MLI #2 Trade or Business Expenses Under IRC § 162 and Related Sections

SUMMARY

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998.[1] We identified 99 cases involving a trade or business expense issue that were litigated between June 1, 2014, and May 31, 2015. The courts affirmed the IRS position in 57 of these cases, or about 58 percent, while taxpayers fully prevailed in 11 cases, or about 11 percent. The remaining 31 cases, or 31 percent, resulted in split decisions.

TAXPAYER RIGHTS IMPACTED[2]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*

PRESENT LAW

Internal Revenue Code (IRC) § 162 allows deductions for ordinary and necessary trade or business expenses paid or incurred during the course of a taxable year. Rules regarding the practical application of IRC § 162 have evolved largely from case law and administrative guidance. The IRS, the Department of the Treasury, Congress, and the courts continue to provide guidance about whether a taxpayer is entitled to claim certain deductions. The cases analyzed for this report illustrate that this process is ongoing and involves the analysis of facts and circumstances particular to each case. When a taxpayer seeks judicial review of the IRS's determination of a tax liability relating to the deductibility of a particular expense, the courts must often address a series of questions, including those discussed below.

What is a trade or business expense under IRC § 162?

Although "trade or business" is one of the most widely used terms in the IRC, neither the Code nor Treasury Regulations provide a definition.[3] The definition of a "trade or business" comes from common law, where the concepts have been developed and refined by the courts.[4] The Supreme Court has interpreted "trade or business" for purposes of IRC § 162 to mean an activity conducted with "continuity and regularity" and with the primary purpose of earning income or making profit.[5]

1 See National Taxpayer Advocate 1998-2014 Annual Reports to Congress.

2 See Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

3 In 1986, the term "trade or business" appeared in at least 492 subsections of the IRC and in over 664 Treasury Regulations. See F. Ladson Boyle, *What Is a Trade or Business?*, 39 Tax Law. 737 (Summer 1986).

4 Carol Duane Olson, *Toward a Neutral Definition of "Trade or Business" in the Internal Revenue Code*, 54 U. Cin. L. Rev. 1199 (1986).

5 *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

What is an ordinary and necessary expense?

IRC § 162(a) requires a trade or business expense to be both "ordinary" and "necessary" in relation to the taxpayer's trade or business to be deductible. In *Welch v. Helvering*, the Supreme Court stated that the words "ordinary" and "necessary" have different meanings, both of which must be satisfied for the taxpayer to benefit from the deduction.[6] The Supreme Court describes an "ordinary" expense as customary or usual and of common or frequent occurrence in the taxpayer's trade or business.[7] The Court describes a "necessary" expense as one that is appropriate and helpful for development of the business.[8]

Common law also requires that in addition to being ordinary and necessary, the amount of the expense must be reasonable for the expense to be deductible. In *Commissioner v. Lincoln Electric Co.*, the Court of Appeals for the 6th Circuit held "the element of reasonableness is inherent in the phrase 'ordinary and necessary.' Clearly it was not the intention of Congress to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount."[9]

Is the expense a currently deductible expense or a capital expenditure?

A currently deductible expense is an ordinary and necessary expense paid or incurred during the taxable year in the course of carrying on a trade or business.[10] No current deductions are allowed for the cost of acquisition, construction, improvement, or restoration of an asset expected to last more than one year.[11] Instead, those types of expenses are generally considered capital expenditures, which may be subject to depreciation, amortization, or depletion over the useful life of the property.[12]

Whether an expenditure is deductible under IRC § 162(a) or is a capital expenditure under IRC § 263 is a question of fact. Courts have adopted a case-by-case approach to applying principles of capitalization and deductibility.[13]

When is an expense paid or incurred during the taxable year, and what proof is there that the expense was paid?

IRC § 162(a) requires an expense to be "paid or incurred during the taxable year" to be deductible. The IRC also requires a taxpayer to maintain books and records that substantiate income, deductions, and credits, including adequate records to substantiate deductions claimed as trade or business expenses.[14] If a taxpayer cannot substantiate the exact amounts of deductions by documentary evidence (*e.g.*, invoice, paid bill, or canceled check) but can establish that he or she had some business expenditures, the courts may employ the *Cohan* rule to grant the taxpayer a reasonable amount of deductions.

6 290 U.S. 111, 115 (1933) (suggesting an examination of "life in all its fullness" will provide an answer to the issue of whether an expense is ordinary and necessary).

7 *Deputy v. du Pont*, 308 U.S. 488, 495 (1940) (citation omitted).

8 *See Comm'r v. Heininger*, 320 U.S. 467, 471 (1943) (citations omitted).

9 176 F.2d 815, 817 (6th Cir. 1949), *cert. denied*, 338 U.S. 949 (1950).

10 IRC § 162(a).

11 IRC § 263. *See also INDOPCO, Inc. v. Comm'r*, 503 U.S. 79 (1992).

12 IRC § 167.

13 *See PNC Bancorp, Inc. v. Comm'r*, 212 F.3d 822 (3d Cir. 2000); *Norwest Corp. v. Comm'r*, 108 T.C. 265 (1997).

14 IRC § 6001. *See also* Treas. Reg. §§ 1.6001-1 and 1.446-1(a)(4).

The *Cohan* rule

The *Cohan* rule is one of "indulgence" established in 1930 by the Court of Appeals for the 2nd Circuit in *Cohan v. Commissioner*.[15] The court held that the taxpayer's business expense deductions were not adequately substantiated, but stated that "the [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."[16] In *Estate of Elkins v. Commissioner*, the 5th Circuit recently described "the venerable lesson of Judge Learned Hand's opinion in *Cohan*: In essence, make as close an approximation as you can, but never use a zero."[17]

The *Cohan* rule cannot be used in situations where IRC § 274(d) applies. IRC § 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deductions are allowable for:

- Travel expenses;
- Entertainment, amusement, or recreation expenses;
- Gifts; and
- Certain "listed property."[18]

A taxpayer must substantiate a claimed IRC § 274(d) expense with adequate records or sufficient evidence to establish the amount, time, place, and business purpose.[19] A contemporaneous log is not explicitly required, but a statement not made at or near the time of the expenditure has the same degree of credibility only if the corroborative evidence has "a high degree of probative value."[20] In addition, entertainment expenses require proof of a business relationship to the taxpayer.[21]

Who has the burden of proof in a substantiation case?

Generally, the taxpayer bears the burden of proving that he or she is entitled to the business expense deductions and the IRS's proposed determination of tax liability is incorrect.[22] IRC § 7491(a) provides that the burden of proof shifts to the IRS when the taxpayer:

- Introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer's liability;
- Complies with the requirements to substantiate deductions;

15 39 F.2d 540 (2d Cir. 1930). George M. Cohan was an actor, playwright, and producer who spent large sums travelling and entertaining actors, employees, and critics. Although Cohan did not keep a record of his spending on travel and entertainment, he estimated that he incurred $55,000 in expenses over several years. The Board of Tax Appeals, now the Tax Court, disallowed these deductions in full based on Cohan's lack of supporting documentation. Nevertheless, on appeal, the 2nd Circuit concluded that Cohan's testimony established that legitimate deductible expenses had been incurred. As a result, the 2nd Circuit remanded the case back to the Board of Tax Appeals with instructions to estimate the amount of deductible expenses.

16 39 F.2d 540 (2d Cir. 1930) at 544 (2d Cir. 1930), *aff'g and remanding* 11 B.T.A. 743 (1928).

17 767 F.3d 443, 449, n. 7 (5th Cir. 2014), *rev'g* 140 T.C. 86 (2013).

18 "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); and any other property specified by regulations. IRC §§ 280F(d)(4)(A) and (B).

19 Treas. Reg. § 1.274-5T(b).

20 Treas. Reg. § 1.274-5T(c)(1); *Reynolds v. Comm'r*, 296 F.3d 607, 615-16 (7th Cir. 2002) (noting that keeping written records is not the only method to substantiate IRC § 274 expenses but "alternative methods are disfavored").

21 Treas. Reg. § 1.274-5T(b)(3)(v).

22 *See Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted) and U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

- Maintains all records required under the Code; and
- Cooperates with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews.

ANALYSIS OF LITIGATED CASES

The deductibility of trade or business expenses has been one of the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998.[23] This year, we reviewed 99 cases involving trade or business expenses that were litigated in federal courts from June 1, 2014, through May 31, 2015. Table 2 in Appendix 3 contains a list of the main issues in those cases. Figure 3.2.1 categorizes the main issues raised by taxpayers. Cases involving more than one issue are included in more than one category.

FIGURE 3.2.1, Trade or Business Expense Issues in Cases Reviewed[24]

Issue	Type of Taxpayer	
	Individual	Business
Substantiation of Expenses, Including Application of the *Cohan* Rule	14	60
Ordinary and Necessary Trade or Business Expenses	1	11
Personal vs. Business Expense	4	19
Trade or Business Carried on for Profit	2	19
Economic Substance	0	4
Home Office	1	10

Taxpayers represented themselves (*pro se*) in 60 of 99 cases. Taxpayers represented by counsel (39 of 99 cases) fared slightly better than their *pro se* counterparts. Taxpayers with representation received full or partial relief in approximately 49 percent of cases (19 of 39). By contrast, *pro se* taxpayers received full or partial relief in 38 percent of cases (23 of 60).

Individual Taxpayers

None of the 16 decisions involving individual taxpayers (where the term "individual" excludes a sole proprietorship) were issued as a regular opinion of the Tax Court.[25] Eleven of the 16 individual taxpayers appeared *pro se*. Two individual taxpayers received full relief, while nine earned split decisions. The court fully upheld the IRS position in five of 16 cases (31 percent).

23 See National Taxpayer Advocate 1998-2014 Annual Reports to Congress.

24 Multiple issues can appear within one case; therefore, these issue-spotting breakdown figures will not match the total case count.

25 Tax Court decisions fall into three categories: regular decisions, memorandum decisions, and small tax case ("S") decisions. The regular decisions of the Tax Court include cases which have some new or novel point of law, or in which there may not be general agreement, and therefore have the most legal significance. In contrast, memorandum decisions generally involve fact patterns within previously settled legal principles and therefore are not as legally significant. Finally, "S" case decisions (for disputes involving $50,000 or less where the taxpayer has elected Small Case status) are not appealable and, thus, have no precedential value. *See* IRC § 7463(b). *See also* U.S. Tax Court Rules of Practice and Procedure, Rules 170-175. More than half of the cases reviewed this year involving individual taxpayers (excluding sole proprietorships) were "S" cases.

The most prevalent issue was the substantiation of claimed trade or business expense deductions. For example, in *Garza v. Commissioner*, the Tax Court denied a travel expense deduction for failure to substantiate.[26] The taxpayer, a direct sales representative for Time Warner Cable, used his personal vehicle to make service calls and maintained a calendar planner in which he recorded his vehicle's odometer readings at the beginning and end of each month, sometimes also including intermediate readings and personal notes. Although the taxpayer's calendar planner was contemporaneous, it lacked information detailing the amount, date, and business purpose of each use of his vehicle. As a result, the Court denied the taxpayer a deduction for these claimed travel expenses.[27]

Business Taxpayers

We reviewed 83 cases involving business taxpayers. As it turned out, business taxpayers had a much lower success rate compared to individual taxpayers. Individual taxpayers received full or partial relief in approximately 69 percent of cases (11 of 16). Meanwhile, business taxpayers received full or partial relief in only 37 percent of cases (31 of 83).

Business taxpayers were represented by counsel in 55 percent (17 of 31) of favorably decided cases, including eight cases in which the taxpayer received full relief. Business taxpayers were represented by counsel in 33 percent (17 of 52) of the cases the IRS won. To the extent that *pro se* taxpayers were successful in court, these favorable outcomes stemmed mostly from their ability to provide records substantiating deductions in cases where such substantiation was in controversy.

As was the case for the individual taxpayers, substantiation of expenses was by far the most prevalent issue, and in most instances, the courts denied the business taxpayers' deductions for failure to substantiate.[28] Courts did, however, allow some of these deductions when the taxpayer produced sufficient evidence.[29] Courts occasionally applied the *Cohan* rule where the taxpayer presented sufficient documentation to prove an expense was incurred but had limited documentation of the precise amount.[30] As previously mentioned, however, IRC § 274(d) makes the *Cohan* rule unavailable in certain circumstances in which the taxpayer must substantiate the deductions.

Taxpayers were also denied business expense deductions under IRC § 262(a) when the courts found the expenses were related to personal rather than business activities.[31] In *Peterson v. Commissioner*, the taxpayer was a full-time police officer for the city of Chicago and also owned and operated a private security company.[32] The taxpayer claimed deductions for vehicle, transportation, and travel expenses resulting

26 T.C. Memo. 2014-121.

27 *See also Flores v. Comm'r*, T.C. Memo. 2015-9 (denying deductions for vehicle and other Schedule A expenses for insufficient or absent documentation).

28 *See Sheridan v. Comm'r*, T.C. Memo. 2015-25 (finding that taxpayer was not entitled to annual theft loss deductions of $1 million for alleged smokeless tobacco vaporizer patent infringement); *Robinson v. Comm'r*, T.C. Memo. 2014-120, *aff'd*, No. 15-1380 (4th Cir. Sept. 3, 2015) (denying deductions for vehicle, home office, and other personal expenses).

29 *See ABC Beverage Corp. v. U.S.*, 756 F.3d 438 (6th Cir. 2014), *aff'g* 577 F. Supp. 2d 935 (W.D. Mich. 2008) (holding that a portion of the purchase price from a burdensome lease buyout was deductible); *Cooper v. Comm'r*, 143 T.C. 194 (2014) (finding that reverse engineering expenses were sufficiently related to taxpayer's business as an inventor and were deductible as a result), *appeal docketed*, No. 15-70863 (9th Cir. Mar. 20, 2015).

30 *See Mylander v. Comm'r*, T.C. Memo. 2014-191 (allowing deduction for continuing dental education based on approximated expense of class hour and annual education requirement); *Sawyer v. Comm'r*, T.C. Memo. 2015-55 (allowing deduction for labor costs approximated from taxpayer's testimony and invoices).

31 IRC § 262(a) provides that personal, living, and family expenses are generally not deductible. *See, e.g.*, *Lussy v. Comm'r*, T.C. Memo. 2015-35 (denying deductions for legal fees, travel, and other expenses personal in nature), *appeal docketed*, No. 15-11626 (11th Cir. Apr. 13, 2015).

32 T.C. Memo. 2015-23.

from his off-duty work activities. He also deducted expenses for meals and entertainment, an additional bulletproof vest, and classes towards a master's degree in emergency management.

The Tax Court did not allow deductions for an additional bullet proof vest or expenses towards the taxpayer's master degree as these expenses were personal in nature.[33] Similarly, the Tax Court found that the taxpayer failed to substantiate travel, meal, and entertainment expenses to the strict degree required by IRC § 274(d). As a result, no deductions whatsoever were allowed.

Similarly, in *Engstrom, Lipscomb & Lack, APC v. Commissioner*, a law firm (Engstrom) challenged the IRS's disallowance of business-related air travel expenses.[34] The Tax Court denied all deductions for flights where no Engstrom personnel were present because they lacked a business purpose and failed to meet the strict IRC § 274(d) substantiation requirements. By contrast, the substantiation requirements and other prerequisites for deductibility, such as a business purpose, were held to have been satisfied with respect to many of the air travel expenses for flights on which the firm's owner or employees were passengers.[35]

Courts likewise generally sustained IRS determinations that business expense deductions were not attributable to an activity engaged in for profit within the meaning of IRC § 183. However, in *Crile v. Commissioner*, the taxpayer successfully established that she engaged in art making as a for profit business activity.[36] To arrive at this determination, the Tax Court proceeded to examine the taxpayer's deductions using the nine-factor test of Treas. Reg. § 1.183-2(b).[37]

The Tax Court stated that the taxpayer's business plan, credentials as an artist, time and effort spent on her art business, and the expectation of appreciation in the value of her artwork weighed in favor of her art making being for profit. According to the Court, these factors weighed more heavily in favor of the taxpayer's art making being for profit than the fact that she earned profits in only two of the multiple years in which she claimed deductions.[38]

Another common theme was the difficulty in proving that expenses were ordinary and necessary to the taxpayer's business.[39] The Tax Court in *Guardian Industries Corp. v. Commissioner* denied the taxpayer a deduction for a fine it paid to the Commission of the European Community (the Commission).[40] Guardian Industries and its Luxembourg subsidiary manufactured and sold fabricated-glass products. The Commission began an investigation of Guardian Industries and ultimately concluded that Guardian

33 39 F.2d 540 (2d Cir. 1930).

34 *Engstrom, Lipscomb & Lack, APC v. Comm'r*, T.C. Memo. 2014-221, *appeal docketed*, No. 15-70591 (9th Cir. Feb. 26, 2015).

35 For a more detailed discussion of this case, see Most Litigated Issue: *Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)*, *supra*.

36 T.C. Memo. 2014-202.

37 Those factors are (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

38 *Crile*, T.C. Memo. 2014-202.

39 *See* IRC § 162(a). For examples of cases examined in which the court denied deductions for failure to prove the expense was ordinary and necessary to the taxpayer's business, *see, e.g.*, *Fargo v. Comm'r*, T.C. Memo. 2015-96 (holding that payments made by the taxpayer's S corporation were not ordinary and necessary business expenses and therefore not deductible); *Midwest Eye Ctr., S.C. v. Comm'r*, T.C. Memo. 2015-53 (holding that taxpayer's $1 million bonus to sole executive and shareholder was not an ordinary and necessary business expense because it was not reasonable).

40 143 T.C. 1 (2014).

Industries had engaged in a cartel with its subsidiary, violating a European treaty on price fixing. A fine was issued against Guardian Industries as a result.

Guardian Industries attempted to deduct the fine it paid to the Commission as an "ordinary and necessary" business expense under IRC § 162. The IRS denied Guardian Industries this deduction, explaining that the fine paid to the Commission was more appropriately categorized as a non-deductible "fine or similar penalty paid to a government for the violation of any law."[41] The Tax Court agreed, ruling that the Commission is an "entity serving as an agency or instrumentality" of "[t]he government of a foreign country," and holding that the fine paid by Guardian Industries to the Commission therefore was not a deductible "ordinary and necessary" business expense.[42]

Taxpayers also had difficulty validating their home office deductions, losing cases where business use of a personal residence was in question.[43] One example of this issue was *Longino v. Commissioner*, where the taxpayer, an attorney, sought to claim a number of IRC § 162 expenses, including home office deductions for the use of his apartment.[44] The taxpayer, however, failed to substantiate that he used the apartment exclusively as his principal place of business, as his testimony provided "almost no details" about business activities conducted in the rooms in question.[45] Consequently, the 11th Circuit affirmed the denial of the home office expense deductions on appeal.

Another issue addressed by the courts this year deals with the question of whether a transaction has economic substance, which is a prerequisite for deductibility.[46] For example, in *Reddam v. Commissioner*, the taxpayer sought to offset his potential tax liability from the sale of a company he founded.[47] To realize this offset, the taxpayer engaged in the trading of foreign bank stock through a series of interrelated entities. The culmination of these trades and transactions created a sizable capital loss that the taxpayer sought to claim for tax purposes. In 2001, however, the IRS had announced it would not recognize tax benefits from the type of transactions in which the taxpayer had engaged.[48] The Tax Court held that the taxpayer was not entitled to claim the capital loss at issue, and the taxpayer appealed.

On appeal, the 9th Circuit utilized the "economic substance doctrine" to determine if the taxpayer's claimed capital loss should be disregarded for income tax purposes.[49] The court concluded from the facts of the case that the taxpayer pursued his foreign bank stock transactions solely for their tax benefits and that any potential economic gain from these transactions was vastly outweighed by their designed purpose

41 IRC § 162(f).

42 *Guardian Indus.*, 143 T.C. 1, 20 (2014). Treas. Reg. § 1.162-21(a) states that "[n]o deduction shall be allowed under section 162(a) for any fine or similar penalty paid to— (1) The government of the United States, a State, a territory or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico; (2) The government of a foreign country; or (3) A political subdivision of, or corporation or other entity serving as an agency or instrumentality of, any of the above."

43 IRC § 280(A)(c)(1) allows the deduction of "a portion of the dwelling unit which is exclusively used on a regular basis… as the principal place of business for any trade or business of the taxpayer." If the taxpayer is an employee, the home office deduction is only allowable if the exclusive use is for the convenience of the employer.

44 *Longino v. Comm'r*, 593 F. App'x 965 (11th Cir. 2014), *aff'g* T.C. Memo. 2013-80.

45 *Id.* at 969.

46 Taxpayers lost all four cases focused on the economic substance inquiry. *See Reddam v. Comm'r*, 755 F.3d 1051 (9th Cir. 2014), *aff'g* T.C. Memo. 2012-106; *Kenna Trading, LLC v. Comm'r*, 143 T.C. No. 18 (2014) (disallowing deductions for bad debt derived from sham partnership that lacked economic substance); *Vanney Assocs., Inc. v. Comm'r*, T.C. Memo. 2014-184 (holding that the taxpayer's payment of year-end bonus to shareholder-CEO was not deductible as officer compensation); *Graffia v. Comm'r*, 580 F. App'x 474 (7th Cir. 2014), *aff'g* T.C. Memo. 2013-211 (denying deductions for flow-through losses from sham transactions that lacked economic substance).

47 755 F.3d 1051 (9th Cir. 2014), *aff'g* T.C. Memo. 2012-106.

48 IRS Notice 2001-45, 2001-2 C.B. 129.

49 *Reddam*, 755 F.3d at 1059.

of creating capital losses. As a result, the court held that these transactions lacked economic substance and therefore the capital loss was not deductible.

CONCLUSION

The existence and amounts of allowable business expenses are highly fact-specific and are often open to interpretation. This circumstance continues to generate substantial controversy between the IRS and taxpayers regarding the scope and extent of properly claimed business deductions. This year, as in prior years, the IRS actively scrutinized and challenged many such deductions, while taxpayers were often willing to resort to litigation where the disallowance could not be resolved administratively within the IRS. From June 1, 2014, through May 31, 2015, courts generally favored the IRS's denial of business expense deductions, but specific facts and circumstances yielded some victories for taxpayers.

Eleven of these full or partial victories by taxpayers involved the courts' application of the *Cohan* rule. Use of this common law doctrine allowed taxpayers to deduct estimated expenses in cases where the expenses clearly existed but where available documentation made certainty regarding the amount of these expenses difficult or impossible. The IRS Office of Appeals also utilizes the *Cohan* rule in assessing hazards of litigation and in seeking to reach settlements with taxpayers.[50] The Examination process that often leads to Appeals, however, does not employ the *Cohan* rule and has adopted a more stringent document request policy to close cases and bypass Appeals in several instances.[51]

Given the relative frequency of business expense substantiation litigation, we recommend that IRS Compliance functions adopt the *Cohan* rule as a tool for evaluating and resolving tax controversies. This step would reduce potential hazards of litigation that the IRS may face and would lead to a higher rate of mutually beneficial settlements at the earliest possible stage of administrative proceedings. By embracing the opportunities for education, outreach, and collaboration with stakeholders that increased use of the *Cohan* rule would bring, the IRS can help taxpayers better understand business expense deductions and can effectively reduce the costly litigation to which both taxpayers and the government are currently subject. This education, outreach, and collaboration likewise would promote taxpayers' *right to be informed* and *right to challenge the IRS's position and be heard*.

50 See National Taxpayer Advocate 2015 Annual Report to Congress (Most Serious Problem: *Appeals: The Appeals Judicial Approach and Culture Project Is Reducing The Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*), *supra*.

51 *Id.*