

University of Mississippi

eGrove

Guides, Handbooks and Manuals

American Institute of Certified Public
Accountants (AICPA) Historical Collection

1962

Comments on proposed regulations under section 274(d) of the Internal Revenue Code relating to substantiation requirements for expenditures for traveling, entertainment and gifts; formally presented to the Internal revenue service, December 4, 1962.

American Institute of Certified Public Accountants. Committee on Federal Taxation

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_guides



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

American Institute of Certified Public Accountants. Committee on Federal Taxation, "Comments on proposed regulations under section 274(d) of the Internal Revenue Code relating to substantiation requirements for expenditures for traveling, entertainment and gifts; formally presented to the Internal revenue service, December 4, 1962." (1962). *Guides, Handbooks and Manuals*. 955.

https://egrove.olemiss.edu/aicpa_guides/955

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Guides, Handbooks and Manuals by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

*754.7 A

American institute of certified public accountants
Committee on federal taxation

Comments on proposed regulations under section 274(d)
of the Internal revenue code relating to substan-
tiation requirements for expenditures for traveling,
entertainment and gifts; formally presented to the
Internal revenue service, December 4, 1962.

COMMITTEE ON FEDERAL TAXATION
of the
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments on Proposed Regulations Under Section 274(d)
of the Internal Revenue Code Relating to Substantiation Re-
quirements for Expenditures for Traveling, Entertainment and Gifts

Formally Presented to the Internal Revenue Service
December 4, 1962

COMMITTEE ON FEDERAL TAXATION

of the

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments on Proposed Regulations Under Section 274(d)
of the Internal Revenue Code Relating to Substantiation Require-
ments for Expenditures for Traveling, Entertainment and Gifts

Recognizing the broad implications of the proposed regu-
lations, we have separated our comments into two parts: Part I -
General Comments and Part II - Comments on Specific Provisions.

PART I - GENERAL COMMENTS

1. Legislative Objectives can be Achieved with Less Severe
Requirements

Section 274 of the Internal Revenue Code, limiting deduc-
tions for entertainment, traveling expenses, and gifts was enacted
to curb abuses in these areas. The proposed regulations are too
broad in application and establish onerous detailed requirements
applicable to millions of transactions which go far beyond the leg-
islative objectives. The regulations could be designed to be
much narrower in application yet accomplish what is desired. Tax-
payer paper work burdens would be reduced and the possibility of
reasonable enforcement materially enhanced if the requirements of
the regulations were more reasonable.

2. Demands of the Law are Exceeded: The Regulations may well
Contribute to Disrespect for Tax Laws and Regulations

The impression gained is that the proposed regulations,
being more severe than necessary to enforce a law that already is
adequately strict, represents an attempt to go beyond the demands
of the law and achieve some of what Congress was unwilling to grant.

This will tend to degrade the administration of the Internal Revenue laws in the eyes of taxpayers and encourage them to engage in tax evasion by fabrication of support for their deductions.

3. Unnecessary Imposition of Unreasonable and Costly Burden on Taxpayers

The proposed regulation would impose an unreasonable and costly burden on business in time and effort of employees in recording all of the voluminous and minute information demanded and in checking, filing and retaining records for possible review by examining authorities.

4. Doubtful Practical Value and Questionable Need for Masses of Detailed Information

Business is constantly on the alert for cost saving techniques in the accumulation of information and record keeping. The detailed information required is a big step in the opposite direction. Modern business practice is to establish internal controls to accomplish most of the results sought by the proposed regulations. The proposed regulations seek to accomplish the result by the accumulation of a mass of detailed records of doubtful practical value and questionable need.

5. Better Audit Program for Revenue Agents Required - Not Masses of Detailed Information

The basic problem is that the proposal attempts to codify in great detail what is essentially an audit function. The statute requires substantiation "by adequate records or by sufficient evidence" of certain elements of travel and entertainment expenses. Internal Revenue Service agents, who are qualified accountants, should be able to apply acceptable auditing standards to see that these requirements are satisfied. Accountants in practice set for

themselves audit programs to be followed, but reserve wide discretion for the application of common sense rules in the conduct of an audit. The most reasonable way of handling the substantiation problem would be for the regulations to be stated in more general terms, and enforced by an audit program supplied to Revenue Agents. We believe this approach would better serve both the Government and taxpayers than the procedure proposed.

6. Practical Impossibility to Accomplish Total Compliance

It is a practical impossibility for the most conscientious taxpayers to accomplish total compliance with these proposed regulations. They are too complex and the record-keeping requirements are too burdensome.

November 30, 1962

COMMITTEE ON FEDERAL TAXATION

of the

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments on Proposed Regulations Under Section 274(d)
of the Internal Revenue Code Relating to Substantiation Require-
ments for Expenditures for Traveling, Entertainment and Gifts

PART II - COMMENTS ON SPECIFIC PROVISIONS

1

SECTION

1.274-5(a)(2)

The effect of the words in the last part of subparagraph (2) which read, "including the items specified in Section 274(e)" is to apply the substantiation requirements to all of the items that are given statutory exception to the application of the general rule of Section 274(a). Since some of these items cannot properly be classified as coming within any of the subparagraphs of Section 274(d), the effect is to apply to them standards of record-keeping and substantiation that would not otherwise be applicable. This effect is not warranted by construction of the Code or by the practical necessities of the particular situations, and is not alleviated sufficiently by the exceptions of Proposed Regulations Section 1.274-5(c)(4)(viii).

2

1.274-5(b)(1)

There is no requirement in the statute that elements of expense be "proved." This word may have a different meaning than "substantial."

3

1.274-5(b)(1)(i)

Telephone, telegraph and sample rooms are included in the term "incidental expenses." It would seem that sample rooms and most telegraph and telephone expense are not travel expenses, under a reasonable interpretation. Incidental travel expenses should only include items directly related to travel, such as taxi fares and tips.

SECTION

1.274-5(b)(1)(ii)

Requiring a record of the "hour of departure and return" is unduly burdensome and is justified, if at all, only where a taxpayer is away from home in excess of a week and has spent a part of the time away from home on pleasure. A record of "the number of days (and hours, thereof, if material)" spent on business should also be eliminated where there is no pleasure portion of the travel. Perhaps the elements of an expense to be proved should be separately stated, so that the elements in the case of an all-business trip are not as strict as those to be proved in the case of a combined business-pleasure trip. The language "(and hours thereof, if material)" should be clarified.

1.274-5(b)(1)(iv)

The element, "nature of the business benefit expected to be derived" is not essential, particularly since it is usually implicit in a statement of business purpose. This requirement is not required or implied in the statutory background. The phrase should be eliminated because it adds to the burden of record keeping.

1.274-5(b)(2)(ii)

The required record of the "hour and duration" of entertainment could be eliminated without reducing the effectiveness of the regulations. It is an unjustified extension of the statute.

1.274-5(b)(2)(iii)

A "description of the entertainment" is an unduly strict requirement and is not specifically required by the statute.

1.274-5(b)(2)(iv)

The element, "nature of the business benefit expected to be derived" is not essential, particularly since it is usually implicit in a statement of business purpose. This requirement is not required or implied in the statutory background. The phrase should be eliminated because it adds to the burden of record keeping.

1.274-5(b)(3)

Where entertainment is preceded or followed by a business discussion it should be necessary to record only the cost, time, place and names of those entertained in addition to the information specified in Proposed Regulations Section 1.274-5(b)(3)(i)(ii), (iii) and (iv). This would eliminate the unnecessary portion of Proposed Regulations Section 1.274-5(b)(2).

1.274-5(b)(4)(iv)

The element, "nature of the business benefit expected to be derived" is not essential, particularly since it is usually implicit in a statement of business purpose. This requirement is not required or implied in the statutory background. The phrase should be eliminated because it adds to the burden of record keeping.

1.274-5(c)

It is very clear that the statute, with no real change of intent indicated by the Committee Reports, requires substantiation by adequate records or by sufficient evidence corroborating a taxpayer's own statement. A clear distinction should be made between the two types of requirements. There is no justification for departing from the expressed intent, as reported at page 35 of the Senate Finance Committee Report, that a "clear, contemporaneously kept diary or account book" may constitute an adequate record, except for receipts retained for such major items of expenditure as transportation and hotel expenses. The requirement of documentary evidence for other items in support of the type of record contemplated by Congress is not actually warranted by the record. In this respect the proposed regulations seem to be seeking to achieve what Congress was unwilling to grant in the statute. While the absence of documentary evidence may make the records of a taxpayer vulnerable to challenge, it should not be a basis for disallowance.

1.274-5(c)(1)

The emphasis on the contemporaneous recording is so strict as to imply that it would be impossible in any other way to substantiate the expenditures. This is a stronger implication than that made in the Committee Reports and should be modified.

SECTION

13

1.274-5(c)(2)(i)

Incidentals would have to be recorded in the account book, diary, etc., regardless of amount. The regulations should take notice of the fact that a certain amount of incidental expense must be incurred and allow the deduction of a reasonable amount of incidental expense (whether travel or entertainment) without requiring the maintenance of records therefor. See example in Proposed Regulations where 10 and 25 cent items are listed. In other words, under a reasonable rule, circumstantial evidence should be adequate to substantiate incidentals. In the case of travel expenses a reasonable rule might eliminate the detail where such expenses do not exceed prescribed minimums.

14

1.274-5(c)(2)(ii)

The proposed regulations require an itemized paid bill or similar evidence in support of any expenditure of \$10 or more. In many instances, this requirement is going to be extremely difficult to comply with. For example, suppose a taxpayer takes six customers to a movie at a total cost of \$12.50. It is unlikely that the theatre will have any facilities to give him an itemized bill. The ticket stubs should be sufficient. The same comment could be made with respect to any form of entertaining in which the stub is by its very nature an evidence of payment. This problem, and a multitude of similar ones, indicate the difficulty, as indicated in our general comments, of dealing with an audit problem by setting forth rigid rules. Discretion should be vested in the Revenue Agent to determine the adequacy of the documentary evidence.

In the case of travel, documentary evidence should not be required where a prescribed minimum per diem is not exceeded.

The absolute exclusion of cancelled checks per se as sufficient documentary evidence is too strict. Language to the effect that cancelled checks alone are usually not sufficient documentation would allow room for argument in a proper case.

The proposed requirement of itemization should be relaxed, at least where the diary provides reasonable details and can be related to a receipt.

In addition, the \$10 minimum amount for which documentary evidence is required is too low and should be increased. At least different minimums could be set for different types of expenditures with recognition being given to existing commercial practices for rendering receipts. As was noted in the comments under 1.274-5(c), no documentary evidence should be required for most items of expenditure, where the evidence is in support of a diary or other record.

1.274-5(c)(3)(ii)

It is proposed that if the taxpayer does not have the required documentary evidence, the expenditure must be established by the taxpayer's own statement and by oral testimony or the sworn statement of persons entertained. It is wholly impractical for the regulation to make deductibility of the expenditure contingent upon such assistance from those entertained. This would destroy the expected business benefit of the entertainment. In addition, there should be some discretion to waive the requirement of direct evidence.

1.274-5(c)(4)(ii)

In the last sentence reference is made to the "sworn" statement required by Proposed Regulations Section 1.274-5(c)(3)(i). The statement referred to in Proposed Regulations Section 1.274-5(c)(3)(i) is not required to be "sworn."

1.274-5(c)(4)(iv)

Although the provision for substantiation in exceptional circumstances may be helpful in some instances, it is too rigid and is not an adequate substitute for some relaxation of the standards set in other provisions. In any event, clarification and examples are needed to clarify what is contemplated.

1.274-5(c)(4)(v)

The statement as to substantiation is unnecessary since a taxpayer implicitly states that he can provide substantiation, as required by the statute, when he claims a deduction. If a statement is required at all it would only be to the effect that the taxpayer believes he can substantiate.

SECTION

1.274-5(c)(4)(vii)

Primary use of a facility is apparently to be determined by number of uses. According to the Senate Finance Committee Report the determination of primary use of a facility is under provisions of the Code prior to amendment by the Revenue Act of 1962. Further, the Committee Report states that this determination is made on the basis "of the entertainment expense with respect to such facility" and if more than one-half of the entertainment expense would be deductible under the Code before amendment, that portion of the facility expense would continue to be deductible subject to the new "directly related", etc., requirements. The Committee Report does not appear to be concerned with number of uses in determining primary use. The proposed regulations should be changed in the following respects:

- a. It should be made clear that primary use is determined under prior law and hence a facility could have a primary business use and yet under the statute as amended less than 50% of the facility cost would be deductible.
- b. The allowable portion of facility expenses should be determined by an allocation of entertainment expenses in connection with the facility rather than by number of uses
 Example - if an individual has luncheon alone at a club at a cost of \$2.00 and later is host at an entertainment event costing \$1,000, it would be more equitable to allocate the dues on the basis of expenditure involved in each event rather than to take the position that each represents a "use" of the club bearing an equal proration of the dues. In addition, this suggested method may be more easily verified.

1.274-5(c)(4)(viii)

As now presented, the provision for exceptions is much too complex and will be difficult for many taxpayers to even understand. In view of Congressional recognition that the items listed in Section 274(e) are somewhat less critical, an attempt should be made to except from the Section 274(d) substantiation requirement all categories of expenditure that can reasonably be viewed as not constituting entertainment, amusement or recreation. This extension might include exceptions (2), (6), and (7) of Section 274(e) in addition to (3), (8), and (9) which are already included.

In addition, some attempt should be made to alleviate the substantiation requirement for item (5), Recreational, etc. expenses for employees, in view of the difficulty of providing the required information. For example, if a taxpayer maintains club facilities for the general use of its employees it would be practically impossible to maintain the required record of names of employees who use the club. Also, it would appear that, if any taxpayer was host at a Christmas party for employees and their families, a complete listing of the people attending and their relationship to the business benefit expected from each expenditure would be a prerequisite to the allowance of any expense.

In any event, this subparagraph should be amended to indicate that the elements of an expenditure contained in Proposed Regulations Section 1.274-5(b)(3) have no application to any item covered in Section 274(c) of the statute. Proposed Regulations Section 1.274-5(b)(3) deals only with situations in which the expenses are being justified on the basis of a substantial and bona fide business discussion. The specific exceptions in Proposed Regulations Section 1.274-5(e) are not subject to the rules of Proposed Regulations Section 1.274-5(a), and therefore, are not affected by the business discussion provision.

1.274-5(c)(5)

The Proposed Regulations provide that the District Director need not accept any of the evidence submitted to him in substantiation of expenses in accordance with these regulations without the opportunity to question the person "making or maintaining such record or giving such statement or testimony." This appears to be a provision under which the District Director for any reason at all could disallow arbitrarily items in any case where the individuals originating the evidence could not be produced for examination. With death, retirement and normal turnover of employees in the two or more years between the event and the desire of the Director to question, this could be a serious matter.

Since the substantiation rules are merely requirements and do not automatically assure deductibility, this paragraph appears to be unnecessary and should be eliminated. It is unwarranted if its intention is to permit requiring additional substantiation arbitrarily where the substantiation already submitted is admitted to be bona fide. If the submitted substantiation is not bona fide and is fraudulent, the District Director should need no additional instructions or powers to be able to disallow the related deductions.

In any event, there should be added a requirement that the District Director have reason to doubt the authenticity of the substantiation before he can invoke this provision in Proposed Regulations Section 1.274-5(c)(5)(ii). In the first sentence, reference is made to the "sworn" statement of the taxpayer specified in subparagraph (3). This statement is not required to be sworn by sub-paragraph (3).

1.274-5(c)(6)

The details of small items provided for in the expense report in these illustrations and the excessive detailed information, are unrealistic, unreasonable, and unnecessary. It invites disrespect for the law to require a taxpayer to keep track of the amount and place of each business telephone call he makes. The same criticism can be made of many smaller items that will necessarily be incurred in the course of a business day. Must he recall and record separately each taxi fare, each toll charge, each tip to a bellboy, each payment for a newspaper? The most careful business in requiring accounting from its employees will be satisfied with a grouping of these small miscellaneous expenses. The approach taken in this illustration is evidence of the need for audit discretion and the futility of rigid rules.

Examples 2 and 3 cover the business expenditures of a taxpayer, an individual, with others. It is stated in the examples that if the taxpayer fails to indicate the exact amount of his own portion, it is considered to be a pro rata part of the total. This particular portion of the example should be deleted because of the implication that the allocated portion of the

taxpayer is not deductible. These proposed regulations deal with substantiation and not deductibility. If the Service decides to take this position with respect to the taxpayer's luncheon, it should be done elsewhere.

23

1.274-5(e)(3)(iii)

This paragraph provides that if an employee makes an adequate accounting to his employer, but is not reimbursed for all of his expenses and wishes to claim the unreimbursed balance, he is required to maintain records and supporting evidence substantiating each expenditure. In defining adequate accounting to the employer, it is required that an expense report or similar record together with the prescribed documentary evidence shall be submitted to the employer. It is not possible to make an adequate accounting to the employer and at the same time keep the data necessary to comply with the requirements of this regulation.

24

1.274-5(e)(5)

The proposed regulations require that an employee will maintain "an account book, diary, statement of expense, or similar record... in a contemporaneous and consistent manner throughout the taxable year." It should be made clear that this does not mean the employee must maintain a diary on an annual basis which he submits to the employer at the year-end in addition to his periodic expense reports. In practice, expense reports and related data are normally rendered on a weekly, semi-monthly or monthly basis and the employer wants supporting data delivered to him for review in connection with approval of the expense report.

The last sentence states that this regulation does not permit alternative methods of substantiation such as statements, etc., in determining if an "adequate accounting" is present. This is most unrealistic since the loss of one receipted bill supporting an expenditure in excess of \$10.00 would presumably mean that the employee has not accounted to the employer for his expenditures during the employee's entire taxable year.

1.274-5(e)(6)(i)(b) It is proposed that an employee who owns 10% or more of his employer's stock, either actually or constructively, may be called upon to substantiate his expenses even though he has adequately accounted to his employer. If he has accounted to his employer and has delivered all of his expense account data, receipted bills, etc., to his employer, how can he again substantiate his expense account upon demand by the District Director?

1.274-5(e)(6)(i)(c) The proposed rule may put an impossible burden of proof on employees where it is discovered after the year in question that accounting procedures are inadequate. The impact should be alleviated to provide for a notice procedure and prospective effect, except where the District Director determines gross failure to meet the requirements of the regulations.

1.274-5(e)(6)(ii) The proposed regulations provide that the Commissioner may approve certain travel allowance practices as satisfying the requirements of adequate accounting to the employer. This was done under prior law and allowances of \$20 per day for meals and lodging and 15¢ per mile for use of personal automobiles were so approved. It appears that these prior rulings have been revoked by the Revenue Act of 1962. The position of the Commissioner in this regard should be made known promptly and it is urged that the practice previously in effect be reinstated if it is not now effective.

This approach should be broadened to permit flat allowances for certain segments of travel expenses, such as meals or incidental expenses. This rule as drafted is applicable only to employees. It should likewise apply to independent contractors and be made a part of Proposed Regulations Section 1.274-5(6)(3).

November 30, 1962