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Person to Contact:

Telephone Number:

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Date:

August 6, 2002

Legend

Taxpayer =

State X =

Credit Card Company =

proposed program =

Dear _____ :

This responds to your request of January 22, 2002, for a private letter ruling that the Taxpayer's travel and entertainment expense reimbursement reporting procedures satisfy the accountable plan requirements of section 62(c) and the substantiation requirements of section 274(d) of the Internal Revenue Code the ("Code").

FACTS

The Taxpayer is a corporation organized under the laws of State X. Its principal products include a variety of software and services. The Taxpayer's yearly expenditures on business travel and entertainment are significant.

The Taxpayer uses a business expense reimbursement program under which it reimburses employees for all reasonable and necessary expenses while traveling on authorized company business. Employees with a necessary business reason for incurring travel and entertainment expenses are provided a charge card from the Credit Card Company. Employees may pay for business travel and entertainment by using the credit card or, alternatively, they may pay with their own money. Employees may not use the card to obtain cash advances.

The Taxpayer allows on occasion temporary cash advances to employees to cover incidental business expenses. Typically, advances are done with manager approval for new employees or international employees who do not have credit cards. The dollar limit is \$2500 for domestic travel and \$5000 for international travel. Employees have 20 days upon completion of the trip to fully account for the advance by either (1) repaying the full amount, or (2) repaying any portion not used and submitting expense reimbursement requests validating the expenditures which account for the balance of the advance. If one of these requirements is not met within 45 days following the completion of the trip, the Taxpayer will deduct the amounts from the employee's paycheck.

Employees are required to document all travel-related business expenses on an approved expense report in order to be reimbursed. The employee completes and submits the expense report electronically, which generates a confirmation page. Employees are instructed to print the confirmation page, attach any necessary receipts, and obtain manager approval. After obtaining such approval, the employee is instructed to send his/her receipts to the Taxpayer. For all entertainment expenses, the employee is required to provide the names of individuals that were present, their titles and company name; the name and location of where the meal or event took place; the exact amount and date of the expense; and the specific business topic(s) discussed. Employees are also instructed in the travel policy to note the specific time the business discussion took place (*i.e.*, before, during or after the event).

Currently employees are required to submit paper receipts for all expenditures over \$75 with their expense reports within 30 days of a trip. With respect to hotel bills, the Taxpayer instructs employees to obtain a bill that not only itemizes all hotel expenses but is also marked "paid in full". The Taxpayer's travel policy specifically discourages the use of the express checkout feature that some hotels offer because of its failure to show that the bill has been paid. The Taxpayer advises employees that expense reports found to be missing receipts or with insufficient receipts attached may cause reimbursed amounts to be included in taxable income, or at the Taxpayer's discretion, withheld from future payments to the employee.

The Taxpayer proposes to implement a program whereby it will receive electronic receipts directly from the Credit Card Company for two types of expenses: 1) those that are clear on their face (*i.e.*, an airline ticket or car rental charge); or 2) if not clear on their face, those for which an itemized breakdown is available from the Credit Card Company. For these two types of expenses, the Taxpayer will not require its employees to submit paper receipts.

For any expenses over \$75 that are not clear on their face and for which an itemized breakdown is not available via electronic receipt, the Taxpayer will continue to require a paper receipt containing the proper level of detail. For example, an electronic hotel receipt that fails to break out lodging, meals, entertainment, green fees and spa charges would inadequately describe the expense and therefore a paper receipt that

contains the proper level of detail would be required. In addition, paper receipts will continue to be required for all expenses which are paid with the employee's own funds.

In addition, the Taxpayer also proposes to pay the Credit Card Company directly for all business expenses that the employees charge to the card. After receiving the expense data electronically from the Credit Card Company, the Taxpayer will transfer it into a system that can be accessed by the employees for purposes of creating expense reports. The data consists of: (1) the date of the charge; (2) the amount of the charge; (3) the merchant's name; and (4) the merchant's location. To create an expense report, the employee is required to add the following information: (1) the Company Cost Center from which the expense is paid; (2) the general ledger account number properly classifying the expense as travel and entertainment; (3) a description of the expense; and (4) an itemization of any expense in addition to lodging incurred at a hotel. Employees are also required to designate any expenses as personal. Once the expense report is completed and approved, the Taxpayer sends payment to the Credit Card Company for all business expenses listed on the report. The employee is required to send payment directly to the Credit Card Company for any personal charges.

Taxpayer represents that its use and retention of electronic records under both the current and proposed programs meet or will meet the requirements of *Rev. Proc. 98-25, 1998-1 C.B. 689*.

RULING REQUESTED

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

LAW

Section 62 generally defines "adjusted gross income" as gross 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 his or her performance of services as an employee, under a reimbursement or other expense allowance agreement with his or her employer. 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 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 regulations provides that reimbursements by an employer to an employee for business expenses paid or incurred by the employee are paid under an accountable plan if the reimbursement arrangement meets the three requirements of business connection, substantiation, and returning amounts in excess of expenses, set forth in paragraphs (d), (e), and (f), respectively. Under section 1.62-2(c)(3), amounts failing to meet these requirements are treated as not paid under an accountable plan.

An arrangement meets the business connection requirement of section 1.62-2(d) if it provides advances, allowances, or reimbursements only for business expenses that are allowable as deductions under sections 161 through 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 substantiated to the payor within a reasonable period of time. An arrangement that reimburses travel, entertainment or other deductible business expenses governed by section 274(d) of the Code meets this requirement if information sufficient to satisfy the substantiation requirements of section 274(d) and the regulations thereunder is submitted to the payor.

Section 274(d) disallows a deduction under section 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, section 1.274-5T(b)(2) of the temporary regulations 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, section 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) of the regulations provides that the taxpayer must substantiate each element by adequate records or by sufficient evidence corroborating his own statement. According to section 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 sheet, 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. An expense account statement which is a transcription of an account book, diary, log, 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 section 1.274-5T(c)(2)(ii) of the regulations.

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 section 1.274-5(c)(2)(iii)(B) of the regulations.

Section 1.274-5T(f) of the regulations provides rules for reporting and substantiating of certain expenses paid or incurred by employees in connection with the performance of services as employees. An employee need not report on his tax return business expenses for travel or entertainment paid or incurred by him solely for the benefit of his employer for which he is required to, and does, make an adequate accounting 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 that the total amount of such advances, reimbursements and charges is equal to such expenses.

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.

Under section 1.274-5T(f)(5), an employee who makes an adequate accounting to his employer will not again be required to substantiate such expense account information, unless (1) the employee claims a deduction for unreimbursed expenses; (2) the employee is a related employee within the meaning of section 267(b) of the Code; or (3) it is determined that the accounting procedures used by the employer for the reporting and substantiation of expenses by such employees are not adequate, or it cannot be determined that such procedures are adequate. This determination is made

by the Director of Field Operations by considering the facts and circumstances of each case, including the use of proper internal controls.

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 section 1.62-2(f) of the regulations. The determination of whether an arrangement requires an employee to return amounts in excess of substantiated expenses will depend on facts and circumstances.

Section 1.62-2(g) which establishes safe harbors for purposes of the "reasonable period of time" requirements, 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.

ANALYSIS

The Taxpayer's employee reimbursement reporting procedures, both the current and proposed programs, provide reimbursements only for business expenses that are deductible under sections 161 through 198. The charge cards are only provided to employees who are likely to incur business expenses, and reimbursement for personal expenses is prohibited. Consequently, Taxpayer's travel and entertainment reimbursement procedures, currently and as proposed satisfy the business connection requirement of section 1.62-2(d) of the regulations.

The Taxpayer's employees are required to submit detailed expense reports within 30 days of taking a trip or incurring an entertainment expense, describing each element of such expenditure. This time period is well within the safe harbor of 60 days set forth in section 1.62-2(g) of the regulations. Requiring employees to complete an expense report within 30 days after returning from a trip or incurring an entertainment expense satisfies the requirement under section 1.274-5T(c)(2)(ii) of the regulations 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.

Currently, employees are required to submit documentary evidence for all expenses over \$75. Under the Taxpayer's proposed program, the electronic receipts forwarded to the Taxpayer directly from the Credit Card Company for certain expenses 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 section 1.274-5(c)(2)(iii) of the regulations. For any expenses for which an itemized breakdown is not available via electronic receipt (and which are not clear on their face), the Taxpayer will continue to require a paper receipt from employees if the expenditure exceeds \$75. In addition, the Taxpayer will continue to require paper receipts sufficient to support the respective

expenditures for all out-of-pocket expenses.

Based on the representations made by the Taxpayer, all of the documentary evidence submitted to the Taxpayer, whether paper or electronic, is sufficient to support the respective expenditure. Therefore both the current and proposed programs relating to the reimbursement of travel and entertainment expenses require the employee to make an “adequate accounting” to the employer by submitting “adequate records” for all travel and entertainment expenses and, thus, satisfy the substantiation requirement of section 162-2(e). See also section 1.274-5T(f) of the regulations.

Under the Taxpayer’s current and proposed programs, the Taxpayer’s employees are not able to receive cash advances from their charge cards. The Taxpayer provides cash advances to employees only when the employee is unable to use a charge card such as new employees or international employees who do not have credit cards. Under both reimbursement programs, the Taxpayer’s employees are required to return to the payor within 20 days either (1) the full amount or (2) any amount paid in excess of the substantiated expenses. Thus, the arrangement meets the return of excess within a reasonable amount of time requirement of section 1.62-2(f).

CONCLUSIONS

The Taxpayer’s current and proposed programs for reimbursing their employees for their travel and entertainment expenses satisfy the business connection, substantiation, and return of excess requirements of section 1.62-2(c) of the regulations and, thus, qualify as an “accountable plan” under section 62(c) of the Code. The Taxpayer’s expense reporting with either electronic or paper receipts satisfies both the adequate records and accounting requirements under sections 1.274-5T(c)(2)(i) and 1.274-5T(f). Therefore, the reporting procedures for reimbursing employees for their travel and entertainment expenses satisfy the substantiation requirements of section 1.62-2(c) of the regulations.

The above conclusion regarding the proposed program is conditioned on the representation by the Taxpayer that its use and maintenance of electronic records meet the requirement 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.

Sincerely,

WILL E. MCLEOD
Chief, Employment Tax Branch 1
Division Counsel / Associate Chief Counsel
(Tax Exempt and Government Entities)