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July 10, 2008

Legend:

Mr. A =
Year X =

Dear :

This ruling is in response to your letter, dated January 2, 2008, in which you requested a letter ruling and a closing agreement concerning the federal income tax treatment of payments made by a former prisoner to a community corrections center (CCC).

FACTS

In Year X, Mr. A pled guilty to multiple criminal counts and was sentenced to several years in prison, several years of supervised release and a fine. The Federal Board of Prisons (BOP) determined that Mr. A was eligible for placement in a CCC and assigned him to one. The assignment was made under 19 USCS § 3624(c), which provides that to the extent practicable a prisoner will spend a reasonable part, but not more than 6 months, of the last 10 percent of his term under conditions that will afford the prisoner a reasonable opportunity to adjust to and prepare for re-entry into the community.

In anticipation of his release to the CCC, Mr. A entered into an agreement with the BOP, under which he promised, while a resident of a community corrections center or work release program, he would abide by all the rules and regulations. The rules and regulations governing participation in his particular CCC program are set forth in the Residential Handbook, which provides that "employed residents shall pay twenty-five (25) percent of their weekly gross income, rounded to the nearest dollar amount" to the CCC. The Handbook also states that "[r]esidents who are not employed, but who have other means of income (i.e., Social Security, Disability benefits, Pensions) shall pay an

amount of 25% of [their] gross income." The Handbook states in regard to the purpose of the payments, "[i]n order to promote financial responsibility, the Bureau of Prisons requires residents to contribute to the cost of the [CCC] residence through subsistence payments to the contractor."

The payments are to be made at the conclusion of each week and failure to make subsistence payments may result in disciplinary action, including termination from the program. The payments apparently represent a very small portion of the costs of the facility and must be made whether or not the prisoner lives at the CCC facility.

RULINGS REQUESTED

(1) Mr. A's required payments of a percentage, i.e., 25%, of his income to a CCC are deductible under I.R.C § 162.

(2) Alternatively, Mr. A's required payments of a percentage of his income to a CCC are deductible under § 212.

CONCLUSIONS

(1) Mr. A's required percentage payments are not deductible under § 162. The payments are required for his participation in a CCC program and his opportunity to secure and retain employment. However, that Mr. A could not work as employee "but for" the payments is not a sufficient basis to allow a deduction under section 162. The required payments are not connected with his trade or business; that is, they are not related to the performance of his job. The required payments are also inherently personal in that they are meant to cover or at least replicate the cost of his housing and sustenance and are for the purpose of his rehabilitation. See § 262(a). As shown, in the cases discussed below, expenditures that are normally personal are only allowed in very limited circumstances not involved here.

(2) Mr. A's required percentage payments are not deductible under § 212; the same analysis is applicable to the expenses under § 212 as under § 162.

LAW & ANALYSIS

Ruling Request 1: Deduction under § 162

Section 162(a) allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Being an employee constitutes a trade or business for purposes of section 162(a). Primuth v. Commissioner, 54 T.C. 374 (1970), acq. in result on another issue, 1972-2 C.B. 2 (1972); Gordon El v. Commissioner, T.C. Memo 1990-182, aff'd without op., 980 F.2d 723 (3rd Cir. 1992).

Section 262(a) provides that, as a general rule, no deduction shall be allowed for personal, living or family expenses.

In Green v. Commissioner, 74 T.C. 1229 (1980), taxpayer's blood contained rare antibodies and was highly sought after by drug companies. Because of the frequency of her blood sales, it was necessary for the taxpayer to eat a special diet, i.e., one higher in protein than her ordinary requirements. The court held that, to the extent substantiated, the taxpayer could deduct the cost of the special food that was beyond that necessary for her personal needs. However, the court agreed with the Service that the taxpayer was not entitled to a deduction simply because she would not have incurred the expenses "but for" her sale of the blood plasma, and cited Drake v. Commissioner, 52 T.C. 842 (1969), acq. 1970-2 C.B. xix (1970); and Kroll v. Commissioner, 49 T.C. 557 (1969). Based on this holding, the court did not allow her the portion of the food deduction necessary for her personal comfort.

In contrast to the taxpayer in Green, Mr. A has not alleged that the expense of the required percentage payments exceeds the amount necessary for his personal needs. More importantly, the food allowed in Green was directly related to income being earned. Instead, the stated purpose of Mr. A's required involvement with the CCC, under 19 USCC § 3624(c), is to help with his readjustment to the outside world. That Mr. A is the subject of rehabilitation is a personal matter and the required payments are not incurred in the conduct of his trade or business. Instead, his argument is a "but for" argument that was explicitly rejected in Green, as well as Drake and Kroll.

In Drake, the taxpayer argued he should be able to deduct haircuts because his employment by the military required him to keep his hair short. In rejecting the "but for" test as the sole determination of whether an amount is deductible under section 162, the court noted that many kinds of expenses are incurred by a taxpayer solely because he is engaged in a trade or business, but are still not deductible, e.g., commuting, clothing that is adaptable for nonbusiness wear, and certain educational expenses.

In Kroll, the taxpayer was an 8-year old actor, who was employed in a Broadway show. The taxpayer claimed private school tuition was a business expense because the school made special accommodations for his absences to work in the play, which would not have been made by a public school. In disallowing the tuition deduction, the court stated "[t]his is another example of expenditures made to enable a taxpayer to carry on a trade or business but which are not incurred in the conduct of that trade or business." 49 T.C. at 566. The court expounded on the examples of commuting and work clothes adaptable to general use, and then stated - "of those expenses necessary to the carrying on of a trade or business, only those incurred in the conduct of the trade or business are deductible." Id.

Expenditures, even ones that seem to be personal, can be deductible if they are required by the employer as related to the job. Mr. A relies upon cases involving the deduction of fireman meals and similar circumstances. Specifically, Sibla v. Commissioner, 611 F.2d 1260 (9th Cir. 1980), acq. in part 1978-2 C.B. 2, nonacq. in part, 1978-2 C.B. 4, nonacq withdrawn and acq. in part, 1985-2 C.B. viii (1985) and Belt v. Commissioner, T.C. Memo 1984-167, as well as Pollei v. Commissioner, 877 F.2d 838 (10th Cir. 1989); Christy v. United States, 841 F.2d 809 (8th Cir. 1988), cert. denied, 489 U.S. 1016 (1989); and Walsh v. Commissioner, T.C. Memo 1987-18.

Sibla affirmed an opinion of the Tax Court, Cooper v. Commissioner, 67 T.C. 870 (1977), nonacq., 1978-2 C.B. 3, nonacq. withdrawn and acq., 1985-2 C.B. viii (1985), that a fireman could deduct his share of the cost of a mandatory organized mess at the firehouse. The Tax Court had allowed the deduction reasoning that a personal expense can become a deductible expense when circumscribed by company regulations. The Ninth Circuit relied upon the Tax Court's finding of facts as they were well supported by the record. In distinguishing the cases relied upon by the government, the Ninth Circuit noted the unusual and unique circumstances involved and the department's requirement that the firemen participate in the mess as a condition of employment. The Tax Court subsequently found the facts involved in Belt indistinguishable from those found in Sibla and Cooper.

Again, the present case is clearly distinguishable from Cooper, Sibla and Belt because the payments made to CCC are not required by Mr. A's employer and are not related to the performance of his job. Similarly, the present case is distinguishable from Pollei and Christy in that they again involve expenditures found to be related to the taxpayers' performance of their jobs, that is, an on-duty policeman's commuting in Pollei and an on-duty policeman's meals in Christy. Further, Mr. A resides outside the circuits in which Pollei and Christy were decided. Lastly, in Walsh, the taxpayer, who was a pharmacist, was not allowed to deduct the meals he ate at work.

Ruling Request 2: Deduction under § 212

Section 212 allows individuals to deduct all ordinary and necessary expenses paid or incurred (1) for the production or collection of income and (2) for the management, conservation, or maintenance of property held for the production of income.

The legal analysis under section 212 for these expenses is the same as that under section 162. Under the regulations, deductions under section 212 must also be ordinary and necessary and therefore closely related to the production or collection of taxable income. See Treas. Reg. 1.212-1(d). Further, § 211 makes section 212 subject to section 262, disallowing personal and living expenditures. Specifically, personal expenditures are not allowed as investment-related expenses. United States v.

Gilmore, 372 U.S. 39 (1963). The taxpayer in Drake argued that his expenses could alternatively be deducted under section 212. The court held that section 212 "merely enlarged the category of incomes with reference to which expenses were deductible. It did not enlarge the range of allowable deductions." 49 T.C. at 561, quot'g McDonald v. Commissioner, 323 U.S. 57, 62 (1944).

Administrative:

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

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Thomas D. Moffitt
Branch Chief, Branch 2
(Income Tax & Accounting)