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Taxation - Traveling Expenses - Taxpayer Must Maintain Permanent Home to Be Entitled to Deduction

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cult to ascertain before excavation, it is extremely difficult to prove, even with the aid of the questions outlined previously, that an economic interest has not been retained.[37] Therefore, a taxpayer may find that a transaction which is a sale under the intent of the parties test may be deemed a lease in a circuit which follows the retained economic interest test. In order to eliminate such a situation and to secure uniformity throughout the circuits, it is suggested that in the area of extraction of sand, earth fill and gravel, the intent of the parties test should be adopted. If this test had been presently applied, the true substance of the contract and the surrounding circumstances would have made clear that the transaction was intended by both parties to be a sale. The instant decision is a good example of the confusion that results when one attempts to apply the retained economic interest test to an area where the test is inappropriate.

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TAXATION—TRAVELING EXPENSES—TAXPAYER MUST MAINTAIN PERMANENT HOME TO BE ENTITLED TO DEDUCTION.

James v. United States, (9th Cir. 1962)

Appellant worked as a traveling salesman for six manufacturers on a commission basis, establishing his own route within the designated territory which he covered several times each year. He deducted from his gross income all money spent for lodging, meals, and tips while away from Reno, Nevada as traveling expenses "while away from home" within the meaning of § 23(a) (1) (A) of the Internal Revenue Code of 1939.[1] He contended that Reno was his tax home since there he maintained a Post Office box and bank account, dealt with a stockbroker, had

37. Suppose the taxpayer is hesitant to make an absolute sale and the contractor, who seeks to purchase the earth fill, is hesitant to make an absolute purchase since the land may not produce the desired quantity or quality of earth fill. The parties may decide to incorporate into their agreement a provision that the contractor take only usable fill or that the taxpayer supply only fill that meets certain specified standards. A strict application of the economic interest test may, therefore, result in the transaction being taxed as a lease, although the parties may have clearly intended a sale.

1. INT. REV. CODE OF 1939, ch. 1, § 23(a) (1) (A), 53 Stat. 12 (now INT. REV. CODE OF 1954, § 162(a) (2)), provides:

"Deductions from gross income. In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) Trade or business expenses.

(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, . . . ; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business."

purchased his automobile and insurance, had filed his income tax return and stored certain personal belongings. In addition, he asserted that Reno was his headquarters for resting, taking care of his insurance, and various other items. However, the evidence showed that his contacts with Reno were similar to those in other cities in the sense that he spent only thirty days of the year there while he called on business accounts. During this period he stayed at hotels and took his meals about town. The Commissioner disallowed the deduction on the ground that it was not shown that the expenses were incurred while taxpayer was "away from home." On appeal, the Circuit Court of Appeals for the Ninth Circuit sustained the district court's affirmance[2] of the Commissioner's ruling, *holding* that a taxpayer, in order to be entitled to a deduction for traveling expenses while away from home, must maintain a permanent place of residence at which are incurred substantial continuing living expenses. Appellant's contacts with Reno were found to be insufficient for this purpose. *James v. United States,* 308 F.2d 204 (9th Cir. 1962).

The court in the instant case rested its opinion on an analysis of the purposes of the traveling expense deduction. Concluding that the basis for the deduction lay in alleviating the tax discrimination between those who are forced to travel for business reasons and those who are not, it was noted that the former are subjected to substantially higher expenditures by reason of duplication or inherently higher cost. Since James lived in the same manner in Reno as he did elsewhere, the court reasoned that he had suffered no inherently higher cost attributable to travel. Nor had James been subjected to a duplication of living expenses since, in his absence from Reno, he had kept no permanent quarters.

A disproportionate share of litigation has centered about the meaning of the phrase "away from home" when applied to traveling expense deductions under the Internal Revenue Code. The paucity of legislative history surrounding the provision has prompted many questions as to whether a particular taxpayer was away from home or whether he had a tax home at all. The principal conflict has centered about whether the tax home is the taxpayer's residence or his post of duty, or principal place of business, when these are separately located. This dispute arose through the insistence of the Commissioner and the Tax Court[3] that a person may not maintain a home where he is not engaged in a business and at the same time deduct his business traveling expenses when away from that home.[4] The circuits are split on this question with the Ninth

2. James v. United States, 176 F. Supp. 270 (D. Nev. 1959).

3. See Robert A. Coerver, 36 T.C. 252 (1961); James M. Eaves, 33 T.C. 938 (1960). The classic case in this area, still often cited, is Mort L. Bixler, 5 B.T.A. 1181 (1927).

4. At least one commentator has implied that the special meaning used by the Commissioner is without support in the legislative history of the act. See Haddleton, *Traveling Expenses "Away from Home"*, 17 TAX L. REV. 261, 262-263 (1962).

Circuit adhering to the view that home is to be interpreted literally, that is, as the taxpayer's residence.[5] However, in the present case, the court noted that a similar decision would have been rendered under either definition. The basic question in James concerns what contacts are necessary to establish the physical home requisite to the deduction, regardless of whether the tax home be located at the place of residence or the place of business.

Among the most durable of the Code provisions, the pertinent section has remained virtually unchanged in substance since 1921.[6] At that time it was amended for the benefit of the business traveler, relieving him of the burden of proving an excess of his traveling expenses over his normal living costs by providing that "the entire amount expended for meals and lodging" could be deducted. Congressional debate made specific mention of the applicability of the new addition to traveling salesmen[7] but failed to produce any criteria for the determination of what is a "home."

The United States Supreme Court has twice had the opportunity to provide guides for interpretation but each time has bypassed the question of "home" in favor of deciding the case on another basis. In *Commissioner v. Flowers,*[8] the Court set out the three general conditions to be satisfied before a traveling expense could qualify as a deduction.[9] In this and the later case of *Peurifoy v. Commissioner,*[10] an interpretation of the word "home" was not directly passed upon, although it is questionable whether a construction clear enough to control the instant case would have resulted. In both *Flowers* and *Peurifoy* the taxpayers main-

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5. Wright v. Hartsell, 305 F.2d 221 (9th Cir. 1962); Wallace v. Commissioner, 144 F.2d 407 (9th Cir. 1944). *Accord,* Burns v. Gray, 287 F.2d 698 (6th Cir. 1961). *Contra,* Barnhill v. Commissioner, 148 F.2d 913 (4th Cir. 1945). A recent study of the problems in this area may be found in note, *A House Is Not A Tax Home,* 49 VA. L. REV. 125 (1963).

6. *Compare* Revenue Act of 1921, § 214(a) (1), 41 Stat. 239, *with* INT. REV. CODE OF 1954, § 162(a) (2).

7. ". . . when the language to which I have referred was considered by the committee it was discussed from the standpoint of allowing the exemption to traveling salesmen. It was thought that their traveling expenses were a matter for proper deduction and that their meals and lodging should also be included in such deduction." 61 CONG. REC. 6673 (1921) (Remarks of Mr. Walsh).

8. 326 U.S. 465, 66 S. Ct. 250 (1946).

9. "Three conditions must thus be satisfied before a traveling expense deduction may be made under § 23(a) (1) (A):
(1) The expense must be a reasonable and necessary traveling expense, as that term is generally understood. This includes such items as transportation fares and food and lodging expenses incurred while traveling.
(2) The expense must be incurred 'while away from home.'
(3) The expense must be incurred in pursuit of business. This means that there must be a direct connection between the expenditure and the carrying on of the trade or business of the taxpayer or his employer. Moreover, such an expenditure must be necessary or appropriate to the development of the business or trade." 326 U.S. 465, 470, 66 S. Ct. 250, 252 (1946).

10. 358 U.S. 59, 79 S. Ct. 104 (1958).

tained permanent abodes for their families and neither case would have presented the factual question at issue.[11]

Few opinions make express mention of the standards of permanence and continued expense which the present court relied on. As early as 1929, however, the deductions of a traveling salesman were denied on the basis that the home he claimed lacked permanence.[12] The taxpayer claimed residence at a hotel in Buffalo, but it was shown that he lived and operated his business from there only when his wife, who otherwise lived apart from him because of her poor health, was able to be in that town. The Board said that in its opinion "Congress did not intend to allow as deductions all the year's expenses for meals, lodging, laundry, etc., incurred by a taxpayer who maintained no permanent home, no definite headquarters; who traveled on a roving commission, with headquarters wherever he happened to be."[13] Although the concept of permanence was alluded to in later cases as the controlling factor in denying a traveling show manager[14] and a telegraph lineman[15] tax homes within the meaning of the Code, it is difficult to agree within the logic of the instant case, that permanence alone should control the deduction. Since the fundamental rationale, as that court conceived it, is an equalization of the tax burden, it is evident that the primary requirement to establish a tax home should be a substantial expense arising from maintenance of a residence and continuing during the absence of the taxpayer.

On the other hand, a line of cases may be found that have permitted the deduction despite the lack of a continuing expense in the taxpayer's absence. In *Charles G. Gustafson,*[16] the taxpayer was a national circulation promoter for a magazine and traveled extensively, stopping occasionally to visit his sister at her home where he stored his belongings. The Tax Court allowed him to deduct his expenses while away from his sister's home, although there were no actual home expenses to be duplicated and he conducted no appreciable business from that address.[17] In his dissent, Judge Harron maintained that the occupation of a traveling salesman had its necessary personal expenses attached and these should be separated from the business expenses for tax purposes.

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11. Either case, however, could have resolved the dispute as to whether the tax home was located at the residence or the business post. Dissenting opinions in each case favored the former approach.

12. Charles E. Duncan, 17 B.T.A. 1088 (1929), *aff'd per curiam,* 47 F.2d 1082 (2d Cir. 1931).

13. *Id.* at 1091.

14. Moses Mitnick, 13 T.C. 1 (1949).

15. Max W. Tugal, 20 CCH Tax Ct. Mem. 693 (1961).

16. 3 T.C. 998 (1944), *acq.* 1944 CUM. BULL. 12.

17. Gustafson was cited as controlling in a Tax Court memorandum decision, Philip D. Graham, 12 CCH Tax Ct. Mem. 663 (1953). The taxpayer was permitted to claim his mother's residence as a tax home, despite the fact that he returned there only on vacations and when unemployed. Although this home required no expense while he was away, it was held sufficient that he stored his personal property there, received mail and paid personal property taxes, and used that address for his driver's license.

An interesting comparison may be made between the present case and *Simeon J. Smith,*[18] although the latter is only a memorandum decision and therefore of limited value as authority. The petitioner was an office manager of a book company who spent most of his time traveling. He rented a home for his sister but stayed himself in Atlanta, Georgia at a hotel room which he rented intermittently, relinquishing the room and checking his bags at the hotel while away traveling. The court based a finding that Atlanta was his home on the fact that his hotel quarters were permanent and that his managership established a business post. This finding is not inconsistent with the present holding if it is remembered that in the instant decision the taxpayer was substantially an independent contractor and his residence within Reno varied, while in *Smith* the taxpayer was an employee of a company which maintained a permanent office and he always resided in the same hotel. Nevertheless, on the rationale of the principal case, there appears to be no valid reason why a deduction should be allowed in the one situation and not in the other, since a continuing expense during the taxpayer's absence is lacking in both.

None of the above cases directly discusses or applies the continuing expense factor. But in *Chester D. Griesemer,*[19] this element was made the foundation of a holding permitting the taxpayer to deduct expenses incurred during three years he was in France on business. The court pointed out that the expenditures were in addition to those incurred in maintaining his usual place of abode for his mother and sister and thought that Congress undoubtedly intended such amounts to be deductible.[20] In a similar vein, a tacit acknowledgment of the importance of continuing expenses may be inferred from the decision of the Court of Appeals for the Seventh Circuit in *Fisher v. Commissioner.*[21] The taxpayer, a professional itinerant musician, claimed his home to be with his mother. He invariably returned to her residence between engagements and used that address for mail and phone replies to his requests for future commitments. In a brief opinion disallowing deduction of his traveling expenses, the court quoted largely from the findings of fact of the Tax Court which pointedly noted that the taxpayer had paid no rent on his mother's apartment and had contributed to the household expenses only when he was there. The *Flowers* case was cited as controlling, "despite an absence of definitive characteristics for the word 'home,' . . ."[22]

It is difficult to argue with either the rationale of the present court or the apparent ease of application of the standards it suggests. While both permanence and continuing expense are advocated as being necessary

18. 2 CCH Tax Ct. Mem. 837 (1943).
19. 10 B.T.A. 386 (1928).
20. *Id.* at 389.
21. 230 F.2d 79 (7th Cir. 1956), *affirming* 23 T.C. 218 (1954), *acq. in part,* 1955-1 CUM. BULL. 4.
22. *Id.* at 81.

factors, it would seem that the latter should be emphasized. If, as the court reasons, equalization of the tax burden between the business traveler and the non-traveler is conceded to be the reason for the deduction (and there appears to be no strong opposing argument) to permit the deduction without the requirement that the taxpayer show he has been subject to some substantial expense in maintaining his "home" is but to shift the discrimination upon the non-traveler or to give the traveler a benefit to which he is not justifiably entitled. Granting that the expense of constant traveling is in excess of that required in living at a fixed location, it is felt that such excess is more properly deductible as an "ordinary and necessary" business expense. This was conceded by the instant court with recognition of the difficulty of the resultant burden of proof on the taxpayer in separating his personal and business expenses. Having already noted that Congress had passed corrective legislation alleviating that problem earlier as it was applied to traveling expenses,[23] the court suggested that the enigma might be resolved either through application of the *"Cohan"* doctrine[24] or through legislative relief. Since the former has been recently abolished,[25] the only solution appears to lie in further corrective legislation. One suggestion has been to eliminate the "away from home" requirement in cases of this type, insisting only that the expense be attributable to traveling on business.[26] Another has been to amend the Code to permit the deduction of an arbitrary percentage of the living expenses,[27] presumably on a basis similar to that of the standard deduction.

Considering that expense deductions in general have been tightened in recent legislation[28] following recognition of frequent abuses in this area,[29] the standards proposed in the present case for the determination of the home do not appear to be too harsh.[30] Furthermore they provide a workable criterion that appears to be acceptable to the Internal Revenue Service. The Service has stated that no deduction would be allowed

23. 308 F.2d 204, 206 & n. 5 (9th Cir. 1962).

24. This doctrine provided that where it was acknowledged that expenditures had been made which would be deductible, but the taxpaper was unable to prove the amount, the Board must allow an estimated amount based on its own experience and bearing heavily against the taxpayer. Cohan v. Commissioner, 39 F.2d 540, 543-544 (2d Cir. 1930).

25. Under new amendments to the Code, considerable substantiation is required for all traveling expense deductions. Revenue Act of 1962, § 4, adding new Code § 274(d).

26. ALI Fed. Income Tax Stat. § X151(B) (5) (Feb. 1954 Draft). See also Note, 43 VA. L. REV. 59, 76-77 (1957).

27. Comment, 19 U. CHI. L. REV. 534, 546 (1952).

28. Revenue Act of 1962, § 4.

29. See generally Wakeley, *Some New Thoughts on Travel and Entertainment Expenses,* N.Y.U. 20TH INST. ON FED. TAX. 505 (1962).

30. Granting that the burden of proof in separating the taxpayer's personal and business expenses may be a difficult one, travel expenses relating to meals and lodging are basically personal in nature. Except when specifically exempted, as in the travel expense deduction section, personal expenses have always been taxable under the Code. See INT. REV. CODE OF 1962, § 262. It should be remembered that the taxpayer seeking to place himself within the exemption provision is attempting to gain a privilege and is not being denied a right.

"because of any purported connection with a particular locality where the connection is more nominal than real and he [the taxpayer] appears predominantly to be an itinerant worker. . . ."[31] To be consistent with the present decision, future cases similar to *Smith*[32] and *Gustafson*[33] should be resolved against permitting the deduction. There appears to be no better reason to allow the full deduction to one whose only connection with a community is a free room in the home of a relative than to allow it to the taxpayer in the instant case. While such a connection is nominally permanent, it in no way results in a continuing expenditure in the taxpayer's absence.

What further ramifications this case may have is difficult to predict. Each case must still stand on its own facts. Now, however, the court has a reasonable and practicable standard with which to avoid the inconsistencies of past decisions. To the extent that the traveler without a home is discriminated against, it seems that he must await legislative relief.

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31. See Rev. Rul. 60-189, 1960-1 CUM. BULL. 60, 68.
32. *Supra* note 18.
33. *Supra* note 16.