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Presented by:

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Reconstructing Tax Records
Overview

We will discuss:

1. Adequate records
2. IRS position on record reconstruction
3. Reconstructing records.
Adequate Records
(Publication 583 & Section 274(d))

Income:
- Cash register tapes
- Bank deposit slips
- Receipt books
- Invoices
- Credit card charge slips
- Forms 1099-MISC

Purchases and Expenses:
- Canceled checks
- Cash register receipts
- Credit card sales slips
- Invoices

274(d) requires that the documents show:
- The amount;
- The time and place (or date); and
- The business purpose.
### IRS Position or Authority for Record Reconstruction

- **Publication 483**

  **Destroyed records.** If you can't produce a receipt because of reasons beyond your control, you can prove a deduction by reconstructing your records or expenses. Reasons beyond your control include fire, flood, and other casualties.

- **EITC FAQs**

  **I have a client who is self-employed but has no receipts for income or expenses. Should I refuse to prepare the return?**

  Not necessarily. You can take the opportunity to teach your clients about record-keeping requirements. If your client has any records and data on the amount earned and any expenses, you can explain how to reconstruct and/or help make a reasonable estimate of the income earned and expenses. If you choose to help your client reconstruct the records, be sure to document how you computed the income and expenses. Refusing to prepare the return is a decision only you can make.
Section 274(d) permits taxpayer to substantiate expense “by sufficient evidence corroborating his own statement”

26 CFR 1.274-5A

- (c)(1) - If record not made at or near time of expenditure, reliable documentary evidence needed to corroborate it.
- (c)5 - Reasonable reconstruction permitted when records lost due to circumstances beyond taxpayer’s control
Process

1. Interview taxpayer (Can use IRS form 11652)
   - Determine how they receive income.
   - Determine types of expenses.
   - Identify documentary evidence that can support expenses.
   - Identify sources from which duplicate records can be obtained.

2. Obtain income and expense statement
   - Use form 433-A Collection Information Statement.

3. Obtain copies of available documentary evidence (e.g., bank statements, credit card statements, etc.)
Reconstruction Process


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The following is a table of helpful example options and tools to use in reconstructing records:

<table>
<thead>
<tr>
<th>Example source</th>
<th>How to use to reconstruct records</th>
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</table>
| Appointment books or calendars | An appointment book could be used to develop:  
  - Where a taxpayer traveled to provide services, and how many trips  
  - A count of how many people were provided services  
  - A count of how many of each type of service was rendered; for example, how many haircut appointments, how many manicure appointments  
  Using summary counts of the number of each kind of service rendered, the taxpayer could apply an average or standard cost to come up with an estimate of total costs and receipts. |
| Online map tools             | Online map tools can be used to reconstruct mileage calculations.                                  |
| IRS standard allowances      | The IRS provides standard expense allowances including per diem expenses for truck drivers and standard mileage rates. |

<table>
<thead>
<tr>
<th>Examples of documentation used for reconstruction</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Checkbook, cancelled checks, bank statements or credit card statements</td>
<td>These documents can be used to gain information about expenses incurred and what types of services were performed for clients. Using summary counts of the number of each kind of service rendered, the taxpayer could apply an average or standard cost to come up with an estimate of total costs and receipts.</td>
</tr>
<tr>
<td>List of regular clients</td>
<td>Using a list of regular clients, a taxpayer could reconstruct a reasonable calendar of services. Regular expenses could be extrapolated from that information. The taxpayer could apply an average or standard cost to come up with an estimate of total receipts.</td>
</tr>
<tr>
<td>Partial receipts or sales tax records</td>
<td>Partial receipts can lend information regarding what expenses were incurred for services. The taxpayer could apply an average or standard cost to come up with an estimate of total receipts.</td>
</tr>
<tr>
<td>Cell phone records and call history or computer logs</td>
<td>Cell phone records and call history can be used to develop a list of clients served during specific timeframes.</td>
</tr>
<tr>
<td>Prior year returns</td>
<td>Prior year returns can provide the basis for records if activities are similar from year to year.</td>
</tr>
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IRS Methods for Estimating Income if there are no records

- Source and Application of Funds Method - analyze cash flows to determine income by amount expenses exceed income.
- Bank Deposits and Cash Expenditures Method - compute income by showing what happened to a taxpayer’s funds.
- Net Worth Method - Evaluate financial information to obtain increase in net worth, which indicates income for the year.
- Markup Method - use industry averages to compute income based on activity (Obtain averages from Bureau of Labor Statistics or [www.bizstats.com](http://www.bizstats.com))
- Unit and Volume Method - Apply the sales price to the volume of business
Tips for Record Reconstruction

Be thorough

▶ If substantiation is required, be thorough and recreate records for entire year.

➢ Larson v. Commissioner, TCM 2008-187 - mileage deductions permitted because record was detailed.

➢ Jarman v. Commissioner, TCM 2010-285 - mileage deductions disallowed because amounts were not corroborated and were estimated (taxpayer rounded up) - use google maps to calculate mileage; mileage can be corroborated by gas and toll charges along route.

➢ Viar v. Commissioner, T.C. Summary Opinion 2004-46, Docket No. No. 13785-02S - providing credit card statements alone is not sufficient if other requirements of 274(d) are not met.
Questions?

Contact Us!

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