Calendar No. 51

99TH CONGRESS
1st Session

SENATE

REPORT
99-23

REPEALING THE REQUIREMENT THAT CONTEMPORANEOUS RECORDS BE KEPT TO SUBSTANTIATE CERTAIN DEDUCTIONS AND CREDITS

APRIL 2 (legislative day, FEBRUARY 18), 1985.—Ordered to be printed

Mr. PACKWOOD, from the Committee on Finance, submitted the following

REPORT

[To accompany S. 245]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance, to which was referred the bill (S. 245) to repeal the requirement that contemporaneous records be kept to substantiate certain deductions and credits, having considered the same, reports favorably thereon with an amendment to the text and an amendment to the title and recommends that the bill as amended do pass.

The amendment to the text of the bill is shown in italics.

51-109 O

I. Explanation of the Bill

A. PRESENT LAW

Substantiation rules

Background

A taxpayer may deduct expenditures, including depreciation and operating costs, attributable to business use of an automobile or other means of transportation. No deduction is allowed for expenditures attributable to the personal use of an automobile or other property (other than for interest on purchase indebtedness or for certain State taxes). For example, the costs of commuting to and from work are personal expenses that are nondeductible pursuant to Code section 262.[1]

Under general tax law principles, the courts have held that a taxpayer bears the burden of proving both the eligibility of an expenditure as a deduction or credit and also the amount of any such eligible expenditure, including the expenses of using a car in the taxpayer's trade or business.[2]

In the Revenue Act of 1962, the Congress enacted Code section 274(d), under which a taxpayer must substantiate the business purpose, amount, and date of certain types of expenditures "by adequate records or by sufficient evidence corroborating his own statement." This provision was added because the Congress recognized that "in many instances deductions are obtained by disguising personal expenses as business expenses." [3] These specific substantiation rules were made applicable to (1) traveling expenses (including meals and lodging while away from home); (2) expenditures with respect to entertainment, amusement, or recreation activities or facilities; and (3) business gifts. Local travel expenses were not subject to this provision as enacted, but instead were subject to the general substantiation requirements applicable to all other business expenditures.

1984 Act amendments

Recordkeeping.—The Tax Reform Act of 1984 (P.L. 98-369) made several amendments to Code section 274(d), effective for taxable years beginning after December 31, 1984. First, the 1984 Act added a requirement that the taxpayer must keep "contemporaneous" records to substantiate deductions for expenditures subject to section 274(d). Second, the 1984 Act deleted from section 274(d) the alternative method of substantiating deductions, which was by means of sufficient evidence (written or oral) corroborating the taxpayer's own statement. Third, the 1984 Act made additional property subject to the requirements of section 274(d), including automobiles and other means of transportation. As a result, local travel expenses, like traveling expenses away from home, became subject to the section 274(d) rules.

---

[1] *Fausner* v. *Comm'r* 413 U.S. 838 (1973).

[2] See, e.g., *Interstate Transit Lines* v. *Comm'r* 319 U.S. 59, 593 (1943); *Comm'r* v. *Heininger*, 320 U.S. 467 (1943); *Gaines* v. *Comm'r*, 35 T.C.M. 1415 (1976).

[3] H. Rept. No. 87-1447, 87th Cong., 2d sess. (1962), at 19.

Tax preparer rules.—The 1984 Act required that paid income tax return preparers must advise the taxpayer of the section 274(d) substantiation requirements and obtain written confirmation from the taxpayer that these requirements were met. Failure to advise the taxpayer or to obtain the confirmation subjects the return preparer to a penalty of $25 for each failure, unless due to reasonable cause and not to willful neglect (sec. 6695(b)).

Special negligence penalty.—The 1984 Act provided that, for purposes of the section 6653 negligence penalty, any portion of an underpayment of tax due to a failure to comply with the section 274(d) recordkeeping requirements is treated as due to negligence, in the absence of clear and convincing evidence to the contrary. The penalty is five percent of the portion of the understatement attributable to the failure to comply with the section 274(d) recordkeeping requirements (sec. 6653(h)).

B. REASONS FOR CHANGE

The contemporaneous recordkeeping requirement and related compliance provisions enacted in the Tax Reform Act of 1984 reflected concerns of the Congress about significant overstatements of deductions and credits for claimed business use of automobiles and other types of property that typically are used for personal purposes, such as for commuting, vacation trips, personal errands and shopping excursions, etc. Many taxpayers who did make business use of automobiles or other vehicles failed to keep fully accurate records or based exaggerated claims of business use on inexact recollections at the time of filing their returns. To achieve increased compliance and accuracy, the Congress required that only contemporaneous records could be used to substantiate traveling expenses and the other types of expenditures listed in section 274(d), as revised by the 1984 Act. No definition of "contemporaneous" was set forth in the statute.

As businesses and individuals have sought to understand and comply with the contemporaneous recordkeeping requirement, it has become clear that the requirement sweeps too broadly and generally imposes excessive recordkeeping burdens on many taxpayers. While the Internal Revenue Service has modified its initial regulations interpreting the new requirement and has scheduled public hearings prior to adoption of final rules, the committee has concluded that the only appropriate actions that will provide a speedy and certain resolution to these problems are to repeal the "contemporaneous" requirement (and the tax return preparer and negligence penalty provisions) as added by the 1984 Act, to repeal the IRS temporary regulations interpreting the "contemporaneous" requirement, and to reinstate the prior-law substantiation standards under section 274(d) and the long-standing regulations thereunder.

C. EXPLANATION OF PROVISIONS

1. Repeal of 1984 Act provisions

Repeal of "contemporaneous"

The bill strikes the words "adequate contemporaneous records" from Code section 274(d) as if those words had never been a part of that provision, and inserts in lieu thereof the words "adequate records or by sufficient evidence corroborating the taxpayer's own statement". This is the substantiation standard that had been in effect prior to the Tax Reform Act of 1984 and that had been interpreted in long-standing IRS regulations originally issued in 1962.

The substantiation standard reinstated by the bill applies, as provided by section 274(d), to traveling expenses; entertainment, amusement, or recreation activities or facilities; business gifts; and, effective for taxable years beginning after 1984, and listed property (as defined in sec. 280F(d)(4)).

Repeal of return preparer provision

The bill repeals the provision of the 1984 Act requiring that a return preparer must specifically advise the taxpayer of the recordkeeping requirements of section 274(d) and must obtain written confirmation from the taxpayer that such requirements were met (Code sec. 6695(b)). The bill provides that the Internal Revenue Code shall be applied and administered as if this provision had never been enacted.

Repeal of special negligence penalty

The bill repeals the provision of the 1984 Act providing a special negligence penalty rule (Code sec. 6653(h)) applicable to an underpayment of tax attributable to a failure to comply with the recordkeeping requirements of section 274(d). The bill provides that the Internal Revenue Code shall be applied and administered as if this provision had never been enacted.

Repeal of certain regulations

The bill repeals all Treasury regulations (temporary or proposed) issued prior to the enactment of the bill which carry out the amendments made by paragraphs (1)(C), (2), and (3) of section 179(b) of the Tax Reform Act of 1984 that are repealed by this bill. These revoked regulations are to have no force and effect whatsoever.

2. Limited-use vehicles and certain flight benefits

The committee intends that Treasury regulations are to provide that the fair market value of an employee's commuting use of a limited-use vehicle furnished by the employer is excluded, as a working condition fringe, from the employee's gross income for Federal income tax purposes, and from the wage base (and, if applicable, from the benefit base) for purposes of income tax withholding and FICA, FUTA, and RRTA taxes. A limited-use vehicle is a vehicle the characteristics of which make it unlikely that it will be used more than a very minimal amount for personal purposes. Example of such limited-use vehicles include marked police and fire vehicles, ambulances used as such, school buses used as such, dump trucks, cement mixers, refrigerated trucks, tractors, and specialized utility repair trucks used as such.

The committee also intends that the Treasury is to substitute the following safe-harbor valuation rules with respect to employee flights on employer-provided noncommercial aircraft that constitute taxable fringe benefits, for the valuation rules with respect to such benefits that are currently set forth in temporary regulations. The committee believes that these substitute safe-harbor rules reflect the intent of the Congress concerning the valuation of personal use of noncommercial aircraft under the fringe benefit rules in the Tax Reform Act of 1984.

Weight of aircraft	Includible value for control employees	Includible value for other employees
More than 10,000 pounds	First class fare	Value imputed to parent of airline employee.
More than 6,000 pounds but not more than 10,000 pounds.	Coach fare	¾ value imputed to parent of airline employee.
6,000 pounds or less	½ coach fare	½ value imputed to parent of airline employee.

The amount imputed to employees other than control employees is intended to be no more than the amount imputed to a parent of an airline employee, since it is difficult to distinguish the value of a standby flight on a commercial airline and a flight on a space-available basis on a similar noncommercial jet aircraft. However, the amount imputed to a parent of an airline employee under temporary Treasury regulations is presently 50 percent of the highest unrestricted coach fare for the trip which is charged by the carrier for which the employee works. The safe-harbor valuation regulations (as revised to reflect the committee's intent) are to utilize rules referring to commercial airline fares, such as Standard Initial Fare Level (SIFL) rates or industry average rates.

For purposes of the valuation rules in the table above, the term control employee means an employee (whether or not an officer) who controls the use of the aircraft for the trip, i.e., who controls either the use, scheduling, or destination of the aircraft.

D. EFFECTIVE DATE

The provisions of the bill repealing certain provisions enacted in the Tax Reform Act of 1984 take effect as if included in the amendments made by section 179(b) of the 1984 Act.

E. REVENUE EFFECT

The provisions of the bill are estimated to reduce fiscal year budget receipts by $48 million in 1985, $150 million in 1986, $225 million in 1987, $247 million in 1988, $259 million in 1989, and $270 million in 1990.

II. Budget Effects and Vote of the Committee

A. BUDGET EFFECTS

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the budget effects of S. 245, as reported by the committee.

Revenue effects

The revenue provisions of the bill are estimated to reduce fiscal year budget receipts by $48 million in 1985, $150 million in 1986, $225 million in 1987, $247 million in 1988, $259 million in 1989, and $270 million in 1990.

B. VOTE OF THE COMMITTEE

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the vote of the committee on the motion to report the bill, S. 245, as amended, was ordered favorably reported by a record vote.

III. Regulatory Impact of the Bill and Other Matters To Be Discussed Under Senate Rules

A REGULATORY IMPACT

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of S. 245, as reported.

Numbers of individuals and businesses who would be regulated

The bill does not involve new or expanded regulation of individuals or businesses. The bill reduces recordkeeping burdens on individuals and businesses.

Economic impact of regulation on individuals, consumers, and businesses

The bill repeals certain recordkeeping requirements imposed in the Tax Reform Act of 1984 and thereby reduces recordkeeping burdens on individuals and businesses.

Impact on personal privacy

The bill reduces recordkeeping burdens on individuals.

Determination of the amount of paperwork

The bill reduces paperwork burdens on individuals and businesses.

B. OTHER MATTERS

Consultation with Congressional Budget Office on budget estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates for the bill (as shown in

Part II of this report) and agrees with the committee's budget estimates. The Director submitted the following statement.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 2, 1985.

Hon. BOB PACKWOOD,
Chairman, Committee on Finance,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has examined S. 245, a bill which makes changes to certain provisions enacted in the Deficit Reduction Act of 1984 (DEFRA), as ordered reported by the Committee on Finance on April 2, 1985. The bill would repeal the contemporaneous recordkeeping requirement for certain deductions and credits imposed by DEFRA. In addition, the bill would change regulations governing the valuation of private use of corporate airplanes.

The Congressional Budget Office has reviewed and concurs with estimates of the revenue effects of the bill prepared by the staff of the Joint Committee on Taxation. The bill would reduce fiscal year revenues by $48 million in 1985, $150 million in 1986, $225 million in 1987, $247 million in 1988, $259 million in 1989, and $270 million in 1990.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes.

Sincerely,

RUDOLPH G. PENNER.

New budget authority

In compliance with section 308(a)(1) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by the bill involve no new budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act with respect to tax expenditures, and after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by the bill will involve no new or increased tax expenditures.

IV. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the provisions of S. 245, as reported by the committee).

O