

## THE ADDITIONAL EXPENSE TEST: A PROPOSAL TO HELP SOLVE THE DILEMMA OF MIXED BUSINESS AND PERSONAL EXPENSES

*"The income tax laws do not profess to embody perfect economic theory. They ignore some things that either a theorist or a business man would take into account in determining the pecuniary condition of the taxpayer." Mr. Justice Holmes in Weiss v. Wiener, 279 U.S. 333, 335 (1929).*

In computing his net income for purposes of federal taxation, the individual taxpayer may deduct a variety of expenses under section 162 of the Internal Revenue Code, which permits "as a deduction all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ."<sup>1</sup> The policy underpinning this deduction<sup>2</sup> reflects the traditional congressional concern that costs of *producing* income should not be included in net income, *i.e.*, in the amount upon which the tax is levied.<sup>3</sup> Since this policy does not include expenditures other than the costs of producing income, "personal, living or family expenses" are generally nondeductible.<sup>4</sup> Yet, all of the taxpayer's expenditures cannot be neatly categorized as either "trade or business" or "personal" expenses, for certain expenses are incurred for *both* business and personal reasons. Due to the difficulty in distinguishing between business and personal components, these mixed expenses pose a serious and often vexing problem for the courts. Unfortunately, it is a problem which the judiciary has yet to resolve in a logically consistent manner. However, a consistent approach is necessary in order to prevent the present abuse of the tax system by those

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1. INT. REV. CODE OF 1954, § 162(a).

2. A similar provision is found as early as the 1913 Act, Act of Oct. 3, 1913, ch. 16, § II(B), 38 Stat. 114, and was retained in the original Internal Revenue Code of 1939, INT. REV. CODE OF 1939, ch. 1, § 24(a)(1), 53 Stat. 16. See 4A J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION § 25.17, at 95 n.66 (Malone ed. 1972) [hereinafter cited as J. MERTENS].

3. In the Senate debate over the wording of the original business expense deduction, see Act of Oct. 3, 1913, ch. 16, § II(B), 38 Stat. 114, Senator John Williams, the floor manager of the bill, explained the business expense section as an attempt to define net income:

The object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. 50 CONG. REC. 3849 (1913).

4. INT. REV. CODE OF 1954, § 262.

taxpayers who attempt to partially finance personal expenses by mixing such expenses with business costs and deducting them from gross income pursuant to section 162.

Determining the proper deduction for mixed business-personal expenses entails two questions. First, does the purpose for which the expense was incurred contain any component related to carrying on a trade or business? Second, if a business component is present, what proportion of the total expense is properly deductible? With respect to these questions, the statutory law is often unclear and contradictory; consequently, the task of resolving the mixed expense puzzle has fallen on the judiciary.

The Supreme Court recently suggested the basis for such a resolution in *Fausner v. Commissioner*,<sup>5</sup> a case involving a professional pilot who was denied an income tax deduction for his commuting expenses. Although commuting expenses are normally deemed not to have any business purpose component,<sup>6</sup> Fausner claimed that his commuting to work included a business purpose because he had to carry his flight bag and overnight bag from his home to the airport and back. Since the transportation of these items was necessitated by his job as a pilot, Fausner attempted to deduct the entire expense of commuting to the airport. In disallowing any deduction, the Court reasoned that since the taxpayer would have commuted by private automobile even if he were not forced to transport his flight and overnight bags, the happenstance of carrying the "incidentals of his occupation" did not change the personal nature of the commuting expense.<sup>7</sup> Moreover, in dictum the Court suggested a test for determining when a mixed expense contains a deductible business component and the portion of that expense which can be deducted as a business expense: "*Additional expenses* may at times be incurred for transporting job-required tools and materials to and from work. Then an allocation of costs between 'personal' and 'business' expenses may be feasible."<sup>8</sup> By allowing a partial

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5. 413 U.S. 838 (1973) (per curiam).

6. See *Commissioner v. Flowers*, 326 U.S. 465 (1946), discussed in notes 18-20 *infra* and accompanying text.

7. 413 U.S. at 838-39. The Court said that it would not read INT. REV. CODE OF 1954, § 262 (no deduction for "personal, living, or family expenses"), to mean that commuting expenses were not to be categorized as "personal" expenses merely because the taxpayer had to carry the incidentals of his occupation. This holding is consistent with Treas. Reg. § 1.262-1(b)(5) (1960) which says, "The taxpayer's costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible expenses."

8. 413 U.S. at 839 (emphasis added). A footnote at the end of this sentence cited Rev. Rul. 63-100, 1963-1 CUM. BULL. 34 (musician's total transportation expenses de-

deduction to a taxpayer who can show that a normal personal expense was increased for a business purpose, the *Fausner* test adequately covers the taxpayer who would have incurred the expense without regard to its possible business purpose. However, the test has shortcomings. The Court's language, applied literally, would seem to eliminate the possibility of a *full* deduction for an expense from which both personal and business benefits flow but which would not have been incurred absent the business purpose. This result is in conflict with the existing tax laws which allow an individual to deduct *all* of the expenses that he incurs as a condition of employment even in cases where the employee may get substantial personal benefits from the expense.<sup>9</sup> Furthermore, since the use of an administrative formula based on a percentage of use as a means of proving a business purpose<sup>10</sup> is inapplicable to the commuting situation, the "additional expense" language, as it is presented in *Fausner*, is not sufficiently inclusive to handle situations where such a formula would be appropriate.<sup>11</sup>

Nevertheless, it is possible to use the *Fausner* rationale without accepting the changes in tax law that would flow from the literal application of its language to other mixed business-personal expense circumstances. To achieve this result, a more expansive test than the one suggested by *Fausner* will be developed. Specifically, this Note proposes a two-step test which extends the *Fausner* rationale to resolve many of the problems encountered in the troublesome area of mixed expenses.<sup>12</sup> The first step is directed at identifying the presence of a business component in the mixed expense and is structured to accommodate factual situations beyond the situation considered in *Fausner*.<sup>13</sup> The second step is devoted to an allocation of an expense be-

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ductible under INT. REV. CODE OF 1954, § 162, where he would not use his automobile *but for* the need to carry bulky musical instruments).

By citing this ruling the Court made it unclear whether it meant the "additional expense" language to be read literally. The ruling contains no language to suggest that the taxpayer's deduction should be limited to only an incremental portion of his transportation expense. See 4A J. MERTENS § 25.96, at 391 n.97.2. See notes 24-25 *infra* and accompanying text.

9. See notes 130-34 *infra* and accompanying text.

10. See subsections (1)(c) and (2)(c) of proposed test *infra*.

11. See notes 125-28 *infra* and accompanying text.

12. In applying the proposed test, an expense or part thereof would be presumed to be of a personal nature and hence nondeductible, unless proved to the contrary by the taxpayer. See *Elott H. Rafferty Farms, Inc. v. United States*, 369 F. Supp. 653, 656 (E.D. Mo. 1973) ("Any income tax deduction is a matter of legislative grace, the right to which the plaintiff has the burden of proving.").

13. While the Court determined that Mr. Fausner would have driven *even if* the necessity of transporting his flight and overnight bags had not existed, the suggested

tween its personal and business components and modifies, in part, the *Fausner* rationale in order to facilitate administrative feasibility.<sup>14</sup> After describing the proposed test and demonstrating its operation by means of a hypothetical example, the Note examines a number of different factual situations involving mixed expenses. It begins with the commuting expense, discussing the law prior to *Fausner* and assessing *Fausner's* impact on the commuting expense deduction. Next, the Note deals with the office-at-home deduction and explains why the current law in this area would be substantially changed by the *Fausner* rationale if the courts extend it to that area. The application of the proposed test to the office-at-home deduction and the way in which the result under the proposed test is preferable to the result reached by a strict application of the *Fausner* rationale are also discussed. Finally, the present status of other mixed expenses, including travel, entertainment, and duplicative living expenses, is considered in light of the proposed test.

#### PROPOSED TEST

The use of *Fausner* as a starting point for structuring a generally applicable test is not without difficulties. The Supreme Court in *Fausner* did not elaborate on what it meant by "additional expenses," nor did it intimate how it might apply the concept to other factual situations. Nevertheless, *Fausner* is the Supreme Court's most recent decision interpreting section 162 as it applies to mixed personal and business expenses, and the Court is likely to try to make future decisions in that area of the law at least generally consistent with the *Fausner* rationale. Since that rationale serves an important function in preventing an erosion in the distinction between personal and business expenses, it is doubtful that *Fausner* will be abandoned as aberrational.

At first glance, the "additional expense" test does not seem to be an appropriate one for expansion. The apparent narrowness of the test results from the Court's use of the same test to answer two different questions. The test suggested in *Fausner* identifies the presence of a business component in a mixed expense while simultaneously

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test would also encompass the opposite factual situation where the taxpayer would not have driven *but for* the need to transport his tools.

14. Although a literal reading of *Fausner* requires a precise allocation before any deduction would be allowed, a presumption of business motivation if a more than fifty percent use test is met would be helpful to both the taxpayer and the Service in areas where the problems of proof are difficult. See note 127 *infra*. Such a presumption has been adopted by the regulations to determine the deductibility of entertainment facility expenses. Treas. Reg. § 1.274-2(a)(2) (1963). See notes 125-26 *infra* and accompanying text.

indicating how much of the total expense can be deducted. However, there is no reason why both questions must necessarily be answered simultaneously, as the analysis of mixed expenses should be clarified and broadened to include a wider range of factual situations by handling these two questions separately. Therefore, a two-step additional expense test is proposed to clarify the Court's reasoning and to extend its application beyond the limited facts of *Fausner*. The test is:

1. *Identification of the Presence of an Additional Expense.* The taxpayer may show a deductible business related expense:

- (a) if he would not have incurred any of the expense *but for* a business purpose; *or*
- (b) if he incurred an additional expense related exclusively to time spent for a business purpose *even if*<sup>15</sup> he would have incurred the basic expense for purely personal reasons (*e.g.*, additional operating expenses as opposed to the initial purchase price and regular maintenance expenses); *or*
- (c) if the taxpayer cannot meet the *but for* requirement of subsection (1)(a) under all the facts and circumstances, a conclusive *presumption* of the existence of a business-related expense will arise if the taxpayer proves that more than fifty percent of the time spent in the expense-generating activity was related to a business purpose.

2. *Allocation of Additional Expenses.* The taxpayer may deduct:

- (a) one hundred percent of the mixed expense if he meets the *but for* test under subsection (1)(a); *or*<sup>16</sup>
- (b) those additional expenses allocable exclusively to a business purpose under the *even if* test of subsection subsection (1)(b); *and*

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15. A *but for* determination is also inherent in subsection (1)(b). The test of this subsection could be restated: "if he would not have incurred the *incremental* expense *but for* a business purpose." The *even if* expression of the test has been used to highlight the fact that the taxpayer has conceded that the basic expense is personal. In this case the taxpayer is only trying to get a deduction of the incremental expense. The courts have also used the *even if* language. *See, e.g.*, *Sullivan v. Commissioner*, 368 F.2d 1007, 1008 (2d Cir. 1966).

16. Any expenses allocable exclusively to personal purposes would be deducted from the total expense. *See* example under *The But For Test*.

- (c) that part of the mixed expense equal to the percentage of time actually spent for the business purpose if the subsection (1)(c) *presumption* is relied upon.<sup>17</sup>

The additional expense test can be illustrated by the following example: the taxpayer owns a yacht which he often uses to entertain business guests. However, he and his family also use the yacht for pleasure cruising. During the taxable year, the expenses of the yacht are \$10,000, which includes:

Depreciation .....	\$ 6,000
Maintenance .....	1,000
Fuel .....	2,000
Other .....	1,000
TOTAL .....	<u>\$10,000</u>

The yacht was used sixty percent of the time for business purposes and forty percent for personal reasons.

1. *The But For Test.* If taxpayer could prove that he would not have purchased the yacht *but for* the need to entertain business guests, he could deduct the total yearly depreciation on the yacht as well as all maintenance and docking expenses for the year. The theoretical basis for a total deduction when the taxpayer meets the *but for* test is that his motivation for incurring the expense was purely business-related and his personal benefits were merely incidental. The total fixed expenses of the yacht, such as depreciation and basic maintenance, should be deductible because the expenses would be the same regardless of the percentage of personal use. On the other hand, any operational expenses attributable exclusively to personal use, such as fuel used when no business guests were present, would have to be subtracted from total expenses before the deduction is taken. Business operational expenses, of course, would be totally deductible. Assuming personal fuel expenses to be \$500 for the year, the amount deductible under the *but for* test would include:

Depreciation .....	\$6,000
Maintenance .....	1,000
Fuel .....	1,500
Other .....	1,000
TOTAL .....	<u>\$9,500</u>

The *but for* test must be proved under all the facts and circumstances. One way that the taxpayer might meet that burden of proof

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17. Any expenses allocable exclusively to business or personal use would have to be deducted from the total mixed expense before the deductible percentage is determined in subsection (2)(c). See example under *The Presumption*.

would be to show that his employer required him to purchase the yacht for business entertainment purposes and that he never owned a yacht until his employer made him get one. This argument might succeed under these circumstances even though the taxpayer actually used the yacht more for personal use than for business use. On the other hand, merely showing that the yacht was used more for business purposes than for personal use would not necessarily meet the burden of proof imposed by the *but for* test.

2. *The Even If Test.* If the taxpayer does not qualify under the *but for* subsection, he could still claim a deduction for the expense of fuel allocable exclusively to the time the yacht was used for entertaining business guests. In the above example, that would amount to a \$1,500 deduction.

3. *The Presumption.* Even though he does not satisfy the *but for* subsection, the taxpayer does not have to settle for an *even if* deduction if he uses the yacht more than fifty percent of the time for business purposes. This "safe harbor" is proposed to allow some deduction to the taxpayer who cannot meet the difficult *but for* burden of proof yet still evidences a business motivation for the mixed expense by actually using the yacht primarily for business related activities. Under the facts of the example, the taxpayer could deduct sixty percent of the fixed expenses:

Depreciation (60% of \$6,000) _____	\$3,600
Maintenance (60% of \$1,000) _____	600
Fuel _____	1,500
Other (60% of \$1,000) _____	600
TOTAL	<u>\$6,300</u>

Although this "safe harbor," unlike the *even if* and *but for* tests, is not precisely consistent with the "additional expense" language of *Fausner*, the percentage limitation accomplishes two objectives. First, since the taxpayer would be relying on an administratively promulgated alternative to complete *but for* proof, his deduction should be limited to the business percentage he actually proves. Second, limiting the deduction under the presumption serves as an incentive to the taxpayer to prove his actual additional expenses under the first two tests in order to get a full deduction.

#### COMMUTING EXPENSES

As indicated earlier, *Fausner* involved the deductibility of mixed commuting expenses. Over the years the attitude of the courts and of the Service toward the appropriateness of this type of deduction has

changed. In the landmark case of *Commissioner v. Flowers*,<sup>18</sup> the Supreme Court succinctly categorized the general criteria for determining the deductibility of commuting expenses: "The exigencies of business rather than the personal conveniences and necessities of the traveler must be the motivating factors."<sup>19</sup> Since an employee is ostensibly free to choose the location of his personal residence, commuting has traditionally been deemed a purely personal expense.<sup>20</sup> However, to avoid the harshness of the general rule that none of a taxpayer's commuting expenses is deductible, a number of judicial and administrative exceptions have been developed.<sup>21</sup> One of these is the "tool exception," which allows the tool-carrying commuter a deduction for his commuting expenses. The first Treasury Department statement, Revenue Ruling 56-25,<sup>22</sup> was unclear as to whether a taxpayer could deduct any of his commuting expenses even where carrying tools increased those expenses.<sup>23</sup> Later, Revenue Ruling 63-100<sup>24</sup> approved

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18. 326 U.S. 465 (1946). *Flowers* lived in Jackson, Miss., and most of the time he worked there although his employer was located in Mobile, Ala. The Court held that he could not deduct traveling expenses for trips between Jackson and Mobile nor could he deduct his living expenses while in Mobile. The location of his home lacked the relationship to his employer's business necessary to justify a deduction.

19. *Id.* at 474.

20. See Harold Gilberg, 55 T.C. 611 (1971), where the court stated:

If a person chooses to incur the inconvenience and increased expenses in living far from his place of employment or from public transportation, he does so for personal reasons, and it is therefore for personal reasons that he incurs the additional commuting expenses. To allow a deduction for such expenses would be to allow a deduction for personal expenses. *Id.* at 616-17.

*Accord*, cases cited in 1 CCH 1974 STAND. FED. TAX REP. ¶ 1350.07; Treas. Reg. § 1.262-1(b)(5) (1967) ("The taxpayer's costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible expenses . . . ."); Treas. Reg. § 1.62-1(g) (1965) ("Transportation expenses do not include the cost of commuting to and from work; this cost constitutes a personal, living, or family expense and is not deductible."); Treas. Reg. § 1.162-2(e) (1958) ("Commuters' fares are not considered as business expenses and are not deductible."); Rev. Rul. 56-25, 1956-1 CUM. BULL. 152.

Treasury regulations have been considered particularly important by some courts since the Supreme Court has held that Treasury regulations will have the effect of law if they have been in effect for many years and apply provisions of law that have not been amended. *Helvering v. Winmill*, 305 U.S. 79, 83 (1938). See also Harold Gilberg, 55 T.C. at 617, where the court noted that many requests had been made for modifications of the commuting expense rule, but that the rule had generally remained unchanged.

21. Exceptions have been made for tools, see notes 22-51 *infra* and accompanying text; temporary employment situations, *Harvey v. Commissioner*, 283 F.2d 491 (9th Cir. 1960); *Arthur Sansone*, 41 T.C. 277 (1963), and two or more places of business, *Chandler v. Commissioner*, 226 F.2d 467 (1st Cir. 1955); *Joseph H. Sherman*, 16 T.C. 332 (1951).

22. 1956-1 CUM. BULL. 152.

23. *Id.* However, a partial deduction for the increased expenses could be implied from the statement therein that "[t]he expenses so incurred in going to and from work



a deduction for the full amount of the transportation expenses if the taxpayer could show that he would not have used his automobile *but for* the need to transport his employment incidentals.<sup>25</sup> Although 63-100 did not apply to the commuter who would have driven to work *even if* he did not have to carry job-related incidentals, the Second and Seventh Circuits were willing to find a business purpose component in the taxpayers' commuting expenses in a similar *even if* situation.<sup>26</sup> In order to reflect the dual character of the expense, these courts allowed a partial deduction.<sup>27</sup> The Tax Court, however, has applied a stricter standard and suggested that a taxpayer could only deduct any *additional* expense caused by his need to transport tools,<sup>28</sup> thus fore-

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were not increased . . . ." *Id.* This type of implication foreshadowed the *Fausner* rationale.

24. 1963-1 CUM. BULL. 34.

25. *Id.* See, e.g., *Tyne v. Commissioner*, 409 F.2d 485, 487 (7th Cir.), *cert. denied*, 396 U.S. 833 (1969) (if taxpayer can prove that he would not have used his car *but for* the necessity of transporting his tools, he will be entitled to deduct one hundred percent of his transportation expenses). *But cf.* Neil M. Kelly, 33 P-H Tax Ct. Mem. ¶ 64,073 (1964), where the Tax Court did not consider the practicalities of transporting the taxpayer's flight bag and suitcase, but only considered the dominant purpose of the trip, *viz.*, commuting.

26. The Second Circuit in *Sullivan v. Commissioner*, 368 F.2d 1007 (2d Cir. 1966), *rev'g and remanding* 45 T.C. 217 (1965), established the rule that "[e]ven if taxpayer would have driven to and from work had it not been necessary to transport his tools, he ought to be allowed to deduct that portion of his reasonable driving expenses which is allocable to the transportation of tools." *Id.* at 1008. The court suggested two ways to justify the deduction: (1) the Tax Court should establish if the taxpayer had some means of storing his tools; if so, the cost of storage would be the maximum deduction; (2) if no storage was available, the Tax Court was to allocate the cost of transportation between the taxpayer and his tools. *Id.* at 1009. On remand, *Sullivan* was allowed a one-third deduction of his commuting expense, Lawrence D. Sullivan, 37 P-H Tax Ct. Mem. ¶ 68,144 (1968), *aff'd*, 69-2 U.S. Tax Cas. ¶ 9448 (2d Cir.), *cert. denied*, 396 U.S. 827 (1969).

The Seventh Circuit in *Tyne v. Commissioner*, 385 F.2d 40 (7th Cir. 1967), adopted the rule laid down in *Sullivan*. The court recognized the difficulty of making an allocation but doubted "that it is practically impossible to make such an allocation." *Id.* at 42. After a series of decisions described in *Tyne v. Commissioner*, 468 F.2d 913 (7th Cir. 1972), *Tyne* was ultimately allowed to deduct fifty percent of his commuting expenses.

In *Coker v. Commissioner*, 487 F.2d 593, 594 (2d Cir. 1973), *cert. denied*, 414 U.S. 1130 (1974), the Second Circuit concluded that *Fausner* had overruled *Sullivan*. See notes 37-39 and accompanying text.

27. *Tyne v. Commissioner*, 385 F.2d 40, 42 (7th Cir. 1967); *Sullivan v. Commissioner*, 368 F.2d 1007, 1008 (2d Cir. 1966).

28. In *Robert A. Hitt*, 55 T.C. 629 (1971), the Tax Court presented the rationale for this approach by stating:

The need to transport equipment would not have burdened the taxpayer with any additional expenses . . . . A deduction for transporting heavy, bulky, unwieldy and cumbersome tools and equipment should be allowed only to the extent that the transporting of such items causes the taxpayer to incur expenses *above and beyond* those he would otherwise incur in commuting. *Id.* at 623 (emphasis added).

shadowing the *Fausner* rationale. These conflicting opinions presented the Supreme Court in *Fausner* with several reasoned analyses from which to choose the appropriate deduction in a mixed business-personal expense circumstance.

### *The Impact of Fausner on Commuting Deductions*

The conflict between the Second and Seventh Circuits on the one hand, and the Tax Court on the other was presented in the tax proceedings of Donald W. Fausner. While regularly commuting into New York City with a flight kit and overnight bag required by his employment, Fausner was allowed a \$105 deduction, which the Tax Court found to be a reasonable portion of the 1965 transportation expenses attributable to his tools.<sup>29</sup> However, after moving from New York and the jurisdiction of the Second Circuit, Fausner was confronted with the same issue when he attempted to deduct his commuting expenses for 1966 and 1967. Since his case was then appealable to the Fifth Circuit, the Tax Court was not constrained by the Second Circuit's "partial deduction" approach<sup>30</sup> and declined to allow any deduction.<sup>31</sup> In affirming the latter Tax Court decision, the Fifth Circuit noted that Fausner had neither incurred additional expenses related to transporting his tools nor established a rational basis for allocating a portion of his expenses to the "exigencies of business."<sup>32</sup>

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This language is markedly similar to the *Fausner* opinion, where the Court stated that the taxpayer might deduct any additional expenses caused by his tools, 413 U.S. 838, 839 (1973) (per curiam). See note 7 *supra* and accompanying text.

In fact, however, the Tax Court has been unwilling to recognize that in the commuting situation the taxpayer has incurred additional, deductible expenses. See, e.g., Thomas L. Bradley, 42 P-H Tax Ct. Mem. ¶ 73,163 (1973); Richard W. Drake, 42 P-H Tax Ct. Mem. ¶ 73,129 (1973); Samuel D. Woolsey, 41 P-H Tax Ct. Mem. ¶ 72,038 (1972); Harold Gilberg, 55 T.C. 611 (1971); John E. Scott, 40 P-H Tax Ct. Mem. ¶ 71,158 (1971); Stanley E. Bailey, 40 P-H Tax Ct. Mem. ¶ 71,107 (1971); Gregorio Castillo, 40 P-H Tax Ct. Mem. ¶ 71,087 (1971).

29. Donald W. Fausner, 55 T.C. 620 (1971). Since at the time the deduction was claimed Fausner was a resident of New York an appeal from the Tax Court would have been to the Second Circuit. Under the rule established in *Golsen v. Commissioner*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971), the Tax Court followed the appropriate precedent in the circuit in which the Tax Court sat. In this instance, the Tax Court found *Sullivan v. Commissioner*, 368 F.2d 1007 (2d Cir. 1966), to be controlling and therefore adopted *Sullivan's* "partial deduction" approach. 55 T.C. at 625-26.

30. See note 29 *supra* and accompanying text.

31. Donald W. Fausner, 40 P-H Tax Ct. Mem. ¶ 71,277 (1971) (for tax years 1966-67). The court based its holding on the reasoning of the nearly identical case of Robert A. Hitt, 55 T.C. 628 (1971).

32. *Fausner v. Commissioner*, 472 F.2d 561, 563 (5th Cir.), *aff'd per curiam*, 413 U.S. 838 (1973). The court further stated:

The Supreme Court, in a per curiam decision, resolved the conflict over the scope of the tool exception by affirming the Fifth Circuit's denial of any deduction.<sup>33</sup> While Fausner's forty-pound flight kit and overnight bag did not increase his ascertainable costs, the Supreme Court at least conceded that employment incidentals such as tools could cause higher transportation expenses in some instances.<sup>34</sup> By implying that it would, in an appropriate case, allow a deduction amounting to the *additional* business-related expenses,<sup>35</sup> the Court endorsed a more restrictive method of separating the business and personal components of a mixed expense than the simple allocation method previously used by the Second and Seventh Circuits.<sup>36</sup>

Since *Fausner* was decided, the lower courts have considered the cases of three taxpayers who claimed a deduction of their commuting expenses. The Second Circuit in *Coker v. Commissioner*<sup>37</sup> concluded that *Fausner* "clearly overruled" its policy of allowing a partial deduction to commuters who were required to transport tools.<sup>38</sup> In applying *Fausner*, the court held that none of Coker's commuting costs were deductible since he would have driven anyway and had not shown that he had incurred any additional expenses.<sup>39</sup> Similarly, in *Bernard W.*

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Congress has determined that all taxpayers shall bear the expense of commuting to and from work without receiving a deduction for that expense. This common burden cannot be negated for a particular taxpayer by the happenstance that he must carry incidentals of his occupation with him. *Id.* (footnote omitted).

33. 413 U.S. at 838-39. See text accompanying notes 5-7 *supra*.

34. *Id.* The Court cited, as an example, Rev. Rul. 63-100, 1963-1 CUM. BULL. 34, which allowed a musician to deduct his full automobile expenses for transporting his musical instruments between his residence and his place of employment "because they [were] too bulky to be carried otherwise, and he would not use his automobile on such trips except for that reason." *Id.*

35. 413 U.S. at 839.

Prior cases have held that two initial findings are necessary to lay the foundation for a possible deduction of commuting expenses. First, the taxpayer must have actually transported his tools back and forth to work. Michael DeMichele, 42 P-H Tax Ct. Mem. ¶ 73,115 (1973). Second, there must be a necessity to carry the tools. Such a necessity can be established in a number of ways. An employer might require his employees to transport tools, John E. Scott, 40 P-H Tax Ct. Mem. ¶ 71,158 (1971); there might be a lack of sufficient safe storage space at work, Frank W. Coker, 41 P-H Tax Ct. Mem. ¶ 72,080 (1972), *aff'd*, 480 F.2d 146 (2d Cir.), *rev'd in part on rehearing*, 487 F.2d 593 (2d Cir. 1973), *cert. denied*, 414 U.S. 1130 (1974); or the employee might have a continuing need to have the incidentals readily available at all times, *Sullivan v. Commissioner*, 368 F.2d 1007, 1009 (2d Cir. 1966).

36. See note 26 *supra*.

37. 487 F.2d 593 (2d Cir.) (per curiam), *rev'g in part* 480 F.2d 146 (2d Cir. 1973).

38. *Id.* at 593-94.

39. *Id.* at 594. This court interpreted *Sullivan* to mean that "a taxpayer may deduct from his commuting expenses an appropriate percentage allocable to the transpor-

*Mugleston*<sup>40</sup> the Tax Court denied an airline pilot's claim of a deduction because "[i]t was clear that no expenses in addition to his normal commuting costs were incurred as a result of carrying such baggage."<sup>41</sup>

In the case of *Thomas L. Bradley*,<sup>42</sup> the taxpayer tried to deduct the expense of driving 11,038 miles to and from work; he computed his costs at ten cents per mile.<sup>43</sup> His computation did not show that carrying fifty-one pounds of police equipment caused any increment in the costs of operating his automobile. Despite his testimony that he would use public transportation if he did not have to carry his equipment, the court decided that the taxpayer could not use the cost of public transportation for a basis to compute the incremental expense of operating his automobile. The use of public transportation would have been much more time-consuming and inconvenient.<sup>44</sup> Therefore, the court had no "normal" commuting expense which it could subtract from the actual commuting expense to derive the additional and deductible expense. This court read *Fausner* to say "that commuting expenses incurred in using one's own automobile are not deductible merely because the taxpayer carries heavy equipment with him if he would have driven his automobile in any event."<sup>45</sup>

This restrictive interpretation of *Fausner's* additional expense language seems to exclude the possibility of using the *even if* test. Possibly, this expression of *Fausner's* holding was motivated by the Supreme Court's citation of Revenue Ruling 63-100.<sup>46</sup> This citation in the context of the *Fausner* case was misleading. First, 63-100 does not specifically address the question of the deductibility of commuting expenses when the taxpayer would have driven to work regardless of a need to transport his tools. Under the *Fausner* additional expense lan-

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tation of his tools." *Id.* at 593. *Fausner* does preclude a straightforward allocation of the total expense in the *even if* situation. Instead the taxpayer has to identify a particular *increment* of expense before he can get a deduction in this situation.

40. 42 P-H Tax Ct. Mem. ¶ 73,260 (1973).

41. *Id.* at 1187.

42. 42 P-H Tax Ct. Mem. ¶ 73,163 (1973).

43. *Id.* at 771.

44. *Id.*

45. This characterization of *Fausner's* holding seems to exclude the possibility that a taxpayer could prove a deductible expense by showing that carrying his tools had caused an *incremental* operating cost in the *even if* situation. By implication, however, this court would seem to be willing to allow Mr. Bradley some deduction if he could have shown that he actually would have used public transportation and that it was less expensive than his actual commuting costs. In other words, if the taxpayer could meet the *but for* requirement, he would be allowed to deduct whatever *additional* expenses that he could prove.

46. See notes 8 & 34 *supra*. The *Bradley* court also cited this revenue ruling, 42 P-H Tax Ct. Mem. ¶ 73,163, at 771 (1973).

guage, however, a commuter who incurs a business-related commuting expense over and above normal commuting costs<sup>47</sup> should be able to deduct any additional expenses incurred even though he would have driven to work had he not been required to transport his tools.<sup>48</sup> For example, a construction worker with several hundred pounds of tools should be able to deduct something (probably a small amount) for increased expenses attributable to poorer gasoline mileage and more rapid depreciation resulting from the increased load carried.<sup>49</sup> Second, the reference is misleading because 63-100 seems to permit a *full* deduction of commuting expenses whenever the taxpayer would not have driven *but for* the need to transport his tools. However, *Fausner* may be read to modify this interpretation of 63-100, because the language of *Fausner* only justifies the deduction of the incremental costs of carrying tools. Apparently, to get a full deduction under this reading of *Fausner*, the taxpayer will have to prove that he would walk if he did not have to carry tools. In *Arnold T. Anderson*,<sup>50</sup> a case decided before *Fausner*, the Tax Court used such an approach. The court computed Anderson's actual commuting expense and the expense of a hypothetical commute without tools. Mr. Anderson was allowed to deduct the difference between these two figures.<sup>51</sup>

47. For the determination of the presence of a deductible expense in the *even if* situation, see subsection (1)(b) of the proposed test *supra*.

48. For the determination of the amount to deduct in the *even if* situation, see subsection (2)(b) of the proposed test *supra*.

49. The confusion that the *Fausner* Court's reference to 63-100 has caused can also be seen in 9 CCH 1974 STAND. FED. TAX REP. ¶ 8290. There it is stated that *Fausner* indicates that additional expenses in a commuting situation may be deductible only if:

(1) It is necessary to use an automobile because the equipment transported is too bulky to be otherwise carried; [and] (2) The automobile would not have been used except to transport the equipment; [and] (3) Such expenses are ordinary and necessary and paid or incurred in carrying on a trade or business. *Id.*

The second point only covers a *but for* situation, while additional expenses could arise in an *even if* situation as well. See 39 J. TAX. 155, 156 (1973). While the calculation of these extra costs may be difficult, the use of estimates may be practicable. For example, the General Motors Corporation has estimated that 400 pounds of extra weight would decrease gasoline consumption one mile per gallon. Durham Morning Herald, Mar. 18, 1974, at 10A, cols. 1-5.

50. 55 T.C. 756 (1971).

51. *Id.* at 761. Anderson's automobile expenses were \$4.50 per trip (45 miles at \$ .10 per mile) and his alternative transportation expenses without his tools were \$2.85:

8 miles roundtrip to train	\$ .80
railroad transportation	1.80
bus to airport	.25
Total	\$2.85

Therefore he received a \$1.65 deduction per trip since that amount represented Anderson's additional expenses necessitated by his tools.

The impact of the *Fausner* additional expense language also should be felt in factual situations where commuters, under previously valid precedent, have been denied a deduction even though the use of an automobile was necessary to get to and from their employment. For example, in *Mary L. Roberts*<sup>52</sup> the taxpayer was a laboratory and x-ray technician on call twenty-four hours a day, five days a week plus alternate weekends. In deciding against Mrs. Roberts' deduction for the use of her car as a business expense, the Tax Court cited earlier, similarly decided, cases and noted that the use of a car "for traveling between the taxpayer's residence and place of employment is essentially personal in nature."<sup>53</sup> To the extent that the irregular hours incident to Mrs. Roberts' employment precluded her from utilizing less expensive forms of transportation,<sup>54</sup> she incurred additional transportation expenses. The *Fausner* rationale would seem to allow her a deduction for these additional expenses.

#### THE ADDITIONAL EXPENSE TEST AND OFFICE-AT-HOME DEDUCTIONS

It has long been held that under certain circumstances a taxpayer may deduct part or all of the expenses he incurs in maintaining a business-related office in his home.<sup>55</sup> Yet in recent years, the inability to differentiate between deductible section 162 business expenses and nondeductible section 262 personal expenses has paralleled the

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Further, if the required tools necessitated the use of a truck instead of a normal passenger car, only those excess expenses related to the truck would be deductible. See 11 *Taxation for Accountants* 82-83 (1973).

52. 40 P-H Tax Ct. Mem. ¶ 71,282 (1971).

53. *Id.* at 71-1277. The cases cited were: Harold Gilberg, 55 T.C. 611 (1971) (field auditor); Margaret G. Sheldon, 50 T.C. 24 (1964) (fulltime anesthesiologist); Lenke Marot, 36 T.C. 238 (1961) (electrocardiograph operator).

54. It is also possible that her on-call status required her to get to the hospital by a means faster than mass transit. The problem, of course, is that it may be difficult for a court to determine whether Mrs. Roberts would have used public transportation *but for* her irregular hours. Undoubtedly the burden would be on the taxpayer to prove this point. For other decisions denying a deduction, see Bernard W. Mugleston, 42 P-H Tax Ct. Mem. ¶ 73,260 (1973) (no adequate public transportation between home and airport); Thomas L. Bradley, 42 P-H Tax Ct. Mem. ¶ 73,163 (1973) ("It was a great deal more convenient for petitioner to commute by private automobile than it would have been by use of public transportation." *Id.* at 73-771).

55. See, e.g., *Beaudry v. Commissioner*, 150 F.2d 20 (2d Cir. 1945) (lawyer who maintained a law library at home entitled to a tax deduction for depreciation on the furnishings); *Freda W. Sandrich*, 15 P-H Tax Ct. Mem. ¶ 46,082 (1946) (writer who found it necessary to seek the seclusion of his home to do much of his work allowed a deduction). See also *Lyndol L. Young*, 268 F.2d 245 (9th Cir. 1959); *Rupert Stuart*, 30 P-H Tax Ct. Mem. ¶ 61,156 (1961); *Louis Lindauer*, 25 P-H Tax Ct. Mem. ¶ 56,172 (1956).

difficulty encountered in the commuting expense area.<sup>56</sup> A continuing controversy has resulted from the fact that the test proposed by the Internal Revenue Service<sup>57</sup> has not been accepted by the courts, which instead have formulated various tests of their own in an attempt to resolve the tension between sections 162 and 262 in the "home office" area. After reviewing the prior law in the area, this section of the Note will suggest that the current test—whether the home office expense is "appropriate and helpful" to the taxpayer in his business<sup>58</sup>—is inadequate to prevent the deduction of personal living expenses, and that application of the additional expense concept would more likely prevent the potential tax abuse inherent in an office-at-home expenditure.

### *Development of the Office-at-Home Deduction*

1. *Condition of Employment Doctrine.* The first test articulated by the courts for the office-at-home deduction was the strict "condition of employment" doctrine. In the 1962 case of *Harold H. Davis*,<sup>59</sup> the Tax Court denied a deduction to a university professor who used a room above his garage to prepare lectures, grade exams, perform research, and hold student conferences.<sup>60</sup> Despite Davis' use of the room for exclusively professional purposes and the admitted inadequacy of his employer-provided office, the court held that no deduction would be allowed unless the home office was maintained as a condition of employment.<sup>61</sup> In a vigorous dissent, Judge Raum condemned

56. See text accompanying notes 18-54 *supra*. See also Crumbley, *Courts Are Changing Current Tax Climate on Office-at-Home Deduction*, 31 J. TAX. 300 (1969); Lewis, *Taxes and the Home Office*, 44 TAXES 653 (1966); *Courts Reject Two IRS Rules for Deducting Office-at-Home Expenses*, 34 J. TAX. 46 (1971).

57. Rev. Rul. 62-180, 1962-2 CUM. BULL. 52. See note 63 *infra*.

58. Stephen A. Bodzin, 60 T.C. 820, 825 (1973).

59. 38 T.C. 175 (1962). See Wolfman, *Professors and the "Ordinary and Necessary" Business Expense*, 112 U. PA. L. REV. 1089 (1964).

60. 38 T.C. at 177-80. Davis maintained this office primarily because he was unable to pursue these activities in his school office without interruption. While admitting that he was not required by his employer to use his home, Davis argued that the inadequacy of his campus office rendered his home office expenses "ordinary and necessary" within the meaning of section 162.

61. *Id.* at 180. The court pointed out that Davis' research and writing activities were voluntary on his part and were undertaken for the purpose of increasing his prestige as a scholar. "Expenditures made to acquire reputation or learning are not ordinary and necessary business expenses;" therefore the office-at-home was for the taxpayer's personal convenience and not deductible. *Id.* at 179.

The condition of employment test proposed in *Davis* is consistent with the tests imposed in other areas of employee business expenses. For example, expenses for education are deductible only if they meet the "express requirements of a taxpayer's em-

this test and foreshadowed the subsequent liberalization of the home office deduction. He pointed out that the statutory test requiring a deductible expense to be "ordinary and necessary" meant only that the expense must be "appropriate and helpful," rather than indispensable and required, to the taxpayer in his trade or business.<sup>62</sup> The *Davis* case is important in the office-at-home chronology because the majority's "condition of employment" doctrine and the dissent's "appropriate and helpful" standard set out the divergent positions which the Service and the courts were to take as the controversy continued. Just six months after its victory in *Davis*, the Service issued Revenue Ruling 62-180<sup>63</sup> allowing a deduction only when the home office was required as a condition of the taxpayer's employment.

2. *Implied Condition of Employment Requirement.* The courts quickly attacked the Revenue Ruling's strict "condition of employment" doctrine. In a factual situation very similar to *Davis*,<sup>64</sup> the Tax Court allowed an office-at-home deduction to a university professor because his professional status depended on his ability and productivity as a researcher and teacher, and his employer-provided office was inadequate for these activities.<sup>65</sup> Even though the taxpayer was not required by the university to provide his own office, the court apparently found the home office to be an implied condition of employment because it was *necessary* for the taxpayer to prepare lessons and research

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ployer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status, or employment." Treas. Reg. § 1.162-5(a)(2) (1967). See *Hill v. Commissioner*, 181 F.2d 906 (4th Cir. 1950). Also, expenses for uniforms or special clothing are deductible only if required as a condition of employment and not suitable for off-duty wear. Mimeograph 6463, 1950 CUM. BULL. 29; Rev. Rul. 70-474, 1970-2 CUM. BULL. 34. See *Roth v. Commissioner*, 17 T.C. 1450, 1455 (1952); Karachale, *Deduction for Office-at-Home Expenses by Employees*, 50 TAXES 343 (1972).

62. 38 T.C. at 186. See *Welch v. Helvering*, 290 U.S. 111, 113 (1933); 4A J. MERTENS § 25.122, at 552-54. *Davis* not only easily met the appropriate and helpful test, but he also had clearly segregated any personal expense from his home office expense by constructing the room specifically for use as a professional office and by using the room exclusively for his work as a professor. 38 T.C. at 187.

63. 1962-2 CUM. BULL. 52. The revenue ruling provides that a deduction will be allowed if: (1) as a condition of his employment, the taxpayer must be required to provide his own space and facilities for performance of some of his duties; (2) he must regularly use a part of his personal residence for that purpose; or (3) the employer must not provide other convenient or suitable facilities that could be used instead of his home.

64. See notes 59-62 *infra* and accompanying text.

65. Clarence Peiss, 40 T.C. 78 (1963). Peiss' employer-provided office was inadequate because it was not separated from a research laboratory which was in constant use by students. *Id.* at 83-84. See generally Lewis, *Taxes and the Professor's Home Office: Rulings, Cases, and Commentary*, 47 CH. B. REC. 161 (1966).



publishable articles in order to retain his professional status.<sup>66</sup>

3. *Efficiency of the Employee Test.* In 1970, the Second Circuit took a further step away from the "condition of employment" doctrine. In *Newi v. Commissioner*,<sup>67</sup> the court allowed a salesman of television network advertising time to deduct the expenses of an office-at-home, even though his employer provided adequate office space and equipment and did not require or request him to maintain a home office. The court's decision seems to be based on the fact that because the taxpayer's job included watching television programming in the evening, he could not afford to miss many of the programs important to his work which were televised during the time in which he would be returning to his employer-provided office after dinner.<sup>68</sup> Although the court's reasoning could be read as another application of the existing "implied condition of employment" requirement,<sup>69</sup> the significance of the decision lies in the court's inquiry into the meaning of the "necessary" requirement of section 162. In going beyond previous judicial efforts to define "necessary,"<sup>70</sup> the Second Circuit attempted to determine whether the home office was the *most practical* or *best* location in which to perform the taxpayer's work.<sup>71</sup> This mode of analysis, which focuses on the increased efficiency or work quality produced by the office-at-home to determine the business necessity of the

66. See Rev. Rul. 63-275, 1963-2 CUM. BULL. 85, which allows a professor to deduct expenses, including reasonable traveling expenses, "incurred by a professor for the purpose of teaching, lecturing, writing and publishing in his area of competence . . ." *Id.* at 86. This ruling does not deal explicitly with the question of deducting the costs of an office-at-home.

67. 432 F.2d 998 (2d Cir. 1970), *aff'g* 38 P-H Tax Ct. Mem. ¶ 69,131 (1969). See Note, *Newi v. Commissioner: Home Office Deductions and Equal Treatment for Employees*, 47 IND. L.J. 546 (1972).

68. 432 F.2d at 1000.

69. The restrictive nature of *Newi* was emphasized when the Tax Court later denied a deduction in *Paul v. O'Connell*, 41 P-H Tax Ct. Mem. ¶ 72,171 (1972). O'Connell was a comptroller and tax consultant who claimed he worked 24 hours per week in his apartment, although the home office was not required by the employer and space was always available at the company offices. *Newi* was distinguished because O'Connell made no showing that his work could be done better at home or that it was more practical to do it there. Rather, the court held his work at home was only for his own convenience and entirely voluntary. *Id.* at 880. The *O'Connell* holding should serve as a warning that where the taxpayer can prove no plausible reason for his home office other than personal preference, the deduction will not be upheld.

70. Previous attempts to expand the interpretation of "necessary" beyond the condition of employment test had resulted only in the "appropriate and helpful" redefinition (see Judge Raum's dissent in *Davis*, note 62 *supra* and accompanying text), which merely left the courts with two *new* words to define.

71. "It would be hard to imagine a better method than, in the isolation of his study-den, to view, ponder over and make notes relating to television programs." 432 F.2d at 1000.

expense,<sup>72</sup> would allow an employee some freedom of choice in how to best perform his employment duties.<sup>73</sup> However, this approach comes close to recognizing the mere convenience of the taxpayer as an appropriate criterion for the business deduction, a criterion which has been held to be indicative of a *personal* preference and, therefore, a nondeductible *personal* expense.<sup>74</sup>

*The Latest Development: Stephen A. Bodzin and the Appropriate and Helpful Standard*

The most recent office-at-home test was articulated by the Tax Court in the case of *Stephen A. Bodzin*,<sup>75</sup> decided about two months after *Fausner*. The taxpayer was an I.R.S. attorney who regularly took his work with him and completed it in his personal study,<sup>76</sup> even though his employer-provided office was adequate and always open for his use. He was not required, requested, expected, or even encouraged

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72. Efficiency was considered a dispositive criterion in the case of Marvin L. Dietrich, 40 P-H Tax Ct. Mem. ¶ 71,159 (1971), where a resident physician was allowed a deduction for a home office and library because the hospital did not provide facilities where he could read without interruption to keep abreast of current developments in his field. Cf. LeRoy W. Gillis, 42 P-H Tax Ct. Mem. ¶ 73,096, at 424-25 (1973) (because of the distance from the taxpayer's house to his place of business, the court considered the efficiency promoted by the home office in upholding the deduction).

In James L. Denison, 40 P-H Tax Ct. Mem. ¶ 71,249 (1971), a teacher was allowed a deduction for his home office even though it was not required and other teachers at the school were able to complete their work at the school during normal school hours. Focusing on the possibility of better *quality* teaching, the court said of Denison: "The method of presentation, the material to be corrected and the sincere desire to teach the subject will distinguish the taxpayer from his fellow teachers." *Id.* at 1133.

Increased efficiency and work quality have not been the only criteria accepted by the courts to determine the business validity of an expense. The danger of criminal assault was also considered important in granting deductions in *Gillis* and *Denison*. In *Gillis* the court considered the hazards of working alone at night, 42 P-H Tax Ct. Mem. ¶ 73,096, at 424-25 (1973), and in *Denison*, the possibility of harm to a teacher was found significant because the school principal had advised her to leave the school by 4:30 p.m. 40 P-H Tax Ct. Mem. ¶ 71,249 (1971), at 1133.

73. See Note, *supra* note 67, at 557.

74. Paul v. O'Connell, 41 P-H Tax Ct. Mem. ¶ 72,171 (1972), discussed in note 69 *supra*.

75. 60 T.C. 820 (1973).

76. Besides his official work, the taxpayer used his study for professional reading to keep abreast of current developments in the tax law. *Id.* at 822. The study was furnished with a desk, lamps, bookcases and cabinets, and contained Bodzin's personal tax books and periodicals. It was not used when the taxpayer entertained visitors and for the most part was used solely by the taxpayer. Occasionally, he used the room for purposes unrelated to his business such as payment of bills and stamp collecting. Besides his legal materials, the room was used for storage of personal papers, his stamp collection, and his and his wife's personal libraries. *Id.* at 823.

to work after normal hours, but he thought it desirable to do so in order to insure his best performance.<sup>77</sup> In fact, Bodzin usually brought his extra work home with him rather than completing it at his office, because working at home was, in his opinion, more convenient and efficient.<sup>78</sup> Thus, he deducted part of his apartment rent as a business expense.<sup>79</sup> Allowing the deduction, the Tax Court held that the proper test was whether the maintenance of the office-at-home was "appropriate and helpful under the circumstances,"<sup>80</sup> the same test proposed ten years earlier by Judge Raum's dissent in *Davis*.<sup>81</sup> Since Bodzin's home office was directly related to his business, it was deemed "appropriate and helpful" and therefore a "necessary" business expense under section 162.<sup>82</sup>

When considered in light of earlier decisions, *Bodzin* is unique because the Tax Court did not inquire whether the home office increased the efficiency or work quality of the taxpayer in his business.<sup>83</sup> Although the facts of the case seem to indicate that these requirements were met,<sup>84</sup> the court, in its formal opinion, made no such finding. Instead, it interpreted the "appropriate and helpful" test to require (1) a proximate relationship between the home office and the taxpayer's

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77. Although Bodzin received some "expedite" cases which had to be completed in a short period of time, such cases were relatively few and he had effective control over his own schedule. *Id.* at 823.

78. Bodzin customarily traveled the ten miles to and from work in a car pool. He chose to use his home office because it enabled him to make better use of his car pool and to spend more time with his family. *Id.*

79. The taxpayer's total rent per year was \$2,100 for an apartment consisting of a living room, dining room, kitchen, two bedrooms, two bathrooms, and a study. Of this amount, he deducted only \$100 for the expenses of his home office. *Id.* at 823-24.

80. *Id.* at 825. See Richard Keith Thomas, 41 P-H Tax Ct. Mem. ¶ 72,192, at 985 (1972).

81. 38 T.C. at 186. See text accompanying note 62 *supra*.

82. 60 T.C. at 826. To block Bodzin's deduction, the Commissioner attempted to rehabilitate Revenue Ruling 62-180 by interpreting the term "required as a condition of employment" to mean required in order to "properly perform employment duties." *Id.* at 825. Although this requirement was very similar to both the implied condition of employment test and the increased employee efficiency test, which had been accepted by the courts in earlier cases, the Service's argument failed. The court criticized this argument because "'required' can be interpreted strictly as meaning 'absolutely essential' or 'absolutely necessary,' and such an interpretation leads to the imposition of a standard which is too strict." *Id.*

83. See note 72 *supra* and accompanying text.

84. The distance between Bodzin's home and the office, coupled with his use of a car pool, might support a finding that working at home was more efficient. See note 78 *supra*. Also, the taxpayer's desire to work overtime in order to "perform to the best of his ability" might support a finding that use of his home office promoted the quality of his work. 60 T.C. at 822.

business,<sup>85</sup> and (2) the taxpayer's good faith in taking the deduction.<sup>86</sup>

Although liberalizing the office-at-home deduction has the advantage of providing more equal tax treatment between employees and self-employed individuals,<sup>87</sup> the approach puts the Service at a handicap. The *Bodzin* standard presents a very nebulous distinction between personal and business expenses. Conceptually, it is weak because in many cases an office-at-home expense is too much *like a personal* expense even if it is not *unlike a business* expense.

Recognizing the inability of the "appropriate and helpful" test to separate these "look-alike" expenses into their business and personal components, four judges dissented in *Bodzin*.<sup>88</sup> They were particularly concerned that the majority opinion would open up the deduction to almost every professional or business person, since the majority of such persons do professional reading and writing at home.<sup>89</sup> Two of the dissenting judges specifically noted *Fausner* and suggested that

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85. *Id.* at 826. The proximate relationship criterion has been applied in other interpretations of the ordinary and necessary requirement of section 162. See Boehm, "Ordinary and Necessary" Expenses: Proximate Relationship as a Rejuvenated Test for Deductibility, 30 U. CIN. L. REV. 1 (1966).

86. 60 T.C. at 826. Something more than personal convenience must be shown before the deduction will be allowed. *Id.* Although the court failed to specify the necessary added ingredient, the taxpayer will probably have to show the office actually helps him better perform his employment duties. The *Bodzin* court seemed to recognize that a taxpayer ought to be able to perform the duties of his *business* in the best possible manner, and if this includes maintaining an office-at-home, this deduction should not be disallowed.

87. The self-employed individual, under the earlier tests, had more flexibility in saying what his work required. Until *Bodzin* the employee was limited by the conditions that his employer would set. See Frank P. Sylos, 35 P-H Tax Ct. Mem. ¶ 66,151 (1966) (a self-employed commercial artist who had previously used a kitchen table for work at home allowed a deduction for the expense of a den which had been enlarged into a studio specifically for use as a home office).

88. The four dissenting judges expressed their views in three separate opinions. 60 T.C. at 827-29.

89. *Id.* The mere fact that a lawyer decides to use his home to do some of his professional reading and some written work for his employer should not operate to transform part of the personal expense of home rental into a business expense. *Id.* If the *Bodzin* approach is construed broadly, any taxpayer sufficiently interested in his work to do some at home would be able to deduct a portion of his residential expense from gross income.

Two commentators have approved the "appropriate and helpful" test set out by *Bodzin*. See Comment, *Trends in the Home Office Deduction*, 42 U. CIN. L. REV. 741, 748-49 (1973); Note, *The Employee's Home Office Deduction: The Problem of Duplicative Facilities*, 72 MICH. L. REV. 348, 354-57 (1973). However, neither writer recognized the inability of this minimal standard to separate the business from the personal aspects of the same expense. See note 92 *infra* and accompanying text.

its reasoning would preclude *any* deduction for Bodzin unless he proved that he would not have rented the room *but for* his business use.<sup>90</sup> A taxpayer should not be allowed a deduction for an expense admittedly related to his business if he would have incurred all of the expense regardless of business exigencies;<sup>91</sup> *Fausner* demands at least this much.

### *Application of the Proposed Additional Expense Test*

Although the "appropriate and helpful" standard of *Bodzin* may be useful to determine the proximate relationship of the mixed expense to the taxpayer's business, the proposed additional expense test is necessary in order to isolate the bona fide business purpose component of the expenditure from any personal aspects of the same expense.<sup>92</sup>

1. *The But For Test.* In the commuting area, the taxpayer can prove the existence of a deductible expense if he can show that he would not have driven a private automobile to work *but for* the need to transport job-related incidentals.<sup>93</sup> In the office-at-home context, the taxpayer could prove the existence of additional deductible expenses if he could show that he would not have rented the same size apartment or purchased the same size house *but for* the need to acquire home office space.<sup>94</sup> Under these circumstances, a taxpayer

90. 60 T.C. at 827-29. Judges Featherston and Quealy seem to read *Fausner* as standing for a strict *but for* test. This interpretation has been seconded by at least one commentator. Comment, *supra* note 89, at 748. However, given the additional expense language of the decision, it is doubtful that the Court intended to restrict deductions to the limited *but for* situation. See notes 98-99 *infra* and accompanying text.

91. Support for this proposition is found in the Tax Court's "*Sutter* rule," regarding the nondeductibility of a taxpayer's portion of a business meal to the extent of his normal food expense for the meal. See note 138 *infra*.

92. In most business deduction cases, courts customarily defer to the taxpayer's business judgment by applying the minimal "appropriate and helpful" standard. This is because "[n]ormally a taxpayer will not incur an expenditure unless required or justified by the needs of the business. Proceeding on that logical assumption, the courts are slow to override the taxpayer's judgment as to the necessity for incurring the expenditure." 4A J. MERTENS § 25.09, at 46. See, e.g., *Commissioner v. Pacific Mills*, 207 F.2d 177 (1st Cir. 1953). But this deference to taxpayer judgment would not seem justified in the office-at-home context, *unless* the taxpayer actually makes an *extra* expenditure on a room exclusively for the benefit of his business use. If this is not the case, then the room is appropriate and helpful to the taxpayer's business only in the same sense that such accepted personal expenses as food and clothing are appropriate and helpful.

93. See *Arnold T. Anderson*, 55 T.C. 761 (1971); Rev. Rul. 63-100, 1963-1 CUM. BULL. 34. See notes 50-51 *supra* and accompanying text.

94. For example, under this standard the consultant living in a small one room apartment who does substantial work at home would not get *any* rent deduction.

should be able to deduct the total expense of the extra room<sup>95</sup> including depreciation<sup>96</sup> and all utility and furnishing expenses, *except* those directly attributable to time spent in this room for personal reasons.<sup>97</sup>

2. *The Even If Test.* *Fausner* does not stand for a strict *but for* rule; rather, the Supreme Court presumably would have allowed a partial deduction *even if* *Fausner* would have commuted by car irrespective of his need to transport his tools, if an allocation of costs between the personal expenses and the additional business expenses had been feasible.<sup>98</sup> The proposed test merely adopts the analysis suggested by *Fausner* in the *even if* situation. Therefore, a taxpayer, who would have acquired an extra room for personal reasons, would be allowed to prove and deduct any extra utility and furnishing expenses due to his business use of the room. For example, if *Bodzin* would have rented the extra room without considering the needs of his professional work—to use as a personal library or guest room—any bookshelves used exclusively for tax materials, his desk, his chair, desk lamp, and electricity and heating costs attributable to the time spent for business use could be deducted.<sup>99</sup> *Bodzin*, in this situation, could not deduct rent, which would usually be the greatest percentage of the expense, for unless the *but for* test is met, he could not claim that any additional rental payments were dictated by his business purpose.

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95. This is in conflict with the method of allocation presently accepted by the courts, which requires the taxpayer to allocate the rent or depreciation—as well as utility and furnishing expenses—between time spent in the room for business purposes and time spent for personal use. See, e.g., *George W. Gino*, 60 T.C. 304 (1973); *International Artists, Ltd.*, 55 T.C. 94 (1970). See also Rev. Rul. 62-180, 1962-2 CUM. BULL. 52. However, it seems inappropriate to allocate rent or depreciation when the *but for* test has been met because the taxpayer has proved that he would not have incurred any of that particular expense absent the business purpose.

96. The taxpayer may depreciate the adjusted basis of the part of his home used for business. Rev. Rul. 62-180, 1962-2 CUM. BULL. 52. The basis of property converted to business use is the adjusted basis or fair market value on the date of conversion, whichever is lower. Treas. Reg. § 1.167(g)-1 (1964).

97. The *entire* rent and depreciation in this *but for* situation would be an expense *in addition to* the amount that the taxpayer would otherwise have expended. This is because the rental or construction costs of an extra room are an all-or-nothing proposition. The additional deductible utility expenses, on the other hand, would be a function of the percentage of time spent in the room on business activities.

98. See 413 U.S. at 839.

99. Rent, light, taxes, insurance, and interest on mortgages are among the items deductible. Rev. Rul. 62-180, 1962-2 CUM. BULL. 52. The ruling does not specifically mention furnishings in either the text or the examples, but there is no reason to presume that expenses attributable to the business use of fixtures should not be equally deductible. Their purchase price, of course, would not be immediately deductible; rather they would be treated as capital assets and depreciation allowed for exhaustion, wear, and tear. See *Beaudry v. Commissioner*, 150 F.2d 20 (2d Cir. 1945).

3. *The Presumption.* Although, in theory, the additional expense test can fairly accurately reflect the business and personal elements of mixed expenditures, the practical problems of proof in the home office area can be very difficult. The difficulty involved in reviewing and resolving the competing personal and business motives of taxpayers who claim home office deductions are considerable. When the taxpayer uses a room for both personal and business reasons, how does he prove that the business purpose mandated the extra expense? How does he prove that the purely personal purpose of having an extra guest room, library, or den is not great enough to have motivated the additional expense absent the business use? It may be that the personal calculus hidden in the taxpayer's mind determined that neither purpose alone was enough to warrant the expense, but both together made it worthwhile.

These complex problems of proof show the need for a standard guideline upon which the taxpayer can rely for a presumption in favor of business motivation. In the home office context, if the room is used more than fifty percent of the time for business purposes, there would be a presumption that *but for* the business use the room would not have been rented or constructed, and a deduction for rent or depreciation would be allowed. If business use drops below fifty percent in a particular year, the presumption would be that the room would have been obtained primarily for personal purposes, and no deduction for rent or depreciation would be allowed unless an alternative component of the proposed test were met.

Because there may be situations outside of the fifty percent guideline where the taxpayer *is* able to prove a business purpose for the expense,<sup>100</sup> the more than fifty percent business use test should be considered a "safe harbor" rather than a rigid prerequisite for the deduction. If it is impossible for the taxpayer to prove under all the facts and circumstances that he would not have incurred the expense *but for* a business reason, he should be able to rely on the safe harbor provision for a deduction. Since the fifty percent guideline would only serve as an alternative to complete proof of additional business expenses, the presumption of business motivation is limited to those expenses actually attributable to the time spent in business use.

The minimal "appropriate and helpful" standard applied by the *Bodzin* court<sup>101</sup> not only conflicts with the reasoning of *Fausner* but

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100. The taxpayer, for example, may be able to meet the *but for* test of business purpose even if his business use falls below fifty percent if he can show that the home office actually was *required* as a condition of his employment.

101. See notes 75-86 *supra* and accompanying text.

also is inconsistent with the legislative policy which distinguishes between business and personal expenses.<sup>102</sup> By identifying, as precisely as possible, the additional expenses attributable to business use of the home office, the proposed test more closely follows the Supreme Court's suggestion in *Fausner* and is consistent with statutory commands.

#### OTHER MIXED BUSINESS-PERSONAL EXPENSES

##### *Transportation Expenses in Combined Business-Pleasure Trips*

The transportation expenses incurred in a combined business-pleasure trip currently receive different tax treatment depending upon whether the trip is within the United States or is to a foreign country.<sup>103</sup> If the trip takes place within the United States, the primary purpose of the trip will determine the deductibility of the transportation expenses.<sup>104</sup> Where the trip is determined to relate primarily to the taxpayer's trade or business (for example, where it would not have been made *but for* the business purpose), the taxpayer's entire transportation expenses to and from his destination are deductible even though some personal activities were conducted upon arrival.<sup>105</sup> The same equitable result would be reached under subsections (1)(a) and (2)(a) of the proposed additional expense test, since any transportation expenses would clearly be in addition to what the taxpayer would have otherwise spent. However, if the primary purpose of the trip was determined to be personal, no deduction should arise since the taxpayer would not have incurred expenses in excess of his personal transportation costs.<sup>106</sup>

On the other hand, under Internal Revenue Code section 274(c) when travel is to a foreign country the taxpayer must arbitrarily allocate his transportation expenses between his business and personal

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102. See notes 1-4 *supra* and accompanying text.

103. Compare Treas. Reg. § 1.162-2(b) (1958) with Treas. Reg. § 1.274-4(d)(2) (1969).

104. Treas. Reg. § 1.162-2(b) (1958). While the primary purpose will depend on the facts of each case, the amount of time spent on business versus personal activities "is an *important factor*" in such a determination. *Id.* § 1.162-2(b)(2) (emphasis added).

105. *Id.* § 1.162-2(b)(1). However, if the trip is primarily personal in nature, no traveling expenses are deductible. *Id.* Cf. Treas. Reg. § 1.162-5(a)-(b) (1958), where, like transportation expenses, the arguably mixed expense of education is considered to be either completely personal or completely business-related.

106. However, it is possible that a taxpayer could deduct additional expenses under steps (1)(b) and (2)(b) of the proposed test even if the trip was primarily of a personal nature. For example, if a salesman had to pay an extra baggage fee for sample cases, even though he was primarily traveling on a vacation, he should be able to deduct the additional expense.



endeavors.<sup>107</sup> Instead of making an inquiry into the primary purpose of the trip, foreign travel expenses are currently allocated on a per day basis.<sup>108</sup> For example, if a taxpayer spends ten days overseas and an additional five days on vacation, he can deduct only two-thirds of his transportation expenses.<sup>109</sup> However, *Fausner* would suggest a change from the present per day arbitrary allocation of transportation expenses to the two-step additional expense test. As in the domestic travel case, a taxpayer who proves that an excursion is dictated by his business should be able to deduct his entire transportation expenses since the travel costs would be in excess of what he otherwise would have spent. Thus, under the proposed test, only after the taxpayer has had a chance to deduct his entire additional expenses and failed should a less accurate standard, such as a per day basis,<sup>110</sup> be used. Failing to get a complete deduction, however, under subsections (1)(a) and (2)(a) the taxpayer would get a partial deduction if he spent more than fifty percent of his time on business.

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107. INT. REV. CODE OF 1954, § 274(c)(1) provides:

*In General.*—In the case of any individual who travels outside the United States away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel otherwise allowable under such section which, under regulations prescribed by the Secretary or his delegate, is not allocable to such trade or business or to such activity.

108. Treas. Reg. § 1.274-4(d)(2) (1969). *But see* Walter H. Hendrix, Jr., 40 P-H Tax Ct. Mem. ¶ 71,049 (1971), where the Tax Court reached an even more inequitable result by allowing a complete deduction for the taxpayer's transportation expenses abroad even though he only spent three of eighty-three days on business, a result that seems flatly contradictory to the statutory language.

109. Treas. Reg. § 1.274-4(f)(1)(i)-(ii) (1969).

110. The per day basis, as presently used, is objectionable because a number of the criteria in the regulations used in determining whether a day is devoted to business or nonbusiness purposes seem unjustifiable. First, transportation days are always considered business days regardless of the primary purpose of the trip. Treas. Reg. § 1.274-4(d)(2)(i) (1969). Thus, in a case such as Walter H. Hendrix, Jr., 40 P-H Tax Ct. Mem. ¶ 71,049 (1971), even though the taxpayer spent only three days of an eighty-three day trip on business, his transportation days would be deemed business days for allocating his transportation expenses. Second, weekends and holidays are automatically considered business days if the taxpayer conducts some business the following week. Treas. Reg. § 1.274-4(d)(2)(v) (1969). While such a standard is simple to administer, it neglects the situation where the taxpayer had the choice whether to continue his work on the weekend and for personal reasons declined to do so. A better standard for determining whether a taxpayer's activity on weekends and holidays is of a personal or business nature would be to expand the concept of "circumstances beyond his control," which is found in Treas. Reg. § 1.274-4(d)(2)(iv) (1969). For instance, if it is legally impossible for the taxpayer to conduct his business on the weekend then his living expenses would automatically be deductible. However, if the taxpayer had his choice whether to work or not, an inquiry into whether it was reasonable to expect the taxpayer to work would have to be made.

*Entertainment Expenses*

Although for many years the Internal Revenue Code did not explicitly allow a deduction for business entertainment expenses, these deductions were routinely taken as "ordinary and necessary" business expenses under section 162.<sup>111</sup> Since the general statutory requirements did not sufficiently distinguish between personal and business expenditures, taxpayers inevitably took deductions in excessive amounts and deducted personal expenditures in the guise of business expenses.<sup>112</sup> The problem of abuse is similar to the difficulty currently experienced in the home office context where the courts are applying only the minimal "appropriate and helpful" standard to a mixed personal-business situation.<sup>113</sup> To remedy the problem in the entertainment area, the Service appealed to Congress,<sup>114</sup> which responded by narrowing the scope of the entertainment deduction in the Revenue Act of 1962.<sup>115</sup>

Section 274,<sup>116</sup> which was added to the Internal Revenue Code

111. 4A J. MERTENS § 25.88.

112. See Emmanuel & Lipoff, *Travel and Entertainment: The New World of Section 274*, 18 TAX L. REV. 487, 488 (1963). If a taxpayer could show that a direct business benefit was expected to flow from the entertainment, then the expenditure would be deductible even if some personal benefits were also realized. Johnson v. United States, 45 F. Supp. 377 (S.D. Cal. 1941); William Auerbacher, 25 P-H Tax Ct. Mem. ¶ 56,218 (1956); Walter O. Kraft, 18 P-H Tax Ct. Mem. ¶ 49,159 (1949); Vinson v. United States, 34 Am. Fed. Tax R. 1714 (1945). Only if the personal benefits were found to be primary would the deduction be disallowed. Emily Marx, 18 P-H Tax Ct. Mem. ¶ 49,014 (1949), *aff'd*, 179 F.2d 938 (1st Cir.), *cert. denied*, 339 U.S. 964 (1950); Home Guar. Abstract Co. v. Commissioner, 8 T.C. 617 (1947). There were also great difficulties for the Service in administering these standards due to lax requirements of proof. See 4A J. MERTENS § 25.100, at 421.

113. See notes 75-91 *supra* and accompanying text.

114. See Caplin, *The Travel and Entertainment Expense Problem*, 39 TAXES 947 (1961).

115. Rev. Act of 1962, Pub. L. No. 87-834, § 4, 76 Stat. 960 (1962) (codified at INT. REV. CODE OF 1954, § 274); see S. REP. No. 1881, 87th Cong., 2d Sess. 29 (1962); H. REP. No. 1447, 87th Cong., 2d Sess. 16 (1962). See generally Lipoff, *Entertainment and Related Expenses Under Legislative Attack*, 17 TAX L. REV. 183 (1962).

116. INT. REV. CODE OF 1954, § 274(a):

(1) IN GENERAL.—No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) ACTIVITY.—With respect to an activity which is of a type generally considered to constitute entertainment . . . unless the taxpayer establishes that the item was directly related to, or, . . . associated with, the active conduct of the taxpayer's trade or business, or

(B) FACILITY.—With respect to a facility used in connection with an activity referred to in subparagraph (A), unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the item was directly related to the active conduct of such trade or business . . .

by the 1962 Act, is a statutory attempt to differentiate between the personal and business aspects of an entertainment expense by requiring the taxpayer to show more of a proximate relationship between the expenditure and his trade or business than was required by prior law.<sup>117</sup> In order to obtain a deduction, a taxpayer must meet either the "directly-related" or "associated with" test prescribed by the Code and defined by the regulations.<sup>118</sup> This statutory scheme is partially consistent with the additional expense approach. It attempts to determine whether an additional expense has been incurred by identifying whether there was a bona fide business motivation for the expense. Under the "directly-related" test, there must be a showing that the "principal character" of the expense was related to the taxpayer's trade or business.<sup>119</sup> This is to be judged in light of "all the facts and circumstances of the case,"<sup>120</sup> and is similar to a *but for* inquiry. If the business aspect of the expense can be shown to be primary, there is an assumption that *but for* the business purpose, no expenditure would have been made, and the entire expense attributable to the taxpayer and his business associates is deductible.<sup>121</sup> If the expense is not prin-

117. See H. REP. NO. 1447, 87th Cong., 2d Sess. 20 (1962).

118. 1. "Directly-related" test: The taxpayer must show that:

- a. he had more than a general expectation of deriving future income or some other specific benefit (other than the goodwill of the person entertained) from the entertainment expenses;
- b. he did engage in business during the entertainment period with the person being entertained; and
- c. the principal character or aspect of the combined business and entertainment was the transaction of business. Treas. Reg. § 1.274-2(c)(3) (1963).

2. "Associated with" test: The taxpayer must show that:

- a. there was a clear business purpose in making the expenditure (such as getting new business); and
- b. the entertainment directly preceded or followed a substantive and bona fide business discussion. *Id.* § 274-2(c)(4).

The Code also provides for several exceptions to these general requirements: (1) business meals; (2) food and beverages for employees; (3) expenses treated as compensation; (4) reimbursed expenses; (5) recreational expenses for employees; (6) employees and stockholders meetings; and (7) meetings of business leagues. INT. REV. CODE OF 1954, § 274(e).

119. See note 118 *supra*.

120. Treas. Reg. § 1.274-2(c)(3)(iii) (1963). To meet this requirement, it is not necessary that more time be devoted to business than to entertainment. *Id.*

121. See *id.* § 1.274-2(c)(3)(iv), limiting the "directly related" deduction to expenses allocable to the taxpayer and persons with whom he is engaged in the active conduct of business; *id.* § 1.274-2(d)(2), which denies an "associated with" deduction for expenditures allocable to a person who was not closely engaged in a substantial and bona fide business discussion. Although the regulations would seem to allow a full deduction for the expenses attributable to the taxpayer himself in such a mixed personal-business situation, the *Sutter* rule, see note 138 *infra*, would allow only a partial deduction for expenses based on his own consumption.

cipally for business purposes, no deduction is allowed. Thus, if a taxpayer invites a business associate to his country club for the day and has to pay a flat all day visitor's fee, no part of the fee would be deductible unless the taxpayer could prove that the activities of the day were principally business-oriented. However, the additional expense test would extend the inquiry two steps further: (1) to presume business motivation if more than fifty percent of the time were spent in business discussion, and (2) to allow a deduction to the extent of the percentage of the fee attributable to the time so spent.

The additional expense inquiry could have no application under the alternative method of obtaining an entertainment deduction under the present statute—the “associated with” test.<sup>122</sup> By allowing a deduction for entertainment that directly precedes or follows a substantive business discussion,<sup>123</sup> Congress seems to recognize that *pure* entertainment can be a bona fide business expense. In this case, no *mixed* expense is involved at all since the business purpose encompasses the time attributable *solely* to entertainment as well as the time spent specifically in business discussions. Inquiry is concerned with whether the expense *directly* preceded or followed a substantive business discussion.<sup>124</sup>

Perhaps the closest analogy to the proposed additional expense test under present law is found in another type of entertainment deduction. The taxpayer is given an opportunity to show additional expenses by proving that the “primary use” of an entertainment facility, under all the facts and circumstances, was business-related,<sup>125</sup> therefore creating an assumption that *but for* the business purpose he would not have acquired the facility. Yet even if this test is met, the deduction is limited to that portion of the expense attributable to the time spent in actual business use.<sup>126</sup> Under an additional expense analysis, a full deduction for rent or depreciation should be allowed if the *but for* test is met, although utility expenses attributable exclusively to personal use would be disallowed. The regulations currently in force provide for a presumption of primary business motivation if the facility is used more than fifty percent of the time to further the taxpayer's trade or busi-

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122. See INT. REV. CODE OF 1954, § 274(a)(1)(A). See notes 116 & 118 *supra*.

123. *Id.* See also Treas. Reg. § 1.274-2(d)(3) (1963). See note 116 *supra*.

124. Also, the taxpayer must establish that the “business meeting, negotiation, discussion, or transaction was substantial in relation to the entertainment.” *Id.* § 1.274-2(d)(3)(a).

125. *Id.* § 1.274-2(e)(4)(i).

126. *Id.* § 1.274-2(a)(2).

ness,<sup>127</sup> with the deduction again limited to expenses attributable to actual time spent for business purposes.<sup>128</sup> In this case, the limited deduction is appropriate since the taxpayer could not prove that he was motivated solely by business purposes and would have to rely on the presumption's safe harbor. The proposed test would modify the present scheme slightly to allow a deduction for the utility expenses directly attributable to time spent in business use *even if* the taxpayer cannot establish *primary* business use by satisfying the *but for* test or by meeting the more than fifty percent time requirement.

These proposed modifications are consistent with the present Code provisions governing the deductibility of entertainment expenses, and could be implemented by a revision of the regulations. In the entertainment area, the additional expense test is needed to identify the business component of the mixed expense more precisely and more consistently. This will result not only in increased fairness to the taxpayer in the amount of his deduction and his burden of proof, but it will also prevent certain taxpayers from passing a part of their personal expenses to the government.<sup>129</sup>

#### *Duplicative Living Expenses*

Under section 162 (a)(2) of the Internal Revenue Code, a taxpayer is allowed to deduct his traveling expenses while away from home in the pursuit of a trade or business.<sup>130</sup> Despite the apparent personal nature of such expenses, taxpayers in temporary employment situations<sup>131</sup> or on overnight business trips<sup>132</sup> have been allowed full de-

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127. *Id.* § 1.274-2(e)(4).

The regulations provide that the number of days of business use (which include any day during which the facility was used for a bona fide business discussion) are to be compared with the number of days of *actual use* (not the number of days *available* for use) to meet the more than fifty percent primary use requirement. *Id.* § 1.274-2(e)(4)(i).

128. Once the primary use is established, the taxpayer may deduct only that portion of his expenses (depreciation, rent, utilities, insurance, maintenance, etc.) which is "directly related" to the active conduct of his trade or business. Although "associated with" expenses are considered to determine fifty percent use, the portion of expenses attributable to associated expenses is not deductible. *Id.* § 1.274-2(a)(2).

129. For entertainment activities, the proposed test would allow the taxpayer a partial deduction under either the *even if* test or the presumption's safe harbor if he could not meet the difficult *but for* burden of proof. For entertainment facilities, the test would allow the taxpayer a full deduction (rather than a percentage) if he meets the *but for* test, and a partial deduction under the *even if* test (rather than no deduction). However, expenses allocable exclusively to personal use would be one hundred percent nondeductible.

130. INT. REV. CODE OF 1954, § 162(a)(2).

131. When a person accepts a temporary job, generally a year or less, he is allowed

ductions for the following expenses: meals and lodging (both en route and at the destination), cleaning and laundry expenses, telephone and telegraph charges, and certain commuting expenses (to and from the hotel and place of work; and to and from the railroad station or airport).<sup>133</sup> The purpose of allowing such deductions is to ease the burden of the taxpayer whose business travels require additional and duplicative living expenses.<sup>134</sup>

Since the suggestion in *Fausner* limits deductions to additional expenditures attributable to the taxpayer's business, the present full deduction may be questioned to the extent that living expenses are not actually duplicated.<sup>135</sup> For example, where lodging expenses are not duplicated, such as when the taxpayer stays with friends or sublets his apartment, additional, business-related expenses have not been incurred and hence no deduction should arise. Likewise, a total deduction for meals is inconsistent with the analysis suggested in *Fausner*, since the taxpayer would have incurred some personal expense for meals if he had remained at home.<sup>136</sup> For example, if a traveling taxpayer spends fifteen dollars a day on meals when he normally would have spent five dollars a day at home, then he should be permitted to deduct ten dollars a day as a business-related expense.<sup>137</sup> The Treasury

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to deduct his transportation and living expenses incurred in performing that job while away from home. See, e.g., *Harvey v. Commissioner*, 283 F.2d 491 (9th Cir. 1960); *Barnhill v. Commissioner*, 148 F.2d 913 (4th Cir. 1945); *Arthur Sansone*, 41 T.C. 277 (1963).

A similar deduction is allowed for the cost of a business luncheon or dinner with a client. For both the taxpayer's and his client's meal expenses to be deductible, the taxpayer would have to show that any expenditure for food and beverage was furnished under circumstances conducive to a business discussion. Treas. Reg. § 1.274-2(f) (2)(i) (1963). See also *Huffaker & Hulce, What May Be Done to Salvage a Deduction for Meals on One-Day Trips*, 28 J. TAX. 88, 89 (1968).

132. *United States v. Correll*, 389 U.S. 299 (1967).

133. See 1 CCH 1974 STAND. FED. TAX REP. ¶ 1350.022.

134. See, e.g., *Ronald D. Kroll*, 49 T.C. 557, 562 (1968).

135. See *James v. United States*, 308 F.2d 204, 206-07 (9th Cir. 1962). See also *Comment, Living Expenses While "Away From Home": Business or Personal?*, 19 U. CHI. L. REV. 534, 546 (1952).

The existence of this windfall was a reason the Supreme Court in *United States v. Correll*, 389 U.S. 299 (1967), interpreted the phrase "away from home" of section 162 only to apply if the taxpayer was away "overnight." *Id.* at 302. However, this standard is inconsistent with *Fausner* since it is possible that additional expenses, such as increased meal expenses during the day, occur even though the taxpayer is not away "overnight."

136. Similarly, only infrequently would any cleaning and laundry expenses reflect anything but the personal expenses the taxpayer would have incurred anyway. However, such additional expenses might occur if the taxpayer had to get his clothing cleaned more frequently or at a higher cost than normal.

137. This method of pro-rating the personal and business portions of such meals was

Department, however, decided that such a determination of the excess duplicative living expenses would be administratively infeasible and convinced Congress to grant a deduction for the "entire amount" of such expenditures.<sup>138</sup> While the determination of the excess expense could be difficult,<sup>139</sup> an administratively feasible calculation is arguably possible. In making such a determination, since the taxpayer's away-from-home expenses would have to be determined in any event, the feasibility of an allocation would depend upon the ease of calculating the taxpayer's daily meal expenses at home. In this regard, the taxpayer's daily meal expense at home could be shown by ascertaining the taxpayer's yearly food expenses and dividing by the number of days he was at home.<sup>140</sup>

### CONCLUSION

#### The equitable handling of mixed business and personal expenses

first adopted in the now defunct article 292 of Treasury Regulation 45, 3 CUM. BULL. 191 (1920) which provided:

Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for other than business purposes, such railroad fares are personal expenses and such meals and lodging are living expenses. If the trip is on business, the reasonable and necessary traveling expenses, including railroad fares, and meals and lodging in an amount in excess of any expenditures ordinarily required for such purposes when at home, become business instead of personal expenses.

Initially, the Bureau of Internal Revenue had held that meals and lodging during such trips were not deductible. Treas. Reg. 45, art. 292, 1 CUM. BULL. 161 (1919).  
138. See *United States v. Correll*, 389 U.S. 299, 301 n.6 (1967).

This pattern of shifting from a deduction only for the "excess" amounts spent to a full deduction has also emerged in the handling of the personal portion of entertainment meals. In *Sutter v. Commissioner*, 21 T.C. 170 (1953), *acquiesced in*, 1954-1 CUM. BULL. 6, the Tax Court presented a strict rule allowing only excess meal expenses to be deductible. Subsequently, the Treasury Department stated that it would apply the *Sutter* rule only in cases of abuse. T.M.M. 63-10, Rev. Rul. 63-144, 1963-2 CUM. BULL. 129, 135 (Question and Answer 31).

139. In applying the *Fausner* rationale, one consideration would be the difficulty of proving the "excess" meal expenses. Cf. *Commissioner v. Bagley*, 374 F.2d 204, 206 (1st Cir. 1967). It is important to note that if a calculation of the excess can reasonably be done, both standards would suggest a full deduction of the excess.

In *Bagley* the reason stated for the conclusion that these difficulties were so onerous was the statement of Dr. T.S. Adams, a tax advisor to the Treasury Department. See *Hearings on H.R. 8245 Before a Subcomm. of the House Comm. on Finance*, 67th Cong., 1st Sess. 50,234 (1921). However, on closer examination, the problems in making such a calculation are never discussed, but just described as "cumbersome" and "troublesome." *Id.* at 50,235.

140. This would entail the same type of detailed record-keeping as is required in other deductible expenses, such as medical costs. Most families do not routinely keep such records. To implement this approach, the burden of proof would have to be placed on the taxpayer by the presumption that no additional expenses exist unless proven. Further, if necessary, a reasonable approximation could be used in determining a taxpayer's daily at home meal expenses, perhaps using the Bureau of Labor Statistics' "Market Basket" figures.

in an administratively feasible framework is a difficult problem to resolve. In *Fausner*, the Supreme Court may have signaled that it will take a more severe attitude towards the deduction of any portion of an alleged mixed business and personal expense. However, the "additional expense" language of *Fausner* is not generally applicable, and a strict application of that language would result in an upheaval in the tax law. On the other hand, this result need not follow because, as this Note has demonstrated, it is possible to fashion a more comprehensive test which has *Fausner* as its starting point. This test embodies much of the existing tax law without materially distorting the policies advanced in *Fausner*. It could be used to bring greater consistency to the interpretation of section 162 "ordinary and necessary" business expenses in the inherently difficult factual situations of mixed expenses. In addition, the test can provide a better balance between the congressional mandate to tax an individual only on his *net* income and the need of the government to prevent widespread deduction of expenses incurred primarily for personal motivations. The possibility for achieving this reform has been presented by *Fausner*; the sound principles suggested by this decision should provide a starting point for the improvement of the tax system.



