

[Back to Winter 2020 issue](#)

Income Available for Support and TCJA Tax Deduction Disallowances

JEREMY SALVADOR

Partner Miod and Company, LLP

By this time, most of us in the California Family Law community have in one way or another seen the effects of The Tax Cuts and Jobs Act (TCJA) on revoking the deductibility of spousal support. However, another deductibility issue exists that few recognize and fewer consider.

The TCJA changed deductions, depreciation, expensing, tax credits and other tax items that affect businesses. While the disallowance of certain items may be appropriate to conform to the TCJA, the same disallowances may not be appropriate when computing income available for support. This creates a situation where, in practice, an expense may be disallowed for tax purposes, but, at the same time, expensed for purposes of computing income available for support. This article aims to highlight some examples of this issue, but is not to be construed as exhaustive.

Meals and Entertainment

The TCJA places limits on deduction for meals and entertainment expenses. Previously under IRC § 274(a)(1)(A) and IRC § 274(n)(1), a business was able to deduct up to 50% of meals and entertainment expenses directly related to the active conduct of a trade or business or incurred immediately before or after a substantial and bona fide business discussion.

The TCJA generally eliminated the deduction for any expenses related to activities considered entertainment, amusement or recreation. However, under the new law, taxpayers can continue to deduct 50% of the cost of business meals if the taxpayer (or an employee of the taxpayer) is present and the food or beverages are not considered lavish or extravagant. The meals may be provided to a current or potential business customer, client, consultant or similar business contact. If provided during or at an entertainment activity, the food and beverages must be purchased separately from the entertainment, or the cost of the food or beverages must be stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. In addition to separation from food and beverage costs, the interim guidance

published by the IRS on this topic specifically warns against circumventing the new rule on disallowance of entertainment through the inflation of charges for food and beverages.

De minimis food and beverages, such coffee and snacks in an office pantry, are now subject to a 50% deduction limit. These de minimis snacks and beverages are still excludable from employee compensation, but the employer expense is no longer fully deductible.

This means that businesses incurring legitimate meals and entertainment expenses necessary in its operations will have some or all of these expenses eliminated for tax purposes. Therefore, further analysis should be conducted to determine if any of these expenses should be added back to total business deductions for purposes of income available for support in a family law proceeding.

As a side note, meals and entertainment expenses treated by the taxpayer as compensation paid to an employee are fully deductible.

Prohibition of Certain Employee Benefits

The TCJA places a prohibition on cash, gift cards and other non-tangible personal property awarded to or paid on behalf of an employee. Previously, employers could deduct the cost of certain employee achievement awards. Those deductible awards were excludable from employee income for tax purposes.

Under the current tax rules, special rules allow an employee to exclude certain achievement awards from their wages if the awards are tangible personal property. An employer also may deduct awards that are tangible personal property, subject to certain deduction limits. TCJA clarifies that tangible personal property doesn't include cash, cash equivalents, gift cards, gift coupons, certain gift certificates, tickets to theater or sporting events, vacations, meals, lodging, stocks, bonds, securities, and other similar items.

Additionally, under the TCJA, certain transportation expenses paid or incurred by employers for the benefit of employees are generally no longer deductible. These expenses include parking expenses, transit passes, and transportation in a commuter highway vehicle ("vanpooling").

For purposes of income available for support, however, these awards and expenditures may materially affect income available for support of the employee receiving these benefits. Examining an employee's taxable income may not reveal the full amount of benefits and awards received. If not deductible to the business, using taxable income for income available for support services could overstate income of business owner.

Deduction for business interest expenses

Deductions for net interest was limited to 50% of the adjusted taxable income for firms with a debt to equity ratio above 1.5. Interest above the limit was able to be carried forward indefinitely.

The change limits deductions for business interest incurred by certain businesses. Generally, under IRC §448(c), for businesses with 25 million or less in average annual gross receipts, business interest expense is

limited to business interest income plus 30% of the business's adjusted taxable income and floor-plan financing interest. There are some exceptions to the limit, and some businesses can elect out of this limit. Disallowed interest above the limit may be carried forward indefinitely, with special rules for partnerships.

While for certain businesses, business interest expense would be non-deductible, care should be taken to ensure that the deductions for business interest do not materially affect income available for support of the business owner.

Unreimbursed Employee expenses

Before the TCJA, employees who incurred out-of-pocket expenses to perform their jobs were entitled to claim deductions to the extent such expenses were not reimbursed by the employer. These expenses were an itemized personal deduction claimed on IRS Schedule A; and were deductible only if, and to the extent, they exceeded 2% of the employee's adjusted gross income (AGI). Deductible employee expenses included:

- job-related mileage (not including personal commuting to and from home to the workplace)
- long-distance travel expenses
- uniforms and work clothes
- continuing education expenses required for a current job
- job search expenses for the same occupation
- work-related dues, including union dues, and subscriptions
- a home computer used for work, and
- home offices used for the convenience of the employer.

In 2015, 14.6 million taxpayers claimed unreimbursed employee expenses for a total of more than \$96 billion.

The TCJA completely eliminates the deduction for unreimbursed employee expenses for 2018 through 2025. This means, for example, that an employee salesperson who spends \$5,000 per year out of pocket driving for work will not be able to deduct the expense. The deduction is scheduled to return in 2026.

In the context of Family Law, this means that certain business-related deductions typically seen on Schedule A of the employee's personal tax return, will no longer be found there. Care should be taken to perform the appropriate due diligence and analysis to determine whether any unreimbursed employee expenses materially affect income available for support.

Conclusion

Many have rightly observed that Family Code § 4058 defining income for child support purposes lifts language from IRC § 61 which defines gross taxable income. However, clearly, dissonance exists between the definitions of income between a family law proceeding and an income tax matter. The discrepancy may be the result of legitimate business expenses that are not allowed as a tax deduction or are not reported as part of an employee's taxable income, which may include meals and entertainment, certain employee benefits, and business interest expense. One should take the time to analyze the differences and determine if a material discrepancy exists.