

Contractors beware!!!! Are you making your employees car payments? Do you have a policy in place for mileage expense reimbursement to employees? Do you have signed employee agreements that document whether you have an accountable or non-accountable reimbursement plan? If you are unsure of these answers now, you may have to answer to the IRS.

Last year the IRS issued Revenue Ruling 2002-35. The revenue ruling re-states the Internal Revenue Code 62 (c), which defines the treatment of allowances or reimbursements to employees for use of their vehicles.

Employee reimbursement plans are either accountable or non-accountable. Under an accountable plan, the employer provides an expense allowance for the employee. At the end of the year, the employee must substantiate to the employer, with receipts showing, how the expense allowance was used. Any unused or un-substantiated allowance must either be returned or reported on the employee's W-2 as wages.

Under a non-accountable plan, the employee is given an expense allowance (i.e. car payment), and the allowance is added to the employee's wages. A non-accountable plan does not require the employee to substantiate, to the employer, how the allowance was used. Rather, the employee keeps the records and is entitled to a miscellaneous itemized deduction, to the extent that the aggregate of those deductions exceeds two percent of the adjusted gross income.

It is a fact that the IRS has re-stated its position due to the abuse and improper reporting of vehicle and expense allowances. To keep your business from being susceptible to an audit, potential penalties and interest for improper reporting of auto allowances, you will need to have a policy in place. If you choose an accountable plan, have your employee sign an agreement, obtain substantiated evidence of how the allowance was used and report any unused portion on the employee's W-2. Keep a log in the employee's file. If it is not an accountable plan, inform them that you will report the allowance on their W-2.

Don't let yourself get caught up with how your employees will feel for reporting the auto allowance on their W-2. Just think of how you will feel if the IRS asks you the questions about your auto allowances. Think of how you would feel if you did not properly account for the allowances correctly. Are your employees going to pay your taxes, penalties and interest for an audit change?

As we begin the new tax year, this would be a good time to review your auto allowance and expense reimbursement policies. Remember, to consult with your tax advisor regarding your specific situation.