



Coordinated Issue All Industries Meal Allowances (Effective: April 14, 1994)

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ISSUES:

1. Whether the payments of meal allowances and/or meal reimbursements by a company ("Company") constitute taxable income to employees or, in the alternative, whether the amounts qualify for exclusion as de minimis fringe benefits under section 132(a)(4) of the Internal Revenue Code (Code).
2. If the allowances or reimbursements paid by Company are includible in the gross income of the employees, whether these amounts constitute wages for federal employment tax purposes (federal income tax withholding, the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA)) or, in the alternative, whether it is reasonable for Company not to withhold and pay federal employment taxes with respect to these amounts.

FACTS:

In an effort to facilitate and insure the timely performance of employment services, Company has a policy of providing "overtime meals" to its employees in the form of reimbursements for meals and payments of meal allowances. Because the policy is incorporated in a collective bargaining agreement, Company is contractually liable to provide employees with "a comparable substitute" for meals when employees are prevented from observing their usual meal practice. Under normal circumstances, Company extends these overtime meal provisions to non-bargaining employees (other than management). In general, however, the bulk of the overtime meals are provided to production plant workers and maintenance/tradespersons who are frequently called upon to remedy situations that jeopardize uninterrupted service or production.

Although Company has a computerized accounting system, its accounting data for meal allowances generally is not integrated with its payroll system. It is common for overtime meals to be paid from petty cash, hence Company does not have records reflecting the total amount of overtime meals paid.

In general, overtime work is a routine part of Company's business. In most cases, Company has an established practice of providing meal allowances and reimbursement. Often, the practice is to provide a union or non-union employee with a "meal" every time the employee works a specified amount of overtime or performs services on a non-work day or outside normal hours. The likelihood that meal allowances and reimbursements will be provided is so well established that it is incorporated into Company's collective bargaining agreement with its unionized employees, the result being that meal allowances and reimbursements are contractually mandated payments.

LAW & ANALYSIS - Issue 1:

Section 61 of the Code 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. Section 1.61-21 (a)(2)^[1] of the Income Tax Regulations provides that to the extent a particular fringe benefit is specifically excluded from gross income pursuant to another section of subtitle A of the Code, that section shall govern the treatment of the fringe benefit.^[2]

Section 132(a)(4) of the Code provides that gross income shall not include any fringe benefit that qualifies as a de minimis fringe.

Under section 132(e) of the Code, a "de minimis fringe" is defined as "any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable." (Emphasis added.)

Section 132(l) of the Code provides that section 132 (other than subsection (e)) does not apply to any fringe benefits of a type the tax treatment of which is expressly provided for in any other section of Chapter 1 of Subtitle A.^[3]

Section 1.132-6(d)(2)(i) of the regulations states that meals, meal money or local transportation fare provided to an employee is excluded as a de minimis fringe benefit if the benefit provided is reasonable and is provided in a manner that satisfies the following three conditions:

- (A) The meals, meal money or local transportation fare is provided to the employee on an occasional basis (with reference to the availability, regularity and routine basis with which the benefit is provided);
- (B) The meals, meal money or local transportation fare is provided to an employee because overtime work necessitates an extension of the employee's normal work schedule; and
- (C) In the case of a meal or meal money, the meal or meal money is provided to enable the employee to work overtime.

In no event shall meal money or local transportation fare calculated on the basis of the number of hours worked (e.g., \$1.00 per hour for each hour over eight hours) be considered a de minimis fringe benefit.

In defining the term "de minimis fringe," section 132(e) directs the employer to take into account the "frequency" with which the benefits are provided to its employees before considering whether the value of the benefit is so small as to make accounting for it impracticable. Thus, frequency and value are separate elements for consideration. For example, if an employer provides an employee with a single annual benefit of \$1,000, the benefit has been provided occasionally. Because it is not small in value, however, it does not qualify for de minimis treatment under section 132(e). 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 violates the statutory directive that frequency is a relevant factor when determining whether the exclusion under section 132(a)(4) applies. See H.R. Rep. No. 861, 98th Cong., 2d Sess., at 1171 (1984), 1984-3 (Vol. 2) C.B. 425. Thus, in order to determine whether cash meal allowance or reimbursements provided by Company qualify as de minimis, it is necessary to determine the frequency with which the benefits are provided to employees in addition to determining whether the benefits are small in amount.

The issue of frequency is more specifically addressed in section 1.132-6(b)(1) of the regulations. It generally provides that the frequency with which similar fringes are provided by the employer to employees is determined by reference to the frequency with which the employer provides the fringe to each individual employee. Section 1.132-6(b)(2). In other words, to measure frequency, it is necessary to consider the provision of benefits on an individual employee basis. This requirement that frequency must be measured by reference to how often a benefit is provided to each individual employee did not apply, however, to meals or meal money provided before January 1, 1989. For benefits provided in taxable years 1985 through 1988, the temporary regulations permitted employers to determine the frequency with which meals or meal money were provided to employees by reference to the frequency with which the employer provided de minimis fringes to employees as a group.^[4] To illustrate, under the temporary regulations an employer was permitted to determine whether meal allowances were paid frequently by computing the average number of times these allowances were paid to employees (e.g. to all of its employees or a particular group of employees). Under the final regulations, use of this method for determining the frequency of "occasional meal money or local transportation fare" was eliminated and, therefore, frequency must be measured on an employee-by-employee basis for meals or meal money provided on or after January 1, 1989.

After determining the frequency with which the meals or meal money have been provided to employees, it is necessary to determine the value of the benefits. A "de minimis fringe" is any property or service the value of which is so small as to make accounting for it unreasonable or administratively impracticable. Section 132(e) of the Code. Section 132(e) is essentially a rule of administrative convenience for employers to permit them to exclude small, infrequent benefits, when the costs associated with treating these amounts as wages would exceed the nominal tax revenue generated. Whether a benefit is de minimis is determined by reference to the value of the benefits attributed to the individual employee and not whether the total amount of benefits provided by the employer to its employees is de minimis when compared to the employer's payroll, gross receipts, or total assets.

Examples in the legislative history confirm that section 132(e) was intended to exclude only those benefits that are provided infrequently and are so small that the employer cannot reasonably account for them:

For example, benefits which generally are excluded as de minimis fringes include the typing of a personal letter by a company secretary, occasional personal use of the company copying machine, monthly transit passes provided at a discount not exceeding \$15, ... **occasional supper money or taxi fare for employees because of overtime work**, and certain holiday gifts of property with low fair market value.

H.R. Rep. No. 861, 98th Cong., 2d Sess., at 1168 (1984), 1984-3 (Vol. 2) C.B. 422 (emphasis added).

. . . [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. By way of illustration, the exclusion is not available if ...sandwiches are provided free-of-charge to employees on a regular basis.

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

Section 1.132-6(d)(2)(i) of the regulations, above, specifically address the example in the legislative history concerning "occasional supper money or taxi fare for employees because of overtime work". It states that meals, meal money or local transportation fare provided to an employee is excluded as a de minimis fringe benefit if the benefit provided is **reasonable** and is provided in a manner that satisfies three conditions. First, the benefit must be provided on an occasional basis. Second, it must be provided because overtime work necessitates an extension of the employee's normal work schedule. Finally, it must be provided to enable the employee to work overtime.

CONCLUSION - Issue 1:

Meals or meal allowances are fringe benefits to be included in gross income under section 61 of the Code unless specifically excluded from gross income pursuant to another section of the Code.

To be excludable under section 132 (a)(4) of the Code, the meal allowances/reimbursements must be "de minimis" after taking into account the value and frequency of such payments. In order to be considered "de minimis", meal allowances/reimbursements must be reasonable, provided on an occasional basis, provided because overtime work necessitates an extension of the employee's normal work schedule, and provided to enable the employee to work. Sec. 1.132-6(d)(2)(i) of the regulations.

Whether a benefit is provided occasionally must be determined on a case-by-case basis, taking into consideration the availability, regularity and routine with which the benefit is provided. Examiners are advised to closely analyze union contracts and non-union policy statements for overtime meal policies. Accounting procedures must be reviewed and the audit trail fully developed (particularly with respect to Company's accounting classifications for "Overtime Meals" and "Meals and Lodging"). Examiners have successfully reconstructed the frequency with which overtime meals

allowances have been paid through examination of accounting, payroll, and personnel records, including statistical sampling of petty cash vouchers and payroll data (to project total overtime by employee and average cost of a meal allowance or reimbursement).

Assuming all the conditions of section 1.132-6(d)(2)(i) of the regulations are met, if an employee's receipt of meal money is dependent on the discretion of the employer, the meal money may be occasional and hence excludable under section 132(a)(4) of the Code. If it is the employer's policy to pay a meal allowance based upon a pre-identified factual pattern or pre-existing entitlement program or rule (written or unwritten), further analysis may be warranted to determine whether the employer's policy to provide meals is beyond that which would be considered "occasional" under the regulations.

For years prior to 1989, examiners should attempt to analyze these payments on an individual employee basis. In the event that records on an individual basis are unavailable or the employer can otherwise demonstrate that obtaining them is administratively difficult within the meaning of the regulations, analysis based on an aggregate group of employees is acceptable. After 1988, the regulations require that these payments be analyzed on an individual employee basis. Payments that do not fit within the exception for "occasional meal money" under section 1.132-6(d)(2)(i) of the final regulations or 1.132-6T(d)(2) of the temporary regulations are to be included in the gross income of the employee under section 61 of the Code.

LAW & ANALYSIS - Issue 2:

Sections 3121(a), 3306(b), and 3401(a) of the Code 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, for purposes of FICA, FUTA, and federal income tax withholding, the term "wages" means all remuneration for employment with certain specified exceptions.

For purposes of FICA, FUTA and federal income tax withholding, sections 3121(a)(20), 3306(b)(16), and 3401(a)(19) of the Code, respectively, provide exceptions from the definition of "wages" for any benefit provided to an employee if at the time the benefit is provided it is reasonable to believe that the employee will be able to exclude the benefit from income under section 132. See also sections 31.3121(a)-1T, 31.3306(b)-1T, and 31.3401(a)-1T of the temporary regulations.

Section 1.61-21(a)(3) of the regulations provides that a fringe benefit provided in connection with the performance of services will be considered to have been provided as compensation for services.

Company may contend that even if the meal allowances and reimbursements it paid to its employee were taxable, there was no requirement that it pay and withhold employment taxes. Specifically, it may argue that the meals allowances and reimbursements are excepted from the definition of wages by virtue of sections 3121(a)(20), 3306(b)(16), and 3401(a)(19) of the Code, because it had a reasonable belief that the amounts would be excludable under section 132. Company may attempt to argue that its failure to withhold and pay employment taxes was reasonable due to the lack of clear guidance concerning "occasional" meal money.

The exclusion from wages found in sections 3121(a)(20), 3306(b)(16), and 3401(a)(19) of the Code is not triggered merely by an employer's assertion that it applies. If an employer seeks to rely on the exclusion, it is obligated, at minimum, to have ascertained the applicable law and to have applied it to the particular facts. In this way, the existence of a reasonable belief for excluding the benefits is based on a reasoned judgment.

In **Commissioner v. Kowalski**, 434 U.S. 77 (1977), the Supreme Court held that New Jersey's cash reimbursements to its highway patrol officers for meals consumed while on patrol duty constituted income to the officers within the broad definition of gross income under section 61(a) of the Code, and, further, that those cash payments were not excludable under section 119 of the Code which relates to meals or lodging furnished for the convenience of the employer. In so concluding, the Court traced the long history of the development of the convenience-of-the-employer doctrine. The Court explained that the doctrine is not a tidy one and that the phrase "convenience-of-the-employer" first appeared in O.D. 265, 1 C.B. 71 (1919). 434 U.S. at 84.

The Court continued by explaining that O.D. 514, which was issued the following year and extended the convenience-of-the-employer doctrine to cash payments for "supper money", created an exclusion from income based solely on an employer's characterization of a payment as noncompensatory. Id. at 85.

O.D. 514 provides:

"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.

The **Kowalski** Court concluded that Congress, through its recodification of the Code in 1954 and its enactment of section 119, unquestionably intended to overrule the reasoning behind rulings like O.D. 514 which rest on the employer's characterization of the nature of the payment. 434 U.S. at 92. However, the Court, in a footnote, declined to decide whether, notwithstanding section 119, other grounds for excluding "supper money" existed. 434 U.S. at 93 n.28.

In **Central Illinois Public Service Co. v. United States**, 435 U.S. 21 (1978), 1978-1 C.B. 310, the Supreme Court held that a \$1.40 lunch "reimbursement" paid to employees on non-overnight travel in 1963 was not wages subject to federal income tax withholding. The Court explained that the income tax issue was not before the Court and that the issue was whether the lunch reimbursements were or were not "wages" subject to withholding, even though it was unclear at the time whether these reimbursements might be held to constitute taxable income to employees under the Court's recent decision in **Kowalski**, supra. 435 U.S. 24. The Court observed that congressional "committee reports of the time [when the definition of 'wages' was formulated] stated consistently that 'wages' meant remuneration 'if paid

for services performed by an employee for his employer." 435 U.S. at 27 (emphasis supplied by the Court). The Court pointed out that Congress "'in the interest of simplicity and ease of administration,' confined the obligation to withhold to salaries, wages, and other forms of compensation for personal services." Id.

This explanation by the Court recognizes that, even though the lunch reimbursements in Central Illinois were not "wages" under the circumstances, the term "wages" does include payments received by employees for the performance of services. For several years after the decision in Kowalski, Congress precluded the Service from issuing regulations or rulings altering the tax treatment of nonstatutory fringe benefits. Pub. L. 95-427, § 1 (1978); Pub. L. 96-167, § 1 (1979); Pub. L. 97-34, § 801 (1981).

Following the expiration of the moratorium extended by the Economic Recovery Tax Act of 1981, Pub. L. 97-34, Treasury announced that the Service, pending Congressional action, would refrain from issuing regulations or rulings in the area and, accordingly, would not change its existing administrative practice prior to January 1, 1985. On July 18, 1984, Congress enacted section 531 of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. 98-369, that amended section 61(a) of the Code, effective January 1, 1985, to include "fringe benefits" in the definition of gross income.^[5]

In addition, DEFRA added section 132 to the Code, which provides a statutory approach for determining which employer-provided benefits should be excluded from income. The corresponding change to the employment tax provisions resulted in the addition of sections 3121(a)(20), 3306(b)(16), and 3401(a)(19) to the Code. The legislative history accompanying the enactment of these provisions sets forth their purpose as follows:

[T]he conference agreement sets forth statutory provisions under which (1) certain fringe benefits provided by an employer are excluded from the recipient employee's gross income for Federal income tax purposes and from the wage base (and, if applicable, the benefit base) for purposes of income tax withholding, FICA, FUTA, and RRTA, and (2) any fringe benefit that does not qualify for exclusion under the bill and that is not excluded under another statutory fringe benefit provision of the Code is includible in gross income for income tax purposes, and in wages for employment tax purposes, at the excess of its fair market value over any amount paid by the employee for the benefit. The latter rule is confirmed by clarifying amendments to the Code sections 61(a), 3121(a), 3306(b), and 3401(a) and section 209 of the Social Security Act.

H.R. Rep. 861, 98th Cong., 2d Sess. 1169 (1984), 1984-3 (Vol. 2) C.B. 423. As a result of DEFRA, only if the employer reasonably believes that the fringe benefit will be excludable from the gross income of the employee under section 132 may the fringe benefit be excluded from wages for employment tax purposes. Otherwise, the allowance will be presumed to be income and subject to employment taxes. As previously discussed, the operative exclusion under section 132 with respect to "occasional" meal money is section 132(e) which defines de minimis fringe benefits. That Congress intended to address meal allowances and reimbursements by the DEFRA amendments is made clear in the committee report which 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** indicates that the issue of whether meal allowances and reimbursements could be treated as noncompensatory was finally resolved by the DEFRA amendments.

If Company had ascertained the applicable law, it would have determined that the general rule as a result of the DEFRA amendments is that remuneration includes cash meal allowances and reimbursements, unless the requirements of section 1.132-6(d)(2)(i) of the regulations are met. Accordingly, it is generally not reasonable for Company to believe that meal allowances which fail to meet the conditions for exclusion under section 132(a)(4) of the Code are excludable from wages for employment tax purposes, but the examiner should recognize a potential issue in close factual cases.

CONCLUSION - Issue 2:

If the allowances paid by Company are includible in the gross income of the employees as determined under issue 1, the allowances constitute wages subject to withholding for purposes of the FICA, FUTA, and federal income tax withholding. Therefore, Company must withhold federal income tax and the employee portion of the FICA tax with respect to these payments. Additionally, Company must pay the employer portion of the FICA tax and any applicable FUTA tax related to the allowances paid.

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1. Sections 1.61-2T and 1.132-1T through 1.132-8T, the temporary regulations concerning the taxation and valuation of fringe benefits and exclusions from gross income for certain fringe benefits, were published December 23, 1985 and were effective from January 1, 1985, to December 31, 1988 with respect to fringe benefits provided before January 1, 1989. The temporary regulations were replaced with final regulations, section 1.61-21 and sections 1.132-0 through 1.132-8, effective for benefits provided on or after January 1, 1989.
 2. Section 119(a)(1) of the Code specifically excludes from gross income the value of employer-provided meals furnished to the employee (or the employee's spouse or dependents) for the convenience of the employer, but only if the meals are furnished on the business premises of the employer. Thus, to the extent meals furnished to an employee are excludable under section 119(a)(1) of the Code, section 1.61-21(a)(2) of the regulations provides that section 119(a)(1) will govern the tax treatment. See also section 1.61-2(d)(3) of the regulations. Section 119, however, is not applicable to Company's situation, because the exclusion under section 119 only applies to meals provided in-kind. See section 1.119-1(e) of the regulations. In Company's case, "overtime

meals" are in the form of reimbursements for meals and payments of meal allowances.

3. Section 1911 of the Comprehensive National Energy Policy Act of 1992, Pub. L. 102-486, amended section 132 of the Code to provide an exclusion for qualified transportation fringes in new section 132(f). Consequently, former section 132(j) was redesignated as section 132(k) after December 1992. Subsequently section 13213 of the Omnibus Budget Reconciliation Act of 1993, Pub. L. 103-66, amended section 132 of the Code to provide an exclusion for qualified moving expense reimbursements in new section 132(g). Thus, section 132(k) (as redesignated by the Energy Policy Act) was redesignated section 132(l) for benefits provided after December 31, 1993.
4. The rule in the temporary regulations (in effect for benefits provided in calendar years 1985-1988), that permits employers to determine the frequency with which meal money is provided to employees with reference to the frequency with which the employer provides the benefits to employees as a group, only applies if the employer demonstrates that it is administratively difficult to measure frequency on an individual basis. See section 1.132-6T(b).
If Company relies on the special rule in section 1.132-6T(b) for benefits provided in 1985 through 1988, care must be taken to insure that the group of employees defined includes employees who actually receive the benefit. For example, employees who perform emergency repair work are more likely to receive overtime meal allowances than clerical employees. If Company defines the group as "all employees", thereby including clerical employees who rarely receive the benefit, the average per employee will be less than if the group were defined as "maintenance employees". The average number of times an employee within a group receives the benefit decreases as the employee "group" increases in size.
5. Correspondingly, section 1.61-21(a)(3) of the final regulations and section 1.61-2T(a)(3) of the temporary regulations provide that a fringe benefit provided in connection with the performance of services is considered to have been provided as compensation for services.

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