Tax Accounting Methods – Tax Reform

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Agenda

- Revenue Recognition
- Bonus Depreciation
- Interest Deduction Limitation
- International Tax Reform Accounting Method Considerations
- Miscellaneous Hot Topics
Revenue Recognition
Revenue recognition

• TCJA modified section 451(b)
  • To provide that under the accrual method, revenue is recognized no later than when recognized in an applicable financial statement
    • Committee reports focus on OID for credit card banks and unbilled revenue for service contracts
  • Requires tax to follow allocation of “amount of” transaction price to separate performance obligations under ASC 606

• TCJA also modified section 451(c)
  • To codifies the 1-year deferral method for advance payments in Rev. Proc. 2004-34
  • Does not override special methods of accounting (except for OID and related provisions)
    • Installment method, section 460, section 475
    • Does not change whether income is “realized”
      • Conference Report footnote 872
  • Effective for tax years beginning after 12/31/17 (12/31/18 for OID)
    • Change in accounting method subject to section 481(a)
Notice 2018-35: Advance payments

• Amended section 451(c) does not exactly mirror Rev. Proc. 2004-34
  • Section 451(c) mentions services and goods and authorizes administrative guidance to permit additional categories of revenue
  • Advance payments accelerated only if the taxpayer ceases to exist

• The notice permits taxpayer to continue to rely on Rev. Proc. 2004-34 until further guidance modifies Rev. Proc. 2004-34

• Waives the prior 5-year same item change eligibility restriction for first or second tax year ending on or after May 10, 2018

• Note that in cases where ASC 606 accelerates the timing of advance payments, Rev. Proc. 2018-31 provides that this change is required to be made on a cutoff basis vs. Rev. Proc. 2018-29
  • Taxpayers may not be able to use Rev. Proc. 2018-29 to obtain a section 481(a) adjustment and a 4-year spread instead of cutoff for advance payment changes
IRS Method Change Guidance on ASC 606

  • Permits automatic accounting method change for revenue recognition for the tax year for which ASC 606 is adopted
  • Eligible changes include only the following:
    • Use of ASC 606 method to:
      • Identify/define the performance obligations
      • Allocate the transaction price to performance obligations
      • Consider when performance obligations are satisfied
  • Modifications to eligibility, and terms and conditions of Rev. Proc. 2015-13
    • Taxpayer may elect a section 481(a) adjustment or cutoff
    • The prior 5-year same item change eligibility restriction is waived
    • Reduced Form 3115 information and filing requirements
IRS Method Change Guidance on ASC 606 (cont’d)

— Rev. Proc. 2018-29 (released on May 9th) (cont’d)
  • Additional requirements and restrictions
    • Must be an otherwise permissible method under section 451
    • Does not apply to PCM contracts under section 460
    • Does not apply to permit a change to follow the new standard for either positive or negative variable consideration
    • Does not apply to a change covered by another automatic change
      • For example, advance payments under Rev. Proc. 2004-34
Bonus Depreciation
Overview

— Bonus depreciation was expanded to include a 100% deduction for the cost of “qualified property,” so long as such property is acquired and placed in service after September 27, 2017, and before 2023. I.R.C. §168(k).
  • Phased down in 20% increments as follows:
    • 80% in 2023,
    • 60% in 2024,
    • 40% in 2025, and
    • 20% in 2026.
  • Longer production period property and certain aircraft get an additional year to be placed in service at each rate.

— For property acquired before September 28, 2017, 50% bonus depreciation is permitted, so long as such property was placed service before 2018.
  • Phased down in 10% increments generally as follows:
    • 40% in 2018, and
    • 30% in 2019.

— For property placed in service during the first taxable year ending after September 27, 2017, a taxpayer may elect 50%, instead of 100%, bonus depreciation for such taxable year. I.R.C. §168(k)(10).
Eligible property

Qualified property must be one of the following:

- Tangible property with a MACRS GDS recovery period of 20 years or less
- Water utility property
- Computer software depreciable under §167(f)(1)
- Qualified film or television production or live theatrical performance
- Specified plants for which the taxpayer has made an election

Only if placed in service in 2017, qualified property includes:

- **Qualified improvement property**
  - Improvements to the interior of nonresidential real property that are placed in service after the building’s original placed in service date, other than elevators, escalators, building enlargements, and building structural framework.
  - Includes all qualified leasehold and qualified retail improvement property
  - Included qualified restaurant and nonresidential real property to the extent it meets the definition of QIP
Ineligible property

— Qualified property does not include:
  • Property required to use ADS (Property for which ADS is elected remains bonus eligible)
    • Foreign-use property, tax-exempt use property & tax-exempt bond-financed property
    • Nonresidential real, residential rental, and qualified improvement property owned by an electing real property trade or business
    • Real property owned by an electing farm business
    • Property > 50% personal use
  • Property for which the taxpayer has elected out of bonus depreciation
  • Property placed in service and disposed of in the same tax year
  • Property for which the taxpayer has elected out of Section 168
  • Property primarily used in the business of a regulated utility (if placed in service in a tax year beginning after 2017)
  • Property used in a business with floor plan financing (FPF) if interest on the FPF was taken into account in computing the business interest expense limitation under section 163(j) (if placed in service in a tax year beginning after 2017)
Original use / used property requirements

Statutory Rule:
- Qualified property must be either:
  - Property of which the taxpayer is the original user
  - Used property that is:
    - Acquired by purchase
    - Acquired from an unrelated party
    - Property not previously used by the taxpayer

Proposed Regs:
- Property is only considered previously used to the extent of a taxpayer’s prior depreciable interest (or a consolidated group member’s depreciable interest)
- Series of related transactions is disregarded – look to original seller and ultimate purchaser to determine eligibility
- Partnership basis step-ups under section 743(b) are not considered to be of previously used property
  - These step-ups qualify for bonus depreciation so long as all other requirements are met
Acquisition date requirements

Statutory Rule:
• Qualified property must be acquired after 9/27/2017
• Property acquired via a written binding contract (WBC) is acquired no later than the date the WBC is entered into
• No rule provided for self-constructed property

Proposed Regs:
• WBC Date is the acquisition date for property acquired or constructed pursuant to a WBC
• Self constructed property is acquired when physical work of a significant nature begins
  • Safe harbor under which property is acquired when 10 percent of the costs are paid / incurred
• No rule for property that is not acquired pursuant to a WBC and not self-constructed
  • Look to physical possession / control
Written Binding Contract definition

Under the Proposed Regs, a WBC must:
- Be enforceable under State law
- Not limit damages to less than 5 percent of the contract price
- Not be subject to a condition within the control of either party

A WBC does not include:
- Letters of intent
- Options
- Supply or similar agreements that are not specific as to both amount and design specification
Placed in service date requirements

Statutory Rule:

- Qualified property must be placed in service after 9/27/2017 and before 2027
- Extra year to place in service long production period property and certain aircraft

Proposed Regs:

- Special rules for specified plants; for qualified film, television and live theatrical productions; and for syndication transactions
- Qualified property placed in service by a terminating partnership in the year of a technical termination is treated as placed in service on the termination date by the new partnership
  - Only applies for tax years beginning before 2018
- Qualified property transferred in one or more section 168(i)(7) transactions in the same year it is placed in service by the transferor is treated as placed in service by the original transferor
Partnership Related Provisions

- The Bad News:
  - No bonus with respect to remedial allocations
  - No bonus for zero basis property under traditional or curative method
  - No bonus on basis determined under section 732(b)
  - No bonus on increases in basis under section 734(b)

- The Good News:
  - Bonus is potentially available for section 743(b) adjustments
    - Each partner is treated as having a depreciable interest in the partner’s proportionate share of partnership property.
    - Transferee partner (or predecessor) did not have a depreciable interest in the portion of the property deemed acquired.
    - The transfer satisfies the purchase and other requirements of section 179(d)(2)(A),(B), and (C) at the partner level (e.g., transferor and transferee partners are unrelated).
    - Election out made at the partnership level but such election (or non-election) is independent of treatment of other qualified property placed in service by the partnership in the same year.
The Creative News:

- Qualified property acquired and placed in service by a taxpayer after September 27, 2017, and contributed to a partnership in the same tax year is eligible for bonus depreciation, but the treatment depends on whether a partner in the partnership had a depreciable interest in the property.
  - If no partner had a depreciable interest, general bonus depreciation allocation rules apply (i.e., bonus depreciable split between the contributor and the partnership based on months in service in year of transfer).
  - If there is a partner who had a depreciable interest in the property (e.g., RR 99-5, situation 1 transaction), the contributing partner is allocated 100% of the bonus depreciation.

The No News:

- The proposed regulations do not specifically address the treatment of disguised sale transactions.
Special Rules

- Technical terminations:
  - No bonus to terminating partnership; all bonus claimed by new partnership
  - Step-into-the-shoes transactions:
    - Bonus allocated between transferor and transferee based on number of months held by each (unless a partner had a prior depreciable interest in the property)

- Like-kind exchanges and involuntary conversions
  - Replacement property is original use: both exchanged basis & excess basis are bonus eligible
  - Replacement property is used: only excess basis is bonus eligible

Basis redeterminations
  - Bonus may be claimed on any additional basis; bonus previously taken on a basis reduction must be recaptured

Changes in use
  - Bonus is neither taken nor given back
Elections

— Election out of bonus under section 168(k)(7):
  • Made by recovery class
  • Made by entity (or by consolidated parent on behalf of its members)
  • Due with timely filed return (including extensions)

— Election to claim 50% bonus in lieu of 100%
  • Available ONLY to the first tax year ending after 9/27/2017
  • Made for ALL bonus-eligible property
  • Made by entity (or by consolidated parent on behalf of its members)
  • Due with timely filed return (including extensions)
Effective date of proposed regulations

General rule:
- Effective for qualified property placed in service in the tax year the regulations are finalized and subsequent years

Early application:
- Taxpayers may choose to rely on the proposed regulations during tax years ending on or after 9/28/2017 and before the tax year that includes the date the regulations are finalized
## Bonus Depreciation Percentages

<table>
<thead>
<tr>
<th>Placed in Service Year</th>
<th>Bonus Depreciation Percentage</th>
<th>Qualifying Property in General/Specified Plants</th>
<th>Longer Production Period Property and Certain Aircraft</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Portion of Basis of Qualified Property Acquired before Sept. 28, 2017</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sept. 28, 2017 – Dec. 31, 2017</td>
<td>50 percent</td>
<td>50 percent</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>40 percent</td>
<td>50 percent</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>30 percent</td>
<td>40 percent</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>None</td>
<td>30 percent</td>
<td>50 percent⁵⁰¹</td>
</tr>
<tr>
<td>2021 and thereafter</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Portion of Basis of Qualified Property Acquired after Sept. 27, 2017</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sept. 28, 2017 – Dec. 31, 2022</td>
<td>100 percent</td>
<td>100 percent</td>
<td></td>
</tr>
<tr>
<td>2023</td>
<td>80 percent</td>
<td>100 percent</td>
<td></td>
</tr>
<tr>
<td>2024</td>
<td>60 percent</td>
<td>80 percent</td>
<td></td>
</tr>
<tr>
<td>2025</td>
<td>40 percent</td>
<td>60 percent</td>
<td></td>
</tr>
<tr>
<td>2026</td>
<td>20 percent</td>
<td>40 percent</td>
<td></td>
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<tr>
<td>2027</td>
<td>None</td>
<td>None</td>
<td>20 percent⁵⁰²</td>
</tr>
<tr>
<td>2028 and thereafter</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

Interest Deduction Limitation – Section 163(j)
Overview of limitation

— Business interest expense deduction shall not exceed the sum of:
  • Business interest income,
  • 30% of positive adjusted taxable income, and
  • Floor plan financing interest

— Unlimited carryover of disallowed portion

— Applies to all businesses, regardless of form
  • For pass-through entities, determined at the filer (partnership or S corp) level
  • For consolidated groups, applies at the consolidated return level

— Effective for tax years beginning after 12/31/17
  • Interest carried over from prior version of section 163(j) is subject to new section 163(j) as carried over interest
Adjusted taxable income

— ATI is generally taxable income not including the following:
  • any income, deduction, gain, or loss not properly allocable to a trade or business;
  • business interest income and expense;
  • any net operating loss deduction;
  • the new “qualified business income deduction (i.e., the 20 percent deduction for certain pass-through income under new section 199A); and
  • for tax years beginning before Jan. 1, 2022, any deduction allowable for depreciation, amortization, or depletion

— The IRS may provide for other adjustments to be made in computing adjusted taxable income.
  • For example, the old proposed regulations included adjustments for changes in accounts receivable and accounts payable to prevent double counting that may have otherwise occurred in certain periods.
Special rules

— Business interest is defined as any interest paid or accrued on indebtedness properly allocable to a trade or business, but does not include
  • Investment interest
  • Payments that are not interest for tax purposes, such as capitalized debt costs that are amortized like OID
  • Non-taxable interest income (e.g., investments in tax-free muni bonds)

— Planning includes acceleration of income, defer expenses, to reduce disallowance

— Following current IRS guidance, application of this section would not be an accounting method, notwithstanding unlimited carryover
Excluded businesses

— Electing Real Property Trades or Businesses:
  • Defined as “any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.”
  • As a result of the election, the taxpayer will have to use the alternative depreciation system (“ADS”) to depreciate nonresidential real property, residential rental property, and qualified improvement.

— Certain utility companies (e.g., electrical energy providers) if the rates for such furnishing or sale have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission (or similar body), or by the governing or ratemaking body of an electrical cooperative.

— Small businesses that satisfy the $25 million gross receipts test in modified IRC Section 448(c) (other than tax shelters) are excluded from the new interest limitation provision.

— Others include T/B of performing services as an employee and electing farming businesses.
Application to partnerships

- The interest deduction limitation is applied at the partnership level, but the results of the partnership-level calculation impact the partner-level interest limitation calculation.
  
  • The partnership may take the interest deductions that are not limited under the partnership-level limitation calculation under IRC Section 163(j).
  
  • To the extent “excess business interest” (“EBI”) exists at the partnership (i.e., the partnership has an interest expense limitation), the EBI is allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership.
  
  • Similarly, to the extent “excess taxable income” (“ETI”) exists at the partnership (i.e., the partnership has greater capacity to (based on its adjusted taxable income) utilize interest expense, the ETI will be allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership.
International Tax Reform – Accounting Method Considerations
Base erosion anti-abuse tax (BEAT)

- Minimum 10% tax (or 5% in 2018) imposed on taxable income with base erosion payments added back
- Base erosion payments generally include payments giving rise to a deduction
- Excludes
  - Amounts taken into account as cost of goods sold (COGS)
  - Amounts attributable to services eligible for the services cost method (turning off the core business activity exception)
- Planning includes
  - Optimize deductions in 2018 for 5% rate
  - Deferral of expenses with all-events test to permit time for planning
  - Evaluation of COGS definition
  - Change in customer contracts to permit pass-through treatment
BEAT: accounting method considerations

- Base erosion payments – generally, amounts paid or accrued to a related foreign person that are deductible
  - Does not include COGS or reductions to gross receipts
    - Accounting method changes (Form 3115) may be required in some cases
      - Section 263A: licensing costs (e.g., sales based royalties)
    - Reverse planning and optional capitalization subject to material distortion standard
  - Includes interest expense – interest disallowed under section 163(j) is allocated first to payments to unrelated persons
  - Includes the acquisition of property that gives rise to a depreciation or amortization deduction
  - Includes payments that are subpart F income
- Enhance R&D credit
# Base erosion anti-abuse tax (BEAT)

An addition to the regular tax liability for large taxpayers with a base erosion percentage of 3 percent or greater.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular taxable income</td>
<td>$100</td>
</tr>
<tr>
<td>Plus, base erosion payments</td>
<td>$130</td>
</tr>
<tr>
<td>Modified taxable income</td>
<td>$230</td>
</tr>
<tr>
<td>x 10 percent (5% in 2018)</td>
<td>$23</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular taxable income</td>
<td>$100</td>
</tr>
<tr>
<td>Tax @ 21 percent (less $5 credits)</td>
<td>$16</td>
</tr>
<tr>
<td>Add back R&amp;D &amp; section 38 credits</td>
<td>$19</td>
</tr>
</tbody>
</table>

- **BEAT = $4 ($23 less $19)**
GILTI: Tax Accounting Method Issues

- Generally, three categories of CFC Income:
  - Exempt income
  - Subpart F (full US taxation at 21%)
  - “Tested income” included in GILTI (minimum tax at 10.5%)
    - Amount included is excess of net tested income over deemed tangible income return
    - 50% deduction limited by net taxable income
    - Deduction reduced to 37.5% in 2026
    - 80% FTC haircut (increases effective tax to 13.125%), and FTC expense allocation
GILTI: Tax Accounting Method Issues

— Transition Issues
  • How are tested income methods adopted and changed?
    o Adopt all new methods?
      • GILTI is entirely new type of income
    o Method change required?
      • GILTI arises from pre-existing CFC’s E&P and such E&P would have been included in taxable income by reason of section 965 no later than 2017
    o Adoption of new methods where it is permissible for taxable income method to deviate from E&P method?
— Can a CFC file a method change in 2018 to get audit protection for GILTI methods if the E&P method carries over?
  o Rev. Proc. 2015-13 provides exception to audit protection for CFC if, for any prior open year, deemed paid taxes in such year exceed 150% of 3 prior years
GILTI: Tax Accounting Method Issues

— Method Change Issues
  • If a change in accounting method is required
    o Is a section 481(a) adjustment or cutoff approach more appropriate?
    o How does the source and character rule for CFCs in Rev. Proc. 2015-13, section 7.07 apply?

— Should the legacy “materiality” exception for E&P permit use of local books
  • See Reg. section 1.964-(a)(2)
    o “No adjustment shall be required unless material”

— Is qualified business investment calculation a method of accounting?
Miscellaneous Hot Topics
Like-kind exchanges

- Limited to real property not held for sale primarily to customers (i.e., non-dealers)
  - Non-US and US are considered not like kind for this purpose
- Applies to exchanges after 12/31/17
- Impact lessened temporarily by 100% expensing of tangible personal property
- Structure ineligible transactions for non-dealers to qualify for installment method
Non-shareholder contributions to capital

- Section 118 was amended to exclude from tax-free treatment:
  - Contributions in aid of construction or contributions as a customer or a potential customer
  - Contributions by a governmental entity or civic group
- Applies to contributions made after date of enactment
  - Except for master development plans approved prior to date of enactment
- Planning:
  - Consider future use of tax abatements in lieu of cash grant to defer taxation
  - Consider impact of *Uniquest Delaware LLC v. US*, W.D. N.Y. (Mar. 27, 2018)
    - At issue was grant received for purchase of a brownfields building
    - Court rejected taxpayer’s arguments:
      - Common-law inducement doctrine
      - Common-law exclusion for capital contributions to partnership
      - Section 118 exclusion for income passed through to corporate partners
Amortization of R&E expenses

- Beginning in 2022, research and experimental expenses, including software development, are required to be capitalized and amortized
  - 5 years (US)
  - 15 years (non-US)
- Remaining basis of retired, abandoned, or disposed property with respect to which specified R&E expenses are incurred must continue to be amortized over the remainder of the amortization period
- Effective for amounts paid or incurred in tax years after 12/31/21 (cutoff basis)
- Planning
  - Consider “on-shoring” of R&E after 2021
  - Consider election under IRC §280C to claim the gross or reduced R&E credit (including potential state and local tax impacts of the election)
Modification of NOL deduction

- NOL deduction limited to 80% of taxable income
- Unlimited carryover (with no inflation adjustment)
- Generally no carrybacks are permitted (except disasters, farming, and small businesses), including 10-year carryback for specified liability losses
  - 3-year carryback for capital losses is unchanged
- Effective for losses arising in tax years beginning* after 12/31/17
  - Loss deduction for losses arising in pre-2018 years are unlimited
- Planning includes change in tax year, accounting method changes and transactions to accelerate deductions or defer income to increase pre-2018 losses

*Technical correction needed to revise from tax years ending after 12/31/17
Modification of NOL rules: effective date

- The effective date of this provision is somewhat unclear
- 80% limitation
  - Effective for tax years BEGINNING after 12/31/17
  - Statutory text is consistent with Conference Report and JCT table
- Repeal of the carryback and the indefinite carryover
  - Both the Conference Report and JCT table indicate that these provisions (like the 80% limitation) are effective for NOLs arising in tax years BEGINNING after 12/31/17
    - Under the statutory text, the NOLs of fiscal year taxpayers arising in tax years that begin before 12/31/17 and end after 12/31/17 would not be subject to the 80% limitation, but could not be carried back or carried forward indefinitely.
- Pending potential clarification by Congress, the statutory language seemingly would govern
Repeal of domestic production deduction

Effective for tax years beginning after 12/31/17

- Fiscal year taxpayers will benefit from rate reduction beginning 12/31/17 and section 199 deduction for fiscal year ending in 2018

Consider closely re-evaluating prior section 199 positions for all open tax years which have taxable income. Potential areas of benefit include:

- Maximizing QPAI potentially eligible for the benefit by refining allocation of production expenses
- Revisiting revenue streams that potentially qualify for the section 199 benefit
  - Recent taxpayer successes in court on definition of production
  - Certain tolling arrangements where taxpayer obtains certification
  - Software development activities (4 docketed court cases)
- Formerly taxable income limited companies may be able to benefit due to income from mandatory repatriation
Repeal of AMT and sequestration

— Corporate AMT repealed for tax years beginning after 12/31/17

— Use of AMT credits
  • May offset full regular tax liability
  • Excess AMT credits are refundable up to 50% through 2021 (100% thereafter)

— Compared with current law where
  • AMT credit limited to excess of regular tax over minimum tax, or
  • Accelerated credit if taxpayer foregoes bonus depreciation (accelerated credit limited to 20% of excess of bonus over non-bonus depreciation)

— Increased need to consider for sequestration in planning in 2018
Compensation cap for public companies

― Amends IRC Section 162(m)
  • IRC Section 162(m)(1) states that “…in the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds $1,000,000.”

― Publicly Held Corporation
  • A publicly held corporation includes an affiliated group of corporations for various income tax purposes; however, an affiliated group of corporations does not include a partnership or LLC taxed as a partnership.
  • The TJCA expanded the definition of publicly held corporation to include all domestic publicly traded corporations and all foreign companies publicly traded through American Depositary Receipts (“ADRs”).

― The TJCA modified the limitation as follows:
  • It expanded the number of individuals whose compensation deduction is subject to a $1 million dollar cap (i.e., Covered Employees).
    ○ Covered Employees now include:
      • Principal Executive Officer
      • Principal Financial Officer, and
      • The top three other highest paid officers
    • Note: Once an employee is treated as a covered person of an employer (or a predecessor) for a tax year beginning after December 31, 2016, the employee will remain classified as such for all future years, including with respect to payments made after retirement, death, etc.
Entertainment, amusement and recreation costs

— No deduction for entertainment, amusement and recreation even when directly related to the conduct of a taxpayer’s trade or business

— No deduction for use of a club organized for business, pleasure, recreation, or other social purposes
  • Not yet clear whether this will also apply to certain business associations that are not really like clubs
  • Not yet clear whether this will apply to a simple meal in a club

— No deduction for a facility or portion thereof used in connection with entertainment, amusement, or recreation
Employer-provided meals

— Expands the 50% limitation to certain employer-provided meals that are currently 100% deductible

  • Food and beverage provided to employees as de minimis fringe benefits in a non-eating facility
  • Breakroom donuts and coffee
  • Soda and snacks at infrequent meetings or trainings
  • Occasional employee breakfast buffet
  • Temporarily provides a 50% deduction for meals provided at an eating facility that meets the requirements for an on-premises dining facility
  • Temporarily provides a 50% deduction for meals provided to employees for the convenience of the employer

— On-premises meals in an eating facility and any meals “for the convenience of the employer” would become **fully non-deductible** after 2025 unless taxed to the employees
Entertainment costs/fringe benefits: summary

- The employee meal and qualified transportation amendments essentially provide the employer with a choice to include these amounts in employee taxable income and take a 100% tax deduction or exclude the amounts and take a lesser (or no) deduction.

- M&E expense disallowance is no longer as simple as taking 50%.

- The amendments disallow deductions for entertainment or recreation costs even if there is an active conduct of business (going to games, concerts, playing golf, etc.).

- Not yet clear whether this will also apply to “entertainment” events for employees.

- Certain social/recreational events and meals primarily for the benefit of employees and their families (if non-discriminatory – that is, most rank and file employees are invited and expected to attend) are still 100% deductible under IRC §274(e)(4).

- Annual picnics
- Holiday parties
- Bowling events
Fines and penalties

Section 162(f) is amended to further limit deductibility

- Prior law: Fines and penalties are nondeductible under section 162(a)
- After amendment: Presumption reversed
  - No deduction under Chapter 1 (Income Tax) is allowed for amounts paid to or at the direction of the government unless
    - Shown to be restitution or amount to come into compliance with a law, and
    - Explicitly identified as such in the court order or settlement agreement
    - Amounts to reimburse the government for costs of litigation are not allowed
  - Effective for amount incurred after date of enactment
- Potential comments from tax groups
  - Request for a safe harbor (rebuttable presumption) that amount is presumed not disallowed if it equals or exceeds maximum compensatory damages asserted or sought by government during settlement
Questions?

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