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Business Travel, Meals and Entertainment Rules

Rick J. Dlugasch, CPA, MST, Shareholder

A common topic amongst our self-employed clients focuses on the rules for deducting the cost of out-of-town business travel within the U.S when an overnight stay is required. We also often receive questions about business meals and entertainment expenses. We will cover both in this month's newsletter.

Business Travel

Please note, these same rules discussed below apply if you are employed and incur unreimbursed travel costs (exception - the deduction is a miscellaneous itemized deduction, subject to the 2%-of-adjusted-gross-income floor threshold).

The actual costs of travel (e.g., plane fare, cab to airport, etc.) are deductible for out-of-town business trips. You are also allowed to deduct the cost of meals and lodging. Your meals are deductible even if they are "personal," although, as with all deductible meals, only 50% of the cost is typically allowed. Additionally no deduction is allowed for meals or lodging expenses that are "lavish or extravagant," a term that has been interpreted to mean "unreasonable." Personal entertainment costs on the trip are not deductible, but business-related costs such as dry-cleaning or phone calls are.

Some allocations may be required if the trip is a combined business/pleasure trip. An important factor in determining if the trip is primarily business or personal is the amount of time spent on each, although this isn't the only factor. Let's say you fly to a location for a few days of business meetings and stay on for an additional period of vacation, the cost of meals, lodging, etc., for the business days are deductible — not for the personal vacation days. However, the cost of the travel itself (plane fare, etc.), if the trip is "primarily" business, can be deducted in its entirety and no allocation is required. On the other hand, if the trip is primarily personal, none of the travel costs are deductible. The IRS checks the nature of the meetings carefully to make sure they are not vacations in disguise. Be careful to save all material helpful in establishing the business or professional nature of this travel.

If your spouse accompanies you on a business trip, the rules are very restrictive. No deduction is allowed unless he/she is an employee of yours or your company and his/her travel is also for a business purpose. Personal expenses you incur at home as a result of taking the trip are not deductible. For example, the cost of boarding a pet while you're away isn't deductible.

Business Meals and Entertainment

Business meals and entertainment expenses require you to jump through several extra hoops to qualify as deductible and are subject to limitations. Nevertheless, if you pay careful attention to rules outlined below, the expenses should qualify as deductible.

Ordinary and Necessary Business Expenses. All business expenses must meet the general deductibility requirement of being “ordinary and necessary” in carrying on the business. These terms have been fairly broadly defined to mean customary or usual, and appropriate or helpful. Thus, if it is reasonable in your business to entertain clients or other business people you should be able to pass this general test.

“Directly Related” or “Associated With.” A second level of tests specifically applicable to meals and entertainment expenses must also be satisfied. Under them, the business meal or entertainment must be either “directly related to” or “associated with” the business. “Directly related” means involving an “active” discussion aimed at getting “immediate” revenue. Thus, a specific, concrete business benefit is expected to be derived, not just general goodwill from making a client or associate view you favorably. And the principal purpose for the event must be business. Also, you must have engaged actively during the event, via a meeting, discussion, etc.

If the “directly related” test cannot be met, the expense may qualify as “associated with” the active conduct of business if the meal or entertainment event precedes or follows (i.e., takes place on the same day as) a substantial and bona fide business discussion.

Goodwill. This test is easier to satisfy. “Goodwill” type of entertainment at shows, sporting events, night clubs, etc. can qualify. The event will be considered associated with the active conduct of the business if its purpose is to get new business or encourage the continuation of a business relationship.

Substantiation. Almost as important as qualifying for the deduction are the requirements for proving that it qualifies. The use of reasonable estimates is not sufficient to stand up to IRS challenge. You must be able to establish the amount spent, the time and place, the business purpose, and the business relationship of the individuals involved. Remember, for expenses of \$75 or more, documentary proof (receipt, etc.) is required.

Deduction limitations. Several additional limitations apply. First expenses that are “lavish or extravagant” are not deductible. This is generally a “reasonableness” test and does not impose any fixed limits on the cost of meals or entertainment events. Expenses incurred at first class restaurants or clubs can qualify as deductible. More importantly, however, once the expenditure qualifies, it is only 50% deductible.

We hope that this has been helpful to you. We recognize that everybody’s situation is different. We are always happy to speak with you about your specific situation to help clarify what tax deductions you are eligible for.

About Rick Dlugasch, Shareholder

Rick Dlugasch joined Waldron H. Rand & Company, P.C., in 1989. Rick’s expertise in real estate, technology and manufacturing provides him with a unique lens through which to view his clients’ challenges and needs. A CPA, Rick primarily focuses on corporate and partnership taxation,

taxation of high-net-worth individuals, international taxation, accounting, auditing and taxation of closely held corporations.

Rick has spoken at a variety of industry conferences on tax and real estate topics and his work has been published in *Taxes: The Tax Magazine*. Rick earned his BS in Accounting from Northeastern University and his MS in Taxation from McCallum Graduate School of Business at Bentley College.

About Waldron H. Rand & Company, P.C.

Waldron Rand, located in Needham, MA, provides unmatched accounting, auditing, tax, and consulting services to individuals and privately held businesses in a wide range of industries throughout the U.S. and globally.

At Waldron Rand, our business, tax and assurance experts are more than scorekeepers. We take a holistic approach to working with clients. For more than 100 years, we have been providing partner-level service to help our clients manage challenges and seize business opportunities. For more information or to personally speak with a partner, please call 781.449.5825 or email us at: advice@waldronrand.com.

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