32 T.C. 257 (1959)

Amounts received as reimbursement for expenses, that result in a "washout" are not considered to be "properly includible" in gross income, and, therefore, not subject to the extended statute of limitations under Section 275(c) of the 1939 Internal Revenue Code.

Summary

The Commissioner determined deficiencies in Abbott L. Johnson's income tax for 1951 and 1952, arguing that reimbursements Johnson received from his employer for business expenses should have been included in his gross income, thereby triggering an extended statute of limitations. Johnson argued that the reimbursements essentially "washed out" the expenses, so they were not "properly includible" in his gross income as per the IRS's own instructions. The Tax Court sided with Johnson, holding that because the reimbursements offset the expenses, only the net amount (if any) was required to be reported as gross income. The court ruled that the extended statute of limitations did not apply because the omitted amounts were not "properly includible" in gross income, thus, there was no omission under section 275(c).

Facts

Abbott L. Johnson, a corporate executive, received reimbursements from his employer for travel, entertainment, and sales promotion expenses in 1951 and 1952. Johnson did not include these reimbursement amounts in his gross income reported on his tax returns, nor did he claim any expense deductions. The Commissioner included the total reimbursement amounts in Johnson's income, which exceeded 25% of the reported gross income. The Commissioner also allowed certain expense deductions to arrive at adjusted gross income. The Commissioner asserted that the excess was "other income" and thus triggered the extended statute of limitations under Section 275(c) of the 1939 Internal Revenue Code.

Procedural History

Johnson filed joint individual tax returns for 1951 and 1952. The IRS issued a notice of deficiency, asserting an extended statute of limitations under section 275(c) of the 1939 Internal Revenue Code. Johnson challenged the deficiency in the U.S. Tax Court.

Issue(s)

1. Whether the amounts received by Johnson from his employer as reimbursement for expenses were "properly includible" in his gross income for the purpose of extending the statute of limitations under section 275(c).

Holding

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1. No, because the reimbursement amounts were essentially offset by the related expenses and were therefore not “properly includible” in gross income to the extent of the “washout” under the IRS’s own instructions.

Court’s Reasoning

The court focused on the phrase “omits from gross income an amount properly includible therein” from section 275(c). The court found the IRS’s own instructions, issued to taxpayers, instructive. The instructions stated that reimbursed expenses should be added to wages, then the actual expenses should be subtracted. Only the balance was to be entered on the tax return. Therefore, the court concluded that the amount “properly includible” in gross income was only the net amount, after expenses were deducted from reimbursements. The court stated, “We may say, at the outset, that we think it apparent that an amount is not to be deemed omitted from gross income under section 275(c) unless the taxpayer is required to include such amount in gross income on his return.” Because Johnson was not required to report the gross reimbursement but only the net, the extended statute of limitations did not apply.

Practical Implications

This case provides guidance on when an extended statute of limitations applies in tax cases involving reimbursements. It highlights the importance of adhering to the IRS’s published instructions. The ruling in Johnson, while it pertains to the 1939 Internal Revenue Code, informs on modern tax law with regard to employee expense reimbursements. It underscores that if reimbursements equal or are less than the expenses, then the employee may not have to include the gross reimbursement in income. This case illustrates that taxpayers should carefully review the applicable instructions for reporting income and deductions. The Court’s emphasis on the instructions highlights the need for the IRS to be clear and consistent in its guidance to taxpayers.

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