

Substantiation

Taxpayers must prove their deductions for travel, meals, entertainment, and business gift expenses by either (1) adequate records or (2) sufficient evidence that will corroborate the taxpayer's own statement. Without such records to substantiate travel and entertainment expenditures, the taxpayer will suffer a total disallowance of deductions by reason thereof. The taxpayer must therefore make every effort to substantiate travel and entertainment expenses.

Travel Expense Substantiation

Items needed for travel expense substantiation include:

- (1) **Amount** - The amount of each separate expenditure for traveling away from home, such as the cost of transportation or lodging.
 - The daily cost of breakfast, lunch, and dinner and other incidental travel elements may be aggregated if they are set forth in reasonable categories, such as for meals, oil and gas, taxi fares, etc.
- (2) **Time and Date** - The dates of the departure and return home for each trip and the number of days spent on business away from home.
- (3) **Place** - The destinations or locality of the travel.
- (4) **Purpose** - The business reason for the travel or the nature of the business benefit derived or expected to be derived as a result of the travel.

Entertainment & Meal Expense Substantiation

To deduct an entertainment or meal expense taxpayer must substantiate each of the following elements:

- (1) **Amount** - The amount of each separate expenditure, except that incidental items like cab fares and telephone calls may be aggregated daily on a separate basis.
- (2) **Time and Date** - The date and time the entertainment took place.
 - If the "associated with" test is used, the time and length of the business discussion should be recorded.
- (3) **Place** - The name, address or location, and the type of entertainment if that information is not apparent from the name.
- (4) **Purpose** - The reason for entertaining, or the nature of any business discussion and the benefit expected as a result of entertaining.
- (5) **Business Relationship**- The occupation or other information relative to the person or persons entertained, sufficient to establish a business relationship to the taxpayer
- (6) **Physical presence** - Taxpayer or his employee was present

Business Gifts Expense Substantiation

Deductions for business gifts are subject to a special \$25 limitation. However, even for these allowable expenses, a taxpayer must substantiate each the following elements:

- (a) **Amount** - cost of gift to taxpayer,
- (b) **Time** - date of gift,
- (c) **Description** - description of gift,
- (d) **Purpose** - business reason for, or business benefit expected from the gift, *and*
- (e) **Relationship** - name, title, occupation, or other information concerning recipient of gift sufficient to establish business relationship to the taxpayer.

Substantiation Methods

There are two basic substantiation methods - adequate records and sufficiently corroborated statements.

Adequate Records

The adequate records rule requires taxpayers to maintain:

- (a) An account book, diary, log, statement of expenses, trip sheets, or similar record listing the required elements of each expense and use, *and*
- (b) Documentary evidence (where necessary) sufficient to establish each element of every expenditure or use. Documentary evidence is required under the "adequate records" rule for the following types of travel and entertainment and listed property expenditures and uses:
 - (1) Expenditures for lodging (regardless of amount) while traveling away from home,
 - (2) Any other "separate expenditure" of \$75.00 or more

Documentary evidence consists of receipts, canceled checks, paid bills or similar evidence that establish the amount, date, place and essential character of an expenditure or use, or of one or more elements of an expenditure or use. Adequate records must be prepared *at or near the time of the expenditure or use* - i.e., at a time when the taxpayer has full knowledge of the elements of the expenditure or use.

Warning: When there is no documentary evidence for lodging costs, or for separate expenditures of \$75.00 or more, no deduction will be allowed, even if records are otherwise "adequate."

Sufficiently Corroborated Statements

When a taxpayer fails to comply with the "adequate records" rule, then they can still substantiate the required elements by written or oral statements, but only if such statements are supported by sufficient corroborating evidence. Written evidence is better than oral evidence, and its probative value increases closer in time to the expenditure or use. However, direct evidence is required when the element to be substantiated is the description of a gift, or amount, time, place, or date of an expenditure or use. Direct evidence constitutes:

- (a) Statements in writing or the oral testimony of witnesses giving detailed information about the element, *and/or*
- (b) Documentary evidence (i.e., receipts).

Exceptional Circumstances

Other evidence may be allowed if because of the inherent nature of the situation in which an expense is made, the taxpayer cannot get a receipt. If a taxpayer can establish that, by reason of the inherent nature of the situation:

- (a) The taxpayer was unable to obtain evidence for an element of the expense or use that conforms fully to the adequate records requirements,
- (b) The taxpayer is unable to obtain evidence for an element that conforms fully to the other sufficient evidence requirements, *and*
- (c) Taxpayer has presented other evidence for the element that possesses the highest degree of probative value possible under the circumstances. This other evidence is considered to satisfy the substantiation requirements. **Note:** Taxpayers may prove an expense by reconstructing their expenses if they cannot produce a receipt for reasons beyond their control, such as fire, flood, or other casualty.

Retention of Records

Records should be retained as long as the income tax return is open to audit. Thus taxpayers should keep expense records for three years from the date of filing the income tax return.

Employees who give their records and documentation to their employers and are reimbursed for their expenses generally do not have to keep duplicate copies of this information. However, an employee who turns over their records to their employer and is reimbursed for their expenditures should still keep duplicate copies of that information if they:

- (a) Claim deductions for expenses in excess of reimbursements,
- (b) Are certain related stockholder-employees, *or*
- (c) Have employers who do not maintain adequate accounting procedures for verification of expense accounts.

Exceptions to Substantiation Requirements

A limited number of expenses are exempt from the strict substantiation requirements of §274(d), and may be deducted and substantiated as any other ordinary business expense, including:

- (a) Expenses for recreational, social or similar activities primarily for the benefit of employees (including the expenses of facilities used for such purposes),
- (b) Expenses for food and beverages furnished on the business premises primarily for the benefit of employees (including the expenses of facilities used),
- (c) Expenses for goods, services and facilities furnished to employees and treated as compensation subject to withholding,
- (d) Expenses for goods, services, and facilities made available to the general public,
- (e) Entertainment sold to customers, *and*
- (f) Telephone and laundry expenses.

