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Who Says There Is No Such Thing as a Free Lunch? -- the US Tax Court in Jacobs v. Commissioner Ruled That There May Be Such a Thing!

By Larry Brant on 7.5.17 | Posted in Federal Law, Internal Revenue Code, Internal Revenue Service, IRS, Tax Laws

Judge Ruwe ruled in *Jeremy M. Jacobs and Margaret J. Jacobs v. Commissioner*, 148 T.C. 24 (June 26, 2017), that a free lunch may exist today under Federal tax law. In this case, the taxpayers, owners of the Boston Bruins of the National Hockey League, paid for pre-game meals provided by hotels for the players and team personnel while traveling away from Boston for games.

Pursuant to the union collective bargaining agreement governing the Bruins, the team is required to travel to away games a day before the game when the flight is 150 minutes or longer. Before the away games, the Bruins provides the players and staff with a pre-game meal and snack. The meal and snack menus are designed to meet the players' nutritional guidelines and maximize game performance.

During the tax years at issue, the taxpayers deducted the full cost of the meals and snacks. Upon audit, the IRS contended the cost of the meals and snacks were subject to the 50% limitation under Code Section 274(n)(1) which provides in part:

"Any expense for food or beverages …shall not exceed 50 percent of the amount of such expense …"

The taxpayers, of course, argued that: (i) the cost of the meals and snacks are deductible under Code Section 162(a) as ordinary and necessary expenses incurred in the operation of its business; and (ii) that the general rule contained in Code Section 274(n)(1) does **not** apply to the instant case. In accordance with Code Section 274(n)(2)(B), the general rule is **inapplicable** to the cost of food and beverages that are excludable from the gross income of the recipients as a de minimis fringe benefit. The taxpayers asserted that the meals and snacks provided to its players and staff before away games were such a de minimis fringe benefit. The Service disagreed with the taxpayers, and eventually the parties found themselves in the United States Tax Court.

The court was faced with at least 2 issues, namely whether the meals and snacks were provided in a non-discriminatory manner in accordance with Code Section 132(e)(2), and whether they constituted a de minimis fringe benefit.

Non-Discriminatory

The salient facts relative to the first inquiry, in part, were:

- The pre-game meals and snacks were provided to all of the team's traveling staff – player and non-players (highly compensated and non-highly compensated employees); and
- The pre-game meals and snacks were only provided before away games.

The court, after reviewing these facts, concluded that the meals and snacks were provided in a non-discriminatory manner. They were provided to all of the employees that traveled with the team. Next, the court looked at whether the meals and snacks were de minimis under Code Section 132(e).

De Minimis

In order for the meals to be deemed de minimis, 5 requirements must be met:

1. The eating facility must be **owned or leased** by the employer;
2. The eating facility must be **operated** by the employer;
3. The eating facility must be near or at the employer's **business premises**;
4. The meals and snacks must be offered **during** or immediately **before or after** the employees' workday; and
5. The annual **revenue** derived from the facility must normally equal or exceed the direct operating costs of the facility.

Lease. The term "leased" is not defined in Code Section 132 or the corresponding Treasury Regulations. Consequently, the court looked to the common meaning of the term. It concluded the term means the contractual right to use and occupy property. It further determined that the Bruins' rental of hotel rooms comes with the right to use the hotel dining and meal rooms. Thus, the first prong of the de minimis test is satisfied.

Operated. In accordance with Treas. Reg. Section 1.132-7(a)(3), a facility is deemed operated by the employer if the employer contracts with another person to operate the facility. In the instant case, the Bruins contract with the hotels to provide food preparation and service. The organization pays the cost of the food, plus a service fee of 22%. Thus, the second prong of

the test is satisfied.

Business Premises. The court, after looking at the plain meaning of business premises and prior case law, determined that the hotels where the Bruins' stayed while traveling to away games was used in the conduct of the employer's business. At the hotels, the team prepares for the games and conducts team business. The court concluded: "Staying in away city hotels is indispensable to the Bruins' preparation and is also necessary for maintaining a successful hockey operation and navigating the rigors of an NHL-mandated schedule." The third prong of the test was satisfied.

During, or immediately before or after. The government conceded that the meals and snacks were provided during or immediately before or after the employees' workday. So, the fourth prong of the test is satisfied.

Revenue. This last prong of the test requires that the revenue derived from the employer-operated eating facility equal or exceed the direct operating costs of the facility. In this case, the employees do not pay for the meals and snacks. Code Section 132(e), however, provides that the direct cost of a meal shall be treated as having been paid for by the employees when the employees are entitled to exclude the value of the meal in gross income under Code Section 119. Meals are excluded under Code Section 119 when the meals are: (i) finished for the convenience of the employer; and (ii) furnished on the employer business premises.

Meals provided to employees at no charge are furnished for the convenience of the employer if they are provided for a "substantial non-compensatory" purpose. When the employer provides un-contradicted credible evidence of its business reasoning – its "substantial con-compensatory" purpose, the courts will refrain from second guessing the employer's business judgment. The rationale presented by the taxpayers for provision of meals at no charge to their employees at away games was as follows:

- Nutrition of its players;
- Performance of the players;
- Avoidance of gastric problems of the players during games; and
- Saving of time when NHL schedules allow for very limited time for preparation and rest between games.

As the court already determined the hotels are considered the employer's business premises, it concluded that the taxpayers met the requirements of Code Section 119. Therefore, the revenue test was also satisfied.

Consequently, the court ruled that the meals and snacks provided by the taxpayers to the players and staff constituted de minimis fringe benefits under Code Section 274(n)(2)(B). Thus, they were entitled to deduct 100% of the cost of the meals and snacks. Likewise, under Code Section 119, the employees are entitled to exclude from gross income the value of the meals and snacks.

There really is such a thing as a "free lunch" after all! Stay tuned, the Internal Revenue Service could appeal Judge Ruwe's decision. So, at least for now, there can be a free lunch. This ruling, if it stands, may be useful to many industries where travel is commonplace (e.g., entertainment and sports).[i] If the government does not appeal, the Bruins scored a hat trick in this case (i.e., (i) the Jacobs got a 100% deduction for the cost of the meals and snacks, (ii) the employees had no income for the value of the meals and snacks they received, and (iii) the taxpayers do not have to spend more money on attorneys to continue the battle)!

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[i] Code Section 274(e)(8) exempts from the 50% limitation expenses for goods or services sold by a taxpayer in a bona fide transaction for adequate and full consideration. The corresponding Treasury Regulations explain that this exception extends to any expense for entertainment to the extent the entertainment is sold to customers in a bona fide transaction for full consideration. In the instant case, the taxpayers argued that the meals were provided to the team and staff as part of the overall expenses they incur to provide entertainment to the fans. Because the court ruled that the de minimis exception applies, it never got to this argument.

Tags: Boston Bruins, Code Section 119, Code Section 132(e)(2), Code Section 162, Code Section 274(n)(1), Code Section 274(n)(2)(B), de minimis fringe benefit, federal taxation, gross income, IRS, meals and entertainment, Treas. Reg. Section 1.132-7(a)(3), union collective bargaining agreement