

1990-1 C.B. 14; T.D. 8276;
1990 IRB LEXIS 2181, *

DEPARTMENT OF THE TREASURY

Treasury Decision 8276

1990-1 C.B. 14; T.D. 8276; 1990 IRB LEXIS 2181

January 1990

[*1]

SUBJECT MATTER: Section 62.-Adjusted Gross Income Defined

APPLICABLE SECTIONS:

26 CFR 1.62-IT: Adjusted gross income (temporary). Internal Revenue Service 26 CFR PARTS 1, 31, AND 602

TEXT:

Employee Business Expenses-Reporting and With holding on Employee Business Expense Reimbursements and Allowances

AGENCY:

Internal Revenue Service, Treasury.

ACTION:

Temporary and final regulations.

SUMMARY:

This document contains temporary and final 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 temporary regulations reflect changes to the law made by the Family Support Act of 1988. These temporary regulations will affect employees who receive payments and payors who make payments under reimbursement or other expense allowance arrangements. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in [EE-8-89, page 616, this Bulletin].

EFFECTIVE DATES:

The provisions of these temporary regulations under § 1.62-1T are effective for expenses paid or incurred in taxable years beginning before **[*2]** January 1, 1989. The income tax provisions of these temporary regulations under § 1.62-2T are effective for taxable years beginning on or after January 1, 1989, with respect to expenses paid or incurred in taxable years beginning on or after January 1, 1989. The provisions of § 1.162-17 (e) (3) of these regulations are effective for taxable years beginning on or after January 1, 1989. The provisions of § 1.274-5T (g) of these regulations are effective upon publication. The provisions of § 1.162-25T of these regulations are effective upon

publication. The reporting provisions of these temporary regulations under § 1.6041-3 (i) are effective for payments made under reimbursement or other expense allowance arrangements on or after January 1, 1989; however, a transition rule is provided under § 1.6041-3 (i) effective for payments made prior to January 1, 1990. The amendments to §§ 31.3121 (a)-1 (h), 31.3231 (e)-1, 31.3306 (b)-1, and 31.3401 (a)-(1) (b) (2) of these regulations 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 provisions of these temporary regulations under §§ 31.3121 (a)-2T, [*3] 31.3231 (e)-3T, 31.3306 (b)-2T, and 31.3401 (a)-2T regarding withholding and payment of employment taxes are effective for payments made under reimbursement or other expense allowance arrangements on or after July 1, 1990.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

This regulation is being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in this regulation has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1148. The estimated average annual burden per-recordkeeper is 0.5 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.

For further information concerning this collection of information, and where to submit comments on this collection of information and the accuracy of the estimated burden, and suggestions for reducing [*4] this burden, please refer to the preamble to the cross-referenced notice of proposed rulemaking published in [EE-8-89, page 616, this Bulletin].

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under sections 62, 162, 274 and 6041 of the Internal Revenue Code, and to the Employment Tax Regulations (26 CFR Part 31) under sections 3121, 3231, 3306, and 3401 of the Code as a result of the Family Support Act of 1988, Public Law No. 100-485 [1989-2 C.B. 338].

Need For Temporary and Final Regulations

Because of the need for immediate guidance regarding the reporting and withholding requirements of these regulations, it is impracticable and contrary to the public interest to issue these temporary and final regulations with notice and public procedure under section 553 (b) of Title 5 of the United States Code, or subject to the effective date limitation of section 553 (d) of Title 5.

Explanation of Provisions

Section 62 (a) of the Internal Revenue Code generally defines "adjusted gross income" as gross income minus certain deductions. These "above-the-line" deductions are allowed without regard to whether a taxpayer itemizes deductions and are not subject [*5] to the two-percent floor of section 67. Among the above-the-line deductions, section 62 (a) (2) (A) allows an employee a deduction for expenses (reimbursed employee business expenses) paid by the employee, in connection with the performance of services as an employee, under a reimbursement or other expense allowance arrangement with his or her employer. In addition, the above-the-line deduction is available for reimbursement or other expense allowance arrangements maintained by an agent of the employer or by a third party for whom the employee performs a service as an employee of the

employer. Throughout these regulations, such employers, agents, and third parties are referred to as "payors."

As amended, 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) unless-

- 1)the arrangement requires the employee to substantiate the expenses covered by the arrangement to the payer, and
- 2)the arrangement requires the employee to return any amount in excess of the substantiated expenses covered under the arrangement.

Reimbursement or Other Expense Allowance Arrangements

1. Defined

For purposes [***6**] of the temporary regulations, a reimbursement or other expense allowance arrangement is an arrangement that meets three requirements: (1) business connection, (2) substantiation, and (3) returning amounts in excess of expenses.

2. Business Connection Requirement

An arrangement meets the business connection requirement under the temporary regulations if it provides reimbursements, advances, or allowances (including per diem allowances, allowances for meals and incidental expenses, and mileage allowances) for business expenses that are allowable as deductions for expenses paid or incurred by an employee in connection with the performance of services as an employee. The business connection requirement therefore requires a nexus between an amount denominated an "advance" and the business expenses that it is anticipated the employee will incur. For example, if an employer provides an employee with an "advance" of \$3000 at a time when it is not anticipated that the employee will incur travel or other expenses deductible in the trade or business of being an employee, the "advance" does not meet the business connection requirement and will not be treated as paid under an accountable plan.

3. Substantiation

In [***7**] order to meet the substantiation requirement, the employee must be required to substantiate the expenses covered by the arrangement to the payor. For example, to the extent employee business expenses covered by such arrangements are governed by the substantiation rules of section 274 (d), the employee must meet the substantiation requirements of that section, which, for example, with respect to a travel expense, generally require substantiation of the amount, time, place and business purpose of the expense.

Under section 274 (d), the Commissioner has the authority to provide simplified methods of substantiation. The Service is publishing several such simplified methods of substantiation. Under these simplified methods, known as "deemed substantiation" methods, employees are deemed to have substantiated an amount of expenses equal to the lesser of the amount of the reimbursement or the amount specified by the Service.

The methods of deemed substantiation available to employers will include methods applicable to

lodging, meal and/or incidental expenses, both within and outside the continental United States, and methods applicable to reimbursement of transportation expenses. Such methods [*8] will include reimbursements paid under arrangements similar to the methods for reimbursing Federal employees. In addition, deemed substantiation methods will be available for reimbursements paid at a flat rate or under a stated schedule, such as reimbursements for lodging, meals and/or incidental expenses calculated on the basis of hours worked or miles driven.

The Service will, in a separate announcement, request suggestions from taxpayers concerning appropriate additional methods of deemed substantiation.

4. Returning Amounts in Excess of Expenses

In order to meet the requirement of returning amounts in excess of expenses, an arrangement must require the employee to return any amount in excess of the substantiated expenses covered under the arrangement. If an employee receives an advance for anticipated business expenses that exceeds the amount of such expenses actually incurred and substantiated by the employee, but the employee uses such excess to pay expenses incurred for other business expenses, the employee need not return such excess to the payor.

The temporary regulations grant the Commissioner the authority to prescribe rules under which an arrangement providing per diem allowances [*9] or mileage allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though an employee is not required to return the portion of such an allowance that exceeds the amount of the employee's expenses which is deemed substantiated under rules prescribed under section 274 (d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance which relates to days or miles of travel not substantiated. For example, assume a payor provides an employee an advance mileage allowance of \$60, based on an anticipated 200 business miles at 30 cents-per-mile (at a time when the applicable standard mileage rate is 26 cents-per-mile), and the employee substantiates 120 business miles. Under these rules, the requirement to return excess amounts will be treated as satisfied if the employee is required to return the amount of the advance allowance that is attributable to the 80 unsubstantiated business miles (\$24.00), even though the employee is not required to return the portion of the allowance (\$4.80) that exceeds the amount [*10] of the employee's expenses deemed substantiated (\$31.20) pursuant to rules prescribed under section 274 (d).

5. Timeliness

Both the requirement of substantiation and the requirement that excess reimbursements be returned must be met within a reasonable period of time after an expense is paid or incurred. What constitutes a reasonable period of time depends on the facts and circumstances. Thus, for example, it is reasonable that an employee who is on an extended travel assignment would have a longer period to substantiate expenses and return excess amounts than an employee who undertakes a single overnight trip.

The regulations provide two safe harbor methods. Under the first, the requirements will be treated as met within a reasonable period of time if an advance is made within 30 days of when an expense is paid or incurred, an expense is substantiated within 60 days after it is paid or incurred, or an excess amount is returned to the payor within 120 days after the expense is paid or incurred. Under the second, the requirements will be treated as met within a reasonable period of time if an expense is substantiated or an amount is returned within 120 days after the payor provides a periodic [*11] statement (no less frequently than quarterly) of the amount paid under the arrangement that exceeds the expenses the employee has substantiated. Both methods are intended solely as safe harbors, and no adverse inference is intended with respect to amounts advanced, substantiated, or returned after such periods. However, for purposes of withholding, a payor may treat amounts substantiated or returned after such periods as not having been substantiated or returned within a reasonable period of time.

Reporting and Employment Taxes

The Conference Report on the Family Support Act of 1988 (H.R. Rep. No. 998, 100th Cong., 2d Sess. 202-206 (1988)) provides that the regulations and rulings regarding the reporting of employee business expense reimbursements and allowances generally are also to be revised to conform to the changes in section 62 and to subject amounts treated as paid pursuant to nonaccountable plans to income tax withholding. In addition, the legislative history provides authority to alter the relevant employment tax rules. Pursuant to the regulatory authority granted by Congress under the Family Support Act, these temporary regulations provide guidance regarding the circumstances **[*12]** under which travel and other expense allowance arrangements are subject to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), the Railroad Unemployment Repayment Tax (RURT) and the Collection of Income Tax at Source on Wages ("employment taxes"). These regulations also provide guidance with regard to reporting of such amounts on Form W-2.

Delayed effective dates are provided for the changes in the employment tax regulations. The changes in the employment tax regulations are effective for payments made under reimbursement or other expense allowance arrangements 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. For reimbursements or other expense allowance payments made before July 1, 1990, or made with respect to expenses paid or incurred before July 1, 1990, the rules in existing regulations will apply. Hence, for payments made under reimbursement or other expense allowance arrangements before July 1, 1990, no withholding or employment tax liability will attach with respect to amounts paid specifically-either as advances or reimbursements-for **[*13]** traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer. Of course, as under existing regulations, such expenses must be identified either by making a separate payment or by specifically identifying the separate amounts if both wages and expense allowances are combined in a single payment.

A delayed effective date is not provided for the amendments to the reporting requirements under section 6041. The reporting requirements are effective for payments made under reimbursement or other expense allowance arrangements on or after January 1, 1989, with respect to expenses paid or incurred on or after January 1, 1989. However, for payments made before January 1, 1990, no reporting is required if 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 prior section 1.6041-3 (i) of the Income Tax Regulations will indicate such reasonable good faith effort to comply with the requirements of section 62 (c). Under those regulations, reporting on Form W-2 was not required if the employee was required to account and did so **[*14]** account to the employer for such expenses. See Rev. Rul. 80-62, 1980-1 C.B. 63, as modified, and Rev. Rul. 84-127, 1984-2 C.B. 246. A payor must, however, report payments made before January 1, 1990, if an arrangement (other than a per diem or mileage type arrangement) does not require the employee to substantiate expenses or to return excess amounts.

Payments Under Accountable Plans

If an arrangement meets all the requirements of the regulations, the amounts paid under the arrangement are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). If an arrangement meets the requirements of the regulations, but an employee fails to return amounts in excess of amounts substantiated, only the amounts not in excess of the substantiated expenses are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax).

Payments Under Nonaccountable Plans

If an arrangement does not meet one or more of the requirements [*15] of the regulations, all payments under the arrangement are included in the employee's gross income, are reported as wages on Form W-2, and are wages for purposes of withholding and payment of employment taxes. If an arrangement meets the requirements of the regulations, but an employee fails to return amounts in excess of amounts substantiated, such excess is included in the employee's gross income, is reported as wages on Form W-2, and is wages for purposes of withholding and payment of employment taxes. Employee business expenses that exceed the amount of the reimbursements that are excluded from the employee's gross income are not allowable as a deduction in computing adjusted gross income. Rather, such employee business expenses are deductible by the employee in computing taxable income only if the employee itemizes deductions, and only to the extent that the total of such expenses and other miscellaneous itemized deductions exceeds two percent of the taxpayer's adjusted gross income.

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 [*16] 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 by adding the following citations:

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

Par. 2. Section 1.62-1T is amended by revising paragraph (c) (2) and by inserting a new sentence before the first sentence of paragraph (f), to read:

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

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

(2) Deductions allowable under part VI, subchapter B, chapter 1 of the Code, (section 161 and following) that consist **[*17]** 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 § 1.62-2T, whichever is applicable) with his or her employer;

□ □ □

(f) Reimbursement or other expense allowance arrangement. This paragraph (f) applies to expenses paid or incurred in taxable years beginning before January 1, 1989. □; □ □

□ □ □

Par. 3. Section 1.62-2T is added immediately following 1.62-1T to read as follows:

§ 1.62-2T Reimbursements and other expense allowance arrangements (Temporary).

(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.*

(e) *Substantiation.*

(1) *In general.*

(2) *Expenses governed by section 274 (d).*

(3) *Expenses not governed by section 274 (d).*

(f) *Returning [* 18] 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.*

(h) *Timing of withholding.*

(i) *Application.*

(j) *Cross references.*

(k) *Effective date.*

(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, 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 [*19] or other expense allowance arrangement-(1) Defined.* For purposes of §§ 1.62-1T and 1.62-2T, 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.

(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), 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 [*20] 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."

(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), 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 required to be reported 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 (j) of this § 1.62-2T for cross references.

(5) *Treatment of payments* **[*21]** *under nonaccountable plans.* Amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported to the employee on Form W-2, and are subject to withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). 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.* An arrangement meets the requirements of this paragraph (d) if it provides advances, allowances (including per diem allowances, allowances for meals and incidental expenses, and mileage allowances), or reimbursements for business expenses that are allowable **[*22]** 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. 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.

(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 **[*23]** 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 [*24] 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 payer'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 [*25] the use of vague, nondescriptive terms (such as "miscellaneous business expenses"). See § 1.162-17 (b).

(f) *Returning amounts in excess of expenses-(I) 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) are required to be returned to the payor within a reasonable [*26] 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 exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under section 274 (d), provided the allowance 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* [*27] *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 [*28] of time.

(h) *Timing of withholding*. If the expenses covered under an arrangement 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) 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. See paragraph (j) of this § 1.62-2T for cross references.

(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 [*29] (e), will not cause amounts paid to other employees to be treated as paid under a nonaccountable plan.

(j) *Cross references*. For employment tax regulations relating to reimbursement and expense allowance arrangements, see §§ 31.3121 (a)-1 (h), 31.3231 (e)-1 (a) (3) (iv), 31.3306 (b)-1-(h), and 31.3401 (a)-(1) (b) (2), which 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 (i), 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.

(k) *Effective date*. This section 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.

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

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

□ [*30] □ □

(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 § 1.62-2T.

Par. 5. Paragraph (b) of section 1.162-25T is amended by removing the first sentence and adding in its place three new sentences to read as follows:

§ 1.162-25T Deductions with respect to noncash fringe benefits (temporary).

□ □ □

(b) *Employee.* If an employer provides the use of a vehicle (as defined in § 1.61-21 (e) (2)) to an employee as a noncash fringe benefit and includes the entire value of the benefit in an employee's gross income without taking into account any exclusion for a working condition fringe allowable under section 132 and the regulations thereunder, the employee may deduct that value multiplied by the percentage of the total use of the vehicle that is in connection with the employer's trade or business ("business value"). For taxable years beginning before January 1, 1990, the employee may deduct the business value from gross income in determining adjusted gross income. For taxable years beginning on or after January [*31] 1, 1990, the employee may deduct the business value only as a miscellaneous itemized deduction in determining taxable income, subject to the 2-percent floor provided in section 67. □; □ □

□ □ □

Par. 6. Paragraph (g) of § 1.274-5T is revised by adding the words "in pronouncements of general applicability" immediately following the word "rules" in the first sentence, effective upon publication.

Par. 7. 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 § 1.62-2T, 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 January 1, 1990, to the extent that the employee **[*32]** 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. 8. The authority for Part 31 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 Secs. 31.3121 (a)-1, 31.3231 (e)-1, 31.3306 (b)-1, and 31.3401 (a)-1 also issued **[*33]** under 26 U.S.C. 62.

Par. 9. In § 31.3121 (a)-1, paragraph (h) is amended by adding a sentence at the end to read as follows:

§ 31.3121 (O)-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)-2T.

Par. 10. Section 31.3121 (a)-2T is added to read as follows:

§ 31.3121 (a)-2T 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 § 1.62-2T 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. If a reimbursement or other expense allowance arrangement **[*34]** does not satisfy the requirements of section 62 (c) and § 1.62-2T (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. If an arrangement satisfies the requirements of section 62 (c) and § 1.62-2T, 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.

(c) Effective date. This section 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.

Par. 11. In § 31.3231 (e)-1, **[*35]** paragraph (a) (3) (iv) is amended by adding a sentence at the end to read as follows:

§ 31.3231 (e)-1 Compensation.

(a)

(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)-3T.

Par. 12. Section 31.3231 (e)-3T is added to read as follows:

§ 31.3231 (e)-3T 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 § 1.62-2T 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. If a reimbursement or other expense allowance arrangement does **[*36]** not satisfy the requirements of section 62 (c) and § 1.62-2T (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. If an arrangement satisfies the requirements of section 62 (c) and § 1.62-2T, 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.

(c) Effective date. This section 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.

Par. 13. In **[*37]** § 31.3306 (b)-1, paragraph (h) is amended by adding a sentence at the end 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)-2T.

Par. 14. Section 31.3306 (b)-2T is added to read as follows:

§ 31.3306 (b)-2T 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 § 1.62-2T 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. If a reimbursement or other expense allowance arrangement does not satisfy the [*38] requirements of section 62 (c) and § 1.62-2T (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. If an arrangement satisfies the requirements of section 62 (c) and § 1.62-2T, 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.

(c) Effective date. This section 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.

Par. 15. In § 31.3401 (a)-1, paragraph (b) [*39] (2) is amended by adding a sentence at the end 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)-2T.

Par. 16. Section 31.3401 (a)-2T is added to read as follows:

§ 31.3401 (a)-2T 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 § 1.62-2T 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.* If a reimbursement or other expense allowance arrangement does not [*40] satisfy the requirements of section 62 (c) and § 1.62-2T (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. If an arrangement satisfies the requirements of section 62 (c) and § 1.62-2T, 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.

(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, [*41] 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 date.* This section 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.

PART 602-[AMENDED]

Par. 17. The authority for Part 602 continues to read as follows:

26 U.S.C. 7805

Par. 18. Section 602.101 (c) is revised by inserting in the appropriate places in the table " 1.62-2 ... 1545-1148".

Fred T. Goldberg,

Commissioner of Internal Revenue.

Approved December 4, 1989.

Kenneth W. Gideon,

Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 7, 1989, 12:20 p.m., and published in the issue of the Federal Register for December 12, 1989, 54 F.R. 51021)







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