

Tax & Business Alert

JANUARY 2015

TAXABILITY OF REWARDS PROGRAMS

For anyone who spends a lot of time traveling by air for business purposes, one of the nice things that typically occurs because of all of that travel is frequent flyer miles. Even better, about 14 years ago the IRS addressed the controversial question of what happens tax-wise if someone earns those miles (from air travel, rental cars, hotels, etc.) on trips paid for by their company, but uses them for personal purposes. Happily, the IRS said it wasn't going to assert that someone has taxable income merely because they personally benefited from frequent flyer miles or other in-kind promotional benefits resulting from their business or official travel.

That all sounds good and seemed like the end of the matter—until a recent Tax Court decision said a taxpayer, who cashed in points to purchase a plane ticket, was taxed on the value of the ticket. What happened?

REWARDS THAT WEREN'T SO FREE

In the recent court decision, the taxpayer opened a bank account with a large financial institution and was awarded enough points because of this to earn an airline ticket. He cashed in the points, the bank acquired the ticket for him (apparently spending \$668 in the process), and at the end of the year, sent him a Form 1099-MISC reporting the \$668 as income to him. When he ignored the 1099, failed to report the income, and had a couple of other problems with his return, he and the IRS ended up in Tax Court arguing over whether the ticket should be taxable to him.

The IRS's position was that, of course, it's taxable. After all, he received a Form 1099 reporting it as income. The taxpayer's position was basically that he didn't remember receiving the points or the ticket—thus, nothing should be taxed to him.

The Tax Court took a more methodical approach to its conclusion, noting that gross (taxable) income includes all income from whatever source, unless otherwise excluded. It also acknowledged (without challenging) the IRS position from 2002 regarding points or miles earned from business travel and used personally. However, its view was that the current taxpayer's situation was different.



Instead of the taxpayer receiving miles or points due to purchases that he had made (which would effectively make what he received nontaxable purchase price adjustments), he received an award for making a deposit with a bank or leaving funds with the bank for some period of time. This, to the Court, looked similar to interest and, thus, it agreed with the IRS that the \$668 was taxable income.

CONCLUSION

What's the takeaway value of this case? A couple of key points: First, although probably no one was looking for it, it's nice to have the Tax Court's support of the IRS position on business miles used for personal purposes. Secondly, purchase rebates and awards are different. The former should be nontaxable (whether from credit card companies, airlines, hotels, rental car companies, or somewhere else), while the latter, even if you don't receive a Form 1099, are generally going to be taxable. ■

IRS GRANTS TAX RELIEF TO DROUGHT-STRICKEN FARMERS AND RANCHERS

If you're a farmer or rancher and drought forced you to sell your livestock, special IRS tax relief may help you.

The IRS has extended the time to replace livestock that farmers were forced to sell due to drought.

If you're eligible, this may help you defer tax on any gains you received from the forced sales. The relief applies to all or part of 30 states affected by drought.

Here are several points you should know about this relief:

- If the drought caused you to sell more livestock than usual, you may be able to defer tax on the extra gains from those sales.
- You generally must replace the livestock within a four-year period. The IRS has the authority to extend the period if the drought continues. For this reason, the IRS has added one more year to the replacement period in 30 states.
- The one-year extension of time generally applies to certain sales due to drought.

- If you are eligible, your gains on sales of livestock that you held for draft, dairy, or breeding purposes apply.
- Sales of other livestock, such as those you raised for slaughter or held for sporting purposes and poultry, are not eligible.
- The IRS relief applies to farms in areas suffering exceptional, extreme, or severe drought conditions. The National Drought Mitigation Center has listed all or parts of 30 states that qualify for relief. Any county that is contiguous to a county that is on the NDMC's list also qualifies.
- This extension immediately impacts drought sales that occurred during 2010.
- However, the IRS has granted previous extensions that affect some of these localities. This means that some drought sales before 2010 are also affected. The IRS will grant additional extensions if severe drought conditions persist.

Please give us a call if you would like more information. ■

DEDUCTING LOCAL LODGING EXPENSES

Generally, personal, living, or family expenses, such as the costs of lodging, are not deductible unless the taxpayer is traveling away from home on business. However, thanks to recently finalized IRS regulations, local lodging expenses may be a deductible business expense if certain conditions are met.



An individual's local lodging expenses can be deducted as business expenses if the applicable facts and circumstances dictate that such treatment is appropriate

and the lodging is not lavish or extravagant, or primarily to provide the individual with a social or personal benefit. If paid by an employer, the expense can be treated as a tax-free working condition fringe benefit (WCFB) for the employee. The employer can deduct the cost of WCFBs.

Safe Harbor Rule. IRS regulations provide a safe-harbor rule where local lodging expenses are automatically treated as ordinary and necessary business expenses if all of the following conditions are met:

1. The lodging is necessary for the individual to participate fully in or be available for a bona fide business meeting, conference, training activity, or other business function.

2. The lodging is for a period no longer than five calendar days and does not occur more frequently than once per calendar quarter.

3. In the case of an employee, the employer requires the employee to remain at the activity or function overnight.

4. The lodging is not lavish or extravagant under the circumstances and does not provide any significant element of personal pleasure, recreation, or benefit.

EXAMPLE: TAX-FAVORED TREATMENT ALLOWED FOR EMPLOYEES.

Alpha Corporation puts on periodic employee training sessions at a hotel near its main office. Alpha requires all attending employees, including employees from the local area, to remain at the hotel overnight for the bona fide business purpose of maximizing the effectiveness of the training sessions.

If Alpha directly pays the lodging costs for attending employees and the lodging is not lavish, the costs qualify as tax-free WCFBs for the attending employees, including those who live in the local area, and Alpha can deduct the costs as business expenses. ■