005-2 C.B. at 732. Compare sec. 1.274-5(f), Income Tax Regs. (allowing a deduction for travel when employees provide substantiation to their employers) with sec. 1.274-5(j), Income Tax Regs. (allowing a deduction for per diem meals, mileage, and incidental expenses under the optional method determined by the Commissioner when a taxpayer is away from home).

Section 172(a) describes when a taxpayer may deduct an NOL. An NOL is the excess of the allowable deductions over gross income, subject to specified modifications.[38] In the case of a taxpayer who has an NOL arising in 2003, 2004, and 2005, an NOL generally must first be carried back for 2 years and if not completely absorbed, it may be carried forward for up to 20 years.[39] Further, a taxpayer must carry the NOL back to the earliest year first.[40] Under section 172(b)(3), a taxpayer may elect to waive the carryback period and carry the entire loss forward. However, the election must be made by the due date (including extensions) of the return for the year in which the NOL arose and for which the election is to be in effect.[41]

Generally, the taxpayer bears the burden of establishing both the actual existence of an NOL for another year and the amount of that NOL that may be carried to the years in issue.[42] A taxpayer's return is merely a statement of the taxpayer's position and cannot be used to substantiate a deduction.[43] We have jurisdiction to consider facts related to years other than the years in issue in order to redetermine the liability for the periods before us.[44]

Mr. Chaganti reported NOLs for 2003, 2004, and 2005 and used an NOL carryforward to offset net income from his Schedule C legal business in 2007.

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[38] Sec. 172(c) and (d).

[39] Sec. 172(b)(1)(A), (H); sec. 1.172-4(b)(1), Income Tax Regs.

[40] Sec. 172(b)(2); sec. 1.172-4(b), Income Tax Regs.

[41] Sec. 172(b)(3).

[42] *Keith v. Commissioner*, 115 T.C. 605, 621 (2000).

[43] *Wilkinson v. Commissioner*, 71 T.C. 633, 639 (1979).

[44] Sec. 6214(b).

Mr. Chaganti did not elect to forgo the requirement to carry his NOLs back. We will take each claimed NOL in turn.

Put simply, for 2003 Mr. Chaganti provided no evidence of any excess loss to carry forward. Even if we accept that Mr. Chaganti had an NOL for that year, he would be required to first carry the NOL back to 2001 and 2002.[45] Mr. Chaganti did not offer evidence about his income tax for 2001 or 2002, and thus he failed to prove that the NOL was not fully absorbed in 2001 or 2002. Because of that failure of proof, he has no NOL to carry forward.

For 2004 Mr. Chaganti has not established that he actually had an NOL. Mr. Chaganti's NOL was a function of the net Schedule C business loss he reported. On his return Mr. Chaganti reported gross receipts of $30,255 and expenses of $89,598, which equals a net loss of $59,343. His total expenses of $89,598 included $55,000 of contract labor expenses. Mr. Chaganti provided substantiation for only $7,500 of the contract labor expenses and for approximately $16,100 of the other expenses he reported. Although Mr. Chaganti might be entitled to deduct some per diem amounts for meals for business travel for 2004, he has not proven that his business expenses exceeded the gross receipts he reported. Accordingly, he has not established a net business loss and is not entitled to any NOL deduction for 2004.

Likewise for 2005 Mr. Chaganti has not established that he actually had an NOL. Mr. Chaganti's NOL was a function of the net Schedule C business loss he reported. On his return Mr.

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[45] See sec. 172(b)(1)(A), (H); sec. 1.172-4(b)(1), Income Tax Regs.

Chaganti reported gross receipts of $71,200 and expenses of $106,589, which equals a net loss of $31,968. His total expenses of $106,589 included $55,000 of contract labor expenses. Mr. Chaganti did not substantiate any of his reported expenses for 2005. Although the Commissioner stipulated that Mr. Chaganti made a few court appearances in California during 2005, Mr. Chaganti did not submit any documents to show what expenses he incurred. The only documents Mr. Chaganti provided were bills he submitted to his brother's business for reimbursement. These documents do not show that Mr. Chaganti actually incurred expenses. Accordingly, he did not establish a net business loss and has not shown entitlement to any NOL deduction for 2005.

Overall, Mr. Chaganti cannot use an NOL to offset income for 2007 because he has not proven he had any NOL left over to carry forward for 2003 and has not proven he actually had an NOL for 2004 or 2005.

IV. Gross Receipts

Mr. Chaganti argues that his gross receipts for 2006 and 2007 should be reduced from the amounts he reported by $40,000 and $22,200, respectively, because these amounts represented client reimbursements and should not be taxable. He cites a case holding that if a lawyer has a contractual right to reimbursement for expenses the lawyer pays on behalf of a client, then the lawyer must treat these amounts as advances.[46] Under this approach the lawyer cannot deduct the expenses he pays on

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[46] Mr. Chaganti cites *Humphrey, Farrington & McClain, P.C. v. Commissioner*, T.C. Memo. 2013-23.

behalf of the client and does not have gross income when the client reimburses the lawyer for the expenses the lawyer paid.[47]

Mr. Chaganti's argument has merit, but he has failed to substantiate his position. The Court previously held that Mr. Chaganti received $40,000 and $22,200 in 2006 and 2007, respectively, from his brother's business as reimbursement for expenses paid from 2001 to 2005, but the Court did not make any determination as to the "veracity of the expenses themselves."[48] Mr. Chaganti cannot treat these expenses as client advances because he failed to substantiate them.

V. Payment Pursuant to 28 U.S.C. Sec. 1927

In our prior opinion we held that Mr. Chaganti could not deduct the $18,125 sanction imposed by a court under 28 U.S.C. sec. 1927 because it was not an ordinary and necessary business expense under section 162, but we left open the question of whether he could deduct this payment under a different theory.[49] Mr. Chaganti now argues that he should be able to deduct the payment under section 165.

Under 28 U.S.C. sec. 1927, if an attorney "multiplies the proceedings in any case unreasonably and vexatiously", then a court may require that attorney to pay the excess costs, expenses, and attorney's fees of another party. The U.S. Court of Appeals for the Eighth Circuit, the court to which this case is appealable, has explained that "section

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[47] See *Hearn v. Commissioner*, 36 T.C. 672, 674 (1961), aff'd, 309 F.2d 431 (9th Cir. 1962); *Cochrane v. Commissioner*, 23 B.T.A. 202, 208 (1931).

[48] *Chaganti v. Commissioner*, T.C. Memo. 2013-285, at *4, *8.

[49] *Chaganti v. Commissioner*, at *12-*13.

1927 is penal in nature".[50] Further, it has stated that "[t]he imposition of sanctions is a serious matter and should be approached with circumspection."[51]

It may be helpful to contrast the penal sanction imposed on Mr. Chaganti pursuant to 28 U.S.C. sec. 1927 with the taxation of costs under 28 U.S.C. sec. 1920 (2006). Taxation of costs is a routine part of litigation, and costs are not imposed by courts for punitive reasons. Costs that are taxed include clerk fees, transcript fees, expenses for copies, docket fees, and compensation of court- appointed experts.[52] The Supreme Court has explained that "the assessment of costs most often is merely a clerical matter that can be done by the court clerk."[53]

Mr. Chaganti argued that he should be allowed a deduction under section 165 for the $18,125 he paid. Section 165(a) allows taxpayers to deduct a loss they sustained during the taxable year if they were not compensated for that loss. Section 165(c) limits the deductibility of losses for individuals to those losses (1) incurred in a trade or business; (2) incurred in any transaction entered into for profit; and (3) incurred because of fire, storm, shipwreck, or other casualty, or from theft.

Because the 28 U.S.C. sec. 1927 sanction is penal, it cannot give rise to a loss incurred in a trade or business or a loss incurred in a transaction entered into for profit and clearly is not the type of

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[50] *Lee v. L.B. Sales, Inc.*, 177 F.3d 714, 718 (8th Cir. 1999).

[51] *O'Connell v. Champion Int'l Corp.*, 812 F.2d 393, 395 (8th Cir. 1987).

[52] 28 U.S.C. sec. 1920 (2006).

[53] *Taniguchi v. Kan Pacific Saipan, Ltd.*, 566 U.S. ___, ___, 132 S. Ct. 1997, 2006 (2012) (quoting *Hairline Creations, Inc. v. Kefalas*, 664 F.2d 652, 656 (7th Cir. 1981)).

circumstance contemplated in section 165(c)(3).[54] Indeed, we have disallowed loss deductions "if the allowance thereof would frustrate sharply defined national or state policies proscribing particular types of conduct."[55] The Supreme Court explained that "to allow a deduction in those circumstances would have directly and substantially diluted the actual punishment imposed."[56] Thus, because the sanction paid pursuant to 28 U.S.C. sec. 1927 is penal, it would be against public policy to allow it to give rise to a business loss or a loss in a transaction entered into for profit under section 165(c). Accordingly, Mr. Chaganti cannot deduct the $18,125 he paid.

VI. Foreign Tax Credit

Section 901 allows taxpayers a foreign tax credit for foreign income, war profits, and excess profits

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[54] See *Commissioner v. Heininger*, 320 U.S. 467, 473 (1943) ("Where a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a tax deduction for its payment.").

[55] *Lincoln v. Commissioner*, T.C. Memo. 1985-300, 50 T.C.M. (CCH) 185, 186 (1985); *see also Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30, 34-35 (1958) (disallowing a deduction because the fine paid by the taxpayer "was punitive action and not a mere toll for use of the highways" and explaining that allowing "the deduction sought here would but encourage continued violations of state law by increasing the odds in favor of noncompliance"); *Blackman v. Commissioner*, 88 T.C. 677, 680 (1987) ("Courts have traditionally disallowed business expense and casualty loss deductions under section 162 or 165 where national or State public policies would be frustrated by the consequences of allowing the deduction."), aff'd, 867 F.2d 605 (1st Cir. 1988).

[56] *Commissioner v. Tellier*, 383 U.S. 687, 694 (1966); *see also Fuller v. Commissioner*, 213 F.2d 102, 106 (10th Cir. 1954), *aff'g* 20 T.C. 308 (1953).

taxes they have paid or accrued during the taxable year.[57] Taxpayers claiming a foreign tax credit must prove that they have met all the conditions to be entitled to any credit.[58] Because Mr. Chaganti has not provided any evidence that he paid or accrued foreign tax, he is not entitled to the foreign tax credit he claimed for 2007.

VII. Self-Employment Tax

The Code imposes in addition to other taxes a tax on the net earnings from self-employment of individuals.[59] Net earnings from self-employment are defined as "the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business".[60] And section 164(f) allows a deduction from gross income for one-half of a taxpayer's self-employment tax for the year.

Mr. Chaganti has a legal services business and is liable for self-employment tax on his net earnings from that business. The exact amount of self-employment tax and any corresponding deduction will be based on Rule 155 computations.

VIII. Failure To File Additions to Tax Under Section 6651(a)(1)

The Code requires individuals to file income tax returns by April 15 of the year following the calendar

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[57] Sec. 901(a) and (b); sec. 1.901-1(a), Income Tax Regs.

[58] *Wilcox v. Commissioner*, T.C. Memo. 2008-222, 96 T.C.M. (CCH) 194, 200 (2008) (relying on *Irving Air Chute Co. v. Commissioner*, 143 F.2d 256, 259 (2d Cir. 1944), aff'g 1 T.C. 880 (1943)).

[59] Secs. 1401(a) and (b), 1402(b).

[60] Sec. 1402(a).

year for which the return is being filed[61] and imposes consequences on those who fail to timely file their tax returns.[62] One such consequence is found in section 6651(a)(1), which imposes an addition to tax for failure to timely file a Federal income tax return unless the failure to file was for reasonable cause and not due to willful neglect. A taxpayer may have reasonable cause if the taxpayer exercised ordinary business care and prudence but was not able to timely file.[63] Willful neglect means a "conscious, intentional failure or reckless indifference."[64]

Mr. Chaganti filed his returns for 2006 and 2007 late. He argues that his filing was late because his tax issues were complex, he was extremely busy with his business, and his mother was ill. Tax issues are often complex, and return filing is time consuming; but complexity and lack of time alone do not remove the requirement to timely file one's return.[65] Because Mr. Chaganti has not shown his tardy filing was due to reasonable cause and not due to willful neglect, he is liable for the section 6651(a) additions to tax for 2006 and 2007.

IX. Accuracy-Related Penalties Under Section 6662(a)

Section 6662(a) and (b)(1) and (2) imposes a 20% accuracy-related penalty on any portion of an underpayment of tax required to be shown on a return if the underpayment is due to negligence,

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[61] See secs. 6012(a)(1)(A), 6072(a).

[62] Sec. 6651(a)(1).

[63] See sec. 301.6651-1(c)(1), Proced. & Admin. Regs.

[64] *United States v. Boyle*, 469 U.S. 241, 245 (1985).

[65] See, e.g., *Ellwest Stereo Theatres of Memphis, Inc. v. Commissioner*, T.C. Memo. 1995-610, 70 T.C.M. (CCH) 1655, 1659 (1995).

disregard of rules or regulations, or any substantial understatement of income tax. The Commissioner bears the burden of production as to penalties.[66] Penalties will not apply to any portion of the underpayment for which a taxpayer establishes that he or she had reasonable cause and acted in good faith.[67]

As defined in the Code, negligence includes any failure to make a reasonable attempt to comply with the provisions of title 26, and the term "disregard" includes any careless, reckless, or intentional disregard.[68] Negligence has been further defined as a "lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances."[69] Additionally, a taxpayer is negligent if he or she fails to maintain sufficient records to substantiate the items in question.[70]

An understatement of income tax is "substantial" if the understatement exceeds the greater of 10% of the tax required to be shown on the return or $5,000.[71] However, if the taxpayer has substantial authority for the tax treatment of an item, then the portion of the tax attributable to that item is not included in the understatement.[72] A taxpayer has

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[66] Sec. 7491(c).

[67] Sec. 6664(c)(1).

[68] Sec. 6662(c).

[69] *Neely v. Commissioner*, 85 T.C. 934, 947 (1985) (quoting *Marcello v. Commissioner*, 380 F.2d 499, 506 (5th Cir. 1967), *aff'g in part, remanding in part* 43 T.C. 168 (1964), and T.C. Memo. 1964-299).

[70] *Higbee v. Commissioner*, 116 T.C. 438, 449 (2001); sec. 1.6662-3(b)(1), Income Tax Regs.

[71] Sec. 6662(d)(1)(A).

[72] Sec. 1.6662-4(d)(1), Income Tax Regs.

substantial authority only if the weight of authority supporting the tax treatment of the item outweighs the contrary authority.[73]

After taking into account the parties' concessions, Mr. Chaganti's understatements for both 2006 and 2007 are greater than 5,000 and exceed 10% of the tax required to be shown on the respective returns. Accordingly, the Commissioner has met his burden of production for the accuracy-related penalties because of substantial understatements of income tax.

The Commissioner has also satisfied his burden of production for the accuracy-related penalties because of negligence. Taxpayers are required to maintain adequate records.[74] And negligence includes a failure to keep adequate books and records or to substantiate items.[75] Mr. Chaganti acted negligently because he failed to substantiate many of the expenses he reported.

Mr. Chaganti did not prove he acted with reasonable cause and in good faith. He argued that he was not a tax lawyer and "didn't know all the intricacies * * * about tax law". He explained that he did not keep good business records because of the chaotic nature of his legal services business. Also, he explained that he had returned many of the client records to his clients and that some of his other records had been lost. These explanations do not show that Mr. Chaganti acted with reasonable cause and in good faith. We have previously explained that "[r]easonable cause requires that the taxpayer have exercised ordinary business care and prudence as to

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[73] Sec. 1.6662-4(d)(3)(i), Income Tax Regs.

[74] Sec. 6001.

[75] Sec. 1.6662-3(b)(1), Income Tax Regs.

the disputed item."[76] Mr. Chaganti did not. Accordingly, he is liable for the section 6662(a) accuracy-related penalties for 2006 and 2007.

X. Conclusion

Mr. Chaganti has failed to substantiate many of the expenses he reported for his legal services business. He did not keep adequate records to prove that he incurred NOLs to carry forward. And he did not timely file his tax returns. Because of his failure of proof, he was not entitled to deductions for many of the expenses or to the foreign tax credit he claimed. He is liable for self-employment tax on his earnings. He is also liable for the additions to tax and accuracy-related penalties for 2006 and 2007.

To reflect the foregoing,

Decision will be entered under Rule 155.

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[76] *Neonatology Assocs., P.A. v. Commissioner*, 115 T.C. 43, 98 (2000), *aff'd,* 299 F.3d 221 (3d Cir. 2002).

APPENDIX E

UNITED STATES TAX COURT
WASHINGTON, DC 20217

NAREN CHAGANTI,) **SD**
Petitioner,)
v.) Docket No. 7344-12.
)
COMMISSIONER OF)
INTERNAL REVENUE,)
Respondent)

O R D E R

Pursuant to the determination of this Court as set forth in its Memorandum Opinion (T.C. Memo. 2013-285), filed December 17, 2013, it is

ORDERED that petitioner's March 4, 2013, motion for partial summary judgment is denied. It is further

ORDERED that so much of respondent's March 12, 2013, motion for partial summary judgment as to the deductibility of court-ordered payments is granted, in that petitioner is not entitled to deduct the $18,125 fine levied against him pursuant to 28 U.S.C. section 1927 (2006) and the $2,300 court-ordered sanction as ordinary and necessary business expenses for taxable year 2007. The remainder of respondent's motion for partial summary judgment is denied.

(Signed) Elizabeth Crewson Paris
Judge

Dated: Washington, D.C.
December 18, 2013

SERVED Dec 19 2013

APPENDIX F

T.C. Memo. 2013-285

UNITED STATES TAX COURT

NAREN CHAGANTI, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent
Docket No. 7344-12. Filed December 17, 2013.

Naren Chaganti, pro se.[1]
Karen O. Myrick, for respondent.

MEMORANDUM OPINION

PARIS, Judge: On March 4, 2013, petitioner filed a motion for partial summary judgment pursuant to Rule 121,[2] requesting the Court find in his favor in regard to the following issues, believed to be questions of law about which there exist no genuine issues of material fact:

(1) whether petitioner was entitled to deduct business expenses paid in previous years for tax

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[1] Mr. Chaganti filed an entry of appearance with the Court to represent himself. Though his name is represented as Narendra Chaganti on his tax returns and the notice of deficiency, Mr. Chaganti apparently uses the name "Naren" to practice law.

[2] Unless otherwise indicated, section references are to the Internal Revenue Code in effect for the years in issue, and Rule references are to the Tax Court Rules of practice and procedure.

years 2006 and 2007 when those expenses were actually reimbursed; and

(2) whether petitioner was entitled to deduct court-ordered payments made in tax years 2006 and 2007.

On March 12, 2013, respondent filed a cross-motion for partial summary judgment on the same issues. Also on March 12, 2013, both petitioner and respondent filed objections to each other's respective motions for partial summary judgment. On the basis of the following, the Court will grant respondent's motion for partial summary judgment in part and will deny it in part. The Court will deny petitioner's motion for partial summary judgment in full.

Background

Some of the facts have been stipulated and are so found. The stipulation of facts, supplemental stipulation of facts, and exhibits received in evidence are incorporated herein by this reference. Petitioner resided in Missouri at the time this petition was filed.

Petitioner is a licensed attorney who has been providing legal services to clients since 1998. Among these clients is petitioner's brother's business, which is based in St. Louis, Missouri. For all relevant years at issue, petitioner was a cash basis taxpayer.

In providing legal services to his brother's business, petitioner incurred and paid significant expenses for travel, meals, and incidentals.[3]

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[3] In all the tax years at issue petitioner reported his home address as being in Town & Country, Mo. (a suburb of St. Louis, Mo.) and his business address as being in Los Angeles, Cal. Petitioner has not at this time made any showing as to why he

Petitioner and his brother also had an arrangement by which petitioner's brother's business would pay petitioner a per diem expense reimbursement of $147 per day for each day petitioner was in St. Louis performing services for the business. Petitioner was not immediately reimbursed for these expenses but rather was reimbursed periodically as the business could afford to do so. From tax year 2001 to 2005 petitioner paid significant expenses related to legal services provided to his brother's business. It is unclear whether petitioner reported or deducted these expenses on his Federal income tax returns for the tax years in which he paid them.[4] In tax years 2006 and 2007 petitioner received $40,000 and $22,200, respectively, from his brother's business as reimbursement for expenses accumulated from tax years 2001 through 2005.

In 2004 petitioner also began performing legal services on behalf of a plaintiff litigating in the U.S. District Court for the Eastern District of Missouri (District Court). On November 14, 2005, petitioner was ordered to pay a $262 fine for opposing counsel attorney's fees and court reporter charges as a result of petitioner's role in his client's failure to appear at a deposition. After failing to pay the fine as ordered, petitioner was held in contempt by the District Court at a hearing on December 29, 2005, and ordered to pay the $262 on or before January 2, 2006. The

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was entitled to deduct travel expenses related to legal services provided to his brother's business in St. Louis.

[4] It is also unclear whether petitioner included these expenses in determining the net operating losses of $18,048, $19,510, and $29,104 he reported on his Federal income tax returns for tax years 2003, 2004, and 2005, respectively.

District Court stated that after that date it would impose a daily fine of $100 until the sanction was paid. Despite being held in contempt, petitioner did not pay the $262 sanction until January 26, 2006. During the remainder of the litigation, petitioner engaged in behavior that the District Court deemed unnecessarily protracting and contentious.

The District Court ruled against petitioner's client and for the defendant on a motion for summary judgment in March 2006. Petitioner, as plaintiff's counsel, filed a motion to reconsider, vacate, and set aside the judgment, which was denied on April 12, 2006. Petitioner appealed the ruling to the U.S. Court of Appeals for the Eighth Circuit, which affirmed the District Court's decision on April 26, 2007.

Following the entry of judgment, the defendant in the case filed a motion for attorney's fees and bill of costs. The defendant's motion requested that petitioner, as opposed to the plaintiff himself, pay the excess attorney's fees incurred as a result of petitioner's "bad faith, unreasonable, and vexatious multiplication of the proceedings". On August 22, 2007, the District Court granted this motion in part, allowing the award of excess attorney's fees of $18,125 which it specifically attributed to petitioner's misconduct. The District Court ordered petitioner to pay that amount to opposing counsel and also ordered petitioner to pay to the Clerk of the Court a $2,300 fee for late payment of the original $262 fine.[5] Petitioner paid these amounts on December 28, 2007.

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[5] This late fee was based on the $100 daily fine multiplied by the 23 days that passed between the court-ordered deadline

Petitioner did not timely file Federal income tax returns for tax years 2006 and 2007. After respondent prepared substitutes for returns on March 22, 2010, and June 15, 2009, respectively, petitioner eventually filed delinquent returns for tax years 2006 and 2007 on May 26, 2010. On these returns petitioner listed business expenses of $40,000 and $22,200 for tax years 2006 and 2007, respectively, described as "prior years' travel and per diem expenses." For tax year 2007 petitioner also listed as a business expense $20,425 in court-ordered payments. This amount was attributable to the $2,300 fee for late payment of petitioner's $262 deposition fine, plus the $18,125 petitioner was ordered to pay for opposing counsel attorney's fees.

On January 6, 2012, respondent mailed to petitioner a notice of deficiency for tax years 2006 and 2007. The notice determined a deficiency in Federal income tax for tax year 2006 of $9,332, as well as an addition to tax for failure to timely file under section 6651(a)(1) of $2,102 and an accuracy-related penalty under section 6662(a) of $1,866. It also determined a deficiency in Federal income tax for tax year 2007 of $21,936, as well as an addition to tax for failure to timely file under section 6651(a)(1) of $5,192 and an accuracy-related penalty under section 6662(a) of $4,387. The determination, in part, was due to respondent's finding that petitioner was not entitled to deduct prior years' business expense per diem payments and court-ordered payments as business expenses for tax years 2006 and 2007. On

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of January 2, 2006, and January 26, 2006, the actual date that payment was received.

March 19, 2012, petitioner timely filed a petition in this Court for review of respondent's determination.

Discussion

Summary judgment serves to "expedite litigation and avoid unnecessary and expensive trials." *Fla. Peach Corp. v. Commissioner,* 90 T.C. 678, 681 (1988). The Court may grant summary judgment only if there are no genuine disputes of material fact. *Naftel v. Commissioner*, 85 T.C. 527, 529 (1985). The moving party must prove that no genuine disputes of material fact exist and that he is entitled to judgment as a matter of law. *FPL Grp., Inc. & Subs. v. Commissioner*, 115 T.C. 554, 559 (2000); *Bond v. Commissioner*, 100 T.C. 32, 36 (1993). In deciding whether to grant summary judgment, the Court considers the facts, and any inferences drawn from the facts, in the light most favorable to the nonmoving party. *Naftel v. Commissioner*, 85 T.C. at 529.

Both petitioner and respondent have filed motions for partial summary judgment. Because neither party contends that there are any genuine disputes of material fact with respect to the above-stated issues, the Court must evaluate which party is entitled to summary judgment on those issues as a matter of law.

Prior year per diem payments

Section 461(a) requires a taxpayer to deduct expenses in the year required under his method of accounting. A cash basis taxpayer generally must deduct his expenses in the year that payment of those expenses takes place. *Tippin v. Commissioner*, 104 T.C. 518, 531 (1995); *Reynolds v. Commissioner*, T.C. Memo. 2000-20, *aff'd*, 296 F.3d 607 (7th Cir. 2002); sec. 1.461-1(a), Income Tax Regs. Petitioner

admits that he incurred and paid the expenses relating to his brother's business during tax years 2001 through 2005. Petitioner argues only that he complied with section 461(a) by deducting the per diem expenses in the year the reimbursements were paid to him. Petitioner's argument reflects a semantic misunderstanding. The law is clear that, for a cash basis taxpayer, the deduction generally must be taken in the year the expense is actually paid by the taxpayer. See Reynolds v. Commissioner, T.C. Memo. 2000-20. Petitioner has failed to point out any exception in the Code that would exclude him from the general rule. Accordingly, petitioner was not entitled to deductions for tax years 2006 and 2007 for reimbursements related to business expenses paid in prior years.[6]

Section 6214 empowers the Court to consider net operating loss (NOL) carryforwards and carrybacks in determining the correct amount of tax for the years at issue. See *Harris v. Commissioner*, 99 T.C. 121, 124-125 (1992); *Calumet Indus., Inc. v. Commissioner*, 95 T.C. 257, 274-275 (1990); *Lone Manor Farms, Inc. v. Commissioner*, 61 T.C. 436, 440 (1974), aff'd without published opinion, 510 F.2d 970 (3d Cir. 1975). Petitioner has not yet shown whether he included the above-discussed expenses in determining his NOLs for tax years 2003, 2004, and 2005. The inclusion of these expenses in petitioner's NOLs for those years and the veracity of the expenses themselves are questions of material fact that must be addressed in determining the

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[6] It should be noted that this determination reflects the Court's findings with respect to the timing of the deductions only and not the veracity of the expenses themselves.

applicability of petitioner's NOLs to the years at issue. Accordingly, the Court will not make any decisions as to those issues at this time.

Court-ordered payments

The court-ordered payments petitioner made during tax years 2006 and 2007 consisted of three separate fines. The first was the $262 petitioner was ordered to pay in reimbursement of deposition fees and opposing counsel attorney's fees for failure to present a client at a deposition. The second was the $2,300 imposed on petitioner as a fee for failure to timely pay the $262 fine once held in contempt. The last was the $18,125 petitioner was ordered to pay pursuant to 28 U.S.C. sec. 1927 (2006), as opposing counsel attorney's fees attributable to petitioner's unreasonable protraction of the litigation.

Section 162 provides for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 162(f), however, disallows a deduction for fines or penalties paid to a government or a governmental agency for the violation of any law. Disallowance under section 162(f) is not limited to criminal fines and penalties. *Huff v. Commissioner*, 80 T.C. 804, 821 (1983). It is clear that the $2,300 fine imposed on petitioner for failure to pay that sanction was for the violation of his duties as an officer of the court in being held in contempt and failing to timely pay the $262 sanction. This amount was paid to the Clerk of the Court for the District Court, a governmental agency responsible for collecting such fines and penalties. Accordingly, petitioner is not entitled to deduct the $2,300 sanction as an ordinary and necessary business expense for tax year 2007.

The remaining two sanctions, while court ordered, were not paid to a government or governmental agency but rather to opposing counsel.[7] Section 162 sets forth dual requirements that, to be deductible, an expense must be both ordinary and necessary. An ordinary expense is one that is common and acceptable in the taxpayer's particular business. *Welch v. Helvering*, 290 U.S. 111, 113-114 (1933). A necessary expense is an expense that is appropriate and helpful in carrying on the taxpayer's trade or business. *Heineman v. Commissioner*, 82 T.C. 538, 543 (1984).

Petitioner was ordered to pay a $262 sanction for reimbursement of deposition fees and opposing counsel attorney's fees for failure to present a client at a deposition. It is clear that it may be ordinary and necessary to a taxpayer's practice of law to hold depositions and that such expenses may be deductible under section 162. Petitioner argues that it was ordinary and necessary to his practice to keep his client from appearing at the scheduled deposition because, due to some unforeseen circumstance, he felt it was in his client's best interest. Petitioner has yet to present evidence in support of this assertion.

Unlike the sanction imposed under 28 U.S.C. sec. 1927, discussed below, it is unknown at this time

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[7] The Court refrains at this time from engaging in an analysis of whether such payments could be considered constructively paid to a government or governmental agency for the purposes of sec. 162(f). With respect to the $18,125 sanction issued under 28 U.S.C. sec. 1927 (2006), the analysis below renders this question moot. With respect to the $262 sanction which, for reasons discussed below, presents a genuine dispute of material fact, this question will be decided at a later time.

under which statute petitioner was ordered to pay the $262 sanction to opposing counsel. It is similarly unknown what criteria were required to impose this sanction and whether such an imposition in and of itself would indicate that the expense was not ordinary or necessary to the practice of law. Taken in a light most favorable to each nonmoving party in these cross-motions for summary judgment, a genuine dispute of material fact exists. Accordingly, neither petitioner nor respondent is entitled to summary judgment at this time with regard to the deductibility of the $262 sanction. Petitioner was ordered to pay the remaining $18,125 fine as a result of what was found to be his willful and unreasonable protraction of the litigation. The District Court found petitioner liable under 28 U.S.C. sec. 1927, which states that "[a]ny attorney or other person admitted to conduct cases in any court of the United States * * * who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorney's fees reasonably incurred because of such conduct." The District Court then engaged in a lengthy itemized analysis to separate the amount of opposing counsel attorney's fees that could be directly attributed to petitioner's improper conduct from those which would be reasonably typical to the practice of law.[8]

The Court finds that the mere fact that petitioner was ordered to pay opposing counsel attorney's fees

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[8] The District Court found that of the $42,675 in opposing counsel attorney's fees, $18,125 was attributable to petitioner's improper conduct.

under 28 U.S.C. sec. 1927, demonstrates that those amounts were not ordinary and necessary to the practice of law. The District Court's further analysis in removing the amounts attributable to typical legal expenses confirms that the remaining $18,125 that petitioner was ordered to pay was not common to the practice of law, nor was it appropriate or helpful to his business. Accordingly, petitioner is not entitled to deduct the $18,125 fine levied against him under 28 U.S.C. sec. 1927, as an ordinary and necessary business expense for tax year 2007.

To reflect the foregoing,

An appropriate order will be issued.