INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
June 29, 2000

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Third Party Contact:
Index (UIL) No.: 274.07-00

CASE MIS No.: TAM -100359-00/CC:DOM:IT&A:B2

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

A =
B =
C =
X =
Y =

ISSUE(S):

After reconsideration, should the conclusion in our prior technical advice memorandum that the expenses incurred by X in connection with the use of Y should not be disallowed because they were not items with respect to a facility used in connection with an activity of a type generally considered to constitute entertainment, etc., under § 274(a)(1)(B) of the Internal Revenue Code be modified or affirmed?

CONCLUSION(S):

Our prior conclusion that the expenses incurred by X in connection with the use of Y should not be disallowed as a deduction under § 274(a)(1)(B) because X's expenses for the use of Y are not items with respect to a facility is affirmed.

FACTS:

In your memorandum dated December 21, 1999, you asked for reconsideration of a technical advice memorandum issued November 30, 1999, with respect to X (TAM). All of the facts contained in the TAM are hereby incorporated by reference.

As stated in the TAM, X requested (with the concurrence of the appeals office) our consideration of the issue whether § 274(a)(1)(B) denies a deduction for the expenses X incurred at Y. We concluded that because X did not dominate the use of Y to the extent of the exclusive use contemplated in § 274(a)(1)(B), the disallowance for deducting items related to an entertainment ***facility*** is inapplicable.[1]

LAW AND ANALYSIS:

The overlap between the two provisions contained in § 274(a)(1) creates a tension. Section 274(a)(1)(A) limits the deductions available for items with respect to an entertainment activity. Section 274 (a)(1)(B) is more severe in that it completely disallows any deduction for items with respect to a facility used in connection with entertainment. A "facility" is broadly defined as "any item of personal or real property owned, rented, or used by a taxpayer ... for, or in connection with, entertainment ...." Section 1.274-2(e)(2)(i) of the Income Tax Regulations.

However, as the United States Tax Court observed in Harrigan Lumber Co., Inc. v. Commissioner, 88 T.C. 1562, 1565 (1987), aff'd without published opinion, 851 F.2d 362 (11th Cir. 1988), "it is hard to conceive of any entertainment that does not involve [a facility]." Further, "the distinction drawn by [Congress] between entertainment activities within the meaning of section 274(a)(1)A) and entertainment facilities within the meaning of section 274(a)(1)(B) is fuzzy at best." Id. at 1566. Naturally, from the taxpayer's standpoint, a limitation is preferable to a disallowance; therefore the characterization of whether expenses are related to an entertainment activity as opposed to an entertainment facility is often disputed. The Tax Court has determined that "a material difference between an entertainment activity that includes the use of real or personal property and an entertainment facility is whether the property used for the entertainment is occupied exclusively by the taxpayer for or during the recreation or entertainment." Id. at 1566. See also On Shore Quality Control Specialist, Inc. v. Commissioner, T.C. M. 1996-95.

In your opinion, Y was occupied exclusively by X. As support for this determination, you have focused on the related party status of several principal actors, i.e., in your request for reconsideration you noted that A and B own both X and C; and C owns Y. Notwithstanding the formal distinctions between A, B, C, and X, you have urged in your request for reconsideration that the personal use of Y by A and B shouldn't preclude a determination that under the facts presented (i.e., pursuant to an oral arrangement X used Y as needed and Y was not leased to anyone else), X's use of Y was exclusive. As a general statement of the law, we agree with you.

However, just as the personal usage of Y by the controlling shareholders of X, A and B,

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[1] Further, if § 274(a)(1)(B) had denied the deduction, we were then asked to consider whether the exceptions of § 274(e)(4) or (5) applied. Because of our conclusion, there was no need to address these questions.

for their personal entertainment, amusement, or recreation wouldn't preclude exclusive usage from being attributed to X, we also did not uncover in our research any *per se* rule making it determinative.[2] To the contrary, absent some compelling reason to pierce the corporate veil, it is a well-established principle of tax law that the formal distinctions between different, albeit related, taxpayers should be respected. Catalano v. Commissioner, T.C.M. 1998-447, citing to Moline Properties, Inc., v. Commissioner, 319 U.S. 436 (1943), 1943 C.B. 1011.

The term "entertainment" may include an activity, the cost of which is claimed as a business expense by the taxpayer, which satisfies the personal, living, or family needs of any individual. Section 1.274-2(b)(1)(i). The cases in which the use of a facility by a shareholder is essentially attributed to the corporate taxpayer all have one thing in common that has not been demonstrated here: the corporate taxpayer in question bore the costs of the shareholder's personal usage, i.e., it entertained the shareholder. See, Catalano; Frisbie v. Commissioner, T.C. M. 1990-419; McReavy v. Commissioner, T.C. M. 1989-172; Nguyen v. Commissioner, T.C. M. 1989-101; Schautz Co. v. U.S., 567 F.2d 373 (Ct. Cl. 1977); and Oleander Co. v, U.S., Civil No. 77-81-CIV-7 and Civil No. 77-80-CIV-7 (E.D.N.C. 1981).

Therefore, we believe that before A or B's use of Y taints X's separate use of Y, X must have paid for at least some of A or B's personal, family, or living needs, and X must have claimed that cost as a business expense. Neither factor (the payment nor the claimed expense) has been established.

In our view, unlike in Harrigan Lumber and On Shore Quality Control cases, the facts do not demonstrate that X dominated the use of Y, so we cannot consider its use to be the exclusive use contemplated in § 274(a)(1)(B). Rather, in the situation presented payment was made for a short term nonexclusive use in connection with overnight lodging in a manner more similar to the payments made in United Title v. Commissioner, T.C.M. 1988-38.

Accordingly, we affirm our prior conclusion that the expenses incurred by X in connection with the use of Y should not be disallowed under § 274(a)(1)(B).

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) provides that it may not be used or cited as precedent.

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[2] Note that the reverse situation, i.e., a complete absence of any personal use by the taxpayer, is also not determinative and does not insulate the property from being an "entertainment facility". Ireland v. Commissioner, 89 T.C. 978 (1987).