

Insights

Proposed Regulations on Meals and Entertainment Expenses

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On February 26, 2020, the IRS and Treasury published proposed regulations ("Proposed Regulations") providing guidance under §274 of the Internal Revenue Code ("Code") as amended by the Tax Cut and Jobs Act, Pub. L. No. 115-97, §13304, 131 Stat. 2054, 2123 (2017) (the "TCJA"). The Proposed Regulations address the TCJA's elimination of the tax deduction for entertainment expenses, provide guidance for determining whether an activity constitutes "entertainment," and address the limitation of the deduction of food and beverage expenses, and are generally consistent with interim guidance provided under Notice 2018-76 issued in October of 2018 ("Notice 2018-76").

Background

Code §162(a) provides a deduction for necessary trade or business expenses. Prior to amendment by the TCJA, Code §274(a)(1)(A) generally prohibited the deduction of entertainment, amusement, or recreation expenses ("entertainment expenses"). However, §274(a)(1)(A) provided exceptions to that prohibition if the taxpayer established that: (1) the item was directly related to the active conduct of the taxpayer's trade or business (the "directly related" exception), or (2) in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that the item was associated with the active conduct of the taxpayer's trade or business (the "business discussion" exception).

In summary, under prior law, taxpayers could deduct 50% of meal expenses and 50% of entertainment expenses that met the directly related or business discussion exceptions.

TCJA Amendment of §274

The TCJA repealed the directly related and business discussion exceptions to the general prohibition on deducting entertainment expenses. As a result, entertainment expenses are no longer deductible. The TCJA did not amend the Code provisions relating to the deductibility of business meals, however. Therefore, taxpayers generally may continue to deduct 50% of the food and beverage expenses associated with operating their trade or business.

Under the Proposed Regulations, taxpayers may deduct 50% of an otherwise allowable business meal expense if:

- The expense is an ordinary and necessary expense under §162(a) paid or incurred during the taxable year in carrying on any trade or business;
- The expense is not lavish or extravagant under the circumstances;
- The taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages;
- The food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and

- In the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages.

Notice 2018-76 generally required that food and beverages be provided to a business contact, which was described in the notice as a “current or potential business customer, client, consultant, or similar business contact.” In response to comments received on Notice 2018-76, the Proposed Regulations clarified the term “potential business contact” as a “person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer’s customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective.”

Examples

In response to comments received on Notice 2018-76, the Proposed Regulations provide several examples to illustrate the impact of the TCJA amendments under several common fact sets:

Business Lunch

As was the case prior to the TCJA, where a taxpayer takes a client out to lunch and discusses the client’s business activities, the taxpayer may deduct 50% of the food or beverage expenses. Similarly, if a taxpayer takes an employee out to lunch and discusses a business matter, 50% of the food or beverage expense is deductible.

Food/Beverages Provided to Restaurant Workers

Food or beverages provided to food service workers who consume the food or beverages while working in a restaurant or catering business are not subject to the 50% deduction limitation and are 100% deductible. Here, a distinction is made because the restaurant/catering business otherwise sells the food and beverages to customers in a bona fide transaction for adequate and full consideration.

Food/Beverages Provided at Company Holiday Parties and Picnics

The cost of the party/picnic, including food and beverage expenses, is not subject to the deduction limitation because the function is a recreational, social, or similar activity primarily for the benefit of non-highly compensated employees. Accordingly, 100% of the cost of the party/picnic is deductible. However, if the employer invited only highly compensated employees to a holiday party, the recreational exception from the deduction limitation would not apply because only highly compensated employees are invited.

Snacks Available to Employees in a Pantry

Snacks available to employees in a pantry, break room, or copy room are only 50% deductible. Unlike the holiday party or picnic in the example above, the break room is not considered a recreational, social, or similar activity primarily for the benefit of the employees (even though employees may incidentally socialize while there).

The IRS and Treasury have requested comments on the Proposed Regulations, which are due by April 13, 2020. A public hearing is scheduled for April 7, 2020.