



# TaxNewsFlash

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## KPMG report: Final regulations on deductibility of meal and entertainment expenses (initial impressions)

The IRS on September 29, 2020, posted on its website a version of final regulations (T.D. 9925) providing guidance under section 274 regarding changes made to section 274 by the U.S. tax law enacted in 2017 limiting the deductibility of meal and entertainment expenses.

The final regulations adopt the proposed regulations (February 2020) with minor modifications related to certain comments received.

One change to the final regulations addresses the use of the section 274(e)(2) and (e)(9) exceptions for meals included in employee and non-employee compensation, respectively. The proposed regulations provided that if less than the required amount was included in compensation, then the exception could not be used. The final regulations eliminate the “all or nothing approach” in this scenario (e.g., when there has been an error in value), but limit the section 274(e)(2) and (e)(9) exceptions to the amount included in compensation or reimbursed to the taxpayer.

The [final regulations](#) [PDF 317 KB] were released by the U.S. Treasury Department and IRS for publication in the Federal Register in the afternoon of October 2, 2020. The final regulations are effective for tax years that begin on or after October 9, 2020 (the date of publication in the Federal Register).

This report of initial impressions is based on the version of the [final regulations](#) [PDF 384 KB] released by the IRS.

### Background

The 2017 tax law (Pub. L. No. 115-97)—the law that is often referred to as the “Tax Cuts and Jobs Act” (TCJA)—eliminated the deduction for any expenses related to activities generally considered entertainment, amusement or recreation. It also increased the scope of the deduction limitation for expenses related to food and beverages provided by employers.

The [proposed regulations](#) [PDF 309 KB] (February 2020) addressed the elimination of the deduction for expenditures related to entertainment, amusement or recreation activities and provided guidance to determine whether an activity is considered to be entertainment. The proposed regulations also addressed the limitation on the deduction of food and beverage expenses and the applicability of exceptions under section 274(e).

## Final regulations

As noted briefly above, the final regulations substantially adopt the guidance in the proposed regulations with a few clarifications and additional examples in response to comments received.

### Overview

The final regulations describe and clarify the statutory requirements of section 274(a), (k), and (n), as well as the applicability of certain exceptions under section 274(e) to food or beverage expenses. These final regulations address the changes made to deductions for meals and entertainment under the TCJA.

### Entertainment expenditures

The final regulations add a new Reg. section 1.274-11 that:

- Restates statutory rules under section 274(a), including the application of the entertainment deduction disallowance rule to dues or fees to any social, athletic or sporting club or organization.
- Substantially incorporates the existing definition of entertainment in Reg. section 1.274-2(b)(1) (including use of an “objective test”), with minor modifications to remove outdated language.
- Confirms that the nine exceptions in section 274(e) continue to apply to entertainment expenditures for which a deduction is otherwise disallowed under section 274(a).
- Provides that for purposes of section 274(a), the term “entertainment” does not include food or beverages unless the food or beverages are provided at or during an entertainment activity and the costs of the food or beverages are not separately purchased nor separately stated from the entertainment costs.

### Separately stated food or beverages, not entertainment

In addition, the final regulations retain the guidance in the proposed regulations that:

- Distinguishes between entertainment expenditures and food or beverage expenses in the context of business meals provided at or during an entertainment activity.
- Provides that unless food or beverages provided at or during an entertainment activity are purchased separately from the entertainment, or the cost of the food or beverages is stated separately from the cost of the entertainment on one or more bills, invoices or receipts, no allocation can be made and the entire amount is a nondeductible entertainment expenditure.
- Provides that the amount charged for food or beverages on a bill, invoice or receipt must reflect the venue’s usual selling cost for those items if they were to be purchased separately from the entertainment or must approximate the reasonable value of those items.

- Includes examples regarding food and beverages that are either (1) purchased separately at an entertainment event or (2) separately stated on an invoice and the stated cost of the food and beverages reflects the venue's usual selling price if purchased separately. These food and beverage expense amounts are subject to the 50% deduction disallowance but are not treated as a nondeductible entertainment expense.

## **Food or beverage expenses**

### **Business meal expenses**

Concerning business meal expenses, the final regulations add a new Reg. section 1.274-12 that:

- Substantially incorporates the proposed regulations addressing business meals provided during or at an entertainment activity.
- Incorporates other statutory requirements taxpayers must meet to deduct 50% of an otherwise allowable business meal expense—specifically, the expense must not be lavish or extravagant under the circumstances and the taxpayer, or an employee of the taxpayer, must be present at the furnishing of the food or beverages.
- Provides that the food and beverages must be provided to the taxpayer or a business associate, which incorporates the definition as a “a person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business such as the taxpayer's customer, client, supplier, employee, agent, partner, or professional adviser.” Such individual can be a business associate whether the relationship is established or prospective.
- Clarifies the proposed regulations to provide that the meal expenses must be an ordinary and necessary expense under section 162(a) and that these regulations provide guidance only under section 274 (i.e., they are not intended to provide guidance under section 162). The examples now assume that the expenses are otherwise deductible as ordinary and necessary under section 162. Therefore, the examples were revised to remove any discussion of business purpose from the facts of the example.
- Adds two new examples addressing meals provided during business meetings at a hotel:

**Example 3.** Taxpayer E holds a business meeting at a hotel during which food and beverages are provided to attendees. Expenses for the business meeting, other than the cost of food and beverages, are not subject to the deduction limitations in section 274 and are deductible if they meet the requirements for deduction under section 162. Under section 274(k) and (n) and paragraph (a) of this section, E may deduct 50% of the food and beverage expenses.

**Example 4.** The facts are the same as in Example 3 (above), except that all the attendees of the meeting are employees of E. Expenses for the business meeting, other than the cost of food and beverages, are not subject to the deduction limitations in section 274 and are deductible if they meet the requirements for deduction under section 162. Under section 274(k) and (n) and paragraph (a) of this section, E may deduct 50% of the food and beverage expenses. The exception in section 274(e)(5) does not apply to food and beverage expenses under section 274(k) and (n).

### **Travel meal expenses**

The final regulations:

- Incorporate the substantiation requirements in section 274(d), unchanged by the TCJA, to travel meals.
- Apply the limitations in section 274(m)(3) to expenses for food or beverages paid or incurred while on travel for spouses, dependents or other individuals accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel.

### **Other food or beverage expenses**

The final regulations also:

- Apply the business meal guidance from the proposed regulations, to food or beverage expenses generally:
  - Under section 274(n)(1), the deduction for food or beverage expenses generally is limited to 50% of the amount that would otherwise be allowable.
  - Prior to the TCJA, under section 274(n)(2)(B), expenses for food or beverages that were excludable from employee income as de minimis fringe benefits under section 132(e) were not subject to the 50% deduction limitation under section 274(n)(1) and could be fully deducted. The TCJA repealed section 274(n)(2)(B) so that expenses for food or beverages excludable from employee income under section 132(e) are subject to the section 274(n)(1) deduction limitation unless another exception under section 274(n)(2) applies.
  - Under section 274(k)(1), in order for food or beverage expenses to be deductible, the food or beverages must not be lavish or extravagant under the circumstances and the taxpayer or an employee of the taxpayer must be present at the furnishing of the food or beverages.
  - Section 274(e) provides six exceptions to the limitations on the deduction of food or beverages in section 274(k)(1) and (n)(1), and the final regulations explain how those exceptions apply.
- Address several scenarios involving the deductibility of food or beverage expenses. Examples address factual scenarios including guidance on the deductibility of expenses for:
  - Food or beverages provided to food service workers who consume the food or beverages while working in a restaurant or catering business.
  - Snacks available to employees in a pantry, break room, or copy room: The final regulations provide that snacks provided for employees in a break room are subject to the deduction limitation. An example is revised to provide, "A break room is not a recreational, social, or similar activity primarily for the benefit of the employees, even if some socializing related to the food and beverages provided occurs."
  - Refreshments provided by a real estate agent at an open house.
  - Food or beverages provided by a seasonal camp to camp counselors.
  - Food or beverages provided to employees at a company cafeteria, and
  - Food or beverages provided at company holiday parties and picnics.

### **Definitions**

- The deduction limitation rules generally apply to all food and beverages, whether characterized as meals, snacks, or other types of food or beverage items.
  - Unless one of the six exceptions under section 274(n)(2)(A) (by reference to subsection (e)) applies, the deduction limitations apply regardless of whether the food or beverages are treated as de minimis fringe benefits under section 132(e).
- The final regulations define food or beverage expenses to mean the cost of food or beverages, including any delivery fees, tips, and sales tax.
  - In the case of employer-provided meals at an eating facility, food or beverage expenses do not include expenses for the operation of the eating facility such as salaries of employees preparing and serving meals, and other overhead costs.

### **Section 274(e) exceptions to section 274(k) and (n)**

Section 274(k)(2)(A) and 274(n)(2)(A) provide that the limitations on deductions in section 274(k)(1) and (n)(1), respectively, do not apply to any expense described in section 274(e)(2), (3), (4), (7), (8), and (9). The final regulations, therefore, provide that the deduction limitations are not applicable to expenditures for business meals, travel meals, or other food or beverages that fall within one of these exceptions.

As such, the final regulations provide guidance on:

- Expenses treated as compensation under section 274(e)(2) or (e)(9)
  - One of the changes in the final regulations addresses the deduction for expenses treated as compensation. The exceptions in section 274(e)(2) and (e)(9) have been interpreted as allowing a taxpayer to deduct the full amount of an expense if the expense has properly been included in the compensation and wages of the employee, or gross income of the recipient, even if the amount of the expense exceeds the amount of the compensation or income.
  - The final regulations provide that if an employee who is not a specified individual receives food or beverages, the expense for the food or beverages is not subject to the deduction limitation to the extent that the taxpayer treats the expense as compensation to the employee. The proper amount of compensation must be determined under Reg. section 1.61-21.
  - If the employee is a specified individual (generally an officer, director or 10% owner), the deduction disallowance does not apply to an expense for food or beverages of the specified individual to the extent that the amount of the expense does not exceed the sum of (1) the amount treated as compensation and (2) the amount reimbursed to the taxpayer by the specified individual. This is known as the dollar-for-dollar methodology.
  - If an amount is excluded from the recipient's income or less-than-the proper amount is included in income, the deduction limitations do not apply to the extent that the amount of the expense does not exceed the sum of (1) the amount treated as compensation and (2) the amount reimbursed. In this case, the dollar-for-dollar methodology as is used for specified individuals is applied rather than the all or nothing approach of fully disallowing the use of the exception as had been provided in the proposed regulations.
- Reimbursed food or beverage expenses
- Recreational expenses for employees
- Items available to the public

- Goods or services sold to customers

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