



Federal Tax Alert

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TAX REFORM RESTRICTS TAX DEDUCTIONS FOR MEALS, ENTERTAINMENT, AND FRINGE BENEFITS

Recent tax law changes may compel taxpayers to make immediate changes to expense tracking procedures to ensure they are capturing information necessary to accurately determine their tax deductions. The Tax Cuts and Jobs Act (TCJA) made several significant changes to deductions for meals, entertainment, and employee fringe benefits. In general, the changes disallow deductions for entertainment, reduce the benefit to 50 percent for most meal expense deductions, and limit the deductibility of employee fringe benefits. These changes are effective for amounts incurred or paid after Dec. 31, 2017.

Entertainment: Historically, business-related entertainment expenses, such as golfing with clients or networking at sporting events would have been 50 percent deductible. Generally, such expenses are entirely nondeductible going forward, even if there is a bona fide business purpose.

Meals: Most food and beverage expenses remain limited to a 50 percent deduction. However, several items that would have been 100 percent deductible in the past are now subject to the 50 percent limitation and are also scheduled to become fully nondeductible starting in 2026. These expenses include:

- “De minimis” fringe deductions: Occasional meals provided where value is so small that accounting for it is unreasonable or unreasonably impracticable.
- Meals provided for the convenience of the employer: Meals provided at no charge or at small charge on the employers’ premises.
- Company cafeteria expenses: Meals provided at no charge or at small charge that covers direct operating costs.

Fully deductible meals and entertainment: The following meals and entertainment expenses remain fully deductible:

- Expenses for recreational, social, or similar activities for the benefit of employees.
- Expenses treated as Form W-2 employee compensation or includible in the income of nonemployees.¹
- Reimbursed expenses, if sufficient detail is provided to the reimbursing party to allow them to properly account for the meals and entertainment expense.
- Expenses for goods and services which are sold by the taxpayer in a bona fide transaction for full and adequate consideration.
- Expenses for goods, services, and facilities made available by the taxpayer to the general public.

Going forward, the most common 100 percent deductible meals and entertainment will often relate to expenses for recreational, social, or similar activities for the benefit of employees. This provision is often applied to holiday parties, summer outings, retirement lunches, as well as fringe benefits like a swimming pool, baseball diamond, or a golf course made available to employees. However, these expenditures must satisfy highly compensated employee nondiscrimination requirements.²

Entertainment and facilities exception for business meetings: Entertainment, recreation, and amusement, as well as related facilities, directly related to meetings of employees, shareholders, directors and business leagues remain 100 percent deductible (to the extent there is a business purpose).³ However, meals at such meetings are still subject to the 50 percent limitation, unless they meet one of the other exceptions discussed above.

Changes to fringe benefits: Similar to the changes to de minimis fringe meals, changes have also been made to certain fringe benefits that affect either the deduction by the employer or nonrecognition of income by the employee.

- **Qualified transportation benefits:** Qualifying cost of employee parking and transit passes may still be excluded from employee income, but the employer may not deduct the expenses.
- **Qualified moving expense reimbursement:** Moving expenses reimbursements are no longer excludible from an employee's taxable income. This exclusion is available again starting in 2026.
- **Qualified bicycle commuting reimbursement:** Bicycle commuting reimbursements are no longer excludible from an employee's taxable income. This exclusion is available again starting in 2026.
- **Employee achievement awards:** The ability to exclude up to \$1,600 of awards for service, safety, or suggestions from an employee's taxable income has been retained in certain circumstances. However, the amount must be paid in the form of tangible personal property, which can include selecting personal property from a catalog, but cannot include cash, gift certificates, stocks and securities, event tickets, meals, vacations, lodging or similar items.

¹ This income must be reported on Form W-2 or 1099, where required, or it is not deductible.

² Specifically, this exception applies only to expenditures made primarily for the benefit of employees of the taxpayer other than employees who are officers, shareholders, or other owners who own a 10 percent or greater interest in the business (after applying family attribution rules of §267(c)(4), or other highly compensated employees. An individual is a highly compensated employee if his or her compensation exceeds the §414(q) threshold (\$120,000 for 2017 and 2018) and is in the top 20 percent of employees ranked by compensation.

³ Changes made under TCJA potentially expanded the deduction available for entertainment and similar expenses in connection with business meetings of employees, shareholders, directors and business leagues. Under previous law, the taxpayer was required to establish that the item was directly related to the active conduct of the taxpayer's trade or business, or, in the case of an item directly preceding or following a substantial and bona fide business discussion, that such item was associated with the active conduct of the taxpayer's trade or business. However, this change may have been inadvertent and may be subject to a technical correction in the future.

Key Takeaways: Taxpayers should consider the impact of these tax changes on their business and employees going forward:

- Consider whether the tax impact of meals and entertainment deductions will impact future purchasing decisions.
- Create or update accounting policies for tracking meals and entertainment expenditures to reflect, at a minimum, (a) nondeductible entertainment, (b) 50 percent deductible meals, and (c) 100 percent deductible meals and entertainment.
- Encourage employees to track and report meals separately from entertainment expenses. For example, taking a customer to a sporting event will have two components: (a) entertainment – the cost of the venue ticket and (b) meals – the cost of food and beverages purchased at the event.
- Ensure changes to fringe benefits have been properly reflected, including inclusion of such amounts in employees' taxable income for payroll withholdings, where appropriate.
- Reevaluate your reimbursement and documentation procedures. The IRS has strict substantiation requirements to take a deduction for meals and entertainment expenses as well as accountable plan requirements to exclude reimbursements from an employee's income. While these substantiation rules did not change as part of this legislation, audits in this area are common, and this is a good time to make sure your documentation processes comply with these requirements.
- Watch for additional IRS guidance. This is an area where taxpayers have asked for additional clarification on what constitutes entertainment, the reach of the fully deductible meals and entertainment categories, and whether meals served in connection with an entertainment activity will be treated as nondeductible entertainment.

Meals & entertainment quick reference guide

	Prior rules	New rules	Examples
Food & beverages			
Business meals, including client meetings or internal meetings	50% deductible	50% deductible	
Employee travel meals	50% deductible	50% deductible	<ul style="list-style-type: none"> Meals away from home for business travel
Meals at business meetings of employees, shareholders, directors or business leagues	50% deductible (generally)	50% deductible	<ul style="list-style-type: none"> Shareholder meetings Chamber of commerce meeting
Meals reimbursed by client – to the extent the payer substantiates the expenses to the client as required by §274(d)	100% deductible	100% deductible	<ul style="list-style-type: none"> Meals and entertainment billed to a client providing sufficient detail for the client to limit their own deduction
“De minimis” fringe meals excluded from employee’s income or meals provided for the convenience of the employer	100% deductible	50% deductible ⁴	<ul style="list-style-type: none"> Break room food and coffee Meals or bagels during meetings Occasional business meals Overtime meals
Meals provided on or near the business premises in an employer-operated eating facility	100% deductible	50% deductible ⁵	<ul style="list-style-type: none"> Employer-provided cafeteria meals for little or no cost
Entertainment & related facilities			
Client, referral, and other business entertainment ⁶	50% deductible	Nondeductible	<ul style="list-style-type: none"> Client golfing event Networking basketball events
Club dues	Nondeductible	Nondeductible	<ul style="list-style-type: none"> Country clubs
Entertainment provided at business meetings for employees, shareholders, directors, or business leagues (exception does <u>not</u> apply to meals)	100% deductible	100% deductible	<ul style="list-style-type: none"> Shareholder meeting Employee meeting facilitates & entertainment
Combined meals & entertainment			
Employee meals & entertainment for recreational, social & similar activities (assuming highly compensated nondiscrimination rules are met)	100% deductible	100% deductible	<ul style="list-style-type: none"> Holiday parties Summer office events Team-building activities
Items available to the public: food, beverages, and facilities	100% deductible	100% deductible	<ul style="list-style-type: none"> Coffee and cookies in building lobby Snacks at expo booth Public invitation events
Meals or entertainment included in employee income as compensation	100% deductible	100% deductible	
Lavish or extravagant expenses	Nondeductible	Nondeductible	
Nonbusiness (personal) expenses	Nondeductible	Nondeductible	
Gifts			
Business gifts less than \$25 (per tax year, per recipient)	100% deductible	100% deductible	<ul style="list-style-type: none"> Gift cards < \$25 Flowers < \$25 Golf balls < \$25
Business gifts greater than \$25 (unless included in income of recipient)	Nondeductible	Nondeductible	

⁴ Such expenses will be nondeductible starting in 2026.

⁵ Such expenses will be nondeductible starting in 2026.

⁶ Assumes amount is not billed to the client with sufficient substantiation required under §274(d).

If you have any questions, please contact your tax advisor or:

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