

The Fun Side of Taxes

New entertainment rules now apply.

BY JAMES D. KRICKETT

Taxes can be fun? Well, not exactly, but our federal tax rules do permit write-offs and deductions for a number of enjoyable activities, events, and other expenditures made by a podiatry professional in the pursuit of income, referrals, happy employees, content principals, clients, and patients. Although much has been said and written about tax deductible picnics and holiday parties, the tax rules allow deductions for many, many other types of enjoyable activities.

Entertainment may, in many cases, be considered a business necessity but it can also be enjoyable. When a podiatry professional or practice entertains fellow professionals, associates, clients, or patients, current or prospective, the costs can really add up but they are usually tax deductible... even after the tax laws were “reformed.”

New Restrictive Entertainment Rules

The deduction for food and beverage costs were impacted by the Tax Cuts and Jobs Act (TCJA) passed in December 2017, but, fortunately, deductions for meal and entertainment expenses remain a viable option for every podiatry practice. Although the limited deductions for meal and entertainment expenses is only 50% of the amount spent, generally, all “ordinary and necessary” expenses of business entertaining, so long as they are not “lavish or extravagant under the circumstances,” are deductible if:

- The expenses qualify as meals or entertainment
- The expenses bear the necessary relationship to the podiatry practice, and

- Adequate records are maintained to substantiate the expense.

Qualifying as meal and entertainment expenses are activities considered to provide entertainment, amusement, or recreation at places such as:

- Nightclubs

- Social, athletic, and sporting clubs

- Theaters
- Sporting events, or
- Hunting, fishing, and similar trips.

However, while the cost of tickets to events can be deductible, only

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the face value of the ticket can be deducted even if a higher price was actually paid. An exception is made when that higher ticket price is part of a package deal or for a ticket to a sporting event that benefits a charitable organization. Even better, the 50% limit on entertainment expenses doesn't apply to any expense that is a means of advertising or promoting goodwill in the community.

Traveling Deductions

Imagine an enjoyable—and educational—vacation with Uncle Sam, in the form of our tax laws, picking up part of the tab. While, thanks to the TCJA, the practice must be the one paying, every principal, partner, or shareholder as well as employees of a podiatry practice (even someone who is a shareholder/employee), can legitimately be reimbursed for the expenses of business travel. In other words, Uncle Sam, in the form of our tax rules, will help pay for that business trip.

The tax rules clearly state travel expenses are tax deductible if the trip was primarily business-related such as a meeting, convention, or to meet

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with potential referral sources, patients, clients, or suppliers. If, on the other hand, the trip was primarily for personal reasons, such as a vacation, the cost of the trip is a non-deductible personal expense.

When vacation days are tacked onto the beginning or end of a business trip, out-of-pocket costs are usually minimal since much of the business portion of the travel could be tax-deductible. Obviously, traveling to a business meeting is work-related and the IRS doesn't really care whether you get there a few days early or hang around for a bit after your business is concluded. Since you had to travel anyway, reimbursement of the cost of transportation usually qualifies as a business expense.

The cost of travel by bus, train, or auto, either a personal auto or one rented by the practice, is also deductible. But don't try to slip in the price of airfare if the ticket was obtained with frequent flier miles.

To make a real mini-vacation out of your next business trip, take the family along. The expenses of an accompanying spouse or children won't be deductible unless they work for the practice and are involved in the out-of-town business meetings. The tax rules will, however, cover at least part of their expenses.

Take lodging, for example. When you share a room, the charge for added occupants typically is not double the fee for one guest. That means that for the days business is conducted, most of the cost of a family-shared room will be deductible. And, while only your airfare is deductible if you fly, driving to an out-of-town meeting means the mileage is fully deductible even with your family along for the ride. Just be prepared for more diligent record-keeping.

Gifting

Every podiatrist should keep in mind the role that taxes play in gifting. As you decide on an appropriate holiday gift for your employees, it's important to consider not only what they'll enjoy but also how taxes will come into play. After all, giving gifts, bonuses, or awards to employees

also has tax implications for both the practice and the recipient/employee. Consider these two questions:

- Are these gifts/awards/bonuses taxable to the employees? If they are taxable, all applicable federal, state, and local income and FICA taxes must be deducted. Other employment taxes (unemployment tax, for example) must also be paid on these amounts.

- Are these gifts/awards/bonuses deductible as a business expense? To be deductible, often these items have limits. Knowing the limits helps de-

termine the amount of the gift. are "de minimis" fringe benefits (a small amount), but the IRS has provided no guidance.

In general, if a podiatrist or practice gives gift cards or gift certificates to employees, taxes must be withheld from employee pay—at least if not "grossed up" (see below)—but, in general, are treated much like other "bonuses." Bonuses to employees/principals are a legitimate business expense and can be deducted under certain circumstances. First, consider bonuses for principals/shareholders:

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Those practice principals considering a "small gift" for employees—fruit baskets, hams, turkeys, wine, flowers and occasional entertainment tickets, such as for a show or sporting event, will find they are generally non-taxable de minimis fringes and tax deductible by the practice.

Many podiatry practices and businesses give used office furniture, computers, etc., to employees. Unfortunately, the tax rules treat those gifts as taxable compensation to the employee. The amount that should be included on the employee's W-2 form is the fair market value of the property.

It's a similar story for a bargain purchase with the difference between the amount paid and the fair market value treated as taxable compensation. Naturally, there are exceptions. Property given to an employee so that he or she can perform their work isn't taxable.

Gift Cards, Certificates, and Taxes

Gift certificates and the newer, and more common, gift cards are, for the most part, taxable to employees because they can be converted to cash. There has been some discussion about whether small amount gift cards/certificates (\$25 or less) could not be subject to taxes because they

- S Corporations can deduct bonuses for shareholders and practice principals, as long as they own their shares at the time the bonus is paid.

- Regular 'C' Corporations can only deduct bonuses for shareholders/principals who have a 50 percent or higher ownership at the time the bonus is paid.

- For sole proprietorships, partnerships, and limited liability companies (LLCs), bonuses are not deductible business expenses because the IRS considers principals/partners/members to be self-employed. This is one situation in which having an incorporated podiatry practice and being an employee of that corporation might result in more tax deductions.

Payroll Tax Withholding and Grossing Up Bonuses

Employee gifts are usually small enough that the practice doesn't need to worry about employees wanting to change their withholding allowances. But for larger bonuses, employees should be given the options of changing their W-4 withholding deduction amount for that one paycheck.

A practice must allow employees to change their W-4 forms as often as they wish. Some employees will want to change their withholding so as to re-

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ceive more of the bonus. This process requires two W-4 forms—one for the smaller withholding on the one check and another to return to the employee's original withholding amount.

In some cases, the podiatry practice might want to “gross” up a bonus. That is, giving the employee more to allow for withholding. For example, if an employer gives an employee a \$1,000 bonus, by the time taxes are taken out, the bonus check might be only, say, \$750. Calculating a higher amount for the bonus so the check shows the full \$1,000 gives the employee a larger bonus to account for the additional taxes.

Business Gifting

Are those gifts given by the podiatry practice for referring professionals, present or potential clients or patients tax deductible? The answer is yes, at least partially.

Many podiatry practices routinely give gifts to clients and patients, particularly around the holidays. What is often overlooked is that only a portion of the cost of certain gifts may be deducted as a business expense.

Basically, the IRS allows a practice to deduct only \$25 or less for business gifts given to any one person during the tax year. Any amount of expense in excess of \$25 is disallowed as a deduction. So, if a client or patient is given a \$50 watch as a gift, only \$25 may be deducted.

Gifts made to corporations or to business entities which are intended for the personal use or benefit of an individual (such as the HR or purchasing manager, president or chief administrator) or a small class of individuals are considered to have been made to the individual or individuals who actually benefit from the gifts.

Some items are, of course, excepted from the gift limitations. Gifts of key chains or pens with the practice's name and/or logo on them are not considered gifts. In a nutshell, the following items are excepted from the \$25 limit that normally applies to business gifts and their cost is deductible without limitation:

- Items costing \$4 or less have the practice's name clearly and per-

manently imprinted on them, and are one of a number of identical items widely distributed, and

- Signs or posters, display racks, or other promotional material to be used on the recipient or practice's premises.

The IRS specifically states that

incidental expenses are not included in the \$25 limit. Incidental expenses include such costs as postage, insurance, engraving, or gift wrapping. Of course, if something adds value to the gift itself, it cannot be considered an incidental expense. Furthermore,

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any item that could be considered either a gift or as entertainment is usually treated as entertainment and cannot be deducted.

Gifting Workers

In general, up to \$400 of the cost of employee safety and service awards of tangible personal property (such as a watch) for each employee for each year can be deducted by the practicing podiatrist or the practice. While these awards are not taxable income to the employee, they must be limited.

Service awards, for instance, cannot be given during the first five years of the employee's service and no more often than every five years. Safety awards cannot be given to more than 10% of employees during the same year.

The TCJA clarified that "employee incentive" awards are generally considered taxable fringe benefits. Thus,

awards such as merchandise or a vacation trip are non-cash fringe benefits that are taxable to the employee and deductible by the podiatry practice.

fringe benefits, such as traditional birthday or holiday gifts of property with a low fair market value, or occasional gifts of theater or sporting

Occasional holiday celebrations, cocktail parties, and employee picnics are fully tax deductible by the podiatry practice, and not subject to the 50% limit on business meals and can be ignored as being taxable by the employee.

The incentive award rules don't apply to non-cash employee achievement awards of tangible personal property made for length of service or safety. These awards are deductible by the employer, and can be excluded by the employee—with certain limits.

So-called non-cash "de minimis"

event tickets, are deductible by the employer and tax-free to employees.

Party Central

Although the TCJA cracked down on deductions for entertainment, a podiatry practice can still write-off the full cost of a holiday party, em-

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ployee picnic, or barbecue—at least if certain requirements are met. This can be a good way to help build practice morale on Uncle Sam’s dime.

Deductions for meals and entertainment, travel away from home, business gifts and, yes, parties, require a higher level of substantiation than many other practice expenses. A notable exception preserved by the TCJA allows a podiatry practice to deduct 100% of the cost of an employee get-together—while remaining tax-free to employees. The important thing to remember is that all employees must be invited. The practice cannot limit attendance to practice principals, officers, or high-ups. It has to be everyone.

Should a few friends crash the party this, in and of itself, won’t jeopardize the deduction although all expenses attributable to social guests are non-deductible. Suppose, for in-

stance, 20 employees and their significant others, plus five couples who are friends, are invited to a picnic, party, or other event costing \$10,000. Under the rules, based on 40 practice guests out of 50 total attendees, 80%, or \$8,000, of the expense can be written-off.

According to the tax rules, entertainment expenses must be “primarily” for the benefit of employees other than a so-called “tainted group.” The tainted group consists of any employee paid more than \$110,000 a year, a 10% owner, or any family member of a 10% owner.

The cost of occasional parties is non-taxable to employees and their families as a de minimis fringe—if they are infrequent and for the purpose of promoting employee health, good will, contentment, or efficiency. Thus, occasional holiday celebrations, cocktail parties, and employee picnics are fully tax deductible by the podiatry practice, and not subject to

the 50% limit on business meals and can be ignored as being taxable by the employee.

Tax-Free Giving

Because employee “gifts” are often considered by the IRS to be compensation, it’s important to note the rules so that employees are not responsible for paying taxes on their gifts. When it comes to giving employees gifts, bonuses, and awards, the tax rules are pretty clear. However, applying those rules to specific situations can be difficult and is best left to an expert. In fact, as is the case with travel, entertainment and, certainly, gifts, it is always a good idea to consult a tax professional. **PM**

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