IRS OKs business deductions for certain local lodging costs

The IRS is making it easier to realize tax benefits for temporary local lodging costs.

**Alert:** New proposed regulations allow employees to deduct local lodging expenses that weren’t previously deductible. The costs may be treated as working condition fringe benefits or accountable plan reimbursements by the employer. *(NPRM REG-137589-07)*

The proposed regs include a new “safe-harbor rule” that employers can rely on.

*Here’s the whole story:* Currently, employees may be able to deduct travel expenses while away from home on business, but they generally can’t deduct lodging costs when they stay in the same locality where they work. If the employer reimburses the employee for the local lodging costs, or pays the expenses directly, the employer may deduct the payments as compensation expenses, but the reimbursements or wages count as taxable compensation income to the recipient employee.

In the preamble to the new proposed regs, the IRS notes that sometimes short-term lodging costs are personal in nature. This includes a weekend stay at a luxury hotel provided by the employer, lodging to avoid a long-distance commute; lodging because the employee must work overtime; housing for an employee who recently relocated; and lodging for the employee’s indefinite personal use. In these cases, the expenses can’t be deducted by the employee, although they will continue to be treated as compensation if the cost is paid by the employer.

Under the new safe harbor rule, an employee may deduct local lodging expenses as long as:

- 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 function.
- The period of lodging does not exceed five calendar days and does not recur more frequently than once per calendar quarter.
- The employer requires the employee to remain at the activity or function overnight.
- The lodging isn’t lavish or extravagant, nor does it provide any significant personal pleasure, recreation or benefit.

Unlike most proposed regulations, you can rely on these right now. Also, you can apply the rules in the new proposed regulations to claim refunds for open tax years.

**Tip:** These new rules may encourage employers to re-evaluate their procedures for handling lodging costs.