

IRS Nixes Meal Allowance Plan

The IRS recently ruled that meal allowances paid to a group of employees are taxable wages unless the employees are traveling away from home overnight. What's more, the fact that the meal allowances are paid to both overnight and nonovernight travelers taints the allowance arrangement for everybody, making the allowances taxable even for overnight travelers [Chief Counsel Advice 201246031].

Background. Under the tax rules, an employee who is not reimbursed by his or her employer may deduct ordinary and necessary expenses connected with a job, subject to certain restrictions. For example, an employee may deduct the cost of meals and lodging if he or she is away from home overnight on business.

If an employee is reimbursed by his or her employer for out-of-pocket business expenses, the reimbursement is free of income tax withholding and employment taxes and does not have to be reported on Form W-2 if the reimbursement arrangement qualifies as an "accountable plan." To qualify as an accountable plan, three requirements must be met:

1. **Business connection.** The plan must have a business connection by providing advances, allowances, or reimbursements for business expenses that (a) are incurred by an employee in connection with the performance of services for the employer, and (b) would be deductible

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by the employee had he or she not been reimbursed by the employer.

2. **Substantiation.** The plan must require the employee to substantiate reimbursed expenses within a reasonable time.
3. **Return of excess reimbursement.** The plan must require employees to return reimbursements in excess of substantiated expenses within a reasonable period of time.

If an employer arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) business expenses, the arrangement does not satisfy the business connection requirement. Instead, the arrangement is treated as a "nonaccountable plan." This means that all payments under the plan are taxed as regular wages and must be reported on Form W-2.

An employee who receives a per diem allowance for lodging and meals or meals only will automatically satisfy the substantiation requirement for his or her expenses as long as the allowance does not exceed the "federal rate." The federal rate is the per diem allowance provided federal employees when they travel for business purposes (see the October 21, 2012 issue).

The new IRS ruling involved the business connection requirement.

Here's What Happened

An airline provided its airplane crew members with a meal allowance. The allowance was a flat, hourly amount for each hour a crew member was on duty. The maximum allowance paid to crew members for any given day did not exceed the IRS-authorized maximums.

Under a union contract with crew members, the airline provided meal allowances to crew members if they reported to their airport duty stations for work. This meant that meal allowances were paid in three different situations: (1) to employees who reported for training at the duty location (nontravelers); (2) to employees who arrived at the duty location for flight duty but returned to the duty location in the same day (day travelers); and (3) to employees who arrived at the duty location for flight duty and had an overnight stay away from the duty location (overnight travelers).

What the IRS Said

First, the IRS said that the meal allowances paid to crew members who were nontravelers or day travelers did not meet the business connection requirement. As far as the tax law is concerned, the meals eaten by nontravelers and day travelers were personal meals because the crew members were not away from home overnight. So the crew members could not have deducted their expenses for these meals if they were not reimbursed. Only the meal allowances paid to crew members who were overnight travelers met the business connection test.

Next, the IRS ruled that the entire meal arrangement was a nonaccountable plan. The airline paid meal allowances to all crew members, including day travelers and nontravelers who the airline knew did not travel away from home overnight and who were not expected to incur deductible travel expenses. Therefore, since the airline paid the same allowances to crew members regardless of whether they incurred deductible expenses, all payments under the plan were taxable, including those going to the overnight travelers. ■