The Deductability of Moving Expenses and Investigatory Expenses

Bernard Goldstein
THE DEDUCTIBILITY OF MOVING EXPENSES AND INVESTIGATORY EXPENSES*

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Introduction

The computation of the adjusted gross income figure is of tremendous importance, since this figure is the basis for so many other computations in determining final individual income tax liability. In general terms, the adjusted gross income represents the gross income included by Section 61, minus the trade and business deductions, long term capital gain deductions, deductions for losses from the sale or exchange of property, the deductions attributable to rents and royalties and certain deductions of life tenants and income beneficiaries of property, as defined by Section 62 of the Internal Revenue Code of 1954.

The size of the adjusted gross income controls many of the deductions allowed from adjusted gross income, such as deductions for charitable contributions, medical expenses, or the standard deduction.

The targets for discussion in this paper are investigatory expenses and moving expenses of employees, and the deductibility of these expenses. In order to determine whether these expenses are deductible, it is necessary to outline some objective test which can be applied by the taxpayer and by the Service in the preparation and audit of the tax forms. For the sake of comparison, the test utilized in the determination of the deductibility of educational expenses will be applied.

Moving Expenses

An example often helps to pinpoint the issues: The Big Green Corporation has operating plants throughout the contin-
ental United States. Employee Loyal has been working in Richmond, Virginia, for a number of years and is quite proficient in his job. When Big Green decides to commence a similar operation in Seattle, Washington, employee Loyal is asked if he will, for the sake of the Corporation, move with his family to Seattle. The company agrees to pay him X dollars as a moving allowance for his entire family.

Question: If X dollars is the exact amount spent for such expense, how will it affect Loyal's Federal income tax?

Answer: Revenue Ruling 54-429, which was issued in connection with Regulation 118, Section 39.22(a)-2, indicates that the allowance is not included in Loyal's gross income.¹

Question: If the amount is (a) in excess of expenses, or (b) inadequate to cover the expenses, what is the result?

Answer:

[a] Any excess of the allowances or reimbursements over the actual expenses incurred is includible in the employee's gross income.

[b] Any moving expenses paid or incurred by the employee in excess of the allowances or reimbursements are not deductible for Federal income tax purposes, since they represent personal, living or family expenses within the meaning of section 24(a) of the [39] Code.²

Employee Ambitious feels that he can get ahead quicker and wants to go to Seattle. Big Green grants his request and agrees to a moving allowance.

Question: How much is includible in Ambitious' gross income?

Answer: All of the allowance.³

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¹"The payment or reimbursement by an employer of the cost of moving an employee, his immediate family, household goods, and personal effects from one place of employment to another permanent place of employment, primarily for the benefit of the employer, is not compensatory in nature. There is no essential difference between a payment of such cost directly by the employer and the payment by the employee and subsequent reimbursement by the employer."

²Rev. Rul. 54-429, 54-2CB53-54.

³Ibid. "In any case in which the transfer is made primarily for the benefit of the employee, any allowance or reimbursement received by the employee is includible in his gross income."
If the deduction from gross income is to be allowed, it must be a reimbursed expense.\textsuperscript{4} And the move must be permanent, as opposed to a temporary move.\textsuperscript{5}

Big Green is interested in obtaining bright young men for its organization and as an inducement to Hotshot, an outstanding engineering student from V.P.I., they offer a liberal moving allowance for his trip to Seattle. The recruiting program also produced Willing, who was working for another company. His moving expenses were to be reimbursed if he agreed to stay on the new job for at least six months.

Question: Are the moving allowances includible in gross income?

Answer:

One of the conditions which induced [the] taxpayers to accept employment was that their moving expenses to the place where they would be employed would be paid by the employer. While it is true that there was no gain or profit from the payments to the taxpayers, it cannot be denied that they received an economic and beneficial gain. Had the expenses not been paid by the employer, the burden would necessarily have been on the taxpayers. The payment was in the nature of a cash bonus as an inducement to accept employment. As a matter of law, these payments are no different than had . . . [Big Green] given the taxpayers cash to pay outstanding obligations, or for the payment of living expenses for a specified period after their arrival in . . . [Seattle]. The form of payment, to constitute income, is immaterial. The statute explicitly declares that gross income shall include compensation for personal services of whatever kind and in whatever form it is paid. [Citations omitted.] These payments come within the statutory description of gross income.\textsuperscript{6}


\textsuperscript{5}George B. Lester, Petitioner, v. Commissioner of Internal Revenue, Respondent, 19 B.T.A. 558 (1930).

\textsuperscript{6}U.S., Appellant v. S. O. Woodall, et al., Appellees, 255 F. 2d 370 (10th Cir. 1960), 58-2 U.S.T.C. ¶ 9547. On November 21, 1960, the U.S. District Court at Atlanta granted a motion for summary judgment in favor of the Government in a case where moving expenses were included in the contract of employment as a condition of acceptance. See, 61-1 U.S.T.C. ¶ 9115. (At the time of the writing of this paper, no official citation is available.) The Court did not discuss any test as to whether the moving expenses was a business expense or for whose advantage it was incurred.
Question: Are the expenses deductible?

Answer: The Court of Appeals, 10th Circuit thinks:

...that it is equally well settled that the expenditures are not deductible expenses under Section 22(n) and Section 23(a) of the Internal Revenue Code of 1939, or Section 62(a) and Section 162 of the Internal Revenue Code of 1954.

The reasons which motivated Hotshot and Willing to accept employment are personal.

The expenditures had no relation to any service which was being performed for the employer. It has been said that "The job, not the taxpayer’s pattern of living, must require the travel" for the expenses therein incurred to be deductible under the statute.7

Willing's position is also covered by Revenue Ruling 55-140, 55-1 C. B. 317. The expenses are held to be "personal, living or family expenses" within the purview of Section 23(a)(1) of the Internal Revenue Code of 1939 or Section 262 of the Internal Revenue Code of 1954, and therefore not deductible.8 Unreimbursed moving expenses, incurred while moving to another locality to accept new employment are non-deductible personal expenses.9

Altering the facts just slightly, Hotshot is to report to Richmond for an intensive training course for a period of six months.

7Ibid. The court in this decision cites Commissioner v. Peurifoy, which was later heard on certiorari by the Supreme Court, 358 U.S. 59; 79 S. Ct. 104; 2 AFTR 2d 6055 (1958). The deduction involved concerns "traveling expenses while away from home in the pursuit of a trade or business." The taxpayers were trying to claim a deduction claiming that the employment was "temporary" as opposed to "indefinite" or "indeterminate," a distinction which the Tax Court makes in determining the taxable "home" in such cases. The Supreme Court stated that they were not deciding the validity of the distinction because its validity was not challenged, but they did uphold the Commissioner's position that the taxpayer had a new taxable home. The moving expense question is similar as far as the requirement that the travel be necessitated by the job, but there is no issue over the expenses once the new location is reached. The issue of deductibility of moving expenses presupposes that the new location is a permanent job.


After completion of the course he is to go to Seattle.

**Question:** Are the reimbursed moving expenses includible in his gross income?

**Answer:** This question falls between the situations of being hired as a new employee at a new location and being transferred to a new location for permanent duty. The situation appears to fit into the definition of transfer, which would allow the taxpayer to exclude the income. The facts that are stated seem to show that Big Green Corporation has a legitimate business purpose for wanting to train Hotshot before paying his expenses to a new location. The training at Richmond has a direct relation to the services he will be rendering.\(^\text{10}\)

The decision here, as in so many cases in the business expense area, will depend on "its own facts and circumstances."\(^\text{11}\) The criterion which must be used is the elusive business purpose test. Does Hotshot's presence at Richmond serve some good business purpose for Big Green, or is his presence merely a sham to allow him to be transferred and have his expenses paid tax free?

**Open End Situations**

The Internal Revenue Service has not stated what is necessary to make a reimbursement deductible for the very obvious reason that different transactions may be involved for various legitimate business purposes. To illustrate:

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\(^{10}\) *Op. cit.*, Woodall, see footnote 6. By Rev. Rul. 60-314, I.R.B. 1960-40, 9, the Service has supplied the partial answer to the question of Hotshot's status. This ruling is concerned with the travel expense of § 162(a)(2), "...A manufacturing corporation has an employment policy under which new engineering employees from various sections of the country are hired on a full-time basis to work at the main plant for a test period of one year. [This period of time is used as a rule of thumb to determine what is 'temporary.'] with the understanding that, if their services have been satisfactory during such period, they will then receive permanent appointments and will either continue to work at the main plant or be transferred [emphasis added] to one of the branch plants..." Notice the fact that he is hired "to work" or render services at the main plant. The Ruling also states that this is his principal or regular place of employment. Therefore, if he is transferred, the moving expense is deductible.

Big Green needs mechanics for their oil fields in Saudi Arabia. Fixit signs a contract of employment at the Richmond office and receives a moving allowance to the oil fields. The moving allowance clearly would be income if he had not become an employee until arriving there, because expenses in acquiring new employment are personal under Section 262 of the Internal Revenue Code of 1954, as has been discussed. What effect, if any, has the signing of a contract?

The addition of the cost of the trip to Saudi Arabia from Richmond would increase Fixit's wages to such heights that it is conceivable that he might have to pay nearly his entire net income in taxes.

The Tax Court is not vested with equity jurisdiction and the U. S. Court of Appeals, 10th Circuit, said:

While it may appear to be equitable that expenses incurred in seeking and obtaining employment, or in traveling to the place of employment, should be treated as though they had been incurred in the performance of one's duty as an employee, it has, nevertheless, been long recognized that deductions are matters of legislative grace, allowable only when there is a clear provision for them, and do not turn upon equitable considerations. *McDonald v. Commissioner*, 323 U.S. 57; *Deputy v. DuPont*, 308 U.S. 488; *New Colonial Ice Co. v. Helvering*, 292 U.S. 435. What should be allowed as an expense deduction is a matter of policy for Congress, not the courts.12

The Commissioner and his Service are charged with the duty of collecting "the taxes imposed by the internal revenue law."13 And Section 7805 of the Internal Revenue Code of 1954 authorizes the issuance of revenue regulations and rules by the Commissioner as a delegate of the Secretary of the Treasury unless otherwise stated in a particular section. Former Commissioner of Internal Revenue Dana Latham was asked:

Q. Would you say that the underlying motive of the Internal Revenue Service is to get in the tax money, even if, in inter-

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13Section 6301 of the Internal Revenue Code of 1954.
interpreting the law, it produces a hardship so far as the taxpayer is concerned?

A. By no means do we approach the matter from that standpoint. If we have a choice between collecting a tax the hard way—that is, with a real hardship on the taxpayer—or giving a liberal construction and not collecting the tax, we will choose the latter unless the impact on the revenue might be so great as perhaps to throw out of balance the national budget. In such cases we go immediately to the Treasury and ask the Treasury Department to recommend to Congress an amendment to the law making the situation clear one way or another.14

The attempt to be reasonable has allowed some items to go untaxed, for example, Christmas turkeys, hams and other holiday distributions of nominal value to employees.15

How equitable is it to require Fixit to include the moving expenses16 which make his tax burden unreasonable, and allow the exclusion of the value of a commodity which is clearly a benefit, which would make little or no difference in the taxpayer's burden?

To return to the original question of the importance of the signing of a contract. The actual signing should be considered as one fact, but the tests which this writer feels should be applied to the whole situation are: (1) has the taxpayer become an employee for some legitimate business purpose of his employer; (2) has he commenced his duties to the extent that he is rendering service for the benefit of the employer prior to the move?

As has already been suggested, there are similarities between the travel expense and the reimbursed moving expense. In the hope of finding a test which might indicate when a person does become an employee, the author explored the bulk of the cases

16Lawrence and Mildred Perry, T.C. Memo. 1950-174, ¶ 50,174 P-H T.C. Memo.
dealing with the definition of a "tax home" for the purpose of determining the deductibility of travel expenses.

Although one of the most commonly used words in the language, the term "home" has not been easy to define for purposes of the Code. It has the same elusiveness as "domicile" or "residence." In Peurifoy v. Commissioner, the Supreme Court for the second time avoided any definitive action although the majority opinion by implication and the dissenting opinion expressly cast serious doubt on the correctness of the gloss on the statute created by the Tax Court and the Commission. In Commissioner v. Flowers, the Supreme Court had denied any deduction for expenses incurred when the taxpayer lived in one city and worked in another city. By choosing to live at an unusual distance from his place of employment, the taxpayer cannot convert commuting and living expenses into business expenses, since such expenditures would not be required by "the exigencies of the business." Notwithstanding that the phrase "while away from home" has been in the revenue law for more than three decades, the Supreme Court has not as yet expressed its opinion as to what it means in its statutory context. Up to the present, however, the Tax Court has consistently held to the view that the taxpayer's "home" means his principal place of business, employment, or post or station at which he is employed, and not where he may reside with or away from his family.

... The determination as to where a taxpayer's principle place of business or employment is located for the purposes of applying the Tax Court rule is a question of fact.\footnote{Mertens, \textit{LAW OF FEDERAL INCOME TAXATION}, § 25.93 (1960). The 9th Circuit U.S. Court of Appeals reversed 32 T.C. 1368 in a decision handed down on Nov. 1, 1960. 60-2 U.S.T.C. ¶ 9771.}

The author does not feel that any of the numerous cases cited in \textit{Mertens}, or later cases which cite them as precedent answer what he had hoped to find. They did serve to point up even more emphatically that the possible combination of facts and the various possible jobs that can occur, force each case to stand on its own peculiar facts.
To state a few examples in situation form: Fixit, the Big Green mechanic, is asked to sign his contract in the Richmond home office for the following reasons: (1) the home office has the final authority to contract for employment; (2) the company wishes to have all the details of the arrangements drafted into a binding legal agreement, and all of the Big Green's legal department is at that location; (3) for the company's convenience and at its request, Fixit travels some distance at his own expense to get to Richmond for the meeting; (4) Fixit actually receives a check for wages in Richmond; (5) he is given a number of instructions which will allow him to go immediately to work upon arrival, and (6) he is directed to deliver some sealed instructions to the supervisor.

With all the facts in Fixit's situation, the distinction between good business reason for clothing him with the look of a bona fide employee and outright sham becomes a little harder to distinguish. Revenue Regulations for the Employment Tax defines the term "employee" as follows:

Regulation Section 31.3401(c)-1. Employee. — (a) The term "employee" includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee.

(b) Generally the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to result to be accomplished by the work but also as to the details and means by which that result is accomplished.

(c) . . .

(d) Whether the relationship of employer and employee exists will in doubtful cases be determined upon an examination of the particular facts of each case.

This definition follows the Restatement of the Law of Agency 2d. Fixit is an employee, and the employer has benefitted to the

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19 Section 2.(2) "A servant is an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right to control by the master."
extent that there is to be no delay in Fixit's commencing work upon arrival and the instructions are being carried. But the personal opinion of the author is that Fixit was hired to perform work as a mechanic and until such time as he commences to render services, he is an employee who is being sent to a new job. He has never had a post of duty from which to be transferred.

In the example with Hotshot, the company being eager to acquire his services and fearful that someone else might hire him first, agreed to pay him a full salary during his last two months at V.P.I. Here, it seems to the author, that he is preparing to commence a new job, and there is no post of duty until such time as he actually renders service, in spite of the receipt of wages.

The wide variety of types of employment, and of facts, makes it impossible to draft one test. Each case must stand or fall on its own facts. The general framework for testing these facts could be: (1) Has the individual become an employee for some good business purpose of his employer, and (2) has he commenced rendering services of the general type for which he was hired for the benefit of the employer?

Conclusion

The problems that are presented by moving expenses cannot be solved by viewing them in a vacuum. Other problems involving the same theory must be considered. The application of the law to a particular situation is not always clear and Congress has given the Revenue Service the authority to issue Regulations for the interpretation of the law for such situations. Even the Regulations do not always clarify particular problems and there remain sections which have no Regulations for the simple reason that the Service is unable or unwilling at the present time to set any standards. It is in these areas of conflict that the great bulk of litigation occurs. From the discussion and examples which have gone before, the areas of conflict in the field can be summarized as follows:

(1) Should any of these reimbursed expenses such as moving expenses, interviewing expenses, or education expenses which are not regarded by either employers or employees as compensation be taxed at all?
(2) Can we reconcile taxing the reimbursement of moving expenses in reporting to the first post of duty\textsuperscript{20} with not taxing the reimbursement of moving expenses in transferring from one post of duty to another for the benefit of the employer?\textsuperscript{21}

(3) What constitutes the first post of duty?

(4) Should any distinction be made between moving expenses to domestic or foreign posts?

The entire area of "fringe benefits" to employees is loaded with the problem that allowing one deduction leads to the demand that another concession be made in a similar type of situation. Payment of moving expenses for a new employee in traveling to his first post of duty is "in the nature of a cash bonus as an inducement to accept employment."\textsuperscript{22} Whether the employer or the employee considers the payment as income does not alter the fact that there is a definite economic gain to the taxpayer. The interpretation of the law "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation."\textsuperscript{23} Only the exceptions specifically allowed are deductible,\textsuperscript{24} and it is settled that these expenditures are not deductible.\textsuperscript{25}

The area of interview expense is troublesome. Although very similar in nature to moving expenses, the event is more "for the convenience of the [prospective] employer."\textsuperscript{26} The prospect is


\textsuperscript{21}Rev. Rul. 54-429, 54-2CB 53-54.

\textsuperscript{22}Op. cit., Woodall, supra note 6. And does it really matter when such a bonus is paid? The cases cited in Woodall include the bonuses no matter the form. Commissioner v. Smith, 324 U.S. 177, 181 (1945) (stock options); Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929) (payment of taxes).

\textsuperscript{23}Commissioner v. Lo Bue, 351 U.S. 243, 247 (1956). "This [Supreme] Court has frequently stated that this language [definition of gross income under § 22 of the 1939 Code] was used by Congress to exert in this field 'the full measure of its taxing power.' Helvering v. Clifford, 309 U.S. 331, 334 (1939); Helvering v. Midland Mutual Life Ins. Co., 300 U.S. 216, 223 (1936); Douglas v. Willcuts, 296 U.S. 1, 9; Irvin v. Gairt, 268 U.S. 161, 166 (1925)."

\textsuperscript{24}Section 61 of Internal Revenue Code of 1954.

\textsuperscript{25}Op. cit., Woodall, supra note 6.

\textsuperscript{26}Section 119 of the Internal Revenue Code of 1954 is limited specifically to meals and lodging.
obliging the businessman by saving him the time and expense of having to travel to see the prospect. There is nothing permanent here. Had the prospect approached the employer, the expense would be personal in seeking employment. The employer has chosen to assume the round-trip expense of the prospecive employee. The payment is not wages or a bonus, the prospective employee is receiving a gift which covers his expenses.

The underlying reason for moving an employee to a new location is simply that he must be there physically to do his job and since the new location will constitute a permanent post of duty, his family and/or belongings will have to be moved. Why or

27 "Reg. § 1.212-1(f) Among expenditures not allowable as deductions under § 212 are the following: ... expenses such as those paid or incurred in seeking employment or in placing oneself in a position to begin rendering personal services for compensation,..." One very noticeable exception to this rule is that "Fees paid to secure employment are considered allowable deductions for the purpose of computing net income subject to tax." O.D. 579 C.B. 3, 130 (1920). The Internal Revenue recognized this inconsistency in Rev. Rul. 60-158, I.R.B. 1960-17, 7. "The Internal Revenue Service has been requested to state whether expenses incurred by an individual in seeking employment, including fees paid to an employment agency are deductible for Federal income tax purposes. I.T. 1397, C.B. 1-2, 145 (1922), holds that 'amounts expended by a taxpayer in seeking a position' are personal expenses and are not deductible from gross income. O.D. 579, C.B. 3, 130 (1920) [quoted above]. "Section 262 of the Internal Revenue Code of 1954 provides as follows: 'Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living or family expenses.' "No provision of the Code or Income Tax Regulations provides for the deduction of expenses incurred in seeking employment...." While employment agency fees are generally paid after employment has been secured, usually through the assistance of the employment agency, the obligation to pay such fees in the event of employment is incurred when the individual is seeking employment. Therefore, it is now the position of the Service that fees paid to employment agencies in connection with obtaining employment are also incurred in seeking employment...." After correcting this inconsistency, the Service reverted to its former position. Rev. Rul. 60-223, I.R.B. 1960-23, is short: "Revenue Ruling 60-158, I.R.B. 1960-177, which holds that expenses incurred in seeking employment, including fees paid to an employment agency, are not deductible for Federal income tax purposes is revoked. This ruling would have been effective for taxable years beginning after December 31, 1959. The Internal Revenue Service will continue to allow deductions for fees paid to employment agencies for securing employment." No explanation is offered, and in a case where the taxpayer contended that no distinction should be made between amounts paid to regular employment agencies and amounts paid to others who perform the same function as an employment agency, the Tax Court in T.C. Memo. 1959-131 (¶ 59,131' P-H Memo. T.C.) did make a distinction on ruling against Thomas W. Ryan.
how can we distinguish the expense of moving a new employee to a permanent duty post, from transferring an old employee to a different permanent post. The question somewhat answers itself. The underlying reason is to utilize the employee, but using somewhat the same theory that will be demonstrated in the educational expense field, the expense will be deductible after the man has qualified for his position. That is, after he has reached his first permanent duty post and commenced service, he has qualified.

What constitutes a first duty post is a problem which this author feels has not yet been fully answered. Because of the distinction made between transferred and new employees, it is submitted that problems will arise as companies engage in practices (1) of training a man in one location before assignment, and (2) of creating situations which may or may not stand up as posts of duty. This paper proposes that an employee must commence rendering services at a permanent duty post before he is considered an employee capable of being transferred. This type of standard is consistent with "qualifying for a position" (educational expense) and more than "temporary" (as a corollary of one of the travel expense tests).

In the opinion of the writer, the current law does not allow for a deduction based on a distinction between foreign and domestic moving expenses in route to a first post of duty. It has been suggested that the employee who must report to a distant duty post, whether trans-oceanic or trans-continental, may well suffer an undue hardship. A possibility would be to suggest legislation which would allow a deduction for amounts above a minimum stated percentage of adjusted gross income — perhaps twenty percent — to prevent the possible inequity. The use of a percentage "floor" for medical expenses has caused administrative difficulty because of its invitation to taxpayers to alter the time of payment to create a tax advantage. The much higher floor, suggested for travel expenses, and the comparative infrequency of such expenses will reduce the likelihood of such shifting. This deduction would be a reduction from adjusted gross income which would prevent the taxpayer's having to bear a completely undue hardship merely because his new job was at a distant point.

28Section 213 of the Internal Revenue Code of 1954.
Educational Expense

One of the difficult problems surrounding business expense in the Code (both of 1939 and 1954) is the deductibility of educational expenses. The final Regulations liberalize the possibility for deduction. The Congress approved action broadening the base for deductions, and indicated their approval by extending the period for filing for refund to sixty days after Congressional action was finalized.

In answer to many questions, the Internal Revenue Service issued a Technical Information Release with various examples and later a Revenue Ruling which thoroughly discussed and outlined the problem. The author feels that the tests, that are developed by these releases, make it possible for most questions

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30 "The Internal Revenue Service long held that relatively few educational expenses were deductible as business expenses, or as expenses incurred in the production of income. Generally, the Service had held that for such expenses to be deductible they must be required as a condition to the retention, by the taxpayer, of his present employment. On April 4, 1958, however, the Treasury Department in a news release announced that it was issuing final regulations which were more liberal than the regulations previously in force, in that the expenses incurred by a teacher for education could be deducted even though they were incurred voluntarily and even though the courses taken carried academic credit or resulted in an increase in salary or in a promotion. The news release also indicated that this change was made in order to remove the distinction previously drawn between self-employed persons and employees, such as teachers. The final regulations issued on April 5, 1958, provide that expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken to maintain or improve skills required by the taxpayer in his employment or in his trade or business. These new, and more liberal, regulations were made effective for years to which the 1954 Code is applicable.... Your committee is pleased with the more liberal interpretation by the Internal Revenue Service of what constitutes deductible educational expense...." Senate Report No. 1983, Eighty-fifth Congress, Second Session, calendar No. 2029. July 28, 1958. Subject: Technical Amendments Act of 1958 (H.R. 8381). Section 101, 58-3CB, pp. 1031-1032.

31 Ibid. This extension allowed taxpayers to review their 1954 return to determine if they were qualified for the deduction.

32 T.I.R. No. 76, April 11, 1958, 586 CCH ¶ 6445.

to be "determined upon the basis of all the facts of each case" with comparative ease. A summary outline follows:

[The General Rule] Expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken primarily for the purpose of:

1. Maintaining or improving skills required of a taxpayer in his employment or other trade or business, or

2. Meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status or employment.

If it is customary for other established members of the taxpayer's trade or business occupying positions similar to that of the taxpayer to undertake education of the type pursued by the taxpayer, the taxpayer will be considered to have undertaken such education for the purpose of maintaining or improving skills.

However, we do not think it was absolutely necessary that the customariness be established by testimony. Of course had such evidence been introduced it would have strengthened petitioner's position.... The emphasis is placed upon the primary purpose of the education.

Minimum Requirements for Qualification or Establishment. Section 1.162-5(b) of the regulations specifically provides that "if education is required for the taxpayer in order to meet the minimum requirements for qualification or establishment in his intended trade or business or specialty therein, the expense of such education is personal in nature and therefore not deductible." It therefore is necessary to determine in every case whether a taxpayer has met these minimum requirements.

34Regs. § 1.162-5(a).
35Ibid.
38Rev. Rul. 60-97, op. cit.
Increased Requirements — Changed Duties. Once a taxpayer has met the minimum requirements established in his intended position, expenses incurred in meeting increased requirements thereafter established for that position are deductible, provided the increased requirements are imposed primarily for a bona fide business purpose of the employer. . . . 39

. . . . However, if the education required by the employer represents a complete course of study which will lead to qualifying the taxpayer in a new trade or business or specialty therein, it will be considered, for purposes of this Revenue Ruling, that the requirement was imposed primarily for the benefit of the employee and not primarily for a bona fide business reason of the employer and, accordingly, the cost of such education will not be deductible. 40

Key Questions. The following is the suggested order in which questions should be resolved in determining the deductibility of expenses incurred for education:

Has the taxpayer met the minimum requirements for qualification or establishment in his intended position?

If “no” no deductions are allowable.

If “yes” is education undertaken primarily to meet employer requirements to retain taxpayer’s position?

If “yes” the taxpayer is entitled to deductions unless (1) the education leads to qualifying the taxpayer in his intended trade or business and taxpayer knew of this employment requirement before assuming his position with his employer, or (2) the employer’s requirement is imposed primarily for the benefit of the taxpayer and not primarily for a bona fide business purpose.

If “no” is it customary for other established members of taxpayer’s trade or business occupying positions similar to that of the taxpayer to undertake education of the type pursued by the taxpayer?

If “yes” the taxpayer is considered to have undertaken education for the purpose of maintaining or improving needed skills and is entitled to deductions.

39Ibid.
40Ibid.
If "no" the taxpayer must show by other means that his primary purpose was to maintain or improve needed skills. If the education undertaken meets express requirements for a new position or substantial advancement, the taxpayer must show that the education was not undertaken primarily for the purpose of meeting those requirements.\textsuperscript{41}

\textit{Expense of Investigation of Prospective Business or Capital Investments}

The cost of living is inching upward. It was estimated that businessmen would increase plant and equipment investments by fourteen percent in 1960 over 1959.\textsuperscript{42} The investments by United States firms in foreign countries has been high.\textsuperscript{43} The fixed capital demands remain high and the comparative ease of acquiring supplies has caused reduced inventories.\textsuperscript{44} Fundamental common sense and good business practice require investigation of many aspects of the possibilities of success before a business of capital investment can be made.

The idea here is comparable to the minimum requirement for qualification of the educational expense; in this case the taxpayer must be in an active business or trade. It has been argued that an unemployed scientist is still in the trade or business of being a scientist, or that an unemployed corporate officer is in the business of being a corporate officer (by inference).\textsuperscript{45} Borrowing a definition from a Regulation of a different Code Section.\textsuperscript{46}

\textsuperscript{41}Ibid.
\textsuperscript{42}40 SURVEY OF CURRENT BUSINESS, No. 3, p. 12.
\textsuperscript{43}"United States firms added $23\frac{1}{2} billion to their investments in foreign subsidiaries and branches in 1959, a larger increase than in 1958 but substantially less than that of the peak year of 1957. Reports for the first half of 1960 indicate a moderate reduction in direct-investment outflows, although the rate is close to $1 billion a year, and a like amount is being invested abroad each year out of undistributed profits of foreign subsidiaries." 40 SURVEY OF CURRENT BUSINESS, No. 9, p. 15.
\textsuperscript{44}40 SURVEY OF CURRENT BUSINESS, No. 10, p. 13. Also causing the inventory cutback has been an easing sales situation. 41 SURVEY OF CURRENT BUSINESS, No. 1, p. 4.
\textsuperscript{45}Arthur Fleischer, Jr., \textit{The Tax Treatment of Expenses Incurred in Investigation for a Business or Capital Investment}, 14 TAX LAW REVIEW, 567, 572 (No. 4, May, 1959).
\textsuperscript{46}Regulation 1.355-1(c).
... a trade or business consists of a specific existing group of activities being carried on for the purpose of earning income or profit from only such group of activities, and the activities included in such group must include every operation which forms a part of, or a step in, the process of earning income or profit from such group. Such group of activities ordinarily must include the collection of income and the payment of expenses. It does not include a group of activities which, while a part of a business operated for profit, are not themselves independently producing income even though such activities would produce income with the addition of other activities, or with large increases in activities previously incidental or substantial.47

The scientist or the corporate officer must be employed in order to connect “every operation” of producing the income or profit. It is obvious that both of these are highly skilled activities, but unless they are joined with other activities, they are not in and of themselves profit-making. The minimum requirement then is to connect the various activities.

Another comparable expense is the expense incurred in seeking employment.48 The legislative history indicates that the Congress wanted the employee and the employers to be as nearly equal as possible. If the moving expense of a new employee is held to be personal preparation, the expense incurred in bringing together the factors would also be preparation and taxable.

In general, preparation costs are not deductible49 as business or trade expenses, but once there is an existing trade or business the investigation expenses are deductible if they are incident to it.50 This rule was expanded by the York v. Commissioner decision


48Many of the cases citing the Frank case are “seeking employment” situations. Mort L. Bixler, 5 B.T.A. 1181 (1927) is an early case which is often cited.

49Rev. Rul. 55-291, 1955-1 C.B. 317, Corporation president became a lecturer for $1 a year to establish his reputation, the expenses were not deductible; O.D. 452, 2 C.B. 157. Admission fees for lawyers are not deductible. As was pointed out in footnote 29, the allowance of employment agency fees as a deduction is not logically consistent.

50Either as a business expense under § 162 or as a business loss under § 165(a), (c)(1) of the Internal Revenue Code of 1954.
to also include the expenses of investigating "a sector already within the compass of his field." Whether the courts will be disposed to hold that new ventures are new business or merely expansions of the old business will depend upon what they consider the scope of the general business field.

Just as it is hard to reconcile the fact that an old employee may deduct moving expenses when he is transferred and a new employee may not, the fact that an established business can deduct expenses or losses for investigation within its own general field is difficult to reconcile with the fact that a new business may not deduct the expenses of investigation which are preliminary to its doing business. One well known fable tells of the deer who leaped into a lion's den and was devoured; the moral of the story being: "Look before you leap." Why should it be any easier for an existing business or, for that matter, a corporation to expand carefully than for a new venture, partnership or sole proprietorship? This writer feels that any discrimination which does exists is unintentional and is the result of an attempt to prevent deductions for pleasure trips which are masked as some purported business purposes. The administrative problem is to determine which are legitimate and which are mere shams. It is submitted that the transaction test is to the businessman what the actual employment test is to the employee; or to state it differently, unless the expenses of seeking employment are deductible, the investigatory expenses of a business cannot be deducted and still maintain the spirit of the law — to make employees and employers equal.

51York v. Commissioner, 261 F. 2d 421 (4th Cir. 1958), 58-2 U.S.T.C. ¶ 9952. The problem here is that there is a discrimination against diversification into different fields, while the investors may study the expansion of an integrated trade, and apparently deduct the cost as a business expense. However, this may be limited by how the court interprets the scope of the trade or business. See, Radio Station WIBR, Inc. v. Commissioner, 31 T.C. 803 (1959).

52An attorney and his wife compiled a book about their trip around the world and being unsuccessful in publishing it, they took a deduction for the expenses, which was denied. Kerns Wright v. Commissioner, 31 T.C. 1264 (1959).
**Deduction as Non-Business Expenses**

In 1942, Section 23(a)(2)53 was added to the 1939 Code because:

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade and nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable.54

Section 23(a)(2) plus "or in connection with the determination, collection, or refund of any tax,"55 was carried into the current Code as Section 212. Just as the taxpayer must be in an existing trade or business before deducting business expenses, he must have an existing interest in property or right to secure income before he is entitled to take the deductions of Section 212.56

**Deduction as a loss from a Transaction Entered Into for Profit**

Where a loss occurs due to the failure to acquire or establish, there may be a deduction where the qualifications of Revenue Ruling 57-41857 are met.

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53"Non-Trade or Non-Business Expenses. — In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."


55Section 212(3) of the Internal Revenue Code of 1954.

56"Prior to the organization of the new business, the taxpayer had neither a business nor a present right to income or income-producing property; and consequently such expenses do not come within the scope of either 23(a)(1)(A) [1939 Code] or 23(a)(2) [or § 212 of the 1954 Code]. Morton Frank, 20 T.C. 511 (1953).” [Emphasis added.] J. D. O'Connor, T.C. Memo. 1954-195, 54; 195 P-H Memo. T.C. § 54-609.

A loss, not compensated for by insurance or otherwise, sustained during a taxable year with respect to expenditures incurred in search of a prospective business or investment is deductible only where the transaction has actually been entered into and the taxpayer abandons the project. The loss is allowable only in the taxable year in which the project is abandoned.58

To clarify a point which has not been made clear previously, if an expense or loss is held to occur in an existing trade or business59 or from a transaction entered for profit involving a sale or exchange of property,60 or rent or royalty producing property,61 it is deductible in computing adjusted gross income. If it is deductible for any other reason,62 it is deductible from adjusted gross income and the deductions must be itemized to take advantage of it.63

The amount of loss which may be deducted by individuals is limited by Section 165(c). The primary problem encountered in deducting a loss not in connection with a trade or business is the determination of when a transaction is actually entered into.

The Revenue Service arrived at the test of actual entry in Revenue Ruling 57-418 which follows the Charles T. Parker v. Commissioner64 case where a taxpayer operated a mine for thirty days and finding the operation unsatisfactory, abandoned the project.

\textbf{Actual Entry}

As has been shown, the requirement of an existing business or of a transaction entered into for profit depends on the decision of when the project commences. Mr. Fleischer, Jr., argues for a broadening of the transaction concept. He feels that "a transac-

\begin{footnotes}
\item[58]Ibid.
\item[59]Under § 62(1) of the Internal Revenue Code of 1954.
\item[60]Section 62(4) of the Internal Revenue Code of 1954.
\item[61]Section 62(5) of the Internal Revenue Code of 1954.
\item[62]Sections 165 and 212 included.
\item[63]Sections 62 and 63(b) of the Internal Revenue Code of 1954.
\item[64]1 T.C. 709 (1943).
\end{footnotes}
tion for profit should be considered entered into when the taxpayer makes his first efforts to find a business. . . . The burden should be a heavy one on the taxpayer to demonstrate the business nature of his expenses.” As has been expressed, the author feels that this would be inconsistent with the seeking employment, the educational expense, and the moving expense situations.

If these situations are to be satisfied with any consistency, the problem is to reach some objective test which will satisfy all types of business transactions and all forms of business and then let the facts in the situation be measured by that standard.

To keep within the spirit of the law, the first test should be commercial motivation—to eliminate transactions purely for sport. Commercial motivation is relatively easy to test and at the same time relatively easy to fake or stage.

The next test requires some groundwork. It seems to the writer that the transaction entered into for profit must conform with the requirements which would be applicable to a business or trade, because the difference between the two depends largely on the amount of time and effort devoted to it. That is to say that a man’s trade or business is measured by these things. If a man sees a chance to buy a business and resell it at a quick profit, he enters into a transaction for profit; but if he is a speculator or dealer in businesses, that can become his trade or business. The logical step then is to determine when a business begins and the same principle should apply to a transaction or series of transactions.

As has already been shown, the determination of when a business begins for Section 355 requires “every operation which forms a part of, or a step in, the process of earning income or profit.” The meanings of the words “trade or business” are almost as numerous as the times they are used, but that is a topic which is beyond the scope of this study. Another section which is analogous is Section 248, which allows an election for amortizing organizational expenses when a corporation is formed. The Regulations say:


66See, supra note 53.
(3) ... The determination of the date the corporation begins business presents a question of fact which must be determined in each case in light of all the circumstances of the particular case. The words "being business" however, do not have the same meaning as "in existence." Ordinarily, a corporation begins business when it starts the business operations for which it was organized; a corporation comes into existence on the date of its incorporation. Mere organizational activities, such as the obtaining of the corporate charter, are not alone sufficient to show the beginning of business. If the activities of the corporation have advanced to the extent necessary to establish the nature of its business operations, however, it will be deemed to have begun business. For example, the acquisition of operating assets which may constitute the beginning of business. 67 [Emphasis added]

In the case of a partnership, the mere drafting of a partnership agreement is not beginning business; in the case of a sole proprietorship, the mere holding out of oneself as in business is not enough. The second test for determining when a transaction is actually entered, would logically seem to be: If every one of the activities necessary for the process of earning income or profit has advanced to the stage that the exact nature of the transaction is established and no further activities need be undertaken to accomplish that end except their continuation.

Summary

This paper has considered and discussed the problems involved in the deductibility of certain expenditures. Most problems arise due to the necessity of applying a tersely worded statute to vastly different fact situations. At present, there is no adequate standard for measuring the various, individual situations objectively. The author offers a number of suggestions for tests to be applied to determine whether or not various expenditures fall within the purview of allowable deductions.

The Service has done an outstanding job in outlining the requirements for establishing the deductibility of educational expenses. 68 The first question that must be answered before any

67Reg. § 1.248-1(a)(3).
68See, Text at p. 12, supra.
deduction can be taken is: "Has the taxpayer qualified for his position?" The author feels that the two tests which follow define a "minimum" qualification for the deduction of the particular expenditure involved.

**Key Questions:** The following is the suggested order in which questions should be resolved in determining the deductibility of reimbursed moving expenses:

At the time of the move, was the taxpayer an employee for a bona fide business purpose of the employer for whom the move was made?

If "no" no deductions are allowable.

If "yes" had he commenced rendering services of the general type for which he was employed, at a permanent duty post?

If "no" no deductions are allowable.

If "yes" was the move effected at the request of and for the primary benefit of the employer?

If "no" no deductions are allowable.

If "yes" moving expenses are deductible up to the amount of reimbursement included in taxpayer’s gross income.

**Key Questions:** The following is the suggested order in which questions should be resolved in determining the deductibility of losses sustained in a transaction entered into for profit:

Was the transaction entered into expressly for the purpose of making or producing income or profit?

If "no" no deductions are allowable.

If "yes" had the exact nature of the transaction been established, and had all activities necessary to the process of earning income or profit been accomplished?

If "no" no deductions are allowable.

If "yes" was the transaction abandoned during the current taxable year?

If "no" no deductions are allowable.

If "yes" losses sustained through the abandonment of the
transaction may be deducted, provided that such losses were not compensated for by insurance or otherwise.

When an employee is required to move a great distance to accept a new employment, an inequity arises because the amount of reimbursed moving expenses is included in his income, and no deduction for the expenses is allowed. At present, there is no means of alleviating this inequity. It has been suggested in some quarters that a distinction should be made between domestic and foreign moving expenses, but the author feels that such a distinction could itself lead to inequities. This paper offers as a suggestion that a percentage “floor” similar to that used in computing the deduction for medical expenses, be utilized. It is understood that this deduction could only be taken if the taxpayer itemized his expenditures.\footnote{On page 2 of Form 1040, or on 1040W.}

A study of the legislative history of deductions indicates that Congress has always attempted to maintain consistency and fairness as far as possible. The general commercial law has served as a guide for tax legislation, but many examples can be raised to show points of inconsistency. A good deal of consideration is being given to the possibilities of making the tax law conform to what is “generally considered as income” by employers and employees in the field of moving expenses and to allowing the deduction of all investigatory expenses in seeking a trade or business, or transaction entered into for profit.

It is submitted that reimbursed moving expenses for a new employee are similar in nature to a cash bonus paid for the employee’s having accepted the job, and constitutes a definite economic gain to the taxpayer. Unless there is some specific legislation to broaden the scope of the deductions, such expenditures cannot be considered deductible. And, unless a complete change of policy toward the deductibility of expenses incurred in seeking employment is implemented, the expenses incurred in investigating a profit-making venture cannot be allowed as deductions.