April 13, 2020

Via Regulations.gov

CC:PA:LPD:PR (REG-100814-19)
Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: IRS REG-100814-19
Comments on Prop. Treas. Reg. § 1.274-11, -12 on Entertainment and Meals

The National Business Aviation Association (NBAA) represents more than 11,000 member companies that depend on general aviation aircraft to make their businesses more productive and successful. We appreciate the opportunity to submit these comments on behalf of the business aviation community with respect to Prop. Treas. Reg. § 1.274-11, -12, which were issued in the federal register with a Preamble on February 26, 2020. "Meals and Entertainment Expenses under Section 274," 85 Fed. Reg. 11,020 (Feb. 26, 2020).

We have been advised that the public hearing on these proposed regulations is scheduled for April 29, 2020. Due to the effect of the COVID-19 pandemic on interested parties' ability to travel and to prepare comments on these proposed regulations, we request that this public hearing be rescheduled to a future date on which it is safe to conduct the public hearing and to allow interested parties sufficient time to prepare comments under the circumstances. We anticipate supplementing our comments below shortly.

1. Meals Are Not Entertainment

The Preamble and the draft regulations state multiple times that meals are not entertainment activities. 85 Fed. Reg. 11,021 (bottom of left column) ("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 . . ."), 11,022 (top of right column) ("the term 'entertainment' does not include food and beverages"), 11,024 (middle of right column) ("the mere provision or availability of food or beverages is not a recreational, social, or similar activity"); Prop. Treas. Reg. § 1.274-11(b)(1)(ii) ("the term *entertainment* does not include food or beverages"). This conclusion in the Proposed Regulations that eating a meal is not an entertainment activity is consistent with the analysis in IRS Notice 2018-76 regarding meals.

The conclusion that eating a meal is not an activity generally considered to constitute entertainment, amusement, or recreation is consistent with the explanation of the concept of entertainment in Treas. Reg. § 1.274-2(b)(1). That regulation defines entertainment as an activity "generally considered to constitute entertainment, amusement, or recreation." The

regulation lists examples of entertainment that focus on vacations, parties, sports, and spectator events. The examples do not include eating meals or going to restaurants.

The regulation contrasts entertainment activities with "routine personal" activities. Merely eating a meal would appear to be a routine personal activity. As the proposed regulations explain, when food or beverages are consumed in connection with an entertainment activity, their cost should be separated as a nonentertainment cost from the rest of the cost of the entertainment activity. Prop. Treas. Reg. § 1.274-11(b)(1)(ii). Likewise, in the case of a nonbusiness activity, the character of the activity (entertainment or nonentertainment) should be determined based on the activity itself, and the presence of food and beverages should not cause an otherwise nonentertainment nonbusiness activity to be classified as an entertainment activity. The proposed regulations provide that a meal does not cause a meeting with a business associate to be classified as an entertainment event, and the same principle should apply to a nonbusiness setting.

Accordingly, we request that the proposed regulations clarify that the concept that consuming food and beverages is not an entertainment activity applies in the case of both business and nonbusiness activities. It would be helpful for the regulations to provide as an example that when a specified individual travels on an employer-provided aircraft to visit family members for nonbusiness purposes, the fact that they have a meal does not cause the visit to be an entertainment activity.

2. Adequate and Full Consideration Exception

I.R.C. § 274(e)(8) provides an exception to the entertainment disallowance for goods or services sold by the taxpayer in a bona fide transaction for adequate and full consideration. While this statute does not limit who the goods and services can be sold to, the corresponding regulation adds the words "to customers" in its statement of this exception. Treas. Reg. § 1.274-2(f)(2)(ix).

The Preamble and proposed regulations explain that the regulatory requirement that the sale be "to customers" is met by a sale to anyone including employees. 85 Fed Reg 11,025 (top of middle column) ("The term 'customer' includes anyone . . . . For example, employees of the taxpayer are customers"); Prop. Treas. Reg. § 1.274-12(c)(2)(v) ("*customer* includes anyone, including an employee of the taxpayer"). This conclusion that the regulatory reference to "customer" includes anyone including employees is consistent with the statute which does not include any requirement that the sale be to a customer. (The reference to "customers" in the caption to § 274(e)(8) has no legal effect. I.R.C. § 7806(b).)

Consistent with the Preamble and the proposed regulations, we request that the regulations clarify that the term "customers," for purposes of § 274(e)(8) generally, includes anyone including employees of the taxpayer. This clarification could appear in Treas. Reg. § 1.274-2(f)(2)(ix) or Prop. Treas. Reg. § 1.274-11(c). The clarification would be particularly helpful by including an example of the sale of goods or services (not limited to food and beverages) to employees at a fair market price.

3. Scope of 50% Disallowance for Meals

The 50% disallowance under § 274(n) no longer applies to entertainment, because the exception for business entertainment in § 274(a) was repealed under the Tax Cuts and Jobs Act (TCJA). However, the 50% disallowance continues to applies to meals. The proposed regulations discuss the scope of the disallowance. They provide that the 50% disallowance applies only to the direct cost of the food and beverages without any allocation of "expenses for the operation of the eating facility such as salaries of employees preparing and serving meals, and other overhead costs." Prop. Treas. Reg. § 1.274-12(b)(2).

Limiting the disallowance to the direct cost of the meal is consistent with the treatment of indirect costs under the prior 50% disallowance of business entertainment expenses. The Blue Book to the Tax Reform Act of 1986 stated that "the cost of transportation . . . is not subject to [the 50% disallowance]." General Explanation of the Tax Reform Act of 1986, at 64 (J. Comm. Print 1987). Consistent with this guidance, it is our understanding that costs of transportation to business entertainment activities were generally considered outside the scope of the 50% disallowance for business entertainment under § 274(n).

Accordingly, we request clarification that the cost of transportation to a meal should not be included in the costs of the meal for purposes of the 50% disallowance under § 274(n).

4. Limitation on Compensation Exceptions

The Preamble and the proposed regulations provide that the compensation exceptions in § 274(e)(2), (9) do not apply to the entertainment disallowance for food and beverages, if the employer fails to impute as income to the employee the full amount required to be imputed under Treas. Reg. § 1.61-21, or if the amount required to be imputed is zero. 85 Fed. Reg. 11,024 (left and middle columns); Prop. Treas. Reg. § 1.274-12(c)(2)(i)(C). This rule is illustrated in an example in which the compensation exception under § 274(e)(2) is not available with respect to the 50% meals disallowance under § 274(n), because the meals were excluded from the employees' income under the convenience-of-the-employer exclusion under § 119 and therefore the amount required to be imputed to the employee under Treas. Reg. § 1.61-21 was zero. Prop. Treas. Reg. § 1.274-12(c)(2)(i)(D)*(2), Example (2)*. The example explains that the amount required to be imputed is zero due to the rule in Treas. Reg. § 1.61-21(b)(1) that the amount required to be imputed is reduced by reimbursements received from the employee and by income exclusions (such as the convenience-of-the-employer exclusion under § 119).

This limitation on the compensation exception in the case of the 50% disallowance applicable to meals is not directly applicable to the costs of transportation to entertainment activities. However, we are concerned that this rule is unfair and that this unfair rule will be applied by analogy by IRS auditors to the costs of transportation to entertainment activities.

In the case of transportation to an entertainment activity of an employee who is a "specified individual," the entertainment disallowance under § 274(a) would apply to the transportation costs under Treas. Reg. § 1.274-10 and the compensation exception under § 274(e)(2) would generally allow the employer to deduct the costs of the trip only to the extent of the amount of income imputed to the employee or reimbursed by the employee. Treas. Reg. § 1.274-10(c).

This limited deduction prevents the double-counting of the disallowance which would occur if the employer's deduction were completely disallowed while income is imputed to the employee (or the employer reports as taxable income a reimbursement received from the employee).

Because denying the employer's deduction to the extent of imputed income or reimbursements of transportation costs to entertainment activities would result in double-counting of deductions, this rule would constitute an unfair and unnecessary punishment to taxpayers who properly report their income and expenses. In the case of employee reimbursements in excess of the required imputed income for the flights, the rule would be unfair, because the employer properly reports zero imputed income to the employee as required under the law. In that situation, there is no valid reason for double-counting the entertainment disallowance.

Calculating the imputed income amount for flights is a burdensome and difficult task particularly in view of the due dates for filing Forms W-2, and it is understandable that taxpayers acting in good faith will make errors in performing these complex calculations. In these cases, there is no reason to impose a penalty of requiring double-counting of entertainment deductions to enforce the imputed income rules. The special valuation rules for calculating imputed income already have penalty provisions to enforce those rules. *See* Treas. Reg. § 1.61-21(c)(5), (g)(13). There is no apparent reason to arbitrarily impose the penalty of double-counting a portion of the entertainment disallowance on taxpayers who make good faith computational errors under these circumstances.

Accordingly, we request that the IRS delete the rule in Prop. Treas. Reg. § 1.274-12(c)(2)(i)(C) which limits the compensation exception in the case of the 50% disallowance applicable to meals. In the alternative, we request that the regulation make it explicitly clear that this limitation is not applicable to the entertainment disallowance under § 274(a).

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Please contact me at sobrien@nbaa.org or 202-783-9451 with further questions. Thank you for your consideration of these comments.

Sincerely,

Scott O'Brien
Senior Director, Government Affairs