



## Tax Reduction Letter

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### Private Letter Ruling 9237014

June 10, 1992

This is in reply to your letter of February 13, 1992, on behalf of X. Your letter requests a ruling with respect to certain travel expenses incurred by employees and reimbursed by X.

X is a corporation engaged in the manufacture, distribution, promotion, and sale of various products. X currently employs approximately 4400 employees in the United States. Under X's current travel reimbursement program employees receive travel allowances and reimbursements to cover the necessary costs incurred by them when traveling away from home in furthering the business activities of X. Current practice provides that when an employee is attending an out-of-town meeting scheduled for a Friday, the employee will return to his home or regular place of business on Friday night or Saturday, depending on the time of the scheduled meeting, its duration, and the distance (or flying time) between the location of the meeting and the employee's regular place of business.

You state that because of the current domestic airfare price structure, [\*2] airfares that do not involve a Saturday night stay away from home are generally much higher than the "excursion" airfare rates that are available to individuals who spend Saturday nights away from home. In order to avail itself of these lower airfares, X proposes to revise its current travel and expense reimbursement program to encourage employees to stay over on Saturday nights when cost effective. The employee will be reimbursed for an additional night's lodging and an additional day's meals in a manner that will conform with the method and amount of reimbursement in effect for the other days of business travel. The location of the one day stay over will be the city where the business meeting or activities took place. The proposed revised policy statement would provide as follows:

When an overall net cost savings to the Company is the result of an employee extending a business trip to utilize lower excursion rate airfares, the employee's supervisor shall have the authority to reimburse the employee for additional expenses incurred due to the extension of the trip. The additional expenses eligible for reimbursement will be limited to the cost of one additional night's lodging, and [\*3] a reasonable allowance for one additional day's meals. It should be noted that cost savings will be measured against the lowest available airfare, for a direct flight, at the time the trip is originally booked. This option is only available if the extension of the business trip is for the convenience of the Company.

Based on the above facts, you have requested the following rulings:

(1) The incremental expenses of an additional night's lodging and an additional day's meals that are incurred in order for the Company to qualify for domestic excursion rate airfares with respect to employees traveling on business trips are deductible business expenses under *section 162(a) of the Internal Revenue Code*.

(2) The Company's reimbursements of these incremental expenses are deductible by the Company as travel and meal expenses (within the limits of *section 274(n) of the Code*).

(3) The Company is not required to report on the employees' Forms W-2 or to withhold or pay employment taxes on the travel expense reimbursements it provides for these incremental expenses that result in an overall net cost savings on the business trip.

*Section 162(a)(2) of the Code* provides for the deduction of all the ordinary [\*4] and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including travel expenses (including amounts expended for meals and lodging other than amounts that are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business.

*Section 1.162-2(a) of the Income Tax Regulations* provides, in part, that only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is solely on business, the reasonable and necessary traveling expenses, including travel fares, meals and lodging, and expenses incident to travel are business expenses.

The phrase in the regulations refers to "reasonable and necessary" as distinguished from the "ordinary and necessary" terminology found in the statute. Ordinary and necessary expenses must be reasonable in amount, have a definite, reasonable purpose connected with the business and be calculated to accomplish the desired end. In *First National Bank of Omaha v. Commissioner*, 276 F. Supp. 905 (D. Neb. 1967), the court stated that to determine whether the expenditures in question [\*5] are ordinary and necessary, the statutory standard tends to follow normal business practice. The words "ordinary and necessary" only become meaningful when viewed through a common sense test such as whether a hardheaded business person would have incurred such expenses under like circumstances.

In *Rev. Rul. 54-497, 1954-2 C.B. 75*, the Service held that when an employee is assigned to a temporary work location, and returns on nonworking days to his family, expenses incurred on such trips for travel between the employee's temporary duty station and his distant residence may be deducted to the extent such expenses do not exceed either (1) the otherwise deductible cost of meals and lodging had he remained at his temporary work location, or (2) the reasonable necessary expenses he would have incurred in traveling between such temporary place of employment and his principal post of duty.

X's revised policy provides for the payment of incremental expenses incurred, for the convenience of the employer, for the employee's one additional night's lodging and an additional day's meals at the temporary business location in order to qualify for the lower domestic excursion rate airfares. X's revised [\*6] policy pays for these incremental expenses only if the sum of the excursion airfare and the expense of the additional meals and lodging is less than the lowest available airfare (not involving a Saturday night stay) at the time the trip is originally booked. These incremental expenses are deductible business expenses under *section 162 of the Code*.

*Section 274(n)(1) of the Code* provides that the amount allowable as a deduction for (A) any expenses for food or beverages, and (B) any item with respect to an activity of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such activity, shall not exceed 80 percent of the amount of such expenses or item that would (but for this paragraph) be allowable as a deduction. X does not treat reimbursements or allowances for travel expenses incurred by its employees as additional compensation. Accordingly, X may deduct under *section 162(a)(2) of the Code*, subject to the limitation provided for in *section 274(n)*, the incremental expenses incurred by its employees under its revised policy.

*Section 62(a) of the Code* provides that "adjusted gross income" means, in the [\*7] case of an individual, gross income minus certain enumerated deductions. *Section 62(a)(2)(A)* includes in those deductions business expenses paid or incurred by an employee under a reimbursement or other expense allowance arrangement with his employer.

*Section 62(c) of the Code* provides that an arrangement shall in no event be treated as a reimbursement or other expense allowance arrangement if the arrangement (1) does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or (2) provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

*Section 1.62-2(c)(1) of the Income Tax Regulations* provides, in part, that the phrase "reimbursement or other expense allowance arrangement" means an arrangement that meets the requirements of business connection, of substantiation and of returning amounts in excess of expenses. If an arrangement meets the above three requirements, then all amounts paid under the arrangement are treated as paid under an "accountable plan".

*Section 1.62-2(d) of the regulations* provides that an arrangement meets the business connection requirement [\*8] if it provides reimbursements, advances, or allowances for business expenses that are allowable as deductions for expenses paid or incurred by an employee in connection with the performance of services as an employee.

*Section 1.62-2(e) of the regulations* provides, in part, that an arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by *section 274(d)* meets the requirements of this paragraph if information sufficient to satisfy the substantiation requirements of *section 274(d)* and the regulations thereunder is submitted to the payor. For example, with respect to travel away from home, *section 1.274-5T(b)(2)* requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor.

Finally, *section 1.62-2(f) of the regulations* provides, in part, that the arrangement must require the employee to return to the payor within a reasonable period of time any amount paid under the arrangement in excess of the expenses substantiated. *Section 7.02 of Rev. Proc. 92-17, 1992-8 I.R.B. 16*, provides that an arrangement providing per diem allowances [\*9] will be treated as satisfying the requirement of *section 1.62-2(f)* if the employee is required to return within a reasonable period of time any portion of such an allowance that relates to days of travel not substantiated, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated.

Accordingly, amounts received by X's employees under X's revised policy, to the extent the amounts received do not exceed the business expenses substantiated, are not includible in gross income and are not subject to employment taxes and income tax withholding.

No opinion is expressed as to the federal income tax consequences of the transaction described above under any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. *Section 6110(j)(3) of the Code* provides that it may not be used or cited as precedent.

Sincerely yours, Assistant Chief Counsel, (Income Tax & Accounting) By: George Baker,  
Assistant to the Chief, Branch 2.