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## PLR 9414040

The real estate broker markets and sells real property in a certain location ("the selling area") to residents of a particular state. The broker receives commissions based on sales. Potential purchasers are selected from residents of the state who enter drawings for free trips to locations such as the selling area. The drawings are generally held at trade shows, conventions, or the state fair. The broker does not engage in any other form of advertising.

To attract purchasers, the broker provides free dinners to attendees prior to the sales presentation. The attendees must stay for the presentation; the meals are free regardless of whether they actually purchase property. No owners or employees of the broker receive a dinner in connection with the presentation.

The Service has ruled that expenses incurred by the broker in serving the meal to potential buyers are deductible as expenses "associated with" the broker's trade or business, and that the deduction is not subject to the 80-percent limitation under section 274(n)(1).

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Full Text:

Date: January 10, 1994

CC:DOM:IT&A:02 – TR-31-2133-93

LEGEND:

X =  
\*\*\*

A =  
\*\*\*

B =  
\*\*\*

C =  
\*\*\*

Dear

\*\*\* This is in response to your letter of July 21, 1993, in which rulings are requested concerning the federal income tax consequences of certain marketing expenses incurred by the taxpayer, X.

The facts presented in support of the requested letter rulings are summarized below.:

X markets and sells real property near A to residents of B. X acts as a broker for the owners of the real property and receives commissions based on sales. X uses telemarketing to reach likely purchasers. It selects potential purchasers from residents of B who enter drawings for free trips to such locations as C and A. These drawings are generally held at trade shows, conventions, or B's state fair. X does not engage in any other form of advertising.

In order to attract purchasers X for the past several years has provided attendees with free dinners prior to the sales presentation. The dinners are provided free of charge regardless of whether the attendees actually purchase any property. The attendees, however, must stay for the presentation. No owners or employees of X receive a dinner in connection with the presentation.

On the basis of the above information you request rulings that:

(1) the meal expenses are "associated with" building goodwill preceding a business meeting, convention, or discussion, and

(2) X's deduction for the expenses of the meals is not subject to the percentage limitation of section 274(n)(1) of the Internal Revenue Code.

Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 274(a)(1)(A) provides, in general, that no deduction otherwise allowable is allowable for an item that constitutes an entertainment activity unless (1) the item directly relates to the taxpayer's trade or business, or (2) if the item directly precedes or follows a substantial and bona fide business discussion, the item is associated with the active conduct of the taxpayer's trade or business.

Section 4 of the Revenue Act of 1962, 1962-3 C.B. 111, added section 274 to the Code. S. Rep. No. 1881, 87th Cong., 2nd Sess. 1 (1962), 1962-3 C.B. 707, 734, states that.:

Under the bill, although deduction for entertainment expenses is restricted, such expenses will not be disallowed merely because they are incurred for the purpose of generating business goodwill. Goodwill has long been recognized as a legitimate objective of business entertaining and where the purpose of the expense and its clear relationship to a business is firmly established, the expense ordinarily will continue to be deductible.

In its explanation of the exceptions to the general disallowance provision the senate report states at page 743:

(h) Expenses for goods, services, and facilities made available to the general public by the taxpayer. This pertains to expenses for the entertainment of the general public by means of television, radio, newspapers, and the like. It also permits deductions for expenses for parks, etc., maintained by companies where the general public may attend. Expenses of distributing samples to the general public would also come within this exception.

Section 142 of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 1, 34 added section 274(n) to the Code. Section 274(n)(1) imposes an 80 percent limitation 1 on the amount otherwise deductible for (A) any expense for food or beverages, and (B) any item with respect to an activity considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such activity. The Conference Committee Report 2 in its explanation of the general requirements for the deductibility of all meal expenses stated:

Thus, under the conference agreement, deductions for meals are subject to the same business-connection requirement as applies under present law for other entertainment expenses. Accordingly, an expense for food or beverages is not deductible unless (in addition to generally applicable deduction requirements) the taxpayer (1) establishes that the item was directly related to the active conduct of the taxpayer's trade or business, or, in the case of an item directly preceding or following a substantial and bona fide business discussion, that the item was associated with the active conduct of the taxpayer's trade or business, and (2) substantiates the deduction as required by section 274(d) and Tres. Reg. sec. 1.274-5(b)(4). Under this requirement, no deduction is allowed unless business is discussed during, or directly before or after, the meal. . . .

Accordingly, in regard to ruling request #1, we believe that the meal expenses incurred by X are "associated with" X's trade or business.

Section 274(n)(2) provides that the provisions of section 274(n)(1) shall not apply to any expense if such expense is described in section 274(e)(2), (3), (4), (7), (8), or (9).

Section 274(e)(7) provides that subsection (a) shall not apply to expenses for goods, services, and facilities made available by the taxpayer to the general public.

S. Rep. No. 313, 99th Cong., 2nd Sess., 72, (1986), 1986-3 (Vol. 3) C.B. 1, 72, in its explanation of the specific requirements needed to come within the exceptions to the general limitation imposed by section 274(n)(1) states that:

[T]he reduction rule does not apply in the case of items, such as samples and promotional activities, that are made available to the general public. For example, if the owner of a hardware store advertises that tickets to a baseball game will be provided to the first 50 people who visit the store during a sale, then the full amount of the face value of the tickets is deductible by the owner. Similarly, a wine merchant who permits potential customers to sample wine of the type that the merchant is offering for sale may deduct in full the cost of wine used as a sample, along with reasonable costs that are associated with the winetasting (e.g., food that is provided with the wine to demonstrate the suitability of the wine for particular types of meals.)

Accordingly, based on the information submitted and the representations made, we conclude that the costs of the meals served to potential customers of X prior to the sales presentation is not subject to the 80 percent limitation provided for in section 274(n).

No opinion is expressed as to the federal income tax consequences of the transaction described above under any other provision of the Internal Revenue Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel  
(Income Tax & Accounting)

By:

Robert A. Berkovsky  
Chief, Branch 2

Enclosure:

1 The limitation will be 50 percent, effective for tax years beginning after December 31, 1993.  
Section 13209 of the Omnibus Budget Reconciliation Act of 1993.

2 H.R. Rep. No. 841, 99th Cong., 2nd Sess. II-24 (1986), 1986- 3 (Vol. 4) C.B. 1, 26.