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The Cohan Rule
An IRS Audit Defense Tool

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Taxpayer Advocate says the Cohan Rule is one of “indulgence”

- 2nd Circuit Court of Appeals
39 F .2d 540 (1930)





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The Taxpayer

- George M. Cohan – entertainer, playwright, songwriter, producer.
- *Give My Regards to Broadway*
- *Yankee Doodle Dandy*



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The Judge

- The esteemed and quotable Learned Hand
- “...*there is nothing sinister in so arranging one’s affairs to keep taxes as low as possible*”



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The Issue

- Cohan spent large sums on traveling and entertaining fellow actors and critics but did not keep records.



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- The IRS audits Cohan – disallows all expenses
- The Board of Tax Appeals (precursor to the Tax Court) sustains the IRS disallowance.



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The Rule

- The 2nd Circuit upholds much of the BTA's decision but based on the testimony decided there were legitimate deductible expenses
- “...*the Board should make an approximation ...bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making*”

Congress sets a limitation on Cohan

- Adds §274(d) to the IRC in 1962
- Strict substantiation rules for items such as auto expenses, travel, entertainment, and listed property
- TCJA amended §274(d) removing the reference to entertainment





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Taxpayers must provide credible evidence of expenditures even though precise amounts cannot be determined

Cohan has been used as a defense in a wide breadth of cases

- **Forman TCM 1988-64** – gambling – horse race betting
- **Briseno TCM 2009-67** – gambling – slot machine play





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- **Olive 139 TC No. 2 (2012)** – COGS in the marijuana business
- **Fortius TCS 2007-39** – expenses for a cab driver
- **Windham TCM 2017-68** – miscellaneous business expenses



Cohan defense not always accepted

- **Stewart TCM 2005-212** – evidence not sufficient
- **Harlan TCM 1995-309** – failed to reasonably reconstruct records.
- **Jones TCM 2011-77** – no evidence to corroborate taxpayer story



Congress sets another limitation on Cohan

- Careful in your research – Cohan was previously allowed for charitable contributions.
- **Hooks TCM 1993-437; Kendrick TCM 2006-9**
- §170(f)(17) added to code in Pension Protection Act of 2006 – no deduction allowed without a receipt, check or similar evidence



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- Remember – Judicial Discretion Controls – “The Court is not required to guess at a number”
- A taxpayer cannot compel the IRS or a Court to accept deductions in the absence of evidence

Not just for expenses – Cohan has been used for basis in assets

- Shank TCM 2018-33 – basis for non-deductible IRA contributions
- Huzella TCM 2017-210 – basis for coins sold on eBay
- Ternovsky 66 TC 695 (1976) – basis for stolen stamps





Cohan is a defense – can it be an offense?

- Preparers' responsibility using estimates.
- Reg. §1.274-5T(c)(3)
- AICPA Standards for Tax Services – No. 4 – Use of Estimates



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Form 8275 – A preparer’s best friend?

- Form 8275 is a disclosure form
- E-filed with the return
- Protection against penalties in §§6694 and 6662
- Urban Legend – Audit me flag – NOT true



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Wrap-Up

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