MEMORANDUM

TO: Ohio Library Council

FROM: Jonathan D. Iten
       Brian D. Hoover

DATE: December 1, 2008

RE: Federal tax treatment of reimbursement for meal expense incurred on library-related day trip

Background

From time to time, library employees attend various library-related meetings and workshops. Attending one of these events requires the employee to travel from the employee’s home to the location at which the event is held. Some employees will have to travel significant distances from home to attend the event. Other employees, however, will not have to travel significant distances because the event will be held relatively close to home. If significant travel is required, the employee typically will be away from her home for the entire day of the meeting. For example, the employee will leave her home at some point early in the morning, attend the meeting and then will return home at some point later that same day (i.e., a day trip). Frequently, the library will advance or reimburse the employee an amount equal to the cost of lunch while attending the event. You have asked us to consider whether providing an advance or reimbursement to an employee for lunch expenses while on a day trip to attend a library-related event would be treated as income to the employee that must be reported for federal tax purposes.

This memorandum address the applicable federal tax reporting and recordkeeping requirements for an employer-provided advance or reimbursement for meal expenses incurred by an employee while on a trip to attend a library-related event.¹

Summary

If an employee, who is advanced or reimbursed for meal expenses while on a day trip to attend a library-related event, makes an adequate accounting for such expenses under an “accountable” plan, the employee may not be required to report the amount of the advance or reimbursement as income for federal tax purposes. Consequently, the employer would not be required to include the amount of the advance or reimbursement on the employee’s Form W-2 as wages or other compensation, nor would it be required to withhold and pay federal employment taxes.

¹ Note that this memo focuses on instances where meals costs are advanced or reimbursed by the employer. For those conferences where meals are included in the price of the conference, there are no employee-related tax implications (this benefit likely is excludable under a “convenience of the employer” exception).
taxes with respect to the advance or reimbursement. As discussed below, the requirements of “accountable” plans are common to most employers’ reimbursement practices.

If an employee, who is advanced or reimbursed for meal expenses while on a day trip to attend a library-related event, does not make an adequate accounting for such expenses under an “accountable” plan (i.e., a “nonaccountable” plan), the amount of the advance or reimbursement would be treated as additional compensation income to the employee. Consequently, the employer must include the amount of the advance or reimbursement on the employee’s Form W-2 as wages or other compensation, and it must withhold and pay federal employment taxes with respect to the advance or reimbursement.

If an employee attends a library-related event that is relatively close to the employee’s home, an employer-provided advance or reimbursement for meal expenses likely would be treated as additional compensation income to the employee, regardless of whether the employee accounts for such expenses under an “accountable” plan or a “nonaccountable” plan. Consequently, the employer would have to include the amount of the advance or reimbursement on the employee’s Form W-2 as wages or other compensation, and it must withhold and pay federal employment taxes with respect to the advance or reimbursement.

The line on what is “close to home” and what is not is open to some interpretation. However, it likely would be difficult for library employees living in Franklin County to qualify for tax-free reimbursement for meal expenses incurred while attending conferences in Franklin County. Conversely, a Cincinnati resident would be more likely to qualify (assuming an “accountable” plan exists) for tax-free reimbursement of meal expenses incurred while attending a conference in Cleveland. There is no “bright line” for this test, however, if the trip is a day trip.

**Analysis**

With respect to an employer-provided advance or reimbursement to an employee for expenditures paid or incurred by the employee in connection with the performance of services as an employee, Section 1.62-2 generally distinguishes between two types of plans by which the employee may account for such expenditures: (1) an “accountable” plan and (2) a “nonaccountable” plan.²

**A. Effect of an “accountable” plan versus a “nonaccountable” plan**

Section 1.62-2(c)(4) provides that if an employee receives an advance or reimbursement under an “accountable” plan, the amount advanced or reimbursed to the employee is not reported.

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² All “Section” references contained herein are to the Internal Revenue Code of 1986, as amended, or the Treasury Department regulations promulgated thereunder.
on the employee’s Form W-2 as wages or other compensation and is exempt from the withholding and payment of federal employment taxes. Conversely, Section 1.62-2(c)(5) provides that if an advance or reimbursement to the employee is paid under a “nonaccountable” plan, the amount advanced or reimbursed to the employee must be reported as wages or other compensation on the employee’s Form W-2 and is subject to withholding and the payment of federal employment taxes.

B. Requirements of an “accountable” plan

Section 1.62-2(c)(2) provides that to qualify as an “accountable” plan, an advance or reimbursement arrangement must satisfy three requirements: (1) business purpose, (2) substantiation and (3) return of amounts in excess of expenses. Section 1.62-2(c)(3) provides that any advance or reimbursement arrangement (or portion thereof) that fails to satisfy these requirements will be treated as a “nonaccountable” plan. Most library expense policies likely already will meet these requirements.

1. Business connection

The business connection element of Section 1.62-2(d) generally requires that an advance or reimbursement must represent payment for expenses, deductible by the employer, that are paid or incurred by the employee in connection with the performance of services as an employee of the employer.3

Section 162(a) generally allows a deduction for all ordinary and necessary expenses paid or incurred during a taxable year in carrying on a trade or business. Section 162(a)(2) also provides a deduction for travel expenses (including amounts expended for meals and lodging) while away from home in the pursuit of a trade or business. According to the Internal Revenue Service, an individual will be treated as “away from home” for travel expense deduction purposes when (1) the individual’s duties require her to be away from the general area of her home substantially longer than an ordinary day’s work, and (2) the individual must sleep or rest to meet the demands of her work.4 An individual need not be away for an entire 24-hour day or from dusk to dawn as long as the relief from duty during the absence is sufficient to obtain necessary sleep or rest.5 So, a conference that has breaks scheduled during the day for attendees may help bolster an argument that an employee obtained the necessary “rest” while attending the event

3 If the arrangement also covers other “bona fide expenses related to the employer’s business” that are not deductible by the employer (for example, expenses for travel that is not away from home), the arrangement is bifurcated into an “accountable” plan (consisting of that portion of the arrangement that pays the deductible employee expenses), assuming that the other requirements are satisfied, and into a “nonaccountable” plan (consisting of that portion of the arrangement that pays the nondeductible employee expenses).

4 See Rev. Rul. 75-168; Rev. Rul. 75-170; IRS Publication 463 (“Travel, Entertainment, Gift, and Car Expenses”).

5 Id.
Some commentators suggest that travel expenses (including meal expenses) may be deductible under the general provision of Section 162(a), with the result that the “away from home” test is not necessary. A library should consult with its tax advisor if it wishes to more fully explore this line of reasoning.

Whether a library employee who makes a day trip to attend a library-related meeting or workshop will be considered away from home depends upon the employee’s particular circumstances. An employee who travels a long distance seems more likely to be treated as being away from home than an employee who attends a library-related event close to home. So, a Cincinnati to Cleveland trip, or a Youngstown to Columbus trip, may be more defensible than a Newark to Columbus trip, or a Bowling Green to Toledo trip (thus, if Chapter Conferences did not include meals in the price, they may be harder to justify than a single statewide event held in another part of the state).

Beyond the general requirement that the advanced or reimbursed costs represent deductible business expenses, the business connection requirement encompasses two additional subtests. First, Section 1.62-2(g) suggests that there must be some degree of reasonably anticipated proximity in time between the disbursement of funds under the arrangement and the expenses that have been or will be incurred by the employee in connection with the performance of services as an employee. An advance or reimbursement made by the employer within 30 days of when the expense is paid or incurred by the employee will be treated as having occurred within a reasonable period of time. Second, Section 1.62-2(d)(1) provides that the amount representing the advance or reimbursement must be separated either by making a separate payment for such amount, or, if it is combined in a single payment with wages, by specifically identifying it as an advance or reimbursement.

2. Substantiation

The substantiation requirement of Section 1.62-2(e) requires that each business expense for travel, entertainment, meals or gifts covered under the advance or reimbursement arrangement must be substantiated by the employee under the provisions of Section 1.274-5T. Generally, this means that the employee must submit to the employer “adequate records” of an expense in the form of an account book, diary, log, statement of expense, trip sheet or similar record and documentary evidence such as receipts so as to enable the employer to identify the specific nature of the expense and to conclude that it is attributable to the employer’s business activities. The employee must provide the appropriate substantiation to the employer within a reasonable period of time. Although the determination of what constitutes a reasonable period of time depends upon the facts and circumstances, Section 1.62-2(g)(2) generally provides that substantiation of an expense within 60 days of it being paid or incurred by the employee will be treated as having occurred within a reasonable period of time.

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6 See CCH-Explanation, 2008FED ¶8570.028.
3. Return of excess amounts

The third requirement of Section 1.62-2(f) is that an employee must return to the employer any excess amount of an advance or reimbursement. In the case of a reimbursement, the arrangement must require the employee to return any amount in excess of the substantiated expenses covered by the arrangement. Any excess amount must be returned to the employer within a reasonable period of time following the receipt of the reimbursement. In the case of an advance, the amount of money advanced to an employee to defray expenses must be reasonably calculated not to exceed the amount of the anticipated expenses, the advance must be paid within a reasonable period of time that the anticipated expenses are paid or incurred and any excess over the substantiated amount of expenses must be returned to the employer within a reasonable period of time following the receipt of the advance.

As with the previous requirements, the determination of what constitutes a reasonable period of time ultimately depends upon the particular facts and circumstances. Section 1.62-2(g)(2), however, creates a safe harbor for returning any excess amounts within a reasonable period of time. Generally, an arrangement that requires the employee to return any excess amounts within 120 days after the expense is paid or incurred will be treated as having occurred within a reasonable period of time.

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Please let us know if you have any questions or if we may be of further assistance.

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