

Let the IRS Entertain You and Your Clients

By Jeff Schnepfer

IRS rules for business-related meals, entertainment and gifts allow you substantial opportunities to convert personal expenses into deductions.

How would you like to get a discount of 14% to nearly 20% on your meals and entertainment expenses? Or how about all those gifts you sent during the holidays to business clients? If your meals and entertainment expenses were deductible, a \$100 meal would cost only \$86 if you're in the 28% tax bracket.

How? Tax laws allow you to deduct half of your meals and entertainment expenses if they're business-related. Any expenses for food and drink provided under circumstances considered favorable to a business discussion, or when a business discussion is held, can be deducted. If you're self-employed, you can deduct them as part of your adjustments to income. If you're an employee, you add them to your miscellaneous deductions.

You can also deduct up to \$25 for each business-related gift given to a client or business associate during a tax year. You'll need to keep the receipts as proof, but the result can save you at tax time, particularly if you typically send several gifts at holiday time each year.

Entertaining business clients

By far, the most commonly used aspect of this deduction relates to entertainment and food, however. The custom of entertaining business clients or potential business clients with food and drink in restaurants and hotels converts your personal feeding frenzies into deductible expenses. When you go out with friends or relatives for a meal or drink, do you ever pick up the check? If they are or could be potential clients or customers for your business, and you discussed business with them, then that check would be deductible.

Even if you don't talk business at the meal, it will be deductible if the meal follows or precedes a bona fide business discussion. Recognize that no actual business need come from the meeting so long as business was discussed. Now don't use this method as a way to alternate who pays for lunch or dinner with your best friend. Any "regular" exchange of meal checks, if caught by the Internal Revenue Service, will be disallowed as a sham in an audit and subject you to fraud penalties. However, don't hesitate to deduct legitimate expenses.

Moreover, not only can you deduct meals, but you can also deduct business entertainment expenses. Money spent for business entertainment, amusement or recreation can be deducted if you can show the expense:

Directly preceded or followed a substantial bona fide business discussion; or;

Directly related to the active conduct of your trade or business.

Examples of potentially deductible expenses include entertaining guests at nightclubs, theaters, sports games, or even vacation trips. In one case, an anesthesiologist was allowed to depreciate his fishing boat and deduct the expenses for entertaining doctors on the boat who were his referral sources.

For meals and entertainment, you must substantiate the following:

The amount of each expenditure;

The date of the expenditure;

The name, address or location, and type of expenditure, such as dinner or theater, if the information is not apparent in the name or designation of the place;

The reason for the expenditure or the business benefit derived or expected to be gained. While this sounds complicated, it's really easy. I'm a tax attorney. My expenditures are to get a new tax client or to help someone in the tax planning process. If I sold insurance, my reason would be to either get a new client or to sell more insurance;

The occupation or other information about the person or persons entertained, including the name, title or other designation sufficient to establish the business relationship to you.

You must have a receipt or other documentary evidence for meals or entertainment expenses of \$75 or more. Currently, for expenditures of less than \$75, you do not need a receipt. Fully acceptable substantiation would include a diary or written planner in which you enter the above descriptive information. Those diary entries are all you would need. Even in an audit, the entries are complete substantiation under the law.

While most meals or entertainment expenses can only be deducted for half of the cost, certain meal and entertainment expenses remain fully deductible:

Expenses treated by an employer as compensation to an employee;

Expenses reimbursed under an "accountable plan;"

Expenses incurred for recreational or social activities provided by the employer for the benefit of its employees. These might be the annual company picnic or holiday party;

Expenses for goods, services and facilities made available to the general public, such as promotional tickets or customer samples;

Expenses related to the ticket package costs for sporting events arranged primarily for the purpose of charitable fund-raising.

The deductions for meals and entertainment allow you substantial opportunities to convert your personal expenditures into business deductions.

Do not fail to claim them and do not fail to keep them because of lack of adequate substantiation. In the 31% tax bracket, \$100 worth of football tickets costs you \$84.50. No matter how much money you're making, it would be worth \$15.50 in tax savings to spend 30 seconds noting the name of your business clients and the business discussion on the back of your ticket stub.