Trips and Events Provided for Donors

Tax law provides that to determine whether an expense is valid for business purposes, or in this case ministry purposes, it must meet the following tests:

- The “ordinary and necessary” test under Code Section 162 – The determination of what is “ordinary and necessary” is based on a factual examination of the particular expense. Basically, expenses are held to be “ordinary and necessary” if they can be expected to arise in the particular business, and are appropriate and helpful to the development or conduct of a business.

- The “directly related” or “associated with” the active conduct of a taxpayer’s trade or business test for meals and entertainment expense.

Although these tests pertain to deductibility for business purposes, they are also relevant in determining whether expenses for certain trips and events for donors may be appropriately expended by a nonprofit organization.

If a charity takes donors or other to a location to perform ministry services, it generally constitutes a valid program expense. However, any costs for entertainment or personal recreation should be incidental in both time and dollars. Alternatively, it may be advisable to have the individuals personally pay the incremental costs related to the tour, entertainment event, or activity.

Only gifts given in support of business (ministry)-related trips are tax deductible.

IRS Treatment of Travel. IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses, outlines proper treatment for travel both within and outside the United States. While the publication is written in the context of business travel, the principles outlined may be used as guidance for trips provided for major donors.

- Travel in the United States. If a trip is conducted primarily for business purposes (ministry program purposes), the trip is considered entirely business related and all travel expenses are deductible. If the trip is conducted primarily for business purposes, but extended for personal activities, only business related travel is
deductible, including getting to and from the business destination. If the trip is conducted primarily for personal reasons, the entire cost of the trip is a nondeductible personal expense.

The IRS takes the position that trips must be conducted primarily for ministry program purposes to qualify as business expenses. However, one court case provides that while the primary purpose may appear to be entertainment, adequate evidence substantiating the business purposes for a trip justifies business expense recognition. In *Townsend Industries, Inc. v. U.S.* (No. 02-3756), the Eight Circuit Court held that the costs of an annual employee fishing trip were deductible business travel expenses and workplace fringe benefits excludable from the employees’ income.

Townsend took their employees on a remote fishing trip following their annual sales meeting. During the trip, at least one formal business meeting was scheduled and employees spent the rest of their time mostly as they wished. However, business discussions were conducted on an on-going basis during the trip. Townsend received tangible business benefits as a result of the trip including interaction between salespeople, factory personnel and other employees that had a major impact on the amount of repair work performed by the sales force. Also, employees of one division of Townsend were excluded from the fishing trip because they had little in common with the other employees attending and therefore no tangible benefits would accrue from their attendance.

The Court determined that the trip met the three criteria needed to justify deducting the business travel expenses:

1. Reasonable and necessary business trip;
2. Directly related to, or associated with, the active conduct of Townsend’s business; and
3. The principal character of the events was business.

Chief Circuit Judge Pasco M. Bowman II, who ruled on the Townsend case, was careful to warn that “Our decision, does not stand for the proposition that in all cases in which a corporation sponsors hunting, fishing, or other trips to ‘luxury’ vacation spots that the sponsoring corporation can avoid including the per-employee cost of the trip in its employees’ wages merely by presenting testimony relating to business allegedly conducted during the sojourn.” In other words, organizations must present sufficient evidence to substantiate business purposes for trips.

- **Travel Outside the United States.** If a trip is conducted entirely or considered entirely for business, then all travel expenses are deductible. For a trip to be considered entirely for business it must meet at least one of the following three exceptions:
o Outside the U.S. for no more than a week when combining business and nonbusiness activities

o Less than 25% of time is spent on personal activities

o Personal vacation is not a major consideration of the trip

If a trip meets one of the above exceptions, the travel expenses are considered business related and consequently deductible.

If the trip is conducted primarily for business, then only the business portion of the costs of getting to and from the destination are deductible. Any expenses related to personal activities are considered personal and therefore not deductible.

If the trip is conducted primarily for personal reasons, then the related expenses are considered personal. Publication 463 states “If you spend some time attending brief professional seminars or a continuing education programs, you can deduct your registration fees and other expenses you have that are directly related to your business.” However, the costs relating to travel are not deductible. This scenario is parallel to trips for major donors that are primarily entertainment with brief ministry purposes, such as a one to two hour introduction to the ministry and subsequent fund-raising appeal. There is not substantial justification to deduct travel expenses for business purposes or ministry purposes in such a situation.

Conventions, seminars, and similar meetings. Also relevant to this issue are the IRS convention rules as set forth in Publication 463. It states that conventions, seminars, or similar meetings held outside the North American area are not deductible expenses unless the meeting is directly related to your trade or business and it is as reasonable to hold the meeting outside the North American area as in it.

The following factors are taken into account to determine if it was reasonable to hold the meeting outside the North American area:

- The purpose of the meeting and the activities taking place at the meeting.
- The purposes and activities of the sponsoring organizations or groups
- The homes of the active members of the sponsoring organizations and the places at which other meetings of the sponsoring organizations or groups have been or will be held.
- Other relevant factors you may present.

These rules should also be taken into consideration concerning fund-raising trips for major donors. Trips outside the North American area should be sufficiently related to ministry programs.
Conclusion. ECFA’s Standard 4 Use of Resources states: “Every member organization shall exercise management and financial controls necessary to provide reasonable assurance that all resources are used (nationally and internationally) to accomplish the exempt purposes for which they are intended.” Exempt resources must be used exclusively for exempt purposes. This is a fundamental provision of tax law, as well as state law. Any part of an organization's resources inuring to the benefit of private individuals is absolutely prohibited.

Charities should exercise caution when conducting events that are primarily entertainment or personally beneficial as part of an organization's activities. There may not only be a concern about the proper use of tax exempt resources, but it may create an appearance that could be extremely damaging to the reputation of the organization if made public. If the organization considers trips and events for donors as legitimate business (ministry) expense, it must be prepared to defend such categorization with thorough written documentation (trip or event purpose, trip or event agenda, benefits of the trip or event to the ministry).

Ministries that use events and trips for donors should have clearly established objectives that support the mission of the organization. While some element of personal travel and entertainment may exist, it should not be central to the event, but rather incidental in terms of cost and time. Establishing a clear and defensible ministry purpose, in advance and with the full knowledge of all participants, and carrying out the events consistently with the objectives will help protect the ministry’s integrity, in reality and in perception.

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