

Preventing Tax Problems When Employees Travel

Article Highlights:

- Employer Deduction for Travel Expenses
- How an Employee Treats Travel Expenses
- Employer Accountable Plans
- Lodging When Attending Local Employer Events
- Tax Home
- Temporary Work Location

Sending employees on business trips is essential for countless companies and can result in tax headaches for both the employer and the employee if the tax regulations are not adhered to. If the rules are followed, the cost of the employee's travel will be fully deductible to the employer, with the exception of meals, which are only 50% deductible, and tax-free reimbursement to the employee. In addition, the reimbursement is not subject to FICA or payroll withholding.

On the other hand, if the rules are not followed, the expenses are still deductible by the employer, but the reimbursement must be added to the employee's taxable wages, subject to both FICA and payroll withholding.

An employer is able to deduct ordinary and necessary business expenses, including an employee's job-related travel and lodging expenses that are not lavish or extravagant, and under the rules of working condition fringe benefits, any such item that is deductible by the employer is not includible in the employee's salary. In addition, an advance or reimbursement made to an employee under an "accountable plan," which requires the employee to adequately account for the expenses and return any excess advances, is deductible by the employer and not subject to FICA or income tax withholding.

Reimbursements not made under an accountable plan are fully taxable to the employee, and the only way for the employee to deduct the expenses is as a miscellaneous itemized deduction on his or her 1040. To do that, the employee must itemize his or her deductions on Schedule A, as opposed to taking the standard deduction. The employee business expense category on Schedule A is subject to a 2% of AGI nondeductible threshold, and this frequently results in the employee not being able to deduct any or only a portion of the expenses.

With the exception noted below, to deduct the cost of lodging and meals, the taxpayer must be away from home overnight. Any trip that is of such a length as to require sleep or rest to enable the taxpayer to continue working is considered "overnight."

Under an exception to the away-from-home rule, the cost of local lodging is deductible if 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 and the duration does not exceed five calendar days and does not recur more frequently than once per calendar quarter. For an employee, the employer must require the employee to remain at the activity or function overnight, the lodging must not be lavish or extravagant, and there can be no significant element of personal pleasure, recreation, or benefit.

A taxpayer's home, for purposes of determining if he or she is away from home and can deduct lodging and meals, is generally where the taxpayer normally lives and works, although that fact is sometimes difficult to determine, in which case the IRS has numerous special rules that apply.

Where an away-from-home assignment, at a single location, lasts for one year or less, it is "temporary," and the travel expenses are deductible. If the assignment is longer, there is a good chance the expenses will not be deductible based upon some complex rules.

The rules for the tax treatment of travel expenses and temporary away-from-home assignments can be complex. Please give this office a call for further details or assistance.