

No Tax Deductions for Business Entertaining

The good news is that the TCJA of 2017 lowered corporate tax rates from a graduated schedule that reached 35% to a 21% flat rate. The bad news? Many business expenses are no longer tax deductible. That list includes all outlays that might be considered entertainment or recreation.

As of 2018, tickets to sports events can't be deducted, even if you walk away from the game with a new client or a lucrative contract. The same is true if you treat a prospect to seats at a Broadway play or take a valued vendor out for a round of golf. Those outlays will be true costs for business owners without any tax relief.

Drilling Down

Does that mean that you should drop all your season tickets supporting local teams? Cancel club memberships? Pack away your putter and your tennis racquet? Before taking any actions in this area, take a breath and crunch some numbers.

Example: In recent years, Luke Watson spent about \$20,000 a year on various forms of entertainment, which his company claimed as a business expense. Indeed, these were valid expenses and helped his LW Corp. grow rapidly.

Assume that LW Corp. paid income tax at a 34% rate. In 2017 and prior years, business entertaining was only 50% deductible. Thus, LW Corp. deducted \$10,000 (half of Luke's expenses) and saved \$3,400 (34% of \$10,000). With \$3,400 of tax savings and \$20,000 of out-of-pocket costs, Luke's net cost for entertaining was \$16,600 under the law in effect during 2017.

Now suppose that Luke has the same \$20,000 of entertainment costs in 2018 and that those costs would have still been 50% tax deductible at the new 21% tax rate. His tax savings would have been only \$2,100, so the net entertainment cost would have been \$17,900. As it is, under the new law his actual entertainment cost would be the full \$20,000 with no tax benefit.

This example assumes that LW Corp. pays the corporate income tax on its profits. If Luke operates his business as an LLC or an S corporation, with business income passed through to his personal tax return, the calculation would be different, but the principle would be the same.

Client Bulletin

Business entertainment has been done mainly with after-tax dollars. Under the new TCJA, you'll entertain clients and prospects solely with after-tax dollars. You should be careful about how this money is spent and judge the expected benefit. Nevertheless, if business entertaining has paid off for your company in the past, it may still prove to be valuable even without tax breaks.

Fine Points

Meal expenses associated with operating a trade or business, including employee travel meals, generally continue to be 50% tax deductible. However, keep in mind that the rules have changed for meals provided for the employer's convenience. Previously, these were 100% deductible if they were excludible from employees' gross income as de minimis fringe benefits. That might have been the cost of providing free drinks and snacks to employees at the workplace. Now outlays for such meals are only 50% deductible and they're scheduled to become nondeductible after 2025.

On the bright side, the new law doesn't affect expenses for recreation, social, or similar activities primarily for the benefit of a company's employees, other than highly compensated employees. So, your business likely can still pay for holiday office parties with pre-tax dollars.