

Employee Reimbursement Policies

The Internal Revenue Code (hereafter referred to "IRC") mandates that certain requirements be met for expense allowance and reimbursement amounts paid to employees and other workers to avoid classification as taxable wages. These requirements are known as "Accountable Plan" requirements. Amounts paid under an Accountable Plan are excluded from the employee's gross income, are not reportable as wages or other compensation on the employee's W-2, and are exempt from the withholding and payment of employment taxes.

ACCOUNTABLE PLAN

IRC §62(c) and Regulation §1.62-2 requirements are as follows:

1. **Business Connection of Expenses** for whom the expenses were incurred (which are ordinary and necessary);
2. **Proper Substantiation of Expenses** requires a receipt;
3. **Written Plan** requiring that employees return to the employer amounts advanced in excess of actual expenses incurred, sample attached;
4. **Actual Return by Employee of Excess Reimbursed Amounts**, within a reasonable time, of advanced amounts in excess of actual expenses incurred (typically 120 days); and,
5. **Reasonableness Requirement** that any advance made by an employer to an employee must be reasonably calculated not to exceed the amount of reasonably anticipated expenditures to which such advance relates.

This article discusses in greater detail each of these requirements and illustrates how you and your company can best comply with these laws.

1. Business Connection of Expenses:

A reimbursement arrangement has a "business connection" if the employer in good faith, provides advances, allowances or reimbursements for deductible business expenses incurred by the employee in connection with the performance of services as an employee.

A reimbursement arrangement will fail the "business connection" requirement if the employer does not reasonably believe that the employee will use the reimbursement to pay bona fide expenses related to the employer's business.

2. Proper Substantiation of Expenses:

There are two categories of expenses to which the substantiation rules apply:

- A. **IRC §274 Expense Items:** Substantiation required relating to a specific expenditure is the "who, what, where, when, why and how much" details related to the expenditure and must be documented in writing. For company automobiles and other "listed property" (business property that can be used for both personal and business use), actual substantiation must meet the following four requirements:

1. the amount of the expense (repairs, gas, oil changes, etc.);
2. business use (number of business miles or percentage of use related to business);
3. time (date) of use; and
4. business purpose/business use (name of customer, destination, project description).

B. **Other Expense Items:** For employee business expenses that do not fall within IRC §274 (such as professional journals, professional dues, etc.), an employee is considered to have substantiated such expenses if information submitted is sufficient to enable the person providing the reimbursement to identify the specific nature and amount of each expense and to conclude that the expense is attributable to the employer's business activities.

It is not sufficient if an employee merely aggregates into broad categories (such as "travel") or reports individual expenses through the use of vague, non-descriptive items (such as "misc. business expenses").

3. **Written Plan:**

The requirement to prove business connection of expenses and proper substantiation of expenses is only met through a *written expense reimbursement plan* (which is incorporated by reference to the worker's employment contract). A written expense reimbursement plan should also include "arrangement requires an employee to return amounts in excess of substantiated expenses."

4. **Actual Return by Employee of Excess Reimbursed Amounts:**

A plan must require the employee to pay back any advance in excess of actual substantiated expenses to be an Accountable Plan. The determination of whether an arrangement required an employee to return amounts in excess of substantiated expenses will depend on the facts and circumstances. Both the requirement of substantiation and the requirement to return excess advances must be met within a "reasonable period of time." The determination of a "reasonable period of time" will depend on the facts and circumstances. Two safe harbor rules exist to establish that the "reasonable period of time" requirement has been met:

A. **Fixed Date Method:** An advance made within 30 days of when an expense is paid or incurred, an expense substantiated to the payer within 60 days after it is paid or incurred, or an amount returned to the payer within 120 days after an expense is paid or incurred will be treated as having occurred within a "reasonable period of time".

B. **Periodic Statement Method:** If the payer provides employees with periodic statements (no less frequently than quarterly):

1. stating the amount, if any, paid under the arrangement in excess of the expenses the employee has substantiated; and
2. requests the employee to substantiate any additional expenses and/or to return any amounts remaining unsubstantiated within 120 days.

5. **Reasonableness Requirement:**

When money is advanced to an employee to defray expenses, such an advance must be reasonably calculated not to exceed the amount of anticipated expenditures, and must be made within a "reasonable period of time" prior to the day that the anticipated expenditures will be paid or incurred by the employee.

KEYS TO UNDERSTANDING ACCOUNTABLE PLAN REQUIREMENTS

1. That amounts reimbursed must actually be for legitimate, properly substantiated business expenditures, and
2. That the plan requires advances or allowances that are not actually spend on business expenses to be returned to the employer within approximately 120 days.

DIFFERENT CATEGORIES OF EXPENSES

Different categories of expenses are eligible for different treatment in expenses reimbursement plans. The options available for different treatment for each of the three following types of expenses are set forth below. Any option for 1) [transportation expenses](#) may be freely combined with any option for 2) [away from home travel](#) and any option for 3) [other expenses](#). In other words, options in each of the three main expense categories may be mixed and matched with the options available in each of the other categories in any desired order.

1. Transportation Expenses:

In addition to the options below, all business related parking fees and tolls might be 100% deductible. Interest incurred by employees on auto loans is not considered an employee business expense, and therefore, not reimbursable. Options available for the reimbursement of local transportation expenses include:

- A. IRS Standard Mileage Rate: The IRS standard mileage rate is 65.5 cents for the calendar year ending December 31, 2023. If an employee substantiates the total number of miles driven and the business purpose, a monetary reimbursement will not be taxable wages to the employee (the reimbursement rate can be any amount of cents per mile, up to, but not exceeding, the IRS standard mileage rate).
- B. Actual Cost Method: Reimbursable actual car expenses include costs for gas, oil, repairs, maintenance, insurance, taxes, licenses and other similar items. Under the actual cost method, these actual expenses are totaled and multiplied by the business use percentage to determine the business expense. Note that the "actual cost method" for local transportation involves tedious record keeping and retention for both the employer and employees, and therefore may not be as administratively expedient as the "IRS standard mileage rate".
- C. FAVR Method: The Fixed and Variable Rate (FAVR) method allows an employer to reimburse the employee's expenses with a mileage allowance using a flat rate or a stated schedule that combines periodic fixed and variable payments (designed to recover depreciation and projected operating costs of the auto for the period in question). At least five employees must be covered by such an arrangement at all times during the year, but at no time can the majority of covered employees be management employees or board members. This method is extremely complex, time-consuming and expensive to establish and administer and there are many restrictions on its use. As a practical matter, it is not likely to be advantageous to a business to use this method.

2. Away From Home Travel:

Employee "away from home" travel expenses that are reimbursed under a "per diem" or other similar expense allowance arrangement will be deemed properly substantiated.

- A. **Per Diem Allowance**, a per diem allowance is a payment under a reimbursement or other expense allowance arrangement that is paid for ordinary and necessary business expenses incurred by an employee for lodging, meals and/or other incidental expenses for travel away from home, reasonably calculated not to exceed the amount of anticipated expenses; or
- B. **Per Diem Flat Rate**, paid at the applicable federal per diem rate, a flat rate, or stated schedule or in accordance with another approved rate or schedule.

Current Federal Per Diem Rates for Lodging, Meals, and Incidentals: For away from home travel, the lodging, meals, and incidentals may be reimbursed at the federal per diem rate, regardless of the actual amount incurred. The federal per diem rate is equal to the sum of the federal lodging expense rate and the federal meal and incidental expense rate for the locality of travel, current per diem rates can be found by typing per diem rates in the search bar at www.gsa.gov.

Current Federal Per Diem Rates for Meals and Incidentals: For away from home travel, meals and incidentals only, may be reimbursed each day in the amount of the federal per diem rate (see above rate link), regardless of their actual amount, but lodging relating to such away from home travel must be reimbursed at an amount equal to the actual cost incurred by the employee for such lodging.

3. **Other Expenses:**

An employer may reimburse expenses, other than transportation and away from home travel expenses, to an employee in the amount of the actual business expense incurred by the employee. This is a "dollar per dollar" reimbursement of legitimate business expenses. No variations of this approach are available. As the need increased for extended accessibility to calls, voicemail, and emails, smartphone plans are another commonly reimbursable expense. Employee moving expenses are no longer eligible to be reimbursed without being included as taxable wages.

Due to the complex nature of this area, we would like to offer our assistance in the implementation of maintenance of your accountable plan. Many companies have not formally adopted reimbursement plans that satisfy the requirements of the regulations. As a drafting aid for employers who wish to conform their reimbursement policies to these rules, we have a sample accountable plan.

Please contact us so we can discuss reporting options and methods that work best for your company.

SAMPLE ACCOUNTABLE PLAN

Many clients have not formally adopted reimbursement plans that satisfy the requirements of the regulations. As a drafting aid for employers who wish to conform their reimbursement policies to these rules, we have included below a sample accountable plan authored by Bradley Burnett, a Denver attorney who was one of our seminar speakers. In addition to the plan itself, Brad has offered some sample language that may be used for adoption of the plan by the Board of Directors. It is our recommendation that you make this part of your corporate minutes for years that may apply.

Accountable Expense Reimbursement Plan (SAMPLE)

Be it resolved, that employees of the Company be reimbursed for business expenses incurred on behalf of and authorized by the Company (hereinafter referred to as "authorized business expenses") in accordance with the following criteria:

1. **Business Purpose.** Authorized business expenses covered by this plan must meet the requirements for deductibility as business expenses under Federal tax law. An employee in connection with the performance of services by such employee on behalf of the company must have incurred such expenses.
2. **Adequate Substantiation.** Any employee requesting reimbursement or authorized business expenses hereunder must furnish to the Company adequate substantiation of expenses to be reimbursed. Adequate substantiation shall be accomplished by the timely submission to the Company of a Company expense reimbursement voucher properly completed in accordance with the substantiation requirements of Federal tax law, together with any relevant documentary evidence required under the substantiation requirements of Federal tax law. Such documentary evidence shall indicate the amount, description indicating the particular nature of the expense, time, place and business purpose or use of any authorized business expense and any other necessary, related information.
3. **Return of Excess Amounts.** Any employee receiving payment from the Company for an authorized business expense incurred by such employee on behalf of the Company must return to the Company, within thirty days after the occurrence of any such expense, any amount of such payment that exceeds the amount the employee has properly substantiated relating to such expense.
4. **Request for Reimbursement.** An employee hereunder must submit any request for reimbursement for any authorized business expense within thirty days after the occurrence of any such expense by such employee. Any request for reimbursement must be submitted via a properly completed and substantiated Company expense reimbursement voucher and related documentary evidence in accordance with the provisions of paragraph 2 above.
5. **Reimbursement of Transportation (Automobile) Expenses.** Authorized transportation (automobile) expenses hereunder shall be reimbursed to an employee at the rate of the federally established maximums per mile for properly substantiated mileage with an authorized company related business purpose.
6. **Reimbursement of All Other Expenses.** All other authorized business expenses hereunder shall be reimbursed in an amount equal to the actual cost thereof incurred by an employee. As of 1/1/2018, these reimbursements no longer include business connected qualifying moving expenses, such reimbursements will be treated as taxable compensation.
7. **Advances.** In limited circumstances, advances of authorized business expenses to be incurred by an employee on behalf of the Company may be granted by and at the sole discretion of the Company. The amount of money advanced by the Company to an employee MUST be reasonably calculated not to exceed the amount of anticipated expenditures and made on a day within thirty days of the day that the anticipated expenditures are paid or incurred. The employee receiving such advance must substantiate any related expense to the Company within thirty (30) days after incurring such expense and return to the company within thirty (30) days any advanced amount that exceeds the amount of the employee properly substantiated relating to such expense.
8. **Additional Rules.** Any reimbursement for expenses hereunder shall be payable to an employee by the Company with a check separate and apart from the employee's regular paycheck, if any. The method of reimbursement enumerated hereunder may not be changed by either action of the Company or employee at any time during a calendar year. This plan shall be maintained on a calendar year (i.e. January 1, through December 31) basis. This plan shall become effective for the 20XX plan year.
9. **Consequences of Failure.** Consequences of failure by an employee to comply with any provision or provisions contained in paragraphs 1 through 8 above may, at the option of the Company, render the expenses related to such failure un-reimbursable.