ACTION ON DECISION

Subject: *Jacobs v. Commissioner*, 148 T.C. No. 24 (2017)

Issue: Whether the IRS will follow the Tax Court's decision in *Jacobs v. Commissioner* that Taxpayer's expenses for provision of pregame meals at away city hotels to professional hockey players and team personnel were de minimis fringe benefits under § 132(e)(2) and were therefore exempt from the 50% deduction limit for meal and entertainment expenses under § 274(n)(1) .

Conclusion: The IRS will follow *Jacobs* only with respect to cases involving sports teams in which the material facts are substantially identical to those present in *Jacobs*.

Discussion: Taxpayers own the Boston Bruins (Bruins), a National Hockey League team. The Bruins play roughly 40-50 road games each year, their participation in which necessitates overnight stays in hotels in dozens of cities spread across the United States and Canada. The Bruins contract with these hotels to provide team personnel with buffet-style pregame meals in meeting rooms. At issue in *Jacobs* was whether Taxpayers could fully deduct the costs they incurred to provide these meals in 2009 and 2010.

Section 274(n)(1)(A) provides that the amount allowable as a deduction for any expense for food or beverages shall not exceed 50% of the amount of such expense which would otherwise be allowable as a deduction.

Prior to January 1, 2018, § 274(n)(2)(B) excepted from this 50% limitation amounts incurred or paid for food or beverages, where such expenses were excludable from the gross income of the recipient by reason of § 132(e)(2), relating to de minimis fringe benefits.[1] This exception is not available regarding amounts incurred on or after January 1, 2018.

Such amounts incurred or paid for food or beverages excludable from recipients' gross incomes under § 132(e)(2) are (subject to the other requirements of the Code):

(1) Fully deductible for amounts incurred prior to January 1, 2018;
(2) 50 percent deductible for amounts incurred after December 31, 2017, and prior to January 1, 2026; and
(3) Nondeductible for amounts incurred after December 31, 2025.

Section 132(e)(2) includes in the definition of de minimis fringe benefit the operation by an employer of any eating facility for employees if (A) such facility is located on or near the

[1] For amounts incurred or paid for food or beverages after December 31, 2017, and before January 1, 2026, section 13304(b) of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," P.L. 115-97 (Tax Cuts and Jobs Act), struck the exception contained in § 274(n)(2)(B) from the 50% limitation for meals excludable under § 132(e). For amounts incurred or paid for food or beverages after December 31, 2025, section 13304(d) of the Tax Cuts and Jobs Act, amended § 274(o) to provide that no deduction is allowed for (1) any expense for the operation of a facility described in section 132(e)(2), and any expense for food or beverages, including under section 132(e)(1), associated with such facility, or (2) any expense for meals described in section 119(a) (relating to meals provided for the convenience of the employer).

business premises of the employer and (B) the revenue derived from such facility normally equals or exceeds the direct operating costs of such facility. As to the revenue requirement under (B), the statute specifies that an employee who would be entitled to exclude the value of a meal provided at the eating facility on the employer's business premises and for the convenience of the employer within the meaning of § 119 shall be treated as having paid an amount for such meal equal to the direct operating costs of the facility attributable to such meal.[2]

Section 132(e)(2) also contains a nondiscrimination requirement, prohibiting the provision of the meals in a manner that discriminates in favor of highly compensated employees.

Section 1.132-7(a)(2) of the Regulations further specifies that a facility is an employer-operated eating facility only if it is owned or leased by the employer, it is operated by the employer, and the meals furnished at the facility are provided during, or immediately before or after, the employee's workday. Section 1.132-7(a)(3) provides that if an employer contracts with another to operate the facility for its employees, it will be "treated" as operated by the employer.

The Internal Revenue Service (IRS) determined income tax deficiencies with respect to the years at issue, derived from the IRS's disallowance of a portion of the meal expense deductions by Taxpayers.[3]

The Court held in favor of the Taxpayers, concluding that the expenses the Bruins incurred to provide meals to the players and team personnel at away city hotels satisfied the exception to the general 50% limitation on deductions for meal and entertainment expenses under § 274(n)(2)(B) for de minimis fringe benefits under § 132(e). Specifically, the Court concluded that the Bruins provided the meals at employer-operated eating facilities, under § 132(e)(2).

The IRS disagrees with the reasoning the Court used to reach its conclusion that the hotel meeting rooms at away city hotels satisfied the requirements for an employer-operated eating facility under § 132(e)(2), particularly with regards to its conclusions that: (1) the hotels in which the Bruins held pregame meals were the team's "business premises," (2) the Bruins "leased" the hotel meeting rooms, and (3) the Bruins did not provide the meals in a manner that discriminated in favor of highly compensated employees,[4] While the changes made by the Tax Cuts and Jobs Act will generally eliminate the availability of a full deduction for meals regardless of the facts surrounding the meals, the Court's errors could continue to have impact in the application of the exclusion from income under § 132(e)(2) for meals provided to employees who are not travelling away from home.

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[2] Section 119(b)(4) provides that all meals furnished to employees on the employer's business premises will be regarded as furnished for the convenience of the employer if more than half of the employees to whom such meals are furnished on such premises are furnished such meals for the convenience of the employer.

[3] Generally, the value of meals provided to players and other employees while travelling away from home are excluded from gross income as working condition fringe benefits under § 132(d).

[4] The IRS also disagrees with portions of the reasoning the Court used, and many of the factual assumptions that the Court accepted, to reach its conclusion that the meals were provided for the convenience of the employer, particularly with respect to non-player employees for whom the Court determined that the meals "minimize[ed] unproductive time (e.g., finding and obtaining appropriate meals from restaurants in each city) and maximize[ed] time dedicated to activities that help achieve the organization's goal of winning hockey games," a general, broad rationale that falls short of enabling those employees properly to perform their duties within the meaning of *Commissioner v. Kowalski*, 434 U.S. 77, 84 (1977).

(1) The IRS disagrees with the standard that the Court used to conclude that the hotels were the Bruins' "business premises."

The IRS disagrees with the reasoning that the court used to reach its conclusion that the away city hotels were the Bruins' business premises. The Court's reasoning, if followed generally, could significantly undermine the business premises requirement by potentially rendering any location at which an individual conducts business activities—even a restaurant or an airport lounge—a business premises.

The Court employed to this end a "functional standard," stating that the inquiry of whether a location constitutes a taxpayer's business premise "infers a functional rather than a spatial unity" and "is not limited by questions of geography or quantum of business activities." The Court instead should have used a "quantum or quality standard," analyzing whether the requisite quantum or quality of the Bruins' activities occurred at the hotels to qualify them as either the locus of the significant portion of the employer's business or of the employees' activities.[5]

The Bruins' away city hotels did not meet this quantum or quality standard. The Bruins played their regular season home games at TD Garden in Boston and trained and conducted daily practice skates on non-game days at the team's practice facility in Ristuccia, Massachusetts. Moreover, the team conducted a majority of its general business activities—such as making travel arrangements, negotiating contracts, payroll, accounting, finance, and conducting media relations—at the team's Boston offices. The quantum of time spent at any one destination city hotel compared to time spent at the practice rink or in Boston thus shows that the away city hotels were not a business premise of the taxpayer.

While the IRS disagrees with the Court's application of the business premises test generally, it will not challenge the conclusion that sports teams—which operate under a unique business model that would not be viable if teams did not travel for half of their games--have business premises in the cities in which the away games occur at the time of the games for purposes of §§ 119 and 132(e)(2).

(2) The IRS disagrees with the reasoning that the Court used to conclude that the Bruins "leased" the meeting rooms at which they conducted pregame meals.

The Court's conclusion that the hotels "leased" the meeting rooms to the Bruins merely by authorizing the team to use the rooms renders a "lease" so expansive as to effectively render the requirement meaningless, potentially converting any location where an employer provides meals (even on a singular occasion) into an employer-operated eating facility.

Citing *Black's Law Dictionary*, the Court stated that a lease is "[a] contract by which a rightful possessor of real property *conveys* the right to use and occupy the property in exchange for consideration." (Emphasis added). However, *Black's Law Dictionary* defines "convey" as:

> To transfer or deliver (something, such as a right or property) to another, esp. by deed or other writing; *esp., to perform an act that is intended to create one or*

[5] The Tax Court, Sixth Circuit, and IRS apply this "quantum or quality standard." See *McDonald v. Commissioner*, 66 T.C. 223 (1976); *Commissioner v. Anderson*, 371 F.2d 59 (6th Cir. 1966); and Rev. Rul. 70-85, 1970-1 C.B. 214; respectively. Disregarding this precedent, the Court in *Jacobs* instead cited to *Adams v. United States*, 585 F.2d 1060, 1066 (Ct. Cl. 1978), a Court of Claims case using the functional standard.

> *more property interests*, regardless of whether the act is actually effective to create those interests. (Emphasis added).

The hotels did not create a property interest in those meeting rooms for the Bruins. The arrangements were, in substance, contracts that merely authorized the Bruins to use the meeting rooms.

Under the Internal Revenue Code, a lease requires more than mere authorization to use. Section 7701(e)(1) provides the following list of factors that are relevant for determining whether a contract is a lease of property: Physical possession of the property, control of the property, significant economic or possessory interest in the property, owner's risk of substantially diminished receipts from non-performance, whether the owner uses the property concurrently for other uses, and whether the total contract price is proportionate to the rental value of the property.[6]

Similarly, more general legal authorities reflect that the Bruins' arrangements with these hotels did not rise to the level of a lease. Digesting property law authorities derived from state and common law, the Restatement (Second) of Property, Landlord and Tenants, states explicitly at § 1.2 that a hotel room reservation is not a lease. A lease is an interest in property that does not exist until the tenant has a present right to possession, which means the tenant assumes a physical relationship to the leased property which gives him control over and the power to exclude others from the property.[7]

Under these principles, the Bruins' arrangements with the hotels are not leases for federal tax purposes, including § 132. The Bruins had no possessory interest in the physical property—neither the hotel rooms nor the meeting rooms. Even if the Bruins had reserved a specific meeting room for team meals, if the hotel booked the room to another group instead, the Bruins could not sue the other group to acquire use of the room nor exclude them from the room. Rather, the Bruins remedy would be to look to hotel management to fulfill its contractual agreement for services.[8]

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[6] *See, e.g.*, *Tidewater v. United States*, 565 F.3d 299 (5th Cir. 2009) (applying criteria set forth in § 7701(e)(1) to determine if a contract was a lease or service contract).

[7] The Restatement illustrates this definition with a situation that is as follows:

> *A* writes the *X* hotel requesting a reservation of a double room for himself and wife for arrival on July 1 and departure five days later. The *X* hotel confirms his reservation, but when *A* arrives at the hotel all rooms are occupied. Neither *A* nor the hotel contemplates that *A* would be entitled to remedies against another occupant of the room reserved for *A* for the recovery of possession of the room. Rather, *A* would look to the hotel management to provide *A* with a room. A shorthand way of expressing this conclusion is that the hotel guest is not given the right to "possession" of a particular hotel room.

Restatement (Second) of Property, Landlord and Tenants § 1.2.

[8] Further, the Court's reliance on *Mabley v. Commissioner*, T.C. Memo. 1965-323, as authority for its conclusion that the Bruins leased the meeting rooms is misplaced. *Mabley* featured a yearly lease between the taxpayer's employer and a nearby hotel that guaranteed the employer use of a particular space. The contracts providing the Bruins with use of the meeting rooms, by contrast, were only part of the overnight rooming contract and did not guarantee the Bruins the use of any particular space.

(3) The IRS disagrees with the Court's implication that cost reduction is relevant to the issue of whether the Bruins provided meals in a manner that discriminated in favor of highly compensated employees.

The IRS also disagrees with dicta that the Court used in analyzing the issue of whether the Bruins provided the meals in a manner that discriminated in favor of highly compensated employees. Section 132(e)(2) requires that access to an employer-operated eating facility must be available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees. The players, executives, and most coaches that traveled were highly compensated, while the other travelling staff was not. The Court stated:

> Petitioners provided credible testimony that the pregame meals were made available to all Bruins' traveling hockey employees—highly compensated, nonhighly compensated, players, and nonplayers—on substantially the same terms. Petitioners also provided testimony, which we find credible, *that any discrepancy between anticipated and actual meal attendees was a function of cost reduction concerns and not discrimination*. We therefore hold that the Bruins' provision of pregame meals to traveling hockey employees satisfies the nondiscriminatory manner requirement of section 132(e)(2). (Emphasis added).

The IRS disagrees with the Court's implication that cost reduction is a permissible reason to discriminate. What is relevant is whether the team allowed access to all members of the travelling staff, or a subset of that staff derived from a reasonable classification, on substantially the same terms.

Due to the fact-specific nature of *Jacobs*, and the IRS's intention to publish regulations under sections 119 and 132 regarding employer-provided meals to address some of the issues presented in the case prospectively, the IRS did not appeal the decision. With respect to employer provided meals furnished prior to the effective date of such regulations, the IRS will follow *Jacobs only with respect to cases involving sports teams in which the material facts are substantially identical to those present in Jacobs*. The Tax Cuts and Jobs Act eliminated the exception to the deduction disallowance under section 274(n)(2)(B) such that the identical issue will not arise for amounts paid or incurred after December 31, 2017.

Recommendation: Acquiesce in result only.

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