



Tax Court case provides lessons on best recordkeeping practices for businesses

Running a successful business requires more than delivering great products or services. Behind the scenes, meticulous recordkeeping plays a crucial role in financial health, compliance and tax savings. Good records can mean the difference between successfully defending a deduction and losing valuable tax breaks. A recent U.S. Tax Court decision underscores just how important this is.

Why it matters

The IRS requires all businesses — no matter how small — to maintain records that accurately reflect income, expenses, assets and liabilities. Without these records, it's nearly impossible to:

- Substantiate tax deductions and credits,
- Track cash flow and profitability,
- Prepare accurate financial statements,
- Monitor the progress of your business,
- Support decisions for financing, and
- Demonstrate compliance during an IRS audit.

In short, strong recordkeeping protects your business, both for operational and tax law purposes.

Taxpayer loses deductions due to insufficient records

In one case, a union power-line worker also had business interests in a storm response partnership, a salon and a rental property. He claimed significant losses and business expenses on his return for the year in question. Among his claimed deductions were partnership losses and expenses for tools, clothing and travel.

In Tax Court Memo 2025-12, the court disallowed substantial deductions because the taxpayer couldn't properly substantiate them. Some invoices or receipts were missing or didn't tie clearly to the business purpose.

For example, with vehicle or travel expenses, the court noted the lack of contemporaneous logs and details that distinguished business vs. personal use. For partnership losses, the taxpayer needed to show his basis in the partnership, but couldn't provide clear documentation of all his capital contributions.

In addition to denying many of the taxpayer's deductions, the court upheld an accuracy-related penalty. This is an extra charge (typically 20% of the underpayment) that can be assessed when a taxpayer makes substantial mistakes on a tax return.

This case isn't unique. Year after year, businesses lose valuable deductions for the same reason: poor recordkeeping.

Six key practices to protect tax breaks

To avoid costly mistakes, businesses should implement a recordkeeping system that's both practical and compliant. Here are six best practices to consider:

1. Separate business and personal finances. Open a dedicated business checking account and credit card. Mixing personal and business expenses is one of the fastest ways to create confusion — and attract IRS scrutiny.

2. Maintain contemporaneous records. Document expenses when they occur, not months later. For example, keep mileage logs for business driving and note the purpose of each trip.

3. Use accounting software. Modern accounting platforms (like QuickBooks® or industry-specific tools) streamline recordkeeping. They allow you to categorize expenses, generate reports and integrate with bank accounts to minimize errors.

4. Keep source documents. For example, retain purchase and sale invoices, receipts, bank statements, canceled checks, and credit card bills. Scanning or photographing

receipts ensures they won't fade or get lost. Also, keep copies of Forms 1099-MISC and 1099-NEC. There are also specific employment tax records you must keep.

5. Retain records for the right amount of time. Generally, the IRS recommends keeping records for at least three years. That's the amount of time that the tax agency can audit a tax return. However, some records (such as payroll tax or property records) should be kept longer. The length of time can be extended to six years if the income is underreported by more than 25%. And if no return is filed or fraud is involved, the IRS can conduct an audit for an indefinite amount of time.

6. Establish internal controls. For businesses with employees, internal checks help ensure the accuracy and integrity of records. Examples of these controls include requiring dual signatures for large expenses and segregating duties so that different employees handle authorization, custody of assets and recordkeeping.

Reliable records are vital

The lesson from the Tax Court case described above is clear: Without reliable records, even legitimate deductions can vanish. Don't let poor documentation cost your business money. We can help your business:

- Set up a recordkeeping system tailored to your business,
- Learn which expenses are deductible (and how to document them),
- Review its books to catch issues before the IRS does, and
- Manage any IRS challenges to tax deductions.

Contact us to discuss how we can help you establish sound recordkeeping practices and safeguard valuable tax breaks.