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Income Tax: Losing Twice on the Sale of a Personal Residence

Imagine this scenario: Your boss calls you into his office. The company has decided to move the research and development division to Dallas. To keep your job, you must relocate and sell your new home. Your company has an excellent employee relocation program. The personnel department has explained that you will be reimbursed for all moving expenses if you turn in completed receipts. The relocation program covers the costs of moving your personal belongings, transporting your family to the new residence, a couple of trips to Dallas to search for a new home, and thirty days' temporary accommodations until your new residence is ready. According to the personnel department memo you received, you must report these reimbursements for income tax purposes, but there is a corresponding deduction that will allow you to offset the entire amount of the reimbursement.[1]

Your actual moving expenses, however, are the least of your worries. You have been told to report for work in Dallas in one month. You will be fortunate to sell your home in sixty days and then only at a price several thousand dollars less than your acquisition cost. Again, you are in luck. Your employer also has a home guarantee program. Under this program, your employer will guarantee that you receive no less than the appraised value of your home. Not surprisingly, because the home is new, the appraised value is the same as your acquisition cost.

You receive one offer to purchase your home—for $5,000 less than its appraised value. The company approves this price, so you sell and receive your reimbursement. You use the sale proceeds and reimbursement to purchase a comparable home in Dallas. When you file your income tax return the following year, you report no income on the sale of your home; your accountant has told you that if you buy a new home for more than the sale price of your old home within 18 months of that sale, you need report no gain on the sale.[2]

Six months later it arrives—the tax deficiency notice. Inside the envelope is a short, uninformative letter. The Internal Revenue Service (IRS) has determined that you failed to report $5,000 in compensation from your employer. The IRS has characterized the reimbursement for the loss on the sale of your home (appraised value/acquisition cost minus sale price) as employer compensation for your services.

[1] I.R.C. § 217 is an express grant of deductibility status to certain moving expenses (including, but not limited to, those listed in the text sentence) conditioned upon the employee meeting the specific criteria of subsection (c). Those criteria are (1) that his new principal place of work be at least 35 miles farther from his former residence than was his former principal place of work, or if he had no former principal place of work, be at least 35 miles from his former residence, and (2) that he be a fulltime employee at that location for 39 weeks of the next 12 months following the move.

[2] I.R.C. § 1034 permits the rollover of gain on the sale of a personal residence if the purchase of the second home is within 18 months of the sale of the first home.

The national character of many United States companies makes the described scenario a common and critical problem for those employees who realize no improvement in their financial position as a result of a relocation. Because the reimbursement from the employer is usually invested in the next home, taxpayers must often liquidate other assets (or borrow) to satisfy the tax deficiency. That course is particularly unpleasant to the employee who sees himself as no better off by the relocation. This note will track the history of the judicial treatment of such reimbursements, analyze the arguments offered in support of nontaxation or deferral of income recognition on the reimbursement, examine the nontax effects of the rule, and propose changes that could allay the Service's true concern and at the same time restore equitable treatment of the taxpayer.

Congressional Authority for the Characterization

With the enactment of the Internal Revenue Code,[3] Congress granted the Internal Revenue Service broad discretion to define gross income.[4] Under the previous Code,[5] the definition of gross income included gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in any form paid.[6] Under the 1954 Code, gross income is defined as all income from whatever source.[7] The Service has used this vague definition plus other Code sections to reach transfers of property heretofore untaxed.[8] Only since the enactment of the 1954 Code has a reimbursement received by an employee from his employer for the loss sustained on the sale of a personal residence incident to an employer-requested relocation been taxed.[9]

To tax this reimbursement, the Service has stretched the umbrella language of section 61(a) to its outer limits. The Service has not relied upon congressional intent; there is none regarding a home sale loss reimbursement. Congress has enacted Code sections to govern the tax treatment of meals and lodging received by an employee from his employer,[10] employer transfers of noncash property to employees,[11] employees' qualified pension, profit-sharing, and stock bonus plans,[12] employee death benefits,[13] and employee moving expenses.[14] However, Congress has failed to provide employers and

[3] Act of Aug. 16, 1954, Pub. L. No. 591.

[4] I.R.C. § 61(a).

[5] INT. REV. CODE OF 1939, 53 Stat. 47.

[6] INT. REV. CODE OF 1939, ch. 1 § 22(a), 53 Stat. 47 (now I.R.C. § 61(a)).

[7] I.R.C. § 61(a).

[8] *See* I.R.C. § 83, Property Transferred in Connection With Performance of Services. The language of this section leaves much room for Service discretion, but as yet no court has construed the language to reach an employer's reimbursement to an employee for home sale loss.

[9] Harris W. Bradley, 39 T.C. 652, *aff'd* 324 F.2d 610 (4th Cir. 1963).

[10] I.R.C. § 119.

[11] I.R.C. § 83.

[12] I.R.C. § 401.

[13] I.R.C. § 101(b).

[14] I.R.C. § 217.

employees guidance as to the taxability of reimbursements for home sale losses incident to an employer-requested relocation.

Before 1954, an employer's payment to an employee for loss sustained on the sale of a personal residence was treated as part of the amount realized from the sale of the home.[15] After 1954, the courts reevaluated this position in light of decisions construing the statutory definition of income[16] and abandoned the earlier characterization.[17] The most recent decision on this issue is the broadest in disallowing avoidance of immediate taxation. A sale of the residence to the employer was treated as illusory, while the subsequent sale by the employer to a disinterested third party was attributed to the employee.[18]

Petitioners objecting to this tax treatment have offered myriad arguments,[19] all of which have been rejected.[20] The Service has consistently maintained that section 61 of the Internal Revenue Code allows the taxation of such reimbursements. According to the Service, the employer's motive in making these payments is to provide an incentive to the employee and therefore compensate him for future performance.[21] In only one case has the Tax Court pierced the Service's superficial arguments and dealt with the real concern that a loosening of the rule will encourage employers to conceal bonuses, dividends, and salary increases in the guise of a nontaxable transfer.[22]

Such a concern is arguably valid, although statutory safeguards or regulations could establish the parameters of a nontaxable reimbursement. However, adherence to the rule as it now stands has deleterious effects on society as a whole that transcend the mere frustration of the affected taxpayer.

The Judicial History

In 1947 the Tax Court heard its first case, *Otto Sorg Schairer*,[23] concerning an employee's reimbursement for loss sustained on the sale of his

[15] Otto Sorg Schairer, 9 T.C. 549 (1947).

[16] Commissioner v. Duberstein, 363 U.S. 278 (1960); Commissioner v. LoBue, 351 U.S. 243 (1956). It seems anomalous that the Service would rely upon cases in which the true issue was whether a transfer was a gift or compensation when other cases construing the Code definition of income would seem more appropriate. *See, e.g.*, United States v. Drescher, 179 F.2d 863 (2d Cir. 1950).

[17] Harris W. Bradley, 39 T.C. 652, *aff'd* 324 F.2d 610 (4th Cir. 1963).

[18] Thomas L. Karsten, 44 T.C.M. (P-H), ¶ 75, 202, at 852 (1975).

[19] A taxpayer who challenges an Internal Revenue Service assessment is, unless he can find a specific Code exception, the petitioner in any proceeding and he bears the burden of production and persuasion. *See* section 534 for a specific exception.

[20] Lull v. Commissioner, 51 T.C. 841, 847 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970); Ritter v. United States, 393 F.2d 823, 831 (Ct. Cl.), *cert. denied*, 393 U.S. 844 (1968); Harris W. Bradley, 39 T.C. 652, 655 (1963).

[21] Otto Sorg Schairer, 9 T.C. 549 (1947).

[22] *Id.*

[23] *Id.* at 550.

personal residence as a result of an employer-requested relocation. The petitioner, a vice-president of RCA,[24] was required to move in order to be closer to a newly constructed laboratory.[25] Schairer conformed to his employer's wishes after his superior assured him that RCA would reimburse him for any loss resulting from the sale of his home.[26] The Tax Court held that the promise of reimbursement was not intended as a promise of compensation for services.[27] Subsequent to an arm's-length sale by Schairer, RCA reimbursed him the difference between the value of the home and the sale price.[28] Schairer did not report the payment as income and RCA entered the payment on its own books as "sundry Expenses".[29] The Service, relying on the statutory definition of gross income,[30] assessed a deficiency.[31] The court rejected the Service's argument and held that the reimbursement was part of the amount realized on the sale of the home.[32] Because the total amount realized did not exceed Schairer's cost basis in the home, it was characterized as capital recovered and not taxable gain.[33]

The definition of income was broadened by the Internal Revenue Code of 1954.[34] The United States Supreme Court, in decisions construing this definition, held that "income" included any economic or financial benefit conferred on an employee as compensation.[35] The Service used these decisions to obtain a reversal of the *Schairer* rule and then an expansion of the reversal's impact.[36]

In 1963 the Tax Court rejected *Schairer* in *Harris W. Bradley*.[37] The petitioner, Bradley, relocated to accept new employment.[38] Two months after Bradley commenced his new employment, his employer guaranteed that Bradley would receive an amount, not necessarily an average, between two appraisals on the home.[39] When the home was sold, the proceeds were less than the guarantee, so the employer made up the difference.[40] The Tax Court

[24] *Id.* at 551.
[25] *Id.*
[26] *Id.* at 552.
[27] *Id.*
[28] *Id.* at 553.
[29] *Id.*
[30] INT. REV. CODE OF 1939, ch. 1, § 22(a), 53 Stat. 47 (now I.R.C. § 61(a)).
[31] Otto Sorg Schairer, 9 T.C. 549, 554 (1947).
[32] *Id.* at 556.
[33] *Id.* at 554.
[34] I.R.C. § 61(a).
[35] Commissioner v. Duberstein, 363 U.S. 278 (1960); Commissioner v. LoBue, 351 U.S. 243 (1956).
[36] Lull v. Commissioner, 51 T.C. 841 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970); Harris W. Bradley, 39 T.C. 652, *aff'd* 324 F.2d 610 (4th Cir. 1963); Seth E. Keener, Jr., 59 T.C. 302 (1972); Thomas L. Karsten, 44 T.C.M. (P-H) ¶ 75, 202 (1975).
[37] Harris W. Bradley, 39 T.C. 652, *aff'd* 324 F.2d 610 (4th Cir. 1963).
[38] *Id.* at 654.
[39] *Id.*
[40] *Id.* at 655.

declined to follow *Schairer*, citing the changes in the law.[41] It held that the reimbursement was compensation and therefore taxable as income.[42] Three judges, in dissenting opinions, objected to the abandonment of the *Schairer* rule and argued that Bradley's reimbursement for his loss on the sale of his home was not compensation within the general principles of *LoBue* and *Duberstein*.[43]

In a subsequent case, *Lull v. Commissioner*,[44] the petitioner tried to distinguish his situation from the facts in *Bradley* in that, unlike Bradley, he moved at the request of his current employer and not to accept new employment.[45] Lull attempted to revive the *Schairer* rule and argued that because he had not accepted new employment, the reimbursement was merely part of the amount realized on the sale of his house. Furthermore, he claimed it was nonrecognizable because he had used the proceeds to purchase a new home.[46] The court rejected this distinction and held that taxation of the reimbursement was mandated by *Bradley*.[47] Because the reimbursement was not part of the amount realized on the sale, the issue of section 1034 was mooted.[48]

Although the *Bradley* decision appears to be definitive, many taxpayers have presented facts similar to those of *Bradley* and *Lull* in unsuccessful efforts to challenge the *Bradley* rule.[49] In 1975 an imaginative taxpayer, with the support of his employer, offered a new argument to avoid *Bradley*.[50] Pursuant to an agreement whereby his new employer promised to reimburse him for any loss sustained on the sale of his residence, Mr. Karsten accepted a job offer and relocated.[51] Because Karsten's efforts to sell his old home were unsuccessful, his employer loaned him $50,000 to purchase a new home.[52] The

[41] *Id.* The court referred to the *LoBue* and *Duberstein* decisions.

[42] *Id.*

[43] *Id.* at 656-57. See text accompanying note 35 *supra.*

[44] Lull v. Commissioner, 51 T.C. 841 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970).

[45] *Id.* at 848.

[46] *Id.* at 849; I.R.C. § 1034(a): "If property . . . used by the taxpayer as his principal residence is sold by him, and, within a period beginning 18 months before the date of such sale and ending 18 months after such date, property . . . is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price . . . of the old residence exceeds the taxpayer's cost of purchasing the new residence."

[47] Lull v. Commissioner, 51 T.C. 841, 849 (1969), *aff'd* 434 F.2d 615, 619 (9th Cir. 1970).

[48] *Id.*

[49] William A. Lull, 51 T.C. 841 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970); Owen E. Harvey, 36 T.C.M. (P-H) ¶ 67, 126 (1967), *aff'd* 402 F.2d 620 (6th Cir. 1968); Baum v. United States, 285 F. Supp. 95 (M.D. Tenn. 1968); Loflin Jr. v. United States, 19 A.F.T.R.2d (P-H) 1091 (W.D. Tenn. 1967); Ritter v. United States, 393 F.2d 823 (Ct. Cl.), *cert. denied*, 393 U.S. 844 (1968); Seth E. Keener, Jr., 59 T.C. 302 (1972); William A. Huffman, 44 T.C.M. (P-H) ¶ 74, 108 (1974); Winston E. McNutt, 37 T.C.M. (P-H) ¶ 68, 198 (1968); John C. Burns, 36 T.C.M. (P-H) ¶ 67, 237 (1967); James D. Hayes, 35 T.C.M. (P-H) ¶ 66, 123 (1966).

[50] Thomas L. Karsten, 44 T.C.M. (P-H) ¶ 75, 202 (1975).

[51] *Id.* at 75,853.

[52] *Id.*

offers made on his old home were considerably less than Karsten's cost, so Karsten persuaded his employer to purchase the home.[53] Before the closing of this sale, a third party made an offer on the home that was $14,000 less than Karsten's cost but which was acceptable to his employer in light of the promise to reimburse for loss sustained.[54] Karsten sold the home to his employer, who immediately sold it to the third party.[55] The employer, in consideration of the sale, cancelled the loan and forwarded Karsten an amount which represented the difference between Karsten's cost and the total of the cancelled loan plus the outstanding mortgage balance.[56]

The Tax Court rejected Karsten's argument that his cost was the fair market value of the home.[57] The court noted that the sale to the employer was not an arm's-length transaction in that the transfer price had no reference to the property's fair market value.[58] Instead, the court found that the subsequent sale to the third party was at the fair market value and that the difference between that price and Karsten's cost was compensation to Karsten.[59] In effect, the court disregarded the complete transfer of the home to the employer and concluded that the transfer, though in the form of a sale, was merely the performance of the reimbursement guarantee condition of the employment contract.[60]

Thus, it seems that all efforts to ease an employee's relocation by assuring him that he will not sustain a loss on the sale of his home are thwarted by the *Bradley* rule and its extensions. No arguments have prevailed against the *Bradley* rule, although they have been many and ingenious.[61]

Petitioner's Arguments

Taxpayers' arguments to avoid taxation of the home-sale loss reimbursement fall into three general categories. The first is the *Schairer* rule: that the reimbursement is merely part of the amount realized on the sale and therefore not compensation for services.[62] The second category includes petitioners' arguments that the reimbursement is a business expense for the convenience of the employer; that "but for" the move, the loss would not have been sustained, and therefore the reimbursement confers no benefit on the employee recognizable as income.[63] The third category includes petitioner's

[53] *Id.* at 75,854.
[54] *Id.*
[55] *Id.*
[56] *Id.*
[57] *Id.* at 75,856.
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *See, e.g.*, Thomas L. Karsten, 44 T.C.M. (P-H) ¶ 75,202 (1975).
[62] William A. Lull, 51 T.C. 841 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970); William A. Huffman, 43 T.C.M. (P-H) ¶ 74, 108 (1974); John C. Burns, 36 T.C.M. (P-H) ¶ 67, 237 (1967); Owen E. Harvey, 36 T.C.M. (P-H) ¶ 67, 126 (1967).
[63] William A. Lull, 51 T.C. 841 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970);.Ritter v.

arguments that the reimbursement guarantee agreement is in effect a sale of the home to the employer.[64]

Although the *Bradley* court rejected the *Schairer* rule, the case most damning to the "amount realized" argument is *Lull.*[65] In that case the petitioner's reimbursement was pursuant to a formal "home guarantee policy" of his employer, IBM.[66] The petitioner presented two arguments: first, the IBM payments were gain from the sale of the property and, under section 1001 of the Internal Revenue Code, constituted part of the amount realized; second, because he had purchased a new home at a price exceeding the adjusted basis in the old home, the payments were eligible for nonrecognition under section 1034 of the Internal Revenue Code.[67]

Strictly construing section 1001, the Tax Court analyzed the actual transaction under which the petitioner received the payments and noted that the reimbursement could not be a part of the amount realized because it was not paid by the purchaser.[68] Because the employer had not purchased the home, the payments were made pursuant to an employment contract, not a sales contract.[69] The court found that the payments were made to secure better services from the employee by relieving him of concern over the sale of the home,[70] and payments to secure better services represent compensation.[71] By this logic, the petitioner's section 1034 corollary argument was irrelevant: the payments were not part of the amount realized on the sale and they were not eligible for nonrecognition.[72]

The "business expense" argument is illogical and faulty because it assumes if an expense is deductible as necessary and ordinary to the furtherance of a business,[73] it may not be considered income to the recipient. The argument is premised on a federal district court decision[74] holding reimbursements to a taxpayer for certain living expenses and other costs incurred as a result of having been transferred by an employer were excludable from gross income.[75] That holding was reversed,[76] and courts have continually re-

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United States, 393 F.2d 823 (Ct. Cl.), *cert. denied*, 393 U.S. 844 (1968); James D. Hayes, 35 T.C.M. (P-H) ¶ 66, 123 (1966).

[64] Seth E. Keener, Jr., 59 T.C. 302 (1972); Thomas L. Karsten, 44 T.C.M. (P-H) ¶ 75,-202 (1975).

[65] William A. Lull, 51 T.C. 841 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970).

[66] *Id.* at 842.

[67] *Id.*; I.R.C. § 1001(b): "Amount Realized—The amount realized from the sale or other disposition of property shall be the sum of money received plus the fair market value of the property (other than money) received . . . ."

[68] William A. Lull, 51 T.C. 841, 849 (1969).

[69] *Id.*

[70] *Id.*

[71] Commissioner v. LoBue, 351 U.S. 243, 247 (1956).

[72] William A. Lull, 51 T.C. 841, 849 (1969).

[73] I.R.C. § 162(a).

[74] England v. United States, 226 F. Supp. 762 (S.D. Ill. 1964).

[75] *Id.* at 767.

[76] England v. United States, 345 F.2d 414 (7th Cir. 1965).

jected the business expense argument.[77] Indirect moving expenses are personal living expenses and as such are not deductible as business or travel expenses.[78]

The "employer purchaser" argument is, though imaginative, arguably specious. It attempts to equate an employee's participation in an employer's moving expense and home sale guarantee program with an equitable sale in which the employee merely retains legal title while the employer succeeds to the beneficial enjoyment of the incidents of ownership.[79] In *Keener*, the petitioner was required to execute an agreement that signified his acceptance of the terms of the reimbursement program.[80] By signing, the petitioner agreed to accept the appraisal made by his employer's real estate department, to forward the deed to his employer, and to endorse his home insurance policies to the employer as second interest loss payee.[81] In addition, petitioner was required to list his home with a real estate agent acceptable to his employer and to accept an offer only upon the employer's consent.[82] If the house remained unsold at the end of ninety days, the employer had the option to take title at the accepted appraised value.[83] The petitioner argued the home, in effect, had been sold to the employer.[84] His argument was based on the agreement clause that provided for reimbursement if the home was sold for less than the appraised value.[85] Alternatively, the agreement provided if the sale was for more than the appraised value, the excess would belong to the employer.[86]

The home was ultimately sold for less than the appraised value, and the employer never exercised the option to take legal title.[87] Previously the petitioner had received a loan from his employer for the purchase of a new home.[88] Because the proceeds were inadequate to satisfy the loan balance plus accrued interest, the bulk of the reimbursement was applied to cancel the loan.[89] On the petitioner's wage statement, his employer reported the difference between the appraised value and the actual sale price as compensation.[90] The petitioner's accountant deducted this amount and attached to the tax return a statement explaining that because petitioner had sold his house to his employer, the use of the sale proceeds and reimbursement to purchase a new home made both eligible for nonrecognition.[91]

[77] Ritter v. United States, 393 F.2d 823, 827-29 (Ct. Cl. 1968); James D. Hayes, 35 T.C.M. (P-H) ¶ 66, 123 (1966).

[78] England v. United States, 345 F.2d 414, 416 (7th Cir. 1965); I.R.C. § 262.

[79] Seth E. Keener, Jr., 59 T.C. 302, 308 (1972).

[80] *Id.* at 303.

[81] *Id.*

[82] *Id.* at 304.

[83] *Id.* at 305.

[84] *Id.* at 304.

[85] *Id.*

[86] *Id.*

[87] *Id.* at 306.

[88] *Id.* at 305.

[89] *Id.* at 306.

[90] *Id.* at 307.

[91] *Id.*

The petitioner argued:

> The agreement entered into by Keener and INA on January 8, 1966, constituted an absolute sale of the Harrisburg residence to INA because under the terms of the agreement, all of the benefits and burdens of ownership of the property passed from them to INA and petitioners retained only bare legal title, which the parties intended.[92]

Rejecting this argument, the Tax Court held that the reimbursement was compensation to induce Keener to move and to insure quality performance in his new job,[93] citing *Lull, Bradley*, and *Ritter*.[94] The court noted two weaknesses in the petitioner's argument: (1) he had paid the taxes, utilities, and upkeep on the home during the listing period; and (2) he could, by resigning, terminate the arrangement.[95] Thus, the courts will not find an employer-employee sale without a transfer of legal title.

The mere transfer of legal title, however, does not provide the employee with a safe harbor. In *Karsten* the court refused to recognize a sale even though legal title had passed because the transaction was not at arm's length;[96] rather, it was made primarily for tax avoidance purposes.[97] *Keener* and *Karsten* imply that an arm's-length transaction between an employer and an employee in which the employee sells his home at fair market value might survive the scrutiny of the courts. The danger is that a subsequent sale by the employee at a lower price to realize a loss for offsetting purposes or as a favor to an associate might be imputed to the employee.[98]

The Effects of the Bradley Rule

There is no foolproof way an employer can help his employee avoid the potential loss on the sale of a home incident to relocation without also creating a potential employee tax liability. Whether there should be a nontaxable method is debatable. The Service position that the reimbursement of the difference between the employee's cost and the actual selling price is compensation is reasonable and certainly within the logic of *LoBue*[99] and

[92] *Id.*
[93] *Id.* at 309-10.
[94] *Id.* at 308-309.
[95] *Id.* at 310.
[96] Thomas L. Karsten, 44 T.C.M. (P-H) ¶ 75, 202 (1975).
[97] *Id.* at 75, 856.
[98] The editors of Prentice-Hall suggest that a sale to an employer at a reasonable price substantiated by the appraisals of disinterested experts will minimize the risk of taxation; 2 P-H FEDERAL TAXES ¶ 7031.1, at 7026-27 (1980), but there is no case authority behind this statement. One Revenue Ruling, Rev. Rul. 72-339, 1972-2 C.B. 31, does suggest that the sale of a personal residence by a transferred employee to an employer will produce gain eligible for nonrecognition, but the ruling does not discuss the parameters of a sale, *i.e.*, when the IRS will challenge a sale as a sham intended to avoid taxation of a loss reimbursement. Therefore, the ruling is of little aid in the planning stage.
[99] Commissioner v. LoBue, 351 U.S. 243 (1956).

Duberstein.[100] However, a logical and reasonable characterization is not necessarily desirable or advisable.

The Internal Revenue Code has numerous functions other than providing government revenue. One congressional use of the Code is to influence societal behavior.[101] Consequently, any Code section or regulation should be analyzed not only for its potential to provide clarification and consistency to the revenue process but also for the behavior it will encourage or discourage. So long as a statute is constitutional, it is not the function of the courts to pass judgment on its reasonableness. Nevertheless, the absence of grounds for voiding a statute has seldom precluded courts from commenting on its soundness. In analyzing the *Bradley* rule's clarification of section 61 of the Internal Revenue Code, however, the courts have seemed loath to address the underlying purposes of the rule or its effects on individual behavior.

In *Schairer*[102] the Tax Court rejected the Service argument that a reimbursement was compensation because it determined that the employer's intent was not to compensate the petitioner for services but rather to induce him to relocate for the employer's convenience.[103] The court's conclusion that the reimbursement was part of the sale transaction[104] does not logically follow from the prior conclusion concerning the employer's intent. However, the reasoning behind the "intent analysis" has some validity and should have received more consideration from the *Bradley* court.[105] Instead, the courts have cited *LoBue*, *Duberstein*, and section 61 as inflexible mandates precluding judicial challenge of the *Bradley* characterization.

If the intent of the employer were to hide a salary payment in the guise of a loss reimbursement, then the Service argument that the payment is compensation would be appropriate. The concern that an employer might use a reimbursement guarantee as a tool to transfer dividends, bonuses, or salary to a key employee is valid, but this concern has not been voiced in any arguments in support of the *Bradley* rule. The failure to air this concern probably stems from the nature of the cases on this issue. In all the cases, *Bradley* and *Schairer* included, the facts clearly indicate the reimbursements are not a subterfuge but instead are sincere efforts by employers to relieve the employee of one of the burdens of relocation.[106] This burden should rest on the employer's shoulders when the transfer is for his convenience.

[100] Commissioner v. Duberstein, 363 U.S. 278 (1960).

[101] W. ANDREWS, FEDERAL INCOME TAXATION 4 (1969).

[102] Otto Sorg Schairer, 9 T.C. 549 (1947).

[103] *Id.* at 555.

[104] *Id.*

[105] It seems strange that courts may impute the legal owner-employer's sale of a home to the employee, Thomas L. Karsten, 44 T.C.M. (P-H) ¶ 75, 202 (1975), yet are unwilling to impute the employer's reimbursement to the third party purchaser.

[106] For example, in *Lull*, 51 T.C. 841 (1969), the reimbursement was pursuant to a nondiscriminatory moving policy available to all employees; in *Huffman*, 43 T.C.M. (P-H) ¶ 74,107 (1974), the reimbursement was pursuant to a Ford Motor Co. policy applicable to all employees who moved at the request of the employer.

The opinion in *Schairer* and the dissenting opinions in *Bradley* pierce the logic of the hard and fast *Bradley* rule, but no court since has been willing to look beyond the employer-to-employee nature of the reimbursement—if it smells like compensation, it must be. That an employee who realizes only his own cost in his residence has not improved his financial position as a result of the reimbursement is apparently irrelevant.

As a result of the *Bradley* rule, employees of companies with a reimbursement program may be presented with a Hobson's choice. This potential impact has not been considered by any court, yet its effect on society as a whole may be very detrimental. It is not uncommon for an employee to be told that he can preserve his job only by relocating. Many companies have programs to help their employees relocate by reimbursing them for moving expenses.[107] There is a statute that makes these expenses deductible and thus offsets the income realized by the reimbursement.[108] But there is no deduction to offset a company's reimbursement to an employee for what may be the greatest monetary loss sustained by a relocating employee: the loss on the sale of a home. This problem is particularly acute at the present time when high interest rates force many buyers out of the housing market. Thus, an employee declining to move gives up his position and enters the job market. An employee who elects to retain his position by moving is penalized because he is taxed on a payment that merely enables him to maintain his pre-relocation financial status quo.

The *Bradley* rule also promotes the squandering of human talent. In the first place, those who opt to resign are often unable to obtain equivalent employment. Seldom will they be able to step into a new job that demands the same level of skills utilized in their former employment.[109] Sometimes relocation is a condition to promotion. An employee who is offered a promotion has been judged by his superiors in the business hierarchy as capable of assuming greater responsibility or handling more technical work than was required by his former position. Yet the *Bradley* rule works to discourage his acceptance. If an employee declines a promotion, not only does his employer lose the opportunity to benefit from his talents, but society is denied the incremental increase in productivity that would accompany the employee's realization of his work potential. There are other factors, of course, which influence an employee's decision for or against relocation.[110] However, in the

[107] *E.g.*, in the cases discussed in this note alone—IBM, William A. Lull, 51 T.C. 841 (1969), *aff'd* 434 F.2d 615 (9th Cir. 1970); Ritter v. United States, 393 F.2d 823 (Ct. Cl.), *cert. denied*, 393 U.S. 844 (1968); E.R. Carpenter Co., Harris W. Bradley, 39 T.C. 652 (1963), *aff'd* 324 F.2d 610 (4th Cir. 1963); INA, Seth E. Keener, Jr., 59 T.C. 302 (1972); RCA, Otto Sorg Shairer, 9 T.C. 549 (1947); Ford Motor Co., William A. Huffman, 43 T.C.M. (P-H) ¶ 74, 107 (1974); Insinger Machine Co., John C. Burns, 36 T.C.M. (P-H) ¶ 67,237 (1967); Valeron Corp., Owen E. Harvey, 36 T.C.M. (P-H) ¶ 67, 126 (1967); Atlas Bradford Co., James D. Hayes, 35 T.C.M. (P-H) ¶ 66, 123 (1966). *See* MANAGEMENT REVIEW, July, 1980, 18 at 22.

[108] I.R.C. § 217.

[109] *See* AMERICAN ECONOMIC REVIEW, May 1978, at 156.

[110] *E.g.*, spouse's employment, community attachments, children's education, etc.

aggregate, the loss to society of the productivity potential of employees who reject promotions because of the *Bradley* rule may well outweigh the short term revenue benefit.

Proposed Changes

The courts are inappropriate places to consider the sociological arguments against the *Bradley* rule. The Internal Revenue Code is statutory, and therefore the courts are limited in what they can do to remedy an arguably unjust characterization of home loss reimbursement as compensation. Congress and the Internal Revenue Service are the proper forums. Following are three suggestions, any of which could work to eliminate or lessen the punitive effect of the *Bradley* rule on the employee and its consequential societal detriments:

1. *I.R.S. Regulation—Income: Employer's Purchase of Transferred Employee's Principal Residence*

As a minimum, the Treasury Department should issue a regulation authorizing the treatment of the proceeds of a sale of a relocated employee's home as amount realized if the employer purchased the home, regardless of a subsequent sale by the employer. The regulation should, of course, be limited to employees transferred for their employers' convenience and should require two independent expert appraisals to determine the value of the house. Such a regulation would eliminate the ambiguities presented by Revenue Ruling 72-329 and *Karsten.*[111]

2. *I.R.S. Regulation—Income: Reimbursement Pursuant to a Home Guarantee Program*

The remedial effect of the first proposal is weakened because few employers are financially able or willing to purchase employee homes. On the other hand, home guarantee programs like those in the above discussed cases are common. Consequently, an alternative regulation could provide that reimbursement for a loss sustained on a home sale necessitated by either a transfer for the convenience of the employer or for new employment shall be considered part of the amount realized on the sale. A provision in the regulation requiring the sale to be an arm's-length transaction could protect the employer, as well as prevent an employee from thwarting gift tax statutes. Further provisions could detail the form of basis substantiation necessary to enjoy this treatment.

This proposed regulation allowing for amount realized characterization to the basis-proceeds difference reimbursement, rather than the appraised value-proceeds difference, would enable the employee to maintain his dollar status quo, although not his real financial position (inasmuch as inflation may have altered the value of his invested dollars). An alternative would be

[111] Thomas L. Karsten, 44 T.C.M. (P-H) ¶ 75, 202 (1975).

to grant this characterization to the reimbursement for the appraised value-proceeds difference. This alternative would allow the employee to realize his appreciation despite the imposition of a relocation time deadline by the employer because the employee would not be forced to adjust his price downward for a quick sale. A provision that the appraisals be made by independent expert appraisers would be appropriate. Both provisions could be adopted as alternative options allowing the employee to avoid the vagaries of a fluctuating economy.

3. *Code Section: Deduction of Loss on Sale of Principal Residence Conditioned on Reinvestment of Any Employer Reimbursement*

Congress could enact a new code section similar to section 217 of the Internal Revenue Code.[112] The section would create a deduction for the loss on the sale of a principal residence sustained by a person relocating to obtain or to continue employment. The section's application could be conditioned on several factors:

a. That the distance and durational requirements of section 217[113] be met;
b. That the relocation be for the convenience of the employer;
c. That any reimbursement from the employer for this loss be reported as ordinary income and also be used for the purchase of a new principal residence within three months of the sale of the old principal residence;
d. That the home purchased must equal or exceed in price the total of the proceeds from the sale of the prior residence plus the reimbursement;
e. That the amount of the deduction and reimbursement eligible for section 1034 treatment not exceed the difference between the average value of the residence as determined by not less than two nor more than four independent expert appraisers and the net selling price of the residence in an arm's-length transaction; and
f. That if the employee is reimbursed by his employer and does elect to take the deduction by using the reimbursement to purchase a new residence, his basis in the new residence shall be the price of the new home less the amount of the reimbursement, *i.e.*, section 1034 treatment of the reimbursement.

This section would represent a compromise between the *Schairer* rule and the *Bradley* rule. A person who is not reimbursed by his employer would not be penalized by his employer's decision to transfer the employee because the deduction would still be available to help defray a loss. A person who

[112] I.R.C. § 217 provides that certain moving expenses are deductible.

[113] To be eligible for the deduction, a person's new place of employment must be at least 35 miles farther from his former residence than was his old place of employment and he must work full time at the new job for 39 consecutive weeks in the next 12 months. I.R.C. § 217(c).

does not elect to purchase a new residence would receive no deduction and his reimbursement would be characterized as ordinary income. A person who elects to purchase a new residence would not be immediately taxed on the reimbursement but would instead be able to defer that tax until a subsequent residence sale without a rollover of the proceeds into a new residence.

Conclusion

A person who must sell his personal residence in order to obtain or to continue employment is often backed into a corner by the Internal Revenue Code as it is now construed. Frequently, he must take a loss on the sale, either because he has a limited time in which to complete the sale and report to work, or because the market is deflated at the time he must sell. The Internal Revenue Code designates this a noncasualty personal loss for which there is no deduction,[114] even though the pressure to move is applied by his employer. If the employer reimburses the employee, the *Bradley* rule characterizes the reimbursement as ordinary income.[115]

Unless the employee receives a substantial salary increase for moving, the inflated price of homes, the inability to avoid immediate taxation on the reimbursement, and the loss on the sale of the home combine to present him with an unenviable choice: he may increase his level of personal indebtedness to purchase a new residence of comparable value; he may purchase a residence of lesser value; or he may elect not to purchase a new home. In effect, the Service's taxation of the reimbursement denies the employee the opportunity to realize the full appreciation in the value of his home and reinvest this appreciation in a new residence without taxation.

Section 1034 of the Internal Revenue Code allows others who sell their homes to reinvest the realized appreciation without immediate taxation. Consequently, a person who relocates at the request (or demand) of his employer is penalized. This should not be a result of the Code. There is no doubt that *Bradley* is consistent with the earlier cases of *LoBue* and *Duberstein*, which define income. Perhaps Congress should recognize that this definition often spawns injustices and should set more definite parameters on the definition. One such delineation should involve the reimbursement by an employer to an employee of the loss sustained on the sale of the employee's residence when he is required to relocate to preserve his job.

Douglas M. Rather

114 I.R.C. § 165(c)(3).
115 Harris W. Bradley, 39 T.C. 652, 655 (1963).