Meal & Entertainment Expenses Tests

Taxpayer: ______________________________ Tax Year: ______________

Congress and the IRS have limited the deductibility of Meals and Entertainment expenses. Entertainment expenses must be both ordinary and necessary in carrying on your trade or business **and** they must meet one of the following two tests:

The directly-related test, **or**
The associated test

Directly Related Test (Setting & Purpose Key)

The expense **must meet all** of the following requirements:

1. You must have more than a vague expectation of deriving some income or other specific business benefit (other than a favorable attitude of the person entertained) from the meal or entertainment. However, you don't need to show that income or other business benefit actually resulted from each deducted expenditure.
2. During the meal or entertainment, you actively engaged in business discussions.
3. The main purpose of the combined business and entertainment is the active conduct of business.

Associated-With Test

Meals and entertainment expenses may be deductible under this more lenient test if they meet the following two requirements (Both Tests):

1. The expenses are associated with the active conduct of your business. This means that there was a clear business purpose, including getting new business or bolstering an existing business relationship.
2. The meal or entertainment directly precedes or follows a substantial and bona fide business discussion

In addition you must document the meeting.

Under Sec. 274(d), for certain expenses, taxpayers are required to be able to provide specific detailed information to substantiate the expenses. As the recent case of Garza, T.C. Memo. 2014-121, demonstrates, this is an all-or-nothing proposition. Without proper substantiation, no deduction is allowed for a Sec. 274(d) expense, even if the court believes that a legitimate expenditure was made.

Whenever you incur an expense for business-related entertainment, meals, gifts or travel, you must document the following five facts:

1. **The date**. The date the expense was incurred will usually be listed on a receipt or credit card slip; appointment books, day planners, and similar documents have the dates preprinted on each page, so entries on the appropriate page automatically date the expense.
2. **The amount**. How much you spent, including tax and tip for meals.
3. **The place**. The nature and place of the entertainment or meal will usually be shown by a receipt, or you can record it in an appointment book.
4. **The business purpose.** Show that the expense was incurred for your business — for example, to obtain future business, encourage existing business relationships, and so on. What you need to show depends on whether the business conversation occurred before, during, or after entertainment or a meal.
5. **The business relationship.** If entertainment or meals are involved, show the business relationship of people at the event — for example, list their names and occupations and any other information needed to establish their business relation to you.

Business Gifts Are Subject to Limits ($25 per person per tax year)

Small business owners often give gifts to clients, customers and, even employees, in the course of their business, particularly around the holidays. Although you can deduct the cost of certain gifts as a business expense, there are substantial limitations on what you can deduct.

Most "gifts" to an employee will be treated as taxable compensation for the employee, which is deductible for your business under the normal rules for employees' pay (must be included on their Form W2).

Gift Deduction Limit Is $25 Per Recipient

Your business can deduct a maximum of $25 for business gifts you give to any one person **during your tax year**. This means that no matter how many of your employees, co-owners, or business partners give a customer a business gift, you tax deduction will be limited to $25 per recipient. Any expense over $25 can not be deducted—it simply comes out of your pocket (or the profits of the business.) For example, if you give a client a $50 dollar watch as a gift, you can only deduct $25.

Taxpayer Statement.

I have read the above requirements for deducting meals, entertainment, and gifts.

I certify that all amounts provided in my tax organizer, self prepared schedules, lists, and/or receipts comply with the above requirements. That for meals and entertainment I meet either the directly-related test, **or** the associated test. That for each event claimed as a deduction I meet the five requirements of substantiation. That I have maintained the required documents which support the deductions claimed.

I certify that I am not claiming any gifts to an individual or couple in excess of $25.

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Signature Date

____

Printed Name

Joe Garrison SM

Joseph E. Garrison, CPA, PA
Certified Public Accountant
Voice: 727/535-2257 Fax: 727/478-4564 e-mail: dunedincpa@gmail.com

Is Your Expense Reimbursement Policy Compliant with IRS and DOL Guidelines?

Have you reviewed your expense reimbursement policy recently to determine if it adheres to the Internal Revenue Service (IRS) and/or Department of Labor (DOL) guidelines? With the start of the New Year, now is a great time to review your policy and determine whether it is compliant.

Let's take a look at what the IRS guidelines entail. Most expense reimbursement plans are structured as *accountable plans*. An *accountable plan* exists when an employee is reimbursed for expenses or receives an allowance to cover expenses only when the following conditions are met:

- There must be a business reason for the expense. The expense must be in connection with the performance of services as an employee.
- The expense must be substantiated or deemed substantiated. There must be receipts and invoices that document the nature and amount of the expenditure(s). Deemed substantiation includes using mileage allowance rather than actual expenses for operating a vehicle.
- Employees must return to the employer amounts in excess of substantiated expenses within a reasonable time. The return should be made either from a periodic (within 60 days of travel) statement or at fixed date (quarterly if on perpetual travel status).

If your plan does not meet the above conditions or if your employees or officers are not adhering to the policy as designed, the IRS may take the position that you are operating under a non-accountable plan. If this were to occur, the amounts reimbursed would be considered **income** to the employee and should be included on his/her FormW-2 as taxable income. Making sure your expense reimbursement policy is compliant and adhered to is very important, to ensure reimbursements are not considered taxable.

The IRS does provide an exception to keeping records (actual receipts) for any expense, other than lodging, that is less than $75.

Your policy may include the use of *per diem* allowances for meal and/or lodging expenses during travel. The IRS considers this deemed substantiation and therefore this is still considered an *accountable plan.* The amount of the expense that is deemed substantiated for each calendar day is equal to the lesser of the per diem allowance for that day or the amount computed at the Federal per diem rate for the locality of travel for that day (Federally established amounts – see http://www.gsa.gov/portal/content/104877).

If you are not using a per diem allowance, the IRS requires the Five "Ws" to be documented for proper substantiation for **actual meal receipts**:

- Who was there?
- Why the meal was considered official business?
- Where did the meal occur?
- What was the cost of the meal?
- When did the meal occur?

The IRS also requires that **automobile expenses** be appropriately substantiated. Your policy should describe how the employee/officer determines business use of an automobile that is owned/leased by the organization. Your policy should include the use of a contemporaneous mileage record and personal use of the vehicle *must* be included in taxable income.

For organizations that are subject to regulation by the Department of Labor's Office of Labor-Management Standards (OLMS) or Employee Benefits Security Administration (EBSA), the following information is provided to make sure your organization is also in compliance. The DOL, as does the IRS, requires the 5 Ws to be documented for all expenses reimbursed.

416 Douglas Avenue
Dunedin, Florida 34698

Post Office Box 1221
Dunedin, Florida 34697-1221

The DOL requires that your policy must provide for original receipts and written descriptions of the above. A lost receipt should be the exception and your reimbursed expense policy should require a signed statement from the employee or officer regarding any lost receipts. There should be substantiation for *all* reimbursed expenses, i.e., the IRS rule for anything under $75 is not applicable for organizations regulated by the DOL.

Specifically, for **meal** expense reimbursements, the DOL requires *itemized receipts* which detail every individual item ordered on the bill. This requirement is not satisfied with just the credit card charge slip – your reimbursement policy must require both the credit card charge slip (which should include the tip) and the detailed *itemized receipt*.

Many organizations provide advances for employees that will be on official business travel status and this is an acceptable practice. However, the DOL can take the view that **advances** for travel are considered loans unless the following conditions are met:

- The advance does not exceed the amount reasonably expected to be incurred and is accounted for or repaid within 30 days of the trip; or
- The advance is a standing advance to officer/employee who must frequently travel on official business and the advance does not exceed average monthly travel expenses and employee/officer does not exceed 60 days without engaging in official travel.

Similar to the IRS, the DOL requires certain substantiation for use of **organization-owned/leased** vehicles. This substantiation includes a contemporaneous mileage log detailing the following for each trip:

- Date of travel
- Number of miles driven
- Whether personal or business (if business, indicate purpose)
- Odometer reading

If your policy allows for the reimbursement of automobile expenses related to **personal automobiles**, the DOL requires at least one record that includes date of travel, locations traveled to and from, number of miles driven, and business purpose of each use.

Take a look at your organization's policy for reimbursing employee/officer expenses and make sure your policy is compliant with government regulations. Then make sure you are adhering to your policy.