

Sometimes, Tax Receipts Are Optional

By Robert W. Wood

At tax time, you may find yourself scrambling for receipts, looking in file folders, in drawers, and these days, in your e-mail inbox. In general, receipts and proof in tax matters are critical. In fact, the Internal Revenue Code and the Treasury Regulations are full of substantiation requirements. Receipts, invoices and cancelled checks count big time.

Sometimes, though, the lack of a receipt may not prevent you from claiming a deduction or even prevailing in court if you end up in a fight with the Internal Revenue Service. In fact, if you can't find one, remember the Cohan Rule.

This tax rule had its genesis in *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930). George M. Cohan was an early Broadway pioneer, authoring such hits as "Give My Regards to Broadway" and "Yankee Doodle Boy." Cohan had a big appetite and spent in a big way. His statue still commands Times Square.

But the IRS disallowed many of Cohan's show business travel and entertainment expenses for lack of receipts. Cohan often paid cash, it seems, and sometimes took dozens of people out for dinner. The IRS demanded receipts for proof, and Cohan didn't like being effectively called a liar.



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He also didn't like losing out on tax deductions. So, he took the IRS to the Board of Tax Appeals, the precursor to today's U.S. Tax Court. It upheld the IRS, receipts being the stock in trade of a tax system.

Still undeterred, Cohan appealed to the 2nd U.S. Circuit Court of Appeals. There, the IRS thought it had a rock solid case, arguing for requiring rigidity in tax records. However, the 2nd Circuit rocked the IRS back on its heels by announcing what would come to be known as the Cohan Rule.

To this very day it serves as an exception to stringent IRS recordkeeping requirements. It allows taxpayers to prove by "other credible evidence" that they actually incurred the expenses for deductible purposes. That means testimony can itself be enough, even if you have no receipts.

Before you start thinking that your tax deductions don't require receipts, think again. You should not consider the Cohan Rule as a get-out-of-jail-free card. In fact, the IRS still is luke-warm to this rule 80 years later! Plus, the Cohan Rule doesn't always work in court either.

The Cohan Rule has most classically been applied to travel and entertainment expenses, the context in which the rule was borne. However, it could apply to virtually any item not specifically subject to heightened substantiation requirements under the Tax Code or Treasury Regulations. There are special substantiation rules for certain travel and meal expenses, passenger automobiles, computers and cell phones, and in those cases, the Cohan Rule can't apply. Furthermore, the Cohan Rule does not permit a complete absence of substantiation. Rather it allows a different kind of substantiation. If you can convince the IRS by oral or written statements or

other supporting evidence and can give a reasonable approximation of the expense, you may be entitled to the deduction despite your lack of documentation.

The IRS sometimes agrees to apply the Cohan Rule, but often you must go to Tax Court to argue it. The Tax Court has applied the Cohan Rule to allow deductions for expenses for items such as education expenses, a beauty consultant's license fee, gambling losses, qualified research activities, the building and placement of signs, and a whole host of other expenses. Travel and entertainment expenses, however, are perhaps the most classic ones.

Even charitable contributions have occasionally been allowed under the Cohan Rule. However, you can't use the Cohan Rule where there are special strict substantiation requirements, as there are for some charitable contributions. Those rules require you to have a receipt even for small cash donations, including \$20 put in the collection plate on Sunday and, for donations of more than \$250, a contemporaneous written acknowledgement from the charity before filing your tax return.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.

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