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The Honorable Jim Jordan  
Member, U.S. House of Representatives  
24 West Third Street, Room 314  
Mansfield, OH 44902

Attention:

Dear Congressman Jordan:

This letter responds to your inquiry dated June 18, 2008, on behalf of your constituent, asked for clarification on the application of the accountable plan requirements to Employee Tool and Equipment Plans (Tool Plans).

Generally, amounts employers pay as reimbursements for employee business expenses are taxable unless treated as paid under an accountable plan. Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not reported as wages on the employee's Form W-2, and are exempt from withholding and payment of employment taxes.

The law treats a reimbursement or other expense allowance arrangement as an accountable plan if it meets the requirements of:

- Business connection
- Substantiation
- Return of excess

[Section 62(c) of the Internal Revenue Code (the Code) and section 1.62-2(c) of the Treasury Regulations (the Regulations)].

## Business Connection Requirement

An arrangement meets the business connection requirement if the employer pays advances, allowances, or reimbursements only for deductible business expenses that the employee pays or incurs while performing services for the employer. If, however, an employer pays an employee regardless of whether the employee incurs (or is reasonably expected to incur) bona fide business expenses, the arrangement does not satisfy the business connection requirement.

## Substantiation Requirement

To meet the substantiation requirement, an arrangement must require the employee to substantiate each business expense to the payor within a reasonable period of time. The employee must submit enough information to allow the employer to identify the specific nature of each expense and attribute the expense to the employer's business activity. Generally, the employee must submit an expense account or other written statement to the employer showing the business nature and amount of each of his or her expenses.

However, for an arrangement that reimburses expenses governed by section 274(d), the employee must submit to the payor information sufficient to satisfy those substantiation requirements of section 274(d) and the regulations. Section 274(d) applies to listed property under section 280F(d)(4). Most tools are not listed in section 280F(d)(4); the list is limited to items such as property used for transportation including automobile, computer or peripheral equipment as defined in section 168(i)(2)(B), and cellular telephone or similar telecommunications equipment. No deduction is allowed for an expense associated with listed property under section 274(d)(4) and the employee must treat any "reimbursement" of these expenses as wages subject to withholding and payment of employment taxes, unless the employee can adequately substantiate the:

- Amount of each expenditure
- Amount of each business or investment use of the listed property and its total use
- Date of the expenditure or use
- Business purpose for an expenditure or use of any listed property.

[Section 1.274-5T(b)(6) of the Code].

## Return of Excess Requirement

To meet the return of excess requirement, the employee must return to the employer within a reasonable period of time any amount the employer paid in excess of the employee's substantiated expenses.

Whether a tool expense reimbursement program complies with the accountable plan requirements depends on the facts of the program's operation. In 2000, we issued a Coordinated Issue Paper (CIP) for the motor vehicle industry that dealt specifically with tool reimbursements, and in 2005, we issued Revenue Ruling 2005-52 that addressed the tax consequences of a typical tool reimbursement plan under the applicable Treasury Department regulations. We recently revised the CIP to further discuss the application of the accountable plan rules and to reflect changes in tool reimbursement plans as we have seen them to date. The CIP is available on our website at [www.irs.gov](http://www.irs.gov). We believe the CIP will provide additional helpful information to about the application of the law to tool plans. It also lists the types of facts relevant to the determination of whether the plan complies with the requirements for accountable plans under section 62(c) and the regulations.

We are conducting examinations that focus on whether the use of tool plans in some cases has resulted in failure to pay appropriate amounts of federal income tax withholding and Federal Insurance Contributions Act tax. The IRS Office of Chief Counsel has released redacted legal advice on one of these examinations, giving taxpayers access to our legal reasoning.

I hope this information is helpful. Please contact me or \_\_\_\_\_ at ( ) \_\_\_\_\_ if you need further assistance.

Sincerely,

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