Business Travel and Entertainment Expense Deductions
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Resources

IRS Publications:
  225-Farmer’s Tax Guide
  529-Miscellaneous Deductions
  521-Moving Expenses
  535-Business Expenses
  946-How to Depreciate Property
  1542-Per Diem Rates

Forms
  1040:
    Schedule A – Itemized Deductions
    Schedule C – Profit or Loss from Business
    Schedule C-EZ – Net Profit from Business
    Schedule F- Profit or Loss from Farming
  2106: Employee Business Expenses
  2106: EZ: Unreimbursed Employee Business Expenses
  4562: Depreciation and amortization
  526: Charitable Contributions
Training objectives

When you have completed this training, you will

- Be familiar with the general terms associated with business travel and entertainment expense
- Understand the difference between business and personal purposes
- Know which kinds of expenses can be claimed and which cannot
- Understand how to substantiate expenses
- Be familiar with the resources at your disposal
Overview

This training module covers expenses associated with travel away from home and entertainment for business purposes and discusses

a. The difference between personal and business purposes
b. When travel is considered travel away from home
c. When entertainment can be deducted
d. How to keep accurate and adequate records
e. How to file expenses on a tax return
Who can claim business travel and entertainment expenses?

A person who is an employee or sole proprietor and incurs gift, travel, or entertainment expenses related to his or her business may claim deductions. Rules differ for corporations.

Travel expenses are “the ordinary and necessary expenses of traveling away from home” for business (IRS Publication 463).
Who cannot claim business travel and entertainment expenses?

f. An employee who is reimbursed for travel expenses by his/her employer

g. A person who has no regular place of business or a regular location where he/she lives is considered an itinerant and is not eligible to claim travel expenses because he/she is never traveling away from home.

h. Members of the Armed Forces who are on permanent duty assignments overseas are not considered to be traveling away from home and are, therefore, not eligible to deduct expenses associated with travel

i. Expenses incurred for another individual such as a spouse or dependent are not deductible unless

1. The individual is an employee or a business associate who meets the same criteria listed earlier in this document
2. The individual has a business reason for travel, and
3. The individual would have been allowed to deduct his/her own expenses
Travel

Travel expenses incurred while away from home can be claimed when the following criteria are met:

**Tax home**
A tax home can be defined as a person’s regular place of business, which includes the region where it is located. An individual is away from his/her tax home for the purpose of performing his/her job.

*Example:* A person’s place of business is just outside of the city limits in Hometown, USA. The city of Hometown as well as other outlying regions is included in the definition of the tax home.

If a person has two places of business, the tax home is the main business location. To determine the main place of business, consider

a. The total time spent in each location
b. The level of business activity in each location
c. The amount of income generated from each location
3. If a person does not have a regular business location due to the nature of the work, the tax home may then be where the person lives.

Note: If a person does not live in his/her tax home, the cost of traveling between the tax home and the family home is not deductible. Expenses associated with meals and lodging while at the tax home are not deductible.

4. In order to perform the duties of the job, an individual is required to be geographically distant from his or her tax home for longer than a day.
   a. Sleep and rest are required to occur in order to perform the duties of the job while traveling.

Note: Napping while in a vehicle or en route does not meet the requirement.
Temporary assignment

When an individual is placed on a temporary work assignment that requires him/her to be at a location different from his/her tax home and it makes it impractical to return to his/her tax home daily, the individual is on a qualified temporary assignment from which certain expenses can be claimed.

j. A temporary assignment is one that lasts for one year or less. Assignments lasting longer than one year are considered to be indefinite and become the new tax home. Expenses that are reimbursed or compensated for by an employer must be reported as income.

Note: Moving costs associated with the new tax home may be deductible. Refer to IRS Publication 521, Moving Expenses, for more information.

k. Federal employees who are part of a federal crime investigation are not subject to a one-year limit and are able to deduct travel expenses while away from their tax home if they meet the following criteria in addition to the criteria already stated:
1. Be certified by the Attorney General as traveling for the federal government
2. Be on a temporary duty status.
Deductible travel expenses

Expenses that are ordinary and necessary are deductible.

**Meals** can be deducted when
1. An individual needs to stop to rest or sleep while performing work away from home
2. The meal is related to business entertainment.

*Note:* Meals that are beyond the reasonable and expected for the situation are considered lavish or extravagant and are not deductible. Meals that are taken at high-end restaurants or clubs are not automatically considered lavish or extravagant.

**Meal cost** can be determined by using either of the following methods:
1. **Actual cost** Fifty percent of the actual cost before any reimbursement can be deducted
2. **Standard meal allowance** Individual may use a pre-established amount for his/her meals and incidental expenses (M&IE). The 2011 standard meal allowance per diem is $46. If an individual is in the transportation industry, the per diem meal rate is $59 in the United States and $65 for travel outside of the U.S.
Note: The standard meal allowance cannot be used when traveling for medical or charitable reasons.

Note: Incidental expenses can only be claimed based on actual cost or by using a $5 per day deduction and are not subject to a percentage limitation; however, the per-diem method can only be used in the event that no meal expenses were incurred.

Incidental expenses include

1. Fees and tips paid
2. Transportation between places of lodging or business places where meals are taken
3. Mailing costs for reimbursement vouchers and payments

Nondeductible travel expenses

1. If a person who is on temporary assignment returns to his/her tax home on days off work, meals and lodging expenses incurred while at the tax home are not deductible.
2. If a person is on probationary status and will retain permanent employment upon successful completion of the probationary period, he/she is not considered on temporary assignment and is not allowed to deduct expenses incurred during the probation.
Allowable expenses for travel in the United States

Expenses for travel in the continental United States and District of Columbia can be deducted if the travel was primarily for business and not primarily for personal reasons.

a. Travel expenses incurred for trips taken primarily for business purposes can be deductible. If a business trip is extended for personal reasons (as for a vacation), only the expenses incurred for the portion of the trip that was for business purposes can be deducted.

Deductible expenses include

1. Costs associated with getting to and from a business destination
2. Business-related expenses incurred at the business destination

b. Travel expenses incurred for trips taken primarily for personal reasons are not deductible. If business is conducted while on a personal vacation, qualifying business expenses are deductible.

Note: Just because a promoter advertises a trip as a business trip does not automatically make it a qualified business expense. Attending a lecture or viewing a business videotape also does not qualify the trip as a business trip.
Allowable expenses for travel out of the United States

Expenses for travel out of the continental United States and District of Columbia may be limited based on if the travel was primarily for business or primarily for personal reasons and are determined by the following:

c. The purpose of the trip was taken entirely for business even if the entire time wasn’t spent on business
d. The individual does not have substantial control over arranging the trip
e. The time spent outside the U.S. is not more than one week
f. Less than 25% of the trip is spent on personal activities
Conventions

Conventions can be deducted when attendance can be proved to benefit the business or company.

Conventions that are held outside of North America are not deductible for an attendee except in the following circumstances:
1. The convention is directly related to the business
2. The convention held outside the United States is just as reasonable as it would be if it were held within the United States.

Seminars, meetings, or conventions held on cruise ships
Conventions, seminars, or other business meetings held on any ship that sails is considered to be held on a cruise ship. A limit of $2,000 per year of related business expenses can be deducted if
1. The seminar or meeting relates directly to the business.
2. The ship is registered in the United States.
3. All ports of call are in the United States.
4. The appropriate records are kept and submitted.
Business-related entertainment expenses

Business-related expenses for entertaining clients may be deductible. The following tests help determine if expenses qualify as deductible.

**Directly-related test**

Expenses for entertainment purposes must meet the following criteria:
1. The combined business and entertainment event is held primarily to conduct business.
2. Business is conducted during the entertainment period.
3. Business conducted would increase the likelihood of a business benefit at some future time.

*Note:* Business conducted on hunting and fishing trips and on yachts or pleasure boats is generally not considered the primary reason for the trip or entertainment event and is, therefore, not typically deductible.

**Associated test**

Expenses for entertainment purposes must meet the following criteria to be considered deductible even if the entertainment expenses did not meet the directly-related test criteria. The entertainment
5. Must have a clear business purpose, such as the following:
   a. Be related to the active pursuit of business
   b. Be for the purpose of getting new business
   c. Be for the purpose of promoting the continuation of existing business
1. Must occur directly before or after a substantial business discussion such as
   a. A discussion that actively pursues business
   b. A discussion that occurred on the same day as the entertainment

c. **The 50% limit** applies to entertainment expenses just as it does for meal expenses unless an individual is a transportation worker.

d. **Exceptions to the 50% limit** include those meals or entertainment expenses that are incurred by
   1. An employee who is reimbursed for expenses by his/her employer
   2. An individual who is self-employed if
      a. The expenses were incurred as an independent contractor
      b. The expenses are reimbursed by a client or customer (who provides an allowance for such expenses)
      c. Adequate records are kept
   3. Providing meals, entertainment, or recreation to the public as a means of promoting or advertising business or fostering goodwill in the community
   4. The sale of meals or entertainment, goods or services, or use of facilities (*IRS Publication 463*).
   5. The purchase of a package that includes a ticket to a qualified charitable sports event (*IRS Publication 463*).
Allowable expenses for entertainment

Entertainment may include any of the following but is subject to qualification based on the other criteria and rules discussed throughout this training module

a. Nightclubs
b. Social clubs
c. Athletic clubs
d. Sporting clubs
e. Theaters
f. Sporting events
g. Yachts
h. Hunting, fishing, or vacation trips
i. Meal as entertainment
j. Entertainment ticket (face-value only)
Entertainment expenses that cannot be deducted

Some entertainment expenses are not deductible and can be described as follows:

a. Entertainment tickets when the price is higher than the price of the face value - only the face value can be deducted.
   Skyboxes and private luxury boxes when the price includes attendance in the same box for more than one event - only the price of a non-luxury box seat can be deducted.

b. Expenses for spouses (except as noted earlier)

c. Club dues and membership fees including
   1. Country clubs
   2. Golf clubs
   3. Athletic clubs
   4. Airline clubs
   5. Hotel clubs
   6. “Clubs operated to provide meals under circumstances generally considered to be conducive to business discussions” (IRS Publication 463).
Gifts

Gifts given to individuals for business purposes can be deducted when they are

a. Not more than $25 per person gifted per year.
b. Incidental costs associated with giving the gift but are not generally included in determining the value of the gift.

c. When a gift can be considered entertainment, it is generally considered entertainment and rules for entertainment deductions apply.

Example: Gift wrapping is incidental, and the cost of gift wrapping is not included in the value of the gift.
Recordkeeping

a. Deductions for travel away from home, entertainment, gifts, and transportation expenses while traveling away from home must be substantiated.

b. The following elements must be provable by having the information and receipts when needed for the expense:
   1. Amount
   2. Time
   3. Place or description
   4. Business purpose or business relationship

c. Evidence of the expense may include the following:
   1. Receipts
   2. Canceled checks
   3. Bills

d. Accurate and adequate recordkeeping should be kept on a regular basis. Records should be kept in something such as
   1. An account book
   2. Diary
   3. Log
   4. Statement of expense
   5. Trip sheet

e. Evidence/records are not needed when
   1. Meals or lodging expenses while traveling away from home are accounted for under a plan with an employer
2. Meals or lodging expenses while traveling and a per diem allowance is used.

f. Proof of business purposes must be provided. A written statement of the purpose will usually suffice and is not necessary when the purpose is clear and is based on the circumstances/documentary evidence.

g. Incomplete records will require that a written or oral statement be used instead in addition to any other supporting evidence that substantiates the expense.

h. Records that have been destroyed can be reconstructed to prove expenses.

i. Separate events require separate expense records.

Example: A dinner event with a client and a theater event following the dinner with the same client are two separate events and each must be substantiated separately.

j. Car expenses incurred as part of a round-trip event or uninterrupted business use may be substantiated with one record.

k. Records should be kept as long as necessary to meet the provisions of the Internal Revenue Code, which is generally three years from the date of the return.
Reporting Expenses

a. Self-employed individuals must use
   1. Schedule C or C-EZ of Form 1040 if a sole proprietor
   2. Schedule F of Form 1040 if a farmer.

b. Car and truck expenses may require use of Form 1040 Schedule C, Schedule C-EZ, or Form 4562. Refer to IRS Publication 463 for further information.

c. Individuals who are both self-employed and employees use Form 1040 Schedule C, C-EZ, or F as above, and Form 2106 or 2106-EZ.

d. Individuals who are employees use Form 2106 or 2106-EZ.
Glossary

*Ordinary expense:* One that is common and accepted in a person’s trade or business.

*Entertainment:* Any activity generally considered to provide entertainment, amusement, or recreation and includes meals provided to a customer or client.

*Incidental expenses:* Fees and tips paid to workers, transportation between places of lodging, business places where meals are eaten, and other items such as mailing costs.

*Necessary expense:* Expenses that are deemed to be needed as part of doing business and are, therefore, allowable.

*Travel expenses* are “the ordinary and necessary expenses of traveling away from home” for business (IRS Publication 463).