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Employee Meals: The Most For You — The Least For The IRS

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Employee Meals

The Most For You — The Least For The IRS

By Betty Borrett

There are various ways a taxpayer-employee can treat the cost of meals. The tax treatment depends upon the manner in which the employee receives the meals. For example, the employer can (1) furnish the meals in kind, (2) reimburse the employee for the cost (or by an allowance plan) or (3) let the employee take care of the meals. If the employee pays for the meals, he can try to take a deduction for the expense. Recent court decisions in the area of employer furnished meals have limited the tax benefits to arrangements in which meals (not cash allowances) are supplied by the employer (not a third party).[1] Another recent decision in the withholding area has restricted the impact of the cases regarding employer furnished meals.[2] A discussion of these changes in conjunction with other alternatives available can prove helpful to the taxpayer-employee in planning his tax situation.

Employer Furnished Meals

In certain circumstances meals furnished by the employer are *not* included in the employee's income as a form of compensation. The effect is a free meal for the employee and a trade or business deduction by the employer. This is an exception to the general rule of what constitutes income under the Internal Revenue Code.

The Internal Revenue Code of 1954 defines gross income by giving a list of examples, but it explicitly states that gross income is not limited to such items. Explicitly listed as being in gross income is "compensation for services, including fees, commissions, and similar items."

The Regulations expand on this definition:

Gross Income a) *General definition.* Gross income means all income from whatever source derived, *unless excluded by law.* Gross income includes income realized in money, property, or services. Income may be realized, therefore, in the form of services, *meals,* accommodations, stock, or other property, as well as in cash.[3] (Emphasis added.)

Where services are paid for in property, the fair market value is includible in gross income. Therefore, the *value* of meals furnished to an employee is includible as *compensation,* except to the extent excluded by Section 119.

Code Section 119 and the regulations thereunder state that the value of meals furnished to an employee is *excluded* from gross income if two tests are met:

(1) the meals must be furnished on the business premises of the employer and

(2) the meals are furnished for the convenience of the employer.[4]

Business Premises

What constitutes the employer's business premises has been the issue in various court cases and is determined by considering the facts of the situation.

> CASE: In Anderson the taxpayer, a motel manager, was provided a house "two short blocks" from the motel as a condition of his employment. The Sixth Circuit strictly construed the language of Section 119 and held that the phrase "on the business premises of the employer" meant that "in order for the value of meals... to be excluded from gross income the meals must be furnished... at a place where the employee performs a significant portion of this duties or the premises where the employer conducts a significant portion of his business."[5]

A similar conclusion was found recently.

> CASE: In *Goldsboro Christian School Inc.* lodging furnished for schoolteachers was not located on the business premises because the premises were found to be the school's physical facilities in which the teaching occurred.[6]

Thus the "business premises" means either (1) property that constitutes an integral part of the business property or (2) premises where the company carries on some of its business activities. The courts have broadened the meaning of premises by encompassing areas on which the company carries on some of its business.

> CASE: In *Carlton R. Mabley, Jr.* the petitioner was required along with other officers of the company to attend daily luncheon conferences in a hotel suite rented by the company. The petitioner contended that such conferences were held for the purpose of providing necessary daily contact among the officers and for the purpose of conserving time which might otherwise be consumed by separate conferences among various officers. The Tax Court held that such reasons constituted "a substantial noncompensatory business reason" of the employee and that the suite constituted "the business premises of the employer."[7]

Although the courts have previously interpreted "premises" broadly, it appears the Fourth Circuit is constructing strict interpretation.

> CASE: Recently in *Koerner,* the Fourth Circuit held that the phrase "furnished on the business premises of the employer" is neither vague nor indefinite and thus "the highway patrolmen while engaged in their duties concededly were not furnished meals"...on the business premises of the employer.
>
> Further the Court recognized its dissension from other opinions.

"We realize that in directing judgment...we are going against decisions in the Third, Fifth, Eighth and Tenth Circuits."[8]

The Fifth Circuit has a broad interpretation.

CASE: In *Barrett,* the Court held that amounts paid as reimbursements for meals purchased while on duty as state policemen were not income to them because the meals were furnished on the "business premises." Because the major business of the state police is the enforcement of the law in the state on a 24 hour basis the meals were furnished on their employer's business premises.[9]

In summary the business premises is generally the place where either

(1) the *employee* performs a significant postion of his duties or
(2) the *employer* conducts a significant portion of his business.

Convenience of the Employer

Meals furnished with a charge. Section 119 covers an exclusion not only for meals but also for lodging providing for the convenience of the employer. In order to get the exclusion for lodging, the employee must accept the lodging "as a condition of his employment." No such requirement exists in the Code for meals although the regulations state that if the employer provides meals which an employee may or may not purchase, the meals will not be regarded as furnished for the convenience of the employer.[10] The version of Section 119 passed by the House of Representatives required *both* meals and lodging to be conditions of employment in order to be excludible but in conference the House conferees accepted the change from the Senate which dropped this requirement for meals.[11] Although the reasoning is not clear, the fact that the change was discussed in conference leaves little doubt that it was intentional.

There is an alternative for the employee who is charged a flat rate (for example, by subtraction from his stated compensation) irrespective of whether or not the employee accepts the meals.[12] The flat charge is not includible in gross income but to determine whether the meal is furnished for the convenience of the employer, the value of the meal is subject to the test regarding meals which are furnished without a charge (see below). If the meals are found *not* to be for the convenience for the employer, then the value will be included in gross income.

Meals furnished without a charge. The Regulations explicitly state that in order to determine if the meals are furnished for the convenience of the employer, the facts and circumstances must be analyzed. If the facts satisfy one test then the exclusion will apply regardless of the wording of any employer-employee agreements which state that the meals are part of the employee's compensation. The test:

(1) the meals must be furnished for a substantial non-compensatory business reason of the employer.[13]

If an employer furnishes meals as part of the compensation (and not for a substantial noncompensatory business reason of the employer), then the meals are not for the convenience of the employer. But on the other hand, if there is a substantial non-compensatory business reason for furnishing the meals even though they are also furnished for a compensatory reason, the meals will be regarded as being for the convenience of the employer.[14] Thus, it becomes important to decide what is considered compensatory and what is noncompensatory.

Noncompensatory

Meals are considered provided for a noncompensatory reason if they:

(1) are furnished during the employee's working hours to have the employee available for emergency calls during his meal period. (The possibility of an emergency must be verifiable by past experience or that they can reasonably be expected to occur, or are such emergencies which will result in the employer calling the employee to work during his meal.)
(2) are furnished because the employee's work is such that the employee must be restricted to a short meal period. (An example given of a "short" meal period is 30-45 minutes. Meals may qualify if the peak workload occurs during the normal lunch hours but meals cannot be considered restricted to a short period when the reason for restricting the period is to allow employees to leave earlier in the day.)
(3) are furnished because they could not otherwise be obtained during the lunch period. (Such situations occur when the employer is located in an area which is sufficiently far away from any food facilities to enable employees to leave the business premises, order, eat and return within the normal lunch period.)
(4) are served to a number of employees and the reason for serving substantially all of those employees is noncompensatory, then the reason for serving the other employees will also be regarded as noncompensatory.
(5) are furnished to restaurant employees or other food service employees for each meal period which the employees work. This is regardless if the meal is furnished during, immediately before or after the working hour of the employee.
(6) would have been furnished during work hours but are furnished after work hours because the employee's duties provented him from getting the meals during his work hours.[15]

These last two are an exception to the rule that meals must be furnished during work hours — not before or after — in order to be for the convenience of the employer.

Compensatory

Meals are considered provided for a compensatory reason if they:

(1) are furnished to promote morale or goodwill of the employees or
(2) are given with the incentive to attract prospective employees.[16]

Other important factors

Even if you meet the extensive tests of the meals being (1) on the business premises and (2) for the convenience of the employer, you may not always exclude the value of the meal. The courts have decided that in order for Section 119 to apply, the meals must be furnished "in kind."

CASE: The taxpayer in *Kowalski* tried to exclude cash payments from the employer which were for lunches. The Supreme Court held that "the *payments* are not subject to exclusion from gross income under Section 119, since Section 119 by its terms, covers *meals* furnished by the employer and not cash reimbursement for meals."[17]

The Commissioner has recently followed this same interpretation.

RULING: In *Rev. Rul. 77-80,* the allowance provided by an exempt religious organization to full-time representatives for groceries with which meals were prepared on the employer's premises were not excluded from gross income.[18]

The courts have also aroused more controversy in another area. The identity of the donor is not important.

CASE: In *Fuhrmann,* the taxpayer was furnished lodging on the employer's business premises, a housing project, but he was denied an exclusion for the rent and utilities paid to the general contractor of the housing project in part because the general con-

tractor was not the employer — he was a third party.[19]

Although this last case does not involve meals, the implications are clear: if the employer does not furnish the meals the employee cannot exclude the value from gross income. The exclusion would possibly be allowed if an agency relationship existed between the employer and the person furnishing the meals. The relationship would have to be very clear as the attitude of the courts are clearly strict.

Thus, the employee can exclude the value of meals furnished by his employer if they are

(1) on the employer's business premises,
(2) for the convenience of the employer for a noncompensatory reason,
(3) furnished in kind and
(4) furnished by the employer, not a third party.

The employer in turn can deduct the value of the meals as a necessary and reasonable cost of doing business.

If the above criteria are not met the employee must include the value of the meal in his gross income as it will be considered a part of his compensation. In addition, the courts have subjected such additions to income to withholding taxes.[20] If this is the situation, the employee may try to be reimbursed for his expenses.

Reimbursement For Employee Meal Expenses

If an employee is reimbursed for an income-producing expense in some manner, for example, by allowances, advances, reimbursements or otherwise, Regulation Section 1.162-17 (b) (1) provides a guide for the treatment of the reimbursement and expense. It states that if an employee is required to account and does account to his employer for expenses which are charged directly or indirectly (via reimbursements) to the employer then the employee does not have to report the actual expense or the reimbursement. Basically, the Regulation states that reimbursements do not have to be included in gross income and expenses cannot be deducted unless reimbursements are less than the actual expenses. In such a case the reimbursements are included with gross income and the expenses are deducted accordingly. Regulation Section 1.162-17 (c) states that if the employee is not required to or fails to account to his employer, then the expenses and reimbursements must be a part of the return. However, the IRS has relaxed the requirements for the employee to account to his employer.[21] If the per diem limits for employee reimbursement are not exceeded then the employee does not have to report to the employer *and* he also does not have to include either the reimbursement or the expense on the return.[22] Again, if the reimbursements were greater or smaller than the expense, then both would be on the return.

Conflicts have arisen in this area and the reimbursements have, at times been held to be additional compensation. The problem centers around the issue of whether the original expenses were for the benefit of the employer or the employee. If the expense incurred by an employee is solely for the convenience and benefit of his employer, there is no doubt that the reimbursement will not be part of the employee's gross income and subsequently no deduction is allowed for the related expense.[23] But, where an expense is incurred by an employee which is for his own benefit and convenience, then any reimbursements are income to him.[24]

The problem arises when benefits enure to both the employee and the employer. This occurs in cases where the employee is reimbursed for expenses for meals.

> CASE: In *Kowalski*, state police troopers received cash meal allowances biweekly in advance in an amount which varied with the trooper's rank. The Supreme Court held that such cash meal allowances constituted part of gross income since they were accessions to wealth, clearly realized and over which the trooper had complete dominion.[25]

The impact of *Kowalski* was restricted in a recent Supreme Court Case.

> CASE: The Supreme Court unanimously overturned the Seventh Circuit in *Central Ill. Public Service Co.* and held that lunch allowances paid to workers who were not traveling overnight were not subject to withholding.[26]

Thus the Supreme Court distinguished between "income" on which the employer pays tax and "wages" on which the employer must withhold taxes. Having the payments classified as wages forces the employer to withhold social security tax in addition to withholding tax unless the employee is above the social security wage limit. The employer then has to pay the government an amount equal to the social security paid by the taxpayer-employee. The effect is therefore (1) an immediate reduction in cash to the employee via the withholding and social security payments and (2) an expense to the employer if the cash allowances are income, as the Supreme Court ruled, then the employee pays a tax at the end of the year when he files his federal income tax return in April.

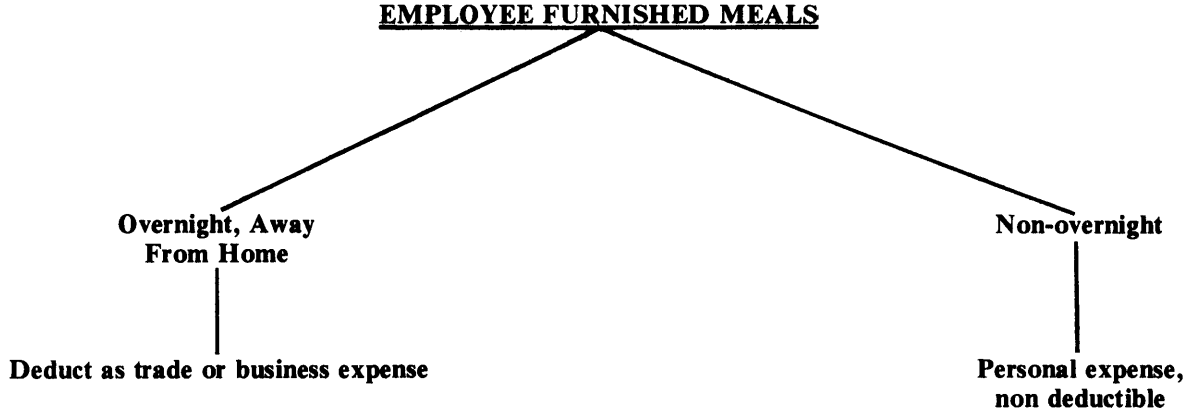
In summary, the courts have clearly defined reimbursement or cash allowances for employer meals as income to the employee but they have excluded these amounts from wages subject to withholding. The impact to the employee is the same as receiving meals which do not qualify for the Section 119 exclusion discussed above. The impact to the employer is the same as under Section 119; the expense is deductible as a necessary trade or business expense. As another alternative the employee can pay for his meals and try to deduct the expense on his income tax return.

Employee Furnished Meals

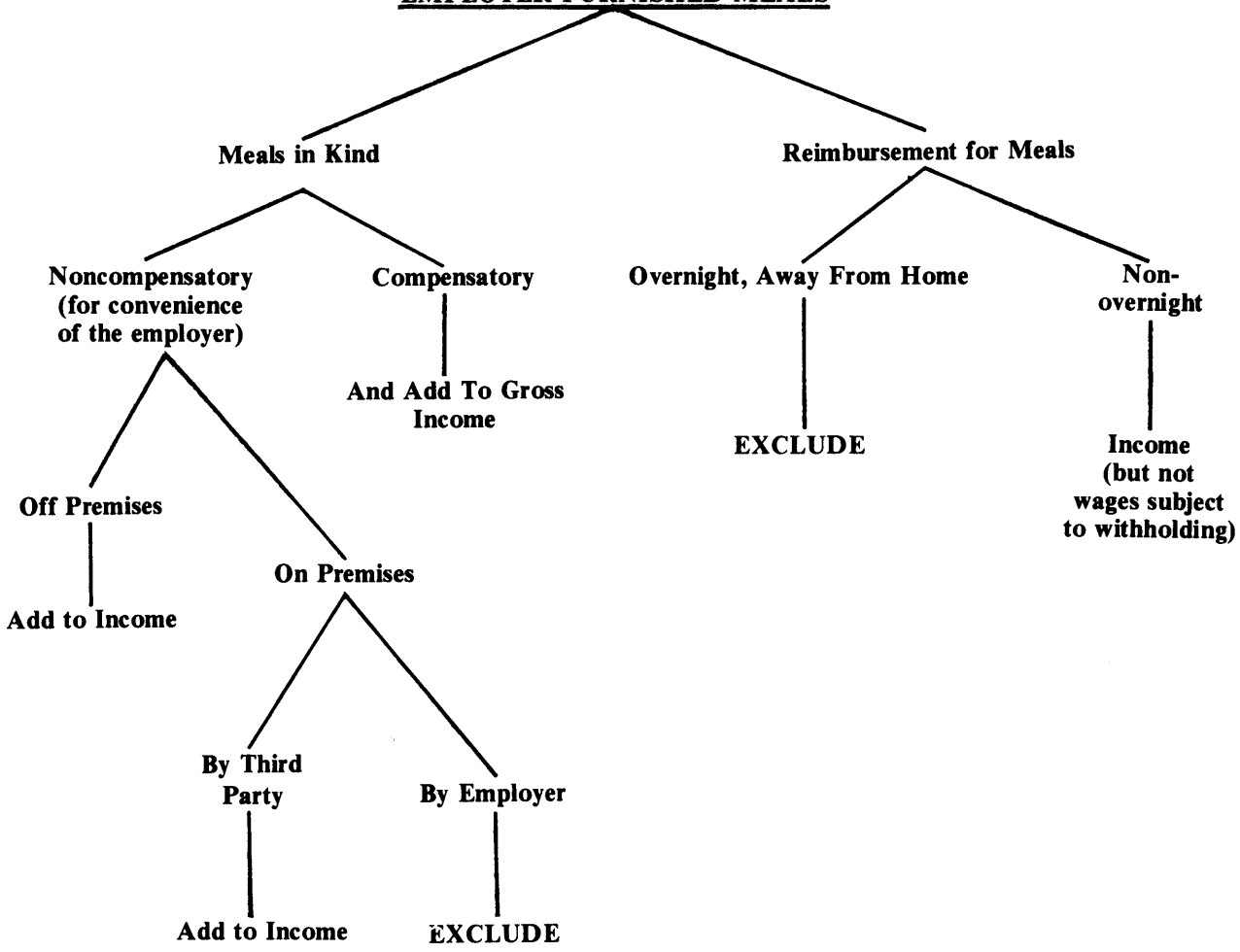
Section 162 (a) (2) provides for a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including...traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business..." It appears that the section allowing a deduction for such expenses would be considered personal and therefore not deductible but such controversy was lessened by the Supreme Court.

> CASE: In order to deduct expenditures for meals as trade or business expenses, the Supreme Court in *Flowers* ruled that three conditions must be met.
>
> (1) "The expense must be incurred while away from home."
> (2) "The expense must be incurred in the pursuit of business," i.e., there must be a "direct connection" with the carrying on of the taxpayer's or his employer's business and the expense must be "necessary or appropriate" to the "development and pursuit of the trade or business."

EMPLOYEE FURNISHED MEALS



EMPLOYER FURNISHED MEALS



(3) The expense must be a "reasonable and necessary" traveling expense.[27]

Thus purely personal expenses are not deductible but some expenses which are personal in nature, but which are incurred in a trade or business can be deducted.

Section 162 is also concerned with transportation and lodging expenses and the Supreme Court's conditions hold for those expenses too. Travel expenses are distinguished from transportation expenses in that the transportation expenses are a more narrow concept and do not include meals and lodging. This is important because an employee may treat traveling expenses (including the cost of meals and lodging) incurred while away from home as deductions from gross income but if he is not "away from home" he may only deduct transportation costs. Two questions become apparent because of the conditions the Supreme Court established — and they both are in the most troublesome area relating to expenses incurred while "away from home":

(1) What is "away from home or conversely, what is home and
(2) How long must the taxpayer be away from home in order to deduct the expenses?

The Commissioner has stated that "home" is not necessarily a taxpayer's residence, domicile, or abode but he has consistently defined "home" as the taxpayer's principal place of business. If the taxpayer has no regular or principal place of business because of the nature of his work, home is at this regular place of abode in a real and substantial sense. After more than 20 years of cases on the issue, the Supreme Court upheld the Commissioner's definition in *Flowers*[28] and *Peurifoy v. Comr.*[29] The IRS has stated that "the term 'home' is not limited to a particular building or property, but includes the entire city or general area in which your business premises or place of employment is located."[30]

The Commissioner defined home similarly in a ruling. RULING: In *Rev. Rul. 56-49,* a fireman was not able to deduct expenses he incurred for lunches. The fireman was trying to prove that he incurred the expenses while away from home but the Rev. Rul. stated that the realm of the fireman's duties encompassed the entire area and were not merely limited to a particular building or property.[31]

Even though a taxpayer's home is defined, problems arise with respect to being away from home. How far away and how long must the taxpayer stay away in order to deduct the expenses? The Commissioner's rule on the deductibility of meals on one-day trips is that meals and lodging are deductible when "incurred in traveling away from home *overnight* in pursuit of business, profession, or employment." The term "overnight" as clarified by the IRS in relation to meals means a period, not necessarily 24 hours, in which the relief from work is sufficiently long as to enable you to get necessary sleep and rest.

The Supreme Court has supported the IRS on this issue in deciding against the taxpayer.

CASE: The Court in *Correll* held that "the Commissioner's rule allowing a deduction for the cost of meals as a business expense only if the taxpayer's trip required him to stop for sleep or rest is a valid and justifiable interpretation of the statutory phrase 'travel away from.'"[33]

The requirements of the "overnight" test are so stringent that the majority of employees cannot benefit on a regular basis from the deduction Section 162 allows.

There are other tax aspects to the employee meals situation than deciding whether the fair market value of the meals should be included in gross income. The meals are possibly subject to Federal income tax withholding, FICA and FUTA. The meals which are not included in gross income are not subject to withholding. Those meals included in gross income are subject to withholding.

FICA (Federal Insurance Contributions Act) and FUTA (Federal Unemployment Tax Act) are additional taxes which must also be considered.[34] FICA is partially withheld from the employee and partially paid by the employer. FUTA is borne by the employer. Neither FICA nor FUTA provides for excluding the value of meals from wages even though that value may be excluded from gross income.[35] Thus, the value of an employee's meals is generally subject to FICA and FUTA but may not be subject to Federal income tax. In order to avoid Federal income taxation the tests described above must be met, but in order to avoid FICA and FUTA the employee must fall under a statutory exception. Four common exceptions are listed.

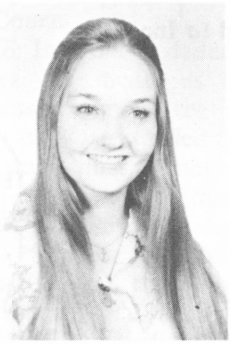
1) *Agricultural labor* — Remuneration paid to one employee in any medium other than cash is excluded from wages if it paid for "agricultural labor." Agricultural labor is a service in the employ of an owner, tenant, or operator of a farm which is directly related to farm activities.[36]

2) *Domestic services* — Payments to a person performing household services in or about his employer's home are also excluded from being taxable "wages" for FICA and FUTA purposes.[37]

3) *Casual labor* — Wages for FICA and FUTA purposes does not include noncash payments for services not in the course of the employer's trade of business.[38]

4) *Homeworkers* — "Homeworkers" perform services for another usually in their home or the employer's home, on a contract or piecework basis. A common example is a babysitter. If a homeworker is paid at least $100 in cash in any calendar quarter, all his remuneration, cash and noncash including the value of meals is subject to FICA for that quarter. Conversely, if a homeworker is paid less than $100 in cash during any calendar quarter, none of the remuneration for that quarter, cash or noncash, is subject to FICA.

Because there is no specific provision excluding from FUTA compensation for services performed by homeworkers, common law governs whether the homeworker is an employee.[39] FUTA must be paid if it is determined that the homeworker is an employee and it need not be paid if it is determined that he is not an employee.



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In summary, if meals are included in gross income they are subject to withholding but if they are not in gross income withholding is not required. Generally both FICA and FUTA do apply to the fair market value of meals of an employee whether they are included in or excluded from gross income.

Summary

There are various alternatives available to the employee who is trying to get the most meal for the least money. One can try to get the employer to furnished meals on his business primises for a noncompensatory reason and for the employer's convenience. Special care must be taken to meet those requirements. Then, if the meals are furnished in kind and by the employer — not a third party, the employee can exclude the value from his gross income. The employee can be in a situation where there is reimbursement for the expense. This results in income to the employee but as recently held by the Supreme Court, the income is not considered "wages" and is not subject to withholding.[40] Finally meals can be furnished by the employee, who may then try to get a deduction as a trade or business expense. Along with meeting other tests the employee must be away from home long enough to require him to stop for sleep or rest.

Clearly, the most advantageous position for the employee is to have the employer furnish the meals in kind and fall within the purview of Section 119. It is less clear which of the other two alternatives discussed is preferable as items such as the taxpayer's cash flow and income tax bracket must be considered.■

NOTES

[1] *Kowalski,* 77-2 USTC #9748 (Sup. Ct., 1977) and *Fuhrmann,* TCM 1977-415, 321 F. 2d 911 (1963).

[2] *Central Ill. Public Service Co.* (Sup. Ct., 1978) rev'g. 76-1 UTSC #9167 (CA-7, 1976).

[3] Reg. 1.61-1.

[4] Reg. 1.119-1.

[5] *Anderson,* 371 F. 2d 59 (CA-6, 1966).

[6] *Goldsboro Christian School, Inc.,* D. Ct. E.D.N.C. 9-14-77.

[7] *Carlton R. Mabley, Jr.,* 24 TCM 1974 (1965).

[8] *Koerner v. U.S.* 77-1 USTC #9258 (CA-4, 1977).

[9] *Barrett,* 321 F. 2d 911 (1963).

[10] S.R. 1622, 83rd Cong., 2nd Sess. 190-191 (1954).

[12] Reg. 1.119-1 (a) (3) (ii).

[13] Reg. 1.119-1 (a) (2) (i).

[14] *Ibid.*

[15] Reg. 1.119-1 (a) (2) (ii).

[16] *Ibid.*

[17] *Kowalski,* 77-2 UTSC #9748 (Sup. Ct., 1977); Also see *Howard Austin,* TCM 1977-434 (1977); *Smith,* 40 AFTR 2d 77-6161 (Sup. Ct., 1977).

[18] *Rev. Rul. 77-80.*

[19] *Fuhrmann,* TCM 1977-416.

[20] *Kresge Co.,* 67-2 USTC #9528 (CA-6, 1967).

[21] *Rev. Rul.* 65-412.

[22] Reg. 1.274-5(f); *Rev. Rul.* 71-412; *Rev. Rul.* 72-508.

[23] *Fehr Kremer,* 20 TCM 1756 (1961); *Abbot L. Johnson,* 32 TC 257 (1959), aff'd. 276 F. 2d 110 (CA-7, 1960); *Rudolph v. U.S.,* 370 U.S. 269 (1962).

[24] *S. J. Campbell,* 20 TCM 841 (1961); *Greenspon,* 229 F. 2d 947 (CA-8, 1956).

[25] *Kowalski,* 77-2 USTC #9748 (Sup. Ct., 1977).

[26] *Central Ill. Public Service Co.* (Sup. Ct., 1978) rev'g. 76-1 USTC #9167 (CA-7, 1976).

[27] *Flowers,* 46-1 USTC #9127 (Sup. Ct., 1946).

[28] *Ibid.*

[29] *Peurifoy,* 58-2 USTC #9925 (Sup. Ct., 1958).

[30] *IRS publications* 463.

[31] *Rev. Ru. 56-49.*

[33] *Correll,* 68-1 USTC #9109 (Sup. Ct., 1967).

[34] FICA is Chapter 21 of the Internal Revenue Code and FUTA is Chapter 23.

[35] Code Sec. 3121 (a), Code Sec. 3306 (b)

[36] Code Sec. 3121 (a) (8), Code Sec. 3306(b)(11)

[37] Code Sec. 3121 (a)(7)(A), Code Sec. 3306(c)(2)

[38] Code Sec. 3121(a)(7)(A), Code Sec. 3306 (b)(7), Code Sec. 3306 (c)(3)

[39] Code Sec. 3306(c)

[40] *Central Ill. Public Service Co.* (Sup. Ct., 1978) rev'g. 76-1 USTC #9167 (CA-7, 1976).