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## Employment Taxes

A Littler Mendelson Newsletter  
specifically for the Employment Taxes

### IRS Will Not Challenge Local Lodging Expenses for Employees If Lodging Is Necessary to Participate in a Business Meeting or Function

By GJ Stillson MacDonnell and William Hays Weissman

In an about face from a position held for many years, the IRS recently announced that it would no longer challenge an employer's deduction for lodging expenses incurred by an employee in the metropolitan area where the person lived, provided that the lodging is necessary to take part in a meeting or other function of the employer.<sup>1</sup>

#### The Old Rules

The Internal Revenue Code (Code) section 162(a) allows as a deduction all the ordinary and necessary business expenses paid or incurred during the taxable year in carrying on any trade or business. Traveling expenses, including lodging expenses that are not lavish or extravagant under the circumstances, while away from home in the pursuit of a trade or business, are treated as deductible business expenses.

However, under Code section 262(a), no deduction is allowed for personal, living, or family expenses. Treasury Regulation 1.262-1(b)(5) of the Income Tax Regulations provides that the costs of a taxpayer's lodging not incurred in traveling away from home are personal expenses and are not deductible unless they qualify as deductible moving expense.

Thus, under these rules an employer could not put up an employee locally for any purpose and claim a business expense deduction. Were an employer to pay the expenses of an employee to stay locally, it would constitute additional compensation to the employee.

#### Interim Guidance

The IRS issued Notice 2007-47 to provide interim guidance pending expected amendments to Treasury Regulation 1.262-1(b)(5) to provide an exception to the

general rule that the costs of a taxpayer's lodging not incurred in traveling away from home are personal expenses and are not deductible. Under Notice 2007-47, the IRS will not apply the prohibition under Treasury Regulation 1.262-1(b)(5) to expenses for lodging of an employee not incurred while the employee is traveling away from home that an employer provides to the employee, or requires the employee to obtain, under the following conditions:

1. The lodging is on a temporary basis;
2. The lodging is necessary for the employee to participate in or be available for a bona fide business meeting or function of the employer; and
3. The expenses are otherwise deductible by the employee, or would be deductible if paid by the employee, under Code section 162(a).

In addition, the IRS has stated that the issue of local lodging will not be raised in any taxable year ending on or before publication of the guidance and, if already raised as an issue in examination or before the Office of Appeals or the Tax Court in a taxable year ending on or before May 23, 2007, the issue will not be pursued by the IRS.

For employers, this gives significantly more flexibility to schedule functions such as retreats locally that allow employees to stay in the same general vicinity as where they live without having such lodging treated as additional compensation. This may be particularly useful where, for example, persons are brought in from around the country for a meeting to a particular hotel location for a few days, but local employees had not also been able to stay there based on the IRS's prior position. Employer should be careful, however, that all three criteria are present, particularly that there be some

<sup>1</sup> IRS Notice 2007-47.

kind of business function such as a retreat or training session that makes it reasonable and necessary to house employees close to where they live.

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