

## Deductions for Travel

Section 162 allows a deduction for all the ordinary and necessary expenses paid or incurred in carrying on a trade or business. One of the items listed in Section 162 is travel expenses while away from home engaging in trade or business activities, other than amounts that are lavish or extravagant. Many issues related to travel and commuting expenses are revisited regularly by the Service and by the various courts.

### Mixed Business and Pleasure Travel Expenses

Many complications occur in the travel expense area. Two of the main complications are mixed business and pleasure travel expenses and travel as a form of entertainment. Travel expenses are deductible only if a valid business reason exists for the travel. The tax law looks to whether the trip is primarily for business or pleasure. A business reason can be established through either Section 162 or 212. Four areas that deserve special attention are domestic travel, foreign travel, accompanying family members on a trip, and entertainment expenses while on a trip.

**Domestic travel.** Domestic travel includes trips that begin and end in the U.S.

**Example.** Mr. Brown travels from Seattle, Washington, on a non-stop flight to Fairbanks, Alaska. The trip qualifies as domestic travel even though the taxpayer flies over foreign territory to reach his U.S. destination. If, however, Brown drives from Seattle to Fairbanks, the travel expenses from the U.S. border in Washington to the U.S. border in Alaska border fall under the foreign travel rules, which are discussed below.

----- FOOTNOTE:-----  
Reg. 1.274-4(e)(3).  
----- END FOOTNOTE:-----

If an individual incurs travel expenses on a trip that has both business and personal activities, the deductibility of the travel expenses depends on whether the trip is primarily business or personal. To determine whether the trip is primarily business or personal, time spent on each activity is an important factor.

**Example.** During a trip to Seattle, Washington, Ms. White spends one week engaged in activities directly related to her trade or business and an additional five weeks for personal activities. The trip is considered primarily personal in nature in the absence of a clear showing to the contrary.

If the travel is primarily personal in nature, the travel expenses to and from the destination are not deductible. Expenses related to the taxpayer's trade or business incurred while at the destination, however, are deductible. In contrast, if the travel

is primarily business in nature, the travel expenses to and from the destination are deductible. While at the destination, the cost of the lodging and 50% of the cost of meals while on the business portion of the trip are deductible. The cost of lodging and meals are only deductible if the trip is long enough to require the taxpayer to stop for sleep or rest. Lodging and meals incurred during the personal portion of the trip are not deductible.

Other deductible travel expenses incurred while carrying on a trade or business purpose are as follows:

- Taxi fares and other local transportation expenses.
- Baggage charges and transportation costs for work-related materials.
- Cleaning and laundry expenses.
- Telephone and fax expenses.
- Tips that are incidental to any of these expenses.
- Other similar ordinary and necessary expenses related to travel.

**Foreign travel.** Under Section 274, foreign travel expenses must be allocated based on the portion of the trip that is for deductible business purposes. This allocation is not required if one of the following exceptions is met:

- Travel outside the U.S. does not exceed one week.
- Travel where the nonbusiness-activity portion is not 25% or more of the travel time.
- The taxpayer has no substantial control (other than timing) over arranging the trip.
- Obtaining a vacation was not a major consideration in making the trip.

If none of these exceptions are met, the following formula is usually used to determine the disallowed portion of the travel expenses:

- $$\frac{\text{Number of nonbusiness days}}{\text{Total number of nonbusiness and business days}} \times \text{Total travel expenses}$$

Total travel expenses subject to this allocation depend on when and where in the trip the nonbusiness activity takes place. If the nonbusiness activity takes place at, near, or beyond the taxpayer's business destination, the above formula applies to the total travel expenses--the travel expenses that were incurred in a round trip

from the taxpayer's U.S. departure point to his or her business destination.

**Example.** Mr. Wilson, a sales executive, plans to attend a business conference in London. He travels from New York to London on business and then takes a vacation in Paris before returning to New York. The total travel expenses subject to the special allocation rule are airfare, in-flight meals, and other travel costs from New York to London and back. (The travel expenses from London to Paris are nondeductible.)

If the nonbusiness activity takes place en route to or from his business destination, the total travel expenses to which the allocation formula is applied are the expenses that would have been incurred in a round trip from the taxpayer's U.S. departure point to his or her nonbusiness destination.

**Example.** The facts are the same as in the previous example, except Wilson took his vacation in Paris while en route to London. In this situation, the travel expenses subject to the special allocation rule would be the cost of traveling from New York to Paris and back. (Travel costs from Paris to London are not subject to the allocation rule since that portion is all from a business activity.)

An individual who is related to his or her employer or is a managing executive for the employer must prove he or she did not have substantial control over arranging the business trip to avoid the allocation rule. The individual's relationship status is determined within the meaning of Section 267(b). A managing executive is defined as one who is authorized to decide on the necessity of the business trip and whose decision cannot effectively be vetoed. An individual who does not fall into one of these categories is considered not to have had substantial control over arranging the business trip and thus does not have to use the allocation rule.

#### PLANNING TIP

Business need not actually be transacted on a particular day for it to count as a business day. For determining whether 25% or more of the time spent outside the U.S. is attributable to nonbusiness activity, Reg. 1.274-4(d) provides that a day counts as a business day in these situations:

1. The taxpayer spent any portion of the day traveling to or returning from the foreign business destination (assuming a reasonably direct route was taken).
2. The taxpayer's presence was required for a specific and bona fide business purpose at a particular place outside the U.S., even if the business meeting was so short in duration that the taxpayer had most of the day free to pursue nonbusiness activities.
3. During normal business hours, the taxpayer's principal activity was the pursuit of business.

4. The taxpayer was prevented from conducting business as the day's principal activity due to circumstances beyond his or her control.

5. The day was a weekend, holiday, or other reasonably necessary standby day that fell during the course of the taxpayer's trade or business while outside the U.S.

**Accompanying family members.** Section 274(m)(3) disallows a deduction for travel expenses paid or incurred for a family member accompanying the business traveler, unless the following conditions exist:

- The family member is an employee of the taxpayer.
- The family member's travel is for a bona fide business purpose.
- Travel expenses would otherwise be deductible by the accompanying family member.

The family member's performance of some incidental service does not cause the travel expenses to be deductible. If the accompanying family member's expenses are not deductible, the deductible costs are only those that would have been incurred for a single traveler.

**Example.** The Smiths live in Amarillo, Texas. Mrs. Smith plans on taking a business trip to Dallas accompanied by her husband who works for another firm. They fly from Amarillo to Dallas and stay for three nights at the Marriott. The deductible costs are as follows:

- Cost of Mrs. Smith's plane ticket.
- Cost of a single room at the Marriott.
- Mrs. Smith's meals (subject to a 50% limitation).
- Taxi fares for business local transportation costs.
- Other incidentals, such as tips.

If the Smiths drive, the full cost of transportation to and from Dallas is deductible since the cost would be the same whether there was one person or two.

**Entertainment expenses on trip.** Under Section 274(n), 50% of meals and entertainment are deductible if these expenses are found to be related to a trade or business and are properly substantiated. Section 274(a) disallows a deduction for entertainment expenses unless the entertainment was directly related to or associated with the active conduct of the taxpayer's trade or business.

- *Directly related* entertainment usually involves a business discussion that should result in income or some other business benefit at some specific time in the future. This discussion can take place during the entertainment or in a clear business setting.

- *Associated with* requires that a substantial business meeting must have taken place before, between, or after the entertainment activities and that the entertainment was associated with the active conduct of a trade or business.

These rules are the same whether the entertainment took place on a business trip or not.

Business travel can revolve around a convention, business, or professional meeting. As long as the convention or meeting is for a bona fide business purpose, the cost of entertaining is deductible, although still subject to the 50% limitation. The entertainment itself can be for goodwill purposes and consist of events such as going to clubs and theatres. As discussed above, travel expenses for a spouse are generally not deductible. An exception exists for the cost of entertainment for a taxpayer's spouse or for the spouse of a customer. These costs can be deducted if there is a clear business purpose, rather than a personal or social purpose, for providing the entertainment.

**Example.** Mr. Jones entertains a customer. The cost is an ordinary and necessary business expense and is allowed under the entertainment rules. The customer's spouse joins the group because it is impractical to entertain the customer without the spouse. Mr. Jones can deduct the cost of entertaining the customer's spouse as an ordinary and necessary business expense. If Ms. Jones joins the party because the customer's spouse is present, the cost of the entertainment for Ms. Jones is also an ordinary and necessary business expense.

#### Educational travel expenses

Section 274(m)(2) specifically disallows deductions for expenses of travel as education.

**Example.** Ms. Smith is a French language teacher who was granted sabbatical leave to travel through France to improve her knowledge of the French language. The itinerary and most of the activities were planned to improve her French language skills. Ms. Smith cannot deduct her travel expenses as educational expenses. The deductibility does not depend on how much time was spent learning the language or engaging in activities that required use of the French language.

When an individual travels away from home for qualifying education, however, the travel expenses are deductible. Just like under the mixed business and pleasure rules discussed above, any personal activity expenses on the trip are not deductible.

The two primary qualifications are that the travel must be overnight and the main purpose of the trip must be to attend a work-related course or seminar.

**Example.** Mr. Adams, a self-employed tax practitioner, decides to take a one-week course in new developments in taxation. It is offered in Boston, 500 miles away from his home. His primary purpose in going to Boston is to take the course, but he also takes a side trip to Gloucester for one day, takes a sightseeing trip while in Gloucester, and entertains some personal friends. Adams' transportation expenses to Boston and to return home are deductible, but his transportation expenses to Gloucester are not. Adams' expenses for meals and lodging while away from home must be allocated between his educational pursuits and his personal activities. The expenses that are entirely personal in nature, such as costs incurred sightseeing and entertaining friends, are entirely nondeductible.

If instead Adams spent three weeks vacationing around the Boston area, his transportation expenses would not be deductible. His meals and lodging would be deductible only during the week he attended the tax course.

**Example.** Ms. Smith, the French teacher in a previous example, traveled to a specific educational institution in France that offered unique language classes. The costs of traveling to the institution are deductible educational expenses.

#### Conventions and cruises

When the mode of travel is considered entertainment, the tax law places restrictions on the deductibility of the travel expenses even when the travel was primarily for business. One popular location for conventions, seminars, or other meetings is on a cruise ship. The following requirements must be met to deduct a maximum of \$ 2,000 per person per year when attending a business activity on a cruise ship:

- The cruise ship is a U.S. flagship.
- The meeting is directly related to the active conduct of the taxpayer's business.
- All ports of call are located in the U.S., its possessions, or Puerto Rico.
- Special substantiation requirements must be met.

**Convention location.** When the destination is a convention outside the North American area, special requirements must also be met before the expenses are deductible.

- The meeting must be directly related to the active conduct of the taxpayer's trade or business.

- It must be as reasonable for the meeting to be held outside the North American area as within the North American area.

In determining the reasonableness of holding the meeting outside North America, the following factors are taken into account:

- The purpose of the meeting and the activities taking place at the meeting.
- The purposes and activities of the sponsoring organizations or groups.
- The residences of such organization's active members and the places at which their other meetings have been held.
- Other relevant factors.

The locations considered to be inside the North American area, and thus not subject to the rules for foreign conventions, are the 50 states of the U.S., the District of Columbia, U.S. possessions, Canada, Mexico, Palau, the Republic of the Marshall Islands, the Federated States of Micronesia, Barbados, Bermuda, Costa Rica, Dominica, the Dominican Republic, Granada, Guyana, Honduras, Jamaica, Santa Lucia, and Trinidad and Tobago.

**Investment conventions.** Section 274(h)(7) disallows deductions for costs of attending conventions, seminars, or similar meetings for investment purposes unrelated to carrying on a trade or business. This disallowance applies to only production of income expenses under Section 212, not to trade or business deductions under Section 162.

#### Substantiation requirements

Each one of the travel expense areas listed above must meet certain substantiation requirements. Each substantiation must include the required information and be in the correct format and form. Also, taxpayers have some options in lieu of meeting all of the substantiation requirements

**Required information.** Expenses for away-from-home travel are deductible only if documentation is maintained that includes the following information about the costs:

- *Amount.* Individual amounts must be reported except for a day's meals and incidental expenditures, which may be aggregated.
- *Time.* Dates of departure and return for each trip, and number of days away from home spent on business.
- *Place.* Destinations or locality of travel, described by name of city or town or

other similar designation.

- *Business purpose.* Business reason for travel or nature of the business benefit derived or expected to be derived as a result of travel.

When the travel includes entertainment expenses, the following must be substantiated in addition to the above:

- *Entertainment activity.* Each of the elements above should reveal details about the specific entertainment activity (e.g., name of restaurant).

- *Business relationship.* Occupation or other information relating to the person or persons entertained, including name, title, or other designation, sufficient to establish business relationship to the taxpayer.

If the business travel involves attending a convention, seminar, or similar meeting on a cruise ship, the taxpayer must attach the following information to the tax return on which the deduction is claimed:

- A written statement signed by the individual attending the meeting. The statement must specify the total days of the trip (excluding the days of transportation to and from the cruise ship port), the number of hours of each day of the trip the individual was devoted to scheduled business activities, and a program of the scheduled business activities of the meeting.

- A written statement signed by an officer of the organization or group sponsoring the meeting, which includes a schedule of business activities of each day of the meeting, and the number of hours the individual attending the meeting attended such scheduled business activities.

**Correct format and form.** The substantiation must be by adequate records such as an account book, diary, log, statement of expenses, trip sheets, or similar record, and documentary evidence that supports the required elements listed in the prior section. The accounting must be made at or near the time of the expenditure. > The records may be kept either manually or electronically.

Documentary evidence includes receipts, paid bills, or similar evidence that shows the amount, date, place, and essential character of the expenditure. A credit card statement that does not segregate expenses is not acceptable. The evidence is required for any expenditure for lodging and any other expenditures of \$ 75 or more except for transportation costs if documentary evidence not readily available.

**Optional methods in lieu of substantiating.** The adequate accounting discussed above can be relieved of the documentary evidence requirements if the taxpayer uses reimbursement arrangements (excluding transportation to and from destination), per-diem allowances, or mileage allowances. The taxpayer must still

provide evidence of business purpose, time, and location of trip. If the taxpayer (or an employee of the taxpayer) does not make an adequate accounting for any reimbursement, the excess must be included in income. In addition, if the per-diem allowance or mileage rates are higher than the maximums established by IRS guidelines, the excess is includable in income.

Taxpayers have options concerning the use of per-diem rates. The taxpayer may use the per-diem rates established for federal government workers to substantiate lodging, meals, and incidental expenses (MI&E). However, the rates vary among localities. Alternatively, the taxpayer can use the high-low per-diem method, where there is a set per-diem rate for high-cost areas and another for all other areas. Effective 10/1/01, the per-diem rate for high-cost localities is \$ 204 (\$ 162 for lodging and \$ 42 for MI&E) and \$ 125 for other localities (\$ 92 for lodging and \$ 34 for MI&E). Some examples of high-cost areas are Chicago, New Orleans, Boston, San Francisco, and Aspen.

**Accountable plans.** An accountable plan established by the employer to pay reimbursements or allowances for travel expenses results in the best tax treatment for employees. If the payments are not made under an accountable plan, the employee can deduct reimbursed business expenses only from adjusted gross income as a miscellaneous itemized deduction (as discussed below). An accountable plan established by the employer must satisfy the following requirements:

- The reimbursement or allowance must be for valid business expenses that are incurred by the employee in connection with the performance of services as an employee.
  - The plan should require the employee to meet all of the substantiation requirements listed above under this section.
  - The plan must require the return of any payment for unsubstantiated expenses.
- Placement on tax return

If the taxpayer is an employer, deductible travel expenses are shown on Schedule C (filed by an individual), Form 1120 or 1120S (filed by a corporation), or Form 1065 (filed by a partnership). If the taxpayer is an employee, reimbursed employee business expenses paid under an accountable plan are deductible for adjusted gross income, but non-reimbursed travel expenses are reported on Form 2106 and then as miscellaneous itemized deductions subject to the 2%-of-AGI floor. The non-reimbursed expenses include business travel expenses not reimbursed in their entirety or reimbursed expenses under a non-accountable plan. Employees also have the option of including all reimbursements in income and then using their actual expenses as deductions.

Reasonable vs. lavish or extravagant

Section 162(a)(2) specifically addresses the requirement that travel expenses not be lavish or extravagant. "[T]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including ... traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business." Recent cases and IRS releases have addressed the reasonable nature of deductions.

In a recent Tenth Circuit decision, the court determined that the use of a Lear jet for business travel may be a reasonable expense and is, therefore, a deductible transportation cost. Stanley and Anne Kurzet owned a Lear jet that they used, among other trips, to fly to their Oregon timber farm from their home in Orange, California. The Oregon timber farm was a for-profit business activity, so the Kurzets were allowed deductions for all ordinary and necessary business expenses of traveling to the farm. The court determined that to establish that the costs of the Lear jet are ordinary and necessary business travel expenses, the Kurzets had to show that the Lear jet costs are reasonable compared with the value received. To show the value received, the IRS looked to the number of trips and the time savings combined and compared this with a first-class ticket on the available flights between Orange, California, and North Bend, Oregon. The circuit court determined that the Tax Court had erred in disallowing the Lear jet expenses as unreasonable. This does not mean, however, that the IRS will consider all Lear jet costs to be reasonable. Without a clear showing of the reasonableness of the costs versus the value, the deduction for Lear jet costs will probably be rejected. In a field service advice, the IRS considered the cost of first class plane tickets as a reasonable standard to be used to determine the value of alternative forms of air travel.

#### Charitable contributions or medical expenses

Some travel expenses may qualify as charitable contributions or medical expenses.

**Charitable contributions.** Generally, out-of-pocket expenses incurred in performing services for a qualified charitable organization are deductible. Expenses that have been found to be deductible include out-of-pocket travel and transportation, and the cost of meals and lodging while traveling away from home. For purposes of computing the deduction for use of a passenger automobile, the standard mileage rate is 14 cents per mile. No deduction is allowed for travel while away from home, however, if there is a significant element of personal pleasure, recreation, or vacation in the trip.

Two court cases point out the difficulty in determining the deductibility of out-of-pocket expenses related to services performed for a charitable organization. In *Patterson*, a softball coach was not allowed to deduct amounts paid to a tax-exempt softball tournament league. Meals, lodging, and transportation to tournaments were also found not to be deductible. The court disallowed these

expenses because they were made primarily to benefit the coach and his team rather than the tax-exempt organization. The court did allow a deduction for a donation made directly to the YMCA.

In *Davis*, the taxpayers were not allowed to deduct amounts paid to their sons as Mormon missionaries. The Supreme Court agreed with the lower courts that these travel expenses could be deducted only if paid by the person incurring the expenses and if the primary motive in paying the expenses was to benefit a charity. The funds were not donated for the benefit of the church.

**Example.** Ms. Conner is a volunteer for the Make-a-Wish Foundation. Make-a-Wish helps very ill children to fulfill a dream vacation or other wish. Conner is a registered nurse and pays her own expense to accompany the very ill children to Disneyland or other destinations. Conner should be able to deduct her expenses as charitable contributions since her primary motivation for the travel to Disneyland or other destinations is to assist in the charitable function of Make-a-Wish and is not personal pleasure.

**Medical deductions.** Section 213(d) generally allows amounts paid for transportation primarily for and essential to medical care to be deducted as medical expenses. A taxpayer who chooses to travel in an automobile may deduct 12 cents per mile in 2001 and 13 cents per mile in 2002. Lodging expenses for travel away from home to receive specialized medical treatment or to receive treatment unavailable in the taxpayer's home area are deductible up to \$ 50 per night each for the person receiving medical care and for a necessary individual accompanying the person receiving the care.

**Example.** Ms. Rivers and her son, Dylan, travel to the Mao Clinic in Scottsdale for medical treatment for Dylan that is not available in their hometown. They stay in a hotel near the clinic so that Dylan can receive treatment each day for the necessary number of treatments. Rivers may deduct either the cost of airline tickets or 12 cents per mile if she chooses to drive. Hotel bills are deductible up to \$ 100 per night--\$ 50 each for Rivers and her son.

### Commuting expenses

Section 162 allows a deduction for all the ordinary and necessary expenses paid or incurred in carrying on a trade or business. Section 262 provides that no deduction is allowed for personal, living, or family expenses. Commuting expenses, expenses incurred in traveling between an individual's home and place of business, are generally considered nondeductible personal expenses. A long series of court cases, regulations, and rulings have consistently denied any tax benefits for this personal expenditure. These expenses are not allowed as deductions even if the distance is long or if the work location is remote and unsuitable for habitation.

**Multiple businesses or jobs.** If an individual has two or more businesses or

jobs in the same general area, the cost of transportation from one business location to another business location is deductible. If the individual goes home between jobs, the deduction is the lesser of the cost of transportation between jobs and the amount actually spent.

**Rev. Rul. 99-7.** There are three situations that allow for the deduction of otherwise nondeductible expenses incurred in traveling between the individual's home and place of business. These exceptions are outlined in Rev. Rul. 99-7.

*Exception 1.* Travel between taxpayer's residence and temporary work location outside the metropolitan area where taxpayer usually lives and works. An individual may deduct daily transportation expenses incurred in going between the individual's residence and a temporary work location outside the metropolitan area where the taxpayer lives and normally works. The important points to note are that the work location must be temporary and must be outside the area where the individual lives and normally works. Commuting expenses to a temporary work location within that metropolitan area are not deductible under this exception, but may meet the requirements of one of the next two exceptions.

*Exception 2.* Travel between residence and temporary work location in same trade or business, regardless of distance, if taxpayer has more than one regular work location away from home. If an individual has one or more regular work locations away from the individual's residence, the individual may deduct commuting expenses for travel between the individual's residence and a temporary work location in the same trade or business, regardless of the distance. The primary requirement for this exception is that one or more regular places of work exist.

It is possible for the principal residence to be the required regular place of work. This situation has generated some controversy. In *Walker*, the taxpayer, Charles Walker, was a logger whose regular place of business was his home. He received his temporary work assignments at his home, stored his tools there, and spent about seven hours a week there working on his equipment. He traveled to various logging sites in a nearby forest, his "metropolitan area." The numerous job sites at which Walker worked were widely dispersed throughout the large national forest. Walker's work at any specific job site was short-lived and with the expectation that no specific job site would be worked for more than a year.

Walker asserted that his home was his regular place of work and that travel from his home to the temporary sites resulted in deductible commuting expenses. The IRS attempted to apply the more stringent "principal place of business" test as required for the home-office deduction, a test that Walker would not meet. However, various rulings have required only the "regular place of business" test under this exception for the allowance of commuting expenses as deductible transportation expenses. The Tax Court allowed the deduction. It is noted in Rev. Rul. 99-7 that the IRS will continue to not follow the *Walker* decision and will apply the stricter "principal place of business" test when an individual asserts that

the personal residence is the requisite "regular place of business."

*Exception 3.* If residence is principal place of business, travel between residence and a work site in same trade or business, regardless of whether site is regular or temporary in nature and regardless of distance. This exception requires that the individual's residence be considered the individual's principal place of business within the meaning of the home-office deduction rules under Section 280A. If these rules are satisfied, all transportation expenses between the residence and other work locations in the same trade or business are allowable deductions, regardless of the distance or the nature of the work locations as temporary or regular.

For these exceptions, the determination of whether a work site is regular or temporary may be important. If employment at a work site is realistically expected to last (and does in fact last) for one year or less, the employment is temporary in the absence of facts and circumstances indicating otherwise. If employment at a work site is realistically expected to last for more than one year, the site is not considered temporary, even if the employment actually lasts for one year or less. If employment at a work site is realistically expected to last for one year or less, it will be treated as temporary until the realistic expectation changes. The work site will not be treated as temporary after that time.

**Employer-owned vehicle.** Personal use of an employer-owned vehicle is a taxable fringe benefit. The value of the personal use must be included in gross income. Guidance for computing the amount included in gross income is found in Reg. 1.61-21. Unless a special valuation method is used, the amount that must be included in gross income is the fair market value of the cost of leasing the same or a comparable vehicle from an unrelated third party under the same or comparable lease terms. Three special valuation methods are outlined in Reg. 1.61-21.

Under the lease valuation method, the value of having an auto made available to the employee must first be determined. The value of the vehicle is generally the purchase price, including sales taxes and title fees. With the fair market value, a vehicle's annual lease value can be determined using the table in Reg. 1.61-21(d)(2)(iii). The business use of the vehicle is deducted from the annual lease value to determine the employee's gross income from use of the vehicle. (Special rules apply for employers with fleets of automobiles, employees using a vehicle for less than a year, and employee contributions to the purchase price of the automobiles.)

**Example.** An automobile that has an FMV of \$ 12,500 is available to an employee for the entire year. The annual lease value of the car, determined from the table, is \$ 3,600. If the business use of the car, based on mileage, is 80%, the employee must include \$ 720 ( $\$ 3,600 \times 20\%$ ) in gross income.

The vehicle cents-per-mile method allows for the use of the standard mileage rate

in computing the amount included in the employee's gross income. The standard mileage rate is 34.5 cents per mile for personal miles driven in 2001 and 36.5 cents per mile in 2002. This method can be used only if the value of the vehicle, on the date it is first made available to any employee for personal use, does not exceed the maximum recovery deductions allowed for the first five years under Section 280F. That amount is \$ 14,460 for automobiles placed in service in 2001. In addition, the automobile must be reasonably expected to be regularly used in the employer's business throughout the year (with safe harbors to meet the requirement) or must be driven at least 10,000 miles during the year, primarily by employees.

The last special method is available for employees required to commute in an employer-provided vehicle. If the requirements are met, the employee can include \$ 1.50 per one-way trip in gross income. The employer must elect this method and must meet all of the following requirements:

- The vehicle must be owned or leased by the employer, and be provided for and used for the employer's trade or business.
- For bona fide noncompensatory business reasons, the employer must require the employee to commute to and from work in the vehicle.
- The employer must have a written policy that disallows personal use of the vehicle by the employee, or any individual whose use would be taxable to the employee, except for de minimis personal use.
- The employee must not use the vehicle for any personal purpose other than commuting and de minimis personal use.
- The employee using the vehicle must not be a control employee as defined in the regulation--an director, officer, 1% owner of the employer, or employee whose compensation is at least \$ 100,000.

There are additional provisions for chauffeurs and transportation provided because of unsafe conditions.

**Substantiation requirements.** Section 274(d) requires that deductions or credits for the use of any listed property, including automobiles, be substantiated by adequate records or by sufficient evidence corroborating the individual's own statements. The requirements for an employer to satisfy this mandate are found in Temp. Reg. 1.274-6T. Two written policy statements can be implemented under this regulation to qualify as sufficient evidence and do not require a second set of employee records to satisfy the Section 274(d) substantiation requirements.

The first qualifying statement must prohibit personal use of the vehicle. The following requirements must be met:

- The vehicle must be owned or leased by the employer and provided to one or more employees for use in connection with the employer's trade or business.
- When the vehicle is not used in the employer's trade or business, it must be kept on the employer's business premises, unless it is temporarily located elsewhere, such as for maintenance or because of a mechanical failure.
- No employee using the vehicle can live at the employer's business premises.
- Under a written policy of the employer, neither an employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, except for de minimis personal use (such as a stop for lunch between two business deliveries).
- The employer must reasonably believe that, except for de minimis use, neither the employee, nor any individual whose use would be taxable to the employee, uses the vehicle for any personal purpose.
- There must also be evidence that would enable the IRS to determine whether the use of the vehicle meets the preceding five conditions.

The second alternative qualifying statement must prohibit personal use of the vehicle other than commuting. The following requirements must be met:

- The vehicle must be owned or leased by the employer and provided to one or more employees for use in connection with the employer's trade or business.
- For bona fide noncompensatory business reasons, the employer requires the employee to commute to or from work in the vehicle.
- The employer must establish a written policy under which neither the employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home).
- The employer must reasonably believe that, except for de minimis personal use, neither the employee, nor any individual whose use would be taxable to the employee, uses the vehicle for any personal purpose other than commuting.
- The employee required to use the vehicle for commuting must not be a control employee required to use an automobile. A control employee is an officer or 1% owner of the employer.
- The employer must account for the commuting use by including in the employee's gross income the commuting value not reimbursed by the employee.

- There must be evidence that would enable the IRS to determine whether the use of the vehicle met the preceding six conditions.

**Conducting business during the commute.** Many hard-working business people make business calls or do other work during the commute to work. These activities do not make an otherwise nondeductible commute deductible. A police captain, however, was required to perform inspection and supervisory duties while commuting to police headquarters. The Tenth Circuit allowed the deduction of commuting costs in this situation.

**Transporting tools or equipment.** The transportation of tools or equipment used in the individual's trade or business do not make the total cost of the commute deductible. If the individual can show that commuting costs are solely attributable to the need to carry tools or equipment and are in excess of normal commuting costs, a portion of the commuting expense may be deductible. The deductible portion is the amount by which the cost of commuting with the tools or equipment exceeds the cost of commuting, using the same mode or transportation, without the tools or equipment. Thus, a worker who normally rides the bus but who is required to commute in a small truck in order to carry tools or equipment can deduct only the cost difference of commuting in the truck with the tools or equipment and without the tools or equipment. The amount will be inconsequential unless the tools or equipment are very large, heavy, or specialized, causing substantially worse gas mileage, the necessity of excessive repairs and maintenance, or other costs (such as additional insurance).

**Transportation fringe benefits.** Section 132(a) allows a limited exclusion for qualified transportation fringe benefits. This exclusion supersedes the working condition and de minimis fringe benefits rules. Employees who choose to receive cash compensation rather than an excludable transportation fringe benefit must include the cash in gross income. However, an employee who chooses the excludable benefit does not have gross income if certain requirements under Reg. 1.132-9(b) are met. That regulation also outlines the requirements to provide employees with a compensation reduction arrangement for these benefits or to provide for cash reimbursement for these benefits. Qualified transportation benefits include:

- Transit passes.
- Qualified parking.
- Van pools (i.e., transportation to or from work in a "commuter highway vehicle.")

For 2001, the exclusion is limited to \$ 65 per month for any combination of transit passes and other commuter transportation. Section 132(f)(2)(A) raises the combined limit for the exclusion for transit passes and van pools to \$ 100 for tax

years beginning after 2001. This limit will be indexed for inflation.

**Qualified parking.** Qualified parking expenses also are excluded from gross income under Section 132. The exclusion applies for parking provided by an employer at or near the employer's place of business or a place from which the employee commutes to work by carpool, mass transit, commuter highway vehicle, or commercial vehicle seating at least six passengers not counting the driver. Parking provided at or near the employee's residence does not qualify for the exclusion. The value of parking that is excludable as a working condition fringe or amounts paid to an employee for parking costs that are excludable from gross income as an amount treated as paid under an accountable plan are not qualified parking. For 2001, the exclusion is limited to \$ 180 per month for qualified parking. This limit will be indexed for inflation.