

Business Deductions for Meals and Entertainment

Determining what qualifies has legitimate deductions for meals and entertainment can be challenging task for any business. Paying careful attention to the rules and restrictions will help you make informed decisions.

What are the requirements for deducting meals and entertainment? The rule is that all business expenses must meet the general deductibility requirement of being “ordinary and necessary” for the business. You can deduct ordinary and necessary expenses to entertain a client if:

- all expenses must be directly related to or associated with the active conduct of business
- your expenses are of a type that qualifies as meals or entertainment
- you keep adequate records and can substantiate the expense

If the expense qualifies it is 50% deductible. Expenses that are “lavish or extravagant” are not deductible (this is a “reasonableness test and does not impose any fixed limits on the cost of meals or entertainment). Legal fines and penalties, such as parking tickets, are never tax deductible.

Entertainment expenses can include entertaining guests at social or athletic events, the theater, vacations, or nightclubs. The cost of meals provided to clients or customers can also be an entertainment expense. A meal expense includes the cost of food, taxes, and tips. You can also deduct 50% of the cost of attending business meetings, receptions, or dinners; entertaining business clients and customers at a restaurant or other location; and when traveling on business whether you eat alone or with others on business.

Along with the guidelines of “ordinary and necessary” for gauging a business expense, there is a second level of testing known as “directly related” and “associated-with”. All business expenses for meals or entertainment must be either “directly related to” or “associated-with” the business.

Directly-related to test means that the meal or entertainment will directly benefit your business. You expect to see business derived from the expense. The main purpose of the event must be business and you actively engage in business discussions. There can be no meaningful personal or social relationship between you and the others attending the event. If the directly related to test can not be met, than the expense may fall under the associated-with classification. This is a more lenient test and is easier to satisfy. Under this test the expense must be associated with the active conduct of your business and/or directly precede or follow a business meeting or discussion. The event purpose must be to generate new business or retain existing business relationships. If the event is a meal, you or one of your employees, must be present.

For any expenses of \$75 or more documentary proof is required. Detailed and consistent recordkeeping is important in order to keep track of expenses. A receipt describing the item and cost along with a canceled check, credit card statement or credit card charge slip are usually sufficient in proving the purpose and amount of the expense. For entertainment and gift expenses you should write the person(s) receiving the gift or being entertained on the back of the receipt or in an expense log. It is best to keep all records that substantiate your spending for four years since the IRS has three years to challenge your return.

pg. 6)

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If traveling away from home on business, the cost of travel (plane tickets, cab rides to and from the airport, etc) is deductible. You may also deduct the cost of lodging. While traveling out of town on business, your personal and business related meals are all deductible up to 50% of the cost. If the trip is business and pleasure combined, the deduction depends on the primary purpose of your travel. If the trip is primarily business than deductions are allowed. However, if the trip is primarily pleasure than no travel costs are deductible. There are no deductions allowed for a spouse accompanying you on a business trip unless your spouse is an employee of yours or your company and is traveling for business purposes as well.