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INTERNAL REVENUE SERVICE
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MEMORANDUM FOR REGIONAL COUNSEL
MIDSTATES REGION

FROM: Heather C. Maloy
Deputy Associate Chief Counsel (Domestic)

SUBJECT: Taxability of Local Transportation Reimbursements

This Chief Counsel Advice is in response to a memorandum dated April 15, 1996, from the Acting Assistant Regional Counsel (GL), Midstates Region. Issuance of this response was delayed until the publication of Rev. Rul. 99-7, 1999-5 I.R.B. 4 (Feb. 1, 1999) (attached), which modifies and supersedes earlier Service position on the issues involved. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be relied upon or otherwise cited as precedent.

LEGEND:

X =

ISSUE:

What are the rules for determining the proper tax treatment of reimbursements that X provides to its personnel who are required to incur daily transportation expenses in going between their residences and a business location other than the designated office of each.¹

CONCLUSION:

¹The examples in the memorandum from your office do not raise, and this response does not address, issues concerning the tax treatment of traveling expenses paid or incurred while away from home overnight in the pursuit of a trade or business. See Rev. Rul. 93-86, 1993-2 C.B. 71, for the proper application of § 162(a)(2) to overnight travel.

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This memorandum provides a general overview of the applicable law and Service position in the daily transportation deduction and reimbursement area, and it addresses the tax treatment of 12 examples included in the memorandum from your office.

FACTS:

The memorandum from your office provides 12 examples that generally illustrate the types of expenses X reimburses. Our response will specifically address each of the 12 examples.

LAW:

Section 162(a) of the Internal Revenue Code allows a deduction for ordinary and necessary business expenses paid or incurred in carrying on a trade or business. Deductible expenses include business expenses paid or incurred by a taxpayer in connection with the performance of services as an employee. Primuth v. Commissioner, 54 T.C. 374 (1970). As discussed below, certain daily transportation expenses of an employee are deductible business expenses under § 162(a), while other daily transportation expenses of an employee are nondeductible personal expenses under § 262.

Section 62(a)(2)(A) allows a deduction from gross income for reimbursed expenses of employees under a reimbursement or other expense allowance arrangement with the employer. Section 62(c) provides that an arrangement will not be treated as a "reimbursement or other expense allowance arrangement" if (1) the arrangement does not require substantiation of covered expenses, or (2) the employee may retain any amounts in excess of substantiated expenses.

Section 1.62-2 of the Income Tax Regulations sets forth rules for reimbursement or other expense allowance arrangements and for payments made under such arrangements. These rules provide that an amount paid by an employer to an employee under an arrangement that meets specified requirements is treated as paid under an "accountable plan." An amount treated as paid under an accountable plan is excluded from the employee's gross income, is not reported as wages, and is exempt from the withholding and payment of employment taxes.² If the arrangement does not satisfy one or more of the specified requirements, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." An amount treated as paid under a nonaccountable plan is included in the employee's gross income, is reported as wages, and is subject to the withholding and payment of employment taxes.

The three specific requirements that a reimbursement or other expense allowance arrangement must meet in order to be treated as an accountable plan are:

²The employment taxes generally include income tax withholding and the Federal Insurance Contributions Act taxes.

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(1) Business connection. Advances, allowances, or reimbursements under the arrangement must be provided for business expenses that are deductible under §§ 161 - 197 and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer.

(2) Substantiation. Each business expense under the arrangement must be substantiated to the payor within a reasonable period of time, using adequate records. Although the elements to be substantiated vary somewhat depending on the type of expense, for transportation expenses the elements are amount, time, use, and business purpose.

(3) Returning amounts in excess of expenses. In general, the arrangement must require the employee to return to the payor within a reasonable period of time amounts paid under the arrangement in excess of the expenses substantiated.³

The position of the Service on the deductibility of daily transportation expenses paid or incurred by a taxpayer in going between the taxpayer's residence and one or more work locations is succinctly summarized in the holding of Rev. Rul. 99-7 as follows:

In general, daily transportation expenses incurred in going between a taxpayer's residence and a work location are nondeductible commuting expenses. However, such expenses are deductible under the circumstances described in paragraph (1), (2), or (3) below.

(1) A taxpayer may deduct daily transportation expenses incurred in going between the taxpayer's residence and a temporary work location outside the metropolitan area where the taxpayer lives and normally works. However, unless paragraph (2) or (3) below applies, daily transportation expenses incurred in going between the taxpayer's residence and a temporary work location within that metropolitan area are nondeductible commuting expenses.

(2) If a taxpayer has one or more regular work locations away from the taxpayer's residence, the taxpayer may deduct daily transportation expenses incurred in going between the taxpayer's residence and a temporary work location in the same trade or business, regardless of the distance.

(3) If a taxpayer's residence is the taxpayer's principal place of business within the meaning of § 280A(c)(1)(A), the taxpayer may deduct daily transportation expenses incurred in going between the residence and another work location in the same trade or business, regardless of whether the other work location is regular or temporary and regardless of the distance.

³An arrangement for automobile mileage allowances may provide special rules for returning amounts in excess of expenses. See section 9.03 of Rev. Proc. 98-63, 1998-52 I.R.B. 25.

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The following rules apply in determining whether a work location is temporary for purposes of Rev. Rul. 99-7:

If employment at a work location is realistically expected to last (and does in fact last) for 1 year or less, the employment is temporary in the absence of facts and circumstances indicating otherwise. If employment at a work location is realistically expected to last for more than 1 year or there is no realistic expectation that the employment will last for 1 year or less, the employment is not temporary, regardless of whether it actually exceeds 1 year. If employment at a work location initially is realistically expected to last for 1 year or less, but at some later date the employment is realistically expected to exceed 1 year, that employment will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's realistic expectation changes, and will be treated as not temporary after that date.

ANALYSIS:

We will now address the 12 examples included in the memorandum from your office. At the time the examples were submitted, Rev. Rul. 90-23, 1990-1 C.B. 28 defined "temporary work location" for this purpose as any location at which the taxpayer performs services on an irregular or short-term (i.e., generally a matter of days or weeks) basis; Rev. Rul. 99-7 has modified this definition, creating the 1-year rule described above.

Our analysis of these 12 examples is based, to a large extent, on the above-stated holding (2) of Rev. Rul. 99-7 because we assume that the employee in each example has a regular place of business away from the employee's residence, except where otherwise indicated in the facts of the particular example. We also assume that the employees are not assigned to the work locations at any time other than as specified in the example. For purposes of our analysis, we note that the employer's directive that the employee incur these daily transportation expenses is not controlling in determining the deductibility or nondeductibility of these expenses.

Example (1). An employee is directed to a work location other than his regularly assigned office and conducts business activities at the directed work location for at least 70 percent of a tax year.

If, upon commencement of the directed work assignment, that assignment is realistically expected to last for 1 year or less, it is a temporary work location. The employee incurs deductible daily transportation expenses in going between the residence and the temporary work location. Assuming the accountable plan requirements are met, X's reimbursement of such expenses would be excluded from the employee's income, would not be reported as wages, and would not be subject to the withholding and payment of employment taxes. However, if, upon commencement of the directed work assignment, the assignment is realistically expected to last for more than 1 year or for an indefinite period, it is not a temporary work location and the

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daily transportation expenses the employee incurs in going between the residence and the directed work location are not deductible. Any employer reimbursement of these expenses would be paid pursuant to a nonaccountable plan. Such amounts would be included in the employee's income, would be reported as wages, and would be subject to the withholding and payment of employment taxes.

Example (2). An employee is directed to a work location other than his regularly assigned office for an indefinite period of time.

If the employee is directed to a work location that is indefinite, it is not a temporary work location. The employee does not incur any deductible daily transportation expenses in going between the residence and the indefinite work location. Any employer reimbursement for these expenses would be paid pursuant to a nonaccountable plan. Such amounts would be included in the employee's income, would be reported as wages, and would be subject to the withholding and payment of employment taxes.

Example (3). An employee is assigned to a client's office for 3 consecutive weeks.

The assigned work location is a temporary work location within the meaning of Rev. Rul. 99-7. Assuming the accountable plan requirements are met, X's reimbursement of the expenses of the employee's round trip between the residence and the assigned work location would be excluded from the employee's income, would not be reported as wages, and would not be subject to the withholding and payment of employment taxes.

Example (4). An employee is assigned to go to a client's office for 31 consecutive days.

The answer is the same as the answer for Example (3).

Example (5). An employee is assigned to go to a client's office for 6 consecutive months.

The answer is the same as the answer for Example (3).

Example (6). An employee is directed to attend a 5-week training course at a location other than his regular office location.

The answer is the same as the answer for Example (3).

Example (7). An employee is directed to perform a special 5-week assignment at the employer's second office location within the employee's local transportation area. The employer's second office location is not the employee's regular office location.

The answer is the same as the answer for Example (3).

Example (8). In Examples (3), (4), and (5), the employee's local transportation is assumed to be for consecutive days with round-trip transportation between the employee's residence and the client's office. Would the result in each of these examples be different if the employee's duties included transportation to the employee's regular office location for 1 to 3 days a month to conduct full day office related assignments? In this example it is assumed that there is no travel between the client's office and the employee's regular office location. What duration of interruption in consecutive round-trip transportation between the residence and the client's office, if any, causes a change in the determination of temporary work location?

There would be no change in the results of Examples (3), (4), and (5). However, the employee's transportation expenses incurred in going between the residence and the employee's regular office location would not be deductible daily transportation expenses.

Example (9). Assume that the employee maintains a qualified office in the home, as provided under I.R.C. § 280A(c)(1)(A). Would there be a different result in Examples (1) through (8), above?

If an employee's office in the home is the employee's principal place of business under § 280A(c)(1)(A),⁴ holding (3) of Rev. Rul. 99-7 allows the employee to deduct the daily transportation expenses of going between the residence and any regular or temporary work location in the same trade or business. If it is substantiated to X that the employee's office in the home is the employee's principal place of business within the meaning of § 280A(c)(1)(A), and the other accountable plan requirements are met, X's reimbursement of these expenses in Examples (1) through (8) would be excluded from the employee's income, would not be reported as wages, and would not be subject to the withholding and payment of employment taxes.

Example (10). An employee is assigned to perform work at a client's office for a period estimated to last at least 18 months. During this 18-month period the

⁴Section 280A(c)(1)(A) generally provides that an employee may claim a home office deduction with respect to the portion of the residence exclusively used on a regular basis (and for the convenience of the employer) as the employee's principal place of business. Generally, an employee's home office satisfies § 280A(c)(1)(A) if it meets the "relative importance" and "time" tests set forth in Commissioner v. Soliman, 506 U.S. 168 (1993), 1993-1 C.B. 45. See Rev. Rul. 94-24, 1994-1 C.B. 87. Also, § 280A(c)(1) provides that the term "principal place of business" includes a place of business that is used by the taxpayer for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business.

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employee will make 15 round-trip visits from the residence to the employee's regularly assigned office. In addition, the employee will attend a 2-week training course during the 18-month period at a location other than the client's office or the employee's regularly assigned office.

Employment at the client's office is clearly not temporary for purposes of holding (2) of Rev. Rul. 99-7 because the assignment is realistically expected to last more than 1 year. Although the Service has not published a position on the duration of breaks and the effect on temporary work locations, clearly the 2-week training course is an insignificant break that does not affect the determination that the client's office is not a temporary work location. See Blatnick v. Commissioner, 56 T.C. 1344, 1348 (1971), where the court held that a 3-week layoff did not interrupt the otherwise nontemporary character of the work assignment.

Transportation expenses incurred going between the residence and both the client's office and the regularly assigned office are nondeductible commuting expenses. Employer reimbursement of such expenses would be pursuant to a nonaccountable plan, would be includible in the employee's gross income, would be reported as wages, and would be subject to the withholding and payment of employment taxes.

Transportation expenses incurred in going between the residence and the 2-week training course are deductible daily transportation expenses. Assuming the accountable plan requirements are met, X's reimbursement of such expenses would be excluded from the employee's income, would not be reported as wages, and would not be subject to the withholding and payment of employment taxes.

Example (11). An employee is assigned to perform work at a client's office for a period estimated to last at least 6 months. During this 6-month period the employee will make 10 to 15 round-trip visits to the client's office.

The answer is the same as the answer for Example (3).

Example (12). An employee participates in the flexiplace program and elects to work on cases and other administrative duties at the flexiplace worksite. The employee, however, is required by management to report to a post-of-duty for meetings, mail, etc. Does the employee have more than one "regular work location," which would entitle the employee to deduct the transportation expenses incurred by the employee between the employee's residence and a client's office?

If an employee's flexiplace work location in the residence is the employee's principal place of business under § 280A(c)(1)(A),⁵ holding (3) of Rev. Rul. 99-7 allows the employee to deduct the daily transportation expenses of going between the flexiplace

⁵See the discussion of § 280A(c)(1)(A) in footnote 4, above.

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work location and any regular or temporary work location in the same trade or business. If it is substantiated to X that the employee's flexiplace work location is the employee's principal place of business within the meaning of § 280A(c)(1)(A), and the other accountable plan requirements are met, X's reimbursement of these expenses would be excluded from the employee's income, would not be reported as wages, and would not be subject to the withholding and payment of employment taxes.

If the flexiplace location at the employee's residence is not the employee's principal place of business within the meaning of § 280A(c)(1)(A), the daily transportation expenses incurred by the employee in going between the employee's residence and a regular post of duty would be nondeductible and nonaccountable plan expenses. However, the employee's expenses of going between the residence and a client's office would be deductible and accountable plan expenses, assuming the client's office qualifies as a temporary work location and the post-of-duty for meetings, mail, etc., is a regular work location away from the residence.

If the flexiplace work location is not at the employee's residence, that work location would be a regular place of business that makes the daily transportation costs of going between the residence and a client's office deductible and accountable plan expenses, assuming the client's office qualifies as a temporary work location. However, the daily transportation expenses of going between the residence and the flexiplace regular work location or the regular post of duty for meetings, mail, etc., would be nondeductible and nonaccountable plan expenses.

If you have any further questions, please contact George Baker, of my office, at (202) 622-4920.

Attachment

Rev. Rul. 99-7