

DEDUCT T&E EXPENSES RIGHT

FINANCE REPORT



“Is the cost of today’s activities tax deductible?” That’s the question one of my land care clients recently asked me at a fancy dinner after a Green Industry golf outing.

Having just been through a tax audit for another client where the Internal Revenue Service (IRS) auditor disallowed most of his travel and entertainment deductions on his prior three years of tax returns, I replied, “It might be.”

“Are you kidding? This day is absolutely deductible,” my client replied with righteous indignation. He’s probably correct, but it’s because several tests for deductibility had been passed—not just because he was having a great day on the golf course with his buddies.

Many businesses deduct expenses

AVOID EXPOSING YOUR COMPANY TO AN AUDIT.

BY DANIEL S. GORDON

related to travel, meals and entertainment and hope the statute of limitations passes, thereby avoiding disallowance of those expenses upon audit. Take note: New IRS technology makes that a risky strategy.

In fact, the IRS receives millions of tax returns each year and it doesn’t have the resources to go through them all, so it uses an automated computer-based scoring system called the Discriminant Inventory Function System (DIF).

According to the IRS website, the DIF score rates the potential for change or irregularities based on past IRS experience with similar returns. Though the calculation of the actual scoring system is a well-kept secret, the purpose behind the programming is likely an attempt to determine which returns would have the most potential of generating additional revenue for the IRS through audit.

Traditionally, travel, meal and entertainment disallowances have been a significant revenue generator for the IRS, and it’s likely that if the deductions you take are outside the norm, you will be audited. That does not mean there will be an audit adjustment, just that you will be audited. How well you keep records showing your compliance with the law will determine if there will be an adjustment—and if so, how much.

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T&E DEDUCTION RULES

So what are the rules for deductibility of travel, meals and entertainment? Here are four to consider:

1 Business purpose. For travel, meals and entertainment to be deductible, the expenses must meet the “business purpose” requirement. Under this requirement the expenses of attending a convention or meeting, including the cost of travel, meals, lodging and incidental expenses, are deductible as a business expense as long as the professional can prove that his or her attendance primarily benefits or advances the interest of his own employment or business. Generally, travel expenses paid or incurred for a spouse or other family member aren’t deductible unless the family member is a company employee, has

a bona fide business purpose for the travel and otherwise would be allowed to deduct the travel expenses if not a family member.

2 50 percent reduction. Landscape professionals generally may deduct meals and entertainment expenses incurred for business purposes. However, deductions for meals and entertainment must be reduced by 50 percent. Specifically, this reduction applies to any expense for food or beverages and any cost for an entertainment activity.

3 No club dues. Another rule related to meals and entertainment relates to membership dues for social or country clubs. The landscape professional must remember the dues or initiation fees to such clubs are not deductible, although amounts expended specifically for business

meals and entertainment while at these clubs is deductible subject to the 50 percent limitation.

4 51/49 split for combo trips. For purposes of travel, the landscape professional can deduct all travel expenses if a trip was entirely business related. If the trip was primarily for business but extended a few days to make a personal side trip, you can only deduct the business-related travel, which includes the cost of getting to and from the business location as well as related expenses. Caveat: When a combination business and personal trip is taken domestically, there’s the 51 /49 percent rule, which precludes a travel deduction to and from the business destination if the trip is more than half personal. Therefore, the business purpose should account for more than half the time spent away to deduct the travel.



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IT'S LIKELY THAT IF THE DEDUCTIONS YOU MAKE ARE OUTSIDE THE NORM YOU WILL BE AUDITED.

BURDEN OF PROOF

The burden of proof is on you. To deduct travel, meals and entertainment without having them disallowed upon audit, you need to maintain meticulous records.

Specifically stated in the regulations, you cannot deduct amounts that you approximate or estimate. You will need to retain source documents, such as receipts, cancelled checks and credit card statements. It's helpful to retain meeting or convention brochures and agendas to fulfill your burden of proof.

In the case of an audit, timely accurate and well-organized information is paramount.

For your records to be considered "timely-kept," record the expense and supporting information at or near the time of the expense. The IRS considers a timely-kept record more valuable than a statement prepared later.

Source documents are typically considered adequate if they show the amount, date, place and essential character of the expense.

You must keep records as long as

they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you should keep records that support your deduction for three years from the date you file the income tax return on which the deduction is claimed.

If you don't follow the guidelines, don't be surprised if you get audited, are precluded from taking a deduction listed on your tax return and are forced to repay the tax plus penalties and interest. A good reading of IRS publication 463 should provide the information needed to comply with the tax laws as they apply to the deductibility of travel, meals and entertainment. **LM**

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