[COMMITTEE PRINT]

DESCRIPTION OF BILLS (H.R. 3340, H.R. 3812, H.R. 4007, H.R. 4284, AND H.R. 4611) LISTED FOR A HEARING BY THE COMMITTEE ON WAYS AND MEANS ON MARCH 28, 1977

RELATING TO

BUSINESS USE OF RESIDENCE FOR DAY CARE SERVICES

AND

TRAVEL EXPENSES WHILE AWAY FROM HOME FOR LEGISLATORS

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

MARCH 24, 1977

U.S. GOVERNMENT PRINTING OFFICE
86-264 WASHINGTON : 1977 JCS-13-77

CONTENTS

I. INTRODUCTION

The bills described in this pamphlet are those on which the Committee on Ways and Means has announced a one-day public hearing for Monday, March 28, 1977. The hearing relates to two topics: (1) the deductibility of expenses attributable to the use of a personal residence to provide day care services as trade or business expenses, and (2) the tax home of legislators for purposes of deducting travel expenses while away from home.

In connection with this hearing, the staff of the Joint Committee has prepared a description of the bills, similar to the descriptions the staff was directed to prepare in connection with the hearings on miscellaneous bills in the 94th Congress.[1]

For each topic, the pamphlet first briefly summarizes the bills in consecutive bill number order. This is followed by a more detailed description of each bill indicating in each case the present law treatment, the issue involved, an explanation of what the bill would do, any prior Congressional consideration of the topic, the effective date of the provision, the revenue effect of the provision, and the position of the Treasury Department with respect to the bill.

[1] The description which the staff was directed to prepare in the 94th Congress was to indicate whether any of the bills were retroactive and to name any particular taxpayers to which a bill might be directed if the staff had such information. The bills included in this hearing, however, deal with general provisions included in the Tax Reform Act of 1976.

II. SUMMARY

A. Business Use of Residence to Provide Day Care Services

1. H.R. 3340—Mr. Fraser

The bill would provide an exception to the exclusive use test enacted in the Tax Reform Act of 1976 for the deduction of expenses allocable to the use of any portion of a residence in the trade or business of providing day care services to individuals. The business expenses deductible under the bill would be limited to the amount by which the gross income from day care services exceeds the allocable portion of the property taxes, mortgage interest, etc., which are deductible in any event.

2. H.R. 4284—Mr. Frenzel

The bill is similar to H.R. 3340. However, the exception from the exclusive use test would apply only if the trade or business is licensed, certified, registered, or approved under the provisions of applicable State law as a day care center or as a family or group day care home.

B. Travel Expenses While Away From Home for Legislators

1. H.R. 3812—Mr. Brodhead

The bill provides that for purposes of computing the deduction for away from home living expenses, the tax home of a State legislator is the place of residence within the legislative district he or she represents. The expenses deductible under the bill would be limited to an amount determined by multiplying a daily dollar limitation by the total number of days of legislative participation. The daily dollar limitation is to be established by the Secretary of the Treasury.

2. H.R. 4007—Mr. Corman

The bill differs from H.R. 3812 in two principal respects. First, the daily dollar limit would be established by the Secretary of Labor (rather than the Secretary of the Treasury).

Second, the bill also modifies the $3,000 limitation that now applies to Members of Congress. Under this modification, the Secretary of Labor is to determine an annual dollar limitation (rather than a daily dollar limitation) by taking into account three enumerated factors.

3. H.R. 4611—Mr. Steiger

The bill is essentially the same as H.R. 3812. However, the daily dollar limit is to be established by the Secretary of Labor (rather than the Secretary of the Treasury).

III. DESCRIPTION OF BILLS

A. Business Use of Residence to Provide Day Care Services

Pre-1976 law

Under the Internal Revenue Code, no deductions are allowable for personal, living, and family expenses except as "expressly provided" (sec. 262). Generally, under this provision, expenses and losses attributable to a dwelling which is occupied by a taxpayer as his or her personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowable under other provisions of the tax laws (secs. 163, 164 and 165). Under prior law, if a portion of the residence was used in the taxpayer's trade or business or for the production of income, a deduction was allowable for an allocable portion of the expenses incurred in maintaining such personal residence.

In any case involving the business use of a personal residence, it must first be established that the expenses were incurred in carrying on a trade or business (sec. 162) or for the production of income (sec. 212). Thus, there must be some relatively clear connection between the activities conducted in the home and a trade or business or the production of income. Under the regulations (Reg. § 1.262–1(b)(3)), the expenses of maintaining a household are treated as nondeductible personal expenses if the taxpayer only incidentally conducts business in the home. However, under prior law, if a part of the home was used as the taxpayer's place of business, the allocable portion of the expenses attributable to the use of the home as a place of business was allowable as a deduction.

For this purpose, the expenses attributable to the office or business use of the home were deductible if they were "ordinary and necessary" expenses paid or incurred in carrying on a trade or business or for the production of income. These expenses were claimed as deductions by self-employed individuals who used portions of their residences for trade or business purposes, employees who maintained offices in connection with the performance of their duties as employees, and investors who maintained offices in connection with investment activities. Typically, the expenses for which a deduction was claimed included an allocable portion of the depreciation or rent, maintenance, utility, and insurance expenses incurred in connection with the residence.

In determining the deductible amount attributable to the business use of the home, the general rule is that any reasonable method of allocation may be used. In all cases involving the dual use of a home, the allocation of expenses attributable to the portion of the residence used for business purposes will take into account the space used for those purposes, e.g., a percentage of the expenses based on the square feet of that portion compared to the total square feet of the residence. In addition, a further allocation based on time of use is required when the

portion of the residence is not used exclusively for business purposes. In Rev. Rul. 62–180, 1962–2 C.B. 52, 54, the Internal Revenue Service took the position that, after allocating expenses attributable to a den used for business and personal purposes on the basis of space, a further allocation must be made on the basis of time of use to reflect the dual use. For purposes of the latter allocation, the Service ruled that the allocation should be made on the basis of availability for use rather than actual use, i.e., the ratio of time actually used for business purposes to the total time it is available for all uses. However, in *George W. Gino*, 60 T.C. 304, 314 (1973) (followed in *Lena M. Anderson*, T. C. Memo, 1974–49), the Tax Court held that such expenses should be allocated on the basis of actual business use as compared with actual total use.

In another case where the allocation could not clearly be determined, the *Cohan* rule was applied to estimate the approximate space of an apartment which was used for business purposes. *George H. Newi*, T.C. Memo. 1969–131, aff'd., 432 F.2d 998 (2d Cir. 1970). The *Cohan* rule provides, generally, that where there is evidence that the taxpayer incurred certain deductible expenses but the exact amount cannot be determined, a close approximation would be acceptable and, therefore, the deduction would not be entirely disallowed.

Present law—Tax Reform Act of 1976

The Tax Reform Act of 1976 added a new section to the Code (sec. 280A) which provides, in part, that no deductions shall be allowed with respect to a dwelling unit which is used by the taxpayer as a residence, unless (1) the use is specifically excepted from this new section or (2) the deduction is allowable even if there is no trade or business, or income-producing context. The provisions of this section apply to individuals, trusts, estates, partnerships, and electing small business corporations. This provision does not apply to a corporation (other than an electing small business corporation).

The general disallowance provision, however, does not apply with respect to certain expenses which are otherwise allowable as deductions. For example, the deductions allowable for interest (sec. 163), certain taxes (sec. 164) and casualty losses (sec. 165) may still be claimed as deductions without regard to their connection with the taxpayer's trade or business or income producing activities.

In the case of a taxpayer (other than an employee whose use constitutes meals and lodging furnished for the convenience of the employer) who exclusively uses a portion of a dwelling unit on a regular basis as his principal place of business, as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or in the case of a separate structure which is not attached to the dwelling, in connection with the taxpayer's trade or business, an allocable portion of ordinary and necessary trade or business expenses paid or incurred in connection with such trade or business use will be allowed as a deduction. However, the amount of the deduction is subject to a limitation discussed below.

Exclusive use of a portion of a taxpayer's dwelling unit means that the taxpayer must use a specific part of a dwelling unit solely for the purpose of carrying on his trade or business. The use of a portion of a dwelling unit for both personal purposes and for the carrying on of a

trade or business does not meet the exclusive use test. Thus, for example, a taxpayer who uses a den in his dwelling unit to write legal briefs, prepare tax returns, or engage in similar activities, as well for personal purposes, will be denied a deduction for the expenses paid or incurred in connection with the use of the residence which are allocable to these activities.

Under the Act, an exception to the exclusive use test is provided in the case of a taxpayer whose trade or business is selling products at retail or wholesale and whose dwelling unit is the sole fixed location of such trade or business. Under this exception, the ordinary and necessary expenses allocable to space (within a dwelling unit) which is used as a storage unit for inventory will not be disallowed. However, the space must be used on a regular basis and must be a separately identifiable space suitable for storage.

In addition to the exclusive use test, the Act requires that the portion of the residence used for trade or business purposes must be used by the taxpayer on a regular basis in order for the allocable portion of the expenses to be deductible. Expenses attributable to incidental or occasional trade or business use of an exclusive portion of a dwelling unit are not deductible.

Present law does not permit a deduction for any portion of expenses paid or incurred with respect to the use of a dwelling unit which is used by the taxpayer both as a residence and in connection with income producing activities (sec. 212). For example, no deduction is allowed if a taxpayer who is not in the trade or business of making investments uses a portion of his residence (exclusively and on a regular basis) to read financial periodicals and reports, clip bond coupons and perform similar activities because the activity is not a trade or business.

In the case of an employee, a deduction for the portion of the ordinary and necessary business expenses attributable to the use of a residence which are paid or incurred in connection with the performance of services as an employee is allowable only if, in an addition to satisfying the exclusive and regular use tests, the use is for the convenience of his employer. If the use is merely appropriate and helpful, no deduction attributable to such use is allowable.

The Act also provides an overall limitation on the amount of deductions that a taxpayer may take for the business use of the home. The allowable deductions attributable to the use of a residence for trade or business purposes may not exceed the amount of the gross income derived from the use of the residence for that trade or business reduced by the deductions which are allowed without regard to their connection with the taxpayer's trade or business (e.g., interest and taxes). In the case where gross income is derived both from the use of the residence and from the use of facilities other than the residence, a reasonable allocation (based on the facts and circumstances of each case) must be made to determine that portion of the gross income derived from the use of the residence. With respect to the deductions which are allocable to the trade or business use of the residence, deductions allowable without regard to whether the activity is a trade or business are to be deducted first. Any remaining gross income may then be reduced (but not below zero) by the remaining allowable deductions which are allocable to such use.

The Act applies to taxable years beginning after December 31, 1975.

Issue

It has been pointed out that the exclusive use test will rarely be satisfied in the case of the use of a personal residence to provide day care services. Typically, the portion of the residence used to provide these services will also be used for personal purposes. In these cases, it is not practicable to cordon off a portion of the residence to be devoted exclusively to provide day care services. The question is whether an exception to the exclusive use test should be provided for expenses allocable to the use of a portion of a residence in a trade or business of providing day care services.

Explanation of bills

1. H.R. 3340—Mr. Fraser

H.R. 3340 provides an exception to the exclusive use test for expenses allocable to the use on a regular basis of any portion of a residence in a trade or business of providing day care services. The business expenses deductible under the bill would be limited to the amount by which the gross income from day care services exceeds the allocable portion of the property taxes, mortgage interest, etc., which are deductible in any event.

2. H.R. 4284—Mr. Frenzel

H.R. 4284 also provides an exception to the exclusive use test for expenses allocable to the use on a regular basis of any portion of a residence in a trade or business of providing day care services. However, under the bill, the exception would apply only if the trade or business is licensed, certified, registered, or approved under the provisions of applicable State law as a day care center or as a family or group day care home.

The deductible business expenses would be limited (as in H.R. 3340) to the amount by which the gross income from day care services exceeds the allocable portion of the property taxes, mortgage interest, etc., which are deductible in any event.

Effective date

Both H.R. 3340 and H.R. 4284 would apply to taxable years beginning after December 31, 1975.

Revenue effect

It is estimated that H.R. 3340 would reduce budget receipts by $40 million in fiscal year 1977 and $35 million in fiscal year 1978 and thereafter.

If the impact of H.R. 4284 on budget receipts is assumed to be one-half of the impact of H.R. 3340 because of the limitation to State-licensed, certified, registered, or approved day care homes, budget receipts under H.R. 4284 would be decreased by $20 million in fiscal year 1977 and $18 million in fiscal year 1978 and thereafter.

Other Congressional considerations

On March 21, 1977, the Senate Finance Committee ordered reported H.R. 3477 (The Tax Reduction and Simplification Act of 1977), which included a provision essentially similar to H.R. 3340.

B. Travel Expenses While Away From Home for Legislators

Present law—general

Under present law, an individual is allowed a deduction for traveling expenses (including amounts expended for meals and lodging) while away from home in the pursuit of a trade or business (sec. 162 (a)). These expenses are deductible only if they are reasonable and necessary in the taxpayer's business and directly attributable to it. "Lavish or extravagant" expenses are not allowable deductions. In addition, no deductions are allowed for personal, living, and family expenses except as expressly allowed under the code (sec. 262).

Generally, under section 262, expenses and losses attributable to a dwelling unit which is occupied by a taxpayer as his personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowed under other provisions of the tax laws (secs. 163, 164, and 165).

In addition, generally, under section 274, a taxpayer must substantiate the amount, time, place and business purpose of each expenditure for traveling expenses by adequate records or by sufficient corroborating evidence. In Revenue Ruling 74–433 the Internal Revenue Service, pursuant to the authority of section 274(d), ruled that if, in the case of expenses for travel away from home (exclusive of costs of transportation to and from destination), an employer reimburses his employees for subsistence or provides his employees with a per diem allowance in lieu of subsistence such reimbursements and allowances shall be deemed substantiated if (1) the employer reasonably limits payment of such travel expenses to those which are ordinary and necessary in the conduct of his trade or business and (2) the elements of time, place, and business purposes of travel are substantiated. This special rule which treats reimbursement arrangements as satisfying the requirements of substantiation and an adequate accounting to the employer applies only where the reimbursement or allowance does not exceed the greater of (1) $44 per day or (2) the maximum per diem rate authorized to be paid by the Federal Government in the locality in which the travel is performed.

A taxpayer's "home" for purposes of the deduction for traveling expenses generally means his principal place of business or employment. Where a taxpayer has more than one trade or business, or a single trade or business which requires him to spend a substantial amount of time at two or more localities, his "home" is held to be at his principal place of business. A taxpayer's principal place of business is determined on an objective basis taking into account the facts and circumstances in each case. The more important factors to be considered in determining the taxpayer's principal place of business (or tax home) are: (1) the total time ordinarily spent by the taxpayer at each of his business posts, (2) the degree of business activity at each location, (3) the amount of income derived from each location,

and (4) other significant contacts of the taxpayer at each location. No one factor is determinative.

In 1952, a provision was adopted with respect to the living expenses paid or incurred by a Member of Congress (including a Delegate or Resident Commissioner). Under these rules, the place of residence of a Member of Congress within the congressional district which he represents in Congress is considered his tax home. However, amounts expended by the Member within each taxable year for living expenses are not deductible in excess of $3,000. Therefore, a Member of Congress (who does not commute on a daily basis from his congressional district) can deduct up to $3,000 of his expenses of living in the Washington, D.C. area. Prior to the Tax Reform Act of 1976, no rule similar to the special rules for ascertaining the place of residence for a Member of Congress applied in the case of a State legislator. As a result, the tax home of a State legislator was determined in accordance with the general rules described above.

Present law—Tax Reform Act of 1976

The Tax Reform Act of 1976 provided an election for the tax treatment of State legislators for taxable years beginning before January 1, 1976. Under this election, a State legislator may, for any such taxable year, treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for living expenses. If this election is made, the legislator is treated as having expended for living expenses an amount equal to the sum of the daily amount of per diem generally allowed to employees of the U.S. government for traveling away from home, multiplied by the number of days during that year that the State legislature was in session, including any day in which the legislature was in recess for a period of four or less consecutive days. In addition, if the State legislature was in recess for more than four consecutive days, a State legisator may count each day in which his physical presence was formally recorded at a meeting of a committee of the State legislature. For this purpose, the rate of per diem to be used is the rate that was in effect during the period for which the deduction was claimed. No substantiation of the amount of such expenses was required. In addition, the total amount of deductions allowable pursuant to this election may not exceed the amount already claimed under a Federal income tax return filed by a State legislator before May 21, 1976. For this purpose, amounts shall be considered claimed under a return even though the taxpayer treated his living expenses as an offset against any reimbursement of per diem he received from the State legislature and, therefore, did not actually set forth these expenses as a deduction on his income tax return. The election is to be made at such time and in such manner as provided under Treasury regulations.

These limitations apply only with respect to living expenses incurred in connection with the trade or business of being a legislator. The 1976 Act did not impose a limitation on living expenses incurred by a legislator in connection with a trade or business other than that of being a legislator. As to other trade or businesses, the ordinary and necessary test of prior law will continue to apply.

Issue

The questions are (1) whether a definitive place of residence rule should be prescribed for determining deductible away from home expenses for State legislators and whether some type of overall limitation should be imposed upon the amount deductible, and (2) whether the $3,000 fixed dollar annual limitation set in 1952 for deductible away from home living expenses for Members of Congress should be modified or adjusted.

Explanation of bills

1. H.R. 3812—Mr. Brodhead

Under the bill, the tax home of a State legislator for purposes of the deduction for trade or business expenses expended in connection with his trade or business expenses as a legislator, would be the place of residence of the State legislator within the district he or she represents. The bill, however, provides a dollar limitation on the amounts that are to be allowable as a deduction in connection with living expenses paid or incurred while away from home.

In the case of a State legislator, the Treasury Department would determine a dollar limitation on a State-by-State basis for each day of legislative participation. The factors to be taken into account are: (1) the cost of living during the calendar year in the place where the legislature meets and (2) amounts normally allowed as business expenses of businessmen under similar circumstances. Deductions are not to exceed the daily amount so established, multiplied by the total number of days of legislative participation by the State legislator during the calendar year. For this purpose, a day of legislative participation is to include each day that the legislator is recorded as physically present at a meeting of the State legislature or at a meeting of a committee of the State legislature or is physically present in the State capital for purposes of conducting legislative business.

These limitations would apply only with respect to living expenses incurred in connection with the trade or business of being a legislator. The general rule regarding substantiation would apply. The bill would not impose a limitation on living expenses incurred by a legislator in connection with a trade or business other than that of being a legislator.

2. H.R. 4007—Mr. Corman

This bill differs from H.R. 3812 in two respects. First, H.R. 4007 provides that the Secretary of Labor (rather than the Secretary of Treasury) is to determine the daily dollar limitation.

Secondly, H.R. 4007 also modifies the $3,000 limitation that now applies to Members of Congress (including any Delegate or Resident Commissioner) to provide similar treatment for them.

In the case of a Member of Congress (including a Delegate or Resident Commissioner) a similar determination is to be made by the Secretary of Labor. However, in this case, the Secretary is to determine an annual dollar limitation (rather than a daily dollar limitation) by taking into account three factors. The factors to be taken into account are: (1) the number of days during the calendar year

on which legislators are away from home; (2) the cost of living during the calendar year in the Washington, D.C. area; and (3) amounts normally allowed as living expenses for businessmen under similar circumstances. As described below, this change would have a delayed effective date so that it will apply only with respect to future sessions of Congress.

3. H.R. 4611—Mr. Steiger

This bill is essentially the same as H.R. 3812. However, the bill provides that the Secretary of Labor (rather than the Secretary of Treasury) is to determine the daily dollar limitation.

Effective date

The amendments made by H.R. 3812, H.R. 4007, and H.R. 4611, would generally apply to taxable years beginning after December 31, 1975. However, the amendment under H.R. 4007 relating to Members of Congress would apply only to taxable years beginning after December 31, 1978.

Revenue effect

It is estimated that H.R. 3812 and H.R. 4611 would reduce budget receipts by $2.3 million in fiscal year 1977, $2.6 million in fiscal year 1978, and $2.1 million in fiscal year 1979.

It is estimated that H.R. 4007 would reduce budget receipts by $2.3 million in fiscal year 1977, $2.6 million in fiscal year 1978, and $2.4 million in fiscal year 1979.

Other Congressional considerations

On March 21, 1977, the Senate Finance Committee ordered reported H.R. 3477 (The Tax Reduction and Simplification Act of 1977), which included a provision to extend the treatment provided under the Tax Reform Act of 1976 for State legislators for one year (i.e., to taxable years beginning before January 1, 1977.

○