April 1, 2004

Dear Clients and Friends:

With thoughts of personal income taxes almost behind you and summer rapidly approaching, many of you are thinking about getting out of town. With a little planning, you may be able to get Uncle Sam to pick up part of the cost!

Most of you are familiar with the rules for deducting domestic travel costs for business trips, but the foreign travel rules are a little more complicated. The general rule says that you must allocate your transportation expenses between the business and personal components of your trip. However, with a little planning, you can take advantage of two taxpayer friendly regulations and still deduct 100% of your transportation expenses for foreign trips.

The One-week Rule. You'll meet this rule if your business trip is a week or less, not counting the day you leave, but counting the day you return. In this case, you can deduct 100% of your transportation costs (plane fare, cabs to and from the airport, etc.) and your other out-of-pocket expenses for business days (hotels, cabs, tips, 50% of your meals). You cannot deduct out-of-pocket costs incurred on vacation days. The good news is that weekends and holidays falling between business days count as business days. You can also count "stand-by" days—days when your physical presence is required, whether or not you are actually called upon to work. As you can see, these guidelines are rather taxpayer friendly. However, the main reason for your foreign trip must still be for business. Otherwise, none of your transportation costs are deductible.

The 25% Rule. Obviously, some foreign business trips last over a week. No problem if you just plan ahead and take advantage of the 25% rule. Under this rule, you can deduct 100% of your transportation expenses, as long as you spend less than 25% of your days on vacation. For this purpose, count the day of departure and the day of return as business days. Also, count all the other types of business days mentioned under the one-week rule above. Again, you cannot deduct meals, lodging, and other expenses allocable to personal days.

If 100% of your transportation expenses aren't deductible under either 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 just as the other types of days are considered business days for purposes of the one-week rule and the 25% rule.

Example. On Thursday, you travel to Zurich, Switzerland 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 can also deduct your out-of-pocket expenses for the six business days.

The transportation expense allocation rule doesn't apply to parts of your trip that begin and end within the U.S. For example, say you are flying from Dayton to Zurich. You must change planes in New York. You can deduct 100% of the outbound leg from Dayton to New York, and 100% of the leg from New York to Dayton on the way back. The allocation rules apply to the remainder of your airfare. Once again, the trip must be primarily for business for any part of your airfare to be deductible.

We hope this letter helps you plan some exotic foreign trips that also deliver some nice tax breaks. However, we realize that these rules are rather complicated. Please give us a call if you have questions or would like more information.

Best regards,

Linda Hadley