LIZ FARR, CPA

Documentation of Business Miles: Lessons from a Recent Tax Court Case

If your clients are unlucky enough to be audited, you can count on the IRS asking for documentation to support their business expenses. Business deductions that fall under Code Section 274(d) – travel, vehicle expenses, meals and entertainment, and business gifts – have additional strict substantiation requirements. This substantiation must document the amount, time and place of travel or use, and the business purpose for the expense.

For vehicle expenses, the best practice for your clients is to record this information in a contemporaneous log. Here's an easy way to track business miles.

But not always allowed!

If your clients don't keep a detailed log of their business miles, the IRS may allow them to reconstruct a mileage log from other documents, such as calendars, diaries or appointment books. However, this reconstructed log needs to be internally consistent and credible, which was not the case in *Taylor,* T.C. Memo. 2017-99.

Mrs. Taylor worked full time at a hospital and ran a medical collections service on the side. Her marketing consisted of driving to prospects throughout West Virginia and neighboring states to drop off brochures. Her husband ran a recycling business, which terminated in 2012. Throughout the years in which they ran both businesses, they combined the income and expenses for both ventures on a single Schedule C.

The Taylors' 2012 Schedule C showed $74,373 of vehicle mileage expenses, $1,595 of other expenses and zero receipts. At the U.S. Tax Court hearing, Mrs. Taylor presented a spreadsheet of her mileage she had reconstructed from various logs and records, but did not provide those additional records at her trial. Her mileage spreadsheet showed 136,456 miles driven on 144 distinct trips. The purpose for each trip was described identically as "Distribute Informational Brochures/Market."

Examination of this spreadsheet turned up a number of inconsistencies and oddities:

- Odometer readings for trips in the same vehicle on different days overlapped: a trip on Jan. 10 began at 156,500, but an earlier trip on Jan. 7 ended at 156,572.
- Nearly all of her driving consisted of long one-day round trips, with an average of 920 miles per day and a report of 1,696 miles for the longest day. As the judge pointed out, this would have required driving nonstop at 70 mph for nearly 24 hours.
- Driving distances appeared to have no connection to actual geographic locations.
- Rather than visiting several prospects located in the same general area on the same trip, which would have saved time and money, her log showed numerous separate trips to individual prospects in the same areas over several weeks.

Mrs. Taylor had no explanation for the discrepancies, and as the judge noted, “We are not persuaded that Mrs. Taylor could have taken 144 full-day trips of this length, while concurrently holding a full-time job at Jefferson Memorial Hospital.”

Was she lying about her driving? Possibly, but without the additional logs and records she claims to have used as the basis for her spreadsheet, there’s no way to know.

Unfortunately for the Taylors, vehicle expenses tend to be an all-or-nothing deduction for the IRS. The U.S. Tax Court didn’t find her documentation credible, so all of the vehicle expenses were disallowed. In addition to the loss of the deduction, which cost them $13,885, they were also hit with an accuracy-related penalty of $2,777.

Here are four lessons that came out of this case:

1. Keep a mileage log.
2. For each trip, clearly document the miles driven, time and place, and business purpose. Don’t use the same business purpose for every trip.

3. If no log is being kept, be sure to keep other corroborating evidence of your driving. Diaries, calendars or appointment books may be acceptable, but they must include enough detail to support the driving.

4. A reconstructed mileage log needs to be internally consistent and reasonable. Check for errors in distances.

Keeping these guidelines in mind will ensure your clients benefit from this valuable business deduction. Above all, this case is a reminder that honesty in claiming deductions is always a good idea!

About the Author

Liz has worked in tax and accounting since 2002. Besides focusing on tax returns of all flavors, she's worked on audits of governmental entities and not-for-profits, business valuations, and litigation support. Liz is also a freelance writer specializing in content marketing for accountants and bookkeepers around the world.

Liz Farr, CPA

@liz_farr http://farrcommunications.com/