

## TAX PLANNING LETTER

FEBRUARY 2018, #282

# Impact of TCJA on Business Deductions for Meals & Entertainment

Before the Tax Cuts and Jobs Act (TCJA), taxpayers could generally deduct 50% of business-related meal and entertainment expenses, and exceptions allowed bigger deductions in certain circumstances. The TCJA shifts the playing field for expenses paid or incurred after 12/31/17. This Tax Planning Letter explains how meal, food and beverage, and entertainment expenses were treated under prior law and how they are treated now.

Under prior law, taxpayers could generally deduct 50% of business-related meal and entertainment expenses incurred or paid before 1/1/18 (former §274(n)). Taxpayers had to establish that the expenses were directly related to or associated with the active conduct of a trade or business or income-producing activity. The general 50% deductibility rule applied to all business-related meals and entertainment expenses unless a specific exception applied.

### EXCEPTIONS TO THE 50% LIMITATION UNDER PRE-TCJA LAW

#### PRE-TCJA LAW:

The following exceptions to the general 50% deductibility rule were available. Some of these exceptions survive under TCJA.

▼ **These exceptions are still available under TCJA, albeit in a modified form (see discussion later)**

- (1) An employer could deduct 100% of meal expenses that were excluded from the recipient employee's gross income as a *de minimis* fringe benefit (e.g. occasional meals for employees working overtime qualified for this exception).
- (2) An employer could deduct 100% of the cost (including facility costs) of providing meals to employees at a qualifying employer-operated eating facility (e.g. this exception applied to a qualifying company cafeteria).

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▼ **These exceptions are still available under TCJA, and still cover applicable entertainment**

- (3) An employer could deduct 100% of meal/entertainment expenses that were reported as taxable compensation to recipient employees.
- (4) An employer could deduct 100% of food, beverage, and entertainment expenses incurred for recreational, social, or similar activities primarily for the benefit of employees other than certain highly-compensated employees (e.g. a company picnic or holiday party).
- (5) Taxpayers could deduct 100% of the cost of food, beverages, and entertainment that were made available to the general public (e.g. free food/beverages at a new store grand opening).

(6) Taxpayers could deduct 100% of the cost of food, beverages, and entertainment sold to customers for full value, including the cost of related facilities.

(7) Taxpayers could deduct 100% of the cost of meals/ entertainment that were reported as taxable income to a nonemployee recipient on a Form 1099 (e.g. a prize won by a potential customer who is issued a Form 1099 for the value of the prize).

▼ This exception is still available under TCJA

(8) An employer could deduct 80% of the cost of meals provided to employees whose work is subject to U.S. Department of Transportation hours-of-service limitations (e.g. airline pilots, interstate truckers).

▼ TCJA has eliminated this exception

(9) Taxpayers could deduct 100% of the cost of tickets to fundraising charitable sporting events if: (1) the event was organized for the benefit of a qualifying charitable organization, (2) 100% of the net proceeds were contributed to the charity, and (3) volunteers did substantially all the work in staging the event.

Concern has been expressed about the TCJA's potential effect on certain meal and entertainment expenses, such as company picnics and holiday parties. However, the Joint Committee on Taxation recently commented that the TCJA did not alter the §274(e) exceptions to the disallowance of certain entertainment expenses. Therefore, such expenses are still deductible. The IRS is expected to issue further guidance on changes to meal and entertainment expenses under §274, particularly with respect to meals.

## MOST ENTERTAINMENT EXPENSES ARE DISALLOWED UNDER TCJA

### NEW LAW:

Effective for amounts paid or incurred after 12/31/17, the TCJA disallows deductions for the most common business-related entertainment expenses, including the cost of facilities used for most business-related entertainment activities. Specifically, nondeductible treatment now applies to the cost of such expenditures as:

- sporting event tickets and private boxes, including license fees for stadium or arena seating rights;
- tickets to concert and theater events, including season tickets at concert/theater venues;
- dues paid for golf club memberships, as well as associated golf, hunting, fishing, and sailing outings for customers/vendors.

**Note:** *Some business entertainment expenses are still deductible, but only in very limited circumstances. See the exceptions discussed earlier.*

## STILL ALLOWED ARE DEDUCTIONS FOR “ELIGIBLE” FOOD AND BEVERAGE EXPENSE

After the TCJA, the most common business-related meals are still 50% deductible, and the time-honored rules for proving that meals are business-related still apply. In addition, food and beverage expenses that fall under Exceptions (3) – (7) (above) are still 100% deductible after the TCJA. Meals that fall under Exception (8) are still 80% deductible after the TCJA. Also, in the opinion of Thomson Reuters, it appears businesses can still deduct 50% of food and beverage expenses incurred at entertainment events, but only if business was conducted during the event or immediately before or after. Due to the uncertainty surrounding this position, taxpayers should proceed with caution until the IRS issues guidance.

**Note:** *Technically, if a hotel or other lodging establishment includes meals in its room charges, the taxpayer must use a reasonable method to determine the portion of expenditures that are allocable to meals and subject to the 50% deductibility rule.*

**Recommendation:** Taxpayers should assess their current expense allowance policies to determine if changes are necessary due to the unfavorable TCJA provisions—especially for entertainment expenses incurred by employees, which are now nondeductible (unless reported as taxable compensation). To facilitate recordkeeping, accounting system changes may be needed to separately track employee entertainment expenses and employee business-related meal expenses, which are still 50% deductible.

## TAX TREATMENT OF *DE MINIMIS* MEALS

### PRE-TCJA LAW:

Under former §274(n)(2)(B), employers could deduct 100% of the cost of food and beverages if they qualified as a tax-free *de minimis* fringe benefit to employees (meaning a benefit with a value and frequency of occurrence that made accounting for it administratively impractical). Examples of *de minimis* fringe benefits include:

- Meals or meal money provided to employees on an occasional basis.
- Meals or meal money provided to employees because overtime work is necessary, and the meals or meal money enables the employees to work overtime.

### NEW LAW:

The TCJA eliminated former §274(n)(2)(B); therefore, *de minimis* meals are no longer 100% deductible for amounts paid or incurred in 2018 and beyond. However, the new law apparently still allows a 50% deduction for *de minimis* meals or meal money, assuming costs fall within §274(e)(1) and §274(n)(2)(A).

### **§274(e)(1)**

Expenses for food and beverages (and facilities used in connection therewith) furnished on the business premises of the taxpayer primarily for his employees.

### **§274(n)(2)(A)**

Such expense described in §274(e), paragraphs (2), (3), (4), (7), (8), or (9),

- (2) Expenses treated as compensation.
- (3) Reimbursed expenses.
- (4) Recreational, etc., expenses for employees.
- (7) Items available to public.
- (8) Entertainment sold to customers.
- (9) Expenses includible in income of persons who are not employees.

## TAX TREATMENT OF EMPLOYER-OPERATED EATING FACILITIES

### PRE-TCJA LAW:

Under former §274(n)(2)(B), employers could deduct 100% of the cost of operating a qualified eating facility for employees, such as a company cafeteria. Such a facility had to meet the following requirements:

- Be owned or leased by the employer.
- Be operated by the employer (directly or through a contract with a vendor).
- Be on or near the employer's business premises.
- Revenue from the facility equals or exceeds the cost of operating the facility.
- Meals are served during or immediately before or after the employees' workday.
- The facility is available to generally all employees.

NEW LAW:

The TCJA eliminated former §274(n)(2)(B). As such, for amounts paid or incurred from 1/1/18 through 12/31/25, the new law allows employers to deduct only 50% of the cost of operating a qualified eating facility for employees. After 2025, no deductions will be allowed.

**Recommendation:** *Employers that operate eating facilities for employees should review the costs of running their facilities and determine if the temporary 50% deduction rule and the eventual complete disallowance rule dictate a change in policy. Since these facilities are expensive, lost tax deductions may dictate discontinuing their operation.*

## TAX TREATMENT OF MEALS PROVIDED FOR THE CONVENIENCE OF THE EMPLOYER

PRE-TCJA LAW:

Under prior law, the cost of meals furnished to an employee for the convenience of the employer could be fully deducted by the employer and treated as tax-free to the recipient. However, 100% deductibility for the employer only applied if a laundry list of requirements were met. If not, the general 50% deductibility rule for meals applied.

NEW LAW:

For 2018-2025, the TCJA allows employers to deduct only 50% of the cost of meals provided for the convenience of the employer. After 2025, no deductions for such meals will be allowed.



### Questions?

For more details on information presented in this Tax Planning Letter or other issues, please feel free to call Roger Rossmeisl, CPA direct at (714) 325-0442 or via e-mail at [roger@khopatel.com](mailto:roger@khopatel.com).

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