

IRS Clarifies Temporary 100% Meal Deduction

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The Consolidated Appropriations Act of 2020 provided an interesting benefit for businesses in 2021 and 2022. Instead of being limited to a 50% deduction for business meals, businesses can deduct 100% of certain meals provided by restaurants. This benefit was intended as a form of stimulus for restaurants, many of which were hit hard during the pandemic.

The change was welcome, but led to two important questions:

1. For these purposes, what is considered a restaurant? *and*
2. For traveling employees, what would they need to prove that a meal was provided by a restaurant?

Background

Generally, Internal Revenue Code (IRC) Section 274(n)(1) provides a limitation of 50% deductibility on all food and beverage expenses. However, Section 274(n)(2)(D) provides for a temporary 100% deduction for food and beverage expenses provided by a *restaurant* and which are paid or incurred after December 31, 2020 and before January 1, 2023.

Historically, employers who have employees travelling away from home on business were able to deduct meal expenses only at 50% if the substantiation requirements were met. The employees would be reimbursed for the travel expenses incurred. If these expenses are part of an accountable plan and satisfy all requirements of such plan, the employees would not include such reimbursement payments in their income. The rules for substantiating business food and beverage expenses have to be carefully followed to ensure the deduction is allowed.

Pursuant to IRC Section 274, the per diem rules deem an employee's travel expenses to be substantiated up to the permitted per diem rates if the employee has substantiated the business purpose, date and place of a trip, less onerous than a full accounting. As a result, many businesses implemented "per diem allowance" reimbursement arrangements paid to their employees to simplify the compliance process of substantiation of the expenses instead of reimbursing employees' actual travel costs.

What Is Considered A Restaurant?

Notice 2021-25, issued in April 2021, clarified that, for purposes of the business meal deduction rules, a "restaurant" is "a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises." The exception, however, **does not apply** to food or beverages from:

- A business selling pre-packaged food or beverages not intended for immediate consumption;
- An eating facility on an employer's business premises that furnishes meals excluded from an employee's gross income under IRC Section 119; or
- An employer-operated eating facility treated as an IRC Section 132(e)(2) de minimis fringe even if operated by a third party under contract with the employer.

The notice specifically states that purchases from grocery stores, specialty food stores, liquor stores, drug stores, convenience stores, newsstands, vending machines or kiosks would not qualify for a 100% deduction as the purchase would not be considered for immediate consumption.

For example, if an employee purchases prepared items such as pizza from a convenience store and eats the food items immediately after, the purchase would not be eligible for a 100% deduction, since the purchase was made from a convenience store. However, if an employee purchases pizza from a pizzeria

and chooses to eat the pizza outside of the establishment, the purchase of the pizza would still qualify for a 100% deduction as the purchase was made from a restaurant.

Per Diem Substantiation

This raises an obvious question – how can an employer using a per diem substantiate which portion of the food expense was paid at restaurants? The main benefit of the *per diem* rules is to limit cumbersome substantiation requirements; and even if the employees had to provide details of every expense, how is an employer supposed to know whether a store in another state qualified for the IRS definition of a restaurant?

Notice 2021-63, states that a taxpayer that properly follows the per diem rules can attribute the full meal portion of a per diem rate or allowance paid or incurred after December 31, 2020, and before January 1, 2023, to food and beverages provided by a restaurant. Thus, employers may deduct the cost of providing the meals portion of a per diem at 100% without having to demonstrate that the meals were, in fact, purchased from a restaurant.

For example, when away from home, employees do not have to substantiate their meal expenses in order to get reimbursed, if the amount spent is within the per diem rate for a particular location. The employer, in this instance, can deduct 100% of the per diem rate of meals attributable to the geographical location of the business trip.

PKF O'Connor Davies Observation

Employers should assure that their accounting systems and chart of accounts reflect the nuances for obtaining the 100% deduction. For meal expenses outside of a per diem, a distinction should be apparent when a meal is purchased from a restaurant. Also, employers should consider migrating to a per diem accountability system, at least temporarily, to minimize accountability and maximize tax benefits.

Contact Us

PKF O'Connor Davies has a team of experts ready to assist you. If you need advice related to the deductibility of business meals and other expenses, please contact your client engagement team or the following:

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