

INFORMATION PAPER

SUBJ: QUICK GUIDE TO TAX ISSUES FOR TWO CREW SUBMARINES PERSONNEL

Overview: The Internal Revenue Code permits a taxpayer with a place of employment different from their tax home to take certain employee business deductions in particular circumstances. In particular, crew members of two-crew ballistic missile submarines have the ability to claim certain deductions on their tax returns. A recurring problem, however, is that the tax benefits are commonly misunderstood and erroneously applied, causing the IRS to closely examine tax returns with these deductions. If properly applied, calculated, and documented, this so-called “FBM Deduction” can provide a significant tax benefit. On the other hand, if a Sailor does not carefully follow the rules and maintain proper documentation, the IRS can and will pursue taxes owed, along with interest, penalties, and anxiety.

Discussion: Let’s start with the basics. Section 162(a)(2) of the Internal Revenue Code allows the deduction of amounts expended for meals and lodging as a business expense only while the taxpayer is traveling “away from home in the pursuit of a trade or business.” The general rule is that a taxpayer’s “home” for business expense purposes is located at his principal place of business or regular post of duty. The IRS and Tax Court have concluded that for Naval personnel assigned to a ship or submarine, their tax home is that ship or submarine, and not where their family resides.

The two-crew SSBN deduction is based on the “legal fiction” that the submarine has been determined to be the taxpayer’s tax home by IRS¹. Consequently, when the other crew takes the boat out the Sailor is in the unique situation of having his tax home leave him behind. The Sailor is away from his tax home by virtue of the other crew’s deployment.

How does the FBM Deduction work? Using IRS Form 2106 or 2106-EZ, a Sailor can pro-rate certain expenses incurred during off-crew periods including:

- commuting expenses to the “temporary” duty station;
- 50% of the standard meal allowance (\$39 per day in 2008)²; and
- his portion of household living expenses.

These deductions are only applicable during off-crew, non-leave periods. The qualifying time is generally documented by a memo from the CO or his designee. The qualifying time is a critical component of the deduction calculations.

¹ For those who are interested, see the following Ruling and case: Revenue Ruling 67-438, 1967-2 C.B. 82; *Griffin v. Commissioner*, T.C Memo 1992-186.

² Higher meal and incidental rates may apply depending on where a Sailor lives. See http://www.gsa.gov/Portal/gsa/ep/contentView.do?contentId=17943&contentType=GSA_BASIC (Bremerton, for example, permits \$59 per day; Seattle \$64 per day).

One critical error made by many Sailors in calculating these deductions is a failure to offset allowances provided by the Navy for housing and subsistence (meals). If you get BAH, BAS, or other allowances, these tax-free allowances offset the expenses you can declare. If you look at the title of form 2106 you will note that it is called “Unreimbursed Employee Business Expenses.” If you do get reimbursed for your expenses by government paid allowances, you cannot deduct these same expenses on this form.

Another critical error is to not accurately calculate the correct portion of household living expenses. This is particularly true for single Sailors living with others out in town. Only the Sailor’s share is deductible, again only to the extent not offset by allowances. These expenses can include the amount of rent paid by the Sailor, the principal amount of mortgage payments (not the interest portion), the Sailor’s share of the cost of utilities, and even laundry costs.

The final critical error is failure to document or retain the documentation used to calculate the deduction amounts derived from Forms 2106/2106-EZ. The instructions for these forms make it clear: “You cannot deduct expenses ... unless you keep records to prove ... these expenses.” If the IRS reviews your tax return and asks you to support the expenses taken on Form 2106, you will likely lose the benefit of any deduction not supported by documentation.

The Form 2106/2106-EZ deductions are then carried over to Schedule A of Form 1040 and are incorporated into miscellaneous deductions on Line 20 of Schedule A. Note well that those who cannot otherwise itemize their deductions will not benefit from the FBM expense deduction. For those who can itemize, only the total miscellaneous expense amount that exceeds 2% of their adjusted gross income will be deductible. For example, let’s assume total 2106 and other expenses of \$2400 and an adjusted gross income of \$40,000. Only the expenses that exceed \$800 (2% of \$40,000) will be deductible, leaving the taxpayer with, in this case, \$1600 of miscellaneous deductions. Not bad but not going to make you dance to the bank.

Sailors who may qualify for the FBM Deduction are often referred to some privately operated web sites that provide “assistance” with the calculations and have worksheets for Sailors to use. While I have no reason to believe these web sites are malicious or provide information that will cause Sailors to violate tax law, they are not run by tax professionals nor sanctioned by the IRS. The old adage GIGO – Garbage In, Garbage Out – should be borne in mind. Use any non-official information at your own risk!

As discussed above, there has been recent IRS scrutiny regarding the FBM Deduction. An old axiom comes to mind, “pigs get fat, but hogs get slaughtered.” I am not quite sure of the origin of this one, but in the tax world it is taken to mean that you can be a bit “aggressive” on your taxes, but if you go too far, you will get in trouble. If you are entitled to the FBM Deduction, by all means take full advantage of it. Document your days accurately, get it validated by your CO, keep track of your mileage and expenses, etc. If you stay within bounds, you will withstand scrutiny. If you don’t, not only will you be penalized, but you might bring undesired attention to your fellow boomer Sailors who, I imagine, will not be real happy about that!