Larry's Tax Law

Taxpayers Can Have Their Cake and Eat It at an Entertainment Event, and the Cost of the Cake May Be 50% Deductible

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As we discussed in our February 27, 2018 blog post, the Tax Cuts and Jobs Act ("TCJA") eliminated the deduction for entertainment expenses. Despite commentary to the contrary, we have consistently reported that meals continue to be deductible (subject to the 50% limitation under Code Section 274(n)) post TCJA under Code Section 274(k) as long the meals are not lavish or extravagant, and the taxpayer (or an employee of the taxpayer) is present at the furnishing of the meals. Our position relative to meals is supported by guidance from the Service (IRS Notice 2018-76) issued on October 3, 2018. More importantly, the recently issued guidance focuses on an issue raised in our prior blog post, namely whether meals purchased at an entertainment event are deductible provided the requirements of Code Section 274(k) are satisfied. We suspected that the Service would issue guidance on this issue. It did.

Notice 2018-76 offers transitional guidance on this issue. The IRS plans to issue proposed regulations, but until the regulations are actually issued, taxpayers may rely on the notice.

Background

In general, taxpayers may deduct ordinary and necessary business expenses under Code Section 162(a). The Code has historically lumped meals and entertainment for most purposes in the same bucket. Now, these two categories of businesses expenses are generally segregated. Accordingly, taxpayers now need to keep track of these expenses separately.

A. Entertainment.

Prior to the TCJA, Code Section 274(a) prohibited the deduction of entertainment expenses, except in the case where such expenses were business-related. The TJCA eliminated this

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exception altogether. Consequently, beginning in 2018, entertainment expenses incurred by a taxpayer in the conduct of a trade or business are nondeductible.

B. Meals.

As stated above, Code Section 274(k) allows a deduction for food or beverage expenses, provided such expenses are not lavish or extravagant, and the taxpayer (or an employee of the taxpayer) is present when the food or beverages are served. Code Section 274(n) limits food and beverage expense deductions to 50%.

Prior to the TCJA, the cost of meals were 100% deductible by taxpayers in the limited cases of: (i) meals provided to workers that were included to the recipients as employee wages or as non-employee compensation; (ii) were employer-provided meals that qualified under a "de minimus" exception; or (iii) were employer provided meals "for the convenience of the employer" (e.g., employer operated on-premises cafeterias).

The TCJA changed the rules in this area a bit, but the changes only impact items (ii) and (iii) above (i.e., the rules relative to meals included in wages or as compensation are unchanged). Beginning in 2018, meals provided under the "de minimus" and "for the convenience of the employer" exceptions are no longer 100% deductible; rather, they are 50% deductible.

CAUTION: After 2025, however, these two categories of meals will no longer be deductible at all. We suspect, however, large employers that have employer provided cafeterias (e.g., Google) will be lobbying Congress.

Notice 2018-76

Notice 2018-76 sets forth transitional guidance regarding the deductibility of food and beverages in the entertainment context.

The Notice provides that taxpayers may deduct 50% of an otherwise allowable business meal expense if:

1. The expense is an **ordinary and necessary** trade or business expense under Code Section 162(a);
2. The expense is **not lavish or extravagant** under the circumstances;
3. The taxpayer, or its employee, is **present** at the furnishing of the food or beverages;
4. The food and beverages are provided to a current or potential **business** customer, client, consultant, or similar business contact;
5. 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; **and**

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6. Amounts charged for food and beverages may **not be inflated** to circumvent the rule.

The Notice provides three examples to illustrate the above rules (each example assumes that the expenses are ordinary and necessary, and are **not** lavish or extravagant):

EXAMPLE 1: A taxpayer pays for a business contact and the taxpayer to attend a sporting event, purchasing tickets and food and beverages separately. In such instance, the taxpayer may **not** deduct the ticket expense, but the taxpayer **may** deduct 50% of the separately billed food and beverage expenses.

EXAMPLE 2: A taxpayer pays for a business contact and the taxpayer to attend a sporting event in a suite where the cost of the ticket includes but does not separately state the cost of food and drinks. The taxpayer may **not** deduct the ticket expense or any of the food and beverage expenses as the two were not separately stated from each other.

EXAMPLE 3: A taxpayer pays for a business contact and the taxpayer to attend a sporting event in a suite where the cost of food and drinks are separately stated from the cost of the tickets. The taxpayer may not deduct the ticket expense, but the taxpayer may deduct 50% of the separately stated food and beverage expenses.

The IRS plans to issue proposed regulations regarding the deductibility of meals in the entertainment context. Until then, as stated above, taxpayers may rely on the Notice.

We suspect, entertainment venues will start doing a better job to separately state food and beverage costs from event ticket costs. That said, some cautions relative to the deductibility of meals provided at entertainment events should be closely followed:

1. **As was the case prior to the TCJA, all business expenses, including meals, must be ordinary and necessary. In the context of meals provided at entertainment events, the person(s) attending the events with the taxpayer or the taxpayer's employee must be current or potential business customer(s), client(s), consultant(s), or similar business contact(s).**
2. **The meal expense cannot be not lavish or extravagant under the given circumstances.**
3. **The taxpayer or an employee of the taxpayer must be present at the event where the meals are provided.**
4. **The food and beverages must be purchased separately from the entertainment event tickets, or the cost of the food and beverages must be stated separately from the cost of the entertainment event on the bill, invoice or receipt.**
5. **Amounts charged for food and beverages may not be inflated to circumvent the rule.**

The TCJA does little to provide simplification to our tax laws. We will continue to provide guidance on the many issues that arise from this comprehensive and complex tax act. Stay tuned!

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