

HB

97

<TARGET><BILL>HB 97</BILL><SUBJECT>HB
97</SUBJECT><COMM>HSTA28</COMM></TARGET>



Representative Scott Jiu Wo Kawasaki

Alaska State Legislature

District 4 Fairbanks

MEMORANDUM

Date: February 26, 2013

To: Representative Bob Lynn, Chair
House State Affairs Committee

From: Representative Scott Kawasaki 

RE: House Bill 97

I respectfully request a hearing to be scheduled in the House State Affairs Committee for HB 97 "An Act relating to office accounts for each member of the legislature for legislative office expenses."

A copy of the bill, a sponsor statement and additional support materials are included. No fiscal notes are attached at this time. A sectional analysis has been requested and will be delivered to the chairman's office when received. As this will be the first committee of referral, no changes have yet been made to the bill. I do not anticipate audio/visual or teleconferencing needs.

If you have any questions or need additional information, please call Mindy O'Neall at 465-6890.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

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Juneau, Alaska 99801-1182
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MEMORANDUM

February 26, 2013

SUBJECT: Sectional for HB 97 (Work Order No. 28-LS0310\P) Amending AS 24.10.110; Legislators' Office Accounts

TO: Representative Scott Kawasaki
Attn: Mindy O'Neill

FROM: Doug Gardner
Director

You have requested a sectional summary of the above-described bill. As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

Section 1 of HB 97 amends AS 24.10.110, by providing the authority to support the current practice, that Legislative Council has the legal authority to set the dollar amounts of legislators' office accounts. Note that at present, AS 24.10.110 provides that office accounts are to be set by the Alaska State Officers Compensation Commission as provided in AS 39.23. The Commission, in January of 2009, concluded that it was Legislative Council's responsibility to set these amounts. HB 97 deletes reference to AS 39.23, clarifying the current practice of Legislative Council setting office dollar amounts for legislators.

The bill would require that all legislators' office accounts comply with 26 U.S.C. 62(c), and the Internal Revenue Code Regulations adopted under that statute, so that the reimbursements provided to legislators under an accountable office account plan would not be subject to federal income tax. As you know, unless an exception is provided, the Internal Revenue Code (IRC) states that gross income includes all income from whatever source, including compensation for services, fees, commissions, fringe benefits, and similar items.¹ Income received from a reimbursed office expense may be excluded from adjusted gross income -- and therefore no taxes are paid on that amount -- *only* if the office expense reimbursement plan is an "accountable plan," as defined in sec. 62(c) of the IRC.

¹ 26 U.S.C. 61(a).

Under applicable IRS regulations, an "accountable plan" expense allowance arrangement has three requirements:

- 1) Business connection: To be valid, the expenses charged to the allowance must be expenses otherwise allowable by the tax code as business expenses and must be paid or incurred by the employee in connection with the performance of services as the employee. If an employer pays an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) allowable business expenses, the arrangement does not satisfy the business connection requirement and all amounts paid under the arrangement are treated as paid under a nonaccountable plan, subject to tax;²
- 2) Substantiation: An arrangement meets this requirement if it requires each business expense to be substantiated to the employer within a reasonable period of time;³ and
- 3) Amounts in excess of expenses are returned to the employer: In an arrangement where money is advanced to an employee, this requirement will be met only if the amount of money advanced is reasonably calculated not to exceed the amount of anticipated expenditures, the advance of money is made on a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, and any amounts in excess of the expenses substantiated are required to be returned to the employer within a reasonable period of time after the advance is received.⁴

If an expense allowance arrangement fails to satisfy one or more of these requirements, amounts paid to an employee are treated as paid under a "nonaccountable plan" and must be included in gross income unless another exception applies.

So, the amendments proposed in section 1 of the bill would require office accounts to be accountable plans as discussed above, requiring a business connection, substantiation, and a return of any excess expenses to the Legislative Affairs Agency for either re-appropriation, or lapse back into the general fund.

Section 2 of the bill amends AS 24.10.110 by providing for a new subsection that might be viewed as the "mechanics" of the bill. New subsection (b) would establish that each legislator's office account funds would be managed in a separate sub-account by the Legislative Affairs Agency, subject to subparagraphs 1 - 3.

² 26 C.F.R. § 1.62-2(d).

³ 26 C.F.R. § 1.62-2(e).

⁴ 26 C.F.R. § 1.62-2(f).

Representative Scott Kawasaki

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Subparagraph 1 places the responsibility on the legislator for requesting reimbursement for expenditures, subject to review by the Legislative Affairs Agency Accounting Office, which would review the expenditures and make a determination, based on IRS regulations, to determine if the expenditures and resulting request for reimbursement is for a qualified business expense.

Subparagraph 2 provides an option for a legislator to limit the amount of funds in that legislator's office account in a budget year, based on the legislator's preferences. In other words, a member of the Senate could decide, for example, that rather than have available \$20,000 for a yearly office allowance, the Senator would like to limit his or her account to \$10,000.

Subparagraph 3 provides that any remaining funds at the end of the year shall lapse into the general fund unless re-appropriated by the Legislature.

Section 3 of the bill contains an applicability section that applies the amendments to AS 24.10.110 discussed above to office accounts established after January 1, 2014.

I am enclosing the IRS regulations at 26 C.F.R. § 162-2 so that you can review the requirements for accountable plans referenced in this memorandum. If you have questions, please advise.

DDG:plm
13-034.plm

Enclosure



Representative Scott Jiu Wo Kawasaki

Alaska State Legislature

District 4 Fairbanks

Sponsor Statement for HB 97

“An Act Providing Open and Transparent Office Allowance Accounts.”

HB 97 provides clear guidelines to legislative annual office allowance accounts for members of the Alaska State Legislature. The guidelines are simple: keep them publically transparent and enhance accountability.

A recent change in the legislative office accounts policy mandates all members of the legislature take the entitled office allowance account as income. Under AS 24.10.110 this account must be used for “postage, stationery, stenographic services, and other expenses.”

The amount, \$16,000 for Representatives and \$20,000 for Senators, is taxed as income while public monies for member state-issued retirement plans are withdrawn, sometimes up to 33%. Aside from the substantial cut in the office account, which many use to communicate to constituents, this opens the door for unethical and unregulated use of public funds designated specifically for a public purpose.

HB 97 restores the integrity of keeping generous office allowances accountable by the Legislative Affairs Agency in a separate account.

HB 97 complies with the current IRS standards and regulations.

HB 97 provides LAA with the authority to reimburse a legislator after a purchase has been vetted by provisions administered as ethical accounting practices designed by the state and federal government.

HB 97 allows for any remaining funds to be distributed back the general fund if they are not needed for a public purpose.

In government, it is imperative to demonstrate the highest level of transparency when spending public funds. This legislation ensures the public can trust the members of the legislature are being held accountable. I urge your steadfast support for HB 97.

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ELGEE REHFELD MERTZ, LLC

CERTIFIED PUBLIC ACCOUNTANTS

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October 8, 2012

[REDACTED]
Legislative Affairs Agency
State Capitol Bldg. Room 3
Juneau, AK 99801-1182

Re: Recommending Changes to the Legislature's Accountable Plan

Dear [REDACTED]

Last year the Legislative Affairs Agency asked us to determine if the Legislature's Accountable Allowance Reimbursement Guidelines (AARG) was consistent with existing IRS statutes, regulations and other guidance for reimbursement or other expense allowance arrangements also known as accountable plans. We reported our findings and recommendations to you in our report dated September 19, 2011. At our exit conference an issue came up that was outside the scope of our review because it was not covered in the AARG. The issue pertains to the manner of payment of the Legislator's annual allowance for postage, stationery and other expenses. The allowance is made to Legislators under Alaska Statute Sec. 24.10.110.

At issue is whether any or all of the allowance made to a Legislator constitutes either, what the IRS terms, a "disguised salary" or a "salary reduction arrangement". Under these arrangements, if an employer pays an expense reimbursement to an employee as a portion of the employee's salary (regardless of whether the employee incurs or is reasonably expected to incur business expenses), the IRS considers this to be disguised compensation. This means all reimbursements under the accountable plan (including reimbursements to employees who incur legitimate business expenses) fail the business connection requirement for allowable accountable plans and are treated as made under a nonaccountable plan. The consequence of payments made under a nonaccountable plan is that they are considered fully taxable compensation.

While much of the Legislative annual allowance meets the IRS accountable plan requirements, one provision raised the issue of whether the plan constitutes a salary reduction arrangement. Under the plan, at the beginning of each year a Legislator is given one of three options of receiving the allowance: (1) receive the full amount of the allowance as a lump sum of which the full amount is taxable and will be included on the W-2 and the amount does not need to be substantiated; (2) participate in the accountable plan and receive reimbursement for substantiated expenses on a pre tax basis; or (3) elect to receive part of the allowance in cash subject to tax withholding, and the remainder under the business expense plan on a pre-tax basis (essentially a combination of options 1 and 2). The annual allowance is currently set at \$20,000 for each Senator and \$16,000 for each Representative.

The plan further provides that if a Legislator chooses option 2 but by year end does not submit requests for reimbursement up to the set allowance, the Legislator will receive the balance of the

allowance in the form of taxable compensation. It is this component of the plan that raised the issue of whether the allowance constitutes disguised salary.

We recommended the LAA have the issue studied more closely so we suggested they obtain a legal opinion on whether the Legislature's accountable plan met the requirements of Section 62 of the Internal Revenue Code. In her April 9 letter (copy attached), Juneau attorney Beth Chapman could not conclude with any degree of certainty that the plan is a valid accountable plan under Code Section 62 primarily because the plan allows the Legislator to receive the same amount of allowance regardless of whether the expenses are substantiated.

Given this uncertainty, we provided two options that the Legislature could adopt to bring the accountable plan into compliance and one option that effectively eliminates the accountable plan in its entirety. Since Ms. Chapman indicated that allowing a Legislator to select an option effectively creates a salary reduction arrangement, she recommended that one option be selected that will apply to all Legislators. The options are:

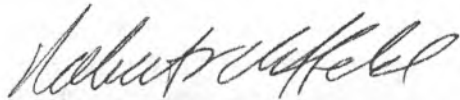
Full Accountable Plan. This arrangement would be similar to your existing plan for those who request reimbursement for their allowable expenses except that any unclaimed balance at year end would be forfeited instead of paid out in compensation as is the current practice.

Split Plan. This option provides some flexibility for Legislators as it effectively maintains the accountable plan for a part of the allowance and a nonaccountable plan for the balance. The Legislature would determine how much of the annual allowance would be a fixed payment that would be included as compensation (the nonaccountable portion). The balance would be paid under the accountable plan rules with any unclaimed portion forfeited at year end.

Nonaccountable Plan. The entire allowance would be paid to the Legislator and included as taxable compensation.

If you have any questions, please feel free to contact me.

Regards,
Elgee Rehfeld Mertz, LLC
Certified Public Accountants



Robert L. Rehfeld, CPA
Partner

Attachment: Chapman letter to [REDACTED] letter dated April 9, 2012, Re: Accountable Plan

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BETHANN BOUDAH CHAPMAN
Direct Phone: 907.523.6147
bchapman@faulknerbanfield.com

April 9, 2012

[REDACTED]
Alaska Legislative Affairs Agency
Mail Stop 3100
Juneau, Alaska 99801-1182

Re: Accountable Plan
Our File No. 2159

Dear [REDACTED]

You have retained our firm, on behalf of the Alaska Legislative Affairs Agency, to review and advise you on whether the annual expense allowance plan established for legislators qualifies as a nontaxable benefit under Section 62 of the Internal Revenue Code ("IRC"). This letter summarizes our preliminary advice and cannot be relied upon to avoid any penalty that may be imposed by the Internal Revenue Service relating to this matter.

We have reviewed the plan, a November 7, 2011, memorandum from Executive Director, Pamela A. Varni, to all legislators outlining the terms of the plan and the annual allowance option form. We also have relied on email responses from you, dated March 14, 2012, regarding how the plan is operated.

Background

Alaska Statute 24.10.110 provides each member of the legislature with an annual allowance for postage, stationary, stenographic services, and other expenses. Currently, each member of the Senate is entitled to receive an annual allowance of \$20,000, and each Representative is entitled to an annual allowance of \$16,000. Prior to the beginning of each legislative session, each legislator is given the following options: (1) receive the full amount of the allowance in a lump sum (this amount is fully taxable and reportable on the W-2 and the use of the amount does not need to be substantiated); (2) participate in the business allowance plan and receive reimbursement for substantiated expenses on a pre-tax basis; or (3) elect to receive part of the allowance in cash subject to tax

withholding, and the remainder under the business expense plan on a pre-tax basis.

It is our understanding that each legislator will receive the full amount of the allowance each year regardless of his or her election to participate in the plan. Those legislators who elect to participate in the business expense plan will receive a payment for any amount of the allowance remaining after expenses have been substantiated. For example, if a Representative submitted receipts and was reimbursed for \$10,000 in expenses, he or she would receive a lump sum check for \$6,000 at the end of the year. The additional check would be taxable and subject to withholding.

Analysis

Internal Revenue Code Section 62(a)(2) provides that amounts reimbursed under a reimbursement or other expense allowance arrangement may be excluded from gross income. IRC section 62(c) provides that for purposes of §62(a)(2)(A), an arrangement will not be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement; or (2) the arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered by the arrangement.

The IRS issued regulations further refining the requirements for an “accountable plan” as follows: (1) the plan must only reimburse business related expenses; (2) the employee must substantiate the expenses; and (3) any amounts in excess of the reimbursement must be returned. Treas. Reg. § 1.62-2(c). This memorandum will focus on the third element, as it does not appear that the plan satisfies this requirement.

A plan will not be considered an “accountable plan” if it does not require an employee to return any amount received in excess of substantiated expenses. Treas. Reg. § 1.62-2(f). For example, if an employee is advanced funds for deductible expenses and only substantiates expenses for a portion of the advance, the employee must be required to return the excess advance. If the employee fails to return the excess amount, the entire plan is not disqualified as an accountable plan, rather, the excess amount is included in the employee’s taxable income. Treas. Reg. § 1.62-2(c)(3)(ii).

A plan will also not be considered as accountable if it requires that the excess amount be returned, but the employer still pays the employee a “bonus” for the excess amount. Under those circumstances, the plan is not an accountable plan because the employee receives the same amount of income regardless of the


substantiation rule. In the example described in the regulations, the employer advanced the employee certain amounts to cover business expenses. The employee was required to substantiate his expenses and to return any advanced funds that exceeded the substantiated expenses. Each time an employee returned excess funds, the employer “bonused” the employee an amount equal to the excess amount. As a result, each employee received a fixed amount regardless of whether the expenses were substantiated. Treas. Reg. § 1.62-2(j), Example 8.

The legislator’s plan does not advance money and therefore there are no excess amounts to be returned. Rather than limit reimbursement to the substantiated expenses, the plan pays each legislator the amount in excess of substantiated expenses up to the total allowance each year. Therefore, each legislator electing to participate in the accountable plan receives the full amount of the allowance each year regardless of the expenses actually incurred. The Accountable Allowance Reimbursement Guidelines state “Any remaining funds in the accountable allowance account after the cut-off date will be paid out as income to the Legislator.” (Guidelines, page 9.)

This arrangement is analogous to the example contained in the regulations where the employer required the return of an amount in excess of substantiated expenses but then “bonused” the employee with the excess amount each year. In essence, the employee received the full amount regardless of the substantiation requirement. In this case, there is no risk that the Legislator will receive less than the full allowance and it does not differ from the circumstance where the employee who returns the excess amount receives it back as compensation.

Therefore, we cannot conclude with any degree of certainty that the plan is a valid accountable plan under IRC § 62.

Sincerely,



BethAnn Boudah Chapman

IRS Rulings & Other Documents (2002-Current), Rev. Rul. 2012-25, Internal Revenue Service, (Sep. 10, 2012)

[Click to open document in a browser](#)

Rev. Rul. 2012-25, I.R.B. 2012-37, 337, September 10, 2012.

[[Code Sec. 62](#)]

Employee reimbursements: Accountable plan: Business connection requirement: Recharacterization of taxable wages.—

The IRS has provided guidance which clarifies that an arrangement that recharacterizes taxable wages as nontaxable reimbursements or allowances does not satisfy the business connection requirement of the accountable plan rules under [Code Sec. 62\(c\)](#). The guidance includes four situations, three of which illustrate arrangements that impermissibly recharacterize wages such that the arrangements are not accountable plans. A fourth situation illustrates an arrangement that does not impermissibly recharacterize wages. In this arrangement, an employer prospectively altered its compensation structure to include a reimbursement arrangement. Back reference: ¶[6006.123](#).

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 62.—Adjusted Gross Income Defined

An arrangement that recharacterizes taxable wages as nontaxable reimbursements or allowances does not satisfy the business connection requirement of the accountable plan rules under [section 62\(c\)](#) and the applicable regulations. See Rev. Rul. 2012-25, page 337.

26 CFR 1.62-2: Reimbursements and other expense allowance arrangements.

Wage recharacterization. This ruling provides guidance for employers under [section 62\(c\)](#) of the Code and the applicable regulations. The ruling clarifies that an arrangement that recharacterizes taxable wages as nontaxable reimbursements or allowances does not satisfy the business connection requirement of the accountable plan rules under [section 62\(c\)](#) and the applicable regulations. Specifically, this ruling includes four situations. Three of the situations illustrate arrangements that impermissibly recharacterize wages, such that the arrangements are not accountable plans. The fourth situation illustrates an arrangement that does not impermissibly recharacterize wages, where an employer prospectively alters its compensation structure to include a reimbursement arrangement.

ISSUE

Whether an arrangement that recharacterizes taxable wages as nontaxable reimbursements or allowances satisfies the business connection requirement of the accountable plan rules under [§62\(c\)](#) and the applicable regulations.

FACTS

Situation 1.

Employer A, a company contracting with cable providers, employs technicians to install cable television systems at residential locations on behalf of different cable providers. Employee technicians are required to provide the tools and equipment necessary to complete the various installation jobs to which they are assigned.

Employer A compensates its employees on an hourly basis, which takes into account the fact that technicians are required to provide their own tools and equipment. Employer A decides to begin reimbursing its technicians for their tool and equipment expenses through a tool reimbursement arrangement (tool plan).

Under Employer A's tool plan, a technician provides Employer A with an amount equivalent to the technician's tool and equipment expenses incurred in connection with providing services to Employer A. Employer A takes the technician's total expenses for the year and divides the total amount by the number of hours a technician is expected to work over the course of a year to arrive at an hourly tool rate. Once

Employer A has determined the hourly tool rate amount for a technician, it pays the technician a reduced hourly compensation rate and an hourly tool rate. Employer A treats the reduced hourly compensation as taxable wages. Employer A treats the hourly tool rate as a nontaxable reimbursement. The hourly tool rate plus the reduced hourly compensation rate approximately equal the pre-tool plan compensation rate. The tool plan tracks the hourly tool rate up to the amount of substantiated tool and equipment expenses. Once a technician has received tool plan payments for the total amount of his or her tool and equipment expenses, Employer A ceases paying the technician an hourly tool rate but increases the technician's hourly compensation to the pre-tool plan hourly compensation rate.

Situation 2.

Employer B, a staffing contractor, employs nurses and provides their services to hospitals throughout the country for shortterm assignments. Employer B compensates all of the nurses on an hourly basis and the hourly compensation amount does not vary depending on whether the hospital is located away from the assigned nurse's tax home.

When Employer B sends nurses on assignment to hospitals that require them to travel away from their tax home and incur deductible expenses in connection with Employer B's business, Employer B treats a portion of the nurses' hourly compensation as a nontaxable *per diem* allowance for lodging, meals, and incidental expenses under Employer B's *per diem* plan; Employer B treats the remaining portion of the nurses' hourly compensation as taxable wages. When Employer B sends the nurses on assignment to hospitals within commuting distance of their tax home, Employer B treats all of the nurses' compensation as taxable wages. In each case, the nurses receive the same total compensation per hour.

Situation 3.

Employer C, a construction firm, employs workers to build commercial buildings throughout a major metropolitan area. As part of their duties, some of Employer C's workers are required to travel between construction sites or otherwise use their personal vehicles for business purposes. These workers incur deductible business expenses in operating their personal vehicles in connection with their employment with Employer C. Employer C compensates all of its workers for their services on an hourly basis, which Employer C treats as taxable wages. Employer C also pays all of its workers, including those who are not required to travel or otherwise use their personal vehicles for Employer C's business, a flat amount per pay period that Employer C treats as a nontaxable mileage reimbursement.

Situation 4.

Employer D, a cleaning services company, employs cleaning professionals to perform house cleaning services for Employer D's clients. Employee cleaning professionals are required to provide the cleaning products and equipment necessary to complete the cleaning service jobs to which they are assigned.

Employer D compensates its employees on an hourly basis, which takes into account that employees are required to provide their own cleaning products and equipment. Employer D decides to begin reimbursing its employees for their cleaning and equipment expenses through a reimbursement arrangement.

Employer D prospectively alters its compensation structure by reducing the hourly compensation paid to all employees. Under Employer D's new reimbursement arrangement, employees can substantiate to Employer D the actual amount of deductible expenses incurred in purchasing their cleaning products and equipment in connection with performing services for Employer D. Employer D reimburses its employees for substantiated expenses incurred in performing services for Employer D. Any reimbursement paid under Employer D's reimbursement arrangement is paid in addition to the hourly compensation paid for the employees' services. Employees who do not incur expenses for cleaning products and equipment in connection with their jobs for Employer D, or who do not properly substantiate such expenses to Employer D, continue to receive the lower hourly compensation and do not receive any reimbursement and are not compensated in another way (for example, with a bonus) to substitute for the reduction in the hourly compensation. Employer D treats the hourly compensation as taxable wages. Employer D treats reimbursements for cleaning and equipment expenses as nontaxable reimbursements.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code (Code) defines gross income as all income from whatever source derived. Section 62(a) defines adjusted gross income as gross income minus certain deductions. Section 62(a)(2)(A) provides that, for purposes of determining adjusted gross income, an employee may deduct certain business expenses paid by the employee in connection with the performance of services as an employee of the employer under a reimbursement or other expense allowance arrangement. Section 62(c) provides that, for purposes of §62(a)(2)(A), an arrangement will not be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or (2) the arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Under section 1.62-2(c) of the Income Tax Regulations, if a reimbursement or other expense allowance arrangement meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses, all amounts paid under the arrangement are treated as paid under an accountable plan. Amounts treated as paid under an accountable plan are excluded from an employee's gross income, are exempt from withholding and payment of employment taxes, and are not reported as wages on the employee's Form W-2. If the arrangement fails any one of these requirements, amounts paid under the arrangement are treated as paid under a nonaccountable plan, must be included in the employee's gross income for the taxable year, are subject to withholding and payment of employment taxes, and must be reported as wages or other compensation on the employee's Form W-2.

Section 1.62-2(d)(1) provides that an arrangement satisfies the business connection requirement if it provides advances, allowances, or reimbursements only for business expenses that are allowable as deductions by part VI, subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer. Thus, not only must an employee actually pay or incur a deductible business expense, but the expense must arise in connection with the employment for that employer.

Section 1.62-2(d)(3)(i) provides that the business connection requirement will not be satisfied if a payor pays an amount to an employee regardless of whether the employee incurs or is reasonably expected to incur deductible business expenses. Failure to meet this reimbursement requirement of business connection is referred to as wage recharacterization because the amount being paid is not an expense reimbursement but rather a substitute for an amount that would otherwise be paid as wages.

Section 1.62-2(i) Example 1 provides an illustration of a case in which the reimbursement requirement is not satisfied. In this example, Employer S pays its engineers \$200 a day. On those days that an engineer travels away from home on business for Employer S, Employer S designates \$50 of the \$200 as paid to reimburse the engineer's travel expenses. On all other days, the engineer receives the full \$200 as taxable wages. Because Employer S would pay an engineer \$200 a day regardless of whether the engineer was traveling away from home, the \$50 Employer S redesignates as travel expense reimbursement on days the engineer is away from home on business is not a reimbursement and the arrangement does not satisfy the reimbursement requirement of §1.62-2(d)(3)(i). Thus, no part of the \$50 Employer S designated as a reimbursement is treated as paid under an accountable plan. Rather, all payments under the arrangement are treated as paid under a nonaccountable plan. Employer S must report the entire \$200 as wages or other compensation on the employees' Forms W-2, and must withhold and pay employment taxes on the entire \$200 when paid.

Section 1.62-2(j) Example 3 also illustrates a failure to satisfy the reimbursement requirement. In this example, Corporation R pays all its salespersons a salary. Corporation R also pays a travel allowance under an arrangement that otherwise meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. The allowance is paid to all salespersons, including salespersons that Corporation R knows, or has reason to know, do not travel away from their offices on Corporation R business and would not be reasonably expected to incur travel expenses. Because the allowance is not paid only to those employees who incur (or are reasonably expected to incur) expenses of the type described in §1.62-2(d)(1) or (d)(2), the arrangement does not satisfy the reimbursement requirement of §1.62-2(d)(3)(i). Thus, no part of the allowance Corporation R designated as a reimbursement is treated as paid under an accountable plan. Rather, all payments under the arrangement are treated as paid under a nonaccountable plan. Corporation R must report all payments under the arrangement as wages

or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the payments when paid.

In Rev. Rul. 2004-1, 2004-1 C.B. 325, drivers of a courier company were paid a mileage allowance for local transportation expenses. In situation 1 of the ruling, the employer paid the couriers a commission equal to X percent of the per package charge (based on location, time of day, type of service, mileage between pickup and delivery, and other factors), known as the tag rate, and a mileage allowance equal to Y percent of the tag rate. In situation 2, the employer paid the couriers a commission equal to Z percent of the tag rate reduced by a mileage allowance equal to the number of miles traveled multiplied by the standard mileage rate. The revenue ruling concludes that the reimbursement arrangement in situation 1, which pays a mileage allowance as a fixed percentage of the tag rate, meets the business connection requirement. In contrast, the revenue ruling concludes that the reimbursement arrangement in situation 2, which subtracts a mileage allowance (calculated at the standard business mileage rate) from the driver's set commission rate and treats only the remaining commission as wages, fails the business connection requirement. The variable allocation between commission and mileage allowance in situation 2 ensures that each driver always receives the same gross amount regardless of the amount of deductible employee business expenses incurred by the courier by varying the amount treated as wages in light of the mileage allowance paid. Accordingly, the arrangement effectively recharacterizes amounts otherwise payable as a taxable commission as a nontaxable mileage allowance. The ruling provides that a *bona fide* reimbursement arrangement must preclude the recharacterization as a mileage allowance of amounts otherwise payable as commission. See *Shotgun Delivery v. United States*, 269 F.3d 969 (9th Cir. 2001) (holding that a plan guaranteeing that employee drivers always received 40% of the tag rate with a variable allocation between taxable wages and nontaxable mileage reimbursement was nonaccountable, and noting that "the evidence suggests that the plan's primary purpose was to treat the least amount possible of the driver's commission as taxable wages").

The legislative history of §62(c) indicates that a taxpayer should not be able to recharacterize an amount that would have been paid as wages as a nontaxable reimbursement in order to avoid the two-percent of adjusted gross income limitation (two-percent floor), enacted by the Tax Reform Act of 1986, for deducting most employee business expenses. Specifically, the Tax Reform Act of 1986 significantly changed rules for deduction of employee business expenses by converting most of these expenses into itemized deductions that an employee could only deduct if the aggregate of such expenses exceeded the two-percent floor. However, the 1986 Act left in place the ability of a taxpayer to deduct from gross income and without regard to the two-percent floor, pursuant to §62(a)(2)(A), employee business expenses incurred by a taxpayer as part of a reimbursement or other expense allowance arrangement with his or her employer. After enactment of the 1986 Act, tax practitioners proposed that employers could use reimbursement and expense allowance arrangements to (1) eliminate the effect of the two-percent floor on deductible employee expenses, and (2) save both employer and employee employment taxes by restructuring their compensation packages to convert a portion of an employee's compensation into a nontaxable reimbursement. This restructuring would permit employers to pay a lesser total amount while increasing employees' after-tax compensation.

Congress responded by enacting §62(c) in §702 of the Family Support Act of 1988, 100 P.L. 485, 102 Stat. 2343 (1988). In describing the conference agreement, the House-Senate Conference Committee Report on that Act states that "[i]f an above-the-line deduction is allowed for expenses incurred pursuant to a nonaccountable plan, the two-percent floor enacted in the [Tax Reform Act of 1986] could be circumvented solely by restructuring the form of the employee's compensation so that the salary amount is decreased, but the employee receives an equivalent nonaccountable expense allowance." H.R. Rep. No. 100-998, at 203, 100th Cong., 2nd Sess. (Sept. 28, 1988). Section 62(c) was enacted to prevent such restructuring of compensation arrangements and permit an above-the-line deduction only for expenses reimbursed under what legislative history referred to as an accountable plan.

Consistent with legislative history, the preamble to Treasury Decision 8324, 55 FR 51688, 1991-1 C.B. 20, 21 (1990), states:

Some practitioners have asked whether a portion of an employee's salary may be recharacterized as being paid under a reimbursement arrangement. The final regulations clarify that if a payor arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) deductible business expenses or other *bona fide* expenses related to the employer's business that are not deductible, the arrangement does not meet the business connection requirement of

§1.62-2(d) of the regulations and all amounts paid under the arrangement are treated as paid under a nonaccountable plan.... Thus, no part of an employee's salary may be recharacterized as being paid under a reimbursement arrangement or other expense allowance arrangement.

While an employer may establish or modify its compensation structure to include nontaxable reimbursement under an accountable plan, recharacterizing as nontaxable reimbursements amounts that would otherwise be paid as wages violates the business connection requirement of §1.62-2(d), and more specifically the reimbursement requirement of §1.62-2(d)(3)(i). This is true even if an employee actually incurs a deductible expense in connection with employment with the employer.

The presence of wage recharacterization is based on the totality of facts and circumstances. Generally, wage recharacterization is present when the employer structures compensation so that the employee receives the same or a substantially similar amount whether or not the employee has incurred deductible business expenses related to the employer's business. Wage recharacterization may occur in different situations. For example, an employer recharacterizes wages if it temporarily reduces taxable wages, substituting the reduction in wages with a payment that is treated as a nontaxable reimbursement and then, after total expenses have been reimbursed, increases taxable wages to the prior wage level. Similarly, an employer recharacterizes wages if it pays a higher amount as wages to an employee only when the employee does not receive an amount treated as nontaxable reimbursement and pays a lower amount as wages to an employee only when the employee also receives an amount treated as nontaxable reimbursement. An employer also recharacterizes wages if it routinely pays an amount treated as a nontaxable reimbursement to an employee who has not incurred *bona fide* business expenses.

HOLDINGS

Situation 1.

Employer A's tool plan does not satisfy the business connection requirement of the accountable plan rules because the employer pays the same gross amount to a technician regardless of whether the technician incurs (or is reasonably expected to incur) expenses related to Employer A's business. Specifically, Employer A's tool plan ensures that a technician receives approximately the same gross hourly amount by substituting a portion of what was paid as taxable wages with a tool rate amount that is treated as nontaxable reimbursement, and then increasing the wages again once all tool expenses have been reimbursed. Accordingly, the purported tool reimbursements are merely a recharacterization of wages because approximately the same amount is paid in all circumstances. The fact that a technician actually incurs a deductible expense in connection with employment does not cure the incidence of wage recharacterization. The arrangement fails to satisfy the business connection requirement of §1.62-2(d). Therefore, without regard to whether it meets the other requirements of an accountable plan as set forth in §1.62-2. Employer A's tool plan is not an accountable plan under §62(c) and the applicable regulations.

Situation 2.

Employer B's *per diem* plan does not satisfy the business connection requirement of the accountable plan rules because Employer B pays the same gross amount to nurses regardless of whether the nurses incur (or are reasonably expected to incur) travel expenses related to Employer B's business. Specifically, Employer B pays the same gross compensation to nurses, but a portion of the hourly compensation is treated as nontaxable *per diem* when a nurse is traveling away from his or her tax home on assignment. For nurses traveling away from their tax home on assignment, Employer B reduces the amount of the nurses' compensation treated as taxable wages and treats an amount equal to the reduction in compensation as a nontaxable *per diem*. For nurses assigned to hospitals within commuting distance of their tax homes, Employer B treats all compensation as taxable wages. Accordingly, the purported *per diem* payments are merely recharacterized wages because nurses receive the same gross compensation per hour regardless of whether travel expenses are incurred (or are reasonably expected to be incurred). The fact that a nurse traveling away from his or her tax home actually incurs a deductible expense in connection with employment does not cure the incidence of wage recharacterization. The arrangement fails to satisfy the business connection requirement of §1.62-2(d). Therefore, without regard to whether it meets the other requirements

of an accountable plan as set forth in §1.62-2. Employer B's *per diem* plan is not an accountable plan under §62(c) and the applicable regulations.

Situation 3.

Employer C's mileage reimbursement plan does not satisfy the business connection requirement of the accountable plan rules because it operates to routinely pay an amount as a mileage reimbursement to workers who have not incurred (and are not reasonably expected to incur) deductible business expenses in connection with Employer C's business. The purported mileage reimbursement is merely recharacterized wages because all workers receive an amount as a mileage reimbursement regardless of whether they incur (or are reasonably expected to incur) mileage expenses. The arrangement fails to satisfy the business connection requirement of §1.62-2(d). Therefore, without regard to whether it meets the other requirements of an accountable plan as set forth in §1.62-2, Employer C's mileage reimbursement plan is not an accountable plan under §62(c) and the applicable regulations.

Situation 4.

Employer D's reimbursement arrangement satisfies the business connection requirement of the accountable plan rules. Employer D's plan only reimburses employees when a deductible business expense has been incurred in connection with performing services for Employer D and the reimbursement is not in lieu of wages that the employees would otherwise receive. Although Employer D has reduced the amount of compensation it pays all of its employees, the reduction in compensation is a substantive change in Employer D's compensation structure. Under Employer D's arrangement, reimbursement amounts are not guaranteed and employees who do not incur expenses in connection with Employer D's business, or who do not properly substantiate such expenses, continue to receive the reduced hourly compensation amount. These employees do not receive any reimbursement and are not compensated in another way to make up for the reduction in the hourly compensation. Employer D's reimbursement arrangement does not operate to pay the same or a substantially similar gross amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) expenses related to Employer D's business. The reimbursement is paid in addition to the employees' wages rather than as a substitute for wages that would otherwise be paid. Accordingly, Employer D's reimbursement arrangement satisfies the business connection requirement of §1.62-2(d). Therefore, as long as the substantiation and return of excess amounts requirements are also met, Employer D's reimbursement arrangement is an accountable plan under §62(c) and the applicable regulations.

DRAFTING INFORMATION

The principal author of this revenue ruling is Kelly Morrison-Lee of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue ruling, contact Kelly Morrison-Lee at (202) 622-0047 (not a toll-free call).

Wages can't be recharacterized as nontaxable reimbursements

Rev Rul 2012-25, 2012-37 IRB 337

A new ruling clarifies that an arrangement that recharacterizes taxable wages as nontaxable reimbursements or allowances, for example, to provide a tool reimbursement for employees, does not satisfy the business connection requirement of the Code Sec. 62(c) accountable plan rules. Thus, the reimbursements are treated as made under a nonaccountable plan and are taxable. The ruling illustrates its holding by way of four detailed situations.

RIA observation: IRS has fought for many years against what it calls wage recharacterizations, principally in the venue of tool reimbursements. Rev Rul 2012-25, appears to be an effort to present a comprehensive and more authoritative statement of IRS's position than it had previously espoused chiefly in guidance such as chief counsel advice.

Background. Reimbursements are tax-free to the employee and aren't subject to withholding or payroll taxes if made under an accountable plan. To be treated as made under an accountable plan, a reimbursement must meet all of the following requirements:

1. The reimbursed expense must be allowable as a deduction and must be paid or incurred in connection with performing services as an employee of the employer; (Reg. § 1.62-2(d)(1))
2. Each reimbursed expense must be adequately accounted for to the employer within a reasonable period of time; (Reg. § 1.62-2(e)) and
3. Any amounts in excess of expenses must be returned within a reasonable period of time. (Reg. § 1.62-2(f))

If the above requirements aren't met, reimbursements are treated as made under a nonaccountable plan and are subject to withholding and employment taxes, and must be treated as wages paid to the employee.

Under Reg. § 1.62-2(c)(1), an arrangement satisfies the business connection requirement if it provides advances, allowances, or reimbursements only for business expenses that are allowable as deductions by part VI, subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee "in connection with the performance of services as an employee of the employer." Under Reg. § 1.62-2(d)(3)(i), the business connection requirement isn't satisfied where a payor pays an amount to an employee regardless of whether he incurs or is reasonably expected to incur deductible business expenses or other bona fide expenses related to the employer's business.

In Rev Rul 2012-25, IRS labels the failure to meet the Reg. § 1.62-2(d)(3)(i) reimbursement requirement of business connection as "wage recharacterization" because the amount being paid

is not an expense reimbursement, but rather a substitute for an amount that would otherwise be paid as wages.

Wage recharacterization sinks accountable plan reimbursements. In Rev Rul 2012-25, IRS reiterates its position that while an employer may establish or modify its compensation structure to include nontaxable reimbursement under an accountable plan, recharacterizing as nontaxable reimbursements amounts that would otherwise be paid as wages violates the business connection requirement of Reg. § 1.62-2(d), and more specifically the reimbursement requirement of Reg. § 1.62-2(d)(3)(i). This is true even if an employee actually incurs a deductible expense in connection with employment with the employer.

IRS says that while the presence of wage recharacterization is based on the totality of facts and circumstances, it generally is present when the employer structures compensation so that an employee receives the same or a substantially similar amount whether or not he has incurred deductible business expenses related to the employer's business. Wage recharacterization may occur in different situations.

For example, IRS says an employer recharacterizes wages if:

- It temporarily reduces taxable wages, substituting the reduction in wages with a payment that is treated as a nontaxable reimbursement and then, after total expenses have been reimbursed, increases taxable wages to the prior wage level.
- It pays a higher amount as wages to an employee only when he does not receive an amount treated as nontaxable reimbursement and pays a lower amount as wages to an employee only when he also receives an amount treated as nontaxable reimbursement.
- It routinely pays an amount treated as a nontaxable reimbursement to an employee who has not incurred bona fide business expenses.

Rev Rul 2012-25, illustrates the wage recharacterization by way of four detailed situations.

Situation (1). Corp A pays its service technicians on an hourly basis, taking into account the fact that they must provide their own tools and equipment. A decides to begin reimbursing its technicians for their tool and equipment expenses through a tool reimbursement arrangement (tool plan). Under the tool plan, a technician provides Corp A with an amount equivalent to his tool and equipment expenses incurred in connection with providing services to Corp A. Corp A takes the technician's total expenses for the year and divides the total amount by the number of hours he is expected to work over the course of a year to arrive at an hourly tool rate. Corp A pays the technician a reduced hourly compensation rate, which is treated as taxable wages, and an hourly tool rate, which it treats as a nontaxable reimbursement. The hourly tool rate plus the reduced hourly compensation rate approximately equal the pre-tool plan compensation rate. The tool plan tracks the hourly tool rate up to the amount of substantiated tool and equipment expenses. Once a technician has received tool plan payments for the total amount of his tool and equipment expenses, Corp A stops paying him an hourly tool rate but increases his hourly compensation to the pre-tool plan hourly compensation rate.

IRS concludes that Corp A's tool plan isn't an accountable plan because Corp A pays the same gross amount to a technician regardless of whether he incurs (or is reasonably expected to incur) expenses related to Corp A's business. The purported tool reimbursements are merely a recharacterization of wages because approximately the same amount is paid in all circumstances. The fact that a technician actually incurs a deductible expense in connection with employment does not cure the incidence of wage recharacterization.

RIA observation: IRS has been willing to compromise on the tool reimbursement issue on an industry-by-industry basis if certain criteria are met. In Rev Proc 2002-41, 2002-1 CB 1098, it OK'd a deemed substantiation method for pipeline industry workers that make rig reimbursements to employees (see Weekly Alert ¶ 6 05/30/2002). And in Notice 2005-59, 2005-2 CB 443, IRS issued provided the criteria it would consider in an Industry Issue Resolution (IIR) Program to give employers accountable-plan relief when making tool allowances (see Weekly Alert ¶ 2 08/11/2005).

Situation (2). Employer B, a staffing contractor, hires nurses and provides their services to hospitals throughout the country for short-term assignments. All nurses are paid on an hourly basis that's the same regardless of the hospital location. When nurses are assigned to hospitals that require them to travel away from their tax home and incur deductible expenses in connection with Employer B's business, Employer B treats part their hourly compensation as a nontaxable per diem allowance for lodging, meals, and incidental expenses under a per diem plan. The remaining portion of the nurses' hourly compensation is treated as taxable wages. When nurses are assigned to hospitals within commuting distance, Employer B treats all of their compensation as taxable wages. In each case, the nurses receive the same total compensation per hour.

IRS concludes that Employer B's per diem plan isn't an accountable plan. It does not satisfy the business connection requirement because Employer B pays the same gross amount to nurses regardless of whether they incur (or are reasonably expected to incur) travel expenses related to Employer B's business. The purported per diem payments are merely recharacterized wages because nurses receive the same gross compensation per hour regardless of whether travel expenses are incurred (or are reasonably expected to be incurred). The fact that nurses traveling away from their tax home actually incur a deductible expense in connection with employment does not cure the incidence of wage recharacterization.

Situation (3). Builder C employs workers to build commercial buildings throughout a major metropolitan area. Some of them are required to travel between construction sites or otherwise use their personal vehicles for business purposes. Builder C compensates all workers for their services on an hourly basis, which it treats as taxable wages. Builder C also pays all of its workers, including those who are not required to travel or otherwise use their personal vehicles for its business, a flat amount per pay period that it treats as a nontaxable mileage reimbursement.

IRS concludes that Builder C's mileage reimbursement plan isn't an accountable plan. It fails the business connection requirement because it routinely pays an amount as a mileage reimbursement to workers who have not incurred (and are not reasonably expected to incur) deductible business expenses in connection with Builder C's business. Amounts paid under the

plan are merely recharacterized wages because all workers receive an amount as a mileage reimbursement regardless of whether they incur (or are reasonably expected to incur) mileage expenses.

Situation (4). Corp D, a cleaning services company, employs cleaners who are required to provide the cleaning products and equipment necessary to complete the jobs to which they are assigned. Their hourly pay takes into account the fact that employees must provide their own cleaning products and equipment. Corp D decides to begin reimbursing its employees for their cleaning and equipment expenses. It prospectively alters the compensation structure by reducing the hourly compensation paid to all employees. Under Corp D's new reimbursement arrangement, employees who substantiate to D the actual amount of their work-related cleaning products and equipment are reimbursed for their expenses. Any reimbursement paid under the reimbursement arrangement is paid in addition to the hourly compensation paid for the employees' services. Those employees who don't incur job-related expenses or don't properly substantiate them continue to receive the lower hourly compensation, don't receive any reimbursement, and aren't compensated in another way (for example, with a bonus) to substitute for the reduction in the hourly compensation.

IRS concludes that the reimbursements for cleaning and equipment expenses are nontaxable reimbursements paid under an accountable plan. Corp D's plan only reimburses employees when a deductible business expense has been incurred in connection with job-related services and the reimbursement is not in lieu of wages that the employees would otherwise receive. IRS stressed that although Corp D reduced the amount of compensation it pays all of its employees, the reduction is a substantive change in compensation structure. Reimbursement amounts are not guaranteed and employees who do not incur expenses in connection with Corp D's business, or who do not properly substantiate the expenses, continue to receive the reduced hourly compensation amount.

References: For accountable plan requirements, see FTC 2d/FIN ¶ L-4700 ; United States Tax Reporter ¶ 624.02 ; TaxDesk ¶ 296,000 ; TG ¶ 17800 .

**2012 Legislator Compensation- Legislator Compensation
for Office Supplies, District Offices and Staffing**

State	Office Supplies, District Offices and Staffing.
Alabama	None, although annual appropriation to certain positions may be so allocated
Alaska	Senators receive either \$20,000/ year or \$10,000/year and representatives receive either \$16,000/year or \$8,000/year for postage per their choice for postage, stationery and other legislative expenses. Staffing allowance determined by rules and presiding officers, depending on time of year.
Arizona	None.
Arkansas	Legislators are entitled to receive a maximum reimbursement of \$14,400/year for legislative expenses. Committee chairs, vice chairs, and standing subcommittee chairs may claim additional reimbursement up to \$3,600/year.
California	Assembly members have an annual base allowance of \$263,000 to cover these expenses. Senate member expenses are paid directly and maintained by the Senate Rules Committee.
Colorado	None.
Connecticut	Senators receive \$5,500 and Representatives receive \$4,500 in unvouchered expense allowance.
Delaware	Reimbursement provided for office expenses.
Florida	Senate \$2,921.00/month for district office expenses-House \$2,482.00/month for district office expenses
Georgia	Legislators have \$7,000/year reimbursable expense account. If members request and provide receipts, they are reimbursed for personal services, office equipment, rent, supplies, transportation, telecommunications, etc.
Hawaii	There is no set dollar amount for office supplies. All supplies are provided by the House Supply room. Any item not carried in the Supply Room may be purchased with statutory legislative allowance fund which is currently \$10,200/year. House members do not have district offices. With the exception of the Speaker's Office and Majority and Minority Leadership offices, the House Finance, Judiciary and Consumer Protection offices, each House Majority and Minority member is allowed 1 permanent full-time Office Manager. During the session each committee chair receives \$5,100/month for temporary staff salaries, and all other members receive \$4,800 month.
Idaho	\$1,875/year for unvouchered constituent expense-no staffing allowance
Illinois	Senators receive \$83,063/year and Representatives \$69,409/year for office expenses, including district offices and staffing.
Indiana	All of these expenses come out of one main Senate budget-do not have district offices.
Iowa	\$300/month to cover district constituency postage, travel, telephone, and other expenses. No staffing allowance.
Kansas	Allowed \$7,083/year, which is taxable income to the legislators. Staffing allowances vary for leadership who has its own budget. Legislators provided with secretaries during session only.
Kentucky	\$1,788.51 for district expenses during interim.
Louisiana	Allowed \$500/month. Senators and Representatives receive an additional \$1,500 supplemental allowance for vouchered office expenses, rent, and travel mileage in district. Senators and Representatives staff allowances \$2,000/month starting salary up to \$3,000 with annual increases.
Maine	None; however, supplies for staff offices are provided and paid for out of general legislative account.
Maryland	Members, \$18,265/year for normal expenses of an office with limits on postage, telephone and publications. Members must document expenses. Legislators must use \$5,800 for clerical services. Senators receive one administrative assistant and session secretary.
Massachusetts	Allowed \$7,200/yearly for office expenses.
Michigan	Allowed \$46,800 per majority Senator for office budget; \$46,800 per minority Senator for office budget
Minnesota	No district offices. Supplies provided in State Capitol. In the House, staffing provided centrally. Senators have one legislative assistant and are given \$75/week for interns.
Mississippi	A total of \$1,500 month out of session.
Missouri	\$700/month to cover all reasonable and necessary business expenses.
Montana	None.
Nebraska	No allowance; however, each member is provided with two full-time capitol staff year-round.
Nevada	None.
New Hampshire	None.

New Jersey	Allowed \$1,250 for office supplies; equipment and furnishings supplied through a district office program and \$110,000/year for district office personnel. State provides stationery for each legislator and 10,000 for postage stamps.
New Mexico	None.
New York	Staff allowance set by majority leader for majority members and by minority leader for minority members. Staff allowance covers both district and capitol; geographic location; seniority and leadership responsibilities will cause variations.
North Carolina	Non-leaders receive \$6,708/year for any legislative expenses not otherwise provided. Full-time secretarial assistance is provided during session.
North Dakota	None.
Ohio	None.
Oklahoma	Allowed \$350/year for unvouchered office supplies plus \$500 per month credit for postage.
Oregon	For interim periods, legislators receive \$61,476 per biennium. They can spend as they choose. For session, they receive \$24,290 for session staffing and \$2,325 for services and supplies. They also receive an additional \$450-750/month as a district allowance, depending on geographic size of district.
Pennsylvania	Staffing is determined by leadership.
Rhode Island	None.
South Carolina	Senate-\$3,400/year for postage, stationary and telephone. House-\$1,800/year for telephone and \$600/year for postage. Legislators also receive \$1,000/month for in district expenses that is treated as income.
South Dakota	None.
Tennessee	Allowed \$1,000/month for expenses in district (U).
Texas	Approved allowance for staff salaries, supplies, stationery, postage, district office rental, telephone expense, etc. Senate and House allocations are not the same.
Utah	None.
Vermont	None.
Virginia	Legislators receive \$1,250/month; leadership receives \$1,750/month office expense allowance. Legislators receive a staffing allowance of \$39,765/year; leadership receives \$59,644/year.
Washington	Senate-\$7,800/year for legislative expenses, for which the legislator has not been otherwise entitled to reimbursement. No staffing allowance.
West Virginia	None.
Wisconsin	Allowed \$12,000 for 2 year session in the Assembly. N/A staffing, DO. Allowed \$45,000 for two year period for office expenses. Allowed \$191,700 for two year period for staffing allowance.
Wyoming	Up to \$750 quarter through the constituent service allowance.

Source: National Conference of State Legislatures 2012

PewResearchCenter

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FEBRUARY 12, 2013

Trust in Government in Washington Remains Low

For the past seven years, a period covering the final two years of the George W. Bush administration and Barack Obama's entire presidency, no more than about three-in-ten Americans have said that they trust the government in Washington to do the right thing always or most of the time.

26 %

Only about a quarter of Americans say they trust the federal government to do the right thing all or most of the time.

A January 2013 survey finds only about a quarter (26%) saying they can trust the government always or most of the time, while nearly three-quarters (73%) say that they can trust government only some of the time, or volunteer that they can never trust the government.

Majorities across all partisan and demographic groups express little or no trust in government. However, there continue to be sizable racial, age and partisan differences in these opinions.

More than twice as many Hispanics as whites trust the federal government (44% vs. 20%); among blacks, 38% say they can trust the government always or most of the time.

People younger than 30 have more trust in government than do those older than 30. And far more Democrats (38%) than independents (21%) or Republicans (15%) say they can trust the government at least most of the time.

The Pew Research Center’s 2010 study of attitudes toward government found that, since the 1950s, the party in control of the White House has expressed more trust in government than the so-called “out party.” But partisan differences in trust in government have been much wider during the Bush and Obama administrations than during previous administrations. [Read more](#)

(See interactive graphic “Public Trust in Government: 1958-2013”)

Broad Distrust of Government

Trust gov't in Washington to do right thing ...	Always/ Most of the time	Only some of the time/ Never (Vol.)	DK
	%	%	%
Total	26	73	2=100
Men	22	75	2=100
Women	29	70	1=100
White	20	79	1=100
Black	38	59	4=100
Hispanic	44	54	2=100
18-29	35	65	*=100
30-49	24	75	1=100
50-64	23	75	2=100
65+	22	74	4=100
Post-grad	27	73	1=100
College degree	22	78	1=100
Some college	25	73	1=100
HS or less	28	70	2=100
Republican	15	85	*=100
Conservative	12	88	*=100
Mod/Lib	21	78	1=100
Independent	21	78	1=100
Democrat	38	59	2=100
Conserv/Mod	41	56	3=100
Liberal	32	67	1=100

PEW RESEARCH CENTER Jan. 9-13, 2013. Q32. Whites and blacks are non-Hispanic; Hispanics are of any race. Figures may not add to 100% because of rounding.

Code of Federal Regulations

Title 26. Internal Revenue

Chapter I. Internal Revenue Service, Department of the Treasury

Subchapter A. Income Tax

Part 1. Income Taxes (Refs & Annos)

Normal Taxes and Surtaxes

Computation of Taxable Income

Definition of Gross Income, Adjusted Gross Income, and Taxable Income

26 C.F.R. § 1.62-2, Treas. Reg. § 1.62-2

§ 1.62-2 Reimbursements and other expense allowance arrangements.

Currentness

(a) **Table of contents.** The contents of this section are as follows:

(a) Table of contents.

(b) Scope.

(c) Reimbursement or other expense allowance arrangement.

(1) Defined.

(2) Accountable plans.

(i) In general.

(ii) Special rule for failure to return excess.

(3) Nonaccountable plans.

(i) In general.

(ii) Special rule for failure to return excess.

(4) Treatment of payments under accountable plans.

(5) Treatment of payments under nonaccountable plans.

(d) Business connection.

(1) In general.

(2) Other bona fide expenses.

(3) Reimbursement requirement.

(i) In general.

(ii) Per diem allowances.

§ 1.62-2 Reimbursements and other expense allowances, 26 C.F.R. § 1.62-2

(e) Substantiation.

(1) In general.

(2) Expenses governed by section 274(d).

(3) Expenses not governed by section 274(d).

(f) Returning amounts in excess of expenses.

(1) In general.

(2) Per diem or mileage allowances.

(g) Reasonable period.

(1) In general.

(2) Safe harbors.

(i) Fixed date method.

(ii) Periodic payment method.

(3) Pattern of overreimbursements.

(h) Withholding and payment of employment taxes.

(1) When excluded from wages.

(2) When included in wages.

(i) Accountable plans.

(A) General rule.

(B) Per diem or mileage allowances.

(1) In general.

(2) Reimbursements.

(3) Advances.

(4) Special rules.

(ii) Nonaccountable plans.

(i) Application.

(j) Examples.

(k) Anti-abuse provision.

(l) Cross references.

(m) Effective dates.

(b) Scope. For purposes of determining "adjusted gross income," section 62(a)(2)(A) allows an employee a deduction for expenses allowed by part VI (section 161 and following), subchapter B, chapter 1 of the Code, paid by the employee, in connection with the performance of services as an employee of the employer, under a reimbursement or other expense allowance arrangement with a payor (the employer, its agent, or a third party). Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) if--

(1) Such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) Such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

This section prescribes rules relating to the requirements of section 62(c).

(c) Reimbursement or other expense allowance arrangement--(1) Defined. For purposes of §§ 1.62-1, 1.62-1T, and 1.62-2, the phrase "reimbursement or other expense allowance arrangement" means an arrangement that meets the requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section. A payor may have more than one arrangement with respect to a particular employee, depending on the facts and circumstances. See paragraph (d)(2) of this section (payor treated as having two arrangements under certain circumstances).

(2) Accountable plans--(i) In general. Except as provided in paragraph (c)(2)(ii) of this section, if an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, all amounts paid under the arrangement are treated as paid under an "accountable plan."

(ii) Special rule for failure to return excess. If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, only the amounts paid under the arrangement that are not in excess of the substantiated expenses are treated as paid under an accountable plan.

(3) Nonaccountable plans--(i) In general. If an arrangement does not satisfy one or more of the requirements of paragraphs (d), (e), or (f) of this section, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." If a payor provides a nonaccountable plan, an employee who receives payments under the plan cannot compel the payor to treat the payments as paid under an accountable plan by voluntarily substantiating the expenses and returning any excess to the payor.

(ii) Special rule for failure to return excess. If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, the amounts paid under the arrangement that are in excess of the substantiated expenses are treated as paid under a nonaccountable plan.

(4) Treatment of payments under accountable plans. Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not reported as wages or other compensation on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes (Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), Railroad Retirement Tax Act (RRTA), Railroad Unemployment Repayment Tax (RURT), and income tax.) See paragraph (l) of this section for cross references.

(5) Treatment of payments under nonaccountable plans. Amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). See paragraph (h) of this section. Expenses attributable to amounts included in the employee's gross income may be deducted,

provided the employee can substantiate the full amount of his or her expenses (i.e., the amount of the expenses, if any, the reimbursement for which is treated as paid under an accountable plan as well as those for which the employee is claiming the deduction) in accordance with §§ 1.274-5T and 1.274(d)-1 or § 1.162-17, but only as a miscellaneous itemized deduction subject to the limitations applicable to such expenses (e.g., the 80-percent limitation on meal and entertainment expenses provided in section 274(n) and the 2-percent floor provided in section 67).

(d) Business connection--(1) In general. Except as provided in paragraphs (d)(2) and (d)(3) of this section, an arrangement meets the requirements of this paragraph (d) if it provides advances, allowances (including per diem allowances, allowances only for meals and incidental expenses, and mileage allowances), or reimbursements only for business expenses that are allowable as deductions by part VI (section 161 and the following), subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer. The payment may be actually received from the employer, its agent, or a third party for whom the employee performs a service as an employee of the employer, and may include amounts charged directly or indirectly to the payor through credit card systems or otherwise. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(2) Other bona fide expenses. If an arrangement provides advances, allowances, or reimbursements for business expenses described in paragraph (d)(1) of this section (i.e., deductible employee business expenses) and for other bona fide expenses related to the employer's business (e.g., travel that is not away from home) that are not deductible under part VI (section 161 and the following), subchapter B, chapter 1 of the Code, the payor is treated as maintaining two arrangements. The portion of the arrangement that provides payments for the deductible employee business expenses is treated as one arrangement that satisfies this paragraph (d). The portion of the arrangement that provides payments for the nondeductible employee expenses is treated as a second arrangement that does not satisfy this paragraph (d) and all amounts paid under this second arrangement will be treated as paid under a nonaccountable plan. See paragraphs (c)(5) and (h) of this section.

(3) Reimbursement requirement--(i) In general. If a payor arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) business expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement does not satisfy this paragraph (d) and all amounts paid under the arrangement are treated as paid under a nonaccountable plan. See paragraphs (c)(5) and (h) of this section.

(ii) Per diem allowances. An arrangement providing a per diem allowance for travel expenses of a type described in paragraph (d)(1) or (d)(2) of this section that is computed on a basis similar to that used in computing the employee's wages or other compensation (e.g., the number of hours worked, miles traveled, or pieces produced) meets the requirements of this paragraph (d) only if, on December 12, 1989, the per diem allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the per diem allowance, or a per diem allowance computed on that basis was commonly used in the industry in which the employee is employed. See section 274(d) and § 1.274(d)-1. A per diem allowance described in this paragraph (d)(3)(ii) may be adjusted in a manner that reasonably reflects actual increases in employee business expenses occurring after December 12, 1989.

(e) Substantiation--(1) In general. An arrangement meets the requirements of this paragraph (e) if it requires each business expense to be substantiated to the payor in accordance with paragraph (e)(2) or (e)(3) of this section, whichever is applicable, within a reasonable period of time. See § 1.274-5T or § 1.162-17.

(2) Expenses governed by section 274(d). 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 (e)(2) if information sufficient to satisfy the substantiation requirements of section 274(d) and the regulations thereunder is submitted to the payor. See § 1.274-5. Under section 274(d), information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, § 1.274-5(b)(2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed

property, § 1.274-5(b)(6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See § 1.274-5(g) and (j), which grant the Commissioner the authority to establish optional methods of substantiating certain expenses. Substantiation of the amount of a business expense in accordance with rules prescribed pursuant to the authority granted by § 1.274-5(g) or (j) will be treated as substantiation of the amount of such expense for purposes of this section.

(3) Expenses not governed by section 274(d). An arrangement that reimburses business expenses not governed by section 274(d) meets the requirements of this paragraph (e)(3) if information is submitted to the payor sufficient to enable the payor to identify the specific nature of each expense and to conclude that the expense is attributable to the payor's business activities. Therefore, each of the elements of an expenditure or use must be substantiated to the payor. It is not sufficient if an employee merely aggregates expenses into broad categories (such as "travel") or reports individual expenses through the use of vague, nondescriptive terms (such as "miscellaneous business expenses"). See § 1.162-17(b).

(f) Returning amounts in excess of expenses--(1) In general. Except as provided in paragraph (f)(2) of this section, an arrangement meets the requirements of this paragraph (f) if it requires 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 in accordance with paragraph (e) of this section. The determination of whether an arrangement requires an employee to return amounts in excess of substantiated expenses will depend on the facts and circumstances. An arrangement whereby money is advanced to an employee to defray expenses will be treated as satisfying the requirements of this paragraph (f) only if the amount of money advanced is reasonably calculated not to exceed the amount of anticipated expenditures, the advance of money is made on a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, and any amounts in excess of the expenses substantiated in accordance with paragraph (e) of this section are required to be returned to the payor within a reasonable period of time after the advance is received.

(2) Per diem or mileage allowances. The Commissioner may, in his discretion, prescribe rules in pronouncements of general applicability under which a reimbursement or other expense allowance arrangement that provides per diem allowances providing for ordinary and necessary expenses of traveling away from home (exclusive of transportation costs to and from destination) or mileage allowances providing for ordinary and necessary expenses of local travel and transportation while traveling away from home will be treated as satisfying the requirements of this paragraph (f), even though the arrangement does not require the employee to return the portion of such an allowance that relates to the days or miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under section 274(d), provided the allowance is paid at a rate for each day or mile of travel that is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return to the payor within a reasonable period of time any portion of such allowance which relates to days or miles of travel not substantiated in accordance with paragraph (e) of this section.

(g) Reasonable period--(1) In general. The determination of a reasonable period of time will depend on the facts and circumstances.

(2) Safe harbors--(i) Fixed date method. An advance made within 30 days of when an expense is paid or incurred, an expense substantiated to the payor within 60 days after it is paid or incurred, or an amount returned to the payor within 120 days after an expense is paid or incurred will be treated as having occurred within a reasonable period of time.

(ii) Periodic statement method. If a payor provides employees with periodic statements (no less frequently than quarterly) stating the amount, if any, paid under the arrangement in excess of the expenses the employee has substantiated in accordance with paragraph (e) of this section, and requesting the employee to substantiate any additional business expenses that have not yet been substantiated (whether or not such expenses relate to the expenses with respect to which the original advance was paid) and/or to return any amounts remaining unsubstantiated within 120 days of the statement, an expense substantiated or an amount returned within that period will be treated as being substantiated or returned within a reasonable period of time.

(3) Pattern of overreimbursements. If, under a reimbursement or other expense allowance arrangement, a payor has a plan or practice to provide amounts to employees in excess of expenses substantiated in accordance with paragraph (e) of this section and to avoid reporting and withholding on such amounts, the payor may not use either of the safe harbors provided in paragraph (g)(2) of this section for any years during which such plan or practice exists.

(h) Withholding and payment of employment taxes--(1) When excluded from wages. If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, the amounts paid under the arrangement that are not in excess of the expenses substantiated in accordance with paragraph (e) of this section (i.e., the amounts treated as paid under an accountable plan) are not wages and are not subject to withholding and payment of employment taxes. If an arrangement provides advances, allowances, or reimbursements for meal and entertainment expenses and a portion of the payment is treated as paid under a nonaccountable plan under paragraph (d)(2) of this section due solely to section 274(n), then notwithstanding paragraph (h)(2)(ii) of this section, these nondeductible amounts are neither treated as gross income nor subject to withholding and payment of employment taxes.

(2) When included in wages--(i) Accountable plans--(A) General rule. Except as provided in paragraph (h)(2)(i)(B) of this section, if the expenses covered under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section are not substantiated to the payor in accordance with paragraph (e) of this section within a reasonable period of time or if any amounts in excess of the substantiated expenses are not returned to the payor in accordance with paragraph (f) of this section within a reasonable period of time, the amount which is treated as paid under a nonaccountable plan under paragraph (c)(3)(ii) of this section is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. A payor may treat any amount not substantiated or returned within the periods specified in paragraph (g)(2) of this section as not substantiated or returned within a reasonable period of time.

(B) Per diem or mileage allowances--(1) In general. If a payor pays a per diem or mileage allowance under an arrangement that meets the requirements of the paragraphs (d), (e), and (f) of this section, the portion, if any, of the allowance paid that relates to days or miles of travel substantiated in accordance with paragraph (e) of this section and that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under section 274(d) and § 1.274(d)-1 or § 1.274-5T(j) is treated as paid under a nonaccountable plan. See paragraph (c)(3)(ii) of this section. Because the employee is not required to return this excess portion, the reasonable period of time provisions of paragraph (g) of this section (relating to the return of excess amounts) do not apply to this excess portion.

(2) Reimbursements. Except as provided in paragraph (h)(2)(i)(B)(4) of this section, in the case of a per diem or mileage allowance paid as a reimbursement at a rate for each day or mile of travel that exceeds the amounts of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion described in paragraph (h)(2)(i) of this section is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the days or miles of travel substantiated in accordance with paragraph (e) of this section.

(3) Advances. Except as provided in paragraph (h)(2)(i)(B)(4) of this section, in the case of a per diem or mileage allowance paid as an advance at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion described in paragraph (h)(2)(i) of this section is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the expenses with respect to which the advance was paid (i.e., the days or miles of travel) are substantiated in accordance with paragraph (e) of this section. The expenses with respect to which the advance was paid must be substantiated within a reasonable period of time. See paragraph (g) of this section.

(4) **Special rules.** The Commissioner may, in his discretion, prescribe special rules in pronouncements of general applicability regarding the timing of withholding and payment of employment taxes on per diem and mileage allowances.

(ii) **Nonaccountable plans.** If an arrangement does not satisfy one or more of the requirements of paragraphs (d), (e), or (f) of this section, all amounts paid under the arrangement are wages and are subject to withholding and payment of employment taxes when paid.

(i) **Application.** The requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section will be applied on an employee-by-employee basis. Thus, for example, the failure by one employee to substantiate expenses under an arrangement in accordance with paragraph (e) of this section will not cause amounts paid to other employees to be treated as paid under a nonaccountable plan.

(j) **Examples.** The rules contained in this section may be illustrated by the following examples:

Example (1). Reimbursement requirement. Employer S pays its engineers \$200 a day. On those days that an engineer travels away from home on business for Employer S, Employer S designates \$50 of the \$200 as paid to reimburse the engineer's travel expenses. Because Employer S would pay an engineer \$200 a day regardless of whether the engineer was traveling away from home, the arrangement does not satisfy the reimbursement requirement of paragraph (d)(3)(i) of this section. Thus, no part of the \$50 Employer S designated as a reimbursement is treated as paid under an accountable plan. Rather, all payments under the arrangement are treated as paid under a nonaccountable plan. Employer S must report the entire \$200 as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the entire \$200 when paid.

Example (2). Reimbursement requirement, multiple arrangements. Airline T pays all its employees a salary. Airline T also pays an allowance under an arrangement that otherwise meets the requirements of paragraphs (d), (e), and (f) of this section to its pilots and flight attendants who travel away from their home base airports, whether or not they are "away from home." Because the allowance is paid only to those employees who incur (or are reasonably expected to incur) expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement satisfies the reimbursement requirement of paragraph (d)(3)(i) of this section. Under paragraph (d)(2) of this section, Airline T is treated as maintaining two arrangements. The portion of the arrangement providing the allowances for away from home travel is treated as an accountable plan. The portion of the arrangement providing the allowances for non-away from home travel is treated as a nonaccountable plan. Airline T must report the non-away from home allowances as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on these payments when paid.

Example (3). Reimbursement requirement. Corporation R pays all its salespersons a salary. Corporation R also pays a travel allowance under an arrangement that otherwise meets the requirements of paragraphs (d), (e), and (f) of this section. This allowance is paid to all salespersons, including salespersons that Corporation R knows, or has reason to know, do not travel away from their offices on Corporation R business and would not be reasonably expected to incur travel expenses. Because the allowance is not paid only to those employees who incur (or are reasonably expected to incur) expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement does not satisfy the reimbursement requirement of paragraph (d)(3)(i) of this section. Thus, no part of the allowance Corporation R designated as a reimbursement is treated as paid under an accountable plan. Rather, all payments under the arrangement are treated as paid under a nonaccountable plan. Corporation R must report all payments under the arrangement as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the payments when paid.

Example (4). Separate arrangement, miscellaneous expenses. Under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section, County U reimburses its employees for lodging and meal expenses incurred when they travel away from home on County U business. For its own convenience, County U also separately pays certain of its employees a \$25 monthly allowance to cover the cost of small miscellaneous office expenses. County U does not require its employees to substantiate these miscellaneous expenses and does not require them to return the amounts by which the monthly allowance

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exceeds the miscellaneous expenses. The monthly allowance arrangement is a nonaccountable plan. County U must report the monthly allowances as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the monthly allowances when paid. The nonaccountable plan providing the monthly allowances is treated as separate from the accountable plan providing reimbursements for lodging and meal expenses incurred for travel away from home on County U business.

Example (5). Excessive advances. In anticipation of employee business expenses that Corporation V does not reasonably expect to exceed \$400 in any quarter, Corporation V nonetheless advances \$1,000 to Employee A for such expenses. Whenever Employee A substantiates an expense in accordance with paragraph (e) of this section, Corporation V provides an additional advance in an amount equal to the amount substantiated, thereby providing a continuing advance of \$1,000. Because the amounts advanced under this arrangement are not reasonably calculated so as not to exceed the amount of anticipated expenditures and because the advance of money is not made on a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, the arrangement is a nonaccountable plan. The arrangement fails to satisfy the requirements of paragraphs (d) (business connection) and (f) (reasonable calculation of advances) of this section. Thus, Corporation V must report the entire amount of each advance as wages or other compensation and must withhold and pay employment taxes on the entire amount of each advance when paid.

Example (6). Excess mileage advance. Under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section, Employer W pays its employees a mileage allowance at a rate of 30 cents per mile (when the amount deemed substantiated for each mile of travel substantiated is 26 cents per mile) to cover automobile business expenses. The allowance is paid at a rate for each mile of travel that is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses. Employer W does not require the return of the portion of the mileage allowance (4 cents) that exceeds the amount deemed substantiated for each mile of travel substantiated in accordance with paragraph (e) of this section. In June, Employer W advances Employee B \$150 for 500 miles to be traveled by Employee B during the month. In July, Employee B substantiates 500 miles of business travel. The amount deemed substantiated by Employee B is \$130. However, Employer W does not require Employee B to return the remaining \$20 of the advance. No later than the first payroll period following the payroll period in which the business miles of travel are substantiated, Employer W must withhold and pay employment taxes on \$20 (500 miles x 4 cents per mile).

Example (7). Excess per diem reimbursement. Under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section, Employer X pays its employees a per diem allowance to cover lodging, meal, and incidental expenses incurred for travel away from home on Employer X business at a rate equal to 120 percent of the amount deemed substantiated for each day of travel to the localities to which the employees travel. Employer X does not require the employees to return the 20 percent by which the reimbursement for those expenses exceeds the amount deemed substantiated for each day of travel substantiated in accordance with paragraph (e) of this section. Employee C substantiates six days of business travel away from home: Two days in a locality for which the amount deemed substantiated is \$100 a day and four days in a locality for which the amount deemed substantiated is \$125 a day. Employer X reimburses Employee C \$840 for the six days of travel away from home ($2 \times (120\% \times \$100) + 4 \times (120\% \times \$125)$), and does not require Employee C to return the excess portion (\$140 excess portion = $(2 \text{ days} \times \$20 (\$120 - \$100) + 4 \text{ days} \times \$25 (\$150 - \$125))$). For the payroll period in which Employer X reimburses the expenses, Employer X must withhold and pay employment taxes on \$140.

Example (8). Return Requirement. Employer Y provides expense allowances to certain of its employees to cover business expenses of a type described in paragraph (d)(1) of this section under an arrangement that requires the employees to substantiate their expenses within a reasonable period of time and to return any excess amounts within a reasonable period of time. Each time an employee returns an excess amount to Employer Y, however, Employer Y pays the employee a "bonus" equal to the amount returned by the employee. The arrangement fails to satisfy the requirements of paragraph (f) (returning amounts in excess of expenses) of this section. Thus, Employer Y must report the entire amount of the expense allowance payments as wages or other compensation and must withhold and pay employment taxes on the payments when paid. Compare example (6) (where the employee is not required to return the portion of the mileage allowance that exceeds the amount deemed substantiated for each mile of travel substantiated).

Example (9). Timely substantiation. Employer Z provides a \$500 advance to Employee D for a trip away from home on Employer Z business. Employee D incurs \$500 in business expenses on the trip. Employer Z uses the periodic statement method safe harbor. At the end of the quarter during which the trip occurred, Employer Z sends a quarterly statement to Employee D stating that \$500 was advanced to Employee D during the quarter and that no expenses were substantiated and no excess amounts returned. The statement advises Employee D that Employee D must substantiate any additional business expenses within 120 days of the date of the statement, and must return any unsubstantiated excess within the 120-day period. Employee D fails to substantiate any expenses or to return the excess within the 120-day period. Employer Z treats the \$500 as wages and withholds and pays employment taxes on the \$500. After the 120-day period has expired, Employee D substantiates the \$500 in travel expenses in accordance with paragraph (e) of this section. Employer Z properly reported and withheld and paid employment taxes on the \$500 and no adjustments may be made. Employee D must include the \$500 in gross income and may deduct the \$500 of expenses as a miscellaneous itemized deduction subject to the 2-percent floor provided in section 67.

(k) Anti-abuse provision. If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of section 62(c) and this section, all payments made under the arrangement will be treated as made under a nonaccountable plan.

(l) Cross references. For employment tax regulations relating to reimbursement and expense allowance arrangements, see §§ 31.3121(a)-3, 31.3231(e)-(3), 31.3306(b)-2, and 31.3401(a)-4, which generally apply to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990 with respect to expenses paid or incurred on or after July 1, 1990. For reporting requirements, see § 1.6041-3(i), which generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1989 with respect to expenses paid or incurred on or after January 1, 1989.

(m) Effective dates. This section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee in taxable years of the employee beginning on or after January 1, 1989, with respect to expenses paid or incurred in taxable years beginning on or after January 1, 1989. Paragraph (h) of this section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990 with respect to expenses paid or incurred on or after July 1, 1990. Paragraphs (d)(3)(ii) and (h)(2)(i)(B) of this section apply to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1991 with respect to expenses paid or incurred on or after January 1, 1991. Paragraph (e)(2) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee with respect to expenses paid or incurred after December 31, 1997.

Credits

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Notes of Decisions (32)

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