

Deducting Meals and Entertainment Expenses

How much of my meals and entertainment expense can I deduct and what documentation do I need to support the deduction? Many business owners struggle to answer these questions, especially as Internal Revenue Service and state audits are increasingly challenging these items by asserting lack of business purpose or inadequate business documentation.

First, to qualify as a deduction, the expense must meet all of the following criteria:

- It must not be lavish or extravagant, generally interpreted as meaning that the expense must be reasonable considering the facts and circumstances.
- The taxpayer or taxpayer's employee must be present when the meals are furnished or entertainment occurs.
- The expenditures are "ordinary and necessary" (i.e. it is customary to entertain clients or other business people in your business).
- The expenditure was directly related to or associated with the taxpayer's business. This can be satisfied by showing that a business benefit was expected. In other words, the primary purpose for the meeting was to get new business or enhance a current business relationship.

Second, you need to properly document the deductible expenditure. With the IRS increasing their efforts in this area, proper documentation has become increasingly important. Estimates generally will not hold up in an IRS audit.

To substantiate meals and entertainment expense, at a minimum, you must document the following:

- Amount spent (receipt, credit card statement)
- Type of activity (breakfast, dinner, baseball game, etc.)
- Time, place, and individuals in attendance (from your company as well as guests)
- The business purpose, i.e. the nature of the discussion

Generally, meal expenses and most entertainment will qualify for a deduction of 50 percent of qualified cost. In a few circumstances, meals and entertainment expense may actually qualify for a 100% deduction.

A few examples of expenses that qualify for the 100 percent deduction are as follows:

- De minimis fringe benefits. To qualify, the meals must be provided to more than 50 percent of the employees at the employer's premises for the employer's convenience.
- Employer provided activity that is provided for the benefit of all employees who are not highly compensated. Such events would include summer picnics or holiday parties.
- Promotional activity provided to the general public by the company/entity/taxpayer (i.e. community appreciation celebrations).

Entertainment expenses are subject to additional limitations of deductibility. With the popularity of skyboxes or private luxury boxes at sporting events, the deduction may not be as easy as 50 percent of the cost. Assuming that the above qualifications for deduction have been met, the actual allowable deduction is 50 percent of the highest face value of a non-luxury box seat ticket. Thus, the actual allowable deduction will be significantly less than 50 percent of the total expense of the skybox or private luxury box.

In summary, the above criteria are necessary to convince the IRS that what may be viewed as a personal or enjoyable meal or entertainment expenditure does have a business purpose and therefore should be allowed as a business deduction.



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