



John R. Waters & Company

TAX ALERT

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Business Entertainment and Travel Expenses: What's Deductible?

The following guidelines will help you claim the deductions you deserve.

How to qualify: Deductible entertainment expenses must be both an ordinary and necessary business expense. Ordinary expenses are those that are common and accepted in your business or profession. Necessary expenses are ones that are appropriate and helpful for your business.

Entertainment expenses also must be shown to be "directly related" or "associated with" your business. To be directly related the expenditure must be primarily related to the business' active conduct; you must engage in business with the person during the entertainment; and there must have been more than a general expectation of gaining some future business benefit or income.

Entertainment is considered to be associated with your trade or business if it directly precedes or follows a substantial business discussion. For example, you can take a client to a sporting venue and deduct the qualified cost if a business discussion precedes or follows the event. No actual business need come of it as long as business was discussed.

The Limit: The deductible amount is limited to 50 percent of the cost. Transportation—to and from a business meal or entertainment venue—is fully deductible. Employees willing to pay their own expenses without reimbursement can add their entertainment expenses to their miscellaneous

deductions. Self-employed individuals deduct entertainment expenses as an income adjustment on Form Schedule C.

What's Deductible: Some limits apply when deducting entertainment expenses (e.g., only the face value of tickets is deductible.) Skyboxes or other private luxury boxes rented for more than one event at the same sports arena in the same year are limited to deducting the price of a regular box ticket for each seat. Food and beverage expenses may be deducted in addition to the allowable amounts for the skybox only when they are stated separately. Both expenses are subject to the 50 percent limit.

To qualify to deduct the cost of home entertaining, guests must be employees or have a business connection, such as being present or potential customers/clients. You also can deduct up to \$25 of the cost of business gifts to customers/clients per person annually.

What Is Not Deductible: Not all entertainment costs are deductible. Country, social or athletic club dues are classified as nondeductible. Lavish or extravagant expenses also are not allowed by the IRS. Generally, expenses for maintaining and operating facilities used to entertain clients cannot be deducted, such as hunting lodges, swimming pools, yachts, tennis courts and hotel suites. The disallowance also applies to the facility's operating costs, including rent, utilities and depreciation. It does not, however, apply to

expenses that are deductible without showing a business purpose like interest and taxes.

Records: Keeping good records is important to substantiate your business entertainment deductions. Record the date, place, amount, client/customer name and the business discussed for each deductible expenditure.

Claiming Business Travel Deductions

Why are you traveling away from home? If the reason is primarily for business it is likely those travel expenses classified as ordinary and necessary can be deducted. Deductible travel expenses include air, train or bus fare between home and your business destination and the cost of local transportation once there. Also deductible are 100 percent of lodging, telephone, dry cleaning and other expenses related to conducting business and 50 percent of meal costs.

How long will business keep you away from home? Travel expenses are deductible when the trip is long or far enough away to make it unreasonable to complete the round trip without sleep or rest.

Are expenses related to an existing business? To be deductible, travel must be for an existing business; expenses incurred in acquiring or starting a new venture are not. Those expenses must be added to start-up costs.

Are expenses lavish or extravagant? Answering “no” earns you a deduction. According to the IRS, travel expenses must be reasonable considering the circumstances. Expenses won’t be denied because you flew first class or stayed in a luxury hotel.

Is your trip’s primary purpose business or pleasure? If you add several vacation days to your business trip you may still be able to deduct your travel expenses and the business portion of your lodging and meals, provided you can show that business was the principal purpose of your trip. One factor used in determining if your trip is primarily business or pleasure is the amount of time spent on each. If the trip is mainly for personal reasons,

travel costs cannot be deducted, even if some business is conducted at your destination. You can, however, write-off business expenses incurred once you are there.

Is your spouse and employee of the business? This applies if your spouse accompanies you on a business trip. A spouse’s expenses are deductible only if he or she is an employee. To qualify for a deduction, a spouse’s travel must be for a legitimate business purpose and the expenses must otherwise be deductible by the spouse. If spouse-related expenses are not deductible, a deduction for lodging may be claimed based on the single-rate cost of similar accommodations for you, not half of the double rate.

Do you have good records to substantiate your deductions? Receipts are needed to validate travel and lodging expenses. Record the date, amount, place, purpose of business and business relationship for each expenditure. For incidental expenses and meals, a receipt is required only for expenses of more than \$75. ■

If you would like more information on this subject, please call our offices today.

To the extent the above content contains an opinion on one or more Federal tax issues, such opinion was not written to be used, and cannot be used, for the purposes of avoiding penalties.