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Re: Section 274(o) Related to Employer-Provided Eating Facilities

Dear Mr. Vallabhaneni, Ms. Morrison, Mr. Vance and Ms. Levy:

The American Institute of CPAs (AICPA) is pleased to submit recommendations to the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) to address the need for guidance related to Internal Revenue Code (IRC) section 274(o)[1] as added by Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA).

Specifically, the AICPA recommends that Treasury and the IRS provide guidance clarifying the following areas:

I. Scope of Expenses Subject to Section 274(o)

II. Treatment of Amounts Reported as Compensation

Background

Meals furnished by an employer to its employees on its business premises are potentially excluded from the employees' gross income pursuant to sections 119(a) or 132(e)(2) if they are provided for the convenience of the employer or at an employer-operated eating facility.

Convenience of the Employer

Per section 119(a), the value of a meal provided on an employer's business premises for the convenience of the employer is excluded from an employee's gross income. If the convenience of the employer standard is met with respect to more than half of the employees on the

[1] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.

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premises, meals furnished to the remaining employees are also treated as provided for the convenience of the employer and excluded from their gross income.[2]

The determination of whether a meal is provided for the convenience of the employer is based on facts and circumstances.[3] The regulations provide that a meal is provided for the convenience of the employer if it is furnished for a substantial noncompensatory business reason.[4] The regulations also provide a list of examples to assist taxpayers in determining which types of expenses are considered for the convenience of the employer (e.g., employees subject to short meal periods, and employees at locations with insufficient nearby eating facilities).[5] In 2018 and 2019, the IRS released Generic Legal Advice Memorandum 2018-004 (GLAM) and Technical Advice Memorandum 201903107 (TAM), respectively, detailing the history of the convenience of the employer standard and analyzed whether certain proffered substantial noncompensatory business reasons are sufficient. Although not published guidance upon which taxpayers may rely, the GLAM and TAM provide insight on IRS views of how the standard applies.

Employer-Operated Eating Facilities

If revenue derived from an employer-operated eating facility normally equals or exceeds the direct operating costs of the facility, section 132(e)(2) excludes the value of meals provided to employees at such a facility as a *de minimis* fringe.[6] If a meal is provided to employees for the convenience of the employer at an employer-operated eating facility such that it meets the standard for exclusion under section 119(a), the revenue received from the employees is deemed equal to the cost even if the employee did not pay for the meal.[7] Direct operating costs generally include the cost of food, beverages, and on-site labor.[8]

To be an employer-operated eating facility under the regulations, the following four requirements must be met:

1. The facility must be owned or leased by the employer;

2. The facility must be operated by the employer (including contracting for its operation);

3. The facility must be located on or near the business premises of the employer; and

4. The meals furnished at the facility must be provided during, or immediately before or after, the employees' workdays. [9]

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[2] Section 119(b)(4).
[3] Treas. Reg. § 1.119-1(a)(1).
[4] Treas. Reg. § 1.119-1(a)(2)(ii)(b).
[5] Treas. Reg. § 1.119-1(a)(2)(ii)(b), Treas. Reg. § 1.119-1(a)(2)(ii)(c).
[6] Section § 132(e)(2).
[7] Section § 132(e)(2); Treas. Reg. § 1.132-7(a)(2).
[8] Treas. Reg. § 1.132-7(b)(1).
[9] Treas. Reg. § 1.132-7(a)(2).

Section 274

Section 274 disallows deductions for certain otherwise-deductible business expenses, generally for expenses of meals and entertainment. Specifically, section 274(a) fully disallows deductions for entertainment-related items. In addition, section 274(n) disallows 50 percent of food or beverage expenses. Section 274(e) provides specific exceptions to the disallowance under section 274(a). Section 274(n)(2) incorporates a subset of these exceptions ((e)(2), (3), (4), (7), (8), and (9)) with respect to section 274(n). Notably, section 274(e)(2) excepts amounts treated as compensation paid to employees, and section 274(e)(9) excepts amounts includible in income as compensation paid to independent contractors. Prior to the enactment of the TCJA, the 50 percent disallowance of expenses was subject to an exception for *de minimis* fringe benefits, including those related to an employer-operated eating facility.

The TCJA made changes to section 274, including repealing the *de minimis* exception to section 274(n), and adding a new section 274(o). Section 274(o), effective for amounts paid or incurred after December 31, 2025, will disallow deductions for "(1) any expense for the operation of a facility described in section 132(e)(2), and any expense for food or beverages, including under section 132(e)(1), associated with such facility, or (2) any expenses for meals described in section 119(a)." Thus, as of January 1, 2026 (without regard to the taxable year of the taxpayer), the following expenses will be nondeductible:

- Category 1: Expenses for the operation of an employer-operated eating facility;
- Category 2: Expenses for food or beverages "associated with" an employer-operated eating facility, including other *de minimis* fringe food or beverages; and
- Category 3: Expenses for meals provided for the convenience of the employer.

I. Scope of Expenses Subject to Section 274(o)

Overview

Unlike the current section 274(n) limitation with respect to "food or beverages," the section 274(o) Category 1 expense disallowance contemplates a broader scope as indicated in the following language: "*any* expense *for the operation of a facility* described in section 132(e)(2)." However, the statute does not specify which types of expenses are considered "for the operation of" an employer-operated eating facility.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance specifying the types of expenses disallowed as deductions under section 274(o) related to the operation of an employer-operated eating facility by cross-referencing the definition of "direct operating costs" of an eating facility in Treas. Reg. § 1.132-7(b).

Alternatively, we suggest that the regulations clarify that expenses not incurred for the operation of the facility as an eating facility are deductible and provide that any reasonable method of allocation may be used for purposes of determining disallowed expenses (e.g., time spent using the area as an eating facility versus time spent using it for other purposes.

Analysis

The section 274 regulations related to other disallowances provide a general description of the types of expenses that are disallowed and examples as further clarification.[10] Particularly with respect to the Category 1 expenses related to the operation of an employer-operated eating facility, it is not clear which expenses are in scope.

One potential reference point being the regulations under section 132(e)(2), at Treas. Reg. § 1.132-7(b), which define "direct operating costs" for purposes of the employer-operated eating facility income exclusion requirement that revenue equals or exceeds such costs. Under those rules, direct operating costs generally include the cost of food and beverages and on-site labor. The regulations also provide a helpful level of detail that taxpayers have been using since 1989 to evaluate the extent to which food provided at an employer-operated eating facility is taxable. Leveraging these rules would be efficient and administrable for both taxpayers and the IRS.

Use of the employer-operated eating facility rules under section 132 also avoids the need to develop allocation rules that would be necessary if a broader definition were used. Many employers make significant use of the facility during non-dining times for purposes other than as an eating facility (e.g., for employee meetings or training or for client or other business events). The expenses for the use of the facility for those purposes would not seem to be expenses "for the operation of" an eating facility. However, since many of the expenses will be incurred for overall maintenance of the facility, the employer would need to allocate those expenses between the covered function of operating an eating facility and the noncovered function as a general meeting space or other uses if the cost definition were not tailored to the functions covered by section 274(o).

Absent adoption of the recommended "direct operating costs" definition, the regulations should clarify that any reasonable method of allocation may be used, such as time spent as an eating facility (including time actively spent in preparing and serving meals, as well as any post-dining cleaning and disassembling period), and time spent for purposes other than as an eating facility (including only time actively spent in preparing for, operating as and disassembling after, a period of use as other than a non-eating facility).

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance clarifying that depreciation is not an "expense" potentially subject to disallowance under section 274(o).

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[10] *See, e.g.,* Treas. Reg. § 1.274-10(d) (listing fixed and variable expenses of operating an airplane); Treas. Reg. § 1.274-13(b)(11) (listing expenses related to parking facilities).

Analysis

The regulations under section 274 have reached different conclusions as to the deductibility of depreciation, which is a deduction that is applicable for employers that own the building housing the eating facility, depending on the terminology used in the disallowance. For example, section 274(a)(1) disallows deductions for any "item" in its scope whereas section 274(a)(4) uses the term "expense." For purposes of section 274(a)(1) as applied to personal entertainment flights, the regulations expressly include depreciation as an "item" potentially subject to disallowance.[11] In contrast, the section 274(a)(4) disallowance of the "expense" of a qualified transportation fringe was determined not to include depreciation.[12] Taken together, the section 274 regulations imply that depreciation is an "item" but, not an "expense." Applying this construct to section 274(o), depreciation is not included since the disallowance applies to "any expense" and does not refer to "items." This interpretation is consistent with prior rulemaking and is more administrable for both taxpayers and the IRS.

II. Treatment of Amounts Reported as Compensation

Overview

Section 274(e) includes an express list of exceptions, all of which apply with respect to section 274(a), and some of which also apply to section 274(n). The exceptions under section 274(e)(2) and section (e)(9) for amounts treated as compensation apply in both cases. However, these exceptions do not clearly extend to other disallowances under section 274, including the disallowance under section 274(o).

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance stating that otherwise deductible amounts treated and reported as compensation to an employee or independent contractor are not disallowed by section 274(o) to the extent that such amounts would fall within the section 274(e)(2) or (e)(9) compensation exceptions, respectively.

In addition, the AICPA recommends that Treasury and the IRS issue guidance clarifying that only deductions with respect to amounts excluded from wages pursuant to section 119 and/or section 132(e)(2) are disallowed under section 274(o).

Analysis

At a statutory level, section 274(e) provides a list of exceptions, all of which apply to the disallowances imposed by section 274(a), and some of which also apply under section 274(n), including two exceptions for amounts taxed as compensation. These exceptions do not directly apply to section 274(o). Thus, even in the case where the value of food served to an employee has been reported to the employee as wages, (e.g., the employer does not believe it is

[11] Treas. Reg. § 1.274-10(d)(1).
[12] Notice 2018-99, 2018-52 I.R.B. 1067.

excludable under section 132(e)(2) or section 119), the cost could be subject to disallowance, doubling the negative financial impact to the employer.

There is precedent for allowing amounts treated as compensation to be deductible even in instances in which the section 274(e) exceptions do not explicitly apply. The Omnibus Reconciliation Act of 1993[13] amended section 274 to insert paragraph (3) under subsection (m), which generally disallows the deduction of travel expenses of spouses, dependents, or other individuals accompanying the taxpayer on business travel. The statutory language of section 274(m)(3) does not include an exception for amounts taxed as compensation nor does not reference the exceptions under section 274(e). Nevertheless, the regulations interpreting section 274(m)(3) allow for spousal and dependent travel expenses to be deductible if properly treated as compensation as follows:

> "Any expenditure by a taxpayer for entertainment (or for the use of a facility in connection therewith) *or for travel described in section 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 paragraph (a) through (e) of this section to the extent that the expenditure is treated by the taxpayer—
>
> (1) On the taxpayer's income tax returns as originally filed, as compensation paid to the employee; and
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> (2) As wages to the employee for purposes of withholding under chapter 24 (relating to collection of income tax at source on wages)."[14]

In proposing the regulations, Treasury and the IRS explained that allowing the compensation exception to be available achieved consistency:

> "The Department of the Treasury and the IRS believe that items described in section 274(a)(3) and (m)(3) of the Code should be treated similarly. Therefore, the proposed regulations modify § 1.274-2(f)(2)(iii) of the regulations to achieve this consistent treatment."[15]

This same reasoning supports applying a compensation exception under section 274(o). Additionally, it is in the interest of sound and fair tax policy to allow employers that furnish meals to their employees to not be placed at a greater tax disadvantage than those employers paying club dues for or furnishing personal entertainment to their executives. We believe that this outcome, which is analogous to that provided for under section 274(m)(3), is within the

[13] P. L. 103-66.
[14] Treas. Reg. § 1.274-2(f)(2)(iii).
[15] *Payment of Employer of Expenses for Club Dues, Meals and Entertainment, and Spousal Travel*, 59 Fed. Reg. 64909, 64910 (Dec. 16, 1994).

regulatory authority of Treasury and the IRS to address.[16]

Because section 274(o) is tied to definitions of specific statutory income exclusions, one could look to whether the taxpayer applied the relevant income exclusions referenced in section 274(o). If the value of a meal could have been treated as a meal for the convenience of the employer, but it was instead reported as wages to the employee who received the meal, the deduction should be permitted as a deduction of wages, rather than as a deduction for a meal expense. In developing the rules for the disallowance of deductions for club dues under section 274(a)(3), Treasury and the IRS acknowledged that an employer may elect to report amounts as compensation rather than applying the disallowance:

> "An employer may choose to exercise the option of avoiding any section 274 disallowance at the employer level by characterizing employer-provided club membership dues or payment of travel expenses with respect to a spouse, dependent, or other individual accompanying an employee on business travel as compensation. If the employer makes this election, the amount of such expenditure is fully includible in gross income by the employee as compensation."[17]

Similarly, if a meal is provided at an employer-operated eating facility or for the convenience of the employer and the employer imputes income to employees for the value of the meal, that amount should be deductible as wages. Although necessary for income exclusion, the requirement that employer-operated eating facility revenue equals or exceeds its costs is not part of the regulatory definition of an employer-operated eating facility. Therefore, there is no basis for income exclusion for an employer-operated eating facility operating at a loss (disregarding whether meals were provided for the convenience of the employer).

A sensible approach to the conclusion that the section 274(o) disallowance does not apply is to interpret section 274(o) to implicitly exclude amounts reported as wages, which is the same result that Treasury and the IRS reached in the section 274(m)(3) regulations.

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[16] Treas. Reg. § 1.274-12(a)(4)(iii)(D), Example 1, requires parsing to reconcile under the regulations. Per the example, Taxpayer F, a sole proprietor, travels on a business trip with the spouse (spouse has no business purpose). It is unclear how an expense with no business purpose reaches section 274, which merely disallows "otherwise allowable" deductions. The expenses of Taxpayer F's spouse are not ordinary and necessary business expenses, as would be the case even if section 274(m)(3) did not exist. If a spouse accompanies an employee on a business trip for personal reasons and the employer reimbursed the related costs, the reimbursement would be considered compensation reportable to the employee on Form W-2, deductible to the employer under section 162, and not disallowed under section 274(m)(3) under the compensation exception at Treas. Reg. § 1.274-2(f)(2)(iii). Because Taxpayer F is a sole proprietor with a personal guest, there was no reporting obligation, no compensation, no business expense, and no expenses for section 274 to disallow. Nevertheless, the example considers whether section 274(m)(3) applies, leaving readers are left to ponder whether compensation was reported. The example concludes that the expense is barred by section 274(m)(3) without mentioning income recognition. Had the amount been reported as compensation as set forth in Treas. Reg. § 1.274-2(f)(2)(iii), we believe the conclusion would have been different under the regulations.

[17] *Id.*

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance stating that any exception for amounts reported as compensation should extend to imputed discounts and meals paid for by an employee with regard to section 274(o).

Analysis

The effect of the compensation exception of section 274(e)(2) extends to partial inclusions in income, and amounts paid/reimbursed by an employee, to an employer, on a dollar-for-dollar basis.[18] If the interpretation of treating certain otherwise deductible amounts reported as compensation to an employee or independent contractor as excluded from disallowance by section 274(o), recommended above is adopted by Treasury and the IRS, the same reasoning should extend to discounts treated as imputed income as well as meals that are fully paid for by the employee.

Example 1

An employer operates an eating facility at which all employees pay full fair market value for the meals. The amount treated as wages is equal to zero, as the employees have fully paid for the benefit. The costs of the employer-operated eating facility should be fully deductible by the employer.

Example 2

An employer operates an eating facility at which meals are sold to employees at below fair market value. The discount is imputed as income to the employees. The costs of the employer-operated eating facility should be fully deductible by the employer.

Example 3

At the same employer-operated eating facility as in Example 2, some of the employees are eligible to receive meals for the convenience of the employer (e.g., on-call emergency department staff in a hospital). These employees pay the same discounted price for meals. However, they are not imputed income for the discount because section 119 excludes this amount from income. The cost allocable to the portion of the meal paid for by the employee should be fully deductible. However, the cost allocable to the portion of the meal excluded from income should not be deductible.

[18] *See, e.g.,* Treas. Reg. § 1.274-12(c)(2)(i)(D).

The results illustrated in the examples align with the treatment of other fringe benefits, allowing for the same consistency as that achieved by the regulations under section 274(m)(3). The same consistent approach is appropriate with regard to section 274(o).

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We appreciate your consideration of these comments and welcome the opportunity to discuss them further. If you have any questions, please contact Anne Bushman, Chair, AICPA Employee Benefits Taxation Technical Resource Panel, at (202) 370-8213, or anne.bushman@rsmus.com; Kristin Esposito, AICPA Director – Tax Policy & Advocacy, at (202) 434-9241, or kristin.esposito@aicpa-cima.com; or me, at (830) 372-9692, or bvickers@alamo-group.com.

Sincerely,

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