DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR JOSEPH R. CALDERARO
TECHNICAL ADVISOR SB/SE AREA 13

FROM: Acting Associate Chief Counsel
Income Tax and Accounting

SUBJECT: Refund Claims for Incidental Expenses

This Chief Counsel Advice responds to your memorandum dated . In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES

1. What factors affect the Service's review of refund claims by merchant mariners for expenses associated with their traveling to and from union halls to seek employment.

2. What is the effect of the Tax Court's opinions in Johnson v. Commissioner, 115 T.C. 210 (2000), and Westling v. Commissioner, T.C. Memo. 2000-289, upon refund claims of merchant mariners for shipboard "Incidental Expenses."

CONCLUSIONS

1. Because of the fact-intensive character of these claims, the Service should follow the sequential tests contained herein. Additionally, the Service should require that the taxpayer substantiate these expenses.

2. This is a fact-intensive issue that might or might not be controlled by Johnson and Westling.

ISSUE 1: TRAVEL EXPENSES TO UNION HALLS

Facts

A number of merchant mariners have filed amended returns claiming travel expenses to their union halls to secure work aboard ships. Purportedly, union rules may require that members appear in person at the union halls to learn about vessels needing crew members for a voyage and to "bid" for jobs ("berths") on those ships. In some cases, the union halls are sufficient distances from the mariners' residences as to require an overnight stay.

Law and Analysis

Job Search Expenses

Section 162(a) allows a deduction for ordinary and necessary business expenses. Such deductible expenses include those incurred in searching for new employment in the employee's same trade or business. Cremona v. Commissioner, 58 T.C. 219 (1972); Primuth v. Commissioner, 54 T.C. 374 (1970). If the employee is seeking a job in a new trade or business, the expenses are not deductible under section 162(a). Frank v. Commissioner, 20 T.C. 511, 513 (1953); Hobdy v. Commissioner, T.C. Memo. 1985-414; Evans v. Commissioner, T.C. Memo. 1981-413.

Away From Home

Deductible job-seeking expenses can include travel expenses while away from home. Rev. Rul. 77-16, 1977-1 C.B. 37, clarifying Rev. Rul. 75-120, 1975-1 C.B. 55; see Kozera v. Commissioner, T.C. Memo. 1986-604; Bhargava v. Commissioner, T.C. Memo. 1978-197, affd. by unpublished order (2d Cir. 1979); Boback v. Commissioner, T.C. Memo. 1983-198.

Section 162(a)(2) allows a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business, including traveling expenses (including amounts expended for meals and lodging other than amounts that are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business. See Commissioner v. Flowers, 326 U.S. 465 (1946), 1946-1 C.B. 57. The nature of the travel must be such that it is reasonable for the taxpayer to need and to obtain sleep or rest during release time on such trips in order to meet the demands of the job. See, for example, Rev. Rul. 75-168, 1975-1 C.B. 58, and Rev. Rul. 68-663, 1968-2 C.B. 71. This "sleep or rest" rule was upheld in United States v. Correll, 389 U.S. 299 (1967), 1968-1 C.B. 64, as it achieved ease and certainty of application and also substantial fairness, because the rule places all one-day travelers on a similar tax footing.

Rev. Rul. 93-86, 1993-2 C.B. 71, provides that, for purposes of section 162(a)(2), a taxpayer's "home" is generally considered to be located at the taxpayer's regular or principal (if more than 1 regular) place of business. The more important factors to be considered in determining which place of business is the principal place are the total time ordinarily spent by the taxpayer at each of his business posts, the degree of business activity at each such post, and whether the financial return in respect of each post is significant or insignificant. See Rev. Rul. 54-147, 1954-1 C.B. 51.

If the taxpayer has no principal or regular place of business, then the taxpayer's "home" is at the taxpayer's "regular place of abode in a real and substantial sense," as determined using objective factors set forth in Rev. Rul. 73-529, 1973-2 C.B. 37.[1] If the taxpayer does not have a "regular place of abode in a real and substantial sense" under Rev. Rul. 73-529, then the taxpayer is considered to be an itinerant whose "home" is wherever the taxpayer happens to work.

Union Hall Expenses

In order to be deductible, travel expenses to a union hall must be both (1) away from home and (2) pursuant to the taxpayer's trade or business.

Union Hall as Tax Home

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[1] There are three objective factors used to determine the bona fide nature of a taxpayer's assertion that the claimed abode is the "regular place of abode in a real and substantial sense":

1. Whether the taxpayer performs a portion of the business in the vicinity of the claimed abode and uses such abode (for lodging purposes) while performing such business there;
2. Whether the taxpayer's living expenses incurred at the claimed abode are duplicated because business requires the taxpayer to be away therefrom; and
3. Whether the taxpayer
   a. has not abandoned the vicinity in which the historical place of lodging and the claimed abode are both located;
   b. has a member or members of the family (marital or lineal only) currently residing at the claimed abode, or
   c. uses the claimed abode frequently for purposes of lodging.

Generally, the Service will recognize the claimed abode as the taxpayer's "home" for purposes of § 162(a)(2) if, under bona fide circumstances, all three objective factors are met. If only two of the factors are met, then all the facts and circumstances will be subjected to close scrutiny to determine whether the claimed abode will be recognized as the taxpayer's "home."

In Dean v. Commissioner, 54 T.C. 663 (1970), the Tax Court held that a millwright welder's union hall was not the taxpayer's "place of business," and therefore could not be the taxpayer's "home":

> It appears that officers of [the taxpayer's] union functioning at the union headquarters in Washington were helpful and even instrumental in obtaining employment for [the taxpayer] during the taxable year. However [the taxpayer] worked and created income by his various employments not in Washington but in Chalk Point, Front Royal, and Landover. It was in those places rather than Washington that [taxpayer] had a place of business, a place of employment, or a "post or station at which he was employed."

54 T.C. at 667-668 (footnote omitted). Rather, the court determined that the taxpayer's residence was his "home," and therefore he was "away from home" when working at temporary jobs in the Washington metropolitan area.

In Case v. Commissioner, T.C.M. 1985-530, the Service argued that the taxpayer was not "away from home" while in the vicinity of the union hall. The court, relying on Dean, held that the taxpayer's union hall was not his home. The taxpayer, a merchant seaman, would travel from his residence in Mississippi to the union hall in New Orleans, Louisiana, to secure work on various ships. He would go from New Orleans to the ship's port, which could be in Houston, Texas; Mobile, Alabama; Baton Rouge, Louisiana; or New Orleans. His services were not performed in New Orleans, but rather were performed aboard ship ("The only contact with New Orleans was to go there, find employment in a ship, and steam off."). In finding that New Orleans was not the taxpayer's "home," the court distinguished cases in which taxpayers' employment was "localized" in the vicinity of the union hall. The court found that the taxpayer's residence in Mississippi was his "home."

Union Hall Travel in Pursuit of Business

Regardless of whether the union hall is the taxpayer's "home," the travel to the union hall must be undertaken in pursuit of the taxpayer's trade or business rather than for personal purposes.

Although not a union hall case, Commissioner v. Flowers, supra, focused on the requirement that deductible travel expenses be incurred in pursuit of a trade or business. In Flowers, the taxpayer lived in Jackson, Mississippi, and worked in Mobile, Alabama, and the lower courts disagreed as to which location was the taxpayer's "home." The Supreme Court determined that, regardless of where the "home" was located, the taxpayer's travel expenses "were incurred solely as the result of the taxpayer's desire to maintain a home in Jackson while working in Mobile, a factor irrelevant to the maintenance and prosecution of the [employer's] business." 1946-1 C.B. at 60. The frequent travel and additional expenses were "occasioned solely by his personal propensities." 1946-1 C.B. at 61.

The court pointed out:

> Had [the taxpayer's] post of duty been in [Jackson] the cost of maintaining his home there and of commuting or driving to work concededly would be nondeductible living and personal expenses lacking the necessary direct relation to the prosecution of the business. The character of such expense is unaltered by the circumstance that the taxpayer's post of duty was in Mobile, thereby increasing the costs of transportation, food and lodging. Whether he maintained one abode or two, whether he traveled 3 blocks or 300 miles to work, the nature of these expenditures remained the same.

Similarly, the Tax Court denied transportation expense deductions in Anderson v. Commissioner, 60 T.C. 834 (1970), involving a waitress who was required to report to the union hall daily to receive work assignments. Citing Dean, the court held that the taxpayer was employed where she worked, not where the union hall was located, and that she did not stop at the union hall to further the employer's business. The court disallowed the deductions, determining that the expenses were personal commuting expenses.

Analysis

The intensely factual nature of these cases precludes a universal holding as to whether the trips to the union hall are deductible. The discussion of cases and authorities above provides a framework for analyzing the facts of each case and applying the rules as appropriate. Accordingly, the following is a structure for analyzing the facts, not a chain of reasoning leading to a singular conclusion.

First, is the union hall itself the mariner's "home," or is the mariner away from a "regular place or abode in a real and substantial sense?" Both Dean and Case indicate that if a mariner has a tax home, it is not the union hall. Under certain fact patterns, a mariner might not have a tax home, but rather is an itinerant who would never be "away from home" for tax purposes.

Second, even if the union hall is not the mariner's "home," does the mariner maintain a residence at a distance from the union hall for personal reasons? The Flowers and Anderson cases suggest that the mariner's trips to the union hall are not made in pursuit of the trade or business. Also, if the trip to the union hall is for the purpose of securing a first job as a mariner, the trip is considered a personal, rather than business, expense. In fact, the nature of the union hall activities are distinguishable from the job search expenses discussed in Primuth and Cremona – the union hall does not provide services that actually assist mariners in developing or processing prospective job opportunities – and therefore these expenses may not qualify as job search expenses.

In summary, unless the facts of a given case lead to a favorable answer under all of these tests, a mariner's trips to a union hall to find work on a new vessel are nondeductible travel expenses.

ISSUE 2: INCIDENTAL EXPENSES

Facts

In December 2000, the United States Tax Court issued two opinions regarding substantiation by merchant mariners of their incidental expenses while traveling temporarily away from home, their meals and lodging having been furnished in kind by their employers. Johnson v. Commissioner, 115 T.C. 210 (2000); Westling v. Commissioner, T.C. Memo. 2000-289. The taxpayers introduced no written evidence of the amount of their actual expenses (although one taxpayer testified with respect to his purchases). Instead, they used the annual per diem revenue procedures to calculate their challenged deduction by using the applicable M&IE rate times the number of days for which they claimed a deduction. Although the Tax Court denied a deduction calculated by the taxpayers' formula, the Court held that the taxpayers could deduct daily amounts equal to the "Incidental Expense" portion of the federal Meal and Incidental Expense per diem rates in the Federal Travel Regulations (41 C.F.R. §§ 300 et seq., subsequently referred to as "FTR"), without regard to the partial disallowance for meal deductions.

Law and Analysis

Statute and Regulations

The Internal Revenue Code allows a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business during the taxable year, including expenses paid or incurred while traveling temporarily away from home I.R.C. § 162(a)(2). However, § 262 denies a deduction for any personal, living, or family expenses.

No deduction of a traveling expense is allowed, however, 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 expense. Section 274(d)(1); Treas. Reg. § 1.274-5T(b). Substantiation by adequate records requires some written evidence of the expense (which is more probative if made at or near the time of the expense), such as an account book, diary, or log, as more fully described in §1.274-5T(c)(1) and (c)(2)(ii), along with documentary evidence (such as a receipt) if required by § 1.274-5(c)(2)(iii). In other words, the regulations contemplate written evidence supporting all four elements of an expense, even if a receipt is not required for a particular expense. A receipt is required by § 1.274-5(c)(2)(iii)(A)(2), however, for any expense for

lodging and any other expense of $75 or more (except for expenses for transportation charges if such receipts are not readily available).

For any meal expense deduction, the deduction otherwise allowable is limited to a percentage of the expense under § 274(n).

Also, under § 274(d), however, the Commissioner may relax some or all of the substantiation requirements in regulations or other pronouncements of general applicability in the case of an expense that does not exceed an amount prescribed in such pronouncement. The Commissioner has exercised that authority in pronouncements in areas described in §1.274-5(g) (expenses incurred in connection with certain employer reimbursements) and (j) (deductions for meals while traveling away from home and mileage rates for vehicle expenses).

The Revenue Procedures

In Rev. Proc. 83-71, 1983-2 C.B. 590, the Commissioner permitted taxpayers not reimbursed by their employers for meals while traveling away from home to deduct $14 per day for trips of less than 30 days or $9 per day for trips of 30 days or more. Later, modifying rules set forth in Rev. Proc. 89-67, 1989-2 C.B. 795, for employees who substantiate expenses reimbursed by their employers under a reimbursement or other expense allowance arrangement satisfying section 62(a) and (c), the Commissioner, in Rev. Proc. 90-15, 1990-1 C.B. 476, provided rules for employees and self-employed individuals to use in deducting meal expenses while traveling away from home. Section 4.03 of Rev. Proc. 90-15 (and all subsequent annual revisions) provided for a deduction for meals for each full day of travel in an amount set forth in the Federal Travel Regulations for meal and incidental expenses (“M&IE rate”). Various other provisions of the revenue procedure applicable to deducting meal expenses while traveling away from home are not materially changed. No provision of the revenue procedure specifies directly how much an individual may deduct for only incidental expenses for a day of traveling away from home, although the revenue procedure does allow (under section 6.01 or section 6.03) an employee to be reimbursed by an employer for only incidental expenses for a day traveling away from home, and to substantiate those expenses, if the employer also provides the employee’s meals and lodging in kind.

Section 3 of the current revenue procedure, Rev. Proc. 2001-47, 2001-42 I.R.B. 332, contains the following definitions:

SECTION 3. DEFINITIONS

.O1 *Per diem allowance*. The term "*per diem* allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62-2(c)(1) and that is

(1) paid with respect to ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses for travel away from home in connection with the performance of services as an employee of the employer.

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at or below the applicable federal *per diem* rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.02 *Federal per diem rate and federal M&IE rate.*

(1) *General rule*. The federal *per diem* rate is equal to the sum of the applicable federal lodging expense rate and the applicable federal meal and incidental expense (M&IE) rate for the day and locality of travel.

(a) *CONUS rates*. The rates for localities in the continental United States ("CONUS") are set forth in Appendix A to 41 C.F.R. ch. 301.

* * * *

(b) *OCONUS rates*. The rates for localities outside the continental United States ("OCONUS") are established by the Secretary of Defense (rates for non-foreign localities, including Alaska, Hawaii, Puerto Rico, the Northern Mariana Islands, and the possessions of the United States) and by the Secretary of State (rates for foreign localities), and are published in the Per Diem Supplement to the Standardized Regulations (Government Civilians, Foreign Areas) ....

(C) *Internet access to the rates*. The CONUS and OCONUS rates may be found on the Internet at www.policyworks.gov/perdiem.

* * * *

(3) *Incidental expenses*. The term "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 "incidental expenses" does not include taxicab fares, lodging taxes, or the costs of telegrams or telephone calls.

The Federal Travel Regulations (FTR)

Section 300-3.1 of the FTR is a glossary of terms that is useful in analyzing this issue. Pertinent provisions of section 300-3.1 are as follows:

> *Actual expense* – Payment of authorized actual expenses incurred, up to the limit prescribed by the Administrator of GSA or agency, as appropriate. Entitlement...is contingent upon entitlement to per diem, and is subject to the same definitions and rules governing per diem.
>
> *Continental United States (CONUS)* – The 48 contiguous States and the District of Columbia.
>
> *Foreign area (see also Non-foreign area)* – Any area, including the Trust Territories of the Pacific Islands, situated both outside CONUS and the non-foreign areas.
>
> *Non-foreign area* – The States of Alaska and Hawaii, the Commonwealths of Puerto Rico, Guam and the Northern Mariana Islands and the territories and possessions of the United States (excludes the Trust Territories of the Pacific Islands).
>
> *Per diem allowance* – The per diem allowance (also referred to as subsistence allowance is a daily payment instead of reimbursement for actual expenses for lodging (excluding taxes), meals, and related incidental expenses. The per diem allowance is separate from transportation expenses and other miscellaneous expenses. The per diem allowance covers all charges, including any service charges where applicable for:
>
> > (a) *Lodging*. Includes expenses, except lodging taxes, for overnight sleeping facilities, baths, personal use of the room during daytime, telephone access fee, and service charges for fans, air conditioners, heaters and fires furnished in the room when such charges are not included in the room rate. Lodging does not include accommodations on airplanes, trains, buses, or ships. Such cost is included in the transportation cost and is not considered a lodging expense.
> >
> > (b) *Meals*. Expenses for breakfast, lunch, dinner and related tips and taxes (specifically excluded are alcoholic

> beverages and entertainment expenses and any expenses incurred for other persons).
>
> (c) *Incidental expenses*.
>
> > (1) Fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries;
> >
> > (2) Transportation between places of lodging or business and places where meals are taken, if suitable meals cannot be obtained at the TDY site; and
> >
> > (3) Mailing cost associated with filing travel vouchers and payment of Government sponsored charge card billings.

Court Decisions

In Johnson v. Commissioner, 115 T.C. 210 (2000), the taxpayer, captain of a merchant ship, maintained a home on shore but was required to live aboard ship for extended periods during the tax years in question (1994 and 1996). His employer provided his meals on board ship, but neither provided personal necessities nor gave him an allowance for incidental expenses. While aboard, the taxpayer could purchase clothing items such as foul-weather gear, personal hygiene items, and bottled water at a small ship's store.

On his 1994 amended federal income tax return, the taxpayer claimed miscellaneous itemized deductions, net of the 50-percent limitation of I.R.C. § 274(n), in the amount of $3,784 for meals and entertainment expense. On his 1996 return, the taxpayer claimed a similar miscellaneous itemized deduction for meals and entertainment expense of $3,464, again after taking into account the § 274(n) limitation. For both years, the taxpayer's claimed expenses related solely to the incidental expenses incurred aboard ship. The taxpayer failed to submit receipts (or other written documentation) to substantiate the incidental expenses allegedly incurred. Instead, he used the per diem substantiation method described in the relevant revenue procedure for each tax year, and determined the amount of the deduction claimed by using the full M&IE rate for each city to which he traveled (despite his being provided meals by his employer). The Service disallowed the claimed deductions for both years.

During the litigation, the government based its disallowance of the deduction upon three grounds. First, basing its argument upon Henderson v. Commissioner, 143 F.3d 497 (9th Cir. 1998), aff'g T.C. Memo. 1995-559, and Rev. Rul. 73-529, 1973-2 C.B. 37, the government argued that the revenue procedures did not apply because the taxpayer was an itinerant without a tax home. The government's reasoning was that because the taxpayer's employer furnished his lodging and meals without charge, his traveling in the scope of his employment did not result in his incurring the "duplicative living expenses" required for him to establish a tax home. Second, the government argued that the taxpayer had not substantiated the fact of his incurring the expenses in question, and that his unsupported testimony was insufficient to establish the amounts of his expenditures. Finally, the government argued that the revenue procedures did not apply because the taxpayer did not incur both meal and incidental expenses, but only incidental expenses.

In his opinion in Johnson, Judge Laro denied the taxpayer a deduction for incidental expenses at the full M&IE per diem rate, but allowed a deduction in the amount of the incidental expense component of the per diem rate. The court rejected all three of the government's arguments. The court distinguished the government's authorities factually and found: (1) The taxpayer had a tax home, and that it was his residence ashore; and (2) the taxpayer's testimony was credible as to the fact that he incurred expenses, and his records satisfied the time, place, and business purpose requirements of the regulations under section 274.

In rejecting the government's third argument that the taxpayer could not use the deemed substantiation provisions of the revenue procedure because he had incurred incidental expenses only, the court began by reading the Federal Travel Regulations ("FTR") into the analysis as follows:

> [T]he Commissioner has recognized as much in the subject revenue procedures wherein he states that "the amount of ordinary and necessary business expenses of an employee for lodging, meal, and/or incidental expenses incurred while traveling away from home will be deemed substantiated * * * when * * * [the employer] provides a per diem allowance" to the employee equal to the applicable M&IE rate. E.g., Rev. Proc. 96-28, 1996-1 C.B. at 686. We also note that 41 C.F.R. sec. 301-7.12(a)(2) (1994 & 1996) sets forth explicit rules which reduce the M&IE rates when the Government furnishes meals to an employee without charge and clarifies that "The total amount of deductions made on partial days shall not cause the employee to receive less than the amount allocated for incidental expenses."

Johnson, 115 T.C. at 225. (Emphasis added.)[2]

The court then framed the issue as follows: "We read the revenue procedures to apply to three distinct situations; i.e., (1) where a traveling employee pays only for meals, (2) where a traveling employee pays for both meals and incidental expenses, and (3) where a traveling employee pays only for incidental expenses." Id. at 226. (The court did not view the revenue procedure as dealing with variations on two distinct situations -- an employee who is reimbursed for expenses and is substantiating to his employer, as opposed to an employee or self-employed person taking a deduction on the person's individual return.) The court found that the plain text of the heading of the section of the revenue procedure permitting the taxpayer to use the federal per diem rates to substantiate his expenses, "Optional method for meals only deduction,"[3] was not dispositive. Rather, the court read expansively the text of both the revenue procedure[s] and the FTR and found that the taxpayer is entitled to deductions in amounts for the incidental expense portion only. Further, without discussing § 6.05 of the applicable revenue procedure, the court found in a footnote that the Tax Court Rule 155 computation should reflect a deduction for incidental expenses that did not subject those expenses to the disallowance of I.R.C. § 274(n)[4]. Johnson, 115 T.C. at 227 n.10.

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[2] The FTR section cited by the Court was redesignated 41 C.F.R. sec. 301-11.18. The text of the current revenue procedure contains wording substantially identical to that of Rev. Proc. 96-28, to wit:

> SECTION 6. LIMITATIONS AND SPECIAL RULES
>
> 01. *In general.* The federal *per diem* rate and the federal M&IE rate described in section 3.02 of this revenue procedure for the locality of travel will be applied in the same manner as applied under the Federal Travel Regulations, 41 C.F.R. Part 301-11 (2000), except as provided in sections 6.02 through 6.04 of this revenue procedure. (Emphasis added.)

Rev. Proc. 2001-47, 2001-42 I.R.B. at 337.

[3] E.g., Rev. Proc. 2001-47, 2001-42 I.R.B. at 334.

[4] All of the revenue procedures since Rev. Proc. 90-15, *supra*, have contained language in § 6.05 purporting to treat the entire deduction computed at the M&IE rate (or portion of that rate for certain days) to be subject to the disallowance under § 274(n). However, Rev. Proc. 97-59, 1997-52 I.R.B. 37 (effective January 1, 1998), and all subsequent revenue procedures have contained language in section 6.05(1) more clearly subjecting the entire deduction computed at the M&IE rate to the (generally) 50-percent disallowance of § 274(n). The Johnson and Westling cases

In a second case involving this issue, Westling v. Commissioner, T.C. Memo. 2000-289, the taxpayer was captain of a tugboat hauling barges among various Alaska ports. The taxpayer's employer provided lodging and meals, but no incidental expenses, to the taxpayer when he worked. The Tax Court, citing Johnson, disallowed the taxpayer's claim for deductions at the full federal M&IE rate, but allowed deductions for incidental expenses only.

The Service did not recommend appeal of Johnson and Westling, nor has it issued a pronouncement as to whether it will follow them.

The Tax Court commented further on Johnson in Beech Trucking Company v. Commissioner, 118 T.C. 428 (2002), a case involving the applicability of I.R.C. § 274(n) to per diem payments to truck drivers. In Beech Trucking, the taxpayer's "long-haul" drivers were compensated at a rate of 24 to 26 cents per mile, of which 6.5 cents was labeled a per diem allowance. Its "short-haul" drivers received a salary plus the same 6.5 cents per mile per diem allowance. The drivers were not required to turn in receipts or to account otherwise for how the per diem allowances were spent.

On its Forms 1120-S[5] for 1995 and 1996, the taxpayer applied the 50-percent section 274(n) disallowance for food and beverages to 40 percent of the per diem allowances paid to the drivers, resulting in a claimed deduction of 80 percent of the allowances paid. After examining the taxpayer's returns, the Service issued an FSAA (Final S Corporation Administrative Adjustment) after determining that section 274(n) disallowance applied to the entire amount of the per diem allowances paid. The taxpayer filed a Tax Court petition challenging the Service's determination.

The taxpayer in Beech Trucking argued that the sections 4.02 and 6.05 of the revenue procedures[6] in effect for the tax years in question were invalid to the extent that section 4.02 characterized the per diem payments as being solely for Meals and Incidental Expenses [M&IE], and to the extent that section 6.05 applied the I.R.C. § 274(n) disallowance to the full amount of the per diem payments. The Tax Court rejected this argument, reasoning in part that the substantiation methods in the revenue procedures are not mandatory, and that the taxpayer could have used

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concerned tax years prior to the effective date of Rev. Proc. 97-59.

[5] The Tax Court opinion refers to "Forms 1120." Beech Trucking, 118 T.C. at 432.

[6] Rev. Proc. 94-77, 1994-2 C.B. 825, and Rev. Proc. 96-28, 1996-1 C.B. 686.

actual allowable expenses, properly substantiated with adequate records or other sufficient evidence. Beech Trucking, 118 T.C. at 444. Furthermore, the court concluded:

> Giving due regard to the highly detailed nature of the statutory and regulatory scheme involved here, to the specialized experience and information presumably available to the Commissioner, and to the value of uniformity in administering the national tax laws, we are unpersuaded that the complained-of conditions imposed by section 4.02 or section 6.05 of the Revenue Procedures, as applied in the instant case, are arbitrary or unlawful.

Id. at 449-50. [Internal citations omitted.] Thus, the court in Beech Trucking removed any doubt over the validity of the revenue procedures that might have been raised by footnote 10 of Johnson, cited supra.

The taxpayer in Beech Trucking argued specifically that footnote 10 of Johnson supported his contention that section 274(n) did not apply to the extent that the per diem allowances were reimbursements for incidental expenses. The court, distinguishing Johnson, disagreed. The court pointed out that in Johnson, unlike the situation at hand, the taxpayer had incurred and paid unreimbursed incidental expenses and had claimed a deduction under section 4.03 of the revenue procedures in effect at the time. Further, the mariner in Johnson was provided meals and lodging in kind, so there was no issue of allocation of the M&IE allowance between meals and incidental expenses. By contrast, the taxpayer in Beech Trucking attempted "to deduct per diem payments intended to cover, without differentiation, all otherwise unreimbursed travel expenses, including meals." Beech Trucking, 118 T.C. at 451. Because the taxpayer in Beech Trucking made no attempt to substantiate the travel expenses so as to provide a basis for allocating the payments between meals and incidental expenses, the court concluded that section 274(n) applied to the entire amount of the payments.

Analysis

Although the existence of a reimbursement plan was not a factor in either Johnson or Westling (there was none in either), there should be an inquiry as to whether a merchant mariner received any kind of per diem-like reimbursement from the employer, for any reason, in addition to the meals and lodging provided in kind. If such a plan exists, then a different set of rules, not covered in this advice, applies to the facts of the case. Should such a plan be present, please request further guidance.

In analyzing these cases, it is essential to determine whether the merchant mariner was indeed "traveling away from home overnight." In Westling, the relatively close

proximity of a number of the taxpayer's destinations to his residence ashore raises some questions about the taxpayer's travel status that are not answered by the opinion. The record in Westling is not clear regarding whether this issue was considered when the case was set up. In Beech Trucking, there is considerable doubt as to whether the Service considered this issue with respect to the short-haul truckers. Indeed, the court in more than one instance in the Beech Trucking opinion noted the absence of any argument by the government regarding the overnight travel status of the short-haul truckers. The importance of this issue is manifest; if a taxpayer is not "away from home overnight," then the taxpayer may not claim a deduction for any element of per diem, including incidental expenses.

The fact that the government argued unsuccessfully in Johnson that the taxpayer was an itinerant without a tax home does not foreclose the issue automatically in the future. As mentioned above, the holding in Johnson is fact-intensive. Given different facts, itinerant taxpayer status might be a good ground for setting up a deficiency or rejecting a refund claim. For example, if a merchant sailor's tax return address is a post office box, further inquiry would be appropriate, for the taxpayer might indeed be itinerant with no home ashore. Alternatively, the taxpayer's permanent address might be aboard the same ship throughout the year, in which case the taxpayer's tax home could be the ship itself. In either case, the taxpayer would not be "away from home overnight" for purposes of section 162.

The nature and purpose of the incidental expenses claimed by a mariner should be of interest, also. For example, the facts in Johnson indicate that the taxpayer purportedly claimed incidental expenses for certain items purchased in the ship's store, such as foul-weather gear and bottled water. Foul-weather gear might be separately deductible as a miscellaneous itemized expense for special-purpose clothing required for the job; it does not fall under either the revenue procedure's or the FTR's definition of an incidental expense. Bottled water is "food or beverage"; if an allowable expense under per diem, it is subject to the 50-percent limitation of section 274(n). (There is no indication that the government argued this point in Johnson.)

The use of the revenue procedure by a taxpayer is optional. If a taxpayer chooses not to rely upon the revenue procedure, or if a merchant mariner has claimed a refund for incidental expenses exceeding the daily per diem amount in the FTR, then all elements of per diem claimed must be substantiated, and documentary evidence (such as receipts) must be provided to the full extent required by section 274 and its regulations.

The claims of mariners who claim either the full federal per diem amount (lodging plus meals and incidental expenses) or the full federal M&IE amount under the purported authority of Johnson and Westling are without merit. The holdings in those cases limited the taxpayers to the federal per diem rate for incidental

expenses only, using the rates specified in the Federal Travel Regulations. Therefore, any amount claimed in excess of the IE rates in the Federal Travel Regulations is facially defective, and should be disallowed.

The next question is which federal rate for IE should apply? The Johnson and Westling opinions did not address this issue.

Claims by mariners for "unsubstantiated" incidental expenditure amounts up to $75 per day without supporting receipts on the ground that they are permitted by Notice 95-50, 1995-2 C.B. 333, superseded in pertinent part by Treas. Reg. § 1.274-5(c)(2)(A)(iii)(2), are similarly defective. Taxpayers making such claims confuse the requirement for documentary evidence with the requirement for substantiation. The requirement to provide receipts falls under the documentary evidence requirement. This is the requirement relaxed by Notice 95-50 and the subsequent regulation. By contrast, the requirement for an adequate accounting substantiated by an account book, diary, log, statement of expense, trip sheet, or similar record still exists, whether under an employer's accountable expense reimbursement plan or as an unreimbursed employee business expense. These general documents are necessary to establish the amount, date, place, and essential character of the expenditure still required by the regulations. See Treas. Reg. § 1.274-5(c)(2)(B). Thus, mariners may not claim "actual" expenditures in excess of the federal IE rate without meeting at least these general requirements for a written record. Accordingly, if refund claims contain amounts exceeding the federal IE rate and lacking sufficient explanatory information, they should be disallowed.

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Please call if you have any further questions.

JAMES L. ATKINSON

By: _____

Gerald M. Horan
Senior Technician Reviewer