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No Soup for You! IRS Denies Tax-Favored Employer-Provided Meals in Recent TAM

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One key ingredient for cooking up an employer-provided meal program that does not generate employee income is business purpose. Guidance discussed in this article demonstrates the importance of substantiating business purpose and shines a light on current IRS thinking about the tax consequences of employer-provided meals and snacks.

The IRS recently issued a technical advice memorandum ("TAM"), TAM 201903017, addressing the section 119[1] "convenience of the employer" exclusion for employer-provided meals. The IRS advised that the value of employer-provided meals is not excludable from employee income under section 119(a) unless the employer establishes and follows specific policies and procedures regarding the provision of the meals and there is a "substantial and non-compensatory business reason."

The analysis and comments contained in TAM 201903017 provide valuable insight into the IRS position regarding the exclusion for employer-provided meals as well as with respect to recent changes made to the fringe benefit rules by the law known as the Tax Cut and Jobs Act of 2017 ("TCJA").[2]

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1 Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

2 For information related to the changes to the fringe benefit rules made by TCJA, see *Notice 2018-99: Tax Reform Curbs Parking Deductions and Increases UBIT*, What's News in Tax (Feb. 25, 2019).

Background

Gross income includes compensation for services, including fringe benefits.[3] The value of employer-provided meals is considered a taxable fringe benefit unless the value is excludible from gross income.[4]

Section 119 allows employers to exclude the value of employer-provided meals from employee income if the meals are for the convenience of the employer pursuant to a bona fide non-compensatory business reason. The determination of whether employer-provided meals are for the convenience of the employer requires an analysis of the facts and circumstances.[5] Non-compensatory business reasons may include, but are not limited to, the following: critical response (expectation that the employees will respond to emergencies during work hours, such as medical, security, and data breaches), geographical isolation (employees cannot reasonably be expected to eat elsewhere during meal times),[6] other business needs within an employer's reasonable business judgment (such as casino workers who must not leave the premises during working hours). [7] Further, if 50 percent of the employees meet the criteria to exclude meals, then all employees may be provided meals without income inclusion.[8]

The exclusion for the value of meals provided at an employer-operated eating facility is linked to section 119. Generally, the value may be treated as a de minimis fringe benefit under section 132(e)(2) if certain requirements are met. In particular, the employer must own or lease the facility; the employer must operate the facility; the facility must be located on or near the employer's business premises; the meals must be provided during, or immediately before or after, the employee's workday; and the annual revenue derived from the facility normally must equal or exceed the direct operating costs of the facility ("annual revenue test").[9] The annual revenue test is met if the employer can reasonably determine that the meals are excludable from the employee's income under section 119.[10]

The practical application of the section 119 convenience of the employer criteria is illustrated in *Boyd Gaming Corporation v. Commissioner.*[11] In *Boyd Gaming*, the employer ran a casino in Las Vegas where meals were provided to staff. The employer imposed a "stay on premises" policy during employee meal breaks. The "stay on premises" policy was maintained by the employer for a variety of reasons including safety and efficiency concerns.[12] Although the IRS argued there was no sufficient connection between the business needs of the employer and the "stay on premises" policy, the Ninth Circuit Court of Appeals held that the employer's security and business concerns were sufficient

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3 Section 61(a)(1); section 1.61-2(d).

4 Section 119; section 1.61-2(d)(3).

5 Section 1.119-1(a)(1).

6 Section 1.119-1(a)(2)(ii).

7 *See* Boyd Gaming Corp. v. Commissioner, 177 F.3d 1096 (9th Cir. 1999).

8 Section 119(b)(4).

9 Section 1.132-7.

10 Section 1.132-7(a).

11 Boyd Gaming Corp. v. Commissioner, 177 F.3d 1096 (9th Cir. 1999).

12 *Id.* at 1097-1098.

justification for the employer to require employees to stay on the business premises and satisfied the convenience of the employer test under section 119.[13] The Ninth Circuit also warned against substituting a different business judgment for the employer's business judgment.[14] Thus, the Ninth Circuit held that expenses were fully excludable de minimis fringe benefits.

The IRS issued an action on decision ("AOD") acquiescing in the *Boyd Gaming* decision. The AOD indicates that the IRS will not challenge whether meals are provided to employees of businesses similar to the employer in *Boyd Gaming* meet the convenience of the employer test if the employer's business policies would otherwise preclude employees from obtaining a proper meal within a reasonable period.[15]

The "business premises" of an employer and what constitutes a non-compensatory business reason is further illustrated in *Jacobs v. Commissioner*.[16] In *Jacobs*, the employer, a professional ice hockey team, served meals to employees at a hotel on game day during away games. The Tax Court examined the exact nature of the arrangement between the hockey team and the hotel to conclude that the hotel constituted a business premise leased by the employer, and that due to the nature of the contracts with the hotel, the eating facility was "operated by the employer."[17] As employees were required to attend team meals and the meals were provided for substantially non-compensatory business reasons (ensuring nutritional needs were met, consistency in meals, and the limited time to prepare during the hockey season), the Tax Court determined that the meals were excludable under section 119, and thus fully deductible.[18]

The IRS issued an AOD with respect to *Jacob*s. In the AOD, the IRS acquiesced to the Tax Court's decision in result only—disagreeing with the analysis used to determine that the hotels were business premises of the employer and that the meeting rooms were "leased" premises.[19]

TAM 201903017

The IRS addressed a number of different considerations under sections 119 and 132 in recently released TAM 201903017. These considerations and the IRS's advisory view are discussed in more detail below.

Business Judgment

Referring to *Boyd Gaming* and *Jacobs*, the TAM indicates that the IRS cannot substitute its own judgment for the business judgment of the employer in determining if there is a valid business reason for the provision of meals to employees. However, according to the TAM, the employer is not relieved of

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13 *Id.* at 1100.

14 *Id.*

15 Announcement 99-77.

16 Jacobs v. Commissioner, 148 T.C. 490 (2017).

17 *Id.* at 500.

18 *Id.* at 506-07.

19 IRS A.O.D. 2019-01.

its responsibility to substantiate both the business reason and the connection between the achievement of that business reason and the provision of meals. Further, the TAM posits that the existence of a business policy or goal must still represent a substantial non-compensatory business reason for the provision of meals. Thus, under the TAM, a mere statement that the employer has a business goal, without more, will not result in the availability of the income exclusion under section 119.

For example, in the TAM, the taxpayer supplied only general goals to explain the need for providing lunch and snacks on the employer's premises. These included the employer's interest in maintaining employee health, creating collaborative atmosphere, and protecting proprietary information. However, the taxpayer failed to provide any type of written policy regarding these goals and any substantiation of enforcement related to those goals. As such, the IRS did not consider these substantial non-compensatory business reasons for the provision of meals to employees under section 119.

Substantiation Generally

In the TAM, the IRS examined the employer's business reasons for providing meals to employees, including the following:

- Protecting confidential and proprietary information by encouraging employees to stay on the business premises for secure business discussions
- Encouraging employees to remain on the business premises to boost collaboration
- Protecting employees because of unsafe conditions surrounding the employer's premises
- Improving employee health by providing healthy meals
- Employees cannot obtain meals within a reasonable period due to insufficient eating facilities in the area
- Employees lunch breaks are shortened due to job demands
- Employees expected to handle emergencies during their lunch breaks

Of particular interest, from a substantiation point, is the employee safety discussion. The employer provided general crime statistics for the area, however, the employer did not provide data on "the usual time of day of crimes, effect of any criminal activity on other employers in the area and their employees, comparisons of crime statistics to statistics for employment centers in other cities, or similar data linking the crime statistics to the ability of the employees to obtain meals." The general data provided by the employer did not indicate that employees could not obtain meals with relative safety off the business premises, nor did it indicate that employees could not perform their duties "in accordance with [employer] policies related to ensuring employee safety" without employer-provided meals.

The comments regarding employee safety, coupled with the IRS analysis of the employer's other business justifications for the meals, such as the general nature of the concerns regarding employee health, fostering collaboration, and providing secure areas for discussions around meals, indicate the

level of substantiation required by the IRS to prove that meals are provided for a substantial non-compensatory business reason. According to the IRS, general business objectives are insufficient. Instead, the employer must demonstrate the non-compensatory business reasons, for example, through a written policy and/or enforcement of such policy. Despite advising that the IRS may not substitute its judgment as to the business needs of the employer and the best way to accomplish those needs, the TAM indicates that the employer is still required to prove that the employer actually follows the stated practices and enforces the practices—as well as whether the needs arise to the level of a bona fide non-compensatory business reason.

Employer-Operated Eating Facility and Snacks

After the passage of TCJA, which, in part, limits the deduction for costs associated with employer-operated eating facilities, there has been some discussion about what constitutes an employer-operated eating facility. One common question is whether a break room with snacks arises to the level of an eating facility.

According to the TAM, probably not. Pointing to the section 132(e) regulations, the IRS generally defines an eating facility to mean an identifiable location that is designated and set aside for the preparation or serving and consumption of meals. Here, the snack areas did not contain tables, and there was no indication that individuals were employed to prepare or serve meals in the snack areas. Thus, the snack areas provided by the employer were not eating facilities.

The TAM also addresses whether snacks are considered a meal. Relying on case law, the IRS indicates that meals generally mean particular food prepared at particular times, not raw ingredients that could be made into meals.[20] As the snacks were not foods prepared to be eaten at specific times, the snacks did not rise to the level of meals.

In this particular situation, the employer provided snack to all employees, contractors, and escorted guests. The snacks were not provided in unusually large portions, were not high value items, and quantifying the value consumed by each employee is administratively impractical given the low value (even if snacks are offered on a continual basis). In the TAM, the IRS held that the snacks met the requirements to be considered a de minimis fringe benefit under section 132(e)(1) and excludable from gross income.

Insufficient Eating Facilities

Historically, the ability of employees to bring meals from home has not been part of the analysis used to determine if meals are furnished for the convenience of the employer or whether meals are furnished for a non-compensatory business reason. Due to the lack of guidance in the regulations, legislation, and case law, the TAM indicates that the IRS will not consider this factor in evaluating whether there are insufficient eateries in the area of the employer's business premises for purposes of section 119.

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[20] 51 T.C. 737 (1969).

Meal delivery is not addressed in section 119, the underlying regulations, and relevant case law, largely due to the fact that until recently meal delivery options were extremely limited. However, extensive meal delivery options at a given location indicates that there are extensive eateries at the location. According to the IRS, if employees have a panoply of meal options available for delivery (through a phone call, smart phone application, or website), then the requirement that the employee cannot secure a meal within a reasonable period is not met.[21] Although meal delivery options are not determinative as to whether there are insufficient eateries, the TAM advises that meal delivery options be considered as part of the section 119 analysis.

Implications

The TAM, as well as other administrative IRS guidance, demonstrate that the IRS continues to examine and challenge employer-provided meals expenses.[22] As the TAM illustrates, general policy reasons to provide meals without additional support will likely be rejected by the IRS. Instead, the TAM indicates that employers need to sufficiently demonstrate a valid business reason supported by policy, data, and enforcement to provide meals to their employees while keeping in mind that the availability of meal delivery options may affect eligibility for exclusion under section 119. On the plus side, employers who provide snacks may be able to treat the benefit as excludable as a de minimis fringe benefit under section 132.

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21 *See* section 1.119-1(a)(2)(ii)(c).

22 *See, e.g.,* AM 2018-004 (Oct. 23, 2018).