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TAXATION-FEDERAL INCOME TAX-LIMITED DEDUCTIBILITY OF ENTERTAINMENT EXPENSES

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TAXATION—FEDERAL INCOME TAX—LIMITED DEDUCTIBILITY OF ENTERTAINMENT EXPENSES—In the sophisticated commercial world of today there are many expenses that might be termed of a "mixed complexion," having elements of both a business and non-business character. Nowhere is this better exemplified than in the area of entertainment expenses. Though one may assume that it should be the policy of the courts to allow full and fair deduction of business expenses in general, many difficulties arise regarding expenditures for entertainment purposes. In virtually all entertainment there is personal enjoyment of a social nature by the taxpayer as well as potential business value. Furthermore, what business value there is will often be of an intangible nature; it is difficult for a businessman to point to a specific transaction and say this is the result of taking John Doe out to dinner. In addition, most of the evidence of the purpose of the expenditure will of necessity come from the taxpayer, who is probably inclined to overemphasize the business need for the expenditure. Thus, even if the courts would not generally follow a doctrine that deductions are a matter of legislative grace,[1] the question of what

[1] Interstate Transit Lines v. Commissioner, 319 U.S. 590 at 593, 63 S.Ct. 997 (1943). However, see Lykes v. United States, 343 U.S. 118 at 120, n. 4, 72 S.Ct. 585 (1952), in which Justice Burton states that the legislative grace doctrine interpretation "is not necessary here and is not relied on in this case." The footnote included a citation to Professor

are legitimate entertainment expenses must nevertheless be narrowly construed because of these peculiar factors.

The courts have been struggling with this problem for years, their most effective weapon being the *Cohan* rule,[2] which gives the element of flexibility necessary to meet each new situation confronting a court by allowing as close an approximation as possible of the amount of deductible entertainment expenses where evidence is inexact as to the actual amount. The court may bear heavily upon the taxpayer in making this approximation.[3] However, in the recent decision of *Richard A. Sutter*,[4] the Tax Court set forth a doctrine of partial deductibility to limit further the deduction of entertainment expenses. It will be the plan of this comment to examine the *Sutter* doctrine and then look at the law as it stands after the *Sutter* case. In addition, the treatment of these matters under British law will be compared as an aid in evaluating the law as it should be.

I. *The Sutter Doctrine*

Richard A. Sutter was a doctor practicing industrial medicine. His clients were industrial and commercial organizations, which employed persons who were patients of Sutter, and insurance companies insuring such organizations. It was not the nature of the taxpayer's practice to secure these or other patients directly or via referrals from other doctors. The central issue as phrased by the court was:

> "When a taxpayer in the course of supplying food or entertainment or making other outlays customarily regarded as ordinary and necessary includes an amount attributable to himself or his family, such as the payment for his own meals, is that portion of the expenditure an ordinary and necessary business expense on the one hand or a nondeductible personal item on the other?"[5]

The court held that there is a presumption that such items by their nature are not deductible, because they are personal expenses

Griswold's note, "An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace," 56 HARV. L. REV. 1142 (1943). The writer in 20 UNIV. CHI. L. REV. 247 at 262 (1953), concludes: "The fairness rule would seem to accord more nearly than the doctrine of legislative grace with the intent of Congress to tax only net income." For an implied argument that the Lykes case represents no change in the legislative grace doctrine, see 5 VANDERBILT L. REV. 847 at 849 (1952).

[2] Cohan v. Commissioner, (2d Cir. 1930) 39 F. (2d) 540.

[3] In general see Gluck, "How Cohan Works," 6 RUTGERS L. REV. 375 (1952).

[4] 21 T.C. No. 20 (1953).

[5] Id. at p. 3.

under section 24(a)(1) of the Internal Revenue Code, and that the presumption is rebuttable only by clear evidence showing that the expenditure was different from or in excess of what would have been made for the taxpayer's personal purposes. In other words, if a taxpayer desires to entertain a business acquaintance and his wife for business purposes and feels that it would further the business purpose to have his own wife present, the cost of the meals for the two guests is fully deductible, but the cost of the food for the taxpayer and his wife is deductible only to the extent it exceeds what would have been spent had the taxpayer and his wife remained at home.

This is not necessarily a radically new approach. An inkling of the view taken by the Tax Court in the *Sutter* case appeared in *Eugene H. Lorenz*,[6] a 1949 memorandum decision. Although Lorenz was a certified public accountant as well as a lawyer he kept no records of amounts expended to entertain clients, and the deduction of these amounts was denied because of lack of proof. The opinion went on to say by way of dictum: "It is not shown to what extent they [the claimed expenses] included the cost of petitioner's own meals and entertainment which would not, if separable, be deductible under any circumstances."[7]

Although the philosophy underlying the *Sutter* doctrine seems fair and equitable, there are manifold problems that would be involved in its administration. For instance, how can it be shown what the taxpayer and his wife would have eaten had they not entertained; would they have had steak that night, or hamburger? Suppose the taxpayer has several children who will have to eat at home anyway; the marginal value of two additional servings for the taxpayer and his wife would be rather small as well as hard to prove. Of course, the bureau might adopt a rule permitting the deduction of the amount spent in excess of the average normal expenditure. This is akin to a policy adopted in 1920 with regard to travel expenses which allowed the deduction of excess expenditures.[8] After January 1, 1921, in order to deduct any traveling expenses for meals and lodging, the taxpayer had to support the claim with a table of normal expenditures. This included a showing of "average monthly expense incident to meals and lodging for the entire family, including the taxpayer himself when at home; average monthly expense incident to meals and lodging when at home if taxpayer has no family; total

[6] 8 T.C.M. 720 (1949).
[7] Id. at 721.
[8] T.D. 3101, 3 Cum. Bul. 191 (1920).

amount of expenses incident to meals and lodging while traveling on business and claimed as a deduction. . . ."[9] A more complex system of deductions could hardly be imagined. Fortunately, the change in the law permitting the deduction of the "entire" amount saved the Treasury Department much work and the American taxpayer much anguish. It is appropriate here to note the reference to this change by Justice Rutledge in his dissent in the *Flowers* case, where he declared: "Congress has revised Section 23 once to overcome niggardly construction. It should not have to do so again."[10]

If the *Sutter* doctrine is to be applied in its full ramifications in future cases, with no change in the statute, there will be manifold problems of evidentiary proof. Coupled with the difficulty and cost of administering such a rule, this would seem to make *Sutter* less than an ideal solution to the problems presented by entertainment expenses. In addition, the doctrine does not have the flexibility necessary to meet these problems of mixed personal-business complexion. However, the *Sutter* case today is law; with this in mind, the development of other case law in the labyrinth of entertainment expenses will be examined.

II. *The American Cases*

Underlying every decision in the entertainment expense realm are the competing considerations of sections 24(a)(1) and 23(a)(1)(A) of the Internal Revenue Code—the former denying deductions for "personal expenses" and the latter allowing deductions for "ordinary and necessary" business expenses. Businessmen maintain entertainment is often done for purposes similar to those of advertising. Indeed, the analogy to advertising expense is a cogent argument for deduction. On the other hand, whenever advertising expenses are incurred, there are few of the personal elements present which are prevalent in entertaining. Apart from the argument that these expenses are of a personal nature, it could be said that commercial entertainment is frequently a form of goodwill expenditure and should be capitalized rather than deducted.[11] It is also to be noted that in many respects social status and social obligations complicate the picture. Thus we have the additional problem of the line between "status" income and expenses and legitimate business deductions.[12]

[9] Ibid.

[10] Commissioner v. Flowers, 326 U.S. 465 at 480, 66 S.Ct. 250 (1946).

[11] A. M. Oliver, 1 T.C.M. 8 (1942). See George W. Caswell Co., 14 B.T.A. 15 (1928); Reginald Denny, 33 B.T.A. 738 (1935).

[12] See SURREY AND WARREN, FEDERAL INCOME TAXATION 88 (1953).

A. *General Tests of Deductibility.* In attempting to gain deduction for entertainment expenses, the taxpayer is immediately confronted with the "ordinary" and "necessary" tests of section 23(a)(1)(A). In *Blackmer v. Commissioner*,[13] an actor claimed deduction for theater tickets, lunches, suppers, and various parties given newspapermen and those in the entertainment field in order to enhance his reputation and aid in securing engagements. The court said that these expenditures "tended to promote his popularity and thereby to increase his income from that business. The expenses were therefore ordinary and necessary expenses."[14] In further clarification the court interpreted "necessary" as "appropriate" and "helpful." The true "ordinary" character of the expenses undoubtedly stemmed from the finding that in the theatrical business this type of entertaining was "customary." However, even with this seemingly lenient criterion, the taxpayer did not gain complete deductibility because of the inexactitude of his computation; the *Cohan* rule was applied.[15]

In addition to the "ordinary" and "necessary" standards, a clear showing of business purpose is necessary, and the burden of proof is on the taxpayer.[16] If entertainment is of a mixed complexion in a series of expenditures, deduction will not be allowed unless there is a segregation of the amount and purpose of these expenses as between business and personal.[17] Memoranda supporting the expenditures are helpful in gaining deductibility.[18] The argument that a court should take judicial notice of the business purpose or the necessity in the taxpayer's business or profession of occasionally entertaining clients or others has met with little success.[19]

Recent cases have shown a tendency to emphasize more and more the idea that proof must be presented to "show that such expenditures had a direct relation to the conduct of a business or the business benefits expected."[20] There seems to be a positive correlation between the emphasis on the idea of directness and the increasing number of deduction claims where both personal and business elements are pres-

[13] (2d Cir. 1934) 70 F. (2d) 255.

[14] Id. at 257.

[15] See annotation, 92 A.L.R. 985 (1934).

[16] Nathaniel J. Hess, 24 B.T.A. 475 (1931); N. H. Van Sicklen, Jr., 33 B.T.A. 544 (1935).

[17] N. H. Van Sicklen, Jr., 33 B.T.A. 544 (1935).

[18] James F. Coleman, 3 B.T.A. 835 (1926). Although this was a somewhat terse opinion, the fact that there was a memo book was by implication important.

[19] Eugene H. Lorenz, 8 T.C.M. 720 (1949) (the taxpayer was a lawyer and certified public accountant).

[20] Louis Boehm, 35 B.T.A. 1106 at 1107 (1937). See also Kenneth Blanchard, 12 T.C.M. 550 (1953).

ent. It has been argued that this additional requirement is unfair and that once the hard burden of showing the expenses as ordinary and necessary has been met, the courts should be liberal in allowing full deductibility.[21] However, in rebuttal it can be said that courts must of necessity be cautious where there are attempts to charge off items like trips to the Kentucky Derby and fishing expeditions on which the taxpayer is admittedly accompanied by friends,[22] or contributions by a corporation to the wedding of the daughter of its majority stockholder.[23] Regardless of which argument one prefers, the fact remains that the element of direct relationship to business purpose has become an important peg on which the Tax Court has been hanging many decisions.[24]

B. *Deductions by Individuals: Factors of Reimbursement and Required Duties.* The early cases in the entertainment expense area were fairly liberal in allowing full deductibility, especially with regard to salesmen[25] and corporations.[26] However, even at an early date salesmen had a difficult time deducting entertainment expenses if they were not reimbursed by their employer.[27] The factor of reimbursement is even more important to corporation executives and employees,[28] the courts here generally being very strict about this requirement.[29]

[21] See Johnson v. United States, (D.C. Cal. 1941) 45 F. Supp. 377, revd. on other grounds (9th Cir. 1943) 135 F. (2d) 125.

[22] Maurice E. Harvey, 12 T.C.M. 1358 (1953). The taxpayer also tried to deduct the expense of trips to the Mardi Gras and to the Sugar Bowl football game, along with various other items.

[23] Haverhill Shoe Novelty Co., 15 T.C. 517 (1950).

[24] Promotional expenses of a doctor were disallowed where there was failure to prove the relationship of the expenses to the doctor's business. The court required more than general statements that the taxpayer expected he would benefit by this. Bernard L. Shackleford, 7 T.C.M. 694 (1948).

[25] Wadsworth's Appeal, 1 B.T.A. 1043 (1925). The taxpayer was factor and salesman in his own business of paper and paper products. The entire amount expended by him was held deductible, with no diminution because part of it might have been for personal pleasure.

[26] See Hartford Hat & Cap Co., 7 B.T.A. 714 (1927), in which cigars and cigarettes given to customers to foster "good feeling," making the path easier for salesmen, were deductible expenses for the corporation.

[27] In Coleman's Appeal, 3 B.T.A. 835 (1926), a traveling salesman was allowed to deduct expenses for entertaining customers and prospective customers, although he was not specifically reimbursed for this; however, he was reimbursed for his traveling expenses. A similar situation was involved in Cooper's Appeal, 1 B.T.A. 615 (1925), except that there the salesman was not reimbursed even for his traveling expenses; deduction of entertainment expenses was disallowed.

[28] See Treas. Reg. 118, §39.22(n)-1(f).

[29] A 1926 case, M. Parish-Watson's Appeal, 3 B.T.A. 840 (1926), upheld the deducting of non-reimbursed expenditures made by a taxpayer while engaged in selling for other companies, the taxpayer being president of his own retail sales corporation.

For instance, in *Chivers' Appeal*[30] an employee of a newspaper was not allowed to deduct the expense of operating an automobile used for the convenience of visitors to the city as a means of entertaining them and increasing the goodwill of the employer newspaper corporation.

The problem of entertainment expenses by governmental employees deserves special mention, because there is seldom any reimbursement for their entertaining. In *Commissioner v. Motch*,[31] the entertainment by an army officer of persons with whom he transacted government business was held to be part of "gracious living" and not ordinary and necessary business expenses.[32] On the other hand, an earlier decision in the case of *John J. Ide*[33] reached a contrary result based largely on the intent of the taxpayer in making the expenditures. Ide served in Paris in a capacity similar to that of a military attaché; he was not required to entertain, nor was he reimbursed by the government for money spent in entertaining. But the court upheld the deduction in the particular factual situation, because in incurring the expenses Ide thought he would help get the results the government desired. A similar result was also reached in a case involving the Governor of American Samoa.[34] There the taxpayer's entertainment expenses were held a necessary expense incident to his position and deductible, since he might have been reprimanded for not having extended official courtesy to official visitors.[35]

Where there is no reimbursement, an individual taxpayer is not completely foreclosed from obtaining a deduction, if he can show that the expenses were made in pursuit of or as part of his required duties. In *Schmidlapp v. Commissioner*[36] the taxpayer, a bank vice-president, claimed it was expected that as part of his duties he would entertain visitors whose favor the bank desired. The Second Circuit held that these were "ordinary and necessary expenses incurred in carrying on his business," even though it was for the benefit of the bank. The rationale was that though this was for the benefit of the bank, so were all of the other services of the taxpayer; thus the ex-

[30] 4 B.T.A. 1083 (1926).

[31] (6th Cir. 1950) 180 F. (2d) 859.

[32] See 49 MICH. L. REV. 295 (1950), in which there is criticism of the court for adopting too narrow a view of "trade or business." However, see I.T. 4012, 1950-1 Cum. Bul. 33.

[33] 43 B.T.A. 799 (1941).

[34] Edwin T. Pollock, 10 B.T.A. 1297 (1928).

[35] The petitioner was a naval officer and his only compensation was naval pay. See also Howard Veit, 8 T.C.M. 919 (1949).

[36] (2d Cir. 1938) 96 F. (2d) 680.

penses were deductible as a necessary expense, if there was an understanding that this was a part of the taxpayer's bank duties. The required duty criterion resulted in a seemingly unfair decision in *Franklin M. Magill.*[37] In that case the sum spent by the taxpayer, a corporation executive, for the rental of a room in an athletic club that was used "strictly" for purposes of business in entertaining customers and employees of the firm was not deductible, where there was no showing that the taxpayer's compensation was fixed with the idea that he should be required to make such a rental. The court stated:

> "In the absence of an agreement, such expenses should be adjusted between the employer and the employee. The employee cannot take advantage of the Federal tax law for the purpose of correcting the omissions occurring in his arrangements with his employer."[38]

The fact that the corporation may be wholly owned is of no consequence with regard to the criteria of reimbursement and required duties.[39]

C. *Deductions by Corporations and Other Businesses: Amount Deductible, Custom, Proportion of Expense, and Business Necessity.* The corporation for whose benefit the entertaining is done usually has less difficulty in obtaining a deduction, but there should be more than just a showing of the general purpose of the expenses in order to have them deductible.[40] In *Plymouth Brewing and Malting Co.*[41] expenses incurred by the president of a corporation in the ordinary and necessary entertainment of customers, incident to sales of the corporation, were deductible by the corporation, notwithstanding the fact that there was no detailed accounting of the expenses shown. However, the court said that the amount "actually expended" exceeded the amount claimed.[42]

The custom of the trade will influence the decision also, and if the business in which the taxpayer engages requires such expenditures to meet competition, this will be an important factor favoring deduction.[43] However, there is a limitation with respect to public

[37] 4 B.T.A. 272 (1926).

[38] Id. at 273.

[39] Hal E. Roach, 20 B.T.A. 919 (1930).

[40] Bonwit Teller & Co. v. Commissioner, (2d Cir. 1931) 53 F. (2d) 381, cert. den. 284 U.S. 690, 52 S.Ct. 266 (1932).

[41] 16 B.T.A. 123 (1929).

[42] See also Eitingon-Schild Co., 21 B.T.A. 1163 (1931).

[43] Entertainment expenses, including theater tickets, clothing, and outright cash payments have been held deductible as ordinary and necessary, where such expenses were

policy: purchase of bootleg whiskey contrary to federal law has been held to make an expenditure not deductible.[44] And in *Raymond F. Flanagan*[45] the taxpayer, a salesman of slag and other materials, could not deduct expenses for entertaining public officials where seventy-five percent of his sales were to political subdivisions, even if there were no express provisions of the law involved and even if all of his competitors did similar entertaining. This result was reached in the face of the petitioner's testimony that if he discontinued entertainment, he "would be crucified" and "looked upon as a nonentity." Of course, should the court desire to avoid the possible effect of the *Lilly* doctrine[46] that deduction of ordinary and necessary business expenses is not prohibited simply on the grounds that they violate or frustrate public policy, there is authority that entertainment expenses contrary to public policy are not "ordinary and necessary" to the taxpayer's business.[47] The soundness of this approach can be questioned.

The relation of the amount spent by the company to its purchases or sales is another cogent factor in determining deductibility.[48] This will also bear on how much an individual can deduct; there should be some rational proportion between an individual's entertainment expenses and his income.[49] In addition, the capacity of the taxpayer to expand his business reflects on the legitimacy of the deduction and its business purpose.[50]

customary in the business in which the taxpayer engaged (the wholesale liquor business). The Adler Co., 10 B.T.A. 849 (1928). See also, McQuade's Appeal, 4 B.T.A. 837 (1926), where the taxpayer, also a wholesale liquor dealer, took tickets "off the hands" of retailers who were obliged to buy such tickets as a matter of goodwill for various entertainments. The court found as a fact that it was the practice of wholesale dealers in the liquor trade to do this "in order to keep in their [retailers] good graces" and allowed the deduction. *Contra,* I.T. 2135, IV-1 Cum. Bul. 32 (1925).

[44] The Lorraine Corp., 33 B.T.A. 1158 (1936).

[45] 47 B.T.A. 782 (1942). However, see A. R. Losh, 1 T.C. 1019 (1943).

[46] Lilly v. Commissioner, 343 U.S. 90, 72 S.Ct. 497 (1952).

[47] A. M. Oliver, 1 T.C.M. 8 (1942) (a lawyer was denied deductibility for expenses arising out of entertaining police officers, doctors, and witnesses in connection with forthcoming trials).

[48] See Rodgers Dairy Co., 14 T.C. 66 (1950).

[49] Penn v. Robertson, (D.C. N.C. 1939) 29 F. Supp. 386, affd. (4th Cir. 1940) 115 F. (2d) 167 ($14,725 allowed for travel and entertainment where income was $372,654.29); Benjamin Abraham, 9 T.C. 222 (1947) ($500 allowed to a taxpayer earning $28,000).

[50] James Schulz, 16 T.C. 401 (1951). The taxpayer, a manufacturer and importer of fine watches and jewelry, made expenditures at a time when he had "more business than he could handle." It seems, however, that this in itself should not be controlling; often advertising allotments are made when an enterprise has a large backlog of orders. E.g., consider the automobile business immediately after World War II. But in the Schulz case, much of the expense related to social evenings with little to show that the gathering was primarily for a business purpose.

"Business necessity" has been held to be a controlling element as recently as 1952 in the *Fisher* case.[51] The court there reasoned that in the taxpayer's business as a security salesman, one had to entertain since " . . . one block of United States Steel shares has little to distinguish it from a like block of shares presented by another salesman."[52] *Welch v. Helvering*[53] has been cited for the proposition that "norms of conduct" should be used in judging whether an expense is "ordinary."[54] In some situations even the expense of operating a yacht is deductible where almost exclusive business use and value can be shown.[55] On the other hand, the Commissioner has asserted that where a corporation has a yacht that is used by an officer for personal pleasure, the officer constructively receives income equivalent to at least part of the expenses the corporation paid in operating the yacht.[56] This contention was unsuccessful in 1930, but it might very well be otherwise today. In any case, it does point up the problem of trying to draw the line with regard to fringe benefits.

D. *Entertaining of Employees.* As a general statement it can be said that expenses for entertaining employees are deductible, but there should be a showing of a "direct" business benefit. In this context, the interpretation of what is "direct" has been liberal. Obtaining club membership for a company officer in order to gain access to picnic grounds for an annual employee's picnic with the purpose of "stimulating the interest, morale, and good fellowship" of the company's employees has been held a direct business benefit.[57] The cost of holding dances for employees in conjunction with a system of weekly prizes for those departments which showed the greatest increase in sales volume over the corresponding week of the previous year has also been held to be deductible.[58] The fact that entertaining

[51] Estate of Edwin Raymond Fisher, 11 T.C.M. 607 (1952).

[52] Id. at 610. The merit of such an argument seems tenuous at best; the implication is that the more distinguishable one's merchandise is, the less one should be able to deduct expenses for entertainment.

[53] 290 U.S. 111, 54 S.Ct. 8 (1933).

[54] See F. L. Bateman, 34 B.T.A. 351 (1936), involving the tipping and entertaining of railroad traffic agents by the taxpayer, who engaged in a freight forwarding business. This case has also been cited as suggesting that the reputation of the taxpayer might affect the outcome of the case. 4 MERTENS, FEDERAL INCOME TAXATION 469, n. 88 (1942).

[55] E. E. Dickinson, 8 B.T.A. 722 (1927).

[56] Hal E. Roach, 20 B.T.A. 919 (1930).

[57] Harry A. Koch Co., 23 B.T.A. 161 (1931).

[58] Popular Dry Goods Co., 6 B.T.A. 78 (1927). The idea of the dances was to have all employees benefit, including those who had not gotten the weekly prizes for increased sales volume.

employees may provide advertising as a by-product will enhance the chances of deduction.[59]

Where an individual desires to entertain those working under him, deduction is somewhat more difficult because of problems of non-reimbursement and questions of whether such expenditures are a required part of the person's duties. However, a very recent case allowed a district sales manager to deduct expenses of entertaining the salesmen working under him upon whom his bonus and the general success of the selling depended, although the expenses were made on the manager's own initiative and were neither required nor reimbursed by his employer.[60] But such non-reimbursed expenses are not deductible for adjusted gross purposes, since they are not "trade or business" deductions and the absence of reimbursement prevents these expenses from being categorized as "in connection with employment."[61]

E. *Club Dues and Expenses.* Although clubs may form a convenient means of entertaining business friends, it is obvious that there is normally a large personal element involved in taking out club memberships and in using club facilities. Thus, it seems only fair that the burden of proving these to be business expenses should be on the taxpayer.[62] Deductibility of membership costs depends in large part on the original purpose in taking out the membership and the extent of business use.[63] One cannot meet the burden by saying that in general club memberships are helpful in obtaining clients; rather, there must be a "direct" relation between the initial and subsequent expenses of club membership and the conduct of the business or the expected business benefits.[64] The nature of the business does not make such expenses deductible per se, especially where there is

[59] H. H. Bowman, 16 B.T.A. 1157 (1929). See I.T. 2529, IX-1 Cum. Bul. 298 (1930).

[60] Harold A. Christensen, 17 T.C. 1456 (1952). *Contra,* Harry Boverman, 10 T.C. 476 (1948). In the latter case the taxpayer was an assistant manager of a branch insurance agency; prizes to agents and gifts to prospective clients were forbidden by the taxpayer's contract.

[61] I.T. 3728, 1945 Cum. Bul. 78; I.R.C., §22(n).

[62] For an accountant's summary, see "Social Club Dues and Expenses," 31 TAXES 69 (1953).

[63] Norman M. Hussey, 11 T.C.M. 141 (1952). The taxpayer, a lawyer, left a firm and opened his own law office. He joined a golf club and claimed that this was primarily for the purpose of furthering his law practice. It was held that business gain was the "primary" motive and the Cohan rule was applied, allowing deduction of approximately two-thirds of the amount claimed.

[64] Louis Boehm, 35 B.T.A. 1106 (1937).

also personal use of club facilities.[65] Nor does the fact that the corporation pays the dues of its officers to various clubs make such payment automatically deductible as an entertainment expense, though if not so allowed it would seem deductible by the corporation as compensation paid.[66] Exclusive business use of club facilities, of course, will make the expenses deductible as business entertainment.[67]

An example of the kind of proof required is found in *Johnson v. United States*,[68] in which the petitioner, a lawyer, maintained that when he joined his golf club he had one client, and that every time he went out to the club he had ulterior motives to "become friendly" with particular persons who might be prospective clients. He also said that he did not like to play golf because he felt he should be working at the office and further testified: "What success I have had in the legal business has been largely due to my joining the country club."[69] Deduction was allowed, with the court saying that the government had received high taxes on the fees the taxpayer got as a direct result of the golf club expenditures and that to deny deductibility would "revive the fable of the goose and the golden egg."[70] It is doubtful whether one would have to go to the extreme of taxpayer Johnson in order to win his case, but proof of a substantial nature is, and should be, a prerequisite.

F. *Entertaining in One's Home.* When entertaining is done in the home, problems of what is expended for business purposes as distinguished from what is spent for social entertainment are most difficult; the *Sutter* doctrine would be especially applicable here. Nowhere are the results of such expenditures more intangible, since there is usually no specific business transaction involved, and nowhere is the case for allowing deduction of entertainment expenses weaker, because most entertaining in the home is for non-business reasons. The court will strictly require a showing of a "direct" connection between the expenses and the taxpayer's business.[71] If the individual

[65] Walter J. Munro, 19 B.T.A. 71 (1930). The petitioner was in the investment banking business; there was insufficient proof of the business purpose of the expenses.

[66] Home Guaranty Abstract Co., 8 T.C. 617 (1947). In this case there was indefiniteness of proof of the primary business purpose in joining the club and there was no showing of any business that arose from such joining or any other "direct" results. It might be asked, if this is not an entertainment expense of the corporation, is it income to the executive? Probably, yes.

[67] Charles S. Guggenheimer, 18 T.C. 81 (1952).

[68] (D.C. Cal. 1941) 45 F. Supp. 377, rev. on other grounds (9th Cir. 1943) 135 F. (2d) 125.

[69] Id. at 380.

[70] Ibid.

[71] Reginald Denny, 33 B.T.A. 738 (1935).

involved is an officer of a corporation and has been directly paid to make these expenditures, he will have an easier time gaining deductibility.[72] But even the corporation itself cannot deduct these payments where there is insufficient evidence to allocate properly the amount spent for business purposes by one of its officers.[73] This is especially important where such items as expenses for extra food and servants are involved.[74] Although the courts recognize that expenses for entertaining in one's home may be deductible, tight limits are necessary to prevent abuses. For instance, one cannot claim a deduction for added rental in moving to a "more fashionable address" to "properly entertain wealthy customers," even if one deals almost exclusively with such customers.[75] Claims of this nature show why the Tax Court is rather skeptical of expenditures in the taxpayer's home and why there is a differentiation between entertaining at home and in public.[76] One can be sure that if the deduction is allowed at all, the *Cohan* rule will be stringently applied.

III. *Entertainment Expenses in Great Britain*

The general English statutory rules for deduction are stated negatively:

". . . no sum shall be deducted in respect of—

(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation;

(b) any disbursements or expenses of maintenance of the parties, their families or establishments or any sums expended for any other domestic or private purposes distinct from the purposes of such trade, profession or vocation. . . ."[77]

The "wholly and exclusively" requirement is on its face more strict than the American statutory requirements. In addition, there appears to be no ameliorative *Cohan*-type rule in Great Britain for approximating expenditures.[78] Thus, in the absence of itemization,

[72] Ned Wayburn, 32 B.T.A. 813 (1935).

[73] Walkup Drayage & Warehouse Co., 4 T.C.M. 695 (1945). The common stock of the company was wholly owned by Walkup who was a company officer.

[74] Ibid.

[75] Estate of Edwin Raymond Fisher, 11 T.C.M. 607 (1952), in which the taxpayer had been a salesman of securities.

[76] Reginald Denny, 33 B.T.A. 738 (1935).

[77] Income Tax Act, 1952, 15-16 Geo. VI & 1 Eliz. II, c. 10, §137 (1952).

[78] Bury and Walkers v. Phillips, 32 Eng. Tax Cas. 198 (1951). A deduction of a total of £338 was claimed for entertainment expenses of actual clients or persons closely connected with or accompanying such clients. "Having regard to the fact that the sums

expenses for the general entertainment of clients of a firm of lawyers have been held not "wholly and exclusively" laid out for the purposes of the attorneys' profession.[79] Although English authority is rather limited in this area, there seems to be developing a "dual purpose" doctrine to restrict deductions still further. The basis for this approach is *Bentleys, Stokes & Lawless v. Beeson,*[80] involving the entertainment by a firm of solicitors of their clients at luncheons in social clubs, restaurants, etc. During these luncheons business was discussed and advice was given. Later the clients were charged in the normal way, but the charge did not directly include the cost of the meals, which was paid by the firm. The partners claimed that the practice was one of convenience both for themselves and for their clients, and this claim was upheld. Although there was some element of hospitality inherent in what was done, the sole object of the firm was promotion of its business and therefore the "wholly and exclusively" requirement was met. One of the Crown's arguments was a *Sutter*-doctrine analysis that the amount claimed included the cost of the partners' entertainment. This thesis was held inapplicable on the basis that the entertaining was a "single transaction in which the partners' lunch is an essential ingredient."[81] The court carefully limited its decision to the facts of the case,[82] and there was dictum intimating that where there is a dual purpose to "kill two birds with one stone," e.g., when a lawyer desires to see a friend and also desires to talk business with him, then the expense would not meet the "exclusive" test.[83] This dictum has subsequently been cited as authority for disallowance of expenses where there is a "dual purpose" involved.[84]

IV. *Conclusions*

The complexities of entertainment expenses cannot be dealt with under a rule-of-thumb test that would be both administratively feasible and yet flexible enough to meet the many-faceted situations that arise in this area. Although theoretically the *Sutter* doctrine is fair, it is

claimed are estimated sums and in no way itemized, the Commissioners were perfectly justified in taking the view . . . that the sums claimed were not expended wholly and exclusively for the purpose of the Appellant firm's profession. . . ." Id. at 205.

[79] Ibid.
[80] [1952] 2 All E.R. 82.
[81] Id. at 84.
[82] Id. at 89.
[83] Id. at 85.
[84] Newsom v. Robertson, [1952] 2 All E.R. 728 (travel expenses).

woefully overburdensome in its practical application. There is already an "ordinary and necessary" statutory test, as well as the judicial innovation of requiring a "direct" business purpose. This is enough to curb persons who would otherwise take advantage of allowable business deductions. Even the stringent English "dual purpose" doctrine would not include a *Sutter*-type approach. The English doctrine is otherwise inadequate, however, because it refuses to recognize that the very nature of entertainment expenses includes elements of personal enjoyment and that to deny deduction where there is a "dual purpose" would be nearly equivalent to a complete denial of most legitimate business entertainment expenses.

Another possible approach might be a "but for" doctrine, in which the courts could say that the expense will be deductible, if it would not have been undertaken "but for" the business purpose. However, this would undoubtedly lead to countless situations where the taxpayer once undertaking the expenditure for a business purpose would be rather liberal in including many other items of a social nature.

Perhaps the real answer to this whole problem is that there is no problem at all. The "ordinary," "necessary," and "direct" tests provide the Commissioner with adequate weapons to prevent tax avoidance and the taxpayer with a standard flexible enough to enable him to gain his legitimate business deductions. This latter element is implemented by the court, as arbiter, via the *Cohan* doctrine. Though the *Cohan* doctrine developed in a situation involving the inexact computation of what were admitted to be business expenses, an examination of entertainment expense litigation shows that the greater the personal element in a given case, the more stringently the approximation will be resolved against the taxpayer. The judiciary in this way controls expenditures for personal purposes in situations of mixed complexion. Thus, if there is collateral enjoyment by the taxpayer akin to that in the *Sutter* case, the courts can either look on the matter as a "single transaction" as did the English court in the *Bentleys, Stokes & Lawless* case, or if the personal element is large, the *Cohan* rule can be broadly applied. This is often what has been done in the past; this is what should be continued in the future. The *Sutter* doctrine may be very logical, but the "life of the law has not been logic; it has been experience."[85]

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[85] HOLMES, THE COMMON LAW 1 (1881).