



MEALS AND ENTERTAINMENT (updated 11/8/18)

This is intended to be a brief summary of some of the IRS rules related to business meals and entertainment expenses you may incur in the course of doing business. Because of the Tax Cuts and Jobs Act ("TCJA," enacted in December, 2017, effective January 1, 2018, entertainment, amusement or recreation expenses for clients and business associates are **no longer allowed** as business deductions.

Assuming that meals are deductible, you still need to jump through several extra hoops to deduct them, and the deduction is subject to limitations.

- (1) Ordinary and necessary business expenses: All business expenses must meet the general deductibility requirement of being "ordinary and necessary" in carrying on the business. These terms have been fairly broadly defined to mean customary or usual, and appropriate or helpful. Thus, if it is reasonable in your business to take clients or other business people out to restaurants or otherwise provide them with meals or refreshments you should be able to pass this general test.
- (2) "Directly related" or "associated with": A second level of tests specially applicable to meal expenses must also be satisfied. Under them, the business meal must be either "directly related to" or "associated with" the business. "Directly related" means involving an "active" discussion aimed at getting "immediate" revenue. Thus, a specific, concrete business benefit is expected to be derived, not just general goodwill from making a client or associate view you favorably. And the principal purpose for the meal must be business. Also, you must have engaged actively during the meal, via a meeting, discussion, etc. The directly related test can also be met if the meal takes place in a clear business setting directly furthering your business, i.e., where there is no meaningful personal or social relationship between you and the others involved. Meetings or discussions that take place at cocktail parties - which are essentially social events - wouldn't meet this test. If the "directly related" test can't be met, the expense may qualify as "associated with" the active conduct of business if the meal precedes or follows (i.e., takes place on the same day as) a substantial and bona fide business discussion. This test is easier to satisfy. The "goodwill" type of meal at a restaurant can qualify. The meal will be considered associated with the active conduct of the business if its purpose is to get new business or encourage the continuation of a business relationship. You (or an employee of yours) must be present. That is, for example, if you simply cover the cost of a client's meal after a business meeting but don't join him, the expense doesn't qualify.



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- (3) Substantiation: Almost as important as qualifying for the deduction are the requirements for proving that it qualifies. The use of reasonable estimates isn't sufficient to stand up to IRS challenge. You must be able to establish the amount spent, the time and place, the business purpose, and the business relationship of the individuals involved. You must set up careful and detailed record-keeping procedures to keep track of each business meal and to justify its business connection. For expenses of \$75 or more, documentary proof (receipts, etc.) is required.
- (4) Deduction limitations. Several additional limitations apply. First, expenses that are "lavish or extravagant" aren't deductible. This is generally a "reasonableness" test and doesn't impose any fixed limits on the cost of meals. Expenses incurred at first class restaurants or clubs can qualify as deductible. More importantly, however, once the expenditure qualifies, it is only 50% deductible. Obviously, this rule severely reduces the tax benefit of business meals. If you spend \$50 a week on qualifying business meals, or \$2,600 for the year, your deduction will only be \$1,300, for tax savings of \$300 to \$400.

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Business Meals 50% deductible:

- Take your banker to lunch to discuss a new loan
- Take your employee to lunch to discuss annual review
- Meal costs immediately before, during or immediately after attending continuing education seminar

Business Meals 100% deductible:

- Annual company holiday party dinner at restaurant
- Cost of park rental, food, and decorations for company picnic
- Lunches brought in for staff during a company meeting, if held at your place of business and more than half of the employees are provided the meals for employer's convenience.

Business Expenses *not* considered Meals or Entertainment, 100% Deductible:

- Occasional purchase of de-minimis meals such as doughnuts for staff, consumed on employer premises
- Doughnuts for a company meeting
- Cost of airfare or hotel while attending continuing education class out of state (if your hotel bill includes charges for meals, that cost must be separated)
- Keeping the office refrigerator stocked with soda
- Sending a fruit basket to a client (Gifts are limited to \$25, any cost beyond that is nondeductible)
- Flowers sent to an employee in the hospital

Entertainment – No Deduction Allowed:

- Attend sports event or other entertainment venue with Client