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Revenue Ruling 63-144, Q&A 18

Section 274. – Disallowance of Certain Entertainment, etc., Expenses

July 1963

Answers to a series of specific questions concerning the deductibility of business expenditures for entertainment, travel and gifts in accordance with sections 1.274-1 through 1.274-8 (except for *section 1.274-5*) of the Income Tax Regulations promulgated under *section 274* (except for subsection (d) thereof) of the Internal Revenue Code of 1954.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to answer a series of questions relating to the provisions of the income tax regulations promulgated under *section 274* (except for subsection (d) thereof) of the Internal Revenue Code of 1954, added by the Revenue Act of 1962, C.B. 1962-3, 111. Each question is designed to present, in relatively simple terms, a point of law of general interest to taxpayers, and individual questions should be read in the context of other questions and answers which follow or precede.

Introductory

1. *Question:* How does the new law affect the old law ?

Answer: The new rules are in addition to the requirements of the old law which are still in effect. Therefore, before an expense for entertainment, travel or gifts will be deductible it must (1) be "ordinary and necessary" in carrying on your trade or business within the meaning of prior law, and (2) meet the requirements of the new rules under *section 274 of the Code*.

2. *Question:* Do the new record keeping requirements that were published in December 1962 apply in this area ?

Answer: Yes. An explanation of these record keeping rules was provided in *Revenue Procedure 63-4, C.B. 1963-1, 474*.

3. *Question:* When are these new rules effective?

Answer: These new rules became effective on January 1, 1963. However, the Internal Revenue Service (1) has extended the original 90-day transitional period (announced in *Revenue Procedure 63-3, C.B. 1963-1, 473*), for conforming accounting systems and procedures to the new requirements to July 31, 1963, and (2) will resolve reasonable doubts in favor of taxpayers when there has been a good faith effort to apply the new substantive requirements with respect to travel and entertainment expenses incurred from January 1, to July 31, 1963.

Entertainment Expenses

IN GENERAL

4. *Question:* What must a taxpayer be able to show in order to deduct an entertainment expense under these new rules ?

Answer: He must show that the amount of the expense for which he is claiming a deduction was:

- (1) "directly related" to the active conduct of his business (see questions 33 to 40), or
- (2) "associated with" the active conduct of his business and that the entertainment occurred directly before or after a substantial and bona fide business discussion (see questions 21 to 25), or
- (3) covered by one of several exceptions to the new rules (see questions 5 and 6).

EXCEPTIONS

5. *Question:* What are the exceptions to the new rules ?

Answer: There are nine exceptions to these new rules. They are business meals, food and beverages for employees, expenses treated as compensation, reimbursed expenses of employees and independent contractors, recreational expenses for employees, employee or stockholder business meetings, meetings of business leagues, items available to the public, and entertainment sold to customers.

6. *Question:* What is the significance of these nine exceptions?

Answer: Expenses covered by these exceptions are not subject to the new restrictions on tax deductions for entertainment expenses. They are deductible if they qualify as ordinary and necessary business expenses, as under prior law. However, the new record keeping rules apply to most of these expenses.

ENTERTAINMENT DEFINED

7. *Question:* What is "entertainment ?"

Answer: Entertainment includes any activity generally considered to constitute entertainment, amusement, or recreation, whether or not the activity might also be characterized as advertising or public relations. Generally, this would cover entertaining guests at such places as night clubs, country clubs, theaters, sporting events, and on yachts or on hunting, fishing, vacation and similar trips.

8. *Question:* Does the term "entertainment" under the statute also include expenses which satisfy a personal, living, or family need?

Answer: Yes, it may. For example, it includes any expense for meals purchased for a business customer. However, for special rules applying to certain expenses for meals or beverages, see questions 15 to 20.

9. *Question:* If an employer pays supper money and special transportation home of employees who work overtime, will these costs be considered entertainment expenses?

Answer: The term "entertainment" does not include all expenses which satisfy a personal, living or family need. The supper money and such special transportation are not generally considered entertainment.

10. *Question:* If an employer furnishes a car to his employee primarily for use in the active conduct of trade or business, but the employee uses it for routine personal trips, such as driving to the grocery store and commuting to work, would this personal use be considered entertainment ?

Answer: No.

11. *Question:* If an employer furnishes the use of a hotel suite or an automobile to his employee who is on vacation, will this be considered entertainment of his employee ?

Answer: Yes.

12. *Question:* Is the cost of furnishing an apartment at a vacation resort to a customer to encourage his goodwill treated as entertainment under the new rules ?

Answer: Yes.

13. *Question:* Does the taxpayer's business influence the question of whether an expense is entertainment ?

Answer: Yes, this a very important consideration. For example, if a manufacturer of dresses conducts a fashion show to introduce his products to a group of store buyers, the show would not be generally considered entertainment. However, if an appliance distributor were to conduct a fashion show for the wives of his retailers, the show generally would be considered entertainment.

GOODWILL ENTERTAINING

14. *Question:* Do these new rules disallow all business "goodwill" entertaining ?

Answer: No. Although the new statute imposes restrictions on tax deductions for goodwill entertaining, a significant portion of business goodwill entertaining is still deductible under the new rules: (1) under the "business meal" rule (see questions 15 to 20), or (2) if the entertainment is "associated" with the active conduct of your business and it directly precedes or follows a substantial and bona fide business discussion, including business meetings at a convention or otherwise (see questions 21 to 25 and 32), or (3) in certain limited situations involving entertainment "directly related" to the active conduct of your business, such as entertainment which occurs in a clear business setting (see questions 38 to 40).

BUSINESS MEAL ENTERTAINING

15. *Question:* If, for business reasons, I take a customer to breakfast, lunch, or dinner at a restaurant or hotel, or to a bar for a few drinks, but we do not discuss business, can I deduct the cost of the entertainment under the new rules ?

Answer: Yes, the statute provides that if the circumstances are of a type generally considered to be conducive to business discussion an expense for meals or beverages will be deductible to the extent the expenses were ordinary and necessary business expenses as under prior law.

16. *Question:* When are circumstances considered to be conducive to business discussion ?

Answer: This depends on the facts of each case, taking into account the surroundings in which the meals or beverages are furnished, the taxpayer's business, and the relationship of the person entertained to the taxpayer's business. The surroundings should be such that there are no substantial distractions to discussion. Thus, generally, a restaurant, hotel dining room, or similar place, not involving distracting influences, such as a floor show, would be considered to be

conducive to a business discussion. On the other hand, entertainment at night clubs, sporting events, large cocktail parties or sizable social gatherings would generally be considered to involve distracting influences not conducive to business discussion.

17. *Question:* Does the fact that the business meal entertaining takes place in the taxpayer's home disqualify the deduction ?

Answer: No, as long as the food or beverages are served under circumstances conducive to business discussion. However, in the case of business meal entertaining at home, the taxpayer must clearly show that the expenditure was commercially rather than socially motivated.

18. *Question:* If a taxpayer takes a customer to lunch for business goodwill purposes and the customer's wife comes along, will the expense be disallowed if they don't discuss business ?

Answer: Not if, in the light of all the facts and circumstances, the surroundings were of a type generally, considered conducive to discussing business, and the expense was an ordinary and necessary expense of carrying on the taxpayer's business as under prior law (see questions 26 to 30).

19. *Question:* Is the situation the same if the taxpayer's wife accompanies the taxpayer in entertaining a customer at dinner for business goodwill purposes?

Answer: Yes. Entertainment expenses allocable to the taxpayer's wife when she helps her husband entertain a business customer in surroundings generally considered conducive to business discussion are not disallowed under the new rules, whether or not the customer's wife is also present. However, to be deductible it is required that the expense be an ordinary and necessary business expense, as under prior law (see questions 26 to 30).

20. *Question:* Where a group of businessmen make a practice of having lunch together primarily for personal reasons, and they alternate in paying for the lunch, does this make the cost deductible ?

Answer: This practice is not connected with the carrying on of a trade or business but is a personal or social arrangement. As under prior law, the cost of the lunch would not be an ordinary and necessary business expense, and is not deductible.

ASSOCIATED ENTERTAINMENT

21. *Question:* Are entertainment expenses incurred at places such as night clubs, theaters, sporting events, or hunting or fishing trips, or on yachts disallowed under the new rules if the expenses are incurred solely for business goodwill purposes?

Answer: Not necessarily. If the taxpayer can show that the entertainment took place directly before or after a substantial and bona fide business discussion, the cost of such entertaining would not generally be disallowed by the new rules.

22. *Question:* What is a substantial and bona fide business discussion ?

Answer: Whether a business discussion is substantial and bona fide depends upon the facts and circumstances of each case. However, it must be shown that a taxpayer actively engaged in a business discussion, meeting, negotiation or other bona fide business transaction, other than entertainment, to obtain income or some other business benefit. Also it must be shown that business activity was substantial in relation to the entertainment.

23. *Question:* How long must this discussion be in order to qualify as substantial ?

Answer: There is no specified length. All the facts and circumstances will be considered. The substantial requirement will be satisfied if active conduct of business was the principal character of the combined business and entertainment activity. However, it is not necessary that more time be devoted to business than to entertainment.

24. *Question:* How soon before or after the substantial and bona fide business discussion must the entertainment be so that the cost of "associated" entertainment is not disallowed ?

Answer: Entertainment that takes place on the day of the business discussion will qualify. However, if the entertainment does not occur on the day of the business discussion, all the circumstances of the case will be considered, including the reasons for not having the entertainment on the day of the business discussion. For example, if the customer is from out of town, the entertainment on the day before or the day after the business discussion will qualify.

25. *Question:* If I take a customer and his wife along with my wife to a night club the same day that I have a substantial business discussion with that customer, is the cost of such entertainment allocable to the wives disallowed under the new rules?

Answer: No. The expense is deductible to the extent it is ordinary and necessary as under prior law (see questions 26 to 30).

EXPENSES FOR WIVES

26. *Question:* Several of the answers to the questions mention that certain entertainment expenses allocable to the wife of a taxpayer or his business customer are deductible to the extent they are ordinary and necessary as under prior law. To what extent are such expenses considered ordinary and necessary under prior law ?

Answer: Whether an expense allocable to the wife of a taxpayer or a business customer is ordinary and necessary as under prior law depends on the facts and circumstances of each case. It must, however, be established that the taxpayer had a clear business purpose rather than a personal or social purpose in incurring such an expense.

27. *Question:* If a taxpayer entertains a business customer under circumstances where the cost of entertaining the customer is an ordinary and necessary business expense and is not disallowed under the new rules, and the customer's wife joins the taxpayer and the customer during the entertainment because it is impracticable under the circumstances to entertain the customer without his wife, is the cost of entertaining the customer's wife deductible as an ordinary and necessary business expense?

Answer: Yes. Such a case might arise, for example, if the customer was from out of town and had his wife traveling with him.

28. *Question:* Assuming the same facts as in the preceding question and answer, but, in addition the taxpayer's wife joins them during the entertainment because the customer's wife was present, would the cost of entertainment allocable to the taxpayer's wife be considered an ordinary and necessary expense ?

Answer: Yes.

29. *Question:* Are the travel expenses of a taxpayer's wife deductible if they are ordinary and necessary business expenses as under prior law ?

Answer: Yes. However, regulations under prior law which are still in effect provide that "Where a taxpayer's wife accompanies him on a business trip, expenses attributable to her travel are not deductible unless it can be adequately shown that the wife's presence on the trip has a

bona fide business purpose. The wife's performance of some incidental service does not cause her expenses to qualify as deductible business expenses."

30. *Question:* Are travel expenses for a taxpayer's wife who accompanies him on a business trip in order to assist him in entertaining business associates at the destination generally considered ordinary and necessary business expenses ?

Answer: Generally not. When this question has been presented to the courts under prior law, the courts have generally found that the wife's travel to perform such duties, even though helpful to the taxpayer's business, is not necessary within the meaning of the statute.

PERSONAL PORTION OF BUSINESS MEALS

31. *Question:* Several of these questions and answers refer to the cost of a taxpayer entertaining a business customer at lunch or dinner. To what extent is the cost of the taxpayer's own meal deductible ?

Answer: Judicial decisions under established law, applying the statutory rules that deductions are not allowed for personal expenses, hold that a taxpayer cannot obtain a deduction for the portion of his meal cost which does not exceed an amount he would normally spend on himself. The Service practice has been to apply this rule largely to abuse cases where taxpayers claim deductions for substantial amounts of personal living expenses. The Service does not intend to depart from this practice.

CONVENTIONS

32. *Question:* How is entertaining at a convention affected by the new rules ?

Answer: Generally, expenses incurred directly before or after officially scheduled meetings at a bona fide convention for entertainment of others attending the convention are not disallowed by the new rules, provided the expenses qualify as ordinary and necessary business expenses deductible under prior law.

DIRECTLY RELATED ENTERTAINMENT

33. *Question:* How would a taxpayer show that entertainment is directly related to the active conduct of business ?

Answer: Generally, a taxpayer must show that (1) he had more than a general expectation of deriving income, or other specific business benefit (other than the goodwill of the person entertained), at some indefinite future time; (2) he did engage in business during the entertainment period; and (3) the principal character or aspect of the combined business and entertainment was the transaction of business.

34. *Question:* Is it necessary that income actually result from each and every entertainment expenditure for which a deduction is claimed ?

Answer: No.

35. *Question:* How do you determine that the principal character or aspect of the combined business and entertainment was the transaction of business ?

Answer: All the facts will be considered, including the nature of the business transacted during the entertainment and the reasons for conducting business during a period of entertainment. A business discussion which is only incidental in relation to the entertainment

does not qualify. However, it is not necessarily required that more time be devoted to business than to entertainment.

36. *Question:* Are there situations where the conduct of business is considered not to be the principal character or aspect of the combined business and entertainment ?

Answer: Yes. This would be true where the entertainment takes place on hunting or fishing trips or on yachts and other pleasure boats unless the taxpayer is able to establish otherwise.

37. *Question:* Are there any other situations where entertainment generally is not considered to be directly related ?

Answer: Yes. Entertainment occurring in circumstances where there is little or no possibility of engaging in the active conduct of business generally is not considered directly related. Examples of such circumstances are (a) meetings at night clubs, theaters, sporting events, or essentially social gatherings such as cocktail parties, and (b) situations where the taxpayer meets with a group which includes persons other than business associates, at places such as cocktail lounges, country clubs, golf clubs and athletic clubs, or at vacation resorts. However, a taxpayer may overcome this presumption by establishing, for example, that he did engage in a substantial business discussion during the entertainment.

CLEAR BUSINESS SETTING

38. *Question:* Is it always necessary to meet the tests set forth in question 33 for entertainment to be considered "directly related?"

Answer: No. Those tests are the general rule. However, special provisions treat certain entertainment as "directly related" to business if it occurs in a "clear business setting." For example, entertainment that takes place in a "hospitality room" at a convention where business goodwill is created through the display or discussion of business products will qualify as occurring in a clear business setting.

39. *Question:* Would entertainment of business and civic leaders at the opening of a new hotel or theatrical production be considered in a clear business setting if the purpose of the taxpayer is to obtain business publicity rather than create or maintain the goodwill of the persons entertained?

Answer: Yes. Generally, entertainment of a clear business nature occurring under circumstances where there is no meaningful personal or social relationship between the taxpayer and the persons entertained will be considered "directly related."

40. *Question:* If a restaurant owner were to provide occasional free dinners to customers who had patronized his restaurant, would such dinners be considered in a clear business setting ?

Answer: Yes, entertainment which has the principal effect of price rebates in connection with the sale of the taxpayer's products generally will be considered "directly related."

LAVISH OR EXTRAVAGANT

41. *Question:* Are there limitations on deductions for entertainment expenditures which are lavish or extravagant?

Answer: Yes. To the extent the expenditure is lavish or extravagant, it is not allowable as a deduction.

42. *Question:* Will entertainment expenses be subject to disallowance on grounds of being lavish or extravagant merely because they exceed a fixed dollar amount or are incurred at deluxe restaurants, hotels, night clubs and resort establishments?

Answer: No. An expense for entertainment will not be considered lavish or extravagant merely because it involves first class accommodations or services. An expense which, considering the facts and circumstances, is reasonable will not be considered lavish or extravagant.

ENTERTAINMENT FACILITIES

43. *Question:* Are all expenditures for facilities used in connection with entertainment, such as yachts, disallowed under these new rules?

Answer: Not if the taxpayer can show that (1) the facility was used more than 50 percent for business purposes (see questions 46 and 60 to 66), and (2) the entertainment was directly related to his business (see question 47).

44. *Question:* What is an entertainment facility?

Answer: Generally, an entertainment facility is any property used by a taxpayer in connection with entertainment, such as a yacht, hunting lodge, fishing camp, swimming pool, or an apartment, hotel suite, or a home in a vacation resort.

45. *Question:* What types of expenditures are subject to the entertainment facility rules?

Answer: The facility expenditure limitations cover depreciation and general operating costs such as rent, utility charges, repairs, insurance, salaries of watchmen, etc. Also covered are losses on the sale of the facility. In addition, certain club dues are treated as an expenditure for a facility. (See questions 54 to 59.)

46. *Question:* How does one meet the 50-percent facility test?

Answer: Generally, the taxpayer would satisfy this test if he could show that more than 50 percent of the use of the facility is for "ordinary and necessary" business purposes so that more than one-half of the annual operating expense would be deductible under prior law. (See also questions 60 to 66.)

47. *Question:* If the taxpayer meets the 50-percent test, will he be assured of obtaining a deduction for at least 50 percent of the facility expenditures?

Answer: Not necessarily. Once the 50-percent test is met, a deduction is allowed only for that portion of the cost which is "directly related" to the active conduct of business. (See questions 33 to 38 and 55.) For example, a taxpayer might be able to show that 60 percent of the use of his yacht was for business entertaining, but that only 45 percent was for entertaining "directly related" to the active conduct of his business. In this case, only 45 percent of the facility expenditures would be deductible.

48. *Question:* Do the rules concerning entertainment facilities also apply to expenses for items such as food and beverages, furnished during entertainment at a facility?

Answer: No, such costs would be subject to the general entertainment rules. For example, you can deduct the cost of business meals at a country club even under circumstances where you cannot deduct any of the dues to the club. (See questions 54 to 59 for deduction of club dues.)

49. *Question:* Are interest and taxes on a facility disallowed?

Answer: No. Such expenses are not subject to these entertainment rules but are usually deductible under other provisions of the law even though the facility is used solely for personal purposes.

BOX SEATS

50. *Question:* Are box seats or season tickets to theaters and sporting events treated under the facility rules?

Answer: No. The cost of the box seat or season ticket is allocated to the separate amusement events. The expense for one event may be deductible regardless of whether the box seat or season ticket is used more than 50 percent for business purposes.

NONENTERTAINMENT USE

51. *Question:* Assuming my automobile is used during the year both for entertainment and for business transportation not involving entertainment, can I obtain a deduction for the business transportation use?

Answer: Yes. The portion of depreciation and other operating expenses allocable to business transportation continues to be deductible, even if the automobile is considered an entertainment facility used less than 50 percent for business.

52. *Question:* Does this mean business expenses allocable to operating a facility for other than entertainment purposes are not disallowed under the facility rules?

Answer: Yes, that is right. For example, if a taxpayer uses his yacht primarily for personal purposes, but during the year he rents it to unrelated persons at a reasonable rental, the operating costs attributable to the rental income are not disallowed.

53. *Question:* Does the above rule apply where a taxpayer rents his yacht to his controlled corporation?

Answer: Yes, if it is a reasonable, arm's-length rental agreement entered into for bona fide business purposes. However, such transactions between related taxpayers will be closely scrutinized to insure they are not devised simply to avoid the new rules.

CLUB DUES

54. *Question:* Are dues to country clubs affected?

Answer: Yes. Dues and fees paid to a social, athletic or sporting club are treated as an expenditure for an entertainment facility. If the taxpayer uses the club more than 50 percent for business purposes, he can deduct that portion of his dues which is "directly related" to the active conduct of business.

55. *Question:* Where an entertainment facility is used for "business meal" entertaining (see questions 15 to 20) how is such use treated under the new rule?

Answer: This type of use is considered "directly related" entertainment use for purposes of determining the deductible portion of facility expenditures.

56. *Question:* What about dues to professional associations, such as medical or bar association?

Answer: These organizations are not social, athletic or sporting clubs, and dues to these organizations are not affected by the new rules. The same is true for civic organizations such as Kiwanis, Lions, Rotary and Civitan clubs.

57. *Question:* I have a membership in a business luncheon club which only furnishes lunch to members on business days. Is this a social club?

Answer: For the purpose of the new law limiting deductions for dues and fees to social clubs, such luncheon clubs for business or professional persons are not considered social clubs. This is consistent with the provisions of the new law which do not impose restrictions on expenses for meals and beverages in circumstances generally considered conducive to business discussions. This rule is to be distinguished from the rules under the Federal excise tax on club dues where luncheon clubs may be treated as social clubs.

58. *Question:* If membership in a club entitles other members of a taxpayer's family to use the club facilities, is their use considered in determining whether more than 50 percent of the club use was for business purposes?

Answer: Yes. However, see questions 59 and 64.

59. *Question:* If a taxpayer has two memberships to a country club, one for himself and another solely for his family, must he consider club use by his family in applying the 50-percent test to the cost of his own membership?

Answer: Generally yes, but family use would not be considered if their membership was not dependent upon the taxpayer's membership in the club.

DETERMINATION OF PRIMARY USE

60. *Question:* How can I show that more than 50 percent of the use of a facility during the year was for business purposes?

Answer: All the facts and circumstances will be considered, including the frequency and duration of use for business purposes as compared with personal purposes, the amount of expenditures for each use, the nature of each use, and other pertinent facts. However, certain specific tests which taxpayers may use in establishing primary use are discussed at questions 62 to 66.

61. *Question:* Can use of a facility for business entertainment or any other business purposes which are ordinary and necessary, although not constituting "directly related" entertainment, be used in determining whether the 50-percent test is satisfied?

Answer: Yes. All ordinary and necessary business use will be considered in showing that the facility was used more than 50 percent for business purposes.

62. *Question:* How would I determine primary use in the case of a country club or a yacht?

Answer: One permissible method is to establish that more than 50 percent of the total calendar days of use during the year were days of business use.

63. *Question:* What is a day of business use of a facility?

Answer: If the primary use of the facility during a day is an ordinary and necessary business use, as under prior law, it is a day of business use.

64. *Question:* If I have a substantial business discussion (see questions 22 and 23) at the facility, is it a day of business use?

Answer: Yes, even though most of the day the facility was used by you or your family for personal use not involving entertainment of others.

65. *Question:* Are days when the facility is not used to be counted in determining whether the facility was used more than 50 percent for business purposes?

Answer: No. For example, if a facility was used only 60 days during a year, the 50-percent test would be met where 31 days were days of business use.

66. *Question:* Are there any other specific tests which I might apply in determining whether the 50-percent test is met?

Answer: Yes. The 50-percent test is satisfied in the case of an automobile if more than 50 percent of mileage driven during the taxable year is for ordinary and necessary business travel. In the case of an airplane, the test is satisfied if more than 50 percent of hours flown during the year was for such business travel.

Travel Expenses

67. *Question:* What are the new restrictions on business travel costs where a business trip is combined with a vacation?

Answer: Under certain circumstances, the new rules disallow a deduction for that portion of the expense of traveling to and from the business destination which is not allocable to business.

68. *Question:* Are expenses for meals and lodging while traveling to and from a business destination included in travel expenses?

Answer: Yes.

69. *Question:* Do the new rules apply to all business trips which are combined with a vacation?

Answer: No. The new rules do not apply to travel away from home which does not exceed one week, nor do they apply if the trip exceeds one week unless the personal or vacation time amounts to 25 percent or more of the total time on the trip. In addition, if the travel expense qualifies as an ordinary and necessary business expense, none of it will be disallowed (1) if you did not have substantial control over arranging the business trip, or (2) if you did not have the obtaining of a personal vacation as a major consideration in determining to make the trip.

70. *Question:* Is an employer who reimburses an employee for travel, undertaken on the employer's behalf, affected by the new rules?

Answer: No. The new rules disallow deductions only to the individual who does the traveling and obtains the personal vacation.

71. *Question:* Would an ordinary employee traveling for his employer be affected by the new rules?

Answer: No. An employee who is reimbursed by his employer for his travel expenses is considered not to have substantial control over arranging his business trip provided he is not a managing executive of, or is not closely related to, his employer. Even a managing executive, or an individual who is closely related to his employer, is not affected if he can establish that he did not have substantial control over arranging the particular trip.

SUBSTANTIAL CONTROL

72. *Question:* What type of employee is considered a managing executive for purposes of the travel allocation rule?

Answer: A managing executive would be an employee who, by reason of his authority and responsibility, is authorized, without effective veto procedures, to decide upon the necessity for his business trip.

73. *Question:* Is control over the mere timing of a business trip considered substantial control?

Answer: No. An individual who is required to travel to a business destination will not be considered to have substantial control over arranging the business trip merely because he has control over the timing of the trip.

74. *Question:* What would be considered substantial control? *Answer:* If a professional person decided to attend a convention of a professional association, and he was not sent there by an employer who reimbursed him for the travel, he generally would be considered to have substantial control over arranging the trip.

VACATION PURPOSE

75. *Question:* Under the new rules, will a person who has substantial control over arranging a combined business-vacation trip in excess of a week always have a portion of his travel expenses disallowed if 25 percent or more of the time is devoted to nonbusiness activity?

Answer: No, only if obtaining a personal vacation or holiday was a major consideration in determining to make the trip.

76. *Question:* If a major consideration in determining to make a business trip is to visit a hospitalized relative, do the new rules apply?

Answer: No. Visiting a relative who is ill would not generally be considered a vacation or holiday. However, if the primary purpose of the trip is to visit an ill relative, for personal reasons, no deduction for travel expenses is allowable as under prior law.

REIMBURSED EXPENSES

77. *Question:* If the new travel allocation rules apply to an employee who is reimbursed for his expenses, do not the rules create gross income?

Answer: No. The new rules only disallow deductions and, if the reimbursement is not gross income, the individual is not affected. Whether or not a reimbursement is includible in gross income depends on the general rules of prior and continuing law.

ONE WEEK DEFINED

78. *Question:* How is "one week" determined under these laws? *Answer:* One week means seven consecutive days. The day of departure is not counted, but the day of return is. If you leave on a Wednesday and return on the following Wednesday, you are not away from home more than one week.

BUSINESS DAYS

79. *Question:* How will time be allocated between business and nonbusiness activity?

Answer: Generally, the allocation will be made on a day-by-day basis by comparing the number of "business days" with "nonbusiness days."

80. *Question:* Is the day of departure as well as the day of return considered for purposes of determining whether 25 percent or more of the time away from home is spent on personal trips?

Answer: Yes.

81. *Question:* Are days in transit considered "business days" or "personal days?"

Answer: They are considered "business days" provided the travel is by a reasonable direct route to the business destination and does not involve substantial nonbusiness diversions.

82. *Question:* If the travel is not by a reasonably direct route, what is the rule?

Answer: The number of business days in transit will be counted as if you took a reasonably direct route to the business destination using the same means of transportation.

83. *Question:* If I am required to attend a specific and bona fide business meeting which lasts for only a portion of the normal working day, would this be considered a business day?

Answer: Yes.

84. *Question:* How do you count necessary stand-by time such as legal holidays or weekends falling between business meetings?

Answer: Generally, such days will be counted as business days if they fall between business days. However, if such days fall at the end of your business meetings and you remain at the business destination for personal purposes, such days will be considered personal days.

CIRCUMSTANCES BEYOND CONTROL

85. *Question:* What if, due to circumstances beyond my control, I am not able to pursue business activities at my business destination on a certain day?

Answer: The day will ordinarily be considered a business day.

TRAVEL EXPENSE ALLOCATION

86. *Question:* Assuming the new travel allocation rule applies to a trip which takes 16 days, of which 8 days are business days and the remainder vacation days, and the round trip transportation cost is \$300, how much of the cost is deductible?

Answer: Since one-half (8/16) of the trip was business, one-half of the round trip cost of \$150 would be deductible as a business travel expense.

Business Gifts

87. *Question:* Can I deduct the cost of a business gift?

Answer: Yes, up to \$25 annually for each recipient. If the total cost of all of your business gifts to one individual during the taxable year exceeds \$25, you may only deduct \$25.

88. *Question:* Since different rules apply to entertainment and to gifts, when is an expenditure considered "entertainment" and when is it a "gift?"

Answer: Any item which might be considered either entertainment or a gift generally will be considered to be entertainment and not a gift. However, special rules describe certain items as

gifts. For example, packaged food or beverages, furnished to a business customer for consumption at a later date, are considered as gifts.

89. *Question:* If I provide tickets to a theater performance or to a sporting event to a business customer, is the cost of the tickets considered an expense for entertainment or a gift?

Answer: If you do not accompany your customer to the event, you may treat the cost of the tickets either as a gift or as entertainment, whichever is most advantageous to you. In such a case, you may change your treatment of the expense as either a gift or entertainment during the time prescribed for assessment of tax as provided in *section 6501 of the Code*. In most instances, this would be the three-year period following the due date of your income tax return. However, if you do accompany the customer to the entertainment event, the cost of the tickets must be treated as an entertainment expense.

INDIRECT GIFTS

90. *Question:* Is a gift to the wife of a business customer treated separately from a gift to the customer himself?

Answer: The \$25 limitation applies to gifts made "directly or indirectly" to an individual. A gift made to the wife of a business customer of the taxpayer is generally considered as made indirectly to the customer. However, if the customer's wife has an independent business connection with the taxpayer, a gift to her would not be regarded as an indirect gift to her husband unless it was intended for his eventual use or benefit.

91. *Question:* If corporation X gives to corporation Y a large number of inexpensive gifts, such as tickets to local baseball games, are they subject to the \$25 limitation?

Answer: Not necessarily. The limitation applies only to gifts made directly or indirectly to an individual. If the gift is not intended for the eventual personal use or benefit of a particular individual or a limited class of individuals, the gift will not be considered to be made to an individual.

92. *Question:* If I provide a gift to a business associate which costs \$25, and my wife gives him a gift costing \$25 during the same year, may we deduct both gifts?

Answer: No. A husband and wife who make gifts are considered one taxpayer for purposes of computing the \$25 limitation. This rule applies even if the husband and wife have separate businesses and each has an independent business connection with the recipient.

EXCEPTIONS

93. *Question:* Are there any exceptions to the \$25 limitations on business gifts?

Answer: Yes, there are three major exceptions:

- (1) One exception covers an item costing \$4 or less on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer. This exception includes such items as pens, desk sets, and plastic bags and cases, on which the taxpayer's name is imprinted.

- (2) A second exception covers advertising signs, display racks and other promotional material to be used on the business premises of the recipient.
- (3) A third exception covers an item of tangible personal property having a cost to the taxpayer of not more than \$100 which is awarded to an employee for length of service or for safety achievement.