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# Record Keeping for Travel and Entertainment Deductions

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A new law enacted by the 87th Congress (The Revenue Act of 1962) has caused great consternation in the business world as to what is and what is not allowable for tax deduction purposes pertaining to travel and entertainment. These two items must now be separated in our thinking. Travel refers to the expenses incurred by an employee or businessman while away from home on business. Entertainment may occur on such a business trip or may occur in the ordinary course of business in his office, home or home town. Section 4(a) of the Revenue Act of 1962 along with the Income Tax Regulations, a number of Information Releases, and Published Questions and Answers by the Revenue Service have been the subject of many hours of discussion and thought by every taxpayer affected. When the law was first enacted, there was considerable doubt and many rumors as to what was intended. The fact that it took several months to issue the present regulations and that delays for compliance were allowed, indicates that it was no easy matter for any of us. The Regulations are final on Section 274(d) which deals with record keeping. How it is to be effectually administered still remains to be seen.

Accountants and tax practitioners have spent many hours trying to determine exactly what procedures should be followed by their clients. No doubt the Internal Revenue Service is occupied with the same problems.

In some businesses, the proper record keeping may have necessitated no significant changes in the systems already established. However, some of the requirements are new and probably have made some additional work. Any well-run business has required its employees to make a detailed accounting in connection with all their disbursements, including those for travel and entertainment, as a standard procedure. Sometimes there were exceptions in the case of a few top officials. However, unexplained advances and incomplete records of how the money paid to an employee was spent are no longer allowable. It behooves an employee to obtain approval for each expenditure from some authorized person within the organization. The Legislation was particularly

aimed at unlimited expense accounts with no subsequent itemization by the employee or business man. Frequently this very system was the inducement for a top official to go with a company as at least some items, which were partially personal, were paid by the company without being taxed to the employee.

The new regulations now require complete accounting for all moneys paid by a company to an employee (except his salary, of course). Receipts must be secured for any items of \$25 or more, and for lodging, regardless of the amount. Details must be furnished as to the time, place and business purpose of the expenditure as well as the exact amount.

Per diem expenditures in the amount of \$25 or less need no further receipt than the approval of the employer. These expenditures include hotel, meals, taxis, etc., but do not include transportation to and from the destination. Many items which previously were considered ordinary business expenses may now be questionable. "Promotion" and "good will" alone are not sufficient reason for making expenditures unless they can definitely be tied to a business purpose.

Entertainment is a separate category from travel. Frequently, it is difficult to determine where one leaves off and the other begins. In order to take a tax deduction for entertainment, one must furnish records as to the cost of each item (meals, beverages, tips, theatre tickets, etc.), the time of the entertainment, the place at which the entertainment occurred, the business purpose, and the persons entertained. In order for entertainment to be deductible, it must be proven to have a specific business purpose. There must be a brief statement in the record as to the reason for the entertainment. The entertainment should be directly before or after a substantial business discussion or should be the occasion for a business discussion in order to qualify. In case the entertainment does directly follow a business discussion or day of working with the person entertained, it is permissible to invite and deduct the expense for your business associate's wife or husband. Your own spouse may also accompany the guests if this can be shown to serve a business purpose.

Some items have caused a great deal of confusion. One item was the taxi fares of an employee on an out of town assignment. At first, it was specifically stated that the first taxi fare of the day and the return to the hotel from the last business contact were personal items and must be borne by the employee as a "cost of getting to work." Can't you imagine the amount of record keeping necessary to prove or disprove this item alone? IRS has changed its position on this—employees may have been making up their minds to arrange schedules so that they could "walk to work." Valet services were not allowable under the old law and the published Questions and Answers, but now seem to be ordinary and necessary travel expenses.

The practice of drawing an advance of \$100 which was kept in one pocket for payment of all business expenses with the balance returned to the employer without itemizing the expenses is not considered "sufficient record keeping." It is suggested that the employee keep a small diary in his pocket and jot down his expenses as he goes along so that he can account in detail upon his return. Various printed forms are available and many of these seem to meet all the necessary requirements for detail with the possible exception of the business purpose portion. It is very important that any and all records have a "brief description of your business reason for incurring the expenses."

The IRS has taken the position that taxis for the day, meals for the day, etc., may be lumped together. "Supporting evidence" can become a storage problem if we don't limit the detail. You must have a paid voucher for each item over \$25. Transportation vouchers are usually easily accessible unless you use your own car. In that case, a speedometer reading will serve. In order to avoid disagreements, I have kept a copy of my service bill for January service showing a speedometer reading, have kept accurate mileage on all business use of my car, and will keep the next January service bill to indicate actual mileage. Business usage of the car can then be determined. It is permissible to take a flat per mile deduction (15 cents per mile is allowable)—but remember to get the approval of an authorized company official on your report in order to avoid having the item questioned.

Before concluding the discussion of travel, remember that the Regulations require a "timely accounting." Just what is timely is not stated. Six months after the trip might not appear to be timely. After discussions with other tax practitioners, it was decided that our policy of accounting at the end of each trip was timely—so long as the trip was no longer than two weeks in duration. If you are traveling

for longer periods of time, weekly, semi-monthly, or monthly reports would seem to be necessary.

Another problem arises if the spouse is taken on the trip. Unless he or she serves a business purpose, the expenses are not deductible. How do you allocate the expenses? Are one-half of the expenses excluded? On the hotel room, must the employee bear half of the expense or only the additional amount charged for the double occupancy? What about the taxi fare from the airport to the hotel, tips to hotel porters, or the use of your personal car in getting to the destination? Would you not have these expenses whether you were traveling alone or with your spouse? Through published Questions and Answers, the IRS has indicated an opinion on the proper treatment of these expenses. The expenses for the spouse are only the amounts in excess of the single occupancy or the excess charges for the extra passenger.

What is the policy of the IRS concerning employees who combine business and vacation on a trip for the employer? It is not necessary to allocate cost of transportation to and from destination if the employee has no choice about assignment.

Entertainment falls under a separate set of rules, although the accounting requirements are quite similar. One must keep a record of the amount spent, the date of the entertainment, the exact type of entertainment, where it occurred, the names of persons present, and the business purpose. Good will is not sufficient business purpose unless it can be tied to the business specifically. Use of charge accounts will establish date, place and cost of the entertainment. Some credit card companies have revised their charge slips to include spaces for the names of persons present and business purpose to be inserted at the time the check is signed. This would seem to be sufficient information.

The business purpose description has caused a great deal of discussion. Salesmen feel that their trade secrets will be revealed to one and all under this system. Attorneys and accountants feel that client confidence may be invaded. Some method should be devised whereby a timely record may be kept, which can later be shown to the Internal Revenue auditor, and yet confidential information need not be revealed to the office staff. The disclosure of the parties involved in a complicated real estate deal could mean that the contract might never be signed. Employee leaks of information could be tragic in many businesses. In some instances confidential information regarding expenses

(Continued to page 10)

**Schedule M-1 Reconciliation of Income per Books with Income per Return**

1. Net income per books	7. Income recorded on books this year, not included in this return (itemize) .....
2. Federal income tax	.....
3. Excess of capital losses over capital gains	.....
4. Taxable income not recorded on books this year (itemize) .....	8. Deductions in this tax return not charged against book income this year (itemize) .....
.....	.....
5. Expenses recorded on books this year not deducted in this return (itemize) .....	.....
.....	9. Total of line 7 and 8
6. Total of lines 1 through 5	10. Income (line 28, page 1)— line 6 less 9
=====	=====
=====	=====

**Schedule M-2 Analysis of Earned Surplus and Undivided Profits Per Books** (line 23, Page 4)

1. Balance at beginning of year	5. Distributions (a) Cash
2. Net income per books	(b) Stock
3. Other increases (itemize) .....	(c) Property
.....	6. Other decreases (itemize) .....
.....	.....
.....	.....
.....	7. Total of lines 5 and 6
4. Total of lines 1, 2, and 3	8. Balance end of year (line 4 less 7)
=====	=====
=====	=====

This revision is best explained by the following comparison which lists the lines on the revised schedules where the information will be shown as compared to the lines on the former Schedule M.

<i>Schedule M</i> Line No.	appears on	<i>Schedule M-1</i> Line No.	<i>Revised</i>	<i>Schedule M-2</i> Line No.
1	" "			1
2	" "	10		
3-4	" "	7		
5	" "	8		
6	" "	8		
7	" "			3
8 (total)	" "			
9	" "			5
10	" "	5		
11	" "	2		
12-14	" "	5		
15	" "	3		
16	" "	5		6
17	" "	5		
18	" "	4		
19	" "			6
20 (total)	" "			
21	" "			8

**Record Keeping \* \* \***

(Continued from page 4)

cannot be made available generally at the time the expenses are incurred, but can be made part of the regular files possibly six months later. Perhaps the use of a personal diary to record "business purpose" is the answer.

Business luncheons and dinners are specifically allowable as a deduction—as they were under the old law. They are still governed by it—they should have a business purpose and good will is sufficient.

Even theatre parties, ball game attendance,

etc., are not frowned upon by the Internal Revenue Service if they are a part of, or are immediately connected with, a bona fide business discussion.

The fact that all answers have not yet been resolved is proven by the article which appears in the June 1963 issue of THE JOURNAL OF ACCOUNTANCY entitled "Comments on Proposed Regulations Under Code Section 274 Relating to Disallowance of Certain Entertainment, Gift and Travel Expenses—submitted to the Internal Revenue Service, May 3, 1963, by the AICPA Committee on Federal Taxation."