DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL

FROM: Chief, Branch 2 (Employee Benefits and Exempt Organizations)

SUBJECT: _____ § 119 Issue

This Field Service Advice responds to your electronic mail message dated December 16, 1992. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Taxpayer =

Hotel =

ISSUE

1. Whether section 119 causes Taxpayer's otherwise personal expenses for meals and lodging at Taxpayer's Hotel to be deductible expenses on the Taxpayer's federal income tax return.

2. If these personal living expenses are not deductible by the Taxpayer, whether Taxpayer is considered an employee of Taxpayer's sole proprietorship so that the value of the meals and lodging are excludable from Taxpayer's gross income under section 119 of the Code.

CONCLUSION

1. Section 119 of the Code has no affect on whether Taxpayer's expenses for meals and lodging are deductible by Taxpayer because Taxpayer cannot be an employee of Taxpayer's sole proprietorship. Accordingly, personal living expenses, including the expenses incurred for meals and lodging at the Hotel, must be eliminated from the costs and expenses reported on the Taxpayer's Schedule C.

2. Because Taxpayer cannot be an employee of Taxpayer's sole proprietorship, the exclusion provided under section 119 of the Code is not available to Taxpayer.

FACTS

Taxpayer operates Hotel as a sole proprietorship. This activity is reported on Schedule C of Taxpayer's Form 1040. During the years 1990 through 1992, Taxpayer and his spouse lived in the Hotel. The Service proposed an adjustment to the Taxpayer's income based on the value of the lodging provided to Taxpayer. Taxpayer asserts that it is necessary that he be on the premises at all times and therefore the value of the lodging should be excludable under section 119 of the Code. As support, Taxpayer cites Papineau v. Commissioner, 16 T.C. 130 (1951).

LAW AND ANALYSIS

Section 162 of the Code provides that there shall be allowed as a deduction all the ordinary and necessary costs paid or incurred during the taxable year in carrying on a trade or business. However, section 262 of the Code provides that except as otherwise provided, no deduction shall be allowed for personal, living or family expenses.

Section 119(a)(2) of the Code provides that there shall be excluded from the gross income of an employee the value of any meals or lodging furnished to the employee, the employee's spouse, or any of the employee's dependents by or on behalf of the employer for the convenience of the employer, but only if (1) in the case of meals, the meals are furnished on the business premises of the employer, or (2) in the case of lodging, the employee is required to accept such lodging on the business premises of the employer as a condition of employment.

Papineau v. Commissioner, 16 T.C. 130 (1951), nonacquiescence 1952-2 C.B. 5, considered whether the estimated value of the board and lodging provided to a limited partnership general partner who lived at the hotel owned and operated by the limited partnership was includible in the general partner's gross income. This arrangement was essential in order to properly manage the hotel at all times during the day and night. The court held that a partner, just as a sole proprietor, "can not create income for himself by buying himself meals and providing himself

with lodging any more that he can lift himself up by his bootstraps"; instead, the correct adjustment must be a disallowance of the improper deduction. In footnote 2, the court notes that "[i]n the case of a sole proprietor, it may be academic whether a claimed deduction is disallowed or offset by an inclusion of income, . . . yet the fact remains that it is not income." Thus, the court recognized that an adjustment was necessary to disallow expenses incurred to provide a personal benefit to the general partner; it merely disagreed with the Service's proposed adjustment to income.

Revenue Ruling 80, 1953-1 C.B. 62, holds that where the owner of a hotel lives on the premises, the costs (including cost of goods, wages, general expenses, taxes, and depreciation) attributable to meals, lodging, and other personal or living accommodations of the owner and his family must be eliminated from the costs and expenses of operating the hotel. Likewise, where a partnership operates a hotel and the managing partner lives on the premises, the costs attributable to such accommodations of the resident partner and his family must be eliminated from the operating costs and expenses of the partnership.

The Service's position in Revenue Ruling 80 has been accepted by the courts in several circuit court cases involving partners who lived in a hotel owned by their partnerships. Commissioner v. Everett Doak, 234 F.2d 704 (4th Cir. 1956); Commissioner v. Moran, 236 F.2d 595 (8th Cir. 1956); Commissioner v. Briggs, 238 F2d. 53 (10th Cir. 1956); Commissioner v. Robinson, 273 F.2d 503 (3rd Cir. 1959).

Although the circuit court cases cited above involve years before section 119 of the Code became effective in 1954, there was a regulation in place which set forth the "convenience of the employer" test.[1] Indeed, the Doak court specifically addressed whether the rule under section 119 caused the partner's personal expenses to be deductible. The court stated,

> From our reading of the Code provision and the Regulations then applicable, we think it clear that the costs of meals and

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[1]Under the 1939 Code this rule appeared in Treasury Regulation 118, § 39.22(a)-3 which provided:

> If a person receives as compensation for services rendered a salary and in addition thereto living quarters or meals, the value to such person of the quarters and meals so furnished constitutes income subject to tax. If, however, living quarters or meals are furnished to employees for the convenience of the employer, the value thereof need not be computed and added to the compensation otherwise received by the employees.

> lodging of taxpayer would have been deductible had they occupied the employee status under the above "convenience of the employer" rule. They were not, however, either employers or employees; instead they were husband and wife owning the entity business as partners.

234 F.2d at 707. Thus, the court considered the effect of the "convenience of the employer" rule and determined that it had no effect because the taxpayers could not have employed themselves. See also Robinson, supra at 505. For a more recent case taking a similar position on this issue, see Dilts v. United States, 845 F. Supp. 1505 (D. Wyo. 1994). In Dilts, the court held that the owner of an S corporation was not entitled to an exclusion under section 119 because the court could not "fathom any substantive reasons why the owners of a subchapter S corporation should be entitled to such exclusions while their neighbors, sole proprietors, would not be entitled the same exclusions." Id. at 1510.

Thus, since Revenue Ruling 80 was issued in 1953, the courts have resolved this issue in a manner consistent with the Service's position. The Service's position remains that personal living expenses of a taxpayer living at a hotel owned by the taxpayer must be eliminated from the costs and expenses of operating the hotel. Moreover, because a taxpayer cannot be an employee of the taxpayer's sole proprietorship, section 119 of the Code does not cause such expenses to be deductible, nor does section 119 cause the value of meals and lodging to be excludable from Taxpayer's gross income.

Please call if you have any further questions.

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Jerry E. Holmes
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