

Dear Client:

The Internal Revenue Code provides rules governing the deductibility of business travel, meals and entertainment. First, such an expense is deductible only if it is ordinary and necessary and incurred in carrying on a taxpayer's trade or business. The term *ordinary and necessary* is somewhat subjective, but generally means an expense must be of a type which is customarily incurred in that particular business.

Second, there are additional rules for the deductibility of entertainment expenses incurred in connection with a trade or business. A taxpayer must demonstrate that the entertainment expense is either –

1. Directly related to the active conduct of a trade or business, or
2. Associated with the active conduct of a trade or business, and the entertainment directly preceded or followed a substantial bona fide business discussion.

The term *directly related* refers to expenses incurred in the context of active business discussions or a clear business setting for such discussions where there is a reasonable expectation of deriving a direct business benefit. The *associated with* test refers to expenses incurred for the purpose of building goodwill and the evidence of a business connection is clear.

In addition to the rules defining what constitutes deductible business travel and entertainment expense; there are strict rules that require the taxpayer to maintain adequate records substantiating such expenses. Regardless of the validity of the business travel or entertainment, a deduction for such an expense is not allowed unless adequate records are available. The law requires that a taxpayer's records adequately substantiate the following for each expense:

1. The amount of the expense.
2. The time and place of the travel or entertainment.
3. The business purpose of the expense.
4. The business relationship to the taxpayer of persons entertained.

This documentation can be maintained by making notes on the back of invoices or maintaining a business diary.

Please review your business travel and entertainment expenses and the documentation for these expenses and indicate what part of each item is a corporate business expense or a personal expense. If you have any questions or would like to discuss this further, please let us know.

Sincerely,

Thomas Mangold, CPA/ABV/CITP
President