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COMMAND PERFORMANCE: THE TAX TREATMENT OF EMPLOYER MANDATED EXPENSES

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EMPLOYERS frequently not only expect but require performance of duties by employees beyond a nine to five tour at the office or plant. Such obligations may include the employee's living or eating on the employer's business premises, relocating himself and his family as a condition precedent to promotion or continued employment, obtaining additional education, entertaining his employer's customers, and traveling, including trips (frequently accompanied by his spouse pursuant to employer command, express or implied) to meetings and conventions, either sponsored by the employer or otherwise.

During the last half century, the federal income tax treatment of such activities has been the subject of numerous rulings and considerable litigation. All of the rulings and most of the decisions have compartmentalized the above expenses, thereby failing to recognize their common strands or develop rules of universal application. As a result, the common principles are, with a few significant recent exceptions, revealed in such piecemeal fashion by the various lines of cases involving specific types of deductions or exclusions that uncovering them is similar to piecing together a Chinese puzzle. The task is further complicated by the fact that the pieces are contained not only in cases involving exclu-

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sion from the employee's income of the employer's direct payment or reimbursement of the commanded expense, but also in the employee's deduction of expenses, both reimbursed and otherwise.

This article examines the development of the federal income tax treatment of various types of employer compelled expenses or activities with the goal of isolating common principles that might produce more conceptual harmony, and hopefully, a little tax equity. It must be noted at the outset, however, that the evolution of the case law within these categories has not been without frequent irreconcilable splits in authority, resulting in statutory attempts at clarification and reform in an effort to obtain more uniform and just results. The common factors that will recur in these cases are reducible to the common denominators of (1) employer compulsion and attendant lack of employee control and (2) business purpose or benefit to the employer. While the refinement and delineation of these factors have developed unevenly in the various categories of expenses, the most significant contrasts will be seen in their different application to exclusions and deductions.

I. CONVENIENCE OF THE EMPLOYER: LIVING AND EATING EXPENSES

The "convenience of the employer" doctrine has a long history prior to its partial codification in section 119 of the 1954 Code as an exclusion from income. It first appeared in the initial years of the income tax in administrative rulings proclaimed as early as 1914.¹ After several such rulings were issued in which government employees and others were not required to report as income the fair rental value of quarters furnished them for the benefit and convenience of their employers,² the doctrine was promulgated in the regulations in 1920 as follows:

When living quarters such as camps are furnished to employees *for the convenience of the employer*, the ratable value need not be added to the cash compensation of the employee, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax (emphasis added).³

¹ T.D. 2079, 16 TREAS. DEC. INT. REV. 249 (1914); Note, *Dissection of a Malignancy: The Convenience of the Employer Doctrine*, 44 NOTRE DAME LAWYER 1104 (1969) (hereinafter cited as Note, *Convenience of the Employer*).

² *Id.* O.D. 11, 1 CUM. BULL. 66 (1919); O.D. 265, 1 CUM. BULL. 71 (1919).

³ Treas. Reg. 45, art. 33, T.D. 2992, 2 CUM. BULL. 76 (1920).

The doctrine as thus evolved was first judicially applied in *Jones v. United States*.⁴ There an army officer had been required to live in government quarters in connection with the performance of his official duties for the first part of the taxable year, and during the rest of the year, after transfer to a new post without government quarters, received a cash commutation in lieu of quarters. The Court of Claims held that neither the value of the government quarters nor the cash commutation constituted taxable compensation. The court relied primarily on three factors: (1) the statute taxed such officers only on their "compensation received as such" and the allowances in question were not compensatory in nature but rather a reimbursement; (2) the officer was compelled by the exigencies of his employment to occupy government quarters where such were available—"[i]f the nature of the services requires the furnishing of a house for their proper performance, and without it the service may not properly be rendered, the house so furnished is part of the maintenance of the general enterprise, an overhead expense so to speak, and forms no part of the individual income of the laborer";⁵ and (3) the taxpayer had no control over the quarters or allowance beyond "the naked right of an uncertain period of occupancy"⁶ where quarters were involved and no election to take the strictly regulated cash commutation where quarters were available.

Jones became the touchstone for exclusion in subsequent cases and was relied upon in the first Tax Court decision sanctioning the doctrine, *Arthur Benaglia*.⁷ In that case, the taxpayer was employed as the manager of a resort hotel and was required to take his meals and lodging there. The court ruled that the taxpayer's residence at the hotel was neither compensation for his services nor was for his personal convenience, comfort or pleasure, but was furnished solely because he could not otherwise perform the services required of him. Consequently, it concluded that the value of the meals and lodging was not income to the employee even though it relieved him of expenses that he would have otherwise borne.⁸

⁴ 60 Ct. Cl. 552, 575, 577 (1925).

⁵ *Id.* at 575.

⁶ *Id.* at 577.

⁷ 36 B.T.A. 838 (1937).

⁸ The advantage to him was merely an incident of the performance of his duty, but its character for tax purposes was controlled by the dominant fact that the occupation of the premises was imposed upon him for the convenience of the employer. *Id.* at 840.

The Tax Court subsequently clarified this holding in *Gunnar Van Rosen*:

[T]hough there was an element of gain to the employee, in that he received subsistence and quarters which otherwise he would have had to supply for himself, *he had nothing he could take, appropriate, use and expend according to his own dictates, but rather, the ends of the employer's business dominated and controlled*, just as in the furnishing of a place to work and in the supplying of the tools and machinery with which to work. *The fact that certain personal wants and needs of the employee were satisfied was plainly secondary and incidental to the employment* (emphasis added).⁹

Thus, it may be seen that the case law doctrine rested in the eyes of the Tax Court (and other courts as well) on three factors: the employee's lack of control and dominion, the employer's requirement, and the primary purpose of the expense—to benefit the employer or the employee.¹⁰ It may be noted that where the secondary purpose was not merely incidental and relatively insignificant, but rather the employer benefit and employee benefit purposes were both substantial, an allocation would be made excluding from income the value of the lodging only to the extent attributable to the employer's benefit.¹¹

The Internal Revenue Service, on the other hand, took the position in *Mim.* 6472¹² that the pre-1954 Code convenience of the employer rule was "simply an *administrative test* to be applied only in cases in which the compensatory character of such benefits is not otherwise determinable."¹³ The Tax Court accepted the Service's position without question, stating in *Joseph L. Doran*:¹⁴

⁹ 17 T.C. 834, 838 (1951); *accord*, *Saunders v. Commissioner*, 215 F.2d 768, 774-75 (3d Cir. 1954).

¹⁰ See Michael A. Tougher, Jr., 51 T.C. 737, 745-46 (1969), *aff'd per curiam*, 441 F.2d 1148 (9th Cir.), *cert. denied*, 404 U.S. 856 (1971). These factors are criticized in Bittker, *The Individual as Wage Earner*, N.Y.U. 11TH INST. ON FED. TAX. 1147, 1155-57 (1953) (hereinafter cited as Bittker).

¹¹ Olin D. Ellis, 6 T. C. 138 (1946).

¹² 1950-1 CUM. BULL. 15. This ruling sparked controversy; compare Bittker, *supra* note 10, with Gutkin & Beck, *Some Problems in "Convenience of the Employer,"* 36 TAXES 153 (1958) (hereinafter cited as Gutkin & Beck).

¹³ See Harold Brannon Magness, 26 T.C. 981, 983 (1956), *aff'd*, 247 F.2d 740 (5th Cir. 1957), *cert. denied*, 355 U.S. 93 (1958) (clearly the doctrine is an administrative engrafting of an exclusion from gross income).

¹⁴ 21 T.C. 374 (1953); *accord*, *Charles A. Brasher*, 22 T.C. 637 (1954).

It is undoubtedly true that the petitioner [*i.e.*, taxpayer] lives at his place of employment for his employer's convenience, but it does not necessarily follow from this that the value of his living quarters is not compensation. The weakness of the petitioner's argument is that he considers "compensation" and "convenience of the employer" as necessarily alternative propositions. This is not so. The convenience of the employer rule is merely one test used to determine whether the value of living quarters furnished to an employee is compensation. In the absence of other criteria it has often been controlling.¹⁵

The circuit courts and district courts were less receptive to the Commissioner's contention that the doctrine was merely an administrative test applicable only when the compensatory nature of the benefit was not otherwise determinable.¹⁶ For instance, the Second Circuit in *Diamond v. Sturr*,¹⁷ citing pre-*Doran* Tax Court decisions,¹⁸ pointed out that the issue in such cases was not the issue of "compensation," but whether the food and lodging was supplied for the employer's convenience. The court held that the convenience of the employer test having persisted as the measuring rod of compensation in the interpretations of the Treasury and the Tax Court throughout years of reenactment of the Internal Revenue Code constituted the applicable standard—apparently referring to the familiar rule that "Treasury regulations and interpretations long continued without substantial change, . . . are deemed to have received congressional approval and have the effect of law."¹⁹ Other decisions, such as *Gordon v. United States*,²⁰ while not specifically rejecting Mim. 6472, in the words of one commentator "evaded the philosophy behind it."²¹ There the district court held that there was no inherent contradiction between the existence of an economic advantage and the co-existence of the more important convenience to the employer, the implicit premise being that an economic benefit is non-

¹⁵ Joseph L. Doran, 21 T.C. 374, 376 (1953).

¹⁶ Note, *Convenience of the Employer*, *supra* note 1, at 1117; see Gutkin & Beck, *supra* note 12, at 158-59.

¹⁷ 221 F.2d 264 (2d Cir. 1955).

¹⁸ Arthur Benaglia, 36 B.T.A. 838, 839 (1937); George Lamaze, 9 P-H B.T.A. Mem. 196 (1940). *Contra*, Herman Martin, 44 B.T.A. 185, 189 (1941). *Martin* was followed in *Doran*.

¹⁹ *Helvering v. Winmill*, 305 U.S. 79, 83 (1938); *accord*, George I. Stone, 32 T.C. 1021, 1024 (1959) (applying principle in context of section 119).

²⁰ 152 F. Supp. 427 (D.N.J. 1957).

²¹ Note, *Convenience of the Employer*, *supra* note 1, at 1118.

compensatory where furnished primarily for the benefit or convenience of the employer.

The House version of section 119 in the 1954 Code would have resolved this conflict in favor of the *Diamond* approach by specifically eliminating compensatory intent as a basis for not applying the convenience of the employer doctrine.²² The Senate believed that the House's use of the phrase "whether or not furnished as compensation" for this purpose was confusing²³ and substituted in its place "for the convenience of the employer."²⁴ Significantly, the Senate report despite this change in phraseology maintained that "there is excluded from the gross income of an employee the value of meals and lodging furnished to him for the convenience of his employer whether or not such meals and lodging are furnished as compensation."²⁵

Under section 119 both the Service and the Tax Court initially attempted to adhere to their 1939 Code positions, but they were soon rebuffed by the Eighth Circuit in *Boykin v. Commissioner*.²⁶ In reversing the Tax Court and the Commissioner, *Boykin* held that Congress intended to make the value of maintenance supplied in kind for the convenience of the employer excludable from gross income regardless of whether such maintenance might be regarded as part of the employee's compensation. Despite the fact that the Service has announced that it will follow *Boykin*,²⁷ the regulations continue to provide that meals are considered furnished for the convenience of the employer only if "furnished for a substantial noncompensatory business reason of the employer. If an employer furnishes meals as a means of providing additional compensation to his employee (and not for a substantial non-compensatory business reason of the employer), the meals so furnished will not be regarded as furnished for the convenience of the employer."²⁸ In light of the legislative history of section 119 one commentator has concluded that the proper interpretation of this language is that "substantial noncompensatory business reason of the employer" should have the same meaning as "primarily for the convenience of the em-

²² H.R. REP. NO. 8300, 83d Cong., 2d Sess. § 119 (1954).

²³ S. REP. NO. 1622, 83d Cong., 2d Sess. 19 (1954).

²⁴ INT. REV. CODE OF 1954, § 119.

²⁵ S. REP. NO. 1622, 83d Cong., 2d Sess. 19 (1954).

²⁶ 260 F.2d 249, 254 (8th Cir. 1958).

²⁷ Rev. Rul. 59-307, 1959-2 CUM. BULL. 48.

²⁸ Treas. Reg. § 1.119-1(a)(2) (1956).

ployer.”²⁹ It is submitted that *Diamond v. Sturr* correctly stated the law with respect to the non-statutory exclusion and, consequently, benefits furnished primarily for the employer’s convenience constitute non-compensatory benefits.

Whereas the pre-1954 Code convenience of the employer decisions probed the compensation issue, the 1954 Code section 119 cases examined areas such as the relationship between the employer’s command and the performance of the employee’s duties and between employer compulsion and lack of employee control where the employee is a dominant shareholder in his corporate employer.

A. *Duties of Employee*

Section 119 provides an exclusion from gross income of the value of meals or lodging furnished to an employee “by his employer for the convenience of the employer, but only if — . . . (2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.” It is generally recognized that the condition of employment test is merely a reformulation of the convenience of the employer test and the two are basically similar.³⁰ The Service interprets the condition of employment test as meaning that the employee must be required to accept the lodging in order to enable him to *properly perform the duties of his employment*.³¹ The Tax Court accepted this construction in *Mary B. Heyward*.³² It provided several examples of reasons requiring on premises housing for proper performance of duties: (1) remoteness of job site and unavailability of other housing, (2) necessity of the employee being on call for duty at all times, and (3) “possibly because the employer demands it for reasons of his own.”³³ The *Heyward* court reserved opinion on the question whether section 119 was applicable if the employer insists that the employee live on premises without any apparent connection between such occupancy and the performance of the employee’s duties.³⁴

²⁹ Note, *Convenience of the Employer*, *supra* note 1, at 1122.

³⁰ *United States Junior Chamber of Commerce v. United States*, 334 F.2d 660 (Ct. Cl. 1964); *accord*, Herbert G. Hatt, 38 P-H Tax Ct. Mem. 1293, 1303-04 (1969), *aff’d*, 72-1 U.S. Tax Cas. ¶ 9258 (7th Cir. 1972).

³¹ Treas. Reg. § 1.119-1(b) (1956).

³² 36 T.C. 739, 744 (1961), *aff’d per curiam*, 301 F.2d 307 (4th Cir. 1962).

³³ 36 T.C. at 744.

³⁴ *Id.*

In *Gordon S. Dole*,³⁵ however, the Tax Court came close to eliminating the demand of the employer as a criterion for establishing a condition of employment.³⁶

The standard prescribed by Congress is not subjective. It is objective. The employer's state of mind is not controlling Many employers may prefer that their employees live near the worksite so that they will be more readily available for work. This is not a situation like *William I. Olkjer* and *George I. Stone* where company housing near the construction site was the *only housing* available in which the employees could live. By contrast, it was not necessary for these petitioners to live in the company-owned houses to perform their duties adequately. No company business was conducted in the homes. They were used only as private residences of the petitioners. Granted that petitioners needed to be in close proximity to the mill when emergencies occurred, they could have lived in other available and suitable houses located . . . within a radius of 3 miles from the mill.³⁷

Dole was affirmed on appeal, however, on the basis of a concurring opinion resting solely on the rationale that the lodging was not located on the employer's business premises.³⁸

The Tax Court in *M. Caratan*³⁹ subsequently followed *Dole*, reasoning that the term "required" meant required in order for an employee to properly perform his duties of employment; therefore, the fact that an employee was compelled by his employer to accept lodging on business premises, standing alone, was not sufficient. The court found the lodging furnished was not indispensable to the proper discharge of the employee's duties. The Ninth Circuit reversed the Tax Court, construing the regulations under section 119 as providing alternative means of satisfying the proper performance of duties, *i.e.*, the condition of employment prerequisite is feasibility of performance without furnished lodging *or* a requirement that the employee be available at all times. "It is not necessary to show that the duties would be impossible to perform without the lodging being available. The regulation presumes that, if

³⁵ 43 T.C. 697 (1961), *aff'd per curiam*, 351 F.2d 308 (1st Cir. 1965).

³⁶ Note, *Convenience of the Employer*, *supra* note 1, at 1125.

³⁷ *Gordon S. Dole*, 43 T.C. 697, 706 (1961).

³⁸ *Dole v. Commissioner*, 351 F.2d 308, 309 (1st Cir. 1965). For an exhaustive treatment of the concept of business premises see *Commissioner v. Anderson*, 371 F.2d 59, 67 (6th Cir. 1966).

³⁹ 52 T.C. 960, 963 (1969), *rev'd*, 442 F.2d 606 (9th Cir. 1971).

the employee must be available for duty at all times, the lodging is, practically speaking, indispensable to the proper discharge of his duties.”⁴⁰ Yet, because the Ninth Circuit noted that the nature of the taxpayer’s job required that he be available for duty at all times, the question remains unanswered whether condition of employment is met where the employer requires that the employee live on the premises and be available for duty, but there is no apparent connection between such “on call” requirement and the performance of the employee’s duties. Nevertheless, the underlying rationale of the convenience of the employer doctrine that the lodging, etc., must primarily benefit the employer⁴¹ would appear to require such a rationale connection. Thus, there is an intimate interdependence between the concepts of employer requirement and employer benefit.

B. *Lack of Employee Control*

A further significant and more precisely charted area of interdependence is that of lack of employee control and employer requirement. Usually the former would be a corollary of the latter: since it is the employer who has required the move, lodging, or other “expenditure,” the employee has no control over it. However, this is not always the case. Nevertheless the Tax Court held in *Herbert G. Hatt*⁴² that the fact the employee is also the president and majority shareholder of the employer only necessitates careful scrutiny of the arrangement and does not disqualify the employee from the benefits of section 119 even if he could determine the “convenience” of his employer and the “conditions” of his own employment. Similarly, under this provision the fact that the employee is inconvenienced is not relevant;⁴³ the determinative issue is whether the meals and lodging were provided for the convenience of the employer. On the other hand, where the employee controls the time, manner, and place of an expenditure, such as a cash allowance provided on-duty highway patrolmen for meals, the Tax Court has held under the pre-section 119 law that the allowance constituted compen-

⁴⁰ *Caratan v. Commissioner*, 442 F.2d 606, 609 (9th Cir. 1971).

⁴¹ See Note 9 *supra* and accompanying text.

⁴² 38 P-H Tax Ct. Mem. 1293, 1304 (1969), *aff'd*, 72-1 U.S. Tax Cas. ¶ 9258 (7th Cir. 1972); see T. NESS & E. VOGEL, *TAXATION OF THE CLOSELY-HELD CORPORATION* 8-57 (revised 1972) (hereinafter cited as *Ness & Vogel*).

⁴³ *William I. Olkjer*, 32 T.C. 464, 469 (1959).

sation.⁴⁴ In a subsequent section 119 decision the Tax Court made explicit this interdependence between lack of employee control and convenience of the employer.⁴⁵

Interestingly, the First Circuit, in a case involving reimbursement to state policemen for on-duty meals in public restaurants adjacent to highways assigned to them, reasoned that from the point of view of the taxpayer, his employer's compulsory control over the place, duration, value, and content of the meal might substantially reduce his freedom and enjoyment of the meal and, hence, its *value* to him.⁴⁶ The circuit court noted that the Tax Court has considered these factors to be strong evidence that employer's convenience was served, as distinguished from a mere attempt to supply tax free income to the employee,⁴⁷ but declined to deal with the convenience of the employer requirement of section 119, finding the "meals" were not furnished on the employer's business premises and that the "value of meals" did not encompass cash payments.

In summary, while the Tax Court has on one occasion stated that lack of employee control is strong evidence of "convenience of the employer," *i.e.*, implying that the former element is not always synonymous with employer requirement, the more established and widely accepted view is that the factors of (1) employer requirement, (2) benefit to the employer, and (3) lack of employee control (usually a concomitant of the employer's command) are sufficient for exclusion from income, or at least satisfy the employer convenience and condition of employment requirements of section 119. There is a further conflict

⁴⁴ Harold Brannon Magness, 26 T.C. 981 (1956), *aff'd*, 247 F.2d 740 (5th Cir. 1957), *cert. denied*, 355 U.S. 931 (1958); see Walker, *Employee Meals, Lodging and Moving Expenses*, N.Y.U. 25TH INST. ON FED. TAX. 529, 538 (1966) (hereinafter cited as Walker); Ness & Vogel, *supra* note 42, at 8-55. See generally Note, *Convenience of the Employer*, *supra* note 1, at 1133 n.223.

⁴⁵ "When an employer furnishes a 'meal' in its normal sense, he can control the time, place, duration, value and content of the meal to suit his convenience. These elements of potential control, which are strong evidence that the employer's convenience is involved, are lacking in a case such as this one, where the employee merely purchases groceries." Michael A. Tougher, Jr., 51 T.C. 737, 745-46 (1969), *aff'd per curiam*, 441 F.2d 1148 (9th Cir.), *cert. denied*, 404 U.S. 856 (1971).

⁴⁶ *Wilson v. United States*, 412 F.2d 694, 697 (1st Cir. 1969); *cf.*, Allen J. McDonell, 36 P-H Tax Ct. Mem. 126, 129 (1967). See generally *Diamond v. Sturr*, 221 F.2d 264, 267 (2d Cir. 1955); Bittker, *supra* note 10, at 1155 n.22.

⁴⁷ *Wilson v. United States*, 412 F.2d 694, 697 n.6 (1st Cir. 1969).

under the statutory exclusion as to whether lodging must also be indispensable to the performance of the employee's duties.

II. INTEREST OF THE EMPLOYER: MOVING EXPENSES

In Revenue Ruling 54-429⁴⁸ the Service announced that allowances or reimbursements made to an existing employee from his employer for moving himself, his immediate family, household goods and personal effects, *i.e.*, "direct moving expenses," "in the case of a transfer *in the interest of his employer*, from one official station to another for permanent duty, do not represent compensation . . . , and are not includible in the gross income of the employee"⁴⁹ if the total amount is expended for such moving expenses (emphasis added). *John E. Cavanagh*⁵⁰ made the similarity in terminology to the convenience of the employer doctrine explicit: "the *transfer* was not only for the convenience of his then employer, but specifically directed and required by it."⁵¹ Likewise in its well reasoned opinion in *Homer H. Starr*⁵² the Tax Court in elucidating the Service's phrase "interest of the employer," revealed the complete identity in theory in the two areas of meals and lodging and moving expenses.⁵³

These factors were the same as those utilized in *Gunnar Van Rosen*,⁵⁴ in explication of the pre-1954 convenience of the employer doctrine.⁵⁵ Finally, *Norvel Jeff McLellan*⁵⁶ acknowledged that but a single principle was being applied by citing a pre-section 119 employer convenience decision and ruling in the context of employee moving expenses.

Most cases have not acknowledged that the same principle was in-

⁴⁸ 1954-2 CUM. BULL. 53.

⁴⁹ *Id.*

⁵⁰ 36 T.C. 300 (1961).

⁵¹ *Id.* at 303.

⁵² 46 T.C. 743 (1966), *rev'd*, 399 F.2d 675 (10th Cir. 1968). See generally Note, *Tax Treatment of the Transferred Employee's "Indirect" Moving Expenses. Commissioner v. Starr* (10th Cir. 1968), 48 ORE. L. REV. 299 (1969) (hereinafter cited as Note, "*Indirect" Moving Expenses*).

⁵³ See generally Walker, *supra* note 44, at 549. "In a situation where the transfer of an existing employee is solely at the behest of the employer and where the cause of the temporary expenditure is outside the control of the employer, the expenses are incurred primarily for the benefit of the employer." *Homer H. Starr*, 46 T.C. 743, 747 (1966).

⁵⁴ 17 T.C. 834, 838 (1951).

⁵⁵ See p. 4 & note 9 *supra*.

⁵⁶ 51 T.C. 462, 466 (1968).

volved in the exclusion of meals and lodging under the convenience of the employer doctrine and in the exclusion of reimbursements of moving expenses incurred in the interest of the employer. Consequently, the courts have placed different emphasis on the elements of the single concept which is best described as the benefit of the employer doctrine. While a major focus of the convenience of the employer cases has been on the factor of lack of employee control,⁵⁷ a major concern of the exclusion of reimbursed moving expenses opinions has been whether the employee expense was in the primary interest of the employer.⁵⁸ An issue of common importance has been the circumstances in which an economic benefit, such as meals and lodging or reimbursement for moving expenses, is not compensatory.⁵⁹ Just as the pre-section 119 cases had split irreconcilably over this issue, so did the reimbursed moving cases.⁶⁰ Moreover, Congress also stepped in. In this instance, rather than prescribing a statutory exclusion, Congress fashioned a special deduction for moving expenses (thereby bringing tax parity to the unreimbursed employee)⁶¹ and ultimately provided expressly for inclusion in income of such reimbursements.⁶² While the ground rules are now firmly established for post-1969 tax years, two cases in the earlier tortious case law development that prompted this legislative reform are particularly instructive as to the parameters of the interest of the employer concept and the question of compensation in the context of the broader underlying doctrine of benefit of the employer. These cases, *Homer H. Starr*⁶³ and *Edward N. Wilson*,⁶⁴ epitomize the philosophical problems that have plagued the entire area of employer compulsion of expenditures.

The taxpayer in *Starr* had moved solely at his employer's behest and was unable to obtain a residence for himself and his family due to a housing shortage. Consequently, he resided in a hotel at the new job site for forty-three days while maintaining his family at his old residence until they could move into a residence at his new duty post. The tax-

⁵⁷ See notes 9 and 10 *supra* and accompanying text.

⁵⁸ *Homer H. Starr*, 46 T.C. 743, 746 (1966).

⁵⁹ See, e.g., *Diamond v. Sturr*, 221 F.2d 244 (2d Cir. 1955) ("convenience of the employer"); *Homer H. Starr*, 46 T.C. 743 (1966), *rev'd*, 399 F.2d 675 (10th Cir. 1968).

⁶⁰ Compare the Tax Court's opinion with the Tenth Circuit's opinion in *Commissioner v. Starr*, 399 F.2d 675 (10th Cir. 1968).

⁶¹ INT. REV. CODE OF 1954, § 217.

⁶² *Id.*, § 82.

⁶³ 46 T.C. 743 (1966), *rev'd*, 399 F.2d 675 (10th Cir. 1968) (exclusion).

⁶⁴ 49 T.C. 406 (1968), *rev'd*, 412 F.2d 314 (6th Cir. 1969) (deduction).

payer's employer reimbursed him for meals, lodging and incidental expenses at the new place of employment prior to the arrival of his family. The Tax Court acknowledged that the concept of gross income was all inclusive, but it also recognized that "it is a well-established principle that a reimbursement of costs incurred by an existing employee *primarily for the benefit of the employer is not compensatory in nature* and is excludable from the employee's gross income (emphasis added)." ⁶⁵ Rejecting the Service's contention that indirect moving expenses could not, under any circumstances, primarily benefit the employer, it proceeded to define the limits of the concept "interest or benefit of the employer." In keeping with the intent of Congress as manifested in its first attempt at reform in this area, a deduction under section 217 for the direct moving expenses of old employees, the court met the challenge of Congress' having expressly left the exclusion for judicial interpretation.

The court's starting point was that the criteria used to determine whether a reimbursement is compensatory are in no way dependent upon considerations relevant to the deductibility of the expense by the employee. Proceeding to determine the scope of the concept of "the interest of the employer" it answered the Government's principal contention⁶⁶ with a number of arguments, the strongest of which were: (1) the "picture" of an employer underwriting the whims of its employees at a new job site did not square with the economic realities of such reimbursement insuring for the employer the ready availability of a skilled, mobile labor force;⁶⁷ and (2) the fact the taxpayer was forced, due to a housing shortage, to accept temporary quarters at the new job site while maintaining his family at his old residence could hardly be said to be the result of the taxpayer's "personal preference or taste." Its conclusion was:

[W]here the transfer of an existing employee is solely at the behest of the employer and where the cause of the temporary expenditure is outside the control of the employee, the expenses are incurred primarily for the benefit of the employer. In such a case, the concept of the "interest of the employer" covers those costs which are actually

⁶⁵ Homer H. Starr, 46 T.C. 743, 744-45 (1966).

⁶⁶ "[I]ndirect expenses depend upon the employee's personal taste and the employer's generosity, so that, even though incurred solely as a result of a transfer required by the employer, the expenses cannot be regarded as primarily for the employer's benefit." *Id.* at 746.

⁶⁷ See Note, "Indirect" Moving Expenses, *supra* note 52, at 303-04.

incurred to effect the change in location, including those temporary living costs directly related to and caused by the circumstances in existence at the new post of duty.⁶⁸

Starr thus expressed more clearly than the "convenience of the employer" decisions the principle that compensatory economic benefits and benefits that primarily benefit the employer are mutually exclusive categories.⁶⁹ More significant was its indication that lack of employee control where an expense is incurred pursuant to an employer's requirement need only extend to the cause of the expenditure; thus, lack of control over all the elements of time, place, duration and value of the expenditure is not necessary for the primary benefit of the expenditure to inure to the employer. Accordingly, the very stringent lack of employee control requirements manifested in some of the Tax Court "convenience of the employer" decisions⁷⁰ are not necessarily mandatory as to the contours of the broader underlying benefit of the employer concept.

The Tax Court in *Starr* was careful to maintain a distinction between old and new employees, possibly because an appeal would lie in the Tenth Circuit which had decided *United States v. Woodall*,⁷¹ the first

⁶⁸ 46 T.C. 747; *accord*, Willis B. Ferebee, 39 T.C. 801, 806-07 (1963) (Hoyt, J., concurring).

⁶⁹ See text at notes 17-21, *supra*.

⁷⁰ See text at notes 44 and 45, *supra*.

⁷¹ 255 F.2d 370 (10th Cir.), *cert. denied*, 358 U.S. 824 (1958). The taxpayers all entered into an employment contract providing that the new employer would reimburse certain moving expenses, including cost of moving household effects, hotel and meals en route, and automobile travel expenses, provided that the employees remain in their new employment for at least six months. The Tenth Circuit pointed out that the Supreme Court in *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430 (1955) had construed the scope of income as encompassing "all gains except those specifically exempted" and that, as stated by the Court in *Commissioner v. Lo Bue*, 351 U.S. 243, 247 (1956), "any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected" is includible in gross income. Applying these principles to the facts before it, the *Woodall* court concluded that the reimbursements were includible in gross income.

One of the conditions which induced taxpayers to accept employment was that their moving expenses to the place where they would be employed would be paid by the employer. While it is true that there was no gain or profit from the payments to the taxpayers, it cannot be denied that they received an economic and beneficial gain. Had the expenses not been paid by the employer, the burden would necessarily have been on the taxpayers. *The payment was in the nature of a cash bonus as an inducement to accept employment.* As a matter of law, these payments are no different than had Sandia [the employer] given the taxpayers cash to pay outstanding obligations, or for the payment of living ex-

moving expense decision which had been read as resting on such a dichotomy. Thus, discrimination against new employees was confirmed as to indirect moving expenses. Consequently, one writer accepted *Starr's* economic reality reasoning and believed that it logically extended Revenue Ruling 54-429, and therefore called for further legislative reform to end this distinction in tax treatment.⁷² An earlier commentator, evidencing concern for uniform treatment of similarly situated taxpayers, had argued that the only escape short of legislation from such discrimination was to reject any judicially fashioned exclusion.⁷³ A preferable alternative would have been to extend the compensation-benefit to the employer analysis to reimbursed moving expenses, direct and indirect, of new employees, an approach advocated in a concurring opinion in *Willis B. Ferebee*,⁷⁴ one of the early new employee direct moving expenses decisions.

The Tenth Circuit, which had earlier decided *Woodall*, reversed *Starr* on appeal.⁷⁵ It could find no difference between an old employee and a new employee. Unfortunately, in rejecting this discriminatory

penses for a specified period after their arrival in Albuquerque. The form of payment, to constitute income, is immaterial. The statute explicitly declares that gross income shall include compensation for personal services of whatever kind and in whatever form it is paid. 255 F.2d 372 (emphasis added).

The Tax Court in *John E. Cavanagh*, 36 T.C. 300, 304 (1961) distinguished *Woodall* on the grounds that the latter decision involved a "new" employee, and shortly thereafter in *Willis B. Ferebee*, 39 T.C. 801, 803 (1963) ruled that reimbursements of direct moving expenses of a new employee were includible in income. Thus, at this point reimbursements of direct moving expenses of existing employees were excludible, but reimbursement of identical expenses of a new employee were includible. Furthermore, it was the Service's position that unreimbursed moving expenses were not deductible by old or new employees. See *Hazelwood, Costs Incurred by an Individual Who Moves in Connection with His Employment: A Tax Analysis*, 20 TAX L. REV. 365, 384 (1965) (hereinafter cited as *Hazelwood*). This discrimination against new employees and unreimbursed employees led Congress in 1964 to provide under certain circumstances a deduction in new section 117 for direct moving expenses (the only category whose reimbursements are recognized by the Service as excludible for existing employees) of all employees, including new and nonreimbursed ones. S. REP. No. 830, 88th Cong., 2d Sess. (1964), reprinted in 1964-3 CUM. BULL. 579. Congress stated, however, that no inference was to be drawn that exclusions were necessarily limited to direct expenses. "The question of whether the exclusion for existing employees extends beyond these three categories is left for judicial interpretation." *Id.* at 71-72, 575-76.

⁷² 21 U. MIAMI L. REV. 705 (1967).

⁷³ *Berger, Recent Developments Tighten Up Taxation of Employees' Reimbursed Moving Expenses*, 43 TAXES 519, 524 (1965).

⁷⁴ 39 T.C. 801, 807 (1963) (Judge Hoyt).

⁷⁵ 399 F.2d 675, 676 (10th Cir. 1968).

distinction, it did not consider whether its cash bonus analysis in *Woodall* was incorrect and whether it should yield to the employer benefit analysis of *Starr*.⁷⁶ Indeed, it refused to even discuss the principle relied upon in the Tax Court, *i.e.*, reimbursement of costs incurred by an employee primarily for the benefit of his employer is not compensatory in nature. The Tenth Circuit's position that such reimbursements constituted incentive bonuses, if correct, meant that the Service had been too liberal in Revenue Ruling 54-429 in allowing reimbursement for any moving expense to be excluded, since *Woodall* had involved direct moving expenses of a new employee. The Tenth Circuit's opinion in *Starr*, therefore, conflicted with appellate decisions which had approved the ruling.⁷⁷

⁷⁶ The final judicial chapter in this imbroglio was written in two Tax Court reviewed opinions—Norvel Jeff McLellan, 51 T.C. 463 (1968) and William A. Lull, 51 T.C. 841 (1969), *aff'd*, 434 F.2d 615 (9th Cir. 1970). In *McLellan*, also appealable to the Tenth Circuit, the majority in a singularly unenlightening opinion stated that the court had reviewed its opinion and conclusions in *Starr* in light of the reversal by the circuit court and concluded "that the opinion of the Court of Appeals in *Starr* is decisive of this case." 51 T.C. at 465. It is, perhaps, significant that the majority opinion was written by a judge who had dissented in *Cavanagh*. See note 71 *supra*. A concurring opinion, joined by many of the judges, reasoned that "[s]ome economic benefits received by employees, when furnished for the convenience of their employer, have long been regarded as excludible from gross income." *Id.* at 466. It also reasoned that reimbursement for reasonable moving expenses should qualify for such exclusion. The concurring opinion further pointed out that if an employer furnishes a moving allowance for the additional living expenses of living for a time in a hotel and eating in a restaurant at a new job site, "it is not compensation for services rendered or to be rendered by the employee; it is to prevent the employee from bearing the expenses of the transfer requested by the employer. Like the reimbursement of an employee traveling on business of the employer, the moving allowance relieves the employee of expenses undertaken primarily on behalf of the employer." *Id.* However, it was recognized that to so hold in a case appealable to the Tenth Circuit would be a futile act merely forcing "the parties to the expense and trouble of securing a review and reversal of the decision." *Id.* at 467. The *Lull* majority merely slavishly followed *McLellan*, although appeal lay in a different circuit. Strong dissents were lodged.

⁷⁷ See, *e.g.*, *Lull v. Commissioner*, 434 F.2d 615, 617 (9th Cir. 1970); *England v. United States*, 345 F.2d 414 (7th Cir. 1965), *cert. denied*, 382 U.S. 936 (1966). *Lull* in particular appeared to adopt a "conduit" theory as to direct moving expenses. Although reimbursements for direct moving expenses:

[M]ight properly be viewed as reimbursement for expenses of the employer and, as such, do not constitute income to the employee . . . , payments for "indirect" expenses . . . can [not] be viewed as reimbursement for expenses which should be attributed to the employer. The reimbursement is for expenses incidental to the taxpayer's efforts to provide housing for himself and his family. The expenses are for the kind of items that, for tax purposes, taxpayers usually must provide for themselves from their salary "[I]ndirect" expenses . . .

Since *Edward N. Wilson*⁷⁸ involved the deductibility of employer mandated moving expenses, and the prior discussion of moving expenses as well as of meals and lodging has considered only the question of exclusions from gross income, it is necessary to first sketch the basic, well-established rules regarding deductions.

There are three fundamental prerequisites for deduction of an expense under section 162: it must be (1) incurred in carrying on a "trade or business" (2) "ordinary and necessary" and (3) "paid or incurred within the taxable year."⁷⁹ Only the first two are pertinent here. "Ordinary" serves to distinguish between those that are in the nature of *capital* expenditures, *i.e.*, costs resulting in the acquisition or enhancement of assets having useful lives extending beyond the close of the taxable year and which accordingly must be amortized over the useful lives of the assets.⁸⁰ "Necessary" imposes only the minimal requirement that the expense be "appropriate and helpful" for the development of the tax-

are attributable to the employee, and that reimbursement is simply added compensation paid by the employer. Having been reimbursed for their own expenses, taxpayers have experienced an economic gain. 434 F.2d at 617.

This rationale is made more clear in *John E. Cavanagh*, 36 T.C. 300 (1961), where the Tax Court concluded that employer reimbursements of extra-ordinary food and lodging expenses incurred by an employee at his employer's requirement:

[R]epresent repayment to the employee of an amount he has first paid for and on behalf of his employer and do not constitute income to him. They are the employer's costs, not the employee's The prohibition against the deduction of personal living expenses has reference only to such expenses as are ultimately chargeable to the taxpayer. It has no applicability to such expenses properly chargeable to another which the taxpayer pays and for which he is reimbursed. 36 T.C. at 304.

The court also held that the employer's convenience was primarily served by the taxpayer's relocation. Although *Cavanagh* used language similar to that used by the convenience of the employer cases, its fundamental rationale was not that the taxpayer received an economic benefit that was, however, not compensatory because it primarily benefited the employer—the theory underlying the benefit of the employer doctrine—; rather its not fully articulated rationale was that an expense incurred by a taxpayer on behalf of another constitutes an advance to him and the other's subsequent reimbursement constitutes nontaxable repayment of a loan to the taxpayer. Cf. *Arthur W. Harrison*, 10 P-H B.T.A. Mem. 1904, 1908 (1941). Since this rationale has been of greater import in the area of entertainment expenses, it will be considered more fully there. See text at notes 286 through 289 *infra*.

⁷⁸ 49 T.C. 406 (1968), *rev'd*, 412 F.2d 314 (6th Cir. 1969).

⁷⁹ 4A J. MERTENS, *LAW OF FEDERAL INCOME TAXATION* § 25.07, p. 27 (1966) (hereinafter cited as MERTENS). See generally *Wolfman, Professors and the "Ordinary and Necessary" Business Expense*, 112 U. PA. L. REV. 1089, 1092-93, 1110-11 (1964) (hereinafter cited as *Wolfman*).

⁸⁰ *Commissioner v. Tellier*, 383 U.S. 687, 689-90 (1966).

payer's business.⁸¹ Rarely will courts question the necessity of an expense by the taxpayer,⁸² with the peculiar exception of the Tax Court when travel and entertainment expenditures are involved.⁸³

In the dichotomies that have engendered so much litigation under section 162, "business" expenses are the counterpoise to personal, living, or family expenses, which are not deductible except as expressly provided in the Code.⁸⁴ Personal expenses are nowhere defined in the Code or the regulations. Moreover, business expenses are defined in the regulations only in terms of a relationship: "the ordinary and necessary expenditures *directly connected with or pertaining to the taxpayer's trade or business* (emphasis added)."⁸⁵ Consequently, it should not be surprising that most of the litigation in this area, particularly in the Supreme Court, has focused on the test to be applied in relating the expense to the category of business or personal rather than on the meaning to be ascribed to the category. That test as announced in *United States v. Gilmore*⁸⁶ is the origin and the character of the expense.⁸⁷ There the Court held that the expense of defending a divorce suit was a personal expense because the claim against the taxpayer, although it might affect his holdings of income producing property, arose out of the personal relationship of marriage.

An employer's requirement that an employee incur an expense would seem to make it *necessary* as a matter of course.⁸⁸ But as early as *Welch v. Helvering*,⁸⁹ the landmark "ordinary and necessary" decision, it was recognized that "[m]any necessary payments are charges upon capital."⁹⁰ Thus, employer compulsion cannot convert a capital expenditure into an *ordinary* expense. A more recent Supreme Court example may be found in *Commissioner v. Lincoln Savings and Loan Ass'n*,⁹¹

⁸¹ *Welch v. Helvering*, 290 U.S. 111 (1933).

⁸² J. Mertens, *supra* note 80, at § 25.09; Note, *Determining Whether Convention Trips are a Personal or Business Expense*; 23 OHIO ST. L.J. 567, 568 (1962) (hereinafter cited as Note, *Convention Trips*).

⁸³ See text at note 246 *infra*.

⁸⁴ INT. REV. CODE of 1954, § 262.

⁸⁵ Treas. Reg. § 1.162-1(a) (1958).

⁸⁶ 372 U.S. 39 (1963).

⁸⁷ See generally Note, *Deductibility of Legal Expenses: The Exclusivity of Gilmore*, 40 N.Y.U. L. REV. 351 (1965).

⁸⁸ See Note, *Convention Trips*, note 82 *supra*, at 570.

⁸⁹ 290 U.S. 111 (1933).

⁹⁰ *Id.* at 113.

⁹¹ 403 U.S. 345 (1971).

where the only issue was whether the payment of an "additional premium" to the Federal Savings and Loan Insurance Corporation by the taxpayer under compulsion of federal law "was an expense and an ordinary one within the meaning of § 162(a) of the Code."⁹²

What is important and controlling, we feel is that the . . . payment serves to create or enhance for *Lincoln* what is essentially a separate and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature and not an expense, let alone an ordinary expense . . .⁹³

....
We emphasize that just as compulsory accounting is not controlling taxwise, so the statutory labels of "prepayment" and "additional premium" . . . are not controlling. We also emphasize that the fact that a payment is imposed compulsorily upon a taxpayer does not in and of itself make that payment an *ordinary* and necessary expense (emphasis added) . . .⁹⁴

The crucial question remaining then is whether compulsion, and in particular employer compulsion, makes an expense a *business* expense, *i.e.*, whether incurring an employer mandated expense in order to maintain one's existing position renders that expense a business expenditure regardless of its relationship to the employee's duties, other than the duty to heed his employer's command, and despite the fact that absent the employer compulsion, the expenditure might have displayed aspects of a personal expense. This fundamental question was addressed by the Tax Court in *Edward N. Wilson*.⁹⁵ There the taxpayer, an existing

⁹² *Id.* at 354.

⁹³ *Id.* Although the Court was clearly speaking to the irrelevancy of compulsion to the issue of capital vs. ordinary expenditure, *see* *United States v. Mississippi Chem. Corp.*, 405 U.S. 298 (1972), the Fourth Circuit in *Virginia Nat'l. Bank v. United States*, 450 F.2d 1155 (4th Cir. 1971), unfortunately misread *Lincoln Savings & Loan* as speaking to the issue of whether compulsion is relevant to the question of whether an expenditure is a business expense. *See id.*, at 1159 (Winter, J., dissenting).

⁹⁴ *Commissioner v. Lincoln Savings and Loan Ass'n*, 403 U.S. 345, 359 (1971).

⁹⁵ 49 T.C. 406 (1968), *rev'd*, 412 F.2d 314 (6th Cir. 1969). *See generally* *Hazelwood supra* note 72, at 369. The Tenth Circuit in *Woodall* had also held that the taxpayer could not deduct his moving expenses under section 162. The court noted that the taxpayer had testified that his reasons for accepting the new employment were personal. It also looked to the "away from home" case law development under section 162(a)(2), which provides a deduction for "traveling expenses . . . while away from home in the pursuit of a trade or business," where it found the rule was that "[t]he job, not the taxpayer's pattern of living, must require the travel," *United States v. Woodall*,

employee, had not wished to relocate, but was informed that unless he accepted the transfer he would jeopardize his future. Consequently, he accepted the transfer under protest. The Tax Court pointed out that its prior decision in *Walter H. Mendel*⁹⁶ had been reversed, in part because of its erroneous determination that relocation expenses in the interest of the employer were per se deductions for an employee, and in part because there was no finding that the moving expenses were ordinary and necessary expenses of the employee.⁹⁷ The Tax Court, therefore, specifically analyzed whether the expense so qualified. Its conclusion was:

255 F.2d 370, 373 (10th Cir. 1958), *cert. denied*, 358 U.S. 845 (1958), *i.e.*, there must be a direct connection between the travel expense and the carrying on of the trade or business of the taxpayer or his employer. See Note, *A House Is Not a Tax Home*, 49 VA. L. REV. 125 (1963) (hereinafter cited as Note, *Tax Home*). The Tenth Circuit's conclusion was that the moving expenses had no relationship to any service that was being performed for the employer. Apparently, as an alternative holding, the *Woodall* Court held that the moving expenses fell into the category of expenses incurred to obtain employment, rather than the category of expenses incurred in the course of employment. The Service permits a deduction only for the latter. See Eugene A. Carter, 51 T.C. 932, 935 (1969); David J. Primuth, 54 T.C. 324, 380 (1970); Treas. Reg. 118, § 39.23(a)-15(f). This basis now appears questionable. See note 172 *infra*. The court's conclusion was:

While it may appear to be equitable that expenses incurred in seeking and obtaining employment, or in traveling to the place of employment, should be treated as though they had been incurred in the performance of one's duty as an employee, it has, nevertheless, been long recognized that deductions are matters of legislative grace, allowable only when there is a clear provision for them, and do not turn upon equitable considerations. 255 F.2d at 373.

⁹⁶ 41 T.C. 32 (1963), *rev'd*, 351 F.2d 580 (4th Cir. 1965). See generally *Hazelwood*, note 71 *supra*, at 369. In *Mendel* the majority reasoned from the basic premise that employer reimbursements of personal expenses of an employee were includible in the gross income to conclude that inherent in Revenue Ruling 54-429, and *Cavanagh* was the assumption that reasonable amounts expended by a permanent employee in moving his family and personal effects in a transfer from one permanent post of duty to another were not personal expenses. 41 T.C. at 38. A dissent pointed out that the majority opinion made no finding that the unreimbursed moving expense was an ordinary and necessary business expense of the employee except for the above assumption. However, the dissent did not believe *Cavanagh* required that assumption. 41 T.C. at 39. *Mendel* was reversed by the Fourth Circuit on appeal on precisely these grounds: that (1) the majority opinion was founded upon an erroneous basis, the rationale of Revenue Ruling 54-429 is that reimbursement for moving expenses does not constitute gross income, not that expenses of relocation are per se deductions, and (2) the review court could find no authority permitting a deduction for unreimbursed moving expenses "where, as here, there is no finding that such moving expense is an ordinary and necessary business expense of the taxpayer." 351 F.2d at 583.

⁹⁷ Edward N. Wilson, 49 T.C. 406, 411 (1968).

[I]n these days of the organization man, if a move is ordered by the employer for the employer's convenience and the employee's future earnings would be jeopardized by refusing to accept transfer, non-reimbursed moving expenses are proximately related to the business of the taxpayer-employee so that they constitute a business expense to him.⁹⁸

Although the court in *Wilson* was not favored with the express grant of judicial leeway afforded in the exclusion area by the legislative history of section 217,⁹⁹ it noted that the committee reports accompanying the enactment of that section directed its remarks to the fact that the then existing "tax treatment" did not permit a deduction.¹⁰⁰ Therefore, it reasoned that congressional dissatisfaction lay with the failure of judicial and administrative determinations to allow the deduction; there was no implication "that Congress thought that the existing law might not be broad enough at its roots to encompass allowance of the deduction"¹⁰¹ before the court. The majority also noted that its view was foreshadowed by an earlier concurring opinion in *Willis B. Ferebee*,¹⁰² a new employee reimbursed moving expenses decision, which suggested that a *relocation for the employer's convenience, as an alternative to being dismissed, would lose the aspect of a personal expense* by coming "under the familiar rule exemplified by such situations as the cost of education to retain an existing job as contrasted with obtaining a new one, or the cost of room or meals where an employer and not the employee insists upon the employee's location."¹⁰³

The majority, echoing the language of the benefit of the employer exclusion decisions, concluded that it was the purpose, interest, and convenience of the employer and not of the employee that were served by the transfer; the moving expense was for the taxpayer's business purposes and reasons and not for personal ones. Thus, it seemed to mix a benefit of

⁹⁸ *Id.* at 412.

⁹⁹ See note 71 *supra*.

¹⁰⁰ Edward N. Wilson, 49 T.C. 406, 412 (1968) citing H.R. REP. No. 749, 88th Cong., 2d Sess. 59, reprinted in 1964-1 CUM. BULL. (Part 2) 183; S. REP. No. 830, 88th Cong., 2d Sess., 71, reprinted in 1964-1 CUM. BULL. (Part 2) 575. *But see*, Hazelwood, *supra* note 71, at 370 (the Committee reports "imply no judicial leeway for deductions").

¹⁰¹ Edward N. Wilson, 49 T.C. 406, 412 (1968).

¹⁰² 39 T.C. 801, 805 (1963).

¹⁰³ *Id.* at 805. Similarly, a reimbursement of an expense which primarily benefits the employer would be noncompensatory and, hence, excludible. *Id.* at 807 (Hoyt, J., concurring; the writer of the majority opinion in *Wilson*).

the employer deduction rationale with an analysis of the degree of pressure brought by the employer upon the employee and his unwillingness to move, *i.e.*, a lack of employee control and employer requirement. A dissent focused on the inequities present in the latter approach and advocated that a deduction be allowed for reasonable moving expenses by any employee when the move is in the interest of his employer.¹⁰⁴ Presumably this rule would also extend to new employees.¹⁰⁵ One basis for the dissent against the involuntariness criterion was that the employee had many choices, among them to refuse to move and to accept the consequences or to move in the interest of the employer with the hope of thereby advancing his own interests.¹⁰⁶ This sort of alternative is, however, contrary to the trend in other compulsion decisions as discussed below.

The dissent was on more tenable ground in pointing out that the employer did not require the employee to move his household effects, furniture, and family.

[The taxpayer] could have sold his furniture as he did his house and rented furnished living quarters at the new location or bought new furniture. He could have maintained his personal home at his old location The choice of the petitioner to move his furniture and household effects was personal under the holding of a long line of cases prior to our decision in *Mendel* and in my opinion it was on the basis of this long line of cases that the Court of Appeals reversed our holding in *Mendel*.¹⁰⁷

In resolving the similar question of distinguishing personal from business expenses in the context of deduction of "traveling expenses . . . while away from home in the pursuit of a trade or business"¹⁰⁸

¹⁰⁴ Edward N. Wilson, 49 T.C. 406, 417-18 (1968).

¹⁰⁵ Cf. Willis B. Ferebee, 39 T.C. 801, 807 (1963) (concurring opinion) (no distinction between old and new employees).

¹⁰⁶ Edward N. Wilson, 49 T.C. 406, 417 (1968).

¹⁰⁷ *Id.*

¹⁰⁸ INT. REV. CODE of 1954 § 162(a)(1)(2). A traveling expense must be (1) reasonable and necessary, (2) incurred while away from home, and (3) incurred in the pursuit of business—"a direct connection between the expenditures and the carrying on of the trade or business of the taxpayer or of his employer." *Commissioner v. Flowers*, 326 U.S. 465, 470 (1946). The third test in particular appears closely related to the necessary business expense requirement under the general section 162(a) provision.

(which has repeatedly been used as an analogy to moving expenses),¹⁰⁹ commentators have urged,¹¹⁰ and recently the Second Circuit in *Rosenspan v. United States*¹¹¹ has fashioned, the test as whether the exigencies of business compelled the traveling expenses or whether the taxpayer's failure to move his home was for his personal convenience and not compelled by business necessity,"¹¹² rather than relying on the doctrine that "home" is the taxpayer's place of employment.¹¹³ Earlier decisions had reasoned that the job, not the taxpayer's pattern of living, had to require the travel.¹¹⁴ Indeed, this principle had been the keystone of the Tenth Circuit's denial in *Woodall* of a deduction for moving expenses.¹¹⁵ If a taxpayer maintained a home at a distance from his business for personal reasons his employer's business was not served,¹¹⁶ and as a general rule his travel expense and expenses of maintenance at both his home and place of business were not deductible. The articulated reason for this result by most courts and by the Government was that where a permanent move was involved the taxpayer's "home" moved to his new place of employment, the so-called "tax home," even though his residence and family remained where they had been.¹¹⁷ Thus, on-site living expenses were not incurred "away-from-home" under this approach. The exception permitting a deduction for traveling expenses

¹⁰⁹ See, e.g., *United States v. Woodall*, 255 F.2d 370, 373 (10th Cir. 1958), *cert. denied*, 358 U.S. 824 (1958); cf. *Homer H. Starr*, 46 T.C. 743, 749 (1966), *rev'd*, 399 F.2d 675 (10th Cir. 1968).

¹¹⁰ Note, *Tax Home*, *supra* note 95, at 163; Haddleton, *Traveling Expenses*, "Away From Home," 17 TAX L. REV. 261 (1963).

¹¹¹ 438 F.2d 905, 912 (2d Cir. 1971), *cert. denied*, 92 Sup. Ct. 54 (1971).

¹¹² *Id.*

¹¹³ The Government has long advocated that the term "home" in the statute means the taxpayer's business headquarters, *Commissioner v. Stidger*, 386 U.S. 287, 291 (1967); Note, *Tax Home*, note 95 *supra*, at 127—a position adopted by many tribunals, *England v. United States*, 345 F.2d 414 (7th Cir. 1965), *cert. denied*, 382 U.S. 936 (1966); *Cockrell v. Commissioner*, 321 F.2d 504 (8th Cir. 1963); *Coerver v. Commissioner*, 297 F.2d 837 (3rd Cir. 1962); *Bercaw v. Commissioner*, 165 F.2d 521 (4th Cir. 1948); *York v. Commissioner*, 160 F.2d 385 (D.C. Cir. 1947); *Josette J. Friedman*, 37 T.C. 539 (1961); but not all, *Rosenspan v. United States*, 438 F.2d 905 (2d Cir. 1971), *cert. denied*, 92 S. Ct. 54 (1971); *Steinhort v. Commissioner* 335 F.2d 496 (5th Cir. 1964); *Burns v. Gray*, 287 F.2d 698 (6th Cir. 1961).

¹¹⁴ E.g., *Carragan v. Commissioner*, 197 F.2d 246, 249 (2d Cir. 1952).

¹¹⁵ *United States v. Woodall*, 255 F.2d 370, 373 (10th Cir. 1958), *cert. denied*, 358 U.S. 824 (1958).

¹¹⁶ *Commissioner v. Peurifoy*, 254 F.2d 483, 486 (4th Cir. 1957), *aff'd per curiam*, 358 U.S. 59 (1958).

¹¹⁷ See authorities cited in note 113 *supra*.

of temporary employment was regarded as just that, since the expenses were thought not to be incurred for the benefit of the employer.¹¹⁸ Therefore, an extension of the reasoning of this line of authority to post-arrival *indirect* moving expenses to a "permanent" job site would yield the conclusion that they were not incurred for the benefit of the employer, but they were the result of a personal choice. However, under the *Rosenspan* rationale, the temporary assignment exception falls into place conceptually. When an assignment is truly temporary it would be unreasonable to expect the taxpayer to move his family and home, "and the expenses are thus compelled by the 'exigencies of business'."¹¹⁹ On the other hand, where the assignment is indeterminate and the taxpayer decides to leave his home where it is:

[D]isallowance is appropriate not because he has acquired a "tax home" in some lodging home or hotel at the worksite but because his failure to move his home was for his personal convenience and not compelled by business necessity.¹²⁰

While the Tax Court has traditionally applied the rule that home is where the permanent job is,¹²¹ a recent decision manifests a receptivity to the *Rosenspan* approach. In *Dennis D. Goodman*,¹²² a memorandum opinion,¹²³ the court pointed out that the temporary employment exception was treated by some courts (tax-home jurisdictions) as a gloss on home in the phrase "away from home," while others such as *Rosenspan* have connected it with the relationship of the expenditure to the pursuit of business. The court viewed the ultimate question as:

¹¹⁸ Commissioner v. Peurifoy, 254 F.2d 483, 486 (4th Cir. 1957), *aff'd per curiam*, 358 U.S. 59 (1958).

¹¹⁹ *Rosenspan v. United States*, 438 F.2d 905, 912 (2d Cir. 1971), *cert. denied*, 92 Sup. Ct. 54 (1971).

¹²⁰ *Id.*

¹²¹ See note 113 *supra*.

¹²² 40 P-H Tax Ct. Mem. 1437, 1439-40 (1971).

¹²³ The Chief Judge of the Tax Court determines whether an opinion will be a "regular" decision, printed in the Tax Court reports, or a memorandum decision, published only by the Tax Services. See Gluck, *How Coban Works: Allowance of Business Expense Deductions When No Exact Records Are Kept*, 6 RUTGERS L. REV. 375, 379 n.21 (1952) (hereinafter cited as Gluck). Theoretically the criteria upon which the determination to release a decision in memorandum form is made are that the case involves only a question of fact or the legal question has been decided previously by the Tax Court, hence, there is no need for further precedent (a memorandum opinion being considered as having no precedential value). In fact, however, memoran-

[W]hether it would be reasonable in the circumstances of the particular case to expect the taxpayer to move his family to the new work location and establish his permanent residence in that area. If so, the job assignment is not temporary and either the place of employment becomes his tax home or the costs of living at the place of employment are not incurred in the pursuit of business. In either event, the costs of his meals, lodging, and related items are not deductible under section 162(a)(2).¹²⁴

In its concluding summary on the other hand, analysis was made only in terms of the pursuit of business approach. The court found that there was no business reason for incurring duplicate business expenses; the taxpayer did so solely for personal reasons.¹²⁵

dum decisions are on occasion cited by the Tax Court. Moreover, the conclusion is inescapable from research of unsettled areas of tax law that on rare occasions memorandum opinions are used to sweep a troublesome question or a minority view, perhaps more worthy of court review, under the rug. While this practice may be justified on the basis that bad facts may distort or retard the case-by-case development of a principle of law, the difficulty is that a memorandum opinion implies that the case is completely reconcilable with prior precedent, and proceeding on this assumption tax practitioners and commentators may attempt to reconcile decisions that represent two polar views of an issue, the memorandum opinion having been released as such as an alternative to court review. *Compare* Bogene, Inc., 37 P-H Tax Ct. Mem. 810 (1968), with Alan B. Larkin, 48 T.C. 629 (1967), *aff'd*, 394 F.2d 494 (1st Cir. 1968). See Bass, *Medical Payment Plans Can Discriminate in Favor of Stockholder-Employees*, 29 J. TAXATION 142 (1968) for an attempt to reconcile the two cases. Of even more precedential value than regular opinions are court reviewed Tax Court decisions—the overwhelming majority of moving expense cases were court reviewed. Proposed findings of fact and his opinion are submitted by the Tax Court judge who heard the case to the Chief Judge who determines whether the decision should be reviewed by the “full” Tax Court. INT. REV. CODE OF 1954 § 7460(b). See *Tax Division, Department of Justice, Study of the Trial Court System for Federal Civil Tax Disputes*, reprinted in 22 TAX LAWYER 95, 102 (1968) (hereinafter cited as *Tax Division, Study*). Although the Tax Court has sixteen judges (plus retired judges who hear cases), INT. REV. CODE OF 1954, § 7444(a), a majority of those present constitutes a quorum and may decide a court reviewed opinion. However, the opinion does not necessarily reveal the number of judges present (court reviewed decisions are traditionally discussed on Fridays at the Tax Court in Washington, D. C., throughout the year, but on any given Friday during all of the year, except the summer months, individual judges will be out of town hearing cases) and a majority may represent the views of as few as five judges or as many as seventeen—a retired judge (*Id.* § 7447) will sit and vote in the conference if he originally submitted the case to the Chief Judge. The author of the majority opinion will be the judge who heard the case unless his views did not prevail in conference, in which case the writing of the opinion may be assigned to another judge. *Tax Division, Study, supra*, at 103.

¹²⁴ 40 P-H Tax Ct. Mem. 1437, 1440 (1971).

¹²⁵ *Id.* at 1441.

Rosenspan suggested, however, that the "personal choice" principle had sometimes been pressed too far.¹²⁶ *England v. United States*, an indirect moving expense decision following *Woodall*,¹²⁷ was cited as "another case in which the 'personal choice' principle scarcely provides a satisfactory basis of decision . . ." ¹²⁸ *Homer H. Starr* seems directly on point. There the Tax Court held that the Government's contention "that indirect moving expenses cannot, under any circumstances, be said . . . to inure primarily to the benefit of the employer, ignores the economic realities of the situation."¹²⁹ The taxpayer's acceptance of temporary quarters for himself at his new duty post, while maintaining his family at his old residence, was caused by a housing shortage and was not a result of his personal preference. Temporary living costs directly related to and caused by circumstances in existence at the new post of duty so as to be outside the employee's control and which arise from a transfer at the behest of the employer constitute expenses in the interest of the employer and are incurred primarily for his benefit.¹³⁰ Thus, reading *Starr* and *Rosenspan* together, a failure of the taxpayer to immediately move his family and residence, *i.e.*, his home, when the assignment is permanent, yet the failure is necessitated by the conditions at the new duty post, is not for his personal convenience, but is compelled by business necessity and is incurred in the pursuit of business.¹³¹ Accordingly, the dissent in *Wilson* was in error in its "personal choice" analysis.

¹²⁶ *Rosenspan v. United States*, 438 F.2d 905, 911 n.6 (2d Cir. 1971), *cert. denied*, 92 Sup. Ct. 54 (1971).

¹²⁷ See notes 71 and 95, *supra*.

¹²⁸ *Rosenspan v. United States*, 438 F.2d 905, 911 n.6 (2d Cir. 1971), *cert. denied*, 92 Sup. Ct. 54 (1971).

¹²⁹ *Homer H. Starr*, 46 T.C. 743, 746 (1966).

¹³⁰ *Id.* at 746-47.

¹³¹ While a different panel of the Second Circuit than the *Rosenspan* panel has more recently stated that the temporary employment rule constituted an exception to the requirement that an away from home expenditure manifests a direct connection with the carrying on a trade or business (*see* note 108, *supra*, for a discussion of this requirement), *Six v. United States*, 450 F.2d 66 (2d Cir. 1971); the judges in *Rosenspan* do not appear to have viewed the rule as an exception to the pursuit of business requirement, but rather viewed such expenses incident to temporary employment as not being personal because it would be unreasonable to expect the employee to move; hence, the expenses are compelled by the "exigencies of business." Moreover, *Rosenspan* declined to decide whether the exigencies of business refer to employer's business or of the employee's as well (however, other compulsion areas suggest that an expense which benefits the employer, *i.e.* meets the exigencies of that business, is automatically an expense of

The Tax Court in *Vaal R. Dodd*,¹³² a memorandum opinion, followed *Wilson* where it found that it was reasonable for the taxpayer to believe that he would be laid off if he did not accept a transfer. In *Wilson* the taxpayer had been explicitly told he would jeopardize his future with his employer if he did not move.

Both *Dodd* and *Wilson* were appealed. Ironically, and unfortunately, *Dodd* with the less extensively developed opinion was decided first. However, the appellate court was presented with the *pro se* taxpayer's contentions, derived from *Wilson*, that the unreimbursed moving expense should be the deductible the same as educational expenses of an employee to hold his job, or treated the same as meals and lodging excluded from income because required as a condition of employment. Judge Dyer of the Fifth Circuit dismissed these arguments on the unconvincing and irrelevant ground that "[t]he instances that the taxpayer seeks to analogize to this case are specifically made deductible or exempt by the Code and Treasury Regulations."¹³³ While it is a hoary tax doctrine that deductions are matters of legislative grace, allowable only where made deductible by statute,¹³⁴ the generic category of business expenses is made deductible by statute;¹³⁵ moreover, employer compelled educational expenses were deductible under court decisions for almost a decade before specific reference was made to them in the regulations.¹³⁶ The whole thrust of *Wilson*, missed by the appellate court in *Dodd*, was that employer compulsion makes such moving expenses business expenses, imposed by the employer as a condition of employment, or of retention of employment. The Fifth Circuit's reversal of the Tax Court in *Dodd* may be best viewed as an example of the twin evils of (1) important tax cases involving minor amounts of money being tried and appealed without tax counsel and (2) the absence of a National Tax Court of Appeals.¹³⁷

the employee's business as well, see text at note 347 *infra*) but stated that where the expense need only be necessary to the taxpayer's business—the general rule under section 162, see *United States v. Disney*, 413 F.2d 783 (9th Cir. 1969)—“the ‘personal choice’ principle scarcely provides a satisfactory basis of decision.” *Rosenspan v. United States*, 438 F.2d 905, 911 n.6 (2d Cir. 1971), *cert. denied*, 92 Sup. Ct. 54 (1971).

¹³² 37 P-H Tax Ct. Mem. 134 (1968), *rev'd*, 410 F.2d 132 (5th Cir. 1969).

¹³³ *Commissioner v. Dodd*, 410 F.2d 132, 134 (5th Cir. 1969).

¹³⁴ Mertens, note 79 *supra*, at § 25.03.

¹³⁵ INT. REV. CODE of 1954 § 162(a).

¹³⁶ See *Hill v. Commissioner*, 181 F.2d 906 (4th Cir. 1950); *Treas. Reg. § 1.162-5* (1958); *Wolfman*, note 79 *supra*, at 1102.

¹³⁷ See generally Note, *The Old Tax Court Blues: The Need for Uniformity in*

In recapitulation, the interest-of-the-employer moving expense cases, although now rendered extinct by congressional reform, add significantly to an understanding of the underlying benefit of the employer doctrine. As a preliminary matter, recognition by the Tax Court of the common principles involved in exclusion of employer reimbursement of moving expenses and of the value of employer required meals and lodging forms the basis for discussion of the underlying commonality of employer compelled activities. While the same elements of employer compulsion and lack of employee control and benefit to the employer were involved in both exclusion areas, the focus of the control element in the context of reimbursed moving expenses was on the cause of the expenditure and not on the timing, location, quality, and quantity of the expenditure as in the section 119 cases. Furthermore, a comparison of *Starr* and *Wilson* reveals that in the context of exclusions from income, benefit to the employer is the more important factor, while in the context of deductions, employer compulsion is more significant. The cause of this difference is that on the exclusion side the basic inquiry is whether the employer primarily intends to benefit itself or its employee; if the latter the economic benefit is compensatory. The role played by the factor of lack of employee control is principally that of

Tax Litigation, 46 N.Y.U. L. REV. 970, 979 (1971) (hereinafter cited as Note, *The Old Tax Court Blues*) and authorities cited therein. As could have been predicted from the lack of analytical reasoning and blind adherence to precedent manifested by the appellate opinions treating excludibility of reimbursements for indirect moving expenses, *Wilson* was also summarily reversed without consideration of the employer compulsion arguments relied upon below. *Wilson v. Commissioner*, 412 F.2d 314 (6th Cir. 1969) (order). Furthermore, the Tax Court's response to these reversals was also true to the form established on the exclusion side of the problem: in *Lloyd G. Jones*, 54 T.C. 734, 741 (1970), *aff'd*, 444 F.2d 508 (6th Cir. 1971), the majority stated that the court had issued three opinions in recent years holding such expenses deductible but was reversed in each; "[o]n further consideration, we are persuaded by the Courts of Appeals in these cases and will no longer follow our decisions therein." Again a number of judges concurred solely on the grounds that the case would be appealed to the Fifth Circuit which had recently decided *Dodd* adversely to the Tax Court on this issue. *Id.* at 742. The Tax Court had earlier taken the position in *Authur L. Lawrence*, 27 T.C. 713, 720 (1957) that as a court of national jurisdiction it was not bound by the precedent of a court of appeals to which an appeal would lay. *Tax Division, Study*, *supra* note 123, at 103. This position generated a great deal of criticism particularly by appellate courts, *id.* at 103 n.39. *McLellan*, note 76 *supra*, and *Jones* may be viewed as foreshadowing the abandonment of *Lawrence* that matured in *Jack E. Golsen*, 54 T.C. 742, 756-57 (1970), *aff'd on other grounds*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971). See generally Note, *The Old Tax Court Blues*, *supra*, at 979.

supplying a conceptual basis for the exclusion, *i.e.*, lack of dominion over an economic benefit.¹³⁸ On the deduction side, the expenditure must be related to the employee's trade or business. An employer mandated expense, which if not undertaken by the employee may jeopardize his job, certainly is directly related to preserving that job, his trade or business. Employer benefit or convenience may also be squeezed into that mold: it is the business of the employee to further the interests of his employer, thus a purpose to further the employer's interest is a business purpose as to the employee.¹³⁹ In short, these may be viewed as alternatives, with employer compulsion being relied upon primarily when present.

III. REQUIREMENT OF THE EMPLOYER: EDUCATIONAL EXPENSES

The early development of deductibility of educational expenses was strongly shaped by an example contained in Justice Cardozo's opinion in *Welch v. Helvering*,¹⁴⁰ a non-educational expense case holding that payments made by a commission salesman to creditors of his bankrupt corporation were not deductible because made to establish his relations with customers. There the Court stated that "[r]eputation and learning are akin to capital assets, like the good will of an old partnership. For many, they are the only tools with which to hew a pathway to success. The money spent in acquiring them is well and wisely spent. It is not an ordinary expense of the operation of a business."¹⁴¹ The Service and many Tax Court decisions, nevertheless, came to treat educational expenses as personal rather than capital.¹⁴² For instance, in *Nora Payne Hill*,¹⁴³ the Tax Court, relying upon the definition of the term "or-

¹³⁸ *Stratton v. Commissioner*, 448 F.2d 1030 (9th Cir. 1971).

¹³⁹ The presence of control or dominion was originally a basis for inclusion in non-compensatory income cases; absence of control has since been used as a basis for exclusion. *Commissioner v. First Sec. Bank*, 40 U.S.L.W. 4289, 4292 (March 21, 1972); *United States v. Gotcher*, 401 F.2d 118, 123 (5th Cir. 1968). However, there may well be a difference between lack of control where there is no receipt of income or economic benefit and lack of control where there is such receipt. Indeed, in the doctrine of constructive receipt control serves as an alternative to actual receipt as a basis for taxation. See generally Lee, *Shareholder Withdrawal—Loan or Dividend: Repayments, Estoppel, and Other Anomalies*, 12 WM. & MARY L. REV. 512, 533 n.127 (1971) (hereinafter cited as Lee, *Shareholder Withdrawal*).

¹⁴⁰ 290 U.S. 111 (1933).

¹⁴¹ *Id.* at 115-16.

¹⁴² Wolfman, note 79 *supra*, at 1096-97 and authorities cited therein.

¹⁴³ 13 T.C. 291 (1949), *rev'd*, 181 F.2d 906 (4th Cir. 1950).

dinary" as "common" or "frequently occurring," would not assume that public school teachers *ordinarily* attend summer school to maintain their teaching certificates when alternatives such as passing an examination on selected books are available. Consequently, it found the summer school expense not ordinary, but personal.

The Fourth Circuit in the landmark decision of *Hill v. Commissioner*¹⁴⁴ reversed the Tax Court. It thought unreasonable any requirement of establishing statistically the number of teachers who chose summer school. If the particular course taken by the taxpayer was a response that a reasonable person would normally take under the circumstances, the expense qualified as ordinary. The Court of Appeals concluded that the taxpayer went to summer school to "maintain her present position, not to attain a new position; to preserve, not to expand or increase; to carry on, not to commence."¹⁴⁵ This choice of language implied that the cost of education undertaken to secure promotion or a new position was not deductible.¹⁴⁶ But, on the facts before it, the Fourth Circuit found that the attendance was undertaken essentially to enable the taxpayer to continue her career in her existing position. Thus, the review court concluded that the taxpayer incurred the expenses in carrying on a trade or business, and that they were ordinary and necessary, and were not personal in nature.

The Service picked up the hint in *Hill* and ruled in I.T. 4044¹⁴⁷ that summer school expenses incurred by a teacher to maintain her position were deductible as ordinary and necessary business expenses, but expenses incurred to obtain a teaching position, or to qualify for permanent status, a higher position or salary were personal expenses. More significantly, the Service read *Hill* narrowly: unless a teacher could prove that an educational expense had been incurred under "employer compulsion," it was not necessary but was incurred for enhancement (professional or cultural) and was disallowable as "personal."¹⁴⁸

The course taken up to this point by the Service with respect to employer compulsion and otherwise "personal" expenses is the mirror image of its favored stance in the area of deductibility of moving expenses. In the educational expense context it argued that employer com-

¹⁴⁴ 181 F.2d 906 (4th Cir. 1950).

¹⁴⁵ *Id.* at 909.

¹⁴⁶ Wolfman, note 79 *supra*, at 1098.

¹⁴⁷ 1951-1 CUM. BULL. 163; Cosimo A. Carlucci, 37 T.C. 695, 699 (1962).

¹⁴⁸ Wolfman, note 79 *supra*, at 1101.

pulsion alone could suffice;¹⁴⁹ but in the context of moving expenses, that the taxpayer must show a connection between his duties of employment and his moving expenses and, implicitly, that any employer requirement for the move was not relevant.¹⁵⁰ In both instances, if the expenses were not deductible, they were considered personal in the eyes of the Service.

The originally proposed 1954 Code regulations with respect to deductibility of educational expenses would have allowed an employee a deduction for educational expenses only if his employer *required* him to undertake the study.¹⁵¹ However, the final regulations issued in 1958 provided an alternative basis for the deduction: educational expenses were deductible if undertaken primarily for the purpose of (1) maintaining or improving skills required by the taxpayer in his employment or (2) the traditional meeting of the express requirements of the taxpayer's employment, or the requirements of applicable law, imposed as a condition to the retention by the taxpayer of his salary, status, or employment.¹⁵² This change was intended to remove the distinction previously drawn between self-employed persons and employees.¹⁵³ In effect, this modification recognized "the principle that the term 'necessary' as used in section 162 is broad enough to cover expenditures voluntarily made which are 'appropriate and helpful.'" ¹⁵⁴

The principal criterion under the maintenance or improvement of skills tests was the customariness of established members in the taxpayer's trade or business undertaking such education.¹⁵⁵ Under the requirement of the employer test, such requirement had to be imposed

¹⁴⁹ The employer requirement aspect was not present in *Coughlin v. Commissioner*, 203 F.2d 307, 309 (2d Cir. 1953), where the Second Circuit viewed a self-employed taxpayer's attendance at a tax institute as closely akin to *Hill* and allowed the expense because the education and knowledge so gained was "well adopted to fulfill his professional duty to keep sharp the tools he actually used in his going trade or business," *id.*; they were appropriate and helpful to an established trade or business.

¹⁵⁰ See text at note 95 *supra*.

¹⁵¹ Proposed Treas. Reg. § 1.162-5(d), 21 Fed. Reg. 5093 (1956).

¹⁵² Treas. Reg. § 1.162-5 (1958). These regulations have been construed as offering alternative bases for deduction of educational expenses: employer requirement or improvement or maintenance of existing skills. Ralph A. Fattore, 32 P-H Tax Ct. Mem. 1243 (1963).

¹⁵³ See S. REP. NO. 1983, 85th Cong., 2d Sess. 110 (1958), reprinted in 1958-3 CUM. BULL. 922, 1031.

¹⁵⁴ Cosimo A. Carlucci, 37 T.C. 695, 699 (1962); Rev. Rul. 60-97, 1960-1 CUM. BULL. 69, 70.

¹⁵⁵ Wolfman, note 79 *supra*, at 1103.

primarily for a bona fide business purpose of the taxpayer's employer and not primarily for the taxpayer's benefit.¹⁵⁶

The 1958 regulations also provided that educational expenses incurred primarily for the purpose of obtaining a *new position*, a substantial advancement in position, or of fulfilling the taxpayer's general educational aspirations or other personal purposes were not deductible.¹⁵⁷ Education that met the express requirements for a new position or a substantial advancement strongly evidenced that such education was undertaken primarily to obtain the new position or advancement, unless it was required as a condition to the retention by the taxpayer of his existing employment. These regulations also provided that, in any event, the costs of education required to meet the minimum requirement for qualification in a trade or business were not deductible.¹⁵⁸ The Tax Court in *Cosimo A. Carlucci*¹⁵⁹ read in this proviso recognition that such minimum requirements education was in the nature of a capital asset and that its cost was accordingly personal.

Not surprisingly, most cases under the employer requirement portion of these regulations dealt with whether the education was required as a condition for retention of existing employment, or represented the minimum requirement of the employer.¹⁶⁰ However, the greater number of decisions that arose under the new maintenance or improvement of skills provision of the regulations were the expenditures for improvement of skills or self-improvement.¹⁶¹

In 1967, these regulations were liberalized to provide more objective criteria for determining whether expenditures for education were properly deductible as business expenses than were contained in the 1958 regulations which emphasized the taxpayer's subjective intent.¹⁶² Thus, the new regulations provided that educational expenses were deductible if the education:

¹⁵⁶ Treas. Reg. § 1.162-5(a) (1958).

¹⁵⁷ *Id.* § 1.162-5(b) (1958).

¹⁵⁸ *Id.*

¹⁵⁹ 37 T.C. 695, 700 (1962).

¹⁶⁰ See, e.g., *United States v. Michaelson*, 313 F.2d 668 (9th Cir. 1963); *Laurie S. Robertson*, 37 T.C. 1115 (1962); see generally Annot., 3 A.L.R. 3d 829, 837-39 (1965).

¹⁶¹ See, e.g., *C. Fink Fischer*, 50 T.C. 164 (1968); *Richard P. Joyce*, 38 P-H Tax Ct. Mem. 1443 (1969); *Daniel J. Coughlin, III*, 38 P-H Tax Ct. Mem. 487 (1969).

¹⁶² See *Furner v. Commissioner*, 393 F.2d 292, 293 (7th Cir. 1968). See generally Gbg-gans & Leftwich, *What Is The Present Climate for Educational Expense Deductions*, 31 J. TAXATION 236 (1969).

- (1) Maintains or improves skills required by the individual in his employment or other trade or business, or
- (2) Meets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship status, or rate of compensation.¹⁶³

The 1967 version of the regulations abandoned the "new position" test, and instead provided that educational expenditures made in order to meet minimum educational requirements or made as part of a program of study which would lead to qualifying the taxpayer in a *new trade or business*¹⁶⁴—a change in an employee's duties involving the same general type of work would not constitute a new trade or business. Such expenditures in the eyes of the Service:

[A]re personal expenditures or constitute an inseparable aggregate of personal and capital expenditures and, therefore, are not deductible as ordinary and necessary business expenses even though the education may maintain or improve skills required by the individual in his employment or other trade or business or may meet the express requirements of the individual's employer or of applicable law or regulations.¹⁶⁵

Thus, the amended regulations do not take a position on whether minimum requirement and new business educational expenditures are capital or personal. Similarly, earlier decisions had often declined to identify whether their basis for disallowing certain educational expenses was that they were capital or personal because "the result would be identical."¹⁶⁶ However, characterization of such expense is significant in the broader context of whether expenditures with otherwise personal aspects are made deductible by employer compulsion. Indeed, Judge Opper in his concurring opinion in *Willis B. Ferebee*,¹⁶⁷ a new employee moving expenses case, pointed to educational expenses incurred to retain an existing job, as contrasted with obtaining a new one, as an illustration of the principle that an expense loses its personal aspect if undertaken for the convenience of the employer as an alternative to being dismissed.

¹⁶³ Treas. Reg. § 1.162-5(a) (1967).

¹⁶⁴ *Id.* § 1.162-5(b) (3) (1967).

¹⁶⁵ *Id.* § 1.162-5(b) (1) (1967).

¹⁶⁶ Knut F. Larson, 15 T.C. 956, 958 (1950); *cf.* United States v. Patrick, 372 U.S. 53, 57 (1968) (legal fees).

¹⁶⁷ 39 T.C. 801, 805 (1963).

It is established beyond question that compulsion cannot convert a capital expenditure into an ordinary business expense.¹⁶⁸ If minimum requirements or new trade or business educational expenses are disallowable on the theory that they are personal rather than capital, despite an express employer requirement, then such compulsion, at least in this instance, would not cause an expense to lose its personal aspect. The answer is provided by the Tax Court in *Arthur M. Jungreis*.

One of the requirements for the allowance of a deduction under section 162(a) is that the expense must be paid or incurred during the taxable year *in carrying on a trade or business*. Thus, a taxpayer must be engaged in a trade or business at the time he pays or incurs an expense which is deductible under section 162(a). This is the clear import of section 1.162-5(a)(2) of the 1967 regulations which speaks of "the express requirements of the individual's *employer* * * * imposed as a condition to the *retention* by the individual of an *established employment relationship*, status or rate of compensation." (Emphasis supplied.)

. . . Each appointment or reappointment as a teaching assistant was a separate and distinct employment contract. No number of appointments or reappointments as a teaching assistant created any presumption of a right to reappointment. Consequently, all of the educational expenses incurred by petitioner were conditions precedent which were required in order to "obtain" a new employment contract rather than conditions subsequent required to "retain" an established employment relationship. The educational expenses incurred by him were clearly for the purpose of "commencing" and "increasing," rather than for "carrying on" or "preserving," and therefore do not constitute allowable deductions under section 162(a) of the Code, section 1.162-5(a)(2) of the 1967 regulations, or the principles enunciated in *Hill v. Commissioner* . . . 181 F.2d 906 (C. A. 4, 1950).¹⁶⁹

In short, the basis for disallowance of a new trade or business or minimum requirement expenses is that the taxpayer is not yet engaged in an existing trade or business with which a nexus can be shown to permit a deduction. The theory is that despite a taxpayer's firm decision to enter into a business and the making of expenditures over a considerable period of time in preparation for entering such business, he still has not engaged in carrying on such business for the purposes of section

¹⁶⁸ *Welch v. Helvering*, 290 U.S. 111, 113 (1933).

¹⁶⁹ 55 T.C. 581, 588 (1970).

162(a) "until such time as the business has begun to function as a going concern and performed those activities for which it was organized."¹⁷⁰ Regardless of the validity of such a theory, it is clear that the court's basis for the disallowance of new trade or business educational expenditures is not that they are personal, but that they were not incurred in an *existing* business. Under this approach the taxpayer who ultimately does enter into the business would apparently be able to capitalize these expenditures, but if he does not go that far they cannot be capitalized, nor are they business or personal expenses. Tax equity is not overly abundant in the existing case law in this area.¹⁷¹

Disallowance of educational expenditures for entering a new trade or business is entirely consistent with this conceptual framework; disallowance of such expenditures for a *new position* (the test under the 1958 regulations) in the taxpayer's existing trade or business is not. Indeed, the Tax Court has recently held that the expenses of seeking a new position in the same trade or business are currently deductible,¹⁷² although by way of contrast expenses in preparation of engaging in a new field

¹⁷⁰ *Richmond Television Corp. v. United States*, 345 F.2d 901 (4th Cir.) *vacated and remanded on other grounds*, 382 U.S. 68 (1965). The doctrine has been criticized by commentators. See, e.g., Erbacher, *Start-Up Costs: Are They Deductible by a Corporation for Federal Income Tax Purposes*, 48 TAXES 488 (1970); Mandell, *Deductibility of Pre-Operating Expenses: Successful and Unsuccessful Ventures*, N.Y.U. 25TH INST. ON FED. TAX. 1235 (1967). The conclusion that since such expenditures increase the earning capacity of the business, they must be capitalized, *Mid-State Prods. Co.*, 21 T.C. 696, 714 (1954), conflicts with the deductibility of similar expenditures to expand an existing business, *York v. Commissioner*, 261 F.2d 421 (4th Cir. 1958), and with the deductibility of advertising expenditures which benefit future years, *E. H. Sheldon & Co. v. Commissioner*, 214 F.2d 655, 659 (6th Cir. 1954). The other rationale (espoused in *Richmond Television*) that a pre-opening venture is not engaging in a trade or business conflicts with the Service's position elsewhere, e.g., *Treas. Reg. § 1.248-1(a)(1)* (1956), as well as earlier decisions, e.g., *379 Madison Ave., Inc. v. Commissioner*, 60 F.2d 68 (2d Cir. 1932).

¹⁷¹ B. BITTKER, *FEDERAL INCOME ESTATE AND GIFT TAXATION* 262-63 (1964).

¹⁷² See David J. Primuth, 54 T.C. 374, 377-78 (1970). See generally Tucker, *An Individual's Employment Seeking Expenses & Analyzing The New Judicial Climate*, 31 J. TAXATION 352 (June 1971). The Tenth Circuit in *Woodall* denied the new employee's direct moving expenses in part on the grounds that a distinction was to be drawn between expenses incurred to obtain employment and those incurred in the course of employment. *Primuth* in effect rejected this distinction, 54 T.C. at 381 (Tannenwald, J., concurring), and, indeed, the author of the *Primuth* majority opinion has drawn an explicit parallel between an employment fee to obtain a job and "the expense incurred to reach the location of the new employment," Jon F. Hartung, 55 T.C. 1, 6 (1970), on appeal to the Ninth Circuit (Sterrett, J., dissenting). However, since a major theme of *Primuth* was that the taxpayer was engaged in the business

of endeavor must be capitalized.¹⁷³ Thus, it is significant that the Treasury Department abandoned the "new position" stance in the 1967 regulations.

The minimum requirements rule is more difficult to fit within this framework. For a taxpayer may be engaged in the business of being an employee and the minimum requirements education would appear an employer prerequisite to keep that existing employment. While meeting the minimum requirements frequently qualifies the taxpayer for a new position, permanent as contrasted with provisional employment (the premise of *Jungreis* is that only a permanent position constitutes a trade or business),¹⁷⁴ this usually would not even entail a change in duties, so that at most a change of positions within the same trade or business appears to be involved. Thus, in many instances the minimum requirements rule is not sound conceptually.

The other relevant change in the 1967 regulations of significance in the broader context of the effect of employer compulsion on deductibility of employee expenditures concerns the employer business purpose prerequisite.¹⁷⁵ The 1958 regulations provided that an employee was considered to have made his expenditures to meet an express requirement of his employer only if such requirement was imposed primarily for a bona fide business purpose of the employer and not primarily for the employee's benefit.¹⁷⁶ This test sounds quite similar to the primary benefit to the employer concept encountered in the exclusion from an employee's income of the value of employer expenditures only incidentally benefiting the employee. The 1967 regulations, however, state that a taxpayer is considered to have undertaken education to meet his employer's express requirements "only if such requirements are imposed for a bona fide business purpose of the individual's employer."¹⁷⁷ The latter test is more consonant with the proper function of the business purpose test in this area. Unlike the context of exclusions from income where employer benefit has independent significance (and indeed may

of his occupation—corporate executive—only one of the two taxpayers in *Woodall* could have come within the *Primuth* rationale. The other in the consolidated case was a new graduate from engineering school.

¹⁷³ David J. Primuth, 54 T.C. 374, 382 (1970) (Tannenwald, J., concurring).

¹⁷⁴ Arthur A. Jungreis, 55 T.C. 581, 588 (1970). *But cf.*, James B. Carey, 56 T.C. 477, 487 (1971) (on appeal to the Fourth Circuit) (Sterrett, J., dissenting).

¹⁷⁵ See Treas. Reg. § 1.162-5(b)(3) (1967).

¹⁷⁶ Treas. Reg. § 1.162-5 (1958).

¹⁷⁷ Treas. Reg. § 1.162-5(c)(2) (1967).

well be the principal basis for exclusion), the business purpose test in the context of deductions from income serves merely as a safeguard to insure that the employer compulsion or requirement is bona fide and not a subterfuge to allow deduction of an expense that would be personal absent the employer compulsion. Thus, the relative significance of employer compulsion and employer benefit is constant in the areas of deductibility of educational expenses and moving expenses.

In addition to highlighting the different roles played by the factors of employer requirement and benefit of the employer where exclusion and deduction of employer mandated expenses are involved, the educational expenses development establishes that the employer compulsion and rational connection with the employee's other duties are alternative tests and satisfaction of one does not necessarily meet the other's requirements. This aspect points up the fundamental error in *Woodall*. There the court found that the moving expenses "had no relation to any service which was being performed for the employer,"¹⁷⁸ but ignored the theory underlying the employer requirement rule that it is necessary in an employee's business of earning his salary to abide by his employer's requirements; and if costs are incurred in doing so, they are necessary business expense, deductible if ordinary, *i.e.*, not capital.¹⁷⁹

Although not expressly discussed in the cases, or regulations, it is clear that the fact that the employee may possess and exercise control over the subject matter of the courses taken, quality of the educational experience (*i.e.*, institution attended), and duration of the educational expenses does not preclude his deducting them if required by the employer as long as they are not minimum educational requirements and do not qualify the taxpayer for a new trade or business. In addition, the taxpayer may elect between alternative requirements, such as summer school or a course of reading as in *Hill*, without losing the deduction. Thus, the rules here are more consistent with the moving expense cases where the crucial factor was also lack of control over the cause of the expenditure than with the convenience of the employer requirements.¹⁸⁰

¹⁷⁸ United States v. Woodall, 255 F.2d 370, 373 (10th Cir. 1958), *cert. denied*, 358 U.S. 824 (1958).

¹⁷⁹ This principle is, of course, not peculiar to educational or moving expenses; it reappears below in the entertainment expense and traveling expense areas, see text at notes 279 and 432 *infra*. This doctrine also underlies the rule with respect to employee excess compensation and other types of reimbursement agreements. See Lee, *Shareholder Withdrawal*, note 139 *supra*, at 540 n.168.

¹⁸⁰ See text at notes 57 and 58 *supra*.

Perhaps even more significant than these additional pieces of flesh on the skeleton of employer compulsion is the illustration of conceptual tunnel vision at work. From *Hill* until the 1958 regulations, and thereafter in some instances,¹⁸¹ the administrative view and the view of the Tax Court was that deductibility of educational expenses was dependent upon employer compulsion. In essence this meant that educational expenses which were voluntarily incurred were not deductible. This approach is in no way dictated by the statutory test of "ordinary and necessary," construed by the cases as meaning appropriate and helpful. As pointed out in a dissent in *Harold H. Davis*¹⁸² (which was, in effect, accepted by the Service since it relinquished its victory in *Davis* both by stipulating on appeal to vacate and remand the case for entry of a decision of no deficiency¹⁸³ and by issuing Revenue Ruling 63-275):¹⁸⁴

[T]he test is not whether the expenditure is "required," but rather whether it is "appropriate" or "helpful" and proximately related to the taxpayer's trade or business. Of course, where the taxpayer is compelled by his employer to incur certain expenses, that fact itself may be highly pertinent in allowing the deduction. But the absence of such compulsion certainly does not, of itself, require the opposite result. The question still remains whether the expenditure is reasonably related to the taxpayer's trade or business.¹⁸⁵

The 1958 regulations clearly sought to incorporate this general test by its allowance of deductions for improvement or maintenance of skills used in an existing business, which are, of course, appropriate or helpful to that business. Indeed, it is unlikely that any expense which met the latter test would not also meet the former. However, for the better part of a decade from *Hill* to the 1958 regulations and sporadically thereafter, the Service and the Tax Court attempted to apply the unique rule of allowing educational and related expenses only where employer compulsion was present.¹⁸⁶

¹⁸¹ *Harold H. Davis*, 38 T.C. 175, 178 (1962), *vacated and remanded* (by stipulation), 1964 P-H ¶ 56, 345 (9th Cir.).

¹⁸² *Id.* at 186 (Raum, J., dissenting).

¹⁸³ Wolfman, *supra* note 79 at 1091.

¹⁸⁴ 1963-2 CUM. BULL. 85.

¹⁸⁵ 38 T.C. 175, 186 (Raum, J., dissenting).

¹⁸⁶ The Service has taken a similar position with respect to home office expenses, ruling that such expenses are deductible only if required by the employer as a condition of employment. Rev. Rul. 62-180, 1962-2 CUM. BULL. 432. Not unexpectedly the

IV. PRIMARY BENEFIT TO THE EMPLOYER: ENTERTAINMENT EXPENSES

An economic gain bestowed as compensation upon an employee constitutes income; the gain may be indirect as where a benefit is received without a corresponding diminution in wealth.¹⁸⁷ For example, if an employee (typically a corporate executive) entertains his employer's customers through hosting a cruise on his employer's yacht, the value of the cruise to the employee may be includible in the executive's gross income as taxable compensation or if he is also a shareholder (a common event in close corporations) possibly as a constructive dividend.¹⁸⁸ Since a dividend is not deductible by a corporation,¹⁸⁹ a frequent issue in cases involving employer expense-paid entertainment undertaken by shareholder-employees has been whether the portion of the expenditures allocable to such employees is deductible by the employer. Indeed, in many of the cases in this area, particularly the earlier ones, the question of income to the employee appears incidental to the issue of deductibility of the expense by the corporate employer.¹⁹⁰ Consequently, the strict attitude towards corporate deduction of entertainment expenses where dominant shareholders are involved has significantly and directly influenced the question of exclusion of the value of the indirect gain by the shareholder-employee undertaking the entertainment, whether under employer command or not. Thus, in *Louis Greenspan*¹⁹¹ where a corporate executive allocated to controlled corporations a substantial portion of the expenses of establishing and maintaining a home with elaborate grounds in which business guests were entertained, the court required "very clear" evidence to show that any particular percentage of expenditures for entertainment at the shareholder's home were purely commercial and, hence, deductible by the corporations. Indeed, it expressed concern that a corporation was taking deductions for expenses

judicial response has been to apply the traditional "appropriate and helpful" test. *Newi v. Commissioner*, 432 F.2d 998 (2d Cir. 1970). See generally Staller, *The Second Office at Home*, 58 A.B.A.J. 526 (1972).

¹⁸⁷ *United States v. Gotcher*, 401 F.2d 118, 121 (5th Cir. 1968).

¹⁸⁸ See, e.g., *Challenge Mfg. Co.*, 37 T.C. 650 (1962). See generally Comment, *Disguised Dividends: A Comprehensive Survey*, 3 U.C.L.A. L. REV. 207 (1956).

¹⁸⁹ *Swed Distrib. Co. v. Commissioner*, 323 F.2d 480 (5th Cir. 1963). See generally Lee, *Shareholder Withdrawal*, *supra* note 139, at 512.

¹⁹⁰ See, e.g., *Challenge Mfg. Co.*, 37 T.C. 650, 663 (1962); *Louis Greenspan*, 23 T.C. 138 (1954), *aff'd*, 229 F.2d 947 (8th Cir. 1956); *Robert R. Walker, Inc.*, 34 P-H Tax Ct. Mem. 154, 169-70 (1965), *aff'd*, 362 F.2d 140 (7th Cir. 1966).

¹⁹¹ 23 T.C. 138, 150-51 (1954), *aff'd*, 229 F.2d 947 (8th Cir. 1956).

with respect to the private home of its dominant shareholder and chief executive officer. "In such circumstances, the proof should be very clear and very certain that the expenses charged to the corporation were legitimate business expenses of the corporation. Otherwise, the opportunity for abuse would be very great."¹⁹² This standard of burden of proof bears a striking resemblance to the strong proof required of the Internal Revenue Service in civil tax fraud cases, *i.e.*, "clear and convincing"¹⁹³ evidence—which is greater than the "clear preponderance" standard usually applied.¹⁹⁴ The court found no such clear and certain proof; rather the farm was believed to be primarily the shareholder's home and any use of it to entertain business guests was only incidental. Having devoted extensive analysis to disallowance of the corporate deductions, the court perfunctorially agreed with the Service that the farm expenses charged to the corporation constituted income to the shareholder.

It now appears to be well settled, particularly in cases where a dominant stockholder withdraws or disburses corporate funds for his personal use, without intention of repayment, that the amounts withdrawn are the equivalent of corporate distributions, the informality of the transaction notwithstanding.¹⁹⁵

The same rule extends to corporate-owned facilities made available to a stockholder for his personal benefit.¹⁹⁶

The taxability of the fair value of such expenditures is bottomed on economic benefit—a corporate distribution to a shareholder serving no legitimate corporate purpose that results in economic benefit to the shareholder constitutes a constructive dividend to the benefited shareholder.¹⁹⁷ At the other extreme, the rule appears equally well-established that the cost of a corporate expense does not constitute income to the shareholder if it qualifies as an ordinary and necessary expense of the corporation, although the shareholder obtained personal enjoyment from

¹⁹² *Id.* at 151.

¹⁹³ See, *e.g.*, Allen F. Labay, 55 T.C. 6, 13 (1970), *aff'd*, 450 F.2d 280 (5th Cir. 1971); Henry S. Kerbaugh, 29 B.T.A. 1014, *aff'd*, 74 F.2d 749 (1st Cir. 1935). See generally Note, *The Burden of Proof Required of a Parent Claiming Child Exemption*, 29 WASH. & LEE L. REV. 29, 39 (1972) (hereinafter cited as Note, *The Burden of Proof*).

¹⁹⁴ See Note, *The Burden of Proof*, note 193 *supra*, at 39 nn.56 and 60.

¹⁹⁵ Louis Greenspan, 23 T.C. 138, 151 (1954).

¹⁹⁶ See *Challenge Mfg. Co.*, 37 T.C. 650, 663 (1962) and authorities cited therein.

¹⁹⁷ *Commissioner v. Riss*, 374 F.2d 161, 167 (8th Cir. 1967).

the expenditure.¹⁹⁸ Indeed, this rule was even applied to a big game hunt in Africa conducted by a corporate executive who admittedly enjoyed hunting.¹⁹⁹

While careful consideration has been traditionally given to the circumstances in which the value of such expenditures paid by a corporate employer were taxable to the shareholder-employee, until recently less explicit analysis was given to the circumstances permitting an exclusion from income. Possibly courts felt that the taxable income to the entertaining employee was the natural consequence of disallowance of the deduction taken by the corporation or more likely the unarticulated rationale was that identical factors governed inclusion in the employee's income and deduction by the corporation (not by the employee—the erroneous assumption encountered in the moving expense area) so that discussion of the corporate deduction sufficed. In any event, with the advent of section 274, which disallows under certain circumstances deductions for entertainment expenditures otherwise deductible by the payor under sections 162 or 212, courts have focused more closely on the circumstances in which an employee is not subject to taxation on the value of such costs. Thus, *John L. Ashby*,²⁰⁰ primarily a section 274 case, was the first decision to supply the answer implicit in the earlier case law:²⁰¹ to the extent that a corporate expenditure incidentally benefiting an employee is made for a corporate business purpose its value is not includible in the employee's income; the converse had, of course, been established by prior opinions, *i.e.*, to the extent the cost is paid or incurred for the benefit of the individual its value constitutes income to him.²⁰² In *Ashby* a corporation was denied deductions for costs with respect to entertainment "facilities" (a yacht and two clubs) because it could not show that more than fifty percent of the use of the facilities was for business use so that the facilities would qualify as being used "primarily for the furtherance of the taxpayer's trade or business," a

¹⁹⁸ *United States v. Gotcher*, 401 F.2d 118, 123 (5th Cir. 1968); see *John L. Ashby*, 50 T.C. 409, 418 (1968).

¹⁹⁹ *Sanitary Farms Dairy, Inc.*, 25 T.C. 463 (1955) (effective advertising at low cost for a dairy).

²⁰⁰ 50 T.C. 409, 418 (1968).

²⁰¹ It would appear logical that the same rules should govern exclusions as govern inclusions, see *United States v. Gotcher*, 401 F.2d 118, 123 (5th Cir. 1968), and the Supreme Court has just recognized this. See note 139 *supra*.

²⁰² See note 197 *supra*.

prerequisite to deductibility under section 274(a)(1)(B).²⁰³ The Commissioner argued that the shareholder should be charged with dividend income to the full extent of the disallowed deductions. The Tax Court, however, pointed to the legislative history of section 274,²⁰⁴ which made "it clear that since the only purpose of sec. 274 is to disallow deductions, it does not affect the question of the includability or excludability of an item in income of any individual, and that the usual rules are applicable in this respect."²⁰⁵ Although the court believed that the yacht was not used primarily, *i.e.*, fifty percent or more, for a corporate business use, it was satisfied from the evidence that as much as 20/68 of the boat's use was for corporate business purposes "and accordingly . . . [was] of the opinion that *only* 48/68 of the depreciation and costs of repairs and maintenance of the boat and the same percentage of the boat interest constituted amounts paid or incurred for the benefit of the individual (emphasis added)" ²⁰⁶ and, hence, was dividend income to him.

This line of cases evidences the parallelism between the corporate executive decisions and the benefit of the employer doctrine—both turn in large measure on whether the primary benefit of the expenditure inures to the employer or the employee. The other elements of the latter doctrine (lack of employee control or choice and the closely related factor of employer requirement) have played a less significant, or at least less explicit role in these opinions. Indeed, in the overwhelming majority of the reported decisions the employee was the dominant shareholder of his corporate employer so that if employee control were the determinative factor those decisions could have been resolved on that point.²⁰⁷ In fact, that was not the case. Thus, it would be easy to conclude that employee control or employer requirement is not a relevant factor in the corporate-executive line of authorities. There are two

²⁰³ The item must also be directly related to the active conduct of his trade or business. INT. REV. CODE of 1954, § 274(a)(1)(B). The regulations and legislative history do not define the perimeters of active conduct of a trade or business in this context. For the scope of the concept in other provisions see Lee, "*Active Conduct*" Distinguished from "*Conduct*" of Rental Real Estate Business, 25 TAX LAWYER 317 (1972).

²⁰⁴ S. REP. No. 1881, 87th Cong., 2d Sess. 27 (1962), reprinted in 1962-3 CUM. BULL. 733.

²⁰⁵ John L. Ashby, 50 T.C. 409, 418 n.5 (1968).

²⁰⁶ *Id.* at 418.

²⁰⁷ See, e.g., Challenge Mfg. Co., 37 T.C. 650, 663 (1962).

caveats to such a conclusion. The first is that the benefit of the employer doctrine, at least in its statutory form in section 119, is applicable where the employee controls the employer.²⁰⁸ Thus, it may be argued that employee control is still an element, but the separate identities of the corporate employer and employee-shareholder are respected. The other possibility, also present under section 119, is that in situations of abuse a shareholder will be taxed despite the fact that the primary benefit of the cost inures to the corporation if the shareholder actually does exercise control over the expenditure.²⁰⁹ Similarly, one of the corporate executive cases has indicated in dictum that it might consider actual shareholder control in situations of abuse. In that decision, *United Aniline Co. v. Commissioner*,²¹⁰ the shareholder in fact had received:

[T]angible, and hence taxable, benefits over and beyond the incidental ones which may be conferred by attendance at a predominantly business function. It might be that the court used too large a measure if . . . it suggested that his enjoyment of the yacht when strictly business guests were entertained was such a taxable benefit. This we need not decide, although we might see a basis for such a finding when the choice of an expensive recreational facility for business purposes was fully in the hands of the stockholder who was to use it. But certainly where this facility was enjoyed on entirely separate occasions which were not predominantly, and in some cases not at all, business motivated, the fair value of such use is what has been loosely called a constructive receipt.²¹¹

A further indication of the significance of control in this area may be seen in *Nicholls, North, Buse Co.*²¹² There the Tax Court drew upon the doctrine of assignment of income (the doctrine focuses on the power to control the disposition of income)²¹³ to include in the income of the dominant shareholder the value of his sons' personal use of a corporate facility. The court emphasized that it was the taxpayer's decision that the corporation acquire the facility (the ever familiar yacht) and his

²⁰⁸ See text at note 42, *supra*.

²⁰⁹ See text at notes 44 through 46, *supra*.

²¹⁰ 316 F.2d 701, 704-05 (1st Cir. 1963).

²¹¹ *Id.* The *Aniline* court drew support from the section 274 foreign travel regulations' control concept discussed below at note 346.

²¹² 56 T.C. 1225, 1239-40 (1971).

²¹³ See Lee, *Section 482 and the Integrated Business Enterprise*, 57 VA. L. REV. 1376, 1409 (1971) (hereinafter cited as Lee, *section 482*).

“decision to allow the use of the boat by his sons as they desired and without direct control over either the circumstances of use or the maintenance of appropriate supportive documentation”²¹⁴ The court was not persuaded that the taxpayer’s purpose in agreeing to the acquisition of a large pleasure craft was solely to benefit the corporation. Furthermore, the fact that the principal user of the boat for personal purposes was a mature adult and a shareholder in his own right (although assuredly a lower tax-bracket shareholder) was irrelevant because the taxpayer was in complete control of the events. It may be noted, however, that the taxpayer was not taxed on his (or his sons’) enjoyment of the use of the boat on occasions of entertainment of business guests. Despite the *United Analine* suggestion that shareholder control might trigger taxation in certain circumstances even though the entertainment was predominantly business, case law is more likely to follow precedent in which shareholder-employees are not taxed to the extent the corporate expenditure serves a corporate business purpose, with no consideration being given to such shareholder’s control over the expenditure.²¹⁵

The *United Analine* language—taxability of benefits where use is not predominantly business—serves also as a rather clear example of the primary purpose criterion as applied to deductions and inferentially to income. A deduction for maintenance and depreciation is permitted, for example, where acquisition of property is primarily associated with business motivated purposes and the personal use is distinctly secondary and incidental.²¹⁶ Conversely, if such acquisition and maintenance is primarily motivated by personal considerations the deductions are disallowed.²¹⁷ However, the Tax Court in *International Artists, Ltd.*²¹⁸ pointed out (in the context of deductibility of expenditures) that the primary purpose criterion is applicable only where the secondary purpose is merely incidental and relatively insignificant. “Where substantial business and personal motives exist, however, allocation becomes

²¹⁴ Nicholls, North, Buse Co., 56 T.C. 1225, 1239-40 (1971).

²¹⁵ *International Artists, Ltd.*, 55 T.C. 94, 104 (1970), cited *United Analine* as supporting the proposition that a deduction for maintenance of property is disallowed where primarily associated with profit-motivated purposes and personal use is secondary. The court also pointed out that corporate expenditures benefiting a shareholder were the equivalent of personal expenditures by an individual and the same rules applied.

²¹⁶ See, e.g., Delores Bussabarger, 52 T.C. 819 (1969).

²¹⁷ See, e.g., *W. D. Gale, Inc. v. Commissioner*, 297 F.2d 270 (6th Cir. 1961).

²¹⁸ 55 T.C. 94, 105 (1970).

necessary.”²¹⁹ For deductions by the corporate employer the court believed that a 50 percent allocation properly reflected the business and personal use of the property. Then turning to the question of the amount of the dividend income to the shareholder-employee, the Tax Court applied the same 50 percent allocation factor to the fair rental value to determine the amount of income taxable to the employee. Thus, it seems clear that despite the almost universal use of the term “primary purpose” in the corporate executive decisions, the taxpayer and the courts are not faced with an all-or-nothing choice. Income to the employee can be allocated according to the relative benefit to the employer and the employee. This approach is by no means unprecedented, the value of meals and lodging having been partially excluded from the employee’s income under the pre-1954 convenience of the employer doctrine on just that basis.²²⁰

Development of deductibility and, hence, indirectly of excludability of entertainment expenses has been strongly influenced by the availability of the *Cohan*²²¹ rule of approximation prior to 1963.²²² That rule arose in the following circumstances. The Board of Tax Appeals in *George M. Cohan*²²³ had denied the taxpayer any deduction for the large sums which it believed that he had spent in traveling and entertaining for two reasons: (1) the amounts claimed were bare estimates unsupported by vouchers or bookkeeping entries of any kind, and (2) the court did not know what part of the expenditures were for personal expenses. Judge Hand of the Second Circuit held that estimates were allowable.

Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing

²¹⁹ *Id.*

²²⁰ Olin D. Ellis, 6 T.C. 138 (1946).

²²¹ *Cohan v. Commissioner*, 39 F.2d 540, 543-44 (2d Cir. 1930).

²²² The substantiation rules of section 274 were intended by Congress to overrule the *Cohan* rule in the area of entertainment expenses, S. REP. NO. 1881, 87th Cong., 2d Sess. 35 (1962), reprinted in 1962-3 CUM. BULL. 707, 741; Albert N. Dibs, 39 P-H Tax Ct. Mem. 983, 985 (1970); see generally Comment, *Substantiation of Business Related Entertainment Expense*, 54 MARQ. L. REV. 345 (1971) (hereinafter cited as Comment, *Substantiation*). However, *Cohan* still lives where section 274 is inapplicable. See *Teichner v. Commissioner*, 72-1 U.S.T.C. ¶ 9183, p. 83, 745 n.11 (2d Cir. 1971); *Lillian Pascarelli*, 55 T.C. 1082, 1096 (1971). A catalogue of such areas is available in Kramer, *Estimated Income and Expense in the Tax Law*, 32 TAXES 906 (1954).

²²³ 11 B.T.A. 743 (1929).

heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent. True, we do not know how many trips Cohan made, nor how large his entertainments were; yet there was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any, even though it were the travelling expenses of a single trip. It is not fatal that the result will inevitably be speculative; many important decisions must be such.²²⁴

Commentators pointed out that as a practical matter taxpayers through excessive deductions were able to shift the burden of proof (which normally rests with the taxpayer)²²⁵ to the Service, since it knew that under the *Cohan* rule a reasonable approximation would be made by the courts in the absence of records, and thus it would have to allow something; the question was how much.²²⁶ Consequently, taxpayers were tempted to claim excessive deductions for bargaining purposes.²²⁷ Due to such potential abuse many court decisions sought to limit the *Cohan* rule. For example, some opinions were subject to the interpretation that once the Service had applied *Cohan* a court would uphold such minimum allowance rather than applying its own approximation.²²⁸ It is submitted that the better view is that a court will not substitute its judgment for the Commissioner's *Cohan* approximation in the absence of proof that the latter was arbitrary or unreasonable.²²⁹

²²⁴ *Cohan v. Commissioner*, 39 F.2d 540, 543-44 (2d Cir. 1930). See generally Gluck, *supra* note 123.

²²⁵ Tax Ct. R. P. 32.

²²⁶ See Eichel, *The Missouri Rule—Substantiation Requirements for Travel and Entertainment Expenditures under Section 274(d) of the Internal Revenue Code of 1954*, 18 U. MIAMI L. REV. 613, 616 (1964) (hereinafter cited as Eichel); 44 NOTRE DAME LAWYER 1006, 1007 (1969).

²²⁷ See Emmanuel & Lipoff, *Travel and Entertainment: The New World of Section 274*, 18 TAX L. REV. 487, 517 (1963) (hereinafter cited as Emmanuel and Lipoff).

²²⁸ See, e.g., Neils Schultz, 44 B.T.A. 146, 151 (1941); S. J. Campbell, 30 P-H Tax Ct. Mem. 902, 922 (1961). See generally CAPLIN, THE TRAVEL AND ENTERTAINMENT EXPENSE PROBLEM, 39 TAXES 947, 960 (1961) (approval of *Campbell* and *Schultz*; Service determinations developed in the field will be upheld); Gluck, *supra* note 123, at 383, n.39 (critical of *Schultz* rule); Note, *Business Expense Deduction—The Cohan Rule*, 36 TAXES 177 (1958) (hereinafter cited as Note, *Cohan Rule*).

²²⁹ See *Silverman v. Commissioner*, 253 F.2d 849, 853 (8th Cir. 1958). Significantly, this is a burden of proof similar to that under section 482 and greater than the clear

The principle of *Cohan* . . . dictates that the Court estimate from the evidence what portion of the claimed deduction should be allowed. This, however, is not necessary when respondent has previously employed the *Cohan* principle in asserting his deficiency. In such a case the question really is whether respondent's application is, considering the evidence, fair and adequate.²³⁰

In effect, the Commissioner could place the burden of proof back upon the taxpayer by allowing a portion of the claimed deductions.²³¹ However, where the courts were convinced that the Service's approximation was erroneous, they made their own estimation.²³²

Another gloss which some early decisions attempted to place upon *Cohan* was that in the absence of segregation, for example, of traveling expenses between a taxpayer's official and personal trips there was no basis for an approximation.²³³ This gloss was particularly unfortunate since one of the bases for the Tax Court's original disallowance of the claimed deductions in *Cohan* was that it did not know what portion of the claimed expenditures were personal. Indeed, more recent decisions are legion that have permitted a partial deduction despite a failure to so segregate.²³⁴ Furthermore, many cases that could find no basis for allocation of claimed deductions between personal and business expenditures also stated that the taxpayer failed to prove that he was entitled to any deduction at all.²³⁵ A more sophisticated variant of the segregation principle is the *Sutter* rule.²³⁶ Where a taxpayer in entertaining makes outlays for himself or his family that are personal expenses, he must show "by clear and detailed evidence as to each instance that the

preponderance of evidence placed upon the taxpayer in most Tax Court cases. See Charles Rocco, 57 T.C. No. 85 (1972).

²³⁰ Victor R. Havas, 39 P-H Tax Ct. Mem. 1597, 1601 (1970), appeal docketed, No. —, 9th Cir., June 6, 1971.

²³¹ See Note, *Cohan Rule*, *supra* note 228, at 178.

²³² See Sam Mesri, 25 T.C. 513, 519 (1955), *rev'd on other grounds*, 242 F.2d 558 (7th Cir. 1957); Morris Nemo, 24 T.C. 583, 594 (1955); Michael Potson, 22 T.C. 912, 928-29 (1954), *aff'd sub. nom.*, *Bodoglou v. Commissioner*, 230 F.2d 336 (7th Cir. 1956).

²³³ See George W. Lindsay, 34 B.T.A. 840, 844 (1936); Joseph F. Logel, 24 B.T.A. 798 (1931), *cf.* *Cohan v. Commissioner*, 138 F.2d 763, 765 (2d Cir. 1943).

²³⁴ See, e.g., Ray S. Robinson, 44 T.C. 20, 38 (1965); Herman Drews, 25 T.C. 1354, 1355 (1956). *But see* Best Universal Lock Co., 45 T.C. 1, 13 (1965). See generally Gluck, *supra* note 123, at 387 and authorities cited therein.

²³⁵ Walter I. Greer 28 T.C. 994, 996 (1957); *cf.* *Sperling's Estate v. Commissioner*, 341 F.2d 201 (2d Cir. 1965).

²³⁶ Richard A. Sutter, 21 T.C. 170, 173 (1953).

expenditure in question was different from or in excess of that which would have been made for the taxpayer's personal expenses";²³⁷ otherwise even under *Cohan* no amount is deductible. The *Cohan* doctrine may, nevertheless, be applicable to carve out business expenses from the total expenditures where, as a practical matter, the taxpayer cannot separate them by proof from personal living expenses.²³⁸

Still another limitation, although arguably limited to refund cases where the taxpayer is required to show the correct amount of tax to prevail,²³⁹ is that a court may, rather than must, make an estimate.²⁴⁰ But perhaps the restriction of the *Cohan* principle that reveals most judicial resistance to approximation is the view (not universally held)²⁴¹ that the record must afford a basis for making a reasonable estimate.²⁴² Moreover, it is clear that a taxpayer must first prove that the expenditure was an ordinary and necessary business expenditure before *Cohan* can be applied to determine the amount.²⁴³ Thus, a judge who was reluctant

²³⁷ *Id.*, accord, *LaForge v. Commissioner*, 134 F.2d 370, 372 n.2 (2d Cir. 1970). The Service has announced in Revenue Ruling 63-144, 1963-2 CUM. BULL. 129, 135, that it will apply the *Sutter* doctrine only in "abuse" cases. See Herman Marvin, 40 P-H Tax Ct. Mem. 1042, 1045 n.3 (1971).

²³⁸ *James v. United States*, 308 F.2d 204, 208 (9th Cir. 1962).

²³⁹ *Eustice, Tax Problems Arising from Transactions Between Affiliated or Controlled Corporations*, 23 TAX L. REV. 451, 495 n.115 (1968).

²⁴⁰ *Williams v. United States*, 245 F.2d 559, 560 (5th Cir. 1957). See generally *Lee, Section 482*, note 213 *supra*, at 1400.

²⁴¹ *Polletti v. Commissioner* 330 F.2d 818, 820-21 (8th Cir. 1964) (remanded for application of *Cohan* rule where Tax Court had held that some of expenditures were deductible, but record failed to provide a basis for determining a specific amount); see *Jason L. Honigman*, 55 T.C. 1067, 1081 (1971); *V.H.T. Bien*, 20 T.C. 49, 56 (1953); *Andrew P. Solt*, 19 T.C. 183, 188 (1952); cf. *James E. Caldwell & Co. v. Commissioner*, 234 F.2d 660 (6th Cir. 1956), *rev'ing*, 24 T.C. 597 (1955).

²⁴² *Plisco v. United States*, 306 F.2d 784, 787 (D.C. Cir. 1962), *cert. denied*, 371 U.S. 948 (1963) (refund suit); *Eugene A. Carter*, 51 T.C. 932, 937 (1969) (dictum); *A. Finkl & Sons*, 38 T.C. 886, 903-05 (1962). See generally *Lee, Section 482*, note 213 *supra*, at 1399-1400.

²⁴³ *Oates v. Commissioner*, 316 F.2d 56, 59 (8th Cir. 1963). Indeed, many cases which conclude that there was no basis in facts before them for a reasonable *Cohan* allocation, do so on the grounds that the taxpayer has presented no reliable evidence to show he is entitled to an adjustment. See *Walter I. Geer*, 28 T.C. 994, 996 (1957); accord, *Paul Masters*, 25 T.C. 1093, 1099 (1956), *aff'd*, 243 F.2d 335 (3rd Cir. 1957); *Alfred W. Barber*, 19 T.C. 600, 604 (1952). Cf. *United Aniline Co. v. Commissioner*, 316 F.2d 701, 704 (1st Cir. 1963); accord, *Walker v. Commissioner*, 362 F.2d 140, 143 (7th Cir. 1966). See generally *Kramer, Estimated Income and Expense in the Tax Law*, 32 TAXES 906, 907 (1954). However, where a court holds that some expenditures were made, but refuses to apply *Cohan* because there was no evidence as to extent, dates, amounts, or specific expenditures, *Herbert Schellenburg*, 31 T.C. 1269, 1278 (1959),

to estimate entertainment expenses could easily do so by refusing to find that the claimed expenses were business related.²⁴⁴ Indeed, the explicit judicial response to potential abuse in the entertainment expense area has been that the taxpayer seeking the benefit of such deductions must meet a greater than normal burden of proof: very clear and very certain evidence that the expenses were in fact incurred and that they bore a proximate relationship to the conduct of his trade or business.²⁴⁵ In addition, the Tax Court imposed a special burden of showing that the entertainment expenses were necessary.

In determining that which is "necessary" to a taxpayer's trade or business, the taxpayer is ordinarily the best judge on the matter, and we would hesitate to substitute our own discretion for his with regard to whether an expenditure is "appropriate and helpful," in those cases in which he has decided to make the expenditure solely to serve the purposes of his business. But where, as in this case, the expenditures may well have been made to further ends which are primarily personal, this ordinary constraint does not prevail; petitioner must show affirmatively that his expenses were "necessary" to the conduct of his professions.²⁴⁶

At times in fact the Tax Court appears to have approached a requirement that such entertainment constitutes a direct part of a business discussion or negotiation of specific business matters.²⁴⁷ The feeling of the court has been that the "deduction is one that is peculiarly susceptible of abuse" ²⁴⁸

Despite the special rules regarding burden of proof and degree of business necessity generated by judicial concern about potential abuse of entertainment expenses, this area has produced significant development of the employer requirement concept in its bearing on deduction of employer mandated expenses.

modified, 283 F.2d 871 (6th Cir. 1960) (result would be based solely on inference and guesswork), it is in conflict with *Cohan* as construed by the Eighth Circuit in *Polletti v. Commissioner*, 330 F.2d 818, 820-21 (8th Cir. 1964).

²⁴⁴ See, e.g., *Reginald G. Hearn*, 36 T.C. 672, 674 (1961), *aff'd*, 309 F.2d 431 (9th Cir. 1962), *cert. denied*, 373 U.S. 909 (1963); *Eugene H. Walet, Jr.*, 31 T.C. 461, 471 (1958), *aff'd*, 272 F.2d 694 (5th Cir. 1959); *cf.* *Alfred W. Barber*, 19 T.C. 600, 604 (1952).

²⁴⁵ See text at notes 192 through 194 *supra*.

²⁴⁶ *Robert Lee Henry*, 36 T.C. 879, 884 (1961) (citations omitted).

²⁴⁷ See, e.g., *Louis Boehm*, 35 B.T.A. 1106 (1937); *S. J. Campbell*, 30 P-H Tax Ct. Mem. 902, 928 (1961).

²⁴⁸ *Id.*

The Service's position here, unlike its early stance on educational expenses, is that an employer requirement is not a prerequisite to employee deduction of entertainment expenses incurred on behalf of the employer. Instead, it ruled in Revenue Ruling 57-502²⁴⁹ that:

[A] corporate officer who claims deductions for traveling and entertainment expenses incurred on behalf of a corporation must bear the burden of proof that he is entitled to such deduction. *Reimbursement for such expenses to the corporation officer or a resolution requiring the assumption of such expenses by him would tend to indicate that they are a necessary expense of his office. Although the presence of such evidence does not conclusively determine that the expenses are deductible, neither does the absence of such evidence of itself necessarily result in the disallowance of deductions, provided it can be established otherwise that the expenses are a necessary expense of the office (emphasis added).*²⁵⁰

Subsequent decisions such as *Brown v. Commissioner*²⁵¹ echo the position taken by this ruling, e.g., a clear employer policy requiring the employee to make the expenditure would be helpful in establishing the right to the deduction. However, others following the landmark *Schmidlapp v. Commissioner*²⁵² hold without qualification that where the taxpayer proved that as part of his duties his employer required him to incur expenses on its behalf, without expectation of reimbursement, the expenditures were deductible by the taxpayer.²⁵³ In *Schmidlapp* where the taxpayer, a vice president of a large bank, was expected as part of his implied duties to entertain at his own expense business guests of his employer, Judge Learned Hand of the Second Circuit ruled that "[i]t is no answer to say that they were for the bank's benefit; so were all the taxpayer's services; if it did in fact give him to understand that he was to extend a factitious hospitality in its interest, the cost of it was a necessary expense of his office."²⁵⁴ The premise of the opinion clearly

²⁴⁹ 1957-2 CUM. BULL. 118.

²⁵⁰ *Id.* at 119. In Rev. Rul. 72-192, INT. REV. BULL. 1972-17, 9, the Service reiterated its view that employer compulsion is not conclusive of business necessity, only strong evidence thereof. More important in its eyes is whether the activity is utilized as a means of carrying out the substantive duties of the employee's job.

²⁵¹ 446 F.2d 926, 929 (8th Cir. 1971). See generally MERTENS, note 79 *supra*, at § 25.12.

²⁵² 96 F.2d 680, 681-82 (2d Cir. 1938).

²⁵³ See, e.g., John O. Lockwood, 39 P-H Tax Ct. Memo. 686, 687 (1970); Albert L. Sanderson, 26 P-H Tax Ct. Mem. 87, 88 (1957).

²⁵⁴ *Schmidlapp v. Commissioner*, 96 F.2d 680, 682 (2d Cir. 1938).

was that expenses essential to the continuance of the taxpayer's employment are deductible—the judicial rationale supporting deduction of employer required educational expenses.²⁵⁵

Many entertainment expense decisions involved a common factual pattern: an employee reimbursed by his employer for certain entertainment expenses claimed that his employer also required him to incur other expenses for which he was not reimbursed. The most widely known of these cases, *Noland v. Commissioner*,²⁵⁶ began with the assumptions that (1) every person working for compensation is engaged in the business of earning his pay so that expenses essential to the continuance of that employment are deductible and (2) the business of a corporation is not that of its officers, employees or stockholders, hence, if either the corporation or the stockholder-executive pays the other's obligations, his expense is not deductible.²⁵⁷ The taxpayer did not question these rules but sought to prove that the corporation required him to incur the expenses, including among others the costs of the annual Christmas party which theretofore had been borne by the company. The Fourth Circuit followed the Tax Court in holding that "*the proof was not so certain or definite as to compel a finding that these expenditures were required by the Company or the conclusion that they were deductible business expenses of the taxpayer (emphasis added).*"²⁵⁸ The review court went on to note that the expenses (club and association dues primarily) of the executive in discharging his civic and community responsibilities were personal. In this context, the court made a frequently quoted statement.

It is greatly to be doubted that expenses, which are clearly personal in nature, could be converted into business expenses of the individual by a formalistic requirement of his employer that they be incurred. Personal, living and family expenses are nondeductible by the express provisions of § 24(a)(1), 26 U.S.C.A. § 24(a)(1). No magic form of words occurs to us by which an employer can convert them into some-

²⁵⁵ See text at note 167, *supra*. As one commentator has pointed out, the fact that an expenditure primarily benefits the employer does not lessen its deductibility, instead the employer compulsion makes it deductible. Note, *Deductibility of Expenses Incurred for the Benefit of Another*, 66 HARV. L. REV. 1508, 1509 (1953) (hereinafter cited as Note, *Expenses for Another*).

²⁵⁶ 269 F.2d 108 (4th Cir. 1959), *cert. denied*, 361 U.S. 885 (1959).

²⁵⁷ *Id.* at 111.

²⁵⁸ *Id.* at 112.

thing else, and relieve his employees of a portion of the tax burden uniformly borne by all other individuals.

To distinguish between such expenditures and those having a closer relation to business is not easy. Answers turn upon particular factual situations, and distinctions are usually a matter of degree. If the expense has been billed to an employer and has passed a critical scrutiny of corporate officers concerned with the elimination of needless expense, it becomes prima facie an allowable business expense of the corporation. When the corporation, reimbursing its officers and employees for direct expense incurred in furthering its business, does not reimburse an officer for particular expenses, that expense prima facie is personal, either because it was voluntarily assumed or because it did not arise directly out of the exigencies of the business of the corporation.²⁵⁹

However, simply because a corporation refuses to absorb an expense, it is not rendered automatically outside the traditional scope of corporate expense.²⁶⁰

Another judicial response to the pattern of expenses benefiting the employer with only some of the expenses being reimbursed has been to treat the unreimbursed portion as not necessary. Thus, in *Horace E. Podems*,²⁶¹ the Tax Court ruled that where an employee could have been reimbursed by his employer for certain expenses "had he taken the trouble to claim reimbursement by filing the necessary vouchers,"²⁶² the expenses were not ordinary and necessary.²⁶³

The tenor of *Podems* is that the employee's expenditures for which he failed to claim reimbursement were business expenses, but were not necessary by virtue of such failure. It came, however, to be read as

²⁵⁹ *Id.* at 113. One writer has commented that to say in such cases that the employee is attempting to convert his employer's deductions into his own seems a little unreal; he is bearing an expense that he thinks advisable in order to keep his job and protect his salary. Fischman, *Income Tax Aspects of Third Party Payments of Taxpayer Obligations*, N.Y.U. 19TH INST. ON FED. TAX 31, 39 (1961) (hereinafter cited as Fischman).

²⁶⁰ *Brown v. Commissioner*, 446 F.2d 926, 928 (8th Cir. 1971).

²⁶¹ 24 T.C. 21 (1955).

²⁶² *Id.* at 22.

²⁶³ "Obviously, it was not *necessary* for Horace to remain unreimbursed for the expenses of his automobile to the extent that he could have been reimbursed had he taken the trouble to file a voucher and be reimbursed by his employer. These amounts were not ordinary and *necessary* expenses of Horace's business." *Id.* at 22-23 (emphasis added); *accord*, *Brown v. Commissioner*, 446 F.2d 926, 929 n.5 (8th Cir. 1971).

holding that an employee who is entitled to reimbursement from his employer but does not claim it is not entitled to a deduction, because such deduction properly belongs to the employer and not to the employee, and by failing to seek reimbursement the taxpayer cannot convert business expenses of his employer into his own business expenses.²⁶⁴ This view that expenses reimbursable by another are not the taxpayer's expenses conflicts with the holding in Revenue Ruling 57-502 that employer reimbursement tends to indicate that an employee's expense on its behalf constitutes a necessary business expense of his position. Moreover, the Court of Claims in *RCA Communications, Inc. v. United States*²⁶⁵ ruled that where a taxpayer's expense is otherwise ordinary and necessary the fact that he is entitled to reimbursement does not preclude a deduction (the subsequent reimbursement is, however, includible in income). Furthermore, the Tax Court has carved out an exception to *Podems* where the right to reimbursement is contingent. In such circumstances an otherwise ordinary and necessary business expense is deductible under the annual accounting principle.²⁶⁶

The income tax treatment to the employee of the employer reimbursement is equally murky. Some early decisions seem to have assumed that if the expenses were deductible by the employee, their reimbursement by the employer was not to be included in the employee's gross income.²⁶⁷ Thus, the Tax Court held that reimbursements did not con-

²⁶⁴ See, e.g., *Anaheim Union Water Co. v. Commissioner*, 321 F.2d 253 (9th Cir. 1963); *Roy L. Harding*, 39 P-H Tax Ct. Mem. 868, 872 (1970); *Coplon v. Commissioner*, 277 F.2d 534 (6th Cir. 1960); *Norman E. Kennelly*, 56 T.C. 936, 943 (1971), *aff'd per curiam*, 72-1 U.S. Tax Cas. ¶ 9348 (April, 1972); *William C. Stolk*, 40 T.C. 345, 356 (1963).

²⁶⁵ 277 F.2d 164, 167 (Ct. Cl. 1960).

²⁶⁶ See, e.g., *Electric Tachometer Corp.*, 37 T.C. 158, 161-62 (1961); *Alleghany Corp.*, 28 T.C. 298, 304-05 (1957). The Court of Claims in *RCA Communications* contrasted *Pittsburgh Indus. Eng'r. Co.*, 19 P-H Tax Ct. Mem. 1038, 1042-43 (1950) with earlier Tax Court cases as an example of a more recent trend allowing a deduction as ordinary and necessary business expenses for amounts expended by a taxpayer for which he was subsequently partially reimbursed. However, *Pittsburgh Indus. Eng'r. Co.* on its facts appears to be a contingent right to reimbursement decision although the Tax Court did not expressly rely on that fact, but instead on the annual accounting principle (the basis for *Alleghany Corp.*, which, in turn, was the precedent relied on in *Electric Tachometer*).

²⁶⁷ See *J. S. Sullivan*, 5 B.T.A. 996, 999 (1927); *Jay N. Darling*, 4 B.T.A. 499, 503 (1926). See generally Note, *Income Tax Consequences of the Relocation of Employees*, 51 COLUM. L. REV. 118, 123 n.32 (1951) (hereinafter cited as Note, *Relocation Employees*); MERTENS, *supra* note 79, at 20-21.

stitute income where equal to a fair estimate of deductible expenses (indeed, reimbursement by an employer was thought by one court to support its conclusion that the reimbursement was the equivalent of a fair estimate of such expenses)²⁶⁸ or constituted income only to the extent that the expenses reimbursed were not business related.²⁶⁹ Where the expenses were clearly not deductible other decisions viewed the issue as whether the amounts represented additional compensation *rather than* reimbursement for traveling expenses incurred in the interest of the taxpayer's employer.²⁷⁰ Not surprisingly the latter cases came to be interpreted as holding that a taxpayer must include in income reimbursements received from his employer²⁷¹ (and then take deductions for amounts actually expended for the employer's business or for the business purposes designated by the employer). The Seventh Circuit in *Heidt v. Commissioner*²⁷² made a determined effort to resolve the conflicts in this area by distinguishing between expenses incurred by an employee as a *principal* rather than as a corporate *agent*.

Examples falling under the "principal" category are those where the employee is expected to make certain expenditures in order to earn his salary, without reimbursement from his employer. Such expenditures would be deductible by the employee and not by the employer. And, in cases where the employee is not required by his employer to make the expenditures as a condition to earning his salary and is not reimbursed for making them, such expenditures may be deductible where they have a direct bearing on the amount of his compensation and are made in good faith.

In the instant case we have a situation where the automobile *expense incurred by taxpayer was for the benefit of the employer and taxpayer was clearly entitled to reimbursement*. The employer is entitled to the deduction, and *the employee who receives reimbursement is entitled to offset and deduct his expenditures from his receipts*. Under such circumstances the employee ordinarily realizes no income and incurs no individual expense as a result of the transaction. See, Treasury

²⁶⁸ See Robert L. Gray, 10 T.C. 590, 596-97 (1948).

²⁶⁹ James T. Thrower, 31 P-H Tax Ct. Mem. 1707, 1715-16 (1962), *aff'd*, 330 F.2d 614 (5th Cir. 1964).

²⁷⁰ See, e.g., Eugene H. Rietzke, 40 T.C. 443, 453 (1963); Estate of Earl W. Hamlin, 19 P-H Tax Ct. Mem. 431, 435 (1950).

²⁷¹ See, e.g., Silverman v. Commissioner, 253 F.2d 849, 853 (6th Cir. 1958) (citing *Hamlin's Estate*).

²⁷² 274 F.2d 25, 27-28 (7th Cir. 1959).

Regulations 118, Sections 39.23(a)-1 and 39.23(a)-2, promulgated under the 1939 Code.

....

We have concluded that the case as presented is one where the taxpayer voluntarily gave up reimbursement that he was entitled to receive and could have received if he had claimed it. He is thus attempting to convert the employer's right to a deduction into a right of his own. This he cannot do (emphasis added).²⁷³

The *Heidt* principal agent categorization is, of course, compatible with *Podems* but not with *Schmidlapp* unless the latter is limited to nonreimbursable expenses. The fundamental defects, however, in the *Heidt* approach are (1) that the principal-agent categories in essence merely distinguish between unreimbursed and reimbursed expenses without offering reasoned ground for so doing (an agency theory was rejected in *RCA Communications*), and (2) the theory of the exclusion, the employer is entitled to the deduction and the reimbursed employee is entitled to offset and deduct his expenditures from his receipts, thereby realizing no income and incurring no deductible expense, is internally inconsistent as well as being both novel and without support in the tax treatment of exclusions elsewhere. There are, however, conceptual models available that solve the problems of employer mandated expenses incurred by an employee on behalf of his employer and of reimbursed expenses.

There is an exception to the general rule followed in *Noland* that a taxpayer's payment of expenses on behalf of another are not deductible. That exception arises when the taxpayer's motive for making the expenditure is to protect or promote his own business.²⁷⁴ In such circumstances, the expenses are deductible by the taxpayer "even though the transaction giving rise to the expenditures originated with another person and would have been deductible by that person if payment had been made by him."²⁷⁵ The tests established by the leading case developing the exception, *James L. Lohrke*,²⁷⁶ are (1) the purpose or motive of the taxpayer in paying the obligations of another, and (2) whether the expenditure is appropriate for the furtherance or promotion of the tax-

²⁷³ *Id.*

²⁷⁴ See, e.g., *Young & Rubicam, Inc. v. United States*, 410 F.2d 1233, 1242-43 (Ct. Cl. 1969) and authorities cited therein; *Ernest C. Rink*, 51 T.C. 746, 751 n.3 (1969).

²⁷⁵ *James L. Lohrke*, 48 T.C. 679, 685 (1967).

²⁷⁶ 48 T.C. 679 (1967).

payer's business.²⁷⁷ Decisions following *Schmidlapp* such as *Albert L. Sanderson*,²⁷⁸ where the taxpayer's superiors "suggested" that he join clubs for the better performance of his duties and further made it clear that he was expected to personally bear the expenses or his chances for advancement would be jeopardized, are certainly compatible with the *Lohrke* rationale. Thus, it is clear that the theory underlying *Schmidlapp* is that expenses incurred by an employee on behalf of his employer, so that in effect they are the employer's expenses, are nevertheless deductible by the employee if incurred pursuant to employer command since in such circumstances the expenses are also appropriate to the promotion or at least retention of the taxpayer's business—his employment.²⁷⁹ Indeed, the Tax Court in *Marvin A. Heidt*²⁸⁰ expressly recognized as an exception to the rule that one taxpayer may not take deductions properly belonging to another, that "where a corporate officer incurs an expense on behalf of the corporation, he is entitled to a deduction therefor if he can sustain his burden of establishing that such expenses are a necessary expense of his office."²⁸¹ Significantly, in applying this principle, the Tax Court in *Heidt* also adopted a "personal choice" analysis.²⁸² *Robert G. Fairburn*,²⁸³ in elaborating on the appellate *Heidt*

²⁷⁷ *Id.* at 688.

²⁷⁸ 26 P-H Tax Ct. Mem. 87, 88 (1957).

²⁷⁹ An alternative rationale also connected with *Lohrke* would be that employee expenditures benefiting the employer constitute a business expenditure of the employee because it is his business to further the interests of his employer, *see* text at note 347 *infra*, and, hence, are appropriate for the furtherance or promotion of the taxpayer's business within the meaning of *Lohrke*.

²⁸⁰ 28 P-H Tax Ct. Mem. 131, 133, *aff'd*, 274 F.2d 25 (7th Cir. 1959).

²⁸¹ *Id.*

²⁸² "There is no real evidence that company transportation could not have been available to Heidt had he chosen to use it, and we conclude that his use of his own automobile was based primarily on considerations of personal choice and convenience and certainly not upon any necessity of office. This being the case, his decision not to claim reimbursement for automobile expenses, while perhaps sincerely motivated, cannot convert what would properly be Bendix's expenses into ordinary and necessary business expenses of his own." *Id.* *See* Robert G. Fairburn, 38 P-H Tax Ct. Mem. 462 (1969).

²⁸³ *Id.* at 469. While Samuel F. Patterson, 40 P-H Tax Ct. Mem. 1052-57 (1971), a recent Tax Court memorandum decision, did state that even had the taxpayer been directed or requested by his employer to incur certain expenses (which was not the case), it was "not clear whether the expenses were related to his own trade or business or to that of his employer," it is in the *Noland* line of cases and did not realize that the *Schmidlapp-Lohrke* principle constitutes an exception to the rule that a taxpayer may not deduct the expenses of another, *i.e.*, employer compulsion renders the expense appropriate for the continuance of the taxpayer's employment.

“incurred as a principal” concept, provided an alternative to the *Schmidlapp* employer compulsion basis for deduction: expenditures that have a direct bearing on the employee’s salary, *i.e.*, appropriate and helpful expenditures. In summary the *Schmidlapp-Lohrke* concept solves the problem of employee deduction of expenses incurred on behalf of his employer. Indeed, one commentator has pointed out: “[i]f an expenditure is a business expense, deductibility should not be affected by reimbursement policy or whether it is viewed as the expense of the employer or of employee.”²⁸⁴

The resolution of the reimbursement problem lies in a decision relied upon by the *Podems* court, *Glendinning, McLeish & Co. v. Commissioner*.²⁸⁵ There the Second Circuit held that payments made by a taxpayer which were reimbursed were not expenses at all; where the taxpayer had a right to reimbursement but did not enforce this right the payments were the equivalent of loans or advances to the other party and not deductible. The obvious rationale is that for a taxpayer to incur an expense he must make an out-of-pocket expenditure; “the deduction which the applicable section of the income tax law permits, contemplates an expense only out of the funds and property of the person claiming the deduction.”²⁸⁶ While *Glendinning* did not speak to whether the reimbursement was includible in income, following its conclusion that the payment of another’s expenses constitutes a loan by the taxpayer to that person, the reimbursement would constitute the repayment of the employer’s debt which is not taxable to the employee-creditor. Indeed, precisely this rationale was adopted by the Tax Court in *Arthur W. Harrison*²⁸⁷ to exclude from income reimbursement of expenses incurred by an employee on behalf of his employer. Similarly, *Henry F.*

²⁸⁴ Emmanuel & Lipoff, note 227 *supra*, at 525; Note, *Expenses for Another*, note 255 *supra*, at 1515. See also Fischman, note 259 *supra*.

²⁸⁵ 61 F.2d 950, 952 (2d Cir. 1932); *accord*, *Baker v. Commissioner*, 80 F.2d 813, 815-16 (2d Cir. 1936).

²⁸⁶ *New York, Chicago & St. Louis R.R. v. Helvering*, 71 F.2d 956, 960 (D.C. Cir. 1934); see *Island Petroleum Co. v. Commissioner*, 57 F.2d 992, 995 (4th Cir. 1932).

²⁸⁷ 10 P-H Tax Ct. Mem. 1404, 1408 (1941). One commentator has reasoned that the principle that reimbursement of expenses properly belonging to the employer are non-taxable repayments of loans or advances made by the employee when he originally paid the expenses is the corollary of the rule precluding deduction of expenditures made with the expectation of reimbursement. Lyon, *Federal Income Taxation*, 1957 ANNUAL SURVEY OF AMERICAN LAW 123, 126 (R. Collings, Jr. 1957).

*Cochrane*²⁸⁸ held that since the amounts expended by the taxpayer on another's behalf constituted advancements "it necessarily follows that when they were repaid . . . they did not constitute income . . ." ²⁸⁹

In the event that the reimbursement were included in income, the taxpayer would have an out-of-pocket expenditure and hence expense. If the facts supported the application of the *Schmidlapp-Lobrke* exception to prohibition of deductions for expenses benefiting another, then the reimbursed employee would be entitled to a deduction. Thus, it would appear that the *Glendinning-Harrison* rationale is compatible with *Schmidlapp*. The only fly in the ointment is the amount of the expense. Should it be the full amount of the expenditure benefiting the employer or only the amount equal to the taxes created by the inclusion of the reimbursement in income—the true out-of-pocket expenses? *Carl G. Jordan*²⁹⁰ held that where the taxpayer took into gross income employer reimbursements for traveling expenses incurred while away from home, "deductions to the extent of reimbursement should be allowed." ²⁹¹ Accordingly, the answer appears to be the former.

Commentators have argued that a policy of reimbursement should be given little, if any, weight in the question of deductibility on the basis that what the employer considers ordinary and necessary for its business should not control what is ordinary and necessary to its employee's business.²⁹² This position ignores that reimbursement is a corroborative factor evidencing the business purpose of the employer compulsion—an uncontrolled employer would tend not to make reimbursements unless the expenditures benefited it.²⁹³ This practicality underlies the admin-

²⁸⁸ 23 B.T.A. 202, 208 (1931); *accord*, Adolph B. Canelo, III, 53 T.C. 217, 224 (1969), *aff'd*, 447 F.2d 484 (9th Cir. 1971).

²⁸⁹ 23 B.T.A. 208. Cf. Rev. Rul. 62-113, 1962-2 CUM. BULL. 10.

²⁹⁰ 27 P-H Tax Ct. Mem. 652, 653 (1958).

²⁹¹ *Id.*

²⁹² Recent Case, *Wife's Traveling Expenses Deductible When Her Presence Serves Her Husband's Business Purpose*, 22 VAND. L. REV., 1432, 1437-38 (1969) (hereinafter cited as Recent Case, *Wife's Traveling Expenses*).

²⁹³ This is clearly the premise to the statement in *Noland* that "If the expense has been billed to an employer and has passed a critical scrutiny of corporate officers concerned with the elimination of needless expense, it becomes prima facie an allowable expense of the corporation," 269 F.2d 108, 113. See Walter M. Sheldon, 30 P-H Tax Ct. Mem. 256, 259 (1961), *aff'd*, 299 F.2d 48 (7th Cir. 1962). But see James T. Thrower, 31 P-H Tax Ct. Mem. 1707, 1716 (1962), *aff'd*, 330 F.2d 614 (5th Cir. 1964) (no authority exists for unique argument that approval by employer of reimbursement yields "presumption of regularity"; however, there was considerable evidence that vouchers were "rubber-stamped" without question).

istrative approach taken in the trade or business expense regulations²⁹⁴ and in the substantiation regulations²⁹⁵ under which an employee is not required to report on his tax return reimbursements for travel and other expenses that he incurred "solely for the benefit of his employer" if he was required to make an adequate accounting to his employer. The problem of the uncontrolled employer is covered by special rules applicable to reimbursements to employees who are holders of 10 per cent or more of the stock of their employer, whether directly or by attribution.²⁹⁶

Reimbursement of expenses primarily benefiting the employer would not make such expenses deductible (assuming the reimbursement is included in income) by the employee if they were not also required by the employer or independently directly connected with the taxpayer's business since such expenses would not qualify under the *Schmidlapp-Lohrke* exception to the rule of nondeductibility of another's expenses or obligations. In view of this, the reading of Revenue Ruling 57-502 as establishing an exception to the rule that expenses relating to the business of the taxpayer's employer rather than to his own are not deductible if the employee is (1) reimbursed by his employer, or (2) required to make the expenditures,²⁹⁷ is too broad. The reason for the Service's apparent liberality is that it regards all reimbursements as income (although it administratively has chosen not to require certain reimbursements to be reported on the tax return)²⁹⁸ and, thus, no doubt feels compelled to provide a deduction to an employee for his reimbursed expenditures primarily benefiting his employer. The case law, on the other hand, provides an exclusion from income for employer reimbursements of expenses primarily benefiting it, but no deduction for an expense benefiting another unless the expense is required by the employer or is otherwise directly related to his business.

The development of deductibility of entertainment expenses is in some respects parallel to deductibility of educational expenses in that in both employer compulsion and proximate connection with the taxpayer's

²⁹⁴ Treas. Reg. § 1.162-17(b) (1) (1958).

²⁹⁵ Treas. Reg. § 1.274-5(e) (2). (1962).

²⁹⁶ *Id.* § 5(e) (5).

²⁹⁷ J. Huffaker & R. Falb, *Travel & Entertainment Expenses—Recording and Reporting*, A-15 (TAX MANAGEMENT PORTFOLIO # 180, 1968) (hereinafter cited as Huffaker & Falb).

²⁹⁸ *Id.* at p. A-12; Huffaker, *New T & E Regs. Raise Basic Questions Concerning Gross Income*, 18 J. TAXATION 90 (1963) (hereinafter cited as Huffaker).

other duties are alternative grounds for deduction. The analogue here of the employer business purpose found in the educational expense area (to establish the bona fides of the employer compulsion) has been employer reimbursement. However, it is not the prerequisite to deductibility that the Service had first made of employer business purpose in the educational expense area. There are other dissimilarities also. The Service did not initially attempt to limit deductibility to employer mandated entertainment expenses. On the other hand, neither has the Commissioner conceded that an employer requirement that an employee incur entertainment expenses is conclusive as to their deductibility by the employee as he did with respect to all educational expenses, except new trade or business and minimum requirements expenditures.

Perhaps the most striking difference in the evolution of the two areas has been the explicit development of special rules to combat articulated potential abuse in the entertainment area, whereas the aberrant limitation by the Service and the Tax Court of deductibility to "involuntary" educational expenses was without consideration of the basis for application of a different rule and in most places was utilized without overt recognition of departure from the ordinary. Similarly, the more strict approach that was taken by Congress in the travel and entertainment area in section 274, which had its seeds at least in the judicial attempts to contain the potential for abuse, is to be contrasted with the legislative creation and then liberalization of the new deduction for moving expenses that was enacted and then amended to correct the appellate conceptual astygmatisms.

The most significant contribution of the entertainment expense development to a better understanding of exclusion and deduction of employer mandated expenses in general is its difference in emphasis on the elements of benefit to the employer and employer compulsion (or lack of employee control) with respect to exclusion and deduction from income. As to exclusion of the value of employer expense-paid entertainment, the focus has been on benefit to the employer. Employer requirement has been of little if any significance here. On the other hand, in the context of exclusion of meals and lodging, lack of employee control (the concomitant to employer requirement) has been central to the concept of convenience of the employer. The Tax Court decisions with respect to exclusion of reimbursements of moving expenses present a more balanced approach, resting primarily on benefit to the

employer but with significant emphasis also on lack of employee control and on employer requirement.

As to employee deduction of entertainment expenses that benefit the employer (so that they would be considered expenses of the employer), benefit to the employer cuts against a deduction by the employee; it is the employer requirement that makes the expenses deductible (or a showing that the expenditures had a direct bearing on the amount of the employer's salary). Employer compulsion has also been the central element, as contrasted with employer benefit, in the deduction of educational expenses and moving expenses.

V. PULLING TOGETHER THE THREADS: TRAVELING, CONVENTION, AND WIVES' EXPENSES

Convention and travel expense cases, as well as the wives' traveling expenses decisions, have been decided in most instances by the Tax Court. The historical development in both areas has centered on deductibility. Although several of the very early Tax Court (then Board of Tax Appeals)²⁹⁹ decisions held that where traveling expenses to conventions were deductible the employee received no income upon his reimbursement by his employer,³⁰⁰ the court soon took the position, without recognition of the earlier contrary authority, that as a matter of course employer reimbursement constituted gross income. The sole issue was the deductibility of the costs.³⁰¹

A. Conventions

The convention decisions began auspiciously. The first, *Marion D. Shutter*,³⁰² involved attendance by a clergyman at a church convention of which he was an ex-officio member as well as a member of several committees. The Tax Court held that such attendance was essential to his standing and position in the church and, therefore, constituted an ordinary and necessary expense. Having sanctioned church convention expenses, the court extended the umbrella of deductibility to

²⁹⁹ See generally Note, *The Old Tax Court Blues*, *supra* note 137, at 976 n.2.

³⁰⁰ See note 269 *supra*.

³⁰¹ See, e.g., *Faitoute Iron & Steel Co.*, 11 B.T.A. 818, 820 (1928); *accord*, *Alexander Silverman*, 6 B.T.A. 1328 (1927).

³⁰² 2 B.T.A. 23 (1925).

other professional men, such as professors,³⁰³ doctors,³⁰⁴ attorneys,³⁰⁵ certified public accountants,³⁰⁶ and commercial artists.³⁰⁷ Favorable treatment was also given to corporate executives and employees.³⁰⁸ Furthermore, employers were permitted deductions for traveling expenses of employees to refresher courses³⁰⁹ or regional sale marts.³¹⁰

Unfortunately, these cases did not develop criteria to determine whether a convention trip was primarily of a business or a personal nature.³¹¹ An exception is found in *Alexander P. Reed*.³¹² There, a direct and proximate relationship existed between the purpose of the convention, as reflected by its agenda, and the taxpayer's trade or business. The Tax Court noted that there was no actual or potential business benefit, economic or otherwise, which resulted or might proximately result from attendance at the conference. Thus, the court seemingly would permit deduction of convention expenses if business contacts made by reason of the convention or prestige arising from it directly generated income although the subject matter of the program was not itself germane to the taxpayer's business. The Treasury regulations speak to both approaches (resulting business benefit and content),³¹³ and in published rulings³¹⁴ the Service has held that the method of comparing the purpose of the convention, as manifested in its agenda, with the taxpayer's business is but one method of establishing the business purpose of the taxpayer's travel and such direct subject matter relationship is not a prerequisite for deductibility. Permitting a deduction if either

³⁰³ *Alexander Silverman*, 6 B.T.A. 1328 (1927).

³⁰⁴ Cecil M. Jack, 13 B.T.A. 726 (1927); *accord*, Robert C. Coffey, 21 B.T.A. 1242 (1931); Roy Upham, 16 B.T.A. 950 (1929); J. Bently Squier, 13 B.T.A. 1223 (1928).

³⁰⁵ Wade H. Ellis, 15 B.T.A. 1075 (1929), *aff'd*, 50 F.2d 343 (D.C. Cir. 1931).

³⁰⁶ Charles O. Gunther, Jr., 23 P-H Tax Ct. Mem. 913 (1954).

³⁰⁷ Jay N. Darling, 4 B.T.A. 499 (1926).

³⁰⁸ Rita M. Callinan, 22 P-H Tax Ct. Mem. 175 (1953); L. F. Ratterman, 17 P-H Tax Ct. Mem. 390 (1948), *aff'd per curiam*, 177 F.2d 204 (1949).

³⁰⁹ Pacific Grape Prods. Co., 17 T.C. 1097 (1952), *rev'd on other grounds*, 219 F.2d 862 (9th Cir. 1955).

³¹⁰ A. Finkenberg's Sons, Inc., 17 T.C. 973 (1951).

³¹¹ See Treas. Reg. § 1.162-2(b)(1) (1958). The all-or-nothing test of the regulations is criticized in Klein, *The Deductibility of Transportation Expenses of a Combination Business and Pleasure Trip—A Conceptual Analysis*, 18 STAN. L. REV. 1099 (1966), and is inconsistent with the general approach in deduction of expenses; see *International Artists, Ltd.*, 55 T.C. 94, 105 (1970).

³¹² 35 T.C. 199, 202 (1960).

³¹³ Treas. Reg. § 1.162-2(d) (1958).

³¹⁴ Rev. Rul. 63-266, 1963-2 CUM. BULL. 88.

a special test (agenda content) or the general proximate connection with trade or business or effect on income is met does not conflict with the similar approach taken in the educational and entertainment expense areas.

In virtually all of the reported convention expense decisions prior to 1960 a deduction was permitted. However, the beginning of that decade witnessed widespread administrative, legislative, and judicial concern about abuse in the travel and entertainment area (T & E expenses), including treatment to be accorded to certain types of conventions and expenses allocable to wives.³¹⁵ This concern culminated in the Revenue Act of 1962, which imposed substantial new substantiation requirements on otherwise deductible T & E expenditures.³¹⁶ It was in this context³¹⁷ that the Fifth Circuit decided *Patterson v. Thomas*.³¹⁸

In *Thomas* the taxpayer, an insurance salesman, by selling a requisite amount of insurance, received from his company an expense paid trip for himself and his wife to an annual company convention held at a popular vacation spot. In determining whether the taxpayer's trip was primarily of a personal nature or for business purposes the majority opinion considered the following four factors: (1) the amount of time devoted to business activities compared with the time spent for social activities; (2) the relationship between the sponsor of convention and the participants; (3) the location of the convention; (4) and the attitude of the employer. The majority, in concluding that the primary purpose of the trip was pleasure, stressed the facts that the convention was held at a resort area (two days travel time from the employer's home office) and that "at the most, five hours out of the three and one-half days were spent in only two formal business meetings."³¹⁹ The company official in charge had written to the hotel manager stating that while two business meetings would be held during the four day convention, business would be secondary; the main object was to give the employees a good time. One judge dissented,³²⁰ principally on the

³¹⁵ See BITTKER, FEDERAL INCOME ESTATE AND GIFT TAXATION 230-36 (1964); Caplin, *The Travel and Entertainment Expense Problem*, 39 TAXES 947 (1961); Emmanuel and Lipoff, *supra* note 227.

³¹⁶ INT. REV. CODE OF 1954, § 274.

³¹⁷ See *Patterson v. Thomas*, 289 F.2d 108 (5th Cir.), *cert. denied*, 289 U.S. 837 (1961) (Brown, J., dissenting).

³¹⁸ *Id.*; 47 VA. L. REV. 1097 (1961).

³¹⁹ *Patterson v. Thomas*, 289 F.2d 108, 113 (5th Cir. 1961).

³²⁰ *Id.* at 114.

ground that the taxpayer and his wife were in reality required by the husband's employer to attend the convention, although the "command appearance" was in the form of an invitation. The dissent would have permitted a deduction due to this employer compulsion.

In *Rudolph v. United States*,³²¹ decided several months later by the Fifth Circuit on essentially the same facts, the majority reached the same result as in *Thomas*, with the same judge dissenting. *Rudolph*, however, was appealed to the Supreme Court. Certiorari was granted, but was dismissed as improvidently granted on the basis that the trial court's decision turned on the taxpayer's dominant motive and purpose in taking the trip and the company's in offering it.³²² The district court had found that the company's primary purpose was to afford a pleasure trip in the nature of a bonus and it was primarily a vacation to the employee and his wife.³²³ In a separate opinion Justice Douglas, joined by Justice Black, dissented to the dismissal.³²⁴ He maintained that "[i]ncome has the connotation of something other than the mere payment of expenses."³²⁵ The implication was that the taxpayer was no better off financially after the trip than before it. Nor did the dissenters believe that the trip constituted disguised compensation because isolated and irregular arrangements with no earmarks of "sham" bore no rational connection with compensation for services rendered, and, in fact, no services were rendered. Rather, the exigencies of the taxpayer's employment gave rise to the convention, one which served a good business purpose of the employer. Justice Douglas also made the point that not all awards or fringe benefits constituted income to the recipient. Just as specific statutory exclusions from gross income are provided for certain awards, such as gifts,³²⁶ life insurance proceeds,³²⁷ disability benefits,³²⁸ rental value of parsonages,³²⁹ scholarship grants,³³⁰ and mustering-out

³²¹ 291 F.2d 841 (5th Cir. 1961), cert. dismissed as improvidently granted, 370 U.S. 269 (1962). See generally Price, *Traveling with Your Wife May be Taxing*, 28 FED. BAR J. 75 (1968) (hereinafter cited as Price).

³²² 370 U.S. at 270.

³²³ 189 F. Supp. 2, 4-5 (D. Ala. 1960).

³²⁴ 370 U.S. at 278 (dissent).

³²⁵ *Id.* at 279.

³²⁶ INT. REV. CODE of 1954, § 102.

³²⁷ *Id.* § 101.

³²⁸ *Id.* § 105.

³²⁹ *Id.* § 107.

³³⁰ *Id.* § 117.

payments,³³¹ employees may receive from their employers many fringe benefits which do not constitute taxable income. Examples given were "courtesy" discounts and medical services which the Treasury regulations provide "are not considered as wages subject to withholding if . . . of relatively small value and are . . . furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees."³³²

Justices Douglas and Black would have in any event reversed the Fifth Circuit on the grounds that the expenses of the husband were deductible in accordance with the host of other convention cases that had allowed the deduction. The expenses of the wife were thought deductible as well because of the "equitable concept" that a wife contributes to the business productivity of her husband. Probably an employer compulsion argument was not explicitly raised because the trial court had found no compulsion.³³³

Justice Harlan, also speaking in a separate opinion,³³⁴ would have decided *Rudolph* on its merits, accepting the district court's findings that the employer intended the trip as a bonus with the consequence that its value constituted income to the employee and that the employee considered the trip a pleasure trip in the nature of a vacation and, therefore, a non-deductible personal expense. He noted that the district court did not find any element of compulsion. Subsequent courts, including the Fifth Circuit, have read *Rudolph* and *Thomas* as holding that the conventions were awards based on sales performance.³³⁵ Moreover, it has been emphasized that these cases bear little relevance to the question of tax treatment of a wife's traveling expenses on a business trip since the husband's trip was not primarily for business.³³⁶

Douglas' dissent in *Rudolph* contains the elements developed in the later exclusion cases, but in embryonic form—perhaps the cause of the abortive granting and then dismissal of certiorari—and is supportable only by refashioning its arguments to one degree or another. For ex-

³³¹ *Id.* § 113.

³³² Treas. Reg. § 31.401(a)(b)(10) (1957).

³³³ *Rudolph v. United States*, 189 F. Supp. 2 (D. Ala. 1960).

³³⁴ 370 U.S. 270.

³³⁵ See, e.g., *Stratton v. Commissioner*, 448 F.2d 1030, 1033 n.10 (9th Cir. 1971); *United States v. Disney*, 413 F.2d 783, 789 (9th Cir. 1969); *United States v. Gutcher*, 401 F.2d 118, 121 (5th Cir. 1968); *Bell Electric Co.*, 45 T.C. 158, 167 (1965); *Allen J. McDonell*, 36 P-H Tax Ct. Mem. 126, 128 (1967).

³³⁶ *United States v. Disney*, 413 F.2d 783, 789 (9th Cir. 1969).

ample, the dissent's first contention that income connotes something other than payment of expenses is defensible if such expenses primarily benefit the employer, but not if they primarily benefit the employee.³³⁷ Indeed, one commentator would place this argument by the *Rudolph* dissenters in the line of cases holding that employee expenditures primarily benefiting the employer are deductible only by the employer, but their reimbursement is excludible by the employee.³³⁸ The fit is, however, a bit uneven since Douglas and Black would have permitted the employee and his wife to deduct the expenses if the reimbursement was income to them.

Similarly, the *Rudolph* dissent's emphasis on the isolated and irregular aspect of the convention expense as indicative of the benefit being non-compensatory does not reappear in later cases or analogous areas. However, the belief that the value of the convention was noncompensatory, owing to the business benefit received by the employer and the fact that the exigencies of the taxpayer's employment gave rise to his attendance at the convention, parallels the tack taken in such pre-1954 Code convenience of the employer cases as *Diamond v. Sturr*. These

³³⁷ See text at notes 10 and 58 *supra*. There is, however, some authority that "reimbursements in general do not involve any realization of gain to the taxpayer and therefore do not constitute income under Section 61." Allington, *Moving Expenses and Reimbursements*, 56 A.B.A.J. 495, 496 (1970) (citing *Conner v. United States*, 303 F. Supp. 1187 (S.D. Tex. 1969)). The *Conner* court reasoned that there must be gain before there is income and that reimbursements by insurance for additional living expenses caused by the destruction of the insured's home did not constitute a gain. "If there was any income in the ordinary and real sense of the word realized by anyone relating to these payments, it was the owner of the house that plaintiffs (the taxpayers) rented. With respect to the reimbursement by the insurance company . . . , plaintiffs were no more than a conduit through which these funds passed." *Conner v. United States*, 303 F. Supp. 1187, 1191 (S.D. Texas 1969), *aff'd on this issue*, 439 F.2d 974 (5th Cir. 1971). *Contra*, *Millsap v. Commissioner*, 387 F.2d 420 (8th Cir. 1968); *Arnold v. United States*, 289 F. Supp. 206 (E.D.N.Y. 1968); *McGuire v. United States*, 70-1 U.S. Tax Cas. ¶ 9384 (N.D. Calif. 1970); *Neil F. McCabe*, 54 T.C. 1748, 1748-49 (1970) (since taxpayers have no basis in reimbursement receipts they received a taxable gain); *Edmund W. Cornelius*, 56 T.C. 976, 981-82 (1971); Rev. Rul. 59-360, 1959-2 CUM. BULL. 75 (equivalent to use and occupancy insurance, the proceeds which constitute gross income). INT. REV. CODE of 1954, § 123 provides that such reimbursement received on or after January 1, 1969, are excludible from income. The *Conner* court also overlooked that a taxpayer may be taxed on an indirect economic gain, as where a benefit is received without a corresponding diminution in wealth. *United States v. Gotcher*, 401 F.2d 118, 121 (5th Cir. 1958); see *Irving Sachs*, 32 T.C. 815, 820 (1959), *aff'd*, 277 F.2d 879 (8th Cir.), *cert. denied*, 364 U.S. 833 (1960).

³³⁸ *Huffaker & Falb*, *supra* note 297, at A-10.

elements are also seen in the Tax Court's treatment of reimbursed moving expenses. Finally, the reliance on the withholding regulations' treatment of certain fringe benefits as not being "wages subject to withholding" becomes relevant only in the light of the articulation in later withholding decisions of theories similar to the benefit of the employer concept to exclude the cost of attendance at a convention from the classification of wages³³⁹—wages and income not necessarily being co-extensive.

³³⁹ Having supposedly won the war against insurance agents and their company conventions (although, in fact, the holdings and facts in *Thomas* and *Rudolph* would not support such a claim), the Commissioner apparently found it difficult to collect the spoils, *i.e.*, audit every agent attending such conventions, and resolved to have the employer insurance companies do it for him by treating the value of such conventions to the agents as wages subject to withholding. The Court of Claims in *Peoples Life Ins. Co. v. United States*, 373 F.2d 924 (Ct. Cl. 1967) heard the first such case. The Government, relying heavily upon *Thomas* and *Rudolph*, asserted that the convention trips amounted to awards or prizes in the form of free pleasure trips or vacations to the winner and as such constituted additional wages for withholding tax purposes. The employer (who had paid the withholding taxes under protest and was suing for their refund) maintained that convention expenditures were not awards—which are subject to withholding, Rev. Rul. 55-232, 1955-1 CUM. BULL. 115—but were ordinary and necessary expenses in the conduct of its business and, hence, not remuneration "for services performed by an employee for his employer" within the meaning of INT. REV. CODE of 1954, § 3401(a). The Court of Claims agreed: (1) the expenditures from the employer's point of view were incurred to advance its own wholly legitimate and bona fide business purposes, (2) work sessions exceeded planned social activity time, and (3) the agents were required to attend, which compelled the conclusion that the trip primarily served the employer's purposes. The expenses attributable to the agents' wives (who were also required to attend and be present at planned activities) also benefited the employer. *Id.* at 931. This overall approach is quite similar to that of the dissents in *Patterson* and *Rudolph*. Price, *supra* note 321, at 78 n.19. Significantly, while one basis for distinguishing those two cases was that there was no necessary correlation between what constitutes "wages" and what constitutes income, 373 F.2d 932, another basis was that "insofar as there can be considered to be overlapping considerations or a relationship between the question of what constitutes 'wages or remuneration' . . . and what constitutes 'gross income' . . . , or what is deductible as ordinary and necessary business expenses . . .," *Id.* at 933, the court noted "significant factual differences." *Peoples Life* was followed by *Acacia Mut. Life Ins. Co.*, 272 F. Supp. 188 (D. Md. 1967); however, since it found that the agents' wives did not attend scheduled meetings and could attend only if their husbands sold an additional quota of insurance, the trip as to them was considered an award. The home office wives and all husbands, home office and field agents, fared as well as the employees and their wives in *Peoples Life*. Not only was the Court of Claims close to the *Rudolph* dissenters' approach, but its tack closely parallels the benefit of the employer exclusion doctrine, and, indeed, the Court of Claims has recently ruled that reimbursements of moving expenses of new employees, Humble

Unfortunately, neither the Harlan nor Douglas opinions reached several significant issues concerning deductibility of traveling expenses. The first was the test to be applied when a trip is taken for both business and pleasure. The Commissioner conceded that in a "perfect world" the conceptually ideal solution would be to allocate the cost between business and pleasure. However, he urged that the section 162 regulation's all-or-nothing primary purpose test for traveling expenses was the only feasible solution to the difficulties of ascertaining the relative worth of the business and pleasure portions. The Court's *Duberstein* test of "dominant motive," applied to the issue whether a payment constituted a gift or compensation, was suggested as an analogue.³⁴⁰

Nevertheless, the *Cohan* rule has long been used to measure the value of business and nonbusiness benefits for deduction purposes and such approximation is used with other business expenses.³⁴¹ Alternative models are also in the section 274 regulations that disallow certain foreign travel expenses. As to foreign travel of more than a week, each day is treated as a "business day" or a "nonbusiness day"³⁴² to arrive at a fraction to be applied to total travel expenses. A percentage of the expenses equal to the ratio of nonbusiness days to all travel days is disallowed.³⁴³ A day is deemed a business day, even though the majority of the day is spent on nonbusiness activities, if the taxpayer's presence was required

Oil & Refining Co. v. United States, 442 F.2d 1362 (Ct. Cl. 1971), and of indirect moving expenses, Humble Pipe Line Co. v. United States, 442 F.2d 1353 (Ct. Cl. 1971), do not constitute wages for withholding tax purposes because not intended to compensate the employee for services and were incurred by the employer in the course of its ordinary business to prevent its moving employees from suffering a loss. Similar conclusions have been reached with respect to per diem payments at remote jobsites, Stubbs, Overbeck & Ass'n. v. United States, 445 F.2d 1142 (5th Cir. 1971), and reimbursements for meals by employees on the road in their sales territories, Royster Co. v. United States, 72-1 U.S. Tax Cas. ¶ 9374 (E.D. Va. 1972). Paradoxically, however, meals furnished for the convenience of the employer have been considered "wages" for the purposes of the Federal Insurance Contributions Act and Federal Unemployment Tax Act, S. S. Kresge Co. v. United States, 379 F.2d 309 (6th Cir. 1967). See generally Comment, *Tax Treatment of Compensation in Kind*, 37 CALIF. L. REV. 628, 633-39 (1949). The Service has recently abandoned the argument that wages for withholding and gross income are *in pari materia*. Royster Co. v. United States, *supra*. In this writer's opinion the approaches with respect to gross income and wages are essentially the same, but the income cases requiring inclusion were in most instances in error.

³⁴⁰ Brief for Commissioner.

³⁴¹ See notes 221 through 243 *supra* and accompanying text.

³⁴² Treas. Reg. § 1.274-4(d)(2) (1963).

³⁴³ *Id.* § 1.274-4(f)(1) (1963).

(e.g., by his employer) at a particular place for a specific and bona fide business purpose.³⁴⁴ Furthermore, travel is deemed entirely allocable to business activity if the taxpayer did not have substantial control over the trip.³⁴⁵ In turn, a taxpayer who is reimbursed by his employer or on an expense allowance is deemed not to have such control unless he is a managing executive or a ten percent or more stockholder of his employer.³⁴⁶ Thus, the Treasury itself has adopted more lenient rules where the employee has no control over employer mandated travel expenses.

The Government's most significant concession in *Rudolph* was with respect to the interrelationship of benefit to the employer and proximate relationship to the taxpayer's trade or business.

On the question of whose motivation is controlling—the employer's or the employee's—there is again no substantial disagreement between the parties. Initially, as petitioner agrees, the question is necessarily why did the person claiming the deduction (the employee) incur the expense. Since, however, it is the "business" of an employee to further the interests of his employer, we agree with petitioner that a purpose to advance his employer's interests is a business purpose as to the employee. Thus, since the reason an employer requests an expenditure will normally be to advance his (the employer's) interest, it is normally sufficient that an expense is incurred at the behest of the employer. The necessary limitation, of course, is that if the employer's purpose is to advance not his own interests but the employee's—i.e., to confer a benefit upon the employee—the employee's participation in the endeavor of conferring a benefit upon himself can hardly be a business purpose as to him. If, as petitioner puts it, the employer's "business" purposes are to be "attributed" to the employee, so must his purpose to benefit the employee.³⁴⁷

Since *Rudolph* presented only the seeds for exclusion of employer mandated travel expenses, it was left to subsequent travel cases, albeit not involving conventions, to fully develop the concept. An example is *Allen J. McDonell*,³⁴⁸ a Tax Court decision involving a sales incentive award for territorial salesmen, with winners and their wives receiv-

³⁴⁴ *Id.* § 1.274-4(d) (2) (ii) (1963).

³⁴⁵ *Id.* § 1.274-4(f) (5) (i) (1963).

³⁴⁶ *Id.*

³⁴⁷ Note 340 *supra*.

³⁴⁸ 36 P-H Tax Ct. Mem. 126 (1967).

ing an expense-paid trip to Hawaii. The taxpayer was a home office salesman selected with three other home office salesmen by lottery to host the winners. At the time of the drawing, home office salesmen were told that "those selected and their wives were expected to go, although they would have been excused for good reasons."³⁴⁹ They and their wives were instructed to consider the trip as a work assignment and not as a vacation. Their assignment was to shadow the contest winners and to see that they enjoyed themselves. They were also to protect and, if possible, enhance the employer's image. Since the contest winners went as couples the company felt that the presence of the wives of the home office participants was also essential: "it would be impossible for stag salesmen to host a trip for customers."³⁵⁰ The taxpayer and his wife performed their assigned duties which consumed substantially all of the trip time. The Tax Court distinguished the situation of the taxpayers from that of the contest winners for whom the trip was a reward as well as an incentive.

Unlike the contest winners, petitioners were expected to go as an essential part of . . . [the husband's] employment. *The right to go carried with it the duty to go.* The trip was not a vacation for the petitioners. *It was realistically a command performance to work.* What was a social benefit to the contest winners was a work obligation to these petitioners. *More importantly, petitioners herein were expected to devote substantially all of their time on the trip to the performance of duties* on behalf of DECO [the husband's employer] in order to achieve, albeit subtly, DECO's well-defined business objectives. In this respect the situation is unlike that in *Patterson v. Thomas* . . . where the Court found that, although the taxpayer had an obligation to attend the convention, his work responsibility was minimal (emphasis added).³⁵¹

The fact that, unlike in *Thomas*, the taxpayers' right to go on the trip was not determined by any standard of work performance, was emphasized. Indeed, the *McDonnell* court noted that there was not the slightest suggestion the trip was conceived of as disguised remuneration. Rather, the employer had sound business reasons for the taxpayer and his wife to go.³⁵²

³⁴⁹ *Id.* at 127.

³⁵⁰ *Id.*

³⁵¹ *Id.* at 128.

³⁵² "[S]uch business reasons, when coupled with the equally compelling business cir-

Although the Tax Court explicitly acknowledged the presence of employer compulsion—"command performance"—this was in the eyes of the court a secondary factor to the substantial work responsibilities of both the taxpayers and possibly to the employer business purpose as well. While the Tax Court articulated employee work responsibilities and employer business purpose as separate factors, they are both facets of the concept of benefit to the employer. Where an employee performs precisely the activity the employer expects him to, and such activity serves a corporate business purpose, then the employer benefits from such activity.³⁵³ For instance, where the State Department requires a foreign service employee to return periodically to the United States and reorient himself to the American way of life by travel and communication, his performance of activities, like vacation traveling, constitutes the devotion of substantially all of his time on the trip to the performance of duties on behalf of his employer. From this the employer receives direct benefit.³⁵⁴ Similarly, where the employer expects the employee's wife to accompany him on business trips and entertain clients of the employer, her "services, albeit social in nature, are exactly the type business activity in which the employer expects her to engage."³⁵⁵ The fact that the employer's business purpose can thus be served by activities other than specific "work" duties ultimately defeats the *McDonell* court's obvious strivings to draft its opinion as narrowly as possible and confine its import to the fact that the taxpayers were assigned specific chaperoning duties, the "command performance to work," which both consumed substantially all their time and served sound business reasons of the husband's employer. Indeed, the Fifth Circuit in *United States v. Gotcher*³⁵⁶ read *McDonnell* precisely for the broad principle that "one does not receive taxable income when he is serving a legitimate business purpose of the party paying the expenses."

cumstances involving these petitioners' participation, made the trip no different from any other business trip requiring their services—including . . . [the taxpayer's wife] whose duties were substantial and could not have been performed by stag men." *Id.* at 129. The Tax Court did not consider the taxpayers' alternative argument that the trip had no fair market value to them. Cf. *Wilson v. United States*, 412 F.2d 694, 697 (1st Cir. 1969).

³⁵³ See, e.g., *Peoples Life Ins. Co. v. United States* 373 F.2d 924, 929 (Ct. Cl. 1967).

³⁵⁴ *Stratton v. Commissioner*, 448 F.2d 1030, 1033 (9th Cir. 1971).

³⁵⁵ Recent Case, *Wife's Traveling Expenses*, note 292 *supra*, at 1436 n.28.

³⁵⁶ 401 F.2d 118, 123 (5th Cir. 1968).

Thus, *McDonnell*, too, involved the factors of employer compulsion and benefit to the employer, with greater emphasis on the latter.

Paradoxically, the Fifth Circuit, which had earlier ruled against the taxpayers in *Thomas* and *Rudolph*, decided the leading exclusion of the value of travel expenses case, *United States v. Gotcher*.³⁵⁷ That decision involved an expense-paid trip to Germany provided to a prospective investor in a VW dealership and his wife, paid in part by his employer (a local VW dealership) but in major part by the Volkswagen Company. A substantial portion of the husband's time was spent touring VW factories and German dealerships. After the trip, the taxpayer bought a twenty-five percent interest in his employer's company that had been offered to him before the tour. The Volkswagen company had instituted such tours for potential dealers to overcome the initial unfavorable public image of its products and of Germany. The trial and appellate courts agreed that VW's primary purpose for the trip was to induce the taxpayer to purchase an interest in a VW dealership.

The district court had reasoned that an economic or financial benefit does not constitute income unless conferred as compensation. The Fifth Circuit, as had the Supreme Court over a decade earlier,³⁵⁸ rejected this position as too narrow. However, it also rejected the Service's contention that exclusions from gross income were narrowly limited to the specific statutory exclusions provided in sections 101 through 123. This view also had been rejected by courts,³⁵⁹ commentators,³⁶⁰ and, implicitly, Congress.³⁶¹ The *Gotcher* court generalized from the exclusion provisions, in particular section 119 which excludes from an employee's gross income the value of meals and lodging furnished him for the "convenience of the employer," that "the value of any trip that is paid by the employer or by a businessman primarily for his own benefit should be excluded from gross income of the payee . . ." ³⁶² While the concept of economic gain is key to gross income, the "concept has two distinct requirements: [t]here must be an economic gain, and this gain

³⁵⁷ *Id.*

³⁵⁸ See, e.g., *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

³⁵⁹ See, e.g., *Rudolph v. United States*, 370 U.S. 369 (1962) (concurring and dissenting opinions).

³⁶⁰ See, e.g., Huffaker, note 298 *supra*.

³⁶¹ See S. REP. No. 1881, 87th Cong., 2d Sess. 27 (1962), reprinted in 1962-3 CUM. BULL. 733; S. REP. No. 830, 86th Cong., 2d Sess. 71-72 (1964), reprinted in 1964-1 CUM. BULL. Part 2, 57.

³⁶² *United States v. Gotcher*, 401 F.2d 118, 122 (5th Cir. 1968).

must primarily benefit the taxpayer personally.”³⁶³ Thus, meals and lodging incidentally benefiting an employee are excludible if they primarily benefit or convenience the employee.

The Fifth Circuit also pointed out that where an employee has no choice but to go, and has no control over the schedule or money spent, the Supreme Court definition of income as accessions of wealth over which the taxpayer has complete control is not met. The court stated that complete control and dominion have played a fundamental role in determining the incidence of taxation in landmark decisions involving noncompensatory economic gains. *McDonell* was also thought to suggest that one important factor in analyzing the tax consequences of an expense-paid trip is “whether the traveler had any choice but to go.”³⁶⁴ Although not articulated in *Gotcher*, such lack of control also constitutes one of the conceptual underpinnings of the “convenience of employer” doctrine.³⁶⁵

The third segment of the court’s rationale was based on cases involving corporate executives who traveled or entertained clients at their company’s expense. From those decisions the rule evolved that an economic benefit is taxable to an employee only if the payment serves no legitimate business purpose of the employer.

The corporate-executive decisions indicate that some economic gains, though not specifically excluded from section 61, may nevertheless escape taxation. They may be excluded even though the entertainment and travel unquestionably give enjoyment to the taxpayer and produce indirect economic gains. When this indirect economic gain is subordinate to an overall business purpose, the recipient is not taxed.³⁶⁶

The test to be applied, said the *Gotcher* court, is the employer’s primary purpose for the expense. The circuit court concluded that the taxpayer’s “presence served a legitimate corporate purpose and that no appreciable amount of time was spent for his personal benefit and enjoyment.”³⁶⁷ His personal benefit was clearly subordinate to the concrete benefits to VW.

³⁶³ *Id.* at 121.

³⁶⁴ *Id.* at 123. See note 139 *supra* and text at notes 370-71 *infra* for discussion of the control concept.

³⁶⁵ See text at notes 9 and 10 *supra*.

³⁶⁶ *United States v. Gotcher*, 401 F.2d 118, 124 (5th Cir. 1968).

³⁶⁷ *Id.* at 123.

As to the wife's trip, on the other hand, *Gotcher* reversed the lower court on the grounds that she did not make the trip to see local dealers or to attend discussions about the VW organization.³⁶⁸ Thus, her trip was, in the eyes of the review court, primarily a vacation to her. The majority opinion held, therefore, that the primary benefit of the expense paid trip for the wife went to the husband since he was relieved of her expenses, and he should, therefore, include the expenses attributable to her travel in his gross income. A concurring opinion noted that under the *Gotcher* rationale the taxpayers in *Rudolph*, which also arose in the Fifth Circuit, would have prevailed also. Although bothered by "[a]ttributing income to the little wife,"³⁶⁹ the concurring judge acquiesced, confident that on the proper record the wife would prevail.

The four common factors of significance to the opinion writers in *Gotcher*, *McDonell* and the Douglas dissent in *Rudolph*, (1) payment of expenses as income, (2) employer compulsion and lack of employee control, (3) intent as compensation, and (4) primary benefit to the employer, are reducible to two. They are a primary benefit to the employer and the two facets of employer convenience, *viz.*, employer compulsion and lack of employee control.

Viewed from this perspective, the craftsmanship of the *Gotcher* opinion is striking. The first basis for the exclusion of an expense paid trip to Germany for an employee and potential VW dealer was the generalization, derived from section 119, that the value of an employee's trip paid for by an employer primarily for its own benefit should be excluded from the employee's income. Another basis, however, for this same "convenience of the employer" doctrine, partially codified in that section, is the janus-like factor of employer requirement and lack of employee control. This factor was also considered since the lack of employee choice or control arising from the business necessity of accepting the VW "offer" of hospitality was the second thrust of the Fifth Circuit's opinion. The third and final support for exclusion consisted of a return to the factor of employer benefit, derived from the corporate executive decisions. *Gotcher* reasoned that an economic benefit is taxable to an employee only if it serves no legitimate business purpose of the employer, *i.e.*, does not benefit the employer. Thus, *Gotcher*, as well as the convenience of employer decisions and the indirect moving ex-

³⁶⁸ *Id.* at 124.

³⁶⁹ *Id.* (Brown, J., concurring).

pense cases, predicated exclusion on both employer requirement (with concomitant lack of employee control) and benefit to the employer. Only the corporate executive decisions rested solely on benefit to the employer, and even there employee control may be significant in instances of abuse.

Paradoxically, the two basic elements in *Gotcher* necessary for exclusion each support a separate theory justifying that result. Employer compulsion is inextricably tied with dominion and control over income. Similarly, employer benefit rests on the theory that an employee is to be taxed neither on an incidental benefit from an employer's direct payment of its own expenses, nor on reimbursement; an employee is a mere conduit for payment of his employer's expenses. Significantly, the Supreme Court has recently confirmed in another context that the underlying assumption in cases dealing with the concept of income has always been "that in order to be taxed for income, a taxpayer must have complete dominion over it."³⁷⁰ A dissent sought to limit the reasoning of the classic control or assignment of income decisions to language used to *support* taxation of income,³⁷¹ and would not have extended that language to support nontaxation of income; *i.e.*, to the dissent, control was relevant only to includability, not to excludability.

Whether both lack of employee control and employer benefit are always necessary has never expressly been considered by the courts, but except for the corporate executive decisions the cases seem to assume that the answer is affirmative. In addition to this fundamental question, there exists a number of other uncharted areas. Perhaps the most important involve the necessary interrelationship between the employer mandate and the employee's other duties and between employer compulsion and lack of employee control where the employee is a dominant shareholder of his corporate employer. Applying the lessons drawn from the development under section 119, it may be expected that the boundaries of the necessary connections between employer requirement and everyday employee duties will lie in the element of benefit to the employer. If the employer demands employee participation for reasons of its own without any apparent connection between such activity and the performance of the employee's other duties, then it is highly unlikely that there is any objective benefit to the employer. But if there is, ex-

³⁷⁰ *Commissioner v. First Sec. Bank*, 40 U.S.L.W. 4289 (March 21, 1972).

³⁷¹ *Id.* at 4298 (Blackmun, J., dissenting).

clusion should be permitted.³⁷² Concerning control by a shareholder-employee in the context of closely-held corporations, the lesson to be gleaned from the various lines of authorities relied upon by *Gotcher*, and, in particular, the "convenience of the employer" case law, is that the resolution of this problem also lies in objective benefit to the employer. Employee control over his employer calls for careful scrutiny of the benefit to the employer, but not automatic inclusion. In addition to the careful scrutiny of employer benefit, reasonableness of the expense may also become crucial where the employee has potential control. In summary, of the two elements relied upon in *Gotcher* and the doctrines and cases cited therein, the benefit to the employer appears the more crucial element to exclusion.

Gotcher is the leading opinion to exclude the value of mandated expense-paid travel that does not primarily benefit the taxpayer. Yet perhaps its greatest significance lies in the recognition of the fact that the common elements of primary benefit to the employer and lack of employee control which recur in many tax law areas permitting exclusions from gross income, statutory and otherwise, constitute general principles underlying these areas. Thus, the Fifth Circuit read *McDonnell*, a Tax Court travel expense ruling, the convenience of the employer decisions, and the corporate-executive cases as intimately related in theory. While the *Gotcher* court did not include the Tax Court moving expense decisions in this group of related trends, the latter tribunal had previously recognized the identity in theory between such cases and the convenience of the employer authorities.³⁷³ Thus, it is clear that the exclusion doctrines of convenience of the employer (meals and lodging), interest of the employer (moving expenses), and primary benefit to the employer (entertainment and travel expenses) are but variations on a single theme.

³⁷² On the other hand, it should be noted that in other contexts a distinction has been suggested between employee activities such as educational activities which directly benefit the employer by directly improving the employee's ability to perform his assigned tasks more effectively, and those activities that only indirectly benefit the employer such as employee health or vacation plans which are not directly related to the employee's job function but only indirectly aid his ability to perform by keeping him healthy and, hopefully, happy. *Dimmig v. Workmen's Comp'n App. Bd.*, 40 U.S.L.W. 2686 (Calif. Sup. Ct. March 31, 1972) (injuries incurred in scope of activities directly benefiting the employer are compensable under Workmen's Compensation Act).

³⁷³ See text at note 57 *supra*.

B. Wives' Traveling Expenses

In contrast to the early development in the convention expense area, the first wife's traveling expense cases, which actually did not involve business trips by wives, appear to have established an adverse precedent in the Tax Court that was then applied without critical analysis to more business oriented travel by wives. For example, one early line of decisions dealt with the costs of a taxpayer moving his family to a new location when he had changed his place of business.³⁷⁴ Such expenses are not deductible, at least where relocation is not required by the employer,³⁷⁵ absent special statutory authority. Another line involved the travel of a wife or nurse with an ailing taxpayer on a business trip in order to care for him.³⁷⁶ Here, too, the expense is not a business expense under the origin of expense test,³⁷⁷ but rather a medical expense.³⁷⁸ Although the true nature of both lines of cases was on occasion recognized, they more frequently were uncritically cited for the following propositions:

[A]mounts expended by a taxpayer for the purpose of having his wife accompany him on a business trip where the wife's presence did not serve a bona fide business purpose represent nondeductible personal expenses If such personal expenses as the wife's traveling expenses are paid by the employer directly or under reimbursement, they are not deductible by the husband-employee as business expenses or traveling expenses while away from home in the pursuit of business, notwithstanding such payment by the employer.³⁷⁹

A further element which appears to have played a significant part in the hard-line course taken by the Tax Court is that many of the wife travel cases have also involved entertainment. Not unexpectedly, the special burden of proof, showing of necessity, and relationship to busi-

³⁷⁴ Baxter D. McClain, 2 B.T.A. 726 (1925); *accord*, George B. Lester, 19 B.T.A. 549, 558 (1930); Walter Schmidt, 11 B.T.A. 1199 (1928).

³⁷⁵ See text at notes 95 through 131 *supra*.

³⁷⁶ George W. Megeath, 5 B.T.A. 1274 (1927); *accord*, Wm. E. Reisner, 34 T.C. 1122, 1131 (1960). *Contra*, Allenberg Cotton Co. v. United States, 61-1 U.S. Tax Cas. ¶ 9131 (W.D. Tenn. 1960).

³⁷⁷ See note 87 *supra* and accompanying text.

³⁷⁸ Leo R. Cohn, 38 T.C. 387, 390 (1962).

³⁷⁹ Alex Silverman, 28 T.C. 1061, 1064 (1957), *aff'd*, 253 F.2d 849 (8th Cir. 1958); *accord*, S. J. Campbell, 30 P-H Tax Ct. Mem. 902 (1961); Cornelius Vanderbilt, Jr., 26 P-H Tax Ct. Mem. 916, 921 (1957).

ness discussions or negotiations evolved by that tribunal with respect to deduction of entertainment expenses³⁸⁰ appear to have engendered special deduction rules with respect to deduction of wives' travel expenses as well.³⁸¹

With this background it is not surprising that the deficiency cases lead another court to conclude that "the attempt to cast, for tax purposes, a 'business' coloration upon a wife's traveling expenses is . . . generally frowned upon . . ." ³⁸² For example, in *Frederic C. Moser*,³⁸³ the wife of a traveling insurance salesman *assisted her husband in entertaining clients*, gave assistance in the preparation for solicitation of particular clients, and assisted in the preparation of elaborate, individualized "briefs" submitted to prospective clients. The court held:

[The taxpayer's] wife was of some assistance . . . in the conduct of his insurance business while on the trips in question. However, there is no convincing evidence that this assistance, to any substantial degree, was greater than a wife, with a reasonable interest in her husband's business affairs, would normally provide. With respect to the entertainment of clients, she did no more than her *wifely duty* would require (emphasis added). . . .³⁸⁴

On a different occasion the Tax Court concluded that the wife's services in entertaining her husband's customers "were no more than any *interested wife* would render under the circumstances."³⁸⁵ Indeed, this theme of "wifely duty" forms a common thread running through many of the Tax Court wife's travel expenses decisions, extending even to decisions not involving travel and entertainment.³⁸⁶

Another common strand in these cases is the conclusion that, although a wife's assistance in her husband's work on business trips and help in entertaining customers or clients was helpful, such services were not necessary.³⁸⁷ It should be noted that the Tax Court's stance on this point

³⁸⁰ See text at notes 245 through 247 *supra*.

³⁸¹ See, e.g., S. J. Campbell, 30 P-H Tax Ct. Mem. 902 (1961).

³⁸² Peoples Life Ins. Co. v. United States, 373 F.2d 924, 930 (Ct. Cl. 1967).

³⁸³ 28 P-H Tax Ct. Mem. 106, 108 (1959).

³⁸⁴ *Id.*; accord, Preston B. Rieley, 33 P-H Tax Ct. Mem. 496, 497 (1964). *Contra*, Allenberg Cotton Co. v. United States, 61-1 U.S. Tax Cas. ¶ 9131 (W.D. Tenn. 1960).

³⁸⁵ B. F. Crabbe, 25 P-H Tax Ct. Mem. 189, 193 (1956); accord, S. J. Campbell, 30 P-H Tax Ct. Mem. 902, 922 (1961).

³⁸⁶ See, e.g., Cornelius Vanderbilt, Jr., 26 P-H Tax Ct. Mem. 916, 921 (1957).

³⁸⁷ "The deductibility of the expenses of a wife in attending her husband's business

conflicts with the general weight of authority. As the leading federal income tax treatise writer points out, "[a]n expense will ordinarily be considered 'necessary' if the expenditure is *appropriate and helpful* in developing and maintaining the taxpayer's business. Obviously, under such a view, *the necessity involved is not absolute or inexorable.*"³⁸⁸ This extraordinary "necessary" rule parallels the special necessity the Tax Court (although not appellate courts) initially required in the educational expense area, but has since abandoned,³⁸⁹ and that the Tax Court requires in the entertainment expense area.³⁹⁰

Though not expressly stated in its opinions, the Tax Court's disallowance of deductions for a wife's traveling expenses where she performed only her wifely duties, coupled with the unique circumstances involved in few Tax Court decisions granting deduction of a wife's travel expenses, indicate to some commentators that the court requires that a "wife must exercise a special talent or skill or service. Voice coaching, linguistic ability, and secretarial services have been held to be of this nature."³⁹¹ Similarly, though also based on a handful of cases, commentators have emphasized the theme of the wife having a direct interest in the income producing activities³⁹² so that deductions for her travel could be viewed as deductions for her efforts at producing a share of the family income, rather than as her spouse's deduction for his wife's assistance in producing his income. The Douglas dissent in *Rudolph* would have extended this concept to all travel expenses of wives accompanying their husbands on business trips by analogy to the civil law philosophy embodied in the community property concept, which attributes half of a husband's earnings to the wife due to her contribution to her husband's business productivity.³⁹³ There are, however, too few Tax Court cases in this area resolved in the taxpayer's favor for

meeting or convention requires a finding that she performed services necessary to the husband's trade or business, and not merely helpful thereto." L. L. Moorman, 26 T.C. 666, 679 (1956); *accord*, William H. Leonhart, 37 P-H Tax Ct. Mem. 493, 524-25, *aff'd*, 414 F.2d 749 (4th Cir. 1969); William H. Johnson, 35 P-H Tax Ct. Mem. 964, 971 (1966).

³⁸⁸ Mertens, *supra* note 80, at § 25.09, pp. 38-39 n.727.

³⁸⁹ See text at notes 181 through 185 *supra*.

³⁹⁰ See text at note 246 *supra*.

³⁹¹ Price, note 321 *supra*, at 85; Rich, *A Wife's Tax Value: Tax Aspects of a Wife's Attending Conventions, Sales Meetings, Etc.*, N.Y.U. 22D INST. ON FED. TAX. 895, 900-01 (1964) (hereinafter cited as Rich).

³⁹² Price, note 321 *supra*, at 86; Rich, note 391 *supra*.

³⁹³ *Rudolph v. United States*, 370 U.S. 269, 285 (1962) (dissent).

these two recurring patterns to be categorized as absolute rules rather than mere trends. Nor should they be. The wifely duty concept is too narrow; the direct interest idea too broad. Rather, the decisive question should be how substantial the spouse's assistance on the trip is,³⁹⁴ at least where an employer requirement is not present.

It might be thought that since the potentiality for abuse believed by some to be present in the area of foreign travel and entertainment was substantially eliminated in 1964 by the section 274 substantiation rules and the detailed and demanding regulations thereafter promulgated under that provision, the Tax Court deduction rules for wives' traveling and entertainment expenses (which were clearly influenced by fear of such abuse) would be relaxed so as to be in accord with the usual standards for deductions.³⁹⁵ This has not been the case. For example, in *Elmer K. Zitzewitz*,³⁹⁶ the Tax Court noted that the substantiation requirements imposed by section 274 "are in addition to the requirements imposed by section 162, and the petitioner still has the burden of proving initially that his expenditures were ordinary and necessary expenses, proximately related to his trade or business."³⁹⁷ In ascertaining whether the section 162 standards were met, the court relied upon the familiar, but anomalous, rule enunciated in *Moorman*: "[t]he deductibility of expenditures for a wife on a business trip requires a finding that her services were *necessary* and not just helpful."³⁹⁸

Thus, the traditional Tax Court attitude towards deductibility of wives' traveling expenses was as illiberal as its attitude towards deduction of convention expenses was liberal. This illiberality is placed in even sharper contrast by the fact that the landmark "command performance" decision permitting a deduction for a wife's travel expenses, *United States v. Disney*,³⁹⁹ involved both entertainment and "wifely" activities. There the chief executive officer of Walt Disney Productions made several foreign and domestic business trips in furtherance of his employer's world-wide entertainment operations. In conformity with the company policy, indeed a virtual employer insistence, that executives take their wives with them on extended business trips be-

³⁹⁴ See generally Sax, *A Wife's Traveling Expenses*, 37 TAXES 595 (1959).

³⁹⁵ See Rich, note 391 *supra*, at 904.

³⁹⁶ 38 P-H Tax Ct. Mem. 80, 83 (1969).

³⁹⁷ *Id.*

³⁹⁸ *Id.* See L. L. Moorman, 26 T.C. 666, 679 (1956).

³⁹⁹ 413 F.2d 783 (9th Cir. 1969); Recent Case, *Wife's Traveling Expenses*, *supra* note 292.

cause the company believed that their presence would enhance the company's "family-oriented" image, the taxpayer took his wife on these trips. The Ninth Circuit held that had the taxpayer:

[O]ccupied a less powerful executive position with the company, the necessity of taking his wife on the trips would have been dictated by employer insistence amounting almost to a condition of employment. Another executive of the company, performing the same duties on such trips, would at least have been warranted in concluding that disregard of this firm company policy might jeopardize advancement in the company.⁴⁰⁰

Consistent with this policy the company reimbursed the taxpayer, just as it had paid the expenses of the other executives' wives incurred in accompanying their spouses on business trips.

The *Disney* court acknowledged that most of the wife's activities—she did not attend daytime business meetings and spent most of her day in her hotel room or shopping, and attending to her husband's laundry, taking telephone calls at their hotel room and performing other activities of a "wifely" character—in helping her husband fulfill some of his business purposes in making the trip were of a kind in which she would normally engage while they were both at home.⁴⁰¹ The test for a bona fide business purpose for a wife's travel does not turn on the characterization of her activities as social or business, but whether under the circumstances the wife's presence and activities perform a business function.⁴⁰²

The appellate court's starting point was that the expenses must be ordinary and necessary in connection with the taxpayer's business and not ordinary and necessary in connection with his employer's business.⁴⁰³

⁴⁰⁰ United States v. Disney, 413 F.2d 783, 787 (9th Cir. 1969). Significantly the "conditions of employment" terminology is used under section 119 as virtually a synonym for convenience of the employer. See text at note 30, *supra*.

⁴⁰¹ "But the added factor here is that the husband has, because of company policy, been put to the additional expense of paying his wife's travel expenses so that she could assist him in this way on the road. It is this distinction which accounts for the fact that, under the circumstances of this case, her travel expenses are deductible as ordinary and necessary business expenses, whereas her living expenses at home are not." *Id.* at 788.

⁴⁰² Recent Case, *Wife's Traveling Expenses*, note 292 *supra*, at 1438.

⁴⁰³ United States v. Disney, 413 F.2d 783, 787 (9th Cir. 1969). However, the Service has conceded that an employee expense which benefits the employer (*i.e.*, a necessary employer expense) also furthers the employee's trade or business. See text at note 347 *supra*.

The tests to be met are whether the dominant purpose of the wife's trip was to serve her spouse's business purpose in making the trip and whether she spent a substantial amount of her time in assisting her husband in fulfilling that purpose.⁴⁰⁴ The husband's business purpose in taking the trips was, in essence, to promote the family-entertainment public image of the company, to enhance the morale of company representatives, and to "cultivate close and cordial relationships between his company and the exhibitors and other company executives with whom the company dealt throughout the world."⁴⁰⁵ To perform the latter duties, the trial court found that it was necessary for the taxpayer to have his wife with him at various luncheons, dinners, receptions, film screenings, press conferences and good will visits.

The appellate court believed that this necessity was established not only by the taxpayer's determination, but also by the company requirement, almost a *condition of employment* for lower-echelon executives, that executives' wives accompany them on such trips. This policy was reinforced by the company's practice of defraying the expenses of such travel through reimbursements. In the Ninth Circuit's opinion conformity with this company policy adequately established that these trips had a bona fide business purpose tested by the husband's business purpose in making the trip. The *Disney* court was careful to state that an employer requirement and reimbursement policy does not always render the employee's expenses deductible.⁴⁰⁶

The Ninth Circuit returned to the effect of employer compulsion on deductibility of traveling expenses in *Stratton v. Commissioner*.⁴⁰⁷ There the taxpayer-employee was a foreign service officer for the State Department assigned to a permanent duty station in Karachi, Pakistan. The State Department had issued regulations making it *compulsory* that such employees return to the United States on "home leave" as soon as possible after completion of three years of foreign service. In the fall of 1962, the employee and his family were authorized to travel at government expense to the United States so that he could consult with the

⁴⁰⁴ *Id.* at 788.

⁴⁰⁵ *Id.* at 787.

⁴⁰⁶ "The fact that an employer may prefer to have an executive take his wife along is not controlling if her presence does not serve the taxpayer-employee's business purpose in making the trip. The fact that an employer defrays the travel expenses of the wife is not controlling, for this may, and frequently does, represent only a bonus for past business achievements by the employee." *Id.* at 788 (emphasis added).

⁴⁰⁷ 448 F.2d 1030 (9th Cir. 1971).

State Department in Washington, D. C. and then go on "home leave." During this time the taxpayer and his family traveled throughout the United States. The taxpayer claimed deductions for the unreimbursed expenses he incurred for transportation, meals, and lodging for himself and his family during the period he was on "home leave." The issue before the appellate court was whether the taxpayer's "home leave" was primarily personal in nature (to give the taxpayer a vacation) or was primarily related to the taxpayer's trade or business.⁴⁰⁸ The Commissioner argued that: (1) the "home leave" was primarily a personal trip; (2) on such leave the taxpayer performed no official acts and was accountable to no one; (3) "home leave" was credited to the employee's leave account according to length of time abroad rather than to time needed for reorientation; (4) since the Department did not provide a per diem or reimbursement it did not view "home leave" as a business trip; and (5) the taxpayer's government travel authorization implied that "home leave" was at the taxpayer's request or convenience.⁴⁰⁹ The taxpayer maintained that he was ordered to take "home leave" as a mandatory duty assignment carried out on behalf of his employer.⁴¹⁰

The court acknowledged that "home leave" was akin to vacation; indeed, it was probably so intended in order that a foreign service officer could reorient himself with the American way of life in a short time through travel, observation, reading, and conversation, unburdened by the mundane duties of his everyday job.⁴¹¹ The crucial factor to the Ninth Circuit, however, was that despite the fact that "home leave" was in the nature of a vacation, it was also a "compulsory job requirement."

Unlike other taxpayers, Stratton did not have a choice as to where he could spend a substantial portion of the family treasury. He did not have the option of investing his money or spending it on a new car, a boat, a trip to another country abroad, or an expensive hobby. Instead, he was mandatorily required to take a vacation in the United

⁴⁰⁸ *Id.* at 1031.

⁴⁰⁹ *Id.* at 1032.

⁴¹⁰ *Id.* The Tax Court, 52 T.C. 378, had found no evidence that the taxpayer was compelled to take his "home leave." The review court believed such finding to be clearly erroneous. *Id.*

⁴¹¹ "The Department realizes direct, albeit intangible, benefits in terms of the effectiveness of its employees by virtue of just such 'vacations.'" *Id.* at 1033.

States. *It may not be a particularly onerous burden to many foreign service officers, but it still is an unavoidable expense imposed by the employer and by statute for reasons pertaining directly to the employee's trade or business* (emphasis added).⁴¹²

The *Stratton* court therefore held that the travel expenses, including food and lodging, attributable to the taxpayer while he was on "home leave" were primarily related to his trade or business as a foreign service officer. Just as it had earlier indicated in *Disney* that the expenses of not all employer-required travel were deductible, the court of appeals felt:

[C]onstrained to add, however, that implicit in our decision in this instance is the fact that it was the Congress that has determined to require the travel involved. In the context of a private employer's requirement that certain executives travel on leave to various countries in order to better perform their duties, such a requirement significantly becomes more suspect as a device for tax avoidance than would a similar requirement imposed on government employees by the Congress of the United States.⁴¹³

Stratton disallowed any deduction for the "home leave" expenses attributable to the taxpayer's wife and children. They were not employed by the State Department and there was no mandatory requirement either by statute or regulation that they accompany the husband on "home leave."⁴¹⁴ *Disney* was distinguished on the grounds that there an express company policy requiring executives to take their wives with them on extended business trips to enhance the company's image was present and that the record manifested that the wife's public relations duties served her husband's business purpose in making the trip.⁴¹⁵

Disney was foreshadowed by *Warwick v. United States*,⁴¹⁶ a district court decision. Substantially similar facts were involved in the two cases, including the fact that in *Warwick* lower echelon officers of the corporate employer were required to take their wives with them on certain business trips abroad. However, since the taxpayer was a senior

⁴¹² *Id.*

⁴¹³ *Id.*

⁴¹⁴ *Id.* at 1034.

⁴¹⁵ *Id.* at 1034 n.13.

⁴¹⁶ 236 F. Supp. 761 (E.D. Va. 1964).

officer the decision was left to him as to whether to take his wife. Although not expressly articulated by the district court, it appears that had the taxpayer in *Warwick* occupied a less powerful executive position with his employer as in *Disney*, "the necessity of taking his wife on the trips would have been dictated by employer insistence amounting almost to a condition of employment."⁴¹⁷

The husband's duties in *Warwick* were similar to the husband's in *Disney*, i.e., to project his employer's corporate image of competency and integrity and to have a very close, friendly relationship with European customers.⁴¹⁸ His wife's duties were to assist her husband in establishing that relationship.⁴¹⁹ She occasionally visited the customers' manufacturing establishments and on such occasions made the appropriate remarks. Her more significant activities, however, entailed entertaining customers and their wives in her hotel room and making it possible and congenial for her husband to be entertained in the customer's homes.⁴²⁰ The district court found that all of the wife's time was devoted to assisting her husband on the foreign trips, to the exclusion of vacationing or touring on her own behalf.⁴²¹ Both the taxpayer and his employer were of the opinion that the wife, through her travel with her husband, did contribute measurably to his success, and consequently his earnings.⁴²²

The *Warwick* court's ultimate conclusion was that "[t]he only reason [the wife] . . . went was because of her husband's business, and it was appropriate to the conduct of his business. She assisted him in his business and assisted him in the production of his income."⁴²³ *Warwick* also noted that the trips of the wife before it "differed from those of a wife who accompanies an ordinary salesman while he calls on his trade . . ." ⁴²⁴ Nevertheless, a comparison with the majority of traveling wife decisions reveals that the only truly significant difference was the element of employer compulsion. Thus, *Warwick* may also be regarded as an employer compulsion decision, tested by the husband's business

⁴¹⁷ *United States v. Disney*, 413 F.2d 783, 787 (9th Cir. 1969).

⁴¹⁸ *Warwick v. United States*, 236 F. Supp. 761, 764-65 (E.D. Va. 1964).

⁴¹⁹ *Id.* at 765.

⁴²⁰ *Id.*

⁴²¹ *Id.*

⁴²² *Id.* at 766.

⁴²³ *Id.* at 767.

⁴²⁴ *Id.*

purpose, although only the latter element was expressly relied upon in the holding.

To be contrasted with the facts and holdings in *Disney* and *Warwick* is the Tax Court opinion in *William H. Johnson*.⁴²⁵ This case is an extreme example of its illiberal attitude as to wives' traveling expense. There a division vice president of the taxpayer's employer asked him to take his wife to a convention. The taxpayer testified that his failure to do so would have jeopardized his career.⁴²⁶ His wife did some secretarial work at the convention, visited the company booth, met other wives for breakfast, and worked in the company's hospitality suite.⁴²⁷ The Tax Court acknowledged that the taxpayer's wife aided him through social contacts with the wives of delegates at the convention, but after repeating the talismanic phrase that being "helpful" is not enough, a traveling wife's functions must be "necessary," the court found against the taxpayer for lack of evidence that the wife's presence was of a substantial benefit. The court was not informed of the "extent of the secretarial work," "how much time she spent at the company booth or what she did while there," or "whether she merely ate breakfast with other wives or acted as a hostess."⁴²⁸ The factor of employer compulsion was ignored.

The *Disney* conclusion that the fact that the wife spent much of her time attending to "wifely" duties did not necessarily require the conclusion that her presence did not have a bona fide business purpose, stands in stark contrast to the Tax Court's rather frequent cavalier denial of deductions for the cost of a wife's travel on the grounds that her services, such as entertaining clients, were no more than her "wifely duty."⁴²⁹ *Disney*, of course, held that it was the element of company policy, *i.e.*, an employer requirement, that made her traveling expenses deductible as ordinary and necessary business expenses while the cost at home of her living expenses and implicitly of her performance of wifely duties, constituted nondeductible personal expenses.⁴³⁰ Similarly, in *Stratton* the Ninth Circuit had held that the taxpayer's vacation trip to the United States was an unavoidable expense imposed by his em-

⁴²⁵ 35 P-H Tax Ct. Mem. 964, 970-71 (1966).

⁴²⁶ *Id.* at 970.

⁴²⁷ *Id.*

⁴²⁸ *Id.* at 971.

⁴²⁹ See notes 384 through 386 *supra*.

⁴³⁰ *United States v. Disney*, 413 F.2d 783, 788 (9th Cir. 1969).

ployer for reasons pertaining directly to his trade or business.⁴³¹ Thus, it is clear that expenditures which if incurred by an employee of his own volition would be personal become deductible business expenditures if mandated by the employer for his own business reasons.⁴³²

The Commissioner argued on brief in *Rudolph* before the Supreme Court that this rule could not be the law.

At first sight, it might seem that nothing is more related to the 'business' of being an employee than that which is, in the phrase quoted by petitioner from Judge Brown's dissent, "indispensable" to keeping the job. Reflection, however, reveals the deficiencies of that "but for" reasoning. In what petitioner calls the "ways of modern business" there are many things that it may be essential to do to keep one's job: dress well, belong to the right club, live in an expensive neighborhood, entertain generously, or go on hunting trips with the boss. The extent to which the "corporation" sometimes impinges upon and controls the private life of the "organization man" is, indeed, emphasized in Judge Brown's dissenting opinion of the *Thomas* case (see petition for certiorari). With but slight extension, therefore, the implicit premise that whatever the corporation demands the employee may deduct could readily be applied to substantially all personal and living expenses. Plainly that cannot be the law. One cannot deduct commuting expenses because his employer requires him to come to work (and go home to sleep) to keep his job (Regs. § 1.162-2(d)); the cost of his expensive clothing because his employer requires him to dress well; the cost of being active in community affairs because his employer expects it of him; the cost of a trip to Bermuda because his employer insists that he take his vacation away from the tribulations of home life, the better to perform his work upon return; or the cost of food or shelter because one must eat and sleep to work. So plain, indeed, is the error in petitioner's but-for reasoning, that the problem is not to prove it wrong but to suggest how the obviously necessary limitation on "ordinary and necessary" business expenses is to be drawn.⁴³³

The fallacy in the Commissioner's examples is that the employer usually does not require the employee to make any of the above expenditures. Yet where they are imposed upon the employee for bona fide employer

⁴³¹ *Stratton v. Commissioner*, 448 F.2d 1030, 1033 (9th Cir. 1971).

⁴³² *Cf. Willis B. Ferebee*, 39 T.C. 801, 805 (1963) (Opper, J., concurring).

⁴³³ Note 340 *supra*.

business purposes pertaining directly to the employee's trade or business, and he does not have the option of not making the expenditures, they are in fact deductible.

Customarily the employer does not require the employee to commute; it is the latter's choice whether to live within walking distance of his job. Nevertheless, where the employer requires the employee to move his work location and the employee is unable to move his residence as well for reasons other than personal choice, under the better reasoned decisions such "commuting" expenses are deductible.⁴³⁴

Similarly, the Service has ruled that the cost of clothing that is of a type specifically required as a condition of employment and is not adaptable to general usage to the extent that it would take the place of ordinary clothing, is deductible.⁴³⁵ It may be noted that the convenience of the employer echoes of the ruling are reflected in the case law as well.⁴³⁶ The Tax Court has extended the deduction to "highly stylized" clothing, clearly expensive, which the taxpayer, a fashion coordinator, was required to wear to meetings of style experts and buyers, but which was in her opinion not suited for her personal wear.⁴³⁷ Also, in language reminiscent of the early educational expense cases and rulings, the Service has held that hairdressers may deduct the cost and maintenance of their uniforms which are required to be worn by terms of their employment, state law, or regulations.⁴³⁸

As to the cost of being active in community affairs, the Fourth Circuit in *Noland v. Commissioner*,⁴³⁹ in disallowing deductions for such expenditures, specifically noted that the expenditures were *not* required by the employer. *Stratton*⁴⁴⁰ illustrates that the cost of an employer mandated vacation may be deductible to an employee. Similarly, where an employee is charged for meals or lodging furnished by his employer on premises for the latter's convenience, an amount equal to that charge

⁴³⁴ See text at notes 108 through 125 *supra*.

⁴³⁵ *Mim.* 6463, 1950-1 CUM. BULL. 29.

⁴³⁶ See, e.g., *Louis M. Roth*, 17 T.C. 1450, 1455 (1952); *O. G. Russell*, 21 P-H Tax Ct. Mem. 298 (1952).

⁴³⁷ *Betty Lusk Yeomans*, 30 T.C. 757 (1958).

⁴³⁸ Special Ruling, 6 CCH 1958 Stand. Fed. Tax Rep. ¶ 6630.

⁴³⁹ *Noland v. Commissioner*, 269 F.2d 108 (4th Cir. 1959), *cert. denied*, 361 U.S. 885 (1959).

⁴⁴⁰ *Stratton v. Commissioner*, 448 F.2d 1030, 1033 (9th Cir. 1971).

is excluded from the employee's gross income,⁴⁴¹ albeit technically not through a deduction.

Unlike *Gotcher*, in which the Fifth Circuit synthesized the various trends permitting exclusion of employer mandated employee expenses primarily benefiting the employer, *Disney* and *Stratton* do not draw together the various areas in which employer compulsion forms a basis for deduction of expenses incurred by an employee. Nevertheless, these cases share elements in common, and recurring principles are involved as in the exclusion area. For example, a common element in the areas of moving and educational expenses has been the establishment of the bona fides of employer compulsion through benefit to the employer. This element recurs in *Stratton* where the Ninth Circuit held that the taxpayer's employer received direct, albeit intangible, benefits in terms of the taxpayer's effectiveness by virtue of his compulsory travel. Similarly, *Disney* implied that the entertainment and social activities of the taxpayer's wife on the travel in question helped build the employer's good will. Certainly the company's management believed that the company's special image would be enhanced if its representatives traveled with their wives. Since the function of the employer benefit element in the deduction area is merely to corroborate that the cause of the expenditure is an employer requirement, it would appear that an employer's belief that the expense benefited it is sufficient; an actual benefit to the employer need not be shown. Indeed, the Court of Claims has ruled that where "an employer to all intents and purposes directs an employee to be present at a certain place and at a certain time, the conclusion is compelled that the trip, at least from the employer's point of view, primarily serves his purposes."⁴⁴²

Another recurring element has been employer reimbursement. The Service's entertainment expenses ruling⁴⁴³ that employer reimbursement tends to establish that an expense is incurred in the employee's business is paralleled by the holding in *Disney* that the employer requirement or policy was backed up by a policy of reimbursement. It has been argued, however, that a policy of reimbursement should be given little, if any, weight in the question of deductibility. This argument is based on the theory that what the company considers ordinary and necessary for its business should not control what is ordinary and necessary to its em-

⁴⁴¹ *Boykin v. Commissioner*, 260 F.2d 249 (8th Cir. 1958).

⁴⁴² *Peoples Life Ins. Co. v. United States*, 373 F.2d 924, 929 (Ct. Cl. 1967).

⁴⁴³ Rev. Rul. 57-502, 1957-2 CUM. BULL. 118.

ployee's business.⁴⁴⁴ The answer to this is the unarticulated premise of *Disney*: a reimbursed expense which has to pass the "critical scrutiny of corporate officers concerned with the elimination of needless expense"⁴⁴⁵ does benefit the employer and thus the employer compulsion is bona fide. An employee purpose to advance his employer's interests constitutes a business purpose as to the employee.⁴⁴⁶ This same premise no doubt underlies the rule promulgated in the pre-1962 business expense regulations⁴⁴⁷ and in the substantiation regulations⁴⁴⁸ under which an employee is not required to report on his tax return reimbursements for travel and other expenses that he incurred "solely for the benefit of his employer" if he was required to make an adequate accounting to his employer. The problem of the controlled employer is covered by special rules applicable to reimbursements to employees who are holders of 10 per cent or more of the stock of their employer, whether directly or by attribution.⁴⁴⁹

Further evidence that reimbursement is merely a factor corroborating employer compulsion is manifested by the fact that the appellate court in *Stratton* did not even bother to directly address the Government's argument that the employer's failure to provide a per diem allowance or reimbursement of the taxpayer's expenses suggested that the former did not view the "home leave" as a business trip. Of course, to the extent that the taxpayer's failure to seek or obtain reimbursement for his traveling expenses evidences an acknowledgment by him of the weakness of his position, *i.e.*, an unwillingness to submit the expense to the critical scrutiny of his employer, it tends to establish that the expenses are not deductible.⁴⁵⁰

Thus, the employer deduction trends share the common elements of utilization of employer benefit or employer reimbursement to establish

⁴⁴⁴ Recent Case, *Wife's Traveling Expenses*, *supra* note 292, at 1437-38.

⁴⁴⁵ *Noland v. Commissioner*, 269 F.2d 108, 113 (4th Cir.), *cert. denied*, 361 U.S. 885 (1959). *But see* James T. Thrower, 31 P-H Tax Ct. Mem. 1707, 1716 (1962), *aff'd*, 330 F.2d 614 (5th Cir. 1964) (no authority exists for unique argument that approval by employer of reimbursement yields "presumption of regularity"; however, on facts employer scrutiny was pro forma).

⁴⁴⁶ See text at note 347 *supra*.

⁴⁴⁷ Treas Reg. § 1.162-17 (1958).

⁴⁴⁸ *Id.* § 1.274-5(e)(2)(1)(2) (1962).

⁴⁴⁹ *Id.* § 1.274-5(e)(5)(ii) (1962). See also *Id.* § 162-17(d)(1)(iii) (1958).

⁴⁵⁰ See Walter M. Sheldon, 30 P-H Tax Ct. Mem. 256, 259 (1961), *aff'd*, 209 F.2d 98 (7th Cir. 1962); Price, *supra* note 321, at 86-87.

that the employer compulsion is bona fide. The reason is not hard to see. As noted by commentators:

By itself, however, the commanded appearance by an employee can hardly change the cost of a trip for personal enjoyment into an ordinary and necessary business expense. If such reasoning were followed, all an employer would have to do if he wanted to give his employees a nontaxable bonus, would be to require them to attend a city or resort area under the pretext that it is for a business convention.⁴⁵¹

One answer, advocated by the Service, is to impute any employer intent to benefit the employee to the employee, so that the expense, although compelled, is primarily incurred for his personal benefit and hence not deductible.⁴⁵² A similar theory was recently adopted by the Tax Court in *International Artists, Ltd.*⁴⁵³ The business-personal dichotomy is applicable to a corporation in that if an expenditure is primarily made to benefit an individual in control of the corporate affairs the expenditure is personal and not deductible by the corporation and constitutes taxable income to the benefited individual. Consequently, if the primary purpose of the mandated expense is to benefit the employee, then it is not deductible by him, at least to the extent that it is intended to benefit him. Inherent, however, in such a subjective test is the difficulty of showing employer or employee intent. Thus, objective criteria such as employer business purpose or reimbursement requiring an accounting to the employer constitute a more practical, and easier administered

⁴⁵¹ See Note, *Convention Trips*, note 82 *supra*, at 571; 47 VA. L. REV. 1097, 1103 (1961).

⁴⁵² See text at note 347 *supra*.

⁴⁵³ 54 T.C. 94, 104 (1970). *International Artists* also held that the primary purpose criterion is applicable to claimed business expenses only if the secondary purpose is relatively insignificant; otherwise, allocation is necessary. On the other hand, the section 162 regulations provide that traveling expenses are deductible only if the trip is primarily related to the taxpayer's trade or business; if not, the expenses are not deductible even if the taxpayer engages in business activities at this destination. Treas. Reg. § 1.162-2(b)(1) (1958). Many decisions apply this regulation without question; others add that the taxpayer had not shown any basis for a partial allocation. Edgar A. Basse, 10 T.C. 328 (1948). Most significantly, some decisions have made allocations (particularly where automobile expenses were involved), albeit without discussion of the regulation's all-or-nothing test. See, e.g., William L. Heuer, Jr., 32 T.C. 947 (1968), *aff'd*, 283 F.2d 865 (5th Cir. 1960). It would appear that the *Cohan* rule (see text at notes 222 through 244, *supra*) would require an allocation, even though the business purpose of the travel was relatively insignificant.

solution to the problem of insuring that the employer compulsion is not a device to give the employee a tax free, *i.e.*, deductible, bonus.

Disney required, in addition to the employer business purpose safeguard, that the compelled expense be rationally connected with the employee's business purpose or activities.⁴⁵⁴ Indeed, the employee business purpose appears infinitely more important than employer business purpose. The Ninth Circuit held that the taxpayer's conformance with company policy (the analogue of employer compulsion for lower echelon employees) adequately established that the wife's presence on the trips had a bona fide business purpose *tested by the husband's business purpose in making the trip*.⁴⁵⁵ His business purpose was in part to promote his employer's public image, to enhance the morale and enthusiasm of company representatives, and to cultivate close and cordial relationships between the company and its customers. The circuit court concluded that to fulfill these duties it was necessary for the wife to accompany the taxpayer to the various luncheons, dinners, receptions, press conferences and good will visits.⁴⁵⁶ *Stratton* also found that the taxpayer's travel, conversation, and communication, resulting in renewal of his knowledge of American life, was directly related to his trade or business of being a foreign service officer although primarily achieved through personal activities such as vacation traveling.⁴⁵⁷

The Ninth Circuit has taken this requirement beyond the educational and entertainment expense authorities if it demands a proximate relationship to the employee's activities or duties *other than his duty to obey his employer's command* when the expense is mandated by the employer. In the latter areas, relationship with the taxpayer's other duties is an alternative basis for deduction, not a prerequisite for deduction in addition to employer compulsion.⁴⁵⁸ If *Disney* and *Stratton* are read in this manner, the mistake made by the *Hill* progeny will be repeated. Of course, where a commanded expense benefits the employer, it will usually be intimately related to the employee's duties in addition to following his employer's command. For example, the wife's travel in *Disney* benefited the employer's image, but then the husband's duties included promoting his employer's image. Furthermore, the Service has

⁴⁵⁴ *United States v. Disney*, 413 F.2d 783, 787 (9th Cir. 1969).

⁴⁵⁵ *Id.*

⁴⁵⁶ *Id.* at 787.

⁴⁵⁷ *Stratton v. Commissioner*, 448 F.2d 1030, 1033 n.9 (9th Cir. 1971).

⁴⁵⁸ See text at notes 177 and 283 *supra*.

admitted that it is part of an employee's business to further the interests of his employer. Therefore, an expense incurred in obeying an employer command that benefits the employer meets the test of the employee's business purpose. In short, it is the employer business purpose or benefit, not the employee business purpose in the abstract, that is decisive. In this light *Disney* and *Stratton* are completely consonant with the educational and entertainment expense trends. Furthermore, while the *Gilmore* "origin of the expense" test would only appear to require that the expenses be commanded by the employer,⁴⁵⁹ in which case the origin of the expense would be the employer compulsion which in turn would be business in nature because essential to the continuance of the taxpayer's employment, in actuality if the commanded performance bears no relationship to the trade or business of the employer, it is more likely that no compulsion actually existed or that the employee incurred the expenses for reasons other than the employer's command. Thus, these employer benefit and reimbursement safeguards are compatible with the employer-compulsion-origin test because they insure that the compulsion, which may be susceptible to abuse, is the origin of the claimed expense.

Conclusion

The striking parallelisms in approach, theory, and even terminology manifested in the decisions permitting *exclusion* of employer reimbursement of commanded employee expenditures and allowing *deduction* by employees of similar expenditures clearly establish the existence of common principles supporting such exclusions and deductions, regardless of the specific category of expenditure. This conclusion does not result from inductive reasoning. Rather, it reflects the fact that a single statutory gross income provision (section 61 and predecessors) with its judicial glosses and a single statutory deduction provision (section 162 and predecessors) should each yield consistent results when the factors of employer compulsion and benefit are present, without considering the classification of the expenditure reimbursed or deducted. On the exclusion side, the central element is the primary benefit to the employer. If the employer is primarily benefited, the incidental economic benefit received by the employee is not compensatory, and hence, not

⁴⁵⁹ See note 87 *supra* and accompanying text.

taxable income.⁴⁶⁰ Lack of employee control, the concomitant of employer compulsion, may constitute a secondary basis for exclusion, but the true significance of employer compulsion is that "[w]hen an employer to all intents and purposes directs an employee to be present at a certain place and a certain time, the conclusion is compelled that the trip, at least from the employer's point of view primarily serves his purpose."⁴⁶¹ In any event, this limited role played by employer compulsion or lack of employee control should not extend beyond the cause of the expenditure.⁴⁶² Moreover, the fact that indirect benefits are enjoyed by the employee's wife,⁴⁶³ or a wife's traveling expenses accompanying her husband,⁴⁶⁴ should not preclude exclusion as long as the employer is primarily benefited. The scope of such benefit should encompass at a minimum the following: (1) benefits from activities that directly improve the employee's ability to perform his assigned tasks more effectively;⁴⁶⁵ (2) tangible and substantial economic benefits to

⁴⁶⁰ See text at notes 69 and 142 *supra*. See generally Ness & Vogel, note 42 *supra*, at § 835.

⁴⁶¹ Peoples Life Ins. Co. v. United States, 373 F.2d 924, 929 (Ct. Cl. 1967).

⁴⁶² See text at notes 70 and 214 *supra*.

⁴⁶³ Special Ruling, 5 CCH 1951 Stand. Fed. Tax Rep. ¶ 6031.

⁴⁶⁴ Disney v. United States, 267 F. Supp. 1 (D. Calif. 1967), *aff'd*, 413 F.2d 783 (9th Cir. 1969); Allen J. McDonell, 36 P-H Tax Ct. Mem. 126 (1967).

⁴⁶⁵ Benefit to the employer as a tax concept has not received extensive delineation in tax cases. See text at notes 31 through 34 and 39, *supra*. On the other hand, the concept has received considerable attention in the local law area of workmen's compensation in a striking instance of parallel evolution: (1) the "bunkhouse" rule (see, e.g., Pearson v. Taylor Fruit Farm, 18 Ohio App. 2d 193, 248 N.E.2d 231 (Ct. App. 1969)); Rosen v. Industrial Accident Comm'n, 49 Cal. Rptr. 706 (Dist. Ct. App. 1966) is the analogue of the convenience of the employer doctrine, in some jurisdictions even using identical terminology, In re Kilcoyne, 352 Mass. 572, 227 N.E.2d 324 (1967); (2) educational activities, Kenny v. Rockingham School District, 123 Vt. 404, 190 A.2d 702 (1963); E. R. Burget Co. v. Zupin, 226 Ind. 633, 82 N.E.2d 897 (1948); (3) entertainment of employer's customers, Charles v. Industrial Comm'n, 2 Ariz. App. 202, 407 P.2d 391 (Ct. App. 1965); and (4) the "special errand" rule which encompasses trips to and attendance at employer sponsored conventions, Cabin Crafts, Inc. v. Pelfrey, 119 Ga. App. 809, 168 S.E.2d 168 (1969); Lawrence v. Industrial Comm'n, 78 Ariz. 401, 281 P.2d 113 (1955); Shell Oil Co. v. Industrial Accident Comm'n, 18 Cal. Rptr. 540 (Dist. Ct. App. 1962). The California Supreme Court has recently held that class attendance by an employee which was of direct benefit to the employer constituted a "special mission" within the scope of employment. Dimmig v. Workmen's Comp'n App. Bd., 40 U.S.L.W. 2686 (Cal. Sup. Ct., March 31, 1972). Criteria used to ascertain direct benefit were: (1) employer encouragement, (2) greater percentage of employer reimbursement for expenses of courses directly related to the employee's job, and (3) the educational activity directly improved the employee's ability to perform his assigned tasks more effectively.

the employer;⁴⁶⁶ and (3) benefits from a specific work assignment other than the employee's usual job activities.⁴⁶⁷

The key to the deduction of these expenses is employer compulsion, which establishes the element of necessity as well as provides the required connection with the employee's business. Theoretically, employer benefit could also satisfy the necessary and business related requirements since it is appropriate to the employee's business that he further his employer's business. But in practice benefit to the employer and direct relationship with the employee's everyday activities appear to have been utilized in most cases more as a means of testing the bona fides of the employer compulsion⁴⁶⁸ than as an independent test. Paradoxically, the basis for deduction is the mirror-image of the exclusion, since the latter turns more on benefit to the employer, with the secondary emphasis placed on employer compulsion. Thus, in theory, reimbursement of a given expenditure might not be excludible because the factor of benefit to the employer was not sufficiently strong, but the expenditure itself would be deductible by the employee because of bona fide, albeit mis-directed, employer compulsion. On the other hand, where the expense primarily benefits the employer, not only would reimbursement be excludible but an unreimbursed expense would be deductible as well.⁴⁶⁹ Yet, as a practical matter it is submitted that on the usual set of facts the results will be the same whether exclusion or deduction is involved. For this reason, the sole issue where reimbursed expenses are involved

⁴⁶⁶ The workmen's compensation authorities are in conflict in this area. For example the *Dimmig* court, *id.*, distinguished activities that directly benefit the employer from those that only indirectly benefit the employer, such as an employee vacation or health plan which provides benefits not directly related to the employee's actual job function, but only indirectly aid his ability to perform by keeping him healthy and, it is hoped, happy. A company sponsored picnic would appear to fall on the indirect benefit side of the line, and the leading commentator in this area has stated that a determinative factor is whether the employer benefited tangibly, and not merely through better morale and good will. LARSON, WORKMEN'S COMPENSATION LAW ¶ 22, 23 (1965). But other courts have ruled that improved employer-employee relations fostered by such company picnics (that extend beyond the tangible value of improved employee health and morale common to all recreation) constituted such tangible benefits to the employer. *Lybrand, Ross Bros. & Montgomery v. Industrial Comm'n*, 36 Ill. 2d 410, 223 N.E.2d 150 (1967) (and authorities cited therein); *accord*, *Kohlmayer v. Keller*, 24 Ohio St. 2d 10, 263 N.E.2d 231 (1970).

⁴⁶⁷ See Allen J. McDonell, 36 P-H Tax Ct. Mem. 126 (1967).

⁴⁶⁸ See p. 36 & note 177 *supra*.

⁴⁶⁹ See text at notes 279 and 347 *supra*.

is properly whether the reimbursement is excludible⁴⁷⁰ and deduction should play a role only where the expense is neither paid directly by the employer nor reimbursed.

The above principles point to the directions that exclusions and deductions in this area should have taken. Instead of such uniform development it is as if a morality play were being reinacted in each area. The allegorical characters are Administrative Opposition to exclusion and deduction, Judicial Opposition, Judicial Approval, and Non-Judicial Resolution of the Conflict. The first act stars Administrative Opposition, invariably played by the Service. The Tax Court and the other tribunals have taken turns at being Judicial Opposition and Judicial Approval in the second act. In the third and final act, Congress attempts to end the conflict arising in the second act by imposing a new rule, albeit perhaps arbitrary, in each run of the play decreeing exclusion or deduction in limited circumstances. The Service is substituted for Congress in the educational expense area. This survey has not been intended to be solely a scholastic study of what might or should have been, for the quasi-Hegelian progression has yet to be resolved in one principal area: travel expenses. In this field, especially as to conventions and travel by wives, appellate courts have recently taken positions favoring either exclusions or deductions depending on the forum. The Tax Court has traditionally by and large favored deductibility of convention expenses but has disallowed wives' traveling expenses. It has hardly spoken to the issue of exclusion. It is to be hoped that either the Tax Court or the Service will reassess their positions with respect to such expenses in order that still another otherwise predestined final act with a mechanical and nonconforming conclusion by Congress will be avoided. As the Tax Court itself has recently held:

[I]n the area of the tax laws, Congress has already chosen to legislate with a great deal of particularity; nevertheless, it should not be burdened with the necessity of considering additional details of the law. Congress can and should expect us to assume a responsible role in this

⁴⁷⁰ One commentator has pointed out that if the principle that reimbursements for expenses incurred by an employee for his employer's benefit and convenience do not constitute gross income to the employee discloses a major flaw in the Service's requirement that an employee report all reimbursements as income if he is going to claim a deduction for any unreimbursed expenses. Huffaker & Falb, *supra* note 297, at A-12. It may be further noted that without the reporting requirement much of section 274 becomes ineffectual.

constitutional system of government of attempting to carry out the general policies decided upon by the Congress.

Everybody deplores the complexity of the tax laws, but if we make it necessary for Congress to write every rule in detail, then we contribute toward that complexity.⁴⁷¹

⁴⁷¹ *International Trading Co.*, 57 T.C. 455, 464 (1971) (Simpson, J., concurring).

