Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Identifying Number:

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Refer Reply To:
CC:DOM:IT&A:2 – PLR-100146-00
Date: October 16, 2000

LEGEND:

Taxpayer =

B =

C =

Dear :

This responds to your request of December 22, 1999, for a private letter ruling that Taxpayer's business expense reimbursement program satisfies the substantiation requirements of § 274(d) and the accountable plan requirements of § 62(c) of the Internal Revenue Code.

FACTS

The facts are represented to be as follows. Taxpayer is a C that provides a diverse range of services and products. Taxpayer uses a business expense reimbursement program (the "Current Program") under which B provides a business charge card to Taxpayer's employees who are likely to incur business expenses. Each card is issued in the individual employee's name and may be used for business purposes only. The employee may charge business travel and entertainment expenses to the charge card, use the card to obtain cash advances at automatic teller machines to pay for business travel and entertainment expenses, or pay for such expenses with the employee's own funds. Employees who use the business charge card receive a monthly billing statement from B and are personally responsible for the charges billed as well as any late payment charges. If an employee has submitted an expense report to Taxpayer, Taxpayer will pay the charges for expenses (but not for late payment) to B directly.

Within a reasonable time after an employee incurs a business travel or entertainment expense the employee must submit an expense report to Taxpayer. The expense report must provide, in detail, information about the elements of each expenditure. For expenditures for travel the expense report must show the business purpose of the trip, the amount of each separate expenditure, the travel dates, and the travel locations. For expenditures for entertainment the expense report must show the business purpose of the entertainment (including the business activity conducted), the identity of the person or persons entertained sufficient to establish a business relationship with Taxpayer, the amount of each expenditure, and the date, place, and type of entertainment (if not apparent from the place of entertainment). If the entertainment immediately precedes or follows a business discussion, the expense report must also show the date, place, nature, and identify of the persons participating in, the business discussion.

An employee may enter an expense report on-line through a computer terminal or mail it to the processing location. The employee must also submit paper receipts for all expenditures of $75 or more and all expenditures for lodging. An employee who misrepresents the amount or nature of a business expense violates Taxpayer's business code of ethics and is subject to immediate dismissal.

Each expense report must be reviewed and approved for payment by the employee's manager. One of the manager's primary responsibilities is to ensure that the charges are appropriate for the work performed, are charged to the correct matter or department, and are consistent with Taxpayer's reimbursement guidelines.

After approval by the manager the expense report is reviewed by Taxpayer's expense reimbursement processing department, which verifies that the business purpose for and amount of each expense above a certain defined threshold is reasonable. If the business purpose is unclear or questionable the employee is notified and reimbursement is suspended. An expense amount that exceeds the lower of two defined thresholds is questioned and reimbursement is suspended if the amount exceeds the higher threshold.

If the employee's travel and entertainment expenses are supported by the expense report and receipts Taxpayer will pay B directly for expenses incurred with the charge card or cash advances used for these expenses, and will reimburse the employee for expenses paid from the employee's own funds. If cash advances or charges exceed substantiated expenses the employee alone is responsible to pay B for the excess.

After reimbursement, Taxpayer's internal audit department audits expense reports on a random basis or as the result of certain triggering factors. The random audits are conducted of a representative sampling of reports and on a statistically sound basis. The triggering factors include a large dollar amount (either on a single expense report or on multiple reports from the same employee), a past pattern of errors, or that the employee's department has exceeded its expense budget. If an audit determines that an expense is excessive the employee and/or the employee's manager is asked for additional information. If the auditors conclude that the expense is not justified the employee will be required to repay Taxpayer.

Taxpayer plans to modify its expense reimbursement system to obtain electronic receipts directly from B and to reduce employees' submission of paper receipts (the "Enhanced Program"). These electronic receipts will consist primarily of records of charges made to the employee's charge card with B, and will provide the name of the vendor and date, place and amount of the transaction. Certain receipts will include additional information such as expense type (ground travel, car rental, airfare, etc.), car rental agreement number, airline ticket number, and airline itinerary. Under the Enhanced Program employees will not be required to submit paper receipts to substantiate charges on their B charge card if (1) the nature of the charge is clear on its face (such as a car rental), or (2) the nature of the charge is not clear on its face (such as a non-itemized hotel charge) but the employee completes and submits an itemized breakdown of the expense on the expense report. Employees will continue to be required to submit paper receipts (for all expenses of $75 or more and all expenditures for lodging) if the expense does not meet one of the above criteria or if the expense was not charged to the B charge card. Taxpayer's employees will be required to obtain and retain for at least four years *all* paper receipts for expenses of $75 or more or for lodging (whether or not receipts were submitted electronically) that are not submitted with an expense report.

The audit program under the Enhanced Program will verify that the expenses reported by the employee without accompanying paper receipts conform to amounts reported to B by the vendors and is consistent with profile information (such as standard room rates) built into the computer program. If any item in an expense report exceeds these standards or if any expense item is not fully identified (i.e., is charged to the category "other") the reimbursement process will be suspended and the employee will be required to produce a receipt. In all other respects the Enhanced Program will be identical to the Current Program.

As a C, Taxpayer is subject to extensive government regulation. Taxpayer is required to operate a security program to identify employees who engage in fraudulent acts and to conduct regular audits of all aspects of its business. Taxpayer is also subject to government audits that include reviewing Taxpayer's fraud prevention activities.

Taxpayer's use and retention of electronic records under both the Current and Enhanced Programs meet or will meet the requirements of Rev. Proc. 98-25, 1998-11 I.R.B. 7.

RULING REQUESTED

Taxpayer requests a ruling that the Current Program and the Enhanced Program satisfy the substantiation requirements of § 274(d) and qualify as accountable plans under § 62(c).

LAW

Section 162(a) of the Internal Revenue Code permits deduction of ordinary and necessary business expenses, including expenses for entertainment and for traveling while away from home.

Section 274(d) disallows a deduction under § 162 for expenses for travel (including meals and lodging), entertainment, gifts, or listed property, unless the taxpayer substantiates by adequate records, or by other sufficient evidence corroborating the taxpayer's own statement, the amount, time, place, and business purpose of the expense, and business relationship of persons entertained.

Sections 1.274-5 and 1.274-5T together provide the regulations under this provision. Section 1.274-5T(c)(2)(i) requires that, to meet the "adequate records" requirements of § 274(d), a taxpayer must maintain an account book, diary, log, statement of expense, trip sheets, or other similar record, and documentary evidence, which in combination are sufficient to establish each element of an expenditure or use set forth in § 1.274-5T(b).

Section 1.274-5(c)(2)(iii) provides that documentary evidence, such as receipts, paid bills, or similar sufficient evidence, is required for (A) any expenditure for lodging and (B) any other expenditure of $75 or more, except that for transportation charges, documentary evidence will not be required if not readily available. The Commissioner may prescribe rules waiving the requirement to provide documentary evidence in circumstances in which the Commissioner determines it is impracticable.

Section 1.274-5(c)(2)(iii) further provides that, ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and essential character of the expenditure. For example, a hotel receipt is sufficient to support an expenditure for business travel if it contains the following information: name, location, date, and separate amounts for charges such as lodging, meals, and telephone. A restaurant receipt is sufficient to support an expenditure for a business meal if it includes the following: name and location of the restaurant, date and amount of the expenditure, number of people served, and, an indication that a charge was made for an item other than meals and beverages (if such was the case).

Section 1.274-5(f)(4) requires an employee to substantiate, or make an "adequate accounting" of, expenses to his employer by submitting to the employer records that satisfy the "adequate records" requirement of § 274(d) as defined in § 1.274-5(c)(2). However, § 1.274-5(f)(4)(ii) authorizes the Commissioner to prescribe rules under which an employee may substantiate his expenses to his employer by submitting an expense account alone, without submitting documentary evidence, if the procedures used by the employer for the reporting, substantiation, and reimbursement of expenses of employees include internal controls specified in the rules.

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 connection with his or her performance of services as an employee, under a reimbursement or other expense allowance arrangement 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) 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 requirements of business connection, substantiation, and returning amounts in excess of expenses. Under § 1.62-2(c)(3), amounts failing to meet these requirements are treated as paid under a non-accountable plan.

An arrangement meets the business connection requirement if it provides advances, allowances (including per diem allowances, allowances for meals and incidental expenses, and mileage allowances), or reimbursements 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. Section 1.62-2(d). The payment by an employer, its agent, or a third party of amounts charged by an employee directly or indirectly to the payor through a credit card system constitutes a reimbursement or other expense allowance arrangement provided that the employee is personally liable to the credit card issuer for such expenses.

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. Section 1.62-2(e)(2) provides that an employee who is reimbursed under an accountable plan for expenses covered by § 274(d) may satisfy the substantiation requirement of § 1.62-2(c)(1) by substantiating the expenses to his employer in accordance with § 274(d) and the regulations thereunder.

Section 1.62-2(f) provides that the requirement that amounts in excess of expenses must be returned to the payor is met 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 expenses substantiated.

ANALYSIS

Under both the Current and Enhanced Programs Taxpayer reimburses[1] employees only

[1] For convenience we will use the present tense in discussing both programs.

for expenses that meet the requirement of business purpose and requires employees to repay reimbursements that exceed proper expenditures. Accordingly the Programs satisfy two of the three requirements of § 62(c) and § 1.62-2(c)(1): business purpose and returning amounts in excess of expenses.

The Programs also require employees to submit expense reports and documentary evidence that conform to the substantiation requirements of § 274(d) and § 1.274-5T(c)(2) and (f)(4), except with respect to documentation of lodging expenses. Under the Enhanced Program employees are not required to submit documentary evidence of lodging expenses that itemizes the types of expenses included in the total charges, as specified in § 1.274-5T(c)(2)(iii). Rather, charges for lodging are substantiated by a charge card record that states a total amount charged by the lodging vendor. Only the employee's expense report specifies the types of charges included in the lodging bill.

In many situations, a credit card statement charge record may constitute sufficient documentary evidence of an expense. For example, the nature of an expense paid to a car rental company is ordinarily clear on its face. However, in the case of charges at lodging establishments, a credit card statement or charge record, unlike a hotel bill, normally will not segregate deductible lodging expenses from other business expenses that may not be deductible in full (such as meals and entertainment subject to the 50% partial deduction disallowance of § 274(n)) or from personal expenses (such as personal phone calls or gift purchases) that are not deductible business expenses. Therefore, a credit card statement or charge record alone generally will not constitute acceptable documentary evidence of the amount of a lodging expense.

Nonetheless, there may be circumstances when certain business expense reimbursement procedures contain sufficient safeguards to provide a high degree of certainty that only proper expenses will be reimbursed. In those cases the Commissioner's authority may be exercised under § 1.274-5(f)(4)(ii) by prescribing rules that relax the requirement that documentary evidence of a lodging expense, such as an itemized bill, must be submitted in all situations. For example, in Rev. Proc. 97-45, 1997-2 C.B. 499, we described procedures that federal government agencies can adopt under which an employee may adequately account for expenses of travel away from home without providing documentary evidence. Although Taxpayer's business expense reimbursement procedures are similar in many respects to the procedures specified in Rev. Proc. 97-45, there is currently no similar revenue procedure applicable to Taxpayer.

Accordingly, we hold that Taxpayer's Current Program for reimbursing employee business expenses satisfies the substantiation requirements of § 274(d) and qualifies as an accountable plan under § 62(c). However, Taxpayer's Enhanced Program does not satisfy the substantiation requirements of § 274(d) in that it does not require that employees submit documentary evidence of lodging expenses that itemizes the charges. Therefore, it does not qualify as an accountable plan under § 62(c).

Caveats:

A copy of this letter must be attached to any income tax return to which it is relevant. 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) provides that it may not be used or cited as precedent.

Sincerely,
Associate Chief Counsel
(Income Tax & Accounting)
By George Baker
Assistant to Branch Chief, Branch 2