Leamy v. Commissioner, 85 T. C. 798 (1985)

Expenses incurred by corporate officers and shareholders for the benefit of the corporation are not deductible as personal business expenses.

Summary

Frank and Charlotte Leamy owned Vacations Unlimited (VU), a travel agency. They sought to deduct travel, automobile, and entertainment expenses related to their work with VU, claiming they were independent travel agents. The Tax Court held that the Leamys were not engaged in a separate trade or business as travel agents, but were acting on behalf of VU. Therefore, their expenses were not deductible as personal business expenses. The court emphasized that corporate and personal expenses must be kept distinct, and that officers cannot deduct expenses incurred for the corporation's benefit without a binding reimbursement agreement.

Facts

Frank Leamy was an airline pilot based in San Francisco and Dallas, while Charlotte Leamy was a school teacher in San Diego. They owned VU, a travel agency in San Diego, where Frank spent his non-flying time. VU was incorporated and had both salaried and commissioned employees. The Leamys were treated as commissioned agents by choice but did not receive any income from VU. They incurred various expenses related to travel, automobiles, and entertainment, which they sought to deduct as business expenses. The Leamys did not seek reimbursement from VU for these expenses.

Procedural History

The Commissioner of Internal Revenue determined deficiencies and additions to tax for the Leamys' 1979 and 1980 federal income taxes. The Leamys petitioned the U. S. Tax Court, which heard the case and issued its opinion on November 18, 1985. The Tax Court upheld the Commissioner's determination, denying the Leamys' deductions.

Issue(s)

1. Whether Frank and Charlotte Leamy were engaged in the trade or business of being travel agents, allowing them to deduct travel, automobile, and entertainment expenses as ordinary and necessary business expenses or as unreimbursed employee business expenses.
2. Whether Frank Leamy's travel expenses from Dallas and San Francisco to San Diego were deductible as away from home travel expenses between two places of business.

Holding

1. No, because the Leamys did not conduct a separate trade or business as travel agents; their activities were on behalf of VU, and they did not intend to make a profit independently of VU.
2. No, because Frank's travel to San Diego was primarily for personal reasons to be with his family, not for business purposes related to a separate trade or business.

Court's Reasoning

The Tax Court reasoned that to be engaged in a trade or business, one must have a profit motive. The Leamys did not receive any income from their travel agent activities, and all income was funneled through VU. The court applied the principle that a corporation and its shareholders are separate entities, and expenses incurred for the corporation's benefit are not deductible by shareholders or officers. The court also noted that the Leamys could have sought reimbursement from VU for their expenses but did not. The court distinguished between personal and corporate expenses, emphasizing that personal expenses cannot be deducted when they benefit the corporation. The court cited cases like *Noland v. Commissioner* and *Westerman v. Commissioner* to support its holding that corporate officers cannot deduct expenses incurred for the corporation's benefit without a binding agreement. The court also rejected the Leamys' alternative argument for educational travel deductions, as they were not in a trade or business as travel agents.

Practical Implications

This decision clarifies that corporate officers and shareholders cannot deduct personal expenses incurred for the benefit of the corporation, even if they are actively involved in the business. It reinforces the principle of corporate separateness and the need for clear agreements on expense reimbursement. Legal practitioners should advise clients to keep personal and corporate finances separate and to have written policies on expense reimbursement. This case may impact how corporate officers approach expense deductions and may lead to more formal reimbursement agreements between corporations and their officers. Subsequent cases have cited Leamy to uphold the non-deductibility of corporate expenses by shareholders or officers without proper reimbursement arrangements.

