Where, Oh Where, Did My Tax Home Go?

Employers routinely send employees to other cities (or countries) on assignment. Business travel is often easily classified as “temporary travel” and employers can reimburse employees for travel costs tax free. As this article discusses, when an employee is sent on a longer-term assignment or from assignment to assignment without coming back to the “home” office, or has an assignment extended, companies may not realize that reimbursement of the travel costs could be taxable compensation.

Section 162(a)(2) allows an employee or independent contractor to deduct temporary travel expenses while away from home. Employers can reimburse employees for the cost of temporary travel while away from home and can generally exclude the reimbursement from compensation income if the employee properly substantiates the expenses. The problem is that “home” as used in this section does not necessarily have the meaning typical to the word. This article reviews the “tax home” definition as used by the IRS and the various permutations of being “away from home” for business travel.

If an employee is travelling on business, but is not “away from home” under these rules, the travel expenses may be personal expenses that are not deductible by the employee, and thus not excludable if reimbursed by the employer. If the employer does not realize that the employee’s tax home is elsewhere or has changed and does not properly report and withhold compensation on the longer-term travel costs, the employer can have significant payroll exposure.

With any temporary assignment to another city, the employer and employee may also have unexpected withholding and taxation in the state of assignment. Although important, this state taxation while on temporary travel is not the focus of this article.
Definition of a “Tax Home”

In the Flowers case, a taxpayer who established his residence in Jackson, Mississippi, was employed by a railroad headquarterd in Mobile, Alabama. The taxpayer declined to move to Mobile and instead set up an office in Jackson, making the trip to Mobile 60 and 168 days respectively in two separate years. The IRS disallowed the taxpayer’s deduction for travel expenses, asserting that his home for tax purposes was Mobile and that he could not deduct expenses for living at a distance from work for his own convenience. The Supreme Court held that a deductible travel expense must be “reasonable and necessary,” incurred while “away from home,” and “in pursuit of business.” The Supreme Court declined to define “home” as it is found in section 162(a)(2), but rather stated that the travel was not taken on behalf of the business as the railroad did not require the taxpayer to travel to and from Jackson.

The IRS addressed the definition of a tax home in Revenue Ruling 60-189. The IRS noted that as in Commissioner v. Flowers, one’s “home” for the purpose of section 162(a)(2) is in the vicinity of one’s work or post of duty. In the revenue ruling, the IRS suggests that if a taxpayer chooses to live a great distance away for personal reasons, that finding was enough to support the holding that the travel between the personal residence and the place of business was not business related.

Subsequent case law, later revenue rulings, and other guidance have largely supported this view. The IRS has litigated this position, often successfully, for decades.

In an IRS examination, the IRS’s general position is that an employee who does not relocate soon after the employee is hired to work at a place of business (that is far from the employee’s residence) may not generally deduct travel expenses resulting from travel to the new place of business. Likewise, an employer reimbursing for such travel, meals, and lodging costs must include the reimbursed costs in the employee’s taxable compensation.
In *Hantzis v. Commissioner*, the First Circuit Court of Appeals held that a law student who maintained a home in Boston could not deduct expenses of travelling to New York City for a summer spent working at a firm in New York City. The court held that New York, as the place where the law student earned her income, was her tax home, and she had no business reason to maintain an abode in Boston while employed in New York.

**No Tax Home**

If the employee is hired or transferred to a distant city for an “indefinite” assignment, even with the same employer, the tax home likely switches to the new place of business soon after the date of hire. As a corollary, an employer and employee generally cannot generally treat the first year of that indefinite assignment in a different location as “temporary” travel during which the employer can provide tax-free housing.

As a further complication, for employees who do not have a regular place of business and move from area to area for their job, Revenue Ruling 73-529 details the standards for when an individual is an itinerant and thus does not have a tax home. One cannot be “away from home” under section 162(a)(2), if one has no tax home. If a taxpayer is an itinerant, he or she is unable to take the travel expenses deduction. If the employer pays for travel for a person who is itinerant, the amount paid for travel is taxable compensation.

**Tax Home When There is More than One Place of Work**

This rule is based on old cases and revenue rulings. The IRS allows taxpayers and their advisors to rely on the old revenue rules, but cautions that in most of the fact patterns before the IRS, the facts do not support the use of the revenue rulings. We have found that some fact patterns fit within the revenue rulings, but have also seen many that do not.

According to Revenue Ruling 55-604, when a taxpayer has two separate posts of duty, each required by real business necessity, the expenses incurred at the lesser post of duty are deductible (and thus excludable if paid by the employer). This is true even when the taxpayer maintains his or her family and permanent residence at the lesser post of duty (although in that case the ruling limits the deduction that may be taken only to “that

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3 638 F.2d 248, 249 (1st Cir. 1981).
4 Id. at 254.
portion of the family expenses for meals and lodging which is properly attributable to the taxpayer’s presence there in the actual performance of his duties”.

Revenue Ruling 54-147 provides three factors for use in evaluating which of two posts of duty is the lesser post: the amount of time spent at each post, the amount of business actually conducted at each post, and the income generated at each location. None of these alone is determinative; however, revenue rulings focus on the active business need for the employee to work in each location regularly.

Courts have applied this three-factor test as well, for example in Romer v. Commissioner, the taxpayer maintained a residence in Nashville, Tennessee, where he was employed as an airline pilot. He also maintained aviation activities and an accounting business in Minneapolis, Minnesota. The court determined that, as the majority of his income was produced in Minneapolis and he spent less than half of his time in Nashville, the taxpayer’s tax home was Minneapolis.

**Example 1**

Employee A is Regional Manager of Company X and is expected to regularly work full time most days in Atlanta, where he also maintains his personal residence. Employee A also has separate specific duties in Company X’s main headquarters, in Miami that require his presence on a fairly regular basis. Employee A travels to Miami every second month for a period of one week to meet with his Company B employees, report to his own management, and work with other headquarters employees on long-term planning. Employee A properly substantiates and is reimbursed for travel, lodging, and meal expenses when in Miami.

From the facts, Employee A has two regular posts of duty and thus is covered under Revenue Ruling 54-147. Employee A spends the majority of his time in and conducts most of his business at his post of duty in Atlanta. As such, Atlanta is his tax home, and the reimbursed cost of his travel to his secondary place of business, Miami (if traveling for business purposes) can likely be excluded from his taxable compensation.

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5 T.C. Memo 2001-68, 1-2.
The key to having two posts of duty is to have clear requirements and business needs for the employee to work in two places that are distant enough to require overnight travel. Merely setting up a “home office” in the employee’s house, or in a touch-down office in the employee’s home town does not typically rise to the level of a second post of duty. However, if an employee has a clear, regular job in one town but is also being sent to set up and eventually run a new office, including hiring employees, finding clients, etc., and all parties understand that during the start-up period, which may be over a year, he will have two places with two different revenue streams, it may be possible to argue that he has primary and secondary posts of duty for that time period.

**Transfer of Tax Home**

**Temporary Travel**

This rule is the most typical and is often a straightforward analysis. It often applies to an employee who has a regular office but needs to travel on assignments for a few weeks or a few months, with a clear expectation that the employee will return to the original, “regular” office and continue working in the regular office. Under section 162(a)(2), if the employee accepts a temporary assignment to the other location that is expected to be for less than 12 months the assignment is considered “temporary” and the employer can reimburse the employee’s travel costs without treating the costs as employee income (so long as the expenses are properly substantiated).

In a set of IRS revenue rulings, the IRS dealt with some of the issues that arise in temporary assignments. Under Rev. Ruling 93-86, a taxpayer may deduct expenses (and thus an employer may reimburse on a tax-excluded basis) for maintaining a duplicate home as long as the assignment is temporary and not indefinite. A temporary assignment to a single location is one that is “realistically expected to last (and does in fact last) for a period less than 1 year.” If this expectation changes during the course of the assignment, then the exclusion from income is no longer allowable once the assignment is expected to be for more than one year.
Example 2

Employee usually works in Chicago. He is assigned to an office in Nevada for ten months. After six months, Employee’s assignment is extended for an additional 11 months, and thus is reasonably expected to extend beyond 12 months. Employee’s assignment is no longer temporary as of the date of the extension. Starting with the date of the extension, the employee’s costs for meals, lodging, and travel paid by the employer must be treated as taxable compensation.

Companies often wonder about bringing the employee “home” for a period of time and then sending the employee back to the assignment (or another assignment). Although the IRS has noted that a “brief break” is not enough to make an otherwise indefinite assignment temporary, it has not been helpful in defining a “brief break.” IRS Chief Counsel Advice 200020055 cites Blatnick v. Commissioner, 56 T.C. 1344, 1348 (1971), which states: “Brief interruptions of work at a particular location do not, standing alone, cause employment which would otherwise be indefinite to become temporary.” The CCA states that a break of three weeks is clearly not enough to cause the 12-month clock to start over (the CCA also, unhelpfully, states that a seven-month period working at the home office would be considered enough of a break). Merely allowing the employee to go on vacation is unlikely to satisfy the requirement that the employee go back to work at the “regular” place of employment for an extended period of time. As a practical matter, companies that are aware of these rules appear to typically use a 2-3 month break period during which the employee works in the original office; a few use a 1.5 month break period. Having the employee work at the original “home office” (rather than going on to a new assignment in another city) helps prevent a change in the employee’s tax home status.

Indefinite Assignment

The Mitchell and Wasik cases both provide examples of indefinite assignments. In Mitchell,6 the hospital where the taxpayer worked was closed and his employment was transferred to a hospital some distance away. The taxpayer rented a trailer in the area of his new employment and returned to the home he shared with his wife on the weekends.7 When the IRS disallowed a deduction for his travel, the taxpayer argued that his

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7 Id. at 580.
assignment to the new hospital was only temporary—the court determined that it was not. The taxpayer had already worked at the new hospital for two years before the two years that he took the deduction, and continued to work there after taking the deduction.

Wasik is a similar case of transferred employment. Because of a series of layoffs and the closing of the nearest facility, the taxpayer was offered a job in a separate city in order to maintain his employment with Northwest Airlines. In arguing for a travel deduction, the taxpayer maintained that he hoped to be transferred back to his regular place of employment and his union was bargaining on behalf of his particular class of workers. The court ruled that the deduction was properly disallowed, pointing out that there was no certainty that the taxpayer would ever actually go back to his former post of duty and no business reason to maintain the residence there.

**Sporadic and Infrequent Travel**

In Chief Counsel Advice 200026025, the IRS took up the question of sporadic or infrequent travel.

Under the CCA, an employee has a “regular office but is expected to work in a specific location other than the primary office location for a period spanning more than one year, but does not expect to travel there more than 35 work days during each calendar year, this travel to a specific location does not exceed the 1 year limitation applied to temporary travel because the travel is “sporadic and infrequent.”

**Example 3**

Employee has a regular office in New Jersey, but is assigned to a two-year project that requires travel to Memphis. Employee only travels to Memphis occasionally, for a period totaling six work weeks of each year, and so likely falls within the sporadic and infrequent travel exception to the one-year temporary travel limitation.

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8 Id. at 582.
9 Id.
11 Id. at 2.
12 Id. at 4-5.
Working at Home

All the situations above require the taxpayer to have a tax home (a regular place of business) to which the taxpayer is expected to return.

However, if an employee has no principal place of employment outside the home, the employee may still have a tax home for the purposes of section 162(a)(2). Revenue Ruling 71-247 sets forth the convention that a tax home may be the place of residence for a taxpayer who has no other principal place of employment (does not work in an office outside of the home) and has actual duties that will be performed at home. The revenue ruling supports the home as tax home even if the individual travels to several temporary offices or assignments, so long as the employee is required to return to the employee’s abode in between assignments. As such, expenses related to business trips that require stops for rest away from the home may be deductible under 162(a)(2) (and excluded if reimbursed by the employer).

The question is whether the regular abode is a tax home in the “real and substantial sense.”

Revenue Ruling 99-7 notes that to have the residence as the tax home, the IRS will look to see whether the section 280A rules apply (is there is a portion of the home exclusively set aside for business, and the employee has no other office).

These factors were considered in Henderson v. Commissioner. In Henderson, the taxpayer, a stagehand for a travelling ice show, had substantial connections with Boise, Idaho, where he resided with his parents between tours. The IRS disallowed the deductions the taxpayer attempted to take for travelling expenses, asserting that the taxpayer was an itinerant with no tax home. The court held that the taxpayer had no business reason for returning to Boise—he worked once as a stagehand for a concert, but otherwise was not employed during his time there. Nor did he incur living expenses while there, as his parents paid his expenses, thus not duplicating his living expenses. In light of these two factors, his substantial personal connections to Boise were not enough to make the area his tax home, and the court found he was itinerant.

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13 143 F.3d 497, 498-99 (9th Cir. 1998).

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**Example 4**

Employee M is a travelling sales representative for Company P. His territory includes Portland but extends well beyond the Portland area. He spends several weeks at a time away from his personal residence in Portland. Company P does not provide him with an office in any Company P facility and in fact expects each sales representative to work from the representative’s house, which must be within the assigned sales territory. He has sales clients in Portland and returns to Portland between trips. M does his reports, inventory, training, and bookkeeping for his work for Company P at his house, in a separate room exclusively used for his travelling sales business. Employee M pays to maintain the residence (where his wife and children also reside), while also incurring living expenses on the road. After properly substantiating his expenses for his time on the road, Employee M is reimbursed by Company P.

Employee M’s abode satisfies the criteria for being a “real and substantial” tax home. He is not provided with an office by his employer, has business connections within Portland, does critical parts of his regular business at his home and thus duplicates his living expenses while away from the residence. As such, Employee M is not itinerant, and the travel reimbursements by Company P are excluded from his compensation once properly substantiated.

**Further Rules Regarding Traveling Away From the Tax Home**

**Substantiation**

Tax free reimbursement of expenses incurred while traveling away from the tax home depends upon proper substantiation of these expenses. Proper substantiation is defined by section 274(d) and requires that the substantiation must be made by “adequate records or by sufficient evidence corroborating the taxpayer’s own statement.” These records or evidence must include: the amount of the expense, the time and place of the expense, the business purpose, and if, applicable, the business relationship of the taxpayer to any other individuals for whom the expense was incurred.
Conclusion

The definition of “tax home” as used in section 162(a)(2) is not particularly obvious. In the context of reimbursement for travel expenses, the employer must determine whether the employee has a tax home, has more than one required posts of duty, or the tax home has changed. Failure to keep track of the employee’s tax home can lead to the employer incorrectly treating reimbursements as “tax free” when they should be subject to FICA/Medicare, federal income tax, and W-2 reporting. Under IRS rules, if the employer fails to report and withhold on commuting and other personal expenses that has to be treated as compensation, the IRS is often able to collect the missing withholding from the employer, and the IRS may collect penalties for the failure to properly report income to the employees.