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INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224  
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OFFICE OF  
CHIEF COUNSEL

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MEMORANDUM FOR NATIONAL DIRECTOR OF SYSTEMS AND ACCOUNTING

FROM: Heather C. Maloy  
Deputy Associate Chief Counsel (Domestic)

SUBJECT: Taxability of Mileage and Other Transportation Expenses

This Chief Counsel Advice is in response to your memorandum dated January 2, 1996. Issuance of this response was delayed until the publication of Rev. Rul. 99-7, 1999-5 I.R.B. 4 (Feb. 1, 1999) (attached), which modifies and supersedes earlier Service position on the issues involved. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be relied upon or otherwise cited as precedent.

LEGEND:

X =

ISSUE:

What are the rules for determining the proper tax treatment of reimbursements that X provides to its personnel who are required to incur daily transportation expenses in going between their residences and a business location other than the designated office of each.<sup>1</sup>

CONCLUSION:

This memorandum provides a general overview of the applicable law and Service position in the daily transportation expense deduction and reimbursement area, and it addresses the questions raised in your memorandum.

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<sup>1</sup>Your memorandum does not raise, and this response does not address, issues concerning the tax treatment of traveling expenses paid or incurred while away from home overnight in the pursuit of a trade or business. See Rev. Rul. 93-86, 1993-2 C.B. 71, for the proper application of § 162(a)(2) to overnight travel expenses.

AOO-I-08268-96

FACTS:

Your memorandum asks 5 questions designed to obtain more specific information about the rules in this area. Our response will specifically address each of your 5 questions.

LAW:

Section 162(a) of the Internal Revenue Code allows a deduction for ordinary and necessary business expenses paid or incurred in carrying on a trade or business. Deductible expenses include business expenses paid or incurred by a taxpayer in connection with the performance of services as an employee. Primuth v. Commissioner, 54 T.C. 374 (1970). As discussed below, certain daily transportation expenses of an employee are deductible business expenses under § 162(a), while other daily transportation expenses of an employee are nondeductible personal expenses under § 262.

Section 62(a)(2)(A) allows a deduction from gross income for reimbursed expenses of employees under a reimbursement or other expense allowance arrangement with the employer. Section 62(c) provides that an arrangement will not be treated as a "reimbursement or other expense allowance arrangement" if (1) the arrangement does not require substantiation of covered expenses, or (2) the employee may retain any amounts in excess of substantiated expenses.

Section 1.62-2 sets forth rules for reimbursement or other expense allowance arrangements and for payments made under such arrangements. These rules provide that an amount paid by an employer to an employee under an arrangement that meets specified requirements is treated as paid under an "accountable plan." An amount treated as paid under an accountable plan is excluded from the employee's gross income, is not reported as wages, and is exempt from the withholding and payment of employment taxes.<sup>2</sup> If the arrangement does not satisfy one or more of the specified requirements, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." An amount treated as paid under a nonaccountable plan is included in the employee's gross income, is reported as wages, and is subject to the withholding and payment of employment taxes.

The three specific requirements that a reimbursement or other expense allowance arrangement must meet in order to be treated as an accountable plan are:

- (1) Business connection. Advances, allowances, or reimbursements under the arrangement must be provided for business expenses that are deductible under

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<sup>2</sup>The employment taxes generally include income tax withholding and the Federal Insurance Contributions Act taxes.

AOO-I-08268-96

§§ 161 - 197 and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer.

(2) Substantiation. Each business expense under the arrangement must be substantiated to the payor within a reasonable period of time, using adequate records or other sufficient evidence. Although the elements to be substantiated vary somewhat depending on the type of expense, for transportation expenses the elements are amount, time, use, and business purpose.

(3) Returning amounts in excess of expenses. In general, the arrangement must require the employee to return to the payor within a reasonable period of time amounts paid under the arrangement in excess of the expenses substantiated.<sup>3</sup>

The position of the Service on the deductibility of daily transportation expenses paid or incurred by a taxpayer in going between the taxpayer's residence and one or more work locations is succinctly summarized in the holding of Rev. Rul. 99-7 as follows:

In general, daily transportation expenses incurred in going between a taxpayer's residence and a work location are nondeductible commuting expenses. However, such expenses are deductible under the circumstances described in paragraph (1), (2), or (3) below.

(1) A taxpayer may deduct daily transportation expenses incurred in going between the taxpayer's residence and a temporary work location outside the metropolitan area where the taxpayer lives and normally works. However, unless paragraph (2) or (3) below applies, daily transportation expenses incurred in going between the taxpayer's residence and a temporary work location within that metropolitan area are nondeductible commuting expenses.

(2) If a taxpayer has one or more regular work locations away from the taxpayer's residence, the taxpayer may deduct daily transportation expenses incurred in going between the taxpayer's residence and a temporary work location in the same trade or business, regardless of the distance.

(3) If a taxpayer's residence is the taxpayer's principal place of business within the meaning of § 280A(c)(1)(A), the taxpayer may deduct daily transportation expenses incurred in going between the residence and another work location in the same trade or business, regardless of whether the other work location is regular or temporary and regardless of the distance.

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<sup>3</sup>An arrangement for automobile mileage allowances may provide special rules for returning amounts in excess of expenses. See section 9.03 of Rev. Proc. 98-63, 1998-52 I.R.B. 25.

AOO-I-08268-96

The following rules apply in determining whether a work location is temporary for purposes of Rev. Rul. 99-7:

If employment at a work location is realistically expected to last (and does in fact last) for 1 year or less, the employment is temporary in the absence of facts and circumstances indicating otherwise. If employment at a work location is realistically expected to last for more than 1 year or there is no realistic expectation that the employment will last for 1 year or less, the employment is not temporary, regardless of whether it actually exceeds 1 year. If employment at a work location initially is realistically expected to last for 1 year or less, but at some later date the employment is realistically expected to exceed 1 year, that employment will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's realistic expectation changes, and will be treated as not temporary after that date.

#### ANALYSIS:

Regarding your general question on the income tax treatment of daily transportation expense reimbursements for X's employees, the answer to this question depends on whether a particular reimbursement meets the accountable plan criteria discussed above on page 2. If the reimbursement is paid for deductible daily transportation expenses and the other accountable plan criteria are met, X's reimbursement of such expenses is excluded from the employee's gross income, is not reported as wages, and is not subject to the withholding and payment of employment taxes. If the reimbursement is paid for nondeductible daily transportation expenses (commuting), X's reimbursement of such expenses is treated as paid pursuant to a nonaccountable plan, is included in the employee's gross income, is reported as wages, and is subject to the withholding and payment of employment taxes.

Now we will address the five specific questions that you posed in your memorandum.

Question (1). The Revenue Ruling 90-23 [1990-1 C.B. 28] sets one of the determining factors of taxability as expenses within the "metropolitan area". Is there a definitive description of "metropolitan area" such as a specific number of miles or if the SMSA (Standard Metropolitan Statistical Area) should be used? Do you have any information about how other employers are defining the "metropolitan area"?

Rev. Rul. 94-47, 1994-2 C.B. 18, which modified and superseded Rev. Rul. 90-23 (and was itself modified and superseded by Rev. Rul. 99-7), did away with the "metropolitan area" test for most taxpayers. Rev. Rul. 94-47 was published to obviate the need to deal with the metropolitan area issue or to further define it for most taxpayers, and Rev. Rul. 99-7 continues this approach. If a taxpayer with a regular work location goes to a temporary work location, it makes no difference whether the temporary location is inside or outside the metropolitan area. In either situation, the daily transportation expenses of going to the temporary work location are deductible. Rev. Rul. 99-7 provides for the

AOO-I-08268-96

use of the metropolitan area test (1) only for a taxpayer without a regular work location, and (2) only for trips between the taxpayer's residence and a temporary work location outside the metropolitan area where the taxpayer lives and normally works. The taxpayer group to which the metropolitan area test still applies is small and does not appear to include X's employees.

Question (2). Revenue Ruling 90-23 has another determining factor of taxability as the amount of time that is spent at a temporary location. The Rev. Rul. uses the term "Generally a matter of days or weeks" to define services performed on an irregular or short-term basis. Is there a definitive description of this time period or is the time period set by the particular employer. Do you have any information about the times that other employers have used to determine taxability?

Rev. Rul. 99-7 modifies and supersedes Rev. Rul. 90-23 by providing a definition of "temporary work location" that generally considers a period of 1 year or less to be a temporary period (in the absence of facts and circumstances indicating otherwise).

Question (3). If an employee is assigned to a second location for a long period of time, does the taxable period begin immediately or after the established period of "days or weeks" has passed?

As was stated above, Rev. Rul. 99-7 replaced the "days or weeks" standard with a rule that generally treats a period of 1 year or less as a temporary period (in the absence of facts indicating otherwise). An employee who has a regular place of business and is assigned to a second work location for a period that is not temporary (within the meaning of Rev. Rul. 99-7) is treated, from the beginning of the second work location assignment, as incurring nondeductible daily transportation expenses in going between the employee's residence and that second work location. Any employer reimbursement of such a nondeductible expense would be made pursuant to a nonaccountable plan, would be included in the employee's gross income, would be reported as wages, and would be subject to the withholding and payment of employment taxes.

Question (4). Should parking and related fees, such as tolls, be included in the taxable amount or should it be limited to mileage?

If the daily transportation expense is a nondeductible commuting expense, then items related to that daily transportation, such as tolls and parking fees, would also be nondeductible personal expenses under § 262. Any reimbursement of such nondeductible expenses would be pursuant to a nonaccountable plan with the same tax consequences as discussed in the answer to Question (3) above.

Question (5). Is reimbursement for public transportation or using a private airplane to be considered similar to mileage and related expenses for tax purposes?

AOO-I-08268-96

Neither the Code, the regulations, nor the revenue rulings limit deductions under § 162(a) to the expenses of a specific mode of transportation. Rev. Rul. 70-559, 1970-2 C.B. 36, allows a deduction to an employee for the ordinary and necessary expenses of operating the employee's privately owned automobile used on official business. In Rev. Rul. 70-558, 1970-2 C.B. 35, an employee who was authorized by the employer to travel on business by privately owned aircraft was allowed to deduct the ordinary and necessary expenses allocable to the aircraft. Of course, substantiation of such expenses must satisfy the requirements of § 274. For convenience in computing reimbursements of fixed and operating costs of an automobile, a standard mileage rate may be used in lieu of actual expenses. See Rev. Proc. 98-63, 1998-52 I.R.B. 25.

This memorandum is for your general information and is advisory only. It is not intended to be conclusive as to the tax consequences for any specific taxpayer. If we can be of further assistance, please contact George Baker, of my office, at (202) 622-4920.

Attachment

Rev. Rul. 99-7