

## SUBSTANTIATION REQUIREMENTS UNDER IRC SEC. 274(D)

Proof of payment alone does not establish a deduction. It must also be shown to be an ordinary and necessary expense. The character of the expense may also be challenged (*personal versus business*). Keeping invoices, sales slips, and receipts are necessary to show the nature of the expense and its proper character.

The IRS has determined some expenses are subject to abuse and have applied stricter substantiation requirements. IRC Sec. 274(d) provides additional requirements that apply to the following expenses:

1. Traveling expenses
2. Entertainment expenses
3. Gift expenses.

If a deduction falls under the stricter substantiation rules, no deduction is allowed without establishing the following via "adequate records":

1. The amount of the item.
2. The time and place the expense occurred.
3. The business purpose of the expenditure or item, and
4. The business relationship to the taxpayer of the recipient of the entertainment item.

IRS Publication 463 discusses the deduction for business expenses and required recordkeeping. The chart below is reproduced from this publication and it summarizes the recordkeeping required for travel, entertainment, gifts and transportation.

Table 5-1. How To Prove Certain Business Expenses

IF you have expenses for . . .	THEN you must keep records that show details of the following elements . . .			
	Amount	Time	Place or Description	Business Purpose Business Relationship
Travel	Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, fees and tips, etc.	Dates you left and returned for each trip and number of days spent on business.	Destination or area of your travel (name of city, town, or other designation).	Purpose: Business purpose for the expense or the business benefit gained or expected to be gained.  Relationship: N/A
Entertainment	Cost of each separate expense. Incidental expenses such as taxis, telephones, etc., may be totaled on a daily basis.	Date of entertainment. (Also see <i>Business Purpose</i> .)	Name and address or location of place of entertainment. Type of entertainment if not otherwise apparent. (Also see <i>Business Purpose</i> .)	Purpose: Business purpose for the expense or the business benefit gained or expected to be gained. For entertainment, the nature of the business discussion or activity. If the entertainment was directly before or after a business discussion: the date, place, nature, and duration of the business discussion, and the identities of the persons who took part in both the business discussion and the entertainment activity.  Relationship: Occupations or other information (such as names, titles, or other designations) about the recipients that shows their business relationship to you.  For entertainment, you must also prove that you or your employee was present if the entertainment was a business meal.
Gifts	Cost of the gift.	Date of the gift.	Description of the gift.	
Transportation	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses, the date of the use of the car.	Your business destination.	Purpose: Business purpose for the expense.  Relationship: N/A