

How to avoid tax problems when employees travel out of town on business

Business travel, a necessary evil at many companies, can be an expensive and time-consuming activity for both the employer and employee. It also can create tax headaches for all concerned unless the rules are followed to the letter. If it's done right, business travel will be fully deductible by the company (but only 50% of travel meals are deductible), tax-free to the employee, and free of FICA and payroll tax withholding. If the rules aren't followed, the expense will still be deductible by the employer, but it will be taxed to the employee and fully subject to withholding. This *Practice Alert* reviews the business travel rules that apply in a variety of common situations.

Background. In general, a business may deduct under [Code Sec. 162](#) all the ordinary and necessary business expenses paid or incurred during the tax year in carrying on any trade or business, including travel expenses (such as lodging expenses) that aren't lavish or extravagant while away from home in the pursuit of a trade or business.

Under [Reg. § 1.132-5\(a\)](#), the value of a working condition fringe benefit (WCFB) is not included in an employee's gross income. A WCFB is any property or service provided to an employee to the extent that, if the employee paid for the property or service, it would be deductible under [Code Sec. 162](#) or [Code Sec. 167](#) (dealing with the depreciation allowance).

Under [Reg. § 1.62-2\(c\)\(4\)](#), an advance or reimbursement made to an employee under an "accountable plan" is deductible by the employer and is not subject to FICA and income tax withholding. In general, an advance or reimbursement is treated as made under an accountable plan if: (1) the employee receives the advance, etc., for a deductible business expense that he paid or incurred while performing services as an employee of his employer, (2) the employee must adequately account to his employer for the expense within a reasonable period of time, and (3) the employee must return any excess reimbursement or allowance within a reasonable period of time. By contrast, an advance, etc. made under a "nonaccountable plan" is fully taxable to the employee and subject to FICA and income tax withholding. It will be treated as compensation to the employee and, in general, deducted as such by the employer.

Tax attraction of business travel status. The round-trip cost of traveling on business is deductible whether or not the taxpayer is away from home overnight. For example, if a New York businesswoman takes the shuttle to Washington on business, the airfare is deductible whether she returns home the same day (in which case it's treated as business transportation) or stays in Washington overnight (in which case it's treated as business travel). What makes business travel unique from the tax viewpoint is that when a taxpayer is in business travel status, the entire cost of lodging and incidental expenses, and 50% of meal expenses, is deductible by a business that pays the bill and doesn't result in any taxable income to employees who are reimbursed under an accountable plan.

Qualifying for business travel status. A business trip has the status of business travel only if:

- (1) it involves overnight travel;
- (2) the taxpayer travels away from his tax home; and
- (3) the trip is undertaken solely, or primarily, for ordinary and necessary business reasons, and the trip is "temporary," i.e., the traveler is temporarily away from home.

Overnight travel status. With the exception noted below, to deduct the cost of lodging and meals, the taxpayer must be away from home overnight. (Correll (S Ct 1967) [20 AFTR 2d 5845](#) ; [Rev Rul 75-432, 1975-2 CB 60](#)) This isn't a literal test in the sense that the taxpayer must be away from dusk to dawn. Any trip that is of such a length as to require sleep or rest to enable the taxpayer to continue working is considered "overnight." ([Rev Rul 75-170, 1975-1 CB 60](#))

New exception. Under recently issued final regs (see [Weekly Alert ¶ 12 10/02/2014](#)), there is one exception under which local non-lavish lodging expenses for lodging while not away from home overnight on business, are deductible if all the facts and circumstances so indicate. One factor is whether the taxpayer incurs the expense because of a *bona fide* condition or requirement of employment imposed by his employer. ([Reg. § 1.162-32\(a\)](#))

Under [Reg. § 1.162-32\(b\)](#), local lodging expenses are treated as ordinary and necessary business expenses if all of the

following conditions are met:

- (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.
- (4) The lodging is not lavish or extravagant under the circumstances and does not provide any significant element of personal pleasure, recreation, or benefit.

 **RIA illustration** ABC Corp runs week-long business-related training sessions (i.e., that don't qualify for the safe harbor) at a hotel near its main office. It requires all employees attending the training to remain at the hotel overnight for the *bona fide* purpose of facilitating the training. If ABC pays the lodging costs directly to the hotel, the stay is a WCFB to all attendees (even to employees who live in the area who are not on travel status), and ABC may deduct the cost as an ordinary and necessary business expense. If employees pay for the lodging costs and are reimbursed by ABC, the reimbursement is of the accountable plan variety and is tax-free to the employees and deductible by ABC as an ordinary and necessary business expense. (Adapted from [Reg. § 1.162-32\(c\)](#) , Exs. 1 and 2)

The final regs on the exception make it clear that away-from-home travel expenses (which include transportation expenses, meals, and lodging) and any other transportation expenses are not deductible unless they qualify as expenses deductible under [Code Sec. 162](#) (trade or business expenses), [Code Sec. 170](#) (charitable contributions), [Code Sec. 212](#) (expenses for production of income), [Code Sec. 213](#) (medical expenses), or [Code Sec. 217](#) (moving expenses), and the regs under those sections. They also clarify that the taxpayer's costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible expenses. ([Reg. § 1.262-1\(b\)\(5\)](#))

Travel away from tax home. Deductions for meals and lodging on business trips are allowed because expenses for these items are duplicative of costs normally incurred at the taxpayer's regular home and require the taxpayer to spend more money while traveling. Consequently, the taxpayer can't claim deductions for meals and lodging unless he has a home for tax purposes, and travels away from it overnight. (See, e.g., Correll (S Ct 1967) [20 AFTR 2d 5845](#) ; Andrews (CA 1 1991) [67 AFTR 2d 91-881](#) , vacg [TC Memo 1990-391](#)) There are no deductions when, for instance, a business person sleeps at a local hotel because of a late workday in the city, instead of traveling back to his nearby suburban home.

A taxpayer's "tax home," that is, his home for purposes of the business-travel deduction rules, is located at (1) his regular or principal (if more than one regular) place of business, or (2) if the taxpayer has no regular or principal place of business, the taxpayer's regular place of abode in a real and substantial sense. ([Rev Rul 73-529, 1973-2 CB 37](#)) Where a taxpayer has two or more work locations, his main place of work is his tax home. In determining which location is the main place of work, the factors to be taken into account include the total time at, the degree of business activity in, and the amount of income derived from, each business location. (Markey (CA 6 1974) [33 AFTR 2d 74-595](#) , , revg [TC Memo 1972-154](#) ; [IRS Publication 463, 2014, pg. 3](#))

However, there may be situations where the taxpayer does not maintain a permanent residence. For example, an itinerant salesperson who moves from place to place is "home" wherever he or she stays at each location. Since the taxpayer doesn't have duplicative expenses, there's no deduction for meals and lodging. ([Rev Rul 73-529, 1973-2 CB 37](#) ; Henderson (CA 9 1998) [81 AFTR 2d 98-1748](#) , affg [TC Memo 1995-559](#))

When business traveler is "temporarily" away from home. Except for certain federal criminal investigators and prosecutors, a taxpayer won't be treated as temporarily away from home during a period of employment lasting more than one year. ([Code Sec. 162\(a\)](#)) IRS has ruled that if employment away from home *in a single location* is realistically expected to last (and does in fact last) for one year or less, the employment is "temporary" in the absence of facts and circumstances indicating otherwise. If employment away from home *in a single location* initially is realistically expected to last for one year or less, but at some later date the employment is realistically expected to exceed one year, the employment will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date

that the taxpayer's realistic expectation changes. ([Rev Rul 93-86, 1993-2 CB 71](#))

"Breaks in service" and the 1-year rule. An employee may be asked to work at offsite location 1 for a specified period, then be shifted to offsite location 2 or back to the home office, and then reassigned back to offsite location 1. How long does the "break in service" (i.e., the period at offsite location 2 or back at the home office) have to be for employment at offsite location 1 to be treated as two separate periods of employment for purposes of the 1-year rule for temporary travel away from home?

In Chief Counsel Advice (CCA), IRS dealt with this question in the context of [Rev Rul 99-7, 1999-5 CB 361](#) , which provides a 1-year rule for determining whether transportation between an employee's home and a work location is "temporary" and therefore deductible. The 1-year rule in [Rev Rul 99-7](#) is very similar to the 1-year temporary away-from-home rule in [Rev Rul 93-86](#) . The CCA said that while there's no general guidance on when a break is significant, a break of three weeks or less isn't significant and won't "stop the clock" in applying the one-year temporary workplace limit. By contrast, a continuous break of at least seven months would be significant. Thus, two offsite work assignments separated by a 7-month continuous break would be treated as two separate periods of employment for purposes of the 1-year temporary workplace limit. The CCA said that this would be the case "regardless of the nature of the employee's work activities or the nature of the break, and regardless of whether the subsequent employment at the work location was anticipated."

Illustration 2: On Jan. 1, Year 1, employee Jack Blue is told he will work at Client DEF's office for eight months (Jan. 1-Aug. 31), then work exclusively at Client GHI's office for three weeks (Sept. 1-Sept. 21), and then work again at DEF's office for four months (Sept. 22-Jan. 22). Because the three-week break in service at DEF's office is inconsequential, on Jan. 1, Year 1, there's a realistic expectation that Blue will be employed at DEF's office for a period exceeding 1 year (Jan. 1, Year 1 through Jan. 22, Year 2). As a result, his employment at DEF's office is not temporary. ([Chief Counsel Advice 200026025](#) , Ex. 1)

Illustration 3: The facts are the same as in the previous illustration, except that the interim assignment at Client GHI's office will last for 7 months (Sept. 1, Year 1-Mar. 31, Year 2), followed by a four-month reassignment to DEF's office (Apr. 1, Year 2-July 31, Year 2). Here, Blue's employment at DEF's office is treated as temporary for each of the two periods he's there. This result wouldn't change even if Blue had spent some of the interim 7-month period on vacation or at training rather than working at GHI's office. ([Chief Counsel Advice 200026025](#) , Ex. 2)

 **RIA observation:** Although IRS doesn't say so, its "break in service" guidance for purposes of the 1-year temporary workplace rule also should apply for purposes of the 1-year away from home rule for business travel. Thus, in the last illustration, if Client DEF was located out of town, Blue could be reimbursed tax-free not only for his round-trip travel costs, but also for his lodging and meal expenses while on the out-of-town assignments.