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Analysis that matters from Washington National Tax

Tax Home: Rise of the Telecommuters

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When an employee is commuting versus when an employee is taking a business trip seems like a fairly straightforward concept—unfortunately, it is not simple and can involve a complicated analysis that yields few clear answers. The tax treatment for travel expenses differs for commutes and business trips, so employers should consider the issue before reimbursing employees for those expenses.

The tax home rules on which the commute-or-business-trip analysis is based assume that an employee has a regular office to which they report. However, in the evolving landscape of telecommuting and flexible work arrangements, employees increasingly are not expected to report regularly to an office and in many cases encouraged to secure alternative worksites as employers look to downsize office footprints and to further achieve environmental, social, and governance (ESG) goals. As employers offer more flexibility for employees to maintain alternative work arrangements, it is important to understand the implications that the employer's new commuting and travel policies will have on the treatment of any employer reimbursement of business and travel expenses.

Questions abound.... Where is the tax home? Are alternative office expenses reimbursable working condition fringes? When are an employee's expenses for travel from alternative work places to a central worksite considered reimbursable business working condition fringes (which generally are excluded from income and deductible by the employer) versus commuting expenses (which is generally are neither deductible by the employer nor excludible from income by the employee)?

If an employee is working from an alternative worksite (for this purpose, assume it is the employee's principal residence), travel from the principal residence to an office is commuting if the office is considered the employee's principal place of business. The reimbursement of commuting expenses is not a deductible expense of an employer and is not excludible from an employee's income.

On the other hand, if the employee's principal residence is also the employee's principal place of business, then travel to an office may be business travel. The reimbursement of business travel expenses is a deductible expense of an employer and, if provided under an accountable plan, is excludible from an employee's income.

In the context of reimbursement for travel expenses, the employer must determine whether the employee has a tax home, has more than one required post of duty, or has had a change in tax home. Failure to keep track of the employee's tax home can lead to the employer incorrectly treating reimbursements as "non-taxable" working condition fringes when they should be subject to FICA (Social Security/Medicare) tax, federal income tax, and Form W-2 reporting, as well as potential state income tax withholding. 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 often is 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. As a result, employers often bear the greatest risk in the tax home determinations.

Principal Place of Business

The IRS and Tax Court have consistently taken the position that the term "home" as used in section 162¹ refers to the taxpayer's principal place of business. Determining whether an employee's principal residence is also the employee's principal place of business is not a simple analysis. Revenue Ruling 60-189 confirms that an employee's tax home is the employee's principal place of business. Principal place of business is not a well-defined term. There is case law and section 280A (defining principal place of business for the purpose of a home office deduction).

In *Soliman v. Commissioner*,² the Court of Appeals adopted the test used in the Tax Court, under which a home office may qualify as the "principal place of business" if:

- The office is essential to the taxpayer's business,
- The taxpayer spends a substantial amount of time there, and
- There is no other location available for performance of the business' office functions

The following requirements must be met for an employee's principal residence to be considered the employee's principal place of business under section 280A(c)(1):

- The dwelling unit (or portion thereof) is regularly and exclusively used for business purposes such as administrative and management activities

¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

² 113 S. Ct. 701 (1993), *rev'g* 935 F. 2d 52 (4th Cir. 1991), *aff'g* 94 T.C. 20 (1990).

- The exclusive business use is for the convenience of the employer (not for the convenience of the employee)
- There is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business

Additionally, Revenue Ruling 94-24 considers two primary factors in determining whether a home office is the taxpayer's principal place of business:

- The relative importance of the activities performed at each business location
- The amount of time spent at each location

Though there is no completely objective test, it is important to balance the degree to which employees work from home and their duties at other locations, as well as the importance assigned to the duties performed from home and duties at other locations. In cases preceding *Soliman*, many taxpayers supported as personal residence as a tax home by demonstrating that their home office was essential to their business activity. In *Soliman*, the Supreme Court rejected this as a controlling factor as well as rejecting the Court of Appeals reliance on the availability of alternative office space as an additional consideration in determining an individual's principal place of business. While admitting it might be relevant in determining if an employee uses his or her home office for the convenience of his or her employer, the Supreme Court stated that whether other office space is available should not weigh in on whether a home office is the principal place of business.

The tax home rules are based on the notion that an employee has a regular office to which they report. However, in the evolving landscape of telecommuting and flexible work arrangements, employees are increasingly not expected to report to an office. Although there is no completely objective test, it is important to balance the degree to which employees work from home and their duties at other locations, as well as the importance assigned to the duties performed from home and duties at other locations.

As employers offer more flexibility for employees to work from home, it is important to understand the implications to employee's tax home and employer travel policies. Is the taxpayer working long-distance from the office for their own convenience or for the convenience of the employer? Is the home office truly the employee's principal place of business or is the majority of the work or the more important work conducted from the employer's offices?

Convenience of the Employer

In regard to the "convenience of the employer" test, the IRS and the courts historically have taken a rather narrow view. Specifically, an employee must meet an onerous burden to demonstrate that the exclusive and regular use of her "home office" is for the convenience of her employer. The Tax Court has noted that neither the Code nor the regulations provide guidance as to when a home office is considered used for the convenience of the employer.³ However, that court also noted that when an

³ [Hamacher v. Commissioner, 94 T.C. 348, 358 \(1990\)](#).

employee must maintain a home office as a condition of her employment, or when the home office was necessary for the functioning of the employer's business or necessary to allow an employee to perform her duties properly, a home office may meet the requirement that it was used for the convenience of the employer.⁴ Similarly, a nonprecedential Tax Court summary opinion has suggested that if an employer does not maintain or provide office space for employee use, an employee's home office may be used for the convenience of the employer.⁵

On the other hand, a home office cannot be used purely as "a matter of personal convenience, comfort, or economy" of an employee. Courts have frequently noted that if an employer provides a suitable office at a work location that is accessible to the employee, the employee's choice to use her home office rather than the work office will not satisfy the convenience of the employer requirement.

Whether a taxpayer's residence may be considered the taxpayer's principal place of business is not an objective determination, and thus, one must consider all facts and circumstances.

Reimbursed Travel Expenses

When an employee travels on the business of an employer, the employer may reimburse the travel away from home for employees. Daily commuting costs between an employee's residence and place of employment are generally considered to be personal in nature and, therefore, not deductible, under sections 162(a) and 274(l), unless necessary to ensure the safety of the employee. However, the safety concern must be based on a bona fide business-oriented security concern (e.g., geographic location, recent threat, etc.) as opposed to a generalized safety concern. If the employee's tax home/principal place of business is the employee's principal residence, the travel expenses (transportation and meals) incurred by the employee between the employee's residence and the employer's work site on a temporary basis may be deductible by the employer without income inclusion to the employee. To claim the deduction, the reimbursement must meet the requirements of section 162(a)(2) and be:

- Ordinary and necessary
- Incurred in pursuit of a trade or business, and
- Incurred while "away from home"

Daily commuting expenses generally do not qualify as "away from home expenses" under section 162(a)(2). Generally, a taxpayer is generally considered "away from home" for meals expense purposes if a trip requires the taxpayer to stop for sleep or rest.⁶ However, Revenue Ruling 99-7 describes the ability of taxpayers to deduct (and thus employers to reimburse without income inclusion) the daily travel expenses of a taxpayer to a temporary or another work location in the same trade or business, regardless of distance. The revenue ruling provides that, to the extent a taxpayer's residence meets the

⁴ *Id.* at 358-359.

⁵ *See, e.g., Cadwallader v. Commissioner*, 919 F.2d 1273 (1990).

⁶ *See generally United States v. Correll*, 389 U.S. 299, 302-303 (1967) (upholding the IRS's regulations providing for a sleep or rest rules).

principal place of duty requirements of section 280A(c)(1)(A), then travel between the employee's residence and temporary duty locations are deductible (or excludable from income).

Travel away from an employee's tax home must be temporary in order for the expenses incurred to be deductible. Section 162(a)(2) defines being temporarily away from home as away from the tax home on an assignment that is expected to last, and does in fact last, for less than one year. For long term assignments when the employee is only expected to be at a separate location a few work days a year, however, exceptions exist. Generally, an employee who works at a location for less than 35 business days in a year, even over a period of many years, will still be considered temporarily away from home.⁷ However, as stated in CCA 200026025, these are highly individual factual determinations and therefore general guidelines are not available.

The IRS also acknowledged in CCA 200025052 that an absence of guidance existed as to the effect that a break in service at a particular location will have on the determination of whether an employee's employment at that location is temporary. This issue arises when two discrete periods of assignment at a particular location are interrupted by a period of time long enough to suggest that two separate assignments took place, rather than one continuous period of employment. In this case, the IRS indicated that while a break of three weeks or less will not be treated as significant and therefore would not be treated as tolling the one-year limitation, a break of seven months would generally result in treating the two separate work segments as severable assignments, with separate one-year time limits.

Digital nomads are becoming increasingly common as employers allow employees flexible working arrangements and the ability to work from anywhere. When employees have more than one post of duty caused by real business necessity, resulting in a greater and a lesser tax home, the reimbursable expenses incurred at the lesser tax home may be deductible by the employer without income inclusion to the employee.⁸ The determination as to which tax home is the lesser tax home is generally a fact specific analysis that considers the time spent at each location, the degree of business conducted at each location, and the financial return obtained from each location.⁹

Factors Distinguishing Commuting from Business Travel

On one end of the spectrum, for an employee who is required to work at an office location and not permitted to work from home, the expenses for the travel from home to office is a commuting expense the reimbursement of which is not deductible, even if includible in the employee's income. On the other end of the spectrum, for an employee who has no office building to which to report, works daily from a separate area of the home, and only travels to a separate worksite location on an ad-hoc basis for a specific business purposes, the travel is business travel the reimbursement of which may be deductible and excludable from an employee's income.

⁷ IRS Chief Counsel Advice 200026205.

⁸ See Revenue Ruling 54-147 and Revenue Ruling 55-604.

⁹ Revenue Ruling 54-147.

For the increasingly wide varieties of work situations that fall between these two scenarios, various factors need to be weighed to determine whether the employee's principal residence is also the employee's principal place of business, so that the travel to an office location may be treated as business travel. These factors include:

- Is the alternative worksite for the employer's convenience?
- Is the employee allowed, but not required, to come into the employer's office at their option?
- Is the employee required to work from the employer's office on a regular basis (e.g., one day a week) or only on an ad hoc basis?
- Does the employee have a dedicated office space at the employer's office?
- Does the employee live in the same metropolitan area as the employer's office?
- Does the employer have any nexus or business near the employee's residence?

Ultimately, many of the new "hybrid" work arrangements may not result in the employee's residence becoming the employee's principal place of business, at least under the current IRS guidance. For example, if the employee has a designated office space and is asked to be available to come into the office several days a week, even if the employee may not necessarily be requested to come in on a particular day and even if the majority of the employee's time is spent working at home, the arrangement is not likely to change the employee's principal place of business to the employee's principal residence. Therefore, it is necessary to do a thoughtful analysis before committing to reimbursing any particular travel expenses, to the extent the deduction and taxation of those reimbursements are relevant to the decision to provide the reimbursement.

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