Miller & Chevalier

Tax Court Expands Section 119 Exclusion in Boston Bruins Decision

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In a much anticipated decision, the U.S. Tax Court ruled yesterday that "the business premises of the employer" can include an off-premises facility leased by the employer when its employees are on the road. The decision in *Jacobs v. Commissioner* addressed whether the employer (in this case, the professional hockey team, the Boston Bruins) was entitled to a full deduction for the meals provided to the team and staff while on the road for away games. The debate arose after the IRS challenged the full deduction and asserted that the employer should have applied the 50% deduction disallowance applicable to meals by section 274(n) of the Code. Under section 162 of the Code, an employer may deduct all ordinary and necessary business expenses. However, in recognition that the cost of meals is inherently personal, the Code limits the deductions for most business meal expenses to 50% of the actual expense under section 274(n), subject to certain exceptions. The exception at issue in *Jacobs* allows an employer to deduct the full cost of meals that qualify as de minimis fringe benefits under section 132(e) of the Code. In general, this includes occasional group meals, but would not typically include frequently scheduled meals for employees travelling away from home. (For this purpose, home is the employee's tax home, which is typically the general area around the employee's principal place of employment.) However, under Treasury Regulation § 1.132-7, an employer-operated eating facility may qualify as a de minimis fringe benefit if, on an annual basis, the revenue from the facility is at least as much as the direct operating cost of the facility. In other words, an employer may subsidize the cost of food provided in a company cafeteria, provided the cafeteria covers its own direct costs on an annual basis and meets other criteria (owned or leased by the employer, operated by the employer, located on or near the business premises of the employer, and provides meals immediately before, during, or immediately after an employee's workday). The Bruins' owners argued that they were entitled to a full deduction because the banquet rooms in which employees were provided free meals qualified as an employer-operated eating facility. That may leave some of our readers wondering, "How can a facility that is free have revenue that covers its direct operating cost?" The key to answering that question lies in the magic found in the interface of sections 132(e)(2)(B) and section 119(b)(4) of the Code. Under section 132(e)(2)(B), an employee is deemed to have paid an amount for the meal equal to the direct operating cost attributable to the meal if the value of the meal is excludable from the employee's income under section 119 (meals furnished for the "convenience of the employer") for purposes of determining whether an employer-operated eating facility covers its direct operating cost. In turn, section 119(b)(4) provides that if more than half of the employees who are furnished meals for the convenience of the employer, all of the employees are treated as having been provided for the convenience of the employer. Working together, if more than half the employees are provided meals for the convenience of the employer at an employer-operated eating facility, the employer may treat the eating facility as a de minimis fringe benefit, and deduct the full cost of such facility. The IRS objected to the owners' treatment of the banquet rooms as their employer-operated eating facilities and disallowed 50% of the meal costs. The Tax Court succinctly explained that the Bruins' banquet contracts constituted a lease of the rooms provided for meals and that the contracts also meant that the Bruins operated the facilities under Treasury Regulation § 1.132-7(a)(3). In doing so, the Tax Court summarily dismissed the IRS's argument that the payment of sales taxes meant that the contracts were not contracts for the operation of an eating facility but instead the purchase of meals served in a private setting. Having determined that the first two criteria were satisfied, the Tax Court turned to the question of whether the hotel banquet rooms constituted the "business premises of the employer." The court looked to a series of cases indicating that the question was one of function rather than space. Relying on those cases, the court determined that the hotels were the business premises of the employer because the team's employees conducted substantial business activities there. The court seemed to put significant weight on the fact that the team was required to participate in away games, necessitating it travel and operation of its business away from Boston. The Tax Court was unpersuaded by the IRS's quantitative argument that the team spent more time working at its facility in Boston than at any individual hotel and its qualitative argument that the playing of the away game was more important than the preparation for the game that took place at the hotel. Having determined that the hotel banquet rooms were an employer-operated eating facility, the Tax Court next addressed whether it qualified as a de minimis fringe benefit because more than half of the employees who were furnished meals in the banquet rooms were able to exclude the value of such meals from income under section 119 of the Code. The court determined that this requirement was satisfied because the meals were provided to the team and staff for substantial noncompensatory business reasons. The business reasons included: ensuring the employees' nutritional needs were met so that they could perform at peak levels; ensuring that consistent meals were provided to avoid gastric issues during the game; and the limited time to prepare for a game in each city given the "hectic" hockey season schedule. Relying on the Ninth Circuit's decision in *Boyd Gaming v. Commissioner* from the late 1990s*,* the court declined, once again, to second guess the team's business judgment by substituting the government's own determination. Although the decision focuses on the specific facts and the exigencies of a traveling hockey team, the decision is of interest for other taxpayers as well. This is especially true given the IRS's recent increased interest in both meal deductions and the imposition of payroll tax liabilities with respect to free or discounted meals provided to employees, particularly in company cafeteria settings. The decision expands the scope of the section 119 exclusion to meals further than the IRS's current limited view that it applies only to remote work sites, such as oil rigs, schooners, and camps in Alaska. To date, the most expansive application of the exclusion in the company cafeteria setting occurred in *Boyd Gaming*, where a casino successfully established that its policy requiring employees to eat lunch on-site was based on security concerns and the attendant screening procedures made it necessary to provide employees with meals during their shifts. *Jacobs* seems to take the analysis one step further, because many of the business reasons for providing meals to Bruins employees could be echoed by other taxpayers. No doubt, all employers are concerned with the performance of their employees. To that end, it could be argued that ensuring that they eat well-balanced nutritionally appropriate meals can increase performance even if the employer is more concerned with brains rather than brawn. Indeed, given the large health insurance costs borne by many employers, employers have a legitimate interest in providing healthy meals that may reduce the incidence of obesity, diabetes, heart disease, and other chronic ailments that raise their costs. Moreover, many employees have hectic schedules during the work day with frequent appointments, meetings, and other activities that make it necessary to maximize the time available for work during the day. Given the Tax Court's implicit admonition of the IRS's attempt to substitute its own judgment regarding the employer's business reasoning in *Jacobs* and the court's refusal to substitutes its own judgment as well, the IRS likely has a more difficult road ahead if it attempts to challenge the purported business reasons that an employer provides for furnishing meals to its employees. It remains to be seen how the IRS will react to the decision and whether it will appeal the case, which seems likely. For now, however, the case is a positive development for employers who have made a business decision to provide meals on a free or discounted basis to their employees to increase productivity and improve their health.
