

BUSINESS AND ENTERTAINMENT EXPENSES- DEDUCTIBLE

Per IRC section 162, deductible business expenses (including entertainment expenses) must be an ordinary and necessary expense of carrying on that trade or business.

- An ordinary expense is one which is customary and usual within the experience of a particular trade, industry or business community.
- A necessary expense is one which is appropriate and helpful to a taxpayer's particular business, rather than necessarily essential to the taxpayer's business.

Certain tax courts have held that an expense must not only be ordinary and necessary in order to be deductible, *but that it must also be reasonable in amount, and reasonable in relation to its purpose.* The Tax Court has stated that this requires a demonstration that the expense didn't exceed the income earned or expected from the activity.

Example of disallowed expenses:

... payment by a closely held corporation that operated a flower bulb farm on its sole shareholders' property, for landscaping around the shareholders' residence on the property, the shareholders' groceries, a solarium attached to the residence, and electricity, real property taxes, and hazard insurance attributable to the residence. The residence and its grounds weren't leased to the corporation and the expenses were the shareholders' personal expenses. Although some of the improvements could be seen by the corporation's customers who visited the farm for business purposes, the incidental benefit to the corporation didn't trump the primarily personal benefit to the shareholders.

...no business necessity for the "board of directors" meetings of taxpayer-corporation, where the board consisted of a husband and wife who were the corporation's sole shareholders, and where the meetings were restaurant dinners which were not needed for the corporate purposes alleged – namely, to approve payments for relocating the corporation, to hear reports on taxpayer's earnings, and to approve the husband's consultation with an attorney regarding tax matters of the corporation. In light of the husband's complete control of the corporation, there was no business necessity to spend anything to discuss the affairs of the corporation.

Sited Sources:

IRC section 162

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