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CHECK YOUR TRAVEL EXPENSES

The thought of an examination of your business income tax return provokes fear and worry. One item almost guaranteed to be on the examiner's list is a review of your travel and entertainment deductions. You can eliminate any worry if you know the rules and keep the required documentation.

The Internal Revenue Code defines "travel expenses" as the "ordinary and necessary" expenses incurred while traveling away from home for your business, profession or job. Deductible travel expenses include transportation, baggage, meals, lodging, cleaning, laundry, telephone calls and related tips. Travel expenses do not include expenses for entertainment, an area with its own set of detailed rules.

Regulations require that business travel expenses be substantiated by records or other evidence. Records include diaries, logs, receipts, paid bills and expense reports. You must separately report each expense for transportation, lodging and meals. Records should indicate the date you left and returned for each trip and the number of days away spent on business. Note your destination and the business reason for the trip or the nature of business benefit that you gained or expected to gain.

Total meals separately in your records because deductions for meal expenses are limited. You can only deduct 50% of your business-related meal expense. Taxes and tips relating to meals are included in the amount subject to the 50% limit.

Need a vacation? You may choose to mix business with pleasure by extending a business trip for vacation. If your trip was primarily for business and while at your business destination, you extended your stay for vacation or made a non-business side trip, you can deduct travel expenses to and from your business destination.

However, when a trip is primarily for vacation, the entire cost of the trip is a non-deductible personal expense, except for any expenses you have while at your destination that are directly allocable to your business. There are different, and more stringent, rules for travel outside the U.S. or by luxury water transportation, such as on a cruise ship.

If your spouse accompanies you on a business trip, your spouse's expenses for travel; meals and lodging will not be deductible unless you can prove a real business purpose for your spouse's presence.

If you are a business owner whose employees incur travel expenses, you must meet certain requirements so your employees can exclude from income reimbursements what they receive for business travel expenses.

Employers who follow these rules generally will be considered to have an "accountable plan":

- Employees must substantiate covered expenses.

- Employees must return amounts paid in excess of amounts substantiated.

- There is a business connection between the reimbursement and anticipated business expenses.

If these conditions are not met, the arrangement is considered to be a "non-accountable plan" which the employer is required to report the reimbursements as income on form W-2. In that case, employees would have to substantiate and deduct the business expenses on their personal returns as miscellaneous itemized deductions subject to the 2% of adjusted gross income limitation.

A simplified method of substantiating expenses is a per diem arrangement. The advantage of an employer using a "qualified per diem arrangement" is that the employer need only report the excess, if any, of the employer's reimbursement rate over the standard IRS per diem rates as income to employees. The IRS provides a table of rates based on the costs of various business destinations.

Employees do not have to substantiate their expenses under such an arrangement. They need only substantiate the time, place and business purpose of the travel. Per-diem for travel and lodging or for meals and incidentals are not available to employees who own more that 10% of company stock. One way to avoid any of these problems is for the employer to require that all expenses be substantiated before making reimbursements.

A key to maintaining adequate records is to prepare the records at or near the time that expenses are incurred. You will not recall the expenses adequately if you wait until tax time to prepare the documentation.

Keep a weekly expense report along with documentary evidence, such as receipts or bills, which will provide support for each expense. You must keep proof to support your claim to a deduction as long as your income tax return can be examined. This generally is three years from the date you file the return on which you claimed the deduction. A good record is your small pocket appointment book or annual calendar appointment book.

With proper support of deductions for travel expenses, you will have nothing to fear in this area should the IRS select your business return for examination. If you have questions about travel and entertainment record keeping, consult with your tax advisor on what you have to do to substantiate tax deductions. Specific questions regarding this article should be addressed to Patrick J. Hurley at (800) 996-1040.