

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200433010**

Release Date: 08/13/2004

Index Number: 274.08-00

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B07 – PLR-123139-03

Date:

April 27, 2004

Legend

Taxpayer =

Dear _____ :

This responds to your request dated April 2, 2003, as modified by your letter of August 20, 2003, for a private letter ruling that digital or electronic receipts, as described below, without any accompanying paper receipts, constitute adequate records for purposes of the substantiation requirements of section 274(d) of the Internal Revenue Code.

FACTS

Taxpayer uses a business expense credit card program under which Taxpayer pays a consolidated credit card bill for its employees' out-of-pocket expenses incurred on behalf of Taxpayer for travel and other business expenses. Employees are issued and use a corporate credit card, whenever possible, to pay for the out-of-pocket expenses. The corporate credit card is to be used solely for business purposes. Taxpayer does not permit employees to use the card for personal purposes. Currently, employees submit original paper receipts or invoices, along with a hard copy of their monthly corporate credit card statement, on which the charges appear, to Taxpayer to substantiate the employees' expenses. The expense report must show the business purpose of each expenditure, the amount of each separate expenditure, when each expenditure was made, the location at which each expenditure was made, the identities of all attendees, including third-party vendors and other employees. For expenditures for entertainment, the expense report must show the business purpose of the entertainment, the identity of the person or persons entertained for the purpose of establishing a business relationship with the Taxpayer, the amount of each expenditure, and date, place, and type of expenditure. Taxpayer asserts that it checks all expense reports monthly and at year-end. Taxpayer also asserts that it includes the amount of

any unsubstantiated credit card charges in the Forms W-2 issued to employees and in Forms 1099 issued to former employees.

In May of 2002, Taxpayer changed credit card suppliers and now has Internet access to all credit card charges. For expenditures made with the corporate credit card, the employee cardholders justify their expenditures by adding detail via this internet website. There is a 40-character field to populate with justifications for each corporate credit card charge. (Current procedures require employees to submit expenses by the 27th or 28th day following the month in which they are incurred; Taxpayer asserts that this policy is being changed to require submission by the 10th day after an expense is incurred.) The detail included in this field contains the business purpose, identity of the person or persons in attendance, and an explanation of cash expenditures (ATM withdrawals or checks drawn on the credit card account) for such items as mileage, tolls, etc. This description field is included on the monthly report electronically mailed to the credit card holder.

For all reimbursable out-of-pocket expenses incurred by employees using the corporate credit card, Taxpayer would like to use digital receipts, rather than paper receipts, as documentary support for expenses. Using digital receipts, employees are not required to provide paper receipts to support expenses. Instead, as the corporate credit card is used to pay for expenses, expenses are itemized by category. The credit card company provides Taxpayer with many options to report expenses. Taxpayer has Internet access to all transaction details, including the credit card holder, date, amount, location, name of establishment, and merchant category code of each expense.

Taxpayer can access all credit card transactions. For example, Taxpayer asserts that restaurant expenses are identified automatically by the computer program. With respect to any meal and entertainment purchase other than in a restaurant, "M&E" is required as the first three characters of the 40-character field if the expense. This field can then be sorted to isolate these meal and entertainment charges. Taxpayer asserts that this policy is enforced by audits conducted by Taxpayer's corporate accounting department.

The credit card company report itemizes air and rail travel, lodging (i.e., hotel room charges), meal, entertainment, and sundry expenses separately. Certain digital receipts automatically will include additional information such as expense type (ground travel, car rental, airfare, etc.), car rental agreement number, airline ticket number, and airline itinerary. Separate credit card transactions are obtained for room charges, meals and entertainment, and other services. Room charges may only include telephone access charges to connect to Taxpayer's approved calling card company; Taxpayer asserts that this card may only be used for business purposes. As a result, long distance charges made via cell phone or calling card will not appear on the lodging bill. Meal and entertainment expenses, such as room service, restaurant, or lounge, are charged separately to the corporate credit card as consumed and not charged to the room. Other services, including laundry and other non-meal and entertainment items,

are also charged separately to the corporate credit card as incurred and not charged to the room. Taxpayer requires the employee to retain the hotel lodging receipt.

While employee business expenses normally do not need to be approved in advance, each reimbursement request must be reviewed and approved for payment by the employee's manager. The manager's primary responsibilities are to ensure that the charges are appropriate for the work performed, are charged to the correct matter or department, and are consistent with Taxpayer's payment policies.

Taxpayer asserts that it enforces its policy by auditing the corporate credit card expenses on a regular basis. Specifically, to ensure that hotel charges include room charge and phone access charges only, not meal and entertainment or sundry expenses, Taxpayer randomly audits hotel charges to ensure that other charges are not included. The random audits are conducted using a representative sampling of charges. Other factors, including large dollar amounts, either on a single credit card company report or on multiple reports from the same employee, or a past pattern of errors, may trigger audits. A report is also generated monthly for any expenditure for which there is no required entry in the 40-character description field. If the audit controls determine that an expense is not justified or if a charge remains unsubstantiated at year-end, the employee is required to substantiate the expense by additional documentation or the amount is reported as income to the employee on the employee's Form W-2 (or Form 1099 for a former employee).

If circumstances preclude an employee from using the company credit card to pay an expense, the employee may fill out a paper form listing all expenses paid that are to be reimbursed. In such an instance, the employee is responsible for substantiating all expenses by providing paper receipts for all expenses submitted.

In situations where the company credit card is not accepted by a service provider, the employee is expected to pay the expense with a personal credit card or with cash and then reimburse himself or herself by withdrawing money from an automated teller machine or by writing a convenience check payable to himself and herself. In these situations, the ATM withdrawal and the convenience checks will appear on the employee's credit card account with the credit card company and the employee will have to provide the necessary information to substantiate the expense to the company's satisfaction.

LAW AND ANALYSIS

Section 274(d) disallows deductions under section 162 for any expense for travel away from home, including meals and lodging, or entertainment unless the taxpayer substantiates by adequate records or by sufficient evidence the requisite elements of each expenditure. For travel expenses, the taxpayer must establish the amount, time, place, and business purpose of the expenditure. Reg. § 1.274-5T(b)(2). For business entertainment expenses, the taxpayer must establish the amount, date (and possibly

duration of business discussion), place, business purpose, names and business relationship of the persons entertained, all as set forth in more detail in Reg. § 1.274-5T(b)(3) and (b)(4). Reg. § 1.274-5T(c)(2)(i) provides that, to substantiate each element by adequate records, the taxpayer must maintain: 1) an account book, diary, log, statement of expense, trip sheets, or similar record; and 2) documentary evidence that, in combination, are sufficient to establish each element of an expenditure.

Furthermore, the account book, diary, log, statement of expense, trip sheet, or similar record must be prepared or maintained in such manner that each recording of an element of an expenditure is "made at or near the time of the expenditure." Reg. § 1.274-5T(c)(2)(ii). The phrase "made at or near the time of the expenditure" means the elements of an expenditure are recorded at a time when, in relation to making the expenditure, the taxpayer has full present knowledge of each element of the expenditure, such as the amount, time, place, and business purpose. An expense account statement which is a transcription of an account book, diary, log, or similar record prepared or maintained at or near the time of the expenditure, is considered a record prepared or maintained at or near the time of the expenditure if the expense account statement is submitted by an employee to his employer in the regular course of good business practice. Reg. § 1.274-5T(c)(2)(ii)(A). An employee must use adequate records to make an adequate accounting to substantiate expenses to the payor. Reg. § 1.274-5(f)(4)(i).

Reg. § 1.274-5(c)(2)(iii) requires documentary evidence for any expenditure for lodging while traveling away from home and for any other expenditure of \$75 or more, except for transportation charges if the documentary evidence is not readily available. Acceptable documentary evidence includes receipts, paid bills, or similar evidence sufficient to support an expenditure. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the name, location, and date of the expenditures and separate amounts for each charge, such as lodging, meals, and telephone. Reg. § 1.274-5(c)(2)(iii)(B).

In Rev. Rul. 2003-106, 2003-44 I.R.B. 1, the Service considered an analogous employer's expense reimbursement arrangement for travel and entertainment expenses in which each employee received monthly billing statements from the credit card company for which they were personally liable, holding, among other things, that it met the substantiation requirements of section 274(d), with certain qualifications.

In the ruling, the employer implemented an electronic reimbursement arrangement for travel and entertainment expenses that eliminated the need for paper receipts and paper expense reports in most instances. The credit card company provided the employer with an electronic receipt for all expenses billed to an employee's business credit card. The electronic receipt contained the date of the charge, the amount of the charge, the merchant's name and, if available, an itemization from the merchant for

each expense included in the charge. The employer transferred electronic receipts received from the credit card company to a database. The employees accessed the database to create an electronic expense report to accompany the electronic receipts. The employees were required to provide 1) a description of each expense and the business purpose it provided and 2) for each entertainment expense, the names and business relationship of the person entertained in addition to the date of, place of, duration of, and participants in any business discussion that occurred directly before or after the entertainment. Employees were required to submit expense reports with any necessary receipts to the employer within 30 days after returning from a business trip or incurring travel or entertainment expenses, but no later than 60 days after incurring the expense.

Rev. Rul. 2003-106 did not approve electronic receipts in all circumstances. The employer required employees to submit paper expense reports and receipts for 1) any expense over \$75 where the nature of the expense was not clear on the face of the electronic receipt; 2) all lodging invoices for which the credit card company did not provide the merchant's itemization of each expense; and 3) any expenses paid for by the employee without using the business credit card. The employer required that the paper receipts and expense reports contain information sufficient to substantiate the amount, date, time, place, and business purpose of each expense.

Taxpayer's proposed system is similar to that of the employer in Rev. Rul. 2003-106. Rather than creating an electronic expense report on the employer's database (as in the revenue ruling), Taxpayer's employees create an electronic expense report for expenditures made with the corporate credit card by adding detail to the credit card charges that appear on the internet website, justifying each credit card charge through a 40-character field. Furthermore, Taxpayer's procedures require employees to submit the documentation of the charges by the 27th or 28th day following the month in which they are incurred; this is within the 60-day period for submitting expense reports in the revenue ruling.

In general, with certain exceptions, Taxpayer's digital receipt system meets the substantiation requirements of section 274(d), and Taxpayer will not be required to retain paper receipts and expense reports from their employees if certain conditions are met. Entries that Taxpayer's employees make on the internet website for each expenditure must contain 1) a description of each expense and the business purpose it provided and 2) for each entertainment expense, the names and business relationship of the person entertained in addition to the date of, place of, duration of, and participants in any business discussion that occurred directly before or after the entertainment.

However, regardless of whether the conditions in the previous paragraph are met, Taxpayer must require employees to submit paper receipts, and in some case paper expense reports, for: 1) any expense over \$75 where the nature of the expense is not clear on the face of the electronic receipt; 2) all lodging invoices for which the credit

card company does not provide the merchant's electronic itemization of each expense; and 3) any expenses paid for by the employee without using the business credit card. In such circumstances, the paper receipts and expense reports must contain information sufficient to substantiate the amount, date, time, place, and business purpose of each expense.

For example, if the credit card company provides an electronic receipt for an amount billed by a hotel for the lodging or a total reportable amount billed from a hotel that does not itemize each expense on the bill, the employee must provide paper documentation detailing or itemizing each expense. Also, if the employee incurs a travel or entertainment expense for necessary business reasons but pays for it without using the business credit card, the employee must submit paper receipts and a paper expense report. Thus, where the Taxpayer's employee pays an expense with a personal credit card or with cash and then reimburses himself or herself by withdrawing money from an automated teller machine or by writing a convenience check payable to himself or herself, the employee must submit paper receipts and expense reports, even though the ATM withdrawal and the convenience checks will appear on the employee's credit card account with the credit card company.

CONCLUSION

Taxpayer's digital receipts and expense reports constitute adequate records for purposes of the substantiation requirements of section 274(d), except in the situations outlined above. In those situations, paper receipts and expense reports will be required.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is conditioned on Taxpayer maintaining control over the electronic receipts and insuring their availability for each tax year in which the statute of limitations has not run.

This advice is predicated on the assumption that Taxpayer use and retention of electronic records meets the requirements of Rev. Proc. 98-25, 1998-1 C.B. 689. Any failure to comply with the requirements of Rev. Proc. 98-25 would render this advice inoperative. The ruling is also predicated on the assumption that once Taxpayer's employees have justified their expenditures by adding detail via the internet website, no further changes can be made by the employees to the website regarding those expenses.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

[s] George Baker
GEORGE BAKER
Branch Chief
ITA:07

cc: