



Making sense of the new tax law:

How it impacts corporate sponsorships & tickets



Background

H.R. 1 (the “2017 Act”) includes numerous revisions to section 274 impacting deductions for entertainment and recreation expenses that are directly related to the conduct of an employer’s trade or business. Under section 274, deductions for expenses related to the provision of entertainment, amusement or recreation activities for employees have historically been disallowed unless there’s a valid business purpose for the business event that occurs before, during, or after the activity. If the expense was directly related to the conduct of the employer’s trade or business, 50% of the expenses incurred were still deductible by the employer. The 50% deduction limitation was also subject to various exceptions, such as for nondiscriminatory recreation; employee business meetings; and entertainment sold to customers; as well as stockholder, director, and business league meetings; which were 100% deductible.

The 2017 Act amends section 274 to eliminate the deduction, even if the activities (such as theater and sporting events, golf outings, etc.) are associated with business. However, there are some exceptions that remain intact.

Below is a summary overview of potential exceptions as well as frequently asked questions.

Overview of Relevant Rules under H.R. 1

Disallowed Entertainment

- * Tickets and expenses related to entertainment, amusement, or recreation (including charitable entertainment events)

Fully deductible Entertainment Exceptions

- * Entertainment treated as taxable compensation, including charges effectively passed onto contract providers
- * Entertainment available to the general public – Think promotional, marketing event, etc.
- * Entertainment sold to customers
- * Amounts includable in the gross income of a recipient who is not an employee
- * Certain reimbursed expenses, including reimbursement arrangements in which an employer reimburses the expenses incurred by a subcontractor’s employees
- * Qualified employee recreation, social or similar activities (including facilities) primarily for the benefit of employees (and does not discriminate in favor of highly compensated employees)

FORM
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DEDUCTIONS

Event Suites

- 1 Can companies claim a tax benefit by classifying their leasing of an event suite or venue as a real estate investment like a timeshare?**

No, deductions are not permitted for any item with respect to personal or real property owned, rented, or used by a taxpayer used in connection with an entertainment, amusement, or recreation activity.

- 2 If I buy a luxury suite, what part of that expense is deductible?**

Generally, the cost of the facility will not be deductible. A few exceptions to that general rule may exist, such as hosting an event for employees. If there is a meal involved, that may be deductible. Past guidance suggests that the IRS will look for reasonable expenses with respect to food and beverages that may be claimed as a deduction provided that charges are not inflated. Assuming that the suite is for business purposes only and the company is not passing any costs off to clients, ticket costs and membership costs will not be deductible. Sponsorships may be partially deductible as advertising expense to the extent that there is a reasonable fair market value allocation between marketing and other expenses. Marketing expenses are likely fully deductible up to the fair market value. For example, paid marketing on the jumbotron at a game would likely be deductible as long as it is independently invoiced and fair market value.



Event Tickets

- 3 Prior to H.R. 1, did companies usually take the 50% deduction allowed on live event tickets, or did this benefit often go unclaimed?**

Companies generally took a 50% deduction for business purpose entertainment in prior years. Certain deductions (such as seats in suites) may have been limited below 50% of the expense.

- 4 If I give a ticket to a client, but they do not attend the event, does that change how the cost of the ticket is treated for tax purposes?**

No, it is a non-deductible entertainment expense regardless of whether or not the client actually attends the event.

- 5 Does the tax treatment of events change if attendance is charged at an all-inclusive price versus if attendees have to purchase different elements (i.e. ticket, parking, food, etc.) separately?**

No, each element of the all-inclusive cost would be subject to its own deductibility rules. For example, the parking cost would be subject to the rules on parking deductibility, etc. The key is to allocate the cost appropriately for each item included in the all-inclusive price. For this reason, itemized invoices will likely be preferred in order to support deductions. Without itemization, it may be difficult to support certain deductions.

- 6 Does the person who facilitates the transaction matter when classifying costs for tax purposes? For example, could a customer purchase tickets through the entertainment provider's caterer and classify the ticket costs with the meal cost?**

No, the cost of the ticket would not count as a meal just because it was purchased through the provider's caterer.

DEDUCTIONS

Entertainment

7 If entertainment providers offer more interactive elements (i.e. meet and greets, trips for 2 to an away game) are those activities treated differently from other entertainment?

No, expenses related to all entertainment is disallowed except as noted above.

8 How can entertainment providers help their customers to maximize their deductions? What can they offer?

Providers are considering including meals that customers could likely deduct provided there is a business purpose. Providers are also considering itemized invoices regarding the different elements of the associated costs. Providers are considering selling and/or offering marketing opportunities (sponsorship, jum-botron, logo and other branding activities, etc.) that may be triggered by certain suit/ticket purchases. The fair market value of such non-entertainment expenses is likely deductible.

9 Are company parties/events still deductible? For example a summer outing at the ballpark for employees?

Qualified employee recreation, social or similar activities, including the use of a facility in connection to such activity such as a summer outing at the ballpark may be eligible for full deductibility if it is primarily for the benefit of employees and does not discriminate in favor of officers, shareholders, or other highly compensated employees (\$120,000 in 2018). The reason that this is fully deductible is that it is a non-recurring event. Recurring events for employees would be treated differently.



DEDUCTIONS

Meals

10 Are business events where a meal is served during entertainment considered a meal or entertainment for tax purposes under H.R. 1?

The costs of entertainment associated with a business event would not qualify for a deduction under H.R. 1. Depending upon the scope of the event and opportunities to discuss business before, during, or after the meal, the meal related expenses may be deductible. If the entertainment is the primary purpose of the venue or the entertainment is such that it prevents meaningful discussion during a meal (seating faces the entertainment area, etc.), then it may be difficult to separately support the meal deduction. The meal related deduction must be supported on its own and it's not clear that the expense related to the meal would be deductible if the meal is commingled with the ongoing entertainment and does not provide an adequate opportunity for separate business discussions.

11 Should companies expect a formal ruling from the IRS clarifying how a combined meal and sporting event must be classified for tax purposes? How should companies approach this classification while they wait for formal guidance?

Although guidance is expected, the timing of such guidance is uncertain. A formal tax ruling prior to such guidance is unlikely. Companies should make their best efforts to comply with H.R. 1 and identify those expenses that are non-deductible as well as those entertainment expenses that are potentially deductible. Future guidance may clarify the deductibility of certain items, but many companies should develop policies and procedures to effectively comply and capture potential deductions.

12 What constitutes the line between a meal and entertainment?

IRS Publication 463 references that entertainment includes the cost of a meal you provide your customer or client. It also discusses that deductibility for reasonable expenses for food and beverages can be claimed as a deduction with respect to skyboxes. Ultimately, it's facts and circumstances. The more distinct the meal is from the entertainment, then the more supportable the meal related expenditure as deductible provided it independently satisfies the business purpose rules.

13 Can entertainment providers increase the allocable basis for meals during entertainment by placing greater emphasis on the dining experience by providing high end dining, meals provided by celebrity chefs, wine tastings, etc.?

This would increase the value of the food, so it may be reasonable to deduct a higher portion of the cost as the meal expense. However, the related cost of the facility will still be nondeductible and any increased value of the meal through the use of a third party (a celebrity chef, wine tasting, etc.) might be considered entertainment. This would be a fine line to walk. The key is to increase the value of the meal (i.e. fine dining experience via accomplished, but not celebrity, chef) without adding an element of entertainment. An interactive celebrity chef or an interactive wine tasting would likely be considered to be there primarily for entertainment of the guests, rather than increasing the value of the meal.



DEDUCTIONS

Membership Fees

- 14 If customers instead pay a membership fee and there are no actual ticket face values involved, would that change the tax treatment of the purchase?**

Deductions for membership fees are not allowed with respect to any club organized for business, pleasure, recreation or other social purpose.

Sponsorships

- 15 How are sponsorships treated under H.R. 1?**

Parts of the sponsorship may be deductible if there are multiple aspects. Aspects that would normally be deductible outside of the sponsorship will remain so, but everything else would be nondeductible. Sponsorship with an advertising element may be deductible as advertising expense, but only the amount above the cost of the nondeductible items in the package.

Parking

- 16 How are parking costs treated under H.R. 1?**

Parking associated with meals and entertainment with a business purpose follows the meal or entertainment rule as applicable. There would have to be a business element in order for the parking cost to be deductible in any amount. All other parking (i.e. no business purpose) is disallowed.

General Questions

- 17 What is the best way for companies to track their deductible and non-deductible expenses in order to stay compliant with H.R. 1?**

In prior years, companies may have taken a simplified approach to tracking meals and entertainment expenses as both were 50% deductible. Now that there is no longer alignment between these types of expenses, companies need to make additional compliance efforts to keep logs and receipts with descriptions or who, what, when, where and why, while detailing which part of each expense is allocated to meals and which part is allocated to entertainment. With the lack of current guidance, it is especially important to track these details in order to remain in compliance and capture any potential deductions once there is additional guidance.

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INCOME INCLUSION

Tickets

- 18 What is the maximum value of tickets that an employee can receive from a business without it being considered income? Does the timing of when a ticket is provided to an employee matter when considering whether or not it is includible in income?**

There is not specific maximum dollar amount before it is considered income. However, small value tickets that are irregular or so infrequent that it makes accounting for them unreasonable or impractical are generally viewed as satisfying the de minimis definition, so they do not need to be included in income. If tickets are provided frequently, then they should be considered income. If the tickets are for related business meetings, etc., it may be considered a working condition fringe benefit. In addition, a last minute ticket made available to all employees may more likely be viewed as de minimis than a ticket issued to a specific employee well in advance. Generally, the day of the event would likely be considered “last minute.” It may also be helpful to think of it as an unexpected benefit to the employee. For example, if an employer has tickets that they intended to use for a client, but the client is unable to attend, the employer may be able to offer those tickets to his/her employees generally on a first response basis without there being an income inclusion.

- 19 What if tickets are sold to employees at a discount versus at face value? What if face value is unknown? For example, if the ticket is included in the price of a suite or a sponsorship.**

The value of the discount may only be excluded from wages if the employee provides substantial services in the same line of business as the discounted property. If the face value of a ticket is unknown, it would be valued at fair market value, or what the ticket would cost outside of the suite or sponsorship package. If tickets are sold to employees, the amount that the ticket is sold for is the portion that remains deductible in addition to any amount included in income of the employee.

For additional questions, please contact Tony Knopp, CEO and Co-founder of TicketManager (tony@ticketmanager.com) or Terrance Richardson, Partner at KPMG (trichardson@kpmg.com)

