

APPLICABILITY OF NEW 2012 PROPOSED REGULATIONS ALLOWING DEDUCTIONS FOR LOCAL TRAVEL EXPENSES TO THE ACADEMY

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ABSTRACT

In April, 2012, the U. S Treasury Department proposed regulations reversing a long-held position that lodging expenses incurred in the general area of the taxpayer's tax home are never deductible. Generally, when an employer pays, or reimburses, local lodging expenses, the value of the lodging must be included in taxable compensation; but if the expenses are deductible under the temporary regulations, the value is not compensation. This change might frequently apply in an academic environment, and in fact, provide new flexibility for administrators who want to hold local retreats, workshops, fund raisers, and other events involving overnight stays by employees.

INTRODUCTION

There are many instances when it seems appropriate for a taxpayer to deduct local transportation as a trade or business expense. Even when the expense would appear to be ordinary and necessary, the IRS position was that there was no exception. How could this be? The employee typically has a regular residence, the costs of which are disallowed as personal expenses. Why not allow a deduction for ordinary and necessary duplicate expenses? IRS has disallowed the deduction for temporary living expenses for an employee new to an area, but that is not applicable here [2, § 1.262-1(b)(5)]. IRS relaxed the prohibition of deducting the duplicate expenses in 2007 in Notice 2007-47 [3]. This notice was superseded by Proposed Regulation 1.162-31 [2], which is effective for current tax returns and any returns for which the statute of limitations has not expired (generally three years).

PRIOR LAW

The disallowance of local travel deductions is based on the application of Internal Revenue Code (IRC) § 262 [1] that states that there is no deduction for personal, family, and living expenses. By extension, local lodging is personal in nature. Lodging outside the general area of the tax home is deductible if the taxpayer is in travel status. Travel status generally requires that one be away from home overnight.

If an employee travels and the expense is reimbursed, the reimbursement is income and the expense is a miscellaneous itemized deduction, unless the employee accounts to the employer. Under Regulation § 1.62-2 [2], an employee has accounted to her employer if she provided adequate records, including receipts for larger items and lodging. However, if the employer utilizes a per diem program,

reimbursements under the per diem are deemed “accounted for” as long as the amounts do not exceed IRS maximums.

THE PROPOSED REGULATIONS

The proposed regulations provide for deductibility of local lodging expenses if incurred as an ordinary and necessary trade or business expense. This is a facts and circumstances test, meaning that all facts and circumstances must be considered. Essentially, there must be a business purpose for staying at or near an event. Distance to the person’s residence is not alone sufficient. The requirement is met if the taxpayer’s employer requires, in a bona fide way, that the employee incur the expense.

The proposed regulations also include a very restrictive safe harbor. To qualify for the safe harbor, the stay can last no longer than five days and stays can occur only once each quarter. This comfort will not be available in many instances, requiring taxpayer’s to employ the facts and circumstances test.

APPLICABILITY IN ACADEMIC SETTING

Although an academician may separately own and operate a small business, she is generally an employee of an academic institution. Like employees of other employers, there may be instances where work related activities justify incurring lodging expenses within the general area of the tax home. The same criteria as those addressed above apply in determining whether the expenses qualify favorable tax treatment.

If the expense qualifies and is paid by the employee, it is deductible, but unfortunately, classified as a miscellaneous itemized deduction. These deductions are subject to a two percent of AGI floor, being deductible only to the extent that the total of such expenses exceed two percent of AGI.

If an otherwise nondeductible expense is paid directly or reimbursed by an employer, it is compensation to the employee, and as such reportable on Form W-2. This was the treatment of qualifying local lodging under prior law. Now, under Proposed Regulation 1.162-31 [2], the lodging is not compensation.

Not only does this make incurring local lodging expenses more practical, but it makes tax compliance more likely. For example, payroll functions of massive, decentralized universities may not be set up to routinely pick up these amounts as compensation. Complex, expensive systems might be required to report the income. Additionally, an employee may now find it more acceptable to attend a local event, or schedule an event locally, as opposed to an out-of-town event than she would have attended before.

All of this discussion assumes that employees understand, or should understand, these rules before planning events. As described above, the nuances can be quite complex, so the changes make effective decision making and compliance more likely.

EXAMPLES

Department Retreat

The Department of Confusion occasionally holds a faculty retreat to discuss vision and strategy matters, or significant curricular issues. In the past, the department chair made it clear that participation was

expected, and the events were held out of town. Had they been held locally, the value of lodging, but not meals, would have been taxable compensation, and the university's payroll administrators were obligated to handle the situation. Proposed Regulation 1.162-31 [2] provides that in this situation, where participation is required, the employee would be entitled to a deduction for local lodging if he or she paid for it. As a result, if the expense is paid directly or reimbursed by the university, the academic employee does not have reportable income.

Local Conferences and Continuing Education

The national conference of Confusion USA was held locally in Resort City, Texas. Like many conferences, there was a scheduled reception and dinner for conferees on Friday night and a continental breakfast on Saturday morning. Academic papers and presentations were scheduled for most of Friday afternoon and Saturday, as well as a placement center. Due to the fact that other attendees were staying at the venue, and that recruiting occurred at odd hours, the department chair recommended that registered locals stay there too.

Proposed Regulation 1.162-31 [2] provides that in this situation, similar to the previous one, that the employee would be entitled to a deduction for local lodging if she paid for it. As a result, if the expense is paid directly or reimbursed by the university, the academic employee does not have reportable income.

Fund Raising and Alumni Activities

A department chair at Conscious University is under recent extreme pressure to expand alumni and donor outreach, and increase fund raising. Her department has decided to sponsor a two-day activity associated with university sporting events. The chair and other staff will be on site late the first day and early the second to manage evolving issues. As a result, the chair authorized reimbursement of local lodging expenses. Under the new rules, the reimbursement is not taxable compensation.

CONCLUSIONS

Academicians are under changing pressure in many ways. Research, learning outcomes, fundraising, and other expectations seem to increase. Some of these activities are accomplished, at least in part, through professional interaction, and Proposed Regulation § 1.162-31 [2] makes this interaction more feasible near campus. Compliance for employers and employees will be easier. Events that were once held elsewhere are just as likely to be held locally. And although not without complication, the rules are somewhat simpler.

APPENDIX—THE PROPOSED REGULATION

§ 1.162-31 Expenses paid or incurred for lodging when not traveling away from home.

(a) *In general.* Expenses paid or incurred for lodging when not traveling away from home (local lodging) generally are personal, living, or family expenses that are nondeductible under section 262(a). Under certain circumstances, however, expenses for local lodging may be deductible under section 162(a) as ordinary and necessary expenses paid or incurred in connection with carrying on a taxpayer's trade or business, including a trade or business as an employee. Whether local lodging expenses are paid

or incurred in carrying on a taxpayer's trade or business is determined under all the facts and circumstances. One factor is whether the taxpayer incurs the expense because of a *bona fide* condition or requirement of employment imposed by the taxpayer's employer. Expenses paid or incurred for local lodging that is lavish or extravagant under the circumstances or that primarily provides an individual with a social or personal benefit are not incurred in carrying on a taxpayer's trade or business.

(b) *Safe harbor for local lodging at business meetings and conferences.* An individual's expenses for local lodging will be treated as ordinary and necessary business expenses if—

- (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, the employee's employer requires the employee 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.

(c) *Examples.* The provisions of this section are illustrated by the following examples.

In each example the employer and the employees meet all other requirements (such as substantiation) for deductibility of the expense and for exclusion from income as a working condition fringe or payment under an accountable plan.

Example 1. (i) Employer conducts training for its employees at a hotel near Employer's main office. The training is directly connected with Employer's trade or business. Some employees attending the training are traveling away from home and some employees are not traveling away from home. Employer requires all employees attending the training to remain at the hotel overnight for the *bona fide* purpose of facilitating the training. Employer pays the costs of the lodging at the hotel directly to the hotel and does not treat the value as compensation to the employees.

(ii) Employer has a noncompensatory business purpose for paying the lodging expenses.

Employer is not paying the expenses primarily to provide a social or personal benefit to the employees. If the employees who are not traveling away from home had paid for their own lodging, the expenses would have been deductible under section 162(a) as ordinary and necessary business expenses of the employees. Therefore, the value of the lodging is excluded from the employees' income as a working condition fringe under section 132(a) and (d).

(iii) Employer may deduct the lodging expenses, including lodging for employees who are not traveling away from home, as ordinary and necessary business expenses under section 162(a).

Example 2. (i) The facts are the same as in *Example 1*, except that the employees pay the cost of their lodging at the hotel directly to the hotel, Employer reimburses the employees for the cost of the lodging, and Employer does not treat the reimbursement as compensation to the employees.

(ii) Employer is reimbursing the lodging expenses for a noncompensatory business purpose and not primarily to provide a social or personal benefit to the employees. The employees incur the expenses in performing services for the employer. If Employer had not reimbursed the employees who are not traveling away from home for the cost of the lodging, the expenses would have been deductible under section 162(a) as ordinary and necessary business expenses of the employees. Therefore, the reimbursements to the employees are made under an accountable plan and are excluded from the employees' gross income.

(iii) Employer may deduct the lodging expense reimbursements, including reimbursements for

employees who are not traveling away from home, as ordinary and necessary business expenses under section 162(a).

Example 3. (i) Employer is a professional sports team. Employer requires its employees (players and coaches) to stay at a local hotel the night before a home game to conduct last minute training and ensure the physical preparedness of the players. Employer pays the lodging expenses directly to the hotel and does not treat the value as compensation to the employees.

(ii) Employer has a noncompensatory business purpose for paying the lodging expenses.

Employer is not paying the lodging expenses primarily to provide a social or personal benefit to the employees. If the employees had paid for their own lodging, the expenses would have been deductible by the employees under section 162(a) as ordinary and necessary business expenses. Therefore, the value of the lodging is excluded from the employees' income as a working condition fringe.

(iii) Employer may deduct the expenses for lodging the players and coaches at the hotel as ordinary and necessary business expenses under section 162(a).

Example 4. (i) Employer hires Employee, who currently resides 500 miles from Employer's business premises. Employer pays for temporary lodging for Employee near Employer's business premises while Employee searches for a residence.

(ii) Employer is paying the temporary lodging expense primarily to provide a personal benefit to Employee by providing housing while Employee searches for a residence.

Employer incurs the expense only as additional compensation and not for a noncompensatory business purpose. If Employee paid the temporary lodging expense, the expense would not be an ordinary and necessary employee business expense under section 162(a) because the lodging primarily provides a personal benefit to Employee. Therefore, the value of the lodging is includible in Employee's gross income as additional compensation.

(iii) Employer may deduct the lodging expenses as ordinary and necessary business expenses under section 162(a) and §1.162-25T.

Example 5. (i) Employee normally travels two hours each way between her home and her office. Employee is working on a project that requires Employee to work late hours. In order to maximize Employee's availability to work on the project, Employer provides Employee with lodging at a hotel near the office.

(ii) Employer is paying the temporary lodging expense primarily to provide a personal benefit to Employee by relieving her of the daily commute to her residence. Employer incurs the expense only as additional compensation and not for a noncompensatory business purpose. If Employee paid the temporary lodging expense, the expense would not be an ordinary and necessary business expense under section 162(a) because the lodging primarily provides a personal benefit to Employee. Therefore, the value of the lodging is includible in Employee's gross income as additional compensation.

(iii) Employer may deduct the lodging expenses as ordinary and necessary business expenses under section 162(a) and §1.162-25T.

Example 6. (i) Employer requires an employee to be "on duty" each night to respond quickly to emergencies that may occur outside of normal working hours. Employees who work daytime hours each serve a "duty shift" once each month in addition to their normal work schedule. Emergencies that require the duty shift employee to respond occur regularly. Employer has no sleeping facilities on its business premises and pays for a hotel room nearby where the duty shift employee stays until called to respond to an emergency.

(ii) Employer has a noncompensatory business purpose for paying the lodging expenses.

Employer is not providing the lodging to duty shift employees primarily to provide a social or personal benefit to the employees. If the employees had paid for their lodging, the expenses would have been deductible by the employees under section 162(a) as ordinary and necessary business expenses. Therefore, the value of the lodging is excluded from the employees' income as a working condition fringe.

(iii) Employer may deduct the lodging expenses as ordinary and necessary business expenses under section 162(a).

(d) *Effective/applicability date.* This section applies to expenses paid or incurred on or after the date these regulations are published as final regulations in the **Federal Register**. However, until these proposed regulations are published as final regulations in the **Federal Register**, taxpayers may apply the proposed regulations to local lodging expenses that are paid or incurred in taxable years for which the period of limitation on credit or refund under section 6511 has not expired.

Par. 3. In §1.262-1, paragraph (b)(5) is amended to read as follows:

§1.262-1 Personal, living, and family expenses.

* * * * *

(b) * * *

(5) Expenses incurred in traveling away from home (which include transportation expenses, meals, and lodging) and any other transportation expenses are not deductible unless they qualify as expenses deductible under section 162 (relating to trade or business expenses), section 170 (relating to charitable contributions), section 212 (relating to expenses for production of income), section 213 (relating to medical expenses), or section 217 (relating to moving expenses), and the regulations under those sections. The taxpayer's costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible expenses. For expenses paid or incurred before the date these regulations are published as final regulations in the **Federal Register**, a taxpayer's expenses for lodging when not traveling away from home (local lodging) are nondeductible personal expenses. For expenses paid or incurred on or after the date these regulations are published as final regulations in the **Federal Register**, a taxpayer's expenses for local lodging are personal expenses and are not deductible unless they qualify as deductible expenses under section 162. However, until these regulations are published as final regulations in the **Federal Register**, taxpayers may deduct local lodging expenses that qualify under section 162 and are paid or incurred in taxable years for which the period of limitation on credit or refund under section 6511 has not expired. Except as permitted under section 162 or 212, the costs of a taxpayer's meals not incurred in traveling away from home are nondeductible personal expenses.

REFERENCES

[1] Internal Revenue Code of 1986, Title 26, Unites States Code: § 262.

[2] U. S. Treasury Regulations: § 1.62-2, § 1.162-31, § 1.262-1(b)(5).

[3] IRS Notice 2007-47, IRB 2007-24, June 11, 2007.