

INTERNAL REVENUE SERVICE

June 2, 2005

Number: **INFO 2005-0078**
Release Date: 6/30/05
CONEX 120655-05/CC:TEGE:EOEG:ET1
UIL 62.02-05

The Honorable Carl Levin
United States Senate
Washington, DC 20510

Attention: Evan Cash

Dear Senator Levin:

Thank you for your inquiry dated April 5, 2005, on behalf of your constituent, _____, who works in employee benefit consulting. He wrote that some of his customers require employees to provide their own tools and equipment on the job, and believes the IRS discourages "blue collar businesses" from using accountable plans to reimburse these expenses. He also asked for a copy of the draft accountable plan revenue ruling addressing employee tool and equipment expenses that we are preparing.

_____ is right that we are considering guidance in this area. On July 26, 2004, the Department of Treasury released the 2004-2005 Priority Guidance Plan (copy enclosed and available on our website at <http://www.irs.gov/pub/irs-utl/2004-2005pgp.pdf>). This plan contains 276 projects we intend to complete over a twelve-month period, from July 2004 through June 2005, and reflects the Department's commitment to increased and more timely published guidance. One of the 276 projects listed on the 2004-2005 Priority Guidance Plan does relate to the issue

_____ raised ("Revenue ruling on tool rental," page 4, Employee Benefits, section B, item number four). We added this ruling to our priority guidance plan because we recognize that it is a key issue in tax administration affecting both employers and employees. Our focus is to apply relevant tax law to the facts to promote a uniform application of the tax laws.

The accountable plan rules in section 62(a)(2)(A) of the Internal Revenue Code and section 1.62-2 of the Income Tax Regulations, apply equally to all employers and employees. Generally, an accountable plan allows for reimbursements to be excluded from an employee's gross income and exempt from the withholding and payment of income and employment taxes if the reimbursement arrangement meets the requirements of business connection (deductible business expense incurred as an employee of the employer), substantiation (the employee timely substantiated the

expense to the employer), and return of excess (the employee returned amounts in excess of substantiated expenses to the employer). If an arrangement does not satisfy one or more of these requirements, then the payments are considered paid under a nonaccountable plan, and the amounts are included in the employee's gross income and are subject to withholding and payment of income and employment taxes.

I assure you that we have no policy to discourage blue collar businesses from using accountable plans to reimburse expenses to employees. In fact, in Rev. Proc. 2004-41, 2002-1 C.B. 1098, we provided an optional expense substantiation rule applicable to certain employers and employees in the pipeline construction industry. Under this rule, if an eligible employer's arrangement to pay employee business expenses otherwise satisfies the business connection and return of excess requirements, an employee is deemed to have substantiated expenses of up to \$13.00 per hour, and all amounts paid under the arrangement are treated as paid under an accountable plan. Another example is Rev. Rul. 2004-1, 2004-4 I.R.B. 325, which clarifies when a mileage allowance for local transportation expenses, computed on a basis similar to that used in computing a courier's compensation, may be treated as paid under an accountable plan.

I am sorry, but I cannot provide a draft copy of the ruling, because, in fairness to all taxpayers, we do not share or debate the positions in our rulings before publication. When we publish a revenue ruling, it becomes binding on the IRS for all taxpayers who have the facts addressed in the ruling. One reason we publish the plan is to ensure that taxpayers know what issues we are working on so they can provide input before publication. By encouraging and carefully considering comments as we develop guidance, we create an opportunity for effective and fair input from all interested taxpayers. We appreciate and will consider comments and the issues he raised.

I hope this information is helpful. If you have further questions, please call me at (202) 622-6010 or of my staff at (202) 622-0047.

Sincerely,

Catherine E. Livingston
Assistant Chief Counsel
(Exempt Organizations/Employment Tax/
Government Entities)

Enclosure