

Substance, Not Form, Determines Whether Employee Meals Have Noncompensatory Business Reason, IRS Warns

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In a technical advice memorandum ([TAM 201903017](#)) released on January 18, 2019, the Internal Revenue Service (IRS) provided guidance on whether employer-provided meals and snacks are includable in employee income and subject to employment tax. The memorandum, which cites a number of IRS rulings on this topic, serves as a forewarning to employers of the limitations of providing free meals to employees.



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Employers should be aware that the value of employer-provided meals will not be excludable from employee income unless the employer can (1) demonstrate that the meals were provided for a substantial noncompensatory business reason and (2) substantiate that the employer enforces the policies and practices underlying this substantial noncompensatory business reason.

Background

While an employer is generally required to include compensation for all services and all fringe benefits in an employee's gross compensation, there are exceptions set forth in the Internal Revenue Code.

One such exception is found in Code Section 119(a)(1), which allows an employer to exclude from an employee's income the value of meals provided for the convenience of the employer if the meal is furnished on the employer's business premises and provided for a substantial noncompensatory business reason.

Whether meals are furnished for a substantial noncompensatory business reason requires an analysis of the relevant facts and circumstances. Regulations from the U.S. Department of the Treasury provide several examples, indicating that meals will be regarded as furnished for a substantial noncompensatory business reason when the meals are furnished to the employee during working hours for these purposes:

- To have the employee available for emergency calls
- To restrict the employee to a short meal period
- To enable the employee to secure a meal within a reasonable meal period because the employee could not otherwise do so

Further, Code Section 119(b)(4) provides that all meals furnished to employees on the employer's business premises will be treated as being for the convenience of the employer as long as more than half of the employees on the employer's business premises are furnished meals for the convenience of the employer.

Additionally, Code Section 132(e)(2) provides that the value of meals furnished to employees at an employer-operated eating facility is excludable from income as a de minimis fringe benefit, as long as the revenue from the facility equals or exceeds the direct operating costs of the facility. Although the term "eating facility" has never been expressly defined, the IRS has indicated that an eating facility means an identifiable location that is designated and set aside for the preparation and/or serving and consumption of meals.

Finally, Code Section 132(e)(1) also provides for the exclusion from an employee's wages of any property or service whose value is so small as to make accounting for it unreasonable or administratively impracticable. Determining whether the item received is sufficiently small is a matter of facts and circumstances, including how often the employer provides this benefit to its employees.

The Memorandum

The taxpayer in the memorandum is an unnamed employer that provided free meals to all employees as well as unlimited snacks and drinks. The taxpayer gave the following noncompensatory business reasons for furnishing the meals:

- Protecting confidential information by providing a secure environment for business discussions on the business premises
- Fostering collaboration and innovation by encouraging employees to remain on the business premises
- Protecting employees due to unsafe conditions surrounding the business premises
- Providing healthy eating options for employees to improve employee health
- Because employees cannot quickly purchase a meal elsewhere within a reasonable meal period given the location of the business premises
- Because, due to the demands of the employees' job functions, employees may only take short meal breaks
- Ensuring that employees are available to handle emergency outages that regularly occur

Boyd Gaming Corp. v. Commissioner

To begin its analysis, the IRS pointed to *Boyd Gaming Corp. v. Commissioner*, which precludes the IRS from substituting its judgment for the business decisions of a taxpayer. However, the IRS noted that *Boyd* does not restrict its authority to determine whether those policies qualify as substantial noncompensatory business reasons and whether the taxpayer actually adheres to and enforces its own policies.

The IRS noted that a taxpayer bears the burden of proving that it is entitled to exclusions from income and wages for meals furnished for the convenience of the employer. Upon request, the taxpayer must provide substantiation concerning the business reasons being cited to support its claim of furnishing meals for the convenience of the employer. Additionally, if an employer provides specific written policies to demonstrate a substantial noncompensatory business reason for furnishing meals to employees, the employer also must demonstrate that it actually enforces these policies.

Prevalence of Meal Delivery Services

Interestingly, in the memorandum the IRS discussed the prevalence of meal delivery services, aside from traditional restaurant delivery. In recent years, food delivery services have become more prevalent, and employees can easily order meals online or on their cell phones from a variety of on-demand delivery services.

The IRS expressly noted that the availability of meal delivery services should be considered when evaluating the business reasons proffered by employers as support for providing meals for the convenience of the employer. For example, the inability of an employee to secure a meal within a reasonable meal period may be challenged if the IRS finds that meal delivery services are readily available. However, the ability of an employee to bring food from home should not be considered.

Substance Over Form: Review of Substantial Noncompensatory Business Reasons

The IRS concluded that the business reasons provided by the taxpayer were not sufficient to justify the employer's need to furnish meals. Specifically, the IRS explained that:

- the taxpayer did not demonstrate that it had policies related to protecting confidential information, fostering collaboration, employee health, or shortened length of meal periods that would require employer-provided meals in order for employees to properly perform their duties;
- the taxpayer did not provide sufficient support related to its claim that its employees could not safely obtain meals off the business premises such that employer-provided meals were necessary for the employees to perform their duties; and
- the employees had access to nearby eating facilities, such that employer-provided meals were not necessary for the employees to perform their duties.

Significantly, the IRS noted that the taxpayer sufficiently demonstrated that it had policies in place requiring certain employees to respond to emergencies that regularly occurred. However, the taxpayer did not demonstrate that all employees were expected to be available to respond to emergencies during meal periods as part of their job duties. As a result, the IRS concluded that this exclusion was only available to those employees reasonably expected to respond to emergencies during their meal periods.

The IRS also noted that the taxpayer did not demonstrate that at least half of all employees were furnished meals for the convenience of the employer and, therefore, had not shown that the requirements of Code Section 119(b)(4) were met.

In addition to the above, the IRS ruled that the snack areas and employees' desks at which meals were provided and consumed did not qualify as "eating facilities" under Section 132 of the Code. Additionally, the memorandum noted that because the meals were provided free of charge, the revenue derived from the "facility" did not exceed the operating costs. Thus, along with failing to meet the requirements of Code Section 119, the IRS concluded that the meals the taxpayer furnished to its employees were not excludable as a de minimis fringe benefit for an employer-operated eating facility under Code Section 132(e)(2).

Snacks

While the IRS concluded that the employer-provided meals were not excludable from employee income, the memorandum said that snacks remain tax-free as a de minimis fringe benefit under Code Section 132(e)(1), provided they are not of unusually high value or offered in unusually large portions. The IRS noted that snacks come in small portions that are difficult to quantify and have a low value even if they are provided by the employer on a continual basis. Thus, employers can continue to provide free snacks to employees and expect to exclude the value of these snacks from employee income.

Calculation of Employment Taxes Owed

In the event meals furnished by an employer to an employee do not qualify for exclusion under Code Sections 119 or 132(e) (2), employers must impute into employee income the fair market value of the meal less any amount paid by the employee. Alternatively, a special valuation rule provides that the value of meals provided at an employer-operated eating facility is equal to 150 percent of the direct operating costs.

If employees are charged for meals, the individual meal subsidy may be treated as the value of the meal. However, as was the case in the memorandum, where employees are not charged for meals, the employer may allocate the total meal subsidy among employees in any reasonable manner under the circumstances.

Looking Ahead

While employers may continue to provide free snacks to employees, they should consider taking precautions with regard to furnishing free meals. While the IRS cannot substitute its judgment for an employer's judgment, the IRS can determine whether the policies qualify as a substantial noncompensatory business reason for furnishing meals and whether the policies are followed in practice.

Employers should consider whether they have written policies that describe the specific legitimate business reasons for providing meals and are prepared to bear the burden of proof in demonstrating that they consistently and uniformly enforce the policies in practice. In addition, employers will likely want to be ready to provide evidence as to why access to meal delivery services does not impact the employer's specified business reasons for offering free meals.

The memorandum shows that the IRS is scrutinizing employer-provided meal programs and will consider general business goals and objectives without substance an insufficient showing of a substantial noncompensatory business reason.

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TOPICS

