



business meeting

TRAVEL AND ENTERTAINMENT EXPENSES—WHAT'S DEDUCTIBLE & WHAT'S NOT

In the pursuit of new business relationships and the maintenance of existing ones, businesses often find it necessary to spend a significant amount of money on travel, meal, and entertainment costs. While the general rule in the *Income Tax Act* is that expenses incurred to earn a profit are deductible in the computation of business income, in practice, the tax rules are seldom that straightforward. The tax treatment of travel and entertainment costs is no exception, and this article summarizes the sometimes complex rules which determine what's deductible – and what's not.



Wolters Kluwer

Meal and entertainment expenses

The general rule is that 50% of reasonable amounts paid for food, beverages, and entertainment expenses in the course of earning business income are deductible in computing that income. There are, of course, numerous exceptions to that general rule. Specifically, the 50% limitation does not apply if you are a business owner in the following situations:

- You are in a business (i.e., a restaurant or hotel) which regularly provides food, beverages, or entertainment to customers for compensation.
- You incurred the meal and entertainment costs for a fundraising event whose primary purpose was to benefit a registered charity.
- The costs which you incurred were later billed to and recovered from a client or customer. Of course, in such cases the amount recovered from the client or customer must be included in income, effectively offsetting the deduction.
- You incurred the meal and entertainment costs in order to provide a social event for all of your employees at a particular work location. This exception is intended to cover the costs of the office Christmas party or annual picnic, and the deduction is limited to the costs of only six such special events each year.
- The meal or entertainment was provided to an employee or employees and was then included in their income as a taxable benefit.
- The meals were provided to employees living at a temporary work camp established in order to provide housing and meals to employees working at a construction site. In this case, it must not be reasonable for employees to return home from the construction site daily.

While the definition of what constitutes a meal is reasonably clear on a common-sense interpretation, questions sometimes arise as to what constitutes an entertainment expense.

The Canada Revenue Agency's (CRA's) Interpretation Bulletin 518R, *Food, Beverages and Entertainment Expenses*, provides some guidance in this area, specifying that the following types of expenditures would be considered entertainment expenses:

- the cost of tickets for a theatre, concert, athletic event, or other performance;

- the cost of private boxes at sports facilities;
- the cost of room rentals to provide entertainment, such as a hospitality suite;
- the cost of a cruise; and
- the cost of entertaining guests at night clubs, athletic, social and sporting clubs, and on vacation and other similar trips.

The CRA has also established rules to apply to specific expenditures such as convention and conference expenses and club dues and fees.

Truck drivers' meal expenses

Special rules apply to long-haul truckers. Long-haul truckers paying for food and beverages on or after March 19, 2007 during an eligible travel period will be allowed to deduct a greater percentage of that cost than the 50% general limit for transport employees. The greater percentage is 60% after March 18, 2007 and before 2008, 65% in 2008, 70% in 2009, 75% in 2010, and 80% after 2010. The increased deduction is also available to employers who pay or reimburse such costs incurred by long-haul truck drivers that they employ.

A long-haul truck driver is defined as an individual whose principal business or duty of employment is driving a truck or tractor designed for hauling freight, and that has a gross vehicle weight rating of more than 11,788 kilograms. The eligible travel period in respect of which the driver may claim a greater deduction is defined as a period of at least 24 continuous hours, during which the driver is away from the municipality where his regular place of employment is located (in the case of an employee) or from the municipality where his place of residence is located (in the case of an independent worker) to drive a long-haul truck transporting goods to or from a location that is more than 160 kilometres away from that municipality.

Conference and convention expenses

Business owners might well think of attendance at business-related conventions or conferences as a business obligation rather than as entertainment and, generally, the costs of going to two such conventions each year are fully deductible. However, the tax rules provide that meals consumed or entertainment provided at such conferences or conventions are subject to the 50% limitation. Recognizing the difficulty of separating such costs



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from the charges associated with convention attendance generally, the CRA has prescribed a \$50 per day amount. Consequently, where a convention or conference fee includes the provision of meals or entertainment, and the convention or conference organizers do not specifically itemize the charges associated with such items on the invoice, \$50 must be subtracted from the convention fee for each day that such meals or entertainment are provided. That \$50 fee is then deductible from income, but subject to the 50% limitation – in effect, the deduction is \$25.

For example, if a business owner attends a three-day conference at which meals are provided, and the overall convention fee is \$1,000, the available deductions would be as follows:

Convention expense deduction:

$\$1,000 - \$150 (\$50 \times 3) = \mathbf{\$850}$ (fully deductible)

Meals and entertainment deduction:

$\$150 (\$50 \times 3) \times 50\% = \mathbf{\$75}$

Total allowable deduction for costs associated with the convention:

$\mathbf{\$925}$ ($\$850 + \75)

The CRA is prepared to concede that the cost of items such as coffee and doughnuts provided for convention attendees is not considered to constitute meals or entertainment and does not have to be separated out from the overall cost of convention attendance.

Club dues and fees

Businesses often maintain memberships at private clubs in order to provide a venue at which to entertain clients and prospective clients. However, the income tax rules provide that where the main purpose of the club is to provide dining, recreation, or sporting facilities to its members, the cost of club membership (including any initiation fees) is not a deductible business expense. However, the actual costs (for example, food and beverages) of entertaining clients or prospective clients at such a club may well be deductible (subject to the usual 50% limitation), assuming that such entertainment has a business purpose.

Camps, lodges, and golf courses

Facilities such as camps, lodges, and golf courses owned by a business occupy something of a middle ground for tax purposes, in which the deductibility of costs associated with those facilities can differ, depending on the main activity to which the facility is put. In the CRA's view, if a resort hotel or lodge is used for a genuine business purpose which does not include the entertainment or recreation of clients, suppliers, shareholders, or employees (for example, a conference facility which is used solely for business meetings), the related expenses may be deducted. However, where some business meetings may be involved but the main activity is recreation

or entertainment, no deduction is permitted under the rule applicable to recreation, entertainment, and sporting facilities outlined above. Note that, even if a deduction is permitted, that deduction may still be restricted by the 50% rule applicable to meals and entertainment.

Yachts

Leaving no stone unturned, the CRA has decreed that the cost of maintaining or using a yacht is not generally a deductible business expense. The very small minority of business owners who must concern themselves with such issues should know that a vessel will be considered by the CRA to be a “yacht” where its primary purpose is the entertainment or recreation of clients, suppliers, shareholders, or employees. However, where expenses incurred in connection with a yacht are essential to the operation of the business and the yacht is used 90% or more for business purposes, such expenses will be deductible. Those business purposes do not, however, include the entertainment of suppliers, employees, shareholders, or clients.

Planes, trains, and automobiles—the (mostly) deductible costs of business travel

The rules governing the tax treatment of travel costs, especially automobile costs, have a well-deserved reputation for being complex, excessively detailed, and subject to frequent revision. However, where such travel costs involve business owners, as distinct from employees, the applicable rules are somewhat more straightforward.

Automobiles

The starting point in calculating deductible automobile travel costs is the general rule that expenses incurred to run a motor vehicle used to earn business income are deductible. Where, as is frequently the case for small business owners, the same vehicle is used for personal and business purposes, a record must be kept documenting the total kilometres driven and the kilometres driven for business purposes, so that eligible expenses can be prorated. To that end, the record of each trip taken for business purposes should include the date, destination, purpose, and number of kilometres driven.

Most costs associated with running and maintaining your vehicle will be deductible. Specifically, licence and registration fees, fuel costs, insurance,

interest on money borrowed to purchase the vehicle, maintenance and repair costs, and leasing costs are all deductible, with some limitations. As well, all parking costs associated with the business use of your vehicle and supplementary business insurance costs will be fully deductible.

The following example illustrates the computation of eligible automobile expenses for a typical small business owner.

Jim is the owner of a small lawn maintenance business. He owns a pickup truck which he uses to transport his equipment to job sites. His records for 2009 show the following:

Kilometres driven in connection with the business:	32,000
Total kilometres driven:	48,000
Expenses	
Gas and oil	\$4,800
Licence and registration fees	\$ 150
Maintenance and repair	\$1,000
Insurance costs	\$2,500
Interest on truck loan	\$ 550
Total expenses	\$9,000

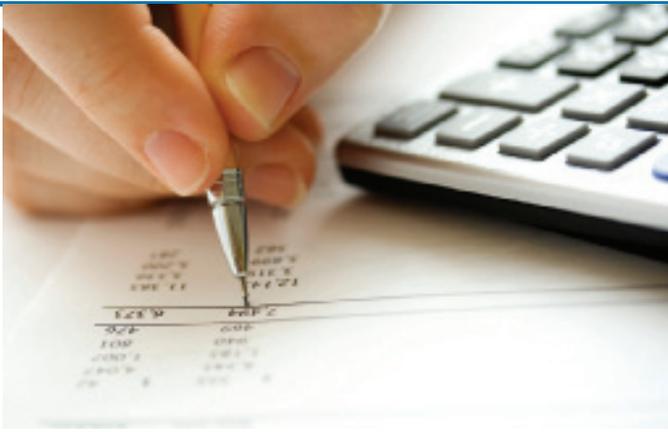
Based on total kilometres driven (48,000) and total kilometres driven for business purposes (32,000), Jim’s prorated deduction for motor vehicle costs for 2009 would be as follows:

$$32,000/48,000 \times \$9,000 = \mathbf{\$6,000}$$

Jim also paid \$60 for business parking during the year. Therefore, his total deduction for business-related motor vehicle expenses for 2009 are:

$$\mathbf{\$6,000 + \$60 = \$6,060}$$

Complexities begin to arise when some of the deduction limitations referred to above come into play. Generally, both interest costs on motor vehicle loans and lease payments are deductible, although both, of course, are restricted by the requirement that expenses be prorated to reflect percentage of business use. However, for tax purposes, a vehicle can be characterized as a motor vehicle, an automobile, or a passenger vehicle, and where the vehicle in question falls into the category of a “passenger vehicle”, additional rules apply to limit the amount of interest or lease payments which may be deducted.



The question of what constitutes a passenger vehicle (as opposed to a motor vehicle) is more complex than might be imagined. The following chart, intended to provide some of the main definitions for different types of vehicles, is taken from the CRA's publication *Business and Professional Income 2007* (T4002(E)).

Vehicle definitions

VEHICLE TYPE: Coupe, sedan, station wagon, sports car, or luxury car
 SEATS (INCLUDING DRIVER): 1 to 9
 BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%
 DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Pickup truck used to transport goods or equipment
 SEATS (INCLUDING DRIVER): 1 to 3
 BUSINESS USE IN YEAR BOUGHT OR LEASED: more than 50%
 DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Pickup truck (other than above)*
 SEATS (INCLUDING DRIVER): 1 to 3
 BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%
 DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Pickup truck with extended cab used to transport goods, equipment, or passengers
 SEATS (INCLUDING DRIVER): 4 to 9
 BUSINESS USE IN YEAR BOUGHT OR LEASED: 90% or more
 DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Pickup truck with extended cab (other than above)*
 SEATS (INCLUDING DRIVER): 4 to 9
 BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%
 DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: SUV used to transport goods, equipment, or passengers
 SEATS (INCLUDING DRIVER): 4 to 9
 BUSINESS USE IN YEAR BOUGHT OR LEASED: 90% or more
 DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: SUV (other than above)
 SEATS (INCLUDING DRIVER): 4 to 9
 BUSINESS USE IN YEAR BOUGHT OR LEASED: 1% to 100%
 DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Van or minivan used to transport goods or equipment
 SEATS (INCLUDING DRIVER): 1 to 3
 BUSINESS USE IN YEAR BOUGHT OR LEASED: more than 50%
 DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Van or minivan
(other than above)

SEATS (INCLUDING DRIVER): 1 to 3

BUSINESS USE IN
YEAR BOUGHT OR
LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

* * *

VEHICLE TYPE: Van or minivan used
to transport goods,
equipment, or passengers

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN
YEAR BOUGHT OR
LEASED: 90% or more

DEFINITION: **Motor vehicle**

* * *

VEHICLE TYPE: Van or minivan
(other than above)

SEATS (INCLUDING DRIVER): 4 to 9

BUSINESS USE IN
YEAR BOUGHT OR
LEASED: 1% to 100%

DEFINITION: **Passenger vehicle**

* A vehicle in this category that is used more than 50% to transport goods, equipment, or passengers while earning or producing income at a remote work location or at a special work site that is at least 30 kilometres from the nearest community having a population of 40,000 persons is considered a motor vehicle.

If a particular vehicle falls into the category of passenger vehicle, then the amount of interest or leasing cost which can be deducted is limited to the actual interest amount or lease payment paid up to a ceiling prescribed by the CRA. To the extent that the interest or lease payments actually paid exceed that ceiling, excess payments are not deductible.

For example, where interest is paid on a loan taken out to purchase a passenger vehicle, the ceiling prescribed is equal to \$10 times the number of days during the year during which interest was paid. So, a taxpayer who took out a loan to purchase a passenger vehicle on April 1 of the year would

be able to deduct up to \$2,750 in interest costs (\$10 times 275 days). That \$2,750 represents the available interest expense deduction. If the interest paid exceeded that amount, no deduction would be available for the excess. Of course, should the actual interest cost be less than \$2,750, the deduction would be limited to the actual interest paid. And, as always, any interest payment made is subject to the general rule requiring proration based on business use, as shown in the example above.

Where a passenger vehicle is leased, the computation of the eligible leasing cost is considerably more complex. In effect, the CRA prescribes upper limits for both the capital cost of the passenger vehicle and the monthly leasing cost, and those amounts, when entered into a prescribed formula, are used to determine the maximum deduction



which may be claimed. The eligible leasing cost to be deducted is therefore the lesser of the actual lease payments made and the maximum deduction calculated under that formula (subject, as always, to proration for the percentage of business use). The prescribed figures used to calculate the maximum deductions available for both interest costs and leasing charges are frequently revised. However, once a lease is entered into for a passenger vehicle, the rates in effect at that time continue to apply for the life of the lease.

Air travel

Fortunately, the rules governing the deductibility of business travel by air (or train, or bus) are far less complex than those governing the deduction

of automobile expenses. The costs of such travel (whether for the business owner or an employee) follow the general rule for the deduction of business expenses – that is, reasonable costs incurred for travel carried out in order to earn income from the business are deductible in the calculation of income from that business. The cost of hotel accommodation at the destination would be similarly deductible, and not subject to the 50% limitation imposed on meals and entertainment expenses.

Where to find more information

The CRA has issued a number of publications which deal with the tax treatment of travel and entertainment expenses by businesses, and all of those publications, along with additional information, are available on the Agency's Web Site at <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/slprtnr/bsnssxpns/menu-eng.html>.

The Agency has issued two Interpretation Bulletins on this subject: IT518R, *Food, Beverage and Entertainment Expenses*, and IT521R, *Motor Vehicle Expenses Claimed by Self-Employed Individuals*. However, as both Interpretation Bulletins were last revised in 1996, the annual guide issued by the CRA outlining the computation of business income, *Business and Professional Income 2009* (T4002(E)), is far more likely to contain current information on the subject.

