The Tax Cuts and Jobs Act of 2017 (TCJA) eliminated the deduction for entertainment purchased as a business expense but left intact the deduction for business meals. Because entertainment and meals are often closely intertwined when purchased in a business context, taxpayers may have difficulty distinguishing deductible meal expenses from nondeductible entertainment expenses.

The Internal Revenue Service (IRS) intends to propose regulations outlining the differences between deductible meal expenses and nondeductible entertainment expenses. However, until those regulations are issued, taxpayers must rely on IRS Notice 2018-76.

Impact of the TCJA

Prior to the TCJA, taxpayers generally could deduct 50 percent of the cost of both entertainment and meals purchased for business purposes. Taxpayers may continue to deduct 50 percent of the cost of business meals if the taxpayer, or the taxpayer’s employee, is present and the food or beverages are not considered lavish or extravagant.

However, the TCJA repealed the deductibility of entertainment expenses. Before the TCJA, deductions for entertainment were generally disallowed under the Internal Revenue Code, but exceptions applied to entertainment expenses that either directly related to the taxpayer’s business (the “directly related” exception) or directly preceded or followed a substantial and bona fide business discussion (the “business discussion” exception). Following the TCJA, business deductions for entertainment expenses are no longer permitted, including those that previously would have qualified for the 50 percent deduction under the business discussion and directly related exceptions.

Prior to the TCJA’s reforms, business expenses for meals and entertainment were generally treated similarly, so little thought or effort was required to determine the amount attributable to each category: meals and entertainment resulted in the same tax treatment regardless of how they were divided. However, following the TCJA, taxpayers have an incentive to categorize ambiguous expenses as meals rather than entertainment to take advantage of the remaining 50 percent deduction for meals.

Notice 2018-76

The IRS issued Notice 2018-76 to provide taxpayers with clarity and guidelines in discerning between expenses that are considered deductible meals and expenses that are considered nondeductible entertainment in close-call scenarios. Until regulations
are issued, taxpayers may rely on the guidance provided in the notice.

The notice clarifies that taxpayers may deduct 50 percent of a business meal expense that meets these five requirements:

1. “The expense is an ordinary and necessary expense under [Code section] 162(a).”
2. “The expense is not lavish or extravagant under the circumstances.”
3. “The taxpayer, or an employee of the taxpayer, is present at the meal.”
4. “The meal is provided to a current or potential business customer, client, consultant, or similar business contact.”
5. For meals provided in conjunction with entertainment, the meal expenses are “stated separately” from the entertainment expenses.

However, the IRS warns against inflating meal expenses to obtain a deduction for entertainment expenses in order to circumvent the TCJA’s repeal of the deduction for entertainment expenses. The notice provides examples that illustrate when meals will remain deductible when provided in conjunction with entertainment.

Under the guidance in the notice, a taxpayer may still deduct 50 percent of otherwise-deductible business meals purchased separately from entertainment. In Example 1, a taxpayer purchases tickets to a baseball game and takes a business contact. While at the game, the taxpayer purchases hot dogs and drinks. Though the tickets to the game are nondeductible, the hot dogs and drinks purchased at the game are 50 percent deductible because they are purchased separately from the baseball tickets.

However, if food and drink are included in the price of the entertainment, the meals are not separately stated and thus may not be deducted. In Example 2, a taxpayer purchases suite tickets to a basketball game that include food and drinks, and takes a business contact. No amount may be deducted for the food and drinks because those costs are included with the cost of the tickets, which are a nondeductible entertainment expense.

Example 3 provides that had the suite tickets in Example 2 separately stated the cost of the food and beverages, then the food and beverage cost would have been 50 percent deductible.

In preparation for future regulations, the IRS has requested comments concerning treatment of business meal expenses and entertainment expenses. However, it is unclear when these regulations may be issued.

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