

Tax Treatment of Transit, Parking, Meals and Entertainment Benefits for Employers and Employees - Post-tax reform implications

SJSU – Small Business Tax Institute

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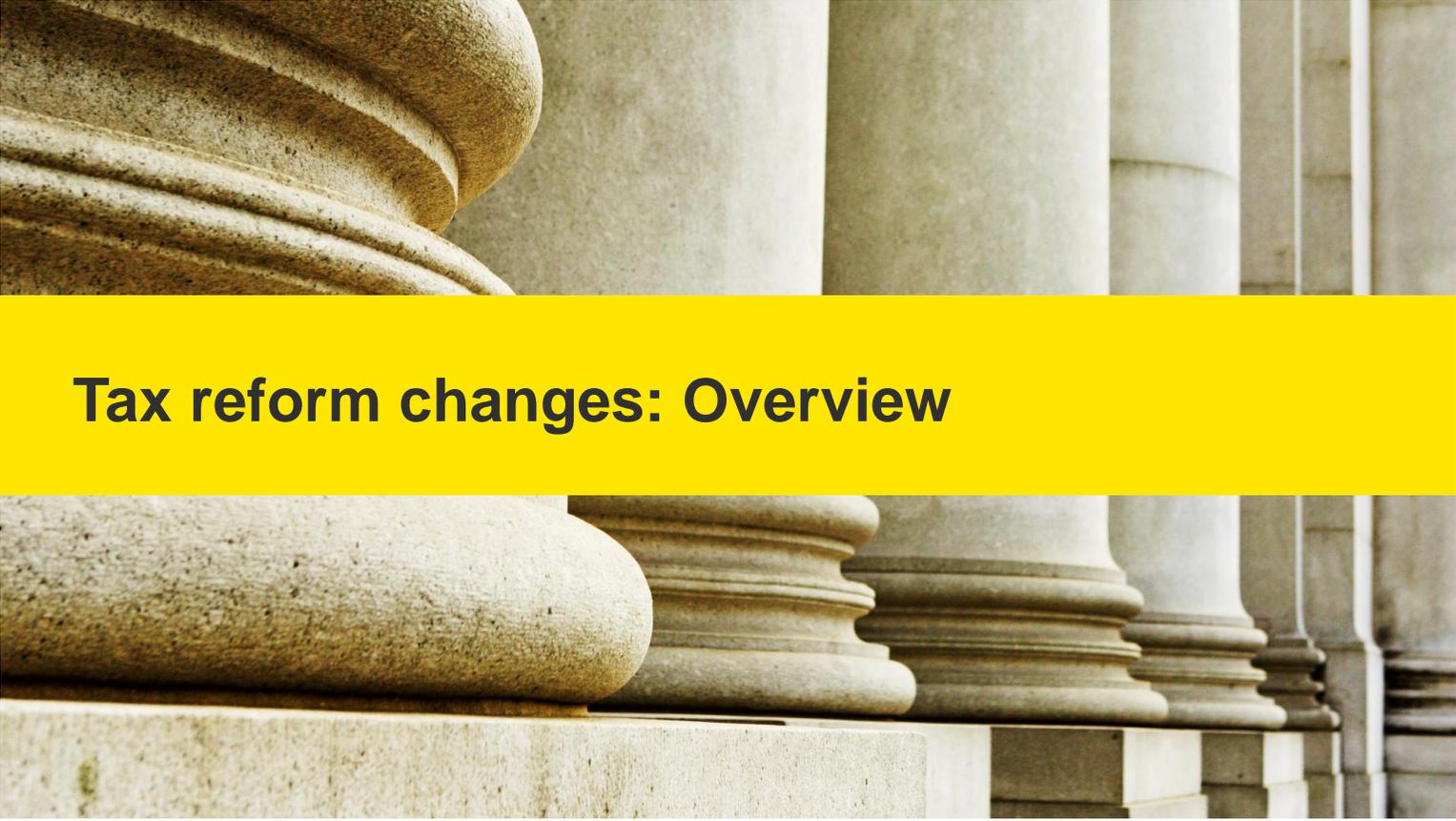
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Agenda

- ▶ Tax reform changes: Overview
- ▶ Prior law vs new law: side-by-side comparison
- ▶ Summary of new vs. old rules
- ▶ Entertainment expenses
- ▶ Employer-operated eating facility
- ▶ Meals provided at the convenience of the employer in an employer-operated facility
- ▶ Other de minimis food and beverage
- ▶ Recent developments
- ▶ Qualified transportation fringes
- ▶ Moving expenses
- ▶ Questions



Tax reform changes: Overview

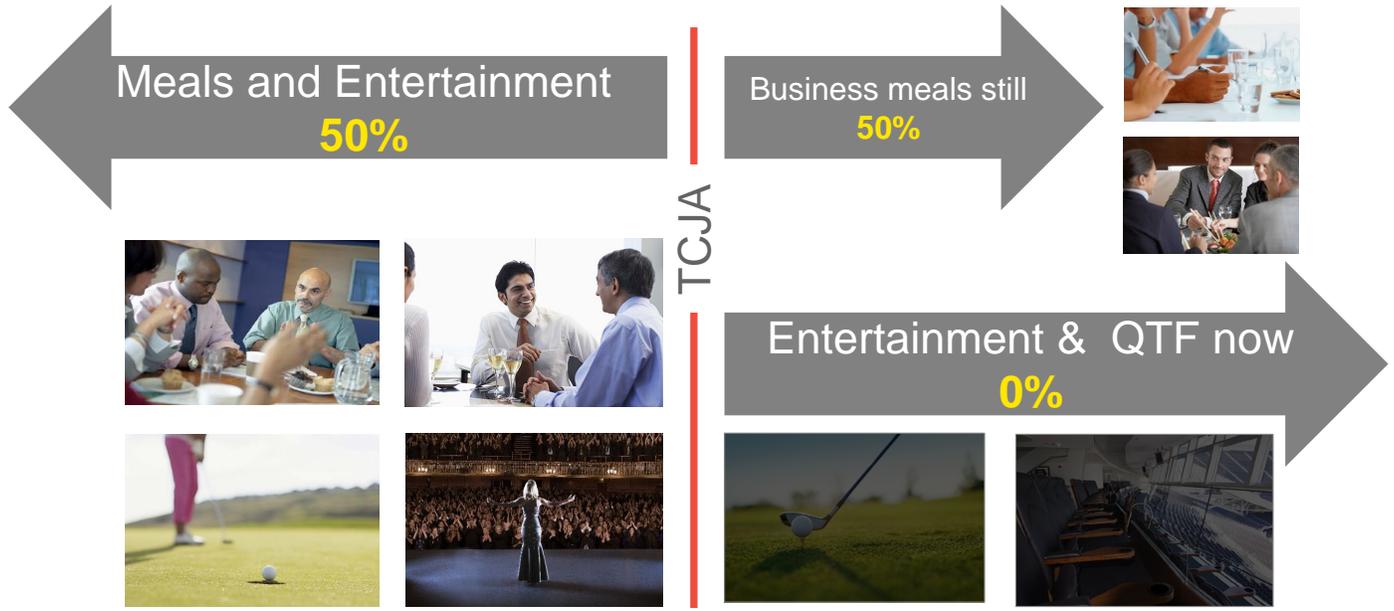
Tax reform changes: Overview

Tax Cuts and Jobs Act (TCJA) effective January 1, 2018, changed the rules governing the deductibility of certain fringe benefits

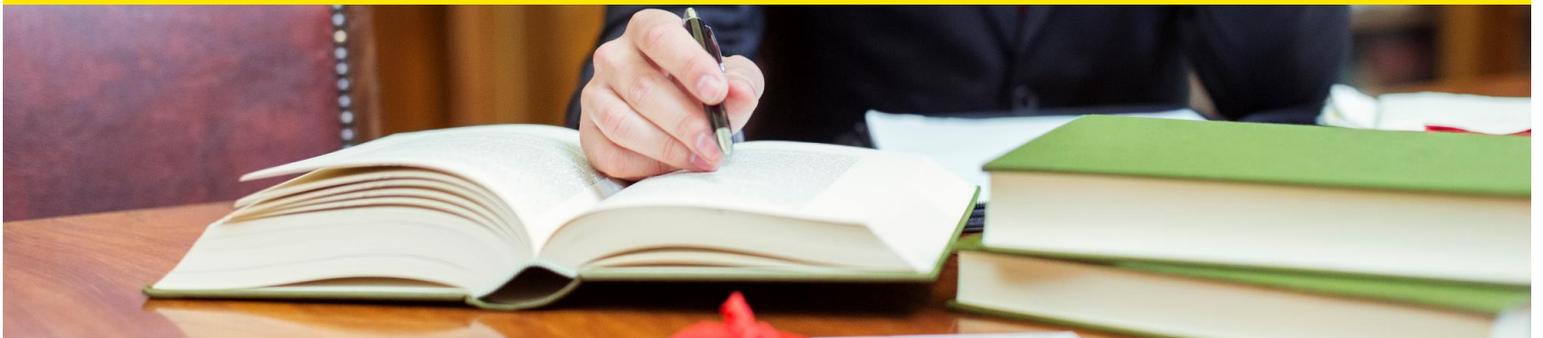
- ▶ Notably, M&E, and transit expenses have changed significantly:
 - ▶ No deduction allowed for entertainment (whether with or without clients)
 - ▶ Employer cafeterias have been reduced to 50% (moving to zero in 2026)
 - ▶ Meals provided for the convenience of the employer in an employer cafeteria have been reduced to 50% (moving to zero in 2026)
 - ▶ *De minimis* food or beverages has been reduced to a 50% deduction
 - ▶ No deduction for qualified transportation fringe benefits. In addition, no deduction for commuting unless provided for employee safety. No deduction for employee parking that has fair market value
 - ▶ Suspension of exclusion from employee income for qualified moving expenses from 2018 through 2025 (except for active duty US Armed Forces moving pursuant to a military order for permanent change of station)

Before

After



**Prior law vs new law:
side-by-side comparison**



Prior law vs new law: side-by-side comparison



Prior law

- ▶ **No deduction**
 - ▶ Meals, entertainment, amusement or recreational activities unless ordinary, necessary and directly related to the active conduct of a taxpayer's trade or business
- ▶ **50% deduction**
 - ▶ Business meals
 - ▶ Employees, stockholder, etc., business meetings
 - ▶ Meetings of business leagues, etc. described in section 501(c)(6) and exempt from taxation under section 501(a)
- ▶ **100% deduction**
 1. Reported as compensation to an employee
 2. Includable in the gross income of recipient who is not an employee
 3. Reimbursed expenses
 4. Items made available to the general public
 5. Goods or services sold to customers in a bona fide transaction for adequate and full consideration
 6. Qualified employee recreation, primarily for the benefit of employees (other than employees who are highly compensated employees)
 7. De minimis food and beverage
 8. Qualified employer operated eating facilities
 9. Meals provided for the convenience of the employer in an employer operated eating facility
 10. Qualified transportation fringes



New law

- ▶ **No deduction**
 - ▶ Entertainment
 - ▶ Qualified transportation fringe benefit
 - ▶ Commuting (except if for employee safety)
- ▶ **50% deduction**
 - ▶ Food or beverage provided outside of an employer operated eating facility
 - ▶ Employees, stockholder, etc., business meetings (F&B only)
 - ▶ Meetings of business leagues, etc. described in section 501(c)(6) and exempt from taxation under section 501(a) (F&B only)
- ▶ **50% deduction (1/1/18–12/31/25) 1/1/26 onward no deduction**
 - ▶ Employer operated eating facilities
 - ▶ Meals provided at the convenience of the employer
- ▶ **Deduction suspended (1/1/18–12/31/25) suspended**
 - ▶ Qualified moving expense reimbursements (except for active duty U.S. Armed Forces moving pursuant to a military order for permanent change of station)
- ▶ **100% deduction**
 - ▶ Items 1-6 listed under prior law
 - ▶ Employees, stockholder, etc., business meetings (entertainment only)
 - ▶ Meetings of business leagues, etc. described in section 501(c)(6) and exempt from taxation under section 501(a) (entertainment only)

Summary of new vs. old rules



Summary of new vs. old rules

Description	Before TCJA Deduction %	After TCJA Deduction %	Effective date (amounts incurred on, or paid after)	Notations		
1 Business Entertainment, amusement or recreation	50%	0%	1/1/2018	I.R.C. § 274(a) edited to disallow any deduction for entertainment, amusement, recreation, etc.		
2 Entertainment tickets	>50*	0%	1/1/2018	* Under old law taxpayers were subject to 50% of the highest non-luxury ticket		
3 Business food and beverage	50%	50%	No Change**	**There is no guidance regarding what constitutes a "business meal" vs. an "entertainment meal." If a meal is deemed an entertainment meal (e.g., a meal consumed during a sporting event) then this meal may be non-deductible.		
4 M&E expenses treated as compensation	100%	100%	No change ↓			
5 Reimbursed expenses	100%	100%				
6 Recreational expenses for employees only	100%	100%				
7 Items available to the public	100%	100%				
8 Entertainment sold to customers	100%	100%				
9 Expenses includible in income of non-employees	100%	100%				
10(a) Employees, stockholder, etc., business meetings – Food & beverage only	50%	50%				
10(b) Employees, stockholder, etc., business meetings – Entertainment only	50%	100%			1/1/2018	Note this appears to be a drafting error
11(a) Meetings of business leagues, etc. described in section 501(c)(6) and exempt from taxation under section 501(a) – Food & beverage only	50%	50%			No change	
11(b) Meetings of business leagues, etc. described in section 501(c)(6) and exempt from taxation under section 501(a) – Entertainment only	50%	100%	1/1/2018	Note this appears to be a drafting error		

Summary of new vs. old rules

Description	Before TCJA Deduction %	After TCJA Deduction %	Effective date (amounts incurred on, or paid after)	Notations
12(a) De Minimis food or beverage expenses excludable from income of recipient that are (1) Infrequent (2) low dollar value (3) unreasonable or administratively impracticable to account for	100%	50%	1/1/2018: 50%	Even though I.R.C. § 274(n)(2)(B) completely removed from I.R.C. may still qualify as 50% deductible employee food/beverage, see row 3 above
12(b) De Minimis food or beverage provided at "employer-operated eating facilities."	100%	50%	1/1/2018: 50% 1/1/2026: 0%	I.R.C. § 274(n)(2)(B) completely removed from I.R.C.
12(c) De Minimis food or beverage provided for the convenience of the employer in an employer-operated eating facilities.	100%	50%	1/1/2018: 50% 1/1/2026: 0%	I.R.C. § 274(n)(2)(B) completely removed from I.R.C.
13 Meals provided at convenience of employer	100%	50%	1/1/2018: 50% 1/1/2026: 0%	New law replaces row 12(b) and 12(c) above. Becomes effective for expenses paid or incurred after 12/31/25
14 Qualified Transportation Fringes	100%	0%	1/1/2018	New I.R.C. § 274(a)(4) disallows any deduction for qualified transportation fringe benefits (as defined under I.R.C. § 132(f)). Further, I.R.C. § 274(l) provides that no deduction is allowed for transportation from an employee's residence to place of employment except for safety of employee or bicycle reimbursements. Further, bicycle fringe benefits incurred between 1/1/18 and 12/31/25 must be included in wages.
15 Qualified Moving Reimbursement	100%	100%	Suspend exclusion from income 2018 - 2025	Moving reimbursements must now be included in employees income but employer will still be entitled to compensation deduction since amounts now included in recipients compensation.
16 Employee Achievement Awards	100%	100%	No change	Current law did not change but language added to I.R.C. § 274(j) to clarify that qualified employee achievement awards cannot include cash, cash equivalents, gift cards, gift coupons, or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or vacations, meals lodging, tickets to theater or sporting events, stocks bonds, other securities, and other similar items.



Entertainment expenses

Entertainment expenses



Prior law

- ▶ **No deduction**
 - ▶ Section 274 prohibited deductions for meals, entertainment, amusement or recreational activities unless such expenses were ordinary, necessary and directly related to the active conduct of a taxpayer's trade or business
- ▶ **50% deduction**
 - ▶ If a taxpayer was able to show that they satisfied the requirements above under Section 274, and the taxpayer was present, the taxpayer was entitled to a 50% deduction for such expenses, unless the expense was deemed to be lavish or extravagant, in which case there would be no deduction.
- ▶ **100% deduction**
 - ▶ In addition, a 100% deduction was allowed for qualified employee recreation, social or similar activities (including facilities) primarily for the benefit of employees (other than employees who are highly compensated employees (within the meaning of Section 414(q))



New law

- ▶ **No deduction**

Entertainment:

 - ▶ The modifications under TCJA deny any deduction for all entertainment expenses, including facilities used for such activities, even if these expenses directly relate to, or are associated with the conduct of business
 - ▶ All forms of business entertainment (including golf outings, fishing, sailing, sporting events, hunting, theater tickets, license fees paid to sporting events, golf club dues, sightseeing, tourist activities, movies, concerts, golf, etc.) are entirely nondeductible, even if a substantial and bona fide business discussion is associated with the activity
- ▶ **50% deduction**

Business food and beverage:

 - ▶ Non-entertainment food and beverage with a substantial business purpose for the meal, other than the entertainment of the client, will still be 50% deductible (unless lavish, extravagant or if the taxpayer is not present)
- ▶ **100% deduction**
 - ▶ It is possible that some employee recreational expenses may be 100% deductible, but that is allowed only in extremely limited circumstances, and in instances where the recreational, social or similar activities is primarily for the benefit of employees
 - ▶ Employees, stockholder, etc., business meetings (entertainment only)
 - ▶ Meetings of business leagues, etc. described in section 501(c)(6) and exempt from taxation under section 501(a) (entertainment only)



Employer-operated eating facility

Employer-operated eating facilities



Prior law

▶ 100% deduction

- ▶ Section 274(n)(2)(B) permitted a taxpayer to take a 100% deduction for qualified employer operated eating facilities (e.g., company cafeteria) as defined in Section 132(e)(2)
- ▶ In order to satisfy the requirements of such a facility under Section 132(e)(2) the taxpayer was required to adhere to certain criteria
- ▶ If the facility was subsidized, the prior law required the taxpayer to include the subsidy in employees' compensation to the extent the revenue at the facility was less than the cost



New law

▶ 50% deduction (1/1/18–12/31/25)

- ▶ TCJA strikes Section 274(n)(2)(B) from the Code, accordingly employer-operated eating facilities are now governed by Section 274(n)
- ▶ Section 274(n) imposes a 50% limitation on "any expense for food or beverages"

▶ No deduction (1/1/26–Forward)

- ▶ TCJA created a new code section, Section 274(o), which becomes effective for amounts paid or incurred after December 31, 2025
- ▶ Section 274(o) disallows a deduction for any expense for the operation of a facility described in Section 132(e), and any expense for food or beverages, including under Section 132(e)(1), associated with such facility; and any expense for a meal provided for the convenience of the employer
- ▶ Section 274(o) has broader reach for nondeductibility than Section 274(n), and will disallow a deduction for **all** expenses, including food and beverages, direct operating costs, depreciation, etc.

Meals provided at the convenience of the employer in an employer-operated facility



Meals provided at the convenience of the employer in an employer-operated facility



Prior law

100% deduction

Meals provided for the convenience of the employer:

- ▶ Section 119(a) – [no income inclusion/convenience of employer]
- ▶ Section 119(b)(4) – [meals provided for 50% or more employees]

and

Provided in an employer-operated eating facility:

- ▶ Section 132(e)(2) – [employer-operated eating facility]
- ▶ Section 274(n)(2)(B) – [deduction for *de minimis* meals]
- ▶ See Slide 15 for prior technical rule



New law

▶ 50% deduction (1/1/18–12/31/25)

- ▶ TCJA strikes Section 274(n)(2)(B); now meals provided in an employer-operated eating facilities are governed by Section 274(n) (including meals for the convenience of the employer at such a facility)
- ▶ Section 274(n) imposes a 50% limitation on “any expense for food or beverages”

▶ No deduction (1/1/26–Forward)

- ▶ TCJA created a new code section, Section 274(o); effective for amounts paid or incurred after December 31, 2025
- ▶ Section 274(o) disallows a deduction for any expense for meals described in Section 119(a) (i.e., meals provided for the convenience of the employer)
- ▶ Section 274(o) has a broader reach for non-deductibility than Section 274(n), and will disallow a deduction for **all** expenses, including food and beverages, direct operating costs, depreciation, etc.

What is the distinction between (1) meals provided at the convenience of the employer in an employer-operated eating facility and (2) provided in an employer-operated facility

1. Employer operated facility = employee pays for meal
2. Convenience of the employer = meals are free



Other *de minimis* food and beverages



Other *de minimis* food and beverages



Prior law

▶ 100% deduction

- ▶ Section 274(n)(2)(B) allowed a 100% deduction for food or beverages, if such expense was excludable from the gross income of the recipient as a *de minimis* fringe benefit under Section 132(e).
- ▶ Section 132(e)(1) provided that a *de minimis* fringe benefit included any property or service provided to employees if the value (after taking into account the frequency with which similar fringes were provided by the employer to employees) was so small as to make accounting for it unreasonable or administratively impracticable.
- ▶ Treas. Reg. Section 1.132-6(d)(2) provided the following examples of expenses that could be *de minimis* fringe benefits:
 - ▶ Meals or meal money provided to the employee on an occasional basis
 - ▶ Meals or meal money provided to an employee because overtime work necessitates an extension of the employee's normal work schedule
 - ▶ In the case of a meal or meal money, the meal or meal money was provided to enable the employee to work overtime



New law

▶ 50% deduction

- ▶ TCJA strikes Section 274(n)(2)(B) from the Code, accordingly *de minimis* food and beverages are now governed by Section 274(n)
- ▶ Section 274(n) imposes a 50% limitation on “any expense for food or beverages”

Recent developments

- ▶ Restaurant industry received clarification about deducting employee shift meals in the Joint Committee on Taxation's blue book
- ▶ Value of employer-provided meals will not be excludable from employee income as provided "for the convenience of the employer" unless employer substantiates its necessity

Meals provided to restaurant employees

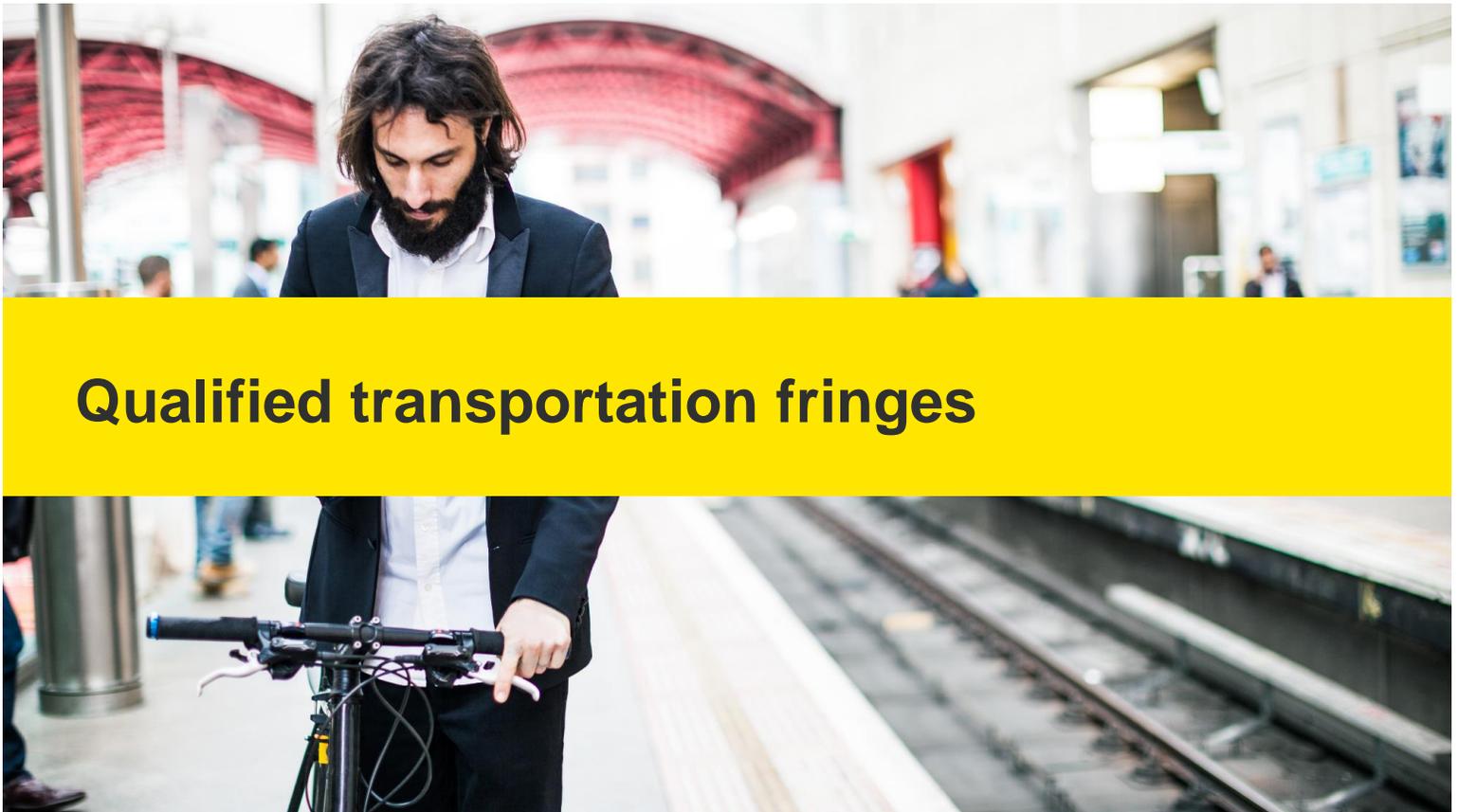
- ▶ The blue book (JCS-1-18) issued December 20, 2018 carried forward some language from legislative history regarding employee shift meals.
- ▶ Footnote 940 in the blue book, referring to the legislative history of the Tax Reform Act of 1986, provides that a "restaurant or catering firm may deduct 100%....of its costs for food and beverage items, purchased in connection with preparing and providing meals to its paying customers, that are consumed at the worksite by employees of the restaurant or caterer."

TAM 201903017: Employer provided meals for the convenience of the employer

- ▶ In January 2019, the IRS issues Technical Advice Memorandum 201903017 concluding the value of employer-provided meals will not be excluded from employee income as provided “for the convenience of the employer” unless the employer proves entitlement to the exclusion by
 - ▶ (1) substantiating that it follows and enforces policies and practices that require the furnishing of meals and
 - ▶ (2) establish that the business need underlying the policies constitutes a “substantial, noncompensatory business reason”

- ▶ Key takeaways:
 - ▶ Value of snacks may be considered de minimis fringe benefits and excludable from income
 - ▶ Employers furnishing free meals to their employees should be prepared to substantiate a policy that necessitates employer-provided meals to enable employees to perform their job
 - ▶ IRS sets high bar in terms of substantiation required
 - ▶ IRS interprets/applies *Kowalski* “business necessity” standard
 - ▶ Availability of meal delivery services and its impact to the assertion that employees are unable to secure a proper meal within a reasonable period
 - ▶ Employees ability to bring in food from home is not relevant
 - ▶ “Reasonable belief” not necessarily satisfied even if employer is ultimately successful under IRC 119
 - ▶ Some guidance on computation of “direct operating costs” when employer uses catering company

Qualified transportation fringes



Qualified transportation fringes



Prior law

- ▶ Four types of qualified transportation
- ▶ Up to annual limit (see table), employees could exclude from income (these fringes could be funded by employee pretax salary reduction)
 - ▶ Employers were also entitled to a 100% deduction for these amounts
- ▶ In addition, under prior law employers could offer a reimbursement for the costs of bicycle commuting (including costs of purchasing bicycle)

Benefit	2017 monthly income exclusion limit	2018 monthly income exclusion limit
Commuter highway vehicle	\$255	\$260
Transit pass	\$255	\$260
Parking	\$255	\$260
Bicycle	\$20	\$0



New law

- ▶ **No deduction**
 - ▶ TCJA adds Section 274(a)(4) which provides that there shall be no deduction for the expense of any qualified transportation fringe (as defined in Section 132(f)) provided to an employee of the taxpayer
 - ▶ Furthermore, TCJA created Section 274(l) which denies any deduction for expenses incurred for providing any transportation or payment or reimbursement to an employee of the taxpayer in connection with travel between the employee's residence and place of employment, except as necessary for the safety of the employee
 - ▶ No deduction for employee provided parking that has fair market value
- ▶ **100% deduction**
 - ▶ Commuting provided for employee safety
- ▶ **100% deduction (1/1/18–12/31/25)**
 - ▶ TCJA suspends the exclusion from taxable income for qualified bicycle commuting reimbursement (as described in Section 132(f)(5)(F))

Notice 2018-99 guidance on qualified transportation fringes

- ▶ In December 2018, the IRS released Notice 2018-99, which provides guidance to help taxpayers determine their parking disallowance
- ▶ Key takeaways:
 - ▶ Treasury and IRS intend to publish proposed regulations on the determination of nondeductible parking expenses and other expenses for QTFs, but in the meantime, **taxpayers are permitted to use any reasonable method for allocation of costs**
 - ▶ **Taxpayers may rely on Notice 2018-99**, which sets forth a deemed reasonable method for allocation of expenses and identifies certain methods as unreasonable
 - ▶ **Depreciation is disregarded** as an expense
 - ▶ Parking allocation must be based on **cost and not value**
 - ▶ **No guidance on segregation of lease costs**

Notice 2018-99: Allocation of parking costs

Parking provided by a third party	Parking owned or leased by taxpayer
<ul style="list-style-type: none"> Amount paid to third party is disallowed except to extent that the amount is imputed in income because it exceeds the monthly exclusion limitation 	<ul style="list-style-type: none"> Use any reasonable method to allocate the expenses of facility Expenses: Repairs, maintenance, utility costs, insurance, property taxes, interest, snow/ice/leaf/trash removal, cleaning, landscape costs, parking lot attendant expenses, security, lease payments Not an expense: <ul style="list-style-type: none"> Depreciation Items not located on or in the parking facility (e.g. landscaping or lighting) Four-step deemed reasonable method

Moving expenses



Moving expenses



Prior law

- ▶ **100% deduction**
 - ▶ Employers entitled to deduct costs of employee moving expenses such as:
 - ▶ Reasonable expenses for moving household goods and personal effects from former residence to new residence
 - ▶ Traveling from former residence to new residence
 - ▶ For foreign move, storage costs
 - ▶ Employees also entitled to an income exclusion for these costs



New law

- ▶ **100% deduction (1/1/18–12/31/25)**
 - ▶ TCJA suspends the qualified moving expense reimbursement exclusion from employee income
 - ▶ Employer must now tax reimbursement
 - ▶ Employer entitled to 100% compensation deduction
 - ▶ Employers should consider grossing-up employees for costs associated with moving

Questions?