JLTR
Volume Three
2005

Tax Planning for Professorial Sabbaticals

Myron C. Hulen, William J. Kenny, and Anne L. Christensen

ABSTRACT: A sabbatical leave and visiting position at another university offers professors many professional and financial advantages. Among the financial advantages are favorable taxation of the expenses incurred and income earned at the visited university. This paper discusses the tax implications of a visiting position, including eligibility for travel deductions, rules for deducting travel and transportation expenses, implications of taking a position outside of the United States, problems caused by the Alternative Minimum Tax, and other related issues. Also covered are the recordkeeping requirements and the use of federal per diem allowances.

Keywords: visiting professors; tax home; travel expenses.

INTRODUCTION

The opportunity to take a sabbatical leave and a visiting position at another university has always been important to professors. It offers a change of scenery, a chance to re-tool, work on important research projects, and other professional advantages. Sabbatical leaves also can have significant financial and tax benefits. This paper updates the Hulen and Kenny (1988) article[1] on the tax implications of sabbaticals. This article discusses the current law in the areas of eligibility for travel status, allowable deductions for travel and transportation expense, rental of residence, inclusion of scholarship and fellowship income, the tax implications of working outside of the United States, and the application of the Alternative Minimum Tax.

TRAVEL EXPENSE DEDUCTIONS

Eligibility for Traveling Status

An individual on temporary assignment away from home may benefit substantially from deductions for traveling expenses. I.R.C. §162 allows deductions of:

> all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including ... (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business.

Many of the deductions allowable under I.R.C. §162 are not normally deductible because they are "for personal, living, or family expenses."[2] Thus, expenditures for rent, food, transportation,

Myron C. Hulen is an Associate Professor at Colorado State University, William J. Kenny is a Professor at Portland State University, and Anne L. Christensen is a Professor at Montana State University.

[1] Myron C. Hulen and William J. Kenny, "Taxation of a Visiting Professorship after Tax Reform," 3 *Issues Acct. Educ.*255 (1988).

[2] I.R.C. §262(a). Except as otherwise provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

laundry, and other personal items, become deductible for federal income tax purposes only when one is traveling away from home in the pursuit of business.

The eligibility requirements for traveling status were enumerated by the Supreme Court in *Commissioner v. Flowers* as:[3]

1. The expense must be a reasonable and necessary traveling expense, as that term is generally understood. This includes such items as transportation fares, food and lodging expenses incurred while traveling;
2. The expense must be incurred "while away from home;"
3. The expense must be incurred in pursuit of business. This means that there must be a direct connection between the expenditure and the carrying on of the trade or business of the taxpayer or of his employer. Moreover, such an expenditure must be necessary or appropriate to the development and pursuit of the business or trade.

In the *United States v. Correll*, the Supreme Court defined "away from home" to require an overnight stay, now called the "stop and rest" rule.[4] Consequently, if one leaves for a trip in the morning and returns home in the evening, he has not traveled for purposes of this rule. An individual is in travel status if his temporary position is in a city of sufficient distance from his regular home that he must spend the night to perform his duties. A taxpayer, who takes a temporary assignment in the same geographical area as his home, will not be entitled to travel deductions such as meals and lodging, however, he may be entitled to deductions for transportation expenses to and from the temporary assignment position.[5]

The concept of a "tax home" is important in determining the eligibility for travel expense deductions under I.R.C. §162. To be away from home, one must be able to identify his or her "tax home." Although this seems a simple task, it has lead to substantial litigation. A taxpayer's "tax home" is generally considered to be located at (1) the taxpayer's regular or principal (if more than one regular) place of business, or (2) if the taxpayer has no regular or principal place of business, then at the taxpayer's regular place of abode in a real and substantial sense. If a taxpayer comes within neither category (1) nor category (2), then the taxpayer is considered to be an itinerant whose "tax home" is wherever the taxpayer happens to work.[6] An individual's tax home is the city where he or she regularly works, not the city where he or she lives, if different. A taxpayer who does not have a "tax home" but takes a temporary visiting position may not have a principal place of business. In that case, the tax home is the city in which he or she has a place of abode in a real and substantial sense; that is, the geographic area where the individual maintains the most substantial social, cultural, business and personal connections. Where an individual resides in one city but works in another, the tax home is the city of his or her work. Trips between the two cities are personal commuting expenses. Also, any lodging and meal expenditures required because that person works in a city other than that of his residence are personal nondeductible expenses.

In 1958, the Supreme Court in *Peurifoy v. Commissioner*[7] held a taxpayer's place of business may not be his tax home when he undertakes a temporary, as opposed to permanent or indefinite, assignment at a distant location. Which assignments are temporary and which are indefinite have been the subject of much litigation. The courts and the IRS have held that employment is

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3 326 U.S. 465 (1946).
4 389 U.S. 299 (1967).
5 Rev. Rul. 99-7, 1999-1 C.B. 361.
6 Rev. Rul. 93-86, 1993-2 C.B. 71.
7 358 U.S. 59 (1958).

temporary only if its termination can be foreseen in a reasonably short period of time. Effective in 1993, Congress amended I.R.C. §162(a) to limit temporary employment to one year.[8] After the amendment the IRS ruled that:

> if employment away from home in a single location is realistically expected to last (and does in fact last) for one year or less, the employment will be treated as temporary in the absence of facts and circumstances indicating otherwise. But, if employment away from home is realistically expected to last for more than one year, or there is no realistic expectation that the employment will last for one year or less, the employment will be treated as indefinite, regardless of whether it actually exceeds one year. If employment away from home is realistically expected to last for one year or less, but at some later date the employment is expected to exceed one year, that employment will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's expectation changes.[9]

What about a temporary position that gets extended? Or, a second temporary position with a different employer that follows the first temporary position? One year is the maximum term for a temporary position for travel status purposes. Therefore, while each visiting position will be examined separately as to the expectation of its term, a taxpayer may not be in travel status for more than one year at a time. When the taxpayer learns that he or she will be away from home for more than one year, travel status ceases. When an individual takes a visiting position that was expected to last less than one year but becomes permanent during the year, he or she ceases to be eligible for travel status on the date the expectation changes. As will be demonstrated below the loss of travel status may have a significant impact on the taxpayer's tax liability.

General Rules For Deducting Travel Expenses

A taxpayer in travel status may deduct all of the reasonable and necessary expenses of that travel.[10] IRS Publication 463, "Travel, Entertainment, Gift and Car Expenses," lists a variety of expenses that may be deducted, including:

(1) The cost of air, rail, bus or taxi, and other public transportation from the professor's tax home to the station or airport; transportation to the temporary place of employment; and the expenses of a return trip.
(2) The cost of operating and maintaining a private car while away from home, including both driving to the temporary place of employment and transportation between the professor's temporary lodging and place of employment.
(3) Baggage charges.
(4) The cost of meals, including tips and lodging.
(5) The cost of dry cleaning, laundry, and pressing of clothing.
(6) Telephone and telegraph charges.
(7) Other similar expenses.

[8] I.R.C. §162(a)(2) "... the taxpayer shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year."
[9] Rev. Rul. 93-86, 1993-2 C.B. 71.
[10] Treas. Reg. § 1.162-2(a).

Many of the above expenses are personal, living, or family expenses that would not normally be deductible.[11] What makes them deductible is that they are necessary to the business being conducted in the travel. The significance of showing the nexus between a business and the incurred expense was illustrated in *Sakalys.*[12] Professor Sakalys, a professor of nursing at the University of Colorado Health Sciences, while on sabbatical, deducted the cost of furniture for her Los Angeles apartment and the costs of maintaining her Colorado residence. In this case, Mr. Sakalys, who had lived in Colorado with his wife until 1987, accepted an engineering position with Willdan Associates in Los Angeles, which lasted three years and eight months. His wife, Professor Sakalys, took sabbatical leave from August 1988 through January 1989 and lived with Mr. Sakalys in Los Angeles. During that time Professor Sakalys attended class at a nearby university and prepared a scholarly paper. The petitioners deducted half the cost of a bed, refrigerator, and couch set as sabbatical living expenses. They also deducted mortgage, telephone, utility, and caretaker services related to their Colorado home. The Tax Court found all these expenses were personal, not I.R.C. §162 business expenses as the deductions did not bear a "direct and proximate relationship" to Professor Sakalys' sabbatical as they were not ordinary and necessary.

Tax Implications of University-Provided Housing

Some universities offer campus housing for free or at a reduced rent to visiting professors and their families. The fair market value of qualified campus lodging (lodging on or near the campus) will not be included in the professor's gross income if the rent equals or exceeds 5 percent of the value of the lodging as determined by an appraiser on an annualized basis.[13] Free or reduced-rent housing is generally an excellent benefit for a visiting professor. If the housing is free or the rent is very low, then I.R.C. §119(d)(2) states the exclusion "shall not apply to the extent of the excess of—(A) the lesser of—(i) 5 percent of the appraised value of the qualified campus lodging, or (ii) the average of the rentals paid by individuals (other than employees or students of the educational institution) during such calendar year for lodging provided to the employee, over (B) the rent paid by the employee for the qualified campus lodging during such calendar year." Hence, at most a visiting professor would only need to include 5 percent of the rental value in income if the housing is free; and if rent of at least 5 percent is paid, then nothing need be included in income. To the extent rent is paid, it will be a deductible business expense. For example, while on sabbatical at another university, Professor Kirk rents a qualified campus condominium with a fair market value of $200,000 for $1,000 per month or $12,000 per year even though comparable apartments in the area rent for $1,500 per month. Because the annual rent exceeds 5 percent of the fair market value of the apartment ($10,000 per year or $833 per month), Professor Kirk is not required to include any of the rent discount in gross income and he gets a travel deduction of $1,000 per month. In contrast, if Professor Kirk paid only $600 per month rent, he would be required to include $233 per month in gross income. He would be eligible for a $600 per month travel expense deduction.

[11] I.R.C. §262.
[12] *Sakalys v. Commissioner*, 68 T.C.M. (CCH) 438 (1994).
[13] I.R.C. §119(d).

Limitations on Deductibility of Travel Expenses

Returning to the Taxpayer's Regular Residence on Days Off or during Vacations

For tax purposes, an individual is not away from home while he or she is in their hometown; therefore, the cost of transportation, meals, lodging, and other such travel expenses cannot be deducted unless he or she is out of town.[14] For example, during Spring break a taxpayer on temporary assignment may travel to his regular tax home and then return to the temporary place of employment. Meals and lodging while the taxpayer is in his hometown are not deductible because these expenses are personal when at home. The taxpayer may deduct what it would have cost to remain at the temporary residence, however, instead of returning to the permanent tax home.[15]

No Deduction Allowed for the Cost of a Spouse or Family Accompanying the Taxpayer on a Business-Related Temporary Assignment

Generally, the incremental travel expenses that are paid or incurred for a spouse or other family members are not deductible under Treas. Reg. §1.162-2(c). However, if three conditions are met, then such expenses are allowable. The spouse or family member's presence has a *bona fide* business purpose, is an employee of the taxpayer, and the expenses would otherwise be deductible by the family member, those travel expenses will be deductible.[16] Incidental services provided by the spouse, such as occasional typing or hosting social or business gatherings, will not qualify the spouse's travel expenses for a tax deduction.[17] The performance of substantial business services, however, may qualify a spouse or family member for the deduction.[18] For example, if a professor is writing a book while on sabbatical and his or her spouse does a major amount of research for this effort or types a lengthy manuscript, then the incremental travel costs of that spouse or family member may be deducted.

No Deduction for Expenses for Travel as a Form of Education

I.R.C. §274(m)(2) expressly denies deductions for travel as a form of education. This provision applies in cases where, for example, an individual goes to Mexico to improve his or her Spanish-speaking proficiency. In *Keller v. Commissioner,*[19] when a university professor of international relations traveled to Europe to study the perspectives of Europeans on the Gulf War during his sabbatical, the IRS, on the basis of I.R.C. §274(m)(2), disallowed the professor's deductions for travel. The IRS noted, and the Tax Court agreed, that Keller had not applied for a sabbatical to study that topic and the university did not require him to study abroad as part of his sabbatical. However, the rule denying deductions for travel in the above case does not apply when travel is a necessary adjunct to an activity which gives rise to a business deduction relating to education. For example, in *Jorgensen v. Commissioner*[20] an English teacher, at a culturally diverse high school, was permitted to deduct travel expenses in connection with university courses she took in Greece and Asia. The Tax Court agreed with the taxpayer that the courses enhanced her teaching, improved the school's curriculum, and permitted her to gain more from

[14] Priv. Ltr. Rul. 79-17-044 (January 24, 1979).
[15] Rev. Rul. 54-497, 1954-2 CB 75; I.R.S. Pub. 463, "Travel, Entertainment Gift, and Car Expenses," 4 (2003).
[16] I.R.C. §274(m)(3).
[17] Treas. Reg. §1.162-2(c)
[18] Rev. Rul. 55-57, 1955-1 C.B. 315.
[19] *Keller v. Commissioner*, 71 T.C.M. (CCH) 3228 (1996).
[20] *Jorgensen v. Commissioner*, 79 T.C.M. (CCH) 1926 (2000).

her travel experiences. The travel costs were considered reasonable regardless of their relationship to the tuition costs.

For many years the IRS has had the problem of separating vacation expenses, which are personal and not deductible, from expenses of legitimate business travel, which are deductible. In *McCulloch v. Commissioner*,[21] an elementary school teacher, who traveled to Ireland to study storytelling while on sabbatical, was permitted to deduct her travel and temporary living expenses. The Tax Court examined the amount of time that the taxpayer spent studying storytelling and the video and extensive collection of stories the taxpayer created while in Ireland in determining the expenses qualified as I.R.C. §162 business expenses, not vacation expenses.

Vacationing or Sightseeing in Connection with a Business-Related Temporary Assignment

If a taxpayer takes vacation or sightseeing days while on a business-related temporary assignment, then travel expenses other than transportation must be allocated between the business portion of the trip, which is deductible, and the vacation portion of the trip, which is not deductible.[22] Transportation expenses, however, have further restrictions. For a temporary assignment within the United States, transportation expenses are deductible only if the travel is primarily for business.[23] For the travel to be primarily for business, a greater number of days must be spent on business activities than on vacation, sightseeing, or other pleasurable activities. Days devoted to travel are counted as business days.

Transportation expenses for temporary assignments outside the United States are handled differently. If the trip is primarily for business, as measured by the number of days spent on business versus those on pleasure, then the professor must allocate transportation expenses between the number of business and pleasure days spent.[24] Transportation expenses do not have to be allocated, if the trip is not over seven days long or less than 25 percent of the time is spent on pleasure.[25] Transportation expenses also do not have to be allocated if the taxpayer has no substantial control over arrangements for the trip and his desire for a vacation is not the major factor in the decision to take the trip. If the trip is primarily for pleasure, however, then no transportation charges are deductible. Allocation of other travel expenses between deductible business costs and nondeductible personal costs is made on the basis of the number of days spent on each activity. Again, days devoted to travel are counted as business days. Weekends and legal holidays are considered to be business days if both the preceding and succeeding days were business days.[26]

Unreimbursed Meal and Entertainment Expenses

Currently, only 50 percent of meals and entertainment expenses are deductible.[27] In other words, the cost of meals and qualifying entertainment expenses must be reduced by 50 percent and the remaining 50 percent potentially will be deductible. If meals and entertainment are partially reimbursed, then the employee must apply the 50 percent limitation to the unreimbursed portion.

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[21] *McCulloch v. Commissioner*, 55 T.C.M. (CCH) 259 (1988).
[22] Treas. Reg. §1.162-2(b)(1) and (2).
[23] Treas. Reg. §1.162-2(b)(1).
[24] I.R.C. §274(c).
[25] I.R.C. §274(c)(2).
[26] Treas. Reg. §1.274-4(d)(2).
[27] I.R.C. §274(n)(1).

Special Rules for Deducting Transportation Expenses

General Rules for Transportation Deductions

A deduction is allowed for job-related expenses under I.R.C. §162. Commuting expenses, however, are personal and, therefore, not deductible[28] with two principle exceptions:
(1) Commuting expenses to a temporary assignment away from home are deductible.[29] Also, as noted above, commuting from the temporary residence to the temporary job assignment is deductible. Rev. Rul. 99-7, 1999-1 C.B. 361 allows a deduction of commuting expenses if either or two tests are satisfied:

(a) The temporary work is within the general area of the taxpayer's employment and he or she has a regular place of employment (such as an office at the university), or

(b) The temporary assignment is outside the general area of the taxpayer's employment.

Occasionally, an individual on a temporary business assignment may undertake employment that does not involve away-from-home travel. An accounting professor, for example, may work for a local public accounting firm while on sabbatical in order to develop or maintain currency in the field. If the non-university employment is both temporary (less than one year) and in the "same trade or business," commuting expenses from the professor's home to the public accounting firm and back should be deductible.[30] To do so, the argument must be made that developing or maintaining currency is in the same trade or business as being an accounting professor.
(2) Commuting expenses may be deducted if they involve transportation between job sites.[31] For example, a taxpayer travels to a university and teaches there. He then travels directly to a different university to teach a supplemental course and afterward returns home. The expenses associated with transportation between the two universities would be deductible.

Calculation of the Transportation Expense Deduction

When a taxpayer uses his personal car for business two permissible methods exist for calculating the amount of business-related automobile expense to be deducted: the actual expense method and the standard mileage method.[32]

Actual expense method. Under the actual expense method, the business-related portion of general automobile expenses such as gas, oil, repair, depreciation, interest, taxes, licenses, parking, fees, tolls, etc., is deductible. If an automobile is used both for business and personal purposes, then the taxpayer must prorate these deductions based on the total business and personal miles driven. Expenses that are specific to business activity, such as parking and tolls, are deductible in full.[33]

Under the actual expense method, there are two major limitations on automobile depreciation deductions. The first relates to the method of depreciation that may be used. Limited expensing under I.R.C. §179 and MACRS depreciation may be used only if the qualifying business use of the automobile is greater than 50 percent in the first year of its operation.[34] "Qualified

[28] *Tauferner v. United States,* 407 F.2d 243 (CA-10, 1969); *Edwards v. Commissioner,* 84 T.C.M. (CCH) 24 (2002), Rev. Rul. 76-453, 1976-2 C.B. 86.
[29] Rev. Rul. 190, 1953-2 C.B. 303.
[30] Rev. Rul. 99-7, 1999-1 C.B. 361.
[31] Rev. Rul. 55-109, 1955-1 C.B. 261.
[32] Rev. Proc. 87-49, 1987-2 C.B. 646.
[33] Treas. Reg. §1.280F-6T(e)(2).
[34] I.R.C. §280F(b).

business use" includes usage related to a trade or business, such as use in traveling while away from home on a temporary business-related assignment. The term does not include use for which a deduction is available under I.R.C. §212, such as use in pursuit of rental property or investment-related activities.[35] If I.R.C. §179 limited expensing or MACRS depreciation methods are used and qualified business use drops to 50 percent or less in subsequent years, then the benefits of these methods must be recaptured.[36]

Congress authorized immediate expensing for qualifying property, including automobiles, used primarily for business.[37] Currently the maximum that may be expensed is $102,000 per year ($105,000 in 2005). In addition, for new vehicles placed into service after May 5, 2003 and before January 1, 2005, "bonus depreciation" is allowed if MACRS depreciation is also allowed. The bonus depreciation is equal to 50 percent of the adjusted basis after the vehicle's basis is reduced by any I.R.C. §179 expense. Regular MACRS depreciation then is applied to any remaining basis. Thus, depreciation is calculated in the following order: (1) I.R.C. §179 expensing; (2) bonus depreciation; and then (3) MACRS depreciation. Of course, few automobiles cost more than $102,000 and so it is improbable the bonus depreciation would be used. Finally, I.R.C. §179 and bonus depreciation may not be used on automobiles used predominately outside the United States.

Automobiles for which qualifying business use is 50 percent or less must be depreciated under the alternative depreciation system (ADS) specified by I.R.C. §168(g).[38] The ADS requires five-year straight-line depreciation for automobiles with the same one-half-year and no salvage value conventions used by the current MACRS. Thus, there would be 10 percent depreciation in the first and sixth years, and 20 percent depreciation in years two through five.

The second major limitation on automobile and truck depreciation establishes a ceiling for annual depreciation and first-year expensing under I.R.C. §179. For automobiles and trucks placed in service in calendar year 2004, these limits are:[39]

Taxable Year	**Maximum Depreciation Year for Autos Allowed**	**Maximum Depreciation for Trucks, Vans, and SUVs**
1	$10,610 if 50% bonus depreciation is elected	$10,910 if 50% bonus elected
2	4,800	5,300
3	2,850	3,150
4 and thereafter	1,675	1,875

Further, these limits are reduced by the percentage of personal use. After the normal MACRS period, the remaining depreciable basis of automobiles can be recovered at the rate of $1,675 per year and trucks and vehicles built on truck platforms at the rate of $1,875 per year. If a taxpayer elects not to use the 50 percent bonus depreciation, then the maximum deduction for automobiles is $2,960 and for trucks $3,260. Bonus depreciation is not available for automobiles or trucks purchased and placed in service after December 31, 2004. Vehicles that weigh more than 6,000 pounds are not subject to these limitations, but I.R.C. §179 expensing is limited to a maximum of $25,000.[40]

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[35] Treas. Reg. §1.280F-6T(d)(2).
[36] I.R.C. §280F(b)(3).
[37] I.R.C. §179.
[38] I.R.C. §280F(b)(2).
[39] Rev. Proc. 2004-20, 2004-13, I.R.B. 642.
[40] I.R.C. §280F(d)(5)(A)(ii), I.R.C. §179(b)(6).

Used automobiles or automobiles used predominately outside the United States do not qualify for bonus depreciation.[41] Bonus depreciation must be claimed unless the taxpayer formally elects not to take it. If the taxpayer does not elect out and does not take bonus depreciation, the depreciable basis of the automobile must be reduced by the amount that could have been claimed.[42]

Standard Mileage Method. Under the standard mileage rate method, 37.5 cents per mile may be deducted for the business miles that an automobile is driven in 2004. Of that amount 16 cents per mile is considered depreciation and reduces the taxpayer's basis in the car, but not below zero.[43]

A taxpayer must satisfy several eligibility tests in order to use the standard mileage method for calculating transportation expense deductions. First, the taxpayer must own or lease the automobile.[44] Second, taxpayers who lease an automobile must use the standard rate over the entire life of the lease including renewals.[45] Third, the car cannot be used for hire, e.g., as a rental car or taxicab. Finally, I.R.C. §179 expensing or accelerated depreciation methods (MACRS) cannot have been used.[46] If these conditions are satisfied and the taxpayer uses the standard rate, then he is precluded from changing to the actual expense method in a later year. If the actual expense method is first used, however, then the taxpayer may change to the standard method in a later year. In addition to the standard mileage rate for deducting transportation expenses of an automobile, the business portion of taxes, parking fees, and tolls is deductible.[47] In addition, self-employed individuals may deduct interest that is paid in conjunction with purchasing an automobile.[48]

SUBSTANTIATION AND RECORDKEEPING

Individuals who travel are not entitled to take travel-associated deductions unless they have records that substantiate their expenses *at the time they file their tax return.* Generally, taxpayers are only required to substantiate the entries on their tax returns when asked by the IRS. However, traveling deductions are among a class of expenditures for which the taxpayer must have adequate records as a condition to taking the deduction.[49] A regulation mandates the existence of records or corroborating evidence for each element of expenditure made. Elements of traveling expenses are the amount, time, place, and business purpose of all expenditures.[50] Adequate records can take the form of account books, expense diaries, logs, statements of expense, or similar records. The records do not have to be made contemporaneously with each expense, but should be made near the time of the expenditure. In addition to the records, the IRS requires documentary evidence such as receipts, paid bills, credit card receipts, cancelled checks, or similar evidence for all items over $75 and for lodging. Electronic records taken directly from a credit card company will suffice for this purpose.[51] It should be obvious that the recordkeeping requirements for travel away from home are essential and onerous. Some relief from the heavy burden of recordkeeping is possible with the use of federal per diem amounts.

[41] I.R.C. §168(k)(2).
[42] Rev. Proc. 2002-33, I.R.B. 2002-20.
[43] Rev. Proc. 2003-76, I.R.B. 2003-43.
[44] Prop. Treas. Reg. §1.274-5(g).
[45] Rev. Proc. 2003-76, I.R.B. 2003-43.
[46] Rev. Rul. 55-57, 1955-1, C.B. 315.
[47] Rev. Rul. 75-380, 1975-2, C.B. 59.
[48] I.R.C. §163(h)(2)(A).
[49] I.R.C. §274(d) and Treas. Reg.§1.274-5T.
[50] Temp. Treas. Reg. §1.274-5T(b)(2).
[51] Priv. Ltr. Rul. 97-06-018 (August 21, 1996).

By using a federal per diem rate as the deduction amount, lodging, meals, and incidental expenses are "deemed substantiated" for recordkeeping purposes. A business traveler must still document the trip and its business purpose, but is spared the need to document the details of her lodging, meals, and incidental expenditures.

The federal government publishes per diem amounts for travel by government employees to specific localities around the continental United States (CONUS) and many foreign locations (OCONUS).[52] These per diem allowances may be used by taxpayers who travel to the same locations. There are several methods available to determine the per diem amount. The most common is referred to as the "federal by-locality" method. For each locality the government publishes a lodging rate and a meals and incidental rate. A taxpayer may use the locality rate for both lodging, and meals and incidentals. An alternative is to use actual lodging expenses and the federal meals and incidental rate. For instance, the locality rate for Washington, D.C. is $201 per day, $150 for lodging, and $51 for meals and incidentals.[53] An individual on a temporary business-related assignment in Washington, D.C. may use the $201 per day figure or her actual lodging costs and $51 for the meals and incidentals. In the event the government does not publish a per diem amount for a specific locality, then the CONUS rate is $86 per day ($55 for lodging and $31 for meals and incidentals) in 2004 and $91 per day ($60 for lodging and $31 for meals and incidentals) in 2005. Another alternative is the federal high-low method where the government identifies certain high-cost locations that are eligible for a $207 per day per diem amount of which $46 is allocated to meals and incidentals. Often the high cost is seasonal, so the $207 rate may only be available for part of the year. In 2005 the per diem amount for high-cost locations decreases to $199 per day, of which $46 is allocated to meals and incidentals.[54]

HOW TO DEDUCT TRAVEL AND TRANSPORTATION EXPENSES

Unreimbursed employee business and travel expenses are deductible from AGI as a Miscellaneous Itemized Deduction on Schedule A of Form 1040.[55] Consequently, a taxpayer must itemize rather than take the standard deduction to claim unreimbursed travel expenses. If these expenses are reimbursed from an accountable plan, then they are treated as deducted for AGI.[56] It should be noted that expenses, which are reimbursable to employees, cannot be deducted, if the employee fails to apply for the reimbursement.[57]

Miscellaneous Itemized Deductions are deductible only to the extent that the sum of all such expenses for the year exceeds 2 percent of Adjusted Gross Income.[58] As a result, it will be more important than ever for a taxpayer to keep records of all employee business expenses, regardless of whether they are connected to business-related travel.

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[52] The rates for localities in the continental U.S. (CONUS) appear in IRS Publication 1542. The federal per diem rates for travel outside the U.S. are published monthly and can be obtained by calling (202) 512-1800. Federal rates can also be found at http://www.policyworks.gov/perdiem or by writing the Superintendent of Documents, PO Box 37194, Pittsburgh, PA 15250-7954. The outside CONUS locations include Alaska, Hawaii, Puerto Rico, and the Northern Mariana Islands.

[53] In 2005 for Washington, D.C. the rate increases to $204 per day, $153 for lodging, and $51 for meals and incidentals, Rev. Proc. 2004-60.

[54] Rev. Proc. 2004-60.

[55] I.R.C. §62(c)(2).

[56] I.R.C. §62(c)(2)(A).

[57] *Alex B. Rhodes, Jr. v. Commissioner*, 85 T.C.M. (CCH) 1276 (2003), *Marvin L. Barnes v. Commissioner,* 80 T.C.M. (CCH) 209 (2000).

[58] I.R.C. §67(a) and (b).

SPECIAL SITUATIONS

Three situations common to individuals on temporary assignment away from home deserve special discussion. These are taking a visiting position abroad, rental of one's regular residence while away, and the impact of the alternative minimum tax on travel deductions.

Taking a Position Outside the United States

When an individual takes a visiting position in a foreign country, the rules become more complex. In addition to the travel status issue discussed above are the problems associated with double taxation, that is, taxation to both the U.S. and the country where the temporary position is located. The United States taxes its citizens and residents on their worldwide income.[59] A taxpayer who is a U. S. citizen and travels abroad and earns income in another country will be liable for U.S. tax on his foreign compensation. He may also be liable for tax to the government of the country in which the income is earned. The Internal Revenue Code has two methods of dealing with double taxation, each with its own limitations. The provisions are:

(1) the I.R.C. §911 exclusion rule that allows U.S. citizens and residents to exclude from U.S. income up to $80,000 in compensation-type income earned abroad, and

(2) the I.R.C. §901 foreign tax credit that allows U.S. citizens and residents who pay income taxes to a foreign country to credit such taxes against their U.S. liability.[60]

Further complicating the matter are income tax treaties between the U.S. and its many treaty partners.

I.R.C. §911 Exclusion

The I.R.C. §911(a) rule provides a qualified individual with an optional exclusion of up to $80,000 in foreign earned income from U.S. income tax. Foreign earned income is that earned from the rendering of services, generally salary or wage compensation.[61] A qualified individual means one whose tax home is in a foreign country and who is:

(A) a citizen of the U.S. and establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign county or countries for an uninterrupted period which includes an entire taxable year (bona fide residence test), or

(B) a citizen or resident of the U.S. and who during any period of 12 consecutive months, is present in a foreign county or countries during at least 330 full days in such period (physical presence test).[62]

The tax home requirement is then complicated further by the following statutory language: "An individual shall not be treated as having a tax home in a foreign country for any period for which his abode is within the United States."[63] This is referred to as the abode factor.

The first thing to note is that the tax home requirements under Sec 911 and Sec 162 are mutually exclusive.[64] If a professor qualifies for the I.R.C. §911 exclusion, then she may not take

[59] I.R.C. §61.

[60] A third alternative provides that foreign income taxes paid may be deducted as an itemized deduction. A taxpayer may choose only one of the three options. Rarely, if ever, will the itemized deduction alternative be preferable.

[61] I.R.C. §911(b).

[62] I.R.C. §911(d)(1).

[63] I.R.C. §911(d)(3).

[64] Treas. Reg. § 1.911-2(b) provides that tax home has the same meaning under both sections.

deductions for travel expenses. Also, taxpayers who are away from home on a temporary basis, for one year or less, will not qualify for the exclusion. The determination of a professor's tax home will be made with reference to her principal place of business. A professor who is visiting abroad with the intent to return, that is, temporarily away from home, will generally be found to have a tax home in the U.S. city where her home university is located. Conversely, a professor who is away from home for longer than a year will experience a shift in his tax home to the city where the foreign university is located. However the shift of tax home will not qualify most professors for the exclusion because of the operation of the abode factor quoted above.

The courts indicate that an abode has a domestic rather than vocational meaning, and is the place where a taxpayer maintains his most substantial economic, familial, and personal connections, such as family, possessions, voter registration, driver's license, bank accounts, credit cards, and the like.[65] So, even if a taxpayer can show that the place of the temporary assignment is his principal place of business, it will be difficult to show it is his place of abode.

A professor who intends to return to the home university and who maintains significant contacts with his home university, receives compensation from the home university, and maintains other economic and social ties in the U.S. will almost always be held to have an abode in the United States. The difficulties in qualifying for the exclusion are illustrated by *Gelhar v. Commissioner.*[66] Here an MIT professor leased out his Massachusetts home for the entire year he was on sabbatical and traveled to numerous countries. He resided in Australia and New Zealand for five months while temporarily employed by the University of Western Australia and an Australian government agency. He met the physical presence test in that he spent 345 days during a 12-month period in foreign countries. However, the court concluded he failed the tax home test because his employment outside the United States was temporary and his principal place of employment continued to be at MIT. The court noted that Professor Gelhar rented out his Concord home for one year and returned to it and to employment at MIT upon return from his sabbatical. Hence, *Gelhar* did not qualify for the foreign earned income exclusion.

A professor who does not have a current position with an American university or who is on a multiple-year leave of absence and takes a visiting position with a foreign university may qualify for the exclusion. While there are no cases on this subject involving professors the cases of American airline pilots working for Japan Airline and living in Japan are instructive.[67] In both cases taxpayers who held permanent positions in Japan, lived in hotels while their families remained in the U.S. were held to have a foreign abode. The court relied heavily on factors such as driver's licenses, voter registrations, bank accounts, mailing addresses, and credit cards, and the understandings between the pilots and their employer as to the expected duration of employment, to find a foreign country abode. A professor who plans on working abroad and expects to take advantage of the exclusion is advised to give serious attention to such matters also.

After clearing the tax home hurdle, the professor must meet either the bona fide residence test or the physical presence test. The bona fide residence test is met when the professor proves he or she intends to establish a residence in a foreign country for an indefinite or extended period lasting a year or more. Intent is indicated by many of the same factors as discussed above regarding abode.[68]

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[65] *John C. Branch v Commissioner*, 67 T.C.M. (CCH) 2822 (1994); *J.B. Coker v. Commissioner*, 67 T.C.M. (CCH) 2515 (1994).
[66] *Gelhar v. Commissioner,* 63 TCM (CCH) 2466 (1992).
[67] *Jones v. Commissioner,* 927 F2d 849 (5th Cir. 1991); *Cobb v Commissioner,* 62TCM (CCH) 408 (1991).
[68] See also *Sochurek v. Commissoner,* 300 F 2d 34 (7th Cir. 1962)

Most professors taking multiple-year visiting positions at foreign universities, unlike airline pilots flying international flights, will meet the physical presence test. To illustrate the physical presence test, consider an individual who leaves the U.S. on September 1, 2004 to take a temporary assignment in Country X. The person will not satisfy the test until July 27, 2005. The physical presence test is an objective test and requires careful record keeping of one's presence. It would behoove a taxpayer to review the recordkeeping requirements that are set forth in Treas. Reg. §1.911-2(d).

The $80,000 exclusion amount must be prorated on a daily basis for the calendar year. The person in the above example who went abroad on September 1 will be entitled to an exclusion in the maximum amount of $26,740 ((122 days/365 days) × $80,000) for 2004. I.R.C. §911 must be elected on a timely filed return, which includes extensions. The person in the example above must make an election on a Form 2555 attached to his 2004 return. Note that the 2004 return must not be filed before July 27, 2005 (the 330th day), so an extension to file will need to be filed by April 15, 2005. The election will then apply to 2005 also.

Foreign Tax Credit

The foreign tax credit (FTC) is the principal tool used by U.S. citizens when dealing with the problems of double taxation. Using the FTC, taxpayers who pay taxes to a foreign government are allowed a credit in the amount of the tax paid against their U.S. liability.[69] The foreign tax paid must be an income tax; consequently, consumption taxes paid in a foreign jurisdiction, such as sales, use, or value-added taxes (VAT) are not creditable.[70] The amount of credit is limited to the proportion of U.S. tax that is attributable to the foreign income.[71] Assume individual A, who has $56,900 of taxable income from U.S. sources, earns an additional $40,000 while on a temporary assignment in Country X, and pays $15,000 in income taxes to the government of X on that foreign income. Thus, although A has U.S. taxable income of $96,900, she is not allowed to reduce her worldwide taxable income by her personal exemption of $3,100 so her worldwide taxable income is $100,000. Hence, assuming A's U.S. tax is $21,759 before credits, her foreign tax credit against the US tax is $40,000/$100,000 × $21,759, or $8,704. Her unused foreign tax credit ($15,000 − $8,704) may be carried back two years and forward five years.[72]

A taxpayer may not take both the FTC and the exclusion. For most professors this will not be an issue because of the difficulty in qualifying for the exclusion. Should a professor have the choice of either the exclusion or the credit, which provision will result in the lowest tax? The general rule is that the exclusion is better when the taxpayer is working in a country with no income tax or a rate of tax that is lower than the U.S. rates. The same logic would favor the credit where the taxpayer is working in a country with a rate of income tax that is greater than the U.S. United States marginal tax rates now vary from 10 percent to 35 percent. Individuals, with the highest marginal tax rates of 33 percent and 35 percent, may find the exclusion more advantageous, while those with marginal rates of 25 percent and 28 percent will most likely find the credit better for them. But the effect of traveling status deductions, which are available when

[69] I.R.C. §911(a).
[70] I.R.C. §901(b)(1).
[71] I.R.C. §904.
[72] I.R.C. §904(c) and Treas. Reg. §1.904-2(g).

the credit is used but not available with the exclusion, may make the credit the best choice. The taxpayer will need to make alternative computations.

Tax Treaties

The United States has income tax treaties with over 50 countries. Each treaty is different and most of them have provisions affecting professors. Generally, the treaties provide that a visiting professor is exempt from taxation for a period of one to three years in the country in which the visiting professorship is located. Even under the treaties that make no special provision for professors, there often are provisions that eliminate or reduce the foreign tax for any U.S. citizen who receives compensation for personal services. A discussion of specific treaties is beyond the scope of this article. Professors who contemplate taking a teaching or research position abroad should consult the treaty with the country in which they will render their services.[73] Where a treaty exempts the professor's foreign earned compensation from foreign tax, the foreign tax credit will not be available since none will be paid. However, income taxed in the U.S. may still be reduced by deductions for traveling expenses. In addition, a professor whose tax home is in a foreign country, while not eligible for traveling expenses, is eligible for the exclusion and treaty exemption.

RENTAL OF A RESIDENCE WHILE ON A BUSINESS-RELATED SABBATICAL

General Rules

If individuals are away from their tax home for an extended period, they often will rent or sublease their residences. I.R.C. §61 requires that any revenues from rentals or subleases be included in income. Fortunately, there are a number of expenses associated with these rentals that may be deducted from revenues such as interest expense, taxes, insurance, repair costs, rental agent fees, and depreciation or lease payments. These expenses are deductible under I.R.C. §212, but, in most cases, I.R.C. §183 and I.R.C. §280A limit the deductions to the amount of rental income.[74]

Internal Revenue Code §280A Limitations

Under I.R.C. §280A, the tax treatment of rental revenues and related deductions depends both on the number of days the residence is rented and on the number of days the owner or lessor uses the residence for personal purposes. The definition of "personal use of a residence" includes any day the taxpayer used the residence, or any day any individual uses the residence under an arrangement that enables the taxpayer to use some other dwelling unit, regardless of whether rent is charged.[75] An example of this would be a house swap where person A lives in another individual's residence in return for that individual being in the person A's residence.

[73] I.R.S. Pub. 901, "U.S. Tax Treaties," provides a summary of the treaties and an explanation of the provisions that apply to professors, teachers, and researchers, and is a good place to begin a review of the subject.

[74] I.R.C. §183(b)(2), I.R.C. §280A(c)(5).

[75] I.R.C. §280A(d)(2)(b).

I.R.C. §280A divides rentals into three categories: nominal rentals, rentals that involve substantial owner use, and rentals for a qualified rental period.

Nominal Rentals

The first category applies when a dwelling unit is used during the taxable year by the taxpayer as a residence and the dwelling unit is actually rented for less than 15 days during that year. In this case, no rental revenue is included in income and, conversely, no deductions, other than mortgage interest and property taxes, are allowed.[76]

Substantial Owner Use

When the owner has used the dwelling as a personal residence for more than the greater of 14 days or 10 percent of the number of days rented (the "substantial owner use" test), the deduction scheme becomes more complex. First, so-called "direct expenses" reduce gross rental receipts to arrive at "gross rental revenue." Direct expenses do not relate to the operation and maintenance of the rented home, but are the costs incurred to obtain tenants.[77] Examples of direct expenses include advertising and rental broker fees. Second, I.R.C. §280A(c)(5) limits other deductions to the amount of this gross income from the rental.

I.R.C. §280A(c)(3) also requires that this group of expenses be appointed between rental and personal use if the taxpayer uses the residence for personal purposes on any day during the year. The rental portion of the expenses is deductible within I.R.C. §280A limitations. Two different methods are used to allocate these expenses. Under the so-called "Bolton" method, interest and taxes are presumed to accrue daily, regardless of usage.[78] Consequently, interest and taxes are apportioned by the number of days rental use divided by 365 days. In contrast, expenses of operating, maintaining, and depreciating the rental unit are allocated by the number of rental days divided by the sum of days rented plus days used personally. The IRS continues to oppose the Bolton method. Instead, it specifies allocation according to the total days of usage.[79]

Finally, I.R.C. §280A(c)(5) requires rental expenses to be deducted in a three-tiered order up to the limit of gross rental revenue. Interest and taxes are deducted against gross rental revenue first, then operating and maintenance expenses second, and depreciation third. Expenses not deductible by reason of the gross rental revenue limitation may be carried over and deducted against gross rental revenues in subsequent years. Rental revenues and allowable expenses are reported on Form 1040, Schedule E.

Qualified Rental Periods

The third basic case is one in which the taxpayer uses a residence for personal purposes for a portion of the tax year and then rents the dwelling for a period of one year or longer. In this instance, I.R.C. §280A(d)(4)(A) states the taxpayer is not considered to have used the residence for personal purposes for any day during the taxable year that occurs before or after a "qualified rental period." A "qualified rental period" means a consecutive period of 12 or more months that begins or ends at any point during the taxable year, or a period of less than 12

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[76] I.R.C. §280A(g).

[77] Prop. Treas. Reg. §1, 280A-3(d)(2).

[78] *Bolton v. Commissioner*, 694 F2d 556 (CA-9, 1982), *Ronald P. Barranti v. Commissioner,* 76 T.C.M. (CCH) 957 (1998).

[79] I.R.S. Pub. 527, "Residential Rental Property."

months that begins at any point in a taxable year and ends when the residence is sold or exchanged. Also, the dwelling either must be rented or be held for rental at a fair rental price in order to establish a qualified rental period.[80] In essence, when a taxpayer rents a personal residence for a qualified rental period, the limitation of I.R.C. §280A does not apply. Under I.R.C. §280A(e), however, allocation of rental expenses between personal use and rental use is still required. The qualified rental period provision of I.R.C. §280A was enacted to allow a loss to be taken on the rental of a dwelling that had been used as a personal residence, if that residence had been converted to a for-profit rental usage.

I.R.C. §183 Limitations

Often an individual on temporary assignment will rent his residence in order to minimize the cost of being away from home. His motivation would be cost reduction, not necessarily profit seeking. The difference is important. I.R.C. §183 establishes limitations on the amount of deductions that can be taken if a rental is not motivated by profit. These limitations are very similar to those of I.R.C. §280A mentioned above; their basic impact is to deny deductions in excess of rental revenues. I.R.C. §183 applies only when the residence has not been used for personal purposes during the taxable year (i.e., §280A applies instead) or when the residence has been rented for a qualified rental period according to I.R.C. §280A(d)(4).

If I.R.C. §183 applies, then the taxpayer must ask whether a profit motive exists for renting the residence. If the profit motive is dominant, then the taxpayer may deduct rental expenses without limitation; if the rental is for personal convenience, then the limitations of I.R.C. §183 apply instead. The burden of establishing a profit motive for the rental of a personal residence falls on the taxpayer in virtually all cases. Treas. Reg. §1.183-2 prescribes a method for establishing the intent to make a profit.

If a profit motive is not present, then deductible expenses will be limited to gross income from the rental under I.R.C. §183. These expenses must be deducted in the following order:[81]

(1) Expenses that would be deductible even if no rental had occurred, such as mortgage interest, taxes, and casualty losses.
(2) Expenses that would not cause an adjustment to basis (such as insurance, repairs, and most other operating costs) and that would be deductible if the rental had been made with an intention to make a profit.
(3) Expenses that would cause an adjustment to basis (such as depreciation) and that would be deductible if the rental had been made with an intention to make a profit.

As already discussed, I.R.C. §280A requires that these expenses be apportioned between rental and personal use if the taxpayer has used the residence for personal purposes during the taxable year. It should be noted that there is no carryover of expenses disallowed by I.R.C. §183 as there is for expenses disallowed by I.R.C. §280A. Consequently, the taxpayer may want to plan his affairs so that he qualifies under I.R.C. § 280A. Shortening the rental period to less than one year would be one action that would produce such a result.

Profit and Losses on Rental of a Personal Residence

Rental activity often results in a loss. When expenses, including depreciation, exceed revenues a loss is the result. I.R.C. §469 defines income or loss on any rental activity to be "passive"

[80] I.R.C. §280A(d)(4).
[81] Treas. Reg. §1.183-1(b).

in nature, as opposed to active, and makes this determination without regard to the level of participation the taxpayer has in the activity.[82] In general, income from passive activities is added to other income and is taxed in the year it is earned. Passive losses however, can be deducted only from passive income. Consequently, if there is no passive income, then there is no deduction allowed for the rental loss. There is an exception, however, to this rule. If the taxpayer satisfies an "active participation" test, then he may be able to offset as much as $25,000 of nonpassive income with losses from rental real estate activities.[83] Thus, if a taxpayer on temporary assignment has a loss on the rental of his residence that is being rented for profit, that loss potentially may be deductible against his earned income. "Active participation" can be satisfied without regular, continuous, and substantial involvement in operations as long as the taxpayer participates in a significant way, for example, in making management decisions or arranging for others to provide services (such as repairs). Management decisions that are relevant in determining whether a taxpayer actively participates include approving new tenants, deciding on rental terms, approving capital or repair expenditures, and other similar decisions.[84]

The $25,000 offset amount is applied by first netting income and loss from all of the taxpayer's rental real estate activities in which the taxpayer or spouse actively participate. If there is a net loss from all such activities for the year, then it is applied against net passive income (if any) from other activities. Any remaining net loss from the rental of real estate, up to the $25,000 maximum, is then applied against nonpassive income. The $25,000 maximum offset for active participation in rental real estate activities is reduced by 50 percent of the taxpayers' adjusted gross income in excess of $100,000. In the case of married individuals who have not lived together at any time during the tax year and who are filing separately, the maximum offset is reduced to $12,500 and this amount is reduced by 50 percent of Adjusted Gross Income in excess of $50,000.[85]

When individuals sell their personal residence, I.R.C. §121 allows gains up to $250,000 for single taxpayers and gains up to $500,000 for married taxpayers, provided several tests are met. They must have both owned and occupied the residence for two years of the last five years to exclude gains. Short temporary absences from the home can be counted as part of the two-year period of occupancy. However, if a college professor is away from home for a year or more, then the absence will not be considered temporary, and thus that period of time cannot be counted toward the occupancy requirement.[86] Further, if the personal residence was rented out for a period of time, then gain must be recognized to the extent depreciation was taken.[87] Such gains on real estate held more than one year will be taxed at a maximum rate of 25 percent.[88]

THE ALTERNATIVE MINIMUM TAX AND TRAVEL EXPENSE DEDUCTIONS

Whatever Congress or the IRS gives, they also may take away. In an effort to ensure that all taxpayers with substantial income pay at least some tax, Congress enacted the Alternative Minimum Tax (AMT). All individual taxpayers first must compute their regular federal income tax.

[82] I.R.C. §469(c)(2).
[83] I.R.C. §469(i).
[84] IRS Publication 527, "Residential Rental Property," 15 (2003).
[85] I.R.C. §469(i).
[86] Reg. §1.121-1(c)(4) Example 4.
[87] I.R.C. §121(d)(6) and Reg. §1.121-1(d).
[88] I.R.C. §1(h)(1)(D).

Then, they must compute their tax under separate AMT rules. If their AMT tax is higher, then they pay their regularly computed tax plus the AMT increment in excess of their regular tax.[89]

In the past, this rarely has been a problem for middle- and lower-income taxpayers. But, as marginal rates are reduced, increasingly more individuals are being subject to the AMT. In 2003, approximately 3.5 million individuals paid AMT; by 2012, this number is expected to rise to approximately 39 million.[90] Stated another way, in 2010, 43 percent of individuals with incomes between $50,000 and $75,000, 78 percent of individuals with incomes between $75,000 and $100,000, and 94 percent of individuals with incomes between $180,000 and $200,000 will pay AMT.[91]

AMT rules reduce, eliminate, or defer many deductions taken for regular tax purposes. Of particular concern to a person on temporary assignment away from home, a number of itemized deductions are eliminated completely for AMT purposes. These include all deductions for state and local income and property taxes, interest on home equity loans unless the loan proceeds are used to improve the home, all miscellaneous itemized deductions, personal and dependency exemptions, and the standard deduction. The practical result for an individual with large travel expense deductions is that he or she usually will incur an AMT. Exhibit 1 gives a common example.

OTHER INCLUSIONS, EXCLUSIONS, DEDUCTIONS, AND CREDITS

There are a variety of other tax benefits and restrictions on deductions that may apply to taxpayers on temporary assignment away from home. The following inclusions, exclusions, deductions, and credits are particularly relevant.

Inclusions in Income

Most scholarship and fellowship awards given to professors must be included in income. To be excluded, a scholarship must be used by degree candidates for qualified tuition and related expenses at qualifying institutions.[92] Because most professors on sabbatical leave will not be pursuing a degree, this provision has limited usefulness for professors. Fellowships and grants for research or teaching likewise must be included in income.[93]

Exclusions from Income

Expenses that are reimbursed by an employer under an accountable plan are not included in income. An accountable plan is one that requires the employee to document expenses to the employer and to return any excess reimbursement.[94] Excess reimbursement commonly occurs where the employer prepays the employee for estimated future expenses. Treas. Reg. §1.62-2(c)(4) states that payments received under accountable plans "are excluded from the

[89] I.R.C. §55(a).

[90] Allen J. Auerbach, William G. Gale, and Peter Orszag, " The Budget Outlook and Options for Fiscal Policy," in *Tax Notes*, June 10, 2002 Appendix Table 5, p. 1661.

[91] Leonard E. Burman, William G. Gale, Jeffrey Rahaly, and Benjamin H. Harris, "The Individual Income Tax: Problems and Potential Solutions," 55 *Nat'l Tax J.* 555 (2002).

[92] I.R.C. §117; also see I.R.C. §170(b)(1)(A)(ii) for a definition of qualifying institutions.

[93] I.R.C. §117(c).

[94] Temp. Reg. §1.162-2T.

EXHIBIT 1

In January 2004, an economist and spouse, who live in Denver, CO, take visiting positions in Washington, D.C. for 11 months. They file Married Filing Jointly with two exemptions. Their Form 1040, Schedule A deductions are:

	Income: $75,000	Income: $150,000
Residence interest	$8,000	$8,000
State income taxes	3,750	7,500
Residence property tax 2,500	2,500	2,500
Charitable contributions	1,500	3,000
Misc. Itemized Deductions:		
Transportation	$850	$850
Commuting to work in Washington D.C. 11 mos. × 22.5 days/ months × $5.00/day	1,238	1,238
Per diem (334 days × $201)	67,134	67,134
Total	$69,222	$69,222
Less: 2% × AGI	(1,500)	(3,000)
Misc. Itemized Deductions	67,722	66,222
Total Sch. A deductions	**$83,472**	**$87,222**
Less: 3% cutback	NA	219[95]
Allowable Schedule A Deductions	$83,472	$87,003
Their regular federal income tax for 2004 would be:		
Adjusted gross income	$75,000	$150,000
Less: Schedule A available deductions	(83,472)	(87,003)
Tax exemptions (2 × $3,050 = $6,100)	(6,200)	(6,200)
Taxable income equals	**$0**	**$56,797**
Federal income tax	**$0**	**$7,805**
Their Alternative Minimum Tax for 2004 would be:		
Regular taxable income	$0	$56,797
Adjustments (all positive)		
State income taxes	$3,750	$7,500
Local property tax	2,500	2,500
Misc. Itemized Ded.	67,722	66,222
3% Cutback		(219)[96]
Personal exemptions	$6,200	$6,200
Alternative Minimum Taxable Income	$79,624	$139,000
Less: AMT Exemption	(58,000)	(58,000)
	$21,624	$81,000
AMT tax rate	× 26%	× 26%
Tentative AMT	$5,622	$21,060
Less: Regular federal income tax	(0)	**(7,805)**
Alternative Minimum Tax	**$5,622**	**$13,255**
Thus, this taxpayer will incur an **ADDITIONAL** tax of[97]	**$5,622**	**$13,255**
TOTAL FEDERAL TAX	**$5,622**	**$21,060**

[95] I.R.C. §68. For 2004, total itemized deductions from Schedule A (except for medical expenses, casualty losses and thefts, investment interest, and gambling losses) are reduced by 3 percent of adjusted gross income in excess of $142,700. In this case: ($150,000 - $142,700)* 3% = $219.

[96] I.R.C. §56(b)(1)(F). The 3 percent cutback rule for some itemized deductions does not apply for AMT purposes.

[97] I.R.C. §53 establishes a credit against regular tax liability for prior year minimum tax liabilities that arise from timing differences such as depreciation. In this case, none of the AMT liability is the result of timing differences.

employee's gross income, are not reported as wages or other compensation on the employee's Form W-2 and are exempt from withholding and payment of employment taxes." If the reimbursement is under a nonaccountable plan, then it is included as income on Form W-2 and is subject to employment taxes. More important, the reimbursement from a nonaccountable plan is deducted as a Miscellaneous Itemized Deduction subject to a 2 percent of Adjusted Gross Income reduction, and is a positive adjustment for AMT purposes as discussed earlier.

Deductions

A deduction is available to an individual who undertakes for-credit education or Continuing Professional Education at a qualifying institution while on a temporary assignment away from home. In 2004 and 2005, up to $4,000 may be deducted for "qualified tuition and related expenses."[98] This deduction is taken in reaching adjusted gross income, that is, a taxpayer gets the deduction even if he or she does not itemize. The deduction is reduced to $2,000 for single taxpayers with income between $65,001 and $80,000 and for married taxpayers with income between $130,001 and $160,000. The deduction is not available for single taxpayers with income over $80,000 or married taxpayers with incomes over $160,000. Interestingly, there is no requirement that the deductible expenses be related to the taxpayer's business. Qualified educational expenses for this purpose include tuition and fees paid to the university or post-secondary institution. Expenses for course-related books, supplies, and equipment may be deducted under I.R.C. §222 only if paid directly to the institution, and no personal expenses can be deducted even if paid directly to the institution. Qualifying institutions include accredited two- and four-year colleges and universities.

Credits

A taxpayer on a temporary assignment away from home who takes educational courses at a qualifying institution may take advantage of the Lifetime Learning Credit authorized by I.R.C. §25A. For 2004, the credit that may be applied against other taxes is 20 percent of qualifying expenses up to $10,000, for a $2,000 maximum credit.[99] Qualifying expenses for this credit include tuition and fees required for enrollment, but not expenditures made for activity or athletic fees, books, room and board, or other expenses unrelated to an academic course of instruction.[100] Qualifying expenses include those paid to educational institutions to acquire or improve job skills of the taxpayer. Thus, continuing education courses, and courses of study in the taxpayer's academic field will qualify. The amount of qualifying expenses must be reduced by amounts covered by excludable scholarship and assistance plans.[101] The credit applies to these expenses incurred during any taxable year during the taxpayer's lifetime. There is a phase-out for high-income taxpayers.[102] The phase-out begins in 2004 when a taxpayer's modified Adjusted Gross Income exceeds $85,000 for joint filers ($42,000 for other taxpayers), and ends at $105,000 for joint filers ($52,000 for other taxpayers). Taxpayers who choose to take the Lifetime

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98 I.R.C. §222. This provision will not be available after 2005 unless Congress extends it.
99 I.R.C. §25A(c)(1).
100 I.R.C. §25A(c)(2)(B).
101 I.R.C. §25A(g)(2).
102 I.R.C. §25A(d)(2).

Learning Credit are unable to take a deduction for tuition and fees even if those expenses exceed the maximum $10,000 available for calculating the credit.[103]

CONCLUSION

A professor who has the opportunity to take a sabbatical and accepts a visiting position is faced with many decisions. The chart below highlights some of those decisions in light of the issues discussed in this paper.

Decision	**Benefits**	**Drawbacks**
To take a position outside the United States.	Foreign tax credit, foreign earned income exclusion, or tax treaty may reduce taxes on earnings.	Greater distance to travel, language barriers, visa may be needed to work in another country.
To be gone less than one year.	Deductions available for travel, meals, and duplication of living expenses.	Foreign earned income exclusion not available.
To take spouse and children.	Companionship and no need to travel home on weekends and/or vacations.	Generally no deductions for travel expenses for family members.
To accept university housing.	Less expensive rent or free housing. If rent paid is at least 5% of fair market value, no additional income.	Limits choice of where to live.
To rent one's personal residence while away.	May generate additional income and provide tax deductions. No empty house while away.	Difficulty finding a good tenant. Gain to the extent of depreciation taken must be recognized on sale of home.

The tax implications of a visiting position are complicated and require diligent planning and recordkeeping. A professor must determine his or her eligibility for traveling and transportation deductions. Such deductions may yield significant advantages and financial rewards. A visiting position abroad is complicated even further by the potential of double taxation resulting from liability to the United States and a foreign jurisdiction. Last, the Alternative Minimum Tax bedevils professors who have significant itemized deductions. Careful understanding and planning will allow a professor to maximize the benefits of his or her sabbatical leave.

[103] I.R.C. §222(c)(2)(A).