Generous Employers May Spend More Due to Drop in IRS Standard Mileage Rates

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The Internal Revenue Service (IRS) has decreased mileage rates for business travel from 58.5 cents per mile (for the last six months of 2008) to 55 cents per mile for 2009. Employers should be aware that this decrease in mileage reimbursement rates could actually increase their employee business travel reimbursement costs. Employers who, by their generous nature, continue to reimburse employees for 2009 business travel at the 2008 rate of 58.5 cents per mile may create a problem for themselves, as these reimbursements will have occurred under, in accordance with IRS regulations, a nonaccountable expense reimbursement plan.

Accountable plans allow employers to reimburse employees, on a tax-free basis, for business expenses incurred while performing services in the ordinary course of business for their employers. Reimbursed expenses under such a plan are typically excluded from the employees' gross income and from statutory withholding requirements. Without such a plan, reimbursed expenses may be taxable to the employee. Herein lies the headache for employers who choose to reimburse under the old rates. In order for business travel mileage reimbursements to employees to occur under an accountable plan (and remain tax free to the employee) the reimbursement rate must not exceed the IRS-specified business standard mileage rate under IRS Reg. 1.62-2(h)(2)(B) (*i.e.*, 55 cents per mile for 2009). If business mileage reimbursement is made in excess of the IRS prescribed rate, the reimbursement will be deemed to be made under a nonaccountable plan.

To the extent reimbursements are made under nonaccountable plans, the excess of the reimbursement rate over the IRS-specified rate is taxable to the employee and reportable on the employee's Form W-2 and also subject to income and payroll tax withholding, which will increase employer payroll costs. In difficult economic times, the employee loyalty to be gained by an employer's generous reimbursement may not be worth the increased cost to the employer. It is likely to be a significant hassle for an employer to withhold income and FICA tax, as well as incur the added cost of the employer's share of FICA and FUTA tax on an additional 3.5 cents of reimbursement. Furthermore, this policy may result in additional bookkeeping complications, despite the fact that the expenses would continue to remain deductible business expenses to the employer.

However the employer chooses to operate, it may be imperative that adequate procedures are in place to prevent abuse or disallowance of deductions for travel, meals and entertainment, and to make clear-cut distinctions between accountable and nonaccountable plan expense reimbursements. There should be formal travel, meals and entertainment policies in place, and those policies should be acknowledged by all employees. The policy should be enforced, and any deviations from the policy should result either in lack of reimbursement or repayment of advances.

For Further Information

If you have any questions regarding this Alert, please do not hesitate to contact **Steven Packer**, CPA, of the Tax Accounting Group or the practitioner with whom you are regularly in contact.

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