

**September 2019**

## TCJA Creates New Reasons for Accountable Plan Expense Reimbursements

For 2018-2025, the Tax Cuts and Jobs Act (TCJA) eliminates itemized deductions for employees who incur unreimbursed expenses for company business.<sup>1</sup>

If you operate your business as a corporation, this can impact you.

If you have employees who incur employee business expenses on behalf of your business and you don't reimburse them, they are simply out that money. The TCJA denies them a deduction for those business expenses.

And if you reimburse business expenses to yourself as a corporate owner or to your employees incorrectly, you turn what you thought was a tax-deductible reimbursement of business expenses into W-2 taxable income. Think how ugly this is.

1. You incur a proper business expense.
2. Your corporation reimburses you, the shareholder-employee, for the expense but does so in violation of the rules.
3. You now have W-2 income from the improper reimbursement.
4. You have no personal tax deduction for the proper business expense.
5. Your corporation pays extra payroll taxes because the proper business expense is now a W-2 wage.

***Solution***

With some straightforward safeguards such as an accountable plan, you don't have to suffer from the TCJA, or worry about business expenses disappearing or creating unhappy employees such as yourself.

In fact, in this article, you will find two tools updated and refined for the TCJA that you can use to seamlessly integrate the accountable plan expense reporting safeguards into your business routine.

## ***Why an Accountable Plan***

Without an accountable plan, business expense reimbursements can easily be improper and count as additional taxable wages.

- For you and your employees, that results in an increase in both (a) personal income taxes and (b) FICA taxes on the reimbursements.
- Your company pays the employer's share of FICA taxes on the reimbursements.<sup>2</sup>

With proper reimbursement under the accountable plan, the employee receives the expense reimbursement tax-free. The corporation deducts the business expenses.

## ***Accountable Plan Rules in a Nutshell***

An accountable plan is an expense reimbursement or allowance arrangement that requires employees to substantiate expenses and return unsubstantiated advances. With the plan, the reimbursements are tax-free to recipient employees. And the company can deduct the reimbursements as business expenses.<sup>3</sup>

To gain this favorable tax treatment, an accountable plan must satisfy all of the following requirements.<sup>4</sup>

### ***Business Connection Requirement***

The plan must provide reimbursements or allowances only for otherwise deductible business expenses that are paid or incurred by employees in connection with performing services for the company.

Your company must clearly identify the reimbursements or allowances as such when the employee is paid. For example, your company could pay the expense reimbursements with checks separate from payroll checks.

If you pay wages and expense reimbursements together on one check, clearly show the reimbursement on the employee's check stub.

## ***Adequate Substantiation Requirement***

The plan must require substantiation of reimbursed expenses via an expense report, diary, log, trip sheet, detailed receipt, or similar record within a reasonable period after the expenses are paid or incurred.

A receipt or other documentation is generally required for any lodging expense of \$75 or more. The documentation should show<sup>5</sup>

1. the amount and business purpose of the expense,
2. the time and place of any travel,
3. the date and description of any business gifts and the business relationship to the company of each person receiving a gift.

For travel expenses, an accountable plan can base reimbursements on the federal per diem rates for meals, lodging, and incidentals, and no substantiation of actual amounts spent is required.<sup>6</sup>

If the per diem allowance exceeds the applicable federal per diem rate, the employee can keep the excess (think "keep the change"), but when using the per diem method, your company must treat as personally taxable W-2 wages any amount it pays in excess of the per diem.<sup>7</sup>

**Key Point.** Find the current federal per diem rates for travel in the continental United States on the General Services Administration website at [www.gsa.gov](http://www.gsa.gov).

## ***Return of Excess Advances Requirement***

The plan must require employees to return any advance that exceeds substantiated business expenses. You treat any unreturned excess amount as additional wages subject to income taxes and federal employment taxes.

## ***Reasonable Time***

Both the substantiation of expenses incurred by employees and the return of any excess (unsubstantiated) advances must occur within a reasonable time period.<sup>8</sup> Facts and circumstances dictate what is reasonable.

For example, an employee on an extended out-of-town assignment would have more time to substantiate expenses and return any excess amounts. If you want certainty in meeting the reasonable time period requirement, IRS regulations offer two safe-harbor ways to meet the requirement.<sup>9</sup>

**1. Fixed Date Method—Safe Harbor.** Under this method, you automatically meet the reasonable time requirement if the plan stipulates that

- advances will be made no more than 30 days before the employee pays or incurs the anticipated expense for which the advance is made, and
- expenses must be substantiated within 60 days after they are paid or incurred, and advances for unsubstantiated amounts must be returned to the company within 120 days.

**2. Periodic Statement Method—Safe Harbor.** Under this method, you automatically meet the reasonable time requirement if the plan stipulates that the company will

- provide affected employees with statements (no less often than quarterly) of the amount of advances that have not yet been substantiated, and
- request that any such advances either be substantiated or returned to the company within 120 days after the statement is issued.

## ***Employee-by-Employee Treatment***

Although your company probably maintains employee expense reimbursement plans on a companywide basis, the tax rules are applied on an employee-by-employee basis.<sup>10</sup>

So one employee's reimbursements could fall under the favorable accountable plan rules while another employee's reimbursements fall outside those rules because the accountable plan requirements were not met for whatever reason.

## ***What about Entertainment Expenses?***

Good question. As you know, the TCJA permanently disallows deductions for business entertainment expenses, other than certain business-related meals that are still 50 percent deductible.

So don't cover disallowed entertainment expenses with an accountable plan.

Instead, set up a way for your employees to charge those expenses directly to a company account. Although that won't change the fact that entertainment expenses are non-deductible, it keeps things simple by removing you and any other employees from the loop of tricky tax rules.

## ***Tools for Your Use***

- **Accountable plan.** You don't have to have an accountable plan in writing. If you abide by the accountable rules, you have an accountable plan. The written plan gives you better odds of making sure you meet the rules. For a sample written plan, [click here](#).
- **Expense report.** The expense report is the nuts and bolts of the accountable plan. For a sample expense report, [click here](#).
- **Specialized home-office expense report.** If you operate your business as a corporation and you want the benefits of the home-office deduction, see [Lock in the Home-Office Deduction for Your S Corporation](#). Once you've finished the article, make sure to download this sample enhanced expense report in Excel format.
- **Enhanced vehicle expense report when reimbursing an employee for actual expenses.** For insights as to why you should use an enhanced vehicle expense report, see [Avoid Lost Deductions When Corp. Vehicle Is in Your Personal Name](#). To access the enhanced expense report in Excel, [click here](#). For a Word doc version, [click here](#).

## ***Takeaways***

Be happy. Protect the business reimbursements your business makes to its employees.

Proper use of the accountable plan rules as explained in this article will make sure that your business can deduct the business expenses as expenses.

Failure to make proper business-expense reimbursements causes the reimbursements to become undesirable W-2 wages, which makes those tax-free expense reimbursements taxable.

[Client Letter on This Article for Use by Tax Pros. Click Here.](#)

- 1 IRC Section 67(g) 2018.
  - 2 IRS Reg. Sections 1.62-2(c)(5); 1.62-2(h).
  - 3 IRC Section 62(c).
  - 4 IRS Reg. Sections 1.62-2(d); 1.62-2(e); 1.62-2(f); 1.62-2(g).
  - 5 IRS Reg. Section 1.274-5T(b)(5).
  - 6 IRS Reg. Section 1.62-2(f)(2).
  - 7 IRS Reg. Section 1.62-2(h)(2)(i)(B).
  - 8 IRS Reg. Section 1.62-2(f).
  - 9 IRS Reg. Section 1.62-2(g).
  - 10 IRS Reg. Section 1.62-2(i).
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