

# **Taxable Fringe Benefit Guide**



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THE INTERNAL REVENUE SERVICE**

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# COMPLIANCE: TAXABLE FRINGE BENEFITS

**Course Description:** This class given by the Internal Revenue Service provides understanding on which employee fringe benefits related to travel and non-travel issues are taxable and reportable under the Internal Revenue Code, regulations, and procedures.

**Target Group:** All personnel who need to determine the taxability, withholding, and reporting requirements regarding employee fringe benefits.

**Course Objectives:** At the conclusion of this course, participants should:

- Know which travel and non-travel related fringe benefits commonly provided by employers are taxable and which taxes must be withheld from employees' payroll,
- Have a general understanding how to compute the taxable value for those taxable fringe benefits discussed,
- Know how to report the taxable value on Forms W-2 and 1099-MISC,
- Know the additional Federal reporting requirements that are in effect for certain fringe benefits, and
- Know how to obtain answers from the Internal Revenue Service to questions throughout the year regarding taxation and reporting requirements.

### **NOTICE**

**This guide is intended to provide basic information on the subjects covered. It was not possible to include complete details on each individual topic. It is intended to serve as a resource guide and not as a legal reference. Additional research may be required before a determination may be made on a particular issue. For that purpose, references and citations are included in each chapter.**

**This text is not an officially approved document of the Internal Revenue Service.**

# FRINGE BENEFITS

## General Information

### What is a Fringe Benefit?

IRC § 61(a)(1)  
Pub. 15-B

A form of pay for the performance of services (includes property, services, cash or cash equivalent). Applies to services of employees and independent contractors. Unless otherwise indicated, this guide applies to fringe benefits provided by an employer to an employee.

## Taxability of Fringe Benefits

Fringe benefits for employees are taxable wages unless specifically excluded by a section of the Internal Revenue Code (IRC).

IRC § 61  
IRC § 3121, 3401

More than one Internal Revenue Code Section may apply to the same benefit :

**Example:** Education expenses up to \$5,250 can be excluded from tax under IRC §127. Amounts over \$5,250 may be excluded from tax under IRC §132.

Taxable to an employee even if the benefit is received by/for another, e.g. a spouse, a child.

Reg. § 1.61-21(a)(4)

Taxable means included in the employees' wages and reported on Form W-2, subject to Federal income tax withholding, social security (6.2%) and Medicare (1.45%), unless the employee has already reached the current calendar year's maximum social security tax limits. An employer's matching contribution is required for social security and Medicare (7.65%).

If an employee's wages are not normally subject to social security or Medicare taxes, any taxable fringe benefits would also not be subject to social security or Medicare taxes.

Section 218 of the  
Social Security Act

**Exceptions:** Certain deferred compensation plans, such as IRC §457 and §403(b) plans, may be subject to social security and Medicare taxes but *not* to Federal income tax (FIT).

# FRINGE BENEFITS

## Valuing Taxable Fringe Benefits

### General Rule - Fair Market Value (FMV)

Reg. §1.61-21(b)

Taxable fringe benefits are valued at the Fair Market Value (FMV).

**FMV-** The amount a willing buyer would pay an unrelated willing seller, neither one forced to conduct the transaction and both having reasonable knowledge of the facts. Often, the cost and FMV of a benefit are the same.

**Valuation** - FMV of taxable benefit less any amount paid by or for the employee

**Example:** An employee has a taxable fringe benefit with a fair market value of \$3.00 per day. The employer may include the \$3.00 per day in the employee's wages, or the employee may pay the employer the \$3.00 per day and no amount for the benefit is included in the employee's wages.

Special valuation rules apply for certain fringe benefits and will be covered in other chapters.

## Types of Fringe Benefits

### Taxable, Nontaxable, Partially taxable, Tax-deferred

**Taxable** – includible in gross income unless excluded under an IRC section. If the recipient is an employee, includible as a wage. Reg. § 1.61-21(a)

**Example:** Bonuses are always taxable because no IRC section excludes them from taxation.

**Nontaxable** – excluded from wages by a specific IRC section

**Example:** Medical care premiums paid by an employer are not taxable wages to employees because IRC §106 excludes them.

**Partially taxable** - Part is excluded by IRC section and part is taxable Reg. §1.132-6(d)(1)

**Example:** Benefits with dollar limitations are not taxable up to certain dollar limits, e.g. public transportation subsidy or parking.

**Deferred taxation** – Employer's contributions to an employee's pension plan may not be taxable when made, but retirement distributions may be taxed when made to the employee. IRC 402(a)

# FRINGE BENEFITS

## Examples of IRC Sections That Exclude Fringe Benefits From Wages

- IRC §117(d) - Qualified tuition reductions
- IRC §119 - Meals or lodging for employer's convenience
- IRC §125 - Cafeteria plans
- IRC § 127 - Educational assistance program
- IRC §129 - Dependent care assistance program
- IRC §132 - Certain fringe benefits

## IRC §132 - Nontaxable Fringe Benefits

IRC §132 excludes certain fringe benefits from taxation. IRC§ 132 may be used only if the taxability of a particular benefit (other than de minimis fringe) is not covered by another Code section. If nontaxable, the benefit is excludable from wages.

### Categories Of Nontaxable (Excludable) Fringe Benefits:

- **No Additional-Cost Service:** IRC §132(b)  
**Example:** Free passes for airline employees
- **Qualified\* Employee Discounts:** IRC §132(c)  
**Example:** Discounts for department store employees
- **Working Condition Fringe:** IRC §132(d)  
**Example:** Business use of employer-provided automobile
- **De minimis Fringe:** IRC §132(e)  
**Example:** Benefit too small to keep record of and infrequent
- **Qualified\* Transportation Expenses:** IRC §132(f)  
**Example:** Transit passes
- **Qualified\* Moving Expense Reimbursements** IRC §132(g)
- **Qualified\* Retirement Planning Services** IRC §132(m)

\*“Qualified” means that the rules in the Code sections are being followed. (i.e., if rules for moving expenses are met, then they are "qualified" moving expenses.)

# FRINGE BENEFITS

## Working Condition Fringe Benefits

### Definition

IRC § 132(d)

Property or service provided by an employer to an employee that if the employee had paid for it, he/she could have deducted the cost as a business or depreciation expense on Form 1040. Therefore, if the cost of an item is deductible by an employee as a business expense, it may be excludable from the employee's wages if provided by the employer.

### General Rules for Working Condition Fringe Benefits

- Benefit must relate to employer's business
- Employee would have been entitled to a 1040 deduction
- Business use must be substantiated with records
- **Certain benefits have other specific requirements**  
Example: Employer-provided vehicles

### Definition of Employee for Working Condition Fringe Benefits

Current employees

Reg. §1.132-1(b)(2)

Partners

Directors of employer

Independent contractors

Volunteers

Reg. §1.132-5(r)(4)

Although not employees for employment tax purposes, independent contractors are eligible to receive nontaxable reimbursements as working condition fringe benefits because they are treated as employees for this purpose.

⇒ **Note:** Taxable fringe benefits for employees are reportable on Forms W-2/W-3. Taxable fringe benefits for independent contractors are reportable on Form 1099.

### Benefits Not Qualifying as Working Condition Benefits

Cash payments/Cash equivalents

- unless paid under an accountable plan

Physical examinations (may be excludable under IRC §105)



# FRINGE BENEFITS

## De Minimis Fringe Benefits

### Definition

Property or service provided by an employer for an employee that has a small value and accounting for it is unreasonable or administratively impractical. The value of the benefit is determined by the frequency provided to each individual employee or if this is not administratively practical, by the frequency provided to the whole workforce. IRC § 132(e)

**Example:** An employer gives employees snacks each day valued at 75 cents. Even though small in amount, the benefit is provided on a regular basis and is, therefore, taxable as a wage.

The IRS has given advice at least once that a benefit of \$100 did not qualify as de minimis. ILM 200108042

**Note:** Technical advice addresses a specific situation and cannot be relied upon in addressing another specific situation.

**Examples of Excludable De Minimis Fringe Benefits:** Reg. §1.132-6(e)(1)

Occasional (infrequent) not routine:

Personal use of photocopier (with restrictions)

Group meals, employee picnics

Theater or sporting event tickets

Coffee, doughnuts, and/or soft drinks

Flowers, fruit for special circumstances

Local telephone calls

Traditional birthday or holiday gifts (not cash) with a low FMV

Commuting use of employer's car if no more than once per month Reg. §1.132-6(d)(3)

### Benefits Not Qualifying as De Minimis Fringe Benefits

Cash - except for occasional and infrequent meal money to allow overtime work

\*Cash equivalent (i.e., savings bond, gift certificate for department store or allowing "cash back")

Certain transportation fares

Use of employer's apartment, vacation home, boat

Commuting use of employer's vehicle more than once a month Reg. §1.132-6(d)(3)

\* American Airlines, Inc, v. United States, 40 Fed. Cl. 712(1998)

# FRINGE BENEFITS

## De Minimis Fringe Benefits - cont.

### Definition of Employee for De Minimis Fringe Benefits

Reg. §1.132-1(b)(4)

Any recipient of a de minimis fringe benefit

### Cliff Provision

Reg. §1.132-6(d)(4)

If a benefit does not qualify as a de minimis fringe benefit, the entire benefit is taxable, not just the portion that exceeds the de minimis limits.

## Special Accounting Rules

IRS Ann. 85-113, 1985-31 provides special rules for reporting taxable fringe benefits.

### Timing of Taxability - Calendar year basis

IRC 451(a)

Generally, taxable fringe benefits are included in employees' wages in the year the benefit is received.

IRS Ann. 85-113, 1985-31  
I.R.B. 31 (Aug. 5, 1985)

### Employer's Election of When to Withhold

Employer may elect to treat taxable fringe benefits as paid on a pay period, quarterly, semi-annual, or annual basis, but no less frequently than annually.

IRS Ann. 85-113, 1985-31  
I.R.B. 31 (Aug. 5, 1985)

### Alternative Rule for Income Tax Withholding

Employer may elect to add taxable fringe benefits to employees' regular wages and withhold on total or may withhold on the benefit at the supplemental wage rate of 25%.

Reg. §31.3402(g)-1  
Reg. §31.3501(a)-1T

See Chapter "Other Types of Compensation"

# FRINGE BENEFITS

## Special Accounting Rules - cont

### Special Accounting Period

Benefits provided in November and December may be treated as paid in the subsequent year.

IRS Ann. 85-113,1985-31  
I.R.B. 31 (August 5, 1985)

An employer may use this rule for some fringe benefits and not others. The special accounting period need not be the same for each fringe benefit. If an employer uses the special accounting period rule for a particular benefit, the rule must be used for all employees who receive the same fringe benefit.

### Employer's Election Not to Withhold Income Tax

Employer may elect not to withhold income taxes on the taxable use of employer's vehicle that is includible in wages if: (1) the employer notifies the employee, and (2) the employer includes the benefit in the employee's wages on the W-2 and withholds required social security/Medicare

IRC §3402(s)(1)

⇒ **Note:** This election is available for employer-provided vehicles only. An employer does not have a choice to withhold or not withhold on other taxable fringe benefits.

## Reporting Fringe Benefits

<b>REPORTING FRINGE BENEFITS</b>	
<b>EMPLOYEES</b>	<b>INDEPENDENT CONTRACTORS</b>
<p><b><u>IF Benefit Fully or Partially Taxable:</u></b> <b>Report on W-2 as Wages</b></p> <p>Subject to withholding for income tax, social security, and Medicare as well as applicable employer taxes.</p>	<p><b><u>IF Benefit Fully or Partially Taxable:</u></b> <b>Report on 1099-MISC</b></p> <p>Report if \$600 or more paid in calendar year. No payments in any amount are subject to income tax withholding, social security, or Medicare withholding.</p>
<p><b><u>IF Benefit Fully Nontaxable:</u></b></p> <p style="text-align: center;"><b>DO NOT REPORT TO IRS.</b></p>	<p><b><u>IF Benefit Nontaxable:</u></b></p> <p style="text-align: center;"><b>DO NOT REPORT TO IRS.</b></p>

# ACCOUNTABLE PLANS

## Definition

IRC § 62(c)  
Pub 463

### ACCOUNTABLE PLAN

An allowance or reimbursement policy (does not have to be a written plan) where amounts are nontaxable to the recipient if certain requirements are met:

- There must be a business connection to the expenditure.
- There must be “adequate” accounting by the recipient within a reasonable period of time.
- Excess reimbursements or advances must be returned within a reasonable period of time.

## Requirements

### Business Connection

Reg. §1.62-2(d)

Business connection means that the expense must be a deductible business expense incurred in connection with services performed as an employee. If not reimbursed by the employer, the expense would be deductible by the employee on the employee’s 1040 income tax return as a business expense.

### Adequate Accounting

Reg. §1.62-2(e)  
Reg. §1.274-5T(b)(2)

Verify date, time, place, amount and business purpose of expenses. Receipts are required unless the reimbursement is made under a per diem plan. (See Per Diem and Actual Expense Reimbursements, later.)

### Timeliness Return of Excess Reimbursements

Reg. §1.62-2(f)

Return any excess reimbursement within a reasonable period of time. A reasonable period of time depends on facts and circumstances. See the next section on timeliness safe harbors.

# ACCOUNTABLE PLANS

## Timeliness Safe Harbors for Substantiating Expenses and Returning Excess Reimbursements

If an employer uses either of the following methods, the requirements of timely substantiation and return of excess advances/reimbursements will be considered met. Reg. §1.62-2(g)

**Fixed Date Method** Reg. §1.62-2(g)(2)(i)

Advance is made within 30 days of when an expense is paid or incurred, and the  
Expense is substantiated within 60 days after it is paid or incurred, and  
Any excess amount is returned to the employer within 120 days after the expense is paid or incurred.

**Note:** Maximum number of days is 150.

**Periodic Statement Method** Reg. §1.62-2(g)(2)(ii)

Substantiation and return of excess is within 120 days after the employer provides employee with a periodic statement (at least quarterly) stating any excess amounts are required to be returned.

**Note:** Maximum number of days is 210.

## Other Timeliness Method

**Other Reasonable Method** Reg. §1.62-2(g)(1)

If an arrangement doesn't meet one of the safe-harbor methods, it may still be considered timely, if it is reasonable based on the facts and circumstances.

**Example:** An employee on an extended travel assignment might have a longer period to substantiate expenses and return any excess allowance than an employee on a single overnight trip.

# ACCOUNTABLE PLANS

## More Information on Accountable Plans

### Other Rules for Employer Accountable Plan(s)

Reg. §1.62-2(j)

- Employers can have multiple expense allowance policies.
- Employers can have both accountable and nonaccountable plans for different types of reimbursements.
- Employers may have more restrictive plans than IRS, but not less restrictive for excludable treatment.
- Employee(s) cannot compel the employer to establish a plan.

## Nonaccountable Plan

### Definition

Reg. §1.62-2(c)(3)  
Pub 463

An allowance or reimbursement program that does not meet all three requirements for an accountable plan.

Payments made under a **nonaccountable** plan are taxable wages to the employee when paid or when constructively received by an employee.

## Withholding Requirements

When to withhold depends on whether payments are made under an accountable or nonaccountable plan.

Reg. §1.62-2(h)

### Under an Accountable Plan

Reg. §1.62-2(h)(2)(i)

If an employer has an accountable plan but an employee does not timely account for expenses or return excess amounts, the employer must withhold employment taxes no later than the first payroll period following the end of the reasonable period.

# ACCOUNTABLE PLANS

## Withholding Requirements - cont.

### **Under a Nonaccountable Plan**

Reg. §1.62-2(h)(4)(ii)

If advances and reimbursements are made under a nonaccountable plan, withholding is required when the advances or reimbursements are made to the employee.

### **Late Substantiation or Return of Excess**

Reg. §1.62-2(h)(2)

If an employee substantiates expenses and returns excess advances *After* the employer has treated amounts as a wage, the employer is not required to return any withholding or treat amounts as nontaxable.

## Travel Advances

To prevent a financial hardship to employees who will be traveling away from home on business, employers will often provide advance payments to cover the costs incurred while traveling. There must be a reasonable timing relationship from when the advance is given to the employee, when the travel occurs and when it is substantiated. There must also be a relationship to the size of the advance and the estimated expenses to be incurred.

### **Accountable plan advances**

Travel advances are not treated as wages and are not subject to income and employment taxes when they are paid under an accountable plan. They must be for travel expenses related to the business of the employer, substantiated by the employee, and any excess returned in a reasonable period of time.

Reg. §1.62-2(c)(4)

If employee does not timely substantiate expenses or return excess advances, the advance is includible in wages and subject to income and employment taxes no later than the first payroll period following the end of the reasonable period.

Reg. §1.62-2(h)(2)

The determination of a reasonable period of time will depend on the facts and circumstances. Timelines are provided as a safe harbor for employers to use. After the end of the calendar year and once included in wages, an employer cannot go back and reverse the transaction unless the amount was erroneously treated as wages.

Reg. §1.62-2(g)(1)

# ACCOUNTABLE PLANS

## Travel Advances - cont.

### Nonaccountable plan advances

Reg. §1.62-2(h)(4)(ii)

Taxable to the employee and subject to withholding when the advances or reimbursements are made to the employee.

### Advances that cross a calendar year

Reg. §1.62-2(h)(2)

Taxable to the extent they are not substantiated by the employee no later than the first payroll period following the end of the reasonable period. A reasonable period may end in the year after the advance was made. After the end of the calendar year and once included in wages, an employer cannot go back and reverse the transaction, unless the amount was erroneously treated as a wage at the time of inclusion.

## Examples

- (1) **A small state agency pays a monthly mileage allowance of \$200 to certain employees. The agency does not require the employees to substantiate their expenses or return any excess. Is the allowance a taxable wage to the employees, and if so, when?**

*The mileage allowance does not meet the rules for an accountable plan and therefore, is a nonaccountable plan. The \$200 allowance is a taxable wage to the employees when paid to them. The employees would receive \$200 less the withholding for social security, Medicare and income taxes. Also, the employer must match the social security and Medicare contributions.*

- (2) **An agency puts an accountable plan into effect that requires employees to account for their business mileage and return any excess allowance. Two of the employees account for their mileage but fail to return the excess. Is the allowance a taxable wage to the employees and if so, when?**

*The mileage allowance meets the requirements of an accountable plan. But, since the excess allowance was not returned, the excess is a wage to the two employees and is subject to withholding for income, social security, and Medicare taxes. The withholding is required no later than the first payroll period following the end of the reasonable period.*



# ACCOUNTABLE PLANS

## Form W-2 Reporting

Pubs. 15/ 463/1542  
Form W-2 Instructions

Generally, payments made under an accountable plan are excluded from the employee's gross income and are not reported on Form W-2. However, if you pay a per diem or mileage allowance and the amount paid exceeds the amount the employee substantiated under IRS rules, you must report the excess as wages on Form W-2. The excess amount is subject to income tax withholding and social security and Medicare taxes. Report the amount substantiated (i.e., the nontaxable portion) in box 12 using code L. (See Form W-2 Instructions.) **Note: This chart is for the 2004 Form W-2.** Make sure you have the current year's correct form and instructions. The box numbers and codes are subject to change annually.

**From Publication 463, page 30.**

TYPE OF REIMBURSEMENT	EMPLOYER	W-2 REPORTING*
<b>Under an Accountable Plan</b>		
<i>Actual expense reimbursement:</i> Adequate accounting made and excess returned		No amount reported
<i>Actual expense reimbursement:</i> Adequate accounting and return of excess both required but <b>excess</b> <u>not</u> returned		The <b>excess</b> amount reported as wages in Boxes 1, 3, and 5. Taxes withheld are reported in Boxes 2, 4, and 6.
<i>Per diem or mileage allowance up to the Federal rate:</i> Adequate accounting and <b>excess</b> returned		No amount reported
<i>Per diem or mileage allowance up to the Federal rate:</i> Adequate accounting and return of excess reimbursement both required but <b>excess</b> <u>not</u> returned		The <b>excess</b> amount reported as wages in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6. The <b>amount up to the Federal rate</b> is reported only in Box 12, Code L - it is not reported in Boxes 1, 3, and 5.
<i>Per diem or mileage allowance exceeds the Federal rate:</i> Adequate accounting but <b>excess</b> reimbursement over Federal rate <u>not</u> returned		The <b>excess</b> amount reported as wages in Boxes 1, 3 and 5. The <b>amount up to the Federal rate</b> is reported only in Box 12, Code L - it is not reported in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6.
<b>Under a Nonaccountable Plan</b>		
Either adequate accounting or return of excess, or both, not required by plan		The entire amount reported as wages in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6.
<b>NO REIMBURSEMENT PLAN</b>		The entire amount reported as wages in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6.

# TRAVEL EXPENSE REIMBURSEMENTS

## Background

Reimbursements received by an employee who travels on business outside of the area of his/her tax home may be excludable from wages. In order to determine if a reimbursement is excludable, you must first understand key travel definitions. This chapter discusses:

IRC §162(a)  
Pub. 463  
Pub. 535

- Travel expenses
- Tax home
- Away from home
  - Overnight/sleep or rest rules
- Temporary vs. indefinite travel expense
- Substantiation methods

## Travel Expenses

Excludable travel expenses are expenses incurred for travel on business away from the general area of the employee's tax home on a temporary basis. In order to have excludable reimbursements, the travel must be temporary and be substantially longer than an ordinary day's work, requiring an overnight stay or substantial sleep or rest.

IRC §162(a)(2)  
Pub. 463

### **Travel expense reimbursements include:**

- Costs to travel to and from the business destination
- Transportation costs while at the business destination
- Lodging, meals and incidental expenses
- Cleaning, laundry and other miscellaneous expenses

If an employer reimburses an employee for business related travel expenses, the reimbursement is not taxable to the employee, provided the accountable plan rules are met.

**Example: An employee works for an agency in Salem, Oregon, and travels to Pendleton to conduct business for an entire week. The employee incurs the cost of transportation to and from Pendleton as well as lodging and meals while there.**

*Since the employee is traveling away from his/her tax home on the employer's business for substantially longer than a day, the employee would be considered in travel status. Reimbursement for substantiated travel expenses incurred by the employee would be considered an excludable travel expense.*

# TRAVEL EXPENSE REIMBURSEMENTS

## Tax Home

Pub.463

Identifying the employee's tax home is critical because the Code only permits an excludable reimbursement for travel expenses incurred while the employee is away from home[tax home]. In most cases, the employee's tax home is the *general vicinity of his principal place of business*. The taxpayer may receive excludable travel reimbursements while temporarily away from the tax home in the pursuit of business. Whether the taxpayer's tax home is his employer's business office or his residence, it includes the entire metropolitan area so that the taxpayer is not away from home unless he leaves the metropolitan area.

Rev. Rul. 73-529

Rev. Rul. 93-86

### One Regular or Main Place of Business

Generally, the tax home is the employee's regular place of business or official duty station, regardless of where the employee maintains a family home.

**Example:** An employee lives and works in Albany. The Albany area is considered the employee's tax home.

**Example:** An employee lives in Albany, but works permanently in Portland. Even though the employee lives in Albany, Portland is considered the employee's tax home.

### More Than One Regular or Main Place of Business

If an employee has more than one regular place of business, the tax home is the employee's main place of business. The main place of business is generally determined by the time worked, degree of business activity, and income earned in each location.

**Example:** An hourly employee works in his employer's office in Portland three weeks a month and in a satellite office in Salem for one week a month. Portland is the employee's tax home.

### No Regular or Principal Place of Business

An employee may have a tax home even if he/she does not have a regular or main place of business. If the employee works in the

Rev. Rul. 73-529

Rev. Rul. 93-86

Pub.463

# TRAVEL EXPENSE REIMBURSEMENTS

## Tax Home - cont.

Pub.463

### No Regular or Principal Place of Business - cont.

general area of the residence where he/she regularly lives, the general area of that residence is the tax home. (Factors used to determine whether there is a tax home are found in the Revenue Rulings and publication cited.)

**Example:** A forestry worker has a home in a remote location and works at various forest sites in the general area. His employer doesn't have an office where the employee works or reports. The general area of his residence may qualify as the employee's tax home.

### Tax Home Election for State Legislators

IRC §162(h)(1)B)  
TAM 9127009

Section 162(h) of the Code provides that a state legislator whose district is more than 50 miles from the capitol building may elect to treat her residence within the legislative district she represents as her tax home.

**Example:** The tax home of a legislator from Pendleton is Salem. If the legislator elects to have Pendleton as a tax home, reimbursements for meals and lodging while in Salem may be excludable.

## Away From Tax Home - The Overnight Rule

Rev. Rul. 75-170  
Rev. Rul. 75-432

In order for a reimbursement of an expense for business travel to be excludable from income, including meals and lodging, a taxpayer must travel "away from home" in the pursuit of business on a temporary basis.

The statutory phrase "*away from home*" has been interpreted by the Supreme Court\* *to require a taxpayer to travel overnight, or long enough to require substantial "sleep or rest"*. Thus, merely working overtime or at a great distance from the taxpayer's residence does not justify receiving excludable reimbursements for travel expenses if the taxpayer returns home without spending the night or stopping for substantial "sleep or rest".

**See the chapter on Meal Allowances for further discussion of the "sleep or rest rule".**

\*Supreme Court Case - *U.S. v Correll, 389 U.S. 299, 302-303 (1967)*

# TRAVEL EXPENSE REIMBURSEMENTS

## Away From Tax Home - The Overnight Rule

### COURT CASES/RULINGS- SLEEP OR REST RULE

#### **Sleep/Rest Not Met - Reimbursements Taxable**

U.S. v Correll, 389 U.S. 299, 302-303(1967)

**Barry v. Commissioner**, 27 AFTR 2d 71-334, 435 F2d 1290(CA1 1970)

Coombs v. Commissioner, 608 F2d 1269, 1276(1979)

Fife v. Commissioner, 73 T.C. 621(1980)

Rev.Rul. 68-663, 1968-2 C.B. 71

Matteson v. Commissioner, T.C. Memo 1974-96

**Unger v. Commissioner**, T.C. Memo 1986-64, 51 TCM 455

#### **Sleep/Rest Met - Reimbursements Not Taxable**

**Williams v. Patterson**, 286 F.2d 333 (5th Cir. 1961)

Rev. Rul. 75-170, 1975-1 CB 60

Anderson, David, (1952) 18 TC 649

Weaver, Don, (1953) PH TCM 54001, 12 CCH TCM 1421

Rev. Rul. 75-168, 1975-1 CB 58

Johnson, Mose, (1982) TC Memo 1982-2

Rev. Rul. 75-432, 1975-2 CB 60

L-1711 - Fed Tax Coord.

Siragusa v. Commissioner, T.C. Memo 1980-68

#### **Court Case 1: Williams v. Patterson**

A railroad conductor regularly rents a hotel room near railroad station where he sleeps and eats during a 5-hour layover during an 18-hour workday. He may deduct his meal and lodging costs because his layover is long enough to obtain sleep or rest and is required by his job to do so.

#### **Court Case 2: Barry v. Commissioner**

A consulting engineer works with clients in a three state area by making one-day trips to each client. She frequently leaves home at 6:30 a.m. and does not return until midnight. During the day, she stops in a rest area and closes her eyes for 20 minutes to refresh herself for the drive. She cannot deduct the cost of her meals on these trips because she is not away from home long enough to obtain substantial sleep or rest.

#### **Court Case 3: Unger v. Commissioner**

A truck driver's "safety breaks" which consisted of resting or sleeping at the wheel of the truck for periods ranging from 45 minutes to three and one-half hours, were considered by the courts to be a mere pause from his daily work routine and consequently did not constitute a substantial amount of sleep or rest. So the truck driver was not considered to be away from home.

# TRAVEL EXPENSE REIMBURSEMENTS

## Away From Tax Home - The Overnight Rule - cont.

### Examples:

- 1) **An employee is required to travel from Salem to Portland to work on a project. She leaves home at 11:00 a.m. on Monday, with plans to return home the same day. She is unable to complete the project on Monday, so she spends the night in Portland. After completing the project the next day, she returns to Salem by 10:30 a.m.**

*Even though the employee had not planned to spend the night and is gone for less than 24 hours she has met the "Away From Home" rule because she spent the night away from her tax home on business.*

- 2) **An employee is required to travel from Eugene to Portland to work for the day. The employee leaves home at 6:30 A.M. and returns that night at 10:00 P.M. On the trip home the employee stops for dinner and rests in the car for two hours. Does this stop meet the substantial "sleep or rest" requirement?**

*Even though the employee has been away from home for substantially longer than his/her normal work day, the employee is not considered to be in travel status. Court cases have ruled that stopping for a meal or a rest in a car does not meet the substantial "sleep or rest" rule.*

- 3) **A government agency supplies office equipment to all agencies within the state. An employee drives a tractor-trailer with equipment from the warehouse in Beaverton to an agency in Medford. After 10 hours the driver stops and rents a room at a rest stop for a 4 hour nap before completing the round trip.**

*Since the driver rented a room in order to sleep, he/she is considered to have met the "sleep and rest" rule. Reimbursements for meals and lodging are not taxable to the employee.*

## "Temporary" vs "Indefinite" Travel Assignments

Reimbursements of travel expenses for "temporary" assignments away from the tax-home are generally not taxable to the employee. If the assignment is "indefinite", the employee is considered to have moved his/her tax home to the new work location. Reimbursements of expenses for "indefinite" travel are taxable.

Rev. Rul. 93-86

Rev. Rul. 99-7

# TRAVEL EXPENSE REIMBURSEMENTS

## "Temporary" vs. "Indefinite" Travel Assignments - cont.

The Internal Revenue Service looks at all of the facts to determine whether the travel assignment was intended to be temporary or indefinite.

Rev. Rul. 93-86

Rev. Rul. 93-7

Pub. 463

⇒ **Note:** The decision of whether an assignment is realistically expected to last less than one year is made when the assignment begins.

### "Temporary" Travel Assignments

- Duration at a single location realistically expected to last and actually lasts one year or less
- Assignment is away from the principal place of work overnight
- Tax home hasn't changed
- If going home on days off:  
Lesser of travel expenses home or cost of staying at temporary assignment are excludable.

Examples of possible **excludable** travel expenses:

Meals and lodging at temporary work location

### "Indefinite" Travel Assignments

Reimbursement of expenses for "indefinite" assignments away from the tax home are generally taxable as a wage to the employee.

Rev. Rul. 93-86

- Duration at a single location is realistically expected to last longer than one year or actually lasts one year or longer
- New assignment location is considered the new tax home

Examples of **taxable** travel reimbursements:

Meals and lodging at indefinite work location

### "Temporary" Travel Assignments Become "Indefinite"

If initially an assignment away from home at a single location is realistically expected to last one year or less, and then later it is realistically expected to last longer than one year, the assignment is considered temporary until the date the expectations change. At that time, the travel is considered "indefinite" and any travel reimbursements from this date on are taxable.

## TRAVEL EXPENSE REIMBURSEMENTS

### "Temporary" vs. "Indefinite" Travel Assignments - cont.

#### Examples:

- 1) **Joan accepts a 6 month work assignment away from her tax home intending to return to her tax home at the finish of the temporary assignment. The assignment lasts for 6 months and Joan returns to her regular job at her tax home. Are reimbursements for Joan's travel and living expenses at her temporary assignment taxable to her?**

*Joan's reimbursements are excludable because the assignment was intended to last for less than one year and did last less than one year.*

- 2) **Joan accepts a temporary assignment away from her tax home for 6 months, intending to return to her tax home at the finish of the temporary assignment. After 4 months at the temporary job assignment, Joan agrees to stay for an additional 14 months. Are reimbursements for Joan's travel and living expenses at her temporary assignment taxable to her?**

*Joan is not taxed on employer reimbursements for travel expenses paid or incurred during the first 4 months of her temporary assignment. Joan will be taxed for reimbursements for the additional 14 months because the assignment has now become an indefinite assignment. If there had been a reasonable basis at the start of the assignment to believe that it would be extended, then it would have been considered indefinite from the start.*

- 3) **Joan accepts an assignment away from her tax home for 15 months. After 7 months, the employer cancels the assignment and Joan returns to work at her tax home. Are any of the reimbursements for Joan's travel and living expenses during the 7 months of her assignment taxable to her?**

*Although Joan's assignment lasted for less than one year, it had been realistically expected to last for more than one year when the assignment began. Therefore, the assignment was considered "indefinite" and the reimbursements for the 7 months are taxable.*



# PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

## Background

Generally, employers reimburse employees for ordinary and necessary business expenses incurred **while traveling away from home overnight**. Employers may reimburse the actual expenses, in which case, the employees will have to substantiate the expenses with receipts. Or an employer may reimburse for travel expenses using a per diem allowance method.

Rev. Proc.2005-10  
Reg. §1.274-5(j)(1)  
Pub. 1542

A per diem is an allowance per day to pay for lodging, meal and incidental expenses while traveling on business. The amount of the expenses reimbursed under a per diem allowance method will be deemed (considered) substantiated without receipts provided the requirements of the regulations are met.

## Excludable When Paid Under Accountable Plan

### Key Requirements:

- Business Connection Reg. §1.62-2(c)  
Pub. 535/463
- Substantiation Reg. §1.274-5T  
Elements required for substantiation:  
(1) Amount, (2) Time and Date, (3) Place, (4) Business Purpose Reg. §1.274-5T(b)(2)
- Excess returned within a reasonable time

**Example: James, who lives and works in Portland, is required to go to Bend for the week on business. His employer will reimburse him for his lodging and meal expenses. His employer requires him to adequately substantiate the expenses he incurs while on the trip.**

*If James provides the required substantiation, the reimbursement he receives would not be taxable to him. If, however, he fails to provide adequate substantiation, then any reimbursement he receives for the unsubstantiated amount would be taxable to him.*

## Per Diem Rules

- If a per diem allowance is used, employees are "deemed" to have substantiated the **amount** of expenses equal to the lesser of the Federal per diem rate or the per diem allowance paid by the employer (if less than the IRS rate).

Rev. Proc.2005-10

# PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

## Per Diem Rules - cont.

Rev. Proc.2005-10

- The per diem must be at or less than Federal rates to be fully excludable.
- Deemed substantiation provides an alternative to providing receipts or bills for actual expenses.
- No receipts are required if a per diem allowance is used, but the payments still must meet the other substantiation requirements including time (date), place, and business purpose.
- An employer's substantiation requirements must meet the Federal requirements at a minimum. An employer may have more stringent requirements, such as requiring meal and/or lodging receipts.

**Example: An employee traveling away from home on business is reimbursed by his employer at the Federal per diem rate for the city in which he spends the night.**

*Since the employee is reimbursed at the Federal per diem rate for the city in which he spends the night, the employee does not have to provide receipts. However, the employee must still provide adequate substantiation verifying the time, place and business purpose of the trip. The employer may require additional substantiation.*

## Federal Per Diem Rate - Breakdown

Federal per diem rates include separate rates for lodging and for meals and incidental expenses (**M&IE**).

Rev. Proc. 2005-10

### **Lodging Includes:**

Only the cost of the lodging. Room tax and energy surcharges are not considered part of the lodging cost.

### **M&IE Includes:**

Meals, tips and fees for food and luggage handling type services.

An employer is not required to reduce the M&IE even if meals are provided in-kind to the employee, if the employer reasonably believes that the M&IE will be incurred.

# PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

## Federal Per Diem Rate - Breakdown - cont.

Rev. Proc.2005-10

### **M&IE Does Not Include Miscellaneous Expenses**

Miscellaneous expenses are not part of M&IE and, therefore, reimbursements of miscellaneous expenses, in addition to the M&IE allowance, may be excludable from wages.

### **Miscellaneous Expenses**

Miscellaneous expenses are not considered part of a per diem reimbursement and, therefore, substantiation is required. Employers may require actual receipts or written certification as substantiation depending on their travel policies.

Miscellaneous expenses include cab fares, fax, telephone charges, room taxes, energy surcharges, laundry, cleaning and pressing of clothes, and other business related expenses.

### **Incidental Expense Only Option**

Employer may reimburse employees \$3 per day or partial day if:

- Employee is traveling away from home on business, and
- Employee does not pay or incur meal expenses, and
- Employee is not receiving per diem or M&IE expenses.

## Travel for Days of Departure and Return

Rev. Proc.2005-10  
Pub. 463

For both the day travel begins and the day travel ends, the per diem meal allowance is to be prorated by one of two methods:

- Claim  $\frac{3}{4}$  of the per diem meal allowance, or
- Use any method that is consistently applied and that is in accordance with reasonable business practice, such as the actual hours away from home on the first and last day.

## Traveling to More Than One Location

# PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

Rev. Proc.2005-10

If traveling to more than one location in one day, use the per diem rate for the area where *stopping for rest or sleep*.

Pub. 463

## Per Diem Paid Under a Nonaccountable Plan

A per diem plan that fails to comply with all accountable plan requirements is considered a nonaccountable plan.

Pub. 535/463  
Reg. §1.62-2(a)(4)

Per diem payments made under a nonaccountable plan are wages subject to Federal income tax, social security and Medicare taxes and are reportable on a Form W-2. Employer matching is required for social security and Medicare taxes.

**Example:** An employee regularly travels as part of her job requirements. The employer provides her with a monthly per diem allowance based on an estimate of the number of days traveled. The employee is not required to return any of the allowance that exceeds substantiated business expenses.

*Since the employer does not require the employee to return excess advances or allowances, the entire amount of the allowance is taxable to the employee as a wage.*

## Other Per Diem Methods

### Meals-Only Substantiation Method

Rev. Proc.2005-10  
Pub. 1542

An employer may reimburse the actual lodging expense and use the M&IE per diem allowance plan for the meals and incidentals expense.

### High-Low Substantiation Method of Substantiation

The high-low substantiation is another deemed substantiation method that may be used in place of the per diem method. The IRS designates key cities or localities as "high-cost" areas. All other localities are considered "low-cost" areas. Rather than having different rates for each

# PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

city, a single per diem rate is assigned to all high-cost areas and all other areas are assigned another rate. An employer that uses the high-low method for an employee must use the high-low method for that employee for the entire year, unless an actual expenses method is used.

## Substantiation Methods

Travel away from home reimbursements may be provided by an employer using either an *actual expense* or *per diem reimbursement* method.

### TRAVEL AWAY FROM HOME OVERNIGHT - Substantiation Methods

#### Actual Expense Reimbursement – Excludable from Wages:

- Must be paid under accountable plan to be excludable
- Amount, date & time, place, business purpose must be proven
- Based on what is actually spent
- Contemporaneous records such as receipts must be kept
- Expenses must not be lavish but reasonable based on circumstances
- If not away from home overnight, meal reimbursements are taxable even if actual receipts are provided

#### Per Diem Meal Allowance (M&IE) – Excludable from Wages:

Rev. Proc.2004-60  
Rev. Proc. 2005-10

- Must be traveling on business away from home overnight or meet the “sleep or rest” requirements to be excludable (See chapter “Travel Expense Reimbursements” for sleep or rest requirements.)
- Provides a set dollar amount depending on where and when traveling instead of keeping actual cost records BUT must still keep records to prove the date and time, place, and business purpose of travel.
- Allowance prorated for partial travel days  
(Day of departure and return)
- If traveling to more than one location in one day, use rate for area where *stopping for rest or sleep*.

# TRANSPORTATION EXPENSE REIMBURSEMENTS

## Transportation Expenses

Pub. 463

Transportation expenses are costs for local business travel that is **not** away from the tax home area overnight and is in the general vicinity of the principal place of business. Travel expenses are expenses for travel away from your tax home overnight.

Rev. Rul. 99-7

Reimbursement of expenses for local transportation for "temporary" assignments are generally not taxable to the employee.

### **Transportation expenses may include:**

- Air, train, bus, shuttle and taxi fares in area of tax-home
- Mileage expenses or costs of operating a vehicle
- Tolls and parking fees

### **Transportation expenses do not include:**

- Meal and lodging costs
- Commuting to regular or principal place of business

## Substantiation Methods – Transportation Expenses

### **Excludable When Paid Under an Accountable Plan**

Reg. §1.62-2(c)  
Pub. 535/463

#### **Key Elements:**

- Business Connection
- Substantiation
- Excess returned within a reasonable time

Reg. §1.274-5T(b)(2)

### **Actual Transportation Expense Reimbursement – Excludable from Wages:**

- Must be paid under accountable plan to be excludable
- Amount, date and time, place, business purpose (and business relationship for entertainment expenses) must be proven
- Based on what is actually spent
- Contemporaneous records such as receipts must be kept
- Must not be lavish; must be reasonable based on circumstances

Reg. §1.274-5T(b)(2)

# TRANSPORTATION EXPENSE REIMBURSEMENTS

## "Temporary" vs. "Indefinite" Transportation Assignments

Reimbursement of transportation expenses for "temporary" assignments in the general area of the tax-home may not be taxable to the employee. Reimbursements of expenses for "indefinite" transportation expenses may be taxable.

ILM 199948019  
Pub. 463  
Rev. Rul. 99-7

The "temporary" and "indefinite" rules only apply to going between an employee's *residence* and a work location, regardless of the distance. The Internal Revenue Service looks at all of the facts to determine whether the travel assignment was truly intended to be temporary.

⇒ **Note:** The decision of whether an assignment is realistically expected to last more than one year is made when the assignment begins.

### Temporary Transportation Expenses

- *Duration at a single location realistically expected to last, and actually lasts, one year or less*
- Assignment is away from the main place of work
- Not considered commuting
- Examples of possible excludable transportation reimbursements: mileage, parking

### Indefinite Transportation Expenses

- *Duration at a single location realistically expected to last longer than one year*
- Assignment location is away from principal place of work
- Examples of taxable transportation expense reimbursements: Mileage, parking that exceeds certain transportation fringe benefit limits
- A break of 7 months generally constitutes a new assignment

IRC 132(f)

## "Temporary" Transportation Assignments Become "Indefinite"

If initially a local assignment at a single location is realistically expected to last one year or less, and then later it is realistically expected to last longer than one year, the assignment is considered temporary *until* the date the expectations change. At that time, the transportation is considered "indefinite" and any reimbursements from this date are taxable.

# TRANSPORTATION EXPENSE REIMBURSEMENTS

## "Temporary" vs. "Indefinite" Transportation Assignments – cont.

### Examples

- (1) **Tom, a state auditor, is assigned to an audit of another agency that is expected to take, and does take, 18 months to complete. The agency he is auditing is in the same town as his regular place of business. Tom travels daily from his residence to the office of the agency he is auditing and is reimbursed for his mileage by his employer. Are the reimbursements for mileage taxable to Tom?**

*Although Tom is not traveling away from his tax home area, the travel is considered "indefinite" since the audit is expected to take more than one year. The reimbursements for mileage are a taxable wage to Tom.*

- (2) **In Example 1, if Tom had traveled from his main place of business rather than from his residence, the reimbursements could be excludable because he wasn't traveling from his residence so the "temporary vs. indefinite" rules don't apply.**

## Transportation Expenses Versus Commuting Expenses

It is important to distinguish transportation expenses from commuting expenses. Commuting is going between an employee's personal residence and main or regular place of work. Reimbursements of transportation expenses for getting from one workplace to another in the course of the employer's business when traveling within the general area that is your tax home may be excludable from wages, whereas reimbursements for commuting are not excludable.

Reg. §1.162-2(e)

### Nontaxable (Excludable) Business Transportation

1. An employee with a one or more regular workplaces drives from her residence to a temporary job site, either within the area of your tax home or outside that area.
2. An employee drives from his regular office (or job location ) to a temporary work site.
3. An employee drives from a first job to a second job.
4. An employee drives between temporary job sites.
5. An employee works at two places in one day and drives between work sites whether or not for the same employer.
6. An employee has an office in the home that qualifies as a principal place of business and drives between the home and another work location in the same trade or business.



# TRANSPORTATION EXPENSE REIMBURSEMENTS

## Transportation Expenses Versus Commuting Expenses – Cont.

### Taxable Commuting

1. An employee drives from his residence to his principal or regular workplace(s) (during or after work hours, required or not by employer).
2. An employee drives from her residence to her regular workplace on the weekend because of an urgent meeting convened by her employer.
3. An employee has an office in the home that qualifies as a principal place of business and drives between the home and another work location in a different trade or business.
4. An employee with no regular or main place of business drives between his residence and his first and last business stops.

### Examples – Transportation vs Commuting

- (1) An employee drives from her home in Silverton to her office in Salem. In the afternoon she drives to Albany to deliver papers at a satellite office and returns to her residence.**

*The trip between the employee's home and regular place of business in Salem is personal commuting and any reimbursement for this part of the trip is taxable to her as a wage. Assuming the accountable plan rules are met, reimbursement for the travel from her office to the temporary work site in Albany and the return trip home is excludable.*

- (2) A Fish and Game warden lives in a remote area and doesn't have a regular place of business. He drives daily to various, temporary job locations and is reimbursed for his mileage. Are any of his reimbursements taxable as a wage?**

*Reimbursements for the daily travel between the employee's residence and the first and last work locations are taxable as a wage because the game warden doesn't have a regular place of business and he isn't driving to a work site outside of the general area of his residence. Reimbursements for travel between the work sites is not taxable.*

- (3) An employee travels from his residence to a temporary work site for the day, driving past his official duty station on the way. Is reimbursement for the mileage from the residence to the temporary work site excludable, or is it limited to the distance from the official duty station if it is less?**

*Reimbursements for transportation between the residence and the temporary work site may be excludable because that is the actual distance traveled. See ILM 199948018.*

# TRANSPORTATION EXPENSE REIMBURSEMENTS

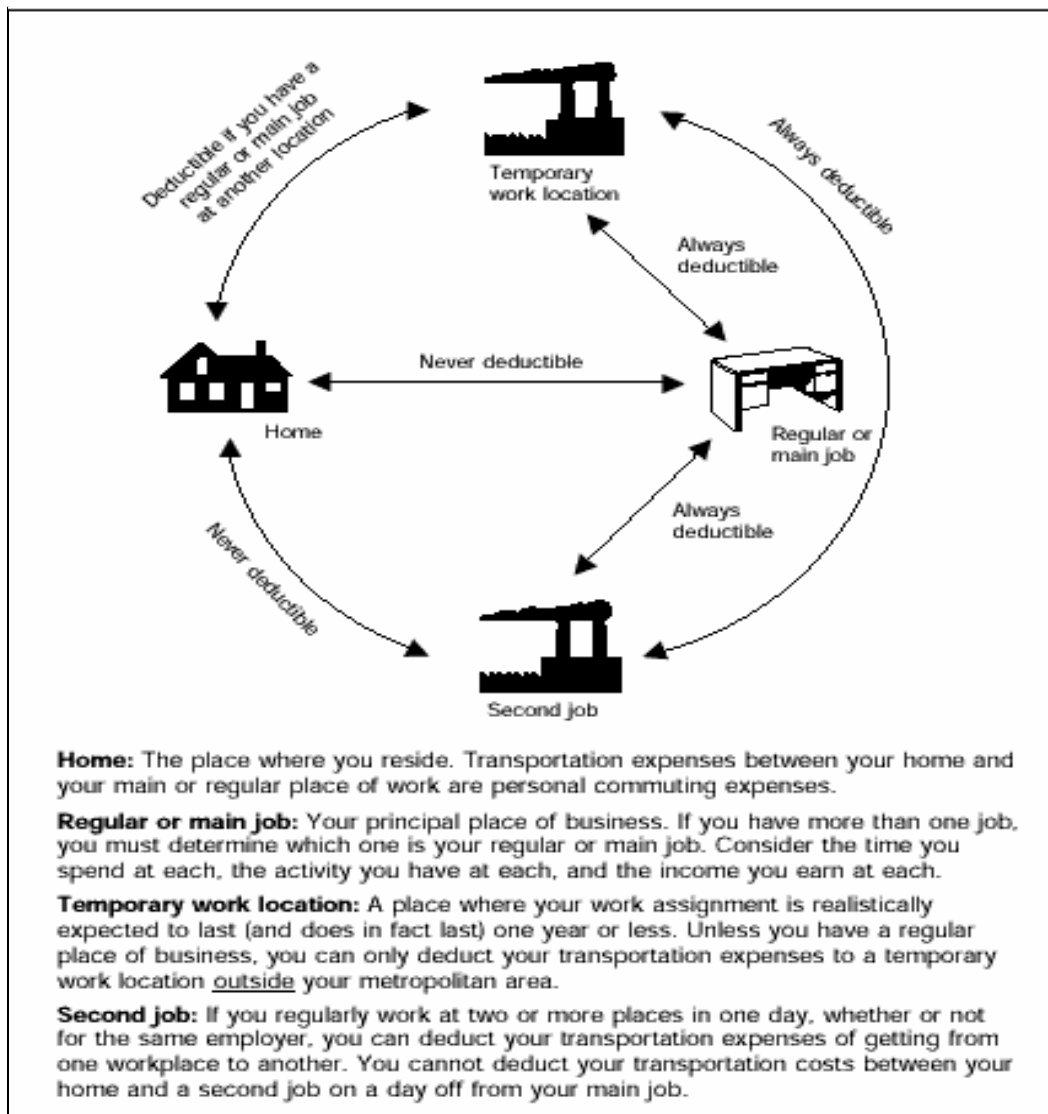
## Transportation Expenses Versus Commuting Expenses – Cont.

### Examples – Transportation vs Commuting – cont.

- (4) A high-school music teacher is assigned to two schools on a permanent basis. She works at the first school in the morning and drives from the first to the second school in the afternoon. She is reimbursed for her travel between the two locations. Is the reimbursement taxable?

*The travel is not taxable to the teacher because she is traveling between work sites.*

Deductible expenses in the illustration below are excludable from wages if reimbursed by an employer. Pub. 463.



# MOVING EXPENSES

## Background

The expenses incurred to change residences, i.e., to move from one place to another, are considered personal expenses and are to be included in wages UNLESS the move is directly related to work and the expenses meet the criteria set forth under the Internal Revenue Code (IRC) § 217. Personal expenses are not deductible under IRC § 262.

If the moving expenses qualify under IRC § 217, they may be taken as a deduction on the individual's Federal income tax return. If the expenses are paid or reimbursed by an employer, the moving expense payment can be an excludable fringe benefit to the employee under IRC § 132(g).

## General Rule

A moving expense reimbursement received directly or indirectly from an employer (under an accountable plan) is excludable to the employee if specific tests of IRC §217 are met.

IRC §82 & §217  
Pub. 521 & 15-B

### Specific Tests:

IRC § 217  
Pub. 521 & 15-B

- Individual must be an employee
- Employee must actually incur or pay the expenses
- Expenses are closely related to starting work at the new job location (generally moving expenses incurred within 1 year from the date you first report to work at the new location qualify).
- Expenses must meet the time and distance tests-

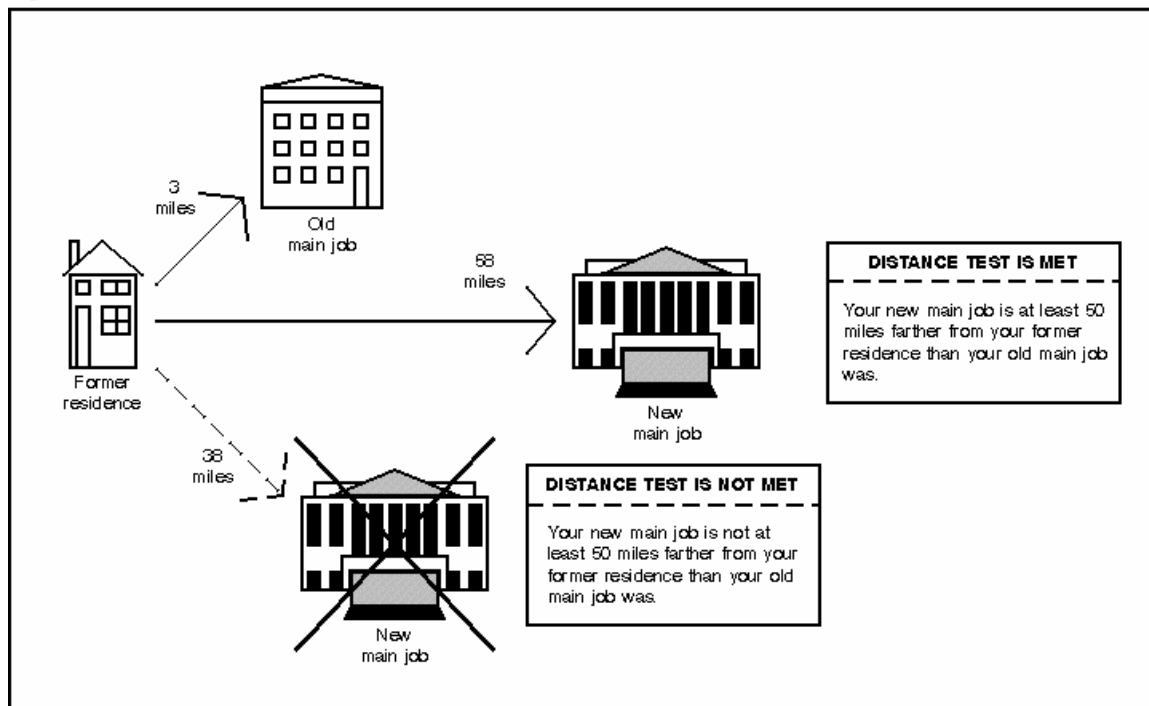
Time: Employed 39 weeks (full time), and

Distance: The New job is at least:

50 miles farther from the former home than the old job location was from the former home.

# MOVING EXPENSES

Figure A. Illustration of Distance Test



## Definitions

**Moving Expenses are the REASONABLE expenses for:**

IRC § 217(b)

moving household goods and personal effects; and,  
the *travel costs between the former and the new residence*  
by the shortest and most direct route.

**Moving Expense Payments Can Be Direct or Indirect:**

Reg. §1.82-1(a)(3)

Direct payments are made directly to the employee for moving expenses.  
Indirect payments are made to a third party on behalf of the employee (i.e.,  
a moving and storage co., or an airline, or travel agency).

**Travel Time for Traveling Expenses:**

Pub. 521

An employee can be reimbursed for the cost of transportation and lodging for herself and members of her household while traveling from her former home to her new home. This includes expenses for the day she arrives. An employee can include any lodging expenses she had in the area of her former home within one day after she could not live in her former home (the furniture had been moved). An employee can be reimbursed for traveling expenses for only one trip to her new home for herself and members of her household. However, all family members do not have to travel together or at the same time.

# MOVING EXPENSES

## Travel Time for Traveling Expenses – Cont.

**Begins:** 1 day after former residence is no longer suitable for occupancy and includes 1 night lodging at prior residence.

**Ends:** Date the employee secures lodging at the new place of residence  
The qualified expenses are deductible only for the first day the employee arrives at the new location.

⇒ **Note:** Any relocation allowances paying for more days than defined above are taxable as wages to the employee.

## Delayed Moving

Rev. Rul. 78-200  
Reg. §1.217-2(a)(3)

Expenses are deductible even after through a 12-month period of after arriving; for example, one is waiting for dependents to finish school.

## Costs and Taxability

Pub. 521, Rev. Proc. 2003-76  
Reg. §1.217-2(b)(3) &(4)

<b>COSTS OF TRAVELING TO NEW HOME:</b>	
<b>EXCLUDABLE (Deductible)</b>	<b>INCLUDIBLE (Non-deductible)</b>
Moving other household members (not necessary to travel together) Airfare Travel by car:** 18 cents for 2006 or actual gas and oil costs Lodging expenses while traveling Parking Fees Tolls	Pre-Move house-hunting Meals Trips back and forth to prior home Transportation expenses: Car: repairs, general maintenance, insurance and depreciation on vehicle Mileage reimbursement in <i>excess</i> of 18 cents for 2006 Living or other expenses related to waiting for movers to arrive or getting into new home
<b>COSTS OF MOVING HOUSEHOLD GOODS/PERSONAL EFFECTS:</b>	
<b>EXCLUDABLE (Deductible)</b>	<b>INCLUDIBLE (Non-deductible)</b>
Packing, Crating and transporting goods Connecting/disconnecting utilities Shipping your car and/or pet Storage and insurance of goods (Any period of 30 consecutive days after goods are moved from our former home and before they are delivered to your new home.)	Meals & Lodging in Temporary Home Storage or transporting boat or RV Selling Costs of Prior Residence & Losses Lease cancellation fees Mortgage cancellation fees Cancelled club memberships Unused tuition expenses

\*\*See Pub. 521, page 7 Travel by Car. All household members do not need to travel together or at the same time. You are allowed to move more than one car.

# MOVING EXPENSES

## Costs and Taxability – Cont.

### Tax Treatment

IRC §132(a)(6)&(g)

Moving expense reimbursements are *not included in income* if the expenses qualify under IRC § 217 *and* are reimbursed in the same calendar year they are deducted.

Reimbursed and employer-paid qualified moving expenses (those that would otherwise be deductible by the employee) are not includible in an employee's income unless you have knowledge that the employee deducted the expenses in a prior year.

If an employer reimburses an employee in the current calendar year for moving expenses that the employee *deducted in an earlier year*, the employer should include the reimbursement in wages subject to withholding taxes in the same way as other pay.  
(See related example at the end of the text.)

Reg. § 1.217-2(a)(2)

### Timing of Taxability

An employee is considered a ‘cash basis’, calendar year taxpayer and is required to include all taxable reimbursements in income in the year received.

Reg. §1.82-1(a)(2)

If an employee fails to repay excess advances or reimbursements, the excess amount is included in wages and subject to income tax withholding, social security and Medicare taxes.

Reg. §1.82-1(a)(2)

If the employee fails to account to his employer within a reasonable amount of time, the advances or reimbursements are included in wages and subject to income tax withholding, social security and Medicare taxes.

Reg. §1.82-1(a)(2)

If the employer advances funds to the employee, any amounts not repaid on the final accounting to the employer are considered received by the employee at that time.

Reg. §1.82-1(a)(2)

A taxpayer may elect to deduct his moving expenses in the year of reimbursement rather than in the year of actual payment. The election is made by claiming the deduction on the return or an amended return for the year of the reimbursement.

Reg. §1.217-2(a)(2)

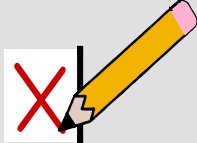
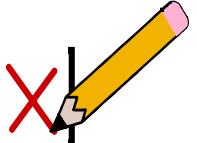
**Example:** An employee moves in 2004. The employer reimburses the employee in 2005 (the subsequent year). The employee can elect to deduct all moving expenses in 2005.

# MOVING EXPENSES

## Reporting Moving Expenses

Form W-2 Instructions 2002

Employer's requirements for reporting moving expense reimbursements for employees: (This refers to Form W-2 for 2005. The box numbers and codes are subject to change annually. Please see the W-2 instructions for the tax year you are reporting.)

MOVING EXPENSES	W-2 Boxes 1,3, and 5	W-2 Box 12, Code P
<p><b><u>INCLUDIBLE (TAXABLE):</u></b></p> <p>Employer-paid <u>Nonqualified</u> Subject to withholding income, social security, and Medicare taxes</p>		<div style="border: 1px solid #ccc; height: 20px; width: 100%;"></div>
<p><b><u>EXCLUDABLE (NONTAXABLE): *</u></b></p> <p>Employer-paid Qualified</p>		

\* **Note:** Even if all the moving expenses are qualified and excludable from wages, the employer needs to report the moving expense reimbursements on the Form W-2 as an information item in Box 12, Code P.

### THIRD PARTY MOVING EXPENSES:

Qualified moving expenses an employer pays **to a third party on behalf of the employee** (e.g., to a moving company, airline, etc) and services that an employer furnishes in kind to an employee are **not reported** on Form W-2.

# MOVING EXPENSES

## Examples

**(1) What happens when calendar years are crossed?**

*An employee moves in November, 2005. The employee received an advance or a reimbursement prior to December 31, 2005. There are additional reimbursable moving expenses after January 1, 2006. There is a choice of how and when to report these reimbursements. The employer may have made taxable and/or nontaxable reimbursements to the employee. At a minimum, the employer has a reporting requirement on the W-2 for the nontaxable or excludable reimbursed moving expenses. The reimbursements made prior to year-end can be included on the current 2005 W-2 and the balance of the reimbursements will be included on the employee's 2006 W-2 (in the next year). The alternative is to report all the reimbursements on the employee's W-2 in the year the move is completed.*

**(2) A state agency requires an employee to remain at the new location at least 12 months. If the employee leaves before the required period is up, but he repays the agency for all the reimbursements, what is the tax implication?**

*Assuming that all events happened within a calendar year (nothing has been reported to the IRS in a prior year), there is no tax impact to the state agency and there would be no notation on the employee's W-2. It should be noted that the employee could be entitled to a moving expense deduction on his personal Federal tax return. He only has to work as an employee for 39 weeks, and he doesn't have to work for the same employer. The former employee would complete a Form 3903 and file it with his Form 1040 return.*

**(3) An agency recruits a new employee for a special job and offers him a \$10,000 moving bonus as an incentive. The employee accepts the job but does not provide any accounting relating to the move to the employer. How does the employer treat the bonus for tax purposes?**

*The bonus is treated as additional wages and subject to all withholding taxes. It appears on the employee's W-2 in Box 1, 3, and 5. It is possible that the employee had qualifying moving expenses. The employee can complete a Form 3903 and file it with his Form 1040 return.*



# MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

## General Rules

IRC §119  
Pub. 535

The fair market value (FMV) of meals or lodging furnished to an employee by an employer may be nontaxable to the employee **IF** the rules of IRC § 119 are met. If a benefit is deductible by an employee under IRC § 119, it may be excludable from wages. Cash provided for meals is not excludable under this Code section but see the chapter on Meal Allowances/Reimbursements.

### Meals excludable from wages of employee if:

- Provided in kind, and
- On employer's business premises, and
- For employer's convenience.

### Lodging excludable from wages of employee if:

- Provided in kind, and
- On employer's business premises, and
- For employer's convenience, and
- Required as a condition of employment

Even if the provisions of a state statute or an employment or union 119(b)(1) contract say that a meal or lodging is taxable or not taxable, the actual facts and circumstances and the requirements of IRC §119 determine the Federal taxability.

IRC§

**Example: An employee of a state institution is required by his employer to reside at the institution in order to be available for duty at all times. Under the applicable state statute, the employee's lodging is regarded as part of the employee's compensation. Is the lodging taxable as a wage to the employee?**

Reg. §1.119-1(f)

Regardless of the state statute, the employee would nevertheless be entitled to exclude the value of such meals and lodging from his wages because the lodging is provided in kind, is on employer's business premises, for the employer's convenience, and is required as a condition of employment.

If an employee has an option to receive additional compensation in place of actual meals or lodging, then the meals and lodging, if taken, are taxable.

Reg. §1.119-1(e)

## "In-Kind" Requirement

"In-Kind" refers to payments made in something other than cash (neither cash allowances nor reimbursements qualify)

# MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

## "On Business Premises" of the Employer

Reg. §1.119-1(c)

- Place where employee performs a significant portion of duties
- Not "near" premises but within perimeter of business
- May include temporary work sites, such as rented hotel conference
- May be a room, if business is conducted there.
- Public restaurants do not qualify as business premises.

**Example: Meals are provided at no cost to employees on a state ferry. Are these meals taxable?**

*No, the meals are not taxable. The ferry qualifies as the employer's business premises and the employee performs a significant portion of duties there. Meals are furnished for the convenience of the employer since the employer can't stop the ferry to allow the employees to go to lunch.*

## Meals: "Convenience of Employer"

Reg. §1.119-1(a)(2)

Provided for substantial non-pay reason ("non-compensatory").  
Depends on the facts and circumstances.

### **Examples: Meals Provided for the Convenience of Employer**

Meals are furnished during working hours so that employee is available for emergency calls during the meal - e.g. firefighter. (You must have evidence that emergencies occur.)

Meals are furnished to employees in a remote site because there are insufficient eating facilities in the area, e.g. remote logging camp.

An employer has pizza delivered to the office at a group meeting to ensure that the employees return in time for the meeting.

Meals are furnished because the nature of the employer's business restricts an employee to a short meal period (not to allow an employee to leave earlier).

### **Examples: Meals *Not* Provided for the Convenience of Employer**

Meals provided before or after working hours are not for the convenience of employer, unless:

Reg. § 1.119-1(a)(2)(ii)(d)

- Restaurant or cafeteria employee, or
- Duties prevent employee from taking meal until immediately after working hours

## MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

### Meals: "Convenience of Employer" - cont.

**Examples: Meals Not Provided for the Convenience of Employer – cont.**

Free lunches provided by an employer to promote goodwill, boost morale or attract prospective employees are not considered for the "convenience of the employer". Reg. § 1.119-1(a)(2)(iii)

Meals provided with a charge may or may not be considered for the "convenience of the employer" IRC § 119(b)(3)

### Lodging - "Convenience of Employer"

Provided for substantial non-pay ("non-compensatory") reason. Depends on the facts and circumstances. Reg. § 1.119-1(b)

Lodging provided to the governor is considered for the convenience of the employer. Rev. Rul. 75-540

Rent subsidized living quarters provided to state legislators do not satisfy the convenience of the employer or condition of employment tests where the legislator is not required to accept. However, there is an election that a legislator may make to have his/her personal residence treated as their tax home and then the value of the lodging may be excludable as a qualified travel expense. (See **Travel Expense Reimbursements chapter.**) IRC § 162(h)(1)B  
TAM 9127009

**Example: W, a full-time executive of the city of Portland, lives in Eugene but works in Portland. The city provides a rented apartment in Portland to help defray the executive's personal commuting costs. Is this benefit taxable?**

*The requirements for lodging to be excluded from income have not been met. The lodging is not on the business premises of the employer, and therefore, doesn't qualify.*

### Lodging - "Required as Condition of Employment"

Where the employer requires employees to live on the premises to be able to perform their job duties. Reg. § 1.119-1(b)

**Example:** firefighters, apartment managers

# MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

## Lodging - "Required as Condition of Employment" - cont.

Employee must be required to accept lodging (cannot be an option).  
Where lodging is provided as a condition of employment,  
meals, if provided, may qualify as excludable.

Reg. §1.119-1(a)(2)(i)

**Example: An employee at a prison is given the choice of residing at the institution free of charge, or of residing elsewhere and receiving a cash allowance in addition to his regular salary. If he elects to reside at the prison, is the value to the employee of the lodging furnished by the employer includible in the employee's wages?**

*The value of the lodging is taxable as a wage to the employee because he is not required as a condition of employment to reside on the premises.*

## Lodging for Educational Institutions

IRC §119(d)

### Excludable Campus Lodging

Qualified campus lodging furnished to employees is not taxable to an employee as a wage, if:

- Lodging is located on or near the campus, and
- Employee pays rent of at least 5% of appraised lodging value, or
- Rent charged to the employee is comparable to rent charged by the institution to students or non-employees.

### Taxable Campus Lodging

#### **If the employee pays no rent:**

Lesser of 5% of the appraised value or the comparable rent is included in income as a wage.

#### **If the employee pays rent that is less than the 5% or comparable rent:**

Difference between what is actually paid and the lesser of 5% of the appraised value or the comparable rent is a wage.

Benefit applies to employees of institution and their spouse and dependents.

# MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

## Meals or Lodging Furnished With a Charge

### Mandatory Charge

IRC§119(a)(2)  
IRC §119 (b)(3)

If an employer charges an employee a fixed amount for a meal or lodging, whether or not taken by the employee, the employee's regular *taxable wage* is reduced by the amount of the charge.

If *not* provided for the convenience of the employer, the FMV of meal or lodging is then added to the wage. Generally, the FMV of the meal will be the amount charged for the meal by the employer.

### Optional Charge

IRC§119(b)(3)

If an employer provides a meal which an employee may or may not purchase, the employee's taxable wage is *not* reduced by the amount the employee pays for the meal. If the meal is not for the convenience of the employer, the FMV of the meal less any amount charged by the employer is included in the employee's wages.

# MEAL ALLOWANCES/REIMBURSEMENTS

## Background

Employers often reimburse employees for meals while traveling away from home overnight or while attending meetings or entertaining customers. The taxability of these reimbursements or allowances depends on whether there is a valid business reason for the meals and whether the expenses are substantiated. Reimbursements or allowances must first meet the accountable plan rules in order to be excludable.

IRC §62(c)  
Pub. 463

This chapter will cover:

- Meals while traveling away from the tax home overnight
- Meals while not away from home, including meals with meetings, entertainment meals, de minimis fringe benefit meals
- Substantiation of employee meal reimbursements and allowances

## Meal Reimbursements While Traveling Away From Home on Business

### Meals Away From Home Overnight

In order for travel meal reimbursements to be excludable from wages, employees must be traveling away from their tax home on their employer's business. Where employees live has no bearing on where their tax homes are.

IRC §162(a)(2)  
Pub. 463  
Rev. Rul. 75-170  
Rev. Rul. 75-432

Traveling "away from home" means:

1. Employee must be traveling away from the general tax home area substantially longer than an ordinary day's work, and
2. Employee needs to obtain substantial sleep or rest to meet the demands of the work while away from home.

## Meal Reimbursements While Traveling on Business - cont.

### Meals Away From Tax Home But *Not* Overnight

Generally, taxable as a wage to the employee because travel must be away from home overnight to be excludable.

**Courts have set very strict rules on what constitutes substantial sleep or**

## MEAL ALLOWANCES/REIMBURSEMENTS

rest. See Travel Expense Reimbursements chapter for additional discussion and court cases regarding the "Sleep or Rest" rule.

**Example:** An employee is required to travel from Eugene to Portland to work for the day. The employer agrees to pay for the employee's meals while in Portland. The employee leaves home at 7:00 a.m. and returns home at 9:00 p.m. Before the employee returns in the evening, the employee takes a nap in his/her car for an hour.

*Even though the employee is away from his tax home for substantially longer than a normal work day and even stops for rest, the employee is not considered to be away from home overnight. The rest would not be considered substantial. Any meal money that the employee receives would be taxable as a wage.*

### Meal Reimbursements While NOT Traveling Away From Home

Pub. 463

#### Entertainment Meals

Reg. §1.274-2(c) and (d)

Reimbursements or allowances provided to employees for meals while entertaining customers may be excludable if the expenses are ordinary and necessary, and meet one of the following tests:

#### Directly-Related or Associated Entertainment:

**Directly-Related Test** - Meal reimbursements meet the directly-related test and may be excludable from wages if:

1. The main purpose of the combined business and meal is the active conduct of business,
2. Business is actually conducted during the meal period, and
3. There is more than a general expectation of deriving income or some other specific business benefit at some future time.

All of the facts must be considered, including the nature of the business transacted and the reasons for conducting business during the meal. If the meal takes place in a clear business setting and is for your business or work, the expenses are considered directly related to your business or work.

### Meal Reimbursements While NOT Traveling Away From Home - cont.

Pub. 463

#### Entertainment Expenses – cont.

Reg. §1.274-2(c) and (d)

#### Examples of Directly-Related Entertainment/Meals

- Meals at a hospitality room sponsored by an employer at a convention.
- Entertainment of civic leaders at the opening

## MEAL ALLOWANCES/REIMBURSEMENTS

of a new City Hall.

**Associated Test** – Entertainment-related meal reimbursements meet the associated test and are excludable if the entertainment is:

1. Associated with the active conduct of the employer's business, and
2. Directly before or after a substantial business discussion.

Generally, an expense is associated with the active conduct of a business, if there is a clear business reason for incurring the expense. The purpose may be to get new business or to encourage the continuation of an existing relationship. These activities need not occur in a clear business setting.

Whether a business discussion is substantial depends on the facts of each case. A business discussion will not be considered substantial unless you can show that you actively engaged in the discussion, meeting, negotiation, or other business transaction to get income or some other specific business benefit. You must show that the business discussion was substantial in relation to the meal.

### **Example of Associated Entertainment/Meal**

- *Meals officially scheduled as part of a business conference or convention*

### **Trade or Professional Association Meetings**

Reg. §1.274-2(d)(3)

Reimbursements for meal expenses directly related to and necessary for attending business meetings or conventions of certain exempt organizations are excludable from wages if the expenses of your attendance are related to your trade or business. These organizations include chambers of commerce, business leagues and trade or professional associations,

## **Meal Reimbursements While NOT Traveling Away From Home – cont.**

### **Examples:**

- (1) **Manager regularly buys lunch for all of the employees in her group after monthly group meetings in an effort to boost morale. The manager and the employees are reimbursed by the employer.**



## MEAL ALLOWANCES/REIMBURSEMENTS

*This does not meet either the directly-related test or the associated test and is not a qualified business meal. The value of the meals is considered taxable to the manager and to the employees.*

- (2) **A government official attends a Rotary Club meeting as a representative of his agency. The meeting is followed by a dinner for which the official is reimbursed by his agency. Is the meal reimbursement taxable?**

*The meal reimbursement meets the associated business test, And, therefore, qualifies as an excludable business meal.*

### De Minimis Exclusion for Occasional Meal Reimbursements

Reg.. §1.132-6(d)(2)

**Regularly provided meal money does not qualify for the exclusion for de minimis fringes provided by an employer. Three conditions must be met for treatment of occasional meal money as an excludable de minimis fringe benefit:**

- **Occasional Basis** - Meal is reasonable in value, and is not provided regularly or frequently, **and**
- **Provided for Overtime Work** - Overtime work necessitates an extension of the employee's normal work schedule, **and**
- **Enables Overtime Work** - Provided to enable the employee to work overtime. Meals provided on the employer's premises that are consumed during the overtime period, or meal money expended for meals consumed during that period, satisfy this condition.

Meal reimbursements as part of a company policy or union contract may not qualify as an excludable de minimis benefit because the benefit is required and may not be considered occasional. In this case, the employer would have the opportunity to set up the administrative procedures for reporting the benefit.

In no event will meal money calculated on the basis of number of hours worked (e.g. \$5.00 per hour for each hour worked over 8 hours) be excludable as a de minimis fringe benefit.

### De Minimis Exclusion for Occasional Meal Reimbursements – cont.

Reg.. §1.132-6(d)(2)

#### **Example: Nontaxable de minimis meal benefit**

A commuter ferry breaks down and engineers are required to work overtime to make repairs. After working 8 hours, the engineers break

## MEAL ALLOWANCES/REIMBURSEMENTS

for dinner because they will be working for an additional 3 hours. The supervisor gives each employee \$5.00 for a meal. The meal is not taxable to the engineers because it was provided to permit them to work overtime in a situation that is not routine.

### **Example: Taxable de minimis meal benefits**

An employer has a policy of reimbursing employees for breakfast or dinner when they are required to work an extra hour before or after their normal work schedule. The reimbursements are taxable because the employer has a policy which indicates payments are routinely made. In addition, the meal reimbursement doesn't enable the employee to work overtime, but is an incentive to do so.

### **Substantiating Employee Meal Expense Reimbursements**

Pub. 463

Meal expense reimbursement/allowance must meet the accountable plan rules in order to be excludable from wages. An employer may reimburse employees using an Actual Expense or Per Diem method.

Reimbursements for allowable business travel meals **while traveling away from home overnight** may be substantiated using either an actual expense method or a per diem method.

Meals **while not traveling**, such as meals with meetings or overtime meals, are substantiated using the actual expense method.

**See Per Diem and Actual Expense Reimbursements, earlier, for additional information on substantiation rules.**

If an employee chooses not to be reimbursed for expenses, the employee cannot claim the expenses on his/her personal tax return *P.W. Havener, 23 TCM 539*.



# EMPLOYEE VEHICLE USED FOR EMPLOYER'S BUSINESS

## **Employer Reimbursement Paid At or Less Than Federal Rate**

If an employer reimburses an employee's business mileage under an accountable plan, at or below the Federal mileage rate, and the employee substantiates the business miles, then:

- The reimbursement is not taxable to the employee.
- No income tax is withheld.
- No reporting is required on Form W-2.

## **Employee Deduction**

If an employer reimbursement is less than the Federal rate, the employee can deduct the difference between the Federal mileage rate and the employer reimbursement on their individual income tax return, using Schedule A and attaching Form 2106.

## **Substantiation Requirements**

The employee is required to provide substantiation to the employer.

Reg. §1.274-5T(c)(1)-(2)

Reg. §1.274-5A(f)(3)

Substantiation rules require the employee to record:

- date,
- business purpose, and
- place of each trip.

Record mileage "at or near the time" incurred. Monthly expense reports generally qualify as "at or near the time".

Reg. § 1.274-5T(c)(2)(ii)

## **Rule If Not Requesting Reimbursement From Employer**

If employees choose not to be reimbursed for business mileage, they cannot claim the expenses on their personal tax returns.

(P.V. Havener, 23 TCM 539)

**Example: In 2006 a state agency paid automobile mileage reimbursements of 44.5 cents per mile to employees for business use of their personal vehicles. The employees verified their expenses on monthly expense reports.**

*Since the reimbursement does not exceed the Federal mileage rate and the business use has been verified, the employees are not taxed for the reimbursements. No reporting is required on Form W-2.*

# EMPLOYER-PROVIDED VEHICLES

## General Rules

Pub. 15-B  
Reg. § 1.61-21(c)

### Employer Vehicle Used Partly for Business/Partly Personal

- Verified business use is not taxable to the employee
- Personal use is taxable to the employee as wages
- Employer can opt to include all use as wages
- Employee can pay the employer for personal use rather than having it treated as wages

### What is Personal Use?

#### Examples of Taxable Personal Use

*Commuting between residence and work station, and vacation, weekend use, or use by spouse or dependents.*

Reg. § 1.162-2(e)

The employee goes into his office on the weekend. This is a personal commute, regardless of whether it is required by the employer.

#### Examples of De Minimis Nontaxable Personal Use

Small personal detour while on business, such as driving to lunch while out of the office on business.

Infrequent (**not more than one day per month**) commuting in employer vehicle. This does not mean that an employee can receive excludable reimbursements for commuting 12 days a year. The rule is available to cover infrequent, occasional situations.

Reg. § 1.132-6(d)(3)

**Example: An employee uses a motor pool vehicle for a business meeting. The employer requires that motor pool vehicles be returned at the end of the business day but the employee is delayed and the motor pool is closed when the employee arrives back at the office. The employee takes the vehicle home and returns it the next morning. Is the commute home and back to the office the next morning taxable to the employee?**

*Assuming that this is an infrequent occurrence for that employee, that is, generally happens no more than once a month, the commuting value of the trip would be considered a nontaxable de minimis fringe benefit. If not an infrequent occurrence, the commute would be taxable to the employee.*

## General Rules - cont.

# EMPLOYER-PROVIDED VEHICLES

## Substantiation Requirements

IRC 274(d)

Separate records of business and personal mileage are required.

### If records are not provided by the employee:

Reg. §1.132-5(b)

the value of all use of the automobile is wages to the employee, and the employee can then deduct any business use on Form 1040.

### If records are provided by the employee to the employer:

only the personal use of the automobile is wages to the employee.

Exceptions to the recordkeeping requirements apply in certain situations discussed latter in this chapter

## Valuing Personal Use of Employer-Provided Vehicle

Reg. §1.162-2(d)

Personal use of an employer's vehicle is a taxable wage to the employee. How do we determine how much to include in wages on the employee's Form W-2?

**Step 1:** Compute personal use based on miles driven

#### Example:

2,000 personal miles/10,000 total *miles* = 20% Personal use

**Step 2:** Apply valuation rule - **General Valuation Rule or Special Automobile Valuation Rules**

## General Valuation Rule

### Computation:

1. Determine what employee would pay to lease auto ( FMV\*).
2. Multiply FMV by % of personal use (computed in Step 1).

Example: Cost to lease car (FMV) for 1 yr.

plus value of fuel provided	\$ 4,000
Multiply by 20% personal use	<u>20%</u>
Include in wage of employee	\$ <u>800</u>

\* FMV (fair market value) - the amount an employee would have to pay to a third party in an arms-length transaction.

Pub. 15-B  
Reg. § 1.61-21(b)(4)

# EMPLOYER-PROVIDED VEHICLES

## Three Special Automobile Valuation Rules

- **Automobile Lease Valuation Rule** Reg. §1.61-21(d)
- **Vehicle Cents-Per-Mile Rule** Reg. §1.61-21(e)
- **Commuting Rule** Reg. §1.61-21(f)

### General requirements for using these special valuations:

Employer and employee must timely report personal use as a wage.  
Generally, the rules apply on a vehicle-by-vehicle basis.  
Employer may use different rules for different vehicles.

## Automobile Lease Valuation Rule

Reg. §1.61-21(d)

### Computation:

1. Determine FMV\* of vehicle on first day made available to employee;
2. Use table in Reg. §1.61-21(d)(iii) or Pub. 15-B to compute Annual Lease Value;
3. Multiply Annual Lease Value by % of personal use computed in **Step 1**;
4. Value the fuel (if provided) at 5.5¢ per mile or the amount reimbursed to employee for the fuel.  
(See Reg. §1.61-21(e)(3)(ii)(B) for valuing fuel outside US.)
5. Maintenance and insurance costs are included.

### \* Safe-Harbor Valuation

Reg. §1.61-21(d)(5)  
Pub. 15-B

The employer's cost, including tax, title, etc. may be used to determine the FMV. See regulations for valuing leased vehicles.

### Example:

*Joe, an employee of Agency XYZ, uses an agency-provided car. In 2005, Joe drives the car 20,000 miles, of which 4,000 were personal miles or 20% ( $4,000/20,000 = 20\%$ ). The FMV of the car is \$14,500 for an Annual Lease Value of \$4,100. Personal use is valued at \$820 ( $\$4,100 \times 20\%$ ) plus \$220 ( $5.5¢ \times 4,000$  miles) for fuel costs. \$1,040 ( $\$820 + \$220$ ) is included in Joe's wages.*

# EMPLOYER-PROVIDED VEHICLES

## Automobile Lease Valuation Rule - cont.

### Recalculation of Value after 4-Year Lease Term

Reg. §1.61-21(d)(2)

Once computed, the Annual Lease Value remains in effect until 12/31 of the 4th full calendar year after the rule is first applied.

#### Example:

Joe is assigned an agency-provided car on 2/17/04. The agency uses the same \$4,100 annual lease valuation until 12/31/08.

After the 4<sup>th</sup> full year, or if the vehicle is transferred to another employee, the value may be recalculated (unless the purpose of the transfer is only to reduce the tax).

### Daily Lease Value

Reg. §1.61-21(d)(4)

This method is required if the vehicle is available for less than 30 days.

### Fleet Average Value

Reg. §1.61-21(d)(5)(v)

If the employer has 20 or more vehicles (for 2005, each valued at less than \$19,600) used for business and personal by employees, a "fleet-average value" may be used to calculate the Annual Lease Valuation.

Rev. Proc. 2005-48

## Vehicle Cents-Per-Mile Rule

Reg. §1.61-21(e)

### Computation

Multiply standard mileage rate by number of personal miles driven. If fuel is not provided, the standard mileage rate can be reduced by up to 5.5 cents. (44.5 cents – 5.5 cents = 39 cents in 2006)

**Example:** *Joe drives his agency-provided car for 2,000 personal miles in 2006. The amount included as a wage is \$890 (44.5¢ x 2,000 personal miles or if no fuel is provided it would be \$780 (39 cents x 2000 miles).*

### Requirements

- Vehicle must be regularly used (50% or more each year) in the employer's business, or the
- Vehicle is generally used each workday to transport at least three employees to and from work, in an employer sponsored commuting vehicle pool, or the
- Vehicle is driven by employees at least 10,000 miles per year.



# EMPLOYER-PROVIDED VEHICLES

## Vehicle Cents-Per-Mile Rule - cont.

### Continued Rule Usage

Must continue using the cents-per-mile rule for the vehicle unless the vehicle no longer meets the requirements, except an employer may change to the commuting valuation rule.

### Non-Availability Rule

Cents-per-mile valuation rule cannot be used for vehicles with FMV exceeding \$15,000 (2006) Note: Amount is revised annually.

Rev. Proc. 2004-20\*

Reg. §1.61-21(e)(1)

Reg. 1.280F(d)(7)

## Commuting Valuation Rule

Reg.. §1.61-21(f)

### Personal use for commuting can be valued at a \$1.50 each one-way commute if:

- Vehicle is owned or leased by the employer
- Vehicle is provided to the employee for business use
- Employer requires the employee to commute in the vehicle for a valid non-compensatory business reasons
- Employer has a written policy prohibiting personal use other than commuting
- Employee does not use the vehicle for other than de minimis personal use

If more than one employee commutes in the vehicle, the \$1.50 each-way rule applies to each employee.

**Key Concepts:** The employer must require the employee to use the vehicle for a business purpose; it cannot be voluntary on the employee's part.

**Example:** A transportation employee, who is on call 24 hours a day to respond to road emergencies, is required by his employer to commute in a vehicle outfitted with communications or other equipment the employee would need if called out at night.

### Commuting Rule Not Available for “Control Employee”

Personal use of a vehicle by a "control employee" cannot be valued using the commuting valuation rule (\$1.50 rule).

# EMPLOYER-PROVIDED VEHICLES

## Commuting Valuation Rule - cont.

### Governmental "control employee" definition

Reg. §1.61-21(f)(6)

Pub. 15-B

A control employee is either an:

Elected official, or an

Employee whose compensation is at least as great as a Federal government employee at Executive Level V (2006 - \$133,900)

Instead of the above definition of control employee, the employer may treat all employees who are "highly compensated" as their only control employees. (Generally, \$100,000 for 2006 (Reg. 1.132-8(f))

### Examples:

- 1) An agency in a rural area does not have secure parking and has had a history of vandalism to its vehicles. The employer requires employees using the vehicles for the day on business to take the vehicles home overnight. Is the trip home and to the office the next day taxable to the employees?**

*The trip home and to the office the next day is considered taxable personal commuting. The commuting may be valued at \$1.50 each way since the employee had a valid noncompensatory business reason for commuting in the employer's vehicle. If this was an unusual situation for the employee, that is, generally occurring no more than once a month, the commuting could be considered a nontaxable de minimis fringe benefit.*

- 2) An agency requires an employee to take home a van to carry displays and equipment to a trade show the next day. Is the trip home from the office taxable to the employee?**

*In this situation, the commuting could be valued at \$1.50 for the trip from the office to home since the agency is requiring the employee to use a specific vehicle for valid business reasons (assuming the other rules of the section are met). If this was an unusual situation for the employee, that is, generally occurring no more than once a month, the commuting could be considered a nontaxable de minimis fringe benefit.*

# EMPLOYER-PROVIDED VEHICLES

## Qualified Nonpersonal Use Vehicle

### **Nontaxable Usage**

Reg. § 1.274-5T(k)

Reg. § 1.132-5(h)

Use of a qualified nonpersonal-use vehicle, including commuting, is nontaxable to the employee; and record keeping and substantiation by the employee are not required by the IRS.

### **Definition of Qualified Nonpersonal-Use Vehicle**

Reg. § 1.274-(k)(2)

A qualified nonpersonal-use vehicle is any vehicle that the employee is not likely to use more than minimally for personal purposes because of its design. Qualified nonpersonal-use vehicles generally include **all** of the following vehicles.

- Clearly marked police and fire vehicles.
- Unmarked vehicles used by law enforcement officers if the use is officially authorized.
- An ambulance or hearse used for its specific purpose.
- Any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds.
- Delivery trucks with seating for the driver only, or the driver plus a folding jump seat.
- A passenger bus with a capacity of at least 20 passengers used for its specific purpose.
- School buses.
- Tractors and other special-purpose farm vehicles.

### **Qualified Specialized Utility Repair Truck**

Reg. § 1.274-5T(k)(5)

Truck (not van or pickup) designed to carry tools, equipment, etc. Permanent interior construction, shelves, racks required. Employer must require employee to commute for emergency Call-outs to restore or maintain power services, i.e., gas, water, sewer.

### **Clearly Marked Police or Fire Vehicles**

Reg. § 1.274-5T(k)(3)

**Note:** Marking on a license plate is NOT considered a 'clear mark'.

Employee must always be on call.

Employee must be required by the employer to use the vehicle for commuting.

Employer must prohibit personal use (other than commuting) for travel outside of the officer or fire fighter's jurisdiction.

# EMPLOYER-PROVIDED VEHICLES

## Qualified Nonpersonal Use Vehicle -cont.

### Unmarked Law Enforcement Vehicles

Reg. § 1.274-5T(k)(6)

Employer must officially authorize personal use and the personal use must be incident to use for law-enforcement purposes; i.e., no vacation use. The employer must be a governmental unit responsible for prevention or investigation of crime.

The vehicle must be used by a full-time LAW ENFORCEMENT Officer, i.e. officer authorized to carry firearms, execute warrants, make arrests. The officer must regularly carry firearms, except when it is not possible to do so because of the requirements of undercover work.

### Vans and Pickups:

Rev. Rul. 86-97

#### **DO NOT Qualify unless specifically modified to be unlikely to have more than minimal personal use.**

A van or pickup truck with a loaded gross vehicle weight of 14,000 lbs. or less. The vehicle must be clearly marked with permanently affixed decals, special painting, or other advertising associated with your trade, business, or function and:

PLR 200236022

**Vans** – must have a seat for the driver only (or the driver and one other person) and either of the following items.

- Permanent shelving that fills most of the cargo area, or
- An open cargo area and the van always carries merchandise, material, or equipment used in your trade, business, or function.

**Pickup Trucks** – must meet either of the following requirements:

1. Equipped with **at least one** of the following items.
  - a. A hydraulic lift gate.
  - b. Permanent tanks or drums.
  - c. Permanent side boards or panels that materially raise the level of the sides of the truck bed.
  - d. Other heavy equipment (such as an electric generator, welder, boom, or crane used to tow automobiles and other vehicles).
2. It is used primarily to transport a particular type of load (other than over the public highways) in a construction, manufacturing, processing, farming, mining, drilling, timbering, or other similar operation for which it was specially designed or significantly modified.

# EMPLOYER-PROVIDED VEHICLES

## Safe-Harbor Substantiation Rules for Employer-Provided Vehicles

Reg. §1.132-(5)(e) and (f)

Employees using the following vehicles are not required to keep detailed records of vehicle use, if the employer maintains a written policy restricting personal use or personal use-other than commuting, and meets the specific requirements of the regulations:

### Vehicles Not Used for Personal Purposes

Reg. § 1.274-6T(a)(2)

- Vehicle is owned or leased by the employer
- Vehicle is provided to the employee for use in the employer's business
- When not in use, the vehicle is kept on employer's premises \*
- No employee using the vehicle lives at the employer's business premises
- Employer has a written policy prohibiting personal use unless de minimis such as, driving to lunch while away from the office
- Employer believes the vehicle is not used for any personal use

\* For example, motor pool cars

### Vehicles Not Used for Personal Purposes Other Than Commuting (\$1.50 each way)

Reg. § 1.274-6T(a)(3)

- Vehicle is owned or leased by the employer
- Vehicle is provided to the employee for business use
- Employer requires the employee to commute in the vehicle for valid business reasons\*
- Employer has a written policy prohibiting personal use other than commuting
- Employee does not use the vehicle for personal use

**\*Key Concept: The employer must require the employee to use the vehicle; it cannot be voluntary on the employee's part.**

### Written Policy Statements

Employer must maintain a written policy statement that implements a policy restricting personal use of employer-provided vehicles. The Conference Report to P.L. 99-44, Contemporaneous Recordkeeping Requirements Repeal, states that a resolution of a city council, or a provision of state law, or the state constitution qualifies as a written policy statement for the safe harbor provisions.

## EMPLOYER-PROVIDED VEHICLES

### Safe-Harbor Substantiation Rules for Employer-Provided Vehicles - cont.

#### Employer Monitoring Required

Although detailed recordkeeping is not required, the employer has to have some way to prove that the vehicles are being used in accordance with the rules. For example, internal controls such as requiring employees using motor pools to sign out the vehicle, and signed statements by the employees agreeing to no personal use, or no personal use other than commuting.

#### Examples:

- 1) An employer has a motor pool where employees use vehicles on a daily basis, returning them at the end of the day. The employer does not have a written policy concerning personal use of the vehicle. The employees using the vehicles are not required to keep a record of use of the vehicles. Is any of the use taxable to the employee?**

*Yes. The employer does not have a written policy in effect and therefore, does not meet the safe harbor substantiation rules. Since the employees do not keep records of use of the vehicles and the employer does not have a written policy prohibiting personal use, the value of the use is considered a wage.*

- 2) In Example 1, if the employer maintained a written policy prohibiting personal use of the vehicles and met all the safe harbor conditions of the regulations, would any of the value of the use be taxable as a wage to the employees?**

*No. If safe harbor substantiation rules are in effect, employees are not required to keep records of the use of the qualified vehicles.*

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

## Background

This chapter discusses rules that apply to benefits an employer provides to his/her employees for the employee's *personal* transportation, such as commuting to and from work..

IRC § 132(f)(1)  
Reg. § 1.132-9(b)  
Pub. 15-A,B & 535

## General Rules

### Qualified Transportation Fringe (QTF) benefits are:

- Commuter transportation in a commuter highway vehicle
- Transit passes
- Qualified parking

Employer-provided QTFs with Fair Market Values (FMV) that do not exceed monthly excludable limits are:

IRC §132(f)(5)  
IRS Notice 94-3

- Exempt from withholding and payment of employment taxes,
- Not reported as taxable wages on the employee's W-2, and
- Not reported as gross income.

The exclusion from income applies only to employees; former Employees and independent contractors are not eligible.

Regs. §1.132-9(b)

### Valuation

Generally valuation is at FMV. Exceptions are as noted.

### Combined Benefits

The exemption applies whether an employer provides one or a combination of these benefits to employees. The total benefits cannot exceed the statutory dollar limitations, or the excess is taxable as a wage to the employee. Workers may pay for the benefits themselves on a pre-tax basis--see section on Salary Reduction Agreements for the applicable rules.

IRC §132(f)(4)

### Cash Reimbursements

Cash reimbursements are allowed as long as the employer establishes a bona fide reimbursement plan. The employee must substantiate the expense.  
See Transit Passes for additional requirements.

Reg. §1.132-9(b)  
IRC §132(f)(3)

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

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## General Rules - cont.

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### Cash Advances

Cash Advances are not considered 'reimbursements'---they are not permitted.

### Non-Discrimination Rules

Do *not* apply to QTFs

Reg. §1.132-8

Such benefits are exempt even if provided exclusively to highly-compensated employees.

### QTFs and Cafeteria Plans

QTFs are prohibited benefits under cafeteria plan rules.

Reg. §1.132-1(b)(2)(i)

In other words, you cannot include these benefits as part of a cafeteria plan.

### Definitions

**"Month"** Calendar month or substantially equivalent period applied consistently.

**"Bona Fide Reimbursement Plan"** Reasonable procedures to verify reimbursements are for QTFs.

**"Employee"** Includes current employees but only common law employees and other statutory employees and not independent contractors. Reg §1.132-1(b)(2)(i)

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## Commuter Vehicle Transportation

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### Definition

A commuter highway vehicle must:

IRC §132(f)(5)  
Reg. §1.132-9(b)

- Be provided by, or for, an employer (hiring a third party),
- Be for travel between the employee's residence (or parking lot) and workplace,
- Have seating capacity for at least 6 adults (excluding the driver),
- Have half of its seating capacity (excluding the driver) occupied by employees,
- Have 80% of the vehicle's mileage be for transporting employees between residences, the workplace and/or parking area.



# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

## Commuter Vehicle Transportation - cont.

### Commuter transportation may include vanpools:

Includes the prior commuter highway vehicle rules above, and the vehicles may be owned and operated by transit authorities or employees.

### Dollar Limitations

Maximum nontaxable value: \$105 per month in 2006 and 2005 (Limited to the combined value of commuter transportation and transit passes per month, i.e., \$105 commuter transp. + \$205 parking= \$310 total in 2005.)

IRC §132(f)(2) & (6)  
Rev. Proc. 2005-70

### Valuation

Automobile lease valuation, vehicle cents-per-mile rule, or commuting valuation rules (discussed in previous chapter) may be used in lieu of FMV. If one of these methods is used, the employer must use the same valuation rule to value the use of the commuter vehicle by each employee who shares the use.

Reg. §1.132-9(b), Q&A-21  
Reg. §1.61-21(d),(e)&(f)

### Substantiation Requirements

Only *cash reimbursements* by employers for use of a commuter vehicle need to be substantiated with actual proof of the commuter vehicle use by the employee.

## Transit Passes

### Definition

Pub. 15-B

Any pass, token, fare card, voucher, or similar item (including an item exchangeable for fare media) entitling a person to transportation. Must be used for transportation on public or privately-owned mass transit system, or on transportation provided by a person in the business of transporting people in a vehicle, seating at least six adults, excluding the driver.

### Dollar Limitations

Maximum nontaxable value: \$105 per month in 2005 (Limited to the combined value of commuter transportation and transit passes per month, i.e.: \$105 commuter transp. + \$205 parking = \$310 in 2006.)

IRC §132(f)(2)&(6)  
Rev. Proc. 2005-70

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

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## Transit Passes - cont.

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Pub. 15-B

### Valuation

For transit passes sold at a discount, the discounted price rather than the face amount of the transit pass can be used to figure the exemption as long as the discount is available to the general public.

Reg. §1.132-9(b)

**Example:** A packet of 10 tickets is \$15.00 or \$1.50 each versus their face value of \$17.50 or \$1.75 each, the single ticket price available to the public.

### Substantiation Requirements

If the employer distributes the transit passes, there are no substantiation requirements. See below for cash reimbursements.

Reg. §1.132-9(b)

### Cash Reimbursements - Special Rule

**Nontaxable only** if a voucher or similar item is **NOT** readily available for direct distribution to employees. "Readily available" means it can be obtained:

IRC§ 132(f)(3)  
Reg. §1.132-9(b)

- (1) on terms no less favorable than those available to an individual employee, and
- (2) without incurring a significant administrative cost

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## Qualified Parking

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### Definition

Parking provided to employees on or near the business work premises, or parking on or near a location from which employees commute to work by commuter highway vehicle, mass transit station, or vanpool.

IRC §132(f)(5)(C)

### Dollar Limitations

Maximum nontaxable value - \$205 per month in 2006.

IRC §132(f)(2)(B)  
Rev. Proc. 2003-85

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

## Salary Reduction Agreements

A salary reduction agreement is a way to provide the benefit pre-tax to employees, without additional cost to the employer.

An employee can choose between receiving a fixed amount of taxable cash or QTF for a specified future period. A QTF salary reduction plan need not be in writing; but the election by the employee must be in writing or another permanent form, such as electronic.

IRC §132(f)(4)  
Regs. 1.132-9  
Q&A 11-15  
Rev. Rul. 2004-98

The election must contain the following:

- Date of the election,
- Amount of compensation to be reduced, and the
- Period for which the election is valid.

### Limitations

The salary reduction may not exceed the combined applicable statutory monthly limits for QTFs, i.e., for the calendar year 2006, the limitation is \$310 (\$105 + \$205).

This election may not be revoked after the employee is currently able to receive the cash or after the beginning the period for which the ATF is to be provided. Any unused QTF may not be refunded. However, the unused portion may be carried over to subsequent periods and used to provide QTFs as long as the amount expended does not exceed statutory limits.

### Negative Election

Permitted---if the employee receives adequate notice that a salary reduction will be made and is given adequate opportunity to choose to receive cash compensation instead of the QTF. A negative election means that no response is a YES, --the employee wants the QTF and does NOT want cash.

### Effect on Deferred Compensation Plans

When employees participate in a deferred compensation Plan, they are limited to a percentage of their compensation annually that they may contribute. In **computing** what is considered compensation for purposes of the limitation, an employer may exclude certain fringe benefits, including QTFs.

IRC §314(e)  
IRC §403(b)(3)  
IRC §414(s)(2)&(3)  
IRC §415(c)(3)  
IRC §125

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

## Other Local Transportation Benefits

Three other local transportation fringe benefits allow employers to provide transportation for commuting to employees that is excludable from wages or taxed at \$1.50 each way:

- Occasional Cab Fare
- Unusual Circumstances
- Unsafe Conditions

### 1. Occasional Cab Fare (Local Transportation)

REG. §132-6(d)(2)

Local transportation fare provided to **any** employee, regardless of income, is a nontaxable de minimis fringe benefit if it is **reasonable, occasional** and is provided to permit the employee *to work overtime*.

**"Occasional"** -Infrequent – something that is not regular or routine

Reg. §132-6(d)(2)(A)

**"Overtime"** -Overtime work necessitates an extension of the employee's normal work schedule

Reg. §132-6(d)(2)(B)

### 2. Unusual Circumstances and Unsafe Conditions

Reg. §132-6(d)(2) (C)(iii)(A)

Local transportation for commuting provided to an employee by an employer because of unusual **and** unsafe conditions is taxable to the employee as a wage at a maximum rate of \$1.50 each way. This benefit is not available to control employees.

#### Unusual Circumstances

IRC §132-6(d)(2)(C)(iii)(B)

**Example:** Employee temporarily working outside his normal work hours, or an employee temporarily making a shift change

#### Unsafe Conditions

IRC §132-6(d)(2) (C)(iii) (C)

A history of crime in the geographic area surrounding the employee's workplace or residence and the time of day during which the employee must commute.

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

## Other Local Transportation Benefits - cont.

### 3. Unsafe Conditions Only

Reg. § 1.61-21(k)

Local transportation for commuting provided to an employee by an employer **solely** because of unsafe conditions is taxable to the employee as a wage at a rate of \$1.50 each way. This benefit is available to qualified employees and the employer is required to have a written plan.

#### Qualified Employee

Only for employees covered by the Fair Labor Standards Act (FLSA) of 1938 **and** with compensation not exceeding specified dollar limitations in IRC § 414(q)(1)(C). Employees covered under the FLSA are not exempt from minimum wage and IRS provisions. See Reg. §1.61-21(k)(6) for details.

#### Unsafe Conditions

Reg. §61-21(j)(5)

For this purpose, unsafe conditions exist if a reasonable person would, under the facts and circumstances, consider it unsafe for the employee to walk to or from home, or to walk or use public transportation at the Time of day the employee must commute.

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

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## Examples

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- (1) **Merlin receives transit passes from his employer, State O, with a value of \$200 in the month of March 2005 (when the applicable statutory monthly limit is \$105 per month). Merlin was hired in January 2005 and has not received any transit passes from the State prior to this. Is this taxable to Merlin?**

No, the value of the transit passes (3 months x \$105 = \$315) is excludable from his wages for income and employment tax purposes. If he were hired in March 2005, only \$105 would be excludable from his wages for income and employment tax purposes.

- (2) **Each month during 2005, the State Health division distributes transit passes with a face amount of \$110 to all employees. These same passes can be purchased from the transit system by any individual for \$105. Do the State Health division employees have any taxable compensation?**

*No, since the value doesn't exceed the applicable statutory monthly limit of \$105 for 2005, no portion of the transit pass is includible as compensation.*

- (3) **Agency Y maintains a QTF benefit arrangement. Employees of Y are paid twice per month, with the payroll dates being the 10<sup>th</sup> and 25<sup>th</sup> day of the month. Employee Q elects, before the first day of the month, to reduce his compensation in return for QTFs totaling \$200 through the year 2005. (\$200 for qualified parking) Does Q have any tax consequences?**

No, since the election was made before he could currently receive the cash and the election is for a specific period, the arrangement satisfies the requirements for a valid salary reduction.

- (4) **In Example 3, what if employee Q revoked his election on the 10<sup>th</sup> of the month? Would it be effective for the first or second period?**

Second pay period, since the revocation cannot be effective during a current pay period. It must be for a future period.

# QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

## Examples

*Continued from previous page:*

- (5) **Maddy buys a \$105 transit pass each month in 2006. At the end of each month, she presents her used transit pass to her employer and certifies that she purchased and used it during the month. The employer reimburses her in the amount of \$105. Lulu also purchases a monthly transit pass for \$105, but presents it to her employer at the beginning of the month and certifies that she purchased it and will use it during the month. Her employer reimburses her at the time she presents the transit pass. Does Maddy and/or Lulu have taxable income?**

*In both situations, the employer has established a bona fide reimbursement arrangement for purposes of excluding the \$105 reimbursements from the employee's gross income in 2006.*

- (6) **Allison is a qualified employee under the requirements for the commuting valuation rule and works as a data-entry clerk for the state revenue Department. Her normal hours of work are 11 p.m. to 7 a.m. Public transportation, the only means of transportation available to her is considered unsafe by a reasonable person at the time she is required to commute from home to her workplace. DOR hires a car service to pick her up at her home each evening to transport her to work and to return her to home each morning when she finishes her shift. What are the tax consequences, if any, to Allison?**

*The amount includible in Allison's income is \$1.50 for the one-way commute from home to work each evening, because public transportation is considered unsafe at that time of day. However, the value of the commute from work to home each morning is includible in Allison's income at FMV since unsafe conditions DO NOT exist for that trip home.*

# INDEPENDENT CONTRACTOR EXPENSES

## General Rules

Pubs. 15, 15-A,463, 535  
1099 Instructions  
Reg. §1.274-5T(h)

### Reimbursements for Travel, Transportation and Other Out of Pocket Expenses

IF SUBSTANTIATED,

Do not report on Form 1099 MISC and not  
taxable to the payee

IF NOT SUBSTANTIATED,

Report on Form 1099-MISC with other compensation  
Taxable to payee--but no withholding required

IRC § 132 (d)

### Substantiation Requirements

See Working Condition Fringe Benefits

Reg. § 1.132-5(a)

Reg. §1.274-5T(h)(2)

## Rules for Independent Contractors

Pub 463

Publication 463 provides information regarding accounting for independent contractors (vendors) regarding records, substantiation and reporting requirements.

In general, all compensation for services for an independent contractor are to be reported on Form 1099-MISC when the amount is \$600 or more in a calendar year. The amounts are not subject to income or employment tax withholding.

If the individual is considered an independent contractor and they do not properly account to you for their reimbursed expenses, then any advances or reimbursements are to be included on a Form 1099-MISC along with the compensation for their services.

Reg. §1.274-5T(h)(2)

## Board and Commission Members

Some of the independent contractor rules and reporting requirements may also hold true for board or commission members. Board or commission members may be employees or independent contractors. If you are not sure of the status of a board or commission member, it may be necessary to consult the statutes or ordinances establishing a position to determine whether that position is a public office. In the case of school boards, the statutes or ordinances likely provide ample evidence that the school board members are public officials. Public officials are usually subject to a degree of control that is characteristic of an employer-employee relationship. The IRS has issued a memorandum discussing the employment status of appointed and elected officials. Elected officials should generally be classified as employees while appointed officials may be either employees or independent contractors. See the cited memorandum for a discussion of the issue.

ILM 200113024



# INDEPENDENT CONTRACTOR EXPENSES

## Board and Commission Members – Cont.

Pub. 15-A  
IRC § 3401(c)  
IRC §3121(d)(2)

Officers, employees and elected officials of states and their political subdivisions and instrumentalities are employees for purposes of Federal **income tax** withholding. But for **FICA** purposes, the common-law rules apply to determine whether an individual is an employee.

## Employee and Independent Contractor

If a worker is an employee, but is working outside of their regular employment or job duties with the employer, then for that work the individual could be an independent contractor. For example, an engineer with the public utility district (PUD) also has a janitorial business that he operates out of his home on weekends. The PUD contracts with the engineer to do the janitorial services for the PUD administrative offices.

## Misclassification of Workers

Pub. 15-A  
IRC §3509

If you classify a worker as an independent contractor and have no reasonable basis for doing so, you may be held liable for employment taxes for that worker. This may be for more than one tax year and could also include the taxes on fringe benefits that should have been provided, i.e.: health insurance, deferred compensation, etc.

## Examples

- 1) **An employee of the Department of Utilities has been approved to also do a consulting project for another state agency. Assuming that the other state agency has not retained the right to control the contractor in the details and means of completing the project, the worker would be considered an independent contractor for the consulting services and an employee for his position with the DOU.**
- 2) **An independent contractor is hired to perform specific services for a set fee, plus out of pocket expenses. If the contractor provides adequate substantiation for the out of pocket expenses, they will not be reported anywhere, either as income on Form 1099 or on the contractor's individual income tax return. The contractor is not permitted to deduct the expenses if they are reimbursed by the payer.**

# ALLOWANCES PAID BY EMPLOYER

## General Rule

IRC §162

Ordinary and necessary business expenses paid or reimbursed by an employer on behalf of an employee are excludable to the employee, if payments meet the rules of an accountable plan.

### Accountable Plan Key Requirements

Reg. §1.62-2(c)(1)

- Business Connection Pub. 535/463
- Substantiation Reg. §1.274-5T  
Elements required for substantiation:  
(1) Amount, (2) Date (Time), (3) Place, (4) Business Purpose Reg. §1.274-5T(b)(2)
- Excess returned within a reasonable time

Under the business connection requirement, the expense would have to qualify as a business expense to the employer and as a deduction on the employee's Form 1040 as an employee business expense, if the employer did not reimburse the expense.

## Work Clothes and Uniform Allowances and Reimbursements

IRC § 162  
Reg. §1.62-2(c)(1)

Excluded from wages of an employee, if the clothing or uniforms are:

- Specifically required as a condition of employment, and are
- Not worn or adaptable to general usage as ordinary clothing.

Accountable plan rules must be met.

⇒ **Note:** If the clothing qualifies as excludable, then the cleaning is also excludable.

## Safety Equipment

IRC § 162  
Reg. §1.62-2(c)(1)

Excludable as a wage to an employee if:

- the equipment helps the employee to perform his/her job in a safer environment.
- The equipment does not have to be required by the employer.
- The accountable plan rules must be met.

Examples: hardhat, anti-glare screen for computer, safety shoes

# ALLOWANCES PAID BY EMPLOYER

## Mileage Allowances

IRC § 162  
Reg. § 1.62-2(c)(1)

Excludable as a wage to an employee, if the allowance meets the accountable plan rules:

- Business Connection
- Adequate Accounting/Substantiation
- Return of Excess Amounts

**Example: Employer provides employee with a car or mileage allowance and no substantiation is required.**

*The car allowance is fully taxable as wages to the employee since the business use has not been substantiated. The accountable plan rules have not been met.*

## Cell Phones /Electronic Devices/Computer

IRC § 274(d)  
IRC § 280F(d)(4)  
IRC § 132(d)

Employers often provide employees with certain electronic and telecommunication equipment for use outside of the employer's premises in the performance of their duties. These items (and other items listed in IRC § 280F) are considered "listed property". Because the nature of the property lends itself to personal use, strict substantiation requirements are in place. Employees are required to account for business and personal use.

Examples: Cell Phones, Automobiles, Computers, Internet Server Allowances

### "Listed Property"

IRC § 280F(d)(4)

- Business use is excludable from the wages of the employee as a working condition fringe benefit.
- Personal use is included in the wages of the employee.
- If substantiation requirements are not met, all use is included in the wages of the employee.

### Substantiation Requirements

IRC § 274(d)

Records of business and personal use must be kept by the employee in order to determine whether the value of any of the use is included in the employee's wages.

# ALLOWANCES PAID BY EMPLOYER

## Cell Phones /Electronic Devices/Computer - cont.

### Substantiation Requirements - cont.

IRC § 274(d)

**Example:** An employer provides an employee with a cell phone and pays the monthly charges. The employer requires the employee to highlight personal calls on the monthly bill. The employer includes the direct charges for personal use and a pro rata share of monthly fees and services in the wages of the employee. The business use is not taxable to the employee.

## Examples

**(1) Periodic allowance payments to employees for the purchase and maintenance of specific articles of *employer required* uniforms.**

*The allowances are not taxable to the employees provided the uniforms are not adaptable to general usage, and are, in fact, not worn for general usage. In addition, the employees must substantiate the expenses. If substantiation is not required and provided, the allowance is taxable as a wage to the employees when paid.*

**(2) Extra premium per working hour for employees who provide their own tools.**

*Premium pay does not meet the accountable plan rules and, therefore, is additional compensation includible in income and fully taxable as a wage. The employees retain ownership and control of their tools and there is no accountability to the employer. The employees are not required to substantiate the cost of each of their tools. The premium is not specifically related to the employees' expenses. Reimbursements based on the hours worked cannot meet the accountable plan requirements. The employees may be entitled to claim an employee business expense deduction on their personal 1040 tax returns (Form 2106, Schedule A.)*

## ALLOWANCES PAID BY EMPLOYER

### Examples - cont.

- (3) **Paying employees on an annual basis for part of the cost of safety equipment not required by employer.**

*The payments may be excludable even though the safety equipment is not required by the employer. If the equipment helps the employee perform his/her job in a safer environment, it may qualify as an employee business expense. If the expenses are substantiated, the reimbursement would be excludable to the employee.*

- (4) **Cell phone allowances paid to employees.**

*Cell phones are considered "listed property" and special substantiation rules apply. Employees are required to keep records of business and personal calls. Reimbursement for personal usage should be included as wages to the employee. If records are not kept of business and personal use, the value of all usage is included in the wages of the employee.*

- (5) **An agency is required to reimburse certain employees for shoes under a union contract. The shoes are not safety shoes.**

*If the shoes are not safety shoes and are adaptable for general wear, the reimbursements are included as a wage to the employees even though the employer is required to make the payment.*

# OTHER TYPES OF COMPENSATION

## General Information

### General Rule

Compensation for services, including fees, bonuses, commissions, taxable fringe benefits, and similar items are taxable as "wages" or regular pay. All income is taxable unless it is specifically excluded by the Internal Revenue Code.

IRC § 61

Some types of payments are considered 'supplemental' wages and are subject to specific withholding rules. Supplemental wages are compensation paid in addition to the employee's regular wages.

### Types of Taxable Supplemental Compensation

Reg. § 1.61-2

- Bonuses
- Signing ,Recruiting, or Relocation Bonus
- Awards for outstanding service or performance
- Back pay
- Severance pay - payments to terminate employment
- Amount paid to someone to refrain from working (administrative leave)
- Recognition payments for exceptional work and performance
- Certain legal settlements and/or damages related to employment.
- Grossing up wages to pay for the employee's share of taxes. Reg. § 1.3401(a)-1(b)(6)

### "Grossing Up" Wages

Rev. Rul. 86-14

Pub. 15-A

If an employer pays the employee's share of payroll taxes without deducting it from the employee's pay, the amounts paid are wages subject to withholding tax. This may result in a "pyramiding". To avoid this, see Rev. Proc. 81-48 which details a formula for grossing up wages. This does not apply to FICA taxes for household and agricultural workers.

### Example:

An agency is offering cash incentives for early retirement. John accepts the "early out" option. At the time he retires, he has 28 years of service. He receives his regular pay for the final pay period, a \$25,000 bonus for retiring early, plus a cash settlement for accrued vacation pay. All of these payments are taxable as compensation for services and subject to all income and employment taxes withholdings. If the employer pays the related income and employment taxes, those amounts would have to be "grossed up".

## OTHER TYPES OF COMPENSATION

### Supplemental Wages Concept – Income Tax Withholding Options

#### Federal Income Tax Withholding On Supplemental Wage Payments.

Reg. §31.3402(g)-1  
Pub. 15 Circular E

- 1) If the employer pays the supplemental wage with regular wages and doesn't specify the amount of each, withhold as if the total were a single payment for the regular payroll period.
- 2) If the employer pays the bonus separately (or combines and specifies the amount of each in a single payment), the withholding method depends on whether the employer withheld income tax on the regular wages:
  - a) If withholding was done on regular wages, the employer can either withhold at a flat percentage of 25%.
  - b) Add the supplemental and regular wages for most recent payroll. Figure the income tax as if the total were a single payment. Subtract the tax already withheld on the regular wages and withhold the remaining income tax amount.
  - c) If withholding was not done on regular wages, use method 'b' above.
  - d) Section 10 of Publication 15-A, Employer's Supplemental Tax guide provides several alternative methods for figuring withholding.

The employer also has the option to use a method not illustrated as long as the amount of tax withheld is about the same as it would be under the percentage method shown in Circular E. The employer must be sure to test the full range of wage and allowance situations to make sure they meet the tolerances contained in Reg. §1.3402(h)(4)-1.

Pub. 15-A

# AWARDS AND PRIZES

## General Rules For Nontaxable Awards and Prizes

Generally, the value of an award or prize given by an employer is taxable to an employee as a wage, included on the W-2, and subject to Federal income tax withholding, social security (6.2%) and Medicare (1.45%). An employer's matching contribution is required for social security and Medicare (7.65%), unless the employee has already reached the current calendar year's maximum social security level.

IRC §74(a)  
IRC §3121(a)(20)  
Pub. 525/535  
Pub. 15-B

If the employer pays the employee's share of taxes, these amounts are additional wages to the employee (except for agricultural and domestic services) and are subject to all payroll taxes. Rev. Proc. 81-48 provides a formula for determining the amount of "grossed up" wages.

Rev. Rul. 86-14

### Three Categories of Nontaxable Awards

Nontaxable awards are limited to three categories. Each category has specific requirements that have to be met in order to be excludable.

Pub. 525/535  
Pub. 15-B

- Certain prizes or awards transferred to charities
- De minimis awards and prizes
- Certain employee achievement awards

Any other awards, such as recognition rewards (unless qualifying de minimis fringe benefits), are taxable. A worksheet to compute the taxability of an award to an employee is provided at the end of this text.

## Nontaxable Prizes or Awards Transferred to Charities

IRC §74(b)

Certain prizes and awards given for charitable, scientific, artistic or educational achievement are not taxable to the recipient if transferred to a charitable organization.

**Examples:** Nobel Peace Prize and Pulitzer Prize for Journalism



# AWARDS AND PRIZES

## Nontaxable Prizes or Awards Transferred to Charities - cont.

### Requirements For Nontaxability

- Award is for past achievement
- Recipient is selected without entering any contest
- No substantial future services are required
- Recipient transfers the award to a charitable (IRC §170(c)) organization prior to receiving the benefit

**Example:** A college instructor is chosen as teacher of the year by a national education association. He is awarded \$1,000 which he directs the education association to transfer to a college scholarship fund at the institution where he teaches before accepting it. The award is not taxable to the college instructor.

## Nontaxable De Minimis Awards and Prizes

IRC §132(e)

A prize or award that is of nominal value and is provided infrequently is excludable from an employees' wages, if it is not cash or a cash equivalent. Prizes or awards that are given frequently to an employee do not qualify as an excludable de minimis award, even if each award is small in value.

### Examples of Excludable De Minimis Awards Provided in the Regulations

Nominal gifts for birthdays, holidays

Holiday turkey and hams

Flowers, plaques, coffee mugs for special occasions

Gold watch on retirement

Parking for employee of the month (If value is less than QTFB limit-2006 limit is \$205/month)

### Definitions

**"Nominal"** - small in value. There is no set dollar amount in the law for nominal prizes or awards. A \$25 limit is imposed on *business gifts*. The IRS has given advice at least once that a benefit of \$100 did not qualify as de minimis.

ILM 200108042

**"Cash equivalent"** - An item that can be converted to cash, such as, a savings bond or gift certificate.

# AWARDS AND PRIZES

## Nontaxable De Minimis Awards and Prizes - cont.

### Cliff Provision

Reg. §1.132-6(d)(4)

If an employer provides an award that exceeds either the value or frequency limitations for de minimis fringes, the entire award is included in the employee's wages, not just the portion that exceeds the de minimis limits.

## Employee Achievement Awards

### General Rules for Employee Achievement Awards

IRC §74(c)  
Reg. §1.274-8(c)(1)

An employee achievement award is an item of tangible personal property for **length of service or safety**. In order to be excludable from wages, special requirements and dollar limitations must be met.

- **Limited to Length of Service and Safety Awards Only**
- Cannot be a disguised wage
- Must be awarded as part of a meaningful presentation
- Must be an item of tangible personal property (Cannot be cash, cash equivalent, vacations, meals, lodging, theater or sports tickets, stocks, bonds.)
- Must meet other special requirements and limitations

Reg. §1.274-8(c)(2)

⇒ **Note:** Taxable if cash or cash equivalent, or if over certain dollar limits

### Length Of Service Awards

Reg. §1.274-8(d)(2)

An award will not qualify as a length-of-service award if either of the following applies.

- The employee receives the award during his or her first 5 years of employment.
- The employee received another length-of-service award (other than one of very small value) during the same year or in any of the prior 4 years.  
Exception to 5-year rule: Traditional retirement award

# AWARDS AND PRIZES

## Employee Achievement Awards - cont.

### Safety Achievement Awards

Reg. § 1.274-8(d)(3)

An award will not qualify as a safety achievement award if either of the following applies.

1. It is given to a manager, administrator, clerical employee, or other professional employee.
2. During the tax year, more than 10% of the employees, excluding those listed in (1), have already received a safety achievement award (other than one of very small value). Eligible employees must have worked full-time for a minimum of one year prior to the award.

**Example:** If an agency has 50 eligible employees and 6 receive safety awards, the 6<sup>th</sup> award is taxable because 10% of the eligible employees have already received it.

## Taxability of Employee Achievement Awards

IRC § 274(j)(2)  
Pub. 535

Generally, if an award is taxable to an employee, it is valued at the fair market value (FMV). The taxable amount of an award to an employee depends on whether the award is made under a qualified or nonqualified plan, whether the cost of the award to the employer exceeds the dollar limitations, and the FMV of the award.

### Qualified Plan Award

Reg. § 1.274-8(c)(5)

A qualified plan award is an award:

- made under an established written plan, *and*
- does not discriminate in favor of highly paid employees, *and*
- the average cost of all employee achievement awards (both qualified and nonqualified awards for length of service and safety) made by the employer during a single year does not exceed \$400. Awards of \$50 or less are not included in computing the average.

IRC § 414(q)(1)

Reg. § 1.274-8(c)(5)

**Example:** *In 2006, an agency presents employee length of service awards to 6 employees for a total cost to the employer of \$1,800. The average cost of awards is \$300 (\$1,800/6). Since the average cost of all awards does not exceed \$400, the awards are considered qualified plan awards provided there is a written plan that does not*

# AWARDS AND PRIZES

*discriminate in favor of highly paid employees.*

## Taxability of Employee Achievement Awards - cont.

### Nonqualified Plan Awards

Reg. §1.274-8(c)(5)(ii)

A nonqualified plan award is one *not* made under a qualified plan. nonqualified awards can discriminate in favor of highly paid employees.

### Dollar Limitation

The maximum amount of excludable awards to a single employee during a calendar year is limited to:

- \$400 for awards made under a nonqualified plan, or
- \$1600 in total for awards made under both qualified and nonqualified plans

**Example:** An employee receives 2 employee achievement awards during the year. The cost and FMV of the awards were the same.

	Cost and FMV
Nonqualified plan award of a watch	\$ 400
Qualified plan award of a stereo	<u>1,350</u>
Total awards	\$1,750
Less: Annual limitation	<u>(1,600)</u>
Taxable portion of awards	<u>\$ 150</u>

### Cost Exceeds Dollar Limitations - Excess Deduction Award

Reg.. §1.74-2(b)

Generally, if an award is taxable to an employee, it is valued at the fair market value (FMV). If the cost to an employer for an award exceeds the plan dollar limitations, either \$400 (non-qualified plan) or \$1600 (qualified plan), then the employee will be taxed on the *greater* of:

1. The part of the employer's cost that is more than the plan dollar limitation (but not more than the FMV), or
2. The amount by which the FMV exceeds the amount of the plan dollar limitation.

# AWARDS AND PRIZES

## Taxability of Employee Achievement Awards - cont.

### Cost Exceeds Dollar Limitations - Excess Deduction Award - cont.

Reg.. §1.74-2(b)

#### Example 1: Excess Deduction Award

An employer pays \$520 for golf clubs given to an employee as a nonqualified plan employee achievement award. The fair market value of the award (golf clubs) at the time it is given to the employee is \$750.

	<u>Cost</u>	<u>FMV</u>
Award	\$520	\$750
less: Limitation	<u>400</u>	<u>400</u>
Excess over limitation	<u>\$120</u>	<u>\$350</u>

The employee is taxed on \$350, the greater of the cost less the limitation or the FMV less the limitation. If the award had been a qualified plan award, the employee would not have been taxed on any of the value of the award.

#### Example 2: Excess Deduction Award

An employer pays \$395 for golf clubs given to an employee as a nonqualified plan employee achievement award. The fair market value of the clubs at the time it is given to the employee is \$450.

	<u>Cost</u>	<u>FMV</u>
Award	\$395	\$450
less: Limitation	<u>400</u>	<u>400</u>
Excess over limitation	<u>\$ 0</u>	<u>\$ 50</u>

Since the employer's cost of the award does not exceed the \$400 limitation for nonqualified awards, the employee is not taxed on the value of the award.

# AWARDS AND PRIZES

## Taxable Prizes and Awards

**Regardless of the cost of an award or its FMV, the following awards are taxable as a wage to an employee:**

- Cash or cash equivalent awards - e.g. savings bonds
- Recognition awards, cash or non-cash, for job performance unless they are qualifying de minimis fringe benefits  
**Examples:** *Awards for outstanding customer service, employee of the month, highest productivity*
- Achievement awards, cash or non-cash, that don't meet the requirements for excludable treatment  
**Examples:** *Awards for length of service or safety achievement that do not meet certain specific requirements and limitations.*
- Non-cash prizes (unless de minimis) won by employees from random drawings at employer sponsored events. Reg.. § 1.74-2(c)(4)

## Source of Funds Implications

If funds for awards or prizes are provided by an outside party, the award is still taxable to the employee. If the funds are turned over to the employer to select and distribute the awards, the employer is responsible for all applicable payroll taxes and withholding. IRC § 3402(d)

### **Examples:**

A bank provides funds to a state agency to support a special performance award program. The agency chooses the recipients and distributes the awards. The value of the awards are additional compensation to these employees and reportable on their Forms W-2, subject to payroll taxes and withholding. This answer would be the same even if the outside party were a nonprofit organization or an educational foundation.

In the case where the outside party selects and distributes the award directly to an agency employee without any direction or decision making from agency personnel, then the award is income to the recipient and must be reported. The outside party would be required to provide a Form 1099-MISC if the amount is \$600 or more in a

## AWARDS AND PRIZES

calendar year.

### Examples

- (1) **Is a television, donated by a business to a state agency, taxable if the agency awards the television in a random drawing of employees?**

Yes. The fair market value of the television would be considered a taxable wage to the employee. Prizes in a random drawing of employees are considered wages. A television is not considered a de minimis benefit.

- (2) **If an agency pays the taxes on an award, is that payment taxable to the employee?**

*Yes, the term for this treatment is “grossing up.” The additional payment for the taxes is a taxable item and must be included on the employee’s W-2 in the year the payment was made. See section 7 of Publication 15-A, Rev. Proc. 81-48 and Rev. Rul. 86-14.*

- (3) **If special duck prints donated by artists are given away as awards to employees, how would the agency establish the fair market value (FMV)?**

*The FMV can be determined by an appraisal, by establishing the sales price of similar prints by the artist, or by any other reasonable method. The taxability of the value of the prints to the employees depends on the type of award, dollar limitations and other specific requirements.*

- (4) **An employer only makes awards to employees that are non-cash qualifying length of service or safety awards. In order to avoid the extensive recordkeeping and tracking required for determining the taxability of awards, the employer has a policy of not making awards that exceed \$400 per employee annually. In this situation, are any of the awards made by the employer taxable to the employees?**

*Assuming that the awards are qualifying length of service or safety awards, none of the awards would be taxable to the employees.*

- (5) **An employer provides dinner at an annual awards banquet for employees. Is the value of the meal taxable to the employees?**

*No. The regulations specifically mention that occasional group meals are considered a nontaxable fringe benefit*

Reg. §1.132-6(e)(1)

# PROFESSIONAL LICENSES AND DUES

## Background

An employer may reimburse employees for the cost of their professional licenses and professional organization dues and have it be excludable from wages, when those licenses or professional organization dues are directly related in the employee's job.

Example: If an employer pays an employee's professional dues to the National Association of Finance Officers (i.e. employee is a finance officer), then that is an excludable reimbursement/payment to the employee as long as the accountable plan rules are met.

This chapter will cover:

- General rules for reimbursement for professional licenses
- General rules for reimbursement for some organizations dues, and examples of each.

## Professional Licenses

### General Rules

- Fees paid to maintain a professional license are considered an ordinary business expense. IRC § 162  
Reg. §1.162-6
- **Examples:** Notary, Engineering, Law, CPA, and other professional licenses
- If paid by an individual, the fees are deductible as a business expense on the individual's Federal income tax return. IRC §162  
Reg. §1.62-1T(e)
- If paid or reimbursed by an employer for an employee, the fees are a working condition fringe benefit, and IRC § 132(a)  
Reg. §1.132-5(a)(1)(v)
- **If paid :**
  - under an accountable plan, it is excludable from the income of the employee; IRC §62(a)(2)(A)  
Reg. §1.62-2(c)(2)
  - under a nonaccountable plan, it is included in the income of the employee and subject to Federal income tax, social security, and Medicare taxes. IRC § 62(c)(1)&(2)  
Reg. §1.62-2(c)(3)



# PROFESSIONAL LICENSES AND DUES

Employees must comply with recordkeeping requirements

IRC §274

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## Organization/Association Dues

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### General Rules

Generally, no deduction is allowed for dues paid to any club organized for business, pleasure, recreation, or other social purposes.

IRC §274(a)(3)

**But...**there is an exception for professional organizations. An employer may provide an excludable reimbursement to an employee for professional organization dues when the professional organization's focus or mission is directly related to the duties performed by the employee.

### Business and Professional Organizations

Clubs organized for business purposes only, such as business leagues, professional organizations, and trade associations, are not considered entertainment or recreational organizations. If related to the employer's business, payment or reimbursement of dues is excludable to the employee when the employee is performing duties for the employer which are related to the professional organization's focus/mission.

Reg. §1.274-2(a)(2)(iii)(b)

Reg. § 1.274-2(b)-2

**Examples:** Bar and Accounting Associations; AICPA, State Association of CPAs, OASBO; WACUBO or Public Service Organizations.i.e.: Kiwanis and Rotary Clubs

### Entertainment and Recreational Organizations

IRC §274(a)(3)

Club dues are a taxable fringe benefit after December 31, 1993.

No business deduction is allowed for club dues.

If an employer pays or reimburses an employee for club dues, the amount is taxable to the employee and subject to income tax withholding, social security and Medicare taxes.

**Types of Clubs:** Country clubs, yacht clubs, golf clubs, or other social clubs

## PROFESSIONAL LICENSES AND DUES

### Examples

- (1) **A state agency requires an employee to be a Notary. The employee submits the paid receipt to the agency and the agency reimburses for the annual fee to maintain this professional license. Is this payment taxable to the employee?**

*It is not taxable to the employee because it is an ordinary and necessary business expense per IRC Section 162 and paid by the employer under an accountable plan.*

- (2) **When are employer reimbursements for obtaining professional licenses or license renewals nontaxable for employees?**

*Once an employee has completed the education or experience required for a professional license, the expenses necessary to maintain a license or status are considered ordinary and necessary expenses. If the employer pays these expenses (under an accountable plan), it is a nontaxable benefit to the employee, as long as the professional license is related to the position the employee holds with the employer.*

- (3) **A state agency executive receives a social club membership and monthly dues paid by his employer. The value of this fringe benefit has not been included in his wages because the executive believes the membership and dues are NOT taxable to him because he represents the agency at the various club functions. Is this a taxable fringe benefit to the executive?**

*Effective December 31, 1993, club dues and memberships are no longer allowed as a business deduction. If an employer provides these benefits to an employee, they are taxable to the employee and subject to Federal income tax withholding, social security and Medicare taxes.*

- (4) **A state agency pays the annual CPA license fee for the chief game warden each year. The warden does not use his CPA expertise on the job for the agency. Is this annual reimbursement taxable to the game warden?**

*Because the game warden does not use his CPA expertise in his game warden capacity with this state agency, the reimbursement to the game warden is a taxable reimbursement to him and is subject to Federal income and employment taxes.*

# STUDENT WAGES - SOCIAL SECURITY/MEDICARE EXCEPTION

## General Rules

Proposed Reg. § 31.3121(b)(10)  
Notice 2004-12

Services performed by students are excepted (exempt) from social security and Medicare if all of the following rules apply:

1. Students' services are performed for a school, college, university (SCU) or IRC § 509(a)(3) affiliated organization, and
2. Student is enrolled and regularly attending classes at the school, college, or university for whom the services are performed, and
3. Services are incidental to, and for the purpose of, pursuing a course of study, and
4. Students are NOT covered under a Section 218 agreement.

## Definitions

Proposed Reg. § 31.3121(b)(10)  
Notice 2004-12

### 1. School, College, University (SCU) Status

IRC § 170(b)(1)(A)(ii)

- SCU includes primary, secondary, preparatory, or high schools, and colleges and universities
- SCU normally maintains regular faculty and curriculum, has regularly enrolled body of students attending at place educational activities are regularly carried on
- **Primary function of SCU must be to carry on educational activities**
  - not merely carry on some educational activities
  - primary function is to conduct classes for identified set of students leading to a credential demonstrating mastery of some subject matter
  - operation of a school by a museum or hospital doesn't necessarily qualify museum or hospital as an educational institution

### 2. Student Status

An individual is a student if the primary relationship with the SCU is as a student and only secondarily or incidentally as an employee.

# STUDENT WAGES - SOCIAL SECURITY/MEDICARE EXCEPTION

## Definitions – cont.

### 2. Student Status – cont.

#### Career Employee

A career employee is not considered a student and does not qualify for FICA exception. A career employee is an individual who –

- a. regularly works 40 hours or more per week; or
- b. is a professional employee defined as an employee whose:
  - primary duty requires advanced knowledge in field of science or learning
  - work requires exercise of discretion and judgment
  - work is predominately individual and varies, or
- c. is eligible to receive certain employee benefits or is classified by employer as a career employee, or
- d. is required to be licensed under state.

#### Enrolled and Regularly Attending Classes

- Classes must involve faculty leadership, set curriculum, and prescribed time frame.
- Students must be registered and regularly attending classes

### 3. Incident to and for Purpose of Pursuing Course of Study

- Based on educational aspect of relationship vs. service aspect
  - can be based on hours worked relative to credits taken

Rev. Rul. 78-17

## Students Qualifying For Social Security/Medicare Exception

### Whose Wages Qualify for FICA Exception?

#### Examples: Exempt Services

- (1) Full-time high school student working during the school year in the kitchen of the school he attends.
- (2) Full-time high school student paid to do repair work during the school year at another school in the district. If the employer is the same at both schools, the services qualify as exempt.

# STUDENT WAGES - SOCIAL SECURITY/MEDICARE EXCEPTION

## Students Qualifying For Social Security/Medicare Exception – cont.

### Whose Wages Qualify for FICA Exception? - cont.

- (3) Part-time undergraduate student enrolled for 12 credit hours and working in the university library 20 hours per week Rev. Rul. 78-17

## Students *Not* Qualifying For Social Security/Medicare Exception

### Whose Wages Do Not Qualify for Exception?

Postdoctoral students or fellows, students covered under Section 218 of the Social Security Act and, generally, medical residents, medical interns, career employees and any others not meeting requirements.

#### Examples: Non-Exempt Services

- (1) College student majoring in avionics and interning at a municipal airport to gain experience during the Christmas break. The institution where the student is enrolled is not the employer.
- (2) Full-time employee of a university enrolled in a three-credit-hour graduate course who will be eligible to participate in the university's retirement plan after being employed for six months. Even though not yet eligible to participate in the retirement plan, the employee will be eligible once service requirements are met and, therefore, he/she is considered a career employee.

#### School Breaks

Exemption from social security/Medicare taxes does not apply to services of student employees not enrolled in classes during school breaks of more than five weeks (including summer breaks of more than five weeks).

## Income Tax Reporting

Payments to student employees performing services exempt from social security and Medicare taxes are still subject to income tax withholding and reporting on Forms W-2.

# VOLUNTEERS

## Background

Volunteers occasionally assist governmental entities and the entities may, in turn, provide the volunteers with various reimbursements, stipends, or other payments. The treatment of the payments for Federal payroll purposes depends on whether the volunteer is an employee or non-employee and what the types of payments are.

## When Is A Volunteer An Employee?

IRC § 3121(d)(2)

Pub. 1779

### Right To Control

A volunteer is an employee if an entity has the right to direct and control the volunteer's performance, not only as to the results to be accomplished, but also as to the methods by which the results are accomplished. It is the "right" to control, even if the entity doesn't exercise the right, that is important. Many factors in an employment relationship have to be considered before a decision can be made as to whether the entity has the right to direct and control.

If an entity does not retain the right to direct and control the details and means of performing the work, the volunteer worker is not an employee.

### Evidence Of The Right To Control

In determining whether an entity retains the right to control a worker, the IRS, generally looks at facts that fall into three main categories of evidence: behavioral control; financial control; and relationship of the parties. The facts considered in these categories include whether the agency provides training or instructions, whether the worker can earn a profit or incur a loss, whether benefits are provided and other factors. Not every evidential factor applies in every situation and the degree of importance varies depending on circumstances.

#### **Example - Right to direct and control results only - Non-Employee**

An agency is required to build a watershed in a state forest. Volunteers who are experienced in forestry work have offered their services. The agency asks the volunteers to build the watershed in accordance with environmental laws to the best of their abilities and experience. The agency does not provide other instructions or supervision.

#### **Example - Right to direct and control results and methods - Employee**

# VOLUNTEERS

An agency is required to build a watershed in a state forest.

## When Is A Volunteer An Employee? - cont.

Volunteers who are experienced in forestry work have offered their services. The agency asks the volunteers to build the watershed in accordance with environmental laws and provides an agency employee to oversee the project. The agency gives instructions, provides the tools and materials, and sets the hours of operation.

## Issues with Volunteers

### “Volunteer” Firefighters

Pub. 963  
ILM 200322002

Generally, “volunteer” firefighters are employees of the fire department or district for which they perform services. The usual common-law tests apply to determine their employment status. For example, the relationship between the firefighter and the fire department will generally indicate that the department provides training and direction in how the work will be performed and provides the equipment to perform the work.

Payments to these firefighters who are employees under the common-law tests are treated the same as payments to other government employees. There is no rule exempting “de minimis” payments from taxes. For instance, volunteer firefighters may not receive salaries, but they may receive amounts intended to reimburse them for expenses. They may also receive other cash or in-kind benefits that may be wages. Volunteer firefighters who are employees can receive tax-free reimbursements for their expenses provided the accountable plan rules are met.

### Property Tax Abatements or Exemptions

FSA 200132035

ILM 200302045

Property tax abatements in exchange for volunteer services by senior citizens and emergency responders have been ruled to be taxable income by the IRS.

### Payments under Domestic Volunteer Service Act (Title II and III)

Rev. Rul. 74-322

Payments for supportive services or reimbursements of out-of-pocket expenses of volunteers under Title II and III of the Domestic Volunteer Service Act are not wages or compensation and no withholding or reporting is required by the payer.

### Liability Insurance for Volunteers

Reg. 1.132-5(r)(3)

# VOLUNTEERS

Liability insurance provided for volunteers by an entity qualifies as a tax-free working condition fringe benefit.

## Issues with Volunteers – cont.

### Payments under Domestic Volunteer Service Act (Title II and III) – cont.

Programs under Title II and III include:

- Retired Senior Volunteer Program (RSVP),
- Foster Grandparent program and other older volunteer programs,
- Service Corps of Retired Executives (SCORE),
- Active Corps of Executives (ACE)

## Tax and Reporting - Employees

### Volunteer as Employee

- Stipends and other payments for services are wages.
- Reimbursements paid under an accountable plan are not taxable and not reportable.
- Reimbursements **not** paid under an accountable plan are taxable and reportable on Form W-2 as a wage subject to withholding.\*
- Wages in the form of stipends, taxable reimbursements, or other payments are subject to withholding\* and reportable on Form W-2.

\* Unless the wages are not normally subject to social security or Medicare taxes under Section 218 of the Social Security Act.

## Tax and Reporting Treatment of Volunteers

### Volunteer as Non-Employee

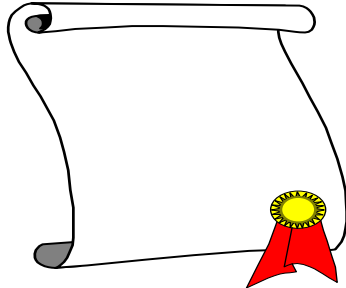
Rev. Rul. 80-99  
Rev. Rul. 67-30

Generally, a volunteer who provides services without compensation does not have gross income when the expenses of providing those services are reimbursed. However, if the reimbursement is greater than the expenses, the difference is gross income.



# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## Background



An employer may pay or reimburse an employee for an education course. Whether or not the cost or value of the course is excludable from wages to the employee depends on various factors. There are a number of sections of the Internal Revenue Code (IRC) that permit the payments or reimbursements to be excludable from wages providing the requirements in the Code sections are met.

An educational payment that is not exempt from tax under one Code section may be exempt under a different Code section. Excludable treatment of an educational benefit under IRC §132(d) (working condition fringe benefit) applies only if benefits under all other code sections do not apply. A comparative chart at the end of this chapter will help in determining whether specific payments or reimbursements for education expenses are excludable.

### Internal Revenue Code Sections:

#### For all employers:

Working Condition Fringe - Educational Reimbursements	IRC §132(d), Reg. §1.162-5
Qualified Educational Assistance Program	IRC §127

#### For certain other employers:

Qualified Tuition Reductions	IRC §117(d)
Tuition Waivers for State Employees	IRC §§117(d), 127, 132(d)
Scholarships and Fellowships	IRC §117

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## Working Condition Fringe - Educational Reimbursements

IRC §132(d)  
Reg. § 1.162-5

**Job-related** educational expenses are excluded from an employee's income as a "working condition" fringe benefit. This is an excludable benefit of property or service provided by an employer to an employee that, if the employee had paid for it, the employee could have deducted as an unreimbursed employee business expense (IRC §162) on form 1040. The exclusion is, generally available for any form of educational instruction or training that improves or develops the job-related capabilities of an employee.

Reimbursements for education expenses will qualify as a nontaxable working condition fringe benefit, if the following rules are met:

### General Rules

- Educational courses must be job-related IRC §132(d)
- No written plan is required Reg. §1.132-1(f)(1)
- May discriminate in favor of highly-compensated employees
- No dollar limitation

### Requirements for Excludable Treatment

**Educational course must:** IRC §132(d)

- Be job-related, and either Reg. §1.162-5(a)(1)
- Maintain or improve job skills, or
- Be required by the employer or by law.

**Educational course must not:**

- Be needed to meet the minimum educational requirements of the current job, or Reg. §1.162-5(b)(2)
- Qualify the employee for a new trade or business Reg. §1.162-5(b)(3)

### Substantiation Requirements of Cash Payments to Employees

Reg. §1.132-5(a)(v)

If an employee receives cash, the employer must require the employee to:

- Use the amount for payment of education expenses that qualify as a working condition fringe benefit,
- Verify that the payment was actually used for such expenses, and
- Return to the employer any unused portion of the payment.

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## Working Condition Fringe - Educational Reimbursements - cont.

### "Employee" For Purposes Of Working Condition Fringe Benefits Only

Regs. . §1.132-1(2)

- Current employees
- Independent Contractors
- Directors and Partners
- Volunteers

Regs. . §1.132-5(r)

### Qualifying Educational Expenses

- Tuition, books, supplies, equipment
- Certain travel and transportation costs
- Graduate or undergraduate level courses

Reg. §1.162-6

Reg. §1.162-5(d)

Reg. §1.162-5(a)

### Courses Required by Employer or Law

- Requirement must be expressly stated by employer (or by state law or regulations);

Examples of court decisions of qualifying (excludable) courses:

Masters Degree required to be obtained in five years or employee is fired; or salary is lower without a Masters Degree

### Courses Qualifying Employee for New Trade or Business

Reg. § 1.162-5(b)(3)

Generally, education courses that qualify an employee for a new position or specialty within his/her existing trade or business are not considered taxable courses qualifying an employee for a new trade or business.

Examples of excludable courses that qualify employees for a new position rather than a new trade or business include:

- elementary school teacher to principal
- elementary school teacher to physics teacher
- manager obtaining M.B.A.

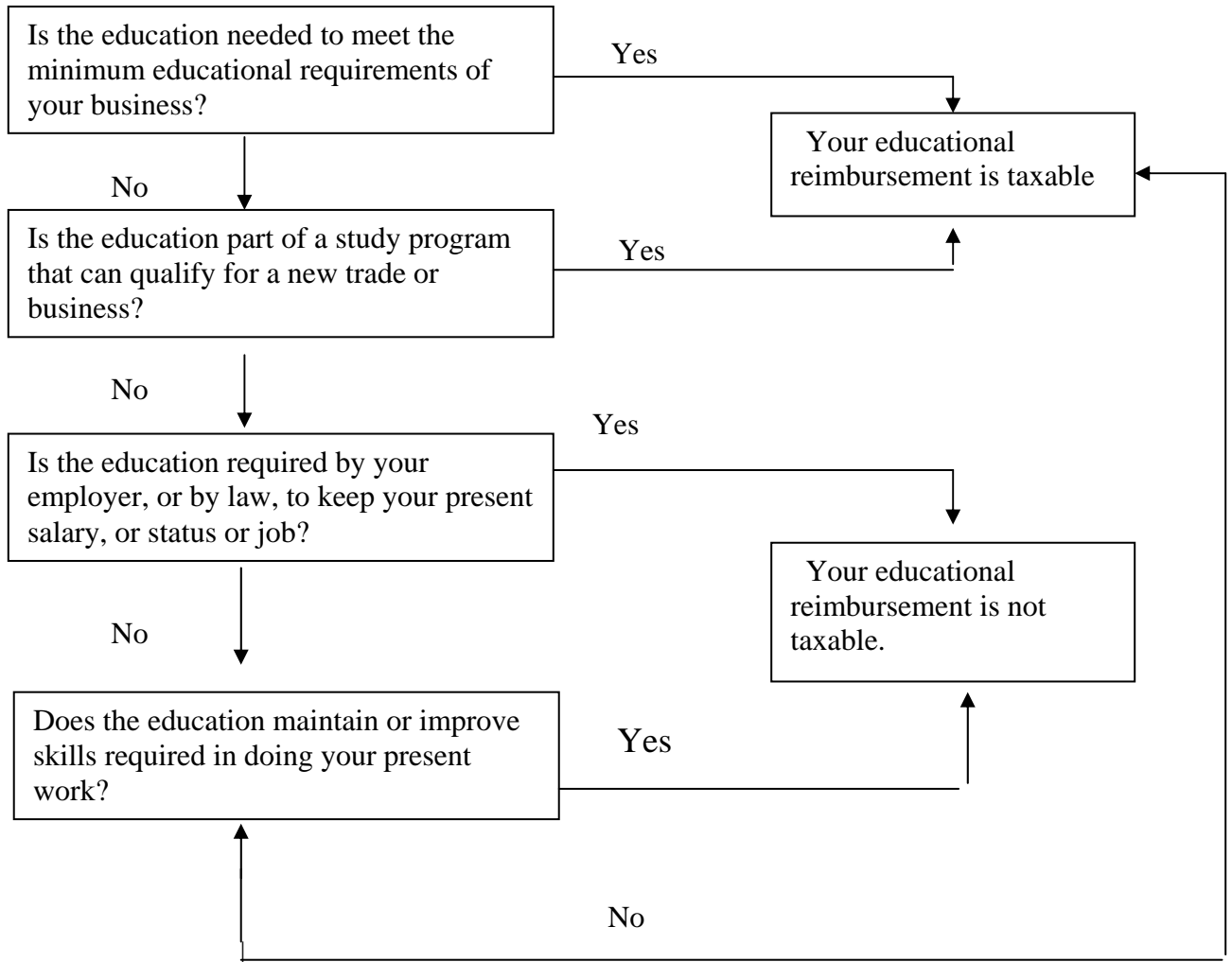
Often, courses needed for acquiring a license or certificate, are considered taxable courses leading to a new trade or business. Examples are:

- Accountant to CPA
- CPA to Lawyer

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## Working Condition Fringe - Educational Reimbursements - cont.

### Quick Flowchart



## EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

### Examples: Working Condition Educational Fringe Benefit

- (1) **Veronica is a computer processor at a state agency. She wants to take a graduate computer course at STU University to enhance her current job skills. Will Veronica have any taxable consequences from taking the class?**

*No, the class is excludable as a working condition fringe because it is job-related and maintains or improves Veronica's skills, and it doesn't prepare her for a new trade or business.*

- (2) **Due to a teacher shortage, Doug, who has 80 hours of college credits, is given a position as a teacher although the job requirements are for 120 hours of credits. Doug is reimbursed by his employer to complete the 40 credits at night school while he is teaching. Is the reimbursement taxable?**

*Yes, the reimbursement for earning the 40 credit hours is taxable to Doug since the courses are needed to meet the minimum requirements of his present job. (This may be excludable under one of the other Code sections, i.e.: Section 127, see the next section.)*

- (3) **Peter, a fiscal tech hired into an Accountant I position, doesn't have all of the accounting credits he needs for the job. He signs up and takes all of the courses required for the position. The courses will improve his job, but the primary purpose of taking them is to acquire the minimum requirements for the position. Is this taxable to Peter?**

*The reimbursement for Peter's classes under IRC Section 132(d) is taxable to him because the education is needed to meet the minimum educational requirements of his position. (This may be excludable under one of the other Code sections, i.e. Section 12. See the next section.)*

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## Qualified Educational Assistance Programs

IRC §127

### General Rules

Amounts paid or expenses incurred by an employer for educational assistance for an employee are excludable from the wages of the employee, if certain requirements are met.

### Excludable (Nontaxable) Requirements:

- Employer must have a written plan Rev Notice 97-60
- May be for undergraduate or graduate level courses IRC §127(c)(1)
- Dollar limitation of \$5,250 per calendar year IRC §127(a)(2)
- Is not required to be job-related educational assistance PL 95-600
- Must not discriminate in favor of highly compensated employees (for 2006, earning \$100,000 or more) IRC §127(b)(2)  
IR 2005-120

### Courses Deemed Starting Date

The first regular day of class for any course offered during a regular academic term at an educational institution will be the first day regular classes *generally begin for courses offered that term.*

### Definitions

#### Eligible Employees

Reg. §1.127-2(h)

Current and/or laid off employees, employees retired or on disability, and certain self-employed individuals.  
Does not include spouses or dependents of employees.

#### Educational Expenses

IRC §127(c)(1)

#### Covers:

Tuition, books, supplies, equipment necessary for class

#### Does not cover:

Tools or supplies which employee may keep after the course is completed.  
Education involving sports, games, hobbies unless job related  
Meals, lodging, or transportation

## EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

### Examples: Qualified Educational Assistance Program

- (1) **Karen is a secretary at a state agency. She wishes to take an undergraduate psychology class at MNO Community College. The state agency has a written educational assistance plan. The state agency pays \$250 for the tuition to the community college for the course. What are the tax effects?**

*Karen has no taxable income because the requirements for an educational assistance plan have been met under IRC §127.*

- (2) **Joe, a janitor at a state agency, wants to take a math class leading towards his bachelor degree. The state agency has a qualified educational assistance plan and reimburses Joe \$300 for the course after he verifies the cost. What are the tax consequences to Joe?**

*Joe does not have taxable wages from this reimbursement. The fact that he is taking a course leading toward an undergraduate degree is not relevant for qualified educational assistance programs under IRC Section 127.*

- (3) **Tom is a recreation specialist for the Division of Parks and Recreation. His employer pays for him to take courses toward a license as a soccer referee. Does Tom have taxable income?**

*Assuming the employer has a qualified plan, Tom does not have taxable income even though the courses he is taking are sports-related. The courses have a reasonable relationship to the business of the employer and this provides an exception to the rule that sports, games and hobby classes are not permitted under educational assistance programs.*

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## Qualified Tuition Reduction - IRC §117(d)

### General Rule

IRC§117(d)(1)

Free or reduced tuition for employees of educational institutions may be excludable to the employees.

### Requirements To Be Excludable (Nontaxable):

IRC§117(d)(1),(2),(3)

- Employee of educational institution
- Employee is involved in educational function
- Available to employees on a non-discriminatory basis
- Education must be below graduate level\* and

⇒ **\*Note:** If employee is a graduate student performing teaching or research activities for the educational institution, he/she may take excludable graduate courses. The courses must be taken at the school where the employee is working.

IRC§117(d)(5)[4]

IRC 170(b)(1)(A)(ii)

### Definitions

#### "Employee" for Qualified Tuition Reduction:

- Current employee or spouse
- Former employee retired or left on disability
- Spouse, widow or widower of deceased employee
- Spouse, widow or widower of employee retired or left on disability
- Dependent child of employee
- Child of employee, under age 25, with both parents deceased

IRC § 117(d)(2)(A)

IRC § 132(h)

#### Educational Organization:

IRC§170(b)(1)(A)(ii)

- Maintains a faculty and curriculum, and
- Normally has a regularly enrolled student body on site.



# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## Qualified Tuition Reduction - IRC §117(d) - cont.

### Nondiscrimination Restriction:

Generally, an employer cannot discriminate in favor of employees earning \$95,000 or more annually. (2005)

IRC 414(q)(1)(B)(i)  
Reg. §1.132-8(f)  
IR-2002-111(01-2003)

### Qualified Tuition Reductions and IRC 132:

Reg. § 1.132-1(f)(1)

If the tax treatment of an educational expense is expressly provided for in a specific Code section, then it is not covered by IRC 132. (except for 132(e)-de minimis fringe benefits). Because section 117(d) applies specifically to tuition reductions, the exclusions under section 132, such as no-additional-cost benefits, or working condition fringe benefits do not apply to free or discounted tuition provided to employees of an educational institution.

If the amounts PAID by the employer for education relating to the employee's trade or business as an employee of the employer (in other words, there is no tuition reduction or free classes) is such that, if the employee had paid for the education, the amount paid could be deducted on their 1040, the costs of the education may be eligible for exclusion as a working condition fringe under 132.

FSA 200231016 (13 Mar 2002)

## Examples: Qualified Tuition Reductions

- (1) **Carl works for ABC Community College, a division of the State University, as a physics teacher. His two children attend the State University undergraduate program at a reduced tuition. What are the tax consequences?**

*This situation meets the requirements for qualified tuition reduction and Carl has no taxable income.*

- (2) **Same facts as in Example 1, but in addition to reduced tuition, Carl's children are receiving free room and board. Does this change the taxation of the benefits?**

*The tuition reduction is still not taxable but the value of the free room and board will be taxed as a wage to Carl.*

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

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## Examples: Qualified Tuition Reductions – Cont.

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### Tuition Waiver for State Employees

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IRC 117(d),127, and 132(d)

#### State Law

Certain states' laws permit state colleges and universities to waive all or a portion of tuition, services and activities fees for state employees employed half-time or more in the following classifications for permanent employees:

- Classified and exempt paraprofessional employees of technical colleges,
- Faculty, counselors, librarians, and exempt professional and administrative employees at institutions of higher education.

#### Determination of Taxability/Non-Taxability

Three Code sections may provide relief from taxation for tuition waivers. In order to be excludable, the course must qualify under one of the following code sections:

- IRC §117(d), Qualified Tuition Reduction,
- IRC §127, Educational Assistance, or
- IRC §132(d), Working Condition Fringe.

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### Tuition Waiver for State Employees - cont.

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#### First Determination Step

**Does the employee work for a state educational institution? If so, look at IRC §117(d).**

- A *qualified* tuition reduction for employee will be excludable
- Employee must be involved in the educational function
- “Employee” includes employee's dependent children and others
- No dollar limit and no written plan required
- Cannot discriminate in favor of Highly Compensated Employees
- Teaching and research assistants may have qualified excludable reductions on graduate courses taken at their employer's educational institution only
- Employee may attend *any* state educational institution undergraduate class except: teaching and research assistants must take their graduate courses at

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

their employer's educational institution.

## **Second Determination Step**

**If the employee works at a state agency other than educational institutions, see §127.**

- Look to this Code section for possible excludable treatment
- Employer paid educational assistance not taxable up to \$5,250 limit
- Employer must have written plan that satisfies §127
- Graduate or undergraduate level courses qualify
- Employee definition – general common-law test (not the section §117(d) test)
- Must not discriminate in favor of highly compensated employees

## **Third Determination Step**

**If §127 doesn't provide relief, look at §132(d):**

- If courses are job-related, they could be considered a working condition fringe benefit (defined as property or services provided to an employee of the employer to the extent that, if the employee paid for it, such payment would be allowable as a deduction on the employee's income tax return). Tuition reductions (IRC §117) do not qualify under IRC§132(d)
- Qualifying education would be classes that maintained or improved skills
- Non-qualifying taxable education would include classes to meet minimum requirements of job or qualify the employee for a new occupation
- Graduate level courses may qualify as excludable
- No dollar limit and no written plan necessary
- Employer may discriminate in favor of highly compensated employees

## **Scholarships and Fellowships**

IRC §117

### **General Rule**

Individuals pursuing a course of study or research often receive awards or funds to pay for their educational costs in the form of scholarships, fellowships, stipends, or grants. Regardless of the name given the fund or award, the taxability depends on whether the provisions of IRC § 117 are met.

#### **Excludable if:**

IRC §117(a)

- Amount is a "qualified" scholarship, and the
- Recipient is a candidate for degree at a qualified educational organization

#### **Taxable if:**

- Payment is for past, present or future services, OR

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

- Payments fund study or research primarily for benefit of the grantor.

## Definitions

### Qualified Scholarship or Fellowship

IRC §117(b)(1)

Scholarship or fellowship to the extent the amounts are used for qualified tuition and related expenses

### Qualified Tuition and Related Expenses

IRC §117(b)(2)

Includes fees, books, supplies, and equipment required for a class. Does not include travel, meals or lodging.

### Candidate for Degree

Reg. §1.117-6(b)(4)

- Primary or secondary school student, or
- Undergraduate or graduate student pursuing studies or conducting research towards a degree at a college or university
- Non-degree candidate if a full or part-time student at an accredited educational institution

**Example:** A data processing student at a technical school which is accredited and authorized by the state to provide the program is considered a candidate for a degree for scholarship purposes.

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## Scholarships and Fellowships - cont.

### Educational Institution

- Educational organization which maintains a regular faculty and curriculum, and
- Has a regularly enrolled body of students on site.

IRC §170(b)(1)(A)(ii)

### Taxable Scholarships and Fellowships if:

IRC §117(c)

- Payments fund study and research for benefit of grantor, or
- Compensation is for past, present or future services.

No services can be required of the student in order to receive the scholarship or grant either presently or in the future to be nontaxable.

**Example:** Jeff, a professor of anthropology at Veritas College,

## EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

is awarded a fellowship by the college which allows him to devote 100% of his time to a research project of his own choice. The fellowship is designed to award faculty for present or past services. The fellowship is a taxable wage to Jeff.

**Example:** Tracy is granted a stipend by the city of Portsworth to attend a paramedic training program. She is required to accept employment with the grantor at the conclusion of the training. The stipend is taxable as a wage to Tracy.

**Example:** Mona is an advanced medical degree candidate at Hospital University. She receives a fellowship grant of \$1,000 per month for performing surgery in a residency program at the university's hospital and a one-time payment of \$1,500 for independent research. The \$1,500 for research is excludable from income. The \$1,000 grant to perform surgery represents payment for services and is taxable as wages.

# EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

## IRS Comparative Regulations Regarding Educational Assistance

Description	§127	§132(d)	§117(d)
<b>Qualified Educational Assistance</b>	<b>X</b>		
<b>Working Condition Fringe</b>		<b>X</b>	
<b>Qualified Tuition Reimbursement for Employees of Educational Institutions</b>			<b>X</b>
Written Plan Required	Yes	No	No
Undergraduate Courses Covered	Yes	Yes	Yes
Graduate Courses Covered	Yes	Yes	No*
Must Be Job Related	No	Yes	No
Courses Qualifying Employee for New Trade or Business Covered	Yes	No	Yes
Courses Needed to Meet Minimum Job Requirements Covered	Yes	No	Yes
Can Discriminate in Favor of HCEs***	No	Yes	No
Dollar Limitation	Yes-\$5250	No	No
Expiration date	None	None	None
<b>Employee Includes:</b>			
Current Employees	Yes	Yes	Yes
Family Members	No	No	Yes
Laid Off Employees	Yes	No	No
Employees Retired or on Disability	Yes	No	Yes
Independent Contractors	No	Yes	No
<b>Educational Expenses Covered:</b>			
Tuition, Books, Supplies, Equipment	Yes	Yes	Tuition Only
Tools or Supplies (non capital)	No*	No	No
Education Involving Sports, Games, Hobbies	No**	No**	Yes
Meals, Lodging or Transportation	No	Yes	No

\* See text for exceptions

\*\* Yes, if specifically job related

\*\*\* Highly Compensated Employees

⇒ **Note:** These are general rules. For details, refer to the text.

# APPENDIX: GENERAL INFORMATION AND RESOURCES

## **Federal Per Diem Rates**

Federal rates can be found in the current IRS Publication 1542 or on the Internet at the following addresses:

General Services Administration – Per Diem Rates

<http://policyworks.gov/org/main/mt/homepage/mtt/perdiem/travel.shtml>

For High Cost Locations – Non Continental USA and Foreign Locations:

<http://www.state.gov/www/perdiems/index.html> – U.S. Secretary of State – Per Diem Rates

## **Office of Federal, State and Local Governments (FSLG)**

Acting Director, Sunita Lough

Pacific Coast Area Manager - Cheryl J. Powers (925)279-4012 x203

FSLG Specialists - Sue Ann Jansen, [sue.jansen@irs.gov](mailto:sue.jansen@irs.gov)

Marilee Basaraba, [marilee.basaraba@irs.gov](mailto:marilee.basaraba@irs.gov)

**Customer Account Services - (877) 829-5500** (for governmental entities)

Assistance with determination letters, deposits, 941s, penalties

## **Other IRS Contacts**

IRS Taxpayer Information - (800) 829-1040

IRS Taxpayer Information (TDD) - (800) 829-4059

IRS Taxpayer Advocate - (877) 777-4778

(For assistance with long-standing tax issues)

IRS Forms Ordering - (800) 829-3676

IRS Forms Ordering (TDD) - (800) 829-4059

Fax Ordering - (703) 368-9694

**IRS Information Returns (W-2, 1099) Assistance**

Toll Free (866) 455-7438 (8:30 am - 4:30 pm Eastern Time)

E-mail your inquiries to: [mccirp@irs.gov](mailto:mccirp@irs.gov)

**Foreign Tax Questions** - (215) 516-2000 (6:00 am – 2:00 am EST) (Not toll free)

## **Internet**

<http://www.irs.gov/govts> - Read Quarterly FSLG Newsletter or sign up to receive

<http://www.fedworld.gov/> Fedworld Information Network

(Good for searching, locating, ordering and acquiring government and business information)

## **Social Security Administration**

Tim Beard, Seattle (206) 615-2125, FAX (206) 615-2643

## **State Social Security Administrator**

# APPENDIX: GENERAL INFORMATION AND RESOURCES

Oregon State - Steve Delaney (503) 603-7694

## Legend for Reading the Citations in the Handout

<b>CITATION SOURCE</b>	<b>EXAMPLES USED IN CLASS HANDOUTS</b>
IRS Code	IRC §132(a)(1)
US Treasury Regulations	Reg. §1.162-2(a)(2)
IRS Revenue Procedures	Rev. Proc. 97-97
IRS Publications	Pub. 15-B
IRS Revenue Rulings	Rev. Rul. 97-97
IRS Notice	Notice 98-03
IRS Announcements	Annc. 85-113
Internal Letter Memorandum	ILM 200113024
Field Service Advice	FSA 200132035



## **APPENDIX: GENERAL INFORMATION AND RESOURCES**

### **IRS Publications Used in Course**

<b><u>PUB #</u></b>	<b><u>TITLE</u></b>
<b>15</b>	<b>Circular E, Employer's Tax Guide</b>
<b>15-A</b>	<b>Employer's Supplemental Tax Guide</b>
<b>15-B</b>	<b>Employer's Tax Guide to Fringe Benefits</b>
<b>463</b>	<b>Travel, Entertainment, Gift, and Car Expense</b>
<b>508</b>	<b>Educational Expenses</b>
<b>520</b>	<b>Scholarships and Fellowships</b>
<b>521</b>	<b>Moving Expenses</b>
<b>525</b>	<b>Taxable and Nontaxable Income</b>
<b>526</b>	<b>Charitable Contributions</b>
<b>535</b>	<b>Business Expenses</b>
<b>970</b>	<b>Tax Benefits for Higher Education</b>
<b>1542</b>	<b>Per Diem Rates</b>

\*New publications are generally available after the first of the year.

**Order IRS forms and publications by calling 1-800-829-3676**

OR

**Download forms and publications at our website: [www.irs.gov](http://www.irs.gov)**

# APPENDIX: CHARITABLE CONTRIBUTIONS TO GOVERNMENT ENTITIES

## Introduction

Many times citizens make contributions to government agencies. A deduction for a charitable contribution by an individual making a contribution is allowed only if made to, or for the use of, certain qualified organizations. A State or local government agency is a qualified organization.

This chapter will cover:

- General rules for donations made to governments
- Substantiation rules, and
- Donor information.

## Donations to Governments

### General Rule

Individuals are allowed to make charitable contributions to certain qualified organizations; i.e.: a state agency. A donor can give a contribution to a State for charitable or public purposes and have a full deduction up to the limitation (50% of adjusted gross income) because a state or government entity is publicly supported and not a private foundation.

IRC § 170(a)  
IRC §170(c)(1)

## Government Agency Information

### What makes a government agency a "qualified" organization for receipt of donations, grants, etc.?

The Internal Revenue Code lists the types of organizations that are considered to be qualified organizations for purposes of receiving charitable contributions in Publication 557 annually. Most familiar Charitable Organizations are exempt under IRC 501(c)(3). A governmental unit, i.e.: state or local government is not a 501(c)(3) organization. A government entity is exempt from income tax by statute (IRC Section 115) and is considered an exempt organization for purposes of receiving donations or grants under IRC Section 170(c)(1).

IRC §170 (c)(1)  
IRC 170(b)(1)  
Reg. §1.170A-9(d)

# APPENDIX: CHARITABLE CONTRIBUTIONS TO GOVERNMENT ENTITIES

## Government Agency Information - cont.

### Substantiation Requirements

Contributions of \$250 or more must be acknowledged in writing by the governmental agency receiving the donation in order for the donor to claim a deduction.

IRC §170(f)(8)  
Reg. §1.170-13

Written acknowledgment to the donor must include:

- Cash received, and a
- Description of property received but not the value, and the
- Value of any goods/services, if any, provided to the donor in exchange for the contribution.

There is no preferred format as long as the acknowledgment is in writing. (Treasury Decision 8690, Dec. 13, 1996)

⇒ **Note:** Do not include the fair market value of any donation in the acknowledgement. Depending on the type of property and the donor's tax situation, different IRS rules apply for property valuation.

## Donor Information

A contribution is deductible only if made to or for the use of a qualified organization, and is voluntary and is made without getting or expecting to get anything of equal value.

IRC §170 (c)(2)(C)  
Pub. 526

In order to claim a charitable contribution as a deduction on Schedule A of the 1040 Federal tax return, the donor must obtain a written acknowledgement from the qualified organization receiving the contribution if it is \$250 or more. Publication 526 provides information on taking a charitable deduction.

Reg. § 1.170A-13 (f)(1)

If the employee needs assistance determining the value of donated property, Publication 561 is available. See the "Government Agency Information" section above about the format of the written acknowledgement.



# INDEX

## Employee Achievement Awards Worksheet for Computing Taxability Per Employee

- | <b>1. Type of Employee Achievement Plan Award: Qualified or Nonqualified</b>  | <b><u>Yes or No</u></b> |
|---|-------------------------|
| A.. Is the award part of an established written plan that does not discriminate in favor of highly compensated employees for eligibility or benefits? | _____                   |
| B. Is the average cost of qualified plan employee achievement awards presented during the year \$400 or less? <sup>1</sup>                            | _____                   |

If the answer to either question A or B is "No", go to Part 2 because the employee achievement award is a nonqualified plan award. Otherwise, go to Part 3.

- | <b>2. Nonqualified Plan Award</b>   | <b><u>Amount</u></b> |
|---|----------------------|
| A. Total cost to employer of all prior excludable nonqualified plan awards given to this employee during the calendar year.<br>If this amount is more than \$400, stop here. Include the fair market value (FMV) of any current nonqualified plan award in the employee's gross income. Otherwise, proceed to Step B. | \$ _____             |
| B. Cost to employer of current nonqualified plan award for this employee <sup>2</sup>   | _____                |
| C. Total employer cost of nonqualified plan awards (A + B)  | _____                |
| D. Fair market value (FMV) of the awards in Step C  | _____                |
| E. Greater of the amounts in Step C or Step D   | _____                |
| F. Less: Excludable nonqualified plan award for this year   | _____ (400)          |
| G. Taxable amount of current nonqualified plan award <sup>3</sup>   | \$ _____             |

- |  |               |
|--|---------------|
| <b>3. Qualified Plan Award</b>   |               |
| A. Total cost to employer of all prior excludable nonqualified and qualified plan awards for this employee given during the calendar year.<br>If the amount is more than \$1,600, stop here, include the FMV of the current award in the employee's gross income. Otherwise, go to Step B. | \$ _____      |
| B. Cost to employer of current qualified plan award for this employee <sup>2</sup>   | _____         |
| C. Total employer cost of nonqualified and qualified plan awards (A + B)   | _____         |
| D. Fair market value (FMV) of the awards listed in Step C  | _____         |
| E. Greater of the amounts listed in Step C or Step D   | _____         |
| F. Less: Excludable qualified plan award for the year  | _____ (1,600) |
| G. Taxable amount of current qualified plan award <sup>3</sup>   | \$ _____      |

**Notes:**

- <sup>1</sup> Awards of nominal or small value (items of \$50 or less per the Regulations ) are disregarded in computing average cost.
- <sup>2</sup> Not to exceed the FMV of the current employee achievement award.
- <sup>3</sup> The taxable award is included in the employee's gross income, is reported as wages on Form W-2, and is subject to withholding and payment of employment taxes.

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