

BUSINESS AND PLEASURE

Although business is business and pleasure is pleasure, the world rarely adheres to absolutes. Thus, this time of year you may want to mix some vacation days with your business travel. With a little planning, you can get Uncle Sam to subsidize your downtime. Here are the strategies for doing just that.

Combine Business and Vacation Plans for Domestic Travel

If you go on a business trip and add on some vacation days, you know you can deduct some of your expenses. The only question is how much. First, let's cover just the pure transportation expenses. By this we mean the costs of getting to and from the scene of your business activity, which includes travel to and from your departure airport, the airfare itself, baggage tips, cabs to and from the destination airport, and so forth. Costs for rail travel or to drive your personal car also fits into this category. The bottom line is your domestic transportation costs are 100% deductible as long as the primary reason for the trip is business rather than pleasure. On the other hand, if vacation is the primary reason for your travel, none of your transportation expenses are deductible.

The IRS doesn't specify how to determine if the main reason for domestic travel is business. Obviously, the number of days spent on business versus pleasure is the key factor. We can look to the rules covering foreign travel for guidance on this issue. They say your travel days count as business days. So do weekends and holidays if they fall between days devoted to business and it would be impractical to return home. "Standby days," when your physical presence is required, also count as business days—even if you're not called upon to work on those days. Any other day principally devoted to business activities during normal business hours is also counted as a business day, and so are days when you intended to work but couldn't due to reasons beyond your control (local transportation difficulties, power failure, etc.).

For domestic trips, you should be able to claim business was the primary reason for a sojourn whenever the business days exceed the personal days. Be sure to accumulate proof about this and keep the proof with your tax records. For example, if your trip is made to attend client meetings, log everything on your daily planner and copy the pages for your tax file. If you attend a

convention or training seminar, keep the program and take some notes to show you attended the sessions.

Once at the destination, your out-of-pocket expenses (lodging, hotel tips, 50% of meals, seminar and convention fees, cab fare, etc.) for business days are fully deductible. Expenses for personal days are nondeductible (except in the "Saturday Night Stayover" situation covered later in this letter).

Example: You are a sole proprietor. You arrange a business meeting with an important client in San Francisco on Wednesday morning. You fly out Sunday evening and spend all day Monday sightseeing. Tuesday you spend most of the day preparing for the meeting, attend the powwow the next morning, take the client to lunch, and return home Wednesday night. So Sunday, Tuesday, and Wednesday count as business days. The business meeting obviously necessitated the trip, and you clearly didn't spend an unreasonable amount of time on personal activities. So you can deduct your airline tickets, plus your lodging for Sunday and Tuesday nights, 50% of your meals for Sunday, Tuesday, and Wednesday, your other out-of-pocket expenses for those days, and 50% of the cost of lunching with your client.

Employer reimbursements for the business portion of an employee's expenses are not taxable income to the employee as long as the employer requires an adequate accounting. The employer can generally write off only 50% of reimbursements for meals and entertainment.

When the employer doesn't reimburse an employee, the 50% disallowance rule for meal and entertainment expenses falls on the employee's shoulders. After this disallowance rule is applied, employees can deduct the remainder of their unreimbursed business travel costs on their personal tax returns as a miscellaneous itemized deduction, subject to the 2% of adjusted gross income deduction floor.

Maximizing the Tax Benefits of a Saturday Night Stayover

A great way to maximize deductions for the personal portions of a trip is with a Saturday night stayover that reduces the overall cost of the trip. If you can show staying the extra day or two costs less (or no more) than coming back home immediately after the business meeting is over, the IRS allows you to deduct your

additional meal and lodging expenses (subject to the 50% rule for meals) for the extra day(s). Naturally, you still must have a dominant business purpose for making the trip in the first place. Be sure to document that your airfare savings equaled or exceeded the out-of-pocket costs of staying the extra day(s). Keep the proof with your tax records.

Example: You have a business meeting in New York on Monday morning. You and your spouse fly into town Saturday morning and spend the weekend seeing the sights in the Big Apple. Your round trip airfare is only \$400 versus \$1,200 if you came in Sunday night and left Monday. In this situation, Saturday is a personal day since you would normally fly in Sunday. No problem. As long as your meal and lodging expenses for Saturday are no more than \$800, you can write off your whole trip (subject to the 50% rule for meals). Of course, you generally can't deduct the additional costs for your spouse (his or her airfare and meals and any extra charges for having two people instead of one in the hotel room), and you can't deduct purely personal expenses like show tickets and baseball games. Still, this is a great deal tax-wise.

Deducting Foreign Travel Costs

When you travel outside the U.S. *primarily* for business reasons, the general rule is you must allocate all your travel expenses—including transportation—between business and personal. However, there are two big exceptions, and you often can plan ahead to take advantage of them. Here they are: you can deduct 100% of your *transportation* expenses if you meet:

- the one-week rule, or
- the 25% rule for longer trips.

One-Week Rule: If your business trip is a week or less—not counting the day you leave but counting the day you return—you can deduct 100% of your transportation costs and 100% of your other out-of-pocket expenses for business days (subject to the 50% rule for meals). You cannot deduct out-of-pocket costs incurred on vacation days. The good news: weekends and holidays falling between business days count as business days. Ditto for an intervening weekday between two business meeting days. "Standby days" when your physical presence is required for business also count, even if you spend most of your time on

personal pursuits during those days. Finally, business days include the day of your return trip plus days you intended to work but couldn't due to reasons beyond your control.

25% Rule: You can also deduct 100% of your transportation expenses for trips lasting over a week, as long as you spend **less** than 25% of your days on vacation. For this purpose, count the day of departure and day of return as business days. Also count all the other types of business days mentioned under the one-week rule above. Once again, however, you cannot deduct meals, lodging, and other expenses allocable to personal days.

Even if you don't qualify for either of the above two exceptions, you (or, more likely, your employer) can still deduct 100% of your transportation costs if you're traveling under a reimbursement or travel allowance arrangement and you're not a managing executive of the company or related to your employer. And finally, in sort of a catch-all provision, 100% of your transportation costs to foreign destinations are deductible if you can prove a personal vacation was not a consideration in choosing to make the trip.

If 100% of your transportation expenses aren't deductible under any of the above rules, the *business percentage* of your transportation costs are still deductible—assuming the trip is primarily for business. To calculate the business percentage, divide the days spent principally on business activities by the total number of days outside the country, counting departure and return days. The travel days count as business days, as do the other types of days considered business days for purposes of the one-week rule and 25% rule. You can also deduct the out-of-pocket expenses allocable to your business days (subject to the 50% rule for meals).

Example: On Thursday, you fly to Milan, Italy for meetings with customers on Friday and Monday. You then vacation the following Tuesday through Friday and return home Saturday. The two travel days, the two meeting days, and the weekend days in between count as business days. However, the four vacation days amount to 40% of your time, so you fail the 25% test. Therefore, you must allocate your airfare between business and personal. You can deduct 60% of your airfare. You also deduct your out-of-pocket expenses for the six business days.

Example: Same as above, except this time you have only two

vacation days (20% of your total days). Remember, the weekend days between your business meetings also count as business days. Now you can deduct 100% of your airfare because you pass the 25% test. You also deduct your out-of-pocket expenses for the eight business days.

Example: Same as above, except this time you return home on Thursday, three days after concluding your business meetings. Now your trip is considered to last only a week (the departure day doesn't count). So you can deduct 100% of your airfare under the one-week rule. You also deduct your out-of-pocket expenses for all the business days.

The transportation expense allocation rule doesn't apply to parts of your trip that begin and end within the United States. For example, say you are flying from Colorado Springs to London. You have to change planes in Chicago going out and coming back. You can deduct 100% of the outbound leg from Colorado Springs to Chicago and 100% of the leg from Chicago to Colorado Springs on the way back. The allocation rule applies to the remainder of your airfare. Once again, the trip must be primarily for business for any of your airfare to be deductible.

Travel to Attend Conventions

If the reason for a trip *outside North America* is to attend a business convention directly related to your trade or business, you may qualify for deductions. However, you must follow all the above foreign travel rules *plus* show it was just as reasonable for the meeting to be held on foreign soil as in North America. Otherwise, you can only deduct the registration fees and other costs directly related to business while on your trip.

Fortunately, the stricter rules for foreign conventions are inapplicable in many cases because the definition of "North America" for this purpose is *very liberal*. It includes Canada, Mexico, Puerto Rico, the U.S. Virgin Islands, American Samoa, the Northern Mariana Islands, Guam, the Marshall Islands, Micronesia, Palau, Barbados, Bermuda, Costa Rica, Dominica, Dominican Republic, Grenada, Guyana, Honduras, Jamaica, Saint Lucia, Trinidad and Tobago, Midway Islands, Palmyra, Baker Island, Howland Island, Jarvis Island, Johnston Island, Kingman Reef, and Wake Island.

If your business-related convention is at any of these locations, you fall under the more lenient domestic travel rules explained at the beginning of this letter.

Example: On Friday, you fly to Puerto Rico for a three-day industry convention. The meeting takes place the following Monday through Wednesday. You vacation the weekend before and on Thursday and Friday after. You return home Saturday. If this were considered a foreign convention, you could deduct only 55.6% of your airfare, based on two travel days plus three convention days out of nine total days. This assumes you could pass the test about it being just as reasonable to hold the convention there as in North America (otherwise, none of your transportation expenses would be deductible). However, since Puerto Rico is considered part of North America, the more liberal domestic travel rules apply. So you can deduct 100% of your travel costs, because the primary purpose for the trip was to attend the business-related convention.

Note that regardless of the location, you cannot deduct travel costs to attend investment or financial planning conventions and seminars.

There you have it. We hope this letter helps you plan some lovely trips that also deliver some nice tax breaks. However, we realize the rules explained here are rather complicated.