26 T.C. 666 (1956)

For an expense reimbursement arrangement to qualify under Internal Revenue Code Section 22(n)(3), the arrangement must provide for reimbursement in addition to compensation, not as a reduction of compensation.

Summary

The case concerned a taxpayer, Moorman, who was employed as a resident vice president and received commissions on sales of securities. His employer reimbursed him for certain expenses. Moorman claimed that, under I.R.C. § 22(n), these expenses were deductible in calculating adjusted gross income. The Tax Court held that, while Moorman could deduct travel, meals, and lodging expenses under § 22(n)(2), other expenses were not deductible under § 22(n)(3) because the employer's arrangement, which deducted approved expenses from Moorman's commissions, did not constitute a true reimbursement arrangement under the statute. This ruling clarified the requirements for expense deductions and distinguished between different types of employment compensation and expense arrangements.

Facts

L. L. Moorman, an investment business professional, was employed by National Securities & Research Corporation. His compensation comprised commissions on sales in his territory. The employer reimbursed Moorman for approved expenses, but these reimbursements were deducted from his commissions. Moorman kept records of his expenses and submitted monthly expense accounts to his employer. He reported only the net amount of his commissions (commissions less expenses) as gross income. The IRS determined that Moorman should have included the full commissions as gross income, then deducted allowable expenses.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Moorman's income tax for the years 1949, 1950, and 1951. The Tax Court reviewed the Commissioner's determinations.

Issue(s)

1. Whether Moorman's gross income included the full commission amounts or the net commissions after subtracting claimed expenses.

2. Whether Moorman's expenses, other than travel, meals, and lodging, were deductible in calculating adjusted gross income under I.R.C. § 22(n)(3).

Holding

1. Yes, because Moorman's gross income included the full commission amounts, and his expenses were deductible separately.

2. No, because the expense arrangement with Moorman's employer did not constitute a "reimbursement or other expense allowance arrangement" as required by I.R.C. § 22(n)(3).

Court's Reasoning

The Court explained that under I.R.C. § 42, which applied since Moorman used a cash method, gross income included all commissions received in the year received. The Court found that Moorman was not a conduit for his employer's expenses. Rather, his employment contract defined his compensation as commissions, from which his approved expenses were deducted. The Court distinguished between the specific deductions allowed under I.R.C. § 22(n)(2) for travel, meals, and lodging and the requirements for reimbursement arrangements under § 22(n)(3). The Court held that because the employer deducted expenses from commissions, there was no true reimbursement arrangement. The Court cited the employment contract, noting that it provided, "The Company will reimburse you for all of your expenses which we approve, but we will deduct the same from the commissions payable to you under this contract." The court stated that "…the claimed effect thereof as a reimbursement arrangement within the meaning of the statute is destroyed by the further provision that 'we will deduct the same from the commissions.'"

Practical Implications

This case is vital for tax advisors, accountants, and businesses who are involved in structuring employee compensation and expense reimbursement programs. It clarified that for an expense reimbursement arrangement to qualify under I.R.C. § 22(n)(3), the arrangement must provide for reimbursement in addition to the employee's compensation and not simply reduce the amount paid as compensation. This decision requires businesses to structure compensation packages and expense reimbursement arrangements correctly. It also is important for anyone claiming employee expense deductions for self-employed workers or those in different tax scenarios. This case has been cited in other tax cases involving the interpretation of employee expense deductions and reimbursement arrangements. In analyzing similar fact patterns, attorneys need to determine whether the employer's arrangement is, in substance, a reduction of compensation or a reimbursement. They must carefully review the terms of any employment agreement, assessing whether payments are truly additional to compensation. The analysis must focus on the economics of the arrangement, not just the labels used.