

Internal Revenue Manual Section 4.19.15.23.1, Paragraph 15 (09-25-17) Evaluating EBE Taxpayer Responses

1. All responses need to be evaluated using judgment considering what is known about the occupation.
2. The reimbursement policy of the employer is the starting point for all EBE audits and MUST be secured.
3. Employees and self-employed individuals claiming un-reimbursed travel expenses may claim the government per diem rate for the meals and incidental expenses (M&IE) portion of travel expenses, provided they have supported the travel. However, employees and self-employed individuals claiming un-reimbursed lodging expenses must provide receipts for lodging expenses and may not use the government per diem rates for lodging expenses.
4. An expenditure for travel, meals, or entertainment, to the extent it is lavish or extravagant, shall not be allowable as a deduction.
5. Unless the taxpayer is eligible to use and does use the government per diem rates, documentary evidence is required for:
 - A. Any expense for lodging while traveling away from home, and
 - B. Any other expenditure of \$75 or more.
6. IRC 274(d) provides that no deduction shall be allowed for entertainment, gifts, listed property or travel unless the taxpayer substantiates the following elements of the expenditures:
 - A. Amount of each expenditure.
 - B. Time and place of the travel, entertainment, amusement, recreation, or use of the facility or property.
 - C. Date and description of the gift.
 - D. Business purpose for each expenditure.
 - E. Business relationship to the taxpayer of each person entertained, using an entertainment facility, or receiving a gift.
7. Many expenses not listed in (5) above can be summarized, or aggregated. See Publication 463 *Travel, Entertainment, Gift, and Car Expenses*, Section 5 *Record Keeping* for a table that shows the substantiation requirement for specific expenses.
8. The deduction for business-related meal and entertainment expenses are generally subject to a 50% limit or 80% if taxpayer is subject to the Department of Transportation's "hours of service" limits.
9. Travel expenses are deductible when taxpayers are temporarily away from their tax home. However, an indefinite assignment to another location is a change in tax home, thus travel expenses are not deductible.
10. Travel expenses for conventions, seminars, and similar meetings are deductible under IRC 162 if the taxpayer's attendance benefits or advances his trade or

business. No deduction is allowable if a taxpayer is attending for social, political, or other purposes not related to his trade or business.

11. IRC 274(c)(1) states foreign travel must first be deductible under IRC 162 or IRC 212. The travel must be ordinary and necessary in the pursuit of a trade or business, or for the production of income. If the expense meets those requirements, then the business portion of the travel is deductible.

12. Travel outside of the United States generally must be allocated between business and personal. IRC 274(c)(2) provides two exceptions to the rule that travel expenses be allocated between business and personal. No allocation is made if foreign travel does not exceed one week, or if less than 25 percent of the trip is personal, then travel to and from the business destination is allowed in full.

13. Any issues beyond the expertise of the examiner assigned the case should be referred to the lead examiner to secure the appropriate technical guidance.

14. It is not necessary to fully allow or disallow any expenses. Expenses can be partially allowed when revising the report. Special care should be taken to explain these revisions to the taxpayer.

15. Additional Items to consider. Consider the following points when processing EBE cases.



Employee Business Expense Auditing Techniques

When examining employee business expenses, you must consider whether the employer has an expense allowance or reimbursement plan.

You must be able to determine if the plan is accountable or non-accountable. When examining expenses you believe are under a non-accountable plan, you may encounter nondeductible expenses that were reimbursed.

Always request a written statement explaining the requirements of the expense allowance or reimbursement plan from the employer. The written statement can be an excerpt from the employee handbook or a statement prepared for the purpose of the examination.

If the statement is prepared for the purpose of examination, be sure the author has sufficient knowledge of the expense allowance or reimbursement plan.

If the statement presented from the employer is vague, discuss with your manager or lead the possibility of making a third party contact.

Be logical in organizing the examination. It may be better to structure the examination of these expenses into categories i.e., travel, entertainment, listed property, gifts, than by time periods (all of May's expenses or July's expenses). Examining by topic will allow you to see inconsistencies in the taxpayer's records. It will also allow you to determine the credibility of the taxpayer's record keeping.

Look for recurring names for entertainment and meals, as well as recurring locations for travel.

Employee Business Expense Auditing Techniques

Recurring names may indicate a family member or a friend.

Be mindful of travel dates. Are the dates during holiday periods? If travel dates are during holiday seasons, this may indicate personal expenses.

Does the taxpayer use a travel agent on some occasions and not at other times? If he uses a travel agent regularly, this may be a source of documentation. A travel agent may or may not be used by his company. Does he use more than one travel agent? Most companies use one travel agent; if there are two or more, there may be some personal expenses intermingled with valid business travel.

Hotel receipts will often show how many people stayed in a room. If friends or family were staying with the taxpayer while they were away from home, you must determine if there was a business purpose for their stay and what, if any, additional charges were incurred.

Airline tickets and travel agency statements will show departure dates and who actually traveled. Compare the dates of the business meetings with the actual length of the trip. You could discover that the taxpayer extended his/her stay for a personal vacation. Request a detailed itinerary.

For employees on "accountable" plans, evaluate any reimbursement records. In most cases, the expenses reimbursed by the employer should be accepted up to the amount of reimbursement on face value since it is assumed that they were incurred for a business purpose. However, look to see if any changes were made to the employee's compensation structure (i.e., where the employee's wages reduced by the amount of the "reimbursement") to determine if the purported reimbursements were merely re-characterized wages. Special attention should be paid when they exceed the reimbursement policy. This may also be used to establish the business portion of the use of an automobile where the employee is taking an actual expense deduction vs. a mileage deduction.

Be alert for altered documents. Look for erasures of dates, times, places or amounts. Look for possible consecutive numbered receipts, especially for high entertainment costs.

Taxpayer should provide documentary evidence along with account book, diary and log to support each element of an expense.

A cancelled check by itself doesn't prove a business expense without other evidence to show that it was for a business purpose.

To verify total miles for the year, the taxpayer should provide repair receipts, inspection slips or any other records showing total mileage at the beginning of the year as well as at the end of the year.

16. The employer's letter regarding the company's reimbursement policy helps to establish:

- A. the business expenses were ordinary and necessary, and

B. the taxpayer is deducting a legitimate "out of pocket" expense. If the taxpayer does not provide the employer's letter regarding the reimbursement policy, the expenses should be disallowed.

Note:

There may be instances when the taxpayer is unable to provide an employer's reimbursement policy letter because the employer is out of business, or in receivership. In these instances, if the taxpayer has provided enough corroborating information which shows the expenses are: a) ordinary and necessary, and b) the taxpayer is "out of pocket" for the expenses, then allow the verified expenses.