Private Letter Ruling 8315006

ISSUE:

Whether *section 274(a)(1)(A) of the Internal Revenue Code* will disallow the deduction of certain travel and entertainment expenses incurred by M to hold golf outings at the W and Y golf resorts.

FACTS:

On May 1, 1975, M received a plan from O Advertising to hold regional meetings with customers at hotels close to golf resorts. In collaboration with O Advertising, M held meetings in 1976 an 1977 at W and Y golf resorts.

In its plan submitted to M, O Advertising noted, in part, that, "the concept of having a golf outing in each of the regions is an opportunity for [M] to capitalize on its advertising program. * * * The golf outings would also utilize the talents of [B] and [C]. [B's] contract calls for ten personal appearances a year on behalf of [M]. His real strength as a spokesman for [M] would be in an informal gathering of [M's] major customers. * * * Along with [B], we propose one other major element be added to the golf outings, [C]. As was stated earlier [C] would be involved both as a participant by playing several holes with each foursome, and also as an [*2] instructor in a golf clinic. [C] has a real respect for [M] and because of his great friendship with [B], he would give each outing a very personal feeling"

No mention was made in the plan to conduct any business meetings with the customers invited to the outings.

Pursuant to the plan proposed by O advertising, M, in 1976, incurred certain travel and entertainment expenses to conduct the outing at W golf resort. The scheduled agenda for this outing provided as follows:

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MONDAY - AUGUST 30
Afternoon arrival
5:30 p.m.
Refreshments in golf club.
B, C and D join M's management group
7:30 p.m.
Dinner served in club room.
Hospitality in this room following dinner.
TUESDAY - AUGUST 31
7:00 A.M. Buffet Breakfast
8:00 a.m. C golf clinic - 18th fairway
8:30 a.m. First foursome off
12:00 - 3:00 p.m. Buffet luncheon
Guests may enjoy tennis, swimming, riding, hiking, trap & skeet
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shooting, cards or relaxation
6:30 p.m. Cocktails 7:30 p.m. Dinner 9:00 p.m. golf award and exhibition - B and D
10:00 p.m. Hospitality
WEDNESDAY - SEPTEMBER 1
7:00 a.m. Buffet breakfast. Remainder of time for departure.

According to M's employee in charge of the outings, golf foursomes were arranged by customer relationships and not be handicaps.

In attendance at the W golf resort were 24 employees of M, 23 executives and marketing personnel of customers, 2 employees of O Advertising, and 3 celebrities, B, C, and D. Wives were not in attendance.

According to A, M's Vice President and General Manager, 3 to 4 hours of business discussion were held with 2 executives. The business discussions involved contract negotiations for a customer's future business. The executives expressed an interest in continuing the negotiations and requested M to put together a formal proposal.

The format for the outing at Y golf club in [*3] 1977 was as follows:

SUNDAY JUNE 12
Late afternoon and early evening
Guests arrive
6:30 p.m.
Cocktails
8:00 p.m.
Dinner
9:00 p.m.
Formal welcome and "warm up" program
10:00 - 11:00 p.m.
Open Bar
MONDAY JUNE 13
6:30 - 9:30 p.m. Buffet breakfast
7:00 a.m.
Buses begin leaving for golf course
8:00 a.m.
Foursomes begin teeing off
Putting contest, sand play contest and video tape swing analysis begins
10:00 a.m.
B and C golf clinic at practice tee for foursomes teeing off after
11:00 a.m.
11:00 a.m. - 3:00 p.m.
Buffet luncheon and refreshments available in clubhouse
4:00 p.m.
B and E golf clinic at practice tee for foursomes teeing off before 10:00 a.m.
5:00 to 6:00 p.m. Buses return to hotel
6:30
Cocktails

8:00 p.m.
Dinner
9:00 p.m.
Awarding of prizes and observation on the day
10:00 - 11:00 p.m.
Open Bar
TUESDAY JUNE 14
7:00 - 8:30 a.m.
Buffet Breakfast
7:00 a.m.
Departure

The number of people in attendance at the Y golf resort was expanded to 159; 49 employees of M, 108 customers and 2 celebrities, B and E. Also, unlike the outing at W golf club, M's employees attending the outing at Y golf club prepared written documentation of whatever discussions occurred with customers during the course of the outing. The documentation of these discussions as general in nature and it is unclear when each employee drafted the documentation to M.

Some time after the Service raised the question of whether the entertainment expenses in question were deductible, M presented a memorandum dated December 12, 1981, recording the statements of A that M conducted substantive business at the 1976 and 1977 golf outings. In addition, A contended in this memorandum that B and D promoted M's products during their remarks to the invitees.

Also M presented an undated memorandum from one of its executives to all of M's employees which stated, in part, the following:

Although this is basically a "fun" outing for all concerned, * * * has asked me to remind the [M] participants of the significant business responsibility each of us bears on June [*4] 12 and 13, ... suggests you make it a point to establish how [M] is doing in a business sense with these key customers.

The expenses in question are those for food and beverages, lodging, golf, prizes, transportation, and miscellaneous expenses.

LAW AND RATIONALE:

Section 162(a) of the Code provides that 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.

On the other hand, *section 274(a)(1)(A)* provides that no deduction otherwise allowable under this chapter shall be allowed for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business. In the case of an item described in *subparagraph (A)*, the deduction shall in no event exceed the portion of such item which meets the requirements of [*5] *subparagraph (A)*.

Therefore, the issue which must be resolved in this case in whether M has carried its burden of establishing that the golf outings in question were either directly related to the active conduct of its trade or business or that the expenses incurred were associated with the active conduct of

its trade or business. For the "associated with" requirement to be met the expenses must directly precede or follow a "substantial and bona fide business discussion."

The Income Tax Regulations describe the elements that must be present in order for a taxpayer to meet the "directly rated to the active conduct of the taxpayer's trade or business" requirement of *section 274(a)(1)(A) of the Code*. Pursuant to the regulations, expenditures for entertainment will be considered to meet this requirement if they are, directly related in general (*section 1.274-2(c)(3)*), are incurred in a clear business setting (*section 1.274-2(c)(4)*), or are expenditures for services performed (*section 1.274-2(c)(5)*).

Section 1.274-2(c)(3) of the regulations provides that to meet the "directly related in general" test the expenditure for entertainment must satisfy 4 specified requirements. Among these requirements [*6] is one that requires the taxpayer to demonstrate that at the time the taxpayer made the entertainment expenditure the taxpayer had more than a general expectation or deriving some income or other specific trade or business benefit (other than the goodwill of the person or persons entertained) at some indefinite future time from the making of the expenditures. A taxpayer, however, shall not be required to show that income or other business benefit actually resulted from each and every expenditure. See *subparagraph (i) of section 1.274-2(c)(2).*

Section 1.274-2(c)(7) of the regulations outlines those expenditures that are generally considered not directly related to the active conduct of a trade or business. There, it is provided, in pertinent part, that expenditures for entertainment, even if connected with the taxpayer's trade or business, will generally be considered not directly related to the active conduct of the taxpayer's trade or business, if the entertainment occurred under circumstances where there was little or no possibility of engaging in the active conduct of trade or business. The following circumstances will generally be considered circumstances where there was little [*7] or no possibility of engaging in the active conduct of a trade or business: the distractions were substantial, such as a meeting or discussion at night clubs, theaters, and sporting events, or during essentially social gatherings such as cocktail parties. This section further provides that an expenditure for entertainment in any such case is considered not to be directly related to the active conduct of the taxpayer's trade or business unless the taxpayer clearly establishes to the contrary.

In this case expenses incurred by M were undoubtedly business related and of general economic benefit to M. However, the information submitted fails to indicate that M has carried its burden of avoiding the more stringent provisions of *section 214(a)(1)(A).*

These outings were presented by O Advertising to M as being part of an "advertising campaign", and informal in nature. The agenda planned by O Advertising and M left little if any time for M to conduct anything more than general business discussions with its customers. Nothing in the agenda indicates that M has "more than a general expectation of deriving some income or other specific trade or business benefit (other than the goodwill of the [*8] persons entertained) at some indefinite future time from the making of the expenditure". See *section 1.274-2(c)(3)(i) of the regulations.* The fact that M's employees and customers may, during the course of the activitie's, have discussed business does not meet the requirement of *section 274(a)(1)(A) of the Code* that the expense be "directly related to the conduct of the taxpayer's trade or business". *Berkley Machine Works & Foundry Co. v. Commissioner, 623 F.2d 898 (4th Cir. 1980).*

The plan prepared by O Advertising, the agenda for the outings, and the general documentation presented by M clearly indicate that the entertainment was primarily directed toward generating goodwill. Such entertainment as a matter of law cannot be "directly related to

the active conduct" of the taxpayer's business. *Handelman v. Commissioner, 509 F.2d 1067, 1074 (2d Cir. 1975)*; *Hippodrome Oldsmobile, Inc. v. United States, 474 F.2d 959, 960 (6th Cir. 1973)*; *St. Petersburg Bank & Trust Co. v. United States, 362 F.Supp. 674 (M.D.Fla.1973)*, aff'd, *503 F.2d 1402 (5th Cir. 1974)*.

The question remains as to whether the entertainment expenditures incurred in this case meet the "associated with" test of *section 274(a)(1)(A) of the Code*. [*9] In Berkley Machine Works & Foundry Co. v. Commissioner, the taxpayer company sought to deduct expenses associated with a fishing camp and certain out-of-pocket entertainment costs incurred during outings at the camp.

The facts concerning the outings at the fishing camp were very similar to the facts in this case in that many customers were invited to visit the fishing camp with no specific business discussions scheduled. The Company in Berkley, like M in this case, hoped that through informal contact between its sales representatives and clients business discussions would take place. The testimony in Berkley, and the information submitted in this case, indicate that the taxpayers employees did discuss business at the fishing and golf outings; however, the United States Court of Appeals for the 4th Circuit in Berkley, when confronted with the issue of whether the out-of-pocket entertainment expenditures met the "associated with" test, stated the following:

But the question arises whether these expenses may be allowed as deductions under the more lenient "associated with" test of subsection (A) which as the legislative history reveals, was intended to include goodwill entertainment. [*10] This test is expressly qualified, however, by the language that the expense must relate to "an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise) ... The Conference Committee Report that discussed the addition of this language notes as examples of expenses that qualify under this section, the entertainment of a group of business associates at a restaurant, theater, or sporting event following substantial negotiations, or the entertainment of out-of-town business associates on the evening before such "substantial business discussions." H.Conf.Rep.No. 2508, 87th Cong., 2d Sess. 17.

The Ocracoke weekends clearly do not come within the statute's contemplation of entertainment that takes place purely as an adjunct to formal business meetings. Nor do we consider that expenses may qualify under the test when the claimed business discussions take place during the course of a combined social/business function. See *St. Petersburg Bank & Trust Co. v. United States, 362 F.Supp. 674 681 (M.D.Fla.1973)*.

In this case too, the entertainment expenses did not directly precede or follow any formal business [*11] meeting as contemplated by the statute. Also see Lennon v. Commissioner, T.C.M. 1976-176; *Israelson v. United States, 367 F.Supp. 1104 838 (4th Cir. 1974)*; and Fixler v. Commissioner, T.C.M. 1978-423. The fact that a few of M's employees may have entered into detailed but unplanned discussions with several of the invitees at the outing at the W golf resort does not cause the entertainment expenses to meet the "associated with" test of *section 274(a)(1)(A) of the Code*.

M also contends that the Service is precluded from issuing adverse technical advice on this issue due to section 801 of the Economic Recovery Act of 1981, Pub. L. No. 97-34, 97th Cong., 1st Sess. (1981). This section prohibits the Service from issuing regulations concerning fringe benefits until December 31, 1983. The moratorium on the fringe benefit regulation has no application to this case because the effect of our ruling will not be to include in income any fringe benefit received by a taxpayer.

The District Director has also contended that in accordance with *section 1.274-1 of the regulations* the entertainment expenses incurred by M should be disallowed on the basis that they are lavish and extravagant. In view [*12] of our conclusion concerning the issue of whether the entertainment expenses met the requirements of *section 274(a)(1)(A) of the Code*, no comment is made concerning the District Director's contention. In any event, that determination is best made by the District Director having knowledge of the business practices of those taxpayers engaged in trade or businesses similar to M's.

CONCLUSION:

Pursuant to *section 274(a)(1)(A) of the Code*, the expenses incurred by M to entertain customers at the W and Y golf resorts in 1976 and 1977 should be disallowed as business deductions.

A copy of this technical advice request is to be given to M. *Section 6110(j)(3) of the Code* provides that it may not be used or cited as precedent.