

Per diem Memo

To: All WD Employees

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From: Mark Elliott

The question below has been asked a lot lately. This response should answer most of your questions about taxable per diem.

What are you going to do about my per diem being taxed?

For a number of reasons many contracts are being extended beyond one year. There are many advantages to these extensions but they do pose the problem of taxable per diem. We have consulted with Simon Lever & Company, certified public accountants, and this is what the law says:

Section 162(a)(2) of the tax code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business, including travel expenses (including amounts expended for meals and lodging other than amounts that are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business. Under section 262(a), no deduction is allowed for personal, living, or family expenses, unless expressly provided by law.

For travel expenses to be deductible under section 162(a)(2) of the Code, they must satisfy the following three conditions: (1) they must be ordinary and necessary, (2) they must be incurred while away from home, and (3) they must be incurred in pursuit of a trade or business. (If you're interested, see Commissioner vs. Flowers, 326 U.S. 465 (1946), 1946-1 C.B. 57, and Rev. Rul. 60-189, 1960-1 C.B. 60.)

A taxpayer's "home" for purposes of section 162(a) (2) of the Code is generally considered to be located at (1) the taxpayer's regular or principal (if more than one regular) place of business, or (2) if the taxpayer has no regular or principal place of business, then at the taxpayer's regular place of abode in a real and substantial sense. If you don't meet either of these, you are considered to be an itinerant whose "home" is wherever you happen to work.

Travel expenses paid or incurred in connection with an indefinite or permanent work assignment are generally nondeductible. Travel expenses paid or incurred in connection with a temporary work assignment away from home are deductible under section 162(a)(2) of the Code. The courts and the IRS have held that employment is temporary for this purpose only if its termination can be foreseen within a reasonably short period of time.

Section 1938 of the Energy Policy Act of 1992, Pub.L. No. 102-486, amended section 162(a)(2) of the Code to provide that a taxpayer shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year. Accordingly, if employment away from home in a single location is realistically expected

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to last (and does in fact last) for 1 year or less, the employment will be treated as temporary in the absence of facts and circumstances indicating otherwise. If employment away from home in a single location is realistically expected to last for more than 1 year or there is no realistic expectation that the employment will last for 1 year or less, the employment will be treated as indefinite, regardless of whether it actually exceeds 1 year. If employment away from home in a single location initially is expected to last 1 year or less, but at some later date the employment is realistically expected to exceed 1 year, that employment will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's realistic expectation changed. (In other words, the day you are formally notified that your contract will exceed 1 year, your per diem becomes taxable.)

Employment that is initially temporary may become indefinite due to changed circumstances.

What if I just leave for a week or two, then come back? *Garlock v. Commissioner* 34 T.C. 611: In this case the taxpayer, a heavy-duty equipment mechanic who maintained a domicile and residence in Mohawk, New York and was affiliated with a union local in Binghamton, New York, was employed at various construction project sites for the same employer from November 1950 until some time in 1954 in the vicinity of Passiac, New Jersey. The taxpayer there presented essentially the same argument, "Each job constituted a separate and distinct temporary job. Each lasted less than one year." The court held that the taxpayer's principal place of employment was the area around Passaic for an indefinite period of time and expenses for meals and lodging there incurred were not deductible as "away from home" traveling expenses. If you are performing the same job tasks and staying in the same geographical location, your per diem is taxable. Taking a little time off won't change your status.

We can get more copies of case law if you want, but it all says the same thing. When you are extended at the same site beyond one year, your principal place of employment becomes that geographical area according to the IRS and the courts, and your per diem will be taxed from the time that you realistically expect the contract to last more than one year. Changing contract numbers won't help. Taking a couple of weeks off won't help.

All of us have faced this tax problem or ones similar to it. In any case, you need to ask yourself this question: "Does my current position provide me with enough job, family and personal satisfaction that I am willing to pay the taxes?" If no, then let us know as soon as you decide so we can look for new work for you and a replacement that the client will accept. If yes, then you pay the taxes.

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As a point of interest, taxable per diem also results in higher costs for the company. When your per diem becomes taxable, the company is required to match FICA and pay additional state and federal unemployment insurance.

The argument that other vendors bend the rules has no merit. We are not going to bend the rules. Doing so puts all WD employees at risk because the company is a risk.

Most of us who are or who have been road warriors would have been willing participants at the Boston Tea Party. As Mr. Clinton says, "I feel your pain." Unfortunately, there is very little we can do about it. Write your congressman, your senators, etc. I have. And, expect your per diem to go taxable if your contract is extended beyond one year.

Mark Elliott
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