

How to prove deductions when you have no records

The regulations provide an exception to the normal substantiation requirements where the taxpayer can establish that at one time he possessed adequate records and that his inability to produce them is attributable to fire, flood, or other casualty beyond his control. In such cases the taxpayer may satisfy his burden of proof by reasonably reconstructing his records. Sec. 1.274-5(c)(5), Income Tax Regs. It is doubtful that loss of documentation in transit is a casualty beyond the taxpayer's control within the meaning of section 1.274-5(c)(5), Income Tax Regs. *Gizzi v. Commissioner* [T.C. Memo. 1972-102]. Under section 1.274-5(c)(5), Income Tax Regs., if the taxpayer can establish that (1) he at one time possessed adequate records and (2) that his present lack of records is due to fire, flood, or other casualty beyond his control, then he is free of the normal substantiation requirements. The taxpayer in such a situation must instead reasonably reconstruct his expenditures. These regulations closely follow the congressional reports which accompanied the 1962 congressional revisions to section 274 . H. Rept. No. 1447, 87th Cong., 2d Sess. (1962) 1962-3 C.B. 405, 427; S. Rept. No. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 741.

Proof of Deductions Absent Adequate Records If the taxpayer does not have adequate records in his possession, as required by the rules for substantiation included in Treas. Reg. §1.274-5(c)(2) (1967), 43 he may prove entitlement to a deduction only if he offers specific and detailed testimony as to each element of each expense, and he sets forth additional sufficient documentary or testimonial evidence, to corroborate his testimony in accordance with Treasury Regulations. See Treas. Reg. §1.274-5(c)(3); Treas. Reg. §1.162-17(d)(3). Subsections (3) and (4) of Treas. Reg. §1.274-5(c) state in pertinent part:

(3) **Substantiation by other sufficient evidence.** If a taxpayer fails to establish to the satisfaction of the district director that he has substantially complied with the "adequate records" requirements of subparagraph (2) of this paragraph with respect to an element of an expenditure, then, except as otherwise provided in this paragraph, the taxpayer must establish such element: (i) By his own statement, whether written or oral, containing specific information in detail as to such element; and (ii) By other corroborative evidence sufficient to establish such element. If such element is the description of a gift, or the cost, time, place, or date of an expenditure, the corroborative evidence shall be direct evidence, such as a statement in writing or the oral testimony of persons entertained or other witness setting forth detailed information about such element, or the documentary evidence described in subparagraph (2) of this paragraph. If such element is either the business relationship to the taxpayer of persons entertained or the business purpose of an expenditure, the corroborative evidence may be circumstantial evidence.

(4) **Substantiation in exceptional circumstances.** If a taxpayer establishes that, by reason of the inherent nature of the situation in which an expenditure was made: (i) He was unable to obtain evidence with respect to an element of the expenditure which conforms fully to the 'adequate records' requirements of subparagraph (2) of this paragraph, (ii) He is unable to obtain evidence with respect to such element which conforms fully to the 'other sufficient

evidence' requirements of subparagraph (3) of this paragraph, and (iii) He has presented other evidence, with respect to such element, which possesses the highest degree of probative value possible under the circumstances, such other evidence shall be considered to satisfy the substantiation requirements of section 274(d) and this paragraph. Treas. Reg. §§1.274-5(c)(3) & 1.274-5(c)(4) (1967). Treas. Reg. §1.162-17(d)(3), which sets forth the standards for the reporting and substantiation of certain business expenses of employees when records are incomplete, or documentary proof is unavailable, states: Where records are incomplete or documentary proof is unavailable, it may be possible to establish the amount of the expenditures by approximations based upon reliable secondary sources of information and collateral evidence. Since detailed records of incidental items are not required, deductions for these items may be based upon reasonable approximation. In cases where a taxpayer is called upon to substantiate expense account information, the burden is on the taxpayer to establish that the amounts claimed as a deduction are reasonably accurate and constitute ordinary and necessary business expenses paid or incurred by him in connection with his trade or business.