Tax Impact

March/April 2024

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Tax Tips

Deducting business travel expenses: A refresher

During the COVID-19 pandemic, business travel nearly came to a halt. Today, it's on the rebound, as "Zoom-fatigued" executives craving face-to-face interaction hit the road again. With more people getting out of their offices, now is a good time for a refresher on the tax deductibility of business travel expenses.

What's your tax home?

Taxpayers are permitted to deduct their ordinary and necessary expenses of business-related travel away from their "tax home." "Ordinary" means common and accepted in the taxpayer's industry. "Necessary" means helpful and appropriate for the business. Expenses aren't deductible if they're for personal purposes, or if they're lavish or extravagant. That doesn't mean you can't fly first class or stay in luxury hotels, but you'll need to show that the expense was reasonable under the circumstances.

Your tax home isn't necessarily the place where you maintain your family home. Rather, it refers to the city or general area where your main place of *business* is located. Suppose, for example, that Walter lives in Philadelphia but works in New York City five days a week, returning to Philadelphia on the weekends. Walter's tax home is New York, so his expenses for traveling there aren't deductible. And while travel to Philadelphia on the weekends is away from his tax home, those trips are for personal reasons, so those expenses also aren't deductible. Special rules apply to taxpayers who have several places of business or who have no regular place of business (for example, consultants who are always on the road).

Generally, you're considered to be traveling away from home if your duties require you to be away from your tax home for substantially longer than an ordinary day's work and you need to get sleep or rest to meet work demands while away. This includes temporary work assignments. However, you aren't permitted to deduct travel expenses in connection with an indefinite work assignment (that is, more than a year) or one that's realistically expected to last more than a year.

What's deductible?

Assuming these requirements are met, commonly deductible travel expenses include (but aren't limited to):

- Air, train or bus fare to the business destination, plus baggage fees,
- Car rental expenses or the cost of using your own vehicle, plus tolls and parking,
- Transportation while at the business destination, such as taxis or ride shares between the airport and hotel and to and from work locations,
- Lodging and meals,
- Tips paid to hotel or restaurant workers, and
- Dry cleaning and laundry service.

Mixing business and pleasure

If you take a business trip in the United States primarily for business, but also take some time for personal activities, you're still permitted to deduct the full cost of airfare or other transportation to and from your destination. However, other expenses, including lodging and meals, are deductible for only the business portion of your trip.

Generally, a trip is primarily for business if you spend more time on business activities than on personal activities. For example, you might travel to Las Vegas for a week, attend a trade show for five days and spend the weekend gambling or going to shows.

What if a trip is primarily for pleasure, but you conduct some business while you're there? In that case, your travel expenses are nondeductible. However, you may write off otherwise deductible expenses for business activities during your trip.

Meal expenses are generally 50% deductible. This includes meals eaten alone while traveling for business. It also includes meals with others, if the meals are provided to a business contact, serve an ordinary and necessary business purpose, and aren't lavish or extravagant.

Who can claim the deduction?

Self-employed people may deduct travel expenses on Schedule C. But employees currently aren't permitted to deduct unreimbursed business expenses, including travel expenses.

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However, businesses may deduct employees' travel expenses to the extent that they provide advances or reimbursements to employees or pay the expenses directly. Advances or reimbursements are excluded from wages (and, therefore, aren't subject to income or payroll taxes) if they're made according to an "accountable plan." In this case, the expenses must have a business purpose, and employees must substantiate their expenses and pay back any excess advances or reimbursements within a reasonable time.

What records should you keep?

To deduct business travel expenses, you must substantiate them with adequate records — typically, receipts, canceled checks or bills — that show the amount, date, place and nature of each expense. Receipts aren't required for nonlodging expenses less than $75, though these expenses must still be documented in an expense report.

Keep in mind that an employer may have its own substantiation policies that are stricter than the IRS requirements. If you use your own car or a company car for business travel, you can deduct your actual costs or the standard mileage rate.

For lodging and meal and incidental expenses (M&IE) — such as small fees or tips — employers can use the alternative per-diem method to simplify expense tracking. Self-employed individuals can use this method for M&IE, but not for lodging.

Under this method, taxpayers use the federal lodging and M&IE per-diem rates for the travel

destination to determine reimbursement or deduction amounts. This avoids the need to keep receipts to substantiate the actual cost. However, it's still necessary to document the time, place and nature of the expense.

To make things even simpler, the optional high-low substantiation method allows a taxpayer to use two per-diem rates for all business travel: One for designated high-cost localities and a lower rate for all other localities. Currently, those rates are $309 and $214, respectively, and the M&IE-only rates are $74 and $64, respectively.

Turn to your advisor

The rules regarding business travel deductions can be complicated. In addition to the rules explained above, there are special rules for international travel and travel with your spouse or other family members. If you're uncertain about the tax treatment of your travel expenses, contact your financial advisor. ■

Considering home improvements?

Tax credits can make going green easier

If you're planning improvements that will boost your home's energy efficiency, be sure to consider tax incentives that may offset some of the cost. The Inflation Reduction Act (IRA), signed into law in 2022, extended and expanded tax credits that reward homeowners who "go green."

New-and-improved EEHIC

The Energy Efficient Home Improvement Credit (EEHIC) — previously known as the Nonbusiness Energy Property Credit — expired at the end of 2021. However, it was revived, renamed and improved by the IRA. The old credit was subject to a $500 lifetime limit, but now you may qualify for tax credits of up to $3,200 per year.

Starting in 2023, the EEHIC equals 30% of qualified expenses for energy efficiency improvements, residential energy property and home energy audits. The maximum aggregate annual credit for most improvements is $1,200 per year, with the following limits for certain expenditures:

- $150 for home energy audits,
- $150 per door for exterior doors (up to $500 total), and
- $600 for exterior windows and skylights, central air conditioners, electrical panels and related equipment, natural gas, propane and oil water heaters or furnaces, and hot water boilers.

A separate aggregate limit of $2,000 per year applies to electric or natural gas heat pump water heaters, electric or natural gas heat pumps, and biomass stoves and boilers. This means that it's possible to claim credits totaling up to $3,200 per year through 2032, when the EEHIC expires. If feasible, consider spreading your qualifying home improvement projects over the next several years to make the most of these credits.

Rules and restrictions

To qualify for the EEHIC, your home must be in the United States. It also must be an existing home that you improve upon or add to. (The credit isn't available for new homes.) In most cases, the home must be your primary residence. Landlords or other property owners who don't live in the home can't claim the credit.

What if you have a home office or otherwise use the property for business? If you use the property *exclusively* for business, the credit is unavailable. However, you can claim a partial credit if you use your home *partly* for business. If the business use is 20% or less, you're entitled to the full credit. If it's more than 20%, the credit is based on the portion of your expenses allocable to nonbusiness use.

Beginning in 2025, the EEHIC won't be allowed for any purchase of energy-efficient property unless it's produced by a qualified manufacturer that assigns a qualified product identification number to the item. You must include that number on your tax return when claiming the credit.

Get the credits you deserve

To lower the cost of going green, be sure to take advantage of the tax incentives available to you. In addition to the EEHIC, consider 1) the residential clean energy credit for investments in solar, wind, geothermal and fuel-cell technology, and 2) the alternative fuel refueling property credit for electric vehicle charging stations or property used to store and dispense clean-burning fuel. State tax incentives may also be available. Contact your tax advisor for more details. ■

Share your values with the use of an incentive trust

Investor Warren Buffett once said that the ideal inheritance is "enough money so that they feel they could do anything, but not so much that they could do nothing." Indeed, if you've worked a lifetime and built up a substantial amount of wealth, you may be uncertain about how your family members will handle their inheritances. Using incentive trusts in your estate plan may be the vehicle that gives you peace of mind.

Be positive

For many people, it's important to share one's values and encourage their children or other heirs to lead responsible, productive and fulfilling lives. An incentive trust essentially conditions asset distributions on certain behaviors or achievements that you wish to inspire.

Incentive trusts can be effective, but plan and draft them carefully to avoid unintended consequences. Begin with focusing on positive reinforcement.

For example, your trusts could emphasize such behaviors as going to college or securing gainful employment. By accentuating the positive, you can discourage negative behavior; it's difficult for a substance abuser to stay in school or hold down a job.

Avoid negative reinforcement, such as conditioning distributions on the avoidance of undesirable or self-destructive behavior — for example, gambling or drug use. This sort of "ruling from the grave" is likely to be counterproductive. Not only can it lead to resentment on the part of your heirs, but it also may backfire by encouraging them to conceal their conduct and avoid seeking help.

Be flexible

Leading a worthy life means different things to different people. Rather than dictating specific behaviors, it's better to establish the trust with enough flexibility to allow your loved ones to shape their own lives.

For example, some people attempt to encourage gainful employment by tying trust distributions to an heir's earnings. But this can punish equally responsible heirs who wish to be stay-at-home parents or whose chosen careers require them to start with a low-paying, entry-level job or an unpaid internship. A well-designed incentive trust should accommodate nonfinancial measures of success.

As you think about the incentives you wish to provide, avoid the temptation to "buy" desired behavior. Suppose, for example, that your trust provides generous distributions to a daughter who cares for her children full time. But what if she really wants to work outside the home? If the "stay-at-home bonus" is too large, she may feel she has little choice. A better approach may be to reward your heirs for a variety of positive options and allow them to choose their own paths.

Rather than imposing a complex, rigid set of rules for distributing trust funds, you might consider using a "principle trust." These trusts guide trustees' decisions by setting forth guiding principles and values, then providing *trustees* with discretion to evaluate each heir on a case-by-case basis. Bear in mind that for this strategy to work, your trustee must be someone you trust to carry out your wishes.

Seek professional help

An incentive trust doesn't need to be an all-or-nothing proposition. You'll want to offer sufficient funds to your loved ones to provide for their basic needs and base additional distributions on the behaviors you wish to encourage. Your estate planning advisor can help you achieve the right balance for your incentive trust based on your family's situation. ■

Short-term rentals may offer tax-free income

Opportunities to earn tax-free income are few and far between, but one often overlooked strategy allows you to do just that by renting out your home on a short-term basis. If you rent out a vacation home for less than 15 days per year, the rental income is tax-free, regardless of how much you earn.

And those earnings can be substantial, especially if the home is in a highly sought-after location or is near a major event — think Super Bowl, U.S. Open, Mardi Gras, political convention or music festival. For example, let's say you rent out your home for $2,000 per night for 14 days. That could result in $28,000 per year in tax-free income. You don't even need to report it on your tax return.

There's a caveat to keep in mind. To qualify for this tax break, in addition to renting out the home for less than 15 days per year, you must also use it for personal purposes for at least 15 days per year. ■

Are you entitled to a Medicare refund?

Most Medicare participants pay premiums for Medicare Parts B and D, and those premiums are bumped up significantly for higher-income participants. In 2024, for example, the Part B premium is almost $2,100 per year ($4,200 per year if both you and your spouse are enrolled in Part B).

However, if your modified adjusted gross income (MAGI) is between $103,000 and $129,000 (between $206,000 and $258,000 for joint filers), the premium is subject to a surcharge that brings the total premium to around $2,935 per year ($5,870 per year for both you and your spouse). MAGI is your adjusted gross income plus tax-exempt interest. The surcharge increases as your MAGI increases, until Part B premiums top out at $7,128 per year (or $14,256 for both you and your spouse) if your MAGI exceeds $500,000 ($750,000 for joint filers).

But here's the twist: Medicare surcharges are generally based on your MAGI from two years earlier. For example, your 2024 premiums are based on your 2022 income. If your income has declined since then — for example, because you married, divorced or your spouse died, you or your spouse stopped working, your income-producing property stopped producing, or your pension income was lost or reduced — you may be entitled to a refund of the excess premiums. Unfortunately, these refunds can be difficult and time consuming to obtain, so it's important to be persistent. ■

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