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DEPARTMENT OF THE TREASURY

Treasury Decision 8864

Substantiation of Business Expenses

2000-1 C.B. 614; T.D. 8864; 2000 IRB LEXIS 1217; 2000-7 I.R.B. 614

February 14, 2000

[*1]

SUBJECT MATTER: Section 274.-Disallowance of Certain Entertainment, Etc., Expenses

APPLICABLE SECTIONS:

26 CFR 1.274-5: Substantiation requirements. Internal Revenue Service 26 CFR Parts 1 and 602

TEXT:

* See Ann. 2000-26 p. 876 *

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Final and temporary regulations.

SUMMARY:

This document contains final and temporary Income Tax Regulations that provide rules for the substantiation of certain business expenses under *sections 62 and 274 of the Internal Revenue Code (Code)*. Individuals and other taxpayers who claim or reimburse certain business expenses will be affected by these regulations.

DATES:

Effective date. These regulations are effective January 26, 2000.

Date of Applicability. For date of applicability, see 1.62-2 (m) and 1.274-5 (m).

FOR FURTHER INFORMATION CONTACT:

Edwin B. Cleverdon, (202) 622-4920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control

number 1545-0771. Responses to this collection of information are required in order [*2] to deduct certain business expenses or exclude from income certain reimbursed business expenses of employees.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent or recordkeeper varies from 10 minutes to 20 hours, depending on individual circumstances, with an estimated average of 1.3 hours.

Comments concerning the accuracy of this burden estimate and suggestions or reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On November 6, 1985, the IRS published in the **Federal Register** (50 F.R. 46006) [*3] temporary regulations (TD 8061, 1985-2 C.B. 93) adding 1.274-5T regarding substantiation of expenses with documentary evidence under section 274 (d) of the Code. A notice of proposed rulemaking (LR-145-84, 1985-2 C.B. 809) cross-referencing the temporary regulations was published in the **Federal Register** (50 F.R. 46087) for the same day. The notice of proposed rulemaking invited comments on only those portions of the temporary regulations under 1.274-5T that amended 1.274-5 (now designated 1.274-5A) to reflect contemporaneous legislation.

On March 25, 1997, the IRS published in the **Federal Register** (62 F.R. 13988) temporary regulations (T.D. 8715, 1997-1 C.B. 79) amending paragraphs (c) (2) (iii) (B) and (f) (4) of 1.274-5T. The amendments raised the receipt threshold from \$25 to \$75 and authorized the Commissioner to prescribe rules modifying the substantiation requirements for an adequate accounting by an employee to an employer. Under the amendment, the Commissioner could publish rules defining the circumstances (including the use of specified internal controls) under which an employee may make an adequate accounting to his employer by submitting an expense account alone, without [*4] the necessity of submitting documentary evidence (such as receipts). A notice of proposed rulemaking (REG-209785-95, 1997-1 C.B. 753) cross-referencing the temporary regulations was published in the **Federal Register** (62 F.R. 14051) for the same day.

On October 1, 1998, the IRS published a notice of proposed rulemaking (REG-122488-97, 1998-42 I.R.B. 19) in the **Federal Register** (63 F.R. 52660), proposing amendments to the Income Tax Regulations (26 CFR part 1) under sections 62 (c) and 274 (d) of the Code regarding substantiation of expenses using mileage and per diem rates. Specifically, the amendments removed the limitation in 1.274 (d)-1 (a) (3) that provides that mileage allowances prescribed in rules by the Commissioner are available only to the owner of a vehicle. On that date the IRS also published temporary Income Tax Regulations (T.D. 8784, 1998-42 I.R.B. 4) under section 62 (c) and 274 (d) of the Code in the **Federal Register** (63 F.R. 52600), relating to the substantiation of expenses under a reimbursement or other expense allowance arrangement.

Comments were received in response to the 1985 proposed regulations, and a public hearing was held on March 3, 1986. Few of the written [*5] comments, and none of the comments at the hearing, relate to the provisions in this Treasury Decision. Written comments were also received with respect to the 1997 proposed regulations, but no public hearing was requested or held. No comments were received, and no hearings were requested or held, with respect to the 1998 proposed regulations.

Summary and Discussion of Comments

This Treasury Decision incorporates the suggestions made in the written comments with some exceptions. With respect to the 1985 regulations, one commentator suggested that the definition of an adequate accounting in 1.274-5T(f) (4), in the case of automobile expense reimbursements, should be satisfied by a reimbursement based on data on the type of automobile and local operating and fixed costs. Although this suggestion has not been specifically adopted in the

final regulations, the standard mileage rate revenue procedure provides for this type of substantiation. See, e.g., section 8 of *Rev. Proc. 98-63, 1998-52 I.R.B. 25*.

Another-commentator suggested, *inter alia*, (1) adding exceptions to the documentary evidence requirements under 1.274-5T(c) (2) (iii) and (2) providing, that the Commissioner, in establishing [*6] a meal allowance under 1.274-5T(j), may allow a specific dollar allowance per meal. These suggestions are not adopted because the intent of the regulations is to give the Commissioner the discretion to make these practical decisions.

Similarly, with respect to the 1997 regulations, commentators made suggestions regarding the specific content of the guidance to be issued under the proposed regulations at 1.274-5 (f) (4). We did not incorporate these suggestions because the regulations are designed to describe appropriate published guidance of general applicability, not the specific provisions of such guidance. However, all of the comments will be taken into consideration by the Commissioner in issuing published guidance.

Explanation of Provisions

This Treasury Decision adopts the revision to 1.62-2 (e) (2) proposed in REG-122488-97, with minor changes. This Treasury Decision also adopts 1.274-5 (c) (2) (iii), (f) (4), (g), (j), and (m), as proposed by LR-216-84, modified by REG-209785-95, 1997-1 C.B. 753, and REG-122488-97, 1998-42 I.R.B. 19, and removes and reserves the corresponding provisions in 1.274-5T. Finally, this Treasury Decision adopts the proposal in REG-122488-97 to [*7] remove 1.62-2T, 1.274 (d)-1, and 1.274 (d)-1T.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553 (b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Sections 1.274-5 (c) (2) (iii) and (f) were originally proposed by a notice of proposed rulemaking (LR-145-84) that was issued on November 6, 1985. Therefore, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply with respect to those collections of information. With respect to the collection of information in

1.274-5 (c) (iii) (B) as proposed by REG-209785-95 on March 25, 1997, it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that, by increasing the receipt threshold from \$25 to \$75, these regulations reduce the existing recordkeeping requirements of taxpayers, including small entities. The regulations do not otherwise significantly alter the reporting or recordkeeping duties of small [*8] entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805 (f) of the *Internal Revenue Code*, the IRS submitted the notices of proposed rulemaking preceding these regulations to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these final and temporary regulations is Edwin B. Cleverdon, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, personnel from other offices of the IRS and Treasury Department participated in their development.

* * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1-INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.274-5 also issued under 26 U.S.C. 274 (d). * * *

Par. 2. Section 1.62-2 is amended by:

1. Revising paragraph (e) (2).
2. Removing the last two sentences of paragraph (m).
3. Adding a sentence to the end of paragraph (m).

The revision and addition read as follows:

1.62-2 Reimbursement and other expense allowance arrangements.

* [*9] * *

(e) * * *

(2) *Expenses governed by section 274 (d).* An arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by *section 274 (d)* meets the requirements of this paragraph (e) (2) if information sufficient to satisfy the substantiation requirements of *section 274 (d)* and the regulations thereunder is submitted to the payor. See 1.274-5. Under *section 274 (d)*, information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, 1.274-5 (b) (2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed property, 1.274-5 (b) (6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See 1.274-5 (g), however, which grants the Commissioner authority to prescribe rules permitting the amount of certain expenses to be deemed substantiated to the payor (in [*10] lieu of substantiating the actual amount of such expenses) by means of per diem or mileage rates for travel away from home or transportation expenses. See also 1.274-5 (j) (1), which grants the Commissioner the authority to establish a method under which a taxpayer may use a specified amount for meals while traveling away from home in lieu of substantiating the actual cost of meals, and 1.274-5 (j) (2), which grants the Commissioner the authority to establish a method under which a taxpayer may use mileage rates to determine the amount of the ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home in lieu of substantiating the actual costs. Substantiation of the amount of a business expense in accordance with rules prescribed pursuant to the authority granted by 1.274-5 (g) or (j) will be treated as substantiation of the amount of such expense for purposes of this section. * * *

(m) * * * Paragraph (e) (2) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee with respect to expenses paid or incurred after December [*11] 31, 1997.

1.62-2T [REMOVED]

Par. 3. Section 1.62-2T is removed.

Par. 4. Section 1.274-5 is added to read as follows:

1.274-5 Substantiation requirements.

(a) and (b) [Reserved]. For further guidance, see 1.274-5T(a) and (b).

(c) *Rules of substantiation*-(1) [Reserved]. For further guidance, see 1.274-5T(c) (1).

(2) *Substantiation by adequate records*-(i) and (ii) [Reserved]. For further guidance, see 1.274-5T(c) (2) (i) and (ii).

(iii) *Documentary evidence*-(A) Except as provided in paragraph (c) (2) (iii) (B), documentary evidence, such as receipts, paid bills, or similar evidence sufficient to support an expenditure, is required for-

(1) Any expenditure for lodging while traveling away from home, and

(2) Any other expenditure of \$75 or more except, for transportation charges, documentary evidence will not be required if not readily available.

(B) The Commissioner, in his or her discretion, may prescribe rules waiving the documentary evidence requirements in circumstances where it is impracticable for such documentary evidence to be required. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, [*12] date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as for lodging, meals, and telephone. Similarly, a restaurant receipt is sufficient to support an expenditure for a business meal if it contains the following: name and location of the restaurant, the date and amount of the expenditure, the number of people served, and, if a charge is made for an item other than meals and beverages, an indication that such is the case. A document may be indicative of only one (or part of one) element of an expenditure. Thus, a cancelled check, together with a bill from the payee, ordinarily would establish the element of cost. In contrast, a cancelled check drawn payable to a named payee would not by itself support a business expenditure without other evidence showing that the check was used for a certain business purpose.

(iv) and (v) [Reserved]. For further guidance, see 1.274-5T(c) (2) (iv) and (v).

(d) and (e) [Reserved]. For further guidance, see 1.274-5T(d) and (e).

(f) *Reporting and substantiation of expenses* [*13] *of certain employees for travel, entertainment, gifts, and with respect to listed property*-(1) through (3) [Reserved]. For further guidance, see 1.274-5T(f) (1) through (3).

(4) *Definition of an adequate accounting to the employer*-(i) *In general*. For purposes of this paragraph (f) an *adequate accounting* means the submission to the employer of an account book, diary, log, statement of expense, trip sheet, or similar record maintained by the employee in which the information as to each element of an expenditure or use (described in paragraph (b) of this section) is recorded at or near the time of the expenditure or use, together with supporting documentary evidence, in a manner that conforms to all the adequate records requirements of paragraph (c) (2) of this section. An adequate accounting requires that the employee account for all amounts received from the employer during the taxable year as advances, reimbursements, or allowances (including those charged directly or indirectly to the employer through credit cards or otherwise) for travel, entertainment, gifts, and the use of listed property. The methods of substantiation allowed under paragraph (c) (4) or (c) (5) of this section [*14] also will be considered to be an adequate accounting if the employer accepts an employee's substantiation and establishes that such substantiation meets the requirements of paragraph (c) (4) or (c) (5). For purposes of an adequate accounting, the method of substantiation allowed under paragraph (c) (3) of this section will not be permitted.

(ii) *Procedures for adequate accounting without documentary evidence*. The Commissioner may, in his or her discretion, prescribe rules under which an employee may make an adequate accounting to an employer by submitting an account book, log, diary, etc., alone, without submitting documentary evidence.

(iii) *Employer*. For purposes of this section, the term *employer* includes an agent of the employer or a third party payor who pays amounts to an employee under a reimbursement or other expense allowance arrangement.

(5) [Reserved]. For further guidance, see 1.274-5T(f) (5).

(g) *Substantiation by reimbursement arrangements or per diem, mileage, and other traveling allowances*-(1) *In general*. The Commissioner may, in his or her discretion, prescribe rules in pronouncements of general applicability under which allowances for expenses described in paragraph [*15] (g) (2) of this section will, if in accordance with reasonable business practice, be regarded as equivalent to substantiation by adequate records or other sufficient evidence, for purposes of paragraph (c) of this section, of the amount of the expenses and as satisfying, with respect to the amount of the expenses, the requirements of an adequate accounting to the employer for purposes of paragraph (f) (4) of this section. If the total allowance received exceeds the deductible expenses paid or incurred by the employee, such excess must be reported as income on the employee's return. See paragraph (j) (1) of this section relating to the substantiation of meal expenses while traveling away from home, and paragraph (j) (2) of this section relating to the substantiation of expenses for the business use of a vehicle.

(2) *Allowances for expenses described*. An allowance for expenses is described in this paragraph (g) (2) if it is a-

- (i) Reimbursement arrangement covering ordinary and necessary expenses of traveling away from home (exclusive of transportation expenses to and from destination);
- (ii) Per diem allowance providing for ordinary and necessary expenses of traveling away from home (exclusive [*16] of transportation costs to and from destination); or

(iii) Mileage allowance providing for ordinary and necessary expenses of local transportation and transportation to, from, and at the destination while traveling away from home.

(h) [Reserved]. For further guidance, see 1.274-5T(h).

(i) [Reserved].

(j) *Authority for optional methods of computing certain expenses-(1) Meal expenses while traveling away from home.* The Commissioner may establish a method under which a taxpayer may use a specified amount or amounts for meals while traveling away from home in lieu of substantiating the actual cost of meals. The taxpayer will not be relieved of the requirement to substantiate the actual cost of other travel expenses as well as the time, place, and business purpose of the travel. See paragraphs(b) (2) and (c) of this section.

(2) *Use of mileage rates for vehicle expenses.* The Commissioner may establish a method under which a taxpayer may use mileage rates to determine the amount of the ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home in lieu of substantiating the actual costs. The method [*17] may include appropriate limitations and conditions in order to reflect more accurately vehicle expenses over the entire period of usage. The taxpayer will not be relieved of the requirement to substantiate the amount of each business use (i.e., the business mileage), or the time and business purpose of each use. See paragraphs (b) (2) and (c) of this section.

(k) and (1) [Reserved]. For further guidance, see 1.274-5T(k) and (1).

(m) *Effective date.* This section applies to expenses paid or incurred after December 31, 1997.

Par. 5. Section 1.274-5T is amended by:

1. Revising paragraphs (c) (2) (iii), (f) (4), (g) and (j).

2. Adding a sentence at the end of paragraph (m).

The revision and addition read as follows:

1.274-5T Substantiation requirements.

* * *

(c) * * *

(2) * * *

(iii) [Reserved]. For further guidance, see 1.274-5 (c) (2) (iii).

* * *

(f) * * *

(4) [Reserved]. For further guidance, see 1.274-5 (f) (4).

* * *

(g) [Reserved]. For further guidance, see 1.274-5 (g).

* * *

(j) [Reserved]. For further guidance, see 1.274-5 (j).

* * *

(m) *Effective date.* * * * Paragraphs (c) (2) (iii), (f) (4), (g), and (j) of this section apply to expenses paid or incurred after December 31, 1997.

1.274 (d)-1 [REMOVED]

Par. [*18] 6. Section 1.274 (d)-1 is removed.

1.274 (d)-1T [REMOVED]

Par. 7. Section 1.274 (d)-1T is removed.

PART 602-OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In 602.101, paragraph (b) is amended by adding the following entry to the table:

602.101 OMB Control numbers

* * *

(b) * * *

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved December 28, 1999.

Jonathan Talisman,

Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 21, 2000, 3:09 p.m., and published in the issue of the Federal Register for January 26, 2000, 65 F.R. 4121)
CFR part or sec- Current OMB

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1.274-5	1545-0771
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