ABO AND COMPANY SUGGESTS A BIGGER BANG WITH EMPLOYEE REIMBURSEMENT BUCKS

Here's the rub. Effective January 1, 2018, an employee no longer can deduct any of his or her unreimbursed employee business expenses. You'll need to read on to see how a slight modification to the arrangement can leave more after-tax dollars in the employee's pocket while costing the employer nothing (and even saving a few dollars).

Most companies cover their employees' business expenses by reimbursing them for their actual expenses or by paying a travel or mileage allowance. (Here's a shocker – such applies to law firms – go figure) Such arrangements are subject to strict tax rules concerning what qualifies as a legitimate reimbursement arrangement and what is treated (at least for tax purposes) as additional compensation to the employee.

According to the tax rules, the key distinction between a true expense reimbursement and disguised compensation is whether the employer's payments are made in accordance with what the IRS calls an "accountable plan." (Such a plan basically requires employees to substantiate all reimbursed expenses and return any advances in excess of expenses incurred.)

Here's our scoop. An employer can operate an accountable plan that reimburses employees for the actual amount of their business-related expenses. Alternatively, an accountable plan can pay predetermined allowances for designated expenses. Either approach is OK with the IRS, as long as the applicable rules are followed.

• Tax Impact of Accountable Plan. When the Company's expense reimbursement or allowance arrangement qualifies as an accountable plan, the business can deduct the payments made under the plan for federal income tax purposes (meal reimbursements still subject to the 50% disallowance). Thus, the payments under an accountable plan are basically treated the same as tax-free employee fringe benefits. This is beneficial for employers and employees alike. Everybody's happy!
• Tax Impact of Nonaccountable Plan. The accountable plan rules must be met on an employee-by-employee basis. If reimbursements or allowances paid to an employee fail to meet

the accountable plan rules, the payments should be treated as wages. This nonaccountable plan treatment generally results in 100% deductibility for the firm because the 50% disallowance rule for meals expenses doesn't apply to the employer for amounts reported as wage compensation to an employee. Even so, employer clients may still come out on the short-end because it must pay the employer's half of the FICA tax, Medicare tax and the Federal and State Unemployment Tax on amounts treated as wages.

1. For the employee, wage treatment is clearly disadvantageous because wages are subject to: (1) federal income tax (including FIT withholding) and (2) withholding for the employee's half of the FICA and Medicare tax.

2. Typically, only the tax collector is happy with the results under a nonaccountable plan. That's why we think meeting the accountable plan rules is important.

ABO AND COMPANY SUGGESTS YOUR ACCOUNTABLE PLAN SHOULD MEET THE FOLLOWING BASIC REQUIREMENTS

1. Business Connection Requirement. The plan should provide reimbursements or allowances only for business expenses that are paid or incurred by an employee in connection with the performance of services. The reimbursements or allowances must be clearly identified as such when the employee is paid.

2. Substantiation Requirement. The plan must require substantiation of the employee's expenses via an expense report, diary, log, trip sheet, or similar record that identifies the specific nature of each expense so that the employer can conclude whether it is a legitimate business expense.

3. Requirement to Return Excess Payments. An accountable plan generally should require employees to return reimbursements or advances that exceed actual substantiated business expense amounts.

4. Reasonable Time Requirement. The proper substantiation of expenses and the return of excess payments should occur within a "reasonable" period of time in order for an expense reimbursement or allowance arrangement to qualify as an accountable plan.

To have the most chance for success, the business should ensure they have a written plan or an agreement with their employees, that the terms of the agreement are actually followed, and that the reimbursement or rental payments are reasonably related to the employee's actual expenses (i.e. perhaps equal to the average expenses of the employee in the last year or two). It can only help to indicate a business reason (besides the payroll tax savings) for why the reimbursement arrangement is being set up.

Reach out to us if you’d like to an agreement Abo and Company has used to adopt a plan we've used and so recommended similarly in the past for clients which, effective January 1, 2018, took on heightened significance for many. Let us know if you need us to explain the pros and cons of such an arrangement to your company (typically the "cons" are mostly the administrative or "headache" factor, especially for larger enterprises).

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