A Report on Meals, Entertainment and Travel Expense Deductions

With the new tax law already in place, a lawyer’s report on the 80 percent business meal deduction might prove helpful.

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Effective for tax years beginning after December 31, 1986 business meals and business entertainment are deductible (subject to the new eighty (80%) percent rule) only if “directly related to” or “associated with” the active conduct of a taxpayer’s trade or business. Generally, business meals or business entertainment satisfy this “directly related to” requirement if the following conditions are met:

1. Taxpayer has more than a general expectation of deriving income, or a specific business benefit, from the meal and entertainment. The taxpayer is not required to show that income or a specific business benefit actually resulted;
2. The taxpayer did actually engage in business discussions during the meal or entertainment;
3. The principal nature of the expense was the active conduct of taxpayer’s trade or business; and
4. The meal or entertainment was for the taxpayer, his business guests and their spouses.

Business meals or entertainment fulfill the “associated with” requirement if it directly precedes or follows a substantial and bona fide business related discussion. This business discussion must be substantial in relation to the meal or entertainment. If the taxpayer’s business guest is from out of town, then the meal or entertainment can occur the day before or after the business discussion.

The cost of a business meal or business entertainment will not be deductible to the extent that it is “lavish and extravagant” under the circumstances. The cost of beverages and food are deductible as a business meal only if the taxpayer or his representative is present at the meal. The representative can be the taxpayer’s employee, or an independent contractor acting on his behalf.

Effective for tax years beginning December 31, 1986, the deduction for allowable business meals and business entertainment is limited to eighty (80%) percent of its cost. This new law applies to meals while away from home and overnight on business, and meals provided by employers to employees. In addition to meals and entertainment, also subject to the eighty (80%) percent rule are taxes, tips and other expenses relating to the meal or entertainment. The transportation to and from business meals or entertainment is not subject to the eighty (80%) percent rule. Thus, a twenty ($20.00) dollar cab fare to meet a client or customer for dinner would produce a twenty ($20.00) dollar business deduction.

A taxpayer may deduct eighty (80%) percent of the cost of meals consumed while he is away from home overnight on business. If the taxpayer eats alone this automatically qualifies the meal as being directly related to the taxpayer’s trade or business, or if he eats with non-business connected persons and deducts only his meal. However, if the taxpayer, while away from home, has a meal with a business client or associate he can deduct eighty (80%) percent of the cost only if the meal is “directly related to” or “associated with” his trade or business.

If an employee is reimbursed for his cost of business meals and entertainment and he makes an adequate accounting to his employer for such expenses, then the eighty (80%) percent rule will apply to the employer who is reimbursing the employee, while the employee does not have to report the expense or the reimbursement on his tax form.

An Exception . . .

One exception to the eighty (80%) percent rule which would directly apply to trade association conventions is the “qualified banquet meeting” exception. Prior to January 1, 1989 there is a full deduction allowable for the cost of meals that are provided as an integral part of a “qualified banquet meeting” so long as the charges for the meals are not separately stated. A “qualified banquet meeting” can be a convention, seminar, annual meeting or other similar business meeting as
long as each of the following conditions are satisfied:

1. The registration fee must include the meals, and the cost of such meal should not be separately stated;

2. More than fifty (50%) percent of the meeting’s attendees are away from home;

3. At least forty (40) persons attend the banquet meeting; and

4. The meal is part of the banquet meeting and includes a speaker.

Beginning January 1, 1989, “qualified banquet meeting” meals will be subject to the eighty (80%) percent rule. Thus, organizations sponsoring such meetings will have to separately state the cost of all meal functions and twenty (20%) percent of such expenses will be disallowed as a business deduction.

Business Expenses for transportation and lodging may be one hundred (100%) percent deductible. Any lodging expenses which include meals or beverages would be subject to the eighty (80%) percent deductible rules. Such travel costs incurred to attend a convention or seminar will be one hundred (100%) percent deductible so long as these expenses are ordinary and necessary and incurred to carry on a trade or business. If such expenses are incurred for travel to an educational or investment seminar, then no deduction would be allowed. However, this disallowance for educational travel will not apply if the deduction relating to travel is necessary to engage in an activity that results in a business deduction relating to education at the destination point.

Foreign travel expenses including meals and lodging outside the United States must be allocated based on the amount of time spent for business and the amount of time spent for pleasure. If the trip is for not more than one (1) week of if the time spent for personal reasons is less than twenty-five (25%) percent of the total time away from home then no allocation is required. If the trip is longer than a week and twenty-five (25%) percent or more of the time away from home is spent for personal reasons, then a deduction for travel expenses will be disallowed to the extent that such expenses are not allocable to the taxpayers trade or business. No allocation is required if the individual traveling has no substantial control over the arrangements
of the business trip or personal vacation was not a major consideration in making the trip.

### Primary Purpose . . .

If no allocation is required then the “primary purpose” test is applied. If a taxpayer takes a trip and while at his destination engages in both business and personal activities, then the full amount of travel expenses are deductible only if the trip is primarily related to the taxpayer’s trade or business, even though personal activity is engaged in. If the trip is personal in nature then the travel expenses are not deductible although one engages in business activities while at his destination. However, business expenses incurred while at such destination would be deductible even though travel expenses are not. The “primary purpose” test rules set forth in this paragraph also apply to domestic travel expenses.

The foreign convention deductibility rules provide that no deduction is allowable for expenses allocable to a foreign convention unless such meeting is directly related to the active conduct of the taxpayer’s trade or business or to an income-producing activity. Further, that it is as reasonable for the meeting to be held outside the North American areas as within it. Factors to be taken into account are:

1. Purpose of the meeting and the activities taking place at the meeting;
2. The purpose and activities of the sponsoring organization or group;
3. The residences of the active members of the sponsoring organization or group and the places which other meetings of the organization or group have been held or will be held; and
4. Any other relevant factor.

A foreign convention is any convention, seminar, or similar meeting held outside the United States, its possessions, the Trust Territory of the Pacific Islands, Canada, or Mexico. In addition, convention costs incurred in the Caribbean may be deductible if the country is a “designated beneficiary country” and there is a bilateral or multilateral agreement providing for the exchange of tax information with the United States.

As is evident there are very technical and restrictive rules that apply to the deductibility of business meals, entertainment, travel and foreign convention expenses that should be consulted in order to determine the likelihood of withstanding an I.R.S. challenge.