

Internal Revenue Service

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Date:
April 13, 2009

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Legend

Taxpayer =
Plan =
Claim Form =

Dear _____ :

This responds to your request of July 19, 2008, for a private letter ruling regarding the proper employment tax treatment of payments made to service technicians for trade equipment (supplies, tools, and equipment), training, and/or certification required as a condition of employment. Specifically, you have requested a ruling concerning whether Taxpayer's expense reimbursement arrangement (the Plan) satisfies the accountable plan requirements of § 62(c) and the regulations thereunder.

According to the information submitted, Taxpayer is expanding its professional consulting business to include a new division that both will sell professional tools and equipment and provide associated services, such as repair and maintenance, to its customer base. Taxpayer will employ service technicians (Technicians) as hourly wage employees to perform the repair and maintenance services on tools and equipment sold by Taxpayer to its customers. Taxpayer's Technicians are required to provide and maintain their own tools and equipment for performing the repair and maintenance work. The Technicians' tools and equipment, which are kept on-site at the Taxpayer's business locations, are owned by them and are used exclusively to perform repair and maintenance work for Taxpayer.

Taxpayer will reimburse Technicians for certain deductible business expenses incurred in connection with supplies, tools, equipment, and training or certification necessary for

Technicians to perform services for Taxpayer through an expense reimbursement arrangement (the Plan). The Plan is only between Taxpayer and Taxpayer's Technicians. As described more fully below, the Plan only reimburses covered costs that the Technician substantiates to Taxpayer. The reimbursements are not provided in lieu of, nor are they a function of, any other compensation such as hourly wages, fixed salaries, bonuses, benefits, or commissions. Nor does the Plan provide for any adjustments to compensation on account of reimbursements.

Prior to each fiscal year, Taxpayer will determine the total amount it can afford to allocate to the Plan for reimbursements in the coming year. The allocated amounts will be treated no differently than any other budget line item and will remain at all times in the general funds of Taxpayer subject to creditors. All allocated amounts will remain the sole property and under the direct control of Taxpayer and used to reimburse expenses at Taxpayer's sole discretion. At the end of each Plan Year, all amounts allocated for Technicians' reimbursable business expenses that are not disbursed will remain in Taxpayer's general fund.

Each Technician will be eligible to receive up to a set amount as reimbursements for substantiated covered costs, based on the total amount available for reimbursements and each Technician's expected need for additional trade equipment (supplies, tools, and equipment), training, and/or certification to accomplish his or her job assignments. Taxpayer will inform Technicians at the beginning of each Plan Year of eligibility to participate in the Plan and their allocated maximum amount available for reimbursement of their substantiated expenses. The amounts allocated for reimbursements of Technician's expenses may not be sufficient to fully reimburse all the Technician's expenses.

Only Qualified Employees will be permitted to participate in the Plan. For purposes of the Plan, Qualified Employees are those employees who have completed at least 30 days of employment, have completed a Certification Form, and have purchased tools or equipment or incurred covered costs, as defined below, for the benefit of Taxpayer's business. The Certification Form details the terms and conditions of the Plan and requires that the Technician certify that he or she understands and agrees to the terms contained in the Plan. The Certification Form includes provisions regarding the purpose of the Plan, the types of expenses that are reimbursable under the Plan, and the requirements for reimbursement under the Plan. The form is intended to assist in the education process for the Technician in order to ensure that the Technician understands the Plan.

The Plan will only reimburse covered costs¹. Covered costs are defined in the Plan as costs incurred on job assignments while employed by Taxpayer during the current Plan Year and while enrolled in the Plan. Covered costs include expenses incurred after

¹ We assume for purposes of this ruling that none of the covered costs reimbursed under the Plan would be nondeductible personal expenses under section 262 of the Internal Revenue Code.

Technician becomes a Qualified Employee to purchase tools, equipment, uniforms, safety equipment, and supplies, and to obtain employee training and certification directly related to Taxpayer's trade or business.² Tools and equipment required by Technicians to perform services for Taxpayer may range from simple hand tools to diagnostic equipment³. The Plan will not reimburse expenses for supplies, tools, or equipment incurred while the Technician was employed by another employer or expenses for any supplies, tools, or equipment purchased prior to the Plan start date. Because the Plan reimburses costs incurred to purchase tools and equipment eligible for a § 179 deduction, the Plan will not reimburse for any depreciation of such tools and equipment that might have been otherwise deductible under § 167(a).

No reimbursements will be made for tools and equipment that are not used exclusively for Taxpayer's business, not maintained at Taxpayer's place of business, not purchased while an employee of Taxpayer, not needed to perform job assignments, not purchased from an approved vendor⁴, or not considered necessary for the applicable industry. Technicians may only purchase tools or equipment from an approved vendor list so that Taxpayer may control the cost of such expenses without sacrificing quality and warranty provisions.

In order to be reimbursed, Technicians will be required to submit a Claim Form. The Claim Form requires the Technician to validate that he or she has read and understands the Plan, and to certify that the information provided is correct and complete, that the expense is required to complete his or her job assignments for Taxpayer, that the item will only be used in the performance of job assignments for Taxpayer, and that the item was purchased from the approved vendor list. The Claim Form also requires the Technician to identify the job assignments that require the trade equipment (supplies, tools, and equipment), training, and/or certification. In addition, the Technician must certify (i) that he or she will not seek additional reimbursement from other sources (any other plan or program of any other employer or person), (ii) that he or she will not claim the expense as a deduction on his or her or his or her spouse's tax return, (iii) notwithstanding clause (ii), that he or she could otherwise claim the cost of the tools and equipment that are § 179 property as a deduction under § 179(a), and (iv) if he or she places in service other § 179 property not reimbursed under the Plan during the taxable year in which he or she receives a reimbursement under the Plan, that he or she will reduce the § 179(b)(1) and (b)(2) limits for that taxable year by the amount of the reimbursement received under the Plan for § 179 property during that taxable year. The Technician's manager will be required to sign the Claim Form, certifying that the request

² Redundant tool and equipment reimbursements are not permitted unless the redundant tools or equipment are required to perform assigned jobs or are required to replace lost or broken tools or equipment that have no associated warranty and/or timely replacement process available to facilitate the type of jobs assigned to the Technician.

³ The Plan will not reimburse for the acquisition or use of cell phones or automobiles.

⁴ Taxpayer plans to distribute the approved vendor list to Technicians at the beginning of each Plan year.

for reimbursement is for an expense required by the Technician for his or her job and validating that the job assignments identified on the Claim Form are accurate. The manager will also verify that the expenses identified will only be used for the benefit of Taxpayer's business.

The Plan also requires that Technicians submit documented proof of purchase for any expenses submitted for reimbursement on the Claim Form. Acceptable forms of purchase validation include a receipt, invoice, or, if a receipt or invoice cannot be obtained, other written confirmation of the actual purchase from a vendor where a Technician may have an open account. The proof of purchase requires that all items be clearly identified along with the purchase date and cost of each associated item.

Taxpayer reserves the right to deny any claim if the documentation is incomplete or if the expense is not eligible as allowed by the Plan or exceeds the allocated reimbursement amount. Claims for reimbursement of expenses may be wholly or partially denied.

Under the Plan, only reimbursements will be made. No provisions for cash advances or allowances are provided under the Plan. As such, there should be no excess reimbursements for Technicians to return. However, the Plan requires that any reimbursements made in error be returned to Taxpayer within 30 days of notification.

Reimbursements will only be made once the Technician completes the required Claim Form, gets the Form signed by his or her manager, and submits the completed form and proof of purchase to the Plan administrator. All eligible reimbursement requests must be submitted within 30 days of purchase. In addition, Technicians will have up to 30 days from the end of the Plan Year, or from the date he or she ceases to be a participant in the Plan, whichever is earlier, to submit for reimbursements for that Plan year. The Plan administrator will be responsible for validating that the Claim Form is complete and within the guidelines of the Plan, including the submission of proof of purchase. The Plan administrator will also conduct periodic audits of reimbursements made to Technicians and of manager authorizations.

The Technician must remain an employee of Taxpayer for at least six months after any such reimbursement is made. If the Technician ceases to be an employee of Taxpayer, he or she must repay all reimbursements made during the prior six months of employment with Taxpayer at the time of departure.

Taxpayer reserves the right to cancel the Plan or cease or reduce reimbursements at any time.

APPLICABLE LAW AND ANALYSIS

Accountable Plan Requirements

Section 61 of the Internal Revenue Code (Code) defines gross income as all income, from whatever source derived. Section 62 defines adjusted gross income as gross income minus certain deductions. Section 62(a)(2)(A) provides that, for purposes of determining adjusted gross income, an employee may deduct certain business expenses 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.

Section 62(c) provides that, for purposes of § 62(a)(2)(A), an arrangement will not be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or (2) the arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 1.62-2(c)(1) of the Income Tax Regulations provides that a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan⁵. See § 1.62-2(c)(2). 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. See § 1.62-(2)(c)(4). Conversely, if the arrangement fails any one of these requirements, amounts paid under the arrangement are treated as paid under a nonaccountable plan and 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. See § 1.62-2(c)(3) and (5).

Business Connection Requirement

An arrangement meets the business connection requirement of §1.62-2(d) if it provides advances, allowances, or reimbursements for business expenses that are allowable as deductions by Part VI (§ 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. Thus, not only must an employee pay or incur a deductible business expense, but the expense must arise in connection with performing services for that employer. If an employer reimburses deductible business

⁵ Revenue Ruling 2005-52 addressed the tax consequences of a tool allowance arrangement and held that the arrangement did not satisfy the substantiation and return of excess requirements of an accountable plan. The revenue ruling did not address the business connection requirement. Although Rev. Rul. 2005-52 deals with tool plans, it is not relevant to the analysis of the plan at issue.

expenses that the employee incurred prior to employment, the plan does not meet the business connection requirement.

Section 162(a) permits a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 1.162-17(a) provides rules for the reporting and substantiation of ordinary and necessary business expenses incurred in connection with the performance of services as an employee. Section 1.162-17 further provides that the term “ordinary and necessary business expenses” means only those expenses which are ordinary and necessary in the conduct of the taxpayer’s business and are directly attributable to such business. The term does not include nondeductible personal, living, or family expenses.

Section 167(a) allows a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the taxpayer’s trade or business to be taken as a depreciation deduction.

Section 179(a) permits a taxpayer to elect to treat the cost of any § 179 property, as defined in § 179(d)(1), as an expense in the year such property is placed in service, in lieu of treating the cost as chargeable to capital account subject to depreciation under §167. The cost is permitted as a deduction for the taxable year in which the §179 property is placed in service by the taxpayer. However, §§ 179(b)(1) and (b)(2) limit the amount that may be deducted.

Section 1.179-4(a) defines § 179 property, in relevant part, as any tangible property described in § 179(d)(1) that is acquired by purchase for use in the active conduct of the taxpayer’s trade or business. The determination of whether property is used in the “active conduct of the taxpayer’s trade or business” is made under § 1.179-2(c)(6). For purposes of §§ 1.179-2(c)(6) and 1.179-4(a), § 1.179-2(c)(6)(i) provides that the term “trade or business” has the same meaning as in § 162 and the regulations thereunder. Further, for purposes of § 1.179-2(c)(6), § 1.179-2(c)(6)(iv) provides that employees are considered to be engaged in the active conduct of the trade or business of their employment.

Section 1.62-2(d)(3)(i) provides that the business connection requirement will not be satisfied if the 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. A payor arranges to pay an amount to an employee regardless of whether the employee is reasonably expected to incur bona fide business expenses by supplementing the wages of those employees not receiving the reimbursement (so that the same gross amount is paid regardless of the reasonable expectation to incur expenses), by routinely paying a reimbursement allowance to an employee who has not incurred bona fide business expenses, or by reducing the wage payment in light of expenses incurred or reasonably expected to be incurred only to the increase the wage payment again after the expenses have been reimbursed.

Where a plan serves to recharacterize amounts as a reimbursement allowance that would otherwise be paid as wages if there were no expenses reasonably expected to be incurred for the employer, amounts paid under the plan will not be treated as paid under an accountable plan. Such recharacterization violates the business connection requirement of § 1.62-2(c) because the employee receives the same amount regardless of whether expenses were incurred or reasonably expected to be incurred.

Based on the totality of the facts set forth above, the Plan satisfies the business connection requirement of § 1.62-2(d). Specifically, the facts and circumstances of Taxpayer's business and its Plan, including the certifications required and the Plan's Claim Form procedures, establish that the Plan will reimburse only business expenses deductible under § 162 or § 179, and incurred, by Technicians in performing services for Taxpayer⁶.

For all tool and equipment expenses reimbursed under the Plan, Technicians are required to certify on the Claim Form that the expenses incurred are necessary for the performance of services for Taxpayer, the tools and equipment are required to be kept on site, and all claimed expenses are verified as necessary for the performance of services for Taxpayer by the Technician's manager.

For tool and equipment expenses reimbursed under the Plan that are deductible under § 179 to the Technician, a Technician is required to further certify that he could otherwise claim the cost of the tools and equipment as a deduction under § 179(a). Further, the Technician is required to certify that he will reduce the § 179(b)(1) and (b)(2) limits for the taxable year by the amount of any reimbursement received under the Plan for § 179 property during that taxable year, thereby limiting any deduction he or his spouse might claim under § 179 for that taxable year if the Technician has other § 179 property that is placed in service during that taxable year but not reimbursed under the Plan. As a result of the Technician's certifications and the Plan's Claim Form procedures, the payment amount that the Technician receives as a reimbursement for expenses incurred in the purchase and placement in service of § 179 property (e.g., certain tools and equipment) under the Plan will be treated as an elected § 179(a) deduction by the Technician.

Furthermore, the payments will be made in addition to, rather than in lieu of, any other compensation such as hourly wages, fixed salaries, bonuses, benefits, or commissions. As such, the payments will not be made 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.

Substantiation Requirement

⁶ See footnote 1.

Section 1.62-2(e)(1) provides that the substantiation requirement is met if the arrangement requires each business expense to be substantiated in accordance with paragraph (e)(2) or (e)(3) of that section, whichever is applicable, to the payor (the employer, its agent or a third party) within a reasonable period of time. Section 1.62-2(g)(1) provides that what constitutes a reasonable period of time depends on the facts and circumstances of each arrangement. However, § 1.62-2(g)(2) provides a safe harbor for substantiation under which the substantiation requirement is met if an expense is substantiated within 60 days after the expense is paid or incurred.

Section 1.62-2(e)(2) provides that an arrangement that reimburses expenses governed by § 274(d) meets the requirements of § 1.62-2(e)(2) if information sufficient to satisfy the substantiation requirements of § 274(d) and the regulations is submitted to the payor. Section 274(d) applies to “listed property” under § 280F(d)(4). Most tools and equipment are not listed in § 280F(d)(4). The list is limited to items such as property used for transportation including an automobile, computer or peripheral equipment as defined in §168(i)(2)(B), and cellular telephone or similar telecommunications equipment. No deduction is allowed for an expense associated with such listed property under § 274(d)(4), and any “reimbursement” of the expense must be treated as wages subject to withholding and payment of employment taxes, unless the employee establishes by adequate records (A) the amount of each expenditure, (B) the amount of each business or investment use of the listed property and its total use, (C) the date of the expenditure or use, and (D) the business purpose for an expenditure or use of any listed property. Section 1.274-5T(b)(6) and (f) and § 1.274-5(f)(4).

Section 1.62-2(e)(3) provides that an arrangement that reimburses business expenses not governed by § 274(d) meets the requirements of § 1.62-2(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. Each of the elements of an expenditure or use must be substantiated to the payor, and it is not sufficient for an employee to merely aggregate expenses into broad categories or to report individual expenses through the use of vague, non-descriptive terms.

Section 1.62-2(e)(3) references §1.162-17(b) which provides substantiation rules for employee business expenses. Section 1.162-17(b)(1) provides that an employee need not report on his tax return expenses for travel, transportation, entertainment, and similar purposes paid or incurred by him solely for the benefit of his employer for which he is required to account and does account to his employer and which are charged directly or indirectly to the employer, or for which the employee is paid through advances, reimbursements, or otherwise, provided the total amount of the advances, reimbursements, and charges is equal to the expenses. Section 1.162-17(b)(4) requires an employee to submit an expense account or other required written statement

to the employer showing the business nature and the amount of all the employee's expenses.

Based on the facts as set forth above, the Plan satisfies the substantiation requirement of § 1.62-2(e). Under the Plan, expenses will be reimbursed only if they would be deductible by Technicians under § 162 or § 179, as applicable, and substantiated either under § 162 or § 274(d), as applicable. For all expenses, Technicians are required to submit a Claim Form along with a receipt, invoice, or other written confirmation of proof of purchase that provides sufficient information for Taxpayer to determine that the expense was incurred in connection with services performed for Taxpayer, specifically, the amount, the date, and the type of expense incurred. In addition, the Plan will only reimburse expenses incurred to purchase tools and equipment that are used only for business purposes on the work site and are kept on the work site at all times. This substantiation satisfies the requirements of § 162 and, for any computer or peripheral equipment subject to § 274(d), this substantiation satisfies those requirements as well. Furthermore, the Plan requires that expenses be substantiated within a reasonable period of time from the date the expense is incurred.

Return of Excess Requirement

Section 1.62-2(f) provides that, in general, an arrangement meets the requirement of returning amounts in excess of expenses 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. An arrangement will not meet the return of excess requirement if it fails to satisfy the substantiation requirement under § 1.62-2(e) since any amounts paid under the arrangement that are not substantiated are treated as excess and must be returned.

Under the facts set forth above, the Plan satisfies the return of excess requirement. The Plan will reimburse only properly substantiated expenses already incurred; it does not provide any allowances or cash advances for expenses. In addition, any reimbursement in error is required to be returned within a reasonable period of time.

Accordingly, we rule that the Plan satisfies the business connection, substantiation, and return of excess requirements of an accountable plan. Accordingly, all payments made under the Plan in accordance with the terms of the Plan will be excluded from the Technician's income and will not be wages subject to the withholding and payment of employment taxes.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code

provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by penalty of perjury statements executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Janine Cook
Branch Chief, Employment Tax Branch 1 (Exempt
Organizations/Employment Tax/Government
Entities)
(Tax Exempt & Government Entities)