Settlement Guidelines: Meal Allowances

APPEALS

INDUSTRY SPECIALIZATION PROGRAM

COORDINATED ISSUE SETTLEMENT GUIDELINE

INDUSTRY:	Utilities
ISSUE:	Meal Allowances
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SETTLEMENT GUIDELINES

MEAL ALLOWANCES

ISSUES

Issue One:

Whether the payments of meal allowances by a company (the "Company") constituted gross income to the Company's employees, or whether these allowances qualified for exclusion from gross income as "de minimis" fringe benefits under section 132(a)(4) of the Internal Revenue Code (the "Code").

Issue Two:

Subpart A: If the Company's meal allowances were gross income to its employees, whether these allowances constituted wages for federal employment tax purposes--Collection of Income Tax at Source on Wages; the Federal Insurance Contributions Act ("FICA"); and the Federal Unemployment Tax Act ("FUTA").

Subpart B: If the Company's meal allowances constituted wages to its employees, whether it was reasonable for the Company not to withhold and pay federal employment taxes on these allowances.

PROCEDURAL BACKGROUND

These coordinated issues were approved by the Office of Chief Counsel on March 1, 1994. Although these issues are common to all industries, the examples used herein pertain to the utility industry for illustrative purposes.

FACTS

The Company is in the business of providing utility

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Service to its customers. Overtime work and emergencies are a routine part of the Company's business. In such situations, the Company has an established practice of providing cash meal allowances to its employees.[1] The Company provides the meal allowances either in advance in the form of a cash allowance or as a cash reimbursement of a meal expense. The Company provides a meal allowance every time an employee works a specified amount of overtime or performs services on a non-work day or outside normal hours.

The practice of providing meal allowances is so well-established that it is incorporated into the Company's collective bargaining agreement with the union representing the Company's union employees. Under the collective bargaining agreement, the Company is contractually liable to provide employees with a meal when employees are prevented from observing their usual meal practices.

Although meal allowances are part of the Company's collective bargaining agreement with the employee union, the Company may also provide meal allowances to non-union or non-bargaining but non-managagement employees. The majority of the meal allowances are provided to production plant employees and maintenance or trade employees who are frequently required to remedy situations jeopardizing uninterrupted utility service or production. These employees are provided meal allowances for meals consumed during the overtime period.

Although the Company has a computerized accounting system, the Company has not integrated the data for meal allowances with its payroll system. Thus, the Company commonly pays meal allowances from petty cash. The Company does not generally have records reflecting the

[1] Meal allowances are also commonly referred to as meal reimbursements, cash reimbursements, overtime meals, cash payments, meals, or payments. These guidelines will use the term "meal allowances."

total amount of meal allowances paid to individual employees. The Company did not report any of the meal allowances on its employees' Forms W-2, and, accordingly, did not withhold and pay federal employment taxes on the allowances.

EXAMINATION DIVISION'S POSITION

Issue One:

The Company's meal allowances did not satisfy section 132(e) or meet the three conditions for "occasional meal money" under section 1.132-6(d)(2)(i) of the final regulations or section 1.132-6T(d)(2) of the temporary regulations, as applicable; therefore, the allowances did not qualify for de minimis treatment under section 132(a)(4) and, consequently, constituted gross income to the Company's employees under section 61.

Issue Two:

Subpart A. Because the Company's meal allowances were includible in the gross income of the Company's employees, the allowances are wages, subject to employment taxes.

Subpart B. The Company could not have reasonably believed that the meal allowances were excludable from the gross income of its employees when the allowances were provided; therefore, the allowances fall within the definition of wages and, consequently, were subject to employment taxes when paid.

TAXPAYER'S POSITION

Issue One:

The Company's meal allowances satisfied section 132(e) and met the three conditions for "occasional meal money" under section 1.132-6(d)(2)(i) of the final regulations or section 1.132-6T(d)(2) of the temporary

regulations, as applicable; therefore, the meal allowances qualified as de minimis fringe benefits under section 132(a)(4), and, consequently, the meal allowances were not income to the Company's employees under section 61.

Issue Two:

Subpart A. Even if the meal allowances failed to qualify as de minimis fringe benefits under section 132(a)(4), the meal allowances did not constitute wages subject to employment taxes.

Subpart B. The Company had a reasonable belief that the meal allowances would be excludable under section 132 when paid. Therefore, the allowances were excepted from the definition of wages and were not subject to employment taxes.

ISSUE ONE

Whether the Company's payments of meal allowances constituted gross income to its employees, or whether the payments of these allowances qualified for exclusion from gross income as de minimis fringe benefits under section 132(a)(4).

A. **Background on Taxation of Fringe Benefits.**

The Deficit Reduction Act of 1984 ("DEFRA") amended section 61(a) and added section 132 to the Code to clarify the income tax treatment of fringe benefits. Effective since January 1, 1985, section 61(a) provides that gross income means all income from whatever source derived, including (but not limited to) compensation for services, including fees, commissions, fringe benefits, and similar items. Consequently, a fringe benefit provided by an employer to an employee is presumed to be income to the employee, unless it is specifically excluded from gross income by another section of the Code. See section 1.61-21(a) of the regulations.

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In adding section 132 to the Code, DEFRA substituted a statutory approach for the compensatory-noncompensatory approach of prior law in determining what employer-provided benefits should be excluded from income. Before DEFRA, the income tax treatment of fringe benefits was governed according to whether such benefits were deemed compensatory. For example, the Service concluded in O.D. 514, 2 C.B. 90 (1920) that cash payments for "supper money" were excludable from income under the "convenience-of-the-employer" doctrine:

'Supper money' paid by an employer to an employee, who voluntarily performs extra labor for his employer after regular business hours, such payment not being considered additional compensation and not being charged to the salary account, is considered as being paid for the convenience of the employer and for that reason does not represent taxable income to the employee.

In 1977 the Supreme Court removed any remaining vitality from the convenience-of-the-employer doctrine in Commissioner v. Kowalski, 434 U.S. 77 (1977). In that case the state of New Jersey reimbursed its highway patrol officers for meals they consumed while on duty. The Court considered whether the reimbursements constituted gross income under section 61(a) or whether the reimbursements were excludable under section 119, concerning meals and lodging furnished for the convenience of the employer.[2] Concluding that Congress, in enacting section 119, unquestionably intended to overturn the reasoning behind rulings like O.D. 514, which were based on the employer's characterization of a payment, the Court held that the reimbursements were gross income to the New Jersey officers under section 61 of the Code.

[2] Generally, under section 119 employees may exclude the value of meals furnished by an employer if: 1) the meals are furnished on the business premises of the employer; and 2) the meals are furnished for the convenience of the employer. See generally, section 1.119-1(a)(1) of the regulations.

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Section 531 of DEFRA amended section 61 to include fringe benefits such as meal money (e.g., meal allowances) in gross income and added section 132 to exclude only certain fringe benefits from income. Thus, by the beginning of 1985, when the DEFRA amendments became effective, the general rule was that fringe benefits such as cash meal allowances and reimbursements were includible in gross income, subject to certain exceptions provided under section 132.

B. **General Law Discussion**.

Gross income means all income from whatever source derived, including (but not limited to) compensation for services, including fees, commissions, fringe benefits, and similar items. See section 61(a). To the extent that a particular fringe benefit is specifically excluded from gross income under another section of subtitle A of the Code, that section governs the treatment of the fringe benefit. Section 1.61-21(a)(2) of the regulations.

Gross income does not include "de minimis" fringe benefits. Section 132(a)(4). A de minimis fringe benefit means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer) so small as to make accounting for it unreasonable or administratively impracticable. See section 132(e)(1).

Frequency and value are separate elements in determining whether fringe benefits are de minimis fringe benefits under section 132(a)(4). Thus, to determine whether the meal allowances provided by the Company qualified as de minimis under section 132(e), the value of the benefits *and* the frequency with which they were provided to individual employees must be separately considered. As the Joint Committee on Taxation explained:

[T]he frequency with which any such benefits are offered

may make the exclusion unavailable for that benefit, regardless of difficulties in accounting for the benefits.

General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, Joint Committee on Taxation, 98th Cong., 2d Sess., at 859 (1984).

For example, if an employer provides an employee with a single annual benefit of $1,000, the benefit has been provided infrequently. However, since it is not so small in value as to make accounting for it unreasonable, it does not qualify for de minimis treatment under section 132(a)(4). Likewise, if an employer provides an employee with bus fare each work day, the benefit in the aggregate may not be great in value, but it is not de minimis because it is frequently provided and, therefore, accounting for it is not unreasonable or administratively impracticable. Determinations of whether it was unreasonable or administratively impracticable to account for certain benefits are made based on the facts of each case, using the elements of frequency and value.

Unless otherwise excluded by a provision other than section 132(a)(4), the value of any fringe benefit that would not be unreasonable or administratively impracticable to account for is includible in the employee's gross income. Treas. Reg. § 1.132-6(c); Temp. Treas. Reg. § 1.132-6T(c). Consequently, the regulations provide that a cash fringe benefit is never excludable under section 132(a)(4) as a de minimis fringe benefit, except as specifically provided in special rules under section 1.132-6(d)(2)(i) of the final regulations or section 1.132-6T(d) of the temporary regulations. Treas. Reg. § 1.132-6(c); Temp. Treas. Reg. § 1.132-6T(c).

The special rules under section 1.132-6(d)(2)(i) of the final regulations add an additional layer of analysis to the determination of whether certain cash fringe benefits are de minimis.[3] This additional analysis

[3] The special rules under the temporary regulations are

overlaps to a certain extent with the analysis under section 132(e). For cash fringe benefits such as meal allowances to qualify as de minimis under section 1.132-6(d)(2)(i) of the regulations, they must be reasonable *and* satisfy the following three conditions:

1) The benefits are provided on an occasional basis;

2) The benefits are provided because overtime work necessitates an extension of the employee's normal work schedule; and

3) The benefits are provided to enable the employee to work overtime.

Under this second layer of analysis, a determination must first be made concerning whether the fringe benefit provided was reasonable. The term reasonable is not defined in the regulations. However, reasonable generally relates to the extravagance of the benefit provided; on the other hand, the three conditions relate to why and how the benefit was provided. Since meal allowances are negotiated with the Company, which generally attempts to keep meal allowances to a minimum, the reasonableness of the meal allowances will likely not be an issue. The determination of whether the meal allowances were reasonable must be made on a case-by-case basis.

The principal issue under the second layer of analysis is condition one--whether the meal allowances were provided on an occasional basis. Whether the benefit is furnished occasionally depends on the frequency with which it is provided.[4] Meal allowances

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discussed in the section on the differences between the temporary and the final regulations.

[4] Hence, the issue of whether meal allowances were provided occasionally under section 1.132-6(d)(2)(i)(A) is, essentially, the same issue as whether the meal allowances were provided frequently under section 132(e).

provided regularly or routinely are not provided on an occasional basis. Treas. Reg. § 1.132-6(d)(2)(i)(A). The determination of whether meal allowances were provided occasionally must be made on a case-by-case basis.

The second and third conditions, generally, will not be in issue. However, Examination may raise the third condition as a basis for including meal allowances in an employee's income if the allowances were not provided for meals consumed during the overtime period. For example, the Company may permit an employee to use the meal allowance for purposes other than the purchase of a meal. But the narrow exception provided under Treas. Reg. § 1.132-6(d)(2)(i) only allows employees to exclude from gross income occasionally-provided meal allowances that enable the employees to work overtime. It does not permit the Company's employees to exclude meal allowances from income unless the meal allowances are attributable to meals consumed during the overtime period.

If meal allowances do not qualify for de minimis treatment under the special rules of either the final or the temporary regulations, no portion of the meal allowances can qualify for de minimis treatment. Treas. Reg. § 1.132-6(d)(4); Temp. Treas. Reg. § 1.132-6T(d)(4).

1. **Differences between the temporary and final regulations**.

The final regulations differ from the temporary regulations in only a few respects. The principal difference concerns whether employees may be aggregated in determining the frequency with which meal allowances have been provided. The temporary regulations cover the period from **January 1, 1985 through December 31, 1988**. See Temp. Treas. Reg. §§ 1.61-2T; 1.132-1T through 1.132-8T. The final regulations are effective beginning on **January 1, 1989**. See Treas. Reg. §§ 1.61-21; 1.132-0 through 1.132-8.

Under section 1.132-6T(b) of the temporary regulations, the frequency with which meal allowances

were provided to an employer's employees is "determined by reference to the frequency with which the employer provides the fringe benefit to each individual employee." The final regulations are the same in this regard. But where it would be administratively difficult to determine frequency for individual employees, the temporary regulations provide a rule of administrative convenience. Under the temporary regulations, the frequency with which similar fringes are provided by the employer is determined by reference to the frequency with which the employer provided the fringes to the aggregate of all employees, rather than by reference solely to individual employees. See section 1.132-6T of the temporary regulations.

In determining whether benefits qualify as de minimis under the final regulations, there is no rule of administrative convenience permitting frequency to be determined on an aggregate employee basis. Frequency is determined on an individual employee basis. See section 1.132-6(b). For example, if an employer provides meal allowances to five of 200 employees on a daily basis, the value of the meal allowances is not de minimis for those five employees, even though the allowances were provided infrequently to the aggregate of the employer's employees. See section 1.132-6(b)(1) and (2).

In addition, the temporary regulations do not use the same special rules for cash fringe benefits. Although the temporary regulations do include special rules applicable to cash fringe benefits like meal allowances, the additional layer of analysis for cash meal allowances consists of only one of the elements included in the final regulations, as follows:

Occasional meal money . . . provided to an employee because overtime work necessitates an extension of the employee's normal workday is excluded as a de minimis fringe.

Temp. Treas. Reg. § 1.132-6T(d)(2). Thus, under the temporary regulations, there are no additional

requirements to show that the meal allowances were furnished "occasionally" or that the meal allowances enabled the employees to work overtime.[5]

2. **Section 119 does not apply to the Company's meal allowances**.

The value of the Company's meal allowances cannot be excluded from an employee's income under section 119 of the Code. As noted earlier, employees may generally exclude the value of meals furnished by an employer under section 119, if: (1) the meals are furnished on the business premises of the employer; and (2) the meals are furnished for the convenience of the employer. See generally, section 1.119-1(a)(1) of the regulations. The exclusion from income provided under section 119 applies only to meals furnished "in kind" by an employer. See section 1.119(e) of the regulations.

The Company furnishes meal allowances, not meals, to its employees. Therefore, section 119 does not apply to the Company's meal allowances because meals are not furnished in kind.

C. **Conclusion**.

Based on the foregoing discussion, the Company's employees must include in their gross incomes, under section 61, the value of meal allowances provided by the Company if the allowances fail to qualify as de minimis fringe benefits under section 132(a)(4).

ISSUE TWO

A. **If the meal allowances paid by the Company were**

[5] Even though there is no additional requirement to show that the meal allowances were provided occasionally under the temporary regulations, the element of "frequency" under section 132(e) nevertheless applies during periods when the temporary regulations applied.

includible in the employees' gross income, whether the meal allowances constitute wages.

Before DEFRA, the issue whether fringe benefits such as meal allowances were wages had received inconsistent treatment. For example, in Central Illinois Public Service Co., 435 U.S. 21 (1978), the Supreme Court held that lunch "reimbursements" paid to employees on non-overnight travel in 1963 were not wages subject to federal income tax withholding. However, the Court observed that when the definition of "wages" was formulated, congressional "committee reports" consistently stated that wages meant remuneration "if paid for services performed by an employee for his employer." This explanation by the Court recognizes that, even though the lunch reimbursements were not wages in 1963, the term wages includes payments received by employees for the performance of services.

As noted earlier, DEFRA amended section 61(a) to include fringe benefits in the definition of gross income and added section 132 to exclude only certain fringe benefits from gross income such as de minimis fringe benefits under section 132(a)(4). In enacting DEFRA, Congress also addressed whether fringe benefits were wages for employment tax purposes. The Committee Report on the DEFRA amendments states:

Since the statutory term 'remuneration' is to be interpreted broadly to include compensation for services which have been performed . . . benefits (such as allowances for meals when the employee is not away from home overnight) which are not excluded under the provisions of this bill or other statutory provisions are subject to these employment taxes.

H.R. Rep. No. 432, 98th Cong. 2d Sess. 1609 (1984)(emphasis added). This explicit reference to the factual issue present in Central Illinois Public Service Co. indicates that the issue of whether meal allowances and reimbursements are wages had finally been resolved. Under both the temporary and final regulations, a "fringe

benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services." See Temp. Treas. Reg. § 1.61-2T(a)(3); Treas. Reg. § 1.61-21(a)(3).

DEFRA also made clarifying amendments to the following employment tax sections: 3121(a)("FICA"), 3306(b)("FUTA"), and 3401(a)("withholding"). These Code sections and sections 31.3121(a)-1(b), 31.3306(b)-1(b), and 31.3401(a)-1(a)(1) of the Employment Tax Regulations provide that the term "wages" means all remuneration for employment unless specifically excepted. The clarifying amendments to the employment tax provisions resulted in the addition of sections 3121(a)(20), 3306(b)(16), and 3401(a)(19) to the Code. Under these sections, an employer may exclude fringe benefits from wage treatment only if, at the time the benefit is provided, the employer reasonably believes that the fringe benefit is excludable from income under section 132. See also Temp. Reg. §§ 31.3121(a)-1T; 31.3306(b)-1T; and 31.3401(a)-1T. The amendments to sections 3121, 3306 and 3401 were intended to and, indeed, did change prior law, including the rule in Central Illinois Public Service Co. Unless an employer reasonably believes that occasional meal allowances fall within the narrow definition under section 132(e), the allowances constitute wages, subject to employment taxes.

B. **If the meal allowances paid by the Company constituted wages, whether it was reasonable for the Company not to withhold and pay federal employment taxes on these allowances**.

If the Company wishes to argue that the meal allowances and reimbursements are excepted from the definition of wages by virtue of sections 3121(a)(20), 3306(b)(16), and 3401(a)(19), based on a reasonable belief that the allowances would be excludable under section 132 when the allowances were furnished, it is obligated to have had, at a minimum, an understanding of the law and to have applied the law to its practices of providing meal allowances. In this way, the existence of

a reasonable belief from excluding the benefits was based on a reasoned judgment. The exclusion for wages was not triggered merely by the Company's assertion that it applied.

To have had a reasonable belief when it provided meal allowances for overtime meals, the Company must show that the value of the meal allowances was (after taking into account the frequency with which similar fringes were provided by the employer) so small as to make accounting for them unreasonable or administratively impracticable.

In cases where the temporary regulations apply,[6] the frequency with which the Company provided meal allowances is based on the frequency with which the Company provided the fringe benefit to each individual employee. However, if the Company can show that it was administratively difficult to have determined frequency for each individual employee, the Company may show the frequency with which it provided the allowances to the aggregate of all its employees, rather than its individual employees. See section 1.132-6T of the temporary regulations. In addition, the Company must show that it satisfied the special rule for cash payments under section 1.132-6T. That is, the meal allowances were provided because overtime work necessitated an extension of the employee's normal workday. Temp. Treas. Reg. § 1.132-6T(d)(2).

In cases where the final regulations apply,[7] there is no rule of administrative convenience permitting frequency to be determined on an aggregate employee basis. Therefore, the Company must show the frequency with which it provided the allowances based on an individual employee basis. See section 1.132-6(b).

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[6] The temporary regulations cover the period from **January 1, 1985 through December 31, 1988**.

[7] The final regulations are effective beginning on **January 1, 1989**.

Furthermore, since the meal allowances are provided in cash, the Company must show that it satisfied the three conditions under the special rules in section 1.132-6(d)(2)(i). Thus, under subparagraph (A) the Company must establish that the cash payments were made on an occasional basis. Under subparagraph (B), the Company must show that the meal allowances were provided because overtime work necessitated an extension of its employees' normal work schedule. Under subparagraph (C), the Company must show that the meal allowances enabled the employee to work overtime; in other words, the Company must show that the meal allowances were used to purchase meals.

Unless the Company can show both that it met section 132(e) and that it complied with the conditions specified under the regulations--when it provided meal allowances--the Company cannot have had a reasonable belief that the meal allowances would be excludable under section 132 when the allowance was furnished.[8]

C. **Conclusion**

If the Company's meal allowances constituted gross income to its employees, the allowances were wages, subject to employment taxes, unless an exception applied. Under section 3401(a)(19), an exception to wages is provided for any benefit, if at the time the benefit is furnished, it is reasonable to believe that the employee

[8] The Company may rely on Central Illinois Public Service Co. v. United States, 435 U.S. 21 (1978) to argue that its failure to withhold was reasonable due to the lack of clear guidance concerning "occasional" meal money. However, this argument should be rejected. Even if the law were unclear in 1963 concerning whether lunch reimbursements were wages, the Company's allowances were paid after the amendment of section 61 and the enactment of section 132 under DEFRA. In other words, the Company's meal allowances were paid when there was clear guidance on the employment tax treatment of these meal allowances.

will be able to exclude the benefit from income under section 132. To qualify for the exception to withholding under section 3401(a)(19), the Company must show it satisfied section 132(e) and complied with the conditions under the regulations--when it provided the allowances.[9]

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[redacted].

ISSUE ONE

[redacted].

[redacted]

[9] The same conclusion applies concerning the Company's obligation to have withheld and paid FICA and FUTA taxes. See sections 3121(a)(20) and 3306(b)(16).

[10] As explained above, where it would be administratively difficult to determine frequency for individual employees, the temporary regulations provide a rule of administrative convenience. Frequency may be determined by reference to the frequency with which the employer provides the fringes to the aggregate of all its employees, rather than by reference to individual employees. See section 1.132-6T of the temporary regulations.

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B. [redacted]

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