



## **TRAVEL & ENTERTAINMENT**

The following is a brief summary of some of the provisions regarding the treatment and deductibility of meals, entertainment, travel, and gifts.

### **MEAL AND ENTERTAINMENT EXPENSES**

The tax law provides that only 50% of any otherwise deductible expenses for business meals or entertainment is allowable as a business-expense deduction. The 50% rule applies to business meals eaten or entertainment provided while away from home or locally.

Example: You spend \$100 for a business meal that meets the other requirements for a tax deduction. The amount that may be claimed as a business expense deduction is \$50.

Exceptions to the 50% rule exist, allowing full deductions for:

1. employer-furnished meals excludable from an employee's income as a nontaxable fringe benefit;
2. traditional employer-provided recreational activities (i.e., a holiday party for employees);
3. tickets for and related expenses of certain charitable fund-raising sports events; and
4. meals served on or at certain vessels, certain drilling rigs and their support camps.

Because amounts reimbursed to employees for meals are subject to the 50% rule, these amounts are not includible as wages or compensation.

### **BUSINESS-CONNECTION REQUIREMENT**

The tax law provides that meal expenses - as with other entertainment expenses - are not deductible unless they:

1. are directly related to the active conduct of the taxpayer's trade or business or
2. directly precede or follow a substantial and bona fide business discussion associated with the active conduct of the taxpayer's trade or business. Thus, no deduction is allowed unless business is discussed during, or directly before or after the meal.

Example: Businessperson **A** and Businessperson **B** have a meeting at which substantial business discussions are held. **A** and **B** break for lunch and continue their business discussions afterwards. The cost of the lunch is a deductible business expense.

An exception to the business-discussion rules applies to meal expenses incurred by an individual traveling away from home on business who eats alone or with persons, such as family members, who are not business-connected and where a deduction is claimed only for the meal of that individual.

## **OTHER MEAL REQUIREMENTS**

The tax law specifically provides that no deduction is allowed for any food or beverage expense that is “lavish or extravagant under the circumstances.” (What is considered “lavish or extravagant under the circumstances” is to be determined using standards developed by the IRS and the courts.) This disallowance rule applies whether or not the expense is incurred while the taxpayer (or the taxpayer’s employee) is away from the home and whether the taxpayer (or employee) incurs the expense alone or with others. The portion of a meal expense that is deemed lavish or extravagant is subtracted from the expense before the 50% rule is applied.

Example: You incur otherwise deductible meal expenses of \$200, though \$50 is not allowable as extravagant. The remaining \$150 is then multiplied by 50%, leaving a deductible meal expense of \$75.

The tax law also requires that the taxpayer or the taxpayer’s employee be present at the furnishing of the food and beverages. For purposes of this rule, an independent contractor who renders significant services to the taxpayer is treated as an employee - if he or she attends the meal in connection with the performance of those services.

Example: Taxpayer’s attorney, who represents Taxpayer’s business’ legal interests, has a business lunch at Taxpayer’s expense with another party to discuss Taxpayer’s business. The taxpayer-attendance rule is satisfied and the meal expense is deductible by Taxpayer, within the law’s limits.

## **OTHER ENTERTAINMENT PROVISIONS**

The tax law provides that no business-expense deduction is allowed for the cost of tickets to a sporting event or other entertainment or recreational activity to the extent the cost exceeds the face value of the tickets (except in the case of tickets for certain charitable fund-raising events). The limitation to the face value of the ticket applies before the 50% rule is applied. The tax code disallows deductions for the costs of rental or other use of a “skybox” facility at a sports arena to the extent those costs exceed the cost of regular box seat tickets. The limitation applies where the skybox is to be used by the taxpayer or a related party for more than one event (e.g., a season ticket).

Club dues (country club, golf and athletic clubs, airline clubs, luncheon clubs) are nondeductible unless it is included in compensation to an employee as a working condition fringe benefit. The same rule holds true for the travel expenses of spouses, family members, or individuals who are not employees.

## **SUBSTANTIATION REQUIREMENTS**

Entertainment expenses, together with business travel expenses and certain other business-related expenditures, are subject to strict substantiation requirements. To deduct such expenses, a taxpayer has to substantiate (by adequate records or other sufficient evidence corroborating the taxpayer’s own statement):

1. (who) the business relationship of the person(s) entertained or visited;
2. (what) the amount of an expense (certain expenditures of less than \$75 are subject to less stringent rules - i.e., no documentary evidence, such as a receipt, is required);
3. (when) the time and place of the expense or travel; and
4. (why) the business purpose.

These requirements also apply to all meal expenses. Accordingly, no deduction is allowed under the tax law for a meal or entertainment expense (or other expense subject to the substantiation rules) if the substantiation requirements are not satisfied.

## **TRAVEL EXPENSES**

We’ve all heard the story about the business tycoon who, in traveling on business to Europe, takes a luxury cruise ship instead of an airplane - and deducts the cost as a business expense. Or the story about the high-school French

teacher who deducts the cost of traveling to France for the summer to maintain familiarity with the language and culture.

The tax law now limits - or eliminates altogether - the business-expense deduction for certain types of travel. First, the law provides that the amount of any otherwise allowable deduction for business travel by cruise ship is limited. The limit: Twice the highest per diem allowance given Federal employees for travel in the U.S. times the number of days in transit.

Second, no deduction is allowed for the costs of travel that would be deductible only on the premise that the travel itself constitutes a form of business-related education.

Transportation costs are deductible only if the trip is related primarily to the taxpayer's business. Primarily can be interpreted as meaning more than 50% of your time at the destination was devoted to business.

### **BUSINESS GIFTS**

The costs of ordinary and necessary business gifts to individuals other than employees are deductible, subject to a \$25 per-year per-person limit. Gifts to employees aren't deductible as gifts, but may be deductible as compensation. Certain noncash awards to employees are deductible, as a general rule up to \$25 per-person limit (the traditional Thanksgiving turkey).

### **CONVENTION EXPENSES**

The tax law continues to allow a business-expense deduction for the costs of attending business-related conventions or similar meetings. However, no deductions allowed for travel or other costs of attending a convention, seminar, etc., with respect to investment-related activities. Thus, the registration fees, travel costs, meal and lodging expenses, etc., related to a convention connected with investing, financial planning, or other non-business income-producing activities are not deductible.

No business expense deduction is allowed for meetings outside of North America (U. S., Puerto Rico, U. S. Virgin Islands, the Trust Territory of the Pacific Islands, Canada, Mexico, Bermuda and certain Caribbean countries). However, there is an exception if it is not reasonable to hold the meeting in North America.

### **BUSINESS USE OF RESIDENCE TELEPHONE**

A business expense deduction is barred for any portion of the standard, monthly base charge (including any sales or excise taxes imposed on such charge) for the telephone line in a taxpayer's residence. The rule does not affect the deductibility of other types of telephone charges, such as for long distance calls, or of business or income-production use of any additional telephone line in the residence.

### **LIMITATIONS ON LISTED PROPERTY**

The availability of depreciated deductions for "listed property" is restricted. This term embraces automobiles and other forms of transportation if the property's nature lends itself to personal use (airplanes, trucks, boats, etc.), entertainment, recreational and amusement property, computers and peripheral equipment, cellular telephones and similar telecommunications equipment. Depreciation deductions for such property is limited. You are required to maintain records to support the business use percentages and adjust for any usage less than 100%.

To simplify record keeping, a company can reimburse employees for actual automobile business mileage at 32¢ per mile.

## BUSINESS USE OF CELLULAR TELEPHONES

Cellular telephones have been added to the definition of “listed property.” What does this mean? First, no accelerated depreciation is generally allowed for a cellular phone where, in the year it is placed in service, it is not used more than 50% for trade or business purposes. Second, for an employee, no depreciation deduction or deduction for lease payments is allowed unless use of the phone is for the convenience of the employer and is required as a condition of employment. Third, no deduction is allowed with respect to a cellular phone unless adequate substantiation of use is maintained.

Management is responsible for the proper recording of transactions in the books of accounts, for the safeguarding of assets, and for the substantial accuracy of the financial records. you have the final responsibility for the income tax returns.

The law provides for a penalty to be imposed where a taxpayer makes a substantial understatement of their tax liability. For corporate taxpayers, a substantial understatement exists when the understatement for the year exceeds the greater of 10 percent of the tax required to be shown on the return or \$10,000. The penalty is 20 percent of the tax underpayment. Taxpayers may seek to avoid all or part of the penalty by showing:

1. that they acted in good faith and there was reasonable cause for the understatement,
2. that the understatement was based on substantial authority, or
3. that the relevant facts affecting the item’s tax treatment were adequately disclosed on the return.

You agree to advise us if you wish disclosure to be made on your returns or if you desire for us to identify or perform further research with respect to any material tax issues for the purposes of ascertaining whether, in our opinion, there is “substantial authority” for the position proposed to be taken on such issue in your returns.

The law provides for a penalty of 20 percent to be imposed on any underpayment that results from negligence or disregard of rules or regulations. Negligence “includes any failure to make a reasonable attempt to comply...” with the code. Disregard “includes any careless, reckless or intentional disregard.” Taxpayers may seek to avoid all or part of the penalty by showing they acted in good faith and reasonable cause for the understatement can be demonstrated.