

Special analysis: Good records save tax penalties

Tax audits are all about your records. Have good, accurate and complete records and you will walk away from an audit relatively unscathed. Have sloppy, incomplete and inaccurate records and you will needlessly pay tax penalties. Two cases are illustrative.

Case No. 1: A walk in the woods

The IRS determined that a taxpayer was \$17,925 in the hole for his income taxes, and, accordingly, was liable for a \$3,585 accuracy-related penalty. The deficiency was due in large part to the IRS disallowing travel and away-from-home expense deductions he claimed in connection with his timber business.

To substantiate his traveling expenses, the taxpayer kept a log listing the days he traveled to his timber lots. He then used the log to prepare a summary for the IRS. The summary showed he traveled for 161 days during 2013, making 47 round trips to his property. Unfortunately, he couldn't produce the log because it had been stolen.

The IRS said the summary wasn't good enough proof of his traveling expenses. The Tax Court didn't buy it and ruled for the taxpayer. *Tax Court*: It would be easy to verify this taxpayer's travel. He always traveled to the same location and he testified credibly that he maintained a log and his summary was extracted from the log. (*Maki v. Commissioner*, T.C. Summ. Op. 2019-34, U.S. Tax Court, 2019)

Case No. 2: Not such a good idea to skip fed tax in law school

For 2013, a self-employed attorney deducted \$67,829 in Schedule A expenses, including unreimbursed employee business expenses. *The breakdown for unreimbursed business expenses*: \$36,963 in vehicle expenses; \$4,036 in parking fees, tolls and transportation expenses; \$12,642 in other business expenses; and \$10,347 in meals and entertainment expenses. *The problem*: He didn't have receipts. The IRS disallowed everything.

The Tax Court upheld the IRS' determination. *Tax Court*: The taxpayer didn't meet the strict substantiation rules applicable to meal and entertainment expenses. Moreover, he didn't provide an account book, log, similar record or other evidence of his expenses. Nor did he provide receipts, invoices or other documents to substantiate any remaining expenses. (*Taber v. Commissioner*, T.C. Memo 2019-149. U.S. Tax Court, 2019)

Receipt, please

The key to meeting the strict substantiation rule is receipts, which are attached to employees' T&E reports. Employees who travel away from home overnight must submit hotel receipts showing the hotel's name and location, the dates they stayed there and itemized charges for rooms and meals. Restaurant receipts are adequate to prove expenses for business meals if they list a restaurant's name and location, the number of people served, the date and the amount of the expense, and itemize other charges.