

# TaxTips

## Entertainment Deductions: Half the Fun?

Here are some basic rules you need to know to ensure that all your entertainment expenses are deductible:

1. Do you have an **ordinary and necessary business reason** for the entertainment?
2. Did you **have a quiet business discussion before, during or after the event?** No discussion, no deduction! You'll need to explain why the entertainment would benefit your business in the future.
3. The discussion must be **conducted in a business setting that allows an active business discussion**. This could be a restaurant, for example. If the main entertainment is done in a non-business setting such as a bar with loud music or a cocktail party, you must speak about business before or after the event in a business setting.
4. Do you have proof? **Keep documentation of who, what, where, why and how much**. This documentation must be written within one week of the meeting.

*Reasonable, Lavish, and Extravagant:* So does the entertainment need to be reasonable? Can you get in trouble if the entertainment is lavish and extravagant? Actually, no. The only rule is that it must be an ordinary and necessary expense. **There are no parameters on how much you can or cannot spend**. In fact, a self-employed business person spent over \$60,000 on entertainment (rock concerts). His entertainment expense was disallowed - not because of the amount - but because he did not have documentation to support the deduction.

**The IRS looks at how much business was generated as a result of the entertainment.** There is no rule regarding the number of times you may entertain a potential client, but a wise business person would limit the frequency within reason. But then again, what is reasonable? Taking your spouse out on a date once a month would not qualify. However, you could consider taking your mother out if she is a potential client/customer who will buy services or products from you - nothing wrong with that!

*50 percent vs. 100 percent Deductible:* **Almost all entertainment is deductible at 50 percent**, meaning that if you spend \$500, you receive only a \$250 deduction. Here's the good news - **any entertainment that revolves around a sporting event is fully deductible**; that includes any ticket or sports event, only if:

- It is organized for the primary purpose of benefiting a 501(c)3 charity
- It donates all the net proceeds to a 501(c)3 charity
- It uses volunteers to put on the event

So a PGA tour event would be fully deductible because they donate the net proceeds to charity, but a ticket to a college or high school sports event does not qualify since that usually goes toward the coaches' pay. Other events that may qualify for a 100 percent

deduction are tennis, skeet shoots, ski tournaments and fishing tournaments, just to name a few.

**Another thing to keep in mind is that generally, you will get a better deduction if you list an expense to a sporting event as a business deduction rather than a charitable donation.** For the contribution to a charity, you can deduct only the amount that exceeds the benefit you received from the item (the value of the entertainment).

**Additional fully deductible entertainment expenses are employee holiday parties, annual picnics or summer outings.** For example, a service corporation rented a powerboat and was able to deduct 100 percent of the \$41,000 expense since it did not discriminate between the owners and employees and it was deemed ordinary and necessary.

\*Note: Create two accounts in your accounting system's chart of accounts - one for 50 percent and the other for 100 percent deductible entertainment.

*Be strategic:* Plan a business meeting for a substantial amount of time (say two hours) and then go skiing. You cannot deduct your personal skiing with your family (unless your spouse is active in the business), but you can deduct the entertainment with people who you plan to do business with. After skiing, resume your meeting for another two hours and one minute.

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