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Expert View

What If A Taxpayer Doesn't Have Receipts?

Robert W. Wood, 11.24.09, 10:00 AM ET

If you understand anything about our tax system, it's probably that you must have receipts. As a tax lawyer for the last 30 years, it seems like heresy to suggest that clients might not have to save all those pesky receipts to prove their deductions. We're trained from an early age to document everything. "Prove it" isn't simply a schoolyard bully's taunt. It's what the Internal Revenue Service says again and again to honest taxpayers who weren't diligent enough in saving their receipts.

In fact, much of the IRS' current "correspondence" audit program for ordinary, wage-earning taxpayers, comes down to sending them letters demanding they document their charitable, employee business expense or other deductions--or have them disallowed.

That's why it's so interesting to find the U.S. Tax Court rebuking the IRS for failing to give a taxpayer without documentation at least a partial charitable deduction. This fellow may not have had any receipts, but he seemed so, well, honest. And one of the people who deserve thanks in this happy story is long-dead Broadway legend George M. Cohan.

A Broadway revival.

When you think about Broadway, you may think of Tommy Tune, Sir Andrew Lloyd Weber or even Mel Brooks. You'll need to reach considerably farther back in Broadway's history to thank the "burn the receipts" legend who's come back from the grave to help all taxpayers.

Cohan was an early Broadway pioneer, author of such hits (and now classics) as "Give My Regards to Broadway" and "Yankee Doodle Boy." His grand old statue still commands Times Square.

But tax lawyers look to George M. Cohan for a different kind of legacy--an "I'll take you to court" audacity that is as American as apple pie. It's a shame that so few taxpayers have even heard of tax law's "Cohan Rule."

The birth of the Cohan Rule.

Its genesis is the case of *Cohan v. Comm'r*, 39 F.2d 540 (2d Cir. 1930). Cohan had many of his show business travel and entertainment expenses disallowed by the IRS because he had no receipts. He was frantically busy, he argued, having little time to document his expenses. The IRS panned his performance.

So Broadway's then baron took the IRS to court. First he went to the Board of Tax Appeals, the predecessor to today's U.S. Tax Court. Predictably, the Board of Tax Appeals upheld the IRS--receipts after all, are the stock in trade of a tax system!

But Cohan appealed to the Second Circuit Court of Appeals, which in 1930 rocked the IRS back on its heals with a one-two punch. Judge Learned Hand would never accede to the Supreme Court, but his tax decisions remain luminary, and the Cohan case does not disappoint. The Cohan Rule serves as an exception to stringent IRS recordkeeping requirements, allowing taxpayers everywhere to prove by "other credible evidence" that they actually incurred the expenses for deductible purposes.

That's (deductible) entertainment.

Cohan had incurred expenses for traveling and entertainment but didn't have receipts. So he proved up his deductions by his testimony. That included his recollections and approximations of the amounts incurred, including cab and railroad fares, hotels, tips, restaurant, and other expenses for Cohan and his considerable entourage. The Second Circuit believed him and told the IRS it better do so too.

To be sure, the Cohan Rule doesn't always impress the IRS, and it doesn't always work in court either. It has been most classically applied in the case of travel and entertainment expenses.

But theoretically, it could apply to virtually any item, so long as the item is not specifically subject to a heightened substantiation requirement under the code or regulations (as is the case now with certain travel and meal expenses, passenger automobiles, computers and cellphones).

If the IRS is convinced by oral or written statements or other supporting evidence, and a reasonable approximation can be made, you may be entitled to the expense notwithstanding a failure to have it documented. For example, in 2009 alone, the Tax Court has applied the Cohan Rule to expenses for items such as a beauty consultant's license fee, gambling losses, qualified research activities, and the building and placement of signs.

Does Cohan apply to charitable contributions?

One place where the Tax Court has been reluctant to apply the Cohan Rule is charitable deductions--or, at least it's been reluctant to do so since Congress passed strict substantiation requirements in 2006. 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.

Just last year, in *Gomez v. Comm'r*, T.C. Summary Opinion 2008-93, the Tax Court ruled against a couple who had written 10 checks tithing $6,100 to their church, even though the IRS itself didn't challenge the fact that they made the contributions. (The problem: They didn't have the written acknowledgement before filing their returns.) Moreover, the IRS noted that any written acknowledgement from a charity must not only include the amount contributed, it must also state whether the charity provided any goods or services in consideration for the contributions. Then it must describe those goods or services and include a good faith estimate of their value.)

The Cohan Rule got a ratings boost in the recent Tax Court case, *Ragassa v. Comm'r*, T.C. Summ. Op. 2009-166 (Nov. 10, 2009). Mr. Ragassa had deducted $3,175 in charitable contributions. A devout member of the Ethiopian Orthodox Church, he attended church at least once a month, shuttling between parishes in Boston and Washington. He'd put about $100 in the collection plate each time he attended church, and he donated clothes too. Lacking receipts, he offered to give the IRS contact information so they could verify it. No thanks, said the IRS.

Echoing Judge Learned Hand's rebuke of the IRS in Cohan, the Tax Court said the IRS went too far in refusing to allow any deduction whatsoever to this honest soul. This taxpayer was an industrious individual working two jobs while attending school, the Tax Court noted. Plus, his religious commitment appeared to be genuine.

Using its best judgment on the entire record--and being appropriately skeptical since Mr. Ragassa didn't have documentation--the Tax Court found it credible that at least once a month throughout 2005, he attended church and made a cash contribution of at least $25 each time. That amounted to $300 for the year.

The *Ragassa* decision involved charitable contributions made during the 2005 tax year, before Congress passed stricter substantiation requirements for charitable contributions in 2006. The Tax Court declined to give specifics on how it will apply the Cohan Rule to charitable contributions from 2006 forward, noting that it had yet to definitively decide whether the Cohan Rule is available to estimate charitable contributions. It did, however, cite existing precedent for applying the Cohan Rule where it finds the taxpayer to be candid, forthright, and credible. Perhaps the Tax Court was hinting it would take a similar approach in the future.

Cohan is no panacea, so keep those records.

Of course, a $300 deduction is less than half a loaf if you actually shelled out $3,600. That should cause you to take with a grain of salt Cohan's victory and the victory of souls like Mr. Ragassa who walk in Cohan's (dancing) foot steps. Still, these crumbs can make a difference when you're dealing with IRS personnel who may want to slap you down with a no-receipt-no-deduction mantra. You might want to go right back at them with a bit of Cohan Rule lore.

But my (free and therefore not binding) advice is not to go paperless just yet.

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