

Epstein Group, PC Newsletter – Summer 2008

With summer in full-swing, the time is ripe for discussions of business travel and business meals. We frequently get questions about what is deductible travel and what is a deductible meal, especially this time of year. I hope I can clear up some of the confusion around this subject

Business Travel

The rules for deducting the cost of your out-of-town business travel within the U.S. only apply if the business conducted out of town reasonably requires an overnight stay. Rules for travel outside the U.S are more complex, and we won't address them here.

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 during the trip are deductible even if they are "personal," i.e., not connected with business, although, as with all deductible meals, only 50% of the cost is allowed. Additionally, no deduction is allowed for meal or lodging expenses that are "lavish or extravagant," a term that has been interpreted to mean "unreasonable."

Personal entertainment costs on the trip aren't deductible, but business-related costs, such as for dry cleaning, phone calls, and computer rentals are. So if you go to a movie on your trip, it's not deductible, but if you spill a latte on your suit you plan to wear for the big meeting, dry cleaning is deductible.

Some allocations may be required if the trip is a combined business/pleasure trip. For example, if you fly to a location for five days of business meetings and stay on for an additional period of vacation, only the cost of meals, lodging, etc., for the business days are deductible – not for the personal vacation days.

The next question we'll tackle is whether you deduct traveling costs, such as airfare on a combined business/pleasure trip. If the trip is primarily business, the travel cost can be deducted in its entirety and no allocation is required. Conversely, if the trip is primarily personal, none of the travel costs are deductible. 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 sole factor.

If the trip doesn't involve the actual conduct of business but is for the purpose of attending a convention, seminar, etc., be careful to save all material helpful in establishing the business or professional nature of this travel. IRS checks the nature of the meetings carefully to make sure they are not vacations in disguise.

The rules on deducting the costs for your spouse if he or she accompanies you on a business trip are very restrictive. No deduction is allowed unless he or she is an employee of yours or your company, and his or her travel is also for a business purpose.

Finally, note that personal expenses you incur at home as a result of taking the trip aren't deductible. For example, the cost of boarding a pet while you're away isn't deductible.

Business Meals

There is even greater confusion around the deductibility of business meals. Here are some guidelines:

(1) **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 businesspeople, then you should be able to pass this general test.

(2) **“Directly related” or “associated with.”** A second level of tests especially 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 that the meal or event you go to is clearly about furthering your business. If you are a realtor and you are signing a listing agreement with a client over lunch, there is no question this is a business meal. If you're working late on a project with a deadline tomorrow and you and your staff continue to work on the project while eating dinner, again, there is no gray area here; it's deductible.

The directly related test can also be met if the meal or entertainment takes place in a clear business setting directly furthering your business, i.e., where there is no meaningful personal or social relationship between you and the others involved. This doesn't mean that friends and relatives can't be involved in a business meal; it just means that the purpose of the meal is to do business. Meetings or discussions that take place at sporting events, night clubs, or cocktail parties – essentially social events – would not meet this test.

If the “directly related” test cannot be met, the expense may qualify as being “associated with” the active conduct of business if the meal or entertainment event happens the same day or reasonably close to the time you conduct business. So sign that big contract, and then take the client to a Blazer game, and then you can deduct the cost of the game.

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. For meals, you (or an employee of yours) must be present; if you simply cover the cost of a client's meal after a business meeting but don't join him at it, the expense does not qualify.

(3) **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. Obviously, you must set up careful and detailed record-keeping procedures to keep track of each business meal and entertainment event and to justify its business connection. For expenses of \$75 or more, documentary proof (receipt, etc.) is required.

(4) **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. Obviously, this rule severely reduces the tax benefit of business meals and entertainment. If you spend about \$50 a week on qualifying business meals, or \$2,500 for the year, your deduction will only be \$1,250, for tax savings of around \$300 to \$400.

I hope this helps you understand the somewhat confusing issues for deducting travel and meals.

When discussing travel and meals deductions, documentation is critical. So with these and all deductions, make sure you have a good accounting system (better than a cocktail napkin) and keep it up to date. Fill in that memo area of your check or write a note on that charge slip.

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Have a great summer!

Victor & the staff at Epstein Group