

ACTION BY: Regional Directors
Special Nutrition Programs

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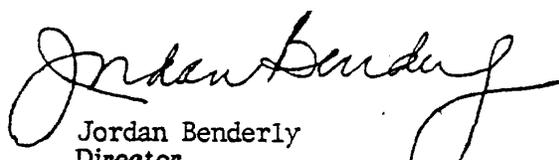
Tax Issues Concerning Day Care Homes

Administering agencies have in the past expressed concern over two Federal income tax issues connected with Child Care Food Program (CCFP) operations in day care homes: (1) tax status of Program reimbursement to providers and (2) possible responsibility of home sponsors for Social Security and unemployment contributions for providers.

With respect to the first issue, providers should be made aware that cost records may be requested by IRS, even though they are not required for home providers by CCFP regulations.

Regarding the second issue, sponsor responsibility depends on whether providers under a given sponsoring organization are considered employees, or are deemed to be self-employed. Provider status can vary from sponsor to sponsor. Only IRS can establish policy and procedures relative to these issues.

State agencies should alert sponsoring organizations of homes to these issues and refer them to IRS for further guidance. Revenue ruling 79-142 states the most recent official IRS position on the CCFP. It might be of general assistance to home sponsoring organizations in dealing with the subject tax issues and could serve as an appropriate point of departure for discussions between them and local IRS officials. Administering agencies may therefore wish to distribute the ruling, made available to them in 1979, to home sponsors. An additional copy is attached as Exhibit A for your convenience.


Jordan Benderly
Director
Child Care and Summer Programs Division

Attachment

DISTRIBUTION: 5, 6, 11, 14	MANUAL MAINTENANCE INSTRUCTIONS: New Instruction. Insert in Manual. Destroy CCFP Policy Memorandum No. 12.	RESPONSIBLE FOR PREPARATION AND MAINTENANCE: CS-100	10-14-82
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Section 61.—Gross Income Defined

26 CFR 1.61-1: *Gross income.*
(Also Sections 162, 170; 1.162-1, 1.170A-1.)

Day care service; Child Care Food Program payments. Payments received from a sponsoring charitable organization pursuant to the Child Care Food Program are excludable from a day care home operator's gross income to the extent that such payments do not exceed expenses incurred in feeding children eligible for assistance under the program. Any portion of the payment that compensates the operator for services is includible in income. Out-of-pocket expenses in excess of reimbursement are deductible under section 170 of the Code where no profit motive exists and under section 162 where such motive does exist.

Rev. Rul. 79-142

ISSUE

What are the federal income tax consequences to family and group day care home operators who participate in the Child Care Food Program (CCF program) authorized by the National School Lunch Act and Child Nutrition Act of 1966 Amendments of 1975, Pub. L. No. 94-105, 94th Cong., 1st Sess. (October 7, 1975), 42 U.S.C. section 1766 (Supp. V 1976)?

FACTS

Situation 1.—Under the auspices of a sponsoring charitable organization described in section 170(c) of the Code, which was formed to provide day care and nutritional meals to needy children, an individual operates a non-profit licensed day care service in the individual's home and provides meals at lunchtime to the children cared for. Pursuant to the CCF program administered by the Department of Agriculture, the sponsoring organization has entered into an agreement with the State Department of Education whereby the organization has agreed to accept final financial and administrative responsibility for the conduct of the food service provided in the day care home under its authority. In the agree-

ment the sponsoring organization ensures the state agency that meals served in the individual's day care home meet specified requirements, and that meals are served free or at a reduced price to all children eligible for free and reduced price meals under the CCF program. The sponsoring organization is also required (1) to provide consultative and technical assistance to ensure that meals meet prescribed standards, that adequate records are maintained, and that other CCF program requirements are met, (2) to train day care personnel responsible for the food service, and (3) to make periodic visits to the day care home to monitor compliance.

In exchange, the state agency reimburses the sponsoring organization for the expenses incurred by the day care home operator in providing free and reduced price lunches to eligible children. The amount of the reimbursement payments is determined by the number and types of meals served and the need of the children enrolled in the CCF program. In no event may reimbursement payments to the sponsoring organization exceed the operating costs of the day care food service.

After receiving reimbursement payments from the state agency the sponsoring organization distributes the funds to the individual operating the day care food service. In the taxable year in question the payments made to the day care home operator are equal to the operating costs of the CCF program. No payments are made to the operator to compensate the operator for the value of services rendered in preparing and dispensing the lunches.

Situation 2.—An individual operates a day care service in the individual's home and provides lunches to needy children under the same facts as in *Situation 1*, except that in the taxable year in question the individual receives payments from the sponsoring organization that include not only reimbursements for operating expenses, but also payments for the value of the individual's services.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code of 1954 provides that, except

as otherwise provided by law, gross income means all income from whatever source derived. Section 162(a) provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 170 provides that subject to certain limitations a deduction shall be allowed for any charitable contribution (as defined in section 170(c)) payment of which is made within the taxable year. Section 1.170A-1(g) of the Income Tax Regulations provides, in part, that unreimbursed out-of-pocket expenditures made incident to the rendition of services to a charitable organization may constitute a deductible contribution.

Section 9(d) of the National School Lunch Act and Child Nutrition Act of 1966 Amendments of 1975 provides that "[t]he value of assistance to children under this Act shall not be considered to be income or resources for any purpose under any Federal or State laws, including laws relating to taxation and welfare and public assistance." Pursuant to section 9(d) of the Amendments of 1975, the value of free and reduced meals served to needy children under the CCF program is not includible in the gross incomes of the children or of their parents. However, reimbursements and payments received by operators of family and group day care homes under the CCF program are not excludable from their gross incomes for federal income tax purposes by reason of section 9(d) of the Amendments of 1975, but they may be otherwise excludable from the day care home operator's gross incomes depending on the particular facts.

The individual operating the day care home in *Situation 1* does not have a profit making motive in operating the day care facility and is not, in fact, making a profit. The expenses incurred by the individual in *Situation 1* in furtherance of the CCF program are incurred on behalf of the sponsoring charitable organization and are directly connected with the rendition of gratuitous services to the sponsoring organization. See Rev. Rul. 77-279 (*Situation 1*), 1977-2 C.B. 12.

In contrast, the individual operating

the day care home in *Situation 2* does have a profit motive and, in fact, received compensation for services rendered in connection with the lunches provided under the CCF program. Nevertheless, as in *Situation 1*, the food service expenditures subject to reimbursement were incurred by the individual in *Situation 2* on behalf of the sponsoring organization. See Rev. Rul. 77-280 (*Situations 3 and 4*), 1977-2 C.B. 14.

HOLDINGS

The payments received from the sponsoring organization in *Situation 1* are not includible in the gross income of the individual as long as the payments do not exceed the expenses incurred by the individual in feeding the children eligible for assistance under the program.

The portion of each payment received by the individual in *Situation 2* from the sponsoring organization that represents reimbursement of actual expenditures incurred on behalf of the sponsoring organization is not includible in the gross income of the individual. The portion of the payment attributable to compensation for the value of the individual's services is includible in the individual's gross income.

In both *Situations 1* and *2*, the individual's reimbursed expenditures are not the individual's own expenses, but are incurred on behalf of the sponsoring organization. Therefore, the reimbursed expenses are not deductible by the individual in either *Situation 1* under section 170 of the Code or *Situation 2* under section 162.

If in *Situation 1* the operating costs of the CCF program had been greater than the reimbursement payments, the excess of the out-of-pocket expenses over the reimbursement would have been deductible by the individual within the limitations of section 170 of the Code as contributions for the use of the sponsoring organization, because the individual would be rendering gratuitous services to the sponsoring organization by feeding the children. See Rev. Rul. 77-280 (*Situations 1 and 2*).

If in *Situation 2* the operating costs of the CCF program had been greater than the reimbursement payments, the excess of the out-of-pocket expenses over the reimbursement would have been deductible as a trade or business expense under section 162 of the Code. See Rev. Rul. 77-280 (*Situations 3 and 4*).

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Deductibility of expenses incurred by family and group day care home operators in providing food services to needy children under the Child Care Food Program authorized by the National School Lunch Act and Child Nutrition Act of 1966 Amendments of 1975. See Rev. Rul. 79-142, page 16.

26 CFR 1.162-2: Traveling expenses.

Travel expenses; state legislator; home in district. Deductible travel expenses are explained for a state legislator who elects to have a residence within the represented legislative district considered his or her tax home.

Rev. Rul. 79-16¹

ISSUE

What travel expenses are deductible for federal income tax purposes by a state legislator who makes an election under section 604 of the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 51, as amended, to have the legislator's place of residence within the legislative district that the legislator represents considered as the individual's tax home?

FACTS

B is a state legislator who makes an election under section 604 of the Tax Reform Act of 1976, as amended, to have the legislator's place of residence in the district represented considered as the legislator's tax home. *B*'s place of residence and the state capital where the legislative sessions are held are in

¹This Revenue Ruling was first published in 1979-3 I.R.B. dated January 15, 1979 and is being republished to reflect additions and corrections.

different cities. When the state legislature is not in session, the legislator incurs other travel expenses in the pursuit of trade or business as a legislator for travel in the district represented, in the state capital, and in other cities. The legislator does not receive a per diem allowance for attending legislative sessions.

LAW AND ANALYSIS

Section 162(a) of the Internal Revenue Code of 1954 provides that a taxpayer is allowed a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including traveling expenses (including amounts expended for meals and lodging other than amounts that are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business.

Generally, in order for a taxpayer to deduct travel expenses under section 162(a) of the Code, the taxpayer must be away from home on business overnight or for a period sufficient to require substantial sleep or rest. *United States v. Correll*, 389 U.S. 299 (1967), [Ct. D. 1917] 1968-1 C.B. 64; Rev. Rul. 75-168, 1975-1 C.B. 58.

Section 604 of the Tax Reform Act of 1976, 1976-3, C.B. (Vol. 1) 1, 51, is entitled "State Legislators' Travel Expenses Away from Home" and deals expressly with the travel expenses of state legislators. As amended by the Act of April 7, 1978, Pub. L. No. 95-258, 95th Cong., 2d Sess. (1978), 1978-1 C.B. 505, section 604 provides that for purposes of section 162(a) of the Code, in the case of an individual who was a state legislator at any time during any taxable year beginning before January 1, 1978, and who elects the application of section 604, for any period during such a taxable year in which the individual was a state legislator, the place of residence of such individual within the legislative district that the legislator represented shall be considered the individual's home. Furthermore, the individual shall be deemed to have expended for living expenses (in connection with the trade or business as a legislator) an amount equal to the sum of the amounts determined by multiplying each legisla-