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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-137589-07]

RIN 1545-BH60

Local Lodging Expenses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the deductibility of expenses for lodging when not traveling away from home (local lodging). The regulations affect taxpayers who pay or incur expenses for local lodging.

DATES: Comments or a request for a public hearing must be received by **INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER**.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-137589-07), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-137589-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-137589-07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, R.

Matthew Kelley, (202) 622-7900; concerning submission of comments or a request for a hearing, Funmi Taylor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 relating to the deduction of local lodging expenses.

Section 1.262-1 of the Income Tax Regulations generally disallows a deduction for local lodging expenses. The proposed regulations allow taxpayers to deduct local lodging expenses as ordinary and necessary business expenses in appropriate circumstances.

Business Expenses Generally

Section 162(a) of the Internal Revenue Code (Code) allows a deduction for all of the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Whether an expense is ordinary and necessary is a question of fact. In general, a trade or business expense is ordinary if it is normal, usual, or customary in the taxpayer's type of business. An expense is necessary if it is appropriate and helpful for the development of the taxpayer's business. See *Commissioner v. Heininger*, 320 U.S. 467, 475 (1943). An expense that serves primarily to furnish the taxpayer with a social or personal benefit, and is only secondarily related to business, is not a necessary business expense under section 162(a).

Employee Expenses

An expense that an employee must bear as a condition of employment may be a deductible employee business expense. See *Sibla v. Commissioner*, 611 F.2d 1260

(9th Cir. 1980), acq. (1985-2 CB viii) (contributions to firemen's mess required as a condition of employment are deductible business expenses). However, expenses that primarily are for the employee's personal benefit or convenience are not deductible employee business expenses. See *Commissioner v. Flowers*, 326 U.S. 465 (1946) (a taxpayer's expenses for lodging near his principal work location, to avoid a long commute to and from his primary residence, were nondeductible personal expenses incurred solely because of the taxpayer's decision to maintain his primary residence far from his work location).

Deductible Employee Expenses

The tax consequences to an employee who is reimbursed by an employer for an expense, or who receives property or services resulting from an employer's payment of an expense, depend on whether the expense is one that would have been deductible if paid directly by the employee.

For example, if an employee pays an expense and an employer reimburses the employee under a reimbursement or other expense allowance arrangement, the reimbursement is not includible in the employee's income if it is made under an accountable plan. A reimbursement is treated as made under an accountable plan only if it is made for an expense that would be deductible by the employee under sections 161 through 199. See sections 62(a)(2)(A) and 62(c).

Similarly, if an employer provides property or services to an employee in the course of business, the value of the benefit to the employee is excludable from the employee's income if the benefit constitutes a working condition fringe under section 132(a)(3). A working condition fringe is defined as property or services provided to an

employee to the extent that, if the employee paid for the property or services, the payment would be allowable as a deduction to the employee under section 162 or 167.

Nondeductible Personal Expenses

Section 262(a) provides that, except as otherwise provided in Chapter 1 of the Code, no deduction is allowed for personal, living, or family expenses.

Section 1.262-1(b)(5) provides, as examples of personal, living, and family expenses, that the costs of a taxpayer's meals incurred when not traveling away from home (local meals) are generally nondeductible personal expenses. Local meal expenses may be deducted, however, if they otherwise qualify as ordinary and necessary business expenses under section 162 or as expenses for the production of income under section 212. In contrast, lodging expenses incurred when not traveling away from home (local lodging) are nondeductible personal expenses. Thus, local lodging expenses that would otherwise qualify as trade or business expenses under section 162 or as production of income expenses under section 212 are not deductible under the current general rule.

Local Lodging Expenses

The cost of local lodging that a taxpayer pays or incurs primarily for the taxpayer's convenience or personal benefit is not an ordinary and necessary expense of a business or income-producing activity. Similarly, the cost of local lodging provided to an employee by an employer for the employee's convenience or personal benefit would not be deductible by the employee if the employee paid the cost directly. Therefore, the value of the lodging under those circumstances is not excludible from the gross income of an employee as a working condition fringe under section 132(a)(3), and

reimbursement for the cost of the lodging under those circumstances is not a payment under an accountable plan under §1.62-2(c). Consequently, unless excludible on another basis, the value of the lodging or the amount of reimbursement under those circumstances is includible in the employee's income under section 61 as compensation for services. See §§1.61-21(a)(3), 1.62-2, and 1.132-1.

The cost of local lodging is for the convenience or personal benefit of an employee (or other recipient) if, for example, the lodging is provided to the employee (1) as additional compensation, such as to provide a weekend at a luxury hotel or resort; (2) to enable the employee to avoid a long-distance commute (Commissioner v. Flowers); (3) because the employee is required to work overtime (Coombs v. Commissioner, 608 F.2d 1269, 1273 (9th Cir. 1979)); (4) as housing for a recently relocated employee while the employee searches for permanent housing; or (5) for the employee's indefinite personal use (International Artists, Ltd, v. Commissioner, 55 T.C. 94 (1970)). An employer may deduct the costs the employer incurs in providing the lodging in each of these cases under section 162(a) as compensation for services. See §§1.162-7(a) and 1.162-25T. However, because the primary purpose of the lodging is to provide the employee with a personal benefit, if the employee pays the cost of the lodging directly, the employee may not deduct the expense as an ordinary and necessary business expense under section 162(a). Therefore, a cash reimbursement of the cost is not excludible from the employee's gross income under section 62(c) and the value of the lodging is not excludible from the employee's gross income under section 132(d) as a working condition fringe.

Expenditures for local lodging may qualify as deductible ordinary and necessary

expenses under appropriate circumstances if all other requirements of section 162 are met. For example, an employer may require its employees to stay at a local hotel for the bona fide purpose of facilitating training or team building directly connected with the employer's trade or business. Similarly, a professional sports team may require its employees (players and coaches) to stay at a local hotel the night before a home game to ensure physical preparedness and allow for last minute training. Under these circumstances, the cost of the lodging is primarily for the business purposes of the employer and not to provide a personal benefit to the employees. The cost of the lodging would be deductible by an employee under section 162 if the employee paid the cost directly, and thus the value of the lodging may be excluded from the employee's gross income as a working condition fringe if other requirements are satisfied. Similarly, a payment from the employer reimbursing the employee for the cost of the lodging may be excluded from the employee's gross income as a payment under an accountable plan if all the requirements of an accountable plan are met.

Notice 2007-47 (2007-1 CB 1393) (see §601.601(d)(2) of this chapter) advises taxpayers that the IRS and the Treasury Department intend to amend the treatment of the costs of a taxpayer's local lodging under §1.262-1(b)(5). The notice provides that, pending issuance of additional published guidance, the IRS will not apply §1.262-1(b)(5) to expenses for local lodging of an employee that an employer provides to the employee or requires the employee to obtain, if: (1) the lodging is provided 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

section 162(a).

Explanation of Provisions

These regulations propose to amend the regulations under sections 162 and 262. The proposed regulations under section 162 provide that expenses paid or incurred for local lodging may be deductible as ordinary and necessary expenses of a taxpayer's trade or business, including the trade or business of being an employee. The proposed regulations provide a safe harbor for certain local lodging at a business meeting, conference, or other activity or function. Other local lodging expenses may be deductible as business expenses depending on the facts and circumstances.

The proposed regulations under section 262 provide that a taxpayer's costs incurred for local lodging are personal expenses unless the expenses are deductible under section 162. Comments are specifically requested on whether the section 262 regulations should be amended to provide that local lodging expenses are not personal expenses if they are deductible under section 212.

The proposed regulations also amend the regulations under section 262 to remove references to section 217 that are obsolete. Section 217 was amended by the Revenue Reconciliation Act of 1993, Public Law 103-66 (107 Stat. 417). Under the amendments, lodging when not traveling away from home and meals are not deductible as moving expenses.

Effective/Applicability Date

The regulations are proposed to apply to expenses paid or incurred on or after the date these regulations are published as final regulations in the **Federal Register**. However, until these regulations are published as final regulations in the **Federal**

Register, taxpayers may apply the proposed regulations to expenses paid or incurred in taxable years for which the period of limitation on credit or refund under section 6511 has not expired.

Effect on Other Documents

Notice 2007-47 is obsoleted as of **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Special Analyses

This notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS invite comments on all aspects of the proposed rules. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person who timely submits comments. If a public hearing is

scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is R. Matthew Kelley of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.162-31 is added to read as follows:

§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.

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Steven T. Miller

Deputy Commissioner for Services and Enforcement.

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