



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

OFFICE OF  
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MEMORANDUM FOR ASSOCIATE AREA COUNSEL

FROM: ASSOCIATE CHIEF COUNSEL, CC:ITA  
by George Baker, Chief, Branch 7

SUBJECT:

This Chief Counsel Advice responds to your e-mail requesting background advice. In accordance with § 6110(k)(3) of the Internal Revenue Code, this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer =  
Year at issue=  
Employer =  
\$X =  
\$Y =  
\$Z =

ISSUES

- (1) Does Notice 95-50, 1995-2 C.B. 333, affect the requirement of § 1.274-5(c) that a taxpayer maintain adequate records in order to claim a deduction for travel expenses under § 274?
- (2) What amount may a taxpayer claim for incidental expenses incurred while traveling on a ship in the middle of the ocean?

CONCLUSIONS

- (1) Notice 95-50 does not affect the requirement of § 1.274-5(c) that a taxpayer maintain adequate records in order to claim a deduction for travel expenses under § 274.

- (2) A taxpayer traveling on a ship in international waters may claim \$3 per day for incidental expenses.

### FACTS

Taxpayer lived with his wife in a residence they owned in \_\_\_\_\_, during the year at issue. Taxpayer husband worked aboard a cargo vessel as a merchant seaman. Although it is not clear from the file, it is understood that merchant seamen are provided room and board on the vessel. A letter from the Employer, attached to the return, merely states the Employer "does not reimburse employees for incidental expenses incurred while on the ships."

For the year at issue, taxpayers claimed unreimbursed employee expenses of \$X, in addition to various itemized deductions, for a total amount of job expenses and miscellaneous deductions of \$Y. The \$X, the bulk of the deductible expenses, was for expenses incurred while aboard ship. The amount of the deductible traveling expenses was determined according to the per diem allowances for meals and incidental expenses for whichever port was the ship's destination on the date the expenses were incurred. Other claimed expenses included expenses for union dues, license requirements, and other miscellaneous business expenses.

Taxpayer's return was filed prior to the Tax Court's decision in Johnson v. Commissioner, 115 T.C. 210 (2000). The per diem amounts claimed are the full amount (lodging, meals, and incidentals) for each location. As stated above, Taxpayer considers himself "at" a location immediately upon the ship leaving a port for such location, even though the ship might not arrive there for several days.

Upon examination, the agent received from the representative a revised schedule of amounts to be allowed in two broad categories: a day-by-day "incidental per diem only" rate request; and additional miscellaneous, taxi, and food expenses. The total amount of the incidental per diem for the year per the revised schedule was \$Z, which is less than 20% of the amount originally claimed as unreimbursed employee business expenses (\$X). A comparison of the locations per the original statement attached to the return and the revised schedule makes it clear that, although the rate for each location was reduced per Johnson, the locations are the same for each date.

The additional "miscellaneous," "taxi," and "sailor required food" expenses claimed on the revised schedule are based on the representative's reading of Johnson to allow such items in accordance with Notice 95-50. A log was also provided, on which notations were made with regard to such expenses, but it is not known whether such log was made at or near the time of the expenses.

The notice of deficiency, in essence, indicates examiner's acceptance of the revised schedule of amounts "deemed substantiated" as incidental per diem amounts for the specified days of travel. As such, examiner did not challenge taxpayers' claimed location for the calculation of such amount. Nor did the examiner question whether taxpayer was traveling away from home in his trade or business. In lieu of the \$X claimed by taxpayers on the original return, the examiner allowed the \$Z amount.

The examiner did not allow the other items per the revised schedule.

### LAW

Section 162(a) allows a deduction for the ordinary and necessary expenses paid or incurred in carrying on any trade or business, including the expenses of traveling away from home.

An amount otherwise deductible under § 162(a) may be subject to disallowance or limitation by § 274.

Section 274(d)(1) provides that no deduction shall be allowed for any traveling expense unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement the amount, time, place, and business purpose of the traveling expense. For such expenses, "This limitation supersedes the doctrine founded in *Cohan v. Comm'r.*, 39 F.2d 540 (2d Cir. 1930)." Sec. 1.274-5T(a) (flush language).

The regulations reiterate, at § 1.274-5T(b)(2), that the elements of a traveling expense that are to be proved are amount, time, place, and business purpose and specify that all of these elements are to be proved.

Reg. § 1.274-5T(c)(2)(i) further provides that a taxpayer, to meet the adequate records requirement of section 274(d), must "maintain an account book, diary, log, statement of expense, trip sheets, or similar record (as provided in paragraph (c)(2)(ii) of this section), and documentary evidence (as provided in paragraph (c)(2)(iii) of this section) which, in combination, are sufficient to establish each element of an expenditure or use specified in paragraph (b) of this section." The regulation further states that the account book or similar record and the taxpayer's documentary evidence will "complement each other in an orderly manner," although information included on a receipt need not be duplicated in an account book.

Under § 1.274-5T(c)(2)(ii), an account book or similar record "must be prepared or maintained in such a manner that each recording of an element of an expenditure or use is made at or near the time of the expenditure or use."

Notice 95-50, 1995-2 C.B. 333, provided information on a change that the Service would make to the substantiation rules in regulations under § 274(d). It stated that the Service intended to amend § 1.274-5T(c)(2)(iii)(B) to increase from \$25 to \$75 the dollar amount at which a receipt for expenditures other than lodging is required, effective on or after October 1, 1995.

The Commissioner may provide that some or all of these requirements do not apply to an expense that does not exceed an amount prescribed. Section 274(d) (next to last sentence.) For taxpayers other than employers reimbursing their employees, § 1.274-5(j) authorizes the Commissioner to specify an amount a taxpayer may use for meals while traveling away from home in lieu of substantiating the actual cost of each meal, provided the taxpayer substantiates the time, place, and business purpose of the expense. Rev. Proc. 98-64, 1998-2 C.B. 825, is an example of guidance specifying those amounts. Section 3.02(3) provides that “incidental expenses” includes, but is not limited to, expenses for laundry, cleaning and pressing of clothing, and fees and tips for services, such as for porters and baggage carriers. The term does not include taxicab fares, lodging taxes, or the costs of telegrams or telephone calls.

## ANALYSIS

### **I. Effect of Notice 95-50**

Reg. § 1.274-5(c)(2)(iii) provides that documentary evidence “such as receipts, paid bills, or similar evidence to support an expenditure” is required for any expenditure for lodging while traveling away from home and for “any other expenditure of \$75 or more, except for transportation expenses. This regulation, effective for expenses paid or incurred after December 31, 1997, effected in the regulations the threshold change announced in Notice 95-50 for expenditures incurred on or after October 1, 1995.

Neither Notice 95-50 nor the amendment to the regulation affected the requirement of § 1.274-5T(c) that a taxpayer maintain adequate records substantiating each element (amount, time, place, and business purpose) of an expense in order to claim a deduction for a travel expense under § 274.

Notice 95-50 merely announced the Service’s intention to increase the threshold amount for which “documentary evidence (such as receipts)” for some expenses were necessary under Reg. § 1.274-5T(c)(2)(iii). As noted above, this increase was effected by § 1.274-5(c)(2)(iii). Nonetheless, “documentary evidence” is only one factor in meeting the “adequate records” standards. As noted above, Reg. § 1.274-5T(c)(2) provides that a taxpayer must maintain an account book, or similar record prepared at or near the time of an expenditure in conjunction with maintaining documentary evidence and that the account book and documentary evidence should “complement each other in an orderly manner.”

Thus, even though Notice 95-50 provides that a taxpayer does not need a receipt to establish the amount of certain expenditures of less than \$75, the Taxpayer must maintain adequate records to substantiate the amount, time, place, and business purpose of an expenditure such as through an account book or similar record prepared at or near the time of expenditure.

We also note that in Johnson v. Commissioner, 115 T.C. 210 (2000), which petitioner cites as support for his position, the taxpayer introduced into evidence records that met the time, place, and business purpose requirement of § 1.274-5T(b)(2). Although the taxpayer in Johnson did not have receipts or other documentary to establish the amounts of certain claimed expenditures, our understanding is that the court treated the amount of all the claimed expenditures as “incidental expenses” substantiated in accordance with a predecessor of Rev. Proc. 98-64 (which applies to the tax year in issue here).

Under section 3.02(3) of Rev. Proc. 98-64

The term “incidental expenses” includes, but is not limited to, expenses for laundry, cleaning and pressing clothing, and fees and tips for services, such as porters and baggage carriers. The term “incidental expenses” does not include taxicab fares, lodging taxes, or the costs of telegrams or telephone calls.

1998-2 C.B. at 827.

The facts as presented are not adequate to determine if the expenses claimed by Taxpayer are incidental expenses. We note, however, that the taxpayer in Johnson was allowed to claim incidental expenses because, according to the Tax Court, his records “show[ed] clearly” the time, place, and business purpose of the expenditures. 115 T.C. at 224-225.

However, if Taxpayer’s traveling expenses are not incidental expenditures, he must prove every element (amount, time, place, and business purpose) of the expenses by adequate records, as required by § 1.274T(b)(2)(i) through (iv). Further, to meet the adequate records requirement as described in § 1.274-5T(c)(2), a taxpayer must maintain an account book or similar statement of expense prepared at or near the time of the expense and documentary evidence such as receipts which, in combination, are sufficient to establish each element of the expense.

## **II. Per Diem Incidental Expenses Amount**

On his original return, Taxpayer deducted the full amount of the M&IE rates for each of the days he was away from home. This is contrary to the court’s ruling in Johnson v. Commissioner, 115 T.C. 210 (2000), which states:

We do not read the revenue procedures to allow a taxpayer to use the full M&IE rates when he or she only

incurs incidental expenses. The M&IE rates represent the amount that the Government pays daily to its traveling employees to compensate them for four items of traveling expense; namely, breakfast, lunch, dinner, and incidental expenses. See 41 C.F.R. sec. 301-7.2(a)(2) (1994 & 1996). Specific amounts are apportioned under the travel regulations to each of these four items, depending on the point of travel...We believe that petitioner's deductions for his incidental expenses are limited under the travel regulations, which are incorporated by reference into the revenue procedures, to the incidental expense portion of the applicable M&IE rate. See 41 C.F.R. sec. 301-7.12(a)(2) (1994 & 1996).

115 T.C. at 227.

Our understanding of the facts is that Taxpayer does not pay for meals or lodging while working aboard ship. Thus, his only traveling expenses covered by the per diem revenue procedure are incidental expenses. Under Johnson, taxpayer's deduction for incidental expenses is limited under the travel regulations to the incidental expense portion of the applicable M&IE rate.

The question then is what is the allowable amount of incidental expenses for a taxpayer on a ship at sea in international waters. As noted above, the court in Johnson stated the taxpayer's deductions for incidental expenses were "limited under the travel regulations, which are incorporated by reference into the revenue procedures, to the incidental expense portion of the applicable M&IE rate. See 41 C.F.R. sec. 301-7.12(a)(2) (1994 & 1996)." Id.

For 1999, 41 C.F.R. § 301-11.101(b) states: "If you travel by ship, either commercial or Government, your agency will determine an appropriate M&IE rate within the applicable maximum rate allowable." (This is an exception to the rule of § 301-11.102, which provides that for travel time of more than 24 hours, the M&IE rate is that of the destination.)

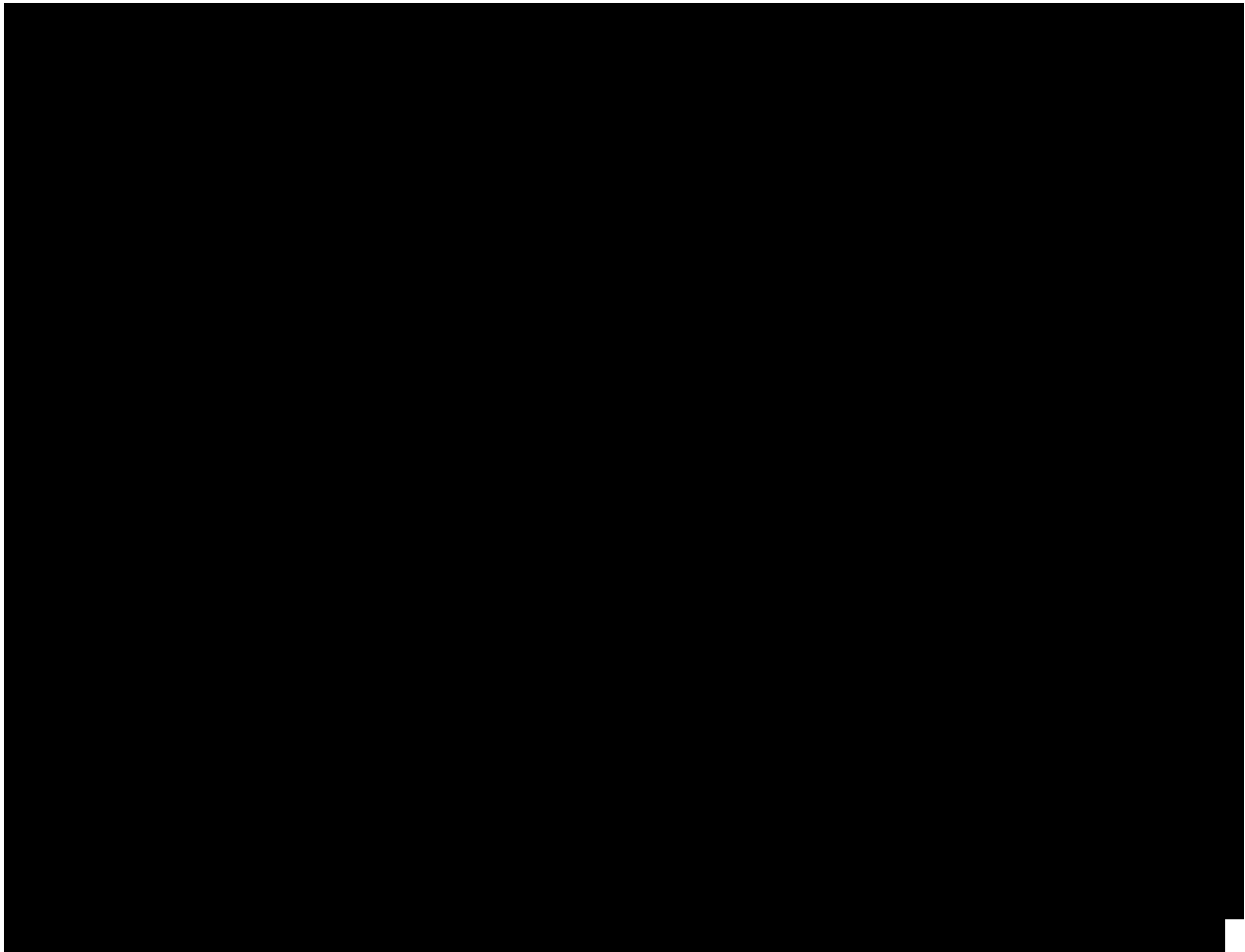
Section 3.02(1)(b) of Rev. Proc. 98-64 and Appendix B to Chapter 301 of the Federal Travel Regulations note that M&IE rates for localities in foreign areas are established by the Secretary of State in Section 925, a per diem supplement to the Standardized Regulations (Government Civilians, Foreign Areas). The appendix provides a table (§ 301-11.18) for allocating M&IE rates in foreign areas for civilian travel in nonforeign and foreign areas.

Section 925, the supplement to the Standardized Regulations referenced in Appendix B, provides per diem allowances for travel in foreign areas. It lists per diem rates for civilians traveling in foreign countries; there is no listing for a civilian aboard a ship in international waters. However, it does list a per diem rate for "other foreign localities." This rate is \$43. This rate is allocated at \$28 for lodging and \$15 for meals and incidental expenses. Since food and lodging is provided to

Taxpayer aboard ship, he is entitled under Johnson only to incidental expenses. Under the aforementioned Appendix B to Chapter 301, the Incidental Expense portion of a \$15 M&IE rate is \$3. Accordingly, we conclude that Taxpayer is entitled to \$3 in incidental expenses each day his ship was sailing in international waters, not the incidental expense rate of his destination. Of course, as discussed above, Taxpayer is still responsible for proving the time, place, and business purpose of the expenditure through an account book or similar record.

We also note that section 4.05 of Rev. Proc. 2002-63, 2002-41 I.R.B. 691, which was not in effect for the year at issue in this case, provides an optional method for incidental expense only deduction. It generally allows for a \$2 per day deduction for incidental expenses, as long as the time, place, and business purpose of the expense is substantiated.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



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Please call if you have any further questions.