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INCOME TAX—EMPLOYEES' INDIRECT MOVING EXPENSES

In the fall of 1958, the plaintiff was informed by his employer that he would be required to relocate permanently to a new location in order to retain his position within the company. The move was made from San Francisco to Los Angeles and plaintiff incurred both direct and indirect[1] moving expenses. Plaintiff's employer, International Business Machines Corporation, reimbursed plaintiff for all moving expenses incurred. In addition, a reimbursement was made for the loss plaintiff sustained on the sale of his residence. The reimbursements for moving expenses were not included in taxpayer's gross income and the reimbursement for the loss sustained on the sale of the residence was treated by the taxpayer as an "amount realized"[2] on the sale of the residence. The Internal Revenue Service[3] treated both reimbursements as additional compensation and denied taxpayer a deduction.[4] The Court of Claims, adopting the trial commissioner's report, *held*, for the Service: Reimbursements by employer to employee for *indirect* moving expenses and for losses on the sale of residences incurred as a result of an employer-directed move are compensatory in nature constituting gross income[5] under the broad sweep of section 61(a) of the 1954 Internal Revenue Code. In addition, no deduction is allowed for indirect moving expenses because of their personal nature.[6] *Ritter v. United States*, 393 F.2d 823 (Ct. Cl. 1968).

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1. Moving expenses have been separated into two categories, (1) direct, and (2) indirect or extraordinary.

Direct moving expenses are those costs basic or fundamental to moving an employee's household. Direct moving expenses include the cost of transporting the taxpayer and his family to the new job location, moving furniture and other household effects from the old to the new residence and meals and lodging while in transit to the new location.

Indirect moving expenses are those costs incurred as a result of the employee's move, but are not so basic as to result each time an employee is required to relocate. Indirect moving expenses are non-transportational expenses. Rev. Rul. 65-158, 1965-1 CUM. BULL. 34, enumerates specific indirect moving expenses. *See* note 14 *infra* (Installation of rugs and draperies at a new residence is an example of indirect moving expenses).

The indirect moving expenses in question were:

(a) Real estate appraisal of plaintiff's residence.
(b) Advertising of residence for sale.
(c) Upkeep of residence pending sale after move to Los Angeles.
(d) Closing costs on purchase of Los Angeles home.
(e) Installation of carpeting in new residence.
(f) Remaking and rehanging draperies in new residence.

2. In theory, when a taxpayer receives back funds which he has invested, these funds are not considered taxable income, but instead are a return of capital (or "amount realized"). *See generally* 1 MERTENS, FEDERAL INCOME TAXATION § 5.06 (1962).

3. Hereinafter referred to as the Service.

4. Rev. Rul. 54-429, 1954-2 CUM. BULL. 53.

5. INT. REV. CODE OF 1954, § 61(a) states:

> [G]ross income means all income from whatever source derived, including (but not limited to) the following items: (1) compensation for services, including fees, commissions and similar items . . . .

6. INT. REV. CODE OF 1954, § 262 provides: "Except as otherwise expressly provided . . . no deduction shall be allowed for personal, living, or family expenses."

Case law[7] and statutes[8] indicate the broad sweep of the definition of *gross income.* As early as 1929, gross income was broadly construed by the United States Supreme Court to include the payments of an employee's personal income taxes by his employer.[9] The Supreme Court in *Commissioner v. Lo Bue,*[10] in dealing with employee stock options stated, "We have repeatedly held that in defining 'gross income' as broadly as it did in § 22(a) [forerunner of § 61(a)] Congress intended to 'tax all gains except those specifically exempted.' "

Based on the broad concept of the term gross income, the Service's position was that the taxpayer was denied exclusion of moving expense reimbursements from gross income.[11]

In 1954, the Service issued Revenue Ruling 54-429[12] limiting the broad concept of the term "gross income," and modifying its position thereon. This ruling excluded from income certain reimbursements received by an employee for moving expenses. The exclusion was limited to payments received from the employer for direct expenses incurred in moving the employee and his family from one permanent station to another permanent station.[13] The Service concluded that these payments were not compensatory in nature because the ruling required that the move be made primarily for the employer's benefit.

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7. *See, e.g.,* Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955); Commissioner v. Smith, 324 U.S. 177 (1945).

In Eisner v. Macomber, 252 U.S. 189 (1920), the Supreme Court attempted a definition of income that could serve as a guiding principle for the future. Shortly thereafter, however, (*See* C. A. Hawkins, 6 B.T.A. 1023 (1927)) it was prophesied that the scope of the sixteenth amendment would not forever be limited by this judicial definition (income was defined as the gain derived from capital, labor, or both), and that taxable income would be judicially found, although outside the precise scope of the Supreme Court's definition.

The concept of income as defined in *Eisner* was later abandoned by the Supreme Court in *Glenshaw Glass,* when the court stated that the term income is to be given a broad meaning.

8. INT. REV. CODE OF 1939, § 22(a) (forerunner of § 61(a)) provides: "Gross income includes gains, profits and income derived from salaries, wages or compensation for personal services . . . of whatever kind and in whatever form paid . . . ." INT. REV. CODE OF 1954, § 61(a) further expands the gross income definition.

9. Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929).

10. 351 U.S. 243, 246. The court cited to *Smith* for the proposition that taxable income includes *any economic or financial benefit* conferred on an individual, whatever the form or mode by which it is effected.

11. In Le Grand v. United States, 105 F. Supp. 177 (N.D. Ohio 1952), the taxpayer's employer gave him a portion of the purchase price of a home at his new job site. The court held the payment to be compensation for continued services and not a gift as the taxpayer contended.

12. *See* Rev. Rul. 54-429, 1954-2 CUM. BULL. 53.

13. The Service limits the exclusion to direct moving expenses stating:

> [I]t is concluded that (1) amounts received by an employee from his employer representing allowances or reimbursements *for moving himself, his immediate family, household goods and personal effects,* in case of a transfer *in the interest of his employer,* from one official station to another for permanent duty . . . are not includable in the gross income of the employee. . . . [A]mounts received as allowances or reimbursements for meals and lodging of the employee and his family while awaiting permanent quarters at the new place of duty are includable in gross income of the employee. (emphasis added)

Rev. Rul. 54-429, 1954-2 CUM. BULL. 53.

The Service's position with respect to reimbursed transportation costs of employees has been inconsistent over the years. Pretermitting an obvious rejoinder that different facts can

Subsequent to Revenue Ruling 54-429 the Service issued Revenue Ruling 65-158[14] which clarified its previous position toward reimbursed moving expenses and fortified its position that *only* direct moving expenses were excludable from gross income. This ruling listed various reimbursed non-transportational items (indirect expenses), which although related to the move constituted additional compensation.

The courts of appeals have generally followed the Service's position on including in gross income, reimbursements for moving expenses.[15]

In *United States v. Woodall*,[16] the court held that a reimbursement to a *new*[17] employee for expenses incurred in moving himself and his family to a new job location constituted taxable income. The court reasoned the reimbursement was in the nature of a cash bonus as an inducement to accept employment and emphasized the principle that gross income should be broadly construed to conclude that the payment was additional compensation.

The Service's position was further followed when the Seventh Circuit in *England v. United States*,[18] reversed a district court decision excluding from gross income, a reimbursement to the taxpayer from his employer, for *indirect* moving expenses. The lower court reasoned that since the taxpayer transferred solely at the request of the employer, any reasonable

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produce different results and opinions, the Service's ruling in O.D. 1135, 5 CUM. BULL. 174 (1921), held that transportation costs paid by the Government for dependents of army officers are in the nature of additional compensation whereas, G.C.M. 18430, 1937-1 CUM. BULL. 137 held that where an employee of the State Department is transferred at the Government's convenience, the amount received by him as reimbursement for the transportation costs should be excluded from gross income.

14. 1965-1 CUM. BULL. 34. Examples of non-transportational items includable in gross income enumerated in the ruling are: preliminary trips to the new place of employment to locate a suitable residence; the amount by which the net selling price of the employee's residence at the former place of employment fell below its appraised value; fees incurred in connection with the sale of the residence and the purchase price of a different residence at the new place of employment; alteration and installation of rugs and draperies at the new residence.

This ruling was issued to clarify Rev. Rul. 54-429, 1954-2 CUM. BULL. 53, primarily so the Tax Court could not misconstrue its purpose as the Service feels it did in John E. Cavanagh, 36 T.C. 300 (1961).

15. *Accord,* Koons v. United States, 315 F.2d 542 (9th Cir. 1963) (taxpayer, a new employee, was reimbursed for direct moving expenses and living expenses and the reimbursement was includable in gross income); United States v. Woodall, 255 F.2d 370 (10th Cir. 1958) (reimbursed direct moving expenses held includable in gross income for new employee).

The service's position prior to Rev. Rul. 54-429, 1954-2 CUM. BULL. 53, was to include all reimbursed moving expenses in gross income. Rev. Rul. 54-429 was construed as not applying to new employees. *See* note 17 *infra.*

16. 255 F.2d 370 (10th Cir. 1958).

17. Rev. Rul. 54-429, 1954-2 CUM. BULL. 53 relates to old employees as clarified by Rev. Rul. 55-140, 1955-1 CUM. BULL. 317 which states:

> Expenses incurred by an employee in moving his family and household goods from one locality to another . . . represent nondeductible expenses under section 24(a)(1) of the Internal Revenue Code of 1939 [forerunner of § 262, Internal Revenue Code of 1954] prohibiting the deduction of personal, living, or family expenses. Allowances or reimbursements for such expenses which are received from the *new* employer under the foregoing circumstances must be included in gross income (emphasis added).

18. 345 F.2d 414 (7th Cir. 1965), *cert. denied*, 382 U.S. 986 (1966), *noted in* 34 GEO. WASH. L. REV. 562 (1966).

expenses incurred, whether *direct* or *indirect*, were really the cost of the employer.[19] On appeal, the court relied on Revenue Ruling 54-429,[20] holding the reimbursement for indirect moving expenses to be taxable income to the taxpayer.[21] The appellate court stated that Revenue Ruling 54-429 was a permissible interpretation of section 61(a) of the Code,[22] and this holding substantiated the Service's position once again.

Generally, the position of the courts of appeals is to include in gross income all indirect moving expense reimbursements along with *all* moving expense reimbursements to *new* employees.

From the standpoint of the Service, the Tax Court has been less than co-operative on the question of moving expense reimbursements.

Subsequent to Revenue Ruling 54-429 the Tax Court in *John E. Cavanagh*[23] extended the application of the exclusionary rule to include reimbursements for direct as well as indirect expenses. The taxpayer was reimbursed for *extraordinary* living expenses[24] occasioned by his transfer to a new job location. The court held the reimbursed *indirect* expenses to be *excluded* from the taxpayer's gross income in that they did not come within the purview of section 61(a).[25]

The Tax Court follows the court of appeals and Service's position in regard to new employees,[26] holding any reimbursement for moving expenses to be includable in gross income as an inducement to employment and, therefore, compensatory in nature.[27]

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19. The theory underlying the exclusion of reimbursed moving expenses from gross income is that the costs constitute employer costs; *accord*, J. CHOMMIE, FEDERAL INCOME TAXATION, § 24 (1968).

20. Rev. Rul. 54-429, 1954-2 CUM. BULL. 53.

21. The court stated the following:

> The expenses of transporting an employee to a new post of duty for benefit of employer is properly an expense of the employer, not compensation of the employee, but the costs of meals, lodging and expenses incidental to securing housing at the post are personal living expenses of the employee and if they are provided by the employer, income is realized thereby.

England v. United States, 345 F.2d 414, 416 (7th Cir. 1965), *cert. denied*, 382 U.S. 986 (1966).

22. *Contra,* Homer H. Starr, 46 T.C. 743 (1966); John E. Cavanagh, 36 T.C. 300 (1961).

23. 36 T.C. 300 (1961).

24. Under an agreement with his employer, the taxpayer was reimbursed for the amount of living costs he sustained which were in excess of the ordinary living expenses of his family while his household effects were in transit. *Id.*

25. INT. REV. CODE OF 1954. A *nonaquiescence* of *Cavanagh* was subsequently issued by the Service, 1962-2 CUM. BULL. 6.

The court in extending Rev. Rul. 54-429, 1954-2 CUM. BULL. 53, reasoned that income is *not* received by an employee, when a reimbursement is received for costs chargeable to the employer but paid by the employee. The court held the *extraordinary* expenses incurred by the employee to be an employer cost and any reimbursement received not to be income under § 61(a) of the Code. In England v. United States, 345 F.2d 414 (7th Cir. 1965), the court rejected *Cavanagh* as being incorrectly decided and failing to follow the literal import of REV. RUL. 54-429.

26. The problem of determining whether a taxpayer is a new or old employee is no longer at issue in the area of *direct* moving expenses because under INT. REV. CODE OF 1954, § 217 (applicable to taxpayers after December 31, 1963), direct moving expenses may be deducted whether the taxpayer is a new or old employee. The problem still appears, however, in the area of *indirect* expenses.

27. *Accord,* Donald W. Haney, ¶ 66,010 P-H Tax Ct. Mem. (1966); Robert L. Wells,

In *Homer H. Starr*,[28] the Tax Court solidified its position with respect to exclusion of indirect moving expense reimbursements from gross income.

The taxpayer was reimbursed for *indirect* moving expenses occasioned by an employer-directed move. The court limited the issue to whether or not the expenditures were incurred primarily in the *interest* of petitioner's employer. The court concluded that the indirect expenses were incurred in the employer's interest and held the reimbursement to be excludable from gross income as not being compensatory in nature.

The Tax Court rejected the *England*[29] case, concluding that the cases relied on by the Seventh Circuit were not directly on point. The court amplified its position by stating the following:

> It is our opinion that [the Commissioner's] unqualified statement that indirect moving expenses *cannot, under any circumstances*, be said also to inure primarily to the benefit of the employer, ignores the *economic realities* of the situation (emphasis added).[30]

The *Starr* case was a significant step for the Tax Court in that *England* was rejected and now a split exists between the courts with respect to the inclusion of reimbursed *indirect* moving expenses in gross income.

The treatment of reimbursements for expenses and losses incurred in the sale of a residence occasioned by an employer-directed move is most nearly uniform in both the Tax Court and courts of appeals[31] with no change in the future apparent.[32] The courts have consistently treated these reimbursements as additional compensation.[33]

¶ 65,103 P-H Tax Ct. Mem. (1965), *aff'd per curiam sub nom.*, 356 F.2d 922 (3d Cir. 1966); Willis B. Ferebee, 39 T.C. 801 (1963); Alan J. Vandermade, 36 T.C. 607 (1961).

28. 46 T.C. 743 (1966); this case was appealed to the United States Court of Appeals, Tenth Circuit on December 27, 1967, *noted in* 15 KAN. L. REV. 394 (1967).

29. 345 F.2d 414 (7th Cir. 1965).

30. 46 T.C. 743, 746 (1966).

31. It should be pointed out that none of the courts has ever treated this type of reimbursement as a moving expense reimbursement.

In Ernest A. Pederson, 46 T.C. 155 (1966), the petitioner argued that Rev. Rul. 54-429, 1954-2 CUM. BULL. 53, was applicable and amounts paid by an employer to an employee for moving expenses (selling expenses on sale of petitioner's residence) are not compensatory in nature and excludable from gross income. The Tax Court held that Rev. Rul. 54-429 should not be extended to include such expenses because reimbursements for such expenses were never treated as moving expense reimbursements.

32. In considering H.R. REP. No. 8363, 88th Cong. 2d Sess. (1964), the legislation which culminated in the Revenue Act of 1964 and added to the Revenue Code the provision for certain deductions of moving expenses (INT. REV. CODE OF 1954, § 217), the committee on Finance, United States Senate, proposed an amendment to the house bill which treated reimbursements for selling expenses and market value losses as part of the proceeds of the sale of the old residence (amount realized) if the sale was occasioned by an employer-directed move. S. REP. No. 830, 88th Cong., 2d Sess. (1964). This provision was never even brought up for a vote but was deleted in conference. CONF. REP. No. 1149, 88th Cong., 2d Sess. (1964).

33. Old Employees: *Accord,* Baum v. United States, 21 Am. Fed. Tax R.2d 1401 (M.D. Tenn. 1968); Owen E. Harvey, ¶ 67,126 P-H Tax Ct. Mem. (1967); Ernest A. Pederson, 46 T.C. 155 (1966); Harris W. Bradley, 39 T.C. 652 (1963), *aff'd sub nom.*, 324 F.2d 610 (4th Cir. 1963), *noted in* 18 U. MIAMI L. REV. 714 (1964); *contra,* Otto Sorg Schairer,

Prior to 1964 and section 217 of the Code,[34] the Service followed a policy of denying deductions to individuals for moving expenses incurred because of an employer-directed move. These expenses were regarded as personal or family expenses[35] and the policy was applied to both existing and new employees, whether the move was made for the convenience of the employer or not.

Prior to 1954, a deduction for unreimbursed moving expenses, whether direct or indirect, was generally disallowed in both the Tax Court and courts of appeals.[36] Subsequent to Revenue Ruling 54-429[37] (allowing an exclusion from gross income for reimbursed *direct* moving expenses), the Tax Court has allowed deductions for direct moving expenses, while the courts of appeals have disallowed such deductions.[38]

The Tax Court, in *Walter H. Mendel*,[39] tried to extend Revenue Ruling 54-429 and held that the unreimbursed direct moving expenses were deductible as an "ordinary and necessary business expense."[40] The court reasoned that if reimbursed expenses were excluded from gross income they could not be personal in nature (otherwise they would be included in gross income); therefore, they must be ordinary and necessary business expenses. The Fourth Circuit reversed,[41] however, stating that while Revenue Ruling 54-429 excluded certain reimbursements from gross income, it did not make the unreimbursed direct expenses deductible *per se*. The court concluded that the expenses constituted non-deductible living expenses.

The split existing between the Tax Court and courts of appeals with respect to deductions for moving expenses, was further amplified by *Edward N. Wilson*,[42] a recent Tax Court case.

In *Wilson*, the court allowed a deduction for unreimbursed direct moving expenses.[43] The court stated that the concept of the "ordinary

9 T.C. 549 (1947) (reimbursement treated as "amount realized" on sale of residence), *overruled by* Harris W. Bradley, 39 T.C. 652 (1963). New Employees: *Accord*, Arthur J. Kobacker, 37 T.C. 882 (1962).

34. INT. REV. CODE OF 1954 (§ 217 allows deductions for direct moving expenses of employees).

35. INT. REV. CODE OF 1954, § 262.

36. York v. Commissioner, 160 F.2d 385 (D.C. Cir. 1947) (a deduction was denied for direct moving expenses incurred by taxpayer in moving to a new job location); H. Willis Nichols, Jr., 13 T.C. 916 (1949); Baxter D. McClain, 2 B.T.A. 726 (1925); *cf.* Commissioner v. Flowers, 326 U.S. 465 (1946) (deduction was denied for travel expenses incurred by taxpayer from commuting between his home and job location).

37. Rev. Rul. 54-429, 1954-2 CUM. BULL. 53.

38. Tax Court: *Accord*, Edward N. Wilson, 49 T.C. No. 43 (1968); Vaal R. Dodd, ¶ 68,023; P-H Tax Ct. Mem. (1968); Walter H. Mendel, 41 T.C. 32 (1963). Courts of Appeals: *Accord*, Commissioner v. Mendel, 351 F.2d 580 (4th Cir. 1965), *rev'g* 41 T.C. 32 (1963); *cf.* Cockrell v. Commissioner, 321 F.2d 504 (8th Cir. 1963); Light v. Commissioner, 310 F.2d 716 (5th Cir. 1962).

39. 41 T.C. 32 (1963).

40. INT. REV. CODE OF 1954, § 162(a).

41. Commissioner v. Mendel, 351 F.2d 580 (4th Cir. 1965).

42. 49 T.C. 406 (1968).

43. It should be pointed out that INT. REV. CODE OF 1954, § 217 now applies in such

and necessary" business expense cannot be static or immutable, but must be flexible. The court found *Mendel* not to be applicable because the record in the *Wilson* case indicated that the expenses incurred were "ordinary and necessary" business expenses, whereas in *Mendel* the record was void of such facts.

The instant case is one of first impression in the Court of Claims. Therefore, the court relied on court of appeals and Tax Court cases in deciding the case.

The majority of the court adopted the views of the courts of appeals in following *England*, along with viewing the historical rise of section 61(a)[44] and concluded that the reimbursements should be included in the taxpayer's gross income. The court reasoned that if an employee is reimbursed for essentially personal expenses connected with an employer-directed move, such reimbursements are not excludable from gross income, merely because the expenses would not have been incurred "but for" the move. The court concluded that the taxpayer's *indirect* expenses were personal and, therefore, the reimbursement constituted additional compensation. The court rejected the "but for" approach in *Cavanagh*.[45]

The court treated the reimbursement for the loss sustained on the sale of the residence as additional compensation following the position of both the Tax Court and courts of appeals.

In following *Mendel*[46] and denying a deduction to the taxpayer, the court stated that the *indirect* moving expenses were personal in nature and non-deductible under section 262 of the 1954 Internal Revenue Code.

On the basis of the instant case and section 217 of the 1954 Internal Revenue Code, as provided by the 1964 Revenue Act, which allows a deduction for direct moving expenses for new or old employees, an *equality* exists between all persons incurring moving expenses. The tax treatment for moving expenses on the basis of the instant case and section 217 is: (1) a reimbursed old employee can exclude only direct moving expenses from gross income and a new employee can deduct these expenses under section 217; (2) an unreimbursed old or new employee can deduct only direct moving expenses under section 217.[47]

The instant case, along with the courts of appeals and Service's position, put all persons incurring moving expenses on an equal footing. The Tax Court's position gives an old employee, who is reimbursed for *indirect* expenses, a tax advantage over a reimbursed *new* employee or an *unreimbursed* new or old employee. To resolve the problem of indirect

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cases. However, the ruling is significant because it could be a harbinger for allowing indirect moving expenses to be deductible. In *Ritter*, Judge Davis dissented in part holding that the taxpayer should be allowed a deduction for *indirect* expenses citing *Wilson*.

44. INT. REV. CODE OF 1954, § 61(a).

45. 36 T.C. 300 (1961).

46. 351 F.2d 580 (4th Cir. 1965).

47. Disregarding the Tax Court cases, tax free treatment is accorded *only* direct moving expenses.

moving expenses a number of approaches must be considered. First, the *Starr* case can be reversed or overruled. This in effect would sustain the courts of appeals and Service's position along with the position of the court in the instant case. Another approach would be to sustain the Tax Court's position by the judiciary or legislature, thereby allowing tax free treatment of indirect moving expenses.

In the writer's opinion, the best solution is the legislative approach. This would greatly enhance the mobility of the labor force, a public policy goal clearly a part of the legislative history behind section 217.[48] The legislation could provide for an exclusion from gross income of reimbursed indirect moving expenses clearly chargeable to the employer, and allow a deduction for unreimbursed indirect moving expenses.[49] Legislation to this effect enhances the mobility of the labor force and also provides an equality in the tax treatment of moving expenses for *all* persons.

IRA ZAGER

48. *See* statement by Hon. C. Douglas Dillon, Secretary of the Treasury, *Hearing on the Tax Recommendations of the President Before the House Committee on Ways and Means*, 88th Cong., 1st Sess. 45 (1964).

49. Legislation similar to this was proposed in H.R. REP. No. 47, 90th Cong., 1st Sess. (1967). Despite extensive support the proposed legislation did not come to a vote.