

Taxpayers should revisit internal policies and procedures due to tax reform changes related to meal and entertainment expenditures

Under prior law, a taxpayer could deduct 50% of entertainment, amusement, or recreation expenses incurred for activities that were directly related to (or associated with) the active conduct of its trade or business, or a facility used in connection with such activity (Sections 274(a)(1) and (n)(1)). For amounts paid or incurred after December 31, 2017, unless otherwise noted below, the 2017 tax reform reconciliation act, also known as the ‘Tax Cuts and Jobs Act’ (the Act), has eliminated the deduction for expenses related to entertainment, amusement, or recreational activities. The Act also significantly limits an employer’s ability to fully deduct expenditures associated with de minimis fringe benefit meals, as well as meals provided for the convenience of the employer at an employer-operated eating facility. The wage exclusions for these benefits are not impacted; therefore, such benefits remain excluded from employee wages.

Background

Under prior law, taxpayers generally could deduct an ordinary and necessary meal and entertainment expense only if the expense was either ‘directly related to’ or ‘associated with’ the active conduct of a trade or business. Additionally, taxpayers had to satisfy strict substantiation requirements supporting the business purpose of the expense. Taxpayers generally could deduct only 50% of the otherwise deductible cost of meal and entertainment expenses.

There were several statutory exceptions to the 50% disallowance for meal and entertainment expenses. To the extent that a specific meal or entertainment expense fell within one of these exceptions, the entire cost of that meal or

entertainment expense was deductible.

Entertainment expenses
Entertainment is defined as any activity that is of a type generally considered to constitute entertainment, amusement, or recreation, including entertaining at theaters, clubs, lounges, and sporting events. Under prior law, if it was established that the entertainment expenses were directly related to (or associated with) the active conduct of a taxpayer’s trade or business, then the deduction was limited to 50% of the amount otherwise deductible.

Under the Act, no deduction is allowed with respect to entertainment, regardless of its connection to the employer’s trade or business.

The IRS explains in Publication 15-B that food or beverage expenses related to employee recreation, such as holiday parties or annual picnics, aren't subject to this 50% deduction limit (meaning, a 100% deduction is allowed) when provided primarily for the benefit of employees other than employees who are officers, shareholders or other owners who own a 10% or greater interest in the employer's business, or other highly compensated employees. (Publication 15-B, page 17.)

Effective January 1, 2018, the TCJA lowers or disallows a business deduction for several fringe benefits and work-related expenses (see the list below). Businesses may respond to some of these changes by including these expenses in federal taxable wages, and if they do, consideration will need to be given to the state income and employment tax treatment of these items. For instance, if reimbursed entertainment expenses are included in federal taxable wages so that the business may claim a deduction on its federal income returns, these reimbursements may be excluded from wages subject to tax in those states that do not conform to the IRC.

Reduction or disallowance of the business deduction under the TCJA

Provision	Effective date	Impact
Eating facilities — meals for employer's convenience	January 1, 2018	100% deduction is lowered to 50%
Eating facilities — meals for employer's convenience	January 1, 2026	50% deduction is lowered to 0%
Entertainment expenses	January 1, 2018	50% deduction is lowered to 0%
Executive compensation	January 1, 2018	Various changes limiting the deduction for executive compensation
Transportation fringe benefits (parking, van pools and transit passes)	January 1, 2018	100% deduction is lowered to 0%