

Now you see it, now you don't: Entertainment expenses under the TCJA

Lately, when we've been to concerts and ball games, we've looked enviously at the luxury boxes. Those boxes didn't materialize out of this air. Arenas and stadiums built them because corporations could pony up lots of money to lease them.

The Tax Cuts and Jobs Act, however, changed the calculus by disallowing corporate deductions for expenses employees incur to entertain clients, customers, etc. That's why we were intrigued by an idea purporting to allow you to skirt the Tax Cuts and Jobs Act's 100% corporate deduction disallowance for your company's entertainment expenses.

So, let's explore.

Let me entertain you

Prior to the TCJA, 50% of the expenses employees incurred to entertain clients were deductible on your corporate return. The tests for deductibility were whether the entertainment was directly related to your business or associated with your business.

You'd fail the directly related test if the entertainment was so distracting it impeded the business discussion. The associated test was looser—employees had to show that the entertainment was associated with your trade or business and that it directly preceded or followed a substantial business discussion.

Perfect luxury box criteria.

The idea now is to take what would be an entertainment expense—leasing a luxury box at, say, a Bruce Springsteen concert—and magically converting this now-disallowed expense into a regular, 100% deductible business expense.

How? Good question. For this to work, an employee, a salesperson, for example, would conduct a seminar or business meeting with a group of clients or potential clients at the arena before the concert. But who wouldn't want to stay to see the show?

Expenses related to such a seminar or business meeting held in, say, a meeting room at your local Ramada Inn, would be 100% deductible on your corporate return, so why wouldn't the same expenses qualify as regular business expenses at a Springsteen show?

After careful consideration, we don't think you could pull this over on the IRS. The issue is whether you're trying to reinstall the directly related to test or the associated-with test, both of which the TCJA nixed, specifically because they were too vague.

Worse: The IRS signaled last year that it's on the lookout for schemes that inflate employees' meal expenses, to make up for the now-disallowed entertainment expenses. We think this falls into that category.

Let me make you smile

But corporate deductibility is only half the story. The TCJA didn't touch employees' reimbursements under the accountable plan rules. So, employees who incur meal and entertainment expenses can be reimbursed 100% tax-free if the following criteria are met:

- Employees incur expenses in connection with employment at the company (i.e., the expenses have a business connection)
- Employees adequately substantiate their expenses (e.g., they submit receipts to you) within a reasonable period of time
- Employees return any excess allowance or reimbursement to you within a reasonable period of time.

The IRS could plausibly argue the expenses the employee incurs in this situation lack a business connection. So reimbursing the employee would be fully taxable, even if the expenses were adequately accounted for.

Bottom line: Be wary if a tax planner dazzles you with ways to beat the 100% corporate deduction disallowance for entertainment expenses.