Signature WEALTH & TAX

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Failed Mileage Log Negates Mileage Deductions

Know This

1. You can spend a lot more time with the IRS when you present an inadequate log of your business mileage.
2. You can spend excessive time re-creating a mileage log that looks really good but will fail.
3. The tax code forbids the IRS from giving you vehicle deductions when you fail to keep adequate records of your business mileage.
4. The tax code forbids the courts from giving you vehicle deductions when you can't prove your mileage.
5. If you fail to keep a mileage log or other record that proves your business mileage and the IRS catches up with you, you will deduct less than your real business mileage and you might end up with no vehicle deductions.
6. Proprietors need a mileage log.
7. A corporate owner-employee needs a mileage log and needs to submit it to the corporation.

Golden Rule

Keep a mileage log.

The Fraud Case

In Flake, the IRS asserted income tax deductions of $16,240 and $58,094 and Section 6663 fraud penalties of $12,180 and $43,571.[1]

In this case, the court had to decide

1. If Jim and Martha Flake were entitled to deduct car and truck expenses greater than the IRS allowed,
2. If they were liable for tax fraud penalties under Section 6663, and
3. (in the alternative to the fraud penalties) whether Jim and Martha were liable for Section 6662(a) accuracy-related penalties.

The Audit

This tax case began when an IRS revenue officer audited the Flakes' tax returns, requested certain documentation, and met with Jim and Martha at their residence every two weeks until the examination ended about a year later.

During the audit examination, Jim and Martha provided odometer readings, credit card statements, fuel receipts, appointment book notes, and invoices as well as reconstructed calendars based on these documents. They asserted that these records met the strict substantiation requirements of Section 274(d) for vehicle deductions and that, accordingly, they were entitled to their full vehicle deductions.[2]

Section 274(d)

Before Section 274(d), you could estimate your business mileage and the IRS and the courts could accept your estimates.

Section 274(d) did away with estimates of business mileage. Today, you need to substantiate the amount of your mileage, your time, and the purpose of each use.[3] The courts may not estimate your vehicle deductions.[4]

In Court

Jim and Martha got zero help for their vehicle deductions in court because:

- They created their mileage records after the fact during the IRS audit.
- The mileage in the submitted records contained math errors and did not tie to the tax return.

In summary, the court stated that:

1. It did not find the calendars reliable or helpful in establishing Jim and Martha's car and truck expenses.
2. Jim and Martha failed the adequate records requirement because they did not establish mileage, time, and purpose of each car and truck use.
3. The IRS's allowance of mileage is correct. Jim and Martha get nothing more than the IRS allowed.

Fraud

Jim and Martha accumulated in a fireproof box a cash reserve of at least $177,000 during the 20 years before the audit. They likely triggered the audit when they took that $177,000 from their fireproof box and deposited it in the bank.

Key point. Tax law and the Bank Secrecy Act require information reporting of most cash deposits and cash payments in excess of $10,000.

In court the IRS asserted that Jim and Martha had to have fraudulently underreported their taxable income in order to have accumulated $177,000 in cash reserves. The court disagreed and found that Jim and Martha accumulated this cash because they were frugal.

The court also noted that in spite of the IRS's biweekly audit visits with Jim and Martha at their home for almost a year, the IRS failed to present clear and convincing evidence of fraud. Accordingly, the court did not assess the fraud penalty.

Accuracy Penalty

But, the Flakes were not so lucky on the accuracy penalty. They court ruled that Jim and Martha were liable for the 20 percent accuracy penalty because they had failed to know the law and to keep accurate records of, among other things, their vehicle deductions.

Takeaways

1. To cut your chances of visiting with the IRS, don't make large cash deposits in a U.S. bank. (Checks are fine, cash is the problem.)
2. Keep a mileage log to prove your business mileage.
3. Know the basics of tax law.
4. Employ a professional to help with your taxes.
5. Operate your business as a business with business books, checks, records, and receipts that prove your business income and expenses.

You want to follow the five steps above so that you don't have to do as Jim and Martha did—visit with an IRS agent every two weeks for almost a year and then have to go to court hoping to overcome the IRS assertions so that at least some of your deductions survive.

1 Flake v Comm,, T.C. Memo 2014-76
2 IRC Section 274(d)
3 Reg. Section 1.274-5(J)(2)
4 Sanford v Commr., 50 T.C. 823

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Mileage Log

Date	Beginning Odometer	Ending Odometer	Mileage	Trip Purpose

Mileage Log

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