Unintended Consequences: Tax Cuts and Jobs Act May Lead to Decreased Sales for Food, Beverage & Hospitality Businesses

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Entertaining customers, clients and other business contacts is (and has long been) a mainstay of commerce in the United States. Whether on the golf course or at a restaurant, the opportunity to wine and dine a potential business partner has been instrumental in cementing relationships and getting deals done. And, assuming that the expense had a legitimate business purpose, the costs of these business entertainment expenses have usually been deductible, in whole or in part, by the business or taxpayer that picked up the check.

With the enactment of the Tax Cuts and Jobs Act (the "Act")[1] in late 2017, all of this is about to change. Specifically, the Act completely disallows the deduction by a taxpayer of business entertainment expenses beginning with the 2018 tax year.

According to IRS Publication 463 (relating to what types of business entertainment expenses have historically been deductible — and in what percentages), entertainment "includes any activity generally considered to provide entertainment, amusement or recreation. Examples include entertaining guests at nightclubs; at social, athletic, and sporting clubs; at theaters; at sporting events; on yachts; or on hunting, fishing, vacation, and similar trips … Entertainment may also include meeting personal, living, or family needs of individuals, such as providing meals, a hotel suite, or a car to customers or their families."

It is certainly possible that the IRS might promulgate new rules that narrow the definition of entertainment (and thus mitigate the impact of the disallowance of the deduction for business entertainment expenses). But in the absence of a new definition (or a revision to the Act itself), consumer-facing businesses in the food, beverage and hospitality industries should assume that their customers will no longer be able to deduct these costs. And with that loss of a deduction one might naturally assume that these same businesses may begin to tighten their belts with respect to incurring the expenses in the first instance.

Wrapped up in all of this is a cautionary tale. Food, beverage and hospitality ventures that receive a meaningful amount of their revenue from customers entertaining business clients need to anticipate and be prepared for a potential downturn in sales to these customers. Whether you are operating a bar on the ground level of the office tower that

[1] In order to comply with Senate rules for the bill to qualify as a budget reconciliation bill, the short title "Tax Cut and Jobs Act" was actually deleted from the final bill but the name, or at least the acronym, seems to have lingered in local parlance.

hosts a well-attended happy hour for professionals in the building or a sports arena that sells season tickets and skyboxes to firms for the purpose of entertaining clients at NBA games, you can be certain that at least some of your customers' buying behaviors will likely change with the loss of this deduction.

It is likely that the businesses most dramatically impacted by this change will be those for which there is little question that the expense is one relating to entertainment. For example, providing clients with tickets to sporting events will — in most cases — no longer be deductible. Similarly, going forward it may be difficult to deduct the costs of sending customers or the salesperson-of-the-year on all-expense-paid trips to sunny destinations. What remains to be seen is the extent to which the loss of deductibility is offset by the Act's reduction in the corporate tax rate. For the largest businesses, it is likely that the loss of deductibility will have little to no effect on their client entertainment expenditures. For the smallest, however, their buying habits may change significantly.

The sad irony of this so-called "Tax Cuts and Jobs Act" is that these changes may pose a very real threat to jobs in the food, beverage and hospitality industries. Killing the tax benefit of entertainment expenses may very well lead to decreased sales and lower profits. Business owners are likely to react by cutting employee hours and possibly their jobs. If the intent of the Act was to create winners and losers, then this expensing provision puts the industry in the loser column. #Sad.