2017

Expense Reimbursements for Employees

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Employer Reimbursements

An employer may reimburse an employee for travel, meals, and entertainment expenses incurred while performing services for the employer. The tax treatment of the reimbursement, including per diem allowances, depends on whether the employer has an "accountable plan" or a "nonaccountable plan."

If expenses are reimbursed under an accountable plan, the employer deducts the amount allowable as travel, meals, and entertainment expense, and the employee excludes the reimbursement from income.

If the expenses are reimbursed under a nonaccountable plan, the employer reports the reimbursement as taxable wages to the employee on Form W-2 and takes a wage expense deduction. The employee is then allowed a deduction on his or her individual income tax return for the reimbursed expenses on Form 2106, *Employee Business Expenses.* These expenses are subject to the 2% AGI limitation as miscellaneous itemized deductions.

Accountable Plan

To qualify as an accountable plan, employees must:
1) Have paid or incurred deductible expenses while performing services as an employee,
2) Adequately account to the employer for these expenses within a reasonable period of time, and
3) Return any excess reimbursement or allowance within a reasonable period of time.

An arrangement under which the employer advances money to the employees is treated as meeting (3), above, only if the following requirements are also met.

- The advance is reasonably calculated not to exceed the amount of anticipated expenses.
- The employer makes the advance within a reasonable period of time.

Excess reimbursement. Any amount advanced to the employee that exceeds the amount adequately accounted for by the employee must be returned to the employer within a reasonable period of time.

If a reimbursement arrangement provides for meal expenses in excess of the federal per diem rate, there must be a mechanism in place to track the actual expenses for purposes of returning the excess to the employer. If such a mechanism is not in place, the entire amount of reimbursement is included in the employees' taxable wages, not just the amount in excess of the federal per diem.

Reasonable period of time. Facts and circumstances determine what is reasonable in a given situation. Actions that take place within the following list will be treated as taking place within a reasonable period of time.
- The employer reimburses an expense within 30 days of the time the employee incurred the expense.
- The employee adequately accounts for the expense within 60 days after the expense was paid or incurred.
- The employee returns any excess reimbursement within 120 days after the expense was paid or incurred.
- The employer gives the employee a periodic statement, at least quarterly, that asks the employee to either return or adequately account for outstanding advances, and the employee complies within 120 days of the date of the statement.

Expense Reimbursements for Employees

Reimbursement not requested. When an employee has a right to reimbursement for expenses related to his or her status as an employee but fails to claim reimbursement, the expenses are not deductible since they are not considered necessary expenses.

Court Case: The taxpayer's job involved extensive traveling in a two-state area. His employer had a policy under which employees were eligible for reimbursement of all types of nonvehicle business expenses. The taxpayer did not submit any expenses for reimbursement from his employer. Instead, he deducted the expenses as unreimbursed business expenses on his tax return. The court noted that it was not necessary for the taxpayer to remain unreimbursed for the expenses. To the extent the expenses could have been reimbursed, the court disallowed the taxpayers claimed deductions. (*Stidham,* T.C. Summary 2012-61)

Nonaccountable Plan

Any form of reimbursement that does not meet the accountable plan rules is a nonaccountable plan. All amounts paid, or treated as paid under a nonaccountable plan are reported as wages on Form W-2. The payments are subject to income tax withholding, Social Security, Medicare, and federal unemployment taxes.

Paying Expenses of an Employer

If the expense paid by an employee is that of the employer and not the employee, the expense might not be deductible. This could be the case where a taxpayer is both the shareholder and employee of his or her corporation. The shareholder-employee may pay a corporate expense, such as office rent, out of personal funds when the corporate checkbook is low on funds. Since the expense is a liability of the corporation and not the employee, the expense is not deductible by the employee because it is not an ordinary and necessary business expense. However, if the corporation has a resolution or policy in place requiring a corporate officer as an employee of the corporation to assume certain expenses, those expenses would be deductible by the employee, subject to the 2% AGI limitation on Schedule A, *Itemized Deductions.*

Reporting Reimbursements

If the type of reimbursement, or other expense allowance is under:	*Then the employer reports on Form W-2:*	*And the employee reports on Form 2106:*
An accountable plan with:		
Actual expense reimbursement with adequate accounting made and excess returned.	No amount.	No amount.
Actual expense reimbursement with adequate accounting and return of excess both required but excess not returned.	The excess amount as wages in box 1, box 3, and box 5.	No amount.
Per diem or mileage allowance up to the federal rate with adequate accounting made and excess returned.	No amount.	No amount.
Per diem or mileage allowance up to the federal rate with adequate accounting and return of excess both required but excess not returned.	The excess amount as wages in box 1, box 3, and box 5. The amount up to the federal rate is reported in box 12 but not in box 1.	No amount.
Per diem or mileage allowance exceeds the federal rate with adequate accounting made up to the federal rate only and excess not returned.	The excess amount as wages in box 1, box 3, and box 5. The amount up to the federal rate is reported in box 12 but not reported in box 1.	The amount that can be substantiated as a business deduction reported in box 12 if expenses in excess of the federal rate are claimed. Otherwise form is not filed.
A nonaccountable plan with:		
Either adequate accounting or return of excess, or both, not required by plan.	The entire amount as wages in box 1, box 3, and box 5.	The amount that can be substantiated as a business deduction.
No reimbursement plan:	The entire amount as wages in box 1, box 3, and box 5.	The amount that can be substantiated as a business deduction

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.