

**November 2018**

## IRS Says TCJA Allows Client and Prospect Business Meal Deductions

Hip, hip, hooray for the IRS!

In Notice 2018-76, the IRS states that client and prospect business meals continue as tax deductions under the Tax Cuts and Jobs Act.<sup>1</sup>

This is very good news indeed.

And as we reported in Tax Reform Update on Strategy for Business Meals with Clients and Prospects, you should have kept track of your business meals all year, so you now have the proof you need for the deductions.

### **Overview**

Under this new IRS guidance, you may deduct 50 percent of your client and prospect business meals if<sup>2</sup>

1. the expense is an ordinary and necessary expense under Internal Revenue Code (IRC) Section 162(a) that is paid or incurred during the taxable year in carrying on any trade or business;
2. the expense is not lavish or extravagant under the circumstances;
3. the taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages;
4. the food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and
5. in the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages.

## ***Ordinary and Necessary***

Black's Law Dictionary defines "ordinary" as "occurring in the regular course of events; normal, usual."<sup>3</sup>

Obviously, a business meal with a client, prospective client, or consultant can be normal and usual for most every business.

The Supreme Court noted that "necessary" means "appropriate and helpful."<sup>4</sup>

The business meal with a client, prospect, or consultant generally is appropriate and helpful to most businesses.

In a nutshell, the ordinary and necessary test should give you no trouble in meeting this standard for your client, prospect, consultant, and similar business contact business meal tax deductions.

## ***Lavish or Extravagant***

The law does not define "lavish" or "extravagant," and no court cases have applied the concept to deny business meal costs.

In Rev. Rul. 63-144, the IRS offers this question and its answer on the application of the lavish and extravagant rule to entertainment expenses:<sup>5</sup>

- *Question: Will entertainment expenses be subject to disallowance on grounds of being lavish or extravagant merely because they exceed a fixed dollar amount or are incurred at deluxe restaurants, hotels, night clubs and resort establishments?*
- *Answer: No. An expense for entertainment will not be considered lavish or extravagant merely because it involves first-class accommodations or services. An expense which, considering the facts and circumstances, is reasonable will not be considered lavish or extravagant.*

You would be hard-pressed to have a business meal that would fail as a tax deduction because it was lavish and extravagant.

## ***Presence***

To qualify for the deduction, you or your employee has to be present during the business meal.

The being-present rule was developed originally to preclude deductions for business meals as business gifts. The being-present rule eliminates the gift idea and requires that the deduction be claimed as a business meal. This rule continues to reside in the IRC.<sup>6</sup>

## ***Meal Separated from Entertainment***

In Notice 2018-76, the IRS gives you three examples of how to deal with business meals that are incurred in combination with entertainment, as described below.<sup>7</sup>

**Example 1.** Taxpayer A invites B, a business contact, to a baseball game. A purchases tickets for A and B to attend the game. While at the game, A buys hot dogs and drinks for A and B.

The baseball game is entertainment, and thus the cost of the game tickets is an entertainment expense and is not deductible by A. The cost of the hot dogs and drinks, which are purchased separately from the game tickets, is not an entertainment expense and is not subject to the IRC Section 274(a)(1) entertainment expense disallowance. Therefore, A may deduct 50 percent of the expenses associated with the hot dogs and drinks purchased at the game.

**Example 2.** Taxpayer C invites D, a business contact, to a basketball game. C purchases tickets for C and D to attend the game in a suite, where they have access to food and beverages. The cost of the game tickets, as stated on the invoice, includes the food and beverages.

The game is entertainment, and thus the cost of the game tickets is an entertainment expense and is not deductible by C. The cost of the food and beverages, which are not purchased separately from the game tickets, is not stated separately on the invoice.

Thus, the cost of the food and beverages also is an entertainment expense that is subject to the IRC Section 274(a)(1) disallowance. Therefore, C may not deduct any of the expenses associated with the game.

**Example 3.** Assume the same facts as in Example 2, except that the invoice for the basketball game tickets separately states the cost of the food and beverages.

As in Example 2, the game is entertainment, and thus the cost of the game tickets, other than the cost of the food and beverages, is an entertainment expense and is not deductible by C. But the cost of the food and beverages, which is stated separately on the invoice for the game tickets, is not an entertainment expense and is not subject to the IRC Section 274(a)(1) disallowance. Therefore, C may deduct 50 percent of the expenses associated with the food and beverages provided at the game.

## ***Documentation***

The IRS has not listed any new or changed documentation standards, albeit the “directly related” rules that used to apply to business meals are no longer part of the tax code.

To prove your business meals, follow the two easy steps below:

1. Keep the receipt that shows the name of the restaurant, the number of people at the table, and an itemized list of food and drinks consumed.
2. On the receipt, record the name or names of the person or persons with whom you had the meal and also record the business reason for the meal.

In the event that the receipt is not available, such as with the purchase of hot dogs and drinks at the baseball game while sitting in the stands, make sure to make a written note of the expenditures immediately after the game.

If you charge a business meal to a credit card, the credit card statement provides your proof of payment. When possible, always pay by credit card or write a check so that you have clear proof of payment.

**Key point.** Proof of payment is not proof of what you purchased, so in addition to proof of payment, keep the receipt with the notations as described earlier. With this combination of proof of payment and receipt with notations, you have what we call audit-proof documentation.

When the IRS issues its proposed regulations on business meals, we’ll likely have more details on what the IRS expects in the way of proof. Meanwhile, by following the two steps above and maintaining proof of payment, you should be in excellent shape.

## ***Takeaways***

Thank goodness for the IRS guidance on business meals. Now you can relax and know that your business meals with clients, prospects, consultants, and similar business contacts are deductible.

Make sure to document the meal deductions as we explained above. Without the right documentation, you not only lose the meal deductions, but you also become suspect to the IRS—and that can lead to a full-blown audit (often known also as misery).

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1 Notice 2018-76.

2 Ibid.

- 3 Black's Law Dictionary, Ninth Edition, p. 1209.
  - 4 *Commr. v Heininger*, 320 U.S. 467 (1943); *Welch v Helvering*, 290 U.S. 111 (1933).
  - 5 Rev. Rul. 63-144, Q&A 42.
  - 6 IRC Section 274(k) 2018.
  - 7 Notice 2018-76.
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