

Tax Alert

Documentation is the Key to Business Expense Deductions

September 19, 2016



If you have incomplete or missing records and get audited by the IRS, your business will likely lose out on valuable deductions. Here are two recent U.S. Tax Court cases that help illustrate the rules for documenting deductions.

Case 1: Insufficient Records

In the first case, the court found that a taxpayer with a consulting business provided no proof to substantiate more than \$52,000 in advertising expenses and \$12,000 in travel expenses for the two years in question.

The business owner said the travel expenses were incurred "caring for his business." That isn't enough. "The taxpayer bears the burden of proving that claimed business expenses were actually incurred and were ordinary and necessary," the court stated. In addition, businesses must keep and produce "records sufficient to enable the IRS to determine the correct tax liability." (TC Memo 2016-158)

Case 2: Documents Destroyed

In another case, a taxpayer was denied many of the deductions claimed for his company. He traveled frequently for the business, which developed machine parts. In addition to travel, meals, and entertainment, he also claimed printing and consulting deductions.

The taxpayer recorded expenses in a spiral notebook and day planner and kept his records in a leased storage unit. While on a business trip to China, his documents were destroyed after the city where the storage unit was located acquired it by eminent domain.

There's a way for taxpayers to claim expenses if substantiating documents are lost through circumstances beyond their control (for example, in a fire or flood). However, the court noted that a taxpayer still has to "undertake a 'reasonable reconstruction,' which includes substantiation through secondary evidence."

The court allowed 40% of the taxpayer's travel, meals, and entertainment expenses, but denied the remainder as well as the consulting and printing expenses. The reason? The taxpayer didn't reconstruct those expenses through third-party sources or testimony from individuals whom he'd paid. (TC Memo 2016-135)

Be Prepared

Keep detailed, accurate records to protect your business deductions. Record details about expenses as soon as possible after they're incurred (for example, the date, place, business purpose, etc.). Keep more than just proof of payment. Also keep other documents, such as receipts, credit card slips, and invoices. If you're unsure of what you need, please check with us.