Private Letter Ruling 9316003

Issue

Whether certain meal and travel expenses incurred by a partner on behalf of a partnership are expenses incurred in carrying on a trade or business under section 162(a) of the Internal Revenue Code that are deductible from gross income by the partner under section 62(a)(1).

Facts

The taxpayer (hereafter referred to as X) is a partner in a partnership involved in the practice of law. In 1987 and 1988 X incurred and paid automobile, travel, and meal expenses related to X's legal practice. X claimed a deduction from gross income on Part II of Schedule E (Form 1040) for the full amount of the expenses.

The expenses that X could properly charge to X's clients were reimbursed by the partnership to X when the partnership received payment from the client. However, any expenses that X could not charge to the clients were personally paid by X out of X' s own funds. Taxpayer represents that he paid such expenses pursuant to an established partnership practice which required all partners to personally pay from their own funds any business expenses that were not charged to their clients.

The District Director notes that X's representative provided a copy of the partnership agreement dated March 1, 1989, that on page 5 states:

11. EXPENSES. No partner shall charge to the Partnership any expenses for automobiles, entertainment, professional dues, conventions, charitable contributions, or club dues WITHOUT THE CONSENT OF THE PARTNERS. [Emphasis added.)

The District Director also refers to a letter dated July 11, 1991, addressed to him from one of the firm's partners. The letter stated:

The Partnership Agreement which was in effect prior to the 1989 Agreement did not specifically address the question of expenses, however, since the formation of this firm in 1978, it has always been the firm policy, and all partners have understood, that no partner would charge any of the aforementioned expenses to the partnership WITHOUT THE CONSENT OF THE PARTNERS. This has always been, and remains, our policy and the procedure under which we operate. [Emphasis added.)

Applicable Law and Regulations

Section 162(a) of the Code provides, in part, 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.

Section 62(a) of the Code provides that "adjusted gross income" means, in the case of an individual, gross income minus specified deductions. Under section 62(a)(1), these deductions include deductions attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee. Section 67(a) of the code provides that in the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income. Section 67(b) defines the term "miscellaneous itemized deductions" to mean the itemized deductions other than the deductions enumerated in that section. Section 63(d) defines the term "itemized deductions" to mean the deductions other than (1) those allowable in arriving at adjusted gross income, and (2) the deduction for personal exemptions provided by section 151.

Section 702(a) of the Code provides, in general, that in determining income tax liability, each partner shall take into account separately the partner's distributive share of the partnership's income, gain, loss, deduction, or credit.
For the purposes of computing income and deductions, the business of a partnership is considered a separate business from that of the partners. Brannen v. Commissioner, 722 F.2d 695, 703 (1984); Rosenthal v. Commissioner, 48 T.C. 515, 530 (1967), aff'd, 416 F.2d 491 (2d Cir. 1969); Estate of Freeland v. Commissioner, 393 F.2d 573, 584 (9th Cir. 1968), cert denied, 393 U.S. 845 (1968); Barham v. United States, 301 F. Supp. 43, 46 (M.D. Ga. 1969), aff'd, 429 F.2d 40 (5th Cir. 1970). For this reason, as a general rule a partner may not deduct the expenses of a partnership on his own income tax return, even if the expenses were incurred by the partner in furtherance of the partnership business. Magruder v. Commissioner, T.C.M. 1989-169; Cropland Chemical Corp. v. Commissioner, 75 T.C. 288, 295 (1980), AFF'D WITHOUT PUBLISHED OPINION, 665 F.2d 1050 (7th Cir. 1981); Farnsworth v. Commissioner, 29 T.C. 1131, 1137 (1958), aff'd, 270 F.2d 660 (3d Cir. 1959), cert. denied, 362 U.S. 902 (1960); Klein v. Commissioner, 25 T.C. 1045, 1051 (1956). As stated in Wilson v. Commissioner, 17 B.T.A. 976, 979 (1929):

Ordinary and necessary expenses of a partnership are properly deducted on the partnership return, and the partner then returns as an individual his distributive share of the net income of the partnership after making such deductions. He cannot take ordinary and necessary expenses of the partnership as a deduction on his individual return.

However, if under the partnership agreement or practice the partner is required to pay certain partnership expenses out of his own funds, then the partner is entitled to a section 162 deduction for the amount of such expenses. Cropland v. Commissioner, 75 T.C. 288, 295 (1980); Lewis v. Commissioner, 65 T.C. 625 (1975); Wallendal v. Commissioner, 31 T.C. 1248, 1252 (1959). In Klein v. Commissioner, 25 T.C. 1045 (1956), the partner incurred expenses for his personal automobile, meals, and lodging on behalf of the partnership. The Tax Court noted that under the partnership practice or agreement the taxpayer was expected to bear the unreimbursed expenses out of his personal funds. Thus, to the extent the taxpayer established that the expenses were not personal but were for travel and entertainment on behalf of the partnership, the Tax Court allowed the expenses to be deducted from gross income on the partner's individual income tax return. Accord, Magruder V. Commissioner, T.C.N. 1989-169 (medical partner disallowed

deduction where he failed to establish that he was required to pay costs of meals without reimbursement). See also Rev. Rul. 70-253, 1970-1 C.B. 31, holding that a partner who is required under a partnership agreement to pay out of his personal funds the compensation of an employee who performs part of the partner's duties may deduct such payments as a business expense.

If a partner has a right to be reimbursed for expenses by the partnership under the partnership agreement or established practice, but does not elect to seek such reimbursement, we believe the partner is not entitled to a section 162 deduction for the expenses. This is because they are not "necessary" expenses for purposes of section 162(a) of the Code and section 1.162-1(a) of the Income Tax Regulations. Such unreimbursed expenses do not become the business expenses of the taxpayer merely because he fails to seek reimbursement, and should be disallowed.

In Ellis v. Commissioner, T.C.M. 1967-94, the taxpayer, a sales coordinator for a corporation, personally entertained other key employees and suppliers at lunches and dinners for purposes of sales promotion. The Tax Court noted that while the employee's expenses were directly related to the business of the company, the employer would have reimbursed the taxpayer had reimbursement been requested. The court therefore held that no part of the expenses were deductible as an ordinary and necessary expense of the taxpayer's business. Accord, Kerr v. Commissioner, T.C.M. 1990-155; Stolk v. Commissioner, 40 T.C. 345 (1963), aff'd per curiam, 326 F.2d 760 (2d Cir. 1964); Podems v. Commissioner, 24 T.C. 21 (1955).

While the foregoing cases deal with employees, we believe that the principle of the cases is fully applicable where a partner fails to seek reimbursement that the partnership would have provided.

Conclusion

To the extent that X can establish that partnership practice required that X personally bear a portion of the automobile, travel and meal expenses at issue, without reimbursement, then under section 62(a)(1) of the Code X will be entitled to deduct the amount of such expenses from gross income on his individual return. Such expenses are not subject to the 2 percent floor imposed by section 67(a) of the Code.

To the extent that X was entitled to reimbursement for the expenses at issue and failed to seek reimbursement therefor, no deduction is allowed under section 162(a) of the Code.
The District Director should determine whether, under the present facts, the expenses at issue were subject to reimbursement for purposes of determining the deductibility of the expenses.
A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.