

January 2018

Tax Reform Wipes Out 50 Percent Business Entertainment Deductions

Lawmakers destroyed a big chunk of usual and normal business entertainment on January 1, 2018.

The good news is that some not-so-usual and not-so-normal entertainment survived the bloodletting. See Tax Reform: Entertainment Deductions That Survived for some of the survivors.

The bad news is that lawmakers massacred entertainment that was already handicapped by the 50 percent cut.

For example, during 2017, you could take a prospect or client to a business dinner followed by the theater or a ballgame and deduct 50 percent of all the monies spent, providing you passed some tax law tests on business discussion and associated entertainment.

Now, in what you thought was a business-friendly tax reform package, you find that lawmakers exterminated a big chunk of business entertainment as a business expense.

Good-bye Traditional Entertainment

The new law repeals—effective January 1, 2018—the tax code section that allowed a deduction for entertainment, amusement, or recreation that was directly related to, or associated with, the active conduct of your trade or business.¹

Because of tax reform, you can no longer deduct entertainment that has as its mission the generation of business income or other specific business benefit. The 2018 tax reform prohibition against deductible entertainment is true regardless of your business discussion, negotiation, business meeting, or other bona fide transaction.

Example. Sue is a real estate sales professional. She sold a home to Janet and Ken, who moved into their new home about a month ago. Sue takes Janet and Ken to dinner with the purpose of asking for referrals and also examining what she could have done better during the sales process.

Result: Because the business dinner occurs in 2018, Sue gets no deduction for her business dinner.

Examples of What Entertainment Died on January 1, 2018

Here's a short list of what died on January 1, 2018, so you can get a good handle on what's no longer deductible:

- Business meals with clients or prospects
- Golf
- Skiing
- Tickets to football, baseball, basketball, soccer, etc., games
- Disneyland

Good News

Tax reform eliminated the need to timely document directly related and associated entertainment. Of course, it's not deductible, so you have no need to document anyway. But getting rid of any documentation requirement has to make you feel good.²

Takeaways

If you used business entertainment as a business-building tool, your cost of doing business increased on January 1, 2018, because of the new tax reform package.

As with most tax legislation, you have winners and losers. Someone has to pay to create the winners.

The elimination of business entertainment by what lawmakers acclaim as a business-friendly reform seems odd.

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Technical Note

Directly related business meals (meals with clients and prospects) are no longer deductible. Before tax reform, the client or prospect meal was 50 percent deductible. Section 274(a) is what made that 50 percent deduction possible before tax reform.

Here's the way IRC Section 274(a) read before tax reform:

(a) Entertainment, amusement, or recreation.

(1) In general. No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) Activity. With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or

(B) Facility. With respect to a facility used in connection with an activity referred to in subparagraph (A). In the case of an item described in subparagraph (A), the deduction shall in no event exceed the portion of such item which meets the requirements of subparagraph (A).

Here's the way it reads after tax reform:

(a) Entertainment, amusement, recreation, or qualified transportation fringes.

(1) In general. No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) Activity. With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or

(B) Facility. With respect to a facility used in connection with an activity referred to in subparagraph (A).

Note that after tax reform the words “directly related” and “associated” entertainment are gone. When deducting a meal with a client or a prospect before tax reform, you did that as directly related or associated entertainment.

You also had to document that client or prospect meal with the basics of who you entertained, where, and why. Tax reform also eliminated the no longer needed entertainment documentation basics of who, where, and why for directly related and associated entertainment. (See IRC Section 274(d) before and after tax reform.)

Because we have had many questions, we have a question and answer article scheduled for the February issue on tax reform's elimination of the client and prospect business meal deductions.

- 1 Section 13304, P.L. 115-97.
 - 2 Ibid.
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