

## Tax Notes

# How the Meals and Entertainment Deduction Is Impacted by the Tax Act

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The Tax Cuts and Jobs Act (TCJA) could very well benefit many taxpayers due to the corporate and individual tax rate reductions. However, there are several revenue raisers that could offset reduced rates, including quite a few eliminated or significantly reduced deductions. One of those deductions is meals and entertainment. The TCJA provides for more restrictions on the deductibility of certain business meals and entertainment expenses incurred after December 31, 2017.

Generally, the TCJA disallows a deduction for entertainment, amusement or recreation activities; membership dues for a club organized for business, pleasure, recreation, or other social purposes; or any item related to a “facility” used in connection with any of the above. However, the tax community is hoping for clarification from the IRS with regard to the application of these new rules, particularly in relation to certain food and beverage expenditures.

We will address how the new rules affect the following more common types of meal and entertainment expenditures taxpayers typically incur.

### Employee Business Meals [IRC Sec 274(e)(1)]

Business meals provided for an employee at the employer’s convenience or in an employer-operated eating facility are now 50% deductible and will be completely disallowed after December 31, 2025. Under prior law, these meals were fully deductible.

### Client Business Meals [IRC Sec 274(k)(1)]

Under prior law, a 50% deduction was allowed for client business meals that were directly related to the active conduct of a trade or business and deemed to be ordinary and necessary, provided that the taxpayer was present and the meals were not extravagant. Under the TCJA, this 50% deduction will remain as long as business is conducted during the meal, the taxpayer is present and the meal is not lavish or extravagant.

In addition, meals during business travel, at a seminar or conference would also be 50% deductible. There is some uncertainty with regard to the treatment of food and beverage expenditures incurred while at an entertainment facility (i.e., sporting event) that we will address below.

### Sporting Event Tickets and Client Entertainment-Related Meals [IRC Sec 274(a)(1)]

The TJCA disallows a deduction for entertainment expenses and any item related to an entertainment facility. As a result, the cost of event tickets, sky boxes and transportation to and from such events are no longer deductible. Under prior law, there was no real need to distinguish between meals and entertainment type of expenditures since both were generally subject to the 50% deductibility limitation. However, now that the TCJA disallows a deduction for entertainment expenses and any costs associated with an entertainment facility, it is not entirely clear how business meals will be treated when they are associated

with or related to an entertainment activity. Tax practitioners are not in uniform agreement on this issue and are calling on the IRS for guidance.

Until further guidance is issued, it may be prudent to separate the business meal from the entertainment event entirely in order to more easily secure the 50% deduction and remove the uncertainty that the meal is considered a nondeductible item associated with an entertainment facility. Either way, care should be taken regarding documentation when these types of expenditures exist. Season tickets to sporting events, like the Yankees and Mets games, will no longer be deductible, and it is possible that the meals one might have while at the game could be nondeductible as well.

### **Recreational or Social Expenses Primarily Benefiting Employees**

Office holiday parties and company picnics surprisingly remain fully deductible under the TCJA as they were under prior law as long as all employees can attend. It will be important for employers to separately track these types of expenses on their books and records, due to their special treatment.

### **Substantiation and Documentation for the Business Element**

There really has been no change in how to document the business purpose of an expenditure. Remember: to be deductible as a business meal, the expenditure must be directly related to or associated with the active conduct of “carrying on” a trade or business. It will be important to show the business purpose of the event, the amount and date of the event. Because client business meals (now 50% deductible) and entertainment-related expenses (now nondeductible) have different tax treatment, one’s documentation procedures will be critical. For example, documenting the names of the attendees at the event, including their business affiliations, as well as the purpose of the expenditure will be important. Lastly, consider creating separate general ledger accounts for the different types of meals and entertainment-related expenses, as described above.

### **Further Guidance**

We will continue to keep you informed with future Thought Leadership communications of any developments with regard to the classification and deductibility of entertainment and food and beverage expenditures.

### **Contact Us**

If you have questions regarding how these rules will apply to your organization, contact either of the partners listed below or another member of your client service team at PKF O’Connor Davies.

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