

## Deduction for Repaid Bonuses Still Available

To the Editor:

A recent article<sup>1</sup> questions the availability of section 1341 relief for an employee's repayment of a sign-on retention bonus owed to an employer. The author's doubt is based on the 2018-2025 suspension of the deduction for unreimbursed employee business expenses.<sup>2</sup>

We also raised this possible interpretation as a concern for clients following the passage of the Tax Cuts and Jobs Act of 2017. By the same logic, the suspension could result in the unavailability of the exclusion for working condition fringe benefits under section 132(a)(3).<sup>3</sup> Thus, under this view, there could be eight years of taxation on business expense reimbursements or on the value of an employee's use of their (the employer's) office — even on their enjoyment of employer artwork hanging on the walls (if more than de minimis)!

Fortunately, it appears that the IRS continues to recognize the availability of both the working condition fringe exclusion and the section 1341 claim of right deduction and credit. In fact, the IRS has reiterated its availability in IRS Publication 525 each year since 2018. This does not appear to be an oversight, given that the same publication was revised to reflect that an itemized deduction is not available for repayments below the \$3,000 threshold needed to qualify for claim of right. Although I have not heard the IRS's explanation for its conclusion, readers might look back to an

earlier *Tax Notes* article by the late (and great) professor Douglas Kahn that offered some rationales.<sup>4</sup>

Careful advisers may still want to raise the potential issue for taxpayers when repayment situations arise. When doing so, it may be even more important to stop and consider if it truly "appeared that the taxpayer had an unrestricted right" to the initial payment.<sup>5</sup> This is an area with confusing and sometimes conflicting guidance and precedent, and one might question whether the taxpayer "appeared" to have an unrestricted right if retention of the payment was explicitly conditioned on continued employment.<sup>6</sup>

Sincerely,

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Apr. 26, 2024

<sup>1</sup> Clinton Tarkoe, "Bonused Out of a Deduction," *Tax Notes Federal*, Apr. 1, 2024, p. 141.

<sup>2</sup> See section 67(g).

<sup>3</sup> See section 132(d); reg. section 1.132-5(a)(1) (excluded if amount "would be allowable as a deduction under section 162," which is similar to the "deduction is allowable" under section 1341(a)(2) governing claim of right).

<sup>4</sup> Douglas A. Kahn, "Return of an Employee's Claim of Right Income," *Tax Notes Federal*, June 17, 2019, p. 1819. See also Steve Johnson, "Remembering Doug Kahn," *ABA Tax Times* (Jan. 11, 2022).

<sup>5</sup> Section 1341(a)(2); see also reg. section 1.1341-1(a)(2) ("it appeared from all the facts available in the year of inclusion that the taxpayer had an unrestricted right to such item") (emphasis added).

<sup>6</sup> For further discussion, see Rosina B. Barker and Kevin P. O'Brien, "Taxing Clawbacks: Theory and Practice," *Tax Notes*, Oct. 25, 2010, p. 423.