missioner, 31 B.T.A. 519 (1934), a taxpayer purchased property without assuming an outstanding mortgage and subsequently satisfied the mortgage for less than its face amount. In a decision based on unclear facts, the Board of Tax Appeals, for purposes of determining the taxpayer's gain or loss upon the sale of the property in a later year, held that the taxpayer's basis in the property should have been reduced by the amount of the mortgage debt forgiven in the earlier year.

The *Tufts* and *Gershkowitz* decisions implicitly reject any interpretation of *Fulton Gold* that a reduction in the amount of a nonrecourse liability by the holder of the debt who was not the seller of the property securing the liability results in a reduction of the basis in that property, rather than discharge of indebtedness income for the year of the reduction. *Fulton Gold*, interpreted in this manner, is inconsistent with *Tufts* and *Gershkowitz*. Therefore, that interpretation is rejected and will not be followed.

HOLDING

The reduction of the principal amount of an undersecured nonrecourse debt by the holder of a debt who was not the seller of the property securing the debt results in the realization of discharge of indebtedness income under section 61(a)(12) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 82-202 is amplified to apply whether the fair market value of the residence is greater or less than the principal balance of the mortgage at the time of the refinancing.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62-1T: Adjusted gross income (temporary).

T.D. 8324

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR PARTS 1, 31, AND 602

Employee Business Expenses—Reporting and Withholding on Employee Business Expense Reimbursements and Allowances

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations concerning the taxation of and reporting and withholding on payments with respect to employee business expenses under a reimbursement or other expense allowance arrangement. These final and temporary regulations reflect changes to the law made by the Family Support Act of 1988. These final and temporary regulations will affect employees who receive payments and payors who make payments under reimbursement or other expense allowance arrangements.

EFFECTIVE DATES: The provisions of these temporary regulations under §1.62-1T are effective for expenses paid or incurred in taxable years beginning before January 1, 1989. The income tax provisions of these final regulations under §1.62-2 are effective for payments made under reimbursement or other expense allowance arrangements received by an employee in taxable years of the employee beginning on or after January 1, 1989, with respect to expenses paid or incurred in taxable years beginning on or after January 1, 1989. However, the provisions of §1.62-2(h) of these regulations are effective for payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, and the provisions of §§1.62-2(d)(3)(ii) and 1.62-2(h)(2)(i)-(B) of these regulations are effective for payments made under reimbursement of other expense allowance arrangements received by an employee on or after January 1, 1991, with respect to expenses paid or incurred on or after January 1, 1991. The provisions of §1.162-17(e)(3) of these regulations are effective for taxable years beginning on or after January 1, 1989. The reporting provisions of these final regulations under §1.6041-3(i) are effective for payments made under reimbursement or other expense allowance arrangements that are received by an employee on or after January 1, 1989, with respect to expenses paid or incurred on or after January 1, 1989; however, a transition rule is provided under §1.6041-3(i) effective for payments made prior to July 1, 1990. The provisions of these final regulations under §§31.3121(a)-1(h), 31.3121(a)-3, 31.3231(e)-1, 31.3231(e)-3, 31.3306(b)-1, 31.3306(b)-2, 31.3401(a)-(1)(h)(2) and 31.3401(a)-4 are effective for amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. The amendment to Part 602 is effective upon publication.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information requirements contained in this final regulation have been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1148. The estimated average annual burden per recordkeeper is one-half hour.

This estimate is an approximation of the average time expected to be necessary for a collection of information. It is based on such information as is available to the Internal Revenue Service. Individual recordkeepers may require greater or less time, depending on their particular circumstances.

Comments concerning the accuracy of these burden estimates and suggestions for reducing the burden should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, D.C. 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503.

Background

On December 12, 1989, the Federal Register published temporary regulations (54 FR 51021) [T.D. 8276, 1990-1 C.B. 14] on employee business expense reimbursements and allowances. Those regulations provided guidance concerning the taxation of and reporting and withholding on payments with respect to employee business expenses under a reimbursement or other expense allowance arrangement. The text of those temporary regulations also served as the comment document for a notice of proposed rulemaking ("the proposed regulations") published in the Federal

Register for the same day (54 FR 51038) [EE-8-89, 1990-1 C.B. 616].

Written comments were received from the public on the proposed regulations. In addition, on June 11, 1990, the Internal Revenue Service held a public hearing concerning the regulations. After consideration of the comments received and the statements made at the public hearing, the proposed regulations are adopted as revised by this Treasury decision. This Treasury decision also supersedes and obsoletes Announcement 90-127, 1990-48 I.R.B. 8.

SUMMARY OF COMMENTS AND EXPLANATION OF PROVISIONS:

More than one expense allowance arrangement.

Commentators requested that the regulations provide guidance on what factors are considered in determining whether an employer has one arrangement or more than one arrangement with an employee. Commentators were especially concerned that small amounts of nonaccountable payments might be treated as part of an otherwise accountable plan, thereby "tainting" the accountable payments if clearly separate plans were not adopted. The final regulations clarify that if an arrangement provides advances, allowances, or reimbursements for deductible employee business expenses and for other bona fide expenses related to the employer's business that are not deductible, the payor will be treated as maintaining two arrangements. The portion of the arrangement that provides payments for the deductible employee business expenses will be treated as one arrangement that satisfies the business connection test and the portion of the arrangement that provides payments for the nondeductible employee business expenses will be treated as a second arrangement that does not satisfy the business connection test.

Reimbursement requirement.

Some practitioners have asked whether a portion of an employee's salary may be recharacterized as being paid under a reimbursement arrangement. The final regulations clarify that if a payor arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) deductible business expenses or other bona fide expenses related to the employer's business that are not deductible, the arrangement does not meet the business connection requirement of §1.62-2(d) of the regulations and all amounts paid under the arrangement are treated as paid under a nonaccountable plan. These amounts are subject to withholding and payment of employment taxes when paid. Thus, no part of an employee's salary may be recharacterized as being paid under a reimbursement arrangement or other expense allowance arrangement.

The final regulations also provide that an arrangement providing a per diem allowance for travel expenses (whether or not deductible) that is computed on a basis similar to that used in computing the employee's wages or other compensation (e.g., the number of hours worked, miles traveled, or pieces produced) satisfies the business connection requirement of §1.62-2(d) only if, as of December 12, 1989, (1) the per diem allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the per diem allowance, or (2) a per diem allowance computed on that basis was commonly used in the industry in which the employee is employed. A per diem allowance that satisfies this requirement may be adjusted in a manner that reasonably reflects actual increases in employee business expenses occurring after December 12, 1989.

Special withholding rules for per diem or mileage allowances.

Some practitioners have suggested that the safe harbors provided for satisfying the reasonable period of time requirements can be used to avoid reporting and withholding on per diem or mileage allowances where the amount paid exceeds the amount of expenses deemed substantiated. The safe harbors were not intended to be used in that manner.

Accordingly, the final regulations provide that, if (under an arrangement that meets the business connection, substantiation, and return of excess requirements of the regulation) a payor pays a per diem or mileage allowance, the portion, if any, of the allowance paid that relates to days or miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated for those days or miles of travel is treated as paid under a nonaccountable plan. Because the employee is not required to return this excess portion, the reasonable period of time provisions (relating to the return of excess amounts) do not apply to this excess portion.

The final regulations also provide that in the case of a per diem or mileage allowance paid as a reimbursement at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel (e.g., the employer reimburses at a rate of 30 cents per mile when the amount deemed substantiated is 26 cents per mile), the excess portion is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the days or miles of travel substantiated. The final regulations further provide that in the case of a per diem or mileage allowance paid as an advance at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the expenses with respect to which the advance was paid (i.e., the days or miles of travel) are substantiated. Of course, the expenses with respect to which the advance was paid must be substantiated within a reasonable period of time.

The final regulations also provide that the Commissioner may, in his discretion, prescribe special rules in pronouncements of general applicability regarding the timing of withholding and payment of employment taxes on per diem and mileage allowances.

The employer's obligation to report.

Commentators requested clarification as to whether amounts treated as paid under an accountable plan may, in certain circumstances, be reported by the employer on the employee's Form W-2. The proposed regulations provided that such amounts "are not required to be reported" on the employee's Form W-2. The final regulations clarify that amounts treated as

paid under an accountable plan are not reported as wages or other compensation on the employee's Form W-2. Thus, if an employer operates an accountable plan and the employee meets all the requirements of the regulations in terms of timely substantiation and return of excess, the employer may not report such amounts as wages or other compensation on the employee's Form W-2. However, the regulations do not require the employer to provide an accountable plan. Thus, if the employer chooses to provide an expense allowance arrangement that does not meet the accountable plan requirements, the employer must report all amounts paid under the plan as wages or other compensation on the employee's Form W-2 even though an employee might voluntarily substantiate expenses to the employer and return any excess amounts to the employer.

Pattern of overreimbursements.

The safe harbors provided for satisfying the reasonable period of time requirements are designed to meet reasonable administrative needs of employers, not to permit avoidance of the rules regarding accountable plans. Accordingly, the final regulations clarify that if, under a reimbursement or other expense allowance arrangement, a payor has a plan or practice to provide amounts in excess of substantiated expenses to employees and to avoid reporting and with holding on such amounts, the payor may not use either of the safe harbors provided under the reasonable period of time requirement for any years during which such plan or practice exists.

Anti-abuse rule.

The final regulations provide that if a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules under section 62(c) of the Code and the regulations thereunder, regarding reimbursement and other expense allowance arrangements, all payments made under the arrangement will be treated as made under a nonaccountable plan and the appropriate penalties will be imposed.

Examples.

As a result of questions raised by commentators, examples have been added to the final regulations to illustrate the application of the regulations.

Exempting state, county, and local governments.

Commentators from state, county, and local governments requested that they be exempted from the requirements of the regulations. There is no indication in the statute or the legislative history that Congress intended that there be an exemption for government employers. The final regulations therefore treat government employers and private sector employers in the same manner and do not exempt federal, state, county, and local governments.

Country club dues.

Practitioners have requested that the final regulations provide special rules for country club dues because of special deduction limitations applicable to such dues. These rules would create a special reasonable period safe harbor for country club dues and would provide an exception to the return of excess requirement for country club dues that are reported as wages and subjected to withholding and payment of employment taxes. These suggestions have not been adopted because they would create needless complexity in the regulations and they are not supported by the statute or the legislative history.

Deemed substantiation issues.

Commentators submitted several comments regarding issues raised by Revenue Procedures 89-66 and 89-67, 1989-2 C.B. 792, 795, and their progeny. Those issues are generally not addressed by these final regulations, but will instead be addressed in revenue procedures or other pronouncements of general applicability.

Moving expenses.

Some practitioners have asked whether the regulations are intended to apply to reimbursements for moving expenses. Section 62(a)(2)(A) of the Code and the regulations refer to advances, allowances, or reimbursements for business expenses that are allowable as deductions by Part VI (section 161 and the following), subchapter B, chapter 1 of the Code. Therefore, neither the proposed regulations nor the final regulations deal with deductions, such as moving expense deductions under section 217, that are not found in Part VI.

Reporting rules.

The final regulations generally retain the same reporting rules that were provided in the temporary regulations. However, in order to simplify reporting in 1990 and because of the July 1, 1990, effective date for withholding, the transitional reporting rule that was provided in the temporary regulations for payments received by an employee on or after January 1, 1989, and prior to January 1, 1990, has been extended to payments received by an employee prior to July 1, 1990 (rather than January 1, 1990, as provided in the proposed regulations).

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Parts 1, 31, and 602 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended in part by removing the citation "§§1.62-1T and 1.62-2T also issued under 26 U.S.C. 62" and by adding the following citations:

Authority: 26 U.S.C. 7805 *** Secs. 1.62-1T and 1.62-2 also issued under 26 U.S.C. 62 *** Sec. 1.6041-3 also issued under 26 U.S.C. 62.

Par. 2. In §1.62-1T, paragraph (c)(2) is revised to read as follows:

§§1.62-1T Adjusted gross income (temporary).

* * * * *

(c) *Deductions allowable in computing adjusted gross income.*

* * * * *

(21) Deductions allowable under part VI, subchapter B, chapter 1 of the Code, (section 161 and following) that consist of expenses paid or incurred by the taxpayer in connection with the performance of services as an employee under an express reimbursement or other expense allowance arrangement (as defined in paragraph (f) of this section or §1.62-2, whichever is applicable) with his or her employer;

* * * * *

Par. 3. Section 1.62-2T is removed and section 1.62-2 is added in the appropriate place to read as follows:

§1.62-2 *Reimbursements and other expense allowance arrangements.*

(a) *Table of contents.* The contents of this section are as follows:

(a) *Table of contents.*
(b) *Scope.*
(c) *Reimbursement or other expense allowance arrangement.*
(1) *Defined.*
(2) *Accountable plans.*
(i) *In general.*
(ii) *Special rule for failure to return excess.*
(3) *Nonaccountable plans.*
(i) *In general.*
(ii) *Special rule for failure to return excess.*
(4) *Treatment of payments under accountable plans.*
(5) *Treatment of payments under nonaccountable plans.*
(d) *Business connection.*
(1) *In general.*
(2) *Other bona fide expenses.*
(3) *Reimbursement requirement.*
(i) *In general.*
(ii) *Per diem allowances.*
(e) *Substantiation.*
(1) *In general.*
(2) *Expenses governed by section 274 (d).*
(3) *Expenses not governed by section 274 (d).*
(f) *Returning amounts in excess of expenses.*
(1) *In general.*
(2) *Per diem or mileage allowances.*
(g) *Reasonable period.*
(1) *In general.*
(2) *Safe harbors.*
(i) *Fixed date method.*
(ii) *Periodic payment method.*
(3) *Pattern of overreimbursements.*
(h) *Withholding and payment of employment taxes.*
(1) *When excluded from wages.*
(2) *When included in wages.*
(i) *Accountable plans.*
(A) *General rule.*
(B) *Per diem or mileage allowances.*
(*1*) *In general.*
(*2*) *Reimbursements.*
(*3*) *Advances.*
(*4*) *Special rules.*
(ii) *Nonaccountable plans.*
(j) *Application.*
(j) *Examples.*
(k) *Anti-abuse provision.*
(l) *Cross references.*
(m) *Effective dates.*

(b) *Scope.* For purposes of determining "adjusted gross income," section 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (section 161 and following), subchapter B, chapter 1 of the Code, paid by the employee, in connection with the performance of services as an employee of the employer, under a reimbursement or other expense allowance arrangement with a payor (the employer, its agent, or a third party). Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) if (1) such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the payor, or (2) such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement. This section prescribes rules relating to the requirements of section 62(c).

(c) *Reimbursement or other expense allowance arrangement*—(1) *Defined.* For purposes of §§1.62-1T and 1.62-2, the phrase "reimbursement or other expense allowance arrangement" means an arrangement that meets the requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section. A payor may have more than one arrangement with respect to a particular employee, depending on the facts and circumstances. See paragraph (d)(2) of this section (payor treated as having two arrangements under certain circumstances).

(2) *Accountable plans*—(i) *In general.* Except as provided in paragraph (c)(2)(ii) of this section, if an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, all amounts paid under the arrangement are treated as paid under an "accountable plan."

(ii) *Special rule for failure to return excess.* If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, only the amounts paid under the arrangement that are not in excess of the substantiated expenses are treated as paid under an accountable plan.

(3) *Nonaccountable plans*—(i) *In general.* If an arrangement does not satisfy one or more of the requirements of paragraphs (d), (e), or (f) of this section, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." If a payor provides a nonaccountable plan, an employee who receives payments under the plan cannot compel the payor to treat the payments as paid under an accountable plan by voluntarily substantiating the expenses and returning any excess to the payor.

(ii) *Special rule for failure to return excess.* If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, the amounts paid under the arrangement that are in excess of the substantiated expenses are treated as paid under a nonaccountable plan.

(4) *Treatment of payments under accountable plans.* Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not reported as wages or other compensation on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes (Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), Railroad Retirement Tax Act (RRTA), Railroad Unemployment Repayment Tax (RURT), and income

tax). See paragraph (l) of this section for cross references.

(5) *Treatment of payments under nonaccountable plans.* Amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). See paragraph (h) of this section. Expenses attributable to amounts included in the employee's gross income may be deducted, provided the employee can substantiate the full amount of his or her expenses (i.e., the amount of the expenses, if any, the reimbursement for which is treated as paid under an accountable plan as well as those for which the employee is claiming the deduction) in accordance with §1.274-5T or §1.162-17, but only as a miscellaneous itemized deduction subject to the limitations applicable to such expenses (e.g., the 80-percent limitation on meal and entertainment expenses provided in section 274(n) and the 2-percent floor provided in section 67).

(d) *Business connection*—(1) *In general.* Except as provided in paragraphs (d)(2) and (d)(3) of this section, an arrangement meets the requirements of this paragraph (d) if it provides advances, allowances (including per diem allowances, allowances only for meals and incidental expenses, and mileage allowances), or reimbursements only for business expenses that are allowable as deductions by Part VI (section 161 and the following), subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer. The payment may be actually received from the employer, its agent, or a third party for whom the employee performs a service as an employee of the employer, and may include amounts charged directly or indirectly to the payor through credit card systems or otherwise. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(2) *Other bona fide expenses.* If an arrangement provides advances, allowances, or reimbursements for business expenses described in paragraph (d)(1) of this section (i.e., deductible employee business expenses) and for other bona fide expenses related to the employer's business (e.g., travel that is not away from home) that are not deductible under Part VI (section 161 and the following), subchapter B, chapter 1 of the Code, the payor is treated as maintaining two arrangements. The portion of the arrangement that provides payments for the deductible employee business expenses is treated as one arrangement that satisfies this paragraph (d). The portion of the arrangement that provides payments for the nondeductible employee expenses is treated as a second arrangement that does not satisfy this paragraph (d) and all amounts paid under this second arrangement will be treated as paid under a nonaccountable plan. See paragraphs (c)(5) and (h) of this section.

(3) *Reimbursement requirement*—(i) *In general.* If a payor arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) business expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement does not satisfy this paragraph (d) and all amounts paid under the arrangement are treated as paid under a nonaccountable plan. See paragraphs (c)(5) and (h) of this section.

(ii) *Per diem allowances.* An arrangement providing a per diem allowance for travel expenses of a type described in paragraph (d)(1) or (d)(2) of this section that is computed on a basis similar to that used in computing the employee's wages or other compensation (e.g., the number of hours worked, miles traveled, or pieces produced) meets the requirements of this paragraph (d) only if, on December 12, 1989, the per diem allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the per diem allowance, or a per diem allowance computed on that basis was commonly used in the industry in which the employee is employed. See section 274(d) and §1.274-5T(g). A per diem allowance described in this paragraph (d)(3)(ii) may be adjusted in a manner that reasonably reflects actual increases in employee business expenses occurring after December 12, 1989.

(e) *Substantiation*—(1) *In general.* An arrangement meets the requirements of this paragraph (e) if it requires each business expense to be substantiated to the payor in accordance with paragraph (e)(2) or (e)(3) of this section, whichever is applicable, within a reasonable period of time. See §1.274-5T or §1.162-17.

(2) *Expenses governed by section 274(d).* An arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by section 274(d) meets the requirements of this paragraph (e)(2) if information sufficient to satisfy the substantiation requirements of section 274(d) and the regulations thereunder is submitted to the payor. See §1.274-5T. Under section 274(d), information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, §1.274-5T(b)(2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed property, §1.274-5T(b)(6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See §1.274-5T(g), however, which grants the Commissioner authority to prescribe rules permitting the amount of certain expenses to be deemed substantiated to the payor (in lieu of substantiating the actual amount of such expenses) where an arrangement provides for a reimbursement, a per diem allowance, or a mileage allowance for travel away from home or transportation expenses. See also §1.274-5T(j), which grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals while traveling away from home in lieu of substantiating the actual cost of meals. Substantiation of the amount

of a business expense in accordance with rules prescribed pursuant to the authority granted by §1.274-5T(g) or §1.274-5T(j) will be treated as substantiation of the amount of such expense for purposes of this section.

(3) *Expenses not governed by section 274(d).* An arrangement that reimburses business expenses not governed by section 274(d) meets the requirements of this paragraph (e)(3) if information is submitted to the payor sufficient to enable the payor to identify the specific nature of each expense and to conclude that the expense is attributable to the payor's business activities. Therefore, each of the elements of an expenditure or use must be substantiated to the payor. It is not sufficient if an employee merely aggregates expenses into broad categories (such as "travel") or reports individual expenses through the use of vague, nondescriptive terms (such as "miscellaneous business expenses"). See §1.162-17(b).

(f) *Returning amounts in excess of expenses*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, an arrangement meets the requirements of this paragraph (f) if it requires the employee to return to the payor within a reasonable period of time any amount paid under the arrangement in excess of the expenses substantiated in accordance with paragraph (e) of this section. The determination of whether an arrangement requires an employee to return amounts in excess of substantiated expenses will depend on the facts and circumstances. An arrangement whereby money is advanced to an employee to defray expenses will be treated as satisfying the requirements of this paragraph (f) only if the amount of money advanced is reasonably calculated not to exceed the amount of anticipated expenditures, the advance of money is made on a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, and any amounts in excess of the expenses substantiated in accordance with paragraph (e) of this section are required to be returned to the payor within a reasonable period of time after the advance is received.

(2) *Per diem or mileage allowances.* The Commissioner may, in his discretion, prescribe rules in pronouncements of general applicability under which a reimbursement or other expense allowance arrangement that provides per diem allowances providing for ordinary and necessary expenses of traveling away from home (exclusive of transportation costs to and from destination) or mileage allowances providing for ordinary and necessary expenses of local travel and transportation while traveling away from home will be treated as satisfying the requirements of this paragraph (f), even though the arrangement does not require the employee to return the portion of such an allowance that relates to the days or miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under section 274(d), provided the allowance is paid at a rate for each day or mile of travel that is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return to the payor within a reasonable period of time any portion of such allowance which relates to days or miles of travel not substantiated in accordance with paragraph (e) of this section.

(g) *Reasonable period*—(1) *In general.* The determination of a reasonable period of time will depend on the facts and circumstances.

(2) *Safe harbors*—(i) *Fixed date method.* An advance made within 30 days of when an expense is paid or incurred, an expense substantiated to the payor within 60 days after it is paid or incurred, or an amount returned to the payor within 120 days after an expense is paid or incurred will be treated as having occurred within a reasonable period of time.

(ii) *Periodic statement method.* If a payor provides employees with periodic statements (no less frequently than quarterly) stating the amount, if any, paid under the arrangement in excess of the expenses the employee has substantiated in accordance with paragraph (e) of this section, and requesting the employee to substantiate any additional business expenses that have not yet been substantiated (whether or not such expenses relate to the expenses with respect to which the original advance was paid) and/or to return any amounts remaining unsubstantiated within 120 days of the statement, an expense substantiated or an amount returned within that period will be treated as being substantiated or returned within a reasonable period of time.

(3) *Pattern of overreimbursements.* If, under a reimbursement or other expense allowance arrangement, a payor has a plan or practice to provide amounts to employees in excess of expenses substantiated in accordance with paragraph (e) of this section and to avoid reporting and withholding on such amounts, the payor may not use either of the safe harbors provided in paragraph (g)(2) of this section for any years during which such plan or practice exists.

(h) *Withholding and payment of employment taxes*—(1) *When excluded from wages.* If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, the amounts paid under the arrangement that are not in excess of the expenses substantiated in accordance with paragraph (e) of this section (i.e., the amounts treated as paid under an accountable plan) are not wages and are not subject to withholding and payment of employment taxes.

(2) *When included in wages*—(i) *Accountable plans*—(A) *General rule.* Except as provided in paragraph (h)(2)(i)(B) of this section, if the expenses covered under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section are not substantiated to the payor in accordance with paragraph (e) of this section within a reasonable period of time or if any amounts in excess of the substantiated expenses are not returned to the payor in accordance with paragraph (f) of this section within a reasonable period of time, the amount which is treated as paid under a nonaccountable plan under paragraph (c)(3)(ii) of this section is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. A payor may treat any amount not substantiated or returned within the periods specified in paragraph (g)(2) of this section as not substantiated or returned within a reasonable period of time.

(B) *Per diem or mileage allowanc-*

es—(1) In general. If a payor pays a per diem or mileage allowance under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section, the portion, if any, of the allowance paid that relates to days or miles of travel substantiated in accordance with paragraph (e) of this section and that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under section 274(d) and §1.274-5T(g) or (j) is treated as paid under a nonaccountable plan. See paragraph (h)(3)(ii) of this section. Because the employee is not required to return this excess portion, the reasonable period of time provisions of paragraph (g) of this section (relating to the return of excess amounts) do not apply to this excess portion.

(2) Reimbursements. Except as provided in paragraph (h)(2)(i)(B)(*4*) of this section, in the case of a per diem or mileage allowance paid as a reimbursement at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion described in paragraph (h)(2)(i) of this section is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the days or miles of travel substantiated in accordance with paragraph (e) of this section.

(3) Advances. Except as provided in paragraph (h)(2)(i)(B)(*4*) of this section, in the case of a per diem or mileage allowance paid as an advance at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion described in paragraph (h)(2)(i) of this section is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the expenses with respect to which the advance was paid (i.e., the days or miles of travel) are substantiated in accordance with paragraph (e) of this section. The expenses with respect to which the advance was paid must be substantiated within a reasonable period of time. See paragraph (g) of this section.

(*4*) *Special rules.* The Commissioner may, in his discretion, prescribe special rules in pronouncements of general applicability regarding the timing of withholding and payment of employment taxes on per diem and mileage allowances.

(ii) *Nonaccountable plans.* If an arrangement does not satisfy one or more of the requirements of paragraphs (d), (e), or (f) of this section, all amounts paid under the arrangement are wages and are subject to withholding and payment of employment taxes when paid.

(i) *Application.* The requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section will be applied on an employee-by-employee basis. Thus, for example, the failure by one employee to substantiate expenses under an arrangement in accordance with paragraph (e) of this section will not cause amounts paid to other employees to be treated as paid under a nonaccountable plan.

(j) *Examples.* The rules contained in this section may be illustrated by the following examples.

Example (1). Reimbursement requirement. Employer S pays its engineers $200 a day. On those days that an engineer travels away from home on business for Employer S, Employer S designates $50 of the $200 as paid to reimburse the engineer's travel expenses. Because Employer S would pay an engineer $200 a day regardless of whether the engineer was traveling away from home, the arrangement does not satisfy the reimbursement requirement of paragraph (d)(3)(i) of this section. Thus, no part of the $50 Employer S designated as a reimbursement is treated as paid under an accountable plan. Rather, all payments under the arrangement are treated as paid under a nonaccountable plan. Employer S must report the entire $200 as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the entire $200 when paid.

Example (2). Reimbursement requirement, multiple arrangements. Airline T pays all its employees a salary. Airline T also pays an allowance under an arrangement that otherwise meets the requirements of paragraphs (d), (e), and (f) of this section to its pilots and flight attendants who travel away from their home base airports, whether or not they are "away from home." Because the allowance is paid only to those employees who incur (or are reasonably expected to incur) expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement satisfies the reimbursement requirement of paragraph (d)(3)(i) of this section. Under paragraph (d)(2) of this section, Airline T is treated as maintaining two arrangements. The portion of the arrangement providing the allowances for away from home travel is treated as an accountable plan. The portion of the arrangement providing the allowances for non-away from home travel is treated as a nonaccountable plan. Airline T must report the non-away from home allowances as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on these payments when paid.

Example (3). Reimbursement requirement. Corporation R pays all its salespersons a salary. Corporation R also pays a travel allowance under an arrangement that otherwise meets the requirements of paragraphs (d), (e), and (f) of this section. This allowance is paid to all salespersons, including salespersons that Corporation R knows, or has reason to know, do not travel away from their offices on Corporation R business and would not be reasonably expected to incur travel expenses. Because the allowance is not paid only to those employees who incur (or are reasonably expected to incur) expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement does not satisfy the reimbursement requirement of paragraph (d)(3)(i) of this section. Thus, no part of the allowance Corporation R designated as a reimbursement is treated as paid under an accountable plan. Rather, all payments under the arrangement are treated as paid under a nonaccountable plan. Corporation R must report all payments under the arrangement as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the payments when paid.

Example (4). Separate arrangement, miscellaneous expenses. Under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section, County U reimburses its employees for lodging and meal expenses incurred when they travel away from home on County U business. For its own convenience, County U also separately pays certain of its employees a $25 monthly allowance to cover the cost of small miscellaneous office expenses. County U does not require its employees to substantiate these miscellaneous expenses and does not require them to return the amounts by which the monthly allowance exceeds the miscellaneous expenses. The monthly allowance arrangement is a nonaccountable plan. County U must report the monthly allowances as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the monthly allowances when paid. The nonaccountable plan providing the monthly allowances is treated as separate from the accountable plan providing reimbursements for lodging and meal expenses incurred for travel away from home on County U business.

Example (5). Excessive advances. In anticipation of employee business expenses that Corporation V does not reasonably expect to exceed $400 in any quarter, Corporation V nonetheless advances $1,000 to Employee A for such expenses. Whenever Employee A substantiates an expense in accordance with paragraph (e) of this section, Corporation V provides an additional advance in an amount equal to the amount substantiated, thereby providing a continuing advance of $1,000. Because the amounts advanced under this arrangement are not reasonably calculated so as not to exceed the amount of anticipated expenditures and because the advance of money is not made on

a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, the arrangement is a nonaccountable plan. The arrangement fails to satisfy the requirements of paragraphs (d) (business connection) and (f) (reasonable calculation of advances) of this section. Thus, Corporation V must report the entire amount of each advance as wages or other compensation and must withhold and pay employment taxes on the entire amount of each advance when paid.

Example (6). Excess mileage advance. Under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section, Employer W pays its employees a mileage allowance at a rate of 30 cents per mile (when the amount deemed substantiated for each mile of travel substantiated is 26 cents per mile) to cover automobile business expenses. The allowance is paid at a rate for each mile of travel that is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses. Employer W does not require the return of the portion of the mileage allowance (4 cents) that exceeds the amount deemed substantiated for each mile of travel substantiated in accordance with paragraph (e) of this section. In June, Employer W advances Employee B $150 for 500 miles to be traveled by Employee B during the month. In July, Employee B substantiates 500 miles of business travel. The amount deemed substantiated by Employee B is $130. However, Employer W does not require Employee B to return the remaining $20 of the advance. No later than the first payroll period following the payroll period in which the business miles of travel are substantiated, Employer W must withhold and pay employment taxes on $20 (500 miles x 4 cents per mile).

Example (7). Excess per diem reimbursement. Under an arrangement that meets the requirements of paragraphs (d), (e), and (f) of this section, Employer X pays its employees a per diem allowance to cover lodging, meal, and incidental expenses incurred for travel away from home on Employer X business at a rate equal to 120 percent of the amount deemed substantiated for each day of travel to the localities to which the employees travel. Employer X does not require the employees to return the 20 percent by which the reimbursement for those expenses exceeds the amount deemed substantiated for each day of travel substantiated in accordance with paragraph (e) of this section. Employee C substantiates six days of business travel away from home, two days in a locality for which the amount deemed substantiated is $100 a day and four days in a locality for which the amount deemed substantiated is $125 a day. Employer X reimburses Employee C $840 for the six days of travel away from home (2 x (120% x $100) + 4 x (120% x $125)), and does not require Employee C to return the excess portion ($140 excess portion = (2 days x $20 ($120—$100) + 4 days x $25 ($150—$125)). For the payroll period in which Employer X reimburses the expenses, Employer X must withhold and pay employment taxes on $140.

Example (8). Return requirement. Employer Y provides expense allowances to certain of its employees to cover business expenses of a type described in paragraph (d)(1) of this section under an arrangement that requires the employees to substantiate their expenses within a reasonable period of time and to return any excess amounts within a reasonable period of time. Each time an employee returns an excess amount to Employer Y, however, Employer Y pays the employee a "bonus" equal to the amount returned by the employee. The arrangement fails to satisfy the requirements of paragraph (f) (returning amounts in excess of expenses) of this section. Thus, Employer Y must report the entire amount of the expense allowance payments as wages or other compensation and must withhold and pay employment taxes on the payments when paid. Compare example (6) (where the employee is not required to return the portion of the mileage allowance that exceeds the amount deemed substantiated for each mile of travel substantiated).

Example (9). Timely substantiation. Employer Z provides a $500 advance to Employee D for a trip away from home on Employer Z business. Employee D incurs $500 in business expenses on the trip. Employer Z uses the periodic statement method safe harbor. At the end of the quarter during which the trip occurred, Employer Z sends a quarterly statement, to Employee D stating that $500 was advanced to Employee D during the quarter and that no expenses were substantiated and no excess amounts returned. The statement advises Employee D that Employee D must substantiate any additional business expenses within 120 days of the date of the statement, and must return any unsubstantiated excess within the 120-day period. Employee D fails to substantiate any expenses or to return the excess within the 120-day period. Employer Z treats the $500 as wages and withholds and pays employment taxes on the $500. After the 120-day period has expired, Employee D substantiates the $500 in travel expenses in accordance with paragraph (e) of this section. Employer Z properly reported and withheld and paid employment taxes on the $500 and no adjustments may be made. Employee D must include the $500 in gross income and may deduct the $500 of expenses as a miscellaneous itemized deduction subject to the 2-percent floor provided in section 67.

(k) *Anti-abuse provision.* If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of section 62(c) and this section, all payments made under the arrangement will be treated as made under a nonaccountable plan.

(l) *Cross references.* For employment tax regulations relating to reimbursement and expense allowance arrangements, see §§31.3121(a)-3, 31.3231(e)-3, 31.3306(b)-2, and 31.3401(a)-4, which generally apply to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. For reporting requirements, see §1.6041-3(l), which generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1989, with respect to expenses paid or incurred on or after January 1, 1989.

(m) *Effective dates.* This section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee in taxable years of the employee beginning on or after January 1, 1989, with respect to expenses paid or incurred in taxable years beginning on or after January 1, 1989. Paragraph (h) of this section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. Paragraphs (d)(3)(ii) and (b)(2)(i)(B) of this section apply to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1991, with respect to expenses paid or incurred on or after January 1, 1991.

Par. 4. In §1.162-17, paragraph (e)(3) is revised to read as follows:

§1.162-17 Reporting and substantiation of certain business expenses of employees.

* * * * *

(e) *Applicability.* ***

(3) For taxable years beginning on or after January 1, 1989, the provisions of this section are superseded by the regulations under section 62(c) to the extent this section is inconsistent with those regulations. See §1.62-2.

Par. 5. In §1.6041-3, paragraph (i) is revised to read as follows:

§1.6041-3 Payments for which no return of information is required under section 6041.

* * * * *

(i) (1) *In general.* Payments made under reimbursement or other expense allowance arrangements that meet the requirements of section 62(c) of the Code and §1.62-2, that do not exceed the amount of the expenses substantiated (i.e., amounts which are treated as paid under an accountable plan), and that are received by an employee on or after January 1, 1989, with respect to expenses paid or incurred on or after January 1, 1989;

(2) *Transition rule.* Payments made under reimbursement or other expense allowance arrangements that

are received by an employee on or after January 1, 1989, but prior to July 1, 1990, to the extent that the employee is required to account (within the meaning of the term "account" as set forth in §1.162-17(b)(4) or 1.274-5T(f)(4), whichever is applicable) and does so account to the payor for such expenses, provided the payor has made a reasonable, good faith effort to comply with the requirements of section 62(c). In general, compliance with the provisions of this section, as in effect for payments made under reimbursement or other expense allowance arrangements that were received by an employee before January 1, 1989, with respect to expenses paid or incurred before January 1, 1989, will constitute such reasonable good faith compliance. In no event, however, will reasonable good faith compliance exist if a payor fails to report payments made under an arrangement (other than a per diem or mileage allowance type arrangement) under which an employee is not required to substantiate expenses paid or incurred or is not required to return amounts in excess of the substantiated expenses;

* * * * *

PART 31—[AMENDED]

Par. 6. The authority citation for Part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 *** Secs. 31.3121(a)-3, 31.3231(e)-3, 31.3306(b)-2, and 31.3401(a)-4 also issued under 26 U.S.C. 62.

Par. 7. In §31.3121(a)-1, the last sentence of paragraph (h) is revised to read as follows:

§31.3121(a)-1 Wages.

* * * * *

(h) *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3121(a)-3.

* * * * *

Par. 8. Section 31.3121(a)-2T is redesignated as §31.3121(a)-3 and revised to read as follows:

§31.3121(a)-3 Reimbursement and other expense allowance amounts—(a) *When excluded from wages.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62-2 and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan and are not wages. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in wages*—(1) *Accountable plans*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, if a reimbursement or other expense allowance arrangement satisfies the requirements of section 62(c) and §1.62-2, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in wages, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(ii) *Per diem or mileage allowances.* If a reimbursement or other expense allowance arrangement providing a per diem or mileage allowance satisfies the requirements of section 62(c) and §1.62-2, but the allowance is paid at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion is treated as paid under a nonaccountable plan and is included in wages. In the case of a per diem or mileage allowance paid as a reimbursement, the excess portion is subject to withholding and payment of employment taxes when paid. In the case of a per diem or mileage allowance paid as an advance, the excess portion is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the expenses with respect to which the advance was paid (i.e., the days or miles of travel) are substantiated. The Commissioner may, in his discretion, prescribe special rules in pronouncements of general applicability regarding the timing of withholding and payment of employment taxes on per diem and mileage allowances.

(2) *Nonaccountable plans.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62-2 (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in wages, and are subject to withholding and payment of employment taxes when paid.

(c) *Effective dates.* This section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. Paragraph (b)(1)(ii) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1991, with respect to expenses paid or incurred on or after January 1, 1991.

Par. 9. In §31.3231(e)-1, the last sentence of paragraph (a)(3)(iv) is revised to read as follows:

§31.3231(e)-1 Compensation.

(a) ***

(3) ***

(iv) *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3231(e)-3.

* * * * *

Par. 10. Section 31.3231(e)-3T is redesignated as §31.3231(e)-3 and revised to read as follows:

§31.3231(e)-3 Reimbursement and other expense allowance amounts—(a) *When excluded from compensation.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62-2 and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan

and are not compensation. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in compensation*—(1) *Accountable plans*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, if a reimbursement or other expense allowance arrangement satisfies the requirements of section 62(c) and §1.62-2, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in compensation, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(ii) *Per diem or mileage allowances.* If a reimbursement or other expense allowance arrangement providing a per diem or mileage allowance satisfies the requirements of section 62(c) and §1.62-2, but the allowance is paid at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion is treated as paid under a nonaccountable plan and is included in compensation. In the case of a per diem or mileage allowance paid as a reimbursement, the excess portion is subject to withholding and payment of employment taxes when paid. In the case of a per diem or mileage allowance paid as an advance, the excess portion is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the expenses with respect to which the advance was paid (i.e., the days or miles of travel) are substantiated. The Commissioner may, in his discretion, prescribe special rules in pronouncements of general applicability regarding the timing of withholding and payment of employment taxes on per diem and mileage allowances.

(2) *Nonaccountable plans.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62-2 (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in compensation, and are subject to withholding and payment of employment taxes when paid.

(c) *Effective dates.* This section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. Paragraph (b)(1)(ii) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1991, with respect to expenses paid or incurred on or after January 1, 1991.

Par. 11. In §31.3306(b)-1, the last sentence of paragraph (h) is revised to read as follows:

§31.3306(b)-1 Wages.

* * * * *

(h) *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3306(b)-2.

* * * * *

Par. 12. Section 31.3306(b)-2T is redesignated as §31.3306(b)-2 and revised to read as follows:

§31.3306(b)-2 Reimbursement and other expense allowance amounts.

(a) *When excluded from wages.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62-2 and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan and are not wages. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in wages*—(1) *Accountable plans*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, if a reimbursement or other expense allowance arrangement satisfies the requirements of section 62(c) and §1.62-2, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in wages, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(ii) *Per diem or mileage allowances.* If a reimbursement or other expense allowance arrangement providing a per diem or mileage allowance satisfies the requirements of section 62(c) and §1.62-2, but the allowance is paid at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion is treated as paid under a nonaccountable plan and is included in wages. In the case of a per diem or mileage allowance paid as a reimbursement, the excess portion is subject to withholding and payment of employment taxes when paid. In the case of a per diem or mileage allowance paid as an advance, the excess portion is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the expenses with respect to which the advance was paid (i.e., the days or miles of travel) are substantiated. The Commissioner may, in his discretion, prescribe special rules in pronouncements of general applicability regarding the timing of withholding and payment of employment taxes on per diem and mileage allowances.

(2) *Nonaccountable plans.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62-2 (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of

the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in wages, and are subject to withholding and payment of employment taxes when paid.

(c) *Effective dates.* This section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. Paragraph (b)(1)(ii) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1991, with respect to expenses paid or incurred on or after January 1, 1991.

Par. 13. In §31.3401(a)–1, the last sentence of paragraph (b)(2) is revised to read as follows:

§31.3401(a)–1 Wages.

* * * * *

(b) ***

(2) *Traveling and other expenses.* *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3401(a)–4.

* * * * *

Par. 14. Section 31.3401(a)–2T is redesignated as §31.3401(a)–4 and revised to read as follows:

§31.3401(a)–4 Reimbursements and other expense allowance amounts.

(a) *When excluded from wages.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62–2 and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan and are not wages. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in wages*—(1) *Accountable plans*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, if a reimbursement or other expense allowance arrangement satisfies the requirements of section 62(c) and §1.62–2, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in wages, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(ii) *Per diem or mileage allowances.* If a reimbursement or other expense allowance arrangement providing a per diem or mileage allowance satisfies the requirements of section 62(c) and §1.62–2, but the allowance is paid at a rate for each day or mile of travel that exceeds the amount of the employee's expenses deemed substantiated for a day or mile of travel, the excess portion is treated as paid under a nonaccountable plan and is included in wages. In the case of a per diem or mileage allowance paid as a reimbursement, the excess portion is subject to withholding and payment of employment taxes when paid. In the case of a per diem or mileage allowance paid as an advance, the excess portion is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the expenses with respect to which the advance was paid (i.e., the days or miles of travel) are substantiated. The Commissioner may, in his discretion, prescribe special rules in pronouncements of general applicability regarding the timing of withholding and payment of employment taxes on per diem and mileage allowances.

(2) *Nonaccountable plans.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62–2 (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in wages, and are subject to withholding and payment of employment taxes when paid.

(c) *Withholding rate.* Employers may add any payments made under reimbursement or other expense allowance arrangements that are subject to income tax withholding to the employee's regular wages for a payroll period and compute withholding taxes on the total. Alternatively, the employer may withhold income tax from the reimbursement or other expense allowance at the flat 20-percent rate applicable to supplemental wages, provided the employer withholds income tax from the employee's regular wages and provided the reimbursement or allowance is paid separately (or separately identified if wages and reimbursement amounts are combined in a single payment). See §31.3402(g)–1 regarding supplemental wage payments.

(d) *Effective dates.* This section generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. Paragraph (b)(1)(ii) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1991, with respect to expenses paid or incurred on or after January 1, 1991.

PART 602—[AMENDED]

Par. 15. The authority for Part 602 continues to read as follows:

26 U.S.C. 7805

Par. 16. The table of OMB control numbers in section 602.101(c) is amended as follows: The entry reading: " 1.62.2 . . . 1545-1148" is revised to read: "1.62–2 . . . 1545-1148".

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved December 4, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 14, 1990, 8:45 a.m., and published in the issue of the Federal Register for December 17, 1990, 55 F.R. 51660)

Part III.—Items Specifically Excluded from Gross Income

Section 103.—Interest on State and Local Bonds

26 CFR 1.103-1: Interest upon obligations of a State, territory, etc.

The national average purchase prices and the average area purchase price safe harbor limitations for the states and the District of Columbia are set forth for use in computing the income limitation under section 143(f)(3) of the Code and satisfying the purchase price requirement under section 143(e). See Rev. Proc. 91-17, page 515.

26 CFR 1.103-1: Interest upon obligations of a State, territory, etc.

The average annual aggregate principal amount of mortgages executed during 1986, 1987, and 1988 are set forth for use by the issuers of qualified mortgage bonds and mortgage credit certificates in determining if the required portion of loans are made available in targeted areas under section 143(h) of the Code. See Rev. Proc. 91-34, page 691.

26 CFR 1.103-1: Interest upon obligations of a State, territory, etc.

Guidance is provided concerning the United States and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in section 143(a) of the Code, and issuers of mortgage credit certificates, as defined in section 25(c), in computing the housing cost/income ratio described in section 143(f)(5) of the Code. Rev. Proc. 90-25 is obsolete. See Rev. Proc. 91-35, page 693.

26 CFR 1.103-1: Interest upon obligations of a State, territory, etc.

What is the "testing date" under section 143(m)(4)(D) of the Code for a loan initially made by a financial institution and subsequently purchased by an issuer of qualified mortgage bonds with bond proceeds? To what extent do the federal subsidy recapture provisions of section 143(m) of the Code apply to (1) post-1990 assumptions of existing loans, and (2) post-1990 loans made from the re-lending of proceeds derived from repayments of prior loans? See Rev. Rul. 91-3, this page.

26 CFR 1.103-1: Interest upon obligations of a State, territory, etc.

Issuers of qualified mortgage bonds are provided safe harbor guidelines for complying with section 143(m)(7) of the Code. Under this section, issuers must provide notice to mortgagors of certain information about the federal subsidy recapture rule of section 143(m) of the Code. See Rev. Proc. 91-8, page 417.

Section 106.—Contributions by Employer to Accident and Health Plans

26 CFR 1.106-1: Contributions by employer to accident and health plans.

If accident and health insurance premiums are paid to a partner for services rendered in the capacity of partner and are determined without regard to partnership income, the payments are guaranteed payments under section 707(c) of the Code. The premiums are deductible by the partnership under section 162. The accident and health insurance premiums are not excludible from the recipient-partner's gross income under section 106 of the Code. For purposes of an S corporation, the premiums also are treated as 707(c) guaranteed payments, deductible by an S corporation, and includible in the recipient-shareholder employee's gross income. See Rev. Rul. 91-26, page 184.

Section 112.—Certain Combat Pay of Members of the Armed Forces

Executive Order 12744

Designation of Arabian Peninsula Areas, Airspace, and Adjacent Waters as a Combat Zone

By the authority vested in me as President by the Constitution and the laws of the United States of America, including section 112 of the Internal Revenue Code of 1986 (26 U.S.C. 112), I hereby designate, for purposes of that section, the following locations, including the airspace above such locations, as an area in which Armed Forces of the United States are and have been engaged in combat:

—The Persian Gulf
—the Red Sea
—the Gulf of Oman
—that portion of the Arabian Sea that lies north of 10 degrees north latitude and west of 68 degrees east longitude
—the Gulf of Aden
—the total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar, and the United Arab Emirates.

For the purposes of this order, the date of the commencing of combatant activities in such zone is hereby designated as January 17, 1991.

George Bush
THE WHITE HOUSE
January 21, 1991.

(Filed by the Office of the Federal Register on January 22, 1991, 11:00 a.m., and published in the issue of the Federal Register for January 23, 1991, 56 F.R. 2663)

Part IV.—Tax Exemption Requirements for State and Local Bonds

Subpart B.—Private Activity Bonds

Section 143.—Mortgage Revenue Bonds: Qualified Mortgage Bond and Qualified Veterans' Mortgage Bond

(Also Section 103; 26 CFR 1.103-1.)

Mortgage revenue bonds. Clarification is provided regarding the effective date of section 143(m) of the Code as applied to loan assumptions and loan recycling, and regarding the testing date under section 143(m)(4)-(D) for loans initially made by a lending institution and later sold to the issuer.

Rev. Rul. 91-3

ISSUES

1. What is the "testing date" under section 143(m)(4)(D) of the Internal Revenue Code for a loan initially made by a lending institution out of moneys other than qualified mortgage bond proceeds and subsequently purchased by an issuer of qualified mortgage bonds with bond proceeds pursuant to a pre-existing agreement?

2. To what extent do the federal subsidy recapture provisions of section 143(m) of the Code apply to a post-1990 assumption of a loan that was originally made from the proceeds of a qualified mortgage bond?

3. To what extent do the federal subsidy recapture provisions of section 143(m) of the Code apply to a post-1990 loan made from the re-lending of proceeds derived from repayments of any prior loan or loans originally made from qualified mortgage bond proceeds?

FACTS

Situation 1

A, an individual taxpayer, applied to *X*, a lending institution, for a federally subsidized loan to finance a principal residence located in city *C1*. *A* satisfied all the requirements imposed by section 143 of the Code in order for *A*'s residence to qualify for financing from proceeds of qualified mortgage bonds.

On January 2, 1991, *X* loaned money to *A* which *A* used to purchase the residence. On April 1, 1991 *X* sold *A*'s loan to *C1* pursuant to an