

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200417022**

Release Date: 4/23/04

Index Number: 62.02-00, 62.02-02, 274.03-00, 274.08-00, 274.12-00

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC: TEGE: EOEG: ET1- PLR-123191-03

In Re:

Date:

January 06, 2004

Legend:

Taxpayer =

System =

Credit Card Company =

Dear _____ :

This responds to your request of January 29, 2003, for a private letter ruling that Taxpayer's travel and entertainment expense reimbursement reporting procedures satisfy the accountable plan requirements of § 62(c) and the substantiation requirements of § 274(d) of the Internal Revenue Code (the "Code").

FACTS

Taxpayer manufactures products for a wide range of clients who produce consumer goods. Approximately _____ percent of Taxpayer's employees incur business-related expenses for meals, travel, entertainment, and lodging. Taxpayer currently maintains a reimbursement arrangement under which it reimburses business-related travel and entertainment expenses incurred and properly substantiated by its employees; paper receipts and expense reports are required.

Taxpayer has arranged to have Credit Card Company issue business credit cards to each employee who is likely to incur travel and entertainment expenses for necessary business purposes. The business credit cards are issued in the name of individual employees who are personally liable to Credit Card Company for all charges billed to the card, including accrued interest and late payment fees. Employees who use the

business credit card receive monthly billing statements from Credit Card Company. Credit Card Company does not offer rebates or other incentives associated with the use of these business credit cards.

Taxpayer proposes to implement a program whereby its accounts payable department receives daily electronic downloads of employee charges directly from Credit Card Company using System. System stores the expense data under each employee's name on a web-based server. Employees have ten days from the download date to enter System, review the business expense charges, and identify the nature of the charges according to a list of expense codes provided by Taxpayer.

Once an employee codes the charges using System and the expense report is reviewed using automated audit procedures, it is routed to an appropriate supervisor. The supervisor has five days to approve reimbursement of the listed expenses. After supervisory approval, the expense report is sent to accounts payable for additional review and audit. When the audit process is complete, accounts payable reimburses the employee by releasing the appropriate funds directly to Credit Card Company.

Generally, paper receipts are not required under this program. However, paper receipts are still required for an expense the nature of which is unclear on its face, for lodging of any amount, and for expenses paid by means other than the business credit card for charges exceeding \$75. For receipts the nature of which is not clear on its face, such as a final bill from a hotel that does not list each charge separately (e.g., cost for meals, lodging, and telephone calls), Taxpayer requires employees to submit paper expense reports and any necessary paper receipts in addition to entering this data into System. Taxpayer also requires employees to submit detailed expense reports, supported by any necessary receipts, describing each element of such expenditure, within ten days of returning from a business trip or incurring an entertainment expense, but no later than 60 days after incurring or paying for the expense.

Taxpayer does not provide cash advances to its employees under this program. Taxpayer reimburses only properly substantiated business-related expenses approved from employee expense reports. Taxpayer does not reimburse personal expenses and treats reimbursements of nondeductible business expenses as wages.

Taxpayer will be responsible for the electronic storage of data for record retention purposes under the proposed reimbursement program. Taxpayer represents that its use and retention of electronic records will meet the requirements of Rev. Proc. 98-25, 1998-1 C.B. 689.

RULING REQUESTED

Taxpayer requests a ruling that the proposed travel and entertainment expense reimbursement reporting procedures satisfy the accountable plan requirements of § 62(c) and the substantiation requirements of § 274(d).

LAW

Section 62 generally defines “adjusted gross income” as income minus certain (“above-the-line”) deductions. Section 62(a)(2)(A) allows an employee an above-the-line deduction for expenses paid or incurred by the employee, in conjunction with services performed as an employee, under a reimbursement or other expense allowance agreement with the employer. Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if (1) such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or (2) such arrangement provides the employee with 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 for business expenses paid or incurred by an employee are paid under an accountable plan if the arrangement meets the three requirements of business connection, substantiation and returning amounts in excess of expenses as set forth in paragraphs (d), (e), and (f) respectively. If an arrangement meets these requirements, all amounts paid under an accountable plan are excluded from the employee’s gross income, are not required to be reported on the employee’s W-2, and are exempt from the withholding and payment of employment taxes. §§ 31.3121(a)-3, 31.3306(b)-2, 31.3401(a)-4 of the Employment Tax Regulations, and 1.6041-3(h)(1) of the Procedure and Administration Regulations.

Under § 1.62-2(c)(3), amounts failing to meet these requirements are treated as paid under a “nonaccountable plan.” Amounts paid under a nonaccountable plan are included in the employee’s gross income for the taxable year, must be reported to the employee on Form W-2, and are subject to withholding and payment of employment taxes. §§ 1.62-2(c)(5), 31.3121(a)-3(b)(2), 31.3306(b)-2(b)(2), 31.3401(a)-4(b)(2), and 1.6041-3(h)(1). Additionally, § 1.62-2(k) provides that if a payor’s reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments made under the arrangement will be treated as made under a nonaccountable plan.

An arrangement meets the business connection requirement of § 1.62-2(d) if it provides advances, allowances, or reimbursements only for business expenses that are allowable as deductions under §§ 161-198 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee. The reimbursement to the employee may include amounts charged directly or indirectly to the payor through credit card systems or otherwise. 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 bona fide business expenses related to the employer's business.

Section 1.62-2(e) of the regulations provides that the substantiation requirement is met if the arrangement requires each business expense to be submitted to the payor within a reasonable period of time. An arrangement that reimburses travel, entertainment or other deductible business expenses governed by § 274(d) of the Code meets this requirement if information sufficient to satisfy the substantiation requirements of §274(d) and the regulations thereunder is submitted to the payor.

Section 1.62-2(g) of the regulations establishes safe harbors for purposes of the "reasonable period of time" requirements and provides that 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.

Section 274(d) of the Code disallows a deduction under § 162 for any expense for travel away from home including meals and lodging or entertainment unless the taxpayer substantiates by adequate records, or by sufficient evidence the requisite elements of each expenditure. For example, when substantiating expenses for travel away from home, § 1.274-5T(b)(2) requires that the elements to be proved are the amount of each expense, and the time, place and business purpose of the travel. Furthermore, when substantiating entertainment expenses, § 1.274-5T(b)(3) requires that the elements to be proved are the amount of each expense, the time, place and business purpose of the entertainment, and the business relationship of the persons entertained.

Section 1.274-5T(c)(i) of the regulations provides that the taxpayer must substantiate each element by adequate records or by sufficient evidence corroborating his own statement. According to § 1.274-5T(c)(2), substantiation by adequate records requires the taxpayer to maintain 1) an account book, diary, log, statement of expense, trip sheets, or similar record and 2) documentary evidence, which in combination, are sufficient to establish each element of an expenditure.

The account book, diary, log, statement of expense, trip sheets, or similar record must be prepared or maintained in such manner that each recording of an element of an expenditure is made at or near the time of the expenditure. The phrase “made at or near the time of the expenditure” means the elements of an expenditure are recorded at a time when, in relation to making the expenditure, the taxpayer had full present knowledge of each element of the expenditure, such as the amount, time, place, and business purpose. An expense account statement which is a transcription of an account book, diary, log, statement of expense, trip sheets, or similar record prepared or maintained at or near the time of the expenditure, shall be considered a record prepared or maintained at or near the time of the expenditure if such expense account statement is submitted by an employee to his employer in the regular course of good business practice. See § 1.274-5T(c)(2)(ii).

Section 1.274-5(c)(2)(iii) of the regulations provides that documentary evidence is required for any expenditure for lodging while traveling away from home and for any other expenditure of \$75 or more (except for transportation charges if the documentary evidence is not readily available). Acceptable documentary evidence includes receipts, paid bills, or similar evidence sufficient to support an expenditure. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as lodging, meals and telephone. See §1.274-5(c)(2)(iii)(B).

For purposes of these employee substantiation requirements, “adequate accounting” is defined as the submission to the employer of information sufficient to meet the “adequate records” requirements. Section 1.274-5(f)(4) provides that, for purposes of an “adequate accounting,” the alternative method of substantiation provided in paragraph (c)(3) (allowing substantiation by the taxpayer’s own statement supported by corroborative evidence) is not permitted.

The third requirement of an accountable plan is satisfied if the arrangement requires the employee to return to the payor, within a reasonable period of time, any amount paid under the arrangement in excess of the substantiated expenses. See § 1.62-2(f). The determination of whether an arrangement requires an employee to return amounts in excess of substantiated expenses will depend on the facts and circumstances.

Recently, the Internal Revenue Service issued Rev. Rul. 2003-106, 2003-44 I.R.B. 936, to address whether an employer’s use of electronic receipts as part of its reimbursement arrangement for deductible travel and entertainment expenses is an accountable plan under § 62(a)(2)(A) and (c). Under the facts of the ruling, the

employer implemented an electronic reimbursement arrangement that eliminated the need for paper receipts and paper expense reports in most instances. The employer arranged to have a credit card company issue business credit cards to employees, and the employees were personally liable for all charges billed to the card. On a daily basis, the credit card company provided the employer with “electronic receipts” containing the date and amount of the charge, the merchant’s name and location, and, if available, an itemization from the merchant of the expenses included in the charge. Employees accessed their expense data in the electronic database to indicate whether the expenses were business or personal and provided a description of each expense, the business purpose it served, and, for entertainment expenses, the names and business relationship of the persons entertained in addition to the date of, place of, duration of, and participants in any business discussion that occurred directly before or after the entertainment. When all required substantiation elements were not available electronically, employees were required to provide substantiation via paper receipts and expense reports. Employees were required to submit expense reports with any necessary receipts to the employer within 30 days after returning from a business trip or incurring a travel or entertainment expense, but never later than 60 days after incurring or paying for the expense. The ruling explains that the arrangement meets all the accountable plan requirements, including substantiation under § 274(d) and § 1.62-2(e)(2), and holds that such an arrangement is an accountable plan.

ANALYSIS

Taxpayer’s proposed expense reimbursement reporting procedures provide reimbursements only for business expenses that are deductible under §§ 161-198 of the Code and treats reimbursements of nondeductible business expenses as wages. Business credit cards are provided only to employees who are likely to incur business expenses, and reimbursement for personal expenses is prohibited. Consequently, Taxpayer’s proposed travel and entertainment reimbursement procedures satisfy the business connection requirement of § 1.62-2(d).

Employees are required to submit detailed expense reports describing each element of an expenditure with any necessary receipts within ten days of returning from a business trip or incurring an entertainment expense but no later than 60 days after it is paid or incurred. This time period is within the safe harbor of 60 days set forth in § 1.62-2(g)(2)(i). Requiring employees to complete an expense report within ten days after returning from a business trip or incurring an entertainment expense but no later than 60 days from when the expense was paid or incurred satisfies the requirement under § 1.274-5T(c)(2)(ii)(A) that an individual have full present knowledge of each element of the expenditure such as the amount, time, place and business purpose of the expenditure.

The electronic receipts forwarded to Taxpayer directly from Credit Card Company in most instances will include information sufficient to establish the amount, date, place and essential character of the expenditure and, therefore, will also qualify as “receipts, paid bills, or similar evidence” for purposes of the documentary evidence requirements of § 1.274-5(c)(2)(iii). For any expense that exceeds \$75, for which an itemization is not available via electronic receipt, the nature of which is not clear on the face of the receipt and for all lodging expenses, Taxpayer requires a paper receipt from employees. In addition, Taxpayer requires paper receipts sufficient to support the respective expenditures for all business expense purchases not paid for with the credit card issued by Credit Card Company.

The documentary evidence submitted to Taxpayer, whether paper or electronic, is sufficient to support the respective expenditure. Consistent with § 1.274-5(f), the proposed reimbursement program relating to travel and entertainment expenses requires employees to make an “adequate accounting” to Taxpayer by submitting “adequate records” and, thus, satisfies the substantiation requirement of § 1.62-2(e).

The arrangement also meets the return of excess within a reasonable amount of time requirement of § 1.62-2(f). Taxpayer’s employees are required to return within 30 days any amount paid in excess of substantiated expenses. In addition, Taxpayer does not provide cash advances to its employees.

Taxpayer’s proposed reimbursement arrangement is similar to that of the taxpayer in Rev. Rul. 2003-106, 2003- 44 I.R.B., 936. Taxpayer implements an electronic reimbursement arrangement that eliminates the need for paper receipts and expense reports in most circumstances. Employees use a business credit card issued by Credit Card Company for travel and entertainment expenses, and employees are liable for all charges to Credit Card Company. Credit Card Company provides Taxpayer with electronic receipts on a daily basis. These receipts indicate the date, amount of the charge, merchant’s name and location and if available, an itemization of expenses included in the charge. Taxpayer’s employees are required to submit detailed expense reports describing each element of an expenditure within ten days of returning from a business trip or incurring an entertainment expense but no later than 60 days after it is incurred or paid. In cases when not all required substantiation elements are available electronically, employees are required to submit paper receipts and reports. Taxpayer reimburses only business-related expenses. Taxpayer does not reimburse personal expenses and treats reimbursements of nondeductible business expenses as wages. Taxpayer’s expense reimbursement procedures are consistent with the program described in Rev. Rul. 2003-106.

CONCLUSION

Taxpayer's proposed program for reimbursing employees for travel and entertainment expenses satisfies the business connection, substantiation, and return of excess requirements of § 1.62-2(c) and, thus, qualifies as an "accountable plan" under § 62(c).

Taxpayer's expense reporting procedures using either electronic or paper receipts satisfies both the adequate records and accounting requirements under §§ 1.274-5T(c)(2)(i) and 1.274-5T(f). Taxpayer's proposed program also satisfies the substantiation requirements of § 274(d). Therefore, the proposed reporting procedures for reimbursing employees for travel and entertainment expenses satisfy the substantiation requirements of § 1.62-2(e)(2).

The above conclusions regarding the proposed program is conditioned on the representation by the Taxpayer that its use and maintenance of electronic records will meet the requirements of Rev. Proc. 98-25.

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.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely Yours,

Joseph W. Spires
Acting Chief, Employment Tax, Branch 1
Office of Division Counsel/ Associate Chief
Counsel
(Tax Exempt and Government Entities)

Enclosures:
Copy of letter
Copy of letter for section 6110 purposes