

Bookkeeping Tips

Three Options for Nontaxable Expense Reimbursements

Reimbursements to employees for business-related overnight lodging and meals can be handled under a cash-receipt-based accountable plan, a per-diem-based accountable plan (cash receipts not required), or a nonaccountable plan.

A. Cash-receipt-based accountable plan. To be nontaxable to the employee under an accountable plan and not reported on the W-2, the advance or reimbursement must meet 3 IRS conditions:

1. there must be a business purpose (that is, the expense would be deductible if claimed on the employee's personal tax return);
2. the amount (verified by a receipt), time, use, and business purpose of the advance or reimbursement must be substantiated within a "reasonable" time; *and*
3. the employee must return the unsubstantiated amount within a reasonable period of time.

If these three conditions are not met, apply FITW, FICA and FUTA to those portions that are unsubstantiated or not returned.

B. Per diem-based accountable plan (receipts not required). Federal per diem rates are for lodging only, for meals and incidental expenses (M&IE) only and for combined lodging and M&IE. Self-employeds can use only meal per diems—lodging is substantiated separately. [Rev. Proc. 2003-80; 2003-45 IRB]

Incidentals include:

- ✓ laundry
- ✓ cleaning
- ✓ pressing
- ✓ fees and tips for services (e.g., baggage carriers)
- ✓ transportation between lodging or business and where meals are eaten—if suitable meals are not available at the temporary duty site
- ✓ mailing costs associated with filing travel vouchers and payment of employer-sponsored charge card billings.

Excluded: cab fares, phone calls and, optionally, room tax.

There is one set of per diems for high-cost areas, another for all other areas and separate M&IE per diems for:

- localities in the continental United States (CONUS);
- nonforeign localities outside the U.S. (OCONUS) including Alaska, Hawaii, Puerto Rico, Northern Mariana Island and U.S. possessions;
- foreign locations.

Per diem reimbursements are nontaxable even if they exceed actual expenses, and employees need account only for time, place and business purpose of travel. But reimbursements that exceed the federal per diem rate, unsubstantiated per diems (i.e.,

when time, place and business purpose of travel are not provided) and unreturned per diems that exceed days traveled are all taxable wages. Room tax above the limit may be reimbursed separately and is nontaxable with a receipt.

Employers may pay an M&IE per diem only if the employer pays for lodging directly, provides lodging-in-kind or reimburses actual lodging expenses, or if there will be no lodging expenses.

Prorate M&IE quarterly. Pay ¼ per diem for midnight to 6 a.m.; 6 a.m. to noon; noon to 6 p.m. and 6 p.m. to midnight spent traveling or away from home.

Employers who use per diems must use them for the entire calendar year, but may reimburse actual expenses or use M&IE for specific locales. High-low substantiation may not be used for travel outside the continental U.S.

- C. Nonaccountable plans** do not have the 3 requirements for an accountable plan, so 100% of advances and reimbursements are subject to FITW, FICA and FUTA and appear on the employee's W-2. In other words, the employee will have to take any possible business expense deductions on his or her tax return.

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