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## Proposed Regulations Clarify the 50% Entertainment Limit for Expense Reimbursement Arrangements

This month, the IRS issued Proposed Regulations under Code section 274(n) regarding the application of the 50% limit on deductions for expenses for food, beverages, entertainment, or use of entertainment facilities under a reimbursement arrangement. 77 Fed. Reg. 45520 (Aug. 1, 2012). The proposed Regulations clarify who is subject to the 50% deduction limit when multiple parties are involved, as only one party is subject to the limit, as follows:

Reimbursement Arrangement with Employees: 50% Limit applies to the employer, unless the expense is treated as taxable wages, in which case, the limit applies to the employee. Therefore, for accountable plan expenses, the limit only applies to the employer.

Reimbursement Arrangement with Independent Contractor: 50% limit applies as expressly identified in the agreement. If the agreement is silent, the limit applies to the client/customer, unless the independent contractor (which can include an employer, its agent, or a third party) does not seek reimbursement from, or substantiate expenses to (referred to as account to the client in accordance with 274(d) regulations) the client/customer, in which case it applies to the independent contractor.

For example, in a third party leasing situation, the leased employee incurs section 274(n) expenses, which the leasing company pays to the leased employee (after the leased employee substantiates the expense). Then the leasing company is later reimbursed by the client, after it provides the client with a copy of the expense substantiation. The client, which is the company that the worker performed the services for, is the only one subject to the 50% limit, unless the agreement expressly provides otherwise. It is the same result if the leased employee sought payment directly from the client (and provided substantiation of the expense).

Therefore, these rules generally apply the limit on the party that bears the ultimate expense (provided that they receive proper accounting of the expense), unless the agreement expressly provides otherwise.

The approach taken in the proposed regulations is consistent with Revenue Ruling 2008-23, and although not effective until finalized, they may be relied upon to seek refunds for an open year under the statute of limitation. Therefore, payors of these expenses should review their arrangements, and consider seeking refunds in the event that 50% limit was not in fact applicable to them. And going forward, companies may need to amend their independent contractor arrangements to expressly provide who is subject to the limit. If there are any concerns with these rules, comments are due October 30, 2012.