ment to retrain for another career, work on a hobby, or travel. The company also provides up to $2,500 for supplies for employees with children with special needs and for adoption fees. The first item would be taxable to the employee, unless the tuition fell under a section 127 educational assistance plan. The adoption reimbursements should be nontaxable if they fit within section 137, and the supplies could qualify as tax-free under a cafeteria or health plan (sections 125 and 105).

Education outside the workplace—tuition reimbursement programs that are tax-free if certain basic requirements are met under section 127—are gaining in popularity. Some companies are providing tuition for children of employees. These are taxable, but better than paying with tax-paid dollars of one's own.

In-house education is growing in importance as well. Some of the training is outside the traditional box of law and management, but most is not. Employees rightly see this as helping their own personal and professional development, a firm commitment to them as people—no matter where they end up. And, in helping them be more marketable, the firm somewhat counter-intuitively is helping bind them to the firm. Here, too, the tax issues may get tricky with training not related to law itself, but between the section 127 plan and the section 132 working condition fringes, the training should be tax-free to the employee. If the training does not fit into one of these two categories, it is taxable. See section 132(j)(8).

Family friendly is not appealing just to women. Almost the same percentage of men (82%) as women (85%) in the 20-39 age group place family time at the top of their work priority issues, according to a study this year by the Radcliffe Public Policy Center. The U.S. Census Bureau this year noted that for the first time since it started keeping track, more than half of married-couple families with wives of childbearing age had children and had both parents in the workforce. Law firms that provide flex-time schedules, telecommuting, and family leaves are likely to retain their associates and employees more than ones that do not. (Family friendly may not sit well with all employees. Something of a backlash has developed among employees without children. The movement "No Kidding!" has more than 50 chapters, to try to deal with, as they call it, a "procreation-crazed" America.)

High billables and the stress of work overall may be part of the trend toward providing home services from work. More companies are providing concierge-type services, such as dry cleaning, shoeshines and car detailing, from work. And the trend now seems to be to provide it through the Internet, with specially designed company portals, such as those sold by Abilizer (formerly perksatwork.com). There also seems to be little doubt why Salomon Smith Barney in London provides gourmet meals, fresh underwear and free toothbrushes to those who work past 7 p.m. Again, given the circumstances, these items should not be taxable to the employee.

This year's survey by the Society of Human Resource Managers (SHRM) of 600 HR managers showed some cutbacks and slowing in employee perks, especially in costly ones like vacation days and personal time. What employees likely will need most in the coming years is more time off, not less, particularly to care for elderly parents. About 25% of all U.S. households now provide care for their aging relatives. Emergency care—for children or elderly relatives—is the "perk" employees now think they will need the most. According to a Hewitt survey this year, 13% of companies it surveyed provide emergency childcare. Again, if the company cannot afford to provide the time or the space, it should look for providing the resources to get this care for its employees. In larger cities firms can negotiate with a service provider to provide a certain amount of days or hours of this type of emergency care. Traditional employee assistance programs (EAPs), which in many cases may need to meet certain welfare plan requirements under the Employee Retirement Income Security Act (ERISA) or at least the reporting requirements of section 6039, could and should be used more by firms. National usage is at about 12%; in Seattle it's about 45%—which says something about the younger and more entrepreneurial companies and how they try to keep their workers.

It's cute and it's funny to look at some of the perks being given to employees these days, whether in-firm massages (that reduce stress, so they say) or pets at work (30 out of 1,000 companies surveyed by Wm. M. Mercer Company) that also reduce stress, some say, but the climate of a workplace is extraordinarily important to today's worker, and law firms would do well to remember that.

CAPITALIZATION VS. EXPENSING: WHAT MORE DO WE KNOW FROM RECENT RULINGS?

by Annette Nellen, San Jose, CA

Whether an expenditure should be capitalized or currently expensed has been a difficult determination under the tax law for decades. Since 1992 when the U.S. Supreme Court "clarified" the capitalization versus expensing rule in the *Indopco* decision,[1] practitioners and revenue agents have perhaps been even more perplexed with the question. While there are

1 Indopco, Inc. v. Commissioner, 503 U.S. 79 (1992).

many court cases and IRS rulings on this topic, the fact that the classification of the expenditures depends on the particular facts and circumstances and the existence of, often, a "fine line" separating the two types of expenditures continues to make the determination a difficult one. In the past year, a few taxpayer-favorable rulings were issued, including two cases that overturned Tax Court decisions. This article provides a brief overview of one recent revenue ruling and three cases and summarizes what these authorities add in helping to distinguish between section 263 and section 162 expenditures.

Revenue Ruling 2000-4[2] holds that costs to obtain, maintain and renew ISO 9000 certification are currently deductible. (ISO 9000 is a series of international standards for management systems.) The Service concluded that the benefits derived from ISO 9000 certification are only incidental and are similar to current benefits of training, advertising and expenditures incurred to retain existing customers or just to improve the overall quality or attractiveness of the taxpayer's business operations. Per the Service, "these future benefits are incidental to the primary benefit of current sales" and are therefore currently deductible. The Service also referred to the *Briarcliff Candy*[3] and *Sun Microsystems*[4] to support its conclusion under section 162 that the "mere ability to sell in new markets and to new customers, without more, does not result in significant future benefits." In addition, the Service stated that ISO 9000 certification is not like obtaining a license or certification that is necessary for market-entry, which would most likely be capitalizable.

In *PNC Bancorp*[5] the Third Circuit held that costs incurred by a bank in creating loans (such as salaries and credit check fees) did not have to be capitalized because they were everyday-type expenditures and were merely associated with origination of the loans and did not become part of the loan balance. In approving a loan, including performing credit checks and appraisals, the bank did not "step out of its normal method of doing business." The court noted that there is a "fundamental distinction between business expenses and capital outlays."

In *Wells Fargo*[6] the Eighth Circuit held that officer salaries incurred in determining whether a company was a suitable merger target were only indirectly related to the acquisition and therefore did not have to be capitalized. If the cost is only "incidentally connected" with a long-term benefit, capitalization is not warranted. The court also noted that these indirect costs originated from the company's obligations to pay a salary due to the employment relationship, rather than the capital transaction.

Finally, in *Ingram Industries*[7] the Tax Court held that the cost of performing periodic cleaning and inspection to towboat engines was deductible. The court found the work to be preventative maintenance rather than overhaul work. The cost was $100,000, which represented only 1.6% of the cost of a new towboat. Also, an overhaul would take 3 to 5 months, rather than 10 to 12 days. Moreover, only about 21% of the parts were replaced. Basically, the periodic cleaning and inspection work enabled the boats to reach their 40-year useful life. The court also noted that even if the maintenance work added $100,000 in value to a boat, such amount was immaterial to the value of both the boat and the engine. Finally, the court observed that the work did not adapt the engine for a new or different use.

PRACTICE POINTS

The four authorities summarized above can be turned into four questions to help in resolving the capitalization versus expensing issue, with a "yes" answer pointing towards deductibility under section 162.

i. Is the expenditure a regular business expense that does not "attach" to the basis of any asset?

ii. Is any potential long-term benefit derived from the expenditure merely speculative or incidental?

iii. Is the expenditure one that did not create or enhance an asset or did not by itself generate anything with a future benefit (such as a credit report)?

iv. If the expenditure arose from work done to property (such as repair of equipment) that did not adapt the property to a new or different use, was the amount spent nominal compared to the replacement cost and value of the property, thus indicating that the work did not appreciably prolong the life of the property or materially add value to it?

We are likely to continue to see more cases that will expand and further clarify the above list of questions. In addition, the 2000 Treasury/IRS Business Plan lists specific expenditures for which guidance may be issued on whether the expenditure falls under section 263 or section 162. Such guidance may address the treatment of cyclical maintenance costs, sales commissions paid to obtain new customers, mutual fund launch costs, and loan origination costs.[8]

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2 Rev. Rul. 2000-4, 2000-4 I.R.B. 331.

3 Briarcliff Candy Corp. v. Commissioner, 475 F.2d 775 (2d Cir. 1973).

4 Sun Microsystems v. Commissioner, T.C. Memo 1993-467.

5 PNC Bancorp Inc. et al. v. Commissioner, 212 F.3d 822 (3d Cir. 2000).

6 Wells Fargo & Co., et al. v. Commissioner, 224 F.3d 874 (8th Cir. 2000).

7 Ingram Industries v. Commissioner, T.C. Memo 2000-323.

8 *See* Rev. Rul. 2001-4, 2001-1 I.R.B._, released Dec. 21, 2000.