Continental Express, Inc. v. Commissioner, T. C. Memo. 2003-223 (U. S. Tax Court, 2003)

In a significant ruling on per diem allowances, the U. S. Tax Court upheld the IRS's application of the 50-percent limitation under Section 274(n) to the full amount of per diem payments made to truck drivers by Continental Express, Inc. The court rejected the company's attempt to deduct 80% of these allowances, affirming the validity of IRS Revenue Procedures that treat such payments as solely for meals and incidental expenses. This decision impacts how businesses in the transportation industry can claim deductions for employee travel expenses.

Parties

Plaintiff: Continental Express, Inc. , an S corporation, and its shareholders (Ralph E. Bradbury, Warren D. Garrison, Bonnie P. Harvey, Edward M. Harvey, Diane M. Miller, James E. Willbanks, and others). Defendant: Commissioner of Internal Revenue.

Facts

Continental Express, Inc. was engaged in long-haul, irregular route trucking, employing between 277 and 324 drivers during the years in issue. The drivers were away from home for a minimum of 21 consecutive days per trip, averaging 25 to 28 days per month on the road. They operated International tractors with sleeper berths. Continental paid its drivers per mile, ranging from 25 to 32 cents, and provided a per diem allowance of 9 cents per mile intended to cover travel expenses. The per diem was not sufficient to cover all expenses, including lodging, as drivers often slept in the sleeper berths rather than motels. Continental did not require receipts or records of drivers' expenses, opting instead to use IRS revenue procedures for substantiating deductions. The company deducted 80% of the per diem payments on its tax returns, applying the 50% limitation of Section 274(n) to 40% of the total per diem amounts.

Procedural History

The Commissioner of Internal Revenue disallowed Continental's deductions for the per diem allowances, asserting that the full amount should be subject to the 50% limitation under Section 274(n). Continental petitioned the U. S. Tax Court for redetermination of the deficiencies. The case was heard by Judge Vasquez, who issued the memorandum opinion in 2003.

Issue(s)

Whether the 50-percent limitation of Section 274(n) applies to the full amount of per diem allowances paid to Continental's drivers?

Rule(s) of Law

Section 274(n) limits the deduction for expenses for food or beverages to 50% of the amount that would otherwise be allowable. Section 274(d) requires strict substantiation for certain travel expenses. IRS Revenue Procedures 94-77, 96-28, and 96-64 provide methods for deemed substantiation of employee travel expenses, including per diem allowances. Under these procedures, per diem allowances calculated on the same basis as wages are treated as being paid solely for meals and incidental expenses (M&IE).

Holding

The court held that the 50-percent limitation of Section 274(n) applies to the full amount of the per diem allowances paid by Continental to its drivers. The court found that the per diem allowances were calculated on the same basis as the drivers' wages (miles driven), thus falling under the IRS Revenue Procedures' definition of a "meals only per diem allowance," subject to the 50% limitation.

Reasoning

The court's reasoning focused on the application of the IRS Revenue Procedures and the doctrine of stare decisis, citing the similar case of Beech Trucking Co. v. Commissioner. The court emphasized that the Revenue Procedures provide elective methods for deemed substantiation, which Continental chose to use. The per diem allowances were calculated based on miles driven, which aligned with the drivers' wages, thus meeting the criteria under Section 4. 02 of the Revenue Procedures to be treated as solely for M&IE. The court rejected Continental's arguments challenging the validity of the Revenue Procedures, stating that they were not arbitrary or unlawful and provided rough justice in lieu of onerous substantiation requirements. The court also found that Continental failed to substantiate the nonmeal travel expenses under Section 274(d), as the company relied on estimates and averages rather than detailed records of each driver's expenses. The court concluded that Continental could not claim a deduction greater than 50% of the per diem allowances, as the Revenue Procedures did not allow for additional deductions based on estimates of nonmeal expenses.

Disposition

The court affirmed the Commissioner's disallowance of Continental's deductions for the per diem allowances, subjecting the full amount to the 50-percent limitation under Section 274(n). Decisions were to be entered under Rule 155 of the Tax Court Rules of Practice and Procedure.

Significance/Impact

This case reaffirmed the validity and application of IRS Revenue Procedures in determining the deductibility of per diem allowances, particularly in the transportation industry. It clarified that per diem allowances calculated on the same basis as wages are treated as solely for M&IE, subject to the 50% limitation under Section 274(n). The decision impacts how companies in similar industries structure their compensation and expense reimbursement policies to comply with tax regulations. It also underscores the importance of maintaining detailed records to substantiate travel expenses under Section 274(d), as estimates and averages are insufficient. Subsequent cases have cited Continental Express in upholding the IRS's position on per diem allowances, affecting tax planning and compliance strategies for businesses nationwide.

