DETERMINING WHETHER CONVENTION TRIPS ARE A PERSONAL OR BUSINESS EXPENSE

Rudolph v. United States
291 F.2d 841 (5th Cir. 1961)

A Texas insurance agent qualified to attend his company's convention in New York City by selling the requisite amount of insurance. The trip lasted five or six days, and of this time a morning meeting and a luncheon were devoted to business activities. The remaining time was spent traveling, renewing old acquaintances, sightseeing, and leisure. A majority of the Court of Appeals for the Fifth Circuit held that the taxpayer realized additional income when his company paid all the expenses for him and his wife to attend the convention, and that the taxpayer could not deduct the cost of the trip as a business expense.[1]

The majority and the dissent agreed that the amount paid by the employer for the trip was income to the taxpayer.[2] The debated issue was whether the taxpayer could deduct the costs of the convention as an "ordinary and necessary" business expense.[3] While most decisions concerning convention expenses relate to deductions by professional men[4] or corporations,[5] it is clear that similar deductions are allowable to persons who are employees.[6] If convention expenditures are to be considered a business expense, the primary purpose of the trip, obviously, must be business, not pleasure.[7] The Regulation provides:

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[1] Rudolph v. United States, 291 F.2d 841 (5th Cir. 1961), *affirming per curiam*, 189 F. Supp. 2 (N.D. Texas 1960). The appellate court referred to Patterson v. Thomas, 289 F.2d 108 (5th Cir. 1961), a case with practically identical facts, for the applicable law. Justice Brown dissented in both of the Court of Appeals' decisions.

[2] The receipt of a benefit in a form other than cash may constitute income to the taxpayer. See Commission v. Lobue, 351 U.S. 243 (1956), stock options; United States v. Drescher, 179 F.2d 863 (2d Cir. 1950), *cert. denied*, 340 U.S. 821 (1950), annuities.

[3] Int. Rev. Code of 1954, § 162(a)(2): "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business including . . . (2) traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business."

[4] Robert C. Coffey, 21 B.T.A. 1242 (1931); Ellis v. Burnet, 15 B.T.A. 1075 (1929), *aff'd*, 50 F.2d 343 (D.C. Cir. 1931); Jay N. Darling, 4 B.T.A. 499 (1926).

[5] Pacific Grape Products Co. v. Commissioner, 17 T.C. 1097 (1952), *rev'd on other grounds*, 219 F.2d 862 (9th Cir. 1955); Finkenburg's Sons, Inc., 17 T.C. 973 (1951).

[6] Treas. Reg. § 1.162-2(d) (1958); Rita M. Callinan, 12 Tax Ct. Mem. 170 (1953); Alexander Silverman, 6 B.T.A. 1328 (1927); Rev. Rul. 60-16, 1960-1 Cum. Bull. 58; Mertens, Law of Federal Income Taxation § 25.08 (1960).

[7] See Int. Rev. Code of 1954, § 262. If the trip is primarily of a personal nature, transportation costs are not deductible, but any expenses incurred for business purposes while at the destination are deductible. Treas. Reg. 1.162-2(b)(1) (1958); Stuetzer Jr., "New Cases on Travel, Education, Help Draw Line Between Personal and Business Deductions," 11 J. Taxation 346 (1959); Chanen, "Business Trips v. Pleasure Trips," 4 Prac. Law. 53 (October 1958). Consequently, Mr. Rudolph should have been allowed a deduc-

> The . . . deduction . . . will depend upon whether there is a sufficient relationship between the taxpayer's trade or business and his attendance at the convention . . . so that he is benefiting or advancing the interests of his trade or business by such attendance.[8]

Whether the cost of the trip is an *ordinary* and *necessary* business expense must be determined from the taxpayer's and not the employer's standpoint.[9] To be *ordinary* a business expense does not have to be habitual or recurring; it may be unique to the taxpayer.[10] However, it must not be unusual or novel in the experience of the community.[11] Admittedly, the term *ordinary business expense* is vague; its interpretion will depend upon the particular facts and circumstances of each case.[12] An expenditure is *necessary* if it is appropriate, helpful or convenient to the taxpayer's business.[13] However, rarely will the courts question the necessity of an expense by the taxpayer.

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tion for his expenses in attending the business meeting and luncheon, but the court did not consider this. See Patterson v. Thomas, *supra* note 1, where such a deduction was allowed to the taxpayer, although the court decided the trip to the convention was for personal reasons.

[8] Treas. Reg. 1.162-2(d) (1958). See Commissioner v. Flowers, 326 U.S. 465, 470 (1946), where the majority of the Court, in stating one of the conditions to be satisfied before a traveling expense deduction may be taken, said, "The expense must be incurred in pursuit of business. This means that there must be a direct connection between the expenditure and the carrying on of the trade or business of the taxpayer or his employer." See also A. P. Reed, 35 T.C. 199 (1960); O. G. Russel, 11 Tax Ct. Mem. 334 (1952).

If the meetings actually promote the knowledge, skill, and attitude of the taxpayer, and the primary purpose of his trip is business, he should be allowed to deduct the cost of the convention as an ordinary and necessary business expense. Such a situation would be analogous to allowing a taxpayer to deduct educational expenses in order to stay abreast of current developments in his field and thereby better execute and maintain his job. Coughlin v. Commissioner, 203 F.2d 307 (2d Cir. 1953). However, if the educational expenditures are made for the purpose of obtaining a promotion or a new job, they will be disallowed as business expenses. See Treas. Reg. 1.162-5(b) (1958).

[9] For example, to increase their spirits and efficiency, an employer may give his salesmen an all-expense-paid vacation. The expense will be deductible to the employer [if it is not an unreasonable allowance of compensation under Int. Rev. Code of 1954, § 162(a)(1)] because such a vacation advances the interests of his trade or business. However, the employee must treat the vacation as income and will not be allowed a deduction, since the purpose of the trip for him is personal and not related to business.

[10] Deputy v. DuPont, 308 U.S. 488 (1939); Welch v. Helvering, 290 U.S. 111 (1933); Kornhauser v. United States, 276 U.S. 145 (1928).

[11] Lilly v. Commissioner, 343 U.S. 90 (1952).

[12] The Supreme Court, in determining what is an ordinary business expense, in Welch v. Helvering, *supra* note 10, at 115, said, ". . . the decisive distinctions are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." For an array of cases dealing with the question of whether an expense is ordinary, see 4 Mertens, *op. cit. supra* note 6, at § 25.09.

[13] Welch v. Helvering, *supra* note 10; 4 Mertens, *op. cit. supra* note 6, at § 25.09.

In determining if the taxpayer's trip was primarily for business or of a personal nature, the court of appeals in *Patterson v. Thomas*,[14] the case upon which the majority of the court in the principal case relied, considered the following:

(1) The amount of time devoted to business compared with the time spent for social activities;[15]

(2) The place where the convention was held;[16]

(3) The sponsor of the convention;[17]

(4) The attitude of the employer.[18]

Deciding against the taxpayer on these factors, the majority of the court in the principal case held that the expenditures were personal expenses and could not be deducted as ordinary and necessary business expenses.

Basing his conclusion on one additional factor, that Mr. Rudolph was required by his employer to attend the convention even though the command was in the form of an invitation,[19] Justice Brown vigorously dissented. The

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[14] *Supra* note 1.

[15] As stated, in the principal case a morning and a luncheon out of a five or six day trip were devoted to business. The taxpayer argued in Patterson v. Thomas, *supra* note 1, that much of his free time was spent in talking to company officials and other salesmen who gave him information on improving his abilities. In answer to this issue, the majority of the court replied that if it were not for the other factors in the case (*infra* notes 16, 17, and 18), the decision would have been more difficult.

The Treas. Reg. 1.162-2(b)(2) (1958) lists only one factor in determining if a trip is primarily personal: the proportion of time devoted to business activities. Yet, the Regulation recognizes that this factor is not conclusive, for it says the question depends on the facts and circumstances in each case. See Stuetzer Jr., *supra* note 7, at 347.

[16] The convention was held in New York, while in Patterson v. Thomas, *supra* note 1, it was held at a Virginia resort hotel. In both cases the conventions were in states where the employers did no business. If their primary purpose were business, such as the education of the salesmen, the gatherings apparently could have been held nearer to the companies' home offices, and not at such distant places. The fact that the conventions were conducted at popular vacation spots made them appear to be pleasure trips—indeed, bonuses given by the companies to their employees. See IR-Circ. No. 57-85, June 20, 1957, 575 CCH ¶ 6585.

[17] The convention was sponsored by the taxpayer's employer, and the only participants in it were the company's employees. In addition, the taxpayer qualified to attend by selling a required amount of insurance. These facts make the convention appear to be really a form of remuneration.

[18] The attitude of the employer was not elaborated upon in the principal case (probably because the court wrote only a *per curiam* opinion), but it can be speculated that it was similar to the viewpoint of the employer in Patterson v. Thomas, *supra* note 1. In the latter case, letters sent by the vice-president of the company to the manager of the hotel were examined by the court. On such letter read, ". . . business is secondary. The main object is to give our people a good time." This indicates that the company regarded the trip as a bonus to its employees.

[19] Rudolph v. United States, *supra* note 1, at 843: "[The company's] vice-president, after stating that an agent indicating he would not attend was required to give an explanation, testified that 'if he [the agent] doesn't have a proper reason it would be

dissenting justice felt that an employee of a large corporation is an "organization man."

> Every waking hour the company's needs, the company's business, the company's welfare is drummed into this person whose inner satisfactions are likewise finally warped into the corporation image through status symbols of job assignments, titles, and prerogatives. . . . [T]he decision to go was compelled . . . as a matter of business necessity. It is a pressure which people every day, everywhere in America now undergo. It is ordinary in all and the worst senses.[20]

Because the man had to go or suffer a loss of prestige, perhaps his chance of promotion, or even his job, Justice Brown felt this was an ordinary and necessary business expense.[21]

Granted that the invitation to the convention was a command, should this fact make the expense deductible? Because the taxpayer was required to attend, it would seem that the expenditures were "ordinary and necessary." Yet, to deduct the cost of the trip, the expenditures must also directly advance the interests of the taxpayer's business.[22] Justice Brown was satisfied when he found the expenses were ordinary and necessary, but he overlooked the fact that there was not a sufficient relationship between the taxpayer's attendance at the convention and his business. Actually the only connection between the trip and the taxpayer's business (other than the few hours spent in business meetings) was that the employer required his employees to attend.

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looked upon with displeasure.'" Similar testimony was given by the president of the insurance company in Patterson v. Thomas, *supra* note 1.

[20] Patterson v. Thomas, *supra* note 1, at 117 and 118. See the remark by Bittker, Federal Income Estate and Gift Taxation, p. 40 (2d ed. 1961 Supp.), where he says, "The dissenting judge, though evidently not much of an organization man himself, did not discuss whether the deduction should have been disallowed on the ground that the system contravened public policy, perhaps because he found it to be (in Justice Brown's words) 'as American as Bedloe's Island, hot dogs, Grand Canyon, Rhapsody in Blue, Chautauqua, P.T.A., Golden Gate, Rose Bowl or Wagon Train.'"

[21] Justice Brown felt that the wife's expenses should also be deductible because the company expected the insurance agent to bring his wife with him. ". . . when the employer beckons, the wife must respond." Patterson v. Thomas, *supra* note 1, at 120. In addition, he felt attendance by the wife would provide her with vital information of the company and her husband's business.

For two reasons, it would seem that the majority of the court was correct in not allowing her expenses to be deducted. First, only the husband, not his spouse, could deduct the latter's expenses, since she was not engaged in a trade or business under Int. Rev. Code of 1954, § 162(a). Therefore, when the court disallowed the man's expenditures, it followed that his wife's could not be included as a business expense. Secondly, even if the husband's costs were allowed as a deduction, her expenses should have been disallowed because her presence served no bona fide business purpose. See Treas. Reg. 1.162-2(c) (1958); Ralph E. Duncan, 30 T.C. 386 (1958); Cornelius Vanderbilt, Jr., 16 Tax Ct. Mem. 1081 (1957); Sax, "A Wife's Traveling Expenses," 37 Taxes 595 (1959).

[22] Treas. Reg. 1.162-1(a) (1958); Treas. Reg. 1.162-2(d) (1958); Commissioner v. Flowers, *supra* note 8.

Certainly this remote connection does not sufficiently prove that the primary purpose of the trip was business rather than pleasure.

If mandatory attendance at the convention is significant at all, it seemingly is more important in determining whether the taxpayer should be required to include the cost as *income* in the first place. Although the court held that the trip was income, this may now appear unjust because of the lack of choice the taxpayer had in making the trip. He may have had no desire to vacation in New York City; perhaps he was saving money for a holiday elsewhere. But because of the court's decision, his cash reserves or savings may have to be spent in taxes to pay for his forced compensation. Normally, a person who receives a non-cash benefit, such as property, can sell or trade it. Thus, the inclusion as income seems justified. However, the fact that this taxpayer received a benefit in such a form that it could not be resold and that the resulting tax must come out of other assets, did not influence the court's decision.[23]

By itself, however, the commanded appearance by an employer 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 non-taxable bonus, would be to require them to attend a city or resort area under the pretext that it is for a business convention. This would provide yet another loophole in business expense deductions.[24] In the area of traveling, entertainment, and convention expenses, the Government has lost revenue because many taxpayers have devised means of writing off personal expenses as business expenses. In the last few years, the President,[25] the Secretary of the Treasury,[26] and officials of the Internal Revenue[27] have spoken increasingly

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[23] *Accord*, United States v. Drescher, *supra* note 2. But see Eisner v. Macomber, 252 U.S. 189, 213 (1920) where Justice Pitney, in deciding that stock dividends were not income under the sixteenth amendment of the Constitution, stated, "Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock."

The taxpayer in the Patterson case, *supra* note 1, at 111, argued that the "sums [paid by the company] come within the rule of Corliss v. Bowers, 281 U.S. 376 (1930), and are not income to him since he had no 'command' over them and was not free to expend them in any manner he saw fit." The court answered that a benefit in a form other than cash may be classified as income.

[24] The remarks of Justice Van Oosterhout, when determining whether a certain type of expenditure was a business expense, are appropriate: "An allowance of this type would open the door to many questionable deductions. Such a deduction should be allowed, if at all, only upon a clear showing that an item of necessary and ordinary business expense has been proved." Greenspon v. Commissioner, 229 F.2d 947, 955 (8th Cir. 1956).

[25] 107 Cong. Rec. 5992 (H. Doc. No. 140, 87 Cong.).

[26] House Ways and Means Committee, H. Doc. No. 140, 87th Cong., 1st sess. (1961).

[27] IR-Circ. No. 57-85, June 20, 1957, 575 CCH ¶ 6585. This publication deals with deductions of personal trips to cities and resorts under the guise of business trips. Rev. Rul. 59-316, 1959-2 Cum. Bull. 57; Rev. Rul. 60-16, 1960-1 Cum. Bull. 58; I.R.S. News Rel. No. IR-394, August 3, 1961, 617 CCH ¶ 6487.

on the many abuses that have developed through the use of the expense account. Certainly the present decision goes a long way in preventing personal expenses from being taken as ordinary and necessary business expenses. The line is now more clearly drawn between a convention trip for business and one for pleasure purposes.[28]

[28] See also A. P. Reed, *supra* note 8, another recent decision denying the taxpayer convention expenses because the trip was of a personal nature.