

IN THE OREGON TAX COURT  
MAGISTRATE DIVISION  
Income Tax

TRICIA RADFORD,	)	
	)	
Plaintiff,	)	TC-MD 070342C
	)	
v.	)	
	)	
DEPARTMENT OF REVENUE,	)	
State of Oregon,	)	
	)	
Defendant.	)	<b>DECISION</b>

Plaintiff appealed Defendant's December 29, 2006, Notice of Assessment of Deficiency for 2005, stemming from Defendant's denial of Plaintiff's working family child care credit (WFC). Trial was held by telephone September 7, 2007. Plaintiff appeared on her own behalf. Testifying for Plaintiff was Leah M. Reade (Reade), the alleged child care provider. Defendant was represented by Becky Segovia (Segovia).

I. STATEMENT OF FACTS

In 2005, Plaintiff worked evenings as a waitress at the Tuscany Grill. Plaintiff had two children, ages six and nine. Plaintiff claimed a \$1,920 working family child care credit for 2005, based on reported child care expenses of \$4,800. Defendant denied the credit in its entirety due to a lack of adequate substantiation. Plaintiff timely appealed.

II. ANALYSIS

ORS 315.262(2)<sup>1</sup> provides a refundable credit for certain low-income taxpayers to partially offset the taxpayer's qualifying child care expenses incurred to enable the taxpayer to

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<sup>1</sup> All references to the Oregon Revised Statutes (ORS) are to 2005.

work, or to go to school. The credit is based on a percentage of the taxpayer's qualifying child care expenses.

The question in this case is whether Plaintiff actually paid for child care and, if so, how much she paid. Plaintiff contends that she paid \$4,800 for child care and is entitled to the credit as reported on her return. Defendant insists the credit should be denied because Plaintiff did not have receipts from the provider or canceled checks to substantiate the expenses, as required by ORS 314.425.

ORS 314.425 does not, per se, require a taxpayer to substantiate expenses reported on a return. Rather, that statute authorizes the Department of Revenue (department) to examine a taxpayer's "books, papers, records or memoranda bearing upon the matter required to be included in the return," and authorizes the department to subpoena such documents. Plaintiff does, however, have the burden of proof and must establish her case by a "preponderance" of the evidence. ORS 305.427. A "[p]reponderance of the evidence means the greater weight of the evidence, the more convincing evidence." *Feves v. Dept. of Revenue*, 4 OTR 302, 312 (1971).

Plaintiff testified that she had two roommates living with her in 2005, one of whom was Reade, who cared for Plaintiff's two children. The other roommate was Emily Bannister. Plaintiff is the one who signed the lease and was obligated to make the monthly rental payments of \$1,200. According to Plaintiff's testimony, she and her two roommates split the rent, each paying \$400 per month. The two roommates paid Plaintiff \$400, each, for their share of the rent, and Plaintiff tendered the total \$1,200 rental payment to the landlord.

Plaintiff testified that Reade cared for Plaintiff's two children in Plaintiff's home, through mid-November 2005, while Plaintiff was at work four nights a week. Plaintiff testified that she paid Reade \$460 per month from January through October 2005, and \$200 in November 2005.

Plaintiff called Reade to testify, and Reade corroborated Plaintiff's testimony, stating that she was paid \$460 per month through October and \$200 in November, after which time she moved out of Plaintiff's home. Plaintiff submitted a written, notarized statement dated June 28, 2007, that was signed by Reade, and corroborates the testimony about the payments Reade allegedly received from Plaintiff in return for caring for Plaintiff's two children, as well as the \$400 monthly rental payments Reade made to Plaintiff.

Plaintiff worked as a waitress and testified that she was typically paid in cash. Plaintiff contends that her payments to Reade were in cash, and made intermittently throughout the month as Reade needed money. Plaintiff kept track of how much she paid Reade as the month went along and presumably reconciled matters at the end of each month. Plaintiff does not have canceled checks or contemporaneous receipts verifying her payments to Reade, or Reade's rental payments to her.

Defendant insists that information from Plaintiff is inconsistent. Defendant is also concerned with the lack of any independent documentary substantiation. Segovia testified she spoke with Plaintiff on May 8, 2006, and that Plaintiff stated she paid \$500 per month for child care, and that Reade paid \$350 in rent. Plaintiff then submitted to Defendant a written statement signed by Reade, dated March 26, 2007, which indicated that Reade was paid \$460 per month for child care. There was no mention of rent in that statement. Plaintiff, thereafter, sent Defendant the June 28, 2007, statement, which Defendant received on July 2, 2007. That statement is similar to the March 26, 2007, statement, but adds information about the rent Reade purportedly paid Plaintiff each month. Segovia testified that she then telephoned Reade on July 5, 2007, and that Reade told her she did not remember what the two written statements said, including the amount of money received (for child care) and paid (for rent), because she had recently had a

baby and was having trouble with her short term memory. The June 28, 2007, statement was the one submitted into evidence, and the purported payments match the witnesses' testimony. Finally, Segovia questions the accuracy of Plaintiff's information because Plaintiff reported \$20,790 in adjusted gross income (AGI) in 2004 and only \$2,400 in child care expenses, whereas Plaintiff's 2005 AGI decreased to \$17,969 while her child care expenses reportedly doubled to \$4,800.

The court has reviewed its previous decisions addressing the WFC. The majority deal with a legal question (*e.g.*, whether the credit was available when one spouse was at home but unable to care for the children due to a disability, or whether a grandson was a qualifying child for purposes of the credit). The following decisions hinged on the question of substantiation.

In *Bello v. Dept. of Rev.*, TC-MD No 060020B, WL 1460903 (May 8, 2007), this court allowed only a partial WFC, and that allowance was based on the department's recommendation. Plaintiffs had submitted written statements signed by the noncommercial individual providers attesting to the amounts they were purportedly paid, but the providers did not testify, and the amount of expenses claimed was substantial (over \$15,000 per year), when compared to the plaintiffs' income. The court stated that a "lack of proof of the majority of the payments is fatal to Plaintiffs' claim to the total credit." *Bello*, TC-MD No 060020B at 4.

In *Marks v. Department of Revenue*, TC-MD No 070124E (May 11, 2007), the taxpayers were denied the credit for failure to meet the statutory burden of proof provided in ORS 305.427. The taxpayers paid cash for the alleged child care expenses and had no receipts or canceled checks. The taxpayers did have a letter from the alleged provider, but that provider was not available for the department's auditor to interview prior to trial, nor did the provider testify at trial. The individual who allegedly provided the child care services was unavailable because of a pending indictment for drug dealing. The court ruled that a provider letter, by itself, was

insufficient evidence to satisfy the statutory burden of proof. In such cases, stated the court, the provider should testify.

In *Rodriguez v. Dept. of Rev.*, TC-MD No 050651C, WL 2614534 (Oct 12, 2005), the court upheld the department's disallowance of the credit because there was no independent proof of child care payments (*e.g.*, cancelled checks, provider receipts), the provider did not testify, and the plaintiff's wife did not work, a requirement under the applicable administrative rule for married couples. *See* OAR 150-315.262(3)(b)(C).

The plaintiff in *Gibson v. Dept. of Rev.*, TC-MD No 060399C, WL 900764 (March 23, 2007) was more successful. In *Gibson*, this court allowed a majority of the plaintiff's claimed expenses because there was proof of childcare payments in the form of cancelled checks, there were provider receipts, and the witnesses were found by the court to be credible. The payments were made by the plaintiff's mother to various commercial child care providers, and plaintiff reimbursed her mother in cash.

With those cases in mind, the court turns to the present dispute. This case presents two questions: did Plaintiff pay for child care, and if so, how much did she actually pay?

Plaintiff paid for child care in cash, and there are no contemporaneous receipts. The evidence includes the testimony of Plaintiff and her provider, Reade, and the June 28, 2007, written statement prepared by Plaintiff and signed by Reade. Both Plaintiff and Reade testified about the amount and nature of the payments made, which purportedly totaled \$4,800 for the year. Plaintiff's testimony would ordinarily be considered self-serving, but her explanation includes the potential for an adjustment for unreported income from the rent payments, which would increase Plaintiff's tax liability. Plaintiff was aware of that possibility prior to trial. The witnesses' testimony did not conflict, and the witnesses seemed to be telling the truth.

Nonetheless, the testimony of Plaintiff and Reade is difficult to accept. Specifically, the court finds it hard to believe that Plaintiff would pay Reade sporadically throughout the month for child care, and then at the beginning of each month, collect rent from Reade, particularly when the total amount paid for child care was \$460 and the rent was \$400.

The written statement signed by Reade comports with the parties' testimony and was accompanied by a detailed table outlining the payments made by Plaintiff to Reade each month. That statement, however, was prepared by Plaintiff, and done so after she filed with her appeal with this court. It does not have the same reliability as do contemporaneous receipts from the provider, and the weight given that evidence by the court is minimal. It is regrettable that the payments were not made by check, a shortcoming Plaintiff has purportedly rectified following the onset of this dispute. On the other hand, Plaintiff's explanation for cash payments was logical; she worked in the food industry as a waitress and was paid primarily in cash. Plaintiff testified that she was not aware that receipts were required, or at least, a good idea. Finally, there is the inconsistency between the statements made by Plaintiff to Segovia during the course of the audit. The court is not too troubled by those apparent inconsistencies because Plaintiff explained that she initially spoke in generalities (\$500 per month), and only when pressed, did she review her records and begin to speak more factually. Of course, Plaintiff did not have much in the way of "records" to review.

The court is persuaded by a preponderance of the evidence that the total amount of consideration "paid" by Plaintiff for child care was \$460 per month. It is possible that Plaintiff actually paid Reade only \$60 per month for child care, and gave Reade a rent free place to live, a benefit with an agreed-upon value of \$400 per month. That certainly seems to be one of Segovia's theories, and strikes the court as the more practical approach typically adopted by

individuals in a situation such this (where one roommate pays another to care for her child, and that roommate, in turn, pays rent to the parent whose child she cares for because she is living in the parent's home.) Or, Plaintiff may have paid the full \$460 per month, as reported on her return (Schedule WFC), and then collected \$400 each month from Reade for rent.

The court need not resolve that question because the economic substance of the transaction between Plaintiff and Reade, recognized by federal tax law, was that Plaintiff "paid" \$460 per month for child care, and received \$400 in income from Reade in the form of monthly rental payments. IRC § 61(a) (defining gross income as "all income from whatever source derived"); Treas Reg § 1.61-2(d)(1) (providing that payment in the form of property in exchange for services is income in the form of compensation); *Badell v. CIR*, TC Memo 2000-303, 80 TCM (CCH) 422, WL 1388000 (September 26, 2000) (holding that taxpayers received bartered income when they exchanged legal services for the installation of a roof). The income attributable to the taxpayer is the fair market value of the rent, which in this case the parties placed at \$400 per month. Plaintiff received another \$400 each month in rent from Bannister, who was her other roommate. The reason those rent payments to Plaintiff from her two roommates are considered income is because Plaintiff was contractually obligated to pay the \$1,200 rent to the landlord, and her liability was reduced by \$800 per month by virtue of the money she collected from roommates. The \$800 difference is the amount by which Plaintiff was enriched, and that enrichment was income. The total amount of child care payments in 2005 was \$4,800, and the amount of additional unreported income was \$9,000.

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### III. CONCLUSION

On the evidence before it, the court concludes that Plaintiff paid Reade \$460 per month for the first 10 months of 2005, and an additional \$200 in November for child care. Plaintiff is, therefore, entitled to the WFC based on total expenses that year of \$4,800. However, Plaintiff also has an additional \$9,000 of unreported income in the form of rent from her two roommates. Plaintiff received \$4,200 (\$400 x 10.5 months) from Reade through mid-November 2005, and \$4,800 (\$400 x 12 months) from the other roommate, Emily Bannister. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiff's appeal is granted in part, and that Defendant shall redetermine Plaintiff's tax liability for 2005 based on the court's decision herein.

Dated this \_\_\_\_\_ day of October 2007.

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DAN ROBINSON  
MAGISTRATE

***If you want to appeal this Decision, file a Complaint in the Regular Division of the Oregon Tax Court, by mailing to: 1163 State Street, Salem, OR 97301-2563; or by hand delivery to: Fourth Floor, 1241 State Street, Salem, OR.***

***Your Complaint must be submitted within 60 days after the date of the Decision or this Decision becomes final and cannot be changed.***

***This document was signed by Magistrate Dan Robinson on October 25, 2007. The Court filed and entered this document on October 25, 2007.***