

## How to Deduct Business-Related Entertainment Costs

Spring is finally here in New England and you know what that means time for those business golf outings and baseball games with clients in company box seats! Can you deduct all or part of these entertainment expenses? It depends.

For starters, you are generally permitted to deduct 50% of your qualified business entertainment and meal expenses. The 50% rule applies to expenses paid by employers, employees and self-employed individuals (including independent contractors). However, employees may be reimbursed tax-free for 100% of their out-of-pocket costs.

This limit extends to amounts spent while traveling away from home on business, entertaining clients at your place of business or some other location, or payments at a business convention, luncheon or other meeting.

To qualify for deductions, the entertainment expenses must be either directly related to or associated with the active conduct of your business.

Directly related test: You can treat entertainment expenses as being directly related to your business if you meet these three conditions:

1. You expect to derive income and some other specific business benefit (other than mere goodwill) at some point in the future;
2. You actively engage in a business meeting, discussion or some other bona fide business transaction with the person being entertained (and not just, Hey Joe, how's business treating you? conversation over hot dogs and beer, but real, bonafide business conversation); and
3. The principal purpose of the activity is the active conduct of your business.

Generally, entertainment expenses will not qualify as directly related expenses if you are absent from the activity, the group being entertained includes social guests or the entertainment takes place in a location where there are substantial distractions, such as a nightclub or at a football stadium. However, if the activity takes place in a clear business setting, such as the hospitality suite at a hotel, you can still write off 50% of the cost.

Associated-with test: It's often difficult to qualify for directly related entertainment deductions, since the fun often gets in the way of the business. But you can still deduct entertainment expenses that are associated with your business.

This test is usually easier to pass than the directly related test. All you have to do is meet these two conditions:

1. The activity must have a clear business purpose such as the intent to maintain a business relationship; and
2. The entertainment must directly precede or follow a substantial business discussion. What's a substantial business discussion? It occurs when you engage in an activity to derive a business benefit and the meeting, negotiation or discussion is significant in relation to the entertainment. For example, if you gather your guests inside the box or even in a separate conference room and spend 30 minutes to provide a corporate update to key clients in attendance before the first pitch, then it is more likely to count as a business entertainment expense.

It's usually best for a company to use an accountable plan for entertainment expenses incurred by employees. If you're still unsure what qualifies as a legitimate expense, talk with your accountant.