

*From the desk of Jeanne M. Kerkstra, Esq., CPA*

**Viewpoint**  
**Partial Infraction = Total Taxation**

Tis the season. We're counting down the days to the end of the year. Employees are trying to make sure that they have all of their necessary expenses in to maximize their reimbursements under their company's reimbursement plan. However, no one, be they an employer or an employee, likes unhappy surprises such as the one in Rev. Rul. 2006-56. The employer had set up a reimbursement arrangement so that by providing certain substantiation, employees were reimbursed for certain expenses. However, because they did not follow the letter of the law and a part of the reimbursement was unsubstantiated and in excess of the allowable amounts, negative tax consequences resulted. The IRS did not merely include the excess that was unsubstantiated. It held that due to the fact that the company was in violation, the company had an abusive reimbursement plan which resulted in all of the amounts, not only the excess, being counted as taxable wages to the employees. A stinging result.

In Rev. Rul. 2006-56, the employer was in the business of long-haul transportation. It reimbursed its drivers for meal and incidental expenses (M&IE) paid or incurred while traveling away from home. Pursuant to Re. Proc. 2005-67, an employer is able to elect an amount as the federal M&IE rate. The employer received substantiation for said amount from its drivers. However, it did not require substantiation for those amounts in excess of the federal rate. The taxpayer did not require the drivers to return the portion of the allowance paid for days they were away from home on business travel that exceeded the \$52.00 per day that may be deemed substantiated. The taxpayer did not treat the excess allowance over \$52.00 per day as wages for withholding for employment tax purposes and did not report the excess allowance as wages on the driver's Form W-2.

A reimbursement arrangement is considered made under an accountable plan if it meets three requirements: 1. The business connection requirement. 2. The substantiation requirement. 3. The returning amounts in excess of substantiated expenses requirement. A reimbursement arrangement must meet all three requirements. See Sec. 1.62(c)(1). Failure to meet *any* of the three requirements results in total inclusion in taxable income of the reimbursements. If the worker does not return the excess amounts, the company must take steps to ensure that the excess reimbursements are tracked and treated as wages subject to withholding and payment of employment taxes and reporting on the W-2's.

Consequently, it is best to review all reimbursement arrangements to make sure that they are in conformity. Otherwise, this can make for a very unhappy holiday season.

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