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# Tax Notes

## "In-house" corporate activity and "foreign convention" limitations

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A CONCERN over perceived abuses in the proliferation of "tax deductible" foreign conventions, seminars, and cruises and the administrative difficulty in applying existing laws led to the passage of Section 274(h) as part of the Tax Reform Act of 1976, according to the General Explanation of the Tax Reform Act of 1976 of the Joint Committee on Taxation.

Section 274(h)(1) denies taxpayers any deduction otherwise allowable for the costs of attendance at more than two "foreign conventions" a year. The deductibility of the costs of attending those two conventions is also limited by Section 274(h)(2), which restricts deductible transportation costs to coach or economy air fare, and by Section 274(h)(5), which limits subsistence expenses to the federal per diem rate for the site of the convention. Transportation costs are deductible in full only if at least half of the total days of the trip (excluding travel time) are devoted to business-related activities, Section 274(h)(3), and full deductibility of subsistence expenses requires a specified amount of business-related activity for each day spent at the convention, Section 274(h)(4).

"Foreign convention" is defined as "any convention, seminar, or similar meeting" held outside the United States, its possessions, and the Trust Territory of the Pacific.

If a taxpayer's foreign convention expenses are paid by another, this limitation may result in additional income to the taxpayer for which no offsetting deduction is allowable. Cf. *Patterson v. Thomas*, 289 F. 2d 108 (5th Cir. 1961). The limitations of Section 274(h) also apply to the person who pays the convention expenses, unless the amount that otherwise would be disallowed is included in the individual's gross income and certain reporting requirements are met.<sup>1</sup> See Sections 274(h)(6)(D) and 274(h)(7).

Expenses not disallowed under Section 274(h) still must satisfy the re-

quirements of Sections 162 or 212 in order to be deductible. See Treas. Reg. § 1.162-2.

### Reporting Requirements

Deductibility of "foreign convention" expenses under Section 274(h) is predicated on both the taxpayer and sponsoring organization meeting the substantiation requirements of § 274(h)(7). A written statement signed by each must accompany the return on which the deduction is claimed. The statement signed by the taxpayer must contain (1) information as to the total days of the trip (exclusive of transportation) and the number of hours devoted each day to scheduled business activities; (2) a program of the convention's scheduled business activities; and (3) any other information that the regulations (as yet unissued) may require. The statement of the sponsoring group or organization, containing similar information, must be signed by an officer of that group or organization.

The strict recordkeeping required by Section 274(h)(7) for foreign conventions is in addition to that required by Section 274(d) for general travel and entertainment expenses. All travel and entertainment must be supported by "adequate records" showing the amount, time, place, business purpose, and business relationship (for entertainment). Treas. Reg. § 1.274-5(b). For nonlodging expenditures of less than \$25, a diary providing the required information as to how much, where, when, and why is deemed an "adequate record." Receipts or other documentary evidence are required for most other expenditures. Treas. Reg. § 1.274-5(c).

When the taxpayer's travel or entertainment activity or both are related to a foreign convention, the prudent course

of conduct would be to expand considerably the information to be kept in the diary to provide a record and basis for his signed statement under Section 274(h)(7). A log should be maintained from the inception of the "foreign convention" trip to its conclusion, which, besides the recordkeeping required by Section 274(d), records information about all business activities scheduled on a given day and the hours of each day that the taxpayer devoted to them.

Stringent recordkeeping also is required of the sponsoring organization. Attendance taking and recording are required, of course, but the degree of thoroughness and frequency with which they must be conducted is as yet unclear and is likely to remain so until regulations are issued. Prudence would seem to require that at any "foreign convention" where entry and exit are not restricted during the activities, records be kept not only of attendees' arrival but also the time of arrival and departure.

Whenever the taxpayer seeking the deduction is other than the attendee, such as an employer paying the costs of attendance of an employee, Section 274(h)(7) substantiation still must be made. Section 274(h)(6)(D). These taxpayers should make sure that they receive the necessary signed statements and require their employees or other sponsored attendees to keep adequate records throughout the trip to justify the deduction.

### In-house "foreign conventions"?

To date, Treasury Regulations interpreting Section 274(h) have not been proposed, and there have been no cases or rulings applying this provision. One question to be answered is whether and under what circumstances an "in-house" corporate business meeting

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1. Before Section 274(h) there was little to concern an employer sponsoring a business meeting of any sort. If the meeting served noncompensatory business purposes it was deductible. I.T. 2602, X-2 C.B. 138-31 (1930). If it was compensatory, its cost once again was deductible. *Patterson v. Thomas*, 289 F.2d 108 (5th Cir. 1961).

conducted abroad will be considered a "convention, seminar, or similar meeting" within the scope of Section 274(h).

Assume, for example, that for good business reasons (such as the location of some of the participants) a corporation holds a meeting in a foreign country to consider a specific business proposal. Assume, further, that the foreign location is a desirable one from the standpoint of the American participants. Is this meeting to be considered a "convention, seminar, or similar meeting" for purposes of Section 274(h)? One would think not.

Other examples are readily apparent, such as a foreign meeting attended by American and foreign executives of the sponsoring company and held in a desirable location, the purpose of which is to brief the participants on marketing strategies or new product lines.

If a convention is any "act of coming together," as defined in *Webster's New Twentieth Century Dictionary of the English Language*, unabridged (Collins & World, 1977), then each of these meetings as well as a large number of other foreign business meetings would come within the scope of Section 274(h). The term "seminar" also might be broadly construed as encompassing foreign business meetings at which, for example, the attendees receive general or specific business information. The legislative history of Section 274(h), however, and prior case law and administrative development in the area of "conventions" and "seminars," strongly suggest that these terms were used to include only meetings of a voluntary nature sponsored by a professional, trade, or business organization. There is no indication that internal business meetings were meant to be included. As stated in *Maxwell on Interpretation of Statutes*, 12th edition (1969): "The first and most elementary rule of construction is that it is to be assumed that words and phrases of technical legislation are to be used in their technical meaning if they have acquired one, and otherwise in their ordinary meaning. . . ."

#### Legislative history

Section 274(h) resulted from congressional concern "that the lack of specific detailed requirements has resulted in a proliferation of foreign conventions, seminars, cruises, etc. which, in effect, amount to government subsidized vacations and serve little, if any, business purpose." The congressional outcry was raised against a "tax-paid

vacation" in a "glorious" location, not legitimate internal business conferences.

The Joint Committee in explaining the provision alluded to an I.R.S. determination that a number of "professional, business and trade organizations" had been sponsoring an increasing number of these events "during which only a small portion of time is devoted to business activity. . . ." This suggests that Congress did not intend Section 274(h) to cover an "in house" foreign meeting for specific company business. Business meetings of this type obviously have little in common with the voluntary meetings that have only a general business nexus and are typical of "conventions" or "seminars" in the usual sense of those terms.

From the very inception of the tax law, the "convention" or "seminar" type of case or ruling has involved voluntary participation in organization-sponsored activities with substantial recreational opportunities for which a deduction or exclusion is sought by the attendee. *Everett S. Lain*, 3 B.T.A. 1157 (1926) (physician allowed deduction for attendance at a medical association meeting to obtain referrals); *Alexander Silberman*, 6 B.T.A. 1328 (1927) (chemist allowed deduction for attendance at convention for educational advancement); *Alexander P. Reed*, 35 T.C. 199 (1960) (lawyer denied deduction for attendance at conference to obtain contacts, reputation, and clients).<sup>2</sup>

The I.R.S. has been concerned throughout with "tours described as professional seminars" and "entertainment travel and expenses of a similar nature, including the cost of purported business trips which are, in fact, vacations." I.R.S. News Release No. IR 357 (1961). As early as 1923, the attention of Congress was directed at "meetings of trades, professional and business organizations of which the taxpayer is a member." Senate Finance Committee, proposed amendment 23(a) to H.R. 1, 70th Cong., 1st Sess. (1928), deleted in conference. H.R. Rep. No. 1882, 70th Cong., 1st Sess. (1928). The terms "convention" and "seminar" have not been used to describe non-compensatory internal business meetings.

#### Section 274(c) applicability

A deduction that would be permissible for foreign travel under Sections 162 or 212, whether further restricted by Section 274(h) as a convention expense or otherwise, would sometimes

be subject to further restriction by the allocation requirements of Section 274(c) for activities during foreign travel that are personal as well as business related. The application of Section 274(c), however, to the in-house corporate meeting abroad should be rare. That section has no effect on the deduction under Sections 162 or 212 (and, to the extent applicable, Section 274(h)) of a taxpayer paying the foreign travel expenses of an employee, client, or other party. *Treas. Reg. § 1.274-4(a)*. The application of Section 274(c) to the traveler himself is restricted to such an extent that the type of bona fide business activity I am discussing should almost always fall outside its scope.

Section 274(c) is inapplicable when the traveler lacks substantial control over the trip, *Treas. Reg. § 1.274-4(f)(5)(i)* (as is certainly the case with employee-attendees who are not managing executives, stockholders, or relatives of the employer); when the trip does not exceed one week, *Treas. Reg. § 1.274-4(b)(2)*; if less than 25 per cent of the time outside the United States away from home is attributable to nonbusiness activity, *Treas. Reg. § 1.274-4(b)(3)*; or if vacation activity was not a major consideration of the trip, *Treas. Reg. § 1.274-4(f)(5)(ii)*.

Viewed in their totality, the exclusions from Section 274(c) would encompass almost any in-house, bona fide corporate business activity that would meet Section 162 or Section 212 criteria. Of course, when employer coverage of foreign meeting expenses is in part a subterfuge for providing "vacation bonuses," Section 274(c) would apply to the employee's exclusion of reimbursement or deduction of unreimbursed expenses.

If Section 274(c) applies, the costs of nonbusiness days, and travel to and from a nonbusiness destination would be disallowed in full as deductions by the traveler. The deductible portion of expenses that relates both to business and pleasure is determined under formulas in *Treas. Reg. § 1.274-4(f)*. These allocation formulas control unless the taxpayer can show that some other method reflects the amount of nonbusiness activity more clearly. *Treas. Reg. § 1.274-4(d)(2), f(4)*.

#### Additional considerations

One interesting problem is the poten-

<sup>2</sup> For an extensive discussion of the history of deductibility of convention and seminar expenses, see Postlewaits, *Deductibility of Expenses for Conventions and Educational Seminars*, 61 *MINN. L. REV.* 253 (1977).

tial requirement of withholding on nondeductible foreign convention reimbursements for employees. In *Central Illinois Public Service Company v. United States*, 435 U.S. 21 (1978), the Court held that withholding was not required on meal allowances for company travel, emphasizing the lack of any clear authority holding these reimbursements to be wages subject to withholding.<sup>3</sup>

To the extent that the in-house corporate meeting relates to both American and foreign source income of a multinational, another problem is allocation of any expense deduction under Section 861 to American and foreign income. When the American entity pays the meeting expenses in full, but the expenditure relates to income of the foreign "relatives" as well, a rather complex allocation of the deduction would be required, as provided by *Treas. Reg. § 1.861-8*, thereby reducing the allowable American deduction.

#### Suggestions for clarification

While it does not appear that Congress intended to bring "in-house" foreign meetings within the scope of Section 274(h), further clarification is necessary. The application of these restrictions to foreign corporate meetings could severely restrict a company's ability to conduct world-wide operations by direct contact among its employees and, in some cases, customers. A company could be required to delay filing its tax returns until every relevant attendee had filed personally. At the very least, it would be required to make an inquiry into the "convention" and "seminar" activities of these attendees, whether the activities were related to their employment or not. American employees abroad conceivably could be within the statute each time they gathered, thereby significantly raising the after-tax cost of doing business abroad by the disallowance of significant portions of the ordinary and necessary cost of operating foreign subsidiaries or divisions. This may be the reason for recent reports of proposals to permit deductibility of "reasonable" foreign convention expenditures in excess of the two-convention limit.<sup>4</sup>

3. For a detailed discussion of the *Central Illinois* case, see Kovey, *Impact of Supreme Court decision limiting withholding on employees meal allowances*, *JOURNAL OF TAXATION*, May, 1978, page 276.

4. *Research Institute of America Tax Reports*, July 28, 1977, as cited in *Beaver, '78 Act Restrictions on Foreign Convention Expenses*, *THE TAX ADVISOR*, December, 1977, page 724.

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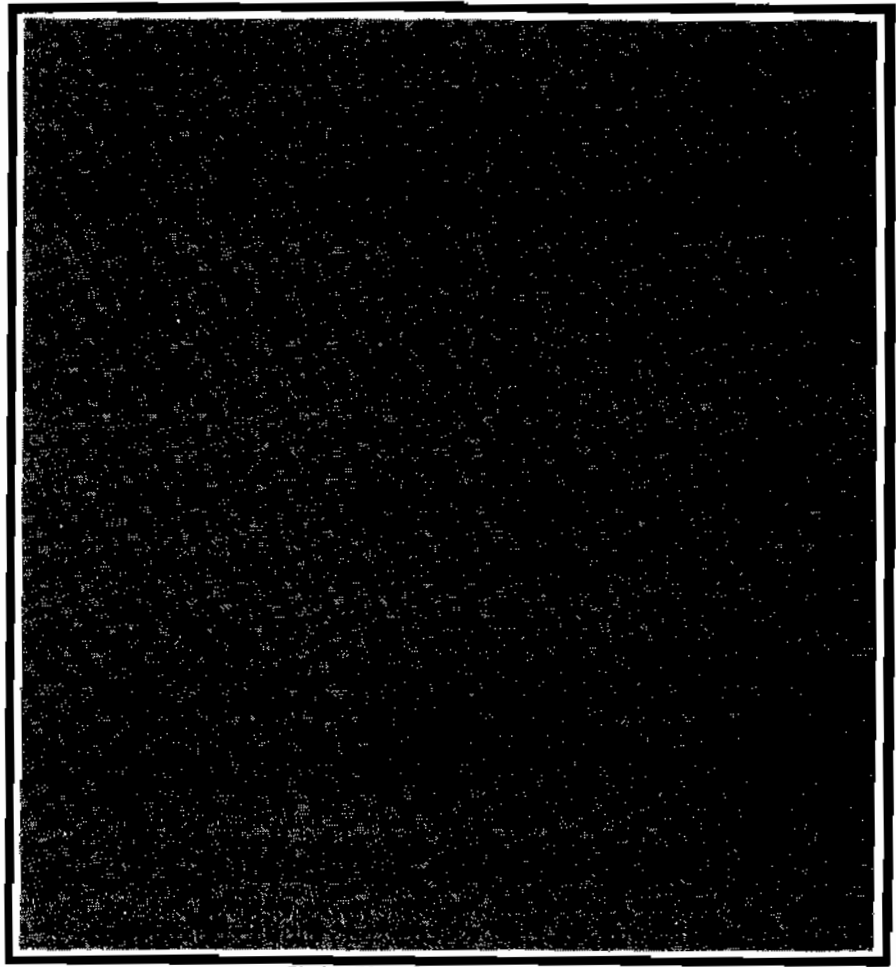
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