



RESOURCE

Updated September 2016

Overview of Meals and Entertainment Expenses®

There are two overriding aspects to optimizing your Meals and Entertainment deductions:

- Understanding what expenditures are potentially deductible
- Understanding the mandatory documentation rules

50% Limitation for (most) Business Meals and Entertainment

In general, all otherwise deductible business meals and entertainment expenses will only be deductible to the extent of 50% of the actual cost, including tips and tax.

EXCEPTIONS: Some meal and entertainment expenses are 100% deductible. The major categories or exceptions are:

1. Traditional employee recreation (holiday party, summer outing, etc.). (Categorize these expenses in a category other than meals and entertainment – e.g. “Meals & Entertainment 100”).
2. Packaged food as a business gift (fruit of the month, bottle of wine, etc. – but limited to \$25 per year per person under the “gift” limitation rule).
3. **On-site** employee meals for the convenience of the employer. This exception could apply to a staff meeting held in the office or doctor’s lunch on-site for valid business purpose (paperwork, weekly meeting with office manager, etc.).
4. Tickets and other costs related to certain qualified charitable sporting and other events.

In order for a business meal or entertainment expense to be deductible, the expenditure must either be "directly related to" and/or "associated with" the active conduct of your trade or business. Simplified, this means that an actual and meaningful business discussion is held during the course of the meal/entertainment or substantial business was conducted immediately preceding or following. This activity must be clearly associated with the active conduct of your trade or business.

If the meal expense is incurred when traveling away from home **on business** overnight, it is deductible at 50% of the cost regardless of fitting either of the "directly related to" and/or "associated with" tests.

The general "goodwill" lunch or entertainment is not deductible, unless active business has been conducted immediately before, during, or after the meal.

Example: *A dentist hosts a party at a restaurant. The party is attended by some patients, persons who referred patients and fellow dentists but no specific business is conducted or discussed. This would not qualify under the "directly related to" or the "associated with" test. Therefore, even though the individuals involved were business related, since there was no specific business discussed or transacted, the expenditures would not be deductible. Had the party followed a substantial meeting of the same parties in regard to referring more patients to the office or perhaps a clinical study meeting the expenditures would qualify for deduction.*

Tickets to Entertainment – Including Sporting Events: If you give tickets away to customers, clients or patients and do not attend the event, curiously, the Internal Revenue Service¹ allows you to deduct these as either gifts (subject to the \$25 per year per person rule) or as entertainment, subject to the 50% rule. Keeping in mind that the \$25 gift rule is per person per year, you may choose either gift status or 50% entertainment – whichever is greater. In short, if the face value of the ticket is less than \$50, gift treatment will achieve the greater deduction. If the face value of the ticket exceeds \$50 or you have already met the annual gift maximum for this individual, then 50% entertainment yields the greater deduction.

Note: Tickets and other costs related to certain qualified charitable sporting and other events can qualify for 100% deduction. These are very special events (golf, tennis, etc.) and qualification should be obtained from the sponsors.

Documentation is still required as described below, except you will not have to meet the requirement of a business meeting or discussion during or directly before or after the activity. Your maximum deduction is 50% of the lesser of what you paid for the ticket or its face value. Agency fees or scalper mark-ups do not count.

Season Tickets: You may only deduct season tickets on a ticket by ticket basis. Meaning, you must account for and maintain contemporaneous documentation as described below for each use of the tickets. If you provide tickets to customers, clients or patients and do not attend, you can deduct as described immediately above. If you attend, you must meet the test of directly related or associated with the active conduct of business rules – in other words, a meaningful business deduction must be held in close proximity to the event. Note: You can also provide tickets to staff members on an "occasional" basis – in which case you can deduct as 50% entertainment and as a de minimis fringe benefit (i.e. not taxable to the employee).

Non-deductible Tickets include those tickets that are unused, tickets that you use but cannot establish a business purpose (directly related to or associated with the active conduct of business) or tickets which may have been deductible but lack documentation.

- If you routinely purchase tickets through your practice, you should allocate the cost at year end in your accounting software between 50% meals and entertainment, gifts and non-deductible. Classify the latter as draws or distributions. Make sure you retain your records related to who and how the tickets were used and the business relationship.

Recordkeeping

1. If you maintain your own books and records, you should set up a separate account to track business meals and entertainment expenses separately from all other such expenditures. You should have a

¹ IRS Publication 463 (2010)

second account (or category) to capture those meal and entertainment expenditures that are 100% deductible.

2. If you are using credit cards for meals and entertainment expenses, and/or otherwise have cash disbursements that may cover a variety of expense categories, you will need to separately break out the portion of these payments relating to business meals and entertainment. (Note: In QuickBooks, use a separate Credit Card register for each card used for business).

DOCUMENTATION: All meals and entertainment; in order to be deductible and by law, must have contemporaneous documentation as to the expense, the business relationship, business purpose and actual topic or topics. ***Without contemporaneous documentation – your deduction will be flatly denied and there are no Mulligans!***

What Documentation is Required: First, for all expenditures that exceed \$75, you must have proof of the expenditure itself in the form of a receipt. In addition, the following are generally required:

- The amount of the expense
- The time and place of the meal and/or entertainment
- The business purpose of the expenditure
- The business relationship of the various parties who attended

As noted above, without such records, your deduction will be flatly denied – even if you can prove the expenditure, unless you have contemporaneous documentation that meets the criteria above.

- Recordkeeping Idea: For most of us, we will tend to use a credit card for most if not all of our business meals and entertainment. Consider documenting the items above on your receipt and then maintaining these receipts by tax year.
- Scanning: To reduce your paperwork and to avoid the problem of fading credit card slips, consider scanning your receipts by year and by date – perhaps with the vendor name included for easy correlation to your credit card bill. You can hand write the information noted above before scanning and/or if your software allows, you can type the information after scanning. Either way you have a well organized and retrievable set of documentation for your meals and entertainment expenditures by year – which will be very handy if audited.

Club Dues and Entertainment Facilities Generally Not Deductible

Dues for clubs organized for business, pleasure, recreation or other social purposes, are no longer deductible. However, actual expenses for qualified meals, entertainment, etc. can be deductible in part or whole. Exceptions to this rule include civic/charitable organizations such as Kiwanis, Rotary, professional/trade organizations and societies.

LAVISH AND EXTRAVAGANT. In addition to the above, to be deductible, meals or entertainment must be an ordinary and necessary expense of the business. To the extent that the expenditures are considered "lavish and extravagant" they will not be deductible. "Lavish and extravagant" are relative terms which are based on the facts and circumstances.

With very limited exception, entertainment facility base expenses (dues, rents, etc.) are not deductible. Examples include yachts, hunting or fishing lodges, swimming pools, tennis courts, airplanes, apartments, condos, etc. However, out of pocket expenses, such as greens fees or meals that meet the rules discussed previously can qualify for deduction.

For more information or answers to your specific expenditures, please call or e-mail.