

Revenue Ruling 80-322¹

Section 83-Property Transferred in Connection with Performance of Services

July 1980

Suits leased for corporate executives. A corporation leases custom-tailored suits for its executives for a two-year period and, at the end of the lease term, returns the suits to the lessor, who sells them for a nominal amount. The corporation is charged a rental fee and a consulting fee, which together equal the normal purchase price of the suits. The fair market value of the suits is includible in the executives' gross incomes, and the corporation may deduct the entire amount paid to lease the suits.

ISSUE

What are the federal income tax consequences to a corporation and its executives when the corporation "leases" suits for its executives, under the circumstances described below?

FACTS

Corporation X offers to "lease" business suits for use by executives of its corporate customers. Forty percent of the cost to a customer will be billed as consulting fees for X's advice on the appropriate number and style of suits and which executives should receive suits. X represents that the customer can deduct the consulting fee as a business expense in the year it is paid. A customer cannot "lease" suits from X without obtaining the consulting services.

The "leases" are for a two-year period, and at the end of the lease term the suits will be returned to X, who will sell them for a nominal amount. In April 1980 Corporation Y "leases" from X ten suits, five of which are to be custom tailored for A, an executive of Y. Upon the execution of the agreement, Y pays X 50x dollars (the full amount called for by the contract), of which 20x dollars is billed as a consulting fee for the advice given by X and 30x dollars is billed as the rental for the suits. Each suit is appropriate for ordinary wear and could be purchased for approximately 5x dollars. Y and A are calendar-year taxpayers.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code defines gross income as income from whatever source derived, except as otherwise provided.

¹ Also released as News Release IR-80-114, dated October 30, 1980.

Section 83 (a) of the Code provides that when property is transferred to a person in connection with the performance of services, the person who performed the services must include in gross income the excess of (1) the fair market value of the property at the time the rights of the person having the beneficial interest in the property are transferable or not subject to a substantial risk of forfeiture, over (2) any amount paid for the property. The taxable year of inclusion is generally the first taxable year in which the rights of the person receiving the property are transferable or not subject to a substantial risk for forfeiture.

Section 83 (h) of the Code provides that, in the case of a transfer of property, a deduction is allowed under section 162 to the person for whom the services were performed. Section 1.83-6 (a) (1) of the regulations provides, that the amount of the deduction is equal to the amount includible as compensation in the gross income of the person who performed the services, but only to the extent the amount meets the requirements of section 162 and the regulations thereunder.

Section 162 (a) (1) of the Code provides in general that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Y purportedly leased the suits from X. Whether an agreement is a lease or a sale depends upon the intent of the parties as evidenced by the provisions of the agreement, read in light of the facts and circumstances existing at the time the agreement was executed. See Rev. Rul. 55-540, 1955-2 C.B. 39. The fact that the suits were custom tailored for particular individuals and have little value at the end of the "lease term" establishes that Y has for federal income tax purposes purchased, rather than leased, the suits.

The advice provided by X as part of the arrangement consisted of services that are typically provided, at no additional cost, to customers by tailors and other sales representatives in the course of selling suits. The amount designated as consulting fees is properly treated as part of the purchase price of the suits, so that the cost of the ten suits is the total amount paid by Y to X.

An amount paid by an employer to an employee for reimbursement of the employee's cost of acquiring uniforms is includible in the employee's gross income under section 61 of the Code.

See Rev. Rul. 72-110, 1972-1 C.B. 24. Similarly, an amount paid by an employer to an employee to defray the cost of a wardrobe is includible in the employee's gross income. See Rev. Rul. 68-20, 1968-1 C.B. 55.

Because Y has provided additional compensation to its executives by furnishing suits to them, they must include in gross income, under section 83 (a) of the Code, the fair market value of the suits. The fair market value is equal to the purchase price. One-half the purchase price, or 25x dollars, is attributable to the suits provided to A. Pursuant to section 83 (h), Y may deduct the total amount paid to X as a business expense under section 162 (a) (1).

The cost of acquisition and maintenance of clothing is deductible by an employee as a business expense under section 162 of the Code only if the clothing is specifically required as a condition of employment and is not a type adaptable to general or continued usage. See Rev. Rul. 70-474,

1970-2 C.B. 34. Thus, because the business suits are appropriate for ordinary wear, the executive may not deduct the fair market value of the suits as a business expense.

HOLDINGS

1. Under section 83 (a) of the Code, A must include in gross income for 1980 the fair market value of the suits provided to A in the amount of 25x dollars. A may not deduct this amount as a business expense under section 162.

2. Under section 162 (a) (1) of the Code, Y may deduct in 1980 the total amount paid to X for the suits provided to Y's executives.