Technical Advice Memorandum 9330004

Issues

(1) Whether expenses incurred by an individual partner for automobile travel on partnership business are section 162(a) trade or business expenses that are deductible from gross income under section 62 (a)(1).

(2) Whether expenses incurred by a partner for entertainment, business publications, and club dues and fees are business expenses deductible by the partner from gross income under section 62 (a)(1).

FACTS:

The taxpayer (hereafter referred to as X) is a general partner in a professional services partnership engaged in the business of providing auditing, tax, and consulting services to its clients. In 1990 X used his personal automobile on behalf of the partnership in order to perform services for clients of the partnership. X represents that he was required, pursuant to the partnership rules, to personally pay the automobile expenses without reimbursement. X claimed a deduction from gross income on Part II of Schedule E (Form 1040) for the full amount of the unreimbursed automobile expenses.

X also incurred expenses for the costs of the promotion and development of the partnership, such as entertainment, business publications and club dues and fees. Under the partnership rules, only "nonsocial" club dues and initiation fees are reimbursed by the partnership to the partner. 1 X claimed a deduction from gross income on Schedule E for the full amount of the unreimbursed expenses.

Applicable LAW:

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 all itemized deductions other than certain 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 274 (a)(1) of the Code provides that no deduction otherwise allowable under Chapter 1 shall be allowed for any item (A) 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, or (B) with respect to a facility used in connection with an activity referred to in subparagraph (A).

Section 274 (a)(2)(A) of the Code provides that for purposes of applying paragraph (1), dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities.

Section 274 (a)(2)(C) of the Code provides that in the case of a club, paragraph (1)(9) shall apply unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the items were directly related to the active conduct of such trade or business.

Section 274(d) of the Code provides that no deduction or credit shall be allowed under section 162 or 212 for any traveling expense (including meals and lodging while away from home), for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, or with respect to any listed property (as defined in section 280(F)(d)(4)), unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility or property, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained or using the facility or property. Section 280F(d)(4) defines the term "listed property" to mean any passenger automobile.

Section 1.274-5T(b)(6) of the Temporary Income Tax Regulations requires the following information in order to substantiate the business use of a passenger automobile: (1) the amount of each separate expenditure; (2) the amount of each separate business use and the total use of the listed property; (3) the date of the expenditure or use; and (4) the business purpose for the expenditure or use.

Section 1.274-2 of the regulations sets forth the general rules relating to the substantiation requirements for expenditures for which deductions are otherwise disallowed, i.e., entertainment, amusement, and recreation. Section 1.274-5T(b)(4) of the temporary regulations sets forth the specific elements to be proved in order to substantiate a claimed deduction for expenses for entertainment directly preceding or following a substantial and bona fide business discussion.

Discussion:

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.

This is because, 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).

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, Rev. Rul. 70-253, 1970-1 C.9. 31, holding that where a partner 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, the partner may deduct such payments as a business expense.

Conclusions:

X represents that he incurred the automobile expenses at issue on behalf of the partnership, in order to service partnership clients. Pursuant to established partnership rules, X was required to bear the expenses without reimbursement.

Assuming that the automobile expenses are trade or business expenses that meet the requirements of sections 162(a) and 274 of the Code, X may deduct the expenses from gross income under section 62(a)(1) in computing adjusted gross income.

X also represents that he incurred the expenses at issue for entertainment, business publications, and club dues and fees on behalf of the partnership. Pursuant to established partnership rules, X was required to bear the expenses without reimbursement.

Assuming that the expenses for entertainment, business publications, and club dues and fees are also trade or business expenses that meet the requirements of sections 162(a) and 274 of the Code, X may deduct the expenses from gross income under section 62(a)(1) in computing adjusted gross income.

We caution that we are not determining that any particular expense meets the requirements of sections 162 or 274 of the Code. These are factual questions to be determined by the district director.

We appreciate that the types of problems that the Congress intended to address through imposition of the 2 percent floor under section 67 of the Code may also be presented in partners' claims for deductions of unreimbursed business expenses in many situations. We believe, however, that section 67 as enacted does not apply to the deduction of business expenses by partners, as they are not considered employees of the partnership. See Rev. Rul. 69-184, 1969-1 C.B. 256.

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.

1 The "nonsocial" clubs are clubs that offer only business luncheons. Clubs that also offer dinner are considered "social" clubs, for example, country clubs and yacht clubs.