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Anne Douthit

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Income Taxation—Ordinary and Necessary Business Expenses—Meals and Lodging Furnished Hotel Managing Partner Not Deductible.

BY ANNE DOUTHIT

Anne Douthit is a student at the University of Denver College of Law and a Registered Accountant. She received her B.S. in Business Administration from the University of Denver in 1951. She is immediate past president of the Denver Chapter of the American Society of Women Accountants.

The taxpayer was a general partner with a forty-nine percent interest in a Denver hotel. The partnership agreement required that he live at the hotel in order to properly perform his duties as manager and executive head of the hotel's operations. His wife and daughter also lived at the hotel, and took their meals there for the convenience and benefit of the partnership, rather than for their own personal convenience. Amounts representing costs of meals and lodging so furnished were not eliminated from the operating costs and expenses which were deducted from income on the partnership income tax return filed by the taxpayer and his partner. Nor were these amounts shown as income to the taxpayer on his individual return. When the Commissioner of Internal Revenue assessed deficiencies on the taxpayer's return for amounts representing the cost of meals and lodging furnished to him and his family, he paid the deficiencies and sued for a refund in the Colorado federal district court. The district court held that these amounts did not constitute income to the taxpayer, nor was it necessary for him to eliminate the amounts from deductible expenses of the partnership. The Commissioner appealed and by a per curiam decision, the Tenth Circuit Court of Appeals held that the partnership could not include these amounts in its deductible expenses. *United States v. Briggs,* 238 F.2d 53 (10th Cir. 1956.)

The question presented by this case, that of whether or not the cost of meals and lodging received by a hotel owner-operator is deductible as an "ordinary and necessary business expense" on the federal income tax return of such owner-operator, has been creating considerable controversy among various courts and internal revenue officials in the past few years. The question first was decided in 1951 by the Tax Court in a case with an identical fact situation. In *George A. Papineau*[1] the Tax Court held that the costs of the managing partner's meals and lodging do not constitute income to him, and are properly operating expenses of the hotel. A few years later three more cases with similar fact situations came before the Tax Court. The Tax Court decisions in these cases followed *Papineau.*[2] Two of these later decisions were reversed

[1] 16 T.C. 130 (1951).
[2] Everett Doak, 24 T.C. 569 (1955); *rev'd,* 234 F.2d 704 (4th Cir. 1956)(leading case); Richard E. Moran, 14 T.C.M. 813 (1955), *rev'd,* 236 F.2d 595 (8th Cir. 1956); Leo B. Wolfe, 14 T.C.M. 791 (1955).

when appealed by the Commissioner[3] to the Fourth and Eighth Circuits respectively. The Tenth Circuit's reversal of the *Briggs* case was on authority of these two decisions.

The internal revenue code provides that all ordinary and necessary expenses incurred or paid during the taxable year in carrying on a trade or business shall be allowed as a deduction. This section specifically includes reasonable allowances for salaries or other compensation for personal services, and also, traveling expenses for meals and lodging while away from home.[4] There is further provision in the code that no deduction shall be allowed for personal, living or family expenses.[5] The 1954 Code in a new provision, section 119, allows an employee whose meals and lodging are furnished purely for the convenience of the employer, and required to be taken on the premises as a condition of employment, to exclude the value of such meals and lodging from his gross income.[6] It should also be noted in connection with the instant case, that the code does not consider a partnership as a separate taxable entity, but holds the individual partners liable for their income tax only in their separate capacities.[7]

Relating these provisions of the code to the problem at hand brings up several questions. Obviously where a resident manager is an employee, hired with the condition that he live in the hotel, the cost of his maintenance is an operating cost, the same as his salary. Now under section 119 of the 1954 code these amounts do not constitute taxable income to him.[8] Although there was no provision in the 1939 code to this effect, there was such an exclusion in the regulations.[9]

But can an owner-operator or resident manager who is a partner in the business consider his living expenses in the same category as those of an employee? The court of appeals decisions would indicate that he cannot. In support of its views, the Fourth Circuit stated that the nature of such expenditures cannot be altered by the fact that there is an indirect contribution to the business. The personal characteristics remain. A deduction could only be justified if the expenses were in excess of what normal personal and living expenses would be.[10]

The views of the Commissioner of Internal Revenue in this situation have been expressed clearly in a revenue ruling which followed the non-acquiescence in the *Papineau* case. This ruling states that costs attributable to personal and living accommodations of a hotel owner-operator should be eliminated from the deductible costs and expenses in computing the income of the business, and the resulting increase in income must be included in the managing partner's share of the net profits.[11]

The Tax Court's reasoning in determining that amounts repre-

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[3] Commissioner v. Moran ,236 F.2d 595 (8th Cir. 1956); Commissioner v. Doak, 234 F.2d 569 (4th Cir. 1956).
[4] Int. Rev. Code of 1939, § 23(a)(1)(A), as amended, 66 Stat. 442 (1952)(now Int. Rev. Code of 1954, § 162).
[5] Int. Rev. Code of 1939, § 24 (a)(1), as amended, 56 Stat. 819 (1942)(now Int. Rev. Code of 1954, § 262).
[6] Int. Rev. Code of 1954, § 119. See also U.S. Treas. Reg. 118, § 39.22 (a)-3 (1953) .
[7] Int. Rev. Code of 1939, § 181, 53 Stat. 69 (now Int. Rev. Code of 1954, § 701).
[8] See note 6 *supra*.
[9] U.S. Treas. Reg. 118, § 39.22 (a)-3 (1953).
[10] Commissioner v. Doak, 234 F.2d 569 (4th Cir. 1956).
[11] Rev. Rul. 80, 1953-1 Cum. Bull. 62.

senting the value of meals and lodging furnished a resident manager who is also an owner do not constitute income directly attributable to him is sound. In the *Papineau* case it was reasoned that a sole proprietor cannot create income for himself by buying himself meals and providing himself with lodging. It was further pointed out that one cannot employ or compensate oneself.

However, it appears to this writer, that the very reasons used to support the fact that an owner-operator cannot create income for himself through personal expenditures in connection with a business, conflict with the Tax Court's reasoning in allowing these expenditures to be deducted in computing net income for the business. Again in *Papineau* it was stated that it was not the intention of the code that expenses of operation be computed, eliminating small portions of depreciation, cost of food, wages, and general expenses to represent the cost of meals and lodging.[12] If a partner cannot be an employee for the purpose of receiving income in the form of meals and lodging, then it should follow that he cannot be an employee for the purpose of creating operating expenses to the business in the form of meals and lodging.

The decisions of the Tax Court have stressed the fact that the owner-operator is living in the hotel, and eating meals there, for the convenience and benefit of the business, rather than for his own convenience. But, as long as he is a partner, or a sole owner of the business, it would seem that anything that is for the convenience and benefit of the business is also for his benefit. Anything he does to increase business income increases his own income. This is not true of the employee who is required to live and board on the premises of an employer. He is not the direct beneficiary of this contribution to the business. Furthermore, an employee has no control over his employment conditions, but must abide by the requirements of his employer. A partner is a party to a partnership agreement which stipulates where, and how, he is to live in order to carry out his obligations. The requirements of a partnership agreement are more or less self-imposed requirements, which cannot be compared with employment contracts. For these reasons, it is this author's opinion, that the Commissioner is entirely justified in disallowing the deduction of this type of expenditure, and in including it in the resident managing partner's proportionate share of income from the partnership.

[12] See 16 T.C. at 132.

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