TRAVEL AND ENTERTAINMENT EXPENDITURES

HEARING

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-EIGHTH CONGRESS

FIRST SESSION

INTERROGATION OF THE COMMISSIONER OF INTERNAL REVENUE ON PROPOSED REGULATIONS IMPLEMENTING SECTION 274 OF THE INTERNAL REVENUE CODE OF 1954 RELATING TO DEDUCTIBILITY OF BUSINESS EXPENDITURES FOR TRAVEL, ENTERTAINMENT, AND GIFTS

Held in executive session February 28, 1963; transcript released to the public April 8, 1963

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CONTENTS

TRAVEL AND ENTERTAINMENT EXPENDITURES

THURSDAY, FEBRUARY 28, 1963

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:10 o'clock a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Smathers, Douglas, Gore, Talmadge, McCarthy, Hartke, Fulbright, Ribicoff, Williams, Bennett, Curtis, Morton, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk; Colin F. Stam, Chief of Staff of the Joint Committee on Internal Revenue Taxation, accompanied by Thomas Vail, a staff attorney.

The CHAIRMAN. The committee will come to order.

This meeting was called at the suggestion of Senator Smathers to interrogate the Commissioner of Interval Revenue on the proposed regulations to implement section 274 of the Internal Revenue Code of 1954 relating to rules for deductibility of business expenditures for travel, entertainment, and gifts.

The CHAIRMAN. The Chair recognizes Senator Smathers for questioning.

Senator SMATHERS. Mr. Chairman, first, I welcome Commissioner Caplin. We are pleased to have you here today.

May I also thank the chairman for being willing to call this meeting. I find a great deal of concern, not only in my State but elsewhere, on the part of the business community with respect to the substantiation regulations issued by the Internal Revenue Service and the substantive regulations now being promulgated under the law that the Congress passed last year in relation to expense accounts.

I would further like to say to the Commissioner that I am sure this holds true for most of the members of this committee. Let me assure you there is nothing of a personal nature involved. I recognize and I am sure all of us do, the very fine job the Commissioner is doing. He has a job to do, and he is doing it with enthusiasm and with zest. The only question that arises in my mind is whether or not, in his desire to do his job and collect taxes, in some instances, he might be exceeding the authority granted to him by the law which the Congress passed last year.

I would like just to say that in reading this brief statement, neither I, nor anyone that I know, condones abuses in the expense account area. I am confident that none of us condone such abuses. Quite frankly, I felt, prior to the adoption of the changes made by Congress last year, that the Internal Revenue Service then had sufficient author-

ity to eliminate expense account abuses. However, the Treasury Department insisted that it did not have this authority, and this was one of the reasons why Congress undertook to make the changes which it felt were designed solely to eliminate abuses.

I am confident that it was never the intent of Congress to enact legislation injurious to the hotel industry or the restaurant industry or the entertainment industry or the many thousands of empolyees who are connected with those industries.

I am equally confident that it was never the intent of Congress to make changes that would restrict legitimate expense account activity essential to the ordinary conduct of business.

From reports and correspondence that I and other Members of the Congress have received since the issuance of your substantiation regulations, pointing out the adverse impact they are having on these industries and employees connected in those industries, as well as expressing the grave concern of the business community that the proposed substantive regulations to be subsequently issued by you will be even more restrictive, it seems to me that it would be very helpful and constructive to examine into the matter to determine whether the medicine prescribed is stronger than that which the patient really needs.

Mr. Commissioner, to support this concern, there is an article in this morning's Wall Street Journal entitled, "Expense Accounts." It says in the headline, "New Tax Guidelines Are Apt To Be Tougher Than Many Imagine." The subheadline says, "Internal Revenue Service Will Overlay New Curbs on Deductions With Tough Court Rulings on Old Law," and so on.

I would like to make that article a part of this record, if there is not objection, at this point.

The CHAIRMAN. Without objection.

(The article referred to follows:)

[From the Wall Street Journal, Feb. 28, 1963]

EXPENSE ACCOUNTS—NEW TAX GUIDELINES ARE APT TO BE TOUGHER THAN MANY IMAGINED—IRS WILL OVERLAY NEW CURBS ON DEDUCTIONS WITH TOUGH COURT RULINGS ON OLD LAW—PROBLEM OF TAKING THE WIFE

(By Arlen J. Large)

WASHINGTON.—Businessmen who fear tough language in the Treasury's forthcoming batch of "substantive" expense account regulations are due for a jarring surprise:

The new rules are apt to be even tougher than imagined.

Not for several weeks will the Internal Revenue Service publish its preliminary version of guidelines on what's deductible—and what isn't—under last year's tax law changes by Congress. It's therefore impossible to forecast exactly what the guidelines will say.

However, the general direction of IRS thinking points to new expense-account explosions ahead. The main reason: While drafting rules under the new 1962 law, officials also are codifying a raft of scattered court decisions and unpublished IRS rulings made under the old law. The result is a discovery that old expense-account rules are a lot stricter than most people thought.

DOUBLE-BARRELED BLAST

Thus, Congress tougher new restrictions are overlaid on tough court interpretations of still-intact provisions of the old law, providing the forthcoming IRS guidelines with a double-barreled blast at expense-account practices that may astonish businessmen and Congress alike.

Take the expenses of a wife accompanying her husband on a business trip, for example. It may well be decreed that her cost on a trip will qualify only rarely as a deduction in the future; but more surprisingly, it may be decreed that such a cost has been practically nondeductible in the past. Too, a more austere definition of how business journeys may be mixed with pleasure could mow down deductions now claimed as a matter of course.

IRS already has been under violent attack for its first set of expense-account rules based on the 1962 tax law changes. These rules, published in final form in December, dealt solely with records now required to back up business expense claims. IRS was accused of making its recordkeeping rules tougher than the law itself required, a charge which tax officials deny.

The uproar over the recordkeeping rules alarmed some lawmakers, however, that Internal Revenue Commissioner Caplin has been summoned today to a closed-door meeting of the Senate Finance Committee. Mr. Caplin will be asked what he thinks of the economic impact of the expense account changes so far. And he probably will be asked how he's coming along in writing the "substantive" part of the regulations dealing with eligible deductions.

PROGRESS IS SLOW

Mr. Caplin's men are coming along slowly. IRS had hoped to publish its second set of proposed regulations this week. But the target date now has been moved to March 15, and officials concede April 1 may be more realistic. Once the proposed regulations appear, about another month will be consumed in receiving written protests, holding a hearing, and rewriting the rules in final form. Thus, taxpayers won't get a firm set of guidelines on what's deductible much before May.

One reason it's taking IRS so long is difficulty in figuring out just what Congress meant last year in tightening the law on business entertainment deductions, especially when wives tag along.

The bare-bones language of the new law itself is little help. The pertinent passage reads: No deduction is allowed "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."

The House-Senate conference committee that drafted the law's final wording said this passage would let a taxpayer deduct the cost of taking business associates "and their wives" to dinner and the theater, if earlier that day the men had conducted "substantial negotiations." But the conference committee said nothing about the taxpayer's own wife.

A TOUGHER STAND

The Senate Finance Committee interpretation of roughly this same passage appeared to take a tougher stand on wives. IRS rule-drafters, looking for hints on the treatment of a taxpayer's own wife on any occasion, can find a Finance Committee example citing a hypothetical company president's trip to a "tractor demonstration" accompanied by his wife. This committee said the wife's expenses would be deductible under the old law, but no deduction would be allowed under the new version.

Why, then doesn't IRS rely on this example to draft regulations barring the deductibility of a taxpayer's own wife? It could well end up doing just that, but for a reason that might surprise some Senators. IRS officials think the Senate committee was wrong in saying flatly that the wife's trip to the tractor demonstration was deductible under the old law. A tax agent might have challenged it anyway, and he probably stood a good chance of being upheld by the courts.

That's because a whole body of tough interpretations has grown up over the years around parts of the longstanding Tax Code requirement that deductions could be claimed only for "ordinary and necessary" business expenses. In 1958, for example, IRS itself published regulations saying a wife's travel expenses in accompanying her husband on a business trip are deductible only when she is along "for a bona fide business purpose." The regulations add: "The wife's

performance of some incidental service does not cause her expenses to qualify as a deductible business expense."

The U.S. Tax Court in 1961 demonstrated how strict this rule could be. Walter M. Sheldon, an Illinois insurance executive, was president of the National Association of Insurance Agents. He took his wife Laura on visits to State meetings of the association. She mainly acted as his hostess at convention social affairs, and the Tax Court itself said it would have been "unusual" for any president of the association to show up at these events without his wife.

COURT AGREED WITH IRS

Nevertheless, the court agreed with IRS in tossing out the claimed tax deductions for Mrs. Sheldon. The court said she went only to meetings held at "primarily resort or tourist locations," that Mr. Sheldon had not proved that his wife's social appearances were necessary in his work, and that he hadn't tried to get reimbursement from the association for her expenses. The decision that Mrs. Sheldon's expenses, thus, were "personal and nondeductible" was upheld in February 1962 by a Federal court of appeals.

A taxpayer might have lost his case under the old law even if he proved his wife did useful work. The Tax Court in February 1959 considered the case of another insurance man, Frederick C. Moser, who claimed deductions for his wife's expenses on business trips from Seattle to Hawaii, New York, southern California, and other places. His wife didn't actually sell insurance with her husband, but she helped entertain his clients and assisted Mr. Moser with his paperwork.

The Tax Court agreed Mrs. Moser was "of some assistance" to her husband in running his insurance business. But in scratching the deductions, the court said "she did no more than her wifely duty would require."

The old "ordinary and necessary" clause on which the *Sheldon* and *Moser* decisions are based remains in the tax law. IRS officials currently are weighing these and other decisions in figuring out what to say in their guidelines on the new law. It seems clear that this dragging together of sometimes obscure court cases and never-published IRS positions will make the old rules on wives appear much more strict than most people supposed. When rules interpreting the new law are placed atop this, it's likely a wife's deductibility will be limited to rare cases.

BUSINESS VACATION TRIPS

Congress also tried to tighten the law on deductibility of combination business-vacation trips. If a businessman goes from New York to Bermuda for a week-long industry convention, and then stays 2 additional weeks lying on the beach, his travel tickets were deductible under the old law. The new law still allows deductions for expenses actually incurred at the convention, but he can deduct only one-third of the cost of his travel tickets.

Though this seems clear enough, IRS officials might feel obliged to offer new guidance on the hazy boundary line between "business" and "pleasure." Once again,, strict court interpretations under the old law may have a bearing on what IRS says.

C. J. D. Rudolph, a Texas insurance man, met his company's sales quota and won an all-expenses-paid trip to New York City. His company transported Mr. Rudolph, his wife, and other winners on two special trains, convened them at a morning business session and a luncheon, and then left the rest of the time free for entertainment and sightseeing. IRS allowed the insurance company to deduct the entire $84,000 cost of the trip as a business deduction from its own taxable income. But it said Mr. Rudolph failed to show as "income" on his personal tax return $560 representing his pro rated share of the trip's cost.

Mr. Rudolph contended the trip's cost wasn't "income," and even if it was, he had the right to deduct it as an ordinary and necessary business expense.

"BONUS, REWARD"

A Federal district judge in Texas sided with IRS, ruling the trip's cost was "in the nature of a bonus, reward, and compensation for a job well done" and added that the holding of conventions in remote places "has the primary purpose or affording a pleasure trip * * *" A U.S. appeals court concurred, and the Supreme Court last summer refused to overturn the lower rulings. Thus, the district court opinion is now part of the body of rulings surrounding the "ordi-

nary and necessary" clause, and IRS may well make use of it in preparing its new guidelines.

The new law's language also is intended to overturn some other court interpretations of the "ordinary and necessary" clause which IRS felt were too easy. In asking for tighter expense-account rules in the first place, the Treasury made much of a case in which the Tax Court allowed a dairy company's African safari to be deductible as an advertising expense. The Finance Committee report said the law will "overrule" the arguments use by the dairy in winning its case.

In some passages of the law where Congress was less precise, IRS probably won't attempt a highly detailed sketch of what was intended. For example, the law bans deductibility of a traveling businessman's outlays for meals and lodging which are "lavish and extravagant under the circumstances." IRS rule-drafters probably will try to define "lavish and extravagant" only in general synonyms, leaving it mostly up to the tax agent's judgment.

Senator SMATHERS. Mr. Commissioner, I submit, respectfully, that the action taken thus far is having an adverse and growing effect on the industries which I have mentioned, and this, in turn, will have a growing adverse impact on our economy generally. Consequently, rather than recouping an estimated loss of $100 million in revenue allegedly resulting from abuses from the expense account area, it appears now that in an effort to correct the abuses, legitimate expense-account activity is so restricted that job losses and lower profits will inevitably offset the anticipated increased revenue receipts.

This is of particular significance and seems somewhat inconsistent with the view of the President of the United States when he recently emphasized before the American Bankers Association the importance of the substantial tax reduction in the neighborhood of $10 billion this year, even without reforms, if necessary, in order to stimulate the economy in sufficient time to offset what might be a recession.

In the February issue of the official journal of the Hotel and Restaurant Employees and Bartenders International Union, it is reported that the Internal Revenue Service regulations thus far issued have already brought about a closing of restaurants, bringing about job layoffs in this industry, as well as the hotel industry.

Let me just quote a couple of paragraphs from this journal:

At the Chase-Park Plaza, Schafers wrote, "A reduction in business expense-account spending has triggered a layoff of about 85 employees effective Monday (Jan. 14) and another 150 to 200 are being placed on a reduced 3- to 4-day week."

"The Sheraton-Jefferson," he found, "has abandoned floor shows in the boulevard room, resulting in the layoff of 43 waiters and associated employees, plus 8 musicians."

Industry spokesmen in Washington for the opening of the new Congress are deeply concerned at mounting reports from all parts of the country that the confusion surrounding the new regulations, and the perfectly natural fears fostered among businessmen by that same confusion, have seriously affected hotel, restaurant and convention operations.

Comments of the St. Louis operators, reported in the Globe-Democrat story, are typical of these reports:

L. C. Schoenbrunn, manager of the 1,600-room Chase-Park Plaza, said:

"We noticed the difference last month when all the publicity on the new tax ruling began. One convention, scheduled for January 6, canceled 150 rooms. Our night club and entertainment have dropped off drastically despite the fact we have one of the best shows ever.

"The businessmen seem to be spooked by confusion," he said. "Some seem to feel that no longer can they justify taking a prospective customer out just to build up future good will. If they can't show a deal was made during the evening, they feel they might not be allowed the costs as a justifiable business expense.

"Our average room rate has fallen off almost 8 percent. Plush suites are almost impossible to sell. It looks like our January gross business will be off about $100,000."

On page 28 of the February 18 issue of U.S. News & World Report, it is stated that:

New rules limiting expense accounts really are hurting some businesses.

Tax loss, due to job loss and lower profits for industries affected by new rules, very probably will offset in large part tax gains of a few millions due to sharper limits on expense-account deductions.

Pressures already are growing to ease the rules. Country clubs often are feeling the pinch badly. The entertainment business is, too.

Then, again, in the March 4 issue of U.S. News & World Report, pages 31 and 32, it is stated as follows:

Tax-law tinkering by reformers can be filled with dangers. A lesson, it now appears, will be provided by a simple move to tighten expense accounts.

The expense account had been built into the American economy. A number of important lines of business grew up around expense accounts. Congress, at the urging of reformers, changed the rules to end "expense-account living."

And so what's happening? Restaurants are hard hit. Country clubs are beginning to be, as well. Entertainment business of all kinds is being hurt. Cattle growers find themselves caught in the backwash. Beefsteak is the favorite on expense-account meals. Beefsteak demand, declining drastically in the fancy cuts, has resulted in a cut of about 20 percent in live-cattle prices.

That's just one small example. Farmers are hit. Investors in luxury establishments will be hit. Jobs are being lost in business that catered to the expense-account trade. It shows the danger of tinkering with taxes.

There's a strong prospect that more revenue will be lost through loss of jobs and taxable income, due to expense-account rules, then will be gained by closing what looked to officials to be a tax loophole.

Treasury now is saying that the new rules aren't as harsh as many people seem to think. Even so, most people simply do not want to be bothered by all the recordkeeping the tax collectors require to support expense deductions.

While I do not necessarily subscribe to all that is quoted in U.S. News & World Report, it appears to me that there is a general consensus that the above does reflect the attitude of the business community.

The deep concern of the business world over these regulations, as well as the fear that the substantive regulations to be promulgated will be more restrictive, has not been alleviated to this date.

Reports are being received that restaurants have closed, employees have been laid off, hotels are experiencing widespread cancellation of convention reservations, and beef prices have tumbled at the Chicago stockyards.

As a matter of fact, the manager of the Key Biscayne Hotel, in my own State, had just informed me this past week, and I have a letter on the way here, that four conventions scheduled for that hotel were canceled during last week, and in each letter the reason was expressed to be because there was uncertainty over the expense-account regulation.

This is not a matter which affects Florida alone. It is a matter which affects our economy generally at a time when we should be striving to stimulate the economy, rather than to deflate it.

All of this has been attributed to the regulations thus far issued, and those that are to be issued in the expense-account area, in the future.

I am sure that you know, Mr. Caplin, perhaps better than most of us, the furor that was raised by the proposed substantiation regulations issued by you on November 8 of last year.

Great concern was expressed then by the business world generally. They were condemned, the regulations which you then proposed were condemned, for requiring unreasonable and unyielding meticulous recordkeeping, both by employees and by their employers.

They were condemned for requiring notes to be recorded immediately upon the incurring of an expense, rather than at the end of the business day.

They were condemned for keeping businessmen from conducting business transactions.

They were condemned for imposing such severe recordkeeping burdens that it was said that the additional expenses incurred by business in maintaining the new records would reduce revenues to the Treasury by a greater amount than would be gained through the disallowance of some entertainment expenses.

As a result of this severe criticism, you felt impelled to modify these original regulations and eased up considerably before issuing the final ones on December 27, 1962.

As a matter of fact, you even announced a number of the modifications at the December 4 hearing before witnesses were heard.

Additional changes were made after the hearing, and I am sure that there is no doubt that with each modification, there was effected an improvement over the original proposals.

It may well be that the Congress, in an effort to eliminate abuses, went too far. On the other hand, it may well be that the regulations have far exceeded congressional intent. Then, too, it may be a combination, and probably is a combination, of both. Either regulation relief, legislative relief, or a combination of both, may be warranted.

I have a personal feeling, and I, of course, could be in error, that the regulations in some instances go further than the statute actually permits.

It seems to me the taxpayers' principal objection is that they impose an excessive recordkeeping burden, which requires taxpayers to choose between forfeiting productive man-hours or forfeiting the deduction of an expense to which they are otherwise entitled.

To determine just what action, if any, may be needed. I would like to ask you some questions which I have prepared, unless you want to make a response to my general statement before I begin to ask you some questions.

STATEMENT OF MORTIMER M. CAPLIN, COMMISSIONER, INTERNAL REVENUE SERVICE; ACCOMPANIED BY DONALD I. LAMONT, ATTORNEY, OFFICE OF CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. CAPLIN. I would be very happy to make a preliminary response, Senator. First, I would like to express my appreciation for the very kind remarks you made at the outset, and I welcome the opportunity to meet with this committee.

As you well know, I have represented taxpayers over a period of 20 years. I have represented businessmen, large and small, over this

period, and it is my expectation, when my days end up here, to return to this endeavor.

With this background, I would just like to say that I am very sensitive to the needs of businessmen, and I regard a large part of my function as Commissioner to make sure that in the carrying out of the law we are not overzealous, and that we are not treading on the rights of taxpayers.

In promulgating these regulations, which, you know, have to be approved by the Secretary of the Treasury, we were endeavoring to be meticulous in following what we considered was the legislative intent. We studied in detail the committee reports, the language of the statute, and I would welcome wholeheartedly, Senator Smathers, any suggestion in any area where you feel that these regulations overstep the congressional intent.

This is what we are endeavoring to do in the present regulations that we have under consideration.

Now, you remarked at the outset, and it certainly was not necessary, the strong feeling that you and the other Members of Congress have against the abuses which had developed in this area. At the same time you indicated your concern about legitimate business expense deductions being allowed as deductions. This is the dual pattern we have been trying to follow.

I do not have to account to you the legislative background. As far back as 1952, Congressman King, of California, after a detailed study of tax administration, introduced a bill to disallow any business expense unless it was substantiated in accordance with the Secretary's regulations. He said at that time:

> One of the most flagrant sources of inequity and of corruption has been found in the inadequacy of existing recordkeeping records and enforcement of these requirements.

Now, this was the setting in which Internal Revenue for over 10 years endeavored to handle this problem administratively. We found evidence of black market payment, of bribery, of all sorts of unrelated expenses thrown into the travel and entertainment expense account. This was the background which the Secretary investigated after the 1960 legislation.

You will recall that the Senate passed a statute which would have abolished all expense accounts except a quiet business meal, and this went into conference. At that time the conferees asked the Secretary of the Treasury to make a report, which he did in 1961.

Now, on the specific record keeping requirements, the abolition of the Cohan rule, you will recall the committee report says that no longer is estimation to be accepted; and the statute says that there must be substantiation, substantiation by adequate records or other evidence corroborating the taxpayer's statement.

The statutes states the amount, the time, the place, the business purpose and the business relationship, must be substantiated.

The Secretary is given a discretion to eliminate some of these items up to certain amounts. This was the de minimis rule for taxis, tips, and the like.

Senator SMATHERS. Was the Secretary given the authority to go beyond that?

Mr. CAPLIN. No, he was not given the authority to go beyond that. Now, I would like to say that the regulations were not drafted in the abstract.

We called in different attorneys, accountants. We examined many forms. We conferred with business leaders. At the same time, we were very anxious to have something out by the first of the year.

We got the first draft out as soon as possible, knowing that there would be comment and hoping to get improvement. I met with over 100 tax executives in Detroit. I invited representatives from large corporations to meet in my office. The improvement that was made over the first draft was not a trading matter. It was an effort for reasonable accommodation to legitimate business needs.

Now, I recognize that there are elements in the country that have reacted strongly. But I would like to call to your attention just a couple of things, and then I would be very happy to subject myself to your questioning.

One was the National Restaurant Association on January 4, issued a public statement in which they said that:

The Restaurant Association's complaint with the original proposals of the Internal Revenue Service would have made the burden of recordkeeping so great as to effectuate a tougher law than Congress intended.

But they close out:

The new regulations are far more reasonable and should not create too great a problem for the honest businessman. Most of our objections were satisfied—

Said the restaurant spokesman.

Then I got a letter from the counsel of the American Hotel & Motel Association, and he says:

We were very grateful, indeed, for the time allowed our association at the hearings held on December 4, and, although the former regulations which you published on December 27 were not all that our association would have hoped for, we do feel that, everything considered, they are very fair and reasonable, and we want you to know that we will do all in our power to encourage prompt compliance by all the member hotels in the association.

Senator SMATHERS. What is the date of that letter?

Mr. CAPLIN. That is dated January 10, 1962. Now, since then, since January——

Senator SMATHERS. 1963?

Mr. CAPLIN. Excuse me, 1963.

The letter actually has a 1962 date on it, but it was a typographical error. We received it January 29, 1963.

Since then I have conferred both with the hotel and restaurant associations, and I have arranged to come down and meet with some of the membership in Orlando to discuss these rules in greater detail.

Next, the Governor of the State of Florida wrote us a letter on January 22, in which he said:

On behalf of the many Florida citizens who were vitally concerned as to the effect your new regulations might have on the tourism which is important to our State, I should like to express my appreciation for your fine attitude and my congratulations on the fairness which is exemplified in your rulings. I believe that you have achieved much in your drive to eliminate abuse of expense accounts without, at the same time, placing detrimental restrictions on legitimate business travel and activities.

I think this is all I need mention at this time except to mention that many companies have written to us that our regulations are less demanding in terms of recordkeeping than their own existing rules.

Senator SMATHERS. Mr. Caplin, may I say that I think and I do not use this word to impute anything but credit to you—you were very clever in first having those real tough regulations issued in November, circulated about, and then acceding to less stringent regulations which you put out December 27.

You read the letter from the hotel association which was dated January 10. I have got a letter from the hotel association dated February 26.

Senator CURTIS. Will the Senator yield?

Senator SMATHERS. Yes.

Senator CURTIS. Mr. Chairman, some of us have conflict with committee meetings. I would like to ask unanimous consent to submit about half a dozen questions in writing and have the questions and the responses incorporated in the hearings. They do not need to be pronounced here orally, but I will hand them in sometime today.

The CHAIRMAN. Without objection.

Senator CURTIS. Thank you very much.

(See questions Nos. 25, 26, 27, 28 and the Commissioner's reply beginning on p. 76.)

Senator SMATHERS. I have here a letter from the Hotel and Restaurant Employees and Bartenders International Union dated February 26:

I have asked our legislative consultant, Mr. Cyrus T. Anderson, to do me the courtesy of placing in your hands the attached material which conveys our deep concern at the alarming loss of jobs growing out of recent changes in Internal Revenue Service regulations governing travel and expense deductions.

I would like to make that letter and the attachments part of the record at this point.

The CHAIRMAN. Without objection.

(The documents referred to follow:)

HOTEL AND RESTAURANT EMPLOYEES AND
BARTENDERS INTERNATIONAL UNION,
Cincinnati Ohio February 26, 1963.

Hon. GEORGE A. SMATHERS,
Senate Office Building,
Washington, D.C.

DEAR SENATOR SMATHERS: I have asked our legislative consultant, Mr. Cyrus T. Anderson, to do me the courtsey of placing in your hands the attached material which conveys our deep concern at the alarming loss of jobs growing out of recent changes in Internal Revenue Service regulations governing travel and expense deductions.

This material includes a letter to Chairman Byrd of the Committee on Finance, a memorandum, and photocopies of a variety of letters containing supporting evidence.

Cordially yours,

ED. S. MILLER, *General President.*

Enclosures.

HOTEL AND RESTAURANT EMPLOYEES
AND BARTENDERS INTERNATIONAL UNION,
Cincinnati, Ohio, February 26, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Since we understand the Committee on Finance will presently review with Commissioner Caplin the new Internal Revenue Service regulations governing deductibility of certain business entertainment expenses, we beg leave to place in your hands the results of a hurried survey concerning the impact of these regulations on employment in the hotel and restaurant industry. We will appreciate it, sir, if you will enter our statement in the committee's record.

I need scarcely add that this organization, representing close to 500,000 men and women engaged in all departments of the public feeding and lodging industry, is deeply concerned whenever there is a threat of lost jobs in this field. We are, with all Americans, distressed at the persistence of unemployment; and commonsense suggests that any act of Government which exacerbates this already serious problem deserves the most earnest reexamination.

As the attachment memorandum indicates, we queried officers of our branches in the following cities: New York, Detroit, Milwaukee, Chicago, San Francisco, St. Louis, and Los Angeles. Each is an important hotel and restaurant center, each a prominent convention city. While our survey is by no means complete, it clearly reflects the alarm felt by our representatives, all widely experienced in the industry's labor supply problems, and by responsible businessmen in a position to know intimately the already grave consequences of the IRS's new posture in respect of travel and expense items in the businessman's budget.

I am taking the liberty of forwarding copies of this letter and the attached exhibits to your colleagues on the Committee on Finance, as well as to Washington representatives of the trade associations of the hotel, restaurant, and licensed beverage industries.

In addition, I have asked our legislative consultant, Mr. Cyrus T. Anderson, to deliver this message to you by hand so that he may answer any questions you have concerning it.

Very truly yours,

ED. S. MILLER,
General President.

FEBRUARY 26, 1963.

Memorandum To: U.S. Senator Harry F. Byrd, chairman, Senate Committee on Finance.
From: Ed S. Miller, General President, Hotel and Restaurant Employees and Bartenders International Union.

On February 20, 1963, upon learning that you had decided to hold informal discussions with the Commissioner of Internal Revenue concerning the impact of new Internal Revenue Service regulations governing the deductibility of travel and expense items associated with the conduct of business, I instructed our staff to query our local representatives in key cities with this question:

"Have the new regulations on business entertainment expense deductions affected employment since January 1, 1963, in hotels and restaurants in your community?"

The query was put to local union officers in seven cities: New York, Detroit, Chicago, St. Louis, Milwaukee, San Francisco, and Los Angeles. While I am attaching photocopies of written statements gathered by our representatives in a number of cases, you will find below the gist of these findings. You will also find attached the results of a similar query put to the American Hotel and Motel Association, of whom I asked that they cull from reports reaching them any citing precise information on specific numbers of employees affected as their members seek to adjust to the new situation.

From New York

(Our respondent: David Siegal, president of our local joint executive board, as well as of Dining Room Employees Local 1, with members employed in the city's first-class restaurants.)

Restaurant Associates, Inc., a group of outstanding restaurants catering to the business community (the Four Seasons, La Fonda do Sul, Forum of the Twelve Caesars, Tavern-on-the-Green, "Mamma" Leone's (on 48th Street), and the Tower Suite, as of February 20 had laid off 350 employees, including 300 in kitchen and dining room departments and the entire staff of their central commissary, closed February 18, at a cost of 50 jobs. (See letter from Austin B. Cox, citing evidence that these layoffs are directly attributed to a decline in business entertainment volume.)

The Brass Rail chain, with seven locations including six in Manhattan and the Golden Door at New York airport (100 Park Avenue, 500 8th Avenue, 521 5th Avenue, 145 7th Avenue, Brass Rail Socony (Socony Building) and (150 East 42d Street) reports a 15-percent decline in business volume and "approximately 200 people laid off" in all departments.

Jack and Charlie's "21," a famous midtown dining room, while citing no figures on numbers laid off, reports a business decline of 11 percent in December-January over a year ago, and relates it to the new IRS regulations. (Letter from I. Robert Kriendler.)

Sardi's, like "21" and El Morocco, as well as Oscar Delmonico's in the lower Manhattan financial district, report sharp declines in the volume of their customary business spending. Same is true of a night club, the Latin Quarter. At all these places, according to a telephone conversation with Mr. Siegal, proprietors, in addition to laying off waiters, cooks, and other personnel, are putting their people on 3- and 4-day weeks. Sardi's has a specially telling experience: the Sardi's in the theater district, on 44th, a popular rendezvous for theatrical personnel and theatergoers, has held its volume pretty well, while the Sardi's on the East Side, catering to a business clientele, has been forced to reduce its working force, put others on short weeks including 3-hour days, and finds its uncertain that the place can be kept in operation.

From Detroit

(Our respondent: Max Gazan, representative of the Detroit Joint Board, with members employed in the city's hotels, clubs, restaurants, and country clubs.)

Private clubs in Detroit (Athletic Club, Town Club, University Club, etc.) report a January decline of 15 percent in out-of-town members—i.e., businessmen in outstate communities who do frequent business in the Detroit area.

Country clubs have reported they will cut crews 15 percent at the opening of their 1963 seasons in March and April.

The city's nightclub business is off 25 percent.

Michigan restaurant and caterers association reports that member establishments catering to charge account customers are down 15 to 20 percent since January 1.

Detroit Hotel Association (major hotels—Sheraton-Cadillac, Statler-Hilton, the Leland, etc.) reports restaurant and bar business off 15 to 20 percent, and double-occupancy room sales for conventions are off 75 percent over previous years. This fact bears directly on uncertainty concerning IRS position on deductibility of expenses entailed in taking one's wife to a convention.

Mr. Gazan reports the following establishments have closed their doors since January 1: Civic Center Restaurant, Anthony's, the Captain's Table, Ranucci's Cascade Room, all first-class houses.

From Milwaukee

(Our respondent: Jack Heisdorf, president, Hotel & Restaurant Employees Local 122, with members in the city's major hotels and restaurants. Attached letters from E. A. Conforti, executive vice president, Wisconsin Restaurant Association and Irving A. Lore, Wisconsin State Hotel Association.)

"Food service business has suffered a reduction of 18.2 per dollar sales in comparison from January 1962 to January 1963—customer count, 21.7 percent; number of people employed, 21.9 percent; man-hours worked, 22.3 percent.

"This decline * * * can be directed largely to the effects of the new Bureau of Internal Revenue regulations * * *"

Hotel Association reports "sales in January 1963 declined approximately 16 percent from similar sales in January 1962."

From Chicago

(Our respondent: John E. Cullerton, executive director, Local Joint Executive Board, with members employed in Loop hotels, major downtown and suburban restaurants, hotels and apartment hotels and nightclubs.)

"January is one of the best months in the hotel industry in the city of Chicago. It may even be the best month. Occupancy figures for January 1962, 70.58 percent. In January, 1963, 65.91 percent."

From San Francisco

(Our respondent: Anthony Anselmo, secretary, Local Joint Executive Board, with members employed in hotels and restaurants belonging to the city's major trade associations, as well as nonassociation houses.)

Del Webb's Town House reports layoffs due to sharp decline in entertaining, reduction in sales of rooms for double occupancy.

Skipper Kent's, a restaurant, has laid off "25 to 30 percent" of personnel in recent weeks, with half of remaining force on shorter workweeks.

Blue Fox restaurant: Ten fewer employees than in February of 1962. Sees "chain reaction" as business decline affects other businesses—purveyors, etc.—leading to layoffs in other businesses.

Normandy International restaurant: Business off 60 percent, six employees laid off, "and a musician of 10 years' service with us."

Gorman's Gay Nineties: Sharp drop since January 1, laying off "a large number of our staff."

Bimbo's 365 Theatre restaurant: "My business is off 15 to 20 percent, forcing me to lay off personnel."

Sir Francis Drake (Western Hotels chain): Reports "crackdown by Bureau" has brought "an alarming fall-off in convention business, many cancellations of rooms. In first 19 February days room sales off 13 percent, food sales off 15 percent."

Fleur de Lys, a celebrated French restaurant: "We have had to reduce many of our people to 3-hour shifts, and many of these are working but 3 days a week." Management here cites danger of reducing take-home pay to point where it is actually below State unemployment compensation levels.

In a telephoned report, commenting on these letters from San Francisco employers, Mr. Anselmo said "in 20 years I have never known such a stream of discharge cases—dozens of them. The San Francisco contract provides machinery for mediating discharges, and Anselmo reports that in "case after case" we're being told the layoffs are directly due to a sharp decline in business growing out of the widespread curtailment by businessmen of their customary business lunches and dinners in an effort to avoid conflict with the Internal Revenue Service.

From St. Louis

(Our respondent: John Gibson, president, Local Joint Executive Board, with members in all major hotels and restaurants.)

The Sheraton-Jefferson is "reducing its force at this moment at the rate of about five workers per day" because of lost volume they now estimate at "about "$100,000 a month"—half in convention business, half in transient. This hotel reports a high rate of "no shows" among convention delegates.

The Chase-Park Plaza cites the following figures, as of the week of February 17: $66,000 decline in room sales; $42,000 decline in their night club; $59,000 decline in banquet department—(this includes, of course, small business lunches and other private dining room volume as well as large evening banquets). The hotel reports 250 of its suites "simply not renting" because "customers are afraid suites will be classed as 'lavish' by IRS." These figures explain why Chase-Park Plaza, as of that week, had laid off 127 workers in all departments, and put 175 other employees on reduced work schedules.

The Mayfair-Lennox hotels report an 8-percent decline since January 1 compared with a year ago, primarily in food and beverage sales and foresee, if decline is not arrested "no alternative but to permanently lay off approximately 55 employees."

John R. Thompson Co., a Chicago-based restaurant chain with St. Louis units, while reporting no layoffs yet, foresees likelihood of reductions in force if present decline continues.

From Los Angeles (our respondent: Paul Greenwood, secretary, local joint executive board, members in all major hotels and restaurants)

While letters supporting his report were not in hand when this memorandum was drafted, Mr. Greenwood reports by telephone as follows:

"Mike Romanoff's has closed because of lost 'business entertainment' lunch and dinner business. Both Dave Chassen's and Robert Cobb's Brown Derby, famous Los Angeles restaurants, report their business lunch and dinner trade to be off 15 to 20 percent, with layoffs and short weeks proportionate. Same is true of the Mike Lyman chain of three units. Managers Weber (Ambassador), Meacham (Statler-Hilton), and Bernard (Biltmore), leading Los Angeles hotels, have told me that layoffs already amount to 10 percent, and short weeks for others are increasing as they try to adjust to the new conditions imposed."

From the American Hotel & Motel Association

At my request the principal trade association in the hotel industry has taken out of reports reaching them specific cases in which hotel owners have cited numbers or percentages of layoffs. This list, of about 30 hotels in 15 or 20 cities—including most of those included in our spot check—only confirms the findings of our survey: hotels are cutting their payrolls draetically in an effort to balance overhead costs with reduced business volume resulting from the new IRS regulations. (See list below of organized cities and unorganized cities.)

CITIES WHERE HOTELS ARE ORGANIZED

Los Angeles, Calif.: Statler-Hilton Hotel. During last 3 months have dropped 92 employees.

St. Louis, Md.: Sheraton-Jefferson Hotel. Dropped 43 waiters in January.

St. Louis, Mo.: Chase-Park Plaza. Laid off 85 employees—put another 150 on a 3–4 day week.

Boston, Mass.: Bradford Hotel. January 1963—19 employees eliminated.

Detroit, Mich.: Statler-Hilton. Dropoff of 47 employees, comparing January 1962 with January 1963.

Minneapolis, Minn.: Holiday Motor Hotel. Since January 1, 1963, employment down 4 percent.

Billings, Mont.: Northern Hotel. Twelve percent of jobs eliminated—shorter hours for remaining ones.

Atlantic City, N.J.: Shelburne Hotel. Employee days for the month of January was 398 less than last year.

New York City: Realty Hotels. Staff reduction as compared to January 1962 was 4.4 percent and 1962 was a poor year.

New York City: Hotel Taft. Reduction of 26 employees January 1962 as compared to January 1963,

New York City: Hotel Pierre. Cotillion Room closed, forcing 63 persons out of work.

New York City: Sheraton-Atlantic. Layoff of approximately 50 employees—January 1962 to January 1963.

New York City: Hotel Dixie. January 1962, 235 on payroll. January 1963, 217 on payroll.

New York City: Hotel George Washington. January 1962, 181 on payroll. January 1963, 175 on payroll.

New York City: Manger-Vanderbilt. Cut staff by 23 employees January 1963.

Columbus, Ohio: Deshler-Hilton. Seven employees in one room, because of the necessity of closing the room.

Dayton, Ohio: Dayton-Biltmore. January 1962, 64.1 employees. January 1963 57.3 employees.

Pittsburgh, Pa.: Hotel Websters Hall. January 1962 to January 1963 reduction in personnel of 20 employees.

Southern California Hotel and Motel Association. Unemployment among hotel and restaurant workers has increased 15 percent since new regulation.

Seattle, Wash.: Olympic Hotel. 88 employees less than 1 year ago.

Seattle, Wash.: Edmond Meany Hotel. Staff reduction of 15 full-time employees.

El Paso, Texas: Hilton Hotel. Reduced number of employees from 172 to 160.

CITIES WHERE HOTELS ARE UNORGANIZED

Solvang, Calif.: Alisal Ranch. January, cut 10 full-time employees.
Wallingford, Conn.: Yankee-Silversmith Inn. Payroll, January 1962, 119 persons. Payroll, January 1963, 97 persons.
Valparaiso, Ind.: Lembke Hotel. January, dropped three full-time employees in addition to cutback on part-time employees.
Frederick, Md.: Hotel Francis Scott Key. January 1962 compared to January 1963, reduction of staff from 127 full-time employees to 122, with even greater decrease in part-time employees and hours of work for regular employees.
Dearborn, Mich.: Dearborn Inn. Running 25 full-time employees less than than a year ago at this time.
Mobile, Ala.: Grand Hotel. Necessary to terminate employment of 51 employees.
(Source: American Hotel & Motel Association.)

DINING ROOM EMPLOYEES UNION LOCAL 1,
New York, N.Y., February 20, 1693.

Mr. FRED SWEET,
Managing Editor,
Washington, D.C.

DEAR FRED: Following our telephone conversation. I would like to tell you that the Brass Rail chain consisting of the following restaurants (6 of them) and also including the Golden Door at the airport since January 1, 1963, find that 15 percent of their business is off and that approximately 200 people have lost their jobs.

The Latin Quarter (a night club) is finding business 10 percent off and many of their people have been taking time out which is a loss of time and money.

The same goes for Sardi's restaurants and particularly a place known as Oscar Delmonico's which is located in the financial district; one of the oldtime restaurants for more than 50 years. They find business is off 20 percent as a result of the expense regulations on business.

I am enclosing some letters for your information.

You must understand that there are many more places that we have not heard from yet and that many people have been laid off.

Best wishes.

Sincerely and fraternally,

DAVID SIEGAL, *President.*

NEW YORK, N.Y., *February 20, 1963.*

Mr. DAVID SIEGAL,
Dining Room Employees Union, Local 1,
New York City.

DEAR DAVE: Pursuant to our conversation earlier today I shall try to give you the information you are seeking in the simplest form:

In November of 1961 the number of persons served at "21" was 23,634, in November of 1962 the number of persons served was 22,398. The result here is a minus figure of 1,236 persons served or 5.5 percent off.

In December 1961–January 1962 (I am lumping this period for convenience) was a total of 42,585 persons served. In the period December 1962 to January 1963, persons served was 37,928. A loss here for the period of 4,657, or minus 11 percent.

I should like you to understand that these figures represent the number of persons served their meals here at "21."

I began these comparative figures in November simply because it was during that period in 1962 that the knowledge of the Internal Revenue Service regulations began to affect the patronage.

I would like to call your attention to the acceleration of rate of decline that coincided with the publicity regarding the expense entertainment deductions on the part of the Internal Revenue Service.

I trust this information will be helpful to you.

Sincerely,

"21" CLUB, INC.,
I. ROBERT KRIENDLER,
President.

RESTAURANT ASSOCIATES, INC.,
New York, N.Y., February 20, 1963.

Mr. DAVID SIEGAL,
President, Dining Room Employees Union, Local 1.

DEAR MR. SIEGAL: During the last 3 weeks we have had to lay off over 10 percent of our force to compensate for the alarming decrease that has taken place in our volume of business since January 1, 1963. This means that nearly 300 men are now in the rank of the unemployed, many of them members of the union of which you are president and still others members of unions comprising the local joint board in New York City.

In addition to this dismal fact, I regret to tell you that the diminution in volume of business has made it impossible for us to continue our central commissary and that we ceased these operations on Monday, February 18, 1963. As a result over 50 workers have lost their jobs.

The January 1963 decline in volume has continued at an even greater rate in February and all we can look forward to is further layoffs.

We attribute this situation to the so-called expense account spending regulations of the Internal Revenue Service and the confusion that exists regarding those regulations.

As you know, we have never made a practice of "bleeding in public," but in this case we must. In 1962 we were ahead of our 1961 volume despite the dislocation in the national economy, the decline in the stock market, and the newspaper strike in New York City—all factors that were generally considered by others to be responsible for severe decreases in their restaurant sales.

Starting the first week in January 1963 our sales started their downward plunge and resulted in decreases in volume during the month of as much as 20 percent against the same month last year, which, by the way, was a bad month for business on account of adverse weather. In short, I am not giving you rigged figures. Our comparison is eminently fair. Significant accounts that made frequent or even regular use of our restaurant facilities have withdrawn their patronage.

I suggest to you that the conclusion I have drawn is plain and ask that you consider this serious situation, growing even more so as February wears on, in the interests of your members.

RESTAURANT ASSOCIATES, INC.,
By AUSTIN B. COX, *Vice President.*

HOTEL & RESTAURANT EMPLOYEES' &
BARTENDERS' INTERNATIONAL UNION,
Detroit, Mich., February 21, 1963.

Mr. FRED SWEET,
Hotel & Restaurant Employees & Bartenders International Union,
Cincinnati 2, Ohio.

DEAR SIR AND BROTHER: On short notice I have been able to get the following facts for you regarding the impact of the new tax rules on our industry:

(1) The private clubs have noted a 15 percent drop in out-of-town members.

(2) The country clubs are going to cut their crew by 15 percent when they open for the season.

(3) The nightclub business has dropped 25 percent.

(4) The Michigan Restaurant & Caterers Association, in establishments that cater to charge-account clientele, are down 15 to 20 percent.

(5) The Hotel Association's restaurants and bars are down 15 to 25 percent.

It was also noted that for conventions the reservations of double rooms has fallen 75 percent below previous years. Delegates no longer bring their wives.

(6) The following establishments have closed this year: Civic Center, Anthony's, Captain's Table, Ranucci's Cascade Room.

Trusting this is the information you seek, we remain,

Fraternally yours,

DETROIT LOCAL JOINT EXECUTIVE BOARD,
MAX GAZAN, *Representative.*

LOCAL JOINT EXECUTIVE BOARD
OF THE HOTEL & RESTAURANT EMPLOYEES
& BARTENDERS INTERNATIONAL UNION,
Chicago, Ill., February 19, 1963.

Mr. FRED B. SWEET,
Managing Editor, Catering Industry Employee,
Cincinnati 2, Ohio.

DEAR FRED: I have just talked with Bill Wilson of the Greater Chicago Hotel Association. Here are some figures that might interest you:

As you know January is one of the best months in the hotel industry in the city of Chicago. It may even be the best month. The occupancy figures for January 1962, 70.58 percent. In January of 1963, 65.01 percent.

With reference to covers served in the 11 major hotels the figures are as follows: In January 1962, 883,000. In January of 1963, 849,000.

With reference to employment in the hotel industry, 6,906 employees within the jurisdiction of the joint board were employed in January of 1962 and approximately 6,811 employees were employed in 1963.

The hotel industry is unable to furnish concrete or specific examples of layoffs or room closings that can be directly attributed to the Treasury Department's regulations governing business spending but these representatives are convinced that the decline in business can be attributed, to a large extent, to the recent regulations. They state in addition that hotel occupancy is down, travel to Chicago is down, and food covers are down and declining.

If I get any additional information on the hotel industry and/or restaurant industry it will be provided to you immediately.

Fraternally yours,

JOHN E. CULLERTON, *Executive Director.*

WINCONSIN RESTAURANT ASSOCIATION,
Milwaukee, Wis., February 22, 1963.

Mr. FREDERICK SWEET,
Manger-Hamilton Hotel
Washington, D.C.

DEAR MR. SWEET: I have been requested by Mr. Phil Valley to provide you with information relating to the effects the new expense account regulation adopted by the Bureau of Internal Revenue had on the food service industry of Wisconsin.

The food service business has suffered a reduction of 18.2 percent per dollar sales in a comparison from January 1962 to January 1963—customer count, 21.7 percent; number of people employed, 21.9 percent; man-hours worked 22.3 percent.

This decline in January sales customer count, etc., can be directed largely to the effects of the new Bureau of Internal Revenue regulation relating to expense account spending.

If adequate relief is not made available to the food service industry, employer members of the industry will further reduce the work force, adding to the great number of unemployed.

Anything that can be done to bring adequate relief will be welcomed not only by the employer members of the industry, but the employees as well.

Cordially yours,

E. A. CONFORTI, *Executive Vice President.*

WISCONSIN STATE HOTEL ASSOCIATION,
Milwaukee, Wis., February 19, 1963.

Re Internal Revenue regulations on expense accounts.

Mr. JACK HEISDORF,
President, Hotel and Restaurant Union,
Milwaukee, Wis.

DEAR MR. HEISDORF: The hotels of Milwaukee and of the entire State of Wisconsin have suffered substantial decline in their restaurant, beverage, and hotel operating revenues as the direct result of changes in expense account reporting required under the Internal Revenue Regulations.

Food, beverage, and hotel sales in January 1963 declined approximately 16 percent from similar sales in January 1962. Hotels blame misunderstanding of the new expense account law as the most apparent cause for this unexpected decline. Virtually all businessmen think that they must discuss business in order to justify the deduction for a business meal. Our hotels have suffered a decline in convention business which we attribute to the uncertainties and confusion existing with respect to deductibility of expenses incurred in attending such conventions. If this decline continues it will result in reduced employment opportunities in the hotel and restaurant industry resulting in widespread unemployment among certain classifications of employees.

Complaints have been pouring into the Milwaukee office of the hotel association about curtailed travel and entertainment expenditures by businessmen. The publicity attendant upon the harsh expense account regulations has had a most adverse psychological effect on businessmen. It is essential that affirmative action be taken to overcome the reluctance to continue legitimate expense account spending by American businessmen. Our industry is fearful that the regulations require such petty, unnecessary, and burdensome record keeping on the part of businessmen claiming expense account deductions that businessmen will be significantly discouraged from normal, reasonable, and necessary expense account spending.

We strongly urge that the regulations be modified so as not to impose an unreasonable hardship upon the hotel and restaurant industry and so that normal and reasonable good will entertaining will not be discouraged and stifled.

IRVING A. LORE,
Chairman, Legislative Committee Wisconsin State Hotel Association.

BIMBO'S RESTAURANT,
San Francisco, Calif., February 20, 1963.

Mr. C. F. DELANO,
Golden Gate Restaurant Association,
San Francisco, Calif.

DEAR MR. DELANO: I am writing to you in regard to the new regulation of the expense account the Government has issued.

My business has dropped off 15 to 20 percent compared to 1962. I have laid off some of my employees because of the situation the Government has put us in.

I sincerely hope you can help us with this new expense regulation.

With best regards.

A. "BIMBO" GIUNTOLI.

NORMANDIE INTERNATIONAL,
San Francisco, Calif., February 20, 1963.

GOLDEN GATE RESTAURANT ASSOCIATION,
San Francisco, Calif.

GENTLEMEN: We feel that you, as representatives of the restaurateurs of San Francisco, should know how unhappy we are at the tremendous drop in business during the past few months.

The businessmen trade, which we depend upon for survival, and to which we have spent huge sums in advertising, has dropped almost 60 percent. We know for a fact that this loss in business was brought about by the new law governing expense accounts.

We have been in business for 17 years, and we have never seen business as slow as these past months. We reluctantly have had to disengage a total of six faithful employees who have been with us for many years. Our musician of 10 years was just placed on his notice. Taxes, overhead, and now the pressure of new laws are driving restaurateurs to close their doors.

We sincerely hope that your association will find some means to improve this unfavorable situation and assist us in our drastic predicament.

Very truly yours,

JORGE TIERNEY, *Owner.*

GOMANS' GAY 90'S, INC.
San Francisco, Calif., February 20, 1963.

Mr. C. F. DELANO,
Executive Vice President,
Golden Gate Restaurant Association,
San Francisco, Calif.

DEAR MR. DELANO: Since the first of the year our business has dropped off considerably due largely, we feel, to the stringent rulings of the Internal Revenue Service governing expense accounts. The decline in business has necessitated our laying off employees as well as cutting down hours for a large number of persons on our staff. This obviously results in a hardship for them and their families.

We urge the restaurant association to use its influence in Washington to explain the situation and do whatever possible to have the expense regulations modified.

Sincerly yours,

BERNICE K. GOMAN, *Secretary.*

MAYFAIR LENNOX HOTELS,
St. Louis, Mo., February 22, 1963.

Mr. JOHN GIBSON,
Miscellaneous Hotel Employees Union,
St. Louis, Mo.

DEAR MR. GIBSON: For your information the gross business of Mayfair-Lennox, Inc., since January 1, 1963, has declined 8 percent as compared with 1 year ago. This decline has taken place primarily in the area of food and beverage. If this decline continues we will have no alternative but to permanently lay off approximately 55 employees.

If there is any other information you desire, please let me know.

Yours very truly,

JOHN C. ROBERTS, Jr.

Senator SMATHERS. I have a further letter from the American Hotel & Motel Association, dated February 4, which I shall not read, it goes into some detail, but it, in essence, expresses their growing concern as to the effect that these regulations, particularly substantiation regulations, are having, adversely, on their business and I would like to make that a part of the record.

The CHAIRMAN. Without objection.

(The documents referred to follow:)

AMERICAN HOTEL & MOTEL ASSOCIATION,
New York, N.Y., February 4, 1963.

Hon. MORTIMER M. CAPLIN,
Commissioner of Internal Revenue,
Washington, D.C.

DEAR MR. COMMISSIONER: Since the first of January we of the hotel and motel industry have had opportunity to evaluate the impact of your regulations pertaining to the substantiantion of travel and entertainment expenses upon our business. We are deeply concerned about the economic consequences, such as the drastic loss of business, and the accompanying reduction of employment throughout the industry. This loss of jobs hits a segment of our population which can least stand unemployment because of their inability to find other jobs and readjust themselves quickly.

This concern was expressed by the report of the Senate Finance Committee, and it was not their intent to disrupt the economy, cause unemployment, or a loss of revenue to the Treasury by imposing too stringent limitations on legitimate travel and entertainment expenses. It was stated on page 25 of the report:

"Expenses incurred for valid business purposes should not be discouraged since such expenses serve to increase business income, which in turn produces additional tax revenues for the Treasury. If valid business expenses were to be disallowed as a deduction (particularly expenses associated with selling functions) there might be a substantial loss of revenue where business transactions are discouraged, or where they fail to be consummated. Moreover, the entertainment industry employs large numbers of service personnel, most of whom are unskilled workers who would find it difficult to obtain new employment in other fields if the disallowance of entertainment expenses created considerable unemployment in the entertainment industry. In such cases taxes now paid by these workers would be lost to the Treasury.

In connection with this last sentence, I am enclosing a photostatic copy of pages 1-4 of the February 1963 issue of the "Catering Employee," a monthly publication of the Hotel and Restaurant Employees and Bartenders International Union. You will note that Mr. Ed S. Miller, general president of this union, distinctly feels that the new regulations have already created an additional problem of unemployment within his union and our industry.

A further problem has arisen because of some of your TV appearances and other public statements which have indicated that goodwill entertainment is no longer deductible. This has had the effect of causing large segments of the business community to sharply curtail, or completely eliminate, many of their entertainment functions, which we believe to be perfectly legitimate under the Revenue Act of 1962.

We believe that Congress has made it adequately clear that goodwill entertainment is recognized, and this is borne out by the following quotation from page 28 of the Senate Finance Committee report:

"Under the bill, although deduction for entertainment expenses is restricted, such expenses will not be disallowed merely because they are incurred for the purpose of generating business goodwill. Goodwill has long been recognized as a legitimate objective of business entertaining and where the purpose of the expense and its clear relationship to a business is firmly established, the expense ordinarily will continue to be deductible."

May I also cite you to language contained on page 16 of the conference report accompanying H.R. 10650:

"Section 274(a) as agreed to by the conference will allow as a deduction the cost of entertaining connected with what are primarily business meetings. For example, if the taxpayer conducts substantial negotiations with a group of business associates and that evening entertains the group and their wives at a restaurant, theater, concert, or sporting event, such entertainment expenses, if associated with the active conduct of the taxpayer's business, will be deductible even though the purpose of the entertainment is merely to promote goodwill in such business."

Further:

"Thus, under the business meal exception contained in proposed section 274(e)(1), and the conference agreement, the cost of providing food and beverages at most business meetings and banquets would be deductible, as well as almost all restaurant and most hotel entertaining. In neither of the situations covered by the conference agreement nor under the business meal exception is their a requirement that business must actually be discussed in order to get a deduction."

Although the fierce impact on goodwill entertaining is the principal area which is so harmful to the hotel business at this time, the day-to-day minutia requirements still existing under the regulations are another serious threat to legitimate business. I hope that you have had an opportunity to read the article in the February 4 issue of U. S. News & World Report, on pages 41-42, entitled "What Expense Account Curbs Are Doing to Business." This article points out very clearly and meaningfully how legitimate hotel and restaurant business is being curbed as a result of these regulations.

We of the hotel and motel industry respectfully suggest that you issue some statement clarifying these issues to the American public. I would be more than happy to confer with you at any time if you should feel that our association might assist you in any way toward a clearer understanding of this problem by the business community.

With kindest personal regards, I am

Sincerely,

DREW MARTIN.

[Reprint from Catering Industry Employee, February 1963]

IRS Crackdown Has Already Cost Jobs

(By Ed. S. Miller, General President)

It will be quite a while before the dust settles and we can read with clarity the full consequences of the administration's tough new posture on tax deductions for "business entertainment." But the early returns already prove that the international union's fears are being borne out: jobs have already been lost as hotel and restaurant owners move to cut payrolls because business spending is down.

At least two big Los Angeles restaurants—including Mike Romanoff's famous rendezvous for the film colony—have closed their doors. Both attribute the action in part to a sharp decline in business entertainment as business and professional men, fearful of the widely publicized threats of a Treasury crackdown, have curtailed their restaurant spending.

In St. Louis, according to a survey published by the Globe-Democrat, which assigned Reporter Ted Schafers to a spot check of hotels and restaurants, layoffs of serious proportions have already hit the industry.

85 AT ONE WEEK

At the Chase-Park Plaza, Schafers wrote, "a reduction in business expense-account spending has triggered a layoff of about 85 employees effective Monday, January 14, and another 150 to 200 are being placed on a reduced 3- to 4-day week.

"The Sheraton-Jefferson," he found, "has abandoned floor shows in the boulevard room, resulting in the layoff of 43 waiters and associated employees, plus 8 musicians."

Industry spokesmen in Washington for the opening of the new Congress, are deeply concerned at mounting reports from all parts of the country that the confusion surrounding the new regulations, and the perfectly natural fears fostered among businessmen by that same confusion, have seriously affected hotel, restaurant, and convention operations.

Comments of the St. Louis operators, reported in the Globe-Democrat story, are typical of these reports:

L. C. Schoenbrunn, manager of the 1,600-room Chase-Park Plaza, said:

"We noticed the difference last month when all the publicity on the new tax ruling began. One convention, scheduled for January 6, canceled 150 rooms. Our night club and entertainment have dropped off drastically despite the fact we have one of the best shows ever.

"The businessmen seem to be spooked by confusion," he said. "Some seem to feel that no longer can they justify taking a prospective customer out just to build up future goodwill. If they can't show a deal was made during the evening, they feel they might not be allowed the costs as a justifiable business expense.

"Our average room rate has fallen off almost 8 percent. Plush suites are almost impossible to sell. It looks like our January gross business will be off about $100,000."

[Editor's note.—Waiters, waitresses, and bartenders, who may be talking about the new rules with restaurant patrons, should know that Congress did not intend, and Treasury apparently doesn't, either, to outlaw "goodwill entertaining." Last year's tax law said in so many words that to be deductible business entertaining must be carried on in places and under circumstances "conducive to business discussion." The rules also speak of permitting deductions for entertainment "immediately preceding or following" a business discussion. It will be some time before we know what the Government considers a place "conducive to business discussion," or what's meant by "immediately following or preceding." It is not true, however, that the law and the regulations now forbid paying for a client's lunch or dinner or cocktails, or a prospect's, either.]

Max Dean, general manager at the Sheraton-Jefferson, told Schafers that "double occupancy room rentals during the last 4 months have dropped from 85 percent last year to 17 percent.

"This means only half as many conventioneers are bringing their wives along," said Mr. Dean. "When this happens this affects not only the hotel, restaurant, and entertainment business, but all retail operations."

Jack Lennox, secretary-treasurer of the Mayfair-Lennox chain of hotels, told the reporter "the new tax law certainly has had an effect on our higher-priced restaurants, but just how much we have not yet determined. The law still allows for business entertainment, but there's a great deal of confusion over how the law will be interpreted."

Spokesmen for the National Restaurant Association, the American Hotel & Motel Association (formerly the AHA), the American Motor Hotel Association, the National Licensed Beverage Association and other trade groups are now attempting to assess the meaning of the new regulations, slightly modified since first proposed because of wrathful complaints to the Treasury.

Among these is our legislative consultant, Cyrus T. Anderson, who has been instructed by me to place the full weight of this international union behind industrywide efforts to bring about changes which will relax these ridiculous rules, eliminate the present confusion, get our people back to work, and help to prevent a snowballing of these layoffs. Anderson will represent me, and the international union, in the ad hoc working committee set up by our friends in the industry to prosecute this program. To back him up, we'll need all the facts we can gather.

Drew Martin, who represents hotel men, said in a bulletin to members that while the rules issued December 27 "are still more rigid than [the association] proposed at the hearings held [in December] we do feel our efforts were rewarded by as much relaxation * * * as possible under the circumstances." Martin advised association members that the December 27 rulings covered largely recordkeeping—that still more is coming from the Internal Revenue Service in the way of elaborate interpretations of such matters as this: What is "lavish" entertainment? What is a "business meal"? Under what circumstances may one deduct the cost of taking his wife to a convention, or out to dinner with a client? These are but samples of scores of such questions, still unanswered, which the Treasury promises to enlighten the luckless taxpayer about in the coming weeks, but meanwhile they are a tangled web of uncertainty to business and professional men.

Paul Jorgensen, coordinator of NLBA's legislative program, and secretary of the national coordinating committee of the beverage industry of which our international union is a leading member, last month called upon the committee to "serve notice on Members of Congress and the IRS that the regulations based on the new revenue law are completely unrealistic. Rather than accomplishing the collection of additional taxes they will actually result in a loss of revenues to the Government through declining sales in licensed premises and reduced incomes among culinary workers."

The coordinating committee met last month in Washington with this critical question at the top its agenda. Made up of 14 unions, trade associations and manufacturers of the licensed beverages, the committee will play an important part in rallying support for our program to get Congress to help restore common sense to the people in the Treasury and the Internal Revenue Service.

Tom Power, Washington lawyer for the National Restaurant Association, in an NRA bulletin points out that much of the lost business being reported stems from the "adverse psychological effect upon businessmen" of the rash of publicity in the press, radio, and TV concerning IRS' first draft of their proposed regulations.

These would have required minute attention to bookkeeping, with a daily diary of money spent, and receipts for everything from a cup of coffee to plane fare. Powers points out that these harsh rules have been somewhat modified, chiefly in these ways:

While records of all expenses should be kept, receipts are required only on expenditures over $25 a day, and on all items of $25 or more. The canny taxpayer, however, will get and keep as many receipts as he can in order to be able to prove the claimed deductions are for legitimate business purposes.

My own view of the situation can be stated in very few words:

The new regulations are a serious burden upon the business community, right enough (see the Wall Street Journal's editorial on the subject, p. 2). They are going to create monumental headaches for those who own and operate hotels, motels, restaurants, cocktail lounges, clubs frequented by businessmen, and establishments offering entertainment. But the greatest burden of all,

because he can least afford it, is going to be borne by the worker in these places.

The members of this union can be assured that the international union will move heaven and earth, in the closest cooperation with the employer associations of the industries in which our members earn their livings, to bring about a return to sanity in this matter.

It seems certain that the sanity we seek will have to be won the hard way: by getting Congress to tell the Treasury and the Internal Revenue Service that when they wrote last year's tax amendments they did not intend to write them in such a way as to kill off thousands of jobs, and force hundreds of businessmen to the wall.

Nobody among the knowledgeable men in Washington concerned about this matter thinks this will be easy to do. The administration wants to crack down hard on business entertainment spending, and as the Journal editorial points out, seem perfectly willing to treat every taxpayer as a determined cheater in order to do so.

But the effort will certainly be made, and your union will be helping to make it. One of the ways in which your local union can help is this: gather as many facts as possible about the impact of the new regulations on the hotel and restaurant business in your own town. When a business lays off help, or closes its doors, try to find out whether the layoff or the closing is brought about because of a marked decline in spending by business and professional people who had previously patronized the place in pursuit of business. Keep an eye on conventions in your town. Are there fewer banquets, hospitality rooms, cocktail parties, luncheons in connection and convention schedules? Check with hotel employers, and operators of first-class restaurants.

[REPORT FACTS FAST

[Congress will want proof to back up our claim that new Treasury ground rules on expense deductions are playing hob with hotel and restaurant jobs. It is urgent that locals and joint boards inform general headquarters promptly of every case that comes to their attention of discharges, layoffs and reduced workweeks that can be attributed to the fact that business and professional men are reducing their patronage of hotels, restaurants, nightclubs, town and country clubs because of the new regulations.

[Labor chiefs, jobs dispatchers, shop stewards, and others in close touch with daily fluctuations in the industry's requirements for personnel are urged to inform their local union officers at once of any evidence of such reductions in force. Of particular importance are those first-class dining rooms in every city's hotels and restaurants which habitually cater to business and professional men.]

THE JUST AND THE UNJUST

The editorial below is from the Wall Street Journal. It is one of the most sensible commentaries yet on the Treasury's new rules governing deductibility of travel and "business entertainment' expenses which are already, as President Miller points out on page 1, having an adverse effect on employment in the hotel and restaurant industry. The editorial is reprinted with thanks to Dow, Jones & Co., publishers of the Journal.

We guess we don't run in the right social circles.

For years we have been reading those books about wild living in the suburbs and wondering somewhat plaintively why the excitement seems to pass us by. In years of suburban living the wildest shock to the even tenor of our domesticity was the day the dog drank up the cocktails and bit the mayor. It was weeks before we were forgiven.

For almost as long, we've been reading about all this notorious highliving on the expense account, boats, and all that, and groaning over what we seem to have missed. After a quarter-century in that den of iniquity, Wall Street, no one has tempted our journalistic virtue with even so much as a night at a hunting lodge, much less a seagoing voyage. Where, indeed, are all those expense-account yachts?

True, we aren't without sin, as defined in the new dogma of the Internal Revenue Service. We suffer business luncheons dreadfully often and when we turn in the voucher we don't deduct the $1.25 we would have spent anyway

for the blue plate special. A man is entitled to some recompense for punishment in line of duty.

When business takes us to Peoria or Dubuque, as it does all too often, we take an aperitif before dinner, choose the steak over the chicken ala king and sometimes splurge on the movies, charging the lot to the stockholders. If it weren't for their business we wouldn't be there at all, and frankly we have better steaks at home.

Moreover, the children being more or less at the age of discretion, we have lately taken our wife along on some trips. We haven't persuaded the curmudgeonly auditor to okay her expenses, but not long ago we drove to Washington on legitimate business (if talking to a Senator is legitimate) and our wife rode along in the car. Even that baleful auditor didn't ask us to reimburse the company for the equivalent price of her bus ticket.

Give or take a few details, this is not unlike the situation of thousands of businessmen in a country where men at work are ceaselessly traveling to and fro. The door-to-door salesman and the flying corporate executive are brothers under the skin; they are working also when they pass the time of day with the lady at the door or the business acquaintance across the luncheon table. Sometimes the smartest business is not to talk "business" at all but to be friendly, interested; to listen and to learn. Only ignorant and petty minds could imagine that the "free" lunch is all beer and skittles.

But now it turns out that all this is under the suspicion of undermining the public morality and the solvency of the U.S. Treasury. In any event the Government is going to treat all the people as crooks until proven otherwise.

This suspicion of malefaction flows from every word of the new regulations on recordkeeping, pedantic in language and picayune in detail, drawn up by the Internal Revenue Service.

Hereafter you must account to the Government not only for your yacht but the beer you buy a business acquaintance. The documents for any entertainment, no matter how trivial, must include the amount, date, place by name and address, type (martini or ham sandwich?), explanation of the benefit to be returned for this bounty, the name of the recipient and sufficient documentation to explain your extravagance to the satisfaction of any revenue agent who subsequently examines your tax report.

And if perchance on a trip you spend more than $25 in any day you must itemize everything else too—the day you left home, day you got back, every telephone call, meal, cup of coffee, taxicab, and bus fare. If you want your books to balance, you'd better even keep track of the postage stamps for the letters to the home office.

The sheer absurdity of this avalanche of paperwork is only the beginning. The metaphysicians of Mr. Mortimer Caplin's bureaucracy have now gone off to mull such esoteric questions as: What, precisely, constitutes a business meal? What is the allowable difference in cost between a lunch for a life insurance prospect ($5,000 policy) and the prospect for an electric dynamo ($5,000,000 sale)? Can you also buy lunch for the prospect's wife, or do you suggest she go eat in the drugstore? What if your own wife is along too—do you leave her back in the hotel room to munch a hamburger and watch television?

As ridiculous as these questions sound, they are precisely the sort of thing that must now be decided upon at the highest levels, and Mr. Caplin confesses—quite understandably, we think—that it will be some weeks before we can expect any official enlightment. It has never been easy to decide how many angels can dance on the head of a pin.

Yet it is neither the absurdity of the paperwork nor the ridiculousness of the metaphysics that is the true evil.

Here is a situation in which the Government is, no doubt about it, confronted with a problem. Some people do hide yachts in expense accounts, just as some do hide misbehavior in the suburbs, and the Government has power to deal with the real tax cheaters. But the vast majority of the people everywhere lead quiet, placid and upright lives, and the vast majority of those whose taxes support the Government give an honest accounting of their affairs.

Yet here we use the majesty of the law to treat every taxpayer as a potential cheater because pinhead minds can think of no other way; the integrity of all must be insulted, and the conduct of their affairs made insufferable, because of the sins of the few.

Now completely apart from this question of expense accounts, this is a philosophy of Government which is evil in itself. We once had an example of this when, to stop a few people from drinking too much, we adopted prohibition which treated all men as potential alcoholics. Surely the results have not left our memory.

The results of this noble experiment can also be foreseen. These new rules will give trouble only to honest men. The real operator—the man who is really out to cheat on his taxes—can drive a truck through them.

The smart lawyers are already figuring out the perfectly legal loopholes; beyond that, those with larceny in their hearts will not be disturbed because they will show records, receipts and paper accounts by the carload. As sure as the sun rises tomorrow, today's rules will have to be followed tomorrow by new rules upon new rules tightening the rules.

And while all this is going on, the honest man—the man who takes a business trip to do an honest job for his company and with no desire to cheat either his company or his country—that man will see himself not merely laden with burdensome paperwork but with the fear that everything he does is under suspicion.

Because he honestly tries to keep honest records, all the records will be there and he can be called up a year later, 2 years later, and find that what he did in good faith is adjudged wrong by some petty bureaucrat imbued with the idea that any expense account must conceal some wickedness. The smart operator will have his lawyers; the little taxpayers will be helpless against the insolence of office.

We submit that to order the public affairs in this manner is an affront to the public morality, just as it would be for the State to require of every citizen a detailed accounting of his home-coming-and-going because some men cheat. That Government governs illy which can find no other way to deal with malefactors than to maltreat all of its citizens, the just and the unjust alike.

Mr. DREW MARTIN,
American Hotel & Motel Association,
New York, N.Y.

DEAR MR. MARTIN: Your letter of February 4 seems to point up a situation which a recent press account has characterized as semantic differences.

There is no intent in the law or on the part of Internal Revenue to curtail legitimate business activity. On many occasions I have reiterated the statement I made at the time the final recordkeeping regulations were issued. The dual goals of the new law are to allow bona fide and legitimate expense deductions and to discontinue personal expense account living and other travel and entertainment abuses.

In speeches and in interviews I have specifically cited the exceptions in the law to the restrictions on good will entertainment. These include entertainment immediately before or after a substantial and bona fide business discussion and the quiet business meal situation.

In addition to considerable information on travel and entertainment released through the news media, we also have made available, free of charge, to the public a booklet "Travel, Entertainment, and Gift Expenses," Internal Revenue Document No. 5049, on page 10 of which both these points are covered.

I think you will agree that no matter how much information is turned out there will be some who will misunderstand for various reasons. It is apparent to me from news reports that while various people are quoted as expressing fears and apparent misunderstanding of the law, many of the same articles quote others who appear to have properly understood. I believe it is safe to say, too, that a greater segment of the public understands than is reflected through the news columns, since people who have no complaint are generally less prone to make themselves heard.

Aside from this, while I am satisfied that we have done a substantial information job thus far, may I assure you that I don't feel the job is complete. I am certainly interested in doing everything we can to help the taxpaying public to know what its rights and obligations are under the tax laws.

At this stage while we are still developing the so-called substantive regulations on travel and entertainment, I cannot go beyond acknowledging our understanding of basic congressional intent in this area:

(a) Ordinary and necessary expenses for entertainment may be deducted (1) if they are directly related to the active conduct of your trade or business, or

(2) in the case of such activities directly before or after a substantial and bona fide business discussion (including business meetings at a convention of professional and business associations), if the expenses are associated with the active conduct of your trade or business.

(b) Expense of business meals furnished to an individual under circumstances which are generally considered to be conducive to a business discussion may be deductible, but so-called reciprocal meals are not. In determining whether such meals are conducive to a business discussion, you must take into account the surroundings in which furnished, your trade or business, and the relationship to your business of the person to whom the meal is furnished. There is no requirement that business actually be discussed.

As I said before, neither Congress nor Internal Revenue has any intention of curtailing legitimate business expenses. The law and the regulations are intended to allow such deductions.

The purpose of the law and the regulations is to curtail abuses in claims for deductions on travel and entertainment which were unfair to millions of taxpayers who do not have the opportunity to claim such deductions.

Legitimate business expenses for which a businessman is willing to submit receipts or keep records as specified by the law and regulations will continue to be allowed.

In the hope that this will help to reduce existing misunderstanding, I am making this letter available to the news media. If you have any other suggestions that may be of use along these lines, please do not hesitate to advise me.

With kind regards.

Sincerely,

MORTIMER M. CAPLIN, *Commissioner.*

Mr. CAPLIN. Senator, did they make available to you the reply that we had sent to them on these letters? With the chairman's permission I would like for my reply to be inserted in the record.

(The Commissioner's reply to the American Hotel & Motel Association appears on p. 25.)

Senator SMATHERS. Now, I might say we have a whole file of letters from practically every State in the Union, some from Connecticut, many from Illinois, Kentucky, Arkansas, some from Virginia, which complain about the adverse effect that these regulations are having on their business.

There are a few States that we do not have them from, but we have them from most every State in the Union, and volumes of them from some of the States, particularly my State and California, what we would ordinarily call tourist States.

I would agree with Congressman King that we want to stop abuses, I started out by saying that, but I do not believe it was ever the intention of this committee or the Congress at any time, in order to catch a few to burn down the barn.

Further, I do not believe that it was the intention of the Congress, in trying to eliminate abuses, to go so far as to frighten the business community and create an adverse effect on our general, over-all economy at a time when we are trying to stimulate that economy.

These are the things that we are concerned about, generally.

Now, specifically, on this matter of receipt requirements, your regulations require retention of receipts for travel and lodging expenses and also for other expenses of more than $25. That is correct, is it not?

Mr. CAPLIN. That is right. That is an individual expenditure. That is right.

Senator SMATHERS. Right.

What I want to ask you is: To what does the $25 limitation relate? You said individual expenditures. Does that mean anything?

Mr. CAPLIN. Let me give you an example. If you were to sit down in a bar and have some drinks with an individual who is in a natural business relationship, and the bill, not including the tip, did not amount to $25, but $24.50, or what have you, then there would be no receipt required.

Then if you later went to the restaurant down the street and had dinner together and the bill was $22, even though the aggregate expenditure was $46, you still would not need a receipt, inasmuch as they were different expenditures.

It was a question of drawing the line some place between the so-called de minimis rule, which was indicated in the statute, and the committee reports. We were trying to delineate what is de minimis.

Senator SMATHERS. Originally, you had set the amount at $10 and you later changed it?

Mr. CAPLIN. That is right. There were some people who felt that $10 was a fair de minimis provision. You could spend any amount that was fair, but, in terms of the language used in the committee reports on what was intended in the delegation of authority to the Secretary and his delegate—the example in the reports indicated something like a cabfare or a tip—we felt that at that time $10 per item was reasonable.

But, then, after discussing this with a number of businessmen, they indicated they felt $25 might be a better rule. This was the suggestion made at the hearings, $25, and we felt that was within a zone of a decent rule. We therefore went to $25 per item.

Senator SMATHERS. Let me ask you this: Do you recall anything in the statute which had any limitation of $10 or $25 or anything of that character?

Mr. CAPLIN. No. If you read the statute literally, it would begin at $1, Senator.

Senator SMATHERS. Let me just read you what I think it says. Page 35 of our committee report says:

Generally, the substantiation requirements of the bill contemplate more detailed recordkeeping than is common today in business expense diaries. However, a clearly, contemporaneously kept diary or account book containing information with respect to the date, amount, nature, and business purpose of the expense may constitute an adequate record under this provision.

We are talking about a diary.

Mr. CAPLIN. Yes.

Senator SMATHERS. Not a receipt. What you are talking about is getting a receipt whenever it gets above $25. If the man happens to have a $25 cabfare during the day, he is supposed to get a receipt from the cabdriver?

Mr. CAPLIN. No, I believe the committee report in the next paragraph——

Senator SMATHERS. Reading the rest of it:

Moreover, expenditures merely incidental to entertainment, travel and so forth, such as taxicab fares, tips, and similar payments, will be deductible if they are substantiated by such a diary—

it does not say anything about receipts—

account book or similar record.

Then it goes on to say that:

The following example illustrates the operational requirements of this provision. The taxpayer establishes he traveled from California to New York on business. He should retain receipts for his transportation and his hotel expenses while in New York.

We have all agreed on that.

However, expenses incidental to that trip such as taxicab fares, tips, business lunches and so forth could be substantiated by entries in a diary.

Now, do you not agree that when you set a rule that says when you exceed $25 that you have got to have receipts from the bartender, the cab driver, or the restaurant man, that you have required something that the statute does not require?

Mr. CAPLIN. Senator, as I read this paragraph, the example of where receipts are not required are references to taxicab fares, tips and similar payments, and I would think they would normally not exceed a few dollars each.

Senator SMATHERS. Taxicab fares, tips, business lunches.

Mr. CAPLIN. No.

As an example here about receipts, the committee reports say:

Moreover, expenditures merely incidental to entertainment, travel, etc., such as taxicab fares, tips and similar payments will be deductible if they are substantiated by such a diary, account book, or similar record.

That is all that would be required today.

Senator SMATHERS. Are you now saying that even if it went above $25, they would not have to have a receipt?

Mr. CAPLIN. No. I will say this: That the regulations say that for an individual expenditure of $25 or more, then a receipt is normally required. But there are two other provisions in the regulations:

(1) That if a man does not have the receipt, he can still get the deduction through other evidence, such as evidence of someone who was with him, who said this was expended.

(2) There also is a provision in the regulations that, if there are circumstances where it would be difficult to get a receipt, that that, too, would excuse any receipt requirement.

Senator SMATHERS. Has any publicity been given to that particular regulation?

Mr. CAPLIN. They were actually stated. They are right in the regulations. It all depends on how carefully they are read. I think part of the difficulty, Senator, if you will permit me, is that there is a misunderstanding of these regulations. I have asked lawyers where could we improve them; what could be done and still be responsive to the congressional direction here. I have not got anybody to suggest substantive corrections.

Senator SMATHERS. I am curious to just get a direct answer as to whether or not you think the statute permitted you to put a limitation of $10, as you originally did, or $25, or for that matter, any dollar limitation, on this matter requiring receipts?

Mr. CAPLIN. The statute specifically refers to the elimination of requirements for substantiation up to a given amount. There is a reference to a figure, reference to a line to be drawn, which indicates that a figure is contemplated.

Senator SMATHERS. What is that? I am curious to see what that is.

Mr. LAMONT. It is the last sentence of 274(d).

Mr. CAPLIN. May we have a copy of the statute, please? Thank you very much. The statute starts off saying:

No deduction shall be allowed

this is section 274(d)—under section 162 or 212, under (1), and then it says:

(2) For any item with respect to any activity which is of a type generally considered to constitute entertainment, amusement or recreation,

and I will skip.

(3) For any expense for gifts unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his 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 the data and description of the gift; (*c*) the business purpose of the expense or other items; and (*d*) the business relationship to the taxpayer of persons entertained, using the facility or receiving the gift.

Here is the crucial sentence:

The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

Senator SMATHERS. You see what you have done, Mr. Caplin. Where that sentence would seem to suggest that you require less substantiation, you have interpreted it making it more stringent. You have set an amount. You have said that there is a requirement to have receipts for everything above a certain amount, that is not stated in the statute.

The statute said you may waive even some of the requirements that are called for in the statute.

Mr. CAPLIN. Senator, I referred to, just a while ago, the fact that there are two other provisions in the regulations which would eliminate the need for the receipt.

Don, could you pick those out in the regulations?

Mr. LAMONT. Yes; this is the question which puts it into the layman's language.

Mr. CAPLIN. The question and answer booklet which you have before you, Senator, on page 19, I think you might find this interesting, question 21:

Is it possible to obtain a tax deduction for an entertainment expenditure of over $25 if a receipt is not obtained.

This is on page 19, sir. The answer is:

A receipt ordinarily is the best evidence to prove the amount of expenditure. However, it may be possible to obtain a deduction for an expenditure of $25 or more, even without a supporting receipt. The regulations provide that a taxpayer who does not have adequate records to substantiate a deduction may establish his right to a deduction by other evidence, such as a statement in writing of witnesses containing sufficient information. In addition, the regulations provide special rules for cases where, by reason of the inherent nature of the situation in which an expenditure is made, a taxpayer is unable to obtain a receipt or where a taxpayer cannot produce a receipt for reasons beyond his control, such as a loss of the receipt by fire, flood or other casualty.

Again, I think a lot of the criticism is because of misunderstanding.

Now, the representative from the restaurant association met with me. He pulled out of his pocket a little, tiny card that he had, and he said,

"I had lunch with somebody this afternoon. This is all I would have to say, and I would be in full compliance with the rules."

And he just wrote down four or five words.

Senator SMATHERS. Is that what he said or what you said?

Mr. CAPLIN. He said and I agreed with him.

You see, it is not required on the recordkeeping that it all be in the diary, if correspondence, the normal records of the company would indicate business relationships.

Then there would be no need for repeating this in the diary book.

Senator SMATHERS. That is a point that I think would be helpful, if we can make that very clear.

What you are saying, for the record, as I understand it, is that, in point of fact, you do not have to have receipts for everything. You do have to have some kind of proof, some kind of substantiation, but you do not, even though you have a $25 limitation, nevertheless, there are regulations which you will let a taxpayer prove what he claims would be a business expense without actually having to have a receipt?

Mr. CAPLIN. That is correct, sir.

Senator SMATHERS. All right, that is very helpful. I do not believe that many people understand it.

Mr. CAPLIN. I have tried to make that clear.

Senator SMATHERS. Not at the present moment.

Mr. CAPLIN. Every time I have had the opportunity and the time, I have made speeches to point that out.

Senator SMATHERS. Let me just go to the next thing about this degree of proof which you have got a regulation on. As I understand it, your regulations on travel and actually entertainment have not yet been published, is that right?

Mr. CAPLIN. That is right, the so-called substantive regulations on defining what is directly related to the active conduct of a trade or business and what is meant by a bona fide and substantial business meeting in statutory terms.

Senator SMATHERS. So the only regulations that we are talking about now are just the regulations which pertain to the substantiation. Those are the only ones that you have thus far issued?

Mr. CAPLIN. That is right, sir.

Senator SMATHERS. Did you read the article in the Wall Street Journal of this morning?

Mr. CAPLIN. Yes, I saw that this morning.

Senator SMATHERS. Do you think there is any justification for the article which throughout implies that you are going to write regulations that are much more strict, even, than businessmen thought they would be?

Mr. CAPLIN. I would say this:

That we would have no authority and we have no intention of making the regulations stricter than what Congress intended. Now, what I think the Wall Street Journal had reference to was to what the state of the law is today, the fact that many people do not understand the state of the law.

They referred to a particular decision, a recent decision of the seventh circuit, on the deductibility of wives, and they indicated that a lot of people do not understand the whole issue of when wives are deductible.

I saw that article and thought it might come up and brought copies of the opinion that they were referring to there, which indicates just what the law is under the old provision. Remember, section 274 merely narrowed what the old law stated. That is what I think they had reference to: That as the searchlight focuses on this issue, the public at large will become aware of certain rules and regulations that they had never been aware of before or never focused on before.

The tax experts, the accountants and lawyers in this field, they appreciate this. But the average individual, unless he has this sort of advice, may have limited understanding.

Senator SMATHERS. The thing that concerns me—and I am sure it concerns you and everybody else—is that, while they may not have previously understood it, what you are saying is the law has always been tough on it; they, nevertheless, have been making the trips and going to conventions and things of that character which had the net effect of providing jobs and keeping money in circulation, whereas, suddenly, they are now afraid to do so.

So what you are, in essence, saying is that the law will not be substantially changed, in your judgment, from what it used to be?

Mr. CAPLIN. Not so, sir. There are certain areas of the law which have not been changed, but there are other aspects that have.

For example, the Congress focused on the question of the relationship of the expenditure to the production of income. The new statute now says that the expenditure must be directly related to the active conduct of a trade or business. This was an effort to chop off some of the extreme situations which had only a remote relationship to the business.

And, of course, both the Senate and the House differed on the question of good will.

You recall that the House, in essence, had eliminated practically all good will. The Senate attempted to restore a good part of it, and in the conference the position was reached that the general good will entertaining would be permitted if it were immediately preceding or immediately following a substantial and bona fide business meeting. This is what is in the statute today.

Senator SMATHERS. Right.

Let me go on here with this degree of proof. In the matter of substantiation our statute requires taxpayers to substantiate time, place and so forth, as you read a moment ago.

Mr. CAPLIN. Yes.

Senator SMATHERS. And then——

Mr. CAPLIN. Business purpose and business relationship.

Senator SMATHERS. I am going to read our statute:

by adequate records or by sufficient evidence corroborating his own statement.

We even said in our committee report, and I quote:

That a clear, contemporaneously kept diary or account book containing information with respect to date, amount, nature and business purpose of the expense may constitute an adequate record under this provision.

Your regulations impose detail on top of detail, and then tops it all off by requiring so much proof that, in my humble judgment, the taxpayer must prove his case beyond a reasonable doubt.

It seems to me that is a judicial matter of criminal law and not tax law. There are some who feel that the use of such terms as you have in your regulations, as you have added on to what we did, the words "clear proof," "high degree of probative value," that is a phrase you have used, "level of credibility," that is another phrase, and "highest degree of probative value possible," because of the judicial connotations and overtones, it seems to me and others that phrases have no part in this administrative function.

That is for the courts. You impute to every taxpayer guilt at the outset, which I do not think you intend to do. You say that in substantiating his entertainment that he has to have the highest degree of probative value possible, he has to have evidence which establishes clear proof, and so on.

Now, this ordinarily frightens a businessman to death, because he does not want to have to try to prove everything, sit down and say, "On such and such a day, I had lunch at a certain restaurant in New York, Hartford, Atlanta," or wherever it was, and then meet this highest degree of probative value possible to justify his deduction.

That would mean he has to get all the people in order to obtain a statement from them. That frightens him.

Mr. CAPLIN. Senator, I believe there is a great deal of misunderstanding on that.

Senator SMATHERS. All right.

Mr. CAPLIN. As I mentioned just before, the regulations are illustrative. They say that a receipt, for example, would have the highest level of probative value. But if the man did not have a receipt, he could have all this other indirect evidence of having somebody else come in, in lieu of even a record.

Now, at the time of the debates on the floor, you certainly were very clear on this as to what was intended when you said:

> The bill requires the taxpayer who claims a deduction for entertainment expenses—or for travel or gift expenses—to clearly establish his right to the deduction by proof other than his own statements which may largely be self-serving. He must claim and prove the amount of the deduction. He must show the circumstances under which the——

Senator SMATHERS. That is what I said?

Mr. CAPLIN. What you said. (Continuing with the quotation)—

> under which the entertainment occurred. He must identify the person entertained and must show the business relationship between that person and a trade or business.

This is on page 17001 of the record. I think this is an example of the congressional thinking at the time of the legislation.

Senator SMATHERS. I remember that statement. Senator Javits had asked me or Senator Kerr a question, as to whether or not in the entertainment or in the dinner which followed a business meeting there was a time limitation. I think that is how that debate on that particular matter started out.

The question arose, then, as to whether or not there was—or they had to immediately get up from the business conference and go to lunch and then come back. The question really involved was as to whether or not they had to talk some business at that particular luncheon or that dinner, whatever the case was, surrounding their general business conference.

Mr. CAPLIN. I do not recall whether or not the other part was in the discussion. My recollection was that this related to the quantum of proof that was in the mind of the draftsmen.

Senator SMATHERS. If a taxpayer could establish the fact that he had a meeting with a legitimate and proper business client, or several clients, and they had met from 10 o'clock until 12 o'clock, a man who is talking to salesmen from various companies, and then goes across the street to the 21 Club in New York, or whatever the club is, and has lunch and that luncheon exceeds the amount of $25, what kind of proof does he have to have?

What is the minimum amount of proof he would have to have in order to charge off that luncheon to business expense?

Mr. CAPLIN. You say the "minimum." I would think that he would come in without any records at all.

Senator SMATHERS. He could come in without any records at all?

Mr. CAPLIN. Without any records at all.

Senator SMATHERS. With respect to that lunch?

Mr. CAPLIN. That is right.

Senator SMATHERS. And Internal Revenue would allow him——

Mr. CAPLIN. The Internal Revenue would question him why was this claimed, assuming this item was segregated for audit, and he would say, "I have no records."

At this point you wonder, well, what did Congress do about this in the 1962 legislation.

Now, it would seem to be contrary to the legislation to permit that deduction.

Nevertheless, we felt that there ought to be a safety valve in the regulations, and if this man can demonstrate by his correspondence that this is the person he entertained and he had somebody coming in saying this was a customer and this was the amount expended, we would accept that.

Senator SMATHERS. In other words, if he had a diary record, that would be sufficient?

Mr. CAPLIN. Yes, sir; with this corroboration through his statement and someone other than himself. It would require more than his own statement, because I think throughout the legislative history that the Congress did not want the uncorroborated statement of the taxpayer. This was the evil under the Cohan rule. This is the difficulty we have in the real extreme abuse cases.

Senator SMATHERS. In other words, then, you are saying—and I hope you are saying; I think it would be helpful to get this point clarified—that a taxpayer does not have to have, even though you use the words "highest degree of probative value possible," that does not really contemplate the taxpayer bringing in what would be the highest degree of probative value possible from all the people who were there or some statement from him or from the owner of the restaurant that the man was there with 15 businessmen?

Mr. CAPLIN. That is right.

Senator SMATHERS. "I overheard him conducting some business transaction." You do not contemplate that?

Mr. CAPLIN. No, they do not contemplate that at all.

Senator SMATHERS. You contemplate a diary?

Mr. CAPLIN. The normal pattern is a diary entry or some other business record entry.

Senator SMATHERS. How would a man make some other business record? I am just curious about that.

Mr. CAPLIN. Well, his secretary might have a record in his appointment book that he had lunch today; it would not be his diary. Or maybe correspondence that they had. This would be evidence that they had this meeting.

Senator SMATHERS. In other words, what he needs to do, in addition to getting a diary, his own statement, he needs to write a letter to one of the men and say, "I am glad that you were at the luncheon today?"

Mr. CAPLIN. He does not have to do that. We are saying what would be a substitute for the diary—if he did not keep a diary, or if he had overlooked keeping any records.

Senator SMATHERS. Are you saying a diary is sufficient?

Mr. CAPLIN. A diary is normally sufficient.

Senator SMATHERS. "Normally sufficient?"

Mr. CAPLIN. Normally sufficient.

Senator SMATHERS. I think that would be very helpful to get that out.

Mr. CAPLIN. Yes.

The CHAIRMAN. At this point I would like to ask a question. We are talking about food. What about drinks?

Mr. CAPLIN. Food and drinks are in the same category, Senator.

The CHAIRMAN. Suppose they did drinking and did not eat any food?

Senator GORE. Lots of business would be done.

Mr. CAPLIN. Let me say that line-drawing in this area is very difficult, and I think this was really the reason why the President originally recommended the total elimination of the deduction. It gets so illogical at times.

The CHAIRMAN. I am constantly invited to parties, and they do not have any food there. Can you separate food and drinks? What do you do?

Mr. CAPLIN. We do not make an effort to separate food or drinks, and/or drinks. In other words, business might be conducted at purely a drinking session, two people sitting down and discussing a business deal over a couple of glasses of bourbon. I would see that this might be conducive to business.

Senator GORE. It sure is.

The CHAIRMAN. Suppose you had a big one, a number of people?

Mr. CAPLIN. The general indication is in this committee report that these general cocktail parties would not be deductible. The only time they would, would be if they immediately preceded or followed a substantial and bona fide business meeting. I think there was an effort to draw a line there, to do away with this general entertaining which is charged to the tax return.

Senator WILLIAMS. What does that do to the cocktail parties that the Embassies and the State Department have?

Mr. CAPLIN. I am not familiar with them.

Senator WILLIAMS. Do they charge that up to Government expense?

Mr. CAPLIN. I am not really familiar with them at all, Senator. I assure you we do not have them in the Treasury Department.

Senator GORE. That is subject to appropriation by Congress, is it not?

Mr. CAPLIN. Yes, that is right.

Senator BENNETT. No, not directly. We give them an entertainment fund, and they spend it the way they please.

Senator GORE. You get a representation out of them.

Senator TALMADGE. They do not file a tax return.

Senator SMATHERS. Mr. Caplin, with respect to the diary, and the degree of proof you people are going to require, as I understand it, you have said that the agents can accept, will accept or are instructed to accept as the highest degree of probative value possible, a diary plus some other letter or statement of substantiation of that diary.

That meets all the criteria which you set out?

Mr. CAPLIN. Of course, we have not covered the $25 receipt rule. When the item exceeds $25 or more, they would normally anticipate that there would be receipts available. If there were not receipts available under those circumstances, then they might attempt to verify that expenditure. They might accept the man's word completely, based upon his overall pattern.

Certainly, if he had receipts for everything and missed one or two, I feel confident that the reasonable agent, the average agent, would not expect every single item to be fully supported by a receipt, if the overall pattern is a good one.

Senator SMATHERS. Suppose that he had a credit card or something of that character. What, in addition to the credit card and the statement as to what is on the credit card, would he need, if he were entertaining after he had done some business and closed a $50,000 deal. Let us say they all went to lunch, and he spent $26.50 for lunch?

Mr. CAPLIN. I would say that, normally, a credit card plus a diary entry would be all that would be required.

Senator SMATHERS. Do you think that would meet your standards here where you say:

> The highest degree of probative value possible under the circumstances.

Mr. CAPLIN. That is taken out of context, Senator. I would like to take that regulation. That phrase is used only when a particular item is given as an example. It is used in a phrase about "substantiation in exceptional circumstances."

To put the whole thing in context, it says:

> If a taxpayer establishes that, by reason of the inherent nature of the situation in which an expenditure was made, (i) he was unable to obtain evidence with respect to an element of the expenditure which conforms fully to the "adequate records" requirements of subparagraph 2 of this paragraph; (ii) he is unable to obtain evidence with respect to such element which conforms fully to the other sufficient evidence requirements of subparagraph 3 of this paragraph; and (iii) he has presented other evidence, with respect to such element, which possesses the highest degre of probative value possible under the circumstances, such other evidence shall be considered to satisfy the substantiation requirements of section 274(d) of this paragraph.

In other words, I think this was an effort to be as lenient as we felt we could be, and still not be inconsistent with the statute. No. 1, we were assuming that you do not have adequate records. No. 2, we were assuming you do not even have other sufficient evidence. Nevertheless, we are willing to accept the highest degree of proof that you have available under the circumstances.

I cannot think of a better way to approach this, Senator, more reasonably.

Senator McCarthy. George, could I ask a question?

Senator Smathers. Yes, sir.

Senator McCarthy. I just this weekend attended a Minnesota newspapermen's association, convention. I looked at the program, and I noted that the dinner at which I spoke was sponsored by the Northern Natural Gas Co. Every luncheon and every dinner in the 3-day period was sponsored; one, by the telephone company; another, by the railroad.

How would that be treated for tax purposes? Someone from the Natural Gas Co. got up and said, "I believe in Minnesota." This was before the newspapermen. Is this a deductible expense? There is no business transacted. Is this advertising? How would that be handled? I am sure they are deducting it.

Mr. Caplin. I do not know if I can give you the definitive answer on that, because we have not completed the regulations. But from the way you describe it, I think it might fit into the pattern of entertainment following a substantial and bona fide meeting.

Senator McCarthy. It was not a gas companies' convention. It was a newspapermen's convention. The gas company came in from outside, by invitation, I assume. They had a cocktail hour beforehand. Who pays? Who deducts?

Mr. Caplin. Well, I would——

Senator McCarthy. What is going to be the case now? I am sure that in the past this would all have been deductible.

Mr. Caplin. I believe that that will wind up as being a deductible expenditure.

Senator McCarthy. Do you think it should be?

Mr. Caplin. I can see justification for it.

Senator McCarthy. If they paid for a dinner at the Democratic or Republican State Convention, it would not be deductible. They would not be as much concerned with promoting good will there as at the Minnesota Newspapermen's Association——

Senator Talmadge. Of course, presumably, there would be some business conducted there, but there would be no discussion immediately prior or immediately subsequent.

Mr. Caplin. Mr. Lamont is here from the Chief Counsel's Office, and he is working on the regulations. He will certainly take note of your comment.

Senator McCarthy. Do you think there is any change? I do not necessarily want them taxed on it. What I am concerned about is that I am sure they have been deducting this sort of expense in the past.

Is there anything that you contemplate by way of new regulations that would deny it to them now? I do not know whether it should be denied or should not.

Mr. Caplin. I will say this is something that we are giving consideration to right now, the whole problem of the business discussion by members of a partnership or members of an industry.

Senator McCarthy. How would you get to the intent of Congress on this question, for example? Do you think it was even contemplated?

Mr. CAPLIN. It may not have been. You touch on the most difficult of problems.

Senator MCCARTHY. What do you do, then?

Mr. CAPLIN. This is one of the most difficult jobs of adminstration. It is one of the most difficult jobs that the courts have in interpreting. Of course, what the courts say is that we are trying to find congressional intent, had Congress thought of the problem. What would Congress have intended had it specifically thought of that problem?

This is what the courts usually say about it, in trying to interpret a statute, based upon the whole flavor of the legislative history.

Had they focused on this particular problem, what do you think they would have intended?

That is the way the court probes for the congressional intent in this sort of situation. It is very difficult for the Administrator under these circumstances. He tries to make a good faith effort to fit into the pattern.

Senator MCCARTHY. Has any thought been given to the approach of allowing a deduction in those cases of expenses which would not have been made if the man had not been in business? This is kind of coming at it another way. I am sure the expenses in this case or even more limited entertainment could not have been made if it were not that the natural gas company is in business.

It seems to me that what you have to do in this case is to set up some fences around the edge, and then try to judge the area inside, instead of coming at it straightaway, the way you do now, and determining particular intent in almost every action on the part of the taxpayer.

Mr. CAPLIN. I do not know whether I have given you the wrong impression as to what we intended to do here in these new regulations. We are deep in the middle of them right now, and we are hoping to have them published in tentative form by the end of this month.

At the same time, on the administrative side, Senator, I do not know whether you are familiar that—although it was not specifically authorized in the statute—we instructed our agents to allow a 30-day familiarization period with these rules and regulations on record-keeping across the board; and not to require, in essence, anything different from what they did before. We also allowed a transitional period up to 90 days for businesses which were encountering difficulty in printing forms and changing their programings.

The effort has been to be reasonable, to be decent and fair. If there is any place where we have stepped over the line, I would certainly be most anxious to face up to this, and, if it is justified, to face up to the desirability of making a change.

We try to reach as many elements of the public as we can. Every comment we received was briefed on a card and was taken into consideration. We did not enforce time limits. If the letter came in 3, 4, or 5 days later, we still put it into the hopper and gave it consideration.

Senator TALMADGE. Let me give you a question nearer home. All of us feed constituents from time to time. Is that a deductible item? I am talking about Senators and Congressmen. Our business is winning votes. Is that deductible?

Mr. CAPLIN. My initial reaction to this Senator—and we are talking about food—is that lunching with a constituent would fall within the ambit of the business meal exception. That is in the statute.

Senator BENNETT. But suppose your wife is one of the parties?

Mr. CAPLIN. Now you get us into one of the most difficult problems we have, and that gets into this Wall Street Journal article.

Senator TALMADGE. Some of the wives are more capable of winning votes than we are.

Senator MCCARTHY. One of your agents told me last year that if it were a constituent, you could deduct it, but if it were a bureaucrat you were trying to influence or somebody from another State, you could not deduct it.

Senator SMATHERS. That is what I have been told.

Senator MCCARTHY. If it were a constituent, you could charge it with intentions. If it were somebody else, you are trying to represent your State.

I thought there was an element of contradiction in what was allowed and what was not allowed.

Mr. CAPLIN. I would be interested in your advice on this. We had discussed the advisability of setting in motion a project which would sketch out a Congressman's entire tax picture, all the variations and changes.

I do not know whether there would be any interest in having such a document available.

Senator BENNETT. There would be a great deal of interest. You might get some suggested improvements in it before you got through.

Mr. CAPLIN. Yes, I am sure we would, sir.

Senator GORE. Mr. Caplin, in your interpretation of the statute and legislative intent, you have been aware, I take it, that the conference report made sufficient changes that the report of this committee could no longer be interpreted as the legislative intent?

Mr. CAPLIN. Well, yes. We have been trying to reconcile both the House, and the Senate, and the conference committee reports.

In certain instances the conference adopts the House provisions. In other instances it adopts the Senate. The so-called good will provision was adopted only in a narrow area immediately preceding and immediately following the substantial and bona fide business meeting.

But there was a lot of language in the Senate Finance Committee report which was not accepted in conference, because it was excluded in the agreement.

Senator SMATHERS. Mr. Caplin, let me direct your attention a moment to this travel provision.

Senator BENNETT. Before that, I think I would like to talk about that problem, but there may be one other question here. Mr. Caplin, suppose an employee satisfies his employer that his entertainment expense of a dinner was proper, and then the Department comes along and the Service comes along and upsets it and refuses the employer the deduction.

Would they then add that to the employee's income and expect him to pay taxes on the money that he received from the employer because the employer has reimbursed him for something which the Service says is not deductible?

Mr. CAPLIN. Just to put that in a little different setting, let us assume that the expenditure is not a deductible one inasmuch as the employee is engaged in an activity which is not directly related.

It might be general goodwill entertaining under circumstances which would not be deductible.

Nevertheless, the employer tells the employee, "Here is $50 or $100. I want you to go out and entertain this fellow and give him a good time."

Is that right?

Senator BENNETT. No, that is not what I am thinking of. In the normal course of his business an employee turns in an expense account.

Mr. CAPLIN. Yes.

Senator BENNETT. Turns in a diary, and the auditors of the company look at it and okay it, reimburse him, but then the revenue men come along and look it over and say, "No, this we cannot allow."

Then what do you do with the employee?

Mr. CAPLIN. I would say this would be an extraordinary case, because the normal pattern will be to lean on the employer-employee relationship; and, as long as the employer is setting up a reasonable sort of audit procedures, we will accept that. Now, if there is a pattern which, on audit, raises the suspicion of the agent—and he now says this is not an allowable deduction as a result of his investigation—I think, normally, in that situation it would be a denial of a deduction to the employer, as opposed to additional income to the employee.

Now, there could be circumstances where this is intended as additional compensation, and there could be circumstances where this could be income to the employee. But, generally speaking, I think it would be a denial of the deduction to the employer and not income to the employee.

Senator BENNETT. That is fine.

Senator SMATHERS. You have got five sections in the regulation which have to do with includibility of income, and, as I remember our committee report—and I do not think it was changed by the conference committee report—we said this:

> Since the only purpose of this section is to disallow deductions, it will not make deductible any expense which is disallowed under the ordinary and necessary test of present law. Moreover, this section does not affect the question of the includibility or excludibility of an item in income of any individual.

Senator GORE. Is this the Senate committee report you are reading or the conference committee?

Senator SMATHERS. This is our committee report and it was not changed by the conference report.

> The rules presently applicable under present law will continue to govern in this respect.

This is an area, again, where I say I wonder whether or not you have not exceeded in some respects the authority which you have. I know that we gave you a lot of leeway but after we said specifically that in no way will the rules be changed with respect to excludability or includibility of income, you issued five sections of regulations which do that.

Mr. CAPLIN. There is no such intention, Senator. There must be some misunderstanding. There is no intention at all in these regulations that are before you to have any impact on includibility. That

is something which comes up under the general section 61 of the law, on the issue of whether you have gross income.

Senator SMATHERS. Is not the fact, as the Senator from Utah tried to bring out, that, if I were head of some company, had an employee who worked for me, and I sent him to Chicago to transact a business matter for me, and he stayed there a week and accomplished the job. Thereafter he stayed on another week to visit his relatives or his mother or whatever he wanted to do, under present regulations I am not permitted to deduct any longer that total cost of his——

Mr. CAPLIN. Travel?

Senator SMATHERS. His travel back and forth?

Mr. CAPLIN. We have not drafted those yet. That is in the next batch of regulations to be considered, and, of course, you have reference to the statutory provision which sets up an entirely new rule.

Senator SMATHERS. Let me just finish asking the question. Do you not already have regulations out which say that if any portion is disallowed this individual will be required to consider it as income?

Mr. CAPLIN. No, sir, we do not.

Senator SMATHERS. Mr. Vail, what about that?

Mr. VAIL. I interpret these regulations that way.

Senator SMATHERS. Which way?

Mr. VAIL. He has to include this amount which is disallowed as a deduction under this bill in the income of the employee. I think we gave you an example there of the disallowed travel expense where there has been an allocation of travel expense under this bill.

Senator SMATHERS. Right.

Mr. VAIL. Where the regulations require the disallowed portion of the travel expense to be included in the income of the employee.

Mr. CAPLIN. In our old regulations, 162–17, we have a provision which relates to situations where an employer may be paying some personal expenditure of the employee. The employer is paying a personal expediture. Under those circumstances, if this were unrelated to the business, the old rules would treat this as income. But there was no intent in these record-keeping regulations to approach the problem that the Senator is referring to about splitting that travel transportation up and treating part of that as income. We do not yet know whether, under the substantive regulations, we are going to reach that result.

Mr. VAIL. I am reading from subsection (g) of the regulation:

> For purposes of this paragraph, the term "business expenses" means ordinary and necessary expenses for travel, entertainment, or gifts which are deductible under section 162 and the regulations thereunder to the extent not disallowed under section 274(c). Thus, the term "business expense" does not include personal, living, or family expenses disallowed by section 262 or travel expenses disallowed by section 274(c).

And the section 274(c) was one of the provisions that was added by this bill.

Senator SMATHERS. Mr. Vail concludes that this would not change in any way existing law. Would you care to comment on that?

Mr. CAPLIN. This is not intended to do that. Of course, we have not published our rules yet on this travel issue. When they come out, this particular problem that is being suggested will be faced; but we have not reached the decision yet on the question.

Mr. VAIL. Let me finish this:

and reimbursements for such expenditures.

This is the 274(c) expenditures.

Mr. CAPLIN. That does not refer just to section 274.

Mr. VAIL (reading).

Thus, the term "business expenses" does not include personal living or family expenses disallowed by section 262 or travel expenses disallowed by section 274(c) and reimbursements for such expenses. Such expenditures must be reported as income by the independent contractor.

Mr. CAPLIN. We are talking about the independent contractor as opposed to an employee.

Mr. VAIL. If you go to (f), you have an employee. You come down to (g) (2) and again on——

Mr. CAPLIN. As I said before, there may be circumstances where something is in the nature of compensation. For example, if an employer paid for a suit of clothes the employee bought while on a business trip, that would certainly be compensation.

Senator SMATHERS. That is true under present law?

Mr. CAPLIN. That is right. And, incidentally, it is very difficult to phrase the drafting of this section without referring to other provisions of the code.

Senator RIBICOFF. Will the Senator yield?

Let us get a specific example. I think one of the reasons this is so good, because it simplifies, instead of generalizing. Let us assume there is a convention in Miami, and a man who works for the Hartford Insurance Co. goes to that convention. The convention is 1 week. The round trip air fare from Hartford, Conn., to Miami would be $300. Now, the convention is a week, and the man decides, since he is down there, he is going to take 2 extra weeks' vacation.

He would not have taken the vacation if he was not down to Miami at a convention, which is legitimate. So he goes up to the proper officer and the travel desk at the insurance company will buy him and give him a round trip ticket of $300. His expenses in Florida for 1 week are paid for by the company. There is no question about that. He stays 2 more weeks, and he pays this out of his own pocket.

Under the present time you would only allow $100 to the company to be deducted because he stayed 2 weeks himself, even though the fare was $300, is that correct?

Mr. CAPLIN. We have not published a position on that. Literally, reading the statute the way it is written now, we think that is a result that could be reached. But we are very much disturbed about that result.

Senator RIBICOFF. That is probably what disturbs you.

Senator SMATHERS. Greatly disturbs me.

Mr. CAPLIN. That is right.

We are very much concerned about that. Our tendency today—and, remember, I have to confer with the Secretary about this—is that, if this employee does not control that corporation, but is just an employee who has been sent down there to the convention, we would not attribute extra income to that man.

Senator RIBICOFF. It is two things. That goes with Senator Bennett's question.

Mr. CAPLIN. Yes.

Senator RIBICOFF. If you allow this to the insurance company, then this becomes, this $200 becomes, income to this man that Senator Bennett is talking about, too.

Mr. CAPLIN. Under this concept that we are talking about, it would be deductible to the company, because they wanted him to go down there for that trip, and they paid his fare.

Senator BENNETT. You mean the whole $300?

Mr. CAPLIN. Yes; the $300 would be deductible; and my personal inclination at this time is not to tax the employee where he has been sent there, and he is not in control of this corporation.

Senator MCCARTHY. What if he were self-employed?

Mr. CAPLIN. Self-employed, he would fall right under the statute precisely. I think he would be denied the deduction.

Senator MCCARTHY. An independent businessman, who would do it, would be denied it?

Mr. CAPLIN. He would lose two-thirds because of the way the statute is written today. If the trip is for more than a week, and 25 percent or more of the time is on a frolic of his own, then you must prorate the travel expenditure for deduction purposes.

Senator SMATHERS. This was something that got into the statute, I think, very unfortunately. We ought to have Mr. Stam tell us how it got in there. I subscribe to the theory that apparently Abe subscribes to and others, that if a man goes to Chicago to perform a business transaction, stays there 1 week, makes $50 million for his company, but the next week his mother gets sick, so he stays on another week. The next week she dies, and he has to go to the funeral. Under the statute, if you interpret it as you indicate you may interpret it, he does not, thereafter, get even to charge off the expense of his trip out there and back, even though he accomplished a great deal of good.

Now, when you talk about "frolics," there are a lot of other things that can happen with a fellow. He can go to New Orleans and visit somebody and not necessarily have a frolic. If the trip is justified in the first instance as a business trip it seems to me that the full travel expense should be deductible. I feel the law we passed last year on travel allocation should be repealed.

Senator WILLIAMS. I do not think Congress ever intended that. I would like to reverse that example.

Suppose the man leaves Connecticut and he goes to Miami for a 2 weeks' vacation, he is down there about 8 days, and his company calls him up and says, "We have got to cut your vacation short; come back." Does it go on the expense account then, because you have reversed it? He went on a clear vacation, and the company calls him back, so he comes back then, by this line of reasoning, he would then go back on an expense account.

Mr. CAPLIN. Senator, just one moment. You know the statute, as drawn, went right to this problem.

Senator SMATHERS. I agree.

Mr. CAPLIN. And it was very specific.

Senator SMATHERS. I agree.

Mr. CAPLIN. I did not participate in these decisions.

Senator SMATHERS. I am going to have Mr. Stam tell us in a minute how it happened.

Suppose a man is doing a radio business in Hong Kong. He goes out there by jet aircraft in 8 hours, gets the work done in a week and then decides to stay on, maybe has a vacation for another week or 2 weeks. Then, of course, the company can only deduct one-half or one-third whichever the case may be, of the travel expense. That which is not deductible is considered income to the individual.

But the same individual can go on a slow boat, have luxury treatment every night, drink champagne, and eat the best food on his way out to accomplish this business. It takes 12 days to get out there and 12 days to get back, and that is deductible.

The thing just does not make sense.

Now, Mr. Stam, why do you not, just for the record, tell us what you remember about how this thing came about, because I remember making a very specific objection to any kind of an allocable deal with respect to the travel to a convention. For example, the AFL–CIO in Miami have it every year, they go down there and they work, I think, a good deal of the time.

But then some of them will stay on, as Abe pointed out.

Then they say that they cannot have even their trip down and back where they really did do some good, where they did work hard, and where it would be totally deductible, I do not see how just the mere matter of putting a time limitation on it and saying if the fellow did have any pleasure, therefore, he did not do his work, and you, therefore, take away from him this legitimate deduction.

I do not think it is the right principle.

Mr. STAM. I might say this:

When the matter came up in the Ways and Means Committee, there was a lot of opposition to cutting down the amount spent for travel, because the purpose of the travel was certainly to attend a business meeting, and the fact that the man stayed after that on a vacation, the point was it should not affect the expenses that he had for travel.

The Treasury Department—I do not think, Mr. Commissioner, you were in on that—the Treasury Department insisted on this proration rule. The committee refused to accept it. Now, when the matter came before the Finance Committee, I think there was an amendment offered by Senator Kerr which took sort of a modified Treasury position which said, in effect, that if you stayed more than 1 week beyond the convention, say, and 25 percent of the time spent, more than 25 percent of the time spent was for personal reasons, that you had to adopt this proration rule.

I think the Finance Committee felt that this was some leniency from the Treasury position. But I do not think you really understood exactly what the effect of it would be.

Senator SMATHERS. I am satisfied we did not.

Senator BENNETT. I would like to raise another question.

We are taking this fellow back and forth to Miami a lot. Let us take him down to Miami. Say he goes down for a business convention; he stays a week and the convention is held during the week. Then he makes an arrangement with his employer that he will stay over into the next week and call on Joe Blow, a customer, but he has got to wait a full week before he can see Mr. Customer, so he has the

time in between and has himself a good time. Then he goes and calls on his customer, and then after another week he finds there is another customer who should be called upon.

In other words, are we not getting to the point where this is a little ridiculous, where a man can, by this kind of finagling, get himself off of this kind of a hook?

Mr. CAPLIN. I do not know what you would do if you were a judge with that case, Senator; but I think, knowing courts, that man might have a pretty tough time in convincing a reasonable judge that this was really bona fide.

Senator BENNETT. In other words, he should go back to Hartford, and then go back to Miami a week later?

Mr. CAPLIN. This is really an extraordinary situation.

Senator BENNETT. It is not extraordinary. You go in and try to do business with a man, and he says, "All right, I want a week to think your proposition over," and you are a $300 travel expense away from home. It is less expensive for you to sit there and wait the week out than it is to come back.

Senator MORTON. If the deal is big enough, this happens all the time. A man may come to sell a proposition. I remember one time a man sold us a pension plan for our business. They were from Cleveland. They must have stayed 6 weeks. The races were going on, and I guess they went to the races, but, finally, they got the contract, and it was enormous, about a quarter of a million dollars a year or something like that. This happens all the time.

Mr. CAPLIN. Senator, I believe that if it is a bona fide transaction, the deduction will be allowed.

Senator MORTON. I am sure this was allowable.

Mr. CAPLIN. I do not think there would be any problem at all under those circumstances.

Senator WILLIAMS. Suppose they had not got the contract?

Mr. CAPLIN. I think that would also be the result, Senator, if it was bona fide. It is a question of the validity of the arrangement.

Senator WILLIAMS. That gets back to Senator Bennett's question, how can you prove it is not if he does not sell Joe Doakes.

Senator MORTON. If you will yield there, it seems to me we go back to the same problem I tried to point out last year in discussing this in argument after argument with my good friends Senator Douglas and Senator Gore.

I am as much in favor of getting rid of these abuses as anybody else with certain companies where they have these hunting lodges and big yachts, but, even more, these businesses where a guy is netting $80,000 a year, and he has got a 40-foot cruiser on the Ohio River, and it is owned by the laundry, and I know well it is being used for the pleasure of the fellow who owns the business.

I want to see us get at that, but, fundamentally, such expenses as they are bringing up here is a question of the exercise of business judgment. Now, the boss of this fellow has got a responsibility to the stockholders, and he is trying to make a profit. I think that is a very difficult problem. I think, you have dealt with it pretty well, under the circumstances.

It is a problem which we did not tie down particularly in the bill last year. But I think we must remember that the exercise of business

judgment in the expense accounts of sales executives or salesmen, themselves, is just the same as the exercise of business judgment in the maintenance of property or anything else.

I have been a sales executive. I have been in charge of sales offices. I had one in Miami, one in Orlando, one in Jacksonville, one in Tampa. We had Augusta, Savannah, Columbus, and Atlanta, all through the South, three in the chairman's State, Norfolk, Richmond and Lynchburg, and each year I had to go before the controller and the board of directors of our company and get a budget for traveling of my salesmen.

That included entertaining customers.

I fought for the best I could get, and I got it and distributed, and I made weekly reports to be sure that they were not taking advantage of it.

Now, I had as much responsibility toward the stockholders, as a sales executive, as the plant engineer had. A guy could come in to him, the superintendent could come in an say, "I want to paint the mill," and the plant engineer would say, "The mill does not need painting; we painted it last year."

"Why, the taxpayers are paying 52 percent of it; let's paint it anyway."

I see no difference in getting away from these few abuses in the normal day-to-day expenses of selling, and there are all these expenses in the selling field, I see no difference between that and ordinary business expenses.

Senator McCarthy. Advertising.

Senator Morton. Advertising is another thing. You do not know how much good it does. Your advertising manager can come in and say, "Let's buy a page in Life because the taxpayer is paying 52 percent of it."

If businesses were run on that philosophy, we would all be broke.

Senator Smathers. Let me ask you this question: Among the records required by the regulations to substantiate travel expenses is a notation "of the number of days away from home spent on business." Your regulation section 1.274(5), subparagraph (2), subparagraph (b), and so on.

We did not make any such requirement in the statute. This is where I think you are going even a little further than we intended for you to go, or that you were even allowed to go. Our section 274, which requires allocation of travel expenses, applies only where travel is for more than 1 week, and then only if more than 25 percent of the total time away from home is for nonbusiness purposes.

Your regulation does not give effect to this 1-week requirement by requiring records of the number of days for travel periods of less than 1 week.

Have you not exceeded the congressional intent on this?

Mr. Caplin. As I understand you, you are raising a question of whether or not the requirement to record the number of days that you are on a trip is exceeding the congressional intent. Is that right?

Senator Smathers. Yes.

Mr. Caplin. I am just wondering how we can tell when a man has been away on a trip for a week and 25 percent of the time has been on other than business activity. How can we determine this unless we know the number of days.

Senator SMATHERS. Your argument is that there is no other way for you to enforce the 1-week provision, short of having him count the days?

Mr. CAPLIN. I am just wondering how we could do it any other way. And, again, Senator, it would not have to be recorded. He could have it in his travel ticket or any other piece of evidence that would demonstrate this.

Senator BENNETT. In calculating that 25 percent, would you include waiting time? That is, a man has to wait for a period of time before he can continue his business conferences. Is that waiting time considered to be nonbusiness time?

Mr. CAPLIN. I certainly would have every expectation. I know my own philosophy is to be reasonable and fair and decent on this. I am trying to convey this approach throughout the entire organization, personally and in frequent communications. I would hope that we would come up with a fair result on this, Senator.

If this waiting time was something which was attributable to his business, it would be put into that category and not be charged on the personal side of the ledger.

Senator BENNETT. Even though he went to the races?

Mr. CAPLIN. If this were bona fide waiting time, people do not expect him to tear his clothes. Again, just to be normal, if you were administering the law, what would you expect under those circumstances? I would hope that my judgments would come up very close to yours.

Senator BENNETT. Part of the problem is your ability to communicate this to the taxpayer.

Mr. CAPLIN. Yes.

Senator SMATHERS. That is right.

Senator BENNETT. There is tremendous confusion among the taxpayers.

Mr. CAPLIN. I have been making every effort in this regard. For example, yesterday I was with a group of 600 people of the New York Board of Trade on this very subject. For the next few months, I have speaking engagements scheduled in different parts of the country almost every other week. Most of this is on this new statute right now—to try to get across the areas in which people are entitled to take deductions; to try to separate the legitimate, normal, reasonable business expense from the abuse area, which is what we are really focusing on.

Senator MORTON. If I could ask just one question, we are in this point of whether the employer or the employee would have to make up a disallowed tax.

Mr. CAPLIN. Yes.

Senator MORTON. Now, as I read your regulations, I think that you have attempted to maintain the status quo in this area.

Mr. CAPLIN. That is right, sir.

Senator MORTON. You have a difficult problem here, but it is true, is it not, that if, for instance, this had happened in 1961 before this law was passed, if I went and hired myself out, and I said I will work for you for $12,000 a year, provided you pay my dues and expenses in the country club, the downtown club, the university club, if you will provide me with an automobile, which I am only going to

use to get to and from work or for my own pleasure, then your revenue agent comes along and finds out that this is going on, and, of course, it is on me.

Mr. CAPLIN. That is right.

Senator MORTON. And that you still try to——

Mr. CAPLIN. Yes, sir, but if it is in the nature of compensation, then the employee would be taxed.

Senator MORTON. That has been going on for years; there is nothing new in that?

Mr. CAPLIN. Yes, sir.

Senator MORTON. Now, one final question.

I have a letter from a businessman in Louisville, for whom I have the highest respect, and I do not know whether this is true or not. He says:

> This past week there was a television spot ad evidently sponsored by the Internal Revenue Department showing an entertainment scene where a girl was pouring champagne and saying that such expenses were now being controlled through the new regulations on expense reports.

Mr. CAPLIN. I am not familiar with that, sir. I will run that down. There are a few public service ads. Most of them are submitted to us for approval. I have seen a group of them. Some of them are not as good as you would like to have them, but I do not remember this one. I will check on this, and I will let you know.

Senator MORTON. I think it is obvious what he is getting at here.

Mr. CAPLIN. Yes.

Senator MORTON. I want to be able to give him the facts.

Mr. CAPLIN. Yes.

Senator MORTON. I doubt if the department, itself, is sponsoring television ads of this nature.

Mr. CAPLIN. This does not sound like anything I remember.

Senator MORTON. They are probably getting them through the advertising council or something, but I would like to have that.

Mr. CAPLIN. Yes.

Could I have the letter, Senator, to look at it?

Senator MORTON. Yes.

Senator HARTKE. Mr. Chairman, may I just ask one question. Mr. Caplin, I was wondering, these regulations have not been in effect long enough, nor law, really, to make a real determination as to any effect upon revenue, is that right?

Mr. CAPLIN. We do not really know. I think many people are uneasy. I think Senator Smathers is touching on a very significant point. They do not know the real situation today.

Senator HARTKE. The claims are being made in so many circles that the revenues which are coming in and that the anticipated increases in revenues are not really going to occur. Are you prepared to make any statement on that?

Mr. CAPLIN. I think I can say this, Senator:

I did not participate in the evaluation of the legislation in terms of the revenue impact and the like, but I do know what some of the thinking was.

I believe it is fair for me to state that the proposal was submitted by the Treasuray Department beyond the bare question of the $100 million of revenue which was attempted to be gained. I think the

feeling was that some 90 percent of the public do not claim these deductions. I think the feeling was that the confidence in the tax system was being affected by the ostentacious abuse.

I think the feeling was that, by indicating congressional concern about an abuse area, it would help strengthen the confidence in tax reporting generally.

I feel that is a very valid position. We received so many letters from people saying, "How come they can charge these things off?" They send us clippings from the newspapers, "Is this fellow charging this party off?"

And this erodes a desire to comply. If you feel the fellow down the street is not paying his fair share, this shakes your own confidence, and it makes you less willing to comply all the way. On the other hand, I think that if people feel there is a sincere effort to apply the law across the board, to curtail abuses, that this helps strengthen compliance, and this is the big asset we have.

Senator BENNETT. Just at this point, I had a telephone call this morning from a friend in New York, who has just returned from Florida to attend an annual business meeting, which in the past also attracted the wives. Now he said that in his business meeting the attendance was off 40 percent, which represents a 40-percent loss of revenue to the hotels, the restaurants, transportation, and everything else that served this business, and he raised the question with me. He said, in his opinion, the loss in revenue from taxes to be paid by these industries is going to be much greater in the end than any gain in revenue from stiffening of these reports.

Mr. CAPLIN. That is weighing the $100 million against the other revenue impact.

Senator BENNETT. He also made the point that this is probably the greatest single, current contribution to unemployment, because these people cannot hire waiters; they cannot hire all the people that go to support a resort hotel and restaurants. Now, he was indignant.

I get this reaction. I have been to one or two of these meetings since the first of the year. I did not go to the one in Florida. This is a report from him. The attendance is being specifically cut down, almost cut in half, by the lack of the presence of the wives, who had always been going as a matter of pattern in the past.

Now, maybe this is desirable, but this could have an offsetting revenue effect and an unemployment effect.

Senator SMATHERS. We talked about this earlier. It is hard to see how it is desirable, when we are talking about the need for a $10.5 billion tax cut in order to stimulate the economy, and in some respects, are following a course of action which in the end results in deflating the economy. So in that respect I am like you. I do not quite understand how it is a consistent position, even though we do want to eliminate major abuses.

Mr. CAPLIN. Senator, the reason why I distributed these photostats of a case is because it is the most recent case on the subject. There is a court of appeals decision affirming it, which illustrates that wives' travel costs were usually not deductible under the old law.

Here is a man—this is Walter M. Sheldon—who was the president of the National Association of Insurance Agents, and one of his duties was to visit various State organizations and participate in

their functions and business affairs. The court found as a fact it would be unusual for the president to attend the various social functions unaccompanied by his wife; and it is customary, the court found, for the wife of the president to serve as his hostess. Nevertheless, this court, the Tax Court, and the Seventh Circuit Court of Appeals, under the old law—and this is a 1961 Tax Court opinion and 1962 court of appeals opinion—held that this expense was not deductible.

Deductibility of the expenses of a wife in attending her husband's business meeting or convention requires a finding that she perform services necessary to the husband's trade or business and not merely helpful thereto.

This is only one of a long series of decisions (The Tax Court memorandum from which the Commissioner quoted appears below:)

TAX COURT MEMORANDUM DECISIONS

WALTER M. SHELDON

[1954 Code Secs. 166(d)(2) and 262]

[Bad debts: Nonbusiness: Recovery of son's body.] 3. Expenses in locating the body of petitioner Laura Sheldon's son in Venezuela were personal in nature and were not made with an expectation of repayment, but a small preexisting debt was deductible as a nonbusiness bad debt.

Thomas F. Pierce, Esq., 111 West Washington Street, Chicago, Ill., and James E. Whealan, Esq., for the petitioners. Arthur N. Nasser, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

FORRESTER, Judge: Respondent has determined deficiencies in petitioners' income tax for the years 1953 and 1955 in the following amounts:

	Deficiency
Year: 1953	$5,414.82
Year: 1955	1,704.34

The correctness of respondent's disallowance of the following deductions is presented for our determination:

1. Petitioners deducted the expenses incurred by petitioner Laura Sheldon in 1953 while accompanying her husband on his trips to convention meetings of the National Association of Insurance Agents.

2. Petitioners deducted as a rental expense certain expenditures they made in 1953 respecting a residence owned by them.

3. In 1955 petitioners deducted, as a nonbusiness bad debt, a small amount owing from John C. Bryan, and their expenses incurred in locating his body and in causing its interment.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. (However, see footnote 1, *infra*.)

Walter M. Sheldon, hereinafter referred to as petitioner, and Laura Sheldon are husband and wife residing in Hinsdale, Ill. They filed timely joint Federal income tax returns for the calendar years 1953 and 1955 with the District Director of Internal Revenue at Chicago, Ill.

1. Wife's Expenses

Since 1919 and at all times herein relavent petitioner has been employed as an insurance agent by W. A. Alexander & Co., a nationwide general insurance firm, and at the time of the trial of this case he was the executive vice president, a director, and a stockholder of that corporation.

The national Association of Insurance Agents (NAIA) is a federated organization consisting of members of the various State organizations, and consisting in 1952 of approximately 82,000 such members. At the annual convention of the NAIA held in Cleveland, Ohio, in September 1952, petitioner was elected president of that group for the year 1953.

One of the duties of the president of the NAIA was to visit the various State organizations and participate in their functions and business affairs. During the year 1953 petitioner expended the following sums so that his wife might accompany him on trips he made in such capacity.

Month	Place	Amount deducted
February	Washington, Baltimore, New York	$320.07
April, May	Hollywood Beach, Fla, and Edgewater Gulf, Miss	320.98
June	San Francisco	313.73
September	Portland and Seattle	334.92
October	Washington and White Sulphur Springs, W. Va	266.65

Laura Sheldon's presence had no connection with the basic meetings or conventions attended. She accompanied petitioner to assist him in carrying on that part of the conventions and meetings that was of a social nature, such as keeping the president's parlor open for entertainment, being his partner at dances and receptions, and generally performing the function of hostess. It would be unusual for the president of the NAIA to attend the various social functions unaccompanied by his wife, and it is customary for the wife of the president to serve as his hostess.

2. Claimed rental expense

For several years prior to 1952 petitioner and his family were living in a 14-room house with an acre and a half of ground located at 106 East Eighth Street, Hinsdale, Ill. By 1952 three of the four children who had resided with petitioners had married and gone, and consequently petitioner began to look for a smaller residence.

On October 2, 1952, petitioner bought for this purpose, a house located at 327 Oak Street, Hinsdale, Ill., paying about $30,000 therefor. The estimated cost of desired repairs to and remodeling of this house was far in excess of what petitioner had anticipated spending, and he therefore rented it at a nominal rental on a month-to-month basis. Petitioner had anticipated spending an amount approximately equal to his cost on the Oak Street house, but when actual estimates were 50 percent higher than expected he delayed his plans to move.

During the year 1952 petitioner listed the Eighth Street property for sale with a real-estate broker. During 1953 an advantageous opportunity to sell this property arose, and it was sold on September 21, 1953.[1] During this same month the tenancy in the Oak Street property was terminated and thereafter petitioner expended the following amounts on such property:

Date	Payee	Amount
Sept. 12, 1953	M. S. Jones	$735.00
Oct. 16, 1953	M. S. Jones	275.06
Dec. 28, 1953	A. H. Viren & Sons	5,096.85

The Oak Street property remained vacant from September 1953 until March 1954, when petitioners physically occupied it as their home. The expenditures involved herein commenced after the month-to-month tenant had vacated, and were completed shortly before petitioners moved in.

3. Debt owed by John O. Bryan and expenditures made in recovering his body.

John O. Bryan, deceased, was the son of Laura Sheldon by a former marriage. In 1955 he was 28 years of age and unmarried, and had never been a member of petitioner's household.

Prior to Bryan's death he had severed his employment in Caracas, Venezuela, with the Chicago Bridge & Iron Co. in order to undertake an adventurous expedition in that locale with a companion. During the course of this expedition Bryan was drowned sometime during the month of September 1955 at Angel Falls in Venezuela. At the time of his death Bryan owed petitioner $251.55 on a personal loan and his assets consisted of personal effects of no realizable value, and a bank balance of $53.99 in the National Bank of Sweetwater, Tex.

[1] So stipulated. A further stipulation specifies the date Feb. 9, 1954, but the earlier date was shown by petitioners in their 1953 return.

Upon learning that his stepson was missing, petitioner contacted an assistant American consul in Caracas, Venezuela, and Brock Bradley, a friend of Bryan's in Venezuela, and during 1955 petitioner authorized and paid a total of about $2,700 in locating and interring Bryan's body. Bryan's body was recovered and interred in Venezuela. Petitioners claimed a deduction of $2,929.01 on their 1955 joint income tax return as a "Bad Debt—Estate of John O. Bryan, Deceased," which sum included the aforementioned $251.55 debt.

OPINION

1. Wife's expenses attending conventions.

Petitioner contends that these expenses of $1,579.75 paid on behalf of his wife, Laura, during 1953 are deductible under section 23(a)(1)(A)[1] of the Internal Revenue Code of 1939,[2] whereas respondent would have us deny the deduction pursuant to section 24(a)(1).[3]

The deductibility of the expenses of a wife in attending her husband's business meeting or convention requires a finding that she performed services necessary to the husband's trade or business, and not merely helpful thereto. *L. L. Moorman* [Dec. 21,811], 26 T.C. 666 (1956). In that case the taxpayer's wife actually assisted him in his work while away from home, and was of additional help in entertaining dealers, but her expenses were held to be personal. In the instant case, Laura performed only social functions and did not assist petitioner in his work at the meetings.

Respondent's interpretation of and ruling upon this question were adopted by this court in *Alex Silverman* [Dec. 22,643] 28 T. C. 1061, 1064 (1957), where we said:

"It is well established that amounts expended by a taxpayer for the purpose of having his wife accompany him on a business trip where the wife's presence did not serve a bona fide business purpose represent nondeductible personal expenses under the provisions of section 24(a)(1), 1939 Code. *Leland D. Webb* [Dec. 280], 1 B. T. A. 759; *George W. Megeath, et al.* [Dec. 2100], 5 B. T. A. 1274, 1287; *Walter Schmidt* [Dec. 3932], 11 B. T. A. 1199; Regs. 118, sec. 39.24(a)-1, and sec. 39.23(a)-2; Rev. Rul. 55-57, 1955-1 C.B. 315. * * *"

See Rev. Rul. 56-168, 1956-1 C. B. 93; *Ralph E. Duncan* [Dec. 22,999], 30 T. C. 386 (1958).

In *Allenberg Cotton Co., Inc.* v. *United States* [61-1 USTC ¶ 9131]—F. Supp.—(W. D. Tenn., November 25, 1960), the taxpayer was a diabetic who required constant attention, and his wife's expenses incurred upon their trip to world cotton markets were deductible. However, the court reaffirmed respondent's rulings and the tests of bona fide business purpose and absence of a pleasure trip or vacation for the wife.

The location of the trips taken by Laura seems to indicate that pleasure or vacation was a consideration in determining whether or not she was to accompany petitioner. Although there were 50 State associations, Laura seems to have visited primarily resort or tourist locations, all of which were a considerable distance from her Illinois home. This, together with petitioner's failure to show that Laura's social functions were necessary to his business, and his failure to seek or obtain reimbursement for her expenses from NAIA, leads us to conclude that the claimed expenses were personal and nondeductible. *L. L. Moorman, supra; Rev. Rul.* 55-57, 1955-1 *C. B.* 315.

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[1] Sec. 23. Deductions from gross income.
In computing net income there shall be allowed as deductions:
(a) Expenses.—
(1) Trade or Business Expenses.—
(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *

[2] All references are to the 1939 Code unless otherwise indicated.

[3] Sec. 24. Items not deductible.
(a) General Rule.—In computing net income no deduction shall in any case be allowed in respect of—
(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under sec. 23(x); * * *

2. Claimed rental expenses.

Petitioner argues that the 1953 expenditure of $5,096.85[5] upon the Oak Street property was for repairs and therefore deductible under section 23(a)(2), apparently on the theory that petitioner might again rent this property in the future. Respondent contends that the expenditure was personal and capital and properly disallowed under section 24(a), *supra*.

We find it unnecessary to determine whether the expenditure was for repairs or capital improvements since the surrounding circumstances belie petitioner's argument in either event.

The property was purchased as a residence, rented for a nominal sum month-to-month, and then the expenses were incurred after all rental activity had ceased. Most important of all, the work was commenced after petitioners had sold the house in which they were then living, and petitioners occupied the Oak Street property as their home almost immediately after the work was completed. We therefore conclude that these expenses were incurred in readying the Oak Street property for use as a personal residence, and that this property was not held for rental purposes after September, 1953. *Lafayette Page* [Dec. 148], 1 B.T.A. 400 (1925). We therefore determine this issue for respondent.

Mr. CAPLIN. Now, this is why the Wall Street Journal really reached that headline today. That is what I think they were referring to: That, as the new law is being articulated, some of the old provisions, which had not been focused upon, will come to light.

Senator SMATHERS. You were in the tax business a good part of your life?

Mr. CAPLIN. Yes, sir.

Senator SMATHERS. As a matter of fact, was it not your understanding that wives who attended a convention, that up until the time of this case, her travel expenses were deductible?

Mr. CAPLIN. No, sir, it was not.

The president of the American Bar Association, going to London, had this problem, and he knew he had the problem going back several years, even though he was the president. I would say this would have been a case that would have concerned me.

The general rule that I would have told my client—and what I follow in my own practice—was that your wife's travel cost is not deductible. There might be situations where a man has a unique position; where he is ordered by his company, let us say, if he is a top officer, to take his wife, where it is highly essential to the business. Under those circumstances if could be deductible.

Senator SMATHERS. Mr. Chairman, I have a number of questions that I think we can dispose of, the Commissioner can, rather quickly, so, if I may be permitted, I will just ask him and let him answer.

They are clarifying in nature. Some of them are sort of argumentive, but I think your answers will be helpful in clearing up the situation for everybody.

I direct your attention to the regulation requiring names. The statute we passed, as I remember it, makes it necessary for taxpayers to make records of: (*a*) the amount of expenses incurred, (*b*) the time and place the travel or entertainment occurred, (*c*) the business purpose of the expense, and (*d*) the business relationship to the taxpayer of persons entertained.

The statute does not require the names of individuals who are entertained or who receive gifts. I am informed that the Ways and Means Committee specifically rejected such a requirement, and that this com-

[5] This is the figure claimed on brief. We assume that petitioner has conceded the other items.

mittee was not, thereafter, asked to provide language to require the production of the names.

Nevertheless, your regulations do require names. That is, your regulation 1.274–5, subparagraph (*b*), subparagraph (3), and so on.

Let me read an objection submitted by the American Mining Congress at your December 4 hearing.

The proposed regulations require the name of each person entertained, and this apparently pertains also to the business meal. Section 274 requires only the business relationship to the taxpayer of persons entertained. During consideration of the Revenue Act of 1962, Congress specifically considered and rejected the proposition of requiring the disclosure of names of the persons entertained. The congressional decision should be respected.

That is what the American Mining Association said.

The question I want to ask is:

Where do you get your authority, in the light of the Congress having specifically turned down the request to now require names?

Mr. CAPLIN. Well, in the first instance, Senator, the language that we have in the regulations is almost identical with the language that has been in the 40-cent booklet "Your Federal Income Tax," for a number of years preceding the new statute.

The actual words in the regulations are these:

To set forth occupation or other information relating to the person or persons entertained, including name, title, or other designation sufficient to establish business relationship to the taxpayer.

So it is name, title, or other designation sufficient to establish the business relationship. Now, how can we establish business relationships unless we have name, title, or other designation?

Senator SMATHERS. Well, I think in the light of the fact that the matter was up before the Ways and Means Committee and rejected and was not, thereafter, brought up for further consideration, apparently on the ground that it would not pass, it is clear that no such authority exists.

I wonder how you can now require it. If you ask a logical question: How do you get this identification, I would say that you strike the names and say "I took the president and/or 15 salesmen of the Prudential Life Insurance to lunch.

Mr. CAPLIN. That would do it.

Senator SMATHERS. All right, but you require the name.

Mr. CAPLIN. Name, title, or other designation—or other designation, sir.

Senator SMATHERS. Let us hear your comment as to whether or not, in writing this regulation, you have gone contrary to the intent of the Congress on this particular matter?

Mr. CAPLIN. I do not think so, sir, particularly, as I point out, this has been in "Your Federal Income Tax" for a long period of time. This is the normal routine of an agent trying to identify a business relationship.

Who is the party? How can we determine whether or not there is a business relationship between the parties, particularly when the Congress says that you do not want to have the uncorroborated statement of the taxpayer?

Senator SMATHERS. Let us take a newspaperman, for example, who is getting some source of information. He likes to keep it confidential.

He takes an individual to dinner, or he may take him to lunch; there are two or three of them; and he does not want to list the name.

Now, your agent can, of course, under your regulations, require that newspaperman to reveal the source of his information.

Mr. CAPLIN. Incidentally, we have a provision here about confidential relationships where it could be kept in a separate place; it would not have to be revealed on normal diary entries or the like.

In the situation you describe, it is possible that if the agent did not believe the particular taxpayer, he would want some indication of this relationship. Otherwise, he would have no other way to verify this.

Senator SMATHERS. I do not want to argue with you about the practicality of it. It may be that you would have to do it. I am just merely saying that the Congress specifically turned it down, and you people have put it back in.

Mr. CAPLIN. Of course, I do not have any evidence of prohibiting the requirement of a name.

Keeping in mind that we have been laying this down as a rule over the years before this legislation came up, the new legislation was not intended to enlarge the deduction, but to narrow it.

The deduction must first pass muster under section 162, which is ordinary and necessary business expense; and under 162 we required the name, title or other designation, the exact language that we have in this new regulation.

Senator SMATHERS. All right, in my judgment, I think this:

You have probably gone beyond it, but, as a practical matter, I cannot help but somewhat agree with you that it is the best identification that there is.

Let me ask you this question now:

In the technical part of the committee report, which actually is generally written mostly by the Treasury Department, there is an example illustrating the application of the rule requiring allocation of travel expenses where travel exceeds 1 week, and the personal portion of the trip represents more than 25 percent of the total time away from home.

This is in Senate Report 1881, page 172. The example makes it clear that travel time is to be treated as business time.

Now, does not this sort of rule make the whole allocation formula sort of ridiculous? For instance, in the example cited, the taxpayer attributed fourteen eighteenths of his trip to personal purposes, 2 days of business, 2 days of travel gave him four eighteenths for business purposes.

If that same individual, instead of taking a fast jet to London, had taken a slow boat which would have involved 5 days of travel over and 5 days of travel back, and if he had spent the same 2 days on business in London and the same 2 weeks on vacation on the Continent, he would have been permitted to allocate twelve twenty-sixths of his expense to business and fourteen twenty-sixths to personal purposes.

This would give him a deduction of nearly 50 percent.

If he goes by jet, his deduction is 22 percent of his cost.

The question is:

Are these computations accurate?

Then I would like to ask you:

Do you not agree that these consequences are irrational?

(Discussion off the record.)

Senator SMATHERS. There are some additional questions that I want to hear your answers to now. Others I will submit to you and let you answer them later.

Mr. CAPLIN. Fine.

Senator SMATHERS. In your original proposed regulation, did you not call for a record of the description of entertainment? Could you answer that now?

I will just give you this whole series on entertainment, and you give me the answers.

(See question No. 41 and the Commissioner's reply on p. 82.)

Senator SMATHERS. Now, this is one we can discuss here for a minute. In the case of entertainment immediately preceding or following a substantial and bona fide business discussion, your regulation requires substantiation of the duration of the business discussion.

Now, I am unable to find a provision for this requirement in the statutory language.

Why do you require a record of duration and how do you justify this requirement?

Mr. CAPLIN. Senator, I believe this is a portion of the regulations which is not an absolute requirement, but is suggested as a method of recordkeeping.

As I pointed out before, there are other ways of proving items by secondary evidence and the like. It is suggested that there be some reflection of the amount of time in order to determine what was the principal purpose of the entire meeting and entertainment.

You conceivably could have a case of our technically sitting down and chatting for 2 minutes and then spending the rest of the day in entertainment. The question whether or not, under the committee reports, the principal purpose of our getting together was business or whether the tail was really wagging the dog in this case.

Senator SMATHERS. It is conceivable that two businessmen could sit down together and transact an enormously big business deal and do it in 5 minutes, and it may be that it is the time of the day that it is now, 5 minutes after 12, and you say, "All right, now, let's go and have lunch," and, thereafter, have lunch.

It may be an expensive lunch. You come back at 3 o'clock and wind it up in another 5 minutes.

Mr. CAPLIN. The pattern you describe would not fall into the rule you first were referring to. The best lunch of this sort falls under the exception of business meals. But I also would like to say this:

There is no intent to have an automatic time test. It is conceivable that a very important transaction might be finished in 15 minutes, and then there might be extensive entertainment after that, and I think that would qualify.

Senator SMATHERS. All right.

What I am afraid of is this, Mr. Caplin:

That the business community might come to the conclusion that this was sort of harassment where you say you have got to sit down now and list how long you had a meeting.

Naturally, for a revenue agent who is, say, not a lawyer and, maybe, like myself, he has had no particular business experience, he could

easily come to the conclusion that the bigger the transaction involved, the longer time it takes. He may allow or disallow a claimed deduction on the basis of how long the meeting was prior to the so-called entertainment which was related to the business meeting.

This is what I am afraid of, and I think that is what most of the businessmen are afraid of. When you say that they have to list the time, whether it be 45 minutes, 50 minutes, 1 hour, 2 hours in conference. This is not required by the statute.

Mr. CAPLIN. The statute says there must be a bona fide and substantial business meeting, and that is all we are trying to determine—whether there was a bona fide and substantial business meeting.

Those are the words of the statute.

Senator BENNETT. You are basing "substantial" on time?

Mr. CAPLIN. No, I do not think so. I think that time could be relevant under certain circumstances. Thirty seconds, a minute, or two minutes might not indicate a substantial business meeting. Five minutes, conceivably, it might. Two people get together, and they want to sign this contract. It may be that in a few minutes you did culminate the transaction. Under those circumstances, I think that this could qualify.

Senator SMATHERS. I am sure you know that it is the Congress that makes the laws, and, with respect to the collection of taxes, we give you certain authority. The Treasury has certain authority to draw regulations pursuant to this authority. But where the regulations require a greater degree of proof than the statute calls for, I wonder about its propriety; that is, the propriety of the regulation.

Mr. CAPLIN. Senator, I do not believe that this is mandatory. I believe you will find, on looking at the entire pattern of the regulation, that the man would not have to keep this record, and he could come forward with secondary proof, and just establish that this was a significant transaction. "We signed this contract. I don't know how long it took me, but we did sign that contract." I think, under those circumstances, that would be adequate.

Senator BENNETT. May I get in here for a second? Here is a man who is considering placing a contract, and he comes into the establishment of the person who is anxious to make the sale, and he spends a few minutes with the sales manager or the president before lunch, and then the president says, "Well, I want to impress you with the fact that we are perfectly capable of handling this contract. I would like to have you meet our chief executives at lunch," and there are 15 of them or 20 of them. So they go out to a country club. They take the customer out. They are impressing him with their responsibility, with the fact that they are substantially able to live up to the contract. They have the business lunch, and the potential buyer says, "Well, thanks very much, I have enjoyed meeting your people, and I will remember you when we place the contract next week or next month," and he goes on his way. It is a 15- or 20-minute meeting and lunch at the country club for 35 people.

Mr. CAPLIN. I do not have any problem with that under the facts as you describe them. I think that would be a proper item and would be a deductible item.

Senator Bennett. Even though there was no substantial business discussed in terms of time?

Mr. CAPLIN. There is a provision in the statute that if you have a luncheon with a person who is in a normal business relationship with you, under circumstances conducive to the discussion of business, you do not have to actually discuss business.

Senator SMATHERS. I think that statement is very helpful. These are the kinds of statements that, would, in many ways, relieve some of the fears that businessmen now have and which, according to your statements, are not justified.

Mr. CAPLIN. Yes.

Senator SMATHERS. Let me ask you this question:

Does the substantiation provision under the statute require records of "substantial and bona fide business discussions"?

I might say, as I understand it, they do not.

Mr. CAPLIN. You just need a general description of the situation. "Discussed contract" would be adequate to identify the nature of the situation, and that is about it. You do not have to go into any of the details of your discussion.

Senator BENNETT. Let me confuse the issue a little further. Take my own business that I know something about, the paint business, which I have been in for many years.

Fifteen years ago we had a very close relationship with another company, and I have formed a close personal relationship with the executive of the other company. He comes to town, and I say to him, "In view of our long years of association, which have now been broken, I would like you to meet my current staff. There are no prospects that you and I can do business. But we have done business over the years. I would like to take you to lunch and give you a chance to meet the boys that are running the various departments, as a matter of sentimental relationship with the past."

I take my friend to lunch and introduce him to the boys. That, I judge, would not be deductible?

Mr. CAPLIN. That is right, sir.

The committee report describes this situation of a reasonable expectation of some benefit, financial benefit or gain, to the entertainer.

Senator BENNETT. Let us turn it around. An important contract was signed a month earlier. The matter is all set up. So there is no longer any question of expectation, but I would say to their executive, "Come over and see me; I would like you to meet the boys that are going to carry out the contract."

Mr. CAPLIN. I would think, under this business relationship, a continuing business relationship of this sort, that this would be a proper item. They are going to have a continuing relationship, and I would think that this would be related to the active conduct of a trade or business.

Senator BENNETT. So the test is either anticipated business or existing business?

Mr. CAPLIN. Yes, sir; the continuation of existing business; yes, sir.

Senator SMATHERS. Or anticipated business?

Mr. CAPLIN. Or anticipated business, yes.

Senator SMATHERS. That is a good statement, and I think it will be very helpful. I talked to a man whom you know, Mr. Caplin, very well, the other day. He told me that he had spent 3 years trying to

get what is now his best customer whose business represents about 90 percent of his business. During the course of time he entertained the man, his wife, and others. He said, "This is the only way you operate this kind of business."

Senator BENNETT. Under the rules you can entertain the man, but not his wife. You have got to segregate his wife.

Mr. CAPLIN. There are certain circumstances when you can entertain his wife. If you had this substantial and bona fide business meeting and afterwards you have the general good will entertaining, his wife would be deductible.

Senator BENNETT. But you cannot bring your own wife?

Mr. CAPLIN. He can bring his own wife, but the present law is not clear on the deductibility of her expenses. We are considering that, and hope to develop a reasonable solution.

Senator SMATHERS. Let me ask you one more question on this and then I will just submit the rest of them to you for written answers which you can submit later.

Mr. Commissioner, I believe you will agree with me that goodwill entertaining is permitted by the conference amendment relating to entertainment immediately preceding or following a substantial, bona fide business discussion.

Mr. CAPLIN. Yes, sir.

Senator SMATHERS. That was its purpose.

Now, the Treasury—I happen to know this—the Treasury drafted the language and told us that it allowed goodwill entertainment. In the process of trying to arrive at an agreement between the House and the Senate, there were varying positions that they took. We turned it over to the Treasury Department and said:

"You people write acceptable language." The Treasury also wrote the conference report explanation of it. They did not ask for records of business discussion, but you do.

The question is:

Why do you ask for these records of business discussions when the Treasury that actually wrote the conference report on this matter did not ask for it?

Mr. CAPLIN. What we ask for is an identification of the situation just sufficient to give us an idea of what the surrounding was.

Again, this is not an absolute requirement, even to that extent. If a person does not maintain a diary book or some other business entry, he still has the means through secondary proof to show that there was an important business meeting at that particular time.

Senator SMATHERS. Suppose he wrote a word like "goodwill entertainment following a substantial and bona fide business discussion"? Would that be sufficient?

Mr. CAPLIN. I would think not, sir, because I try to put myself in the place of the revenue agent who has taken an oath to carry out the law. How can he identify whether this is a valid situation, particularly when Congress says, "We just do not want the uncorroborated statement of the taxpayer."

There must be some indication of what the setting was. I think you would have to identify the surroundings, the XYZ Co. contract, the building of this plant, or the purchase of some equipment.

Senator SMATHERS. But we do agree that goodwill entertaining is permitted?

Mr. CAPLIN. Yes, sir.

Senator SMATHERS. Where it is directly related or where it has immediately followed or preceded, or something of that kind, a business transaction?

Mr. CAPLIN. Yes, sir, and the regulations make clear that this would pertain at a convention; that the convention business meetings would set the stage for goodwill entertaining immediately preceding or immediately following those business meetings.

Senator SMATHERS. Mr. Commissioner, I have——

Senator BENNETT. Let me hit him with another one for a minute, will you?

Senator SMATHERS. Yes.

Senator BENNETT. Company X is interested in employing Mr. A. They bring him from a distant town, and, of course, his wife comes with him, because this means moving from one town to another. And so the president of company X says to his wife—

I have got to impress Mrs. X. She is probably the key to this whole situation. I want you to take her out tomorrow night and introduce her, not only to the wives of the leading executives, but to some of our close friends, because we want her to feel that when she comes to this strange city, she is not going to be lonely.

And so the president's wife sets up a rather pleasant, but expensive, experience for the wife of the prospective employee. Is this deductible, any of it?

Mr. CAPLIN. Generally, as I mentioned before, it is not clear whether the wives of the entertainers would be deductible. The wife of the person who is being entertained would be deductible under the goodwill situation. There could be other special circumstances warranting entertainment deductions.

Senator BENNETT. What about the expense of the president's friends who were brought into meet the newcomer?

Mr. CAPLIN. I think there could be special circumstances where this could be deductible. It is hard for me to give a flat answer to that; but if it could be demonstrated that this was highly significant to the business and the wife was acting, in essence, as an agent of the company under these circumstances, that this setting was necessary to get this very important employee, I think, conceivably, under those circumstances, it could be ruled deductible.

Senator DOUGLAS. Mr. Chairman, if I may be permitted a somewhat irreverent analogy with no parallelism between the person in this illustration and the historical narrative that I will relate, it may be remembered that one of the Pharisees put to Jesus the hypothetical case of the woman who was married to seven successive husbands and then inquired whose wife she was in heaven. You can get all kinds of strained situations here. Jesus parried that question by saying that in heaven there was neither a giving in marriage, nor dissolution of marriage.

I do not know how, in each, individual, hypothetical question put to the Commissioner, he can make definitive rulings.

Senator BENNETT. He has confessed earlier that the whole problem of the status of the wife is giving them a lot of difficulties, and I am just trying to increase them.

Senator SMATHERS. When the Committee for Equal Rights for Women finds out what the Commissioner of Internal Revenue really thinks about them, he is really in trouble.

Senator BENNETT. Maybe we should send those lobbyists down to call on him.

Senator SMATHERS. That is right.

Mr. Commissioner, I am going to submit to you a whole series of additional questions which I would appreciate so much your answering in due course.

Mr. CAPLIN. Yes, I would be very glad to.

The CHAIRMAN. Without objection, they will be inserted in the record.

(See questions numbered 39 through 56 and the Commissioners replies beginning on p. 82.)

The CHAIRMAN. Anything else, Senator?

Senator SMATHERS. I would also like to submit several letters illustrating some of the problems which I have discussed. (The letters referred to follow:)

HOTEL PÈRE MARQUETTE,
Peoria, Ill., February 20, 1963.

Mr. DREW MARTIN,
Manager, Washington Office of the American Hotel Association,
Washington, D.C.

DEAR MR. MARTIN: This morning I was asked to write you a letter and send you information regarding the effect of the new rules of travel and entertainment expense issued by the Internal Revenue Service, and how they affect the business of a medium-sized Midwestern hotel such as the Père Marquette Hotel here in Peoria, Ill.

First of all, I want you to know that I have already written Senator Dirksen and our Congressman, Bob Michel, on this point. There is no question that there is an adverse effect on our business due to these new regulations. Incidentally, I have had nice replies from both the Senator and the Congressman.

Here is a summary of our observations, which cover the first 6 weeks of 1963, and are therefore only an indication of a trend:

1. Our main dining room if off by some 12½ percent, its business having shifted to the coffee shop. In other words, guests are more cost conscious.

2. Liquor sales are affected most. Our public bars in February are down in revenue by close to 28 percent.

3. The same conventions show less attendance from previous years. A firm that might have sent three or four persons to attend a meeting or convention is now only sending two or three, and many groups seem to hesitate to arrange their usual programs for ladies, indicating that fewer wives are going to accompany the men.

4. Attendance at civic functions is down. For example, the patriotic Washington Day dinner sponsored by the Creve Coeur Club for members and nonmembers alike, and involving nationally known speakers, had an attendance last year of some 840 persons. The expense of attending these events is about $16 per person. This year, their attendance is barely 600. Last year's speaker was Archbishop Fulton J. Sheen from New York, while this year's speaker is E. Brainerd Holmes, director of manned space flights for NASA, and the original space capsule is even standing in front of the hotel. * * *

Naturally, it stands to reason that with convention attendance off, banquet attendance off, and bar sales off, we have to adjust our labor force, we buy less merchandise, and we have to adjust and slow down our modernization program and everything else that goes with it.

Yours very sincerly,

FERDINAND P. SPERL, *General Manager.*

THE CURTIS HOTEL,
Minneapolis, Minn., February 22, 1963.

HON. HUBERT H. HUMPHREY,
U.S. Senator,
Senate Office Building
Washington, D.C.

DEAR SENATOR HUMPHREY: We would like to express our views as to the seriousness of the new Internal Revenue regulations regarding substantiation of travel and entertainment expenses.

Mr. Senator, these new regulations and their related publicity have seriously hurt our business. To show you just how serious this law is, let me give you a few figures.

Our fiscal year starts September 1. For the first 5 months of this fiscal year, our Federal income tax liability is exactly zero. In other words, we have made no profit from September 1, 1962, to February 1, 1963. If this continues, our corporation will pay no U.S. income tax for the fiscal year of 1963. This is the first time in our history that this situation has occurred.

Several factors are involved, of course, but we feel one of the most serious factors is the decline in sales due to the publicity of this new tax law.

Because of this situation, we have already eliminated 8 percent of our personnel and further cuts are contemplated for this year.

Very truly yours,

CHARLES MALONEY.

FEBRUARY 12, 1963.

Senator EDWARD KENNEDY,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KENNEDY: May I take a few minutes of your valuable time to tell you how the new travel and entertainment expenses law has affected our business?

At no time in my 30 years in business have I witnessed such a decline during the months of January and also for the first part of February.

Our banquet business has declined 31 percent in food and 30 percent in liquor. Our cocktail lounge is off 29 percent and our coffee shop 14 percent. With this decline in business we have found it necessary to eliminate 19 employees.

I understand that this condition is existing in many other establishments and I am sure that Congress did not want to create a situation such as this at this time.

How a new law could affect a business so quickly is hard to understand except that there are many that say the regulations are not clearly defined and have stopped all entertainment (goodwill included) until they are sure what they can and cannot do.

Anything you can do to help clear up these regulations will be appreciated.

Sincerely,

THE BRADFORD HOTEL,
R. N. APPLETON,
General Manager.

PICK HOTELS CORP.,
Chicago, Ill., February 7, 1963.

Senator EVERETT M. DIRKSEN,
Senate Office Building,
Washington, D.C.

DEAR EV: I can't tell you how nice it was to say "hi" last night while I was visiting with Ben Regan here in Chicago and you were hard at work in Washington.

I will get in touch with Ed Sheehe in Washington and he will call Mrs. Gomien regarding accommodations for you at the new Motor Inn, and you can be sure it will be a pleasure to have you with us.

I have been wanting to write you anyway, so will take this opportunity in regard to the recent ruling of the Internal Revenue Service and its effect on the feeding and housing industry.

I think by this time you are fully aware of everything that has been written into the law, and probably also aware of the consequences that it imposes on those of us who are depending on conventions and entertainment as a business

and way of life, not only for ourselves but our thousands and thousands of employees.

I would just like to mention that as a direct result of this in the month of January the double occupancy in the Pick-Congress Hotel (and I haven't checked our others as yet) went down nine points as a result of wives not attending conventions.

In addition, we had a 40 percent no-show in member attendance at the conventions booked during the month of January and this is an unheard-of percentage in the history of our business.

We had, as a result of business booked, anticipated a 79-percent occupancy for January, which is normally the biggest month in the year, and actually wound up with 64 percent as a result of these no-shows. If we can only do 64 percent in our best month, you can imagine the effect this is going to have on occupancy for the 12-month period.

Also, the food business was off 25 percent—a great deal of this in banquet service, some of which were canceled directly as a result of these rulings.

Doing business on an entertainment basis has been an American way of life for more than a hundred years, and to cut it off can be a crippling blow. This is especially bad when you consider the fact that no real good is accomplished by the effort.

Aside from business, I would just like to say in our courts of law even criminals, whether they are murderers or not, are innocent until proven guilty, and the reading of the new IRS ruling makes everyone guilty until they can be proven innocent.

I am sure you can see the wisdom of the necessity for changing this ruling and I would appreciate any effort you might make in behalf of our industry and other industries so affected.

Hope to see you on my next trip to Washington, and in the meantime please give my best regards to Mrs. Gomien.

God bless you, and warmest personal regards from your big Irish friend in the Windy City.

WILLIAM J. BURNS.

HOTEL LEMBKE,
Valparaiso, Ind., February 22, 1963.

Representative CHARLES A. HALLECK,
Member of Congress,
House of Representatives, Washington, D.C.

DEAR CHARLIE: I am greatly concerned over the ridiculous regulation on expense accounts that have been given by the Internal Revenue Service. It has affected my business tremendously. My January volume is down 20 percent in my room sales, 10 percent in my food sales and 6 percent in my beverage sales. My February volume for the first 20 days in rooms is down 40 percent, food down 12 percent, and beverage down 10 percent.

While this alarming decrease in volume cannot be entirely attributed to the expense account situation it has had a great effect upon hotels and restaurants. I have already laid off three full-time employees in addition to cutting back on our regularly scheduled people.

I ask your support in some remedial legislation to soften the regulation by the Internal Revenue Service. My business is really hurting and I would hate to see the only hotel in a town of 15,000 become a home for the aged. Please give us some help in this matter. With my best wishes, I am

Sincerely yours,

PAUL CARMICHAEL,
Manager.

(Copy of letter sent to Hon. George A. Smathers, U.S. Senate; Hon. Spessard L. Holland, U.S. Senate; Hon. Dante B. Fascell, House of Representatives; and Hon. Claude Pepper, House of Representatives)

DUPONT PLAZA HOTEL,
Miami, Fla., February 9, 1963.

Dear Senator Smathers:

As you know, the hotel business is one of Florida's major industries.

The new Federal regulations, governing the substantiation of travel and entertainment expense, will seriously hurt our business. These stringent regulations will not only be harmful to the owners of hotels but will lead to additional

unemployment. Operating costs of hotels are continually increasing, and a downward trend in room, food, and beverage sales has already started.

With the new regulations little more than a month old, guests in our dining rooms and lounges are requesting signed receipts for cash purchases, to insure the proper backup for Federal income tax returns. A new type of guest check must be purchased in order to provide the guest with the type of receipt that will be acceptable by the Federal income tax examiners.

In comparing January 1963 with January 1962, our room sales are down 5 percent, food sales are down 9 percent, and beverage sales are down 12 percent. Many of our guests have told us that they are becoming more and more cautious about their travel and entertainment expenses. We believe that a good portion of this decrease is directly due to the new tax regulations.

Unemployment in the State of Florida is at its highest point in recent years, and if the downward trend in the hotel business continues, it can only lead to further unemployment.

We urge that you do everything in your power to help bring about a softening of the recent regulation regarding travel and entertainment expense, as our industry is badly in need of your help at this time.

With warm personal regards, I am

Sincerely,

PERRINE PALMER, Jr., *General Manager.*

The CHAIRMAN. On behalf of Senator Long, I will offer for the record certain questions that he wants to ask.

(See questions of Senator Long numbered 29 through 38 and the Commissioner's replies beginning on p. 77.)

Senator BENNETT. While we are in the business of handling the Commissioner questions, I have got one or two I did not raise, and I will hand them to him.

(See questions 13 and 14 and the Commissioner's replies beginning on p. 72.)

The CHAIRMAN. The Chairman will direct that these questions be responded to by the Commissioner. I shall likewise submit a series of questions for your reply.

(See questions 1 through 12 and Commissioner Caplin's replies beginning on p. 66.)

Mr. Commissioner, there is this one question I would like to ask orally, but first, I want to thank you for coming.

Mr. CAPLIN. Thank you, sir.

The CHAIRMAN. You have been frank and clear. We have a great respect for you and shall continue to have all through the years.

We have known each other for a long time. I am a little confused about your Document No. 5049 (1-63) entitled "Rules for Deducting Travel, Entertainment and Gift Expenses for 1962."

Mr. CAPLIN. Yes, sir.

The CHAIRMAN. That is the law before new section 274 became operative?

Mr. CAPLIN. Yes, sir.

The CHAIRMAN. In 1962.

Then you go on to have a subtitle: "New Recordkeeping Rules for 1963." You intend to issue other regulations in the next few days, do you not?

Mr. CAPLIN. The remaining regulations will deal with the substantive rules relating to the circumstances when an item would be deductible. That booklet was aimed at the record-keeping requirements of people who are setting up their records for this coming year.

The CHAIRMAN. It seems that a good deal of the confusion is occasioned by requiring the taxpayers to keep records of travel and enter-

tainment expenditures, perhaps, when such will not be required on their income tax returns. Are you not changing your regulations, or modifying them?

Mr. CAPLIN. No. This particular pamphlet will not be modified. This says that if you are claiming a deduction, then you should keep records along these lines. The next batch of regulations will merely state under what circumstances those claimed deductions will be allowable. A man might claim many things, which will not be allowable. But if he is going to claim them, we are trying to say at the beginning of the year, at least keep your records this way, on whatever you are going to claim.

I just came back from Milwaukee not so long ago, meeting with a group of lawyers and accountants out there. One of the men said to me, "You know, if you just use commonsense, you will be in full compliance with those regulations."

I think if people would take that approach, what would a normally prudent man require of you when you are going out on an expense-account basis—that you will find that you are in substantial compliance.

Senator BENNETT. Will you tell your revenue agents, if they will just use commonsense, they will get along well with the taxpayers?

Mr. CAPLIN. I sent them a letter in which that phrase is used. We expect them to use a commonsense, reasonable approach in all their activities.

Senator BENNETT. I have been sitting on the other side of the table for a long time.

Senator SMATHERS. Can we get that into the record?

Mr. CAPLIN. I would be very glad to put that letter in the record, yes, sir.

(The letter referred to follows:)

SPECIAL MESSAGE FROM THE COMMISSIONER

INTERNAL REVENUE SERVICE,
Washington, D.C., January 31, 1962.

To All Audit Personnel:

In my special message of September 20, 1961, I reported to you on our new directions, explaining my views as to the true mission of the Service, and outlining some of the steps we will be taking to effectively carry out our mission. With the start of the new year I feel that it is an appropriate time to report to you on the progress we are making in implementing the new directions affecting the audit activity. Since my earlier message, the Audit Division has issued or will soon be issuing about 10 major program documents to our field managers, adjusting our total program to the new directions.

I am very pleased with the enthusiasm shown by employees at all levels of the Service toward the new approaches we are adopting. Many of the implementing measures have already been put into effect and many others will become a reality in the very near future.

All quantitative goals and the accumulation and distribution of statistics of case and dollar production by individual agents and auditors and by groups have been eliminated. Steps are also being taken to reduce the size of groups, and to free the group supervisor from most of his informal conference duties, so that he will have more time to devote to his direct supervisory duties.

Our Quality Audit Standards have been reviewed by the field offices and their comments and suggestions are being incorporated, as appropriate, into the final documents. We expect to issue the Standards for Income Tax Field Audits about April 1.

We are also moving ahead rapidly in the development of Audit Technique Guidelines for Specialized Industries. Guidelines for the Insurance, Auto

Dealers, and Mining and Timber Industries have already been distributed to the field. The Guidelines for the Textile Industry have been completed, but not yet issued, and by the end of the year, Guidelines for the Gas and Oil, Transportation, Cooperatives, and Dealers in Securities and Commodities industries will have been issued. To carry this idea one step further, in the interest of improving voluntary compliance we have started a series of meetings with industry groups to discuss tax problems peculiar to the particular industry. This is a new idea and is an attempt to resolve problems in the prefiling period rather than wait for the audit to attempt to resolve differences of interpretation.

We have introduced a random selection of returns into our classification program so as to broaden coverage into areas traditionally subjected to relatively little audit attention. With this approach, no taxpayer, no matter how small his income may be, can feel secure that his return will not be audited.

These are just a few of our accomplishments in the audit area. There are many other measures we are taking to breathe new life into our audit program and to raise the professional level of our agents and auditors. This also is an excellent time for all of us to take stock of our attitudes and approaches to our jobs. The objectives of the New Directions cannot be achieved unless we discharge our responsibilities diligently and intelligently.

You may recall that in some of my recent speeches I made reference to a "vigorous but more reasonable enforcement program." I believe that the steps we are taking to implement the New Directions will contribute to a more vigorous audit program, as will be actions we are taking to curb tax abuses such as in the travel and entertainment expense area, improper inventory reporting practices, and the various schemes used in the international area. We must be constantly on the alert for all devices used to avoid payment of proper tax and continue to develop and improve programs, methods and techniques that will bring to light these abuses.

You will note, however, that in referring to a "vigorous" enforcement program I also use the word "reasonable." By this I mean that a reasonable, practical, commonsense approach is not inconsistent with a vigorous, effective enforcement program and, in fact, will go far toward increasing confidence of the taxpayer in our administration of the tax laws. Issues should only be raised by the examining officer when they have real merit, never frivolously, arbitrarily, or for trading purposes. Once an issue has been raised, the examining officer should weigh all the facts carefully, give full consideration to the taxpayer's arguments, and then make his decision fairly and impartially in a manner reflecting the professional nature of conclusions reached. Our attitude should be one of proper and reasonable appraisal of the merits of the issue. We must not allow our decisions to be unduly influenced by the potential tax adjustment involved; we should never adopt a superior attitude; nor should we take advantage of the taxpayer's technical ignorance. The examining officer should explain the proposed adjustments to him in simple, nontechnical language to enable him to understand the issue. If agreement is not reached, then the taxpayer should be given exact and full information as to his further rights of appeal. Let me hasten to add, however, that an examining officer should never be the least bit hesitant to raise an issue of merit. A hard-hitting audit program is one of our most important means of strengthening our self-assessment system.

I believe a vigorous but reasonable audit program will strengthen confidence that the tax laws are being applied across-the-board without favor and will encourage greater numbers of taxpayers to report income and deductions more accurately. I am convinced that by the close of this new year we will have made a great deal more progress towards our new objectives. I would like to quote from the President's remarks to the Conference of Regional Commissioners and District Directors on May 1, 1961:

"I want to commend you for the efforts that you are making to improve our service, to make it easier for people to understand exactly what their responsibility is. I hope that you will impress upon the agents of the Internal Revenue Service how much we are dependent upon them, on their courtesy, on their efficiency, on their integrity, on their fairness."

Sincerely,

MORTIMER M. CAPLIN,
Commissioner.

The CHAIRMAN. There is tremendous confusion about it, and I thought, perhaps, that the rules for 1963 might be in conflict to some extent with the new regulations, which I understand will be issued, when is it?

Mr. CAPLIN. The end of this month, the end of March, that is.

The CHAIRMAN. The end of March?

Mr. CAPLIN. Yes, sir.

The CHAIRMAN. Thank you very much, Mr. Commissioner.

Mr. CAPLIN. Thank you, sir.

(See questions 15 through 24 of Senator Carlson and Commissioner Caplin's replies beginning on p. 73.)

(The questions and the replies thereto previously referred to follow:)

ADDITIONAL QUESTIONS SUBMITTED BY COMMITTEE MEMBERS AND ANSWERS SUPPLIED BY THE COMMISSION

QUESTIONS SUBMITTED BY SENATOR BYRD

Question No. 1.—The Congress saw fit to provide in the new substantiation requirements (subsec. 274 (d)) authority for the Treasury Department to provide by regulations for a waiver of the amount, time, business purpose and business relationship requirements for the expenses in connection with such activities if they do not exceed an amount prescribed by the administrative regulations. This so-called de minimus exception was intended by Congress to provide relief from the excessive detail on small expenditures for business travel or entertainment.

However, notwithstanding this clear congressional mandate, the substantiation regulations published by the Internal Revenue Service only provide a limited waiver of the substantiation requirement only to the extent that receipts for expenditures of less than $25 are not required except for hotel or motel expenses.

Why did not the Internal Revenue Service more fully invoke the statutory authority so as to eliminate the requirements of reporting small expenses?

Answer.—The Service, under the final recordkeeping regulations, waived the substantiation requirements for small expenditures more fully than your question would indicate. For one, the Service has announced rules providing that reimbursement arrangements and per diem allowances not exceeding $25 per day for ordinary and necessary expenses of an employee traveling away from home will be regarded as satisfying the substantive requirements with respect to the daily total amount of such travel, provided the time, place, and business purpose of travel are established. Also, certain mileage allowances up to 15 cents per mile will be regarded as satisfying the substantiation requirements. These provisions grant general relief from excessive detail in recordkeeping for routine travel. Receipts are not required for transportation expenses if not readily available. Also, it is not necessary, under the new regulations, that receipts for hotel or motel expenses be obtained in order to qualify for the relief provisions applicable to travel expenses paid under reimbursement or per diem allowances. In addition, the regulations permit taxpayers to aggregate expenditures in reasonable categories, such as for taxi fare and local transportation, for gasoline and oil, and for the taxpayer's own meals while traveling. The taxpayer may also aggregate the amount of a tip with the underlying expense, such as with his meals or taxi fares, or, if he so desires, he may separately state the daily aggregate amount of tips. Furthermore, it is important to bear in mind that the regulations clearly permit a taxpayer to substantiate his expense by means other than records and receipts. The regulations provide that a taxpayer who does not have adequate records to substantiate a deduction may establish his right to a deduction by other evidence such as a statement in writing of witnesses containing specific information. In addition, the regulations provide special rules for cases where, by reason of the inherent nature of the situation in which an expenditure is made, a taxpayer is unable to obtain a receipt or where a taxpayer cannot produce a receipt for reasons beyond his control, such as loss of the receipt by fire, flood, or casualty.

Question No. 2.—Section 274(d) as added by the Revenue Act of 1962, lists items which must be substantiated if travel, entertainment, and gift expenses are to be allowed as tax deductions. The last sentence of this section states: "The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations."

Our committee report illustrates our intent as to the operation of this last sentence when it states: "For example, it may be provided that substantiation will not be required for traveling expenses, where such expenses (including the cost of meals and lodging) do not exceed prescribed minimum amounts. This will be of special benefit to employees whose per diem allowance while traveling is within limits established by the Secretary under this provision."

There is a feeling that when Congress enacted the substantiation rule with respect to travel, we had in mind only situations involving mixed business and personal motives. We did not propose to change the law in any respect for the large body of employee-salesmen who do their routework on fixed per diem or mileage allotments. As a matter of fact, the last sentence of the substantiation statute quoted above, was included to provide an opportunity to retain present law.

Nonetheless, your regulations swept in the per diem cases and imposed new recordkeeping requirements on employees and new accounting techniques on employers. And, you have done this despite the absence of any showing of tax abuse in these per diem or mileage allotment situations.

There are some who not only feel your final regulations have exceeded our intent in this respect, but also feel this is an appropriate area for us to preserve the existing law.

There is no question but that you can preserve the existing law through regulations if you choose to do so. Why have you failed to exercise your administrative discretion? Is there tax abuse in these situations that we do not know of?

I know of your January 28 ruling, waiving the receipt requirement for employees on $25 per diem (or less) allowances or on 15 cents per mileage allotments (Rev. Rul. 63-13). The ruling did not waive any of the other requirements of the statute. The ink was hardly dry on this ruling before you, in effect, completely overruled the receipt waiver. On the very next day, January 29, 1963, you warned employees, upon fear of losing a deduction or being charged with additional income, that they should retain the very receipts your ruling informed them would not be required (IR-585).

I have heard this described as harassment, pure and simple. Without debating the merits of Rev. Rul. 63-13, let me say that you published it as an official pronouncement of the Service and theoretically at least, it will be available to anyone who wants to read it. Press releases do not have this stature. Consequently, I suspect that few people other than full-time tax practitioners and revenue agents will know the receipt waiver has been nullified.

How do you intend for your auditors and agents to proceed under these conflicting directives?

With respect to the impact of the new regulations upon employees and the new recordkeeping burdens they must bear, let me read from a protest received from an employee of the Kimberly Clark Corp.:

"My employer, Kimberly Clark of Neenah, Wis., has just revised its expense report(s) to comply with the recent IRS expense reporting procedure. The administrative detail required and the amount of my time required to complete the three required reports is horrendous.

"Where one report was formerly enough, now three separate forms and reports are required. Much of this information is duplicated and transferred from one form to another for explanation purposes. In my case you are not going to increase the income to the Government 1 penny, but only require me to put in extra hours of time and effort. I frankly resent the effort I will be required to make in this area. This, by the way, will decrease revenue, both to the Government and to me, because time spent in administrative work is nonproductive and you can only tax production."

On December 27, when you issued the final substantiation regulations, you made a statement to the press with respect to employee expense accounts. You said: "The general $25 benchmark for vouchers or receipts is consistent with good business practice, although many companies will continue to require detailed documentation for lesser amounts. And the recordkeeping liberaliza-

tion will enable salesmen and other business travelers to make streamlined recordation for routine expenses."

Do you believe the situation described by the Kimberly Clark employee represents "streamlined recordation"? From the standpoint of the Federal revenues, what do we stand to gain by imposing this burden on employees?

Answer.—As I indicated in my answer to your first question, I have announced rules under the final substantiation regulations granting general relief from recordkeeping detail for employees traveling on business under reimbursement arrangements and per diem allowances of up to $25 a day. This general relief is, in part, a liberalization of previous administrative practice. Previously, relief from recordkeeping detail for travel allowances was permitted only up to $20 per day (125 percent of the authorized Government daily allowance). The new mark of $25 per day is the same figure used to determine whether documentary evidence should be obtained to substantiate an expenditure. Using the same amount for both purposes provides a simple rule of thumb for taxpayers. Furthermore, under prior practice, the general relief provision for travel expenses was limited to flat per diem allowances and mileage allowances. Under the new rules, similar relief has been extended to reimbursement arrangements. We believe these new liberalizations constitute a streamlining of the recordkeeping rules.

At the same time we have endeavored to limit the use of such travel allowance arrangements to cover only ordinary and necessary business expenses of travel. We believe this is important, since travel allowance arrangements are not free from abuse. In Technical Information Release No. 221 issued on April 4, 1960, with respect to "Problems Relating to Entertainment Expense and Employees' Expense Accounts" it was pointed out that "some employers give certain of their employees fixed expense account allowances far in excess of their actual or expected expenses * * *." It was law prior prior to the enactment of new section 274, and it continues to be the law, that such excess amounts constitutes gross income to the employee, and must be included as such on his tax return. It was for this reason that we believed it appropriate to point out to employees that, although it was not necessary for an employee to submit lodging receipts to his employer while traveling under a qualifying travel allowance, he may find that retention of receipts is the best means to establish that he has not received taxable income from a travel allowance paid to him. This last point, it might be noted, was officially announced not only in the news release (IR-585) to which you refer, but also in Revenue Procedure 63-4, published in Internal Revenue Bulletin 1963-64 on January 28, 1963. This was the same bulletin in which Revenue Ruling 63-18 was published. We by no means intended the revenue procedure as a nullification of the revenue ruling but rather as a clarification for the assistance of taxpayers.

Question No. 3.—Mr. Commissioner: Under the new travel, gift, and entertainment disallowance rules established by Congress as section 4 of the Revenue Act of 1962, it was made clear that taxpayers should segregate such expenses and not include them in other categories of business deductions. It is also indicated that the expenses for entertainment, amusement, and recreation should be identified by the taxpayer on his return. However, the substantiation regulations issued by the Internal Revenue Service seem to go beyond this requirement by reserving to administrative discretion the determination as to whether an employee shall make "disclosure on his tax return," notwithstanding the fact that he may have adequately accounted and substantiated to his employer for all such expenses.

Does not this requirement go beyond the scope and intent of Congress in seeking to avoid imposing "unreasonable burdens" on taxpayers and their employees?

Answer.—Federal income tax returns for years prior to the enactment of the Revenue Act of 1962 have required certain information on travel and entertainment expenses. This is true both for employees who claimed deductions and employees who received reimbursements or other allowances covering such expenses. For example, form 1120 (the corporate income return) for calendar year 1961 contained an expense allowance schedule, calling for information with respect to travel and entertainment allowances paid to the corporation's officers and 25 highest paid employees. Also, form 1040 (the individual income return) for calendar year 1961 contained questions concerning hunting lodges, yachts, apartments, conventions, and similar items.

The final regulations under section 274 merely recognize the right of the Commission to require such disclosure on income tax returns as is reasonably necessary to guarantee fair administration of the tax law.

Question No. 4.—Mr. Commissioner, as you know, under the new disallowance rules of section 4 of Public Law 87-834 dues to social, athletic, or sporting organization are subject to the "primary" rule applicable to entertainment facilities and that, in addition, a taxpayer must substantiate the business connections of expenses which are related to the use of the club facilities so as to justify the tax deductibility of the dues paid to the organization.

The substantiation regulations which your agency has issued do not appear to provide any meaningful criteria as to what factors will be employed by the Internal Revenue Service in determining the tax status of such club dues. In some of the material which the Internal Revenue Service has published it is indicated that records reflecting time, cost and other information will be utilized in establishing use.

Is it not possible for the Internal Revenue Service to develop more definitive and informative criteria for the information of taxpayers in this area?

Answer.—The new statutory provisions (sec. 274(a)(1)(B) and (a)(2)) covering deductions for dues and fees to social, athletic or sporting clubs provide, in part, that such dues and fees are deductible only if the club is used "primarily for the furtherance of the taxpayer's trade or business." We do not believe that rigid criteria should be imposed in applying this test. For example, a strict comparison of the aggregate time of business use with the aggregate time of nonbusiness use might be appropriate in certain cases. However, in other cases, a comparison of the amounts of expenditures for business use as against nonbusiness use might reflect a more accurate picture of primary use. In still other cases, it might be the number of persons entertained for nonbusiness reasons that would be determinative. In other words, it depends upon the facts and circumstances of each case whether a club has been used primarily in furtherance of a given taxpayer's business. The regulations attempt to make this clear.

At the same time, however, we are endeavoring to provide guidelines which will prove helpful to taxpayers. For one, we would propose that in the case of an automobile, the primary use test will be deemed satisfied if more than 50 percent of mileage driven during the taxable year is for ordinary and necessary business travel. In the case of an airplane the test would be deemed satisfied if more than 50 percent of hours flown during the year was for such business use. In the case of facilities such as country clubs, we would propose another rule under which the primary use test would be considered met if more than one-half of the days of use during the year were days of business use. If a taxpayer uses a facility for a substantial business discussion on a particular day, that day will be considered a full day of business use, even though the facility was also used on the same day for personal or family use not involving entertainment of others. Even if less than one-half of the days of use were days of business use, the taxpayer may still be able to establish primary use under all the facts and circumstances of the case.

Question No. 5.—Assume that a taxpayer and his lawyer come to Washington to discuss a matter with the general counsel of one of the executive branch agencies. Their discussion continues into the lunch hour and they ask such agency official to accompany them to lunch so that they can conclude their discussion.

Would the travel cost of the taxpayer and his counsel, in addition to the luncheon costs, be fully deductible by such taxpayer?

Answer.—Assuming that the taxpayer and his counsel did not stay on in Washington to enjoy personal vacations (so that the new travel allocation rules are not applicable) and that the luncheon occurred in circumstances generally considered conducive to business discussion (so that the expense falls within the business meal exception), no provision of the new travel and entertainment rules would operate to disallow the travel or luncheon cost. However, this hypothetical situation raises certain questions of deductibility of expenses which are against public policy. This matter is under current study. If you wish, we will be happy to furnish additional answers on this other aspect of the question when our study is completed.

Question No. 6.—Mr. Commissioner, assume that the constituent of a Member of Congress comes to Washington to communicate with him on a legislative proposal of substantial interest to the constituent's business. The only time it

is convenient for the two of them to get together would be for a dinner engagement, at which time this problem is extensively discussed. The constituent pays the expenses for this dinner engagement.

Would the travel cost in connection with coming to Washington and the expenses of such dinner be fully tax deductible by such taxpayer?

Answer.—This question is similar to the preceding question. There is no provision in section 274, relating to travel and entertainment, which would operate to disallow either the travel or dinner expense, assuming that the constituent does not combine the trip with a vacation. However, the new lobbying provisions added by section 3 of the Revenue Act of 1962 are pertinent. The regulations are currently being drafted under that new provision. Also, as I mentioned at the hearing on February 28, the Service is developing a position paper on the deductibility of expenses relating to Members of Congress. Questions of public policy are involved. If you wish, I will answer this question in more detail when the study project is completed.

Question No. 7.—With respect to recordkeeping of business entertaining, why does Treasury require a record of the business relationship and purpose when, in most instances, it is not necessary since the taxpayer will recall who the person entertained was and why he was entertained? (Although the regulations contain a provision for establishing this information by circumstantial evidence, this provision has been totally overlooked by the businessman. Consequently, business forms have become exceedingly complex. Now, every time John Wayne is entertained, the businessman thinks he must have a record that John Wayne is a movie star. If a lawyer has a client for years and he buys him a luncheon, he thinks he has to make a record of the fact that the man is a client. Treasury has failed to emphasize simple records are possible.)

Answer.—Section 274(d) requires a taxpayer to substantiate by "adequate records or by sufficient evidence corroborating his own statement" certain elements of an entertainment activity including "the business purpose of the expense" and "the business relationship to the taxpayer of persons entertained." Senator Smathers, in the Senate floor debates, said that a taxpayer, "must show the circumstances under which the entertainment occurred. He must identify the person entertained and must show the business relationship between that person and a trade or business. By these requirements, the taxpayer must reveal to the tax collector all the information he needs to make a determination with respect to any claimed entertainment expense."

It is difficult to say to what extent most taxpayers do recall details of given expenditures. A record of an expense made at or near the time of the expense has a high degree of credibility not present in statements prepared subsequently when there may be a lack of accurate recall. For this reason, I believe taxpayers should be encouraged to maintain adequate records on a current basis. The regulations, however, provide that a written statement of business purpose is not necessary "where the business purpose is evident from the surrounding facts and circumstances, such as the business relationship to the taxpayer of the person entertained." The regulations also expressly recognize that a taxpayer may substantiate his expenses by evidence other than records, provided it meets the requirement of the statute that it be sufficient to corroborate his own statement.

Question No. 8.—Why is it always necessary for an employee to record the business relationship and purpose of entertaining in order to adequately account to his employer? IRS is willing to accept circumstantial evidence to establish this information. If an employee gives a name and can recall the guest's connection and the business purpose, why should he be required to make a record of an easily established fact which IRS and/or the employer can always verify without a time-consuming record?

Answer.—The new statute, although it contains a special rule preventing double disallowance (under the substantive limitations of subsec. (a) of sec. 274) of entertainment expenses incurred by an employee on behalf of an employer, contains no similar relief rule against double disallowance on grounds of lack of substantiation. The regulations provide a relief rule that if an employee incurs an expense on behalf of his employer and makes an adequate accounting to his employer, he will not again be required to substantiate his expense to the Government for Federal tax purposes except in certain limited cases, such as in the case of an employee who is closely related to his employer. Since this is a special relief measure, it should be restricted in its application

to cases where an employee accounts to his employer by adequate records of a standard equal to that called for by section 274 (d). See question No. 7.

Question No. 9.—Why do you require a record of the business purpose of entertaining or a gift when good will is sufficient? (If you read the regulations closely, you will find that a record is not required when the purpose is evident from the surrounding facts and circumstances; but nobody knows this. As a result, most businessmen figure that a taxpayer must have a business purpose; and it never occurs to them that the Government would be so ridiculous as to require a record that entertainment took place or a gift was given to establish good will. They, therefore, conclude that they must dream up some other reason; and being unable to do so, they do not give gifts or entertain in many instances.)

Answer.—As I indicated in my answer to your question No. 7, the statute requires a taxpayer to establish the business purpose of an entertainment expense which is being claimed as a deduction. If the purpose of entertaining is to create or maintain business goodwill, a simple statement to that effect is sufficient. Furthermore, the regulations issued in final form last December make it clear that the business purpose of an expenditure need not be separately stated on an expense record if it is evident from the surrounding facts and circumstances.

Question No. 10.—The principal problem of the expense account law has been the confusion surrounding it. Basically, the confusion is doubt about what is and what is not deductible. It will be over 6 months between the passage of the law and final substantive regulations. I know the law is capable of varying interpretations, but this delay has caused thousands of businessmen to exercise extreme caution. It is not a question of what the law says, it is what they think it says. How do you explain this kind of delay? (Answer—tough law to interpret.)

Answer.—The regulations must be carefully prepared to properly carry out the new requirements of the statute. Some of the new statutory terms, such as "directly related" or "associated with" the active conduct of business, as in the case of many other general rules in the tax law, do not lend themselves to precise definitions. Individual views may differ on the exact meaning of some of these terms. Recognizing this, I called in outside consultants, including leaders in the legal and accounting professions, to review and comment on early draft versions of the regulations. Many of their comments have been incorporated into these regulations. This, of course, has been time consuming. However, I believe it is time well spent to provide regulations which carry out the requirements of the statute.

I believe these regulations strike a fair balance between restricting abuses—curtailing expense account financing of personal costs of living—without imposing undue restrictions on legitimate business activity. In addition, following our usual practice, these regulations are being issued first in proposed form. This is an opportunity for taxpayers who may be affected by these proposed rules to study them carefully, and give us their comments, before final regulations are published.

I realize that the proper application of some of the new substantive rules may raise problems of interpretation for some taxpayers until the final regulations are issued. Accordingly, I am announcing that revenue agents will be instructed to resolve reasonable doubts in favor of taxpayers where—with respect to "T. & E." transactions occurring during the period beginning January 1, 1963, and ending 30 days after the final regulations are issued—there have been good faith efforts to apply the substantive requirements of the new statutory rules.

Question No. 11.—Why do you require a record of the type of entertainment? It seems that this adds to the problem of recordkeeping, as the place of entertainment would almost invariably indicate the type. The taxpayer could always be questioned about the particular establishment. (Actually, the regulations do permit the proof of the type of entertainment from the establishment; but this fact is not well known, and very few businessmen have observed it.)

Answer.—A record of the type of entertainment is not required by the regulations unless such information is not apparent from the designation of the place of entertainment by its name, if any, and its address or location.

Question No. 12 (parts a, b, and c).—If the law is that confusing and is having the unintended effect complained of by the restaurant and hotel industry, maybe we had better take a new look at it. I have a series of questions to ask about the substantive interpretation of the law.

It is my understanding that typical restaurant entertaining (i.e., entertaining in surroundings conducive to the discussion of business) was to be unchanged by the new law by virtue of the business meal exception. This is how Senator Douglas, Senator Clark, and the Treasury Department argued before the passage of the law. You have stated that for the business meal exception to apply there must be a direct, close relationship between the taxpayer and the person entertained.

(*a*) Does this mean that expenses for wives in a restaurant are never deductible under the business meal exception? (For example, where President and Mrs. Kennedy entertain Prime Minister and Mrs. McMillan.)

Answer to part a.—By no means. In my references to the business meal exception, I have stated that, under the statute, it is necessary that the surroundings be of a type generally considered conducive to business discussion. Thus, it would normally be necessary to show that you were entertaining someone with whom you had a business relationship. The presence of wives is another factor to be taken into account in determining whether the circumstances were conducive to business discussion. However, if, in the light of all the facts and circumstances, the surroundings were of a type generally considered conducive to discussing business, and the expense for the wives was an ordinary and necessary business expense as under prior law, the expense for wives will not be disallowed by the new rules.

(*b*) Does this mean all goodwill entertaining is out under the business meal exception and that the statement in the finance report that "the principal form of goodwill entertaining in the country will be left undisturbed under the new law" is false? This same statement was repeated several times during the Senate debate.

Answer to part b.—I believe that many business goodwill expenses, deductible under prior law, will continue to be deductible under the business meal exception. I have attempted to emphasize this on several occasions over that last few months in talking before various groups. The regulations will make this clear. To come within the business meal exception, it is not necessary that business actually be discussed.

(*c*) Most, if not all, country club entertaining is of a goodwill type. Are not a lot of businessmen wasting their time keeping a record of business use of a club to meet the 50-percent requirement when in fact they will get no deduction at all for due since the closely associated rule does not apply to entertainment facilities? About the only deduction they would get is for the time, if any, spent actually discussing business. What have you done to correct this false impression?

Answer to part c.—It is important to bear in mind that the statute expressely provides a dual test in determining deductibility of dues to social, athletic, or sporting clubs. It is the same dual test provided for the case of entertainment facilities generally. First, these expenses are not deductible under the statute unless the facility is used primarily for ordinary and necessary business use. Second, once the primary use test is satisfied, these expenses are deductible only to the extent they are directly related to the active conduct of business. It may well be that in certain cases only a portion of country club dues will be considered allocable to entertainment directly related to business. However, the regulations will provide that clubs operated solely to provide business lunches will not be considered social clubs. In such cases, the dues would be fully exempt from the new dual test. Moreover, if a taxpaper used a country club primarily for furnishing business meals, we will consider the dues allocable to such use directly related to business.

Questions Submitted by Senator Bennett

Question No. 13.—Let me put a situation to you. The Gillette Safety Razor Co. invites the entire United States to witness on television the Rose Bowl football game, and various other major sporting events, and for this pays tremendous sums of money for TV time. It does this in order to sell its product, but its selling efforts represent a sort of scatter gun approach, because there are countless viewers who are neither customers nor prospective customers. The

X Co. on the other hand takes 20 of its best customers and customer prospects, their wives and families to a football game in the hope of creating and maintaining friendly relationships so that it can maintain and increase its sales. This selling effort represents a squirrel gun approach—there is not a dime wasted in the selling effort.

Now which expense is more directly related to the taxpayer's trade or business? Do you think it is highly discriminating to allow the first and disallow the second?

Answer.—I believe the distinction between the two cases, which is clearly made by the new statute, is a reasonable one. Section 274(e)(8) contains a specific exception covering expenses for goods, services, and facilities made available by the taxpayer to the public generally. The new limitations on deducting entertainment expenses appear to be designed to cover entertainment which confers substantial tax free personal benefits on the recipients unless there is a close relationship to the active conduct of business. The individual who views the football game on television obtains a benefit which he acquired through the purchase of his TV set, and this benefit is shared generally by the members of the public who indirectly finance the program through the purchase of the advertiser's products. However, the individual who attends a football game with his wife and family obtains a substantial personal benefit, the cost of which, if paid for by himself, would be a nondeductible personal living expense. Under the new statute, this expense cannot be treated as a deductible business expense except to the extent there is a close relationship with the active conduct of the taxpayer's business.

Question No. 14.—The existing substantive regulations under section 162 (business expenses) provide (and for many years have provided) that business expenses deductible under section 162 include the ordinary and necessary expenses "directly connected with or pertaining to" the taxpayer's trade or business. How does this test differ from the "directly related to" test of the new section 274? Or conversely, what changes did the "directly related to" test make in the existing "directly connected with or pertaining to" test?

Answer.—The requirement of new section 274 that an expense be "directly related to the active conduct of a taxpayer's trade or business" imposes a stricter limitation on deductibility of expenses for business entertainment than existed in the regulations under section 162. New section 274 expressly requires that the expense be related to the active conduct of business. The regulations under section 162 did not contain this latter condition. As the Senate Finance report states (p. 28), a taxpayer, under the new statute, "must show a greater degree of proximate relation between the expenditure and his trade or business" than is required under section 162.

Questions Submitted by Senator Carlson

Question No. 15.—Businessmen who are seeking clarification of the new law and your regulations governing expense accounts seem to be primarily interested in obtaining some quick clarification concerning those expenditures which may be disallowed to the company as a business deduction but which may or may not be considered by the Internal Revenue Service to be a fringe benefit or a salary supplement for the employee who made the expenditure with the company's approval. In order to clear up this point it seems desirable to have some official guidelines in question-and-answer form which cover a series of suppositious transactions which have varying degrees of shading but which generally reflect normal business practices here in Washington.

To lay the basis for these questions let's assume as an example the XYZ Corp., headquartered in Denver, having a Washington vice president with an engineering staff and a sales staff. The stock of the corporation is widely held and the Washington vice president is not related to the president or any of the other corporate officers. The corporation is in the business of producing appliances for industries and individuals generally and also makes sales to the Government. The Washington vice president's duties, among other things, consists of watching legislation, being alert to Government bids,, and acting as a general listening post and adviser for all corporate affairs. He is thus expected to have a broad acquaintance with Members of the Congress, members of the executive departments, other business representatives and business organizations. In order to carry on these important duties he is expected by his company to have business and social relations with these people. To assist in

cultivating the desired acquaintances and contacts the company expects him to be a member of various clubs and associations, and the company pays club dues. He is the company's ambassador—the company's image on the Washington scene. His assignments demand that he reciprocate on entertainment and this requires that he and his wife entertain often at home, at the clubs, and at hotels.

The foregoing narrative is fairly descriptive of the responsibilities of Washington representatives of many of the major corporations having offices here. Now for the questions.

Question.—It has been the practice of the XYZ Corp. to entertain members of the press during Christmas week at a cocktail party and buffet supper. The vice president makes the arrangements and sends out the invitations. The party is for the most part an appreciation party and seeks to preserve the good will that now exists between the corporation, the vice president, and the press corps. No business is discussed during the evening and there is no business meeting immediately prior or after the party. Fifty members of the press and their wives are present. The hotel bill, including gratuities, music, etc. amounts to $1,000. It is strictly a good will party. It appears without question under your new regulations that the Service would hold this expenditure of $1,000 to be unjustified as business expense so far as the company is concerned and it would be, therefore, disallowed to the company. Does it, however, mean—and this is the vital question—that this expenditure becomes a salary supplement to the Washington vice president who arranged the party and approved the expenditure upon which he has to pay a tax?

Answer.—Goodwill entertaining of members of the press and their wives at the request of, and on behalf of, the XYZ Corp. would not, under the circumstances you describe, be considered a salary supplement to the Washington vice president. This assumes that the XYZ Corp. did not treat the expense on its tax return as compensation paid to the Washington vice president.

Question No. 16.—Assuming the same set of circumstances described in question No. 15 but assume the additional fact that the corporation president or board of directors has approved the holding of the party and the making of the expenditure realizing in advance that it may not be deductible as a business expense for the corporation but nevertheless, they are willing to go ahead, and have authorized the Washington vice president to hold the party. The corporation auditor will account for the expenditure in his corporate records not as a business expense but after taxes. The question is the same: Does it necessarily follow that the expenditure then becomes a salary supplement to the Washington vice president who arranged the party and contracted for the expenditure?

Answer.—Our answer to the first question is in no way changed by the facts of your question No. 16.

Question No. 17.—Assuming the facts in question No. 15 but substitute for the 50 members of the press corps a guest list comprised of Members of the Congress.

Answer.—Our answer is in no way changed by these facts.

Question No. 18.—Substitute a guest list composed of members of the executive department some of whom are engaged in handling Government contracts.

Answer.—Our answer is in no way changed by these facts.

Question No. 19.—A businessman residing in Washington meets an out-of-town client in his room at the hotel. After a business discussion the Washington resident spends a total of $18 for refreshments and dinner for the two.

Can the Washington resident charge the total of $18 on his expense account to his company as a legitimate business expense?

Or must he exclude the $9 paid for his own meal on the assumption that he could eat at home if he wanted to?

If it is not possible for him to include his own $9 expense under the foregoing set of facts could he telephone his wife, cancel one plate at home and order the same meal scheduled for home consumption and charge the cost thereof, whether it be hamburgers or pheasant under glass that is scheduled for home consumption?

Answer.—This question involves an issue of law not affected by the new travel and entertainment provisions of the Revenue Act of 1962. Judicial decisions under established law, applying the statutory rule that deductions are not allowed for personal expenses, hold that a taxpayer cannot obtain a deduction for the portion of his meal cost which does not exceed an amount he would normally spend on himself. The Internal Revenue Service practice has

been to apply this rule largely to abuse cases where taxpayers claim deductions for substantial amounts of personal living expenses. The Service does not intend to depart from this practice.

Question No. 20.—The substantiation regulations appear to be unduly detailed in certain particulars and are very ambiguous with respect to other areas. The undue burden of detail specified in the regulations has caused many complaints based upon overenforcement of the law. As to the ambiguities, the business people who have to deal with regulations complain that they have no guidance as to how the regulations will be applied in given situations.

As an illustration of the ambiguities, assume the following facts:

The White House Correspondents Association is composed of members of the press accredited by the White House. It has annual dues which are generally paid by the members and then charged to the newspapers which they represent on an expense account. They join yearly with the White House Photographers Association and hold a rather elaborate banquet at the Sheraton Park Hotel. Each member is usually entitled to buy several seats or a table. The club usually invites the President, members of the Cabinet, members of the Supreme Court, the diplomatic staff and other prominent people in Government. Each member of the club invites prominent people who are considered to be "news sources." No business is discussed at the meeting and it is not held prior or subsequent to a business meeting. The individual member normally pays for his guest's ticket by charging the cost to his employer. The purpose for the most part is restricted to good will.

Question.—Is the annual dues a legitimate business expense for the employer?

Answer.—It would appear that dues to these associations are not dues to a social, athletic, or sporting club or organization, and are not subject to the new limitations on deductions for expenditures with respect to entertainment facilities. The dues would be deductible to the extent they constitute ordinary and necessary business expenses as under prior law.

Question No. 21.—Is the cost of the banquet a legitimate expense for the employer?

Answer.—It would also appear that the cost of the banquet would be deductible to the extent it constitutes an ordinary and necessary business expense as under prior law. The Service proposes to treat expenditures for banquets sponsored by business or professional associations as expenditures to which the specific exception for business meals applies. Even if the business meal exception is not applicable under the facts of the case, the cost of the banquet should qualify as entertainment occurring in a clear business setting.

Question No. 22.—If not, is the dues expense or the banquet expense a salary supplement to the White House correspondent?

Answer.—This is a question not affected by the new statute. The new rules only disallow deductions. Whether or not an item paid for by an employer is considered income to an employee in the form of salary supplement depends upon the general rules of established law prior to the enactment of the Revenue Act of 1962.

Question No. 23.—If wives of members and guests were included at the banquet how would the expense of their tickets be considered?

Answer.—As I indicated in my answer to a question asked by Senator Curtis (question No. 25), we do not believe the new law is aimed at disallowing deductions for entertainment of wives. However, it is necessary, as under prior law, that entertainment of wives serve a bona fide business purpose. Assuming the "ordinary and necessary" business requirement is satisfied, and the taxpayer establishes that the expense for the customer himself is not disallowed under the new statute, the portion attributable to the customer's wife will generally be deductible.

Question No. 24.—It would appear that there are, in some instances, double standards with respect to enforcement of the tax laws. Assume the following factual situation:

A is the president of X Corp. Company owned and operated automobiles are sometimes used to transport A to and from his residence and office.

(1) Is the cost of maintaining and operating the automobile to the extent attributable to transporting A to and from work a deductible expense by X Corp.?

(2) Is the reasonable value of the transportation taxable income to A?

(3) If the answer to (2) is affirmative, would the same thing be true in the case of Government officials using Government-owned vehicles to commute to work?

Answer (1).—The Service proposes to rule that an automobile used in the active conduct of trade or business, even though incidentally used for commuting to and from work, would not be regarded as entertainment. The cost would be deductible by X Corp. to the extent it constitutes an ordinary and necessary business expense, as under prior law.

Answer (2) and (3).—Whether or not an item is includible in income is a question not affected by the new rules.

QUESTIONS SUBMITTED BY SENATOR CURTIS

Question No. 25.—Does the Internal Revenue Service expect to promulgate a regulation which will deny deductibility for entertainment expense spent on the wife of a customer if the wife of a customer is not a participant in the customer's business?

Answer.—No. We do not believe the new law is aimed at disallowing deductions for entertainment of wives. However, it is necessary, as under prior law, that entertainment of wives serve a bona fide business purpose. Assuming the "ordinary and necessary" business requirement is satisfied, and the taxpayer establishes that the expense for the customer himself is not disallowed under the new statute, the portion attributable to the customer's wife will generally be deductible.

Question No. 26.—Suppose an out-of-town company maintains a hotel suite or apartment in Washington for the use of its employees, who come to Washington frequently on business. Would this expense be deductible assuming it is not the type of facility used in connection with an activity generally considered to constitute entertainment, amusement or recreation?

Answer.—An employer who furnishes lodging for his employees who are traveling away from home on business would not be regarded as entertaining his employees. The expenditure will be deductible to the same extent as under prior law.

Question No. 27.—If an expenditure is necessary to the business and if it is an ordinary expenditure, will it, in any event, be disallowed?

Answer.—Certain expenses for entertainment, gifts, and travel which are considered to be ordinary and necessary business expenses deductible under section 162 are nevertheless disallowed as deductions under new section 274. This is true, for example, with expenditures for certain business goodwill entertainment (not coming within any of the exceptions provided for in sec. 274 (e)) if the entertainment does not directly precede or follow a substantial business discussion. It is also true for expenditures with respect to an entertainment facility, if the facility is not used primarily for ordinary and necessary business purposes. Also, under the statute, unless specifically excepted, deductions for business gifts to individuals are limited to $25 annually per recipient.

Question No. 28.—With respect to the disallowance of gifts in excess of $25, the bill defines the term gift as "any item excludable from gross income from the recipient under section 102." Does this mean that the liability of a donor is going to be determined on the basis of the success or lack of success of a donee who contests that the item is not includible in his gross income because it is a gift? For example, if a widow successfully argues that death benefits received from her deceased husband's former employers are excludable from gross income as a gift, as I read it, this bill would disallow a deduction to the employer even though he was not party to the widow's suit and had considered and treated the amount paid to the widow as compensation.

Is this correct?

Isn't the employer denied due process of law?

This can happen. As I understand it, this was precisely the situation in the case of *Mabel Carroll Pixton* v. *U.S.*, U.S. District Court, Southern District of Alabama, August 7, 1962, 62-2 USTC para. 9686. The court found as a fact that the employer deducted the amount paid to the widow ($22,500) as salary expense and that the employer stated "it was never intended by the company that the payment to Mrs. Pixton be considered a gift as the term gift is construed by the Internal Revenue Code, in fact, the company has definitely gone on record as disclaiming the payment as a gift."

Answer.—Even though a widow successfully argues that death benefits received from her deceased husband's former employers are excludable from gross income as a gift, the former employer is not estopped from separately arguing

successfully that the payment is not a gift. There is no denial to the employer of his day in court or of due process of law. In addition, the employer generally will have it within his control to arrange the transaction so that the payment will be considered either as compensation or as an employee's death benefit excludable from the donee's gross income to the extent provided under section 101(b) rather than as a gift excludable from the donee's gross income as a gift under section 102.

QUESTIONS SUBMITTED BY SENATOR LONG

Question No. 29.—Mr. Commissioner, without referring me to any of the exceptions to the general rule of the entertainment provision, explain the extent to which you feel the general rule permits deduction for pure goodwill entertaining.

In other words, aside from business meals, and aside from substantial business discussions, can any expenses for maintaining or creating business goodwill be deductible?

Answer.—The most significant portion of business "goodwill" entertaining is deductible under the "business meal exception" and the general rule for entertainment "associated" with substantial business discussions. In addition, however, the Service interprets the statute to permit expenses of entertainment for maintaining or creating business goodwill where the entertainment occurs in a clear business setting. Generally, this would envisage circumstances where any recipient of the entertainment would have reasonably known that the taxpayer had no motive other than directly furthering his trade or business. This is ordinarily the case with expenses for "hospitality rooms" at conventions where business goodwill is created through the display or discussion of the taxpayer's products. It would also be the case where business entertaining involved no meaningful personal or social relationship between the taxpayer and the recipients of the entertainment, such as entertainment of business representatives and civic leaders at the opening of a new hotel where the clear purpose of the taxpayer is to obtain business publicity. In addition, entertainment which has the principal effect of a price rebate in connection with the sale of the taxpayer's products generally will be considered to have occurred in a clear business setting. This would be the case, for example, if a taxpayer owning a hotel were to provide occasional free dinners at the hotel for a customer who patronized the hotel extensively.

Question No. 30.—Mr. Commissioner, it has been stated that the entertainment provision prevents a deduction for business entertainment which develops goodwill. I believe this is inaccurate with respect to the conference amendment which permits goodwill entertainment "directly preceding or following a substantial and bona fide business discussion." But, it is not clear to me how this amendment applies.

Take this case. A taxpayer and his wife entertain a customer and his wife for the purpose of enabling the taxpayer to discuss business with the customer. And, they do have substantial discussion of business affairs. The customer's wife is invited for the purpose of insuring the customer's presence by making the invitation more attractive, and the taxpayer's wife accompanies him in order to distract the customer's wife so the taxpayer and the customer can discuss business.

Explain for us the tax consequences under the conference agreement of the expenses for entertaining the customer, the customer's wife, the taxpayer, and the taxpayer's wife.

Would your answer be any different if the customer's secretary, rather than his wife, accompanied him to the business discussion, or if the taxpayer's secretary, rather than his wife accompanied him?

Answer.—I agree that it is inaccurate to say that the new entertainment provisions prevent a deduction for business entertainment which develops goodwill. Many business goodwill expenses, if deductible under prior law, will continue to be deductible under the new statute. This is true for goodwill expenses falling under the business meal exception and for expenses associated with business if the entertainment occurs directly preceding or following a substantial business discussion.

In the situation you posed, the taxpayer does in fact engage in a substantial business discussion during the entertainment. Under those facts the cost of entertainment should be deductible, including the expense allocable to the

wives, to the extent allowable as an ordinary and necessary business expense as under prior law. If the entertainment involved substantial distractions such as a meeting at a night club, theater, sporting event, or during an essentially social gathering such as a cocktail party, it would be an indication that there could not be a substantial business discussion during the entertainment.

It might be more difficult to establish a bona fide business purpose in inviting secretaries to join the entertainment. Assuming that it was established that the secretaries' presence served an ordinary and necessary business purpose as under prior law, the result would be the same as discussed for entertainment involving the wives of the customer and the taxpayer.

Question No. 31.—Mr. Commissioner, in the case of reimbursements, per diem situations, and mileage allotments, as I understand it, present rules and regulations in effect state that if an employee's per diem is not more than 125 percent of the Government per diem, the employee will be deemed to have been required to account to his employer for his expenses for purposes of regulations 1.62-17. In other words, as I understand it, the employee would not be subjected to any further accounting for his per diem whether he actually spent it or not.

Under your new regulations and rules, as I understand them, this same employee will be required to account for his expenses, and unless they were for ordinary and necessary business expenses, he will be treated as having realized an additional income.

This seems completely at variance with our intent as stated in our committee report to the effect that no provision enacted by us would affect the includability of any amount in gross income of any taxpayer. Do you have any reaction?

Answer.—I am in complete agreement that new section 274 is intended only to disallow deductions, and has no effect on the includibility of an item in income.

On the other hand, it was the law prior to the enactment of new section 274, and it continues to be the law, that any amount received by an employee under a per diem or mileage allowance which is in excess of ordinary and necessary business expenses incurred on behalf of his employer, is gross income to the employee. It is required under established law, in effect prior to the enactment of new section 274, that the employee account for this excess amount as gross income on his tax return. On the other hand, there is no requirement in the new record keeping regulations that the employee traveling under a qualifying per diem allowance with his employer should account to his employer. To the contrary, the Service has announced rules providing that reimbursement arrangements and per diem allowances not exceeding $25 per day for ordinary and necessary expenses of an employee traveling away from home on his employer's business will be regarded as satisfying the substantiation requirements of the new regulations with respect to the daily total amount of such travel, provided the time, place, and business purpose of the travel are established.

Question No. 32.—Mr. Commissioner, in interpreting the conference amendment relating to entertainment preceding or following a substantial and bona fide business discussion, do you feel the discussion can be held at a hunting or fishing lodge or aboard a company yacht?

The facility in this case would be used for a bona fide business discussion and only incidentals for business good will entertaining.

Answer.—Yes, it is possible for a substantial and bona fide business discussion to be held at a hunting or fishing lodge or aboard a company yacht. However, meetings on hunting or fishing trips, or on yachts, will generally be considered circumstances where there was little or no possibility of engaging in the active conduct of business in the absence of clear evidence to the contrary.

Question No. 33.—Mr. Commissioner, I believe this entertainment provision strikes a particularly serious blow at small business which often must advertise its product on a personal basis through entertainment of potential customers. Big business, on the other hand, would not be so seriously affected by this new law because of specific exceptions for entertainment which generally can be provided only by big business. For instance, expenses of sponsoring radio or television broadcasts are excluded from the new rules. I do not believe small business should be singled out for more harsh tax treatment than their giant competitors. I believe it is essential that the present provision be interpreted as favorably as possible in order to enable small business to survive.

In your opinion, can we rationalize a provision like this entertainment statute which gives big business additional competitive advantages over small business?

Answer.—It is not at all clear that the new entertainment rules give to big business competitive advantages over small business. For example, small businesses might well do most of their entertaining at business meals or at entertainment events directly preceding or following business discussions. Those larger businesses which have been able to afford elaborate entertainment facilities, such as yachts and hunting lodges, may find the adjustment more difficult. I believe a significant portion of business goodwill entertaining will continue to be deductible under section 274, both to small and large businesses.

Question No. 34.—Mr. Commissioner: Because the "directly related" test in case of entertainment expenses does not apply to business gifts, it is important to know in which category borderline cases fall.

I note that question 16 in Revenue Procedure 63-4, relating to high school basketball tickets, and question 17 relative to season tickets to baseball games, treat admission tickets as gifts.

Is it fair to infer from these examples that a taxpayer is not entertaining a business prospect when he takes him to the ball game? (Note.—The committee report treats admission tickets under the more rigid entertainment rules.)

Is there any tax difference between high school tickets and college tickets? Or professional tickets? Or tickets to the Kentucky Derby? Or tickets to the theater? Or tickets to concerts? Or tickets to a Mardi Gras ball? Or greens fees at a country club?

Answer.—The statute (section 274(h)) grants the Secretary or his delegate broad regulatory authority to prescribe whether the provisions covering entertainment expenses or those covering gifts apply in cases where both provisions might apply. Pursuant to this authority the Service proposes to treat most such expenses as entertainment rather than gifts. However, it is proposed to make a special exception to the general rule in the case of expenses for tickets of admission to a place of entertainment. Such tickets may be considered gifts or as entertainment, whichever is most advantageous to the taxpayer, provided the taxpayer or his representative does not accompany the recipient to the entertainment. This is a broad special exception for all classes of tickets of admission. However, greens fees at country clubs generally would not be considered a ticket of admission.

Question No. 35.—Our committee report states the purpose of the substantiation requirements in the following terms:

"This provision is intended to overrule, with respect to such expense the so-called *Cohan* rule. In the case of *Cohan* v. *Commissioner*, 39 F. 2d 540 (C.A. 2d, 1930), it was held that where the evidence indicated that a taxpayer had incurred deductible expenses but their exact amount could not be determined, the court must make 'as close an approximation as it can' rather than disallow the deduction entirely."

In the *Cohan* decision itself, the court stated as part of its opinion that "*absolute certainty in such matters is usually impossible and is not necessary.* * * * To allow nothing at all appears to us inconsistent with saying that something was spent." [Emphasis added.]

It might be said that the pendulum of the *Cohan* rule as broadened from time to time by other court decisions had swung over so far that taxpayers were abusing the Government by claiming personal expenses as business expenses and getting a tax deduction for them. The substantiation rule enacted last year might be described as the swing back of the pendulum. However, your substantiation regulations appear to have swung the pendulum on beyond the statute, so that the Internal Revenue Service might now be accused of abusing the taxpayer.

The words of the statute suggest that it was the intent of Congress to repeal the *Cohan* rule and replace it with a rule of reason under which absolute certainty would not be made a condition precedent to the allowance of a deduction. I believe that if your regulations were more reasonable and less burdensome, there would not be the reaction which has already set in. In other words, if your regulations were completely realistic, taxpayers would be less prone to seek amendment of the statute to escape the harsh consequences of your regulations.

What is your firm opinion as to the intent of Congress in enacting the substantiation requirements?

Don't you believe we can get regulations, which would set that pendulum on dead center?

Answer.—In my opinion, the purpose of the substantiation rules contained in section 274(d) was to require the taxpayer to prove his right to a deduction for a travel and entertainment expenditure by showing that he actually did spend the amount he claimed as a deduction, as well as the time, place, and business purpose of the expenditure. In the case of entertainment and gifts, the business relationship of the person entertained or receiving the gift was also required. I believe this purpose is indicated by statements, such as yours in discussing the bill (108 Cong. Rec. No. 155, Aug. 29, 1962, p. 17001), that "the bill requires the taxpayer who claims a deduction for entertainment expenses—or for travel or gift expenses—to clearly establish his right to the deduction by proof other than his own statements which may largely be self-serving." At the same time, I feel that for most of the business community, the substantiation regulations are fair and reasonable. After the proposed substantiation regulations were published we received many comments from a broad cross-section of the business community and from taxpayers in general. Numerous businesses supplied the Service with their expense account forms and instructions. In addition to public hearings, we held conferences with many representatives of business, the accounting and legal professions, and my regularly constituted advisory group of recognized experts in the field of taxation. The final substantiation regulations reflect in large measure the views expressed by this large body of commentators. We believe that these regulations do set the pendulum on dead center. The comments we have received from a large number of responsible persons in the business community indicate that the requirements under these regulations are consistent with practices followed for many years by prudent businessmen and prudently managed corporations.

Question No. 36.—Mr. Commissioner: In an article entitled "Expense-Account Meals—What the Rules Really Are," appearing in the March 4 issue of U.S. News & World Report, it is stated:

"You can still deduct any reasonable outlay on goodwill entertainment in the form of a quiet business meal—lunch or dinner, with or without drinks.

"The cost of entertaining business contacts—present or prospective—at a quiet cocktail party also is a business deduction, just as before."

I understand that from time to time you have made statements such as the one in your interview on the television program "A Moment With" that goodwill expenses would not be deductible.

The whole purpose of the amendment to the House bill was to insure the deduction of expenses for certain goodwill entertaining.

What is your clear position with respect to the intent of Congress as to deductibility of goodwill entertainment expenses?

Will goodwill entertaining in a night club be deductible under either the business meal exception or the conference amendment relating to entertainment preceding or following a business discussion?

Answer.—Although the new statute imposes restrictions on goodwill entertaining, a significant portion of business goodwill entertaining is still deductible under the new rules: (1) under the business meal rule, (2) if the entertainment is associated with the active conduct of the taxpayer's business, and it directly precedes or follows a substantial and bona fide business discussion, or (3) if it occurs in a clear business setting.

Although business goodwill entertaining at a night club would not generally qualify under the business meal exception, it will be deductible as entertainment associated with business if it is established that the cost was incurred for a clear business purpose, and the entertainment directly precedes or follows a substantial business discussion. However, we have reservations concerning the correctness of the statement quoted from the article to the effect that the cost of cocktail parties, not connected with business discussions, are not affected by the new law.

Question No. 37.—Mr. Commissioner, your proposed regulations apparently required taxpayers to record the names of waiters, cabdrivers, bellhops, and others to whom they had given a tip. Your final regulations modified this requirement at least to the extent of permitting identification by "name, title, or other designation." Does this change mean that under the final regulations the taxpayer still is required to identify the recipient of his tip?

Are there any situations in which the name of a waiter, cabdriver, or bellhop who has been given a tip must be obtained for the tax collector?

Answer.—Neither the proposed recordkeeping regulations nor the final recordkeeping regulations contemplated that the names of waiters, cabdrivers, bellhops, and others to whom a tip was given would be required. We do not know of any provision in the regulations which could lead to such a construction. So far as we can ascertain, there would be no case where the name of such a person would be required.

Question No. 37a.—Are you applying the same rules with respect to recording names in the case of gift expenses as you are with respect to entertainment expenses?

Answer.—Generally yes, since the statute provides expressly, both with respect to gifts and entertainment, that no deduction shall be allowed unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement "the business relationship to the taxpayer of persons entertained—or receiving the gift." I want to emphasize, however, that the regulations do not flatly require *names* of recipients of entertainment or gifts. The regulations broadly call for "occupation or other informaiton relating to the [recipient], including name, title, *or other designation*, sufficient to establish business relationship to the taxpayer." Specifically with respect to *names* in the case of gift expenses, in the question and answer series released last December, it is stated at question No. 16: *"16. Question:* Is it always necessary to record the name of the recipient of a business gift?

Answer.—No. In some situations, a more general designation will be sufficient if it is evident that the taxpayer is not attempting to avoid the new $25 annual limitation on the amount which can be deducted for gifts to any single individual. For example, if a taxpayer purchases a large number of inexpensive tickets to local high school basketball games, and he distributes one or two tickets to each of a large number of his customers, it usually would be sufficient to record a general description of the recipients of the tickets. This answer assumes that the amount, time, description, and business purpose of the gifts also substantiated.

Furthermore, it should be noted that the $25 limitation on gifts applies only to gifts made, directly or indirectly, to individuals. The Service would not regard gifts for the eventual use or benefit of some undesignated member of a large group of individuals as an "indirect" gift to the ultimate recipient unless it is reasonably practicable to ascertain the ultimate recipient. Thus, the substantiation rules on gifts should not involve burdensome recordkeeping requirements.

Question No. 38.—Mr. Commissioner, I know you recall the furor that was raised a few years ago when the Internal Revenue Service attempted to revise the tax form to require individuals on expense accounts to reveal the amount of their per diem, reimbursements, mileage allotments, etc. This was the so-called line 6*a* on the 1957 tax return.

To what extent do you plan to require similar information to be divulged under last year's amendments relating to entertainment, travel, and gift expenses?

If there has been an adequate accounting to his employer, is there any reason why you should seek any further information from employees?

Answer.—The Internal Revenue Service has no plans to revise the individual income tax form to return to the so-called line 6*a* approach. Line 6*a* would have required taxpayers first to report expense account allowances as gross income on their tax returns and then claim off-setting deductions.

The Service believes that it is unnecessary to require an employee who has adequately accounted to his employer for expenses incurred on behalf of the employer to again account for such expenses on his individual income tax return. However, this assumes that the employee is reimbursed under a reimbursement arrangement with adequate independent verification procedures. The regulations prior to the enactment of section 274 made it clear that the Internal Revenue Code contemplates that taxpayers keep such records as will enable the Service to correctly determine income tax liability. We believe additional accounting is required in cases where, generally speaking, an independent verification of expense allowance payments would not be present, such as in the case of employees who are closely related to their employer.

QUESTIONS SUBMITTED BY SENATOR SMATHERS

Question No. 39.—What would the enforcement policy of the Internal Revenue Service be under these separate but similar hypothetical factual situations:

(1) A is the president of X Corp. and confers in his office on an important matter with two of his vice presidents, and his sales manager. At lunchtime the business discussion is not concluded, and A decides to adjourn the conference to a nearby restaurant and continue the discussion during lunch. A pays the lunch tab for all four persons and receives reimbursement for the entire amount from the corporation.

(2) B is the president of Y Corp. The facts are the same as in (1) above, except that Y Corp. maintains an executive dining room, to which the participants retire for lunch to continue the discussion. The cost of the lunch is borne by the corporation under the cost of maintaining the dining room.

What is the deductible status of the cost of the meals in each of the examples above; if any difference, what is it and why?

Answer.—From the facts given, it appears that the corporation's deduction in the first situation would not be disallowed under the new rules since the meal meets the requirements of the "business meal" exception contained in section 274(e)(1). Also, in the second situation, assuming that the executive dining room is on the business premises of the corporation, and the expense is an ordinary and necessary business expense under prior law, the cost of the lunches would meet the requirements of the "food and beverages for employees" exception contained in section 274(e)(2). Accordingly the expenses would not be disallowed under section 274(a).

Question No. 40.—What would the enforcement policy of the Internal Revenue Service be under this hypothetical factual situation:

A is a manufacturer of "Boy-Girl" bicycles. In order to impress the youngsters with the attributes of "Boy-Girl" bicycles with the hope that the youngsters will exercise their parental influence to the end that the parents, when buying bicycles, will buy "Boy-Girl" bicycles, A gives an outdoor party for 200 youngsters of the bicycle age. At the party, food and refreshments (nonalcoholic) are served the youngsters, free rides on Boy-Girl bicycles are given, and other forms of entertainment furnished the youngsters. Is the cost of the entertainment a deductible business expense, and if so, is it deductible as an entertainment expense or as an advertising expense?

Answer.—The Service proposes to treat entertainment occurring in a "clear business setting" as directly related to the active conduct of business. Entertainment of a clear business nature occurring under circumstances where there is no meaningful personal or social relationship between the taxpayer and the recipients of the entertainment, as in the case given, generally will qualify for deduction under this rule.

Question No. 41.—Mr. Commissioner, in your original proposed regulation did you not call for a record of the description of entertainment?

In your final regulation you call for a record of the "designation of the type of entertainment." Is that correct?

Does the statute call for either a "description" or a "designation"? (Note: Answer must be "No.")

Let me recite the requirements of the statute. The statute says the taxpayer must make records of: "(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 the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift."

The statute asks for a description of gifts, but it does not ask for a description of entertainment. If we had wanted a description of both, don't you think we would have asked for it?

Do you feel you have complied with our intent by requiring a description? I think you have exceeded it.

Answer.—The statute does not specifically refer to a "description" or "designation" of entertainment.

However, the accompanying committee reports, and the Senate floor debates give a fairly clear indication that the purpose of the recordkeeping rules of section 274(d) is to require a taxpayer to * * * "clearly establish his right to the deduction. * * * By these requirements the taxpayer must reveal to the tax collector all the information he needs to make a determination with respect to

any claimed entertainment expense." (Quoted from statement of summation of Senator Smathers, in the Senate floor debates on sec. 274(d), 108 Congressional Record No. 155, Aug. 29, 1962, p. 17001.)

Ordinarily, the specific statutory requirement that the "place of entertainment" be recorded should by itself be sufficient to give the type of information necessary to properly apply the substantive provisions of the new "T. & E." law. However, in those situations where the "place of entertainment" does not indicate the type of entertainment, a revenue agent (or an employer in the case of reimbursed expenses of employees) might not be able to ascertain whether the expenditure is deductible unless the particular type of entertainment is recorded. For example, if a taxpayer merely records that he spent a certain amount for entertaining a particular customer at "place X", it could be that the place is a restaurant or a hotel dining room conducive to a business deduction discussion to which the business meal exception applies. On the other hand if "place X" is a night club, where there are substantial distractions such as floor show, the more restrictive requirements of the new substantive law applies before the expense is deductible. In this type of case, if the expense is incurred by an employee under a reimbursement arrangement, setting forth the type of entertainment would be required by a prudent employer so that the employer could justify the deduction. In the case of a self-employed taxpayer, setting forth the type of entertainment not only avoids problems of inaccurate recall, but will enable a revenue agent to audit the expense account without burdensome questioning of the taxpayer. Since the type of entertainment may be the crucial factor in determining deductibility, it would be unfair and misleading to taxpayers not to instruct them to keep a record of this factor.

Question No. 42.—Mr. Commissioner, In the technical part of the committee report, which you know is generally written by representatives of your Department, there is an example illustrating the application of the rule requiring allocation of travel expenses where travel exceeds one week and the personal portion of the trip represents more than 25 percent of the total time away from home. (S. Rept. 1881, 87th Cong., p. 172.) This example makes it clear that travel time is to be treated as business time.

Doesn't this sort of rule make the whole allocation formula sort of ridiculous? For instance, in the example cited the taxpayer attributed fourteen-eighteenths of his trip to personal purposes. The 2 days of business and the 2 days of travel gave him four-eighteenths for business purposes. Now if that same individual instead of taking a fast jet to London had taken a slow boat which would have involved 5 days of travel over and 5 days of travel back, and if he had spent the same 2 days on business in London and the same 2 weeks on vacation on the Continent, he would have been permitted to allocate twelve-twenty-sixths of his expense to business and fourteen-twentysixths to personal purposes. This would give him a deduction of nearly 50 percent. If he goes by jet, his deduction is 22 percent of his cost.

Are these computations about accurate?

Don't you agree that these consequences are irrational?

Answer.—These computations appear to be correct unless the taxpayer is able to establish that a different method of allocation more clearly reflects the time which is attributable to business. We agree that counting "in transit" time as business time weighs the scale in favor of the taxpayer who chooses to travel by the slow means of transportation. On balance, however, it seems that a taxpayer should be permitted to choose a reasonable mode of transportation as long as he travels for business purposes by a reasonably direct route to his business destination. We do not believe that this particular factor will be a significant one in selecting the mode of transportation since the Service proposes that the entire cost of travel to and from the business destination will be deductible unless the taxpayer has substantial control over arranging his business trip and a major consideration in determining to make the trip is to obtain a vacation or holiday. Furthermore, even where the allocation rules apply, the taxpayer may be able to establish that a method of allocation, other than one based solely on a comparison of business days and personal days, more clearly reflects the portion of time which is attributable to business.

Question No. 43.—Subsection 274(*d*), upon which the new substantiation regulations are based, requires that certain elements of an expenditure be established. Among these statutory elements are business purpose of the expense and the business relationship to the taxpayer of the persons entertained.

The regulations appear to go beyond these statutory requirements in that a taxpayer must show the business reason for the entertainment or the "nature of the business benefit derived or expected to be derived as a result of the entertainment."

In view of this requirement, what would the enforcement policy of the Internal Revenue Service be under this hypothetical factual situation:

A is a retail furrier, and learns that B's wife is planning on buying a mink coat. A invites B and B's wife to dinner and the theater with A and A's wife. A pays for the evening's entertainment. Due to the cordial friendship established that evening between the wives of A and B, B purchases his wife a mink coat at A's store. B will testify that prior to the evening's entertainment he had already decided to buy his wife a fur coat from another store, but after the evening's social activity, his, B's wife, insisted that he buy the mink coat at A's store.

Is the cost of the evening's entertainment deductible in whole or in part?

Answer.—Assuming that the dinner was furnished under circumstances generally considered conducive to a business discussion, such as at a restaurant or hotel dining room where there were no substantial distractions, such as a floor show, the cost of the dinner would appear to come within the "business meal" exception (sec. 274(e)(1)). Therefore, this expense would be deductible, even though there was no discussion of business at the dinner, to the extent the cost qualified as an ordinary and necessary business expense as under prior law. However, the expense of attending the theater would be treated differently. Under the facts given, it would appear that the theater entertainment is not directly related to the active conduct of business. Therefore, the expense will be disallowed by section 274 unless the entertainment was associated with the active conduct of the taxpayer's trade or business and immediately preceded or followed a substantial and bona fide business discussion. In the case given, it appears that there was no such discussion.

Question No. 44.—Assume that an employer regularly pays the dues and other expenses of certain employees for country club membership on the theory that the employee utilizes the club principally for business purposes. At the end of the employee's tax year, the employee tabulates his personal and business use of the club and discovers that such use has been 80 percent personal. Under these circumstances, no deduction would be allowed either employee or employer for entertainment facility expense since the facility was not used primarily for business purposes. Section 274(a)(1)(B) of the code.

The dues represent essentially compensation under these circumstances and should be included in the employee's income and deducted from the employer's income as compensation expense. However, it appears from section 274(e) of the code that the employer will not be allowed a deduction unless he treats these payments "as wages to such employee for purposes of chapter 24 (relating to withholding of income tax. * * *)" This places the employer in a dilemma since at the time of payment of the dues he does not know whether the dues represent compensation from which he must withhold or entertainment expenses for which he is not required to withhold. If he does not withhold, and it later appears that the payments represent compensation, the possibility exists that there will be a double disallowance of deduction, both to the employee and the employer.

Do you agree that this is a fairly accurate statement of the application of the statute?

I am informed that this same problem is going to exist in many situations under the new bill where expense allowances are disallowed as a deduction and that this new law is really going to make this a critical problem. How do you intend to interpret the statute in these cases, particularly in view of Congress position that the bill it enacted last year was not intended to result in the inclusion of any amount in the income of any individual?

Answer.—This appears to be an accurate statement of the application of the statute in a case where the employer rewards an employee with a vacation trip, or permits him to use the employer's yacht for a vacation. However, the Service is still studying the proper application of the statute in the case where the employer pays dues for an employee's country club membership with the reasonable expectation that the employee will use the club principally for business purposes.

Question No. 45.—Under the new substantiation regulations, certain special rules are provided and among these is a rule relating to the allocation of an

expenditure. This special rule states that if a taxpayer has established the amount of an expenditure but cannot establish "the portion of such amount which is attributable to each person participating in the event giving rise to the expenditure, such amount shall ordinarily be allocated to each participant on a pro rata basis, if such determination is material."

It would appear that this statement is very ambiguous because of the broad terms of reference used and would also impose unrealistic demands upon taxpayers.

What is meant by the phrase "if such determination is material?"

Does this mean that a host-taxpayer must keep a current record of what each individual participating in the entertainment ordered?

If he does not maintain such a record, does the regulation quoted mean that there will be an arbitrary allocation on a per person basis, regardless of the amount of expense incurred by such person?

Answer.—A determination of the portion of an entertainment expenditure may be material where only some of the persons entertained have a business connection with the taxpayer. For example, if, after a substantial business discussion with business associates, the taxpayer invites them to a party which he is having for his social acquaintances, the portion of the expenditure allocable to the social acquaintances would not be deductible.

Under the allocation rule contained in the substantiation regulations these detailed records are made unnecessary. For example, assume a taxpayer entertains 20 persons at a cost of $200 and it is determined that expenses relating to 10 of the persons are deductible under the new rules. Under the allocation rule it would be permissible for the taxpayer to allocate the total cost of $200 to the 20 persons equally to arrive at a deductible amount of $100 (10 persons at $10 each). This would avoid making the taxpayer keep a current record of what each individual ordered or consumed. We feel this rule will alleviate many burdensome recordkeeping problems for taxpayers generally. However, under the regulations a taxpayer is not precluded from recording the exact amount spent on entertaining a particular person if the taxpayer finds this method convenient.

Question No. 46.—From time to time you have stated that under the new entertainment-expense provision the cost of goodwill entertaining would not be deductible. One such statement was made recently on the television program entitled "A Moment With—"

I don't believe this is a fair statement. In fact, I think it is calculated misinformation.

Clearly, the business-meal exception permits pure goodwill entertaining of a limited sort.

Just as clearly, the conference amendment permits goodwill entertaining, even at nightclubs, theaters, or sporting events. The provision does not by its terms limit deduction, in case of entertainment following a substantial or bona fide business discussion, to entertainment of persons actually participating in the discussion. The committee report states it is not so limited. And I, for one, do not believe it should be so limited.

How do you plan to interpret this conference amendment?

Do you agree that it permits nightclub entertaining?

Suppose that, after a substantial business discussion, the taxpayer does the entertaining at a country club or aboard his yacht. Is the deduction in danger of being disallowed?

What effect would there be on deductions of expenses with respect to the facility in such a case? Is a substantial and bona fide business discussion directly related to the taxpayer's trade or business?

Answer.—I fully agree that section 274 would not limit deductions in case of entertainment directly following a substantial business discussion to entertainment of persons actually participating in the discussion. It is, of course, necessary that the entertainment expense be associated with business to be deductible under the provision to which you refer.

The cost of entertaining solely for good will purposes at a night club would not be disallowed if a taxpayer can show that the entertainment was incurred for a clear business purpose and it took place directly before or after a substantial and bona fide business discussion. The same result would obtain if, under such circumstances, the entertainment took place at a country club or aboard a yacht.

In such a case this entertainment would be considered a business use of the facility for purposes of meeting the 50-percent test. If the entertainment at the facility was directly related to his business and the taxpayer had met the 50-percent test with respect to the facility, then the normal operating costs of the facility allocable to this entertainment would be deductible. A substantial and bona fide business discussion is an activity considered directly related to the taxpayer's business.

Question No. 47.—May trade association officials deduct entertainment of their members, such as a dinner or reception at a country club, when no business meeting precedes or follows the affair?

Answer.—The cost of food and beverages furnished under circumstances conducive to a business discussion is covered by the business meal exception of section 274(e)(1) and is deductible to the extent it is an ordinary and necessary business expense as under prior law. Whether a reception at a country club is within this exception would depend upon the particular facts of the case.

Question No. 48.—Under the above, if business is discussed at the dinner, is it properly deductible?

Answer.—Such a dinner generally would come within the business meal exception and the cost is deductible to the extent it is an ordinary and necessary business expense as under prior law, whether or not business is discussed.

Question No. 49.—To what extent may a business executive give tickets to shows, ball games, etc., to people with whom he does business?

Answer.—Generally the cost of tickets to places of entertainment is considered an entertainment expense which must meet the requirements of section 274(a) before it is deductible. However, if the taxpayer does not accompany the recipient of the ticket to the entertainment, the taxpayment may treat the cost of the ticket as a gift subject to the $25 limitation in section 274(b) or he may treat it as entertainment, whichever is to his advantage.

Question No. 50.—May an executive take business associates to plays or football games as a legitimate business expense?

Answer.—Yes. Generally such expenses will be deductible only if the entertainment was associated with the taxpayer's business and it preceded or followed a substantial and bona fide business discussion.

Question No. 51.—May a lobbyist deduct the cost of meals or entertainment for Members of Congress or for executives of Federal agencies and their staffs, and are there any qualifications?

Answer.—The question of the deductibility of entertaining Members of Congress and employees of the executive branch is a matter which is now under study by the Internal Revenue Service. Many complicated problems must be resolved before we can arrive at a proper answer, such as the effect of public policy in this area and the interplay of new section 162(e) (relating to appearances, etc., with respect to legislation) with new section 274. If you wish, we will be happy to answer this question more fully when the study is completed.

Question No. 52.—May a reporter or an executive who writes a newsletter deduct meals and entertainment of those who supply him information for his letter?

Answer.—A reporter or an executive who writes a newsletter is treated the same as any other taxpayer under these new rules. He is entitled to deduct the cost of the meals and entertainment of those who supply information to the extent he meets the requirements of the new rules. However, for the costs of entertaining Government employees, etc., see the answer to question No. 51.

Question No. 53.—At conventions where wives are customarily in attendance and there are meetings scheduled for wives, can the executive deduct the travel and living expenses of his spouse?

Answer.—Generally the new rules do not affect the cost of wives' travel to a convention. This question is treated under section 162 which requires the travel and living expense of a wife to be an ordinary and necessary business expense before it is deductible. Many court decisions applying this law to cases involving wives' travel cost have found that it was not a necessary business expense for the wife to travel, even though her presence was helpful, and the deduction for her cost was disallowed.

Question No. 54.—May the wife of a lobbyist or trade organization executive deduct the cost of entertaining the wives of Members of Congress, of the heads of executive agencies or of congressional staffs, and what are the qualifications?

Answer.—Assuming, without deciding, that such an expense might be deductible under section 162, in the usual case it would appear that a lunch or dinner, provided by the wife of a lobbyist or trade organization executive for these other wives, would not be a circumstance generally considered conducive to a business discussion. Similarly, such entertainment in the usual case would not be considered to have occurred in a clear business setting. Therefore, unless such entertainment occurs immediately preceding or following a substantial and bona fide business discussion, including business meetings at a convention or otherwise, the expense would probably be disallowed under section 274. For cases where such expenses are not disallowed under section 274, see answer to question No. 25.

Question No. 55.—If a lobbyist entertains congressional people at his home, is that allowable?

Answer.—Please refer to the answer to question No. 51.

Question No. 56.—It is my understanding that the Internal Revenue Service has, from time to time, indicated that certain entertainment expenses are nondeductible as a matter of public policy.

What is the enforcement policy of the Internal Revenue Service as to such expenditures?

Based on this policy, assume the following situation:

A is an employee of a labor union which is tax exempt under section 501(c) of the Internal Revenue Code. As a part of his duties, A finds it necessary to discuss an important piece of legislation affecting his union with Senator Y, a member of the legislative committee dealing with this matter. A arranges to discuss the matter with Senator Y over luncheon. A pays the luncheon expenses and received reimbursement from his employer for the entire cost of the meal. Is the cost of the luncheon a deductible expense?

If not deductible in whole or in part, why?

Upon whom and in what manner would the impact of nondeductibility fall?

Assume the same factual situation except that A is an employee of a trade association which is also tax exempt under section 501(c) of the Internal Revenue Code and wishes to discuss an important industry regulatory matter with Commissioner Z of the agency handling the matter. A arranges to discuss the matter with the Commissioner at luncheon.

Is the cost of the luncheon a deductible expense?

If not deductible in whole or in part, why?

Upon whom and in what manner would the impact of nondeductibility fall?

Answer.—The deductibility of these expenses is not affected by the new section 274. See answer to question No. 51.

(Whereupon, at 1:25 p.m., the committee adjourned, subject to the call of the Chair.)