

In Perspective

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Business Tax Notes

How to Substantiate Business Gifts to Clients

A business may deduct ordinary and necessary expenses paid or incurred in carrying on any trade or business. The expense must be reasonable and must be helpful to the business. Gifts to a business client, customer or contact can be deductible business expenses. The maximum deduction for gifts to any individual is \$25 per year. A gift is any item that is excluded from the income of the recipient under. Gifts that cost \$4.00 or less, as well as promotional items, are not subject to the \$25 limitation.

Gifts by individuals to co-workers are normally considered nondeductible personal expenses. However, employee achievement awards (\$400 limit) and qualified plan awards are deductible and not subject to the \$25 limitation.

Substantiation

Taxpayers must be able to substantiate certain business expenses by adequate records or sufficient evidence to take them as a deduction. Expenses subject to this rule include business gifts, as well as traveling, lodging and entertainment expenses.

For business gifts, IRS regulations require that taxpayers substantiate the following elements of the gift:

- Amount (the cost to the taxpayer);
- Time (the date of the gift);
- Description of the gift;
- Business purpose (the business reason for the gift, or the nature of the business benefit derived or expected to be derived as a result of the gift); and
- Business relationship (occupation or other information relating to the recipient, including name, title and other designation, sufficient to establish the business relationship to the taxpayer).

In order to meet the substantiation requirements, the taxpayer must maintain and produce, on request, "adequate records" or "sufficient evidence" that support the taxpayer's own statements. Written evidence has "considerably more probative value" than oral evidence alone. While a contemporaneous log is not required, written evidence is more effective the closer in time it relates to the expense.

Adequate records

Adequate records include an account book, diary, log, statement of expenses or similar records, as well as documentary evidence, which in combination establish each element of the expense. However, it is not necessary to record information that duplicates information on a receipt. The record should be prepared at or near the time of the expenditure, when the taxpayer has full present knowledge of each element. A statement, such as a weekly log, submitted by an employee to his employer in the regular course of good business practice is considered an adequate record.

An adequate record of business purpose generally requires a written statement of business

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purpose. However, the degree of substantiation required will vary depending on the facts and circumstances.

Sufficient evidence

A taxpayer that does not have adequate records may establish an element by other sufficient evidence, such as the taxpayer's written or oral statement with specific, detailed information, and other corroborating evidence. A description of a gift shall be direct evidence, such as a detailed statement by the recipient or documentary evidence otherwise required as an adequate record.

If the taxpayer loses records through circumstances beyond the taxpayer's control, the taxpayer may substantiate the deduction by reasonably reconstructing his expenditures.

Contact Melody Twigg at mtwigg@mcquadebrennan.com to discuss year end tax planning and your tax situation. Melody is a Senior Tax Consultant at McQuadeBrennan, LLP. She is an expert in interpreting tax code for staff and clients.

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