



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

August 11, 2006

CONEX-128612-06
UILC: 62.02-02

Number: **INFO 2006-0065**
Release Date: 9/29/2006

The Honorable Richard J. Durbin
United States Senator

Attention:

Dear Senator Durbin:

I apologize for the delay in responding to your inquiry dated April 20, 2006, on behalf of your constituent, _____, and the _____ . _____ asked for guidance on the proper tax treatment of payments to volunteer firefighters as reimbursements for expenses. I hope the following general explanation of our regulations governing the treatment of amounts intended to reimburse expenses is helpful.

Whether a payment intended to reimburse an expense constitutes income and wages is controlled by whether the employer pays the reimbursement under an "accountable" plan (Section 62(c) of the Internal Revenue Code (the Code)). The "accountable" plan rules apply equally to volunteers as they do to paid employees if the employer has the right to direct and control the volunteer on how he or she performs the volunteer services.

An employer can exclude payments made under an "accountable" plan from an employee's gross income and not report them on the employee's Form W-2. These payments are exempt from employment taxes. However, if an employer makes payments under a "nonaccountable" plan, the employer must include them in the employee's gross income, and report them as wages or other compensation on the employee's Form W-2. These payments are subject to employment taxes (Section 1.62-2(c)(5) of the Treasury Department Regulations).

The law treats a reimbursement or other expense allowance arrangement as an accountable plan if it meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses (Section 62(c) of the Code and section 1.62-2(c) of the Regulations).

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 in connection with 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.

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. It is not enough for the employee to aggregate expenses into broad categories or report individual expenses using vague, non-descriptive terms such as "miscellaneous expenses."

We have optional, simplified methods, known as "deemed substantiation," for an employee to substantiate either the amount of his or her vehicle expenses when performing services for the employer (Revenue Procedure 2005-78), or the amount of his or her lodging and meal and incidental expenses incurred on business travel away from home (Revenue Procedure 2005-67). We explain these optional substantiation methods in Publication 15 (Circular E), Employer's Tax Guide (the relevant pages are enclosed). The "deemed substantiation" methods still require the employee to substantiate the time, purpose, and number of actual miles driven, or the time, location, and purpose of days traveled away from home.

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 (or deemed substantiated) expenses.

An employer may choose to reimburse employee expenses. However, if the expense reimbursement plan does not satisfy the requirements of an accountable plan, the reimbursements are includible in income and are subject to employment tax.

Again, I hope this information is helpful. If you have any questions, please call me or at () .

Sincerely,

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

Enclosure

cc: