

Reg. Section 1.274-2(f)(2)(iii)(B)

Disallowance of deductions for certain expenses for entertainment, amusement, recreation, or travel.

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(f) Specific exceptions to application of this section -- (1) In general. The provisions of paragraphs (a) through (e) of this section (imposing limitations on deductions for entertainment expenses) are not applicable in the case of expenditures set forth in subparagraph (2) of this paragraph. Such expenditures are deductible to the extent allowable under chapter 1 of the Code. This paragraph shall not be construed to affect the allowability or nonallowability of a deduction under section 162 or 212 [26 USCS § 162 or 212] and the regulations thereunder. The fact that an expenditure is not covered by a specific exception provided for in this paragraph shall not be determinative of the allowability or nonallowability of the expenditure under paragraphs (a) through (e) of this section. Expenditures described in subparagraph (2) of this paragraph are subject to the substantiation requirements of section 274(d) [26 USCS § 274(d)] to the extent provided in § 1.274-5.

(2) Exceptions. The expenditures referred to in subparagraph (1) of this paragraph are set forth in subdivisions (i) through (ix) of this subparagraph.

(i) Business meals and similar expenditures paid or incurred before January 1, 1987 -- (a) In general. Any expenditure for food or beverages furnished to an individual under circumstances of a type generally considered conducive to business discussion (taking into account the surroundings in which furnished, the taxpayer's trade, business, or income-producing activity, and the relationship to such trade, business or activity of the persons to whom the food or beverages are furnished) is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section. There is no requirement that business actually be discussed for this exception to apply.

(b) Surroundings. The surroundings in which the food or beverages are furnished must be such as would provide an atmosphere where there are no substantial distractions to discussion. This exception applies primarily to expenditures for meals and beverages served during the course of a breakfast, lunch or dinner meeting of the taxpayer and his business associates at a restaurant, hotel dining room, eating club or similar place not involving distracting influences such as a floor show. This exception also applies to expenditures for beverages served apart from meals if the expenditure is incurred in surroundings similarly conducive to business discussion, such as an expenditure for beverages served during the meeting of the taxpayer and his business associates at a cocktail lounge or hotel bar not involving distracting influences such as a floor show. This exception may also apply to expenditures for meals or beverages served in the taxpayer's residence on a clear showing that the expenditure was commercially rather than socially motivated. However, this exception, generally, is not applicable to any expenditure for meals or beverages furnished in circumstances where there are major distractions not conducive to business discussion, such as at night clubs, sporting events, large cocktail parties, sizeable social gatherings, or other major distracting influences.

(c) Taxpayer's trade or business and relationship of persons entertained. The taxpayer's trade, business, or income-producing activity and the relationship of the persons to whom the food or beverages are served to such trade, business or activity must be such as will reasonably indicate that the food or beverages were furnished for the primary purpose of furthering the taxpayer's trade or business and did not primarily serve a social or personal purpose. Such a business purpose would be indicated, for example, if a salesman employed by a manufacturing supply company meets for lunch during a normal business day with a purchasing agent for a manufacturer which is a prospective customer. Such a purpose would also be indicated if a life insurance agent meets for lunch during a normal business day with a client.

(d) Business programs. Expenditures for business luncheons or dinners which are part of a business program, or banquets officially sponsored by business or professional associations, will be regarded as expenditures to which the exception of this subdivision (i) applies. In the case of such a business luncheon or dinner it is not always necessary that the taxpayer attend the luncheon or dinner himself. For example, if a dental equipment supplier purchased a table at a dental association banquet for dentists who are actual or prospective customers for his equipment, the cost of the table would not be disallowed under this section. See also paragraph (c)(4) of this section relating to expenditures made in a clear business setting.

(ii) Food and beverages for employees. Any expenditure by a taxpayer for food and beverages (or for use of a facility in connection therewith) furnished on the taxpayer's business premises primarily for his employees is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section. This exception applies not only to expenditures for food or beverages furnished in a typical company cafeteria or an executive dining room, but also to expenditures with respect to the operation of such facilities. This exception applies even though guests are occasionally served in the cafeteria or dining room.

(iii) Certain entertainment and travel expenses treated as compensation -- (A) In general. Any expenditure by a taxpayer for entertainment (or for use of a facility in connection therewith) or for travel described in section 274(m)(3) [26 USCS § 274(m)(3)], if an employee is the recipient of the entertainment or travel, is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section to the extent that the expenditure is treated by the taxpayer --

(1) On the taxpayer's income tax return as originally filed, as compensation paid to the employee; and

(2) As wages to the employee for purposes of withholding under chapter 24 (relating to collection of income tax at source on wages).



(B) Expenses includible in income of persons who are not employees. Any expenditure by a taxpayer for entertainment (or for use of a facility in connection therewith), or for travel described in section 274(m)(3) [26 USCS § 274(m)(3)], is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section to the extent the expenditure is includible in gross income as compensation for services rendered, or as a prize or award under section 74 [26 USCS § 74], by a recipient of the expenditure who is not an employee of the taxpayer. The preceding sentence shall not apply to any amount paid or incurred by the taxpayer if such amount is required to be included (or would be so required except that the amount is less than \$ 600) in any information return filed by such taxpayer under part III of subchapter A of chapter 61 and is not so included. See section 274(e)(9) [26 USCS § 274(e)(9)].

(C) Example. The following example illustrates the provisions this paragraph (f):

Example. If an employer rewards the employee (and the employee's spouse) with an expense paid vacation trip, the expense is deductible by the employer (if otherwise allowable under section 162 [26 USCS § 162] and the regulations thereunder) to the extent the employer treats the expenses as compensation and as wages. On the other hand, if a taxpayer owns a yacht which the taxpayer uses for the entertainment of business customers, the portion of salary paid to employee members of the crew which is allocable to use of the yacht for entertainment purposes (even though treated on the taxpayer's tax return as compensation and treated as wages for withholding tax purposes) would not come within this exception since the members of the crew were not recipients of the entertainment. If an expenditure of a type described in this subdivision properly constitutes a dividend paid to a shareholder or if it constitutes unreasonable compensation paid to an employee, nothing in this exception prevents disallowance of the expenditure to the taxpayer under other provisions of the Internal Revenue Code.

(iv) Reimbursed entertainment, food, or beverage expenses --(A) Introduction. In the case of any expenditure for entertainment, amusement, recreation, food, or beverages made by one person in performing services for another person (whether or not the other person is an employer) under a reimbursement or other expense allowance arrangement, the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1) [26 USCS § 274(n)(1)] apply either to the person who makes the expenditure or to the person who actually bears the expense, but not to both. If an expenditure of a type described in this paragraph (f)(2)(iv) properly constitutes a dividend paid to a shareholder, unreasonable compensation paid to an employee, a personal expense, or other nondeductible expense, nothing in this exception prevents disallowance of the expenditure to the taxpayer under other provisions of the Code.

(B) Reimbursement arrangements involving employees. In the case of an employee's expenditure for entertainment, amusement, recreation, food, or beverages in performing services as an employee under a reimbursement or other expense allowance arrangement with a payor (the employer, its agent, or a third party), the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1) [26 USCS § 274(n)(1)] apply--

(1) To the employee to the extent the employer treats the reimbursement or other payment of the expense on the employer's income tax return as originally filed as compensation paid to the employee and as wages to the employee for purposes of withholding under chapter 24 (relating to collection of income tax at source on wages); or

(2) To the payor to the extent the reimbursement or other payment of the expense is not treated as compensation and wages paid to the employee in the manner provided in paragraph (f)(2)(iv)(B)(1) of this section (however, see paragraph (f)(2)(iv)(C) of this section if the payor receives a payment from a third party that may be treated as a reimbursement arrangement under that paragraph).

(C) Reimbursement arrangements involving persons that are not employees. In the case of an expense for entertainment, amusement, recreation, food, or beverages of a person who is not an employee (referred to as an independent contractor) in performing services for another person (a client or customer) under a reimbursement or other expense allowance arrangement with the person, the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1) [26 USCS § 274(n)(1)] apply to the party expressly identified in an agreement between the parties as subject to the limitations. If an agreement between the parties does not expressly identify the party subject to the limitations, the limitations apply--

(1) To the independent contractor (which may be a payor described in paragraph (f)(2)(iv)(B) of this section) to the extent the independent contractor does not account to the

client or customer within the meaning of section 274(d) [26 USCS § 274(d)] and the associated regulations; or

(2) To the client or customer if the independent contractor accounts to the client or customer within the meaning of section 274(d) [26 USCS § 274(d)] and the associated regulations. See also § 1.274-5.

(D) Reimbursement or other expense allowance arrangement. The term reimbursement or other expense allowance arrangement means--

(1) For purposes of paragraph (f)(2)(iv)(B) of this section, an arrangement under which an employee receives an advance, allowance, or reimbursement from a payor (the employer, its agent, or a third party) for expenses the employee pays or incurs; and

(2) For purposes of paragraph (f)(2)(iv)(C) of this section, an arrangement under which an independent contractor receives an advance, allowance, or reimbursement from a client or customer for expenses the independent contractor pays or incurs if either--

(a) A written agreement between the parties expressly states that the client or customer will reimburse the independent contractor for expenses that are subject to the limitations on deductions in paragraphs (a) through (e) of this section and section 274(n)(1) [26 USCS § 274(n)(1)]; or

(b) A written agreement between the parties expressly identifies the party subject to the limitations.

(E) Examples. The following examples illustrate the application of this paragraph (f)(2)(iv).

Example 1.

(i) Y, an employee, performs services under an arrangement in which L, an employee leasing company, pays Y a per diem allowance of \$ 10x for each day that Y performs services for L's client, C, while traveling away from home. The per diem allowance is a reimbursement of travel expenses for food and beverages that Y pays in performing services as an employee. L enters into a written agreement with C under which C agrees to reimburse L for any substantiated reimbursements for travel expenses, including meals, that L pays to Y. The agreement does not expressly identify the party that is subject to the deduction limitations. Y performs services for C while traveling away from home for 10 days and provides L with substantiation that satisfies the requirements of section 274(d) [26 USCS § 274(d)] of \$ 100x of meal expenses incurred by Y while traveling away from home. L pays Y \$ 100x to reimburse those expenses pursuant to their arrangement. L delivers a copy of Y's substantiation to C. C pays L \$ 300x, which includes \$ 200x compensation for services and \$ 100x as reimbursement of L's payment of Y's travel expenses for meals. Neither L nor C treats the \$ 100x paid to Y as compensation or wages.

(ii) Under paragraph (f)(2)(iv)(D)(1) of this section, Y and L have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(B) of this section. Because the reimbursement payment is not treated as compensation and wages paid to Y, under section 274(e)(3)(A) [26 USCS § 274(e)(3)(A)] and paragraph (f)(2)(iv)(B)(1) of this section, Y is not subject to the section 274 [26 USCS § 274] deduction limitations. Instead, under paragraph (f)(2)(iv)(B)(2) of this section, L, the payor, is subject to the section 274 [26 USCS § 274] deduction limitations unless L can meet the requirements of section 274(e)(3)(B) [26 USCS § 274(e)(3)(B)] and paragraph (f)(2)(iv)(C) of this section.

(iii) Because the agreement between L and C expressly states that C will reimburse L for substantiated reimbursements for travel expenses that L pays to Y, under paragraph

(f)(2)(iv)(D)(2)(a) of this section, L and C have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(C) of this section. L accounts to C for C's reimbursement in the manner required by section 274(d) [26 USCS § 274(d)] by delivering to C a copy of the substantiation L received from Y. Therefore, under section 274(e)(3)(B) [26 USCS § 274(e)(3)(B)] and paragraph (f)(2)(iv)(C)(2) of this section, C and not L is subject to the section 274 [26 USCS § 274] deduction limitations.

Example 2.

(i) The facts are the same as in Example 1 except that, under the arrangements between Y and L and between L and C, Y provides the substantiation of the expenses directly to C, and C pays the per diem directly to Y.

(ii) Under paragraph (f)(2)(iv)(D)(1) of this section, Y and C have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(C) of this section. Because Y substantiates directly to C and the reimbursement payment was not treated as compensation and wages paid to Y, under section 274(e)(3)(A) [26 USCS § 274(e)(3)(A)] and paragraph (f)(2)(iv)(C)(1) of this section Y is not subject to the section 274 [26 USCS § 274] deduction limitations. Under paragraph (f)(2)(iv)(C)(2) of this section, C, the payor, is subject to the section 274 [26 USCS § 274] deduction limitations.

Example 3.

(i) The facts are the same as in Example 1, except that the written agreement between L and C expressly provides that the limitations of this section will apply to C.

(ii) Under paragraph (f)(2)(iv)(D)(2)(b) of this section, L and C have established a reimbursement or other expense allowance arrangement for purposes of paragraph (f)(2)(iv)(C) of this section. Because the agreement provides that the 274 deduction limitations apply to C, under section 274(e)(3)(B) [26 USCS § 274(e)(3)(B)] and paragraph (f)(2)(iv)(C) of this section, C and not L is subject to the section 274 [26 USCS § 274] deduction limitations.

Example 4.

(i) The facts are the same as in Example 1, except that the agreement between L and C does not provide that C will reimburse L for travel expenses.

(ii) The arrangement between L and C is not a reimbursement or other expense allowance arrangement within the meaning of section 274(e)(3)(B) [26 USCS § 274(e)(3)(B)] and paragraph (f)(2)(iv)(D)(2) of this section. Therefore, even though L accounts to C for the expenses, L is subject to the section 274 [26 USCS § 274] deduction limitations.

(F) Effective/applicability date. This paragraph (f)(2)(iv) applies to expenses paid or incurred in taxable years beginning after August 1, 2013.

(v) Recreational expenses for employees generally. Any expenditure by a taxpayer for a recreational, social, or similar activity (or for use of a facility in connection therewith), primarily for the benefit of his employees generally, is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section. This exception applies only to expenditures made primarily for the benefit of employees of the taxpayer other than employees who are officers, shareholders or other owners who own a 10-percent or greater interest in the business, or other highly compensated employees. For purposes of the preceding sentence, an employee shall be treated as owning any interest owned by a member of his family (within the meaning of section 267(c)(4) [26 USCS § 267(c)(4)] and the regulations thereunder). Ordinarily, this exception applies to usual employee benefit programs such as expenses of a

taxpayer (a) in holding Christmas parties, annual picnics, or summer outings, for his employees generally, or (b) of maintaining a swimming pool, baseball diamond, bowling alley, or golf course available to his employees generally. Any expenditure for an activity which is made under circumstances which discriminate in favor of employees who are officers, shareholders or other owners, or highly compensated employees shall not be considered made primarily for the benefit of employees generally. On the other hand, an expenditure for an activity will not be considered outside of this exception merely because, due to the large number of employees involved, the activity is intended to benefit only a limited number of such employees at one time, provided the activity does not discriminate in favor of officers, shareholders, other owners, or highly compensated employees.

(vi) Employee, stockholder, etc., business meetings. Any expenditure by a taxpayer for entertainment which is directly related to bona fide business meetings of the taxpayer's employees, stockholders, agents, or directors held principally for discussion of trade or business is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section. For purposes of this exception, a partnership is to be considered a taxpayer and a member of a partnership is to be considered an agent. For example, an expenditure by a taxpayer to furnish refreshments to his employees at a bona fide meeting, sponsored by the taxpayer for the principal purpose of instructing them with respect to a new procedure for conducting his business, would be within the provisions of this exception. A similar expenditure made at a bona fide meeting of stockholders of the taxpayer for the election of directors and discussion of corporate affairs would also be within the provisions of this exception. While this exception will apply to bona fide business meetings even though some social activities are provided, it will not apply to meetings which are primarily for social or nonbusiness purposes rather than for the transaction of the taxpayer's business. A meeting under circumstances where there was little or no possibility of engaging in the active conduct of trade or business (as described in paragraph (c)(7) of this section) generally will not be considered a business meeting for purposes of this subdivision. This exception will not apply to a meeting or convention of employees or agents, or similar meeting for directors, partners or others for the principal purpose of rewarding them for their services to the taxpayer. However, such a meeting or convention of employees might come within the scope of subdivisions (iii) or (v) of this subparagraph.

(vii) Meetings of business leagues, etc. Any expenditure for entertainment directly related and necessary to attendance at bona fide business meetings or conventions of organizations exempt from taxation under section 501(c)(6) of the Code [26 USCS § 501(c)(6)], such as business leagues, chambers of commerce, real estate boards, boards of trade, and certain professional associations, is not subject to the limitations on allowability of deductions provided in paragraphs (a) through (e) of this section.

(viii) Items available to the public. Any expenditure by a taxpayer for entertainment (or for a facility in connection therewith) to the extent the entertainment is made available to the general public is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section. Expenditures for entertainment of the general public by means of television, radio, newspapers and the like, will come within this exception, as will expenditures for distributing samples to the general public. Similarly, expenditures for maintaining private parks, golf courses and similar facilities, to the extent that they are available for public use, will come within this exception. For example, if a corporation maintains a swimming pool which it makes available for a period of time each week to children participating in a local public recreational program, the portion of the expense relating to such public use of the pool will come within this exception.

(ix) Entertainment sold to customers. Any expenditure by a taxpayer for entertainment (or for use of a facility in connection therewith) to the extent the entertainment is sold to customers in a bona fide transaction for an adequate and full consideration in money or money's worth is not subject to the limitations on allowability of deductions provided for in paragraphs (a) through (e) of this section. Thus, the cost of producing night club entertainment (such as salaries paid to employees of night clubs and amounts paid to performers) for sale to customers or the cost of operating a pleasure cruise ship as a business will come within this exception.

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