***UAL Corp. v. Commissioner, 117 T. C. 7 (2001)***

The U. S. Tax Court ruled that UAL Corporation could deduct per diem allowances paid to its pilots and flight attendants as compensation under Section 162(a)(1) of the Internal Revenue Code. This decision, impacting over $100 million in deductions, clarifies the tax treatment of such payments, distinguishing them from travel expenses subject to strict substantiation requirements.

**Parties**

UAL Corporation and Subsidiaries (Petitioner) v. Commissioner of Internal Revenue (Respondent). The case was heard in the United States Tax Court.

**Facts**

UAL Corporation, through its subsidiary United Air Lines, Inc. , paid per diem allowances to its pilots and flight attendants for both day trips and overnight trips. These allowances were calculated at a rate of $1. 50 per hour ($1. 55 for pilots for certain portions of the years in issue) for the number of hours on duty or on flight assignment. The allowances were part of the employees' compensation under collective bargaining agreements and were not subject to substantiation by the employees. United did not withhold federal income or FICA taxes on these payments, nor were they reported as wages on the employees' W-2 forms. The per diem allowances were reported as travel expenses on UAL's tax returns for the years 1985, 1986, and 1987.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in UAL's federal income taxes for 1983, 1984, 1986, and 1987, totaling over $100 million, due to the disallowance of deductions for per diem allowances. UAL contested these deficiencies, arguing that the allowances were deductible as compensation under Section 162(a)(1). The case was heard by the U. S. Tax Court, which reviewed the case under the de novo standard.

**Issue(s)**

Whether UAL Corporation may deduct the per diem allowances paid to its pilots and flight attendants as personal service compensation under Section 162(a)(1) of the Internal Revenue Code?

**Rule(s) of Law**

Section 162(a)(1) of the Internal Revenue Code allows a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business, including "a reasonable allowance for salaries or other compensation for personal services actually rendered. " The test of deductibility in

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the case of compensation payments is whether they are reasonable and are in fact payments purely for services. (Sec. 1. 162-7(a), Income Tax Regs. )

**Holding**

The Tax Court held that UAL Corporation may deduct the per diem allowances as personal service compensation under Section 162(a)(1). The court found that these payments were made in the context of a bona fide employer-employee relationship and were necessary to secure the employees' services.

**Reasoning**

The court's reasoning hinged on the determination that the per diem allowances were compensatory in nature. The majority opinion noted that the payments would not have been made but for the employer-employee relationship and the need to secure the employees' services. The court emphasized that the allowances were part of the compensation package negotiated with the unions, indicating an intent to compensate for services rendered. The court also addressed the Commissioner's argument regarding the lack of compensatory intent, stating that such intent is merely a pertinent factor, not a prerequisite for deductibility under Section 162(a)(1). The court rejected the Commissioner's position that the allowances should be treated as travel expenses subject to the substantiation requirements of Section 274(d), as they were not contingent on the employees incurring or accounting for any travel expenses. The concurring opinions further supported the majority's view, elaborating on why the allowances for both day and overnight trips should be treated as compensation rather than travel expenses. The dissent, however, argued that the allowances were travel expenses and should be subject to substantiation requirements, criticizing the majority for creating a loophole that could circumvent Congressional intent.

**Disposition**

The Tax Court's decision was to allow UAL Corporation to deduct the per diem allowances as compensation under Section 162(a)(1). The case was to be entered under Rule 155 for computation of the amount of the deduction.

**Significance/Impact**

The decision in UAL Corp. v. Commissioner has significant implications for the treatment of per diem allowances as compensation rather than travel expenses. It clarifies that such payments can be deductible as compensation if they are part of an employment contract and are necessary to secure services, even if not subject to the substantiation requirements applicable to travel expenses. This ruling may influence how corporations structure employee compensation packages, particularly in industries where travel is a significant component of work. Subsequent cases and IRS guidance have further refined the distinction between accountable and

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nonaccountable plans for per diem allowances, impacting how such payments are reported and taxed.

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