LOCATION OF TAX HOME DETERMINES TRAVEL EXPENSE DEDUCTIBILITY

Meal and lodging expenses incurred while working away from one's tax home are deductible, but in some situations, the tax home is wherever the job is—putting deductions out of reach.

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Section 162(a) allows individuals to deduct all the ordinary and necessary expenses incurred while carrying on a trade or business. This includes travel expenses incurred while "away from home" in the pursuit of a trade or business. For purposes of this provision, the term "home" has been interpreted by the IRS and courts to mean, generally, the taxpayer's "place of business, employment, or the post or station at which he is employed, in the prosecution, conduct, and carrying on of a trade or business." Thus, the location of the individual's "tax home," rather than the location of the taxpayer's personal residence, is usually the relevant factor in determining whether travel expenses are deductible. This interpretation gradually evolved into what is now referred to as the "tax home doctrine."

While at first glance the definition of tax home may appear rather straightforward, in some situations its application has been problematic. For example, courts have wrestled with the definition when dealing with taxpayers who, because of the nature of their profession, do not have a regular place of business, such as taxpayers with multiple temporary assignments in various locations, and taxpayers with more than one regular place of business.

Identifying one's "tax home"

The first step in determining the deductibility of travel expenses is to identify the location of the taxpayer's tax home. If the taxpayer has one regular or main place of business, that place is considered the taxpayer's tax home. If a taxpayer has more than one regular place of business, it is necessary to determine which one qualifies as the principle place of business. In other situations, additional analysis is needed to ascertain whether the taxpayer has a tax home, and if so, its location.

The answer to the question of whether a taxpayer has a tax home at all essentially turns on whether the taxpayer has a "regular place of abode in a real and substantial sense." While both the courts and the IRS recognize that this determination is inherently subjective and purport to favor a "facts and circumstances" analysis, in practice they tend to rely heavily on the following, more objective, three-factor threshold test fashioned by the IRS in Rev. Rul. 73-529 :

> (1) Whether the taxpayer performs a portion of his or her business in the vicinity of the claimed abode and uses such abode (for purposes of his or her lodging) while performing business there.

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

Under this ruling, taxpayers meeting all three factors are deemed to have a tax home at the place they regularly live. Taxpayers meeting only two of the three tests fall outside of the ruling's safe-harbor and need to proceed further to the more subjective “facts and circumstances” test. Finally, taxpayers meeting only one test are considered itinerants (i.e., individuals with no permanent personal residence). Since itinerants do not have tax homes, they cannot satisfy the “away from home” requirement of Section 162(a)(2) . Consequently, they may not deduct any amounts incurred for travel expenses.

In general, the determination of whether a taxpayer has a tax home or is an itinerant basically focuses on “(i) the business connection to the locale of the claimed home; (ii) the duplicative nature of the taxpayer's living expenses while traveling and at the claimed home; and (iii) personal attachments to the claimed home.” Many courts have chosen to forego a more subjective analysis and instead employ the objective test of Rev. Rul. 73-529.

Temporary versus indefinite

Taxpayers hoping to qualify under the “personal residence as tax home” exception, discussed above, need to be aware of one other potential problem area. The exception is applicable only when the taxpayer's work assignments are temporary in nature rather than indefinite. If an assignment is deemed indefinite, the location of the assignment becomes the taxpayer's tax home, and any travel expenses related to it are disallowed. In addition, the longer a taxpayer works outside the general vicinity of the personal residence, the more likely his or her motives for maintaining the residence will be deemed personal in nature rather than business. Accordingly, the taxpayer will no longer be able to meet the business motive requirement of Rev. Rul. 73-529 .

One-year test

What threshold distinguishes “temporary” from “indefinite”? The IRS has long opted for a bright-line rule of one year, while the Tax Court traditionally was consistent in its refusal to embrace such a rule, preferring instead to use an "all facts and circumstances" approach. Congress then enacted legislation to reconcile these differing approaches. Effective for years beginning after 1992, Section 162(a)(2) was amended to require that employment away from home that actually exceeds one year be treated as indefinite, and any travel expenses related to the employment whether within or outside the one-year period are disallowed.

Subsequent to the amendment of Section 162(a)(2) , the disparity between the IRS and Tax Court is an issue for only situations that do not fit squarely within Section 162(a)(2) (e.g., periods lasting one year or less). The IRS reiterated its position,

which is contained in Rev. Rul. 93-86, by outlining several scenarios involving employment away from home in a single location:

> (1) Work in a location that is realistically expected to last (and does in fact last) for one year or less is treated as temporary in the absence of facts and circumstances indicating otherwise.
> (2) If it is realistically expected to last for more than one year or there is no realistic expectation that the employment will last for one year or less, the assignment will be treated as indefinite, regardless of whether it actually exceeds one year.
> (3) A position that initially is realistically expected to last for one year or less, but at some later date the employment is realistically expected to exceed one year, will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's realistic expectation changes.

Indefinite duration

The courts have refused to apply such a mechanical one-year rule when trying to ascertain whether an assignment is temporary or indefinite. Instead the courts have opted for a more subjective approach by looking at all the facts and circumstances, such as the nature of the job and the taxpayer's reasonable expectations about the duration of the employment. While this approach affords more flexibility to the taxpayer, it also creates substantial uncertainty, especially given the discretionary terms used by the courts to resolve the issue. Thus, case law prior to 1993 is still relevant.

For instance, the court in *Mitchell* defined employment as being temporary if it is *foreseeable* that it will last for a *reasonably* short period. Similarly, courts have held that employment that is not permanent in nature is nonetheless deemed indefinite unless it is foreseeable that it will end within a short period.

In *Peurifoy,* the court stated, “No single element is determinative of the ultimate factual issue of temporariness, and there are no rules of thumb, durational or otherwise.” In addition, employment, which starts out as temporary, may become indefinite if circumstances change.

The Ninth Circuit, in *Harvey*, attempted to formulate its own test, later referred to as the “*Harvey* test.” In this case, the court stated, “An employee might be said to change his tax home if there is a reasonable probability known to him that he may be employed for a long period of time at his new station.” The Service, however, has been steadfast in its refusal to follow the *Harvey* test.

Multiple temporary assignments

Taxpayers who, because of the nature of their field, work at multiple temporary assignments in various locations are entitled to deduct related travel expenses, assuming the taxpayer passed the two threshold tests discussed previously. First, the taxpayer must have a tax home even though the taxpayer does not have a regular place of business, and second, the assignments must be temporary rather than indefinite in nature.

For example, in Rev. Rul. 71-247, the Service addresses the following scenario. A taxpayer is employed by a construction company that does business in 12 states. The taxpayer receives his assignment from his employer's regional office. The taxpayer does not live in the general vicinity of the regional office and does not travel to the office. The taxpayer does, however, live with his family and maintain a home in a city within the 12-state area.

The Service concludes that, based on these facts, the taxpayer's tax home is where his personal residence is located. In addition, the Service advises that the taxpayer may deduct the costs of traveling away from that home for business purposes, as long as the period away from home is of sufficient length to require a stop for rest.

Two additional examples are the relatively recently decided twin cases involving two brothers. The taxpayers in both cases were employed by a pipeline construction company and spent most of their time traveling around the country working on various projects. When one project was finished, they would usually be immediately assigned to another in a different location. Both claimed travel expenses on their individual tax returns.

The brothers were part owners of an ancestral home in Vallejo, California, and would occasionally stay at the home or in a trailer near the home. The home was occupied by their sister, who was disabled. Jason, one of the brothers, contributed money to the household to cover his expenses while he was staying there. Manuel, the other brother, paid some bills for his sister—including, occasionally, the property taxes on the home.

The IRS challenged the deduction for travel expenses, and the Tax Court held for the IRS. In reaching its conclusion, the court first noted that because the taxpayers did not have a primary place of employment, it would be necessary to determine whether one or both of them had a permanent place of residence that could be treated as a tax home.

The court also noted that while subjective factors should be considered, it and other courts have generally focused on more objective factors. Although the court did not directly mention Rev. Rul. 73-529, it was clear from the court's analysis that the spirit of the Ruling was being employed, and that the court believed the taxpayers had not satisfied the first factor of the test relating to business connection, or the second factor relating to duplicative expenses.

With respect to the business connection requirement, the court found that the taxpayers' connection to the home was based on personal rather than business motives (e.g., caring for their disabled sister). In addition, the court construed the monetary outlays related to the home as financial support for the sister rather than costs of maintaining the home. Consequently, the court held that the Vallejo home was not the tax home of either taxpayer. As a result, the taxpayers had no home to be away from (i.e., they were itinerants, and could not satisfy the requirements of Section 162(a)(2)).

A similar objective analysis was used in another case, *Henderson.* This case involved a taxpayer who spent most of 1990 on the road working for Walt Disney's World of Ice, a traveling ice show. The issue was whether the taxpayer's parents' home in Boise, Idaho, could qualify as the taxpayer's tax home.

The taxpayer lived at the Boise home when he was between shows. He was registered to vote in Idaho, had an Idaho driver's license, kept most of his possessions at the home (including his dog), and paid Idaho state income taxes. On the other hand, the taxpayer had no ownership interest in the home, paid no rent, and contributed very little to the home financially. The taxpayer did contribute some labor with respect to maintaining and improving the home.

Notwithstanding the taxpayer's ties to Boise, Idaho, the court held that the taxpayer did not have a tax home for purposes of deducting travel expenses. The court found that the taxpayer's reasons for staying at the home were personal rather than necessitated by business reasons. In addition, the court found that while the taxpayer's expenses may have been higher because of his business (i.e., traveling rather than living with his parents), they were not duplicative. Consequently, the Boise home could not qualify as the taxpayer's tax home, and the travel expenses were disallowed.

A case that employed the objective three-factor test, to the benefit of the taxpayer, was *Johnson.* It dealt with a taxpayer who traveled worldwide pursuant to his employment as the captain of a vessel. The vessel would occasionally sail in the general vicinity of Freeland, Washington, the taxpayer's area of residence. The taxpayer's employer provided him with meals and lodging, but the taxpayer was not reimbursed for his incidental travel expenses and deducted them on his personal income tax return. The IRS's denial of the deductions was based, in part, on the Service's view that the taxpayer lacked a tax home. The court disagreed with the IRS and deemed the taxpayer's place of residence to be the taxpayer's tax home.

In reaching its decision the court recognized that the facts were different from the previously decided *Henderson* case discussed above. The court noted that unlike the taxpayer in *Henderson*, Mr. Johnson had both an ownership interest in his home and paid a significant amount of the expenses related to the home. The court also found that the taxpayer had legitimate business reasons for maintaining the residence.

The IRS, relying on Rev. Rul. 73-529, countered that because the taxpayer's employer provided the taxpayer with meals and lodging, the duplicative expense requirement of the ruling was not satisfied. The court, while reminding the IRS that revenue rulings are not binding on it, stated that the duplicative requirement was satisfied because, had the taxpayer not been provided meals and lodging by his employer, the taxpayer would not have been able to avoid incurring duplicative expenses. The court contended that the tax home determination should not hinge on the type or extent of the employee compensation package provided to the taxpayer, or whether the benefits are excludable from the taxpayer's gross income.

Taxpayers with multiple businesses

As discussed previously, some taxpayers face the problem of not having a regular place of business. This section focuses on taxpayers with the opposite problem: more than one regular place of business. For them the pertinent question is, which business qualifies as the principal place of business.

While this determination is factual in nature and must be assessed case by case, when dealing with the issue, the courts have long opted for an objective rather than subjective test. Generally, courts employ some version of a three-factor test, known

as the “*Markey* test” named for the case in which the test was created, to identify the principal place of business. Using this test, the courts will, for each location, assess:

(1) The total time spent on business by the taxpayer in the location.
(2) The total business activity engaged in the area.
(3) The income generated by the business activities.

For example, for a taxpayer earning $40,000 working in Cincinnati for eight months and $15,000 working in Miami for four months, Cincinnati will be considered the taxpayer's main place of work.

In *Markey*, the taxpayer retired from General Motors and started a consulting business where he lived in Ohio. A year later he entered into an arrangement with General Motors under which he would work five days a week, 50 weeks per year, in Michigan. Each weekend the taxpayer commuted to Ohio and while there would attend to his other business interests, including his consulting business, two farms, and the rental of several real estate properties. The income generated by these business activities was small relative to the income generated by the taxpayer's employment with General Motors.

The taxpayer deducted the costs of traveling between Michigan and Ohio, and the IRS disallowed the deductions. The Tax Court held in favor of the taxpayer, and the IRS appealed the decision to the Sixth Circuit. In reaching its decision, the Tax Court disregarded the relative amount of time spent and income generated by the activities. Instead, the Tax Court focused on which business was “more important” to the taxpayer.

The Sixth Circuit, after engaging in an extensive review of both its own case law and that of other circuits, reversed the Tax Court decision. Pursuant to its finding that the lower court had inappropriately employed a subjective test to assess which of the taxpayer's businesses qualified as the principal business, the Sixth Circuit fashioned its own objective three-factor test discussed above.

The results of the *Markey* test can be costly for the taxpayer because only the travel costs relating to being away from the main place of business are deductible. For example, in *Fisher*, the taxpayer lived on a ranch that he operated as a business, but also worked as a musician for an orchestra. Pursuant to his employment with the orchestra, the taxpayer traveled to multiple cities. While the taxpayer spent relatively more time at the ranch, the majority of the taxpayer's income came from his employment as a musician. The court held that, under the *Markey* test, the ranch, while a business, was secondary in nature to the taxpayer's principal employment with the orchestra. As a result, the court denied the taxpayer's deductions for travel between the ranch and orchestra assignments.

Conclusion

Determining whether a taxpayer has a tax home and determining the location of the tax home is fraught with difficulties when the taxpayer does not neatly fit within the “one regular or main place of business” category. Accordingly, practitioners and taxpayers should be cognizant of the law in the area and plan ahead to ensure, to the extent possible, the classification most advantageous to the taxpayer. As

discussed, this can often be a difficult task given the divergent views of the meaning of terms such as “foreseeable,” “reasonable probability,” “business connection,” “duplicative expenses,” and “temporary versus indefinite.”

PLANNING TIP

Taxpayers without one regular place of business, including taxpayers with multiple temporary assignments, can follow certain strategies to strengthen their entitlement to travel expense deductions. For example, taxpayers can support the primary residence as tax home notion by documenting duplicative expenses and consistently looking for permanent work in the area. In addition, it is important to document a continuing connection with the residence location by establishing and maintaining bank accounts, having a current driver's license, registering to vote, and paying state income taxes.

With respect to the temporary versus permanent distinction, the taxpayer's intent and beliefs at the inception of the employment are crucial. The taxpayer should document any relevant factors that will support the taxpayer's belief that the employment was for a limited period, not to exceed one year.

Taxpayers with multiple businesses want to consider the effect of which business qualifies as the principle place of business. Given the objective nature of the *Markey* test, taxpayers with more than one business are well advised to be familiar with its requirements before deducting any travel-related expenses.