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## Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-5T: Substantiation requirements (temporary).

T.D. 8715

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

#### Substantiation of business expenses for travel, entertainment, gifts and listed property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains amendments to temporary regulations relating to the requirement that business expenses for travel, entertainment, gifts, or listed property be substantiated by documentary evidence (such as a receipt). The regulations affect persons making or receiving reimbursements for travel, entertainment, gifts, or listed property. The text of these temporary regulations also serves as the text of REG-209785-95, page 46.

DATES: These temporary regulations are effective March 25, 1997. Applicability: These temporary regulations are applicable to expenses paid or incurred after September 30, 1995.

FOR FURTHER INFORMATION CONTACT: Donna M. Crisalli at (202) 622-4920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### *Paperwork Reduction Act*

These regulations are being issued without prior notice and public comment pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under

control number 1545-0771. Responses to this collection of information are required for a taxpayer to deduct certain business expenses or to substantiate certain reimbursements of business expenses.

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.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing the burden, please refer to the preamble in the cross-reference notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

Books or records relating to a 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 and Explanation of Provisions*

##### Receipt threshold

Section 274(d) disallows a trade or business deduction under section 162 for any traveling (including meals and lodging), entertainment, gift, or listed property expense, unless the taxpayer substantiates the elements of the expense by adequate records or by sufficient evidence. Under § 1.274-5T(c) of the temporary Income Tax Regulations, a taxpayer must maintain two types of records to satisfy the “adequate records” requirement: (1) a summary of expenses (account book, diary, log, statement of expense, trip sheets, or other similar record), sometimes called an expense account or expense voucher, and (2) documentary evidence (such as receipts or paid bills). Together, these records must establish the elements of amount, time, place, and business purpose (and for gifts and entertainment, business relationship of recipient or persons entertained) for each expenditure or use.

Section 1.274-5T(c)(2)(iii) generally requires that a taxpayer have a receipt or other documentary evidence to substantiate (A) any expenditure for lodging and (B) any other expenditure of \$25 or more. In Notice 95-50 (1995-2 C.B.

333), the IRS announced that it would raise the receipt threshold of § 1.274-5T(c)(2)(iii)(B) from \$25 to \$75, effective for expenses incurred on or after October 1, 1995. The temporary regulations effect this amendment by changing “\$25” in § 1.274-5T(c)(2)(iii)(B) to “\$75.” This change is applicable to both deductions and reimbursement arrangements and is expected to reduce the recordkeeping burden on affected taxpayers, including individuals and small businesses.

#### *Definition of an “adequate accounting” to the employer*

An employee who is reimbursed under a reimbursement or other expense allowance arrangement for expenses covered by section 274(d) must make an “adequate accounting” to the employer for the reimbursed expenses. Section 1.274-5T(f)(4) specifies that, as part of an adequate accounting, the employee must submit substantiation to the employer that satisfies the requirements of § 1.274-5T(c). Notice 95-50 also solicited comments on whether changes should be made to the substantiation requirements of the adequate accounting rules in § 1.274-5T. Comments received related primarily to the adequate accounting rules and the substantiation requirements in general.

#### 1. Submission and retention of documentary evidence

A number of commentators, particularly federal government agencies, complained of the administrative burden and cost of storing large quantities of paper receipts. Some comments proposed that the employer should be allowed to dispose of the documentary evidence after an employee has made an adequate accounting, or return the documentary evidence to the employee for retention. Other comments suggested that submission by an employee of an expense voucher alone, without documentary evidence, should be considered an adequate accounting.

With the increase in the receipt threshold to \$75, and the use of electronic document transmission and retention (discussed below), the necessity for storing large quantities of paper records is significantly reduced. Nonetheless, the temporary regulations respond to the concerns expressed by these comments by amending § 1.274-5T(f)(4) to authorize 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 the necessity of submitting documentary evidence (such as receipts). This change is expected to reduce the recordkeeping burden for employers and employees. These rules would not change the substantiation requirements of § 1.274-5T(c) for deductions.

## 2. Maintenance of adequate records in electronic form

Some commentators suggested that taxpayers should be permitted to obtain and maintain records substantiating expenses under section 274(d) in electronic form. The temporary regulations make no change to the current regulations, which do not require that the records be in paper form. Rev. Proc. 91-59 (1991-2 C.B. 841), provides procedures for maintaining tax records in electronic form. Section 3.08 of Rev. Proc. 91-59 states that the procedures apply to documentation required by section 274(d).

## 3. Types of records that constitute acceptable documentary evidence

Some commentators suggested that credit card charge records should be considered acceptable documentary evidence of travel expenses, including lodging. They noted, however, that § 1.274-5T(c)(2)(iii) requires that documentary evidence of lodging must show separate amounts for charges such as lodging, meals, and telephone calls. A credit card statement or record of charge, unlike a hotel bill, normally will not segregate lodging and other expenses, such as meals and entertainment subject to the section 274(n) partial deduction disallowance, or personal expenses (such as personal phone calls or gift purchases) that may not be deducted. Therefore, such a credit card statement or record of charge alone will not constitute acceptable documentary evidence of a lodging expense.

The commentators proposed addressing this problem by using statistical sampling, conducted either by the IRS or by taxpayers, to establish a breakdown of expenses on hotel bills. One comment suggested that sampling could

form a basis for a “safe harbor” percentage or percentages (e.g., by industry or size of company) of hotel bills that would be deemed to represent the various types of possible expenses. Another comment suggested that the IRS adopt a mechanical test based on statistical sampling to make a reasonable allocation of the total hotel charge to meals.

The temporary regulations make no change to the current documentary evidence requirements for lodging expenses. Because of the large number of expenses that can be charged to hotel bills, and extensive variation from traveler to traveler in the types of expenses charged to hotel bills, any attempt to establish percentages for allocating hotel bills to lodging and other fully deductible business expenses, meals and entertainment, and personal expenses is considered impracticable.

A comment requested that the IRS clarify whether statements provided to travelers by airlines in lieu of tickets can constitute documentary evidence of travel. The current regulations are sufficiently flexible to permit use of a variety of forms of documentary evidence.

## *Other Comments in Response to Notice 95-50*

### 1. Substantiation of business purpose

A commentator suggested that the regulations be revised to permit an employee to initially substantiate business purpose to the employer orally, for later entry into the expense processing system. The current regulations do not preclude an initial oral substantiation of business purpose which is reduced to writing no later than the time of the employee's final accounting to the employer.

### 2. Post-expenditure verification procedures

A comment suggested that the regulations be revised to permit an employer to conduct a post-expenditure review of only a statistical sampling, as opposed to 100%, of expense vouchers.

Section 1.274-5T(f)(5)(iii) states that an employee who makes an adequate accounting to his employer will not again be required to substantiate such expenses, unless the employer's accounting procedures are not adequate or it cannot be determined that such procedures are adequate. The district director will determine whether the employer's accounting procedures are adequate by considering all the facts and circum-

stances, including the employer's use of internal controls. The employer's accounting procedures should include a requirement that an expense account be verified and approved by a reasonable person other than the person incurring the expense. To the extent the employer fails to maintain adequate accounting procedures, the district director may require the employee to separately substantiate his expense account information.

Section 1.274-5T(f)(5)(iii) cites post-expenditure review of employees' expense accounts as an internal control that should normally be employed. However, whether the employer's post-expenditure review procedures are appropriate is a matter within the discretion of the district director, based on a review of all the facts and circumstances.

### 3. De minimis exception to substantiation requirements

A comment proposed that employees receiving \$1000 or less per year in reimbursed expenses be exempted from the requirement to substantiate the elements of the expenses, other than business purpose, to the employer. In view of the other changes made by the temporary regulations that will lessen a taxpayer's recordkeeping burden, such as the increase in the receipt threshold, the temporary regulations do not incorporate this suggestion.

### 4. Department of Labor substantiation requirements for plan trustees

A comment requested the IRS to coordinate with the Department of Labor to establish common substantiation requirements under ERISA for travel by multi-employer plan trustees. Modifications to conform the substantiation requirements under ERISA to those provided in the temporary regulations are outside the scope of the section 274(d) regulations.

### 5. Increase in limit on deduction for gifts

A comment requested that the \$25 limit on the deduction for gifts contained in section 274(b) be increased to \$75. The IRS has no discretion to raise this statutory limit.

### 6. Use of full federal per diem method to substantiate travel for deduction purposes

A comment suggested that self-employed individuals and unreimbursed

employees should be entitled to substantiate lodging expenses for deduction purposes by means of the "high-low" per diem method. Rev. Proc. 96-64 (1996-53 I.R.B. 52), permits this substantiation method for employee reimbursements only. This suggestion is outside the scope of this revision to the temporary regulations.

*Special Analyses*

It has been determined that these temporary regulations are not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do 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 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, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

*Drafting Information*

The principal author of these regulations is Donna M. Crisalli, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

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*Adoption of Amendments to the Regulations*

Accordingly, 26 CFR part 1 is amended as follows:

**PART 1—INCOME TAXES**

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

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

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

Par. 2. An undesignated centerheading is added immediately following § 1.280H-1T to read as follows:

\* \* \* \* \*

**Taxable Years Beginning Prior to January 1, 1986**

**§ 1.274-5 redesignated as § 1.274-5A**

Par. 3. Section 1.274-5 is redesignated as § 1.274-5A and added immediately following the undesignated centerheading "Taxable Years Beginning Prior to January 1, 1986".

Par. 4. Section 1.274-5T is amended by:

- 1. Revising the first sentence of paragraph (c)(2)(iii)(B).
- 2. Redesignating the text of paragraph (f)(4) as paragraph (f)(4)(i).
- 3. Adding a paragraph heading for paragraph (f)(4)(i).
- 4. Adding paragraphs (f)(4)(ii) and (f)(4)(iii).

The revisions and additions read as follows:

*§ 1.274-5T Substantiation requirements (temporary).*

- \* \* \* \* \*
- (c) \* \* \*
- (2) \* \* \*
- (iii) \* \* \*

(B) Any other expenditure of \$75 or more (\$25 or more for expenditures incurred before October 1, 1995) except, for transportation charges, documentary evidence will not be required if not readily available, provided, however, that the Commissioner, in his discretion, may prescribe rules waiving such requirements in circumstances where he determines it is impracticable for such documentary evidence to be required. \* \* \*

- \* \* \* \* \*
- (f) \* \* \*
- (4) \* \* \* (i) *In general.* \* \* \*

(ii) *Procedures for adequate accounting without documentary evidence.* The Commissioner may, in his discretion, prescribe rules under which an employee may make an adequate accounting to his 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.

\* \* \* \* \*

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

Par. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. In § 602.101, paragraph (c) is amended by:

1. Removing the following entry from the table:

CFR part or section where identified and described	Current OMB control No.
* * *	* *
1.274-5 . . . . .	1545-0139 1545-0771
* * *	* *

2. Adding an entry in numerical order to the table to read as follows:

CFR part or section where identified and described	Current OMB control No.
* * *	* *
1.274-5A . . . . .	1545-0139 1545-0771
* * *	* *

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

Approved February 14, 1997.

Donald C. Lubick,  
*Acting Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on March 24, 1997, 8:45 a.m., and published in the issue of the Federal Register for March 25, 1997, 62 F.R. 13988)

**Section 280G.—Golden Parachute Payments**

Federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

**Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change**

The adjusted federal long-term rate is set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.