Office of Chief Counsel
Internal Revenue Service

memorandum

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SSCanavello

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to: Mia Sylve, Senior Tax Specialist
Taxpayer Education and Communication

from: Associate Area Counsel
(Small Business/Self-Employed:Area 3)

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subject: **Advisory Opinion -- Deduction of Per Diem by Mariners**

This memorandum responds to your request for assistance received May 15, 2002. This memorandum should not be cited as precedent.

ISSUE

To what extent are mariners allowed to claim expense deductions without written substantiation following the Tax court's opinion in Johnson v. Commissioner, 115 T.C. 210 (2000).

CONCLUSION

Mariners who incur only incidental expenses are limited to the incidental expense portion of the federal M&IE rate if they choose to use that method of reporting in lieu of actual expenses. Mariners who choose to report actual expenses, although they do not have to introduce written receipts for expenses under $75, nevertheless must substantiate the actual amounts incurred for incidental expenses claimed.

DISCUSSION

You have requested that we examine the effect of the Johnson opinion on mariners' rights to claim miscellaneous itemized deductions for expenses. During the recent filing season, the Service received numerous inquiries regarding "tax breaks for mariners" based upon the interpretation of this case stated in

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materials distributed by [redacted] of [redacted] California. [redacted] is advising mariners that, based upon the Johnson opinion, they may claim "an almost unlimited amount of travel deductions while working away from home, without ever having to show the IRS any receipts ...."

The *Johnson* Opinion

On September 15, 2000, the Tax Court issued its opinion in Johnson v. Commissioner, supra. The facts in that case may be summarized as follows. The taxpayer was a merchant seaman captain who sailed worldwide during the tax years at issue, but maintained a residence for his family in Freeland, Washington. The taxpayer's employer provided him lodging and meals without charge while he worked on the vessel. The taxpayer paid his other (incidental) travel expenses.

The taxpayer reported incidental travel expenses as miscellaneous itemized deductions, using the full federal meal and incidental expense ("MI&E") per diem rate to calculate the deduction. Petitioner had no receipts for his incidental travel expenses.

Respondent argued that petitioner was not entitled to any deduction based on the federal per diem rates, because 1) he had no tax home for purposes of I.R.C. § 162(a); 2) his oral testimony, standing alone, was insufficient to prove that he actually incurred the expenses; and 3) he may not use the revenue procedures allowing use of applicable per diem rates because they do not apply when only incidental expenses are incurred.

The Service's position that petitioner had no tax home was based on the argument that he did not incur duplicative living expenses and therefore had no tax home. The Tax Court held that his residence in Washington was his tax home, because he incurred substantial living expenses in maintaining his personal residence.

The Tax Court also did not agree that petitioner had failed to establish that he paid incidental expenses during his employment. The Court found his testimony credible and pointed out that it had gone unchallenged by respondent's counsel. The Court further explained that petitioner need not introduce actual receipts of incidental expenses because he could rely on the revenue procedures which allow deduction of a set amount in lieu

of keeping written records. The Court found that the ship's schedule introduced by petitioner met the time, place and business purpose requirements of I.R.C. §274(d) as to incidental expenses. The Tax Court held that, although petitioner may use the applicable federal per diem rates in lieu of actual expenses, his use of the M&IE rates is limited to the incidental expense portions of these rates under the federal travel regulations (41 C.F.R. §§ 301 et seq.).

The Court held that petitioner was entitled to use the revenue procedures, even where he incurred only incidental expenses. The Court did not agree, however, with petitioner's use of the full per diem rate. The federal travel regulations, which are incorporated by reference in the revenue procedures, provide that the applicable M&IE for federal travelers is reduced where the employer provides meals at no charge. Applying this approach, the Court allowed petitioner to deduct only the incidental expense portions of the federal M&IE rate.

The Court then pointed out that petitioner need not limit his deductions to the incidental expense portions of the M&IE rates, if he chooses to claim actual expenses. In order to claim actual expenses, petitioner must meet all substantiation requirements, especially the written documentation of amounts. Under Notice 95-50, 1995-2 C.B. 333, superseded in pertinent part by Treas. Reg. § 1.274-5(c)(2)(A)(iii)(2), written documentation is not required for expenditures under $75 incurred after October 1, 1995 (prior to that date the limit was $25).

At footnote 11, the Court states that "the record does not allow us to apply either of these provisions [i.e., the $25 or $75 rules]. In particular, we note that petitioner has not specified the dollar amounts which he actually paid for any of the incidental expenses."

Thus, although the Court acknowledged the possibility of petitioner claiming more than the incidental expense portions of the M&IE rates, using an actual expenses approach, the Court also specifically stated that the information provided by petitioner was not sufficient to allow actual expenses without receipts.

The Applicable Law

An individual may deduct all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. I.R.C. §162(a). Services performed by an employee constitute a trade or business for this purpose, and ordinary and necessary expenses generally include amounts which an employee pays while traveling away from home in connection with his or her

employment. I.R.C. §162(a)(2). A taxpayer may not deduct travel expenses attributable to personal, living or family expenses. I.R.C. §262.

A taxpayer also may not deduct travel expenses unless he either 1) complies with the substantiation requirements of §274(d), or 2) fulfills criteria set forth by the Service as to "de minimis" expenses. I.R.C. §274(d); Treas. Reg. §1.274-5T(j), which authorizes the Service to provide rules under which taxpayers may deduct a set amount in lieu of substantiation for meals while traveling away from home.

Under section 274(d), the taxpayer must substantiate "by adequate records or by sufficient evidence corroborating the taxpayer's own statement" the amount, time, place, and business purpose of the expense claimed. Section 274(d) further provides that the Service "may by regulations provide that some or all of the requirements ... shall not apply in the case of an expense which does not exceed" a prescribed amount. Such rule is found at Treas. Reg. §1.274-5(c)(2)(A)(iii)(2), which provides that documentary evidence such as "receipts, paid bills or similar evidence sufficient to support an expenditure" is not required for expenditures of less than $75. Notice 95-50 is consistent with this regulation.

The "de minimis" guidelines, for use in lieu of substantiating actual expenses, have been set forth in the following Revenue Procedures, covering the stated periods:

Rev. Proc. 2001-47	01/01/02 to Present
Rev. Proc. 2000-39	01/01/01 to 12/31/01
Rev. Proc. 2000-9	01/01/00 to 12/31/00
Rev. Proc. 98-64	01/01/99 to 12/31/99
Rev. Proc. 97-59	01/01/98 to 12/31/98
Rev. Proc. 96-64	01/01/97 to 12/31/97
Rev. Proc. 96-28	04/01/96 to 12/31/96
Rev. Proc. 94-77	01/01/95 to 03/31/96
Rev. Proc. 93-50	01/01/94 to 12/31/94
Rev. Proc. 93-21	03/12/93 to 12/31/93
Rev. Proc. 92-17	01/01/92 to 03/11/93
Rev. Proc. 90-60	01/01/90 to 12/31/91
Rev. Proc. 89-67	01/01/89 to 12/31/89

Rev. Proc. 89-67 provided that "the amount of ordinary and necessary business expenses of an employee for lodging, meals and/or incidental expenses incurred while traveling away from home will be deemed substantiated ... when ... [the employer] provides a per diem allowance" to the employee equal to the applicable M&IE rate.

Starting with Rev. Proc. 90-60, each superseding revenue procedure reiterates this rule, and also provides that an employee not subject to a travel allowance who incurs traveling expenses while employed away from home may "use [the applicable M&IE rate or rates] in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home." Rev. Proc. 90-60.

Under these revenue procedures, the federal per diem rate is defined as the sum of the federal lodging expense rate and the federal meal and incidental expense (M&IE) rate for the locality of travel. All of these rates are to be applied in the same manner as applied under the Federal Travel Regulations.

A taxpayer need not produce receipts to use this "deemed substantiated" method. However, a taxpayer may choose instead to deduct actual allowable expenses if he or she had adequate records or other supporting documentation.

The Aftermath of *Johnson*

On the same day it decided Johnson, the Tax Court also issued its opinion in Westling v. Commissioner, T.C. Memo. 2000-289. Westling involved facts similar to those in Johnson, except that the mariner was a tugboat captain, and followed the holding in Johnson that the petitioner's deduction was limited to the incidental expense portions of the applicable M&IE rates. The Tax Court did not discuss the actual expense alternative and the "$75 rule" in the Westling opinion.

We believe that Johnson limits the deduction of "deemed substantiated" incidental expenses to the incidental expense portion of the federal M&IE rate(s) for CONUS or OCONUS.[1] Further, although the Tax Court recognized the taxpayer's right to claim actual expenses in lieu of taking the per diem rate, it also specifically recognized the requirement that the taxpayer adequately substantiate the amount of such expenses.

While each "mariner" case will turn on its own facts, it generally appears that the advice being disseminated by [redacted] is misleading, although carefully worded so as to make no outright misrepresentations of the holding of Johnson. Whether a particular mariner is entitled to deductions, and in what amount, will depend upon whether he has a tax home; whether he received

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[1] CONUS refers to localities within the continental United States; OCONUS refers to localities outside the continental United States.

per diem or not, and for what type of expenses (i.e., meals only, incidentals only, neither, or both); and of course, what type of substantiation he or she can provide to support the expenses claimed.

Where meals are included in the per diem being allowed, the deduction is subject to the 50% limitation of I.R.C. §274(n). The taxpayers in Johnson and Westling both applied this limitation to the meals claimed, but not to the incidental expenses. The Court stated at footnote 10 of Johnson that it agreed the taxpayer should be allowed "a deduction of the entire amount of the M&IE rates which are attributable to incidental expenses."

A taxpayer who does not receive a per diem allowance, and could therefore rely on the "deemed substantiated" provisions of the revenue procedures, may choose instead to claim actual expenses. If the taxpayer so chooses, the "deemed substantiation" provisions do not apply and the taxpayer is subject to the full substantiation requirements of Treas. Reg. § 1.274-5.

If you have any further questions, please contact Senior Attorney Susan Canavello at (504) 558-3114.

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