Travel Expense - Background Information

This paper discusses the treatment of the following expense items:

- Housing per diem payments
- Meals and incidental per diem payments
- Company-paid housing
- Mileage to reach the temporary work location

These items shall be referred to collectively as "Travel Expenses".

Qualifying for Tax-Free Treatment of Travel Expenses

In order to be treated as non-taxable compensation to the employee, Travel Expenses must be

- Reasonable and necessary
- Incurred in pursuit of a trade or business
- Incurred while temporarily away from home

The first two conditions are fairly simple to understand. To be considered reasonable, expenses should not exceed the amount of the actual expenses incurred or the expenses that are anticipated. Expenses must be necessary and not simply incurred frivolously. Working as an employee is considered pursuing a trade.

Note that the word "incurred" is included in two of the above conditions. This means that the employee must have actually **expended** funds related to their travel. For example, if an employee decides to commute a long distance rather than stay overnight, then they have not incurred lodging expenses and would not be eligible for the lodging per diem.

Temporarily Away From Home

The condition that Travel Expenses must be incurred temporarily while away from home is much more complex and requires significant analysis into the meaning of the terms "temporarily", "away from home", and "home". For purposes of the treatment of Travel Expenses, these three terms translate into the following practical application:

- Home - the employee must have a permanent tax home.

- Away from home - the assignment must not be within commuting distance of the permanent tax home.

- Temporarily - the assignment including extensions may not extend beyond one year.

Permanent Tax Home

Generally, a taxpayer's "tax home" is the city or location of their principal place of business and NOT where their personal residence is located.

There are three main factors to consider when determining whether the employee has a permanent tax home:

1. Does the employee perform a portion of their business or work in the vicinity of their permanent tax home?

2. Is the employee duplicating living expenses (mortgage, rent, utilities, etc.) to maintain the permanent tax home while away from home on assignment?

3. Does the employee meet one or more of the following criteria regarding their permanent tax home?

    a. Has a member of their family (spouse, child, or parent) residing with them in their permanent tax home.

    b. Uses the permanent tax home frequently for lodging.

    c. The permanent tax home represents a historical place of lodging (In the vicinity of where they grew up/went to college, or has recent and long- term ties to the community.)

If the employee answers Yes to all three questions, then they have a permanent tax home.

If the employee answers No to two or three of the questions, then they do not have a permanent tax home.

If the employee answers Yes to two of the questions, then the following potential "facts and circumstances" attributes must be reviewed to make a determination.

- Is the tax home address the address of record and the address used on income tax returns?
- Does the employee have telephone services at the tax home or is it their primary mailing address?
- Is the employee's auto license plates and driver's license registered in the tax home city?
- Is the tax home the address of record for the employee's professional license?
- Is the employee registered to vote (and actually votes) at their tax home precinct?
- Does the employee have church, club, or other associations in their tax home vicinity?

All questions do not necessarily require a Yes answer to secure a favorable result, but certainly the majority should have a Yes response, and the first four questions are of greatest importance.

Because the determination of the permanent tax home status is sensitive to the facts and circumstances of the employee and can be highly subjective, the employee (in consultation with their tax advisor) must make the final determination. MedPro requires that the employee complete and execute a Permanent Tax Home & Travel Expense Representation Form.

Away from Home

Practically, there is no IRS rule that states what distance constitutes "away from home". What is clear though is that if an employee is working an assignment within typical commuting distance from their permanent tax home, then any Travel Expenses paid must be treated as taxable compensation.

Commuting is generally referred to as within the employee's metropolitan area or broader rural geographic area. It is generally the common practice, reasonable daily commute for the area. An undocumented, one way commuting rule of thumb might be as long as 50 miles or two hours in an urban or suburban area and 100 miles or 1.5 hours for a rural area.

Further, to be considered "away from home", the employee must be away from home for substantially longer than an ordinary day's work.

Temporarily (Away from Home)

Temporarily is determined to be one year or less, based on realistic expectations at the outset of the assignment. The reason for the one-year rule, with respect to employment away from home in a single location, is that at the one-year point the employee could reasonably have been expected to move their residence to the location of the job site.

Therefore, employees are not treated as "temporarily away from home" during any period of employment that exceeds one year. Further, the IRS specifies that an assignment is no longer temporary once the employee reasonably believes that they will be at the work location for more than a year.

Practical application of this rule is as follows:

- 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 will be treated as temporary.
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- If employment away from home in a single location is realistically expected to last for more than one year, or there is no realistic expectation that the employment will last for one year or less, the employment will be treated as indefinite (NOT temporary), regardless of whether it actually exceeds one year.

- 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 is realistically expected to exceed one year, that employment will be treated as temporary until the date that the employee's realistic expectation changes. Travel Expenses paid after the change are taxable to the employee.

In order to avoid taxation of reimbursements for Travel Expenses, many employers manage their employees' assignments so that there is a break in service or a change in work location before the one-year mark is met in a particular location. It is unclear how long a break in service would be necessary before a worker could return to the former work location: the IRS has specifically ruled that a break of three weeks away from the current assignment work location is too short to re-start the one year clock, while a break of seven months is long enough. Unfortunately, there is no guidance for break lengths between these two extremes.

Practically, a break in assignment of 13 weeks or more should be adequate to restart the counting for the one year limitation. The break may be for pleasure or another assignment or both as long as it is in a different location outside of typical commuting distance from the current assignment and the current temporary housing. In addition, there must be no written or oral understanding of returning to the assignment or assignment area during this break period; otherwise the assignment break will not start the counting over.