

Chapter 6: Travel, Meals, and Entertainment

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Corrections were made to this workbook through January of 2013. No subsequent modifications were made.

Travel, meals, and entertainment expenses can be incurred by both self-employed individuals and employees of a business. Many of the requirements for deductibility are the same, but there are some differences. This chapter explains the basic rules and discusses how they are treated on Schedule C, *Profit or Loss From Business*, for the self-employed and Form 2106, *Employee Business Expenses*, for the employee.

TRAVEL AWAY FROM BUSINESS TAX HOME

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Deductible travel expenses are the **ordinary and necessary** expenses for travel away from the taxpayer's **business tax home** to execute duties of their business, profession, or job. The expenses cannot be lavish or extravagant. A **business tax home** is the entire city or general area in which the taxpayer's main place of business or work is located. If the taxpayer has multiple business locations, the time spent in each location is the most important factor in determining which location constitutes the business tax home. Other factors considered in determining the location of the business tax home include the following.

- The degree of business activity in the location relative to other locations
- Relative financial return from each location

Example 1. Bethany lives with her family in New York City (NYC). She is an aide to a senator with the New York legislature in Albany, New York, where she stays in a hotel and eats in restaurants during each work week. She returns home to NYC on weekends.

Bethany cannot deduct any of her hotel or meal expenses in connection with her employment in Albany. Albany is her business tax home. She cannot deduct the costs of traveling between NYC and Albany.

Example 2. Use the same facts as **Example 1**, except Bethany's primary job is to run the senator's NYC office. She travels to Albany at least once a week and stays overnight. Because her tax home is NYC, travel expenses to Albany are deductible.

DEDUCTIBLE TRAVEL EXPENSES

The types of expenses that may qualify for a tax deduction include the following.

- Travel by air, train, bus, or automobile including taxi fares or other costs to travel between an airport, train, or bus station and a hotel
- Costs of traveling from a hotel to the work location, or from one customer to another customer, or from one business site to the next business site
- Expenses of using a car in the course of executing job or business duties

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- Meals and lodging costs
- Tips paid for any deductible travel expense
- Dry cleaning and laundry expenses
- Costs of business calls, faxes, or other business communications made while on the business trip
- Other ordinary and necessary expenses related to the taxpayer's business travel (The nature of these expenses depends upon the nature of the taxpayer's trade, business, or profession and the business purpose of the trip.)

Additional key rules on travel expenses include the following.

- Expenses for which the taxpayer has been reimbursed are not deductible.
- Travel costs that are offset by frequent flyer points or other such programs are not deductible.
- Travel costs in regard to a **temporary** job assignment away from the business tax home **are** deductible.
- Travel costs in regard to an **indefinite** job assignment **are not** deductible because the new location becomes the new business tax home.

TRAVEL EXPENSES

Taxpayers who travel away from their **tax home** on a **temporary basis** may deduct certain travel expenses. The deductibility of the expenses depends on the facts and circumstances.

Taxpayers are traveling away from home if their duties require them to be away from the general area of their tax home substantially longer than an ordinary day's work, and they need to sleep or rest to meet the demands of their work while away from home.

Note. See the 2008 *University of Illinois Federal Tax Workbook*, Chapter 9, Individual Taxpayer Problems, for comprehensive explanations of how to determine an individual's tax home and whether a job is temporary. This can be found at www.TaxSchool.illinois.edu/taxbookarchive.

Travel within the United States

The tax treatment of travel expenses depends on how much of the trip is business related and how much occurs within the United States.

Taxpayers may deduct all their travel expenses if their trip was **entirely business related**. If the trip was primarily for business and, while at their business destination, the taxpayer extended their stay for a vacation, made a personal side trip, or had other personal activities, only their business-related travel expenses are deductible. These expenses include the travel costs of getting to and from their business destination and any business-related expenses at the business destination.

If the trip was primarily for **personal reasons**, such as a vacation, the entire cost of the trip is a nondeductible personal expense. However, taxpayers may deduct any additional expenses directly related to their business while at their destination.

A trip to a **resort or on a cruise ship** may be a vacation even if the promoter advertises that it is primarily for business. The scheduling of incidental business activities during a trip, such as viewing videos or attending lectures dealing with general subjects, **will not change a vacation into a business trip**.

Travel Outside the United States

If any part of the taxpayers' business travel is outside the United States, some of the costs of getting to and from the destination may be deducted.

Taxpayers may deduct all their travel expenses of getting to and from their business destination outside of the United States if the trip is entirely for business or is considered entirely for business. Even if the taxpayer did not spend their entire time on business activities, their trip is considered entirely for business if they meet **at least one** of the following four conditions.

1. **No substantial control** — The trip is considered entirely for business if the taxpayer did not have substantial control over arranging the trip. The fact that the taxpayer controls the timing of the trip does not, by itself, mean that they have substantial control over arranging the trip. The taxpayer does not have substantial control over the trip if they:
 - a. Are an employee who was reimbursed or paid a travel expense allowance,
 - b. Are not related to the employer, and
 - c. Are not a managing executive.
2. **Outside the United States no more than a week** — The trip is considered entirely for business for transportation purposes if the taxpayer was outside the United States for a week or less, combining business and nonbusiness activities. One week means seven consecutive days. In counting the days, the day the taxpayer **leaves the United States is not** counted, but the day **they return to the United States is** counted.

Example 3. Miranda went to Paris to attend a convention. The convention lasted from Tuesday to Thursday. She left the United States on Sunday and returned the following Sunday. The day she left the United States does not count, but the return day does. Therefore, she was away for seven days or less. All of her transportation expenses are deductible. However, her meals and lodging for Friday and Saturday are not deductible.¹

3. The trip is considered entirely for business if:
 - a. The taxpayer was outside the United States for more than a week, and
 - b. They spent **less than 25% of the total time they were outside the United States on nonbusiness activities**. For this purpose, both the day the trip began and the day it ended are counted.
4. **Vacation not a major consideration** — The trip is considered entirely for business if the taxpayer can establish that a personal vacation was not a major consideration, even if they have substantial control over arranging the trip.

If the taxpayer does **not meet one of the four conditions**, only the business portion of the cost of getting to and from their destination is deductible. Taxpayers must allocate the costs between business and nonbusiness activities to determine the deductible amount.

Note. See IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*, for information on how to determine if a day counts as a business or personal day.

If a taxpayer travels outside the United States primarily for **vacation or for investment purposes**, the entire cost of the trip is a nondeductible personal expense. If the taxpayer spends some time attending brief professional seminars or a continuing education program, they may only deduct their registration fees and other expenses that are directly business related.

¹ IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*, p. 7 (2011).

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Transportation Expenses When Not Away from Home

Taxpayers may deduct expenses for business transportation when they are **not** traveling away from home. These expenses include the cost of transportation by air, rail, bus, taxi, and so on, and the cost of driving and maintaining a vehicle.

Transportation expenses include the ordinary and necessary costs of all of the following.

- Getting from one workplace to another in the course of the taxpayer's business or profession when they are traveling within the area of their tax home
- Visiting clients or customers
- Going to a business meeting away from their regular workplace
- Getting from their home to a temporary workplace when they have one or more regular places of work (These temporary workplaces can be either within the area of their tax home or outside that area.)

Temporary Work Location

Taxpayers who **have a regular place of work** may deduct the expenses of the daily round-trip transportation between their home and a temporary location, regardless of distance.

Taxpayers who **do not have a regular place of work** but who ordinarily work in the metropolitan area where they live may only deduct daily transportation costs between home and a temporary work site **outside that metropolitan area**. These taxpayers cannot deduct daily transportation costs between their home and temporary work sites within their metropolitan area. These expenses are nondeductible commuting expenses.

Taxpayers may deduct the expense of getting from one workplace to another. However, if for some personal reason they do not go directly from one location to the other, they cannot deduct more than the amount it would have cost them to go directly from the first location to the second.

Taxpayers whose **principal place** of business is their home office may deduct the daily transportation costs between their home and another work location in the same trade or business.

Note. Union members who get their work assignments at a union hall and then go to their place of work may not deduct the costs of getting from the union hall to their place of work. These are considered nondeductible commuting expenses. Although the member needs the union to get their work assignments, they are employed at the work site, not where the union hall is located.²

Vehicle Expenses

The taxpayer has the option of using the **standard mileage rate** or keeping detailed records of actual automobile expenses. Further reference should be made to Rev. Proc. 2010-51 and IRS Notice 2010-88 for the relevant rules and the required adjustments to the basis of an automobile subject to the standard rates. For the 2012 taxation year, the standard mileage rate for a car, van, pickup truck, or panel van is \$0.555 per mile.³

Note. Beginning with the 2011 taxation year, the taxpayer can use the standard mileage method for taxis and other vehicles for hire.

² *Russell and Elsie Anderson v. Comm'r*, 60 TC No. 88 (1973).

³ IRS Notice 2012-1, 2012-2 IRB 260.

If the taxpayer qualifies to use both methods, it may be beneficial to calculate the deduction both ways to see which provides a larger deduction. However, taxpayers should also consider the long-term implications of choosing the actual car expenses method in the first year of use, because the standard mileage rate **cannot** be used in subsequent years for the same vehicle. The taxpayer must prorate the total cost of operating the vehicle on the basis of business mileage versus total mileage driven.

Note. The IRS requires the business miles to be recorded in a contemporaneous log. However, courts have allowed taxpayers to validate their business miles using other records such as an appointment calendar and car service records showing the mileage at the time of service.

Schedule C filers must complete Schedule C, Part IV, or Schedule C-EZ, Part III, if they are claiming the standard mileage rate, leasing their vehicle, or when the vehicle is fully depreciated and they are not required to file Form 4562, *Depreciation and Amortization*, for any other reason.

An employee must enter the vehicle information on Part II of either Form 2106 or 2106-EZ.

Claiming Employment Travel Expenses

For employees claiming travel expenses, the following two steps are used.

1. Details of the travel expenses, including vehicle depreciation, are calculated on either Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed Employee Business Expenses*.
2. The total amount of deductible business expenses as calculated on Form 2106 or Form 2106-EZ is then reported on Schedule A as a miscellaneous itemized deduction, subject to the 2%-of-AGI threshold.

Generally, **50%** of business-related meals and entertainment costs are deductible. For certain transportation workers, 80% of business-related meals are deductible, as discussed later in this chapter. Entertainment expenses are costs associated with activities that provide entertainment, amusement, or recreation. Examples of such activities include attending sporting events, fees for social or athletic clubs, attending theater performances, and fishing or boating. If the expenses are not reimbursed, the employee reports the expenses on either Form 2106 or 2106-EZ.

Claiming Business Travel Expenses (Schedule C Filers)

A taxpayer can deduct expenses for lodging and transportation connected with overnight travel for the business while the taxpayer is away from their tax home. As explained later, the tax home is usually the taxpayer's main place of business, regardless of where they maintain their family home. Taxpayers cannot deduct expenses paid or incurred in connection with employment away from home if that period of employment exceeds one year. Also, travel expenses for the taxpayer's spouse, dependents, or other individuals cannot be deducted unless that person is an employee of the business and the travel is for a bona fide business purpose. The expenses have to be otherwise deductible by that person.

Instead of keeping records of actual incidental expenses, a taxpayer can use an optional method for deducting incidental expenses only if they did not pay or incur meal expenses on a day they were traveling away from their tax home. The amount of the deduction is \$5 per day. Incidental expenses include fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries. Incidental expenses do not include expenses for laundry, cleaning and pressing of clothing, lodging taxes, or the cost of telegrams or telephone calls. The taxpayer cannot use the optional method on any day that they use the standard meal allowance.

A taxpayer cannot deduct expenses for attending a convention, seminar, or similar meeting held outside the North American area unless the meeting is directly related to the taxpayer's trade or business and it is reasonable for the meeting to be held outside the North American area instead of within it. These rules apply to both employers and employees. Other rules apply to luxury water travel.⁴

⁴ IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*, p. 8 (2011).

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The total deductible business meal and entertainment expenses are entered on line 24b of Schedule C. This includes expenses for meals while traveling away from home for business and for meals that are business-related entertainment. These expenses are discussed in detail in the following section.

BUSINESS MEAL EXPENSES

Business meal expenses are deductible only if they satisfy all of the following conditions.

- Directly related to or associated with the active conduct of the trade or business
- Not lavish or extravagant
- Incurred while the taxpayer or an employee is present at the meal

The taxpayer cannot deduct any expense paid or incurred for a facility (such as a yacht or hunting lodge) used for any activity usually considered entertainment, amusement, or recreation.

Membership dues for any club organized for business, pleasure, recreation, or other social purposes cannot be deducted. This includes country clubs, golf and athletic clubs, airline and hotel clubs, and clubs operated to provide meals under conditions favorable for business discussions. However, it **does not include** civic or public service organizations, professional organizations (such as bar and medical associations), business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards, unless a principal purpose of the organization is to entertain, or provide entertainment facilities for members or their guests.

There are exceptions to these rules as well as other rules that apply to sky-box rentals and tickets to entertainment events.

Note. These rules are explained in Chapters 1 and 2 of IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*.

Instead of the taxpayer maintaining detailed, accurate records for meal expenses, the taxpayer has the option of using an IRS **standard meal allowance** for daily meals and incidental expenses. Under this method, the taxpayer may deduct a specified amount, depending on where they travel. However, the taxpayer must still keep records to prove the time, place, and business purpose of the travel.

If the standard rates are used, reference should be made to IRS Pub. 1542, *Per Diem Rates*, for information on the methods used, available rates for the taxpayer's travel areas, and other details. The IRS recently reestablished the availability of the "high-low method" as an option.⁵

The standard meal allowance is the federal meals and incidental expenses (M&IE) rate. These rates differ based on the locations inside and outside the continental United States. For example, the 2012 rates for travel within Illinois range from \$46 to \$71 per day depending on where the taxpayer traveled in the state.⁶ There are special rules for partial days of travel.

If the taxpayer travels to more than one location in a day, they should use the rate in effect for the area where they stop for sleep or rest. If the taxpayer works in the transportation industry, however, there is a special rate. Transportation industry workers are discussed later in this chapter.

⁵ Rev. Proc. 2011-47, 2011-42 IRB 520.

⁶ *Per diem Rates Look-up*; U.S. General Services Administration. [www.gsa.gov/portal/category/100120] Accessed on Mar. 22, 2012.

For days a taxpayer either departs for or returns from a business trip, they must prorate the standard meal allowance. This is done by one of two methods.

1. The taxpayer can claim $\frac{3}{4}$ of the standard meal allowance, or
2. The taxpayer can use any method that they consistently apply and that is in accordance with reasonable business practices.

Transportation workers can use a special standard meal allowance if their work:

1. Directly involves moving people or goods by airplane, barge, bus, ship, train, or truck; and
2. Regularly requires them to travel away from home and, during a single trip, usually involves travel to areas eligible for different standard meal allowance rates.

Note. Transportation industry workers are discussed later in this chapter in the section entitled “Hours of Service Employees.”

Deduction Amount

In most cases, a taxpayer can deduct only 50% of their business meal and entertainment expenses, including meals incurred while away from home on business. However, certain groups of taxpayers are subject to special rules which are discussed later in this chapter in the section entitled “Taxpayers with Special Rules.”

ENTERTAINMENT EXPENSES

To be deductible, entertainment expenses must meet either a directly related test or an associated test.

- **Directly related test.** The main purpose of the combined business and entertainment activity must be the active conduct of business. Business must be conducted during the entertainment period and there must be more than a general expectation of getting income or some other specific business benefit at a future time.
- **Associated test.** To meet the associated test, the taxpayer must show that the entertainment is associated with the active conduct of the taxpayer’s trade or business and the entertainment must occur directly before or after a substantial business discussion.

The following table shows which entertainment expenses are deductible.⁷

⁷ IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*, p. 10 (2011).

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Table 2-1. **When Are Entertainment Expenses Deductible?**

General rule	You can deduct ordinary and necessary expenses to entertain a client, customer, or employee if the expenses meet the directly-related test or the associated test.
Definitions	<ul style="list-style-type: none"> Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation, and includes meals provided to a customer or client. An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate.
Tests to be met	Directly-related test <ul style="list-style-type: none"> Entertainment took place in a clear business setting, or Main purpose of entertainment was the active conduct of business, and You did engage in business with the person during the entertainment period, and You had more than a general expectation of getting income or some other specific business benefit.
	Associated test <ul style="list-style-type: none"> Entertainment is associated with your trade or business, and Entertainment is directly before or after a substantial business discussion.
Other rules	<ul style="list-style-type: none"> You cannot deduct the cost of your meal as an entertainment expense if you are claiming the meal as a travel expense. You cannot deduct expenses that are lavish or extravagant under the circumstances. You generally can deduct only 50% of your unreimbursed entertainment expenses (see 50% Limit).

Example 4. Art Tickle takes 10 of his out-of-town reporters to dinner and a baseball game prior to the next day's company meeting. The meal and entertainment expense is deductible on Art's Schedule C, line 24b.⁸

50% Limit

In general, a taxpayer can only deduct 50% of their business-related meal and entertainment expenses. The 50% limit applies to employees or their employers, and to self-employed persons (including independent contractors) or their clients, depending on whether the expenses are reimbursed.

The 50% limit is applied after determining the amount that otherwise qualifies for a deduction.

Example 5. Ima Highroller wants to impress her new customer. She purchases two tickets to a sold-out concert. She pays \$1,000 per ticket. The ticket has a face price of \$100. Assuming the entertainment is deductible, Ima can only deduct 50% of the face price of the tickets, or \$100 ($\$100 \times 2 \times 50\%$).

There are exceptions to the 50% deduction limit. Meals and entertainment expenses are not subject to the limitation in the following circumstances.

1. The taxpayer is an employee and is not subject to the 50% limit on expenses that the employer reimburses under an accountable plan.
2. The taxpayer is self-employed and all of the following requirements are met.
 - a. The taxpayer has expenses as an independent contractor.
 - b. The customer or client reimburses the taxpayer or provides an allowance for these expenses in connection with services the taxpayer provides.
 - c. The taxpayer provides adequate records of these expenses to the client or customer.

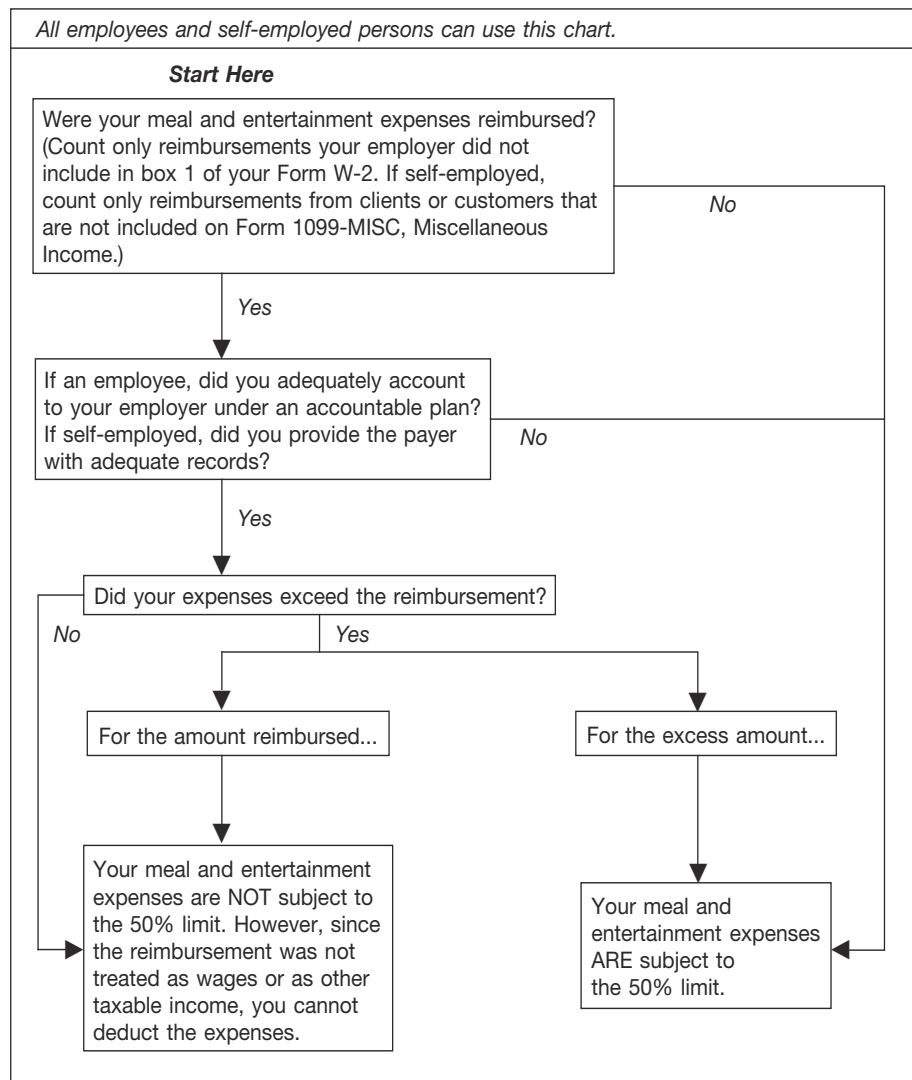
⁸ Ibid.

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The following flowchart from IRS Pub. 463 shows whether the 50% limitation applies.⁹

Figure A. Does the 50% Limit Apply to Your Expenses?

There are exceptions to these rules. See Exceptions to the 50% Limit.



⁹ IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*.

TAXPAYERS WITH SPECIAL RULES

Most employees must treat unreimbursed employment or business expenses as a miscellaneous itemized deduction subject to the 2%-of-AGI threshold. In addition, most taxpayers are subject to the 50% limitation on the deductibility of meals and entertainment expenses. However, certain taxpayers may be eligible to treat some or all of their employment or business expenses under other tax rules.

HOURS-OF-SERVICE EMPLOYEES

Employees subject to U.S. Department of Transportation “hours-of-service” (HOS) regulations may be entitled to a higher deduction. An 80% deduction for meals and entertainment expenses is applicable to HOS employees who are traveling away from the business tax home if the expenses are incurred during the period of work subject to federal HOS regulations. These employees include the following.

- Certain air transportation workers that work under Federal Aviation Administration regulations (such as pilots, crew, dispatchers, mechanics, and control tower staff)
- Interstate truck operators and bus drivers working under Department of Transportation regulations
- Certain railroad employees working under Federal Railroad Administration regulations (such as engineers, conductors, and train crew)
- Certain merchant maritime workers working under U.S. Coast Guard regulations

For 2012, if the transportation-worker rates apply, the taxpayer can claim a standard meal allowance of \$59 per day (\$65 for travel outside the continental United States).¹⁰ Using the special rate eliminates the need to determine the standard meal allowance for each area where the taxpayer stops for sleep or rest. If the taxpayer chooses to use the special rate for any trip, this special rate must be used for all trips taken that year.

Note. More details on the U.S. Department of Transportation’s hours of service regulations can be found at www.fmcsa.dot.gov/rules-regulations/topics/hos/index.htm.

MILITARY RESERVISTS

A military reservist or National Guard member can deduct qualified unreimbursed travel costs. Qualified expenses are:

- Necessary and ordinary in regard to the performance of military duties, and
- Incurred in connection with overnight travel more than 100 miles from the taxpayer’s home.

To the extent of an upper limit based on the federal per diem rate and the standard mileage rate, the military reservist can deduct these expenses as follows.

- Calculate the expenses on either Form 2106 or Form 2106-EZ.
- Deduct the total of the expenses directly against gross income on line 24 of Form 1040.

Expenses in excess of the upper limit can be deducted as a miscellaneous itemized deduction on Schedule A, subject to the 2%-of-AGI threshold.

¹⁰ IRS Notice 2011-81, 2011-42 IRB 513.

DISABLED EMPLOYEES

Impairment-related work expenses incurred by physically or mentally impaired employees are deductible as miscellaneous itemized deductions. However, they are not subject to the 2%-of-AGI threshold. After calculating the impairment-related expenses on Form 2106 or Form 2106-EZ, they are reported on Schedule A, line 28, indicating the nature and amount of these expenses. Employment expenses that are not impairment-related are subject to the 2%-of-AGI threshold and are shown on Schedule A, line 21 (2011).

Schedule C filers report these expenses on either Schedule C or C-EZ if they are only incurred when traveling on business. They are reported on Schedule A as a medical expense if they are required at home as well.

JOB-SEEKING EXPENSES FOR EMPLOYEES

Taxpayers may deduct certain expenses that they incur in looking for a new job in their present occupation, even if they do not find a new job. Taxpayers **cannot** deduct such expenses if one of the following conditions applies.

1. The taxpayer is looking for a job in a **new** occupation.
2. There was a substantial break between the ending of the taxpayer's last job and the date they started looking for a new one.
3. The taxpayer is looking for a job for the first time.

Types of Job Search Expenses

The following are considered job search expenses.

1. Employment and outplacement agency fees
2. Preparing and mailing a résumé to prospective employers
3. Travel and transportation expenses (The amount of time spent on personal activities compared to the amount of time spent in looking for work is important in determining whether a trip is primarily personal or is primarily to look for a new job. Even if the taxpayer cannot deduct the travel expenses to and from an area, they may deduct the additional expenses of looking for a new job while on a personal trip.)

EMPLOYEE REIMBURSEMENT PLANS

An employer may provide a plan to reimburse employees for the expenses incurred in business travel. An employee reimbursement plan can be either an **accountable** plan or a **nonaccountable** plan. The plan is accountable if:

- There is a **business connection** for amounts reimbursed to employees,¹¹
- Reimbursements must be **substantiated**,¹² and
- Reimbursed amounts in **excess** of the actual amount of expenses incurred must be **returned to the employer**.¹³

Note. Details on the above three requirements and how to determine whether a plan meets them are found in Treas. Reg. §1.62-2.

¹¹ Treas. Reg. §1.62-2(d).

¹² Treas. Reg. §1.62-2(e).

¹³ Treas. Reg. §1.62-2(f).

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Substantiation generally requires retention of receipts or paid invoices and maintenance of a log book or diary that, collectively, provide evidence of the necessary elements of the expense.¹⁴ The necessary elements for meals, lodging, travel, and entertainment expenses are the following.

- Amount of the expense
- The time the expense was incurred (as well as departure and return dates for travel expenses)
- Place that the expense was incurred (or travel destination)
- Business reason for the expense
- Business relationship of participants (necessary for entertainment expenses only)

Payments from the plan can be made to the employee in one of three ways.

1. Directly from the employer
2. From an agent of the employer
3. From a third party for which the employee performs services as an employee of the employer

Amounts received by the employee under an accountable plan are excludable from income.¹⁵ Conversely, amounts received by the employee under a nonaccountable plan are included in the employee's gross wages. The employee may then deduct qualifying expenses on Schedule A as miscellaneous itemized deductions subject to the 2%-of-AGI threshold.

SPECIAL RULE REGARDING MEALS AND ENTERTAINMENT EXPENSES

Accountable plan amounts reimbursed to an employee for meals or entertainment expenses are entirely excludable from income despite the 50% limitation on the employer's deduction for these expenses.¹⁶

EMPLOYEE-BY-EMPLOYEE DETERMINATION

The determination of whether a plan is accountable or nonaccountable is made on an employee-by-employee basis.¹⁷

Example 6. Gordon works as an engineer for ACI Consulting Engineers, Inc. The employer reimburses all employees for travel expenses that are incurred to travel from one work site to another. Gordon did not keep proper receipts or records to submit to the employer as the other employees did. Proper records or receipts must be submitted to ensure adequate substantiation. The amounts paid to Gordon under the reimbursement plan are considered reimbursements from a nonaccountable plan because the substantiation requirement is not met.

Gordon must include the amounts received under the plan in his income for the year. He can deduct qualifying expenses as miscellaneous itemized deductions on Schedule A. These expenses are subject to the 2% threshold. However, for the other employees who submitted records necessary for proper substantiation, the reimbursements are considered to be from an accountable plan as long as the other requirements necessary to qualify as an accountable plan are met. This determination is made for each employee. Because the other employees receive reimbursement amounts from an accountable plan, they can exclude the reimbursements from income.

¹⁴ Temp. Treas. Reg. §1.274-5T(c)(2)(i).

¹⁵ Treas. Reg. §1.62-2(h)(1).

¹⁶ Ibid.

¹⁷ Treas. Reg. §1.62-2(i).

In general, the following time limits apply for reimbursements under accountable plans.¹⁸

- Advances must be paid within 30 days of the time of the expense.
- Adequate accounting for expenses must be made within 60 days after they were paid or incurred.
- Any excess reimbursement must be repaid within 120 days after the expense was paid or incurred.

TAINTING AN ACCOUNTABLE PLAN

An accountable plan may become “tainted” by a **pattern of abuse**.¹⁹ This causes the plan to be considered nonaccountable. For example, a plan is considered nonaccountable if it:

- Fails to treat excess allowances as wages,
- Does not have a proper procedure in place to determine when an allowance exceeds the amount that may be deemed substantiated, and
- Regularly pays excess amounts without requiring actual substantiation.²⁰

RELIANCE ON ELECTRONIC RECORDS

An accountable plan may rely on credit card records, electronic records, or paperless systems in connection with meeting the requirements of an accountable plan.

Example 7. Oaktree Manufacturing arranges for a credit card company to issue credit cards to employees for travel and business expenses. The employees receive monthly billing statements. Employees are personally liable for charges to the cards.

The credit card company provides Oaktree with electronic receipts for all expenses billed to the cards, with each receipt indicating the date, amount, and other available details. Oaktree transfers this information to an electronic database used by the employees to develop their expense reports. Employees are obligated to separate personal from business expenses and must describe the business expenses and business purposes. Added details on entertainment expenses must be provided (names, business relationships, dates, places, duration, and participants). Paper expense reports and receipts for any expense over \$75 are required for unexplained lodging expenses, expenses not paid with the credit cards, and expenses with details not clear on the face of the receipt. This arrangement meets all three requirements of an accountable plan.²¹

¹⁸ IRS Pub. 463, *Travel, Entertainment, Gift and Car Expenses*.

¹⁹ Treas. Reg. §1.62-2(k).

²⁰ Rev. Rul. 2006-56, 2006-2 CB 874.

²¹ Based on Rev. Rul. 2003-106, 2003-44 IRB 936.

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