Cohen & Co

Getting Employee and M&E Expense Rules Right

PRESENTED BY:

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Welcome & Introductions

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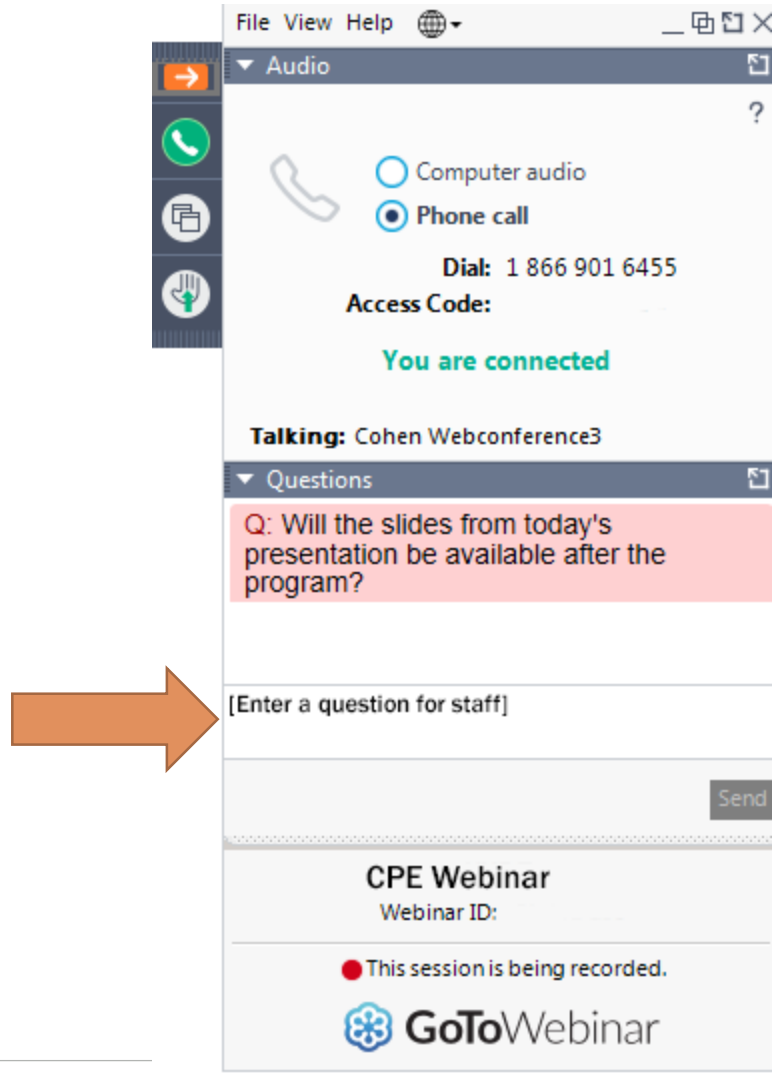
CPE Credit Guidelines

- To receive CPE you must:
  - Be logged in for at least 50 minutes
  - Answer at least 3 of the 4 polling questions

Questions During the Webinar

- If you have questions during the webinar:
  - Use the “Questions” feature to “Enter a question for staff” then click send
  - We will address during the program if there is time or will follow up after the program



Agenda

- Digging Deeper: Before and After Tax Reform
  - Entertainment
  - Employer-provided meals
  - De minimis food or beverages
  - Transportation fringe benefits
  - Moving expenses
  - Unreimbursed employee expenses
- Action Items

Background

- The Tax Cuts and Jobs Act (TCJA)
  - Many well-publicized provisions, most notably the lower corporate tax rate
  - Took a lot of negotiation to keep the total cost within the amount allowed to be passed by a simple majority
  - Removal of deductions was surprising, but commentary has been that Washington felt it was a fair trade-off for the lower tax rate

Digging Deeper: Entertainment – Before TCJA

- No deduction
  - Section 274 disallowed deductions for "entertainment, amusement or recreation" unless such expenses were ordinary, necessary and directly related to the active conduct of a taxpayer's trade or business
- 50% deduction
  - If an expense met the requirements of Section 274; if it was not was deemed to be lavish or extravagant, and if the taxpayer (or taxpayer's employee) was present, then the taxpayer could take a 50% deduction for the expense
- 100% deduction
  - Section 274(e) enumerated various exceptions
  - A 100% deduction was allowed for "recreational, social or similar activities (including facilities) primarily for the benefit of employees (other than employees who are highly compensated employees)"

Digging Deeper: Entertainment – After TCJA

- No deduction for entertainment:
  - TCJA reduces the 50% deduction for entertainment to 0% - even if these expenses directly relate to the conduct of business
  - All forms of business entertainment (including golf outings, sporting events, hunting, theater tickets, golf club dues, concerts, etc.) are entirely nondeductible, even if a substantial bona fide business discussion is associated with the activity
- 50% deduction for business food or beverages:
  - Non-entertainment food or beverages with a substantial business purpose will still be 50% deductible (unless failing the Section 274 requirements regarding being lavish, extravagant or if the taxpayer is not present)
- 100% deduction
  - Continues to be available for activities primarily for the benefit of the employees

Polling Question #1

Digging Deeper: De Minimis Food or Beverages – Before TCJA

- 100% deduction
  - Section 274(n)(2)(B) allowed a 100% deduction for food or beverages, if such expense qualified as a de minimis fringe benefit under Section 132(e) and was excludable from the gross income of the recipient
  - Section 132(e)(1) defines a de minimis fringe benefit 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 employer's employees) so small as to make accounting for it unreasonable or administratively impracticable."

Digging Deeper: De Minimis Food or Beverages – After TCJA

- 50% deduction
  - TCJA removes Section 274(n)(2)(B) from the Internal Revenue Code, so de minimis food or beverages are now governed by Section 274(n)
  - Section 274(n) says “any expense for food or beverages shall not exceed 50 percent…” of the otherwise deductible cost

Digging Deeper: Entertainment – Why the Confusion?

- What is entertainment…and does it include all meals?
- The yea's say…
  - Prior case law
  - Legislative history for Section 274
- The nay's say…
  - The Regulations aren't so clear
    - Reg. section 1.274-2(b)(1) says that entertainment includes things like "entertaining at night clubs, cocktail lounges, 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."
    - It also says that entertainment "may" include providing food and beverages

Digging Deeper: Entertainment – Why the Confusion?

- No substantiation…or no deduction??
- Pre-TCJA 274(d)(2) required substantiation of “entertainment, amusement, or recreation” expenses in order to deduct
- TCJA amended the language of 274(d) to remove substantiation requirements related to entertainment expenses

Digging Deeper: Entertainment – Our Understanding

- Our current understanding of the M&E changes under TCJA
  - Expenses incurred to entertain clients are no longer deductible, including meals associated with entertainment
  - Meals provided to employees for the convenience of the employer, on the employer's premises, are now only 50% deductible
- Other provisions have remained the same
  - Business meals not associated with entertainment remain 50% deductible
  - Payment for employee meals while out of town for a business purpose are still 50% deductible
  - Employee parties remain 100% deductible

Digging Deeper: Entertainment Expense Examples

Q: Taxpayer takes a customer for a round of golf followed by dinner

A. The cost of the golfing is a nondeductible entertainment expense. The dinner is also not deductible unless the taxpayer can prove that the meal was a separate expense that was not an entertainment expense. Since there is no guidance on bifurcating meal and entertainment costs, the conservative position is to disallow the entire amount associated with an entertainment event, including meals.

Q: Employees go out to lunch to discuss the implementation of a new work project

A. 50% deductible

Digging Deeper: Entertainment Expense Examples

Q: Taxpayer provides lunch to all employees to avoid disruptions in work flow close to a deadline

A. These are meals provided for the employer's convenience. They are not considered entertainment and the taxpayer may deduct 50%. However, this is the case only from January 1, 2018 to December 31, 2025; afterward, these costs are not deductible.

Q: Taxpayer stocks a break room with coffee and snacks

A. 50% deductible

Polling Question #2

Digging Deeper: Entertainment Expense Examples

Q: Taxpayer pays for drinks and snacks for a department event or a department happy hour (e.g., the finance department, the sales team, the admin employees). A similar event is available for the other departments at another time.

A. 100% deductible as employee recreational expenses since offered on a non-discriminatory basis

Q: Taxpayer pays for meals at annual events open to all employees (e.g., holiday parties, company picnics, etc.)

A. 100% deductible as employee recreational expenses since offered on a non-discriminatory basis

Digging Deeper: Entertainment Expense Examples

Q: An employee purchases meals while traveling for business

A. 50% deductible (if the meals are not considered an entertainment expense)

Q: Taxpayer has lunch with a client while discussing business

A. 50% deductible (if the meals are not considered an entertainment expense)

Digging Deeper: Entertainment Expense Examples

Q: Taxpayer gives baseball tickets to a client

A. Deductible as a gift, but subject to gift limit of $25 per person

Q: Taxpayer gives baseball tickets to an employee

A. Deductible as compensation if included in employee's wages. However, not deducting the expense may cost less overall.

Example: Tickets cost the employer $100. If not deducted, the cost is $100. If included in wages, the cost would be $116 (presuming the highest individual rates):

Cost of tickets	$100
C Corp tax rate	- 21
Employee tax rate	+ 37
Total cost	$116

Digging Deeper: Transportation Fringes – Before TCJA

- Four types of qualified transportation in Section 132(f)
  - Commuter expenses in connection with travel between the employee's residence and place of employment (e.g., a vanpool)
  - Transit passes
  - Qualified parking
  - Any qualified bicycle commuting reimbursement
- Subject to a monthly limit, employees could exclude these fringes from income
- Employers were entitled to a 100% deduction for these amounts

Digging Deeper: Transportation Fringes – After TCJA

- Fringes remain excludable from income
  - Exception: bicycle commuting reimbursements are taxable through 12/31/2025
- No deduction
  - TCJA adds Section 274(a)(4), which states that no deduction will be allowed for any qualified transportation fringe provided to an employee of the taxpayer
  - TCJA adds Section 274(l), which generally disallows deductions related to expenses paid toward an employee's commute, except as necessary for the safety of the employee
  - Additional guidance needed

Digging Deeper: Transportation Fringes – After TCJA

- Parking is employer-provided if:
  - It is on property that the employer either owns or leases,
  - The employer pays someone else (such as their landlord or a parking lot/garage owner) for the parking, or
  - The employer reimburses the employee for parking expenses.
- IRS guidance needed to determine specifics of how to apply this provision
  - For example, what to do when parking is available for free?

Polling Question #3

Digging Deeper: Moving expenses – Before TCJA

- 100% deduction
  - Employers allowed to deduct costs of employee moving expenses such as:
    - Traveling from former residence to new residence
    - Reasonable expenses for moving household goods from former residence to new residence
  - Employees allowed to exclude the amounts from wages

Digging Deeper: Moving expenses – After TCJA

- 100% deduction (1/1/18 to 12/31/25)
  - Employee income exclusion is suspended
    - Employer must now include reimbursements in taxable wages
  - Employer entitled to 100% compensation deduction
  - Employers might consider grossing-up employee wages for moving costs
    - Be careful of related side-issues such as 401(k) withholding and matching

Digging Deeper: Unreimbursed Employee Expenses

- Before TCJA:
  - Individuals could deduct unreimbursed employee expenses as itemized deductions on form 1040 if the expenses exceeded 2% of adjusted gross income
  - Examples:
    - Mileage
    - Tools and supplies
    - Required clothing not appropriate for normal use (such as scrubs)
    - Union dues
    - Car allowances
- After TCJA:
  - No deduction allowed to individuals for their unreimbursed employee expenses

Digging Deeper: Unreimbursed Employee Expenses

- Accountable plans
  - Formal plan whereby an employer reimburses employees for business-related expenses
  - Generally three requirements:
    - Expenses are otherwise deductible business expenses
    - Adequate substantiation is provided
    - Excess advances are returned in a reasonable timeframe
- Nonaccountable plans
  - Plans that don't meet the requirements noted above (e.g., substantiation is not required)

Digging Deeper: Unreimbursed Employee Expenses

- Benefit of accountable plans
  - Employer can deduct the reimbursement as a business expense
  - Reimbursement is not included in employee's taxable income (i.e., avoids both income and payroll tax)
- Disadvantage of nonaccountable plans
  - Employer may still be able to deduct the expense
  - However, reimbursements must be included in employee's wages, subject to payroll taxes

Digging Deeper: Unreimbursed Employee Expenses

- **Example**: Employee has $1,000 car allowance. If provided through a nonaccountable plan:

Employee payroll tax (7.65% up to FICA base)	$76.50
Employee income taxes (assume 44% for fed, state, local)	440.00
Employer payroll tax (7.65% up to FICA base)	$76.50
Employer 401(k) contribution?	varies
Total additional costs	$593.00

Before & After the Tax Cuts and Jobs Act (TCJA)

Type of Expense	Before TCJA	After TCJA
Entertainment (including meals)	50% Deductible	Nondeductible
Business meals	50% Deductible	50% Deductible
Meals provided for convenience of employer	100% Deductible	50% Deductible
Employee parties	100% Deductible	100% Deductible
Included in compensation of employee	100% Deductible	100% Deductible
Included in the gross income of a non-employee recipient	100% Deductible	100% Deductible
Reimbursed expenses	100% Deductible	100% Deductible
Items or services sold to customers for adequate consideration	100% Deductible	100% Deductible
De minimis food or beverages	100% Deductible	50% Deductible

Polling Question #4

Action Items

- Review general ledger accounts to confirm they are appropriate
  - Need to be able to separately identify expenses that are 100%, 50% and 0% deductible, such as:
    - Entertainment expenses
    - Meals provided for the convenience of the employer
    - Business and travel meals
    - Holiday parties / employee social events
- Verify that your current employee expense reporting system is adequate to capture the above information

Action Items

- Update policy manuals as necessary
- Address any changes needed to payroll systems
  - Not all states conform to the Internal Revenue Code as of January 1, 2018. Consequently, certain income items could be subject to FIT, FITW, FICA and FUTA, but exempt from state and local income tax (e.g., moving expenses).
- Consider issues associated with fiscal year-ends

Questions for our Presenters?

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Upcoming Webinars

Taking Advantage of Opportunity Zones

Tues., July 24 @ 10 a.m.

FEATURING **ANGEL RICE**, CPA, MACC, MT

LEARNING OBJECTIVES

> Discover the types of investments that qualify under the new rules

> Identify tax benefits resulting from qualified investments

Inbound and Outbound International Tax Rules

Tues., July 31 @ 10 a.m.

FEATURING **CYNTHIA PEDERSEN**, JD, LLM
RAY POLANTZ, CPA, MT

LEARNING OBJECTIVES

> Discover the new provisions to capture foreign income

> Recognize how the rules impact different entity types

Thank you.

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July 17, 2018