SUBSTANTIATION RULES AND AUTOMOBILES

The Tax Reform Act of 1984 (TRA) made significant changes in the substantiation rules for travel, transportation and entertainment expenses (T and E) and the maximum amount of automobile depreciation that a taxpayer may now claim on his return.

SUBSTANTIATION RULES

The law now states that no deduction shall be allowed for traveling expenses (including meals and lodging away from home), for an activity considered to be entertainment, amusement, or recreation, or with respect to a facility used in connection with the same (i.e., boat, airplane, condominium, etc.), gifts or with respect to any "listed property"(i.e., any passenger automobile, any other property used as means of transportation, any computer peripheral equipment and other property yet to be specified by the Internal Revenue Service), unless the taxpayer substantiates such expenses by adequate written records.

To be adequate, your record must show the following:

1. The amount of the expense.
2. The time and place of the expense.
3. The business purpose of the expense, and
4. The business relationship to the taxpayer of the person being entertained or receiving a gift.

The records are considered adequate if they are maintained at or about the same time the expense is incurred.

Documents such as a log of auto usage, diary, receipts for expenditure (not a canceled check) shall be considered adequate records.

To state the substantiation rules another way, if the taxpayer keeps a daily log where he records adequate information and can support the log with records, he should meet the substantiation rules for T and E expenses.

The main difference between the new and old law is that under the new law, no deduction will be allowed unless adequate written records are maintained. Under the old law, the taxpayer could support his tax deductions for T and E with adequate records or by sufficient evidence

corroborating his own statements. In other words, if you are audited by the Internal Revenue Service and they ask for your T and E records and you can't produce them, they will disallow all of your T and E deductions. If you can produce only part of the records, they will allow only the part that meets the adequate written records rule.

In addition, if your return is prepared by a tax preparer, the preparer is required to advise you of the substantiation rules and obtain written confirmation from you that you have kept adequate written records. If, upon audit, it is disclosed that such records were not kept, you will be subject to penalty. Even if you prepare your own returns, a similar statement is incorporated into form 2106 (Employee Business Expenses).

AUTOMOBILE

Under the TRA of 1984, a limitation has been placed on the amount of depreciation that may be claimed on a so-called luxury automobile and "listed property". These new rules apply to passenger automobiles and "listed property" placed in service or leased after June 18, 1984.

The maximum amount of depreciation that may be claimed in the first taxable year is $3,060, and $4,900 in the second year, and $2,950 for the third year, and $1,775 in all subsequent years. The maximum amounts will be reduced if the automobile is not used 100% in a trade or business. For example, assume you have kept adequate written records which prove that you used your automobile 70% for business and 30% for personal use. The maximum amount of depreciation you may claim is $2,142 (70% of $3,060). Seventy percent (70%) of any other cost such as gas, oil, repairs, insurance, etc., associated with your automobile would also be deductible.

If the passenger automobile or other "listed property" is not used more than 50% in your trade or business, depreciation will be computed over the earnings and profits life of the asset (automobiles, 5 years; computers, 12 years) using the straight-line method rather than the Modified Accelerated Cost Recovery System.

Automobiles and other "listed property" a taxpayer owns in connection with his employment is eligible for MACRS depreciation, assuming more than 50% trade or business use, only if such property is required for the convenience of the employment. A statement by the employer that an automobile is required is not in itself sufficient to deduct the automobile or other "listed property". The automobile and other "listed property" must be necessary to enable the taxpayer to perform his duties as an employee.

The Internal Revenue Service has published a table via Procedure that designates the portion of a lease payment that will qualify for deduction. The purpose of this table is to give effect to the depreciation limitation imposed on the taxpayer if he purchased the automobile rather than leased it.

CONCLUSION

The need, or more correctly, the requirement that each taxpayer keep adequate written records could work to your advantage.

By keeping adequate written records, you may find that your deductible T and E expenses are greater than you thought possible. In addition, if and when the Internal Revenue Service audits the T and E portion of your return, your level of confidence to sustain your deductions claimed will be significantly higher than in the past. We encourage you to review your record keeping procedure in light of the new law.

While the TRA has limited the maximum amount of depreciation a taxpayer may claim on a passenger automobile and other "listed property", the law should not dissuade you from acquiring such assets if they are needed to properly perform your duties as an employer or employee. The main emphasis of this portion of the law is to limit, not deny, the amount of depreciation that may be claimed in any one year. Accordingly, you should evaluate the acquisition of such assets on a case by case basis.