

50% Disallowance Rule for Meals and Entertainment

When you pay for business meals and entertainment, keep in mind that generally only half of otherwise allowable meal and entertainment expenses are deductible on your federal tax return. This includes 50% of all business meal and entertainment expenses, including those incurred while attending professional seminars and traveling away from home. If a hotel includes meals in its room charge, a reasonable allocation must be made to determine the portion of the expenditure subject to the 50% disallowance.

Taxes and tips related to meals or entertainment are included in the amount that is subject to the 50% limit. Also subject are expenses for cover charges to clubs, room rental for a dinner or cocktail party, and amounts paid for parking at an entertainment location. However, transportation costs incurred getting to and from the entertainment activity are not subject to the 50% disallowance. In addition, when a self-employed taxpayer uses a per diem method for travel expenses, the federal meal and incidental expense rate is treated as an expense for food and beverages and, thus, is subject to the 50% disallowance.

If an employee adequately accounts for these expenses and the employer properly reimburses the expenses under an accountable plan arrangement, the employer is also subject to the 50% limitation on its reimbursement. An *accountable plan* is a reimbursement or other expense allowance arrangement that requires employees to substantiate covered expenses and return unsubstantiated advances. The employee has nothing to report since the reimbursement offsets the expenses incurred.

Conversely, an employer gets a 100% deduction if meal expense reimbursements or allowances paid for or to an employee under a nonaccountable plan are treated as compensation to the employee. Of course, the employer must then pay FICA taxes and the income is subject to normal withholding, but this rule basically allows employers to shift the 50% disallowance to employees. Similarly, meal reimbursements and allowances that are included in the taxable income of independent contractors are also 100% deductible by the service recipient.