Understanding the Complexities of Travel, Meals and Entertainment Expenses

NSAC TACC Breakout Session
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Introduction and Agenda
Agenda

- Tax Deductibility of Travel, Meals and Entertainment Expenses
- Documentation Requirements
- Potential for Income Inclusion with Regard to Employees
- Current IRS Examination Trends
- Q&A
Tax Deductibility of Travel, Meals and Entertainment Expenditures
General Construct of M&E Tax Deductibility

- Meals and entertainment generally subject to 50% limitation unless a specific rule leads to 100% deductibility or 100% limitation
- “M&E is just 50% of a number”…..true but what number do we multiply by 50%?
- M&E that should be subject to 50% limitation on tax return is generally not the number recorded to M&E accounts for book/financial statement purposes
- General rules typically have various exceptions that cause deductibility to be higher or lower than general rule
- Difficulty in applying M&E rules typically a function of:
  - Large volume of transactions
  - Applying detail tax rules to large volumes of transactions
Items Generally Subject to 50% Limitation

- Employee travel meals
- Client meals
- Client entertainment
- Recreation events for employees that do not satisfy the highly compensated nondiscrimination requirements
- Conference/seminar meals for employees where value per person exceeds limits on frequency & value
- Note: Under IRC § 274(n) all meals and entertainment are 50% limited unless a specific exception applies
Items Generally 100% Deductible

• Non-meal expenses
• Employee recreation items satisfying the highly compensated requirements
• Deminimis expenditures satisfying frequency & value limitations
• Items available to the public
• Reimbursed expenses
• Items treated as compensation
• Business gifts <$25
Items Generally Subject to 100% Limitation

• Club dues – such as country club dues, airline memberships, and other groups for social or pleasure purposes.
• Business gifts >$25
• Skybox lease fees or other entertainment facilities (i.e., hunting facilities, etc.)
• Lavish or extravagant expenses.
• Personal items (i.e. cigarettes, movies, toiletries, etc.)
• Items failing documentation/substantiation requirements
Tax Deductibility of Specific Expenditures
Abbreviations We Will Use

- IRC § – Internal Revenue Code Section
- Regulations – Income Tax Regulations
- IRS – Internal Revenue Service
Non-Meal Expenditures

- **IRC § 162**
  - Provides that “in general there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.”

- **Deductibility:** generally 100%

- **Examples** – items connected with M&E but not subject to 50% limitation
  - Transportation
  - Lodging
  - Delivery fee / shipping
  - Meeting room rental
  - Equipment rental
  - Phone
  - Business center
  - Sponsorship of events
Employee Recreation Meals

- IRC § 274(e)(4)
  - 50% limitation does not apply to expenses for recreational, social, or similar activities for benefit of employees
  - Attendees can generally include employees and family members
    » Event can not discriminate in favor of “highly compensated employees” (§ 414(q))
  - Attendees generally cannot include clients, contractors, etc.

- Deductibility: generally 100%

- Examples
  - Team building events for employees
  - Employee holiday parties
  - Employee recognition events
De Minimis Meals

• IRC § 274(n)(1) and 132(e)(1)
  - Food & beverage provided to employees or independent contractors:
    » “Break food” provided during the work day
    » Occasional meals provided during meetings
    » Occasional business meals.
  - Food & beverage must satisfy tests
    » 1) Value “which is so small” that accounting for it is
    » 2) “Unreasonable or administratively impracticable.”

• Deductibility: generally 100% if frequency and value limitations satisfied
De Minimis Meals – Examples

• De minimis snacks/catered meals
  - Meals delivered or brought to the work site, coffee supplies for pantry, snacks, delivered pizza, muffins, bagels.

• De minimis working meals
  - Overtime meals and employee working/meeting meals catered or brought to work location.
Items Available to the Public

- IRC § 274(n)(2)(A) and 274(e)(7)
  - 50 percent limitation does not apply to “expenses for goods, services, and facilities made available by the taxpayer to the general public.”
  - See also Revenue Ruling 65-38 and Private Letter Ruling 200315003

- Deductibility: generally 100%

- Examples
  - Coffee and cookies in building lobby
  - Expo candy
  - Public invitation
  - Foot massages at a marathon
Reimbursed Expenses

- IRC § 274(n)(2) and § 274(e)(3)
  - Expenses for meals and entertainment amounts for which an accounting is made to Company by third parties.
  - Final Regulations (Treasury Decision 9625, July 2013)
    » Two approaches possible to move 50% limit through billing:
      1. M&E detail sent with invoice, or
      2. Provision included in contract stating which party bears the 50% limitation
    » Deductibility: may be 50% or 100% depending on contract & documentation
    » Example: M&E included as part of travel costs billed from outside service providers
Items Treated as Compensation

• IRC § 274(e)(2)
  - Expenses treated as compensation are excluded from 50 percent limit if included on recipient’s original tax return and company treats expenditure as wages for purposes of payroll tax withholding purposes. Regulation § 1.274-2(f)(2).

• Deductibility: 100%

• Examples
  - Performance awards included in employee compensation
  - Club dues included in employee compensation
  - Incentive trip included in employee compensation
  - Spousal travel included in employee compensation
Business Gifts

• IRC § 274(b)(1)
  - No deduction allowed for business gift expenses that cumulatively exceed $25 per tax year, per donee.

• Deductibility: Under $25 is 100% deductible, Over $25 is 100% non-deductible

• Examples
  - Gift cards under $25
  - Flowers under $25
  - Golf balls under $25
  - Candy under $25
Charitable Contributions

• IRC § 170
  - If charitable event included a meal and/or entertainment, portion attributable to meal and/or entertainment expense is subject to 50 percent limitation.

• Deductibility: charitable portion generally 100%, M&E portion generally 50%

• Example
  - Charity golf events
    » Green fees and cart rental generally remain limited
  - Dinner Events
    » FMV of seats remains limited
Skyboxes, Suites, Loges
Skyboxes, Suites, Loges

• Definition: a suite or box with a fixed number of seats that is separate from other seating at entertainment facility leased for more than one event. IRC § 274(l).

• Amount 50% deductible is limited to highest non-luxury box seat price. Any excess of suite cost over this amount is 100% nondeductible

• Components of skybox deductibility
  - Tickets may be 50% or 100% deductible depending on attendees & business purpose of event
  - Lease cost is generally 100% non-deductible
  - Somewhat complicated tax calculation is done to determine deductibility
Per Diems
Per Diems – Overview

• Under rules established by IRS, employers may choose to reimburse employees and/or independent contractors a per diem allowance rather than actual expenditures for lodging and meals during travel.
Per Diems – Methods

• Lodging, meal and incidental expenses

• Meal and incidental expenses only
  - Treated as paid for meal and incidental expenses only if
    » Payor pays employee for actual lodging expenses incurred
    » Payor provides the lodging in kind
    » Payor pays actual expenses directly to lodging provider
    » Payor does not have a belief employee will incur lodging
  - Deemed substantiated, employee still must document:
    » Time
    » Place
    » Business purpose

• Optional method for incidental expenses only deduction

• Lodging only per diem is problematic
Per Diems – Deductibility

• If per diem allowance is paid for lodging, meal and incidental less than federal per diem rate then
  - treat an amount equal to federal M&IE as an expense for food and beverages or
  - Treat an amount equal to 40 percent as an expense for food and beverages

• Per diem allowance amounts paid in excess of federal rate are treated as reimbursed under non-accountable plan
  - Include in employee’s W-2
  - Deduct as wages subject to income tax withholding
Per Diems – Documents to Reference

- Revenue Procedure 2011-47
  - Provides rules for using a per diem rate to substantiate, under IRC 274(d) and 1.274-5 of Income Tax Regulations, ordinary and necessary business expenses paid or incurred while traveling away from home.

- Publication 1542
  - Provides maximum per diem rates for business travel away from home within continental United States (CONUS)

- Publication 535 – Chapter 11

- [www.gsa.gov/perdiem](http://www.gsa.gov/perdiem)
  - CONUS per diem rates
  - Per diem rates for areas outside continental United States (OCONUS), such as Alaska, Hawaii, Puerto Rico and U.S. possessions
  - Foreign per diem rates
Tax Documentation/Substantiation
Tax Substantiation Requirements – General Rule

• Substantiation elements must be satisfied with respect to any travel, meal, or entertainment expense. If substantiation is deemed insufficient, no deduction is available. IRC § 274(d)
Tax Substantiation – Travel Expense Requirements

• IRC § 274(d) and Regulation 1.274-5T(b)(2) (Includes meals and lodging, while away from home):

• The following documentation must be provided:
  1. Amount of each separate expenditure
     » Daily cost of traveler’s own breakfast, lunch, dinner, and incidental expenses may be aggregated
  2. Dates of departure and return
  3. Destination
  4. Business purpose – benefit derived or expected to be derived as a result of travel
Tax Substantiation – Meals and Entertainment

• Entertainment, Including Meals, Requirements — Regulation 1.274-5T(b)(3):

• The following documentation must be provided:
  1. Amount of each separate expenditure for entertainment;
  2. Date and description of type of entertainment (i.e., dinner, theater, etc.)
  3. Place of activity
  4. Business purpose of activity, including a description of any business benefit derived or expected, and nature of any business discussion with person entertained
  5. Business relationship to persons entertained, including name and affiliation
Tax Substantiation – Adequate Records

• Regulation 1.274-5: Documentary evidence, such as receipts, paid bills, or similar evidence sufficient to support an expenditure is required for:

  1. Any expenditure for lodging while traveling away from home. Documentary evidence that breaks out separate charges for room, telephone, meals, etc., such as a hotel folio, is required.

  2. Any other expenditure of $75 or less documentary evidence will not be required if not readily available
Potential Employee Income Inclusion
Employee Incentive Trips
General Rule – Incentive Trips

• Portions of trip not satisfying business purpose requirement are taxable to employee

• Factors to consider include
  - Days/hours on business vs. leisure
  - More than 50% business in order to prorate costs
  - Location – North American Area
  - Presence of spouses
  - Gifts

• Trips involving customers and/or distributors are more complex
  - Potential for gifts
  - Form 1099 issues
Free/Discounted Food - Employee Cafeteria
General Rule – Employee Cafeteria

- “Tax subsidy test” – meals provided to employees at employer-operated eating facility for employees is excludable from gross income as de minimis fringe if
  - Such facility is located on or near business premises of employer, and
  - On an annual basis, revenue from facility equals or exceeds direct operating costs of facility.
  - IRC § 132(e)(2) and Regulation 1.132-7(a)(1)(i)
Income Inclusion – Employee Cafeteria

- If tax subsidy test is not satisfied, recipient of meals provided at such facility must include in income amount by which fair market value of meals provided exceeds sum of:
  - Amount, if any, paid for meals, and
  - Amount, if any, specifically excluded for another reason (such as convenience of employer rules).
  - Regulation 1.132-7(c)
Cafeteria Rules – Example

- Tax subsidy test defined under IRC § 132(e)(2) and Regulation 1.132-7
  - On an annual basis, revenue from facility equals or exceeds direct operating cost of facility
  - Direct operating costs of eating facility are:
    » Cost of food and beverages and
    » Cost of labor for personnel whose services relating to facility are performed primarily on premises of eating facility

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<th>Location</th>
<th>Direct Food</th>
<th>Direct Labor</th>
<th>Total Direct Food &amp; Labor</th>
<th>Revenues</th>
<th>Subsidized Amount</th>
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Convenience of Employer Meals
Convenience of Employer Rules

- Meals or lodging furnished for convenience of employer ("COE"). IRC § 119(a)(1) and 119(b)(4).
  - Meals must be furnished on business premises of employer.
  - Lodging – employee must be required to accept lodging on business premise of employer as condition of employment
  - More than half rule: if more than half of employees to whom such meals are furnished satisfy COE rules, then all meals furnished on business premises of employer satisfy COE rules
  - To satisfy COE rules – meals must be provided for a substantial non-compensatory business reason
Convenience of Employer – Short Meal Period

- Substantial non-compensatory business reason: meals furnished to employee during working hours because employer’s business is such that employee must be restricted to short meal period, such as 30 or 45 minutes, and because employee could not be expected to eat elsewhere in such short meal period. Regulation 119(a)(2)(ii)(b).
  - For example, employer is engaged in a business in which peak workload occurs during normal lunch hours.
  - Meals cannot qualify when reason for restricting meal period is so employee can be let off earlier.
Convenience of Employer – Reasonable Meal Period

• Substantial non-compensatory business reason: meals furnished to employee during his working hours because employee could not otherwise secure proper meals within a reasonable meal period. Reg. Section 119(a)(2)(ii)(c).
  - For example, there are insufficient eating facilities in vicinity of employer’s premises.

• Time and motion studies
IRS Exams
Current Trends

• Exam activity in M&E has increased

• Most common topics
  - Per diems
  - Reimbursed M&E
  - Free food for employees – company cafeteria and/or COE rules

• Other areas of focus for examination agents
  - Documentation/substantiation
  - Meals at company meetings (de minimis)
  - Business purpose for entertainment events
IRS Exam Process

• Documentation is key – follow-up for additional information often required before IDR response can be drafted

• Clear, concise explanation
  - Organized thoughts pointing out facts
  - Consistent approach across multiple IDRs

• Develop a strategy particularly – answer questions specifically
  - Awareness of where Examiner is in disagreement
  - Don’t bring up topics that aren’t in contention
IRS Appeals Process

- **Fast Track Appeals**
  - Examiner retains control of case
  - Examiners generally pushing taxpayers to go this route

- **Rapid Appeals**
  - Appeals officer controls case, but Examiner heavily involved

- **“Traditional” Appeals**
  - Appeals officer controls case
  - Examiner presents their case in front of taxpayer then leaves the room
  - Taxpayer presents their case separately without Examiner

- **Organized arguments are key**
  - Develop arguments to rebut Examiner’s positions
  - Make it easy for Appeals officer to follow and agree
Questions
Presenter Bio

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Ed is the Service Offering Leader of the Travel, Meals and Entertainment Tax Services Group. Ed has more than 21 years of public accounting experience, including 12 years in Travel, Meals and Entertainment Tax Services. As the Service Offering Leader, Ed is responsible for client satisfaction, technical accuracy, quality control of engagements and IRS sustention. Prior to joining National Federal Tax Services, Ed spent his first nine years at Deloitte providing services to clients in the financial services industry including insurance companies, brokerages, and mutual funds. During this time, Ed provided insurance companies with provision support, return preparation, return review, general consulting, IRS Exam and Appellate level support.

Ed is a member of the American Institute of Certified Public Accountants and he is a licensed certified public accountant in the state of Minnesota. Ed holds a Masters of Accountancy in Taxation degree and a Bachelors of Science in Business Administration – Accounting degree, both from the University of Wisconsin - Madison.
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Michael Fincher is a Senior Manager in the Minneapolis office of Deloitte Tax LLP, with over 13 years of experience assisting clients in the area of corporate and cooperative taxation. He specializes in cooperative taxation and corporation reorganizations and consolidations (including mergers and acquisitions, spin-offs, liquidations, and dispositions).

During his career with Deloitte, Michael spent two years in the National Tax office of Deloitte, located in Washington, D.C., as part of a Management Development Program assignment in the Subchapter C Group. In addition to his client responsibilities, Michael leads Deloitte sponsored training seminars in the area of corporate reorganizations, mergers and acquisitions, and accounting periods and methods at the local, regional, and national level on a regular basis. In addition, Michael is an adjunct professor at the University of Minnesota, Carlson School of Business, where he teaches the corporate consolidated returns course in the Master of Business Taxation program.

Michael is a member of the American Institute of Certified Public Accountants, the Tax Committee of the National Society of Accountants for Cooperatives, and he is a licensed certified public accountant in the District of Columbia and the states of Minnesota and South Dakota. Michael holds a Masters of Science in Taxation degree from American University (Washington, D.C.), a Masters of Professional Accountancy degree, and a Bachelors of Science in Business Administration degree, both from the University of South Dakota.