

SEP 28 1998

CC:EL:CT-113920-98
MDPalmer

MEMORANDUM FOR DIRECTOR, NATIONAL OPERATIONS DIVISION

FROM: Barry J. Finkelstein (Sgd) Barry J Finkelstein
Assistant Chief Counsel (Criminal Tax) CC:EL:CT

SUBJECT: Request for Legal Opinion on the Taxability of Travel
Expenses of Special Agent Assigned to Undercover
Operation for Period in Excess of One Year

We are writing in response to your memorandum dated July 1, 1998, wherein you asked whether the per diem paid to a special agent assigned, but not formally detailed, to an undercover operation away from his home district for a period exceeding one year constitutes taxable income to the special agent pursuant to I.R.C. § 162(a).

This is a matter within the purview of Field Service and we sought their advice on this matter. By memorandum dated September 14, 1998, copy attached, they informed us that under the facts provided, and assuming the agent is a federal employee investigating a federal crime, having received certification for the Attorney General or her designee that the Federal employee is traveling on behalf of the United States in a temporary duty status to investigate a federal crime, their conclusion is that the agent's expenses are deductible and therefore, under their analysis, the reimbursements should not be included in the agent's income.¹ See I.R.C. §§ 61, 62 and 162(a).

¹ You will notice the memorandum raised an issue as to whether the arrangement in this case constituted an "accountable plan." We contacted EBEO regarding this issue and they stated that without reviewing the plan itself, they could not opine as to whether the plan was "accountable" or "nonaccountable." They did state, however, that it is extremely likely that the Service has set up an "accountable plan." They looked at whether the plan was being operated in an accountable manner as to the "travel expenses" in question. In this regard, they noted there must be a business purpose, substantiation, and return of excess reimbursement. With regards to the business purpose of the "travel expenses," if the travel expenses are deductible as trade or business expenses under I.R.C. § 162, the plan is being operated in an accountable manner.

EBEO noted that the facts indicated the travel expenses will not be deductible as the employee has been away from his home for over one year, unless the employee has received proper certification under I.R.C. § 162(a) that he has been traveling on behalf of the United States in temporary duty status to investigate or provide support services for in the investigation of a Federal crime.

PMTA : 00309

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Should additional questions arise regarding this matter, please feel free to contact Michele D. Palmer at (202) 622-4470.

Attachment

Internal Revenue Service
memorandum

date: SEP 14 1998

to: Assistant Chief Counsel (Criminal Tax) CC:EL:CT
Attn: Michelle Palmer

from: Assistant Chief Counsel (Field Service) CC:DOM:FS:

subject: Taxability of Per Diem Paid to an Undercover Agent on Assignment
For Period in Excess of One Year

This responds to your July 14, 1998, request for our views on whether per diem paid to a special agent assigned to an undercover operation away from his home district for a period exceeding one year constitutes taxable income to the agent.

The special agent has been assigned, but not formally detailed, from his district to another district since July of 1997. The agent is assisting in an ongoing criminal investigation in an undercover capacity. While on the undercover assignment, the agent lives in an undercover apartment in the other district. He receives per diem that covers all of his expenses except lodging. He travels back to his home on weekends, unless the assignment requires him to be elsewhere. The agent has no assignment other than the long-term undercover assignment.

You have asked if the per diem constitutes taxable income to the agent under section 162(a). Although the issue of whether the income is taxable to the agent turns on the deductibility of the payments under section 162(a), section 162(a) does not in itself operate to exclude the per diem from adjusted gross income. Thus, the inquiry begins not with section 162, but with sections 61 and 62, which define gross income and adjusted gross income.

Section 61 defines gross income as "all income from whatever source derived." Thus, under section 61, reimbursements for employee business expenses are included in gross income. Under section 62(a)(2), however, reimbursed employee business expenses, including expenses deductible under section 162(a), are deductible from gross income. Thus, if a taxpayer incurs reimbursed expenses that are deductible under section 162(a), there is no net result to his taxable income. This is so because the reimbursements are included in income under section 61, and then deducted from gross income under section 62(a)(2)(A) to determine adjusted gross income. Furthermore, in such situations, the regulation may operate to exclude the reimbursements from income. In this regard, the

regulations provide that expenses reimbursed to an employee under an "accountable plan" are excluded from the employee's gross income. Treas. Reg. § 1.62-2(c)(4). Whether an arrangement constitutes an "accountable plan" is an issue under the jurisdiction of EBEO.

Here, we assume that the reimbursements to the agent meet the regulatory requirements for exclusion from income. The only issue is whether the agent's expenses are deductible under section 162(a). Under section 162 (a)(2) ordinary and necessary traveling expenses incurred while away from home in pursuit of a trade or business are deductible. However, section 162(a) further provides a taxpayer "shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year." Under this provision, the agent in question here would not be temporarily away from home for purposes of section 162(a)(2) during his undercover assignment, his expenses would therefore not be deductible, and the reimbursement would in turn be included in his income.

Nevertheless, as you note, Section 1204 of the Taxpayer Relief Act of 1997, Public Law 105-34, added the following sentence to section 162(a):

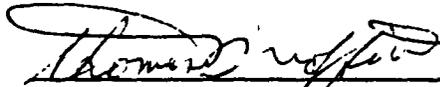
The preceding sentence [the so-called one-year rule] shall not apply to any Federal employee during any period for which such employee is certified by the Attorney General (or the designee thereof) as traveling on behalf of the United States in temporary duty status to investigate, or to provide support services for the investigation of, a Federal crime.

The Service has issued no guidance on this addition to section 162(a). Nonetheless, we see no reason why the addition would not apply to the special agent. We assume that the special agent is a Federal employee and that the criminal investigation involves a Federal crime or crimes. Furthermore, according to the legislative history, the statutory addition was enacted because "it would be inappropriate if [the one-year rule] were to be a hindrance to the investigation of a federal crime." H.R. Report No. 105-148, at 559 (1997). Requiring undercover agents to pay income tax on reimbursements of expenses incurred would probably hinder the investigation of Federal crimes, in that agents might be reluctant to undertake such duties if the undertaking would result in a tax on amounts paid to reimburse them for their expenses. Accordingly, under the facts you have provided, and assuming the agent is a federal employee investigating a federal crime, we conclude that the agents expenses are deductible and that therefore, under the above analysis, the reimbursements should not be included in the agent's income.

We note that the addition to section 162(a) requires that the Attorney General or her designee certify that the Federal employee is traveling on behalf of the United States in a temporary duty status to investigate a federal crime. The Secretary of the Treasury has been delegated the authority to make the required certification. Although the Service has requested that the Secretary redelegate this authority to the Commission, we understand no action has been taken on this request. Thus, we are unable to provide further advice on certification procedures.

We also note that modification of section 162(a) is effective for amounts paid or incurred for taxable years ending after the date of enactment of the Taxpayer Relief Act. Since the Act was enacted in 1997, the addition was effective for the taxpayer's 1997 tax year.

If you have additional questions, or need further information, contact Michael Nixon at 622-7920.



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