Dan Fingerman

Writing Sample

I wrote this memorandum in July 2002, as a Summer Associate at Wiggin & Dana LLP. I have been given appropriate permission to offer this memorandum as a writing sample after making some minor changes to protect the client's privilege. For example, all names have been changed, and the name of the client's employer has been removed.

TO: Tax Partner
FROM: Dan Fingerman
DATE: 31 July 2002
RE: Tax Implications of John Smith's Expenses During Temporary Residence in California

Introduction

Client John Smith's employer has agreed to pay certain expenses on Mr. Smith's behalf. This memorandum discusses the tax implications of that arrangement.

Mr. Smith has lived in New Jersey with his family for many years, but he has recently quit his job to accept new employment with a corporation headquartered in California. This new employment will commence this month, and Mr. Smith understands that the company intends to relocate to Arizona within ten months. Mr. Smith intends to reside temporarily in California until the company moves to Arizona — at which time he will move to Arizona and live there indefinitely thereafter. Mr. Smith's wife and children intend to continue to reside in New Jersey at least until the end of the next school year. Mr. Smith intends that his family will move to Arizona with him (or soon after he moves), directly from New Jersey to Arizona and without ever living in California.

During his interim residence in California, Mr. Smith will financially maintain two households: his family's home in New Jersey and his own apartment in California. Mr. Smith's new employer has agreed to pay for certain of his duplicated household expenses during this period, such as the rent for Mr. Smith's California apartment, a rental car in California, and reasonable expenses for commuting between California and New Jersey several times per month.

Issue

Is the value of the employer-provided lodging, automobile, and transportation taxable to Mr. Smith?

Short Answer

Mr. Smith must pay income tax on the value conferred on him by his employer's provision of his lodgings, automobile, and transportation.

Discussion

A. Deductions Under Tax Code § 162(a)(2)

Generally, the tax code treats employer-paid expenses for an employee's housing, automobiles, and transportation as taxable fringe benefits. Taxable fringe benefits are generally considered additional compensation for income tax purposes. Section 162(a)(2) of the tax code provides an exception:

> There 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.[1]

However, § 162(a) further provides that "the taxpayer shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year."[2]

Under the general rule, the dollar value of the expenses paid by Mr. Smith's employer are taxable fringe benefits, but they might arguably qualify for a deduction under § 162(a)(2). For the reasons below, I believe that these expenses do not fit within the § 162(a)(2) exception, even though Mr. Smith's stay in California is presently anticipated to last for less than one year. Mr. Smith will likely be required to pay income tax on the value of these expenses.

B. The *Flowers* Test

The seminal U.S. Supreme Court decision interpreting § 162(a)(2) is *Commissioner of Internal Revenue (CIR) v. Flowers*, in which the Court articulated the three-prong "*Flowers* test" for the traveling expense deduction.[3] "Failure to satisfy any one of the three conditions destroys the traveling expense deduction."[4]

> (1) The expense must be a reasonable and necessary traveling expense, as that term is generally understood. This includes such items as transportation fares and food and lodging expenses incurred while traveling.
>
> (2) The expense must be incurred 'while away from home.'
>
> (3) The expense must be incurred in pursuit of business. This means that there must be a direct connection between the expenditure and the carrying on of the trade or business of the taxpayer or of his employer. Moreover, such an expenditure must be necessary or appropriate to the development and pursuit of the business or trade.[5]

Subsequent court decisions and IRS rulings have clarified aspects of the *Flowers* test and applied it in various situations.[6] The IRS and the courts still use the *Flowers* test in cases involving § 162(a)(2), despite an intervening amendment to § 162(a)(2) by Congress.[7]

---

[1] 26 U.S.C. § 162(a)(2) (2002)
[2] 26 U.S.C. § 162(a) (2002)
[3] *Commissioner of Internal Revenue (CIR) v. Flowers*, 326 U.S. 465, 470 (1946)
[4] *Id.* at 472
[5] *Id.* at 470
[6] *See e.g., CIR v. Stidger*, 386 U.S. 287 (1958); *Hantzis v. CIR*, 638 F.2d 248 (1st Cir. 1981); *Harvey v. CIR*, 283 F.2d 491 (9th Cir. 1960); *Hendry v. CIR*, 1981 WL 11120 (U.S. Tax Ct. 1981); *Waldrop v. CIR*, 1977 WL 3483

C. Prongs One and Three of *Flowers*

The application of prongs one and three is straightforward, so I will discuss those prongs only briefly. Prong one requires that an expense "be a reasonable and necessary traveling expense" to be deductible.[8] The *Flowers* Court expressly included "transportation fares … and lodging expenses" within this term,[9] and rental cars have also been held to fit within prong one.[10] Prong three requires that "[t]he expense must be incurred in pursuit of business."[11] Courts interpret "in the pursuit of business" broadly in this context, and Smith's expenses fit well within the bounds of that definition because he will incur them in the course of his employment in California.[12]

Therefore, Smith's expenses satisfy prongs one and three of the *Flowers* test. However, the IRS or a court will likely deem them not to have been incurred "while away from home," so Smith's expenses will fail prong two.

D. Prong Two of *Flowers*: Expenses Incurred "While Away From Home"

Expenses deductible under § 162(a)(2) must be incurred while the taxpayer is traveling – i.e., "while away from home."[13] This phrase spawned a large body of litigation over the definition of "home."[14] "Congress … apparently was unsure whether, to be deductible, an expenses must be incurred away from a person's residence or away from his principal place of business."[15] A minority of circuit courts define "home" to mean the taxpayer's residence or personal abode. However, the IRS, the Tax Court, and a majority of circuit courts disagree. This majority view is most relevant to Smith because he wants to know what position the IRS will likely adopt if it audits him.

No two authorities within the majority camp articulate the definition of "home" in quite the same way, although the definitions are substantively close. In the IRS's language, for example, "Generally, a taxpayer's home for purposes of the statute is considered to be located at his regular or principal place of business or employment, regardless of where he maintains his place of abode."[16] The Tax Court has written that a taxpayer's home is "the vicinity of the

---

(U.S. Tax Ct.1977); *Kroll v. CIR*, 49 T.C. 557, 561-62 (1968); *Szloch v. U.S., et al.*, 558 F. Supp. 292 (D.Mass. 1982). *See also* Rev. Rul. 93-86 CB 71, 1993-40 (1993); Rev. Rul. 83-82, 1983-1 CB 45; Rev. Rul. 74-291, 1974-1 CB 42; PLR 9641003.

[7] *See* Rev. Rul. 93-86 CB 71, 1993-40 (1993)

[8] *Flowers*, 326 U.S. at 470

[9] *Flowers*, 326 U.S. at 470

[10] *See Kozera v. CIR*, T.C. Memo 1986-604 (1986)

[11] *Flowers*, 326 U.S. at 470

[12] *See Hantzis*, 638 F.2d at 249–52

[13] *Flowers*, 326 U.S. at 470 (prong two of the *Flowers* test)

[14] *See e.g.*, *Stidger*, 386 U.S. at 291; *Hantzis*, 638 F.2d 248, *Steinhort v. CIR*, 335 F.2d 496 (5th Cir. 1964); *U.S. v. Le Blanc*, 278 F.2d 571 (5th Cir. 1960); *Burns v. Gray*, 287 F.2d 698 (6th Cir. 1961); *Wright v. Hartsell*, 305 F.2d 221 (9th Cir. 1962); *Kroll*, 49 T.C. at 557.

[15] *Hantzis*, 638 F.2d at 252

[16] Rev. Rul. 74-291, 1974-1 CB 42

taxpayer's principal place of employment and not where his personal residence is located, if such residence is located in a different place from his principal place of employment."[17]

Two lines of cases further expound the phrase "away from home." The first line of cases addresses the *duration* of the taxpayer's residency away from home. The second line of cases examines the *reasons* for the taxpayer's residency away from home — i.e., whether the exigencies of the taxpayer's business dictated the maintenance of the second residence.

(1) Duration of Residency "Away From Home"

Congress enacted the one-year ceiling on the duration of "temporary" residencies in 1992, 46 years after the Supreme Court decided *Flowers*. However, the IRS and the courts still apply the *Flowers* test in cases involving § 162(a)(2).[18] Accordingly, the importance of this first line of cases has declined since 1992. These cases are discussed here for two reasons. First, their treatment of the term "home" differs from that of the second set of cases (which explores the *reasons* for the taxpayer's residency "away from home"), and this inconsistency has caused confusion. Second, these cases have never been expressly overruled. While Congress's amendment to the tax code supercedes the decisional law to the extent that no residency may be considered "temporary" if it lasts more than one year, courts still look to their pre-1992 decisions on duration for guidance in ongoing cases.

The IRS determines whether a residency is temporary in the following manner. If a taxpayer's stint of employment "while away from home" "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."[19] If the taxpayer's residency "away from home in a single location 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, that employment will be treated as temporary … until the date the taxpayer's realistic expectation changes."[20] For example, if the employment were initially anticipated to last ten months but it became apparent after eight months that it would last for two years, then the taxpayer may deduct his expenses only for the first eight months.

Before Congress's 1992 amendment, the courts would conduct a fact-specific inquiry into the reasonability of the duration of the taxpayer's stay, given all the circumstances. Today, the reasonability of a residency's duration is less important because of the one-year cap. The expectation of a temporary stay is presumed if initial the expectation is for less than one year and the stay actually lasts less than one year.

Mr. Smith will move to California at the commencement of his employment, then move to Arizona when his employer relocates — which he expects will happen approximately ten months later. Therefore, he will not be disqualified from deducting his expenses under

---

[17] *Kroll*, 49 T.C. at 561-62
[18] *See* Rev. Rul. 93-86 CB 71, 1993-40 (1993)
[19] Rev. Rul. 93-86 CB 71, 1993-40 (1993)
[20] *Id.*

§ 162(a)(2) as long as his residency in California actually ends within one year. If it lasts longer than one year, then he may deduct his expenses only for the period before his realistic expectation changes. While Smith's residency in California seems to qualify as "away from home" under the "duration" line of case law, it probably does not qualify under the "reasons" line of case law, discussed below.

(2) Reasons for Residency "Away From Home"

"[T]he critical step in defining 'home' in these situations is to recognize that the 'while away from home' requirement has to be construed in light of the further requirement that the expense be the result of business exigencies."[21] The definition also reflects *Flowers*' third prong, in "that only expenses necessitated by business, as opposed to personal, demands may be excluded from the calculation of taxable income."[22] Accordingly, the taxpayer's *reasons* for maintaining two residences are as important as the *duration* of the stay in the secondary residence.[23] In fact, the duration limitation is ultimately part of this business/personal dichotomy.

The courts consider it reasonable to expect a taxpayer to reside conveniently near his principal place of business,[24] so they deem a residence located at an inconvenient distance to be maintained for personal, not business, reasons.[25] If the taxpayer must work at a given location permanently or indefinitely, that location is deemed his principal place of business. Therefore, *all* cases involving deductions for dual residences involve the same ultimate issue — whether personal or business reasons required the maintenance of two homes — and duration is merely the most frequently recurring question within this larger issue.

The courts define "business reasons" narrowly in this context — in contrast with that term's broader definition in the "in the pursuit of business" context (*Flowers*' prong three).[26] The key issue in the "in the pursuit of business" analysis seems to be whether business or personal reasons induce the taxpayer to *visit* the *new* locale. In contrast, the key issue in the "away from home" context is whether business or personal reasons induce the taxpayer to *retain* his household in the *old* locale.[27] Several examples illustrate the narrow interpretation of "business reasons" in the "away from home" context.

In *Stidger*,[28] the Supreme Court held that a Marine officer could not deduct the cost of his meals while stationed in Japan for 15 months — notwithstanding that the Marine Corps denied his family permission to join him, thereby forcing him to maintain two households.[29] The Court held that the Marine officer was not "away from home" because it is well settled that a military

---

[21] *Hantzis*, 638 F.2d at 253
[22] *Id.* at 250
[23] *Id.*
[24] *Szlock*, 558 F. Supp. at 294
[25] *Id.* at 295; *Hantzis*, 638 F.2d at 254
[26] *See Hantzis*, 638 F.2d at 249–52
[27] *Id.* at 248
[28] *CIR v. Stidger*, 386 U.S. 287 (1958)
[29] Note that *Stidger* was decided in 1958 — prior to the 1992 amendment which capped the duration at one year.

officer's principal place of business is his current station. Therefore, this officer's continued maintenance of a household in California for his wife and children was for personal, not business, reasons.[30]

The IRS adopted the view of the *Stidger* court in 1996,[31] when it held that a taxpayer's "home" was the locus of his employment in a remote wilderness area — and not his family's residence a significant distance away.[32] The IRS held that his family's residence was maintained for personal, not business, reasons — despite the lack of schools and other amenities in the vicinity of the taxpayer's "home."

In *Hantzis*,[33] the taxpayer lived with her husband in Boston, where she studied full time at Harvard Law School. When she took a ten-week summer job in New York City, her husband continued to live and work in Boston, and she visited Boston several times during the summer. She returned permanently to Boston ten weeks later for the next academic year. She claimed a tax deduction for the cost of her apartment and meals in New York and transportation between the two cities.

The First Circuit denied Ms. Hantzis' deduction (reversing the Tax Court) on the ground that she had no business ties to Boston during the summer.[34] The court reached this result despite that she worked in Boston immediately before and immediately after those ten weeks. The court deemed the expenses to have been incurred for personal, not business, reasons because no business exigency required her to visit Boston during those ten weeks.[35] While the court held that the employment in New York was conducted "in the pursuit of a trade or business" under the *Flowers* test,[36] it court did not address whether her full-time studies during the academic year constituted "a trade or business."

The *Hantzis* court might have rejected the taxpayer's argument simply because she was a student and did not "work" in Boston before and after the summer, but it did not. Instead, it focused on her activities during the summer – emphasizing that her trips between New York and Boston were for personal reasons such as visiting her husband.[37]

> Mrs. Hantzis' trade or business did not require that she maintain a home in Boston as well as one in New York. Though she returned to Boston at various times during the period of her employment in New York, her visits were all for personal reasons. It is not contended that she had a business connection in Boston that necessitated her keeping a home there; no professional interest was served by maintenance of the Boston home…. The home in Boston was kept for reasons involving Mr. Hantzis, but those

---

[30] *Stidger* at 295–96
[31] PLR 9641003 (1996)
[32] *Id.*
[33] *Hantzis v. CIR*, 638 F.2d 248 (1st Cir. 1981)
[34] *Hantzis*, 638 F.2d at 252–256
[35] *Id.* at 253–54
[36] *Id.* at 250–52
[37] *Id.* at 250–52

> reasons cannot substitute for a showing by Mrs. Hantzis that the exigencies of her trade or business required her to maintain two homes.[38]

The court was "not dissuaded by the temporary nature of Mrs. Hantzis' employment in New York. Mrs. Hantzis argues that the brevity of her stay in New York excepts her from the business exigencies requirement."[39] Indeed, the Tax Court had agreed with her in its decision precipitating this appeal, reasoning that "it would have been unreasonable for her to move her residence to New York for only ten weeks."[40] However, the First Circuit rejected the contention that mere brevity of duration could trump the "business reasons" requirement that is integral to § 162(a)(2).[41]

> [The] maintenance of a first home [must] have a business justification. … If no business exigency dictates the location of the taxpayer's usual residence, then the mere fact of his taking temporary employment elsewhere cannot supply a compelling business reason for continuing to maintain that residence. Only a taxpayer who lives one place, works another and has business ties to both is in the ambiguous situation that the temporary employment doctrine is designed to resolve. In such circumstances, unless his employment away from his usual home is temporary, a court can reasonably assume that the taxpayer has abandoned his business ties to that location and is left with only personal reasons for maintaining a residence there. Where only personal needs require that a travel expense be incurred, however, a taxpayer's home is defined so as to leave the expense subject to taxation. Thus, a taxpayer who pursues temporary employment away from the location of his usual residence, but has no business connection with that location, is not 'away from home' for purposes of section 162(a)(2).[42]

E. Location of Mr. Smith's Tax Home

I found no case law or IRS rulings pinpointing the moment when business connections are deemed severed when a taxpayer moves from one permanent home to another in stages comparable to the that Mr. Smith will undertake. In most cases, the moment where business connections with a taxpayer's former tax home are severed is obvious: the taxpayer simply moves to a new location without intermediate steps.

Mr. Smith's business ties to New Jersey might be deemed severed at one of three different times: (1) when Mr. Smith quit his job in New Jersey with the intention of working in California, (2) when Mr. Smith will begin working in California, or (3) when Mr. Smith will begin working in Arizona. If Smith can establish that his business connections to New Jersey are

---

[38] *Id.* at 254
[39] *Id.* at 254
[40] *Id.* at 255
[41] *Id.* at 255
[42] *Id.* at 255 (citations omitted)

severed at time #3, then New Jersey may still be his tax home during his residency in California. For the reasons below, I do not believe that an argument for time #3 would be sustained.

When Smith lived and worked in New Jersey, that state was his principal place of employment *and* his principal residence — and was therefore his tax home, no matter which definition of "home" applies. However, when he quit his job with the intention of working in another state, he severed his only business tie to New Jersey, and he has no present intention to return to New Jersey in the future for business purposes. Therefore, New Jersey ceased to be Smith's principal place of employment and tax home when he quit his job with the intention of leaving New Jersey permanently. The fact that his employment contract permits him to "telecommute" from his family's home in New Jersey will not salvage the deduction because the telecommuting provision is not required by the exigencies of his employer's business: it was a concession to Smith, to permit him to spend more time with his family.[43]

Mr. Smith's residence in California will clearly qualify as "temporary" under § 162(a)(2) if it actually ends within one year, as he anticipates at this time.[44] However, this does not exempt him from the requirement that his purported "primary" residence in New Jersey must be maintained for business reasons. As the *Hantzis* court wrote, "Only a taxpayer who lives one place, works another and has business ties to both is in the ambiguous situation that the temporary employment doctrine is designed to resolve. … Thus, a taxpayer who pursues temporary employment away from the location of his usual residence, but has no business connection with that location, is not 'away from home' for purposes of section 162(a)(2)."[45] Mr. Smith's continued maintenance of the household in New Jersey will be for familial (i.e., personal) reasons — not business reasons.

Conclusion

John Smith will probably be required to pay income tax on the value conferred on him by his employer's provision of his lodgings and automobile in California and his transportation to and from New Jersey — regardless of the duration of his stay in California. Under Section 162(a)(2) of the tax code and the test articulated in *Flowers*, Smith's temporary maintenance of two residences (in California and New Jersey) will likely be deemed to be done for personal, not business, reasons. Mr. Smith should therefore prepare to pay income tax on the value he receives from his employer for his California expenses.

---

[43] *Flowers*, 326 U.S. 465 (holding that a taxpayer's decision to live in Jackson, Mississippi was for personal reasons when his employer was based in Mobile, Alabama and he worked in each city approximately three days per week because he simply preferred Jackson)
[44] Rev. Rul. 93-86 CB 71, 1993-40
[45] *Id.* at 255