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## IRS Proposes New Regulations Allowing Travel Expenses for “At-Home” Lodging

By William Hays Weissman

The IRS has promulgated proposed regulations that would permit travel expenses incurred while not away from home to nonetheless be tax exempt to employees. The proposed regulations are a follow up to IRS Notice 2007-47, 2007-1 CB 1393, in which the IRS first announced modifications to the rules relating to the taxation of travel expenses paid while not away from home.

### Travel Away from the Employee’s Tax Home

Section 162(a)(2) of the Internal Revenue Code (Code) permits a deduction for ordinary and necessary travel expenses incurred while temporarily away from home in the pursuit of a trade or business. The deduction for expenses incurred while away from home is intended to mitigate the burden on a taxpayer who, because of the travel requirements of his trade or business, must maintain two places of abode and therefore must incur duplicative living expenses.<sup>1</sup> In order to be allowed a deduction under Code section 162, a taxpayer must establish that the travel expenses were: (1) reasonable and necessary; (2) incurred while away from home; and (3) incurred in pursuit of a trade or business.<sup>2</sup> Conversely, expenses incurred by an employee who is not “away from home” are treated as a personal expense and thus taxable as wages to the employee.<sup>3</sup>

Generally, a taxpayer’s “home” for purposes of Code section 162(a) is the city or location of his or her principal place of business and not where his or her personal residence is located.<sup>4</sup> A taxpayer’s residence can be his principal place of business if it qualifies as a home office for purposes of the home office deduction.<sup>5</sup> Further, an employee without a principal place of business may treat a permanent place of residence at which he incurs substantial continuing living expenses as his tax home.<sup>6</sup>

In *Flowers v. Commissioner*,<sup>7</sup> the U.S. Supreme Court held that the taxpayer must be “away from home” to deduct travel expenses. This has been determined to mean that a “sleep or rest rule” or “overnight rule” must be satisfied. This requirement is satisfied if the taxpayer must be away from home for “substantially longer than an ordinary day’s work, the employee cannot reasonably be expected to make the trip without being released from duty for sufficient time to obtain substantial sleep or rest while away from the principal post of duty, and the release from duty is with the employer’s tacit or express acquiescence.”<sup>8</sup>

The courts, in considering questions involving deductions for traveling expenses, have frequently

stated that each case must be decided on its own particular facts. Furthermore, there appears to be no set distance requirement for what constitutes “away from home.” Section 162(h)(4) of the Code requires state legislators to reside 50 or more miles from the capitol building of the state in order to deduct traveling expenses. While this is a useful guide, it is not dispositive and applies to legislators only. The IRS has also noted the “metropolitan area” is within the “tax home’s” geographic reach, but there is no definition of metropolitan area, which may vary substantially in different parts of the country.<sup>9</sup>

## Employer Advance or Reimbursement of Travel Expenses

If an employee does travel away from home and the employer either advances the funds or reimburses the employee for the costs of such travel, the expenses may be treated as a working condition fringe benefit, and thus the value of travel excluded from the employee’s wages,<sup>10</sup> if the advance or reimbursement meets the accountable plan rules.<sup>11</sup> To be an accountable plan, the employer’s reimbursement or allowance arrangement must meet all three of the following rules: (1) the expenses must have a business connection, *i.e.*, the employee must have paid or incurred deductible expenses while performing services as an employee of the employer; (2) the employee must adequately account to his or her employer for these expenses within a reasonable period of time (generally 60 days); and (3) the employee must return any excess reimbursement or allowance within a reasonable period of time (generally 120 days).<sup>12</sup> Travel expenses can include fares, meals and lodging, and incidental expenses.<sup>13</sup>

## Proposed Regulations

The proposed regulations allow expenses for lodging that is not away from the employee’s tax home to be excluded as a working condition fringe benefit if accountable plan rules are satisfied under a totality of the facts and circumstances test.<sup>14</sup> The proposed regulations, however, also contain a safe harbor that, if satisfied, would exclude the value of such lodging from the employee’s wages. The following four conditions must be met to take advantage of the safe harbor:

1. The lodging is necessary for the individual to participate fully in or be available for a bona fide business meeting, conference, training activity, or other business function;
2. The lodging is for a period that does not exceed five calendar days and does not recur more frequently than once per calendar quarter;
3. If the individual is an employee, his employer requires him to remain at the activity or function overnight; and
4. The lodging is not lavish or extravagant under the circumstances and does not provide any significant element of personal pleasure, recreation, or benefit.<sup>15</sup>

The proposed regulations contain several examples to illustrate how the proposed rules can be satisfied. For example, when a company runs business-related training at an off-site location near its office and requires employees attending the training to stay overnight at the facility, the value of the lodging is excluded from the employees’ income, presuming that the accountable plan rules are satisfied.<sup>16</sup> Similarly, the value of the lodging is excluded from an employee’s income when the employee is required to stay overnight at a hotel near his employer’s business premises in order to be able to respond quickly to emergencies that occur outside of normal working hours.<sup>17</sup>

There are also examples where the proposed regulations are not satisfied and therefore the value of the lodging is included in the employee’s income as additional compensation. When an employee who commutes two hours each way is allowed to stay in a local hotel so that she can maximize the hours she puts in on a particular project, the value of the lodging must be included in her income.<sup>18</sup> Likewise, when the employer puts up in temporary lodging an employee who relocated to a new city and is house hunting, the value of the lodging is includible in the employee’s income.<sup>19</sup>

The proposed regulations will apply to expenses incurred or paid after they become final, although taxpayers may apply them for any open taxable period.

## Caveats for Employers and Employees

While the new rules are a welcome change, they are still narrowly focused to help employers achieve business-related activities that are

somewhat specific in nature. Thus, employers and employees should not take the new regulations as an opportunity to otherwise pay living expenses of employees, which will still be treated as taxable wages. The examples in the proposed regulations of what does not qualify as a working condition fringe benefit provide helpful guidance that should be used to ensure that employers are not improperly paying personal living expenses on a tax exempt basis.

Further, the proposed regulations only cover lodging expenses. Thus, meals and other travel-related expenses are not addressed. Presumably, a working dinner provided at the off-site training would itself constitute a working condition fringe benefit to the employees, and thus be excluded from wages, without regard to the proposed regulations. However, employers need to be careful about any other incidental kinds of expenses for which employees may seek reimbursement.

William Hays Weissman is a Shareholder in Littler Mendelson's Walnut Creek office. If you would like further information, please contact your Littler attorney at 1.888.Littler, info@littler.com, or Mr. Weissman at wweissman@littler.com.

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<sup>1</sup> *Barone v. Commissioner*, 85 T.C. 462, 466 (1985), *aff'd without published opinion*, 807 F.2d 177 (9th Cir. 1986).

<sup>2</sup> *Horton v. Commissioner*, 86 T.C. 589, 593 (1986).

<sup>3</sup> Treas. Reg. § 1.262-1(b)(5). This can arise in a variety of ways. For example, an employer may pay the living expenses for an employee who has transferred to a new location and is house hunting or for an employee who would otherwise have a long distance commute. An employer may provide an employee with a week-long trip to a resort as a prize or award. In such cases, one or more of the requirements for business related travel are not satisfied.

<sup>4</sup> *Mitchell v. Commissioner*, 74 T.C. 578, 581 (1980); *Jordan v. United States*, 2006 U.S. Dist. LEXIS 17107 (D. Minn. Mar. 23, 2006).

<sup>5</sup> Code section 280A(c)(1)(A); *see also* Rev. Rul. 99-7, 1999-1 C.B. 361.

<sup>6</sup> *Johnson v. Commissioner*, 115 T.C. 210 (2000); *Sapson v. Commissioner*, 49 T.C. 636, 640 (1968).

<sup>7</sup> *Flowers v. Commissioner*, 326 U.S. 465 (1946).

<sup>8</sup> Rev. Rul. 75-432, 1975-2 C.B. 60.

<sup>9</sup> *E.g.*, Rev. Rul. 99-7, 1999-1 C.B. 361.

<sup>10</sup> Treas. Reg. § 1.132-5(a) (working condition fringe benefits excluded from employee's wages).

<sup>11</sup> Treas. Reg. § 1.62-2(c)(4).

<sup>12</sup> IRC § 62(a)(2)(a), (c); Treas. Reg. § 1.62-2(c)(1), (d)-(f), (g)(1), (2)(i).

<sup>13</sup> IRC § 162(a)(2); Treas. Reg. § 1.162-2.

<sup>14</sup> Prop. Reg. § 1.162-31(a).

<sup>15</sup> Prop. Reg. § 1.162-31(b).

<sup>16</sup> Prop. Reg. § 1.162-31(c), Exs. 1-2.

<sup>17</sup> Prop. Reg. § 1.162-31(c), Ex. 6.

<sup>18</sup> Prop. Reg. § 1.162-31(c), Ex. 5.

<sup>19</sup> Prop. Reg. § 1.162-31(c), Ex. 4.