No. _____

In the Supreme Court of the United States

LEONARD FEIN AND PEARL FEIN,
PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a federal Government agency may escape the binding effect of its own stipulation to "the accuracy of these [Petitioners's tax] returns," in light of the rule, adopted by a majority of the Circuits, that such a stipulation must be strictly construed against the Government drafter?

2. Whether the rule announced in *Cohan* v. *Commissioner*, 39 F.2d 540 (2d Cir. 1930), which prohibits a court from disallowing *all* federal income tax deductions claimed by a taxpayer based on a finding that *some* of the taxpayer's documentation was inaccurate or incomplete, remains good law?

PARTIES TO THE PROCEEDING

The caption contains the names of all the parties to the proceeding below.

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JURISDICTION

The court of appeals denied Leonard and Pearl Fein's petition for rehearing and for rehearing en banc on March 11, 2013. On May 31, 2013, Justice Ginsburg extended the time for filing this petition to July 9, 2013. No. 12A1158. This Court has jurisdiction under 28 U.S.C. § 1254.

STATUTORY PROVISIONS INVOLVED

The provisions of the Internal Revenue Code involved in this case, 26 U.S.C. §§ 162 and 274, are reproduced at App. 15a–16a.

STATEMENT

1. This petition is prompted by the Second Circuit's disregard of two basic principles of federal law: *first*, the principle that when the Government, with its awesome advantages in bargaining power, drafts an agreement with a private party, any ambiguities in that agreement must be strictly construed against its drafter; and *second*, the rule—first set forth over 80 years ago in *Cohan* v. *Commissioner*, 39 F.2d 540 (2d Cir. 1930)—that when the exact amount of a taxpayer's proper deductions is not ascertainable from the documentary record, the proper remedy is to approximate the allowable deduction, rather than to disallow *all* deductions. On each point, the Second Circuit's erroneous ruling has put it in conflict with the majority of the federal courts of appeals. This Court's intervention is required to restore uniformity on these issues, which recur frequently in taxpayer litigation.

2. a. Petitioners Leonard and Pearl Fein are a husband and wife living in Brooklyn, New York. Leonard is a certified public accountant who also operated a photography business. App. 6a. In January 2006, the IRS contacted the Feins about their failure to file federal income tax returns for 2002, 2003, and 2004. The Feins filed their returns for those years shortly thereafter. The returns included two Schedule Cs for each year, one for Leonard's accounting activities and one for his photography activities. App. 7a–10a.

The IRS audited the Feins' returns and issued a notice of deficiency in the amounts of $41,465 for 2002, $42,771 for 2003, and $54,959 for 2004. App. 5a. The notice disallowed all of the Feins' claimed business expenses for those three years on the grounds that the Feins had failed to demonstrate that the expenses were incurred in the course of engaging in a business, and that they had failed to substantiate the expenses. App. 10a. The notice also asserted that the Feins were liable for a total of $32,875 in untimely-filing penalties and $27,839 in accuracy-related penalties. App. 5a.

b. The Feins challenged these determinations in the United States Tax Court, where they represented themselves *pro se*.

Before the tax court hearing, the Government drafted a Stipulation of Facts, which the parties entered into pursuant to Rule 91 of the Tax Court Rules.[1] App. 2a. Paragraph 97 of the Stipulation provided:

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[1] Rule 91 provides, in relevant part, that "[t]he parties are required to stipulate, to the fullest extent to which complete or qualified agreement can or fairly should be reached, all matters not privileged which are relevant to the pending case, regardless of whether such matters involve fact or opinion or the application of law to fact. In-

> "Attached hereto as Exhibit 97-J, 98-J, and 99-J are copies of petitoners' 2002, 2003, and 2004 tax returns. *The parties stipulate as to the accuracy of these returns* with the exception of the 2002 Schedule C, as per paragraphs 4 and 5 of this Stipulation of Facts."

Stipulation of Facts (Tax Ct. Dckt. 16), ¶ 97.

During the two-day hearing before the tax court, Leonard Fein presented oral testimony and proffered nearly 100 exhibits (including receipts, credit card and bank statements, spreadsheets, and expense diaries) to detail the allowable business expenses for his accounting and photography activities by category.

The tax court sustained the IRS's disallowance of all of the business expenses claimed by Fein for the years in question, finding that he had failed to substantiate those expenses. App. 5a–14a. It concluded that the "[d]ocumentation petitioner maintained regarding accounting and photographic activities was disorganized and incomplete." App. 7a. It observed that "much" of the documentation Fein offered at trial was "illegible"; and that "[m]uch of the documentation that is legible is utterly unclear as to the purpose of the claimed expense—whether personal, accounting, or photography." App. 12a.

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cluded in matters required to be stipulated are all facts, all documents and papers or contents or aspects thereof, and all evidence which fairly should not be in dispute." Tax Ct. R. 91(a). It further provides that "[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. The Court will not permit a party to a stipulation to qualify, change, or contradict a stipulation in whole or in part, except that it may do so where justice requires." Tax Ct. R. 91(e).

The court's opinion did not engage in an individualized evaluation of the evidence Fein had offered; rather, it simply concluded that it was inadequate, without discussion of particular documents or testimony. For example, the tax court simply concluded that "[p]etitioner produced no credible documentation with regard to claimed gasoline purchases, car repairs expenses, and toll costs," App. 12a, without any particularized discussion of the evidence Fein had proffered as to these categories. Similarly, it conclusorily asserted that "[d]ocumentation petitioner produced in support of car and truck expenses, gifts and promotions, meals, entertainment, and travel does not meet the recordkeeping requirements of [26 U.S.C.] section 274(d)," App. 12a, without further elaboration.

The tax court also sustained the IRS's imposition of late-filing and accuracy-related penalties.

c. The Second Circuit affirmed. App. 1a–4a. The panel rejected the Feins' argument that the Government's pre-trial stipulation "as to the accuracy of these returns" prevented the disallowance of the deductions claimed on those returns. App. 2a. Rather, it read the stipulation simply to "mak[e] clear that the parties agreed that certain attached exhibits were accurate copies," but not to "agree that the returns themselves had accurate information." App. 2a. It further concluded that "the fact that Petitioners offered evidence at trial in order to substantiate their expenses belies the argument that the parties stipulated that the claimed expense deductions were correct." App. 2a–3a (citing *Mildred Cotler Trust* v. *United States*, 184 F.3d 168, 172–175 (2d Cir. 1999)).

The court of appeals affirmed the tax court's holding that the Feins had failed to substantiate their business

expense deductions, pointing to the tax court's findings that "[m]uch of Petitioners' documentation was illegible or blank, and such documentation as was legible did not clearly show a business purpose for the claimed expenses." App. 3a. It made no attempt to estimate the minimum allowable deduction that the Feins to which the Feins were entitled based on the evidence they did submit. Finally, the court affirmed the tax court's imposition of penalties. App. 3a–4a.

The Second Circuit denied the Feins' petition for rehearing and for rehearing en banc in a summary order.

REASONS FOR GRANTING THE PETITION

I. The Court Should Grant Certiorari Because The Second Circuit's Construction Of The Government's Stipulation As To The "Accuracy" Of "These Returns" Conflicts With Substantial Federal Precedent Regarding The Interpretation Of Government-Drafted Contracts.

1. It is a basic principle of the federal law of contract construction[2]—embraced by the majority of federal courts of appeals and, indeed, by the Second Circuit itself before the present case—that ambiguities in a contract with the federal Government should be construed against the party that drafted it. The principle is especially important when the Government—with the full force and

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[2] " 'The validity and construction of contracts through which the United States is exercising its constitutional functions, their consequences on the rights and obligations of the parties, the titles or liens which they create or permit, all present questions of federal law not controlled by the law of any state.' " *United States* v. *Seckinger*, 397 U.S. 203, 209 n.12 (1970) (quoting *United States* v. *County of Allegheny*, 322 U.S. 174, 183 (1944)).

bargaining power of the federal bureaucracy behind it—is the drafter, and doubly so when the party across the table is a private citizen, unrepresented by counsel or sophisticated advisors.

Before the tax court hearing, the Government offered, and the Feins agreed, to "stipulate to the accuracy" of "these [tax] returns" at issue in the case. Stipulation of Facts (Tax Ct. Dckt. 16), ¶ 97. This stipulation was presented to the tax court, where it was required to be treated "as a conclusive admission by the parties to the stipulation." Tax Ct. R. 91(e). The tax court ignored this stipulation, failing even to address it in its opinion. And the Second Circuit erroneously held that the language in question merely referred to the *authenticity* of the copies of the returns marked as exhibits.

This reading is untenable. A plain reading of paragraph 97 of the Stipulation of Facts shows that the Government stipulated to the "accuracy" of "these returns"—not simply to the authentic reproduction of copies (which had already been addressed in a separate paragraph of the Stipulation of Facts). The Government, which drafted the stipulation with the full knowledge and expertise of the IRS and its lawyers, chose to stipulate not to "authenticity," but to "accuracy"—the substantive, factual accuracy of the Feins' returns. If, as the stipulation provides, the returns filed by the Feins are deemed to be substantively accurate, then the case against them disappears. This Court should preserve the uniformity of the interpretation of agreements with the Government by holding the IRS to its own bargain in this case.

2. "[E]ven if not approved or 'so ordered' by a judge, a stipulation 'is an independent contract which is subject to the principles of contract interpretation.' " *Motorola, Inc.* v. *Abeckauser*, No. 07–CV–3963 (JG)(SMG), 2010

WL 415290, *5 (E.D.N.Y. Jan. 29, 2010) (citation omitted); see also Tax Ct. R. 91(e) ("a stipulation of fact is binding on the parties, and the Court is bound to enforce it.").

In construing Government-drafted contracts and stipulations, the great majority of the courts of appeals—following this Court's example—apply the doctrine of *contra proferentum*, "the general maxim that a contract should be construed most strongly against the drafter, which in this case was the United States." *United States* v. *Seckinger*, 397 U.S. 203, 210 (1970)); see also, *e.g.*, *United States* v. *Hill*, 643 F.3d 807, 876 (11th Cir. 2011) ("Ambiguities are construed against the government as the drafter of proffer agreements * * * and that makes all the difference.") (citation omitted); *States Roofing Corp.* v. *Winter*, 587 F.3d 1364, 1372 (Fed. Cir. 2011) ("the basic precept is that ambiguities in contracts drawn by the Government are construed against the drafter"); *United States* v. *Hahn*, 359 F.3d 1315, 1343 (10th Cir. 2004) ("this court also applies the maxim that the agreement should be construed against its drafter, in this case the government"); *United States* v. *Baird*, 218 F.3d 221, 229 (3d Cir. 2000) ("In view of the government's tremendous bargaining power, we will strictly construe the text against it when it has drafted the agreement."); *Fort Vancouver Plywood Co.* v. *United States*, 747 F.2d 547, 553 (9th Cir. 1984) ("The contract between Fort Vancouver and the Forest Service was a form contract prepared by the government. We will construe it against the government."); *Instruments for Indus., Inc.* v. *United States*, 496 F.2d 1157, 1161 (2d Cir. 1974) (quoting *Seckinger*).

The doctrine of construing contracts strictly against the Government drafter is supported by the fact that "the Government ordinarily has awesome advantages in bargaining power." *United States* v. *Ready*, 82 F.3d 551, 559

(2d Cir. 1996); see also *Seckinger*, 397 U.S. at 216 ("This principle is appropriately accorded considerable emphasis in this case because of the Government's vast economic resources and stronger bargaining position in contract negotiations.") The disparity is particularly stark in this case, where the Feins proceeded *pro se* before the tax court, bereft of the assistance of counsel.[3] Given these unequal bargaining positions, the Feins—and others in their position—have no input into the wording of the Government-drafted stipulation and "nothing to say as to its provisions." *P.R. Burke Corp.* v. *United States*, 47 Fed. Cl. 340, 351 (2000) (quoting *Peter Kiewit Sons' Co.* v. *United States*, 109 Ct. Cl. 390, 418 (1947)).

3. In this case, the Second Circuit departed from the long-standing precedent—and the prevailing practice of the other courts of appeals—that the Government-drafted stipulation at issue should be strictly construed

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[3] The Feins' *pro se* status explains why, despite paragraph 97's stipulation as to the accuracy of their tax returns, they proceeded to present evidence when asked to by the tax court. Given that they were unrepresented by counsel, the Second Circuit should not have inferred any waiver of the Feins' rights under the Stipulation of Facts based on their honest attempt to provide what documentation they could to the tax court. See *Tracy* v. *Freshwater*, 623 F.3d 91, 101 (2d Cir. 2010) ("It is well established that a court is ordinarily obligated to afford a special solicitude to *pro se* litigants. The rationale underlying this rule is that a *pro se* litigant generally lacks both legal training and experience and, accordingly, is likely to forfeit important rights through inadvertence if he is not afforded some degree of protection.") (citations omitted). Indeed, Mr. Fein's offer to "go through every expense on the tax return" was declined by the tax court, which responded: "right now I just want you to do what you want to do and I'm trying to help you and nudge you a little bit. Maybe pick a coupler of the big expenses to focus on." Tr. of Nov. 30, 2010 hearing (Tax Ct. Dckt. 19) at 48.

against the drafter. The court below concluded, without textual analysis or elaboration, that "the parties agreed that certain attached exhibits were accurate copies, but did not agree that the returns themselves had accurate information." App. 2a.[4]

This reading is untenable. Had the Government wanted to stipulate merely to the faithfulness of the copies attached to the Stipulation, it easily could have done so—for example, by using the classic formulation that appears in hundreds of lawyers' declarations and affidavits every day: "Attached hereto as Exhibit A is a true and correct *copy* of * * * *" But it did not. Its stipulation as to accuracy does not refer to *copies* of the returns, but to the returns themselves: "The parties stipulate as to *the accuracy of these returns* * * * *" (emphasis added). The Stipulation of Facts refers to "copies" in many places, but in this sentence, the Government chose to stipulate to the "accuracy" not of copies, but of "these returns."

The plain meaning of the stipulation supports the Feins' reading. The word "accuracy" does not primarily refer to matters of form (such as the faithful reproduction of copies). Rather, the primary definition of "accuracy" embraces the concept of substantive, factual correctness:

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[4] The single case cited by the Second Circuit panel on this point, *Mildred Cotler Trust* v. *United States*, 184 F.3d 168, 172–175 (2d Cir. 1999) actually supports petitioners' position. The *Mildred Cotler* court *rejected* the Government's argument that the bare mention of "fraud penalties" in a Government-drafted settlement agreement constituted an admission of fraud by the taxpayer. The Feins' situation is the mirror-image of that in *Mildred Cotler*. Here, it is not the taxpayer, but the IRS—which drafted the stipulation at issue, with the full force of the Government's "awesome" bargaining power and legal expertise behind it—that seeks to avoid a strict construction of the stipulation's terms against it.

"1. Conformity to fact. 2. Precision: exactness." American Heritage Collegiate Dictionary 9 (3d ed. 1997); see also Webster's II New Collegiate Dictionary 8 (rev. ed. 2001) (accurate: "1. In exact conformity to fact : ERRORLESS. 2. Conforming closely to a standard."); Free Merriam-Webster Dictionary, *accessed at* www.merriam-webster.com ("1: freedom from mistake or error : correctness; 2 a : conformity to truth or to a standard or model : exactness b : degree of conformity of a measure to a standard or a true value").

Indeed, one of the very statutory provisions that the Government invoked against the Feins uses the word "accuracy" to refer to substantive, factual correctness. Section 6662 of the Internal Revenue Code governs the "[i]mposition of *accuracy-related penalt[ies]* on underpayments." 26 U.S.C. § 6662 (emphasis added). The term "accuracy," as used in that provision, refers to the *substantive correctness* of a taxpayer's return, and not simply to whether a copy of the return faithfully reproduces some original.[5] It is hardly unreasonable to expect that the IRS lawyers who drafted the agreement would have appreciated that its stipulation to "the accuracy of these

[5] The use of the word "accuracy" to connote substantive, factual correctness is not unique to this provision of the Internal Revenue Code. Federal courts regularly use the term in such a fashion. See, *e.g.*, *In re Assured Fastener Prods. Corp.*, 38 B.R. 161, 164 (Bkrtcy. N.D. Ill. 1984) ("[t]he meeting of the parties' minds upon the correctness of an account stated is usually the result of one party tendering a statement of account, and the other party retaining the statement beyond a reasonable time without objection to its accuracy") (citations omitted); *Quantz* v. *Commissioner*, T.C. Memo. 1990-39, 1990 WL 3794 (1990) ("Respondent stipulated to the admissibility of schedules prepared by petitioner but not to the accuracy or correctness of the information set forth in them.").

returns" would cut to the heart of the Government's case against the Feins, which expressly sought (among other things) the imposition of "accuracy-related penalties."

While the plain language of paragraph 97 supports the Feins' position, other principles of contract interpretation reinforce that plain meaning. "[A]n interpretation of a contract that has 'the effect of rendering at least one clause superfluous or meaningless * * * is not preferred and will be avoided if possible.' " *Galli v. Metz*, 973 F.2d 145, 149 (2d Cir. 1992) (quoting *Garza v. Marine Transp. Lines, Inc.*, 861 F.2d 23, 27 (2d Cir. 1988)); *see also Burdon Cent. Sugar Ref. Co.* v. *Payne*, 167 U.S. 127, 142 (1897) ("the contract must be so construed as to give meaning to all its provisions, and * * * that interpretation would be incorrect which would obliterate one portion of the contract in order to enforce another part"); Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 174 (2012) (no provision "should needlessly be given an interpretation that causes it to duplicate another provision or to have no consequence").

Here, a separate provision in the Stipulation of Facts provides that "[t]he parties agree that all joint exhibits, marked with a number followed by '-J,' may be accepted as authentic and are incorporated in this stipulation and made a part hereof." Stipulation of Facts (Tax Ct. Dckt. 16), 1. That provision independently established the accuracy of the copies included as exhibits to the Stipulation, including the tax returns discussed in paragraph 97. If the only import of paragraph 97 was to establish the accurate reproduction of copies, it would have been mere surplusage, because their authenticity had already been stipulated by their designations as exhibits with a "number-J." Reading paragraph 97 to refer to the substantive, factual accuracy of the Feins' returns not only accords

with the contract's plain language, but also invests the provision with meaning and saves it from redundancy.

In short, both the plain meaning of paragraph 97 and basic principles of contract construction demonstrate that the Stipulation meant what it said: that the parties had stipulated to "the accuracy of these returns"—and not merely to their authenticity or status as true and correct copies. Even if the term "accuracy" were read to be susceptible to more than one meaning, the proper response would be to apply the canon of *contra proferentum* and construe the ambiguous provision strictly against its Government drafter.

4. The Second Circuit's failure to do so has ramifications that reach well beyond this case. Its abandonment of the rule of *contra proferentum* in construing Government-drafted contracts would not only have serious implications in every tax court proceeding (which, pursuant to Tax Court Rule 91, are conducted largely on the basis of stipulations of fact, often drafted by the Government), but myriad situations where the federal Government is a contracting party. Such cases range from criminal plea agreements, see, *e.g.*, *Ready*, 82 F.3d at 559, to multi-million dollar government contracts, see, *e.g.*, *States Roofing*, 587 F.3d at 1372, to Government-drafted stipulations in civil lawsuits, see, *e.g.*, *Land Mine Enters.* v. *Sylvester Builders, Inc.*, No. 81 Civ. 931 (CES), 1993 WL 307853, *2 (S.D.N.Y. Aug. 11, 1993).

By disregarding this basic principle of federal contract construction and subjecting a taxpayer to an implausible and unfavorable interpretation of a Government-drafted stipulation, the Second Circuit has made itself a jurisprudential outlier and encouraged further deviations from the national legal consensus—and from this Court's guidance in *Seckinger*. The Court should grant

review to remedy this situation and restore uniformity to the law.

II. The Court Should Grant Certiorari In Order To Clarify Whether The *Cohan* Rule—That A Deduction Cannot Be Entirely Disallowed Merely Because The Taxpayer Cannot Prove An Exact Figure—Remains Good Law.

1. Over 80 years ago, the Second Circuit handed down its opinion in *Cohan* v. *Commissioner*, 39 F.2d 540 (2d Cir. 1930), which established the basic rule that if a taxpayer can show that he is entitled to *some* deduction, but cannot establish the full amount claimed, it is improper to deny the deduction in its entirety. For nearly a century, *Cohan* has been "one of the most cited cases in all of income tax." Jay A. Soled, *Exploring and (Re)Defining the Boundaries of the* Cohan *Rule*, 79 Temp. L. Rev. 939, 940 (2006).

While most federal circuits have recognized the applicability of the *Cohan* rule, its vitality has come into question in recent decades. As one court of appeals put it, "[t]he present trend, while not to repudiate the *Cohan* rule entirely, is to not invoke it where the claimed but unsubstantiated deductions are of a sort of which the taxpayer would have and should have maintained the necessary records." *Lerch* v. *Commissioner*, 877 F.2d 624, 628 (7th Cir. 1989). In its ruling below, the Second Circuit panel disregarded the *Cohan* rule, disallowing all of the Feins' claimed deductions even though they had presented evidence substantiating at least some of them. In so doing, it added to the confusion surrounding the continuing vitality of the rule, which is implicated in a vast number of taxpayer disputes. This Court's intervention is necessary to clarify and restore uniformity to this muddled landscape.

2. In *Cohan*, the taxpayer, famed Broadway entertainer and songwriter George M. Cohan, had failed to maintain records of items he claimed as business entertainment expenses. The Commissioner disallowed his entire deduction, despite the fact that Cohan had established at least some of the expenses that he claimed. The Second Circuit, in an opinion by Judge Learned Hand, reversed, holding that complete disallowance was unwarranted:

> "Absolute certainty in such matters is usually impossible and is not necessary; the Board [of Tax Appeals, the precursor to the modern Tax Court] should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent. True, we do not know how many trips Cohan made, nor how large his entertainments were; yet there was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any, even though it were the traveling expenses of a single trip. It is not fatal that the result will inevitably be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence."

Cohan, 39 F.3d at 544.

Some years later, Congress acted to circumscribe the scope of the rule. In the Revenue Act of 1962, 76 Stat. 974, Congress enacted section 274(d) of the Internal Revenue Code, 26 U.S.C. § 274(d), which superseded the *Cohan* rule for certain categories of expenses. The new pro-

vision disallowed deductions for traveling expenses, meals and entertainment, or "listed property"[6] unless the taxpayer could properly substantiate (1) the amount of the actual expenses; (2) the time and place of the expense; (3) the business purpose; and (4) for meals and entertainment, the business relationship between the taxpayer and the recipient. 26 U.S.C. § 274(d). "Generally, expenses subject to the strict substantiation requirements of section 274(d) must be disallowed in full unless the taxpayer satisfies every element of those requirements." *Fleming* v. *Commissioner*, T.C. Memo. 2010-60, 2010 WL 1222276, *2 (2010).

Despite this legislative limitation, the federal circuit courts have continued to apply the *Cohan* rule to deductions outside the scope of section 274(d). See, *e.g.*, *United States* v. *McFerrin*, 570 F.3d 672, 679 (5th Cir. 2009) (invoking rule to estimate costs relating to research tax credit); *Hagen* v. *Commissioner*, No. 90-9010, 1991 WL 275644, *7 (10th Cir. Dec. 26, 1991) (invoking rule to estimate costs relating to office repairs); *Edelson v. Commissioner*, 829 F.2d 828, 831 (9th Cir. 1987) ("a court should allow the taxpayer some deductions if the taxpayer proves he is entitled to the deduction but cannot establish the full amount claimed"); *Ellis Banking Corp.* v. *Commissioner*, 688 F.2d 1376, 1382 (11th Cir. 1982) (in-

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[6] "Listed property" means any passenger automobile; any property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; any computer or peripheral equipment (except when used exclusively at a regular business establishment and owned or leased by the person operating such establishment); any cell phones (or similar telecommunications equipment); or other property specified by regulations. 26 U.S.C. § 280F(d)(4).

voking rule to estimate costs relating to business auditing expenses).

Other recent decisions, however, have left the "current vitality of the *Cohan* rule * * * open to question." *Lerch*, 877 F.2d at 628. Specifically, some circuit courts have refused to apply *Cohan* where the claimed deductions "are of a sort for which the taxpayer could have and should have"—but did not—"maintain[n] the necessary records." *Id.*; see also, *e.g.*, *Reinke* v. *Commissioner*, 46 F.3d 760, 764–765 (8th Cir. 1995) (refusing to estimate portion of payments that were made in compensation for damage to land, and therefore deductible); *Pridgen* v. *IRS*, 2 Fed. Appx. 264, 274 (4th Cir. 2001) (where "the taxpayer could have and should have maintained the necessary records," the "tax court was under no obligation to guess as to the amount" of the deductible expenses") (citations and internal quotation marks omitted); *Pfluger v. Commissioner,* 840 F.2d 1379 (7th Cir. 1988) (refusing to estimate allowable deduction for dental supplies and equipment: "Undoubtedly, Dr. Pfluger spent money on materials, but he refused to produce the evidence to *prove* these expenditures. We cannot simply guess as to the amount he could have deducted.").

3. In this uncertain landscape, the Second Circuit's decision below represents an unusually candid disavowal of the long-standing *Cohan* rule: It upheld the tax court's complete disallowance of *any* claimed business deductions, despite the fact that the Feins submitted substantial evidence supporting at least *some* of the deductions in question.

For example, the Feins submitted uncontroverted evidence establishing that they paid rental expenses for office space used for Mr. Fein's accounting business, at which he met clients by appointment. Tr. of Nov. 30, 2010

hearing (Tax Ct. Dckt. 19) at 50. They also submitted evidence of thousands of dollars in expenditures for office supplies from retailers like Staples. Stipulation of Facts (Tax Ct. Dckt. 16), Exs. 97-J, 98-J, 99-J. It is clear that here, as in *Cohan*, "something was spent" and that there is a "some basis for computation" of at least "the minimum of such expenses." *Cohan*, 39 F.2d at 544.

None of the expenses detailed above would trigger the more stringent substantiation requirement of section 164(d); rather, they constitute proper business deductions for expenses that are ordinary and necessary in carrying on a trade or business pursuant to 26 U.S.C. § 162. The fact that the court may have viewed *some* of the Feins' documentation as inadequate does not justify a blanket holding disallowing *all* of their claimed expenses—without any particularized inquiry into the sufficiency of the backup for each claimed deduction or any attempt to estimate at least the minimum of allowable deductions based on the Feins' evidence. Instead, the court assumed that the only thing correct about the Feins' tax returns was their reported income—while disallowing every dollar of the business expenses necessary to earn that income. The Tax Court and the panel disregarded *Cohan* and imposed the inequitable result of permitting not a single deduction for a three-year period during which the taxpayers admittedly ran two separate businesses.

4. This case thus provides a dramatic example of the increasingly hostile reception the *Cohan* rule has received in certain circuits. It also highlights the deep and widening split among the circuits on this issue: The Court need only compare the holding below with, for example, the Fifth Circuit's recent decision in *McFerrin*, which accommodatingly applied "the longstanding rule of *Cohan* v. *Commissioner* that if a qualified expense occurred, the

court should estimate the allowable tax credit," and looked to "testimony and other evidence, including the institutional knowledge of employees, in determining a fair estimate" of the taxpayer's claimed—but largely unsubstantiated—research cost expenses. 570 F.3d at 679. This case provides a timely and appropriate vehicle for the Court to address the continued vitality of the *Cohan* rule, which potentially affects millions of federal taxpayers each year.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 2013

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 11-3760-ag

Leonard FEIN and Pearl Fein,
Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee

December 6, 2012

Appeal from the United States Tax Court (Swift, *J.*).

Before: KEARSE, STRAUB, and POOLER, Circuit Judges.

SUMMARY ORDER

ON CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the tax court be and hereby is AFFIRMED.

Petitioners-Appellants Leonard and Pearl Fein ("Petitioners") appeal from a June 24, 2011 decision of the tax court (Swift, *J.*), sustaining the Commissioner of Internal Revenue's ("Commissioner's") disallowance of deductions under 26 U.S.C. § 6651 and 26 U.S.C. § 174(d) and impo-

sition of penalties under 26 U.S.C. § 6651 and 26 U.S.C. § 6662(a) for Petitioners' 2002, 2003, and 2004 returns. We assume the parties' familiarity with the underlying facts, procedural history, and specification of issues for review.

We review the tax court's conclusions of law *de novo* and its findings of fact for clear error. *Robinson Knife Mfg. Co. v. Comm'r*, 600 F.3d 121, 124 (2d Cir. 2010). The tax court's finding that a taxpayer has not shown reasonable cause sufficient to avoid the imposition of penalties under 26 U.S.C. §§ 66651 [sic] or 6662 is reviewed for clear error. *Fran Corp. v. United States*, 164 F.3d 814, 816 (2d Cir. 1999) (§ 6651). *Thompson v. Comm'r*, 499 F.3d 129, 134 (2d Cir. 2007) (§ 6662).

The tax court requires parties to "stipulate, to the fullest extent to which complete or qualified agreement can or fairly should be reached, all matters not privileged which are relevant to the pending case." T.C. R. 91(a)(1). Petitioners' main argument on appeal is that, in a pretrial stipulation of facts adopted by the tax court, both parties agreed to the accuracy of most of Petitioners' returns, and this prevents disallowance by the Commissioner and tax court of the deductions claimed on those returns. A reading of the stipulation, however, makes clear that the parties agreed that certain attached exhibits were accurate copies, but did not agree that the returns themselves had accurate information. Furthermore, the fact that Petitioners offered evidence at trial in order to substantiate their expenses belies the argument that the parties stipulated that the claimed expense deductions were correct. *See Mildred Cotler Trust v. United States*, 184 F.3d 168, 172-75 (2d Cir. 1999) (rejecting argument that taxpayer stipulated to fraud penalties when government failed to raise issue before the tax court and taxpayer repeatedly denied fraud before the

tax court).

Petitioners also argue that the tax court erred in finding that they filed to substantiate their business expense deductions under Section 162 and Section 274(d). Taxpayers must keep records to substantiate deductions for as long as the records are material to the administration of the tax laws. *See* 26 U.S.C. § 6001; Treas. Reg. § 1.6001-1(a), (e). Business expenses claimed under Section 274(d) are subject to stricter substantiation requirements as to the nature of records to be maintained. Here, the tax court found that Petitioners failed to meet their substantiation requirements under either Section. Much of Petitioners' documentation was illegible or blank, and such documentation as was legible did not clearly show a business purpose for the claimed expenses. On appeal, Petitioners point to nothing that contradicts the tax court's findings. Accordingly, we find that the tax court did not err.

Finally, Petitioners argue that the tax court erred in its imposition of penalties. Section 6651 requires the imposition of a penalty "[i]n case of failure to file any return . . . on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect." 26 U.S.C. § 6641(a)(1). Section 6662 requires the imposition of a penalty on the portion of an underpayment in tax attributable to the taxpayer's "[n]egligence or disregard of rules or regulations." *Id.* § 6662(b). Negligence is defined as "any failure to make a reasonable attempt to comply with the provisions of [the Internal Revenue Code]." *Id.* § 6662(c); *see also* Treas. Reg. § 1.6662-3(b)(1) (providing that it is negligent for a taxpayer to fail "to keep adequate books and records or to substantiate items properly"). Section 6662 also has an exception for "reasonable cause." 26 U.S.C. § 6664(c). In

this case, Petitioners failed to keep adequate records and failed to file timely returns, and are therefore liable for penalties under Sections 6651 and 6662. The tax court found that they did not establish reasonable cause for their failures. Petitioners argue they meet the reasonable cause exception, but they have pointed out no error in the tax court's determination.

We have considered all of Petitioners' other arguments and find them without merit. Accordingly, the judgment of the district court is AFFIRMED.

APPENDIX B

UNITED STATES TAX COURT

No. 15166-09

Leonard FEIN and Pearl Fein,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

June 22, 2011

MEMORANDUM FINDINGS OF FACT AND OPINION

SWIFT, Judge:

Respondent determined deficiencies, penalties, and additions to tax with respect to petitioners' Federal income taxes for 2002, 2003, and 2004 as follows:

Year	*Deficiency*	*Additions to Tax Sec. 6651(a)*	*Penalties Sec. 6662(a)*
2002	$41,465	$9,735	$8,293
2003	42,771	10,064	8,554
2004	54,959	13,076	10,992

The issue for decision is whether petitioners have substantiated claimed business and entertainment ex-

penses under sections 162, 274, and 6001 relating to Leonard Fein's (petitioner's) accounting and photographic activities. The trial of this case was held on November 30 and December 1, 2010, in New York City.

Unless otherwise indicated, all section references are to the Internal Revenue Code applicable to the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. At the time the petition was filed, petitioners resided in New York.

Since the late 1970s petitioner has been a certified public accountant. From 1993 through most of 2000, however, petitioner did not work as an accountant.

In 2000 and through the years in issue petitioner resumed his accounting activity, including the preparation of tax returns.

During the years in issue petitioner also engaged in some photographic activity. The evidence does not indicate that petitioner received any training in photography.

Petitioner paid his children what petitioner refers to as "per diem", allegedly in connection with services they performed in petitioner's accounting activity. These per diem payments, however, appear to have been set at amounts that would allow the children to benefit from the earned income tax credit, not at amounts that reflect the value of any services the children actually performed for petitioner, and the credible evidence does not establish the nature and extent of any services the children performed for petitioner.

Petitioner paid little attention to recordkeeping and

financial aspects of his accounting and photographic activities. Documentation petitioner maintained regarding his accounting and photographic activities was disorganized and incomplete. Petitioner maintained no credible records and no bank accounts relating to these activities, and petitioner commingled funds relating to these activities with funds pertaining to his personal and family activities.

During the years in issue petitioner lived in his father's house with between 10 to 18 other family members and individuals. Other than petitioner, none of the persons living in this house owned a car. The car petitioner owned and used in his accounting and photographic activities was also used by petitioner and by other persons living with petitioner for their personal use.

In some of the office space petitioner apparently rented, petitioner had no phone lines or Internet connections. The eight phones that petitioner alleges to have used in his accounting and photographic activities were all registered in the names of petitioner's wife and children.

During the years in issue petitioner had severe medical problems—poor eyesight, stomach ailments, and eating disorders. In 2004 petitioner traveled to Israel and while there received medical treatment for his eye problems.

Petitioners' Federal income tax returns for 2002, 2003, and 2004 were filed late on February 20, March 3, and March 13, 2006, respectively, on which returns petitioner reported the following gross income relating to his accounting and photographic activities:

	Gross Income		
Year	*Accounting*	*Photography*	*Total*
2002[1]	$98,610	$53,910	$152,520
2003	100,220	63,616	163,836
2004	124,200	74,080	198,280

On each of petitioners' Federal income tax returns for the years in issue, petitioner attached two Schedules C, Profit or Loss From Business, the first relating to petitioner's accounting activity and the second relating to his photographic activity.

The table below summarizes for each year in issue the expenses petitioner claimed on the Schedules C as deductible business expenses relating to petitioner's accounting and photographic activities.

Accounting—Schedule C–1

	Years		
Expenses	*2002*	*2003*	*2004*
Depreciation	$10,507	$12,291	$13,255
Rent	18,000	19,600	21,600
Postage	3,971	4,209	4,672
Telephone & Internet	4,269	4,316	4,520
Per diem	13,250	13,960	28,200

[1] In connection with petitioners' 2002 Federal income tax return, petitioners and respondent dispute which copy of the Schedule C, Profit or Loss From Business, relating to petitioner's accounting activity was filed. We use the figures from the Schedule C respondent asserts was filed.

Office	5,316	5,762	6,572
Repairs & maintenance	369	0	0
Supplies	1,838	1,974	2,139
Professional books	439	463	524
Tax & computer forms	512	502	624
Computer tax programs	7,669	8,034	7,226
Computer supplies	4,639	0	0
Other	572	609	1,024
Tolls & parking	4,312	4,609	4,763
Car & truck	7,696	8,394	8,734
Promotion & gifts	3,312	3,570	3,698
Travel	0	0	1,760
Meals & entertainment	*1,534*	*1,718*	*2,010*
Total expenses	88,205	90,011	111,321

Photography—Schedule C–2

	Years		
Expenses	*2002*	*2003*	*2004*
Depreciation	$7,888	$11,460	$14,136
Postage	1,217	1,334	1,473
Telephone	1,338	1,296	1,489
Office expense	1,834	1,768	1,636
Repairs & maintenance	338	309	256
Supplies	1,743	1,917	1,873
Printing & developing	14,372	15,968	20,192
Computer programs	6,597	6,219	7,618

Computer supplies	3,487	4,383	3,974
Publications	626	734	1,160
Videotapes & discs	4,312	4,297	3,974
Research material	2,472	3,874	3,098
Car & truck	3,626	3,917	4,024
Promotion & gifts	1,594	2,016	2,619
Travel	0	0	2,468
Meals & entertainment	874	1,105	1,098
Total expenses	52,318	60,597	71,088

On the basis of the above-reported income and expenses, petitioners reported on their 2002, 2003, and 2004 Federal income tax returns net profit from petitioner's accounting and photographic activities as follows:

	Net Profit		
Year	*Accounting*	*Photography*	*Total*
2002	$10,405	$1,592	$11,997
2003	10,209	3,019	13,228
2004	12,879	2,992	15,871

On audit respondent disallowed in their entirety the claimed business expenses relating to petitioner's accounting and photographic activities reflected on petitioners' untimely filed Federal income tax returns for 2002, 2003, and 2004, determined the tax deficiencies at issue herein, and imposed on petitioners the section 6651(a)(1) late-filing additions to tax and the section 6662(a) accuracy-related penalties.

Much of the documentation petitioner offered at trial relating to his accounting and photographic activities is illegible, with dates, prices, and descriptions unreadable.

Testimony petitioner gave with regard to his proffered documentation was generally vague and inadequate. Petitioner testified that bills for expenses relating to his accounting and photographic activities were the responsibility of his wife-that he never saw the bills, never paid the bills, and never checked whether his wife had paid the bills. Petitioner, however, did not call his wife, his children, or others to testify at the trial.

OPINION

Respondent claims that petitioner in 2002, 2003, and 2004 was not engaged in a trade or business of accounting or photography and alternatively that petitioner is not entitled to the claimed expenses relating thereto for lack of proper and adequate documentation and substantiation. We address only respondent's lack of substantiation argument.

Taxpayers have a responsibility to maintain records sufficient to determine their correct Federal income tax liability. Sec. 6001; *Higbee v. Commissioner*, 116 T.C. 438, 440, 2001 WL 617230 (2001). No deduction is allowed for personal, living, or family expenses unless expressly provided by law. Sec. 262(a).

Deductions are a matter of legislative grace, and the taxpayer generally bears the burden of proving he or she is entitled to the deductions claimed.[1] Rule 142(a); *New Colonial Ice Co. v. Commissioner*, 292 U.S. 435, 440, 54 S. Ct. 788, 78 L. Ed. 1348 (1934). Taxpayers must be able to substantiate both the amount paid and the purpose of

[1] Because petitioner has not maintained and submitted adequate records to substantiate his claimed expenses, petitioners do not qualify for a shift in the burden of proof under sec. 7491(a). See sec. 7491(a)(2).

claimed deductions. *Higbee v. Commissioner, supra* at 440.

At trial petitioner did not credibly explain how he accounted for the income received and the expenses incurred in his accounting and photographic activities. Petitioner stated he gave funds received to his wife and she did whatever she wanted with them.

As noted above, documentation petitioner offered to substantiate claimed expenses relating to his accounting and photographic activities is illegible, some of it is blank, and much of it is not in petitioner's name, but rather in the names of petitioner's wife and children. Much of the documentation that is legible is utterly unclear as to the purpose of the claimed expense—whether personal, accounting, or photography—and no further explanatory evidence is provided.

Petitioner produced no credible documentation with regard to claimed gasoline purchases, car repairs expenses, and toll costs.

Documentation petitioner produced in support of car and truck expenses, gifts and promotions, meals, entertainment, and travel does not meet the recordkeeping requirements of section 274(d).

There is no credible evidence that petitioners' children worked in any meaningful way for petitioner in either his accounting or his photographic activities that would have justified the per diem payments petitioner paid to them.

In support of claimed depreciation, petitioner offers a list of assets for 2006. This list is insufficient to establish that petitioner purchased and placed into service the depreciable assets and that the depreciation amounts petitioner claimed during the years in issue were correct.

Petitioner claims that some of the documentation relating to his accounting and photographic activities was destroyed in a fire or lost as a result of a computer crash. Petitioner submitted numerous general receipts at trial but has provided no credible evidence that the purpose for those expenses related to petitioner's accounting and photographic activities, and petitioner's ability to produce numerous receipts calls into question petitioner's allegation that a fire or a computer crash occurred that destroyed his records.

Over the course of the 3 years in issue, petitioner claims approximately $8,000 in meal and entertainment expenses. The diary petitioner offers in support of these expenses, however, inadequately describes the business relationship between petitioner, the named client, and any business purpose for the expenses. See sec. 274(d).

Petitioner claims his 2004 trip to Israel qualifies as a business trip in his photographic activities. However, no credible evidence supports that claim; rather, it appears petitioner's trip to Israel related to needed medical treatments.

In summary, we sustain respondent's disallowance of all of the expenses claimed on the Schedules C–1 or C–2 on petitioners' 2002, 2003, and 2004 Federal income tax returns.

Respondent has satisfied his burden of production under section 7491(c), and petitioners have not established any reasonable cause with regard to the late filing of petitioners' 2002, 2003, and 2004 Federal income tax returns and the underpayments associated therewith. See *Higbee v. Commissioner, supra* at 447. The credible evidence does not establish that petitioner's (or other family members') medical problems incapacitated petitioner from filing timely and proper Federal income tax

returns for the years in issue. See *Wright v. Commissioner*, T.C. Memo. 1998–224, affd. without published opinion 173 F.3d 848 (2d Cir. 1999).

We sustain respondent's imposition of both the section 6651 late-filing additions to tax and the section 6662(a) accuracy-related penalties.

To reflect the foregoing,

Decision will be entered for respondent.

APPENDIX C

1. 26 U.S.C. § 162 provides in pertinent part:

Trade or business expenses

(a) **In general.**—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

2. 26 U.S.C. § 274 provides in pertinent part:

Disallowance of certain entertainment, etc., expenses

* * * * *

(d) **Substantiation required.**—No deduction or credit shall be allowed—

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

(2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity,

(3) for any expense for gifts, or

(4) with respect to any listed property (as defined in section 280F(d)(4)),

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility or property, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. This subsection shall not apply to any qualified nonpersonal use vehicle (as defined in subsection (i)).

* * * * *