At the Annual Dinner of the Alumni Association, left to right: George E. Hale, JSD'40, the Honorable Samuel B. Epstein, JD'15, Judge of the Superior Court of Cook County, and the Honorable Elmer J. Schnackenberg, JD'12, Judge of the U.S. Court of Appeals for the Seventh Circuit.

The Conservative Taxpayer’s Pocket Guide to Planning for Deduction of Travel and Entertainment Expenses under the Revenue Act of 1962

or

How To Succeed in a Business Deduction Without Really Trying

By Walter J. Blum
Professor of Law, The University of Chicago Law School

Virtually every piece of income tax legislation invites a host of articles on saving taxes. The travel and entertainment expense provisions of the Revenue Act of 1962 undoubtedly will call forth the usual outpouring of professional advice on how to take maximum advantage of the new rules. I have no intention of entering into this competition. Instead I address myself to the conservative taxpayer who wishes to avoid tax controversy at any cost, and only to him do I offer these random bits of speculation and advice.

Two preliminary observations are in order. It should not be necessary to remind even the conservative taxpayer that there is nothing wrong in planning ahead and thoughtfully arranging one’s affairs in the light of tax considerations. At the same time, it is to be hoped that the ingenuity of taxpayers and their advisors will not reach so far as to bring on new legislation and thus spoil a fertile field. All of my remarks are presented in the spirit of these thoughts, and I trust that they will not be otherwise construed.

Under the old law, entertainment expenses could be deducted if they qualified as ordinary and necessary expenses of a trade or business; and it was held by courts that ordinary and necessary expenses were those “directly connected with” or which “proximately resulted from” the conduct of a trade or business. Now, however, deduction is to be denied unless (with certain exceptions) entertainment activity is “directly related to . . . the active conduct of the taxpayer’s trade or business,” or unless the expense is for entertainment “associated with” the active conduct of his trade or business and “directly preceding or following a substantial and bona-fide business discussion.” Conservative taxpayers will immediately recognize that this conveys the sense of a most dramatic change.

According to the new rules, entertainment activities include those which are of a type “generally considered to constitute entertainment, amusement or recreation.” This seems to be virtually all inclusive, if not a pure tautology. Nevertheless, the tax-conscious individual might be tempted to inquire whether any spectator activities have a reasonable possibility of escaping the net. What comes to my mind is such things as viewing folk dancing, travelogues, wrestling exhibitions, or the Patterson-Liston match. Considerable testimony could be mustered to demonstrate that these are not generally considered to be anything. But, then, the conservative taxpayer must reckon that someone in the Internal Revenue Service might find them to be at least amusing, if not downright entertaining. So, instead of searching hard for activities which are not entertainment, I suggest working out plans for entertaining in ways that will qualify for deduction. Several avenues of planning need to be examined.

One is to provide guests with entertainment, amusement or recreation which is directly related to the active conduct of your business. Let me illustrate. If you happen to sell Cadillacs, you might consider taking potential customers to see “The Solid Gold Cadillac.” Or, if you merchandise fur coats, you should not hesitate to take potential buyers to see “That Touch of Mink.” In a similar vein, clock manufacturers should favor “The Longest Day”; spice salesmen, “A Man for All Seasons”; chess set manufacturers, “Only Two Can Play”; stockbrokers, “The Brave Bulls”; and cloak and suit salesmen, “Measure for Measure.” Dog racing (especially on torrid days) seems ideal for producers of frankfurters, opera for gargle manufacturers, girlie shows for purveyors of skin lotions, and so on and on. The principle is readily apparent. Before long it probably will be reflected in theater advertisements. Alongside of such long familiar comments as “suitable from six to sixty,” we might expect to see such claims as “recommended for entertaining the garment trade” or “especially suitable for visiting fire-
men." Because application of the principle is virtually unlimited, I suggest that one of our major publishers of law books put out a new loose leaf service that cross references all current amusement offerings and all lines of business. Possibly the old West Publishing Company "Key Number System" of indexing court decisions could be extended to cover this additional field. An incidental advantage would be that we at last would have key numbers for all key clubs.

But there undoubtedly will be occasions when circumstances, including the mood of the persons involved, will render it impractical to achieve a direct linkage between the active conduct of the host's business and an entertainment activity. The conservative taxpayer then will have to fall back on post- or pre-business discussion entertainment which is associated with (but not directly related to) his business. Developing a proper arrangement under this category is unfortunately fraught with pitfalls.

An indispensable requirement is that there actually be a substantial and bona-fide business discussion which is associated with the host's business. This is so critical that the conservative taxpayer will want to be able to establish with certainty that such a discussion occurred and mark the precise time. A detailed entry in a diary probably will suffice, but after all it is only a self-serving declaration. More is needed to nail down the facts. A portable tape recorder can be of considerable assistance, especially if the taxpayer will remember to turn it on when the business talk begins and to make a short initial announcement along these lines: "Let the record show that it is now __________ o'clock on the ______ day of ______ in the year ______. With me are ________ of the ______ company and _______ of the ______ company. We now start our bona-­fide substantial business discussion." For the more worried sort of conservative, an even more reassuring procedure is use of a movie camera with synchronized sound recording apparatus. I understand there is now available a lightweight model weighing only twenty-three pounds, and that a transistorized model weighing eight pounds is currently being readied for this new market.

It is questionable whether the conservative taxpayer should hold the business discussion at or during the associated entertainment activity. To illustrate, suppose that the commercial talk occurs at half time during a football game. Superficially, it would appear that the sporting entertainment both preceded and followed the business discussion—the first half coming before and the second half afterwards. But this viewpoint could be a snare. There are some analogies in tax law, particularly in the area of corporate divisions, which argue that a football game is a single activity, not capable of being divided for tax purposes. Moreover, a half-time talk might lack the aura of being substantial even when the crowd is small. Safety would seem to dictate attending to business either directly before reaching the stadium or directly after leaving it. An exception conceivably might be proper in the case of cricket matches.

A special problem exists in the case of professional football games played on Sundays or bowl games played on holidays. Because business offices will be closed, business discussions might have to occur in irregular spots. The problem of proof is therefore likely to be slightly more complicated than usual. One possible solution is to repair from the game to some public building, such as the civic museum or aquarium or art institute, for the critical chat. No one is likely to infer that a group of businessmen went to such a place for anything but business.

A more general problem arises because a carefully planned program for entertaining and thereafter doing business might go astray. Suppose the plan is to entertain business acquaintances on a particular night (in a manner associated with business) and to follow up the party with a business discussion the next morning. All goes well during the night on the town, but—perhaps for that very reason—it becomes necessary to call off the scheduled morning meeting. This could prove embarrassing to the genuinely conservative taxpayer because the entertainment then stands alone. Precautionary planning is thus in order. All that need be done, I suggest, is to schedule such entertainment after rather than before the business session. Then, if plans miscarry, the tax position will not be jeopardized.

In commenting upon pre- or post-business discussion entertainment, the Senate-House Conference Committee Report observes that the host may be entitled to deduct not only for his business guests but also for their wives. By implication the deduction is not available for lady friends and other escorts included in the party. If this is a correct interpretation of the new rules, the conservative taxpayer might find it advantageous to adopt another simple precaution. He should merely ask each accompanied business guest to show his marriage license. I expect that in some circles it will become customary to carry these along with driver's licenses and credit cards.

The general rule limiting deduction for entertainment activities is subject to an exception for business meals "furnished . . . under circumstances which are of a type generally considered to be conducive to a business discussion" (taking into account the surroundings in which the meals are served, the taxpayer's business, and the relationship of the persons who are fed). Several points might help the conservative taxpayer in staying within the exception. The name of the establishment might well be regarded as contributing to the character of the surroundings. Thus—after a quick perusal of the classified telephone directory—I would give a plus to such names as "The Busy Bee," "The Black Bull," "The Gold Coin," and "The Marketplace Inn"; I would be slightly con-
cerned about "The Escape," "The Epicurean," and "Melody Lane"; and I would be definitely worried about "The Boom Boom Room," "The Cozy Nook," "The Moonlight Club Parlor," and "The Painted Doll Bar-B-Que." Of course, there will be occasions when even these apparently adverse names might assist the taxpayer in buttoning down his deduction under the exemption. Who, for example, would deny that the "Boom Boom Room" would appropriately set the stage for a business discussion with a drummer; or who would have difficulty figuring out the application of this point to "The Stork Club"?

Also to be considered is the décor of the restaurant. Wood paneling—of the old English grill type—seems safest. Generally it probably is best to avoid an exotic motif (unless one is in some matching exotic trade); but under current governmental policy there likely is less danger in decorations associated with an under-developed country. Musical background might also count. A total absence of music would seem to be most compatible with talking business. However, in recognition of its virtual omnipresence, the standard juke box might be regarded as though it were not there. For most lines of business, soft strings are not too incongruous; I am more hesitant about singing waiters; and I firmly advise against rock and roll—unless, of course, the particular business discussion just happens to blend, as it might when railroad passenger traffic is on the agenda.

I now turn to the matter of facilities. The new law provides that no deduction is allowed for expenses incurred with respect to an entertainment facility—meaning any real or personal property owned or rented by the taxpayer and used for entertainment, amusement, or recreation activities—unless the facility is used primarily to further the taxpayer's business and the expenditure is directly related to the active conduct of such business. According to the Senate Finance Committee Report, an over-50 per cent test is to be employed in determining the primary usage of a facility. If the test is not met, no part of the expense is deductible; if the test is met, that portion of the expense relating to business use may be deducted. Clearly, a taxpayer who uses entertainment facilities in connection with his business needs to keep a sharp lookout. A tiny modification in the pattern of use can result in a great change in allowable deductions.

The conservative taxpayer therefore above all must
not lose track of his facilities! On first thought, the ultra-conservative might jump to the conclusion that he should affix a permanent label to each facility used to further his business—possibly something like the notification plate which railroad locomotives and cars bear under equipment trust financing. He might even hope that such tags, perhaps numbered serially and stating that the object is a business adjunct, will have some evidentiary value in establishing that it is in fact a business facility. On closer examination, however, he will realize that any permanent marking scheme is wholly impractical. There would seem to be no attractive way to put labels on facilities which are rented by the taxpayer for only part of the year, unless in the highly unlikely event that the lessor was willing to have each lessee add his label on the item. Even in the case of certain owned objects, it might be awkward to attach a label. For example, how would one mark a private wilderness lake, with marshy shores, accessible only by plane? In some instances, the marking might be misconstrued. If a businessman rented a certain hotel bedroom throughout the year for use of out-of-town buyers, I am not sure how people would react to a sign on the door reading "John Smith—Business Facility No.5."

The crucial facilities problem for most conservative taxpayers will concern the over-50 percent business usage requirement. There will, of course, be the usual chores of keeping accurate records and of showing that a particular use qualifies as being directly related to the active conduct of the taxpayer's business and primarily aimed at furthering it. Of greater interest is the fact that measuring usage will now be of key importance because any deficiency in meeting the over-50 percent business use test eliminates all deductions for the particular facility. An illustration in the Senate Finance Committee Report, regarding a yacht, unequivocally employs time as the exclusive measure of use. I suppose this is sound—although I wonder whether a two-day cruise with two private guests on board is really the equivalent of a two-day cruise with twenty business guests on board. If time is the only factor, the conservative taxpayer can reassure himself with nothing more than a good watch featuring a sweep second hand or, better yet, a stop watch. Frankly, I doubt that measurement will always be so simple. Suppose that during the year a person uses an automobile more hours for business entertainment than for pleasure but covers more miles during the pleasure runs; are we safe in assuming that time controls over distance? Or suppose that in the case of a dining facility more time is spent over business meals than social ones, but more food is consumed during the latter; does time control over weight as well as over calories? As to bars, is time paramount in competition with rounds, liquid volume, or proof gallons? And, as to hotel suites, does time pass more slowly where occupancy is by one instead of two?

Faced with these questions, and until the Regulations provide definitive answers, the conservative taxpayer should protect himself by meeting the test under all possible measurements of usage. Thus, in addition to a watch, he might find need for a scale, tape measure, thermometer, and depthometer.

A new form of year-end planning is also called for. Around the beginning of the last month in his taxable year, the conservative taxpayer ought to review his usage log for each facility to determine whether he is safely beyond the over-50 per cent business-use level. Where he is short, he should promptly take appropriate corrective steps to augment business usage. Many taxpayers might find this difficult because their twelfth month—December—is a very busy entertainment period anyway, and their potential business guests are likely already to be engaged, particularly during the holiday season. A constructive approach here is simply to switch from reporting on a calendar to a fiscal year. An ideal one for this purpose would seem to be May 1 to April 30. Of course, if the facility happens to be an unheated hunting camp or fishing lodge which is uncomfortable during April, then a different fiscal year might be advisable.

One further precaution regarding facilities might be noted. If a car is rented for business entertainment and then later in the same year a car is rented from the same agency for pleasure, make sure that two different vehicles are furnished, or else there is a risk that the business use of the particular automobile will be outweighed by that for pleasure. It is well to avoid this particular trap by recording the engine number of all cars rented during the year. However, it is most important not to be confused by doctrines of constitutional law whose phrasing could cause confusion. For tax purposes it is perfectly all right to have equal facilities, but they must be separate.
The new law also modifies the rules for deductions while one is in travel status. An important change is that deduction is denied for the cost of meals and lodgings while away from home in pursuit of business to the extent that they are "lavish or extravagant" under the circumstances. How can the conservative taxpayer avoid running afoul of this limitation without becoming a masochist? A perusal of the motel and hotel advertisements (such as those found in the classified telephone directory) conceivably might supply a few clues to both taxpayers and the Internal Revenue Service. I would give the green light to those which announce "We cater to businessmen," or "Old fashioned service for you and your car," or "Rates that are really reasonable." But I would flash an amber, if not a red, light for those which claim to be "Fabulous," or "The last word in accommodations," or "The ultimate in comfort and pleasure." And I definitely would back away from ones that boast "City facilities in a country club atmosphere," or "A vacationland." One can easily imagine that certain branches of the advertising industry might experience considerable trauma in adjusting to this new factor introduced by the tax law. We may yet live to see the day when resort spots are triumphantly proclaimed to be "delightfully dour."

These clues, however, are highly unreliable and the approach is most haphazard. Given the importance of the subject, we are in need of some systematic treatment, and I am delighted that a model is close at hand. For many years, the Michelin Tire Company of France has published European restaurant and hotel guides which employ a handy rating system. Restaurants are rated by using crossed forks and spoons as symbols: One crossed fork and spoon signifies "plain but good"; two is for "fairly comfortable"; three stands for "very comfortable"; four reflects "top class"; and five, the highest rating, is for "luxury." A similar five-fold classification system for hotels makes use of building shapes as symbols, with a three tower structure being top "luxury" class. In addition, red print, rather than the standard black ink, is used to indicate that the hotel or restaurant is pleasant; and there are various red symbols to designate "exceptionally pleasant view," or "very pleasant surroundings." With a little imagination this system could be modified and adapted to the United States so as to provide almost all the information needed for forming quick judgments in applying the new "lavish or extravagant" test. Merely by way of illustration, I can conceive of a restaurant rating system under which one crossed fork and spoon stood for "plain, but safe taxwise"; two represented "fairly comfortable, but probably safe taxwise"; three meant "very comfortable, but doubtful taxwise"; four signified "top class, but risky taxwise"; and five indicated "luxury, but dangerous taxwise." And in keeping with the spirit of the new law, the listing of all sumptuous accommodations would be carried in purple ink.

Another change in rules regarding travel status provides for allocation of traveling expenses (including means and lodgings) between those which relate to business and those which are personal. An important exception is that there is to be no such allocation where the trip does not exceed one week. To stay within this highly beneficial provision, it might be necessary to fly rather than take the train or a boat; and there might even be occasions when only a non-stop jet flight will permit satisfying the time condition. The conservative taxpayer, however, will quickly perceive a possible pitfall in relying on the airlines. Just suppose he carefully planned to return home from a combined business-pleasure trip on a flight scheduled to land barely within 168 hours of his departure from home, only to learn that his flight is delayed or cancelled and that, as a result, he will exceed one week in travel status. Through no fault of his own, he apparently would lose that part of the travel deduction allocable to personal aspects of the trip. And, of course, he would not have a right of action against the carrier or anyone else. My solution here is somewhat forward looking. Given enough interest on the part of taxpayers, I expect that insurance companies will soon make available, at all major airports, insurance against flight delays which cause tax losses. Such coverage might even be added to the standard life insurance policy now being marketed for commercial air flights.

One final suggestion for the super-conservative taxpayer who is not covered by such insurance. You might find that on returning from a combined business-pleasure trip, the plane has arrived over your home airport in time, but that it is required to circle overhead until weather conditions permit landing. Prolonged circling would run you over the week limit, and the Internal Revenue Service could then argue that you are still in travel status until a landing has been effectuated. To be absolutely sure of not losing a part of the deduction, you should consider resurrecting an old precaution—that of being equipped during flight with a conveniently located parachute.

In short, even under the new rules for travel and entertainment expenses, the conservative taxpayer can always find some way out!

NOTES

* My colleague, Harry Kalven, Jr., was most helpful in reacting to and embroidering on my planning suggestions for the conservative taxpayer. The fact that he is co-author of The Uneasy Case for Progressive Taxation should not give rise to an inference that he is a conservative taxpayer.

1 All theatrical listings in this paragraph are from the New York Times, October 21, 1962.

2 All quoted material in this paragraph is from the 1962 Chicago Classified Telephone Directory, restaurant listings.

3 Ibid., motel listings.