ROBERTS & HOLLAND LLP

June 26, 1997

Employee Sells a Home and Employer Gets a Tax Deduction

By: Elliot Pisem and Ellen Seiler Brody

It sometimes seems that no good deed goes unpunished. The current job market often requires that an employee sell a home in one area and move to a different location. Many employers try to do the right thing and offer financial help to their employees, to ease the burden of relocation. While employers are generally able to deduct the reimbursements they pay to employees for such relocation expenses, there has been much uncertainty as to whether particular costs may constitute ordinary deductions to the employer or whether they should be subject to less favorable capital loss treatment. On June 17, 1997, the United States Tax Court filed a historic decision allowing employers to be more comfortable about the tax treatment of one kind of relocation assistance. In *Amdahl Corp. v. Commissioner*, 108 T.C. No. 24 (1997), the Tax Court held that Amdahl was entitled to deduct payments made to assist its employees in selling their homes, thus providing a methodology for employers to follow in order to avoid an unfavorable contrary line of authority.

In 1982, the Service shocked many employers who had established "home buying plans" as part of their employee relocation programs, by holding that homes purchased and resold by employers were capital assets in the hands of the employers, thus denying employers ordinary deductions for loses incurred on resale of the homes.[1] Under the home buying plan then under review by the Service, ongoing employees of a corporation who were transferring to a new location would sell their homes to the corporation at appraised fair market value. After purchasing the home, the corporation would immediately offer it for resale, either directly to the public or through a real estate broker. The corporation did not hold the homes with an eye toward future investment, nor did it make any improvements to the properties. Its sole objective was to sell the homes as soon as possible, usually achieving this goal within a year from the purchase from the employee. The corporation sometimes realized losses on the resale of the homes. Concluding that the homes were neither held primarily for sale to customers in the ordinary course of the corporation's business nor an integral part of the corporation's business operations, the Service ruled that the homes were capital assets in the hands of the corporation and that any loss realized on a resale would be capital in nature. Similarly, if a gain were realized, it would be capital gain, rather than ordinary income; however, in many cases, the benefit of the capital gain treatment would be outweighed by the detriment of the capital losses.

Similarly, in 1990, the Tax Court denied a deduction for employee compensation to a company for the loss it incurred on the resale of a home that it had purchased from a *terminated* employee under the terms of an employment contract, holding that the loss was a capital loss instead.[2] The court acknowledged that the purchase of the home was connected to the trade or business of the company, but found that the home was not "used" in the company's trade or business and thus did not fall within any of the exceptions which would prevent it from being treated as a capital asset. Therefore, the loss incurred on the resale was a capital loss, not an ordinary business deduction as claimed by the corporation.

Other ways of assisting employees with the sale of their homes were also tried and, initially, seemed to yield better tax results. The Service issued several private letter rulings in the early 1980s, involving situations in which corporations used outside relocation firms to provide home purchase services for transferred employees, rather than purchasing homes themselves. In most cases, the employer was required to reimburse the relocation firm for any losses incurred on the resale of homes below their appraised fair market value. In these situations, the Service at first held that payments made by the corporations to the outside firms to cover the selling costs incurred and fees charged were ordinary and necessary business expenses fully deductible by the corporations.[3] However, the Service did not address in these rulings the impact on the employer of any gain or loss realized on the subsequent disposition of the employee's home by the relocation assistance firm.

In PLR 9036003, the Service attempted to answer this question and focused on whether the relocation company should be viewed as an agent of the employer, so that (1) the employer itself was really purchasing the homes, (2) any gain or loss realized on resale would be subject to the analysis set forth in Rev. Rul. 82-204, and (3) payments to reimburse the relocation company for items such as mortgage payments, brokers' commissions, title examinations, and transfer taxes would be treated as nondeductible capital expenditures rather than ordinary deductions. The employer in PLR 9036003 had agreed to pay a fee to the relocation company for its services, to compensate it for all of the expenses incurred in purchasing and reselling the employees' homes, and to reimburse the relocation firm for any losses incurred on resale. If the relocation firm sold the property at a gain, the gain would be used to reduce the fees charged to the employer. The Service stated that the employer was in the same economic position as if it had purchased the employees' homes directly, in that it was responsible for all expenses incurred in the transaction; thus, the employer indirectly realized any gain or loss on the subsequent resale. The Service ruled that the substance of the transaction would apply over the form created by the employer. The employer could not convert its capital expenditures into deductions against ordinary income simply by inserting an outside entity, which was in substance an agent of the employer, into the transaction.

Faced with this background, the Tax Court last week addressed similar issues in *Amdahl*. Amdahl contracted with relocation service companies to purchase the homes of its relocating employees at fair market value and to resell those homes to third parties and compensated the relocation company for all of the expenses it incurred, as well as paying a fee for its services. If the employee accepted this service, it executed a contract with the relocation company, under which the employee agreed to transfer marketable title to the residence within one year to a third party designated by the relocation company. If no third party purchaser was located within one year, title would pass at the end of the year to the relocation company. Since in most scenarios the employee was moving far away, the employee provided the relocation company with an unrecorded deed in blank to facilitate the later transfer of the property to a third party. Thus, the relocating employee retained legal title to the home until a third party purchaser was located. All of the sales were completed within one year of the contract between the employee and the relocation company.

Once a sale to a third party was completed, the net sales proceeds (after the relocation company deducted all of its costs incurred in connection with the disposition, plus its fee) were remitted to the employer. The employer bore the risk of loss if the property was sold at a value less than the amount that had been paid to the relocating employee. However, if there was a net profit on the sale, the employer apparently turned it over to the employee.

On its tax return, the employer deducted its payments to the relocation company, including the reimbursement to the relocation company of losses from sales made to third parties below the amounts paid to the relocating employees, as ordinary and necessary business expenses.

As in PLR 9036003, the Service argued that the employer was not entitled to deduct these amounts, but rather was required to treat them as capital expenditures, because the relocation company was an agent of the employer. The court stated that the true question was whether the employer could be considered to "own" the residences being sold by the relocating employees. Since legal title remained with the employees until a sale to a third party, it was clear that the employer did not acquire legal ownership of the residences. The employer also did not obtain beneficial ownership, either directly or through an agent; in the court's view, if any agency relationship existed, it was between the relocation company and the *employee*. Moreover, the employees could not be considered to have disposed of *current*, beneficial ownership of their homes. The transactions were structured so that the relocation company would not have to take legal title to the properties unless sales to third parties could not be consummated within one year, and at the worst, could be considered possible future sales to the relocation companies, rather than completed current sales.

In addition, while the employer assumed the risk of loss on resale, it turned over any possible appreciation over to the employees. As there was no potential for profit to the employer in the transaction, the court found it difficult to state that the employer was purchasing the property with a goal toward long-term appreciation, a typical indicium of capital asset status. The court noted that the employer's primary goal in establishing this program was to induce employees to relocate as quickly and efficiently as possible. The employer did not intend to profit from the sale of the residences and viewed the expenses it incurred as ordinary expenses incurred in the conduct of its business, not as investments in real estate. The court acknowledged that the employer was bearing some risk of loss, but felt that this was just part of the reimbursement of the cost of its employees' relocations, since the risks of loss that the employer was bearing were insignificant in comparison to its primary motive of relocating its employees.

Since the court found that all of these factors indicated that the relocating employees retained legal and beneficial interest in their homes, it held that the employer was entitled to deduct the payments made to the relocation company as ordinary and necessary business deductions. "Petitioner relocated its employees to satisfy business needs and provided home disposal assistance to induce its employees to accept its offer of relocation. . . . We find that the payments to the relocation service company conferred employee benefits to relocating employees and are deductible business expenses."

The Tax Court has thus provided a roadmap for employers to follow in helping their employees relocate. An employer can contract with a relocation service company and deduct the expenses associated with the transaction, so long as it follows a simple structure, making sure that: 1) the relocating employee retains legal title to the house; 2) the contracts between the relocation company and the employee are executory in nature; and 3) the employee receives any profit made on the sale to the third party. Since employers are typically not offering this benefit with the intent to make a profit on the transaction, turning over any such profits to the employee should not be an unreasonable burden. Besides, it seems a small price to pay to ensure that the payments made to the relocation company can be characterized as ordinary deductions, rather than nondeductible capital expenditures which can only be realized some time in the future as capital losses to offset capital gains.

---

1 Rev. Rul. 82-204, 1982-2 C.B. 192.

2 *Azar Nut Company v. Commissioner*, 94 T.C. 455 (1990), *aff'd*, 931 F.2d 314 (5th Cir. 1991).

3 *See* PLRs 8244032, 8406033, and 8425069 (also ruling that the employees were not required to recognize income to the extent of these payments, unless they represented selling costs imposed on the seller under local law).