

Don't overpay your income taxes by overlooking expenses which you are entitled to deduct. Use this Financial Guide to ensure you are handling your business travel and entertainment costs in a tax-wise manner.

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This Financial Guide shows you how to take advantage of all of the travel and entertainment expenses you're legally entitled to and offers guidance on which expenses are deductible and what percentage of them you can deduct. It also discusses the importance of following IRS rules for keeping records and substantiating your expenses in order to avoid an audit.

Travel Expenses

Tax law allows you to deduct two types of travel expenses related to your business, local and what the IRS calls "away from home".

1. First, local travel expenses. You can deduct local transportation expenses incurred for business purposes, for example the cost of getting from one

- location to another via public transportation, rental car, or your own automobile. Meals and incidentals are not deductible as travel expenses, although as you will read later in this guide, you can deduct meals as an entertainment expense as long as certain conditions are met.
2. Second, you can deduct away from home travel expenses-including meals and incidentals; however, if your employer reimburses your travel expenses, your deductions are limited.

Local Transportation Costs

The cost of local business transportation includes rail fare and bus fare, as well as the costs of using and maintaining an automobile used for business purposes. For those whose main place of business is their personal residence, business trips from the home office and back are considered deductible transportation and not non-deductible commuting.

Note: Please see the special section below for the most effective ways of deducting [auto expenses](#).

You generally cannot deduct lodging and meals unless you stay away overnight. Meals may be partially deductible as an entertainment expense, as discussed below.

Away From-Home Travel Expenses

You can deduct one-half of the cost of meals (50%) and all of the expenses of lodging incurred while traveling away from home. The IRS also allows you to deduct 100% of your transportation expenses--as long as business is the primary reason for your trip.

To be deductible, travel expenses must be "ordinary and necessary", although "necessary" is liberally defined as "helpful and appropriate", not "indispensable". Deduction is also denied for that part of any travel expense that is "lavish or extravagant", though this rule does not bar deducting the cost of first class travel, or deluxe accommodations or (subject to percentage limitations below) deluxe meals.

What does "away from home" mean?

To deduct the costs of lodging and meals (and incidentals-see below) you must generally stay somewhere overnight. In other words, away from your regular place of business longer than an ordinary day's work and you need to sleep or rest to meet the demands of your work while away from home. Otherwise, your costs are considered local transportation costs, and the costs of lodging and meals are not deductible.

Where is your "home" for tax purposes?

The general view is that your "home" for travel expense purposes is your place of business or your post of duty. It is not where your family lives. (Some courts say it's the general area of your residence).

Example: George's family lives in Boston and George works in Washington, DC. George spends the weekends in Boston and the weekdays in Washington, where he stays in a hotel and eats out. For tax purposes, George's "home" is in Washington, not Boston, therefore, he cannot deduct any of the following expenses: cost of traveling back and forth between Washington and Boston, cost of eating out in Washington, cost of staying in a hotel in Washington, or any costs incurred traveling between his hotel in Washington and his job in Washington (the latter are considered non-deductible commuting costs).

There are some rules in the tax law concerning where a taxpayer's "home" is for purposes of deducting travel expenses that are less clear such as when a taxpayer works at a temporary site or works in two different places.

We'll cover these rules briefly in these two examples:

Example #1: Joe, who lives in Connecticut, works eight months out of the year in Connecticut (from which he usually earns about \$50,000) and four months out of the year in Florida (from which he usually earns about \$15,000). Joe's "tax home" for travel expense purposes is Connecticut. Therefore, the costs of traveling to and from the "lesser" place of employment (Florida), as well as meals and lodging costs incurred while working in Florida, are deductible.

Example #2: Susan works and lives in New York. Occasionally, she must travel to Maryland on temporary assignments, where she spends up to a week at a time. Assuming Susan's employer does not reimburse her for travel expenses, she can deduct the costs of meals and lodging while she's in Maryland, as well as the costs of traveling to and from Maryland. This holds true because her work assignments in Maryland are considered temporary, since they will end within a foreseeable time. If an assignment is considered indefinite, that is, expected to last for more than a year, under the tax law, travel, meal, and lodging costs are not deductible.

Here's a list of some deductible away-from-home travel expenses:

- Meals (limited to 50%) and lodging while traveling or once you get to your away-from-home business destination.
- The cost of having your clothes cleaned and pressed away from home.
- Costs for telephone, fax or modem usage.
- Costs for secretarial services away-from-home.

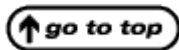
- The costs of transportation between job sites or to and from hotels and terminals.
- Airfare, bus fare, rail fare, and charges related to shipping baggage or taking it with you.
- The cost of bringing or sending samples or displays, and of renting sample display rooms.
- The costs of keeping and operating a car, including garaging costs.
- The cost of keeping and operating an airplane, including hangar costs.
- Transportation costs between "temporary" job sites and hotels and restaurants.
- Incidentals, including computer rentals, stenographers' fees.
- Tips related to the above.

However, many away-from-home travel expenses are not deductible or are restricted in some way. These include:

- *Commuting expenses.* The costs of traveling between your home and your job are not deductible.
- *Travel as a form of education.* Trips that are educational in a general way, or improve knowledge of a certain field but are not part of a taxpayer's job, are not deductible.
- *Costs of looking for a first job.* If you are looking for a new job in your current field, you can deduct the travel expenses. Otherwise, you may not deduct them.
- *Seeking a new location.* Travel costs (and other costs) incurred while you are looking for a new place for your business, or for a new business, must be capitalized and cannot be deducted currently.

- *Luxury water travel:* If you travel using an ocean liner, a cruise ship, or some other type of "luxury" water transportation, the amount you can deduct is subject to a per-day limit.
- *Seeking foreign customers:* The costs of traveling abroad to find foreign markets for existing products are not deductible.

Tip: Starting in 2008, travel (and other) costs incurred in unsuccessfully trying to acquire a specific business are currently deductible.



Entertainment Expenses

There are limits and restrictions on deducting meal and entertainment expenses. Most are deductible at 50%, there are a few exceptions. Meals and entertainment must be "ordinary and necessary" and not "lavish or extravagant" and directly related to or associated with your business. They must also be substantiated. (We'll cover this below.) For employees who are "fully reimbursed" (see below), the limits are imposed on the employer, not the employee.

Your home is considered a place conducive to business. As such, entertaining at home may be deductible providing there was business intent and business was discussed. The amount of time that business was discussed does not matter. Likewise, if you hold a small party (less than 12 people) at your home and discuss business with your guests it may be deductible as well.

Reasonable costs for food and refreshments for year-end parties for employees, as well as sales seminars and presentations held at your home are 100% deductible.

If you rent a skybox or other private luxury box for more than one event, say for the season, at the same sports arena, you generally cannot deduct more than the price of a non-luxury box seat ticket. Count each game or other performance as one event.). Deduction for those seats is then subject to the 50% entertainment expense limit.

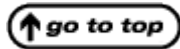
If expenses for food and beverages are separately stated, you can deduct these expenses in addition to the amounts allowable for the skybox, subject to the requirements and limits that apply. The amounts separately stated for food and beverages must be reasonable.

Deductions are disallowed for depreciation and upkeep of "entertainment facilities"-yachts, hunting lodges, fishing camps, swimming pools, and tennis courts. Costs of entertainment provided at such facilities are deductible subject to entertainment expense limitations.

Dues paid to country clubs or to social or golf and athletic clubs are not deductible. Dues that you pay to professional and civic organizations are deductible as long as your membership has a business purpose. Such organizations include business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards.

Tip: To avoid problems qualifying for a deduction for dues paid to professional or civic organizations, document the business reasons for the membership-the contacts you make and any income generated from the membership.

Entertainment costs, taxes, tips, cover charges, room rentals, maids and waiters are all subject to the 50% limit on entertainment deductions.



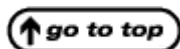
How Do You Prove Expenses Are "Directly Related"?

Expenses are directly related if you can show:

- There was more than a general expectation of gaining some business benefit other than goodwill.
- You conducted business during the entertainment.
- Active conduct of business was your main purpose.

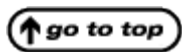
There is a presumption (in the eyes of the IRS) that events that take place in what it considers places non-conducive to doing business are not directly related to your business. These places include nightclubs, theaters, sporting events or cocktail parties. It also includes meetings with a group of people who are not business associates, at cocktail lounges, country clubs, or athletic clubs.

However, you can overcome the presumption by showing that you engaged in a business discussion or otherwise conducted business during the event.



How Do You Meet The "Associated With" Test?

Even if you can't show that the entertainment was "directly related" as discussed above, you can still deduct the expenses as long as you can prove the entertainment was "associated" with your business. To meet this test, the entertainment must directly precede or come after a substantial business discussion. Further, you must have had a clear business purpose when you took on the expense.



For Whom Can You Get The Deduction?

The person entertained must be a business associate. That is, someone who could reasonably be expected to be a customer or conduct business with you, including an employee or professional advisor.

In circumstances where it's customary to entertain a business associate with his or her spouse, and your spouse also attends, entertainment of both spouses is deductible, thanks to the "closely connected rule".