



[4830-01-p]

DEPARTMENT OF TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-100814-19]

RIN 1545-BP23

Meals and Entertainment Expenses Under Section 274

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance under section 274 of the Internal Revenue Code (Code) regarding certain statutory amendments made to section 274 by 2017 legislation. Specifically, the proposed regulations address the elimination of the deduction under section 274 for expenditures related to entertainment, amusement, or recreation activities, and provide guidance to determine whether an activity is of a type generally considered to be entertainment. The proposed regulations also address the limitation on the deduction of food and beverage expenses under section 274(k) and (n), including the applicability of the exceptions under section 274(e)(2), (3), (4), (7), (8), and (9). These proposed regulations affect taxpayers who pay or incur expenses for meals or entertainment in taxable years beginning after December 31, 2017. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by [**INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER**]. Outlines of topics to

be discussed at the public hearing scheduled for April 7, 2020, at 10 a.m. must be received by **[INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. If no outlines are received by **[INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**, the public hearing will be cancelled.

ADDRESSES: Submit electronic submissions via the Federal Rulemaking Portal at www.regulations.gov (indicate IRS and REG-100814-19) by following the online instructions for submitting comments. Once submitted to the Federal Rulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) will publish for public availability any comment received to their public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-100814-19), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, call Patrick Clinton of the Office of Associate Chief Counsel (Income Tax and Accounting), (202) 317-7005; concerning the submission of comments, the hearing, or to be placed on the building access list to attend the hearing, call Regina Johnson, (202) 317-6901 (not toll-free numbers), or email fdms.database@irsounsel.treas.gov.

SUPPLEMENTARY INFORMATION:

Background

1. Statutory Framework

This document contains proposed regulations under section 274 of the Code that

amend the Income Tax Regulations (26 CFR part 1). Section 274 was added to the Code by section 4 of the Revenue Act of 1962, Public Law 87-834 (76 Stat. 960) and has been amended numerous times over the years. In general, section 274 limits or disallows deductions for certain meal and entertainment expenditures that otherwise would be allowable under chapter 1 of the Code, primarily under section 162(a), which allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

On December 22, 2017, section 274 was amended by section 13304 of Public Law 115-97 (131 Stat. 2054), commonly referred to as the Tax Cuts and Jobs Act, (TCJA) to revise the rules for deducting expenditures for meals and entertainment, effective for amounts paid or incurred after December 31, 2017.

2. Business Meals and Entertainment

Section 274(a)(1)(A) generally disallows a deduction for any item with respect to an activity of a type considered to constitute entertainment, amusement, or recreation (entertainment expenditures). However, prior to the amendment by the TCJA, section 274(a)(1)(A) provided exceptions to that disallowance if the taxpayer established that: (1) the item was directly related to the active conduct of the taxpayer's trade or business (directly related exception), or (2) 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), the item was associated with the active conduct of the taxpayer's trade or business (business discussion exception). Section 274(e)(1) through (9) also provides exceptions to the rule in section 274(a) that disallows a

deduction for entertainment expenditures. The TCJA did not change the application of the section 274(e) exceptions to entertainment expenditures.

Section 274(a)(1)(B) disallows a deduction for any item with respect to a facility used in connection with an activity referred to in section 274(a)(1)(A). Section 274(a)(2) provides that, for purposes of applying section 274(a)(1), dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities. Section 274(a)(3) disallows a deduction for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

Prior to amendment by the TCJA, section 274(n)(1) generally limited the deduction of food or beverage expenses and entertainment expenditures to 50 percent of the amount that otherwise would have been allowable. Thus, under prior law, taxpayers could deduct 50 percent of meal expenses and 50 percent of entertainment expenditures that met the directly related or business discussion exception. Distinguishing between meal expenses and entertainment expenditures was unnecessary for purposes of the 50 percent limitation.

Section 13304(a)(1) of the TCJA repealed the directly related and business discussion exceptions to the general prohibition on deducting entertainment expenditures in section 274(a)(1)(A). Also, section 13304(a)(2)(D) of the TCJA amended the 50 percent limitation in section 274(n)(1) to remove the reference to entertainment expenditures. Thus, entertainment expenditures are no longer deductible unless one of the nine exceptions to section 274(a) in section 274(e) applies.

While the TCJA eliminated the deduction for entertainment expenses, Congress did not amend the provisions relating to the deductibility of business meals. Thus, taxpayers generally may continue to deduct 50 percent of the food and beverage expenses associated with operating their trade or business, including meals consumed by employees on work travel. See H.R. Rep. No. 115-466, at 407 (2017) (Conf. Rep.). However, as before the TCJA, no deduction is allowed for the expense of any food or beverages unless (a) the expense is not lavish or extravagant under the circumstances, and (b) the taxpayer (or an employee of the taxpayer) is present at the furnishing of the food or beverages. See section 274(k).

Prior to amendment by the TCJA, section 274(d) provided substantiation requirements for deductions under section 162 or 212 for any traveling expense (including meals and lodging while away from home), and for any item with respect to an activity of a type considered to constitute entertainment, amusement, or recreation or with respect to a facility used in connection with such activity. Section 13304(a)(2)(A) of the TCJA repealed the substantiation requirements for entertainment expenditures. Traveling expenses (including meals and lodging while away from home), however, remain subject to the section 274(d) substantiation requirements. Food and beverage expenses are subject to the substantiation requirements under section 162 and the requirement to maintain books and records under section 6001.

On October 15, 2018, the Treasury Department and the IRS published Notice 2018-76, 2018-42 I.R.B. 599, providing transitional guidance on the deductibility of expenses for certain business meals and requesting comments for future guidance to further clarify the treatment of business meal expenses and entertainment expenditures

under section 274. Under the notice, taxpayers may deduct 50 percent of an otherwise allowable business meal expense if: (1) the expense is an ordinary and necessary expense under section 162(a) 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 notice provides that the entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages.

The Treasury Department and the IRS received approximately 25 comments in response to Notice 2018-76. All comments were considered and are available at www.regulations.gov or upon request. Several of the comments addressing the notice are summarized in the Explanation of Provisions. However, comments recommending statutory revisions or addressing provisions outside the scope of these proposed regulations are not discussed in this preamble. The Treasury Department and the IRS continue to study comments on issues related to section 274 that are beyond the scope of these proposed regulations and may discuss those comments that are beyond the scope of these regulations in the final regulations or future guidance.

3. Travel Meals

Section 274(n)(1) generally limits the deduction of food or beverage expenses, including expenses for food or beverages consumed while away from home, to 50 percent of the amount that otherwise would have been allowable, unless one of the six exceptions to section 274(n) in section 274(e) applies. However, no deduction is allowed for the expense of any food or beverages unless (a) the expense is not lavish or extravagant under the circumstances, and (b) the taxpayer (or an employee of the taxpayer) is present at the furnishing of the food or beverages. See section 274(k). Section 274(d) provides substantiation requirements for traveling expenses, including food and beverage expenses incurred while on business travel away from home.

Section 274(m) provides additional limitations on travel expenses. Section 274(m)(1) generally limits the deduction for luxury water transportation expenses to twice the highest federal per diem rate allowable at the time of travel, and section 274(m)(2) generally disallows a deduction for expenses for travel as a form of education. Section 274(m)(3) provides that no deduction is allowed under chapter 1 of the Code (other than section 217) for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless: (A) the spouse, dependent, or other individual is an employee of the taxpayer, (B) the travel of the spouse, dependent, or other individual is for a bona fide business purpose, and (C) such expenses would otherwise be deductible by the spouse, dependent, or other individual.

4. Employer-Provided Meals

Prior to amendment by the TCJA, section 274(n)(1) generally limited the deduction for food or beverage expenses to 50 percent of the amount that otherwise

would have been allowable, subject to an exception in section 274(n)(2)(B) in the case of an expense for food or beverages that is excludable from the gross income of the recipient under section 132 by reason of section 132(e), relating to de minimis fringes. Section 132(e)(1) defines “de minimis fringe” as any property or service the value of which is, after taking into account the frequency with which similar fringes are provided by the employer to its employees, so small as to make accounting for it unreasonable or administratively impracticable. Section 132(e)(2) provides that the operation by an employer of any eating facility for employees is treated as a de minimis fringe if (1) the facility is located on or near the business premises of the employer, and (2) revenue derived from the facility normally equals or exceeds the direct operating costs of the facility. Thus, under prior law, employers generally were allowed to fully deduct an expense for food or beverages provided to their employees if the amount was excludable from the gross income of the employee as a de minimis fringe. However, the TCJA repealed section 274(n)(2)(B), meaning that expenses for food or beverages that are de minimis fringes under section 132(e) are no longer excepted from section 274(n)(1). As a result, these expenses, like other food or beverage expenses generally, are subject to the 50 percent limitation unless one of the six exceptions to section 274(n) in section 274(e) applies.

5. Section 274(e) Exceptions to Section 274(k) and (n)

Section 274(k)(2) and (n)(2)(A) provide that the limitations on the deduction of food or beverage expenses in sections 274(k)(1) and (n)(1), respectively, do not apply if the expense is described in paragraph (2), (3), (4), (7), (8), or (9) of section 274(e). Expenses described in paragraph (1), (5), and (6) of section 274(e) are not exceptions

to the limitations on the deduction of food or beverage expenses in section 274(k)(1) and (n)(1). However, they are exceptions to the disallowance on deduction of entertainment expenses in section 274(a).

Section 274(e)(2) applies to expenses for goods, services, and facilities to the extent that the expenses are treated as compensation to the recipient. Section 274(e)(3) applies to expenses incurred by a taxpayer in connection with the performance of services for an employer or other person under a reimbursement or other expense allowance arrangement. Section 274(e)(4) applies to expenses for recreational, social, or similar activities for employees. Section 274(e)(7) applies to expenses for goods, services, and facilities made available to the general public. Section 274(e)(8) applies to expenses for goods or services that are sold by the taxpayer in a bona fide transaction for adequate and full consideration in money or money's worth. Section 274(e)(9) applies to expenses for goods, services, and facilities to the extent that the expenses are treated as income to a person other than an employee.

Explanation of Provisions

The proposed regulations describe and clarify the statutory requirements of section 274(a), 274(k), and 274(n), as well as the applicability of certain exceptions under section 274(e) to food or beverage expenses. To implement the TCJA's disallowance of entertainment expenditures under section 274(a), the proposed regulations add a new section at §1.274-11 (proposed §1.274-11) for entertainment expenditures paid or incurred after December 31, 2017. The proposed regulations also add a new section at §1.274-12 (proposed §1.274-12) to address food or beverage

expenses under section 274(k) and 274(n) paid or incurred after December 31, 2017, including the application of the exceptions in section 274(e)(2), (3), (4), (7), (8), and (9). Specifically, proposed §1.274-12 addresses expenses for business meals as described in Notice 2018-76, as well as expenses for other meals including travel meals and employer-provided meals.

1. Entertainment Expenditures

A. In General

Proposed §1.274-11 restates the statutory rules under section 274(a), including the application of the entertainment deduction disallowance rule to dues or fees to any social, athletic, or sporting club or organization. The proposed regulations substantially incorporate the existing definition of entertainment in §1.274-2(b)(1), with minor modifications to remove outdated language. The proposed regulations also confirm that the nine exceptions in section 274(e) continue to apply to entertainment expenditures under section 274(a). Finally, as described further in part I.B. of this Explanation of Provisions, the proposed regulations provide that for purposes of section 274(a), the term “entertainment” does not include food or beverages unless the food or beverages are provided at or during an entertainment activity and the costs of the food or beverages are not separately stated from the entertainment costs.

Taxpayers may continue to rely upon the existing rules in §1.274-2, to the extent applicable and not superseded by the TCJA, for entertainment expenditures paid or incurred after December 31, 2017.

B. Separately Stated Food or Beverages not Entertainment

The proposed regulations substantially incorporate the guidance in Notice 2018-76 to distinguish between entertainment expenditures and food or beverage expenses in the context of business meals provided at or during an entertainment activity. In addition, the proposed regulations generally apply the guidance in Notice 2018-76 to all food or beverages, including travel meals and employer-provided meals, provided at or during an entertainment activity. However, in response to a comment on the notice, the proposed regulations further clarify the rules applicable to food or beverages provided at or during an entertainment activity.

Notice 2018-76 explains that in the case of food and beverages provided during or at an entertainment activity, the taxpayer may deduct 50 percent of an otherwise allowable business expense if the food and beverages are purchased separately from the entertainment, or if 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 notice provides that the entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages. Taxpayers may continue to rely on the guidance in Notice 2018-76 until these proposed regulations are finalized.

One commenter asked for clarification of the requirement in the notice that the entertainment disallowance rule may not be circumvented by inflating the amount charged for food and beverages on one or more bills, invoices, or receipts. In response, the proposed regulations provide that the amount charged for food or beverages on a bill, invoice, or receipt must reflect the venue's usual selling cost for those items if they were to be purchased separately from the entertainment, or must approximate the reasonable value of those items. Further, the proposed regulations provide that unless

food or beverages provided at or during an entertainment activity are purchased separately from the entertainment, or the cost of the food or beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts, no allocation can be made and the entire amount is a nondeductible entertainment expenditure. Finally, in accordance with the TCJA's amendments to section 274(a)(1) specifically repealing the "directly related" and "business discussion" exceptions to the general disallowance rule for entertainment expenditures, the proposed regulations clarify that the entertainment disallowance rule applies whether or not the expenditure for the activity is related to or associated with the active conduct of the taxpayer's trade or business. The Treasury Department and the IRS request comments on these rules.

2. Food or Beverage Expenses

A. Business Meal Expenses

As noted earlier in this Explanation of Provisions, the proposed regulations substantially incorporate the guidance in Notice 2018-76 addressing business meals provided during or at an entertainment activity. The proposed regulations also incorporate other statutory requirements taxpayers must meet to deduct 50 percent of an otherwise allowable business meal expense. Specifically, the expense must not be lavish or extravagant under the circumstances and the taxpayer, or an employee of the taxpayer, must be present at the furnishing of the food or beverages.

The proposed regulations also address the general requirement in Notice 2018-76 that the food and beverages be provided to a business contact, which was described in the notice as a "current or potential business customer, client, consultant, or similar business contact." This requirement is to ensure that the meal expenses are directly

connected with or pertaining to the taxpayer's trade or business, as required under section 162. One commenter on Notice 2018-76 requested a definition of "potential business contact," suggesting that the term could be interpreted broadly to include almost anyone. In response to the comment, and to conform the rule more closely to the trade or business requirement in section 162, the proposed regulations follow the definition of "business associate" as currently provided in §1.274-2(b)(2)(iii). Thus, the proposed regulations provide that the food or beverages must be provided to a "person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business such as the taxpayer's customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective." In addition to clarifying this definition for purposes of determining whether a business meal expense is deductible, the proposed regulations apply this standard to the deduction of food or beverage expenses generally. In particular, the proposed regulations include employees as a type of business associate, making the standard applicable to employer-provided meals as well as to situations in which a taxpayer provides meals to both employees and non-employee business associates at the same event. The Treasury Department and the IRS request comments on this standard.

B. Travel Meal Expenses

Although the TCJA did not specifically amend the rules for travel expenses, the proposed regulations are intended to provide comprehensive rules for food and beverage expenses and thus apply the general rules for meal expenses from Notice 2018-76, as revised in these proposed regulations, to travel meals. In addition, the proposed regulations incorporate the substantiation requirements in section 274(d),

unchanged by the TCJA, to travel meals. Finally, the proposed regulations apply the limitations in section 274(m)(3) to expenses for food or beverages paid or incurred while on travel for spouses, dependents or other individuals accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel. These limitations do not apply to deductions for moving expenses under section 217. However, the TCJA amended section 217 to suspend the deduction for moving expenses for taxable years beginning after December 31, 2017, and before January 1, 2026, except with respect to certain members of the Armed Forces. Thus, the proposed regulations revise the reference to section 217 to reflect that amendment.

C. Other Food or Beverage Expenses

The proposed regulations apply the business meal guidance in Notice 2018-76, as revised in these proposed regulations, to food or beverage expenses generally. Under section 274(n)(1), the deduction for food or beverage expenses generally is limited to 50 percent of the amount that would otherwise be allowable. Prior to the TCJA, under section 274(n)(2)(B), expenses for food or beverages that were excludable from employee income as de minimis fringe benefits under section 132(e) were not subject to the 50 percent deduction limitation under section 274(n)(1) and could be fully deducted. The TCJA repealed section 274(n)(2)(B) so that expenses for food or beverages excludable from employee income under section 132(e) are subject to the section 274(n)(1) deduction limitation unless another exception under section 274(n)(2) applies.

Under section 274(k)(1), in order for food or beverage expenses to be deductible the food or beverages must not be lavish or extravagant under the circumstances and

the taxpayer or an employee of the taxpayer must be present at the furnishing of the food or beverages. However, as discussed in part E of this Explanation of Provisions, section 274(e) provides six exceptions to the limitations on the deduction of food or beverages in section 274(k)(1) and 274(n)(1) and the proposed regulations explain how those exceptions apply.

In response to comments that the Treasury Department and the IRS received after enactment of the TCJA, the proposed regulations address several scenarios involving the deductibility of food or beverage expenses. For example, commenters requested guidance on the deductibility of expenses for: (i) food or beverages provided to food service workers who consume the food or beverages while working in a restaurant or catering business; (ii) snacks available to employees in a pantry, break room, or copy room; (iii) refreshments provided by a real estate agent at an open house; (iv) food or beverages provided by a seasonal camp to camp counselors; (v) food or beverages provided to employees at a company cafeteria; and (vi) food or beverages provided at company holiday parties and picnics. The Treasury Department and the IRS considered all comments received and provide examples in proposed §1.274-12(c) to address many of the factual scenarios raised by commenters.

D. Definitions

The proposed regulations provide that the deduction limitation rules generally apply to all food and beverages, whether characterized as meals, snacks, or other types of food or beverage items. In addition, unless one of the six exceptions under section 274(n)(2)(A) applies, the deduction limitations apply regardless of whether the food or beverages are treated as de minimis fringe benefits under section 132(e).

The proposed regulations define food or beverage expenses to mean the cost of food or beverages, including any delivery fees, tips, and sales tax. In the case of employer-provided meals at an eating facility, food or beverage expenses do not include expenses for the operation of the eating facility such as salaries of employees preparing and serving meals, and other overhead costs.

E. Section 274(e) Exceptions to Section 274(k) and (n)

Section 274(k)(2) and (n)(2)(A) provide that the limitations on deductions in section 274(k)(1) and (n)(1), respectively, do not apply to any expense described in section 274(e)(2), (3), (4), (7), (8), and (9). The proposed regulations, therefore, provide that the deduction limitations are not applicable to expenditures for business meals, travel meals, or other food or beverages that fall within one of these exceptions.

i. Expenses Treated as Compensation under Section 274(e)(2) or (e)(9)

Pursuant to section 274(e)(2), the proposed regulations provide that the limitations in section 274(k)(1) and (n)(1) do not apply to expenditures for food or beverages of an employee of the taxpayer (including food or beverages of a spouse, dependent or other individual accompanying the employee on travel described in section 274(m)(3)), to the extent the taxpayer treats the expenses as compensation to the employee on the taxpayer's income tax return as originally filed, and as wages to the employee for purposes of withholding under chapter 24 of the Code relating to collection of income tax at source on wages.

Pursuant to section 274(e)(9), the proposed regulations provide that the limitations in section 274(k)(1) and (n)(1) do not apply to expenses for food or beverages of a person who is not an employee of the taxpayer to the extent the

expenses are includible in the gross income of the recipient of the food or beverages as compensation for services rendered, or as a prize or award under section 74.

The Treasury Department and the IRS are aware that some taxpayers may attempt to claim a full deduction under section 274(e)(2) or (e)(9) by including a value that is less than the amount required to be included under §1.61-21, which provides the rules for valuation of fringe benefits, or by purportedly including a value of zero, as compensation and as wages to the employee, or as includible in gross income by a person who is not an employee of the taxpayer. The proposed regulations therefore provide that expenses for food or beverages with a value that is less than the amount required to be included in gross income under §1.61-21, or for which the amount required to be included in gross income is zero, will not be considered as having been treated as compensation and as wages to the employee, or as includible in gross income by a recipient of the food or beverages who is not an employee of the taxpayer for purposes of section 274(e)(2) and (e)(9).

ii. Reimbursed Food or Beverage Expenses

Pursuant to section 274(e)(3), the proposed regulations provide that in the case of expenses for food or beverages paid or incurred by one person in connection with the performance of 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 section 274(k)(1) and (n)(1) apply either to the person who makes the expenditure or to the person who actually bears the expense, but not to both. Section 274(e)(3)(B) provides that if the services are performed for a person other than an employer, such as by an independent contractor, the exception in section 274(e)(3)

applies only if the taxpayer, in this case, the independent contractor, accounts, to the extent provided by section 274(d), to such person. The proposed regulations therefore provide that the deduction limitations in section 274(k)(1) and (n)(1) apply to an independent contractor unless, under a reimbursement or other expense allowance arrangement, the contractor accounts to the client or customer with substantiation that satisfies the requirements of section 274(d).

iii. Recreational Expenses for Employees

Pursuant to section 274(e)(4), the proposed regulations provide that any food or beverage expense paid or incurred by a taxpayer for a recreational, social, or similar activity, primarily for the benefit of the taxpayer's employees, is not subject to the deduction limitations in section 274(k)(1) and (n)(1). However, activities that discriminate in favor of highly compensated employees, officers, shareholders or others who own a 10-percent or greater interest in the business are not considered paid or incurred primarily for the benefit of employees.

The Treasury Department and the IRS have received several questions and comments on the deductibility of food or beverage expenses for recreational, social and similar activities for employees. Many commenters requested confirmation that food or beverage expenses for company holiday parties and picnics that do not discriminate in favor of highly compensated employees are not subject to the deduction limitations in section 274(k)(1) and (n)(1) because the exception in section 274(e)(4) applies. Commenters also suggested that expenses for snacks and beverages available to all employees in a pantry, break room, or copy room are not subject to the deduction

limitations in section 274(k)(1) and (n)(1) because the exception in section 274(e)(4) applies.

In response to the questions and comments received, the proposed regulations confirm the rules in the existing regulations that the exception in section 274(e)(4) applies to food or beverage expenses for company holiday parties, annual picnics, or summer outings that do not discriminate in favor of highly compensated employees. However, an example in the proposed regulations demonstrates the section 274(e)(4) exception does not apply to free food or beverages provided in a break room because the mere provision or availability of food or beverages is not a recreational, social, or similar activity, despite the fact that employees may incidentally socialize while they are in the break room.

In addition, the proposed regulations provide that the exception in section 274(e)(4) does not apply to food or beverage expenses that are excludable under section 119 as meals provided for the convenience of the employer. Because these food or beverages are, by definition, furnished for the employer's convenience, they cannot also be primarily for the benefit of the employees, even if some social activity occurs during the provision of food or beverages.

iv. Items Available to the Public

Pursuant to section 274(e)(7), the proposed regulations provide that any food or beverage expense of a taxpayer is not subject to the deduction limitations in section 274(k)(1) and (n)(1) to the extent the food or beverages are made available to the general public. In addition, the proposed regulations provide that this exception applies to the entire amount of the expense for food or beverages provided to employees if

similar food or beverages are provided by the employer to, and are primarily consumed by, the general public. For this purpose, “primarily consumed” means greater than 50 percent of actual or reasonably estimated consumption, and “general public” includes, but is not limited to, customers, clients, and visitors. The proposed regulations also provide that the general public does not include employees, partners, or independent contractors of the taxpayer. Further, an exclusive list of guests also is not considered the general public. See *Churchill Downs, Inc. v. Commissioner*, 307 F.3d 423 (6th Cir. 2002).

Commenters have requested guidance as to whether the exception in section 274(e)(7) for food or beverages made available by the taxpayer to the general public applies in various situations. The Treasury Department and the IRS considered these comments and included examples in the proposed regulations to illustrate that the exception in section 274(e)(7) generally applies to the entire food or beverage expense if the food or beverages are primarily consumed by the general public.

v. Goods or Services Sold to Customers

Pursuant to section 274(e)(8), the proposed regulations provide that any expense for food or beverages that are 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 deduction limitations in section 274(k)(1) and (n)(1). The proposed regulations clarify that money or money's worth does not include payment through services provided.

The Treasury Department and the IRS are aware of concerns raised by commenters that it is a common business practice for employers of restaurant and food service workers to provide food or beverages at no cost or at a discount to their

employees. The Joint Committee on Taxation’s Bluebook on the TCJA explains that amendments made by the TCJA to limit the deduction for expenses of the employer associated with providing food or beverages to employees through an employer-operated eating facility that meets the requirements of section 132(e)(2) do not affect other exceptions to the 50-percent limitation on deductions for food or beverage expenses. For example, a restaurant or catering business may continue to deduct 100 percent of its costs for food or beverage items, purchased in connection with preparing and providing meals to its paying customers, which are also consumed at the worksite by employees who work in the employer’s restaurant or catering business. Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), at 186 n.940 and at 188 n.956, December 2018. The proposed regulations incorporate this interpretation of the exception in section 274(e)(8).

Finally, the proposed regulations provide that for purposes of the section 274(e)(8) exception to the deduction limitations in section 274(k)(1) and (n)(1), the term “customer” includes anyone who is sold food or beverages in a bona fide transaction for an adequate and full consideration in money or money's worth. For example, employees of the taxpayer are customers when they purchase food or beverages from the taxpayer in a bona fide transaction for arm’s length, fair market value prices.

Request for Comments

The Treasury Department and the IRS request comments on all aspects of these proposed regulations. Regarding entertainment expenditures under proposed §1.274-11, comments are specifically requested about the definition of entertainment, including how to distinguish entertainment from advertising and travel; the use of the objective

test in defining entertainment activities; the application of the exceptions in section 274(e) to entertainment expenditures; and whether additional issues or examples should be addressed in the regulations. Regarding food or beverage expenses under proposed §1.274-12, comments are specifically requested about the changes from Notice 2018-76 to the rules for business meals; the application of the exceptions in section 274(e) to food or beverage expenses; and whether additional issues or examples should be addressed in the regulations.

Proposed Applicability Date

Section 7805(b)(1)(A) and (B) of the Code generally provide that no temporary, proposed, or final regulation relating to the internal revenue laws may apply to any taxable period ending before the earliest of (A) the date on which the regulation is filed with the **Federal Register**, or (B) in the case of a final regulation, the date on which a proposed or temporary regulation to which the final regulation relates was filed with the **Federal Register**.

Consistent with authority provided by section 7805(b)(1)(A), these regulations are proposed to apply for taxable years that begin on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Pending the issuance of the final regulations, a taxpayer may rely on these proposed regulations for entertainment expenditures and food or beverage expenses, as applicable, paid or incurred after December 31, 2017. In addition, a taxpayer may rely on the guidance in Notice 2018-76 until these proposed regulations are finalized.

Special Analyses

These proposed regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

In accordance with the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. Although the rule may affect a substantial number of small entities, the economic impact of the regulations is not likely to be significant. Data are not readily available about the number of taxpayers affected, but the number is likely to be substantial for both large and small entities because the rule may affect entities that incur meal and entertainment expenses. The economic impact of these regulations is not likely to be significant, however, because these proposed regulations substantially incorporate prior guidance and otherwise clarify the application of the TCJA changes to section 274 related to meals and entertainment. The proposed regulations will assist taxpayers in understanding the changes to section 274 and make it easier for taxpayers to comply with those changes. Notwithstanding this certification, the Treasury Department and the IRS welcome comments on the impact of these regulations on small entities.

Pursuant to section 7805(f), these proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million (updated annually for inflation). This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Statement of Availability of IRS Documents

Notices cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS web site at <http://www.irs.gov>.

Comments

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS as prescribed in this preamble under the “**ADDRESSES**” heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at <http://www.regulations.gov> or upon request.

Drafting Information

The principal author of this proposed regulation is Patrick Clinton, Office of the Associate Chief Counsel (Income Tax & Accounting). Other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income Taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

Part 1--INCOME TAX

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order for §§ 1.274-11 and 1.274-12 to read in part as follows:

Authority: 26 U.S.C. 7805* * *

Section 1.274-11 also issued under 26 U.S.C. 274.

Section 1.274-12 also issued under 26 U.S.C. 274.

* * * * *

Par. 2. Section 1.274-11 is added to read as follows:

§1.274-11 Disallowance of deductions for certain entertainment, amusement, or recreation expenditures paid or incurred after December 31, 2017.

(a) In general. Except as provided in this section, no deduction otherwise allowable under chapter 1 of the Internal Revenue Code (Code) is allowed for any expenditure with respect to an activity that is of a type generally considered to be entertainment, or with respect to a facility used in connection with an entertainment activity. For purposes of this paragraph (a), dues or fees to any social, athletic, or sporting club or organization are treated as items with respect to facilities and, thus, are not deductible. In addition, no deduction otherwise allowable under chapter 1 of the Code is allowed for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

(b) Definitions--(1) Entertainment—(i) In general. For section 274 purposes, the term entertainment means any activity which is of a type generally considered to constitute entertainment, amusement, or recreation, such as entertaining at bars, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips, including such activity relating solely to the taxpayer or the taxpayer's family. These activities are treated as entertainment under this section, subject to the objective test, regardless of whether the expenditure for the activity is related to or associated with the active conduct of the taxpayer's trade or business. The term entertainment may include an activity, the cost of which otherwise is a business expense of the taxpayer, which satisfies the personal, living, or family needs of any individual, such as a hotel suite or an automobile to a business customer or the customer's family. The term entertainment does not include activities which, although

satisfying personal, living, or family needs of an individual, are clearly not regarded as constituting entertainment, such as a hotel room maintained by an employer for lodging of employees while in business travel status or an automobile used in the active conduct of trade or business even though used for routine personal purposes such as commuting to and from work. On the other hand, the providing of a hotel room or an automobile by an employer to an employee who is on vacation would constitute entertainment of the employee.

(ii) Food or beverages. Under this section, the term entertainment does not include food or beverages unless the food or beverages are provided during or at an entertainment activity. Food or beverages provided during or at an entertainment activity generally are treated as part of the entertainment activity. However, in the case of food or beverages provided during or at an entertainment activity, the food or beverages are not considered entertainment if the food or beverages are purchased separately from the entertainment, or the cost of the food or beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The amount charged for food or beverages on a bill, invoice, or receipt must reflect the venue's usual selling cost for those items if they were to be purchased separately from the entertainment, or must approximate the reasonable value of those items. Unless the food or beverages are purchased separately from the entertainment, or the cost of the food or beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts, no allocation can be made and the entire amount is a nondeductible entertainment expenditure.

(iii) Objective test. An objective test is used to determine whether an activity is of

a type generally considered to be entertainment. Thus, if an activity is generally considered to be entertainment, it will be treated as entertainment for purposes of this section and section 274(a) regardless of whether the expenditure can also be described otherwise, and even though the expenditure relates to the taxpayer alone. This objective test precludes arguments that entertainment means only entertainment of others or that an expenditure for entertainment should be characterized as an expenditure for advertising or public relations. However, in applying this test the taxpayer's trade or business is considered. Thus, although attending a theatrical performance generally would be considered entertainment, it would not be so considered in the case of a professional theater critic, attending in a professional capacity. Similarly, if a manufacturer of dresses conducts a fashion show to introduce its products to a group of store buyers, the show generally would not be considered entertainment. However, if an appliance distributor sponsors a fashion show, the fashion show generally would be considered to be entertainment.

(2) Expenditure. The term expenditure as used in this section includes amounts paid or incurred for goods, services, facilities, and other items, including items such as losses and depreciation.

(3) Expenditures for production of income. For purposes of this section, any reference to trade or business includes an activity described in section 212.

(c) Exceptions. Paragraph (a) of this section does not apply to any expenditure described in section 274(e)(1), (2), (3), (4), (5), (6), (7), (8), or (9).

(d) Examples. The following examples illustrate the application of paragraphs (a) and (b) of this section. In each example, neither the taxpayer nor the business associate is engaged in a trade or business that relates to the entertainment activity.

(1) Example 1. Taxpayer A invites, B, a business associate, to a baseball game to discuss a proposed business deal. A purchases tickets for A and B to attend the game. The baseball game is entertainment as defined in paragraph (b)(1) of this section and thus, the cost of the game tickets is an entertainment expenditure and is not deductible by A.

(2) Example 2. Assume the same facts as in paragraph (d)(1) of this section (Example 1), except that A also buys hot dogs and drinks for A and B from a concession stand. The cost of the hot dogs and drinks, which are purchased separately from the game tickets, is not an entertainment expenditure and is not subject to the section 274(a)(1) disallowance. Therefore, A may deduct 50 percent of the expenses associated with the hot dogs and drinks purchased at the game if they meet the requirements of section 162 and §1.274-12.

(3) Example 3. Taxpayer C invites D, a business associate, 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 basketball game tickets, as stated on the invoice, includes the food or beverages. The basketball game is entertainment as defined in paragraph (b)(1) of this section and, thus, the cost of the game tickets is an entertainment expenditure 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 is an entertainment expenditure that is subject to the section 274(a)(1) disallowance. Therefore, C may not deduct the cost of the tickets or the food and beverages associated with the basketball game.

(4) Example 4. Assume the same facts as in paragraph (d)(3) of this section (Example 3), except that the invoice for the basketball game tickets separately states the cost of the food and beverages and reflects the venue's usual selling price if purchased separately. As in paragraph (d)(3) (Example 3), the basketball game is entertainment as defined in paragraph (b)(1) of this section and, thus, the cost of the game tickets, other than the cost of the food and beverages, is an entertainment expenditure and is not deductible by C. However, the cost of the food and beverages, which is stated separately on the invoice for the game tickets, is not an entertainment expenditure and is not subject to the section 274(a)(1) disallowance. Therefore, C may deduct 50 percent of the expenses associated with the food and beverages provided at the game if they meet the requirements of section 162 and §1.274-12.

(e) Applicability date. This section applies for taxable years that begin on or after **[DATE OF PUBLICATION OF FINAL REGULATIONS IN THE FEDERAL REGISTER]**.

Par. 3. Section 1.274-12 is added to read as follows:

§1.274-12 Limitation on deductions for certain food or beverage expenses paid or incurred after December 31, 2017.

(a) Food or beverage expenses--(1) In general. Except as provided in this section, no deduction is allowed for the expense of any food or beverages provided by the taxpayer (or an employee of the taxpayer) to another person or persons unless--

(i) The expense is not lavish or extravagant under the circumstances;

(ii) The taxpayer, or an employee of the taxpayer, is present at the furnishing of such food or beverages; and

(iii) The food or beverages are provided to a business associate.

(2) Only 50 percent of food or beverage expenses allowed as deduction. Except as provided in this section, the amount allowable as a deduction for any expense for food or beverages provided by the taxpayer, or an employee of the taxpayer, to a business associate may not exceed 50 percent of the amount of the expense that otherwise would be allowable.

(3) Examples. The following examples illustrate the application of paragraph (a)(1) and (2) of this section. In each example, the food or beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business and are not lavish or extravagant under the circumstances.

(i) Example 1. Taxpayer A takes client B out to lunch. While eating lunch, A and B discuss A's trade or business activities. Under section 274(k) and (n) and paragraph (a) of this section, A may deduct 50 percent of the food or beverage expenses.

(ii) Example 2. Taxpayer C takes employee D out to lunch. While eating lunch, C and D discuss D's annual performance review. Under section 274(k) and (n) and paragraph (a) of this section, C may deduct 50 percent of the food and beverage expenses.

(4) Special rules for travel meals--(i) In general. Food or beverage expenses paid or incurred while traveling away from home in pursuit of a trade or business generally are subject to the deduction limitations in section 274(k) and (n) and paragraph (a)(1) and (2) of this section, as well as the substantiation requirements in section 274(d). In addition, travel expenses generally are subject to the limitations in section 274(m)(1), (2) and (3).

(ii) Substantiation. Except as provided in this section, no deduction is allowed for the expense of any food or beverages paid or incurred while traveling away from home in pursuit of a trade or business unless the taxpayer meets the substantiation requirements in section 274(d).

(iii) Travel meal expenses of spouse, dependent, or others. No deduction is allowed under chapter 1 of the Internal Revenue Code (Code), except under section 217 for certain members of the Armed Forces of the United States, for the expense of any food or beverages paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer, or an officer or employee of the taxpayer, on business travel, unless--

(A) The spouse, dependent, or other individual is an employee of the taxpayer;

(B) The travel of the spouse, dependent, or other individual is for a bona fide business purpose of the taxpayer; and

(C) The expenses would otherwise be deductible by the spouse, dependent or other individual.

(D) The following example illustrates the application of paragraph (a)(4)(iii) of this section. Taxpayer E and Taxpayer E's spouse travel from New York to Boston to attend a series of business meetings. E's spouse is not an employee of E, does not travel to Boston for a bona fide business purpose of E, and the expenses would not otherwise be deductible. While in Boston, E and E's spouse go out to dinner. Under section 274(m)(3) and paragraph (a)(4)(iii) of this section, the expenses associated with the food and beverages consumed by E's spouse are not deductible. Therefore, the cost of E's spouse's dinner is not deductible. E may deduct 50 percent of the expense associated with the food and beverages E consumed while on business travel if E meets the requirements in sections 162 and 274, including section 274(k) and (d).

(b) Definitions. Except as otherwise provided in this section, the following definitions apply for purposes of section 274(k) and (n), §1.274-11(b)(1)(ii) and (d), and this section:

(1) Food or beverages. Food or beverages means all food and beverage items, regardless of whether characterized as meals, snacks, or other types of food and beverages, and regardless of whether the food and beverages are treated as de minimis fringes under section 132(e).

(2) Food or beverage expenses. Food or beverage expenses mean the full cost of food or beverages, including any delivery fees, tips, and sales tax. In the case of

employer-provided meals furnished at an eating facility on the employer's business premises, food or beverage expenses do not include expenses for the operation of the eating facility such as salaries of employees preparing and serving meals, and other overhead costs.

(3) Business associate. Business associate means a person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business such as the taxpayer's customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective.

(4) Independent contractor. For purposes of the reimbursement or other expense allowance arrangements described in paragraph (c)(2)(ii) of this section, independent contractor means a person who is not an employee of the payor.

(5) Client or customer. For purposes of the reimbursement or other expense allowance arrangements described in paragraph (c)(2)(ii) of this section, client or customer means a person who receives services from an independent contractor and enters into a reimbursement or other expense allowance arrangement with the independent contractor.

(6) Payor. For purposes of the reimbursement or other expense allowance arrangements described in paragraph (c)(2)(ii) of this section, payor means a person that enters into a reimbursement or other expense allowance arrangement with an employee and may include an employer, its agent, or a third party.

(7) Reimbursement or other expense allowance arrangement. For purposes of the reimbursement or other expense allowance arrangements described in paragraph

(c)(2)(ii) of this section, reimbursement or other expense allowance arrangement

means--

(i) For purposes of paragraph (c)(2)(ii)(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

(ii) For purposes of paragraph (c)(2)(ii)(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 paragraph (a) of this section; or

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

(8) Primarily consumed. For purposes of paragraph (c)(2)(iv) of this section, primarily consumed means greater than 50 percent of actual or reasonably estimated consumption.

(9) General public. For purposes of paragraph (c)(2)(iv) of this section, the general public includes, but is not limited to, customers, clients, and visitors. The general public does not include employees, partners or independent contractors of the taxpayer. Also, an exclusive list of guests is not the general public.

(c) Exceptions--(1) In general. The limitations on the deduction of food or beverage expenses in paragraph (a) of this section do not apply to any expense

described in paragraph (c)(2) of this section. These expenses are deductible to the extent allowable under chapter 1 of the Code.

(2) Exceptions--(i) Expenses treated as compensation--(A) In general. Any expense paid or incurred by a taxpayer for food or beverages, including food or beverages provided during travel described in section 274(m)(3), if an employee is the recipient of the food or beverages, is not subject to the deduction limitations in paragraph (a) of this section to the extent that the expense 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 of the Code, relating to collection of income tax at source on wages.

(B) Expenses includible in income of persons who are not employees. An expense paid or incurred by a taxpayer for food or beverages, including food or beverages provided during travel described in section 274(m)(3), is not subject to the deduction limitations in paragraph (a) 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 by a recipient of the expense who is not an employee of the taxpayer. The preceding sentence does not apply to any amount paid or incurred by the taxpayer if the 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 of the Code and is not so included.

(C) Expenses for which value is improperly included or for which amount required to be included is zero. The exception in section 274(e)(2) and (e)(9) and paragraph

(c)(2)(i) of this section does not apply to expenses paid or incurred for food or beverages for which the value that is included in gross income is less than the amount required to be included in gross income under §1.61-21. Furthermore, if the amount required to be included in gross income under §1.61-21 is zero, the exception in section 274(e)(2) and (e)(9) and paragraph (c)(2)(i) of this section does not apply.

(D) Examples. The following examples illustrate the application of paragraph (c)(2)(i) of this section. In each example, the food or beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business and that are not lavish or extravagant under the circumstances.

(1) Example 1. Employer F provides food and beverages to its employees without charge at a company cafeteria on its premises. The food and beverages do not meet the definition of a de minimis fringe under section 132(e). F treats the food and beverage expenses as compensation and wages, and determines the amount of the inclusion under §1.61-21. Under section 274(e)(2) and paragraph (c)(2)(i) of this section, the expenses associated with the food and beverages provided to the employees are not subject to the 50 percent deduction limitations in paragraph (a) of this section. Thus, F may deduct 100 percent of the food and beverage expenses.

(2) Example 2. Employer G provides meals to its employees without charge. The meals are properly excluded from the employees' income under section 119 as meals provided for the convenience of the employer. Under §1.61-21(b)(1), an employee must include in gross income the amount by which the fair market value of a fringe benefit exceeds the sum of the amount, if any, paid for the benefit by or on behalf of the recipient, and the amount, if any, specifically excluded from gross income by some other section of subtitle A of the Code. Because the entire value of the employees' meals is excluded from the employees' income under section 119, the fair market value of the fringe benefit does not exceed the amount excluded from gross income under subtitle A of the Code, so there is nothing to be included in the employees' income under §1.61-21. Thus, the exception in section 274(e)(2) and paragraph (c)(2)(i) of this section does not apply and G may only deduct 50 percent of the expenses for the food and beverages provided to employees.

(ii) Reimbursed food or beverage expenses--(A) In general. In the case of expenses for food or beverages paid or incurred by one person in connection with the

performance of services for another person, whether or not the other person is an employer, under a reimbursement or other expense allowance arrangement, the deduction limitations in paragraph (a) of this section apply either to the person who makes the expenditure or to the person who actually bears the expense, but not to both. If an expense of a type described in paragraph (c)(2)(ii) of this section properly constitutes a dividend paid to a shareholder, unreasonable compensation paid to an employee, a personal expense, or other nondeductible expense, nothing in this paragraph (c)(2)(ii)(A) prevents disallowance of the deduction to the taxpayer under other provisions of the Code.

(B) Reimbursement arrangements involving employees. In the case of expenses paid or incurred by an employee for 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 paragraph (a) of this section 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 (c)(2)(ii)(B)(1) of this section. However, see paragraph (c)(2)(ii)(C) of this section if the payor receives a payment from a third party that may be treated as a reimbursement arrangement under paragraph (c)(2)(ii)(C).

(C) Reimbursement arrangements involving persons that are not employees. In the case of expenses for food or beverages paid or incurred by an independent contractor in connection with the performance of services for a client or customer under a reimbursement or other expense allowance arrangement with the independent contractor, the limitations on deductions in paragraph (a) of this section 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, then the deduction limitations in paragraph (a) of this section apply--

(1) To the independent contractor (which may be a payor) to the extent the independent contractor does not account to the client or customer within the meaning of section 274(d); or

(2) To the client or customer if the independent contractor accounts to the client or customer within the meaning of section 274(d).

(D) Section 274(d) substantiation. If the reimbursement or other expense allowance arrangement involves persons who are not employees and the agreement between the parties does not expressly identify the party subject to the limitations on deductions in paragraph (a) of this section, the limitations on deductions in paragraph (a) of this section apply to the independent contractor unless the independent contractor accounts to the client or customer with substantiation that satisfies the requirements of section 274(d).

(E) Examples. The following examples illustrate the application of paragraph (c)(2)(ii) of this section.

(1) Example 1. (i) Employee I performs services under an arrangement in which J, an employee leasing company, pays I a per diem allowance of \$10x for each day that I performs services for J's client, K, while traveling away from home. The per diem allowance is a reimbursement of travel expenses for food or beverages that I pays in performing services as an employee. J enters into a written agreement with K under which K agrees to reimburse J for any substantiated reimbursements for travel expenses, including meal expenses, that J pays to I. The agreement does not expressly identify the party that is subject to the limitations on deductions in paragraph (a) of this section. I performs services for K while traveling away from home for 10 days and provides J with substantiation that satisfies the requirements of section 274(d) of \$100x of meal expenses incurred by I while traveling away from home. J pays I \$100x to reimburse those expenses pursuant to their arrangement. J delivers a copy of I's substantiation to K. K pays J \$300x, which includes \$200x compensation for services and \$100x as reimbursement of J's payment of I's travel expenses for meals. Neither J nor K treats the \$100x paid to I as compensation or wages.

(ii) Under paragraph (b)(7)(i) of this section, I and J have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(B) of this section. Because the reimbursement payment is not treated as compensation and wages paid to I, under section 274(e)(3)(A) and paragraph (c)(2)(ii)(B)(1) of this section, I is not subject to the limitations on deductions in paragraph (a) of this section. Instead, under paragraph (c)(2)(ii)(B)(2) of this section, J, the payor, is subject to limitations on deductions in paragraph (a) of this section unless J can meet the requirements of section 274(e)(3)(B) and paragraph (c)(2)(ii)(C) of this section.

(iii) Because the agreement between J and K expressly states that K will reimburse J for substantiated reimbursements for travel expenses that J pays to I, under paragraph (b)(7)(ii)(A) of this section, J and K have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(C) of this section. J accounts to K for K's reimbursement in the manner required by section 274(d) by delivering to K a copy of the substantiation J received from I. Therefore, under section 274(e)(3)(B) and paragraph (c)(2)(ii)(C)(2) of this section, K and not J is subject to the deduction limitations in paragraph (a) of this section.

(2) Example 2. (i) The facts are the same as in paragraph (c)(2)(ii)(E)(1) of this section (Example 1) except that, under the arrangements between I and J and between J and K, I provides the substantiation of the expenses directly to K, and K pays the per diem directly to I.

(ii) Under paragraph (b)(7)(i) of this section, I and K have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(C) of this section. Because I substantiates directly to K and the reimbursement payment was not treated as compensation and wages paid to I, under section 274(e)(3)(A) and paragraph (c)(2)(ii)(C)(1) of this section I is not subject to the limitations on deductions in paragraph (a) of this section. Under paragraph

(c)(2)(ii)(C)(2) of this section, K, the payor, is subject to the limitations on deductions in paragraph (a) of this section.

(3) Example 3. (i) The facts are the same as in paragraph (c)(2)(ii)(E)(1) of this section (Example 1), except that the written agreement between J and K expressly provides that the limitations of this section will apply to K.

(ii) Under paragraph (b)(7)(ii)(B) of this section, J and K have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(C) of this section. Because the agreement provides that the 274 deduction limitations apply to K, under section 274(e)(3)(B) and paragraph (c)(2)(ii)(C) of this section, K and not J is subject to the limitations on deductions in paragraph (a) of this section.

(4) Example 4. (i) The facts are the same as in paragraph (c)(2)(ii)(E)(1) of this section (Example 1), except that the agreement between J and K does not provide that K will reimburse J for travel expenses.

(ii) The arrangement between J and K is not a reimbursement or other expense allowance arrangement within the meaning of section 274(e)(3)(B) and paragraph (b)(7)(ii) of this section. Therefore, even though J accounts to K for the expenses, J is subject to the limitations on deductions in paragraph (a) of this section.

(iii) Recreational expenses for employees--(A) In general. Any food or beverage expense paid or incurred by a taxpayer for a recreational, social, or similar activity, primarily for the benefit of taxpayer's employees (other than employees who are highly compensated employees (within the meaning of paragraph (c)(2)(iii)(B) of this section)) is not subject to the deduction limitations in paragraph (a) of this section. This paragraph (c)(2)(iii)(A) applies to expenses paid or incurred for events such as holiday parties, annual picnics, or summer outings. This paragraph (c)(2)(iii)(A) does not apply to expenses for meals the value of which is excluded from employees' income under section 119 because the meals are provided for the convenience of the employer.

(B) Highly compensated employees. The exception in this paragraph (c)(2)(iii) applies only to expenses for food or beverages 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 is treated as owning any interest owned by a member of the employee's family, within the meaning of section 267(c)(4). Any expense for food or beverages that is made under circumstances which discriminate in favor of employees who are officers, shareholders or other owners, or highly compensated employees is not considered to be made primarily for the benefit of employees generally. An expense for food or beverages is not to be considered outside of the exception of this paragraph (c)(2)(iii) merely because, due to the large number of employees involved, the provision of food or beverages is intended to benefit only a limited number of employees at one time, provided the provision of food or beverages does not discriminate in favor of officers, shareholders, other owners, or highly compensated employees.

(C) Examples. The following examples illustrate the application of this paragraph (c)(2)(iii). In each example, the food or beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business and that are not lavish or extravagant under the circumstances.

(1) Example 1. Employer L invites all employees to a holiday party in a hotel ballroom that includes a buffet dinner and an open bar. Under section 274(e)(4), this paragraph (c)(2)(iii), and §1.274-11(c), the cost of the party, including food and beverage expenses, is not subject to the deduction limitations in paragraph (a) of this section because the holiday party is a recreational, social, or similar activity primarily for the benefit of non-highly compensated employees. Thus, L may deduct 100 percent of the cost of the party.

(2) Example 2. The facts are the same as in paragraph (c)(2)(iii)(C)(1) of this section (Example 1), except that Employer L invites only highly-compensated employees to the holiday party, and the invoice provided by the hotel lists the costs for food and beverages separately from the cost of the rental of the ballroom. The costs

reflect the venue's usual selling price for food or beverages. The exception in this paragraph (c)(2)(iii) does not apply because L invited only highly-compensated employees to the holiday party. However, under §1.274-11(b)(1)(ii), the food and beverage expenses are not treated as entertainment. L may deduct 50 percent of the food and beverage costs that are separately stated on the invoice under paragraph (a)(2) of this section.

(3) Example 3. Employer M provides free coffee, soda, bottled water, chips, donuts, and other snacks in a break room available to all employees. The expenses associated with the food and beverages are subject to the deduction limitations in paragraph (a) of this section because the break room is not a recreational, social, or similar activity primarily for the benefit of the employees. Thus, the exception in section 274(e)(4) and this paragraph (c)(2)(iii) does not apply and M may only deduct 50 percent of the expenses for food and beverages provided in the break room.

(4) Example 4. Employer N has a written policy that employees in a certain medical services-related position must be available for emergency calls due to the nature of the position that requires frequent emergency response. Because these emergencies can and do occur during meal periods, N furnishes food and beverages to employees in this position without charge in a cafeteria on N's premises. N excludes food and beverage expenses from the employees' income as meals provided for the convenience of the employer excludable under section 119. Because these food and beverages are furnished for the employer's convenience, and therefore are not primarily for the benefit of the employees, the exception in section 274(e)(4) and this paragraph (c)(2)(iii) does not apply, even if some socializing related to the food and beverages provided occurs. Thus, N may only deduct 50 percent of the expenses for food and beverages provided to employees in the cafeteria.

(5) Example 5. Employer O invites an employee and a client to dinner at a restaurant. Because it is the birthday of the employee, O orders a special dessert in celebration. Because the meal is a business meal, and therefore not primarily for the benefit of the employee, the exception in section 274(e)(4) and this paragraph (c)(2)(iii) does not apply, even though an employee social activity in the form of a birthday celebration occurred during the meal. Thus, O may only deduct 50 percent of the meal expenses.

(iv) Items available to the public--(A) In general. Any expense paid or incurred by a taxpayer for food or beverages to the extent the food or beverages are made available to the general public is not subject to the deduction limitations in paragraph (a) of this section. If a taxpayer provides food or beverages to employees, this paragraph (c)(2)(iv)(A) applies to the entire amount of expenses for those food or beverages if the

same types of food or beverages are provided to, and are primarily consumed by, the general public.

(B) Examples. The following examples illustrate the application of this paragraph (c)(2)(iv). In each example, the food and beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business and that are not lavish or extravagant under the circumstances.

(1) Example 1. Employer P is a real estate agent and provides refreshments at an open house for a home available for sale to the public. The refreshments are consumed by P's employees, potential buyers of the property, and other real estate agents. Under section 274(e)(7) and this paragraph (c)(2)(iv), the expenses associated with the refreshments are not subject to the deduction limitations in paragraph (a) of this section if over 50 percent of the food and beverages are primarily consumed by potential buyers and other real estate agents. If the food and beverages are not primarily consumed by the general public, only the costs attributable to the food and beverages provided to the general public are excepted under section 274(e)(7) and this paragraph (c)(2)(iv).

(2) Example 2. Employer Q is an automobile service center and provides refreshments in its waiting area. The refreshments are consumed by Q's employees and customers. Under section 274(e)(7) and this paragraph (c)(2)(iv), the expenses associated with the refreshments are not subject to the deduction limitations provided for in paragraph (a) of this section if over 50 percent of the food and beverages are primarily consumed by customers. If the food and beverages are not primarily consumed by the general public, only the costs attributable to the food and beverages provided to the general public are excepted under section 274(e)(7) and this paragraph (c)(2)(iv).

(3) Example 3. Employer R operates a summer camp open to the general public for children and provides breakfast and lunch, as part of the fee to attend camp, both to camp counselors, who are employees, and to camp attendees, who are customers. There are 20 camp counselors and 100 camp attendees. The same type of meal is available to each counselor and attendee, and attendees consume more than 50 percent of the food and beverages. Under section 274(e)(7) and this paragraph (c)(2)(iv), the expenses associated with the food and beverages are not subject to the deduction limitations in paragraph (a) of this section, because over 50 percent of the food and beverages are primarily consumed by camp attendees. Thus, R may deduct 100 percent of the food and beverage expenses.

(4) Example 4. Employer S provides food and beverages to its employees without charge at a company cafeteria on its premises. Occasionally, customers or other visitors also eat without charge in the cafeteria. The occasional consumption of food and beverages at the company cafeteria by customers and visitors is less than 50 percent of the total amount of food and beverages consumed at the cafeteria. Therefore, only the costs attributable to the food and beverages provided to the general public are excepted under section 274(e)(7) and this paragraph (c)(2)(iv).

(v) Goods or services sold to customers--(A) In general. An expense paid or incurred for food or beverages, to the extent the food or beverages are 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 deduction limitations in paragraph (a) of this section. However, money or money's worth does not include payment through services provided. Under this paragraph (c)(2)(v), a restaurant or catering business may deduct 100 percent of its costs for food or beverage items, purchased in connection with preparing and providing meals to its paying customers, which are also consumed at the worksite by employees who work in the employer's restaurant or catering business. In addition, for purposes of this paragraph (c)(2)(v), the term customer includes anyone, including an employee of the taxpayer, who is sold food or beverages in a bona fide transaction for an adequate and full consideration in money or money's worth.

(B) Example. The following example illustrates the application of this paragraph (c)(2)(v). Employer T operates a restaurant. T provides food and beverages to its food service employees before, during, and after their shifts for no consideration. Under section 274(e)(8) and this paragraph (c)(2)(v), the expenses associated with the food and beverages provided to the employees are not subject to the 50 percent deduction limitation in paragraph (a) of this section because the restaurant sells food and beverages to customers in a bona fide transaction for an adequate and full

consideration in money or money's worth. Thus, T may deduct 100 percent of the food and beverage expenses.

(d) Applicability date. This section applies for taxable years that begin on or after **[DATE OF PUBLICATION OF FINAL REGULATIONS IN THE FEDERAL REGISTER].**

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

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