



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224  
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OFFICE OF  
CHIEF COUNSEL

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MEMORANDUM FOR NATIONAL DIRECTOR OF SYSTEMS AND ACCOUNTING

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

SUBJECT: Taxability of Mileage

This Chief Counsel Advice is in response to your memorandum dated April 7, 1997. 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.<sup>1</sup>

CONCLUSION:

This memorandum provides a general overview of the applicable law and Service position in the daily transportation expense deduction and reimbursement area, and it addresses the questions raised in your memorandum.

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<sup>1</sup>Your memorandum does 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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FACTS:

Your memorandum asks several questions about the rules in this area and for more specific information about the rules. Our response will specifically address each of your questions.

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.<sup>2</sup> 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:

- (1) Business connection. Advances, allowances, or reimbursements under the arrangement must be provided for business expenses that are deductible under

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

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§§ 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.<sup>3</sup>

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.

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<sup>3</sup>An 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.

Once a taxpayer arrives at a work location away from the residence, the transportation expenses incurred in then going to another work location away from the residence are generally deductible under § 162(a) as a business expense. Rev. Rul. 55-109, 1955-1 C.B. 261.

#### ANALYSIS:

We will now address the specific questions that you posed in your memorandum. Some of your questions have been modified to conform with the Chief Counsel Advice format. Unless otherwise provided, our discussion assumes that holding (3) of Rev. Rul. 99-7 (relating to home office rules under § 280A(c)(1)(A)) does not apply.

#### The Lack of a Definable Time Period

A major issue is the lack of a definable time period or the "bright line" when mileage would become taxable. Currently, the Revenue Ruling 90-23 [1990-1 C.B. 28] and other guidance refer to the "days or weeks" as the period when the mileage is claimed, it is not taxable. The question is how many weeks of mileage reimbursement can be claimed before the mileage becomes taxable. In addition, if the Internal Revenue Service were to define a "bright line" as eight weeks, should that be interpreted as travel to a temporary duty (TDY) site on consecutive work days, or the number of days which would aggregate to eight weeks over a period of months? When mileage is found to be taxable, is it taxable from the first day of the travel or the first day after the "bright line" period?

Rev. Rul. 99-7 modifies and supersedes Rev. Rul. 90-23 by providing a definition of "temporary work location" that generally considers a period of 1 year or less to be a temporary period. This definition, set out above, should clear up much of the confusion about determining whether a period is temporary or indefinite.

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If the employee is initially expected to perform services at a particular location for more than a temporary period (that is, for more than 1 year), the employment is regular and none of the daily transportation expenses with respect to that work location is deductible. The reimbursement of those daily transportation expenses would be treated as paid under a nonaccountable plan. Such reimbursement 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.

### Withholding

Another issue involves withholding tax, FICA, etc., on these payments. X does not currently withhold on taxable travel payments processed through its financial system. The reason is that X did not design the financial system to act as a payroll system and to withhold taxes. Although X realizes that withholding on these payments should occur, it is X's understanding that it meets the requirements of the Internal Revenue Code (I.R.C.) by issuing Forms W-2 to employees. Do you concur with this assessment that withholding on these payments is desirable, but it is not a mandatory requirement?

An amount paid under a reimbursement or other expense allowance arrangement for nondeductible business expenses is 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. Issuing only a Form W-2, without having withheld or paid the applicable employment taxes on an amount paid under a nonaccountable plan, does not comply with the applicable provisions of the Code or the regulations.

### Flexiplace

How is this rule applied if the employee is involved in flexiplace and the office is the home? The requirement is to tax mileage and the associated charges (parking, tolls) for trips from the residence to a TDY site. But if the employee leaves from the office, then the reimbursements are not taxable. Is it reasonable to conclude that the mileage is not taxable since the employee is leaving from the office under the flexiplace concept?

If an employee's flexiplace work location in the residence is the employee's principal place of business under § 280A(c)(1)(A),<sup>4</sup> holding (3) of Rev. Rul. 99-7 allows the

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<sup>4</sup>Section 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)

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employee to deduct the daily transportation expenses of going between the flexiplace 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 under § 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 away from the residence are not deductible. The reimbursement of these expenses would be treated as paid under a nonaccountable plan. Such reimbursement 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. However, the employee's expenses of going between the residence and a temporary work location (within the meaning of Rev. Rul. 99-7) would be deductible, assuming the employee has a regular work location away from the residence. The reimbursement of these expenses, if the other accountable plan requirements are met, 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.

#### Reimburse Mileage Only for the Distance from the Office to the TDY Site

Is the taxability of mileage still an issue if the employee is reimbursed only for the mileage from the office to the TDY site? For example, if the TDY site is 20 miles from the office and 35 miles from the employee's home, the employee would only be reimbursed for 20 miles even if the departure point was the residence. In addition, the employee would not receive any reimbursement if the residence was closer to the TDY site than the office. Would the mileage and associated expenses still be taxable under these circumstances?

Although the transportation expenses incurred in going between the regular office and a TDY site are deductible pursuant to Rev. Rul. 55-109, these expenses are not being incurred by an employee who goes directly between the residence and the TDY site. Therefore, the employee's daily transportation expenses between an employee's residence and a work location away from the residence are subject to the applicable rules in Rev. Rul. 99-7 discussed above. That is, for an employee with a regular work location, these expenses are deductible only if the TDY site is a temporary work

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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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location (within the meaning of Rev. Rul. 99-7, as set forth on page 4). If the TDY site is a temporary work location (within the meaning of Rev. Rul. 99-7), the reimbursement of the daily transportation expenses would be treated as paid under an accountable plan (assuming the other accountable plan requirements are met). Such reimbursement 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 TDY site is not a temporary work location within the meaning of Rev. Rul. 99-7, the daily transportation expenses are not deductible. The reimbursement of these expenses would be treated as paid under a nonaccountable plan. Such reimbursement 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.

### Voluntary Compliance

Any tax system that X puts into place will be based on voluntary compliance. X cannot determine when these taxable events occur without the employees' input. The basic plan would be for X's travel reimbursement accounting system to ask the employee if the mileage being claimed meets certain listed taxability criteria. If the employee answers "yes," then the expenses will be flagged as taxable and stored in X's financial system until the Form W-2 is issued. Based on this outline, does the plan meet the requirements of the I.R.C., even if X does not withhold?

One of the requirements of an accountable plan is that each business expense must be substantiated to the payor in accordance with § 1.62-2(e)(2). Under these rules, the employee must provide information sufficient to substantiate the requisite elements of each expenditure, including the business purpose of the expense. If the employee does not provide such information, payments to that employee under the arrangement will be treated as paid under a nonaccountable plan. Further, pursuant to § 1.62-2(d)(3), if the payor arranges to pay an amount to an employee regardless of whether the employee incurs deductible business expenses, the entire expense arrangement will be treated as 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. Issuing only a Form W-2, without having withheld on an amount paid under a nonaccountable plan, is not in full compliance with the requirements of the applicable provisions of the Code or the regulations.

### Condition of Employment

If X made using a personal vehicle a condition of employment, would this requirement have any impact on the taxability of mileage?

An employer's directive that an employee incur daily transportation expenses is not controlling in determining the deductibility or nondeductibility of these expenses or the taxability of the reimbursement of these expenses.

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This memorandum is for your general information and is advisory only. It is not intended to be conclusive as to the tax consequences for any specific taxpayer. If we can be of further assistance, please contact George Baker, of my office, at (202) 622-4920.

Attachment

Rev. Rul. 99-7