



Tax Exempt & Government Entities

OFFICE OF FEDERAL, STATE
& LOCAL GOVERNMENTS

Fringe Benefit Guide



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Introduction

The Internal Revenue Service (IRS) created this publication to help government entities determine the correct tax treatment of employee fringe benefits, including using the appropriate withholding and reporting procedures.

This publication covers:

- How to determine whether specific types of benefits or compensation are taxable.
- Procedures for computing the taxable value of fringe benefits.
- Rules for withholding federal income, Social Security and Medicare taxes from taxable fringe benefits.
- Reporting of the taxable value of fringe benefits on Forms W-2, Wage and Tax Statement, and 1099-MISC, Miscellaneous Income.
- How to contact the IRS with questions on taxation and reporting requirements.

What Is a Fringe Benefit?

A fringe benefit is a form of pay (including property, services, cash or cash equivalent) in addition to stated pay for the performance of services. Under Internal Revenue Code (IRC) Section 61, all income is taxable unless an exclusion applies. Some forms of additional compensation are specifically designated as “fringe benefits” in the IRC; others, such as moving expenses or awards, are addressed by statutory provisions providing for special tax treatment but are not designated as fringe benefits by the IRC. This publication uses the term “fringe benefit” broadly to refer to all remuneration other than stated pay for which special tax treatment is available. The definition of fringe benefits for this purpose generally applies to services of independent contractors and employees; however, unless otherwise indicated, this guide applies to fringe benefits provided by an employer to an employee. (For a discussion of whether a worker is an employee or independent contractor, see [Publication 15-A, Employer's Supplemental Tax Guide](#).) Fringe benefits for employees are taxable wages unless specifically excluded by a section of the IRC. IRC Sections 61, 61(a)(1), 3121, 3401

More than one IRC section may apply to the same benefit. For example, education expenses up to \$5,250 may be excluded from tax under IRC Section 127. Amounts for additional education expenses exceeding \$5,250 may be excluded from tax under IRC Section 132(d).

A benefit an employer provides on behalf of an employee is taxable to the employee even if someone other than the employee, such as a spouse or a child, receives the benefit. Treasury Regulation (Treas. Reg.) Section 1.61-21(a)(4)

NOTICE

This publication provides basic information on the tax treatment of fringe benefits. It reflects the IRS interpretation of tax laws, regulations and court decisions. The explanations in the publication are for general guidance only and are not intended to provide a legal determination for a particular circumstance. The text includes citations to legal authority you can use to research an issue. You may also want to consult a tax advisor for your situation.

Types of Tax Treatment of Fringe Benefits

The IRC may provide that a fringe benefit is taxable, nontaxable, partially taxable or tax-deferred. These terms are defined below.

Taxable – Includible in gross income, not excluded under any IRC section. If the recipient is an employee, this amount is includible as wages and reported by the employer on Form W-2 and generally is subject to federal income tax withholding, Social Security and Medicare taxes. For example, bonuses are always taxable because they are income under Section 61 and no IRC section excludes them from taxation.

Fringe benefits that do not meet any statutory requirements for exclusion are fully taxable. Although there are special rules and elections for certain benefits, in general, employers report taxable fringe benefits as wages on Form W-2 for the year in which the employee received them. No tax reporting is required for benefits that meet the accountable plan rules. IRC Section 451(a); Announcement (Ann.) 85-113, 1985-31 I.R.B. 31

If an employee's wages are not normally subject to Social Security or Medicare taxes (for example, because the employee is covered by a qualifying public retirement system), these taxes would not apply to fringe benefits the employee received. However, the value of the benefits must still be reported for income tax withholding purposes.

Nontaxable (excludable) – Excluded from wages by a specific IRC section; for example, qualified health plan benefits are excludable under IRC Section 105.

Partially taxable – Part is excluded by an IRC section and part is taxable. Benefits may be excludable up to dollar limits, such as the public transportation subsidy under IRC Section 132.

Tax-deferred – Benefit is not taxable when received, but subject to tax later. For example, employer contributions to an employee's retirement plan may not be taxable when made but may be taxed when the employee receives a distribution.

General Valuation Rule

Generally, taxable fringe benefits are included in wages at their fair market value (FMV). FMV is the amount a willing buyer would pay an unrelated willing seller, neither one forced to conduct the transaction and both having reasonable knowledge of the facts. In many cases, the cost and FMV are the same; however, there are situations in which FMV and cost differ, such as when the cost an employer incurs to provide the benefit is less than the value of the benefit to the employee. Treas. Reg. Section 1.61-21(b)

The taxable amount of a benefit is reduced by any amount paid by or for the employee. For example, an employee has a taxable fringe benefit with a FMV of \$300. If the employee pays \$100 for the benefit, the taxable fringe benefit is \$200.

Special valuation rules apply for certain fringe benefits. These rules are covered in other sections of this publication.

IRC Sections Excluding Fringe Benefits

The following IRC Sections provide a statutory basis for specific benefits that may apply to public employees. Each of these IRC Sections is discussed later in the publication.

- 105 - Benefits received through employer health or accident insurance
- 106 - Health insurance premiums paid by employer
- 117(d) - Qualified tuition reductions
- 119 - Meals or lodging provided for the employer's convenience

- 125 - Cafeteria plans
- 127 - Educational assistance program
- 129 - Dependent care assistance program
- 132(b) - No-additional-cost service
- 132(c) - Qualified employee discounts
- 132(d) - Working condition fringe
- 132(e) - De minimis benefit
- 132(f) - Qualified transportation fringe
- 132(g) - Qualified moving expense reimbursements
- 132(j)(4) - On-premises athletic facilities
- 132(m) - Qualified retirement planning services
- 132(n) - Qualified military base realignment and closure fringe
- 137 - Adoption assistance programs

Reporting and Withholding on Fringe Benefits

In general, taxable fringe benefits are subject to withholding when they are made available. The employer may elect to treat taxable noncash fringe benefits as paid in a pay period, or on a quarterly, semiannual or annual basis, but no less frequently than annually. Ann. 85-113

Alternative Rule for Income Tax Withholding

The employer may elect to add taxable fringe benefits to employee regular wages and withhold on the total or may withhold on the benefit at the supplemental wage flat rate of 22% (for tax years beginning after 2017 and before 2026). Treas. Regs. 31.3402(g)-1 and 31.3501(a)-1T

Special Accounting Period

Under a special rule, benefits provided in November and December, or a shorter period in the last two months of the year, may be treated as paid in the following year. You may only treat the value of benefits provided during the last two months as paid in the subsequent year. You don't have to notify the IRS that you're using this special accounting rule. Ann. 85-113; Treas. Reg. 1.61-21(c)(7)

An employer may use this rule for some fringe benefits and not others. The special accounting period doesn't need to be the same for each fringe benefit. However, if an employer uses the special accounting period rule for a particular benefit, it must use the rule for all employees who receive that benefit.

Employer's Election not to Withhold Income Tax on Vehicle Use

In general, an employer does not have a choice whether to withhold on taxable fringe benefits. However, an employer may elect not to withhold income taxes on the employee's taxable use of an employer's vehicle that is includible in wages if the employer:

- Notifies the employee, and
- Includes the benefit in the employee's wages on Form W-2 and withholds Social Security and Medicare tax.

Note: This election is available only for employer-provided vehicles. IRC Section 3402(s)(1)

Nontaxable Benefits Provided Under an Accountable Plan

Under an accountable plan, allowances or reimbursements paid to employees for job-related expenses are excluded from wages and are not subject to withholding. An allowance or reimbursement policy (not necessarily a written plan) is considered an accountable plan if:

- There is a business connection to the expenditure.
- There is adequate accounting by the recipient within a reasonable period of time.
- Excess reimbursements or advances are returned within a reasonable period of time. IRC Section 62(c); Treas. Reg. Section 1.62-2(c)(2)

Business Connection

“Business connection” means the employee must have paid or incurred allowable business expenses while performing services as an employee. The reimbursement or advance must be payment for the expenses and must not be an amount that would have otherwise been paid to the employee as wages. Treas. Reg. Section 1.62-2(d)

Wage Recharacterization

Generally, wage recharacterization occurs when the employer structures compensation so that the employee receives the same or a substantially similar amount whether or not the employee has incurred deductible business expenses related to the employer’s business. If an employer reduces wages by a designated amount for expenses, but all employees receive the same amount as reimbursement, regardless of whether expenses are incurred or are expected to be incurred, this is wage recharacterization. If wage recharacterization is present, the accountable plan rules have not been met, even if the actual expenses are later substantiated. In this case, all amounts paid are taxable as wages. For more information, see [Revenue Ruling 2012-25](#).

Example: A government entity employs workers who occasionally incur expenses for travel. The employees receive the same total hourly compensation regardless of whether they incur travel expenses. When an employee incurs travel expenses, the employer will treat a portion of the hourly compensation paid to the employee as a nontaxable per diem allowance for travel expenses and treat the remainder as wages. If the employee doesn’t incur any travel expenses, the employee will receive the same total amount of hourly compensation, but the employer will instead treat the whole amount as wages. This is not an accountable plan because the amount of the reimbursements is not based on actual expenses incurred and substantiated. Treas. Reg. Section 1.62-2(d)(3)(i); Rev. Rul. 2012-25

Adequate Accounting

The employee must verify the date, time, place, amount and business purpose of expenses. Receipts are required unless the reimbursement is made using per diem rates (per diem rates are only available for certain expenses). Treas. Reg. 1.62-2(e), IRC Section 274(d) and Revenue Procedure (Rev. Proc.) 2011-47

Employees generally should have documentary evidence, such as bills, receipts, canceled checks or similar items to support their claimed expenses. This rule does not apply to:

- Meal or lodging expenses that you reimburse on a per diem basis (discussed later), at a rate at or below the allowable maximum, under an accountable plan.
- Individual expenditures (except for lodging) of less than \$75.
- Expenditures for transportation expense for which a receipt is not readily available. IRC Section 274(d)

Timely Return of Excess Reimbursements

The employee must return any excess reimbursement within a reasonable period of time. The determination of the length of a reasonable period of time will depend on the facts and circumstances. The regulations provide “safe harbors” for meeting the test of timeliness. Treas. Reg. 1.62-2(f)(1) and 1.62-2(g)

Nonaccountable Plan

A nonaccountable plan is an allowance or reimbursement program or policy that does not meet all three requirements for an accountable plan. Treas. Reg. Section 1.62-2(c)(3)

Payments, including advances, reimbursements, allowances and so on, made under a **nonaccountable** plan are taxable wages subject to all withholding when paid or constructively received by an employee. Treas. Reg. Section 1.62-2(c)(5)

Employers may have multiple expense allowance policies and may have both accountable and nonaccountable plans for different types of reimbursements. Employers may establish more restrictive conditions for the plan than imposed by the IRS accountable plan requirements. Employees cannot compel the employer to treat nonaccountable plan payments as if they were paid under an accountable plan. Treas. Reg. Section 1.62-2(c)(3)

Travel Advances

To prevent a financial hardship to employees traveling away from home on business, employers often provide advance payments to cover the costs incurred while traveling. Travel advances may be excludable from employee wages if they are paid under an accountable plan. (Allowable travel expenses are discussed in [Transportation Expenses](#)) There must be a reasonable timing relationship between when the advance is given to the employee, when the travel occurs and when it is substantiated. The advance must also be reasonably calculated not to exceed the estimated expenses the employee will incur. Treas. Reg. Section 1.62-2(f)(1)

Accountable Plan Advances

Travel advances made under an accountable plan are not treated as wages and are not subject to income and employment taxes when they're paid. The advances must be paid for travel expenses related to the employer's business, substantiated by the employee, and any excess returned in a reasonable period of time. Treas. Reg. Section 1.62-2(c)

If an employee does not substantiate expenses or timely return excess advances, the advance is includible in wages and subject to income and employment taxes no later than the first payroll period following the end of the reasonable period. Treas. Reg. Section 1.62-2(c)(3)(ii), (h)(2)

Nonaccountable Plan Advances

Advances from nonaccountable plans to the employee are subject to withholding when the advances are made to the employee. Treas. Reg. Section 1.62-2(h)(2)(ii)

When Advances are Included in Income

Advances become taxable, to the extent they are not substantiated by the employee, no later than the first payroll period following the end of the reasonable period of time. A reasonable period may end in the year after the advance was made. After the end of the calendar year, any amounts previously reported in wages cannot be reversed unless the amount was erroneously treated as wages at the time it was included. Treas. Reg. Section 1.62-2(h)(2)

Example: A small state agency pays a monthly mileage allowance of \$200 to certain employees. The agency does not require the employees to substantiate their expenses or return any excess. The mileage allowance does not meet the rules for an accountable plan and therefore is a nonaccountable plan. The \$200 allowances are taxable wages to the employees when paid to them; therefore, the employer should withhold Social Security, Medicare and income taxes, and pay employer shares of these taxes.

Example: An agency has an accountable plan that requires employees to account for their business mileage and return any excess allowance. Two of the employees account for their mileage but fail to return the excess. The mileage allowance meets the requirements of an accountable plan; however, because the excess allowance was not returned, the excess is wages to the two employees and is subject to withholding for income, Social Security and Medicare taxes. The withholding is required no later than the first payroll period following the end of the reasonable period.

Late Substantiation or Return of Excess

If an employee substantiates expenses and returns excess advances after the employer has treated amounts as wages, the employer is not required to return any withholding or treat amounts as nontaxable. Treas. Reg. Section 1.62-2(c)(3)

Safe Harbors for Substantiating Expenses and Excess Reimbursements

If an employer uses either the fixed date method or periodic statement method, the requirements of timely substantiation and return of excess advances/reimbursements will be considered met. Treas. Reg. Section 1.62-2(g)

Fixed Date Method

If the fixed date method is elected:

- The advance must be made within 30 days of when an expense is paid or incurred,
- The expense must be substantiated within 60 days after it is paid or incurred, and
- Any excess amount must be returned to the employer within 120 days after the expense is paid or incurred. Treas. Reg. Section 1.62-2(g)(2)(i)

Under this method, the maximum number of days for repayment of an advance is 150 (up to 30 days in advance plus 120 days maximum for settlement).

Periodic Statement Method

If this method is used, substantiation and the return of excess must be made within 120 days after the employer provides the employee with a periodic statement (at least quarterly) stating that any excess amounts must be returned. Treas. Reg. Section 1.62-2(g)(2)(ii)

Under this method, the maximum number of days for repayment of an advance is 210 (90 days for the calendar quarter plus 120 days maximum for settlement).

Other Reasonable Method

An arrangement that does not conform to one of the safe-harbor methods may still be considered timely if it is reasonable based on the facts and circumstances. Treas. Reg. Section 1.62-2(g)(1)

Example: An employee on an extended travel assignment might have a longer period to substantiate expenses and return any excess allowance than an employee on a brief overnight trip.

Form W-2 Reporting

Payments an employer made under an accountable plan may be excluded from the employee's gross income and are not reported on Form W-2. However, cash advances, allowances and reimbursements that do not fall under the accountable plan rules become wages subject to the reporting rules. If the employer pays a per diem or mileage allowance and the amount paid exceeds the amount the employee substantiated under IRS rules, you must report the excess as wages on Form W-2. The excess amount is subject to income tax withholding and Social Security and Medicare taxes. Report the amount substantiated (the nontaxable portion) in box 12 using code L. (See the Forms W-2 and W-3 [Instructions](#).)

Note: This chart refers to the 2019 Form W-2. If you are considering another year, check the instructions for that year. The box numbers and codes are subject to change.

Type of Reimbursement Employer W-2 Reporting*	
Under an Accountable Plan	
Actual expense reimbursement: Excess returned	No amount reported.
Actual expense reimbursement: Excess not returned	The excess amount is reported as wages in boxes 1, 3 and 5. Taxes withheld are reported in boxes 2, 4 and 6.
Per diem or mileage allowance up to the federal rate: Excess returned	No amount reported.
Per diem or mileage allowance up to the federal rate: Excess not returned	The excess amount is reported as wages in boxes 1, 3 and 5. Taxes withheld are reported in boxes 2, 4 and 6. The allowance up to the federal rate is treated as substantiated and reported only in box 12, Code L - it is not reported in boxes 1, 3 and 5.
Per diem or mileage allowance exceeds the federal rate: Excess reimbursement over federal rate not returned	The excess amount is reported as wages in boxes 1, 3 and 5. Taxes withheld are reported in boxes 2, 4 and 6. The allowance amount up to the federal rate is reported only in box 12, Code L - it is not reported in boxes 1, 3 and 5.
Under a Nonaccountable Plan	
Either adequate accounting or return of excess, or both, not required by plan	The entire amount reported as wages in boxes 1, 3 and 5. Taxes withheld are reported in boxes 2, 4 and 6.
No Reimbursement Plan	The entire amount reported as wages in boxes 1, 3 and 5. Taxes withheld are reported in boxes 2, 4 and 6.

Working Condition Fringe Benefits

Working condition fringe benefits include property or services that, if the employee had paid for the property or service, the cost would have been allowable as a business expense deduction to the employee. That is, if the cost of an item is an allowable business expense deduction for the employee, it may be excludable from the employee's wages as a working condition fringe benefit if provided by the employer. IRC Section 132(d)

If the Internal Revenue Code provides an exclusion from income for a specific benefit, the rules regarding working condition fringe benefits under Section 132 do not apply to that benefit. Treas. Reg. Section 1.132-1(f)(1)

General Rules for Working Condition Fringe Benefits

To be excludable as a working condition fringe benefit, all the following must apply:

- The benefit must relate to the employer's business,
- The expense would have been an allowable business expense deduction to the employee if the expense had been paid personally, and
- The business use must be substantiated with records.

Any expense that meets these tests can be a working condition fringe benefit. It is not necessary that a specific statute addresses that type of expense.

Definition of Employee

All the following are considered employees for purposes of working condition fringe benefits:

- Current employees
- Partners
- Board of directors of the employer
- Independent contractors

Treas. Reg. Section 1.132-1(b)(2)

Although not employees for most employment tax purposes, independent contractors are treated as employees for this purpose and are, therefore, eligible to receive nontaxable reimbursements as working condition fringe benefits. Taxable fringe benefits for independent contractors are generally reported on Form 1099-MISC.

Cash payments or cash equivalents are not working condition fringe benefits; however, they may be excludable if they represent reimbursements paid under an accountable plan.

De Minimis Fringe Benefits

De minimis fringe benefits include any property or service, provided by an employer for an employee, the value of which is so small in relation to the frequency with which it is provided, that accounting for it is unreasonable or administratively impracticable. The value of the benefit is determined by the frequency it's provided to each employee, or, if this is not administratively practical, by the frequency provided by the employer to the workforce as a whole. IRC Section 132(e); Treas. Reg. Section 1.132-6(b)

Example: An employer provides an employee daily taxi fare valued at \$5 for travel to and from work (and the taxi isn't provided for safety reasons). Although small in amount, the benefit is provided on a regular basis and is, therefore, taxable as wages.

Example: An employer provides a meal daily to one employee, but not to any other employee. The benefit is “frequent” for that employee and is, therefore, not de minimis even though the benefit may be “infrequent” with respect to the entire workforce. Treas. Reg. Section 1.132-6(b)(2)

The law does not specify a value threshold for benefits to qualify as de minimis. The determination will always depend on facts and circumstances. The IRS has given advice at least once, in 2001, that a benefit valued at \$100 did not qualify as de minimis. However, this technical advice addresses a specific situation and cannot be relied upon in addressing another specific situation. Chief Counsel Advice 200108042

Definition of Employee for De Minimis Fringe Benefits

Any individual receiving a de minimis fringe benefit is treated as an employee for purposes of applying these rules. Treas. Reg. Section 1.132-1(b)(4)

Examples of Excludable De Minimis Fringe Benefits

All the following may be excludable de minimis fringe benefits if they are occasional or infrequent, **not routine**:

- Personal use of photocopier (no more than 15% of total use)
- Group meals, employee picnics
- Theater or sporting event tickets
- Occasional coffee, doughnuts or soft drinks
- Flowers or fruit for special circumstances
- Local telephone calls
- Traditional birthday or holiday gifts (not cash) with a low FMV
- Commuting use of employer’s car if no more than once per month
- Employer-provided local transportation
- Personal use of cell phone provided by employer primarily for a business purpose

Treas. Reg. Section 1.132-6(e)(1); Notice 2011-72

Special rules apply to occasional meals and local transportation.

Benefits That Do Not Qualify as De Minimis

Common examples of benefits that do not qualify as de minimis:

- Cash - except for infrequent meal money to allow overtime work
- Cash equivalent (for example, savings bond, gift certificate)
- Certain transportation passes or costs
- Use of employer’s apartment, vacation home, boat
- Commuting use of employer’s vehicle more than once a month
- Membership in a country club or athletic facility

Private Letter Ruling (PLR) 200437030; Treas. Reg. Section 1.132-6(e)(2)

Some of these benefits may be excludable under other provisions of the law. For example, the use of athletic facilities on the premises of the employer by current or former employees, or their family members, may be excludable from wages under section IRC Section 132(j)(4). See

[Publication 15-B, Employer’s Tax Guide to Fringe Benefits.](#)

De Minimis Exclusion for Occasional Meal Reimbursements

Regularly provided meal money does not qualify for the exclusion for employer provided de minimis fringe benefits. Occasional meal money can meet an exception and be excludable if three conditions are met:

- 1. Occasional basis** - Meal is reasonable in value and is not provided regularly or frequently.
- 2. Provided for overtime work** - Overtime work necessitates an extension of the employee's normal work schedule.
- 3. Enables overtime work** - Provided to enable the employee to work overtime.

Meals provided on the employer's premises that are consumed during the overtime period, or meal money expended for meals consumed during that period satisfy this condition. Treas. Reg. Section 1.132-6(d)(2)

If meal reimbursements are provided as part of a company policy or union contract, they are not excludable as de minimis benefits because the benefit is required and is not occasional. The employer would normally have the opportunity to set up the administrative procedures for reporting the benefit, so accounting for it does not meet the "administratively impracticable" standard for de minimis benefits.

Meal money calculated based on number of hours worked (for example, \$5 per hour for each hour worked over 8 hours) is never excludable as a de minimis fringe benefit. Treas. Reg. Section 1.132-6(d)(2)(i)

Example: A commuter ferry breaks down and engineers are required to work overtime to make repairs. After working 8 hours, the engineers break for dinner because they will be working for an additional 3 hours. The supervisor gives each employee \$10 for a meal. The meal is not taxable to the engineers because it was provided to permit them to work overtime in a situation that is not routine.

Example: An employer has a policy of reimbursing employees for breakfast or dinner when they are required to work an extra hour before or after their normal work schedule. The reimbursements are taxable because the employer has a policy that indicates the benefit is provided routinely. In addition, the meal reimbursement does not enable the employee to work overtime but is an incentive to do so.

Note: Meals provided by the employer on the business premises and for the convenience of the employer may be excludable under IRC Section 119. See [Meals and Lodging](#).

De Minimis Transportation Benefits

Local commuting transportation fare an employer provides to an employee on an occasional basis and to enable the employee to work overtime may be excluded as a de minimis fringe benefit. Whether the transportation provided is "occasional" depends on the frequency it's provided to the employee. Overtime work must be an extension of the employee's normal work schedule. Treas. Reg. Section 1.132-6(d)(2)(i)

Special Valuation Rule for Unusual Circumstances and Unsafe Conditions

Local transportation for commuting an employer provides to an employee because of unusual circumstances and unsafe conditions is taxable to the employee as wages at a rate of \$1.50 each way; any additional value is excludable. Treas. Reg. Section 1.132-6(d)(2)(iii)(A)

Determining if “unusual circumstances” exist with respect to the employee receiving the transportation is based on all facts and circumstances. Treas. Reg. Section 1.132-6(d)(2)(iii)(B)

Example: Unusual circumstances include an employee temporarily working outside their normal work hours or an employee temporarily making a shift change.

“Unsafe conditions” is determined by a history of crime in the geographic area surrounding the employee’s workplace or residence and the time of day during which the employee must commute. Treas. Reg. Section 1.132-6(d)(2)(iii)(C)

Special Valuation Rule for Commuting – Unsafe Conditions

Under a special rule, transportation provided for commuting (occasionally or regularly) to a qualified employee solely because of unsafe conditions, may be valued and included in wages at \$1.50 per trip, with the remainder excludable. For this purpose, “unsafe conditions” exist if a reasonable person would, under the facts and circumstances, consider it unsafe for the employee to walk to or from home, or to walk or use public transportation at the time of day the employee must commute. Treas. Reg. Section 1.61-21(k)

A “qualified employee” for this purpose is one who:

- Performs services during the year;
- Is paid on an hourly basis;
- Is not exempt under the Fair Labor Standards Act (FLSA) of 1938;
- Is within a classification to which the employer actually pays, or has specified in writing that it will pay, overtime pay of at least 1 ½ times the regular rate provided in FLSA Section 207; and
- Received pay of not more than a specified dollar amount for the year (\$130,000 for 2020

Treas. Reg. Section 1.61-21(k)(6)

To use this rule, the following conditions must be met:

- The employee would ordinarily walk or use public transportation for commuting;
- A written policy is in place under which transportation is not provided for personal purposes other than commuting because of unsafe conditions; and
- The employee does not use the transportation for personal purposes other than commuting because of unsafe conditions. Treas. Reg. Section 1.61-21(k)(1)

Example: Alison is a qualified employee under the requirements for the commuting valuation rule and works as a data-entry clerk for the state revenue department. Her normal hours of work are 11 p.m. to 7 a.m. Public transportation, the only means of transportation available to her, is considered unsafe by a reasonable person at the time she is required to commute from home to her workplace. The employer hires a car service to pick her up at her home each evening to transport her to work and to return her to home each morning when she finishes her shift. The amount includible in Alison’s income is \$1.50 for the one-way commute from home to work each evening, because public transportation is considered unsafe at that time of day. However, the fair market value of the commute from work to home each morning is includible in Alison’s income, because unsafe conditions do not exist for this trip.

This benefit is not available to individuals considered control employees.

No-Additional-Cost Services

A service provided to employees that does not impose any substantial additional cost on the employer may be excludable as a no-additional-cost fringe benefit. A “no-additional-cost service” is a service the employer offers to its customers in the ordinary course of the line of business in which the employee performs substantial services, and the employer incurs no substantial additional cost (including foregone revenue) in providing the service to the employee. IRC Section 132(b)

No-additional-cost services occur frequently in industries with excess capacity services. Examples include transportation tickets, hotel rooms, entertainment facilities and so on; they may also occur with governmental facilities (for example, a municipal golf course or recreation center). Treas. Reg. Section 1.132-2(a)(2)

To determine whether the employer incurs any substantial additional cost, include lost or foregone revenue as a cost. An employer is considered to incur substantial additional costs if the employer or employees spend a substantial amount of time in providing the service to the employee receiving the service, even if their time spent would otherwise be idle or if the service is provided outside normal business hours. Determine whether an employer incurs substantial additional cost without regard to any amounts paid by the employee for the service. Treas. Reg. Section 1.132-2(a)(5)

Employee

For purposes of this exclusion, an “employee” may be a current employee; a former employee who retired or left on disability; a widow or widower of an individual who died while an employee, or who retired or left on disability; or certain leased employees. Treas. Reg. Section 1.132-1(b)(1)

Reciprocal Agreements

A no-additional-cost service provided to your employee by an unrelated employer (for example, another government entity) may qualify as a no-additional-cost service if all the following apply:

- You and the employer providing the service have a written reciprocal agreement under which a group of employees of each employer, all of whom perform substantial services in the same line of business, may receive no-additional-cost services from the other employer.
- The service is the same type of service generally provided to customers in both the line of business in which the employee works and the line of business in which the service is provided.
- Neither you nor the other employer incur any substantial cost either in providing the service or because of the written agreement. Treas. Reg. Section 1.132-2(b)

Highly Compensated Employees

No-additional-cost benefits made available only to highly compensated employees are not excludable. Treas. Reg. Section 1.132-8

For more information on no-additional-cost benefits and restrictions that apply to them, see [Publication 15-B](#).

Qualified Employee Discounts

An employee discount allows employees to obtain property or services from their employer at a price below that available to the general public. When these amenities are offered to the public for a fee and the same amenities are offered to an employee at a reduced price, the benefit may be taxable to the employee. However, the benefit is excludable if it meets the requirements of a qualified employee discount.

For the benefit to be excludable, the property or service must be offered to the public in the ordinary course of business.

An employee, for this purpose, includes individuals that qualify for no-additional-cost fringe benefits.

An excludable “qualified employee discount” generally cannot exceed:

- For merchandise or other property, the employer’s gross profit percentage times the price charged to the public for the property. IRC Section 132(c)(1)(A)
- For services, no more than 20% of the price charged to the general public for the service. For this purpose, the price charged to the general public at the time of the employee’s purchase is controlling. IRC Section 132(c)(1)(B); Treas. Reg. Section 1.132-3(b)(2)(iii)

The exclusion for a qualified employee discount applies whether the property or service is provided at no charge (in which case, only a portion will be excludable as a qualified employee discount) or at a reduced price. The exclusion also applies if the benefit is provided through a partial or total cash rebate of an amount paid for the property or service. Treas. Reg. Section 1.132-3(a)(4)

The exclusion is not available for discounts on real property or personal property of a kind commonly held for investment. Treas. Reg. Section 1.132-3(a)(2)(ii)

Unlike no-additional-cost services, the exclusion for a qualified employee discount does not apply to property or services provided by another employer under a reciprocal agreement. Treas. Reg. Section 1.132-3(a)(3)

You cannot exclude from the wages of a highly compensated employee any part of the value of a discount that is not available on the same terms to all your employees, or a group of employees defined under a reasonable classification that does not favor highly compensated employees. Treas. Reg. Section 1.132-3(a)(6)

For more information on qualified employee discounts, see [Publication 15-B](#).

Qualified Transportation Fringe Benefits

The Tax Cuts and Jobs Act, Section 11047, suspends the exclusion of qualified bicycle commuting reimbursements from your employee’s income for any tax year beginning after December 31, 2017, and before January 1, 2026.

This section discusses rules that apply to benefits provided to an employee for the employee’s personal transportation for commuting to and from work. IRC Section 132(f)(1); Treas. Reg. Section 1.132-9(b)

Qualified Transportation Fringe (QTF) benefits include:

- Commuter transportation in a commuter highway vehicle
- Transit passes
- Qualified parking

- Qualified bicycle commuting reimbursements (not an exclusion for tax years beginning after December 31, 2017, and before January 1, 2026)

Employers may provide an employee with any one or more of these benefits at the same time. Employer-provided QTFs with FMV that does not exceed monthly excludable limits, set annually, are:

- Exempt from withholding and payment of employment taxes,
- Not reported as taxable wages on the employee's Form W -2, and
- Not included in gross income.

The exclusion from income for this benefit applies only to employees; former employees and independent contractors are not eligible to receive this benefit. IRC Section 132(f)(5); Notice 94-3; Treasury Decision 8933; Treas. Reg. Section 1.132-9(b)

Valuation

Generally, transportation benefits, under the general rule for fringe benefits, are valued at FMV; exceptions are noted where applicable.

Cash Reimbursements for Transportation Expenses

Cash reimbursements for qualified transportation expenses can be excludable if the employer establishes a bona fide reimbursement plan (but see special rule for transit passes). This means there must be reasonable procedures to verify reimbursements and the employees must substantiate the expenses. IRC Section 132(f)(3)

Cash Advances

Cash advances for transportation benefits are not considered reimbursements and are treated as taxable wages. Treas. Reg. Section 1.132-9(b) Q-16

Nondiscrimination Rules

Nondiscrimination rules that apply to other benefits do not apply to QTFs – these benefits are exempt even if provided exclusively to highly compensated employees. Treas. Reg. Section 1.132-8

Dollar Limitations

The exclusion is available whether an employer provides only one, or a combination, of these benefits to employees. The total benefits cannot exceed the statutory dollar limitations, or the excess is taxable as wages to the employee. The benefit may also be offered in the form of a pre-tax payroll deduction for employees. See “Salary Reduction Agreements” below. IRC Section 132(f)(4)

For 2020, the maximum nontaxable value per person is limited to:

- \$270 per month for combined commuter highway vehicle transportation and transit passes.
- \$270 per month for qualified parking.

IRC Section 132(f)(2) (annual limits can change each year due to cost of living adjustments; see [Publication 15-B](#) for annual limits).

Salary Reduction Agreements

A salary reduction agreement is a way to provide QTF benefits pre-tax to employees, without additional cost to the employer. An employee can choose between receiving a fixed amount of taxable cash or QTF for a specified future period. A QTF salary reduction plan need not be in

writing; but the election by the employee must be in writing or another permanent form, such as electronically. IRC Section 132(f)(4); Treas. Reg. Section 1.132-9 Q&A 11-15

Note: QTFs are prohibited benefits under cafeteria plan rules. You cannot include these benefits as part of a cafeteria plan. IRC Section 125

The election under a salary reduction agreement must contain the:

- Date of the election
- Amount of compensation to be reduced
- Period for which the election is valid

The salary reduction may not exceed the statutory monthly dollar limits for QTFs.

This election may not be revoked after the employee is able to receive the cash or after the beginning of the period for which the QTF is to be provided. Any unused QTF may not be refunded. However, the unused portion may be carried over to subsequent periods and used to provide QTFs if the amount expended does not exceed annual limits.

Negative Election

An employer may allow for an employee to make a negative election to decline participation in a salary reduction plan, if the employee receives adequate notice that a salary reduction will be made and is given adequate opportunity to choose to receive cash compensation instead of the QTF. A negative election means that no response is treated as a “Yes” vote; that is, the employee is presumed to want the QTF and does not choose the cash. Treas. Reg. Section 1.132-9(b) Q-12

Example: Agency Y maintains a QTF benefit arrangement. Y’s employees are paid twice per month, on the 10th and 25th day of the month. Employee Q elects, before the first day of the month, to reduce his compensation in return for QTFs totaling \$200 per month through the year (for qualified parking). Because the election was made before he could receive the cash and the election is for a specific period, the arrangement satisfies the requirements for a valid salary reduction.

Example: In the above example, if employee Q revoked his election on the 10th of the month, it would be effective for the second pay period, since the revocation cannot be effective during a current pay period. It must be for a future period.

Effect on Deferred Compensation Plans

Employees participating in a deferred compensation plan are limited to a percentage of their compensation that they may contribute annually. In computing what is considered compensation for purposes of the limitation, an employer may exclude certain fringe benefits, including QTFs. IRC 314(e); IRC 403(b)(3); IRC 414(s)(2)&(3); IRC 415(c)(3); IRC 125

Transportation in a Commuter Highway Vehicle

To exclude the value of transportation in a commuter highway vehicle, the following must apply to the vehicle:

- It is provided by an employer, or by a third party for the employer;
- It is used for travel between an employee residence (or parking lot) and the workplace;
- It has seating capacity for at least six adults (excluding the driver);
- Half of the seating capacity (excluding the driver) is occupied by employees; and
- The employer must reasonably expect that at least 80% of the mileage is used for transporting employees between residences, the workplace or parking area.

IRC Section 132(f)(5)(B); Treas. Reg. Section 1.132-9(b)

Commuter transportation may include vanpools, and the vehicles may be owned and operated by transit authorities or employees.

Valuation

Automobile lease valuation, vehicle cents-per-mile rule, or commuting valuation rules (discussed in [Equipment and Allowances](#)) may be used in lieu of FMV. If one of these methods is used, the employer must use the same valuation rule to value the use of the commuter vehicle by each employee who shares the use. Treas. Reg. Section 1.132-9(b), Q&A-21, and 1.61-21(d), (e) & (f)

Substantiation Requirements

Only cash reimbursements by employers for use of a commuter vehicle need to be substantiated with actual proof of the commuter vehicle use by the employee. Treas. Reg. Section 1.132-9(b) Q&A 16(c)

Transit Passes

A transit pass is any pass, token, fare card, voucher or similar item (including an item exchangeable for fare media) entitling a person to transportation. The pass must be used for transportation on a public or privately-owned mass transit system, or on transportation provided by a person in the business of transporting people in a vehicle, seating at least six adults, excluding the driver.

Valuation

For transit passes sold at a discount, the discounted price rather than the face amount of the transit pass can be used to figure the exclusion if the discount is available to the general public. Treas. Reg. Section 1.132-9(b) Q&A 9

Example: 10 tickets cost \$17.50 if purchased separately, but a packet of 10 tickets is available to the public for \$15, or \$1.50 each. Only \$15 counts against the annual maximum exclusion.

Example: Each month during 2020, the state health department distributes transit passes with a face amount of \$300 to all employees. These same passes can be purchased from the transit system by any individual for \$250. Because the value does not exceed the statutory monthly limit of \$270 for 2020, no portion of the transit pass is includible as compensation.

Substantiation Requirements

If the employer distributes the transit passes, there are no substantiation requirements. Treas. Reg. Section 1.132-9(b) Q&A 18

Cash Reimbursements - Special Rule

Cash reimbursements for transit passes are nontaxable only if no voucher or similar item is readily available for direct distribution to employees. A voucher is readily available for direct distribution only if an employee can obtain it from a voucher provider that does not impose fare media charges or other restrictions that effectively prevent the employer from obtaining vouchers. IRC Section 132(f)(3); Treas. Reg. Section 1.132-9(b), Q-16-19

Example: Maddy buys a transit pass for \$200 each month in 2020. At the end of each month, she presents her used transit pass to her employer and certifies that she purchased and used it during the month. The employer reimburses her \$200. Lulu also purchases a monthly transit pass for \$200 but presents it to her employer at the beginning of the month and certifies that she purchased it and will use it during the month. Her employer reimburses her at the time

she presents the transit pass. In both situations, the employer has established a bona fide reimbursement arrangement for purposes of excluding the \$200 reimbursement from the employee's gross income in 2020.

Qualified Parking

Qualified parking is parking provided to employees on or near the business work premises, or parking on or near a location from which employees commute to work by commuter highway vehicle, mass transit or vanpool. IRC Section 132(f)(5)(C)

Qualified Bicycle Commuting Expenses

The Tax Cuts and Jobs Act, section 11047, suspends the exclusion of qualified bicycle commuting reimbursements from your employee's income for any tax year beginning after December 31, 2017, and before January 1, 2026. See [Publication 15-B](#).

For tax years prior to 2018, employees could exclude reimbursements paid by employers for qualified bicycle commuting expenses. The maximum exclusion was \$20 times the number of months the employee used a bicycle for commuting to work. Allowable expenses included the purchase, maintenance, repair and storage expenses related to bicycle commuting. IRC Section 132(f)(1)(D)

The bicycle commuting expense exclusion could not be claimed for an employee for any period in which that employee claimed either the exclusion for public transit passes or qualified parking. IRC Section 132(f)(1)(F)(iii)(II)

Health and Medical Benefits

Under IRC Section 106, employer provided accident and health coverage, including insurance, is excluded from the income of an employee, spouse or dependent. Under IRC Section 105, amounts received from employer provided accident and health coverage, including reimbursements, are excluded from the income of the employee, spouse or dependent.

The following are examples of employer provided accident and health coverage:

Employer contributions to health plans - Contributions to the cost of accident or health insurance, including qualified long-term care insurance paid by an employer, are excludable from the income of employees. This includes employer contributions to an Archer Medical Savings Account (MSA) or to a health savings account (HSA). See [Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans](#), for more information on these plans. IRC Section 106

Direct reimbursement or payment - An employer may pay qualifying employee medical expenses, or reimburse those expenses, without the payment resulting in taxable income to the employee. This includes payments for specific injuries or illness, but not payments based on work missed (for example, sick pay). IRC Section 105

Health Reimbursement Arrangement (HRA) - An HRA is a written plan to provide employer payment or reimbursement for qualifying medical or health benefits. It may provide for the carryover of unused benefits from year to year and may specify the types of medical benefits that are covered. An HRA can only be financed by employer contributions and cannot involve an employee election to participate in a cafeteria plan provided under Section 125. These payments are excludable from income. For more information, see [Publication 969](#). IRC Section 105(b); IRC Section 106; Notice 2002-45 and Notice 2007-22

Flexible Spending Arrangement - Under a written employer plan, the employee may choose to reduce salary and contribute to an account for medical expenses on a pre-tax basis. Amounts in the account may be used to pay for qualifying medical expenses, generally only within that calendar year. Long-term care benefits are not excludable from income tax but are excludable from Social Security and Medicare taxes. IRC Section 106(c)(2)

Cafeteria plan - A cafeteria plan, which may include a flexible spending arrangement, is a written benefit plan that meets the requirements of IRC Section 125. Under Section 125, employees can choose from among cash and any qualified benefits the plan offers, including:

- Accident and health benefits (but not Archer MSA or long-term care insurance)
- Adoption assistance
- Dependent care assistance
- Group-term life insurance coverage
- Health savings accounts

If the employee elects qualified benefits, employer contributions are excluded from wages for income tax and withholding if the benefits elected are excludable from gross income under a specific section of the IRC (other than scholarship and fellowship grants under Section 117 and employee fringe benefits under Section 132). IRC Section 125

For more information, see [Publication 15-B](#), [Publication 963](#), [Federal-State Reference Guide](#), and the [Cafeteria Plans FAQ](#). IRC Section 125

Travel Expenses

Reimbursements received by employees who travel on business outside the area of their tax home may be excludable from wages. This section covers key concepts related to determining whether travel-related expenses are excludable, including:

- Tax home
- The definition of “away from home” (overnight/sleep or rest rules)
- Temporary vs. indefinite travel assignments
- Substantiation methods
- Reimbursements for travel expenses

Qualifying expenses for travel are excludable if they are incurred for temporary travel on business away from the general area of the employee’s tax home. To be excludable from wages, the travel must be substantially longer than an ordinary day’s work, require an overnight stay or substantial sleep or rest. IRC Section 162(a)(2); U.S. v Correll, 389 U.S. 299, 302-303 (1967); Rev. Rul. 75-170

Travel expense reimbursements may include:

- Costs to travel to and from the business destination
- Transportation costs while at the business destination
- Lodging, meals and incidental expenses
- Cleaning, laundry and other miscellaneous expenses

Reimbursements for allowable expenses are excludable from wages if the [accountable plan rules](#) are met.

Example: An employee works for an agency in Detroit and travels to Denver to conduct business for an entire week. The employee incurs the cost of travel to and from Denver, as well as lodging and meals while there. Because the employee is traveling away from their tax home on the employer's business for substantially longer than a day, the employee is considered in travel status. Reimbursements for substantiated travel expenses the employee incurs are excludable from the employee's gross income and are not required to be reported as wages on the employee's W-2.

Tax Home

Identifying the employee's tax home is critical because the employee must be considered away from their tax home for reimbursements of travel expenses to be excludable. In most cases, the employee's tax home is the general vicinity of their principal place of business. The employee may receive excludable travel reimbursements while temporarily away from their tax home for business. Regardless of whether the employee's tax home is the employer's business office or the employee's residence, the tax home includes the entire metropolitan area; therefore, the employee is not away from home unless they leave the metropolitan area. Rev. Rul. 73-529; Rev. Rul. 93-86; Rev. Rul. 56-49; Rev. Rul. 75-432

One Regular or Main Place of Business

Generally, the tax home is the employee's regular place of business or official duty station, regardless of where the employee maintains a family home.

Example: An employee lives and works in New York. The New York area is considered the employee's tax home.

Example: An employee lives in New York but works permanently in Philadelphia. Even though the employee lives in New York, Philadelphia is considered the employee's tax home.

More Than One Regular or Main Place of Business

If an employee has more than one regular place of business, the tax home is the employee's main place of business. The main place of business is generally determined by the time worked, degree of business activity and income earned in each location. Rev. Rul. 54-147, 1954-1 C.B. 51

Example: An hourly employee works in his employer's office in Portland three weeks a month and in a satellite office in Seattle for one week a month. Portland is the employee's tax home.

No Regular or Principal Place of Business

Employees may have a tax home even if they don't have a regular or main place of business. If an employee works in the general area of the residence where they regularly live, the general area of that residence is the tax home. Rev. Rul. 73-529; Rev. Rul. 93-86

Example: A forestry worker has a home in a remote location and works at various forest sites in the general area. Her employer does not have an office where the employee works or reports. The general area of her residence may qualify as the employee's tax home.

Tax Home Election for State Legislators

IRC Section 162(h) provides that state legislators whose district is more than 50 miles from the capitol building may elect to treat their residence within the legislative district they represent as the tax home. IRC Section 162(h); TD 9481; Technical Advice Memorandum (TAM) 9127009; Treas. Reg. Section 1.162-24

Away From Tax Home

For a reimbursement of an expense, including meals and lodging, for business travel to be excludable from income, a taxpayer must temporarily travel in the pursuit of business.

The statutory phrase “away from home” has been interpreted by the U.S. Supreme Court to require a taxpayer to travel overnight, or long enough to require substantial “sleep or rest.” Thus, merely working overtime or at a great distance from the taxpayer’s residence does not create an exclusion for reimbursements for travel expenses if the employee returns home without spending the night or stopping for substantial “sleep or rest.” U.S. v Correll, 389 U.S. 299, 302-303 (1967); Rev. Rul. 75-170; Rev. Rul. 75-432

Example: An employee is required to travel from Milwaukee to Madison to work on a project. She leaves home at 11:00 a.m. on Monday, with plans to return home the same day. She is unable to complete the project on Monday, so she spends the night in Madison. After completing the project the next day, she returns to Milwaukee by 10:30 a.m. Even though the employee had not planned to spend the night and is gone for less than 24 hours, she has met the “away from home” rule because she spent the night away from her tax home on business.

Example: An employee is required to travel from Dallas to Austin to work for the day. The employee leaves home at 6:30 a.m. and returns that night at 10:00 p.m. On the trip home the employee stops for dinner and rests in the car for two hours. Even though the employee has been away from home for substantially longer than her normal workday, she is not considered to be in travel status. The courts have ruled that stopping for a meal or a rest in a car does not meet the substantial “sleep or rest” rule.

Example: A government agency supplies office equipment to other agencies within the state. An employee drives a tractor-trailer with equipment from the warehouse in Sacramento to an agency in San Diego. After 10 hours the driver stops and rents a room at a rest stop for a 4-hour nap before completing the round trip. Because the driver rented a room to sleep, he is considered to have met the “sleep and rest” rule. Reimbursements for meals and lodging are not taxable to the employee if the accountable plan rules are met.

Questions concerning the sleep or rest rule have been addressed in numerous court cases and IRS rulings over the years. Each case addresses a specific situation and should not be relied on in another situation, but each provides an illustration of the development of law in this area. Some of the major cases and IRS rulings in this area are listed below, and some of these cases are referred to in the following discussion.

Sleep/Rest Test Not Met - Reimbursements Taxable

- U.S. v Correll, 389 U.S. 299, 302-303 (1967)
- Barry v. Commissioner, 27 AFTR 2d 71-334, 435 F2d 1290 (CA1 1970)
- Coombs v. Commissioner, 608 F2d 1269, 1276 (1979)
- Fife v. Commissioner, 73 T.C. 621(1980)

- Rev. Rul. 68-663, 1968-2 C.B. 71
- Matteson v. Commissioner, T.C. Memo 1974-96
- Unger v. Commissioner, T.C. Memo 1986-64, 51 TCM 455
- Siragusa v. Commissioner, T.C. Memo 1980-68
- Bissonnette v. Commissioner, 127 T.C. 124 (2006)

Sleep/Rest Test Met - Reimbursements Not Taxable

- Williams v. Patterson, 286 F.2d 333 (5th Cir. 1961)
- Rev. Rul. 75-170, 1975-1 CB 60
- Anderson, David, (1952) 18 TC 649
- Don W. & Sally W. Weaver v. Commissioner, (1953) PH TCM 54001, 12 CCH TCM 1421, 1953 Tax Ct. Memo LEXIS 17 (U.S. Tax Court Memos 1953)
- Rev. Rul. 75-168, 1975-1 CB 58
- Johnson, Mose, (1982) TC Memo 1982-2
- Rev. Rul. 75-432, 1975-2 CB 60
- Bissonnette v. Commissioner, 127 T.C. 124 (2006)

Williams v. Patterson

A railroad conductor regularly rented a hotel room near a railroad station where he slept and ate during a 5-hour layover as part of an 18-hour workday. He could deduct his meals and lodging costs because his layover was long enough to obtain sleep or rest and he was required by his job to do so.

Barry v. Commissioner

A consulting engineer worked with clients in a three-state area by making one-day trips to each client. She frequently left home at 6:30 a.m. and did not return until midnight. During the day, she would stop in a rest area and close her eyes for 20 minutes to refresh herself for the drive. She could not deduct the cost of her meals on these trips because she was not away from home long enough to obtain substantial sleep or rest.

Unger v. Commissioner

A truck driver's "safety breaks" which consisted of resting or sleeping at the wheel of the truck for periods ranging from 45 minutes to 3 ½ hours, were considered by the courts to be mere pauses from his daily work routine and consequently did not constitute a substantial amount of sleep or rest. Therefore, the truck driver was not considered to be away from home.

Temporary vs. Indefinite Travel Assignments

Reimbursements of travel expenses for "temporary" assignments away from the tax home at a single location are generally not taxable to employees. If the assignment is "indefinite," the employees are considered to have moved their tax home to the new work location.

Reimbursements of travel expenses for "indefinite" assignments are taxable.

The employer must determine whether an assignment is realistically expected to last less than one year when the assignment begins.

- An assignment is generally considered temporary if it is realistically expected to be, and does in fact, last one year or less.
- An assignment is generally considered indefinite if it is realistically expected to last for more than one year.

The above are the general rules. All relevant facts must be considered to determine whether the travel assignment was intended to be temporary or indefinite. Rev. Rul. 93-86; Rev. Rul. 99-7

Return Home From Temporary Work Location

If employees go home on days off from a temporary location while traveling away from their tax home, the allowable expense for those days is the lesser of:

1. Travel expenses home, or
2. The cost of staying at temporary assignment.

Rev. Rul. 54-497, 1954-2 C.B. 75

“Temporary” Travel Assignment Becomes “Indefinite”

If an assignment away from home at a single location initially is realistically expected to last one year or less, and then later is realistically expected to last longer than one year, the assignment is considered temporary until the date the expectations change. At that time, the travel is considered “indefinite” and any travel reimbursements from that date on are taxable.

Example: Joan accepts a 6-month work assignment away from her tax home, intending to return to her tax home at the finish of the temporary assignment. The assignment lasts for 6 months and Joan returns to her regular job at her tax home. Joan’s reimbursements are excludable because the assignment was intended to last, and did last, less than 1 year.

Example: Joan accepts a 6-month assignment away from her tax home, intending to return to her tax home at the finish of the temporary assignment. After 4 months at the temporary job assignment, Joan agrees to stay for an additional 14 months. Joan is not taxed on employer reimbursements for travel expenses paid or incurred during the first 4 months of her temporary assignment. Joan will be taxed on reimbursements for the additional 14 months because the assignment has now become an indefinite assignment. If there had been a reasonable basis at the start of the assignment to believe that it would be extended, then it would have been considered indefinite from the start. Rev. Rul. 73-578; Rev. Rul. 93-86

Example: Joan accepts an assignment away from her tax home for 15 months. After 7 months, the employer cancels the assignment and Joan returns to work at her tax home. Although Joan’s assignment lasted less than 1 year, it had been realistically expected to last for more than 1 year when the assignment began. Therefore, the assignment was considered “indefinite” and the reimbursements for the 7 months are taxable. Rev. Rul. 93-86

Reimbursements for Travel Expenses

For reimbursements for ordinary and necessary business expenses incurred while traveling away from the employee’s home overnight to be excludable from taxable wages, the reimbursements must be made under an accountable plan. An [accountable plan](#) requires that expenses have a business connection, adequate documentation of expenses and a timely return of excess reimbursements. An accountable plan may include per diem rates for certain expenses. Rev. Proc. 2011-47; IRC Section 274(d) and (e)(3)

Per Diem Reimbursement

A per diem is a daily allowance to pay for lodging, meals and incidental expenses while traveling on business. The amount of the expenses reimbursed using per diem rates will be deemed substantiated without receipts, provided the requirements of the regulations are met. Treas. Reg. Section 1.62-2(e)(2); Treas. Reg. Section 1.274-5(g)

Federal Per Diem Rate

Federal per diem rates include separate rates for lodging and for meals and incidental expenses (M&IE). These rates apply to employees of the federal government and establish the maximum amounts for different geographical areas that can be excluded per day for lodging and M&IE. An annual notice provides per diem rates for expenses incurred while traveling away from home. This includes alternate per diem rates, including a special transportation industry rate, an incidental expense only rate and rates for a high-low substantiation method. Current and previous per diem rates may be found on the [GSA per diem rate page](#); see [Rev. Proc. 2011-47](#) and [Notice 2019-55](#) for special rules.

Lodging includes only the cost of the lodging itself. Room tax and energy surcharges are not considered part of the lodging cost.

M&IE includes meals, tips and fees for food and luggage-handling services.

An employer is not required to reduce the M&IE even if meals are provided in-kind to the employee, if the employer reasonably believes that the M&IE will be incurred.

Employers may use lower per diem rates than the federal rates. The accountable plan rules apply in the same manner in these cases. If a rate higher than the federal rate is used, the excess is taxable as wages.

Per Diem Allowance Rules

If a per diem allowance is used, employees are deemed to have substantiated the amount of expenses equal to the lesser of the federal per diem rate or the per diem allowance paid by the employer.

- The per diem allowance must be at or less than federal rates to be fully excludable.
- No receipts are required if a per diem allowance is used, but the payments must meet the other substantiation requirements including time (date), place and business purpose.
- An employer's substantiation requirements must, at a minimum, meet the federal requirements. An employer may have more stringent requirements, such as requiring meal and lodging receipts. Treas. Reg. Section 1.62-2(c); IRC Sections 274(d) and (e)(3); Rev. Proc. 2011-47; Rev. Rul. 2006-56

Example: An employee traveling away from home on business is reimbursed by his employer at the federal per diem rate for the city in which he spends the night. In this situation, the employee does not have to provide receipts; however, he must provide adequate substantiation verifying the time, place and business purpose of the trip. The employer may require additional substantiation. Treas. Reg. 1-62-2(c)

Miscellaneous Expenses

Miscellaneous expenses are not considered part of a per diem reimbursement and, therefore, substantiation is required. Employers may require actual receipts or written certification as substantiation depending on their travel policies.

Miscellaneous expenses include cab fares, fax, telephone, copy charges, room taxes, energy surcharges, laundry, cleaning and pressing of clothes and other business-related expenses.

Miscellaneous expenses are not part of M&IE per diem allowance, and therefore these reimbursements, in addition to the M&IE allowance, may be excludable from wages if properly substantiated.

Optional Method for Incidental Expenses Only

An employer payment of \$5 per day or partial day may be deemed to be substantiated expenses under the per diem rules if the employee:

- Is traveling away from home on business,
- Does not pay or incur meal expenses, and
- Is not receiving per diem or M&IE expenses.

Rev. Proc. 2011-47; Notice 2019-55

Travel for Days of Departure and Return

For both the day travel begins and the day travel ends, the per diem meal allowance is to be prorated by one of two methods:

- Allow $\frac{3}{4}$ of the per diem meal allowance for each of those days, or
- Use any method that is consistently applied and that is in accordance with reasonable business practice, such as the actual hours away from home on the first and last day.

Rev. Proc. 2011-47

Traveling to More Than One Location

If the employee is traveling to more than one location in one day, use the per diem rate for the area where the employee stops for rest or sleep. Rev. Proc. 2011-47

Per Diem Paid Under a Nonaccountable Plan

A per diem plan that fails to comply with any of the accountable plan requirements is considered a nonaccountable plan. Treas. Reg. Section 1.62-2(c)(3)

Per diem payments made under a nonaccountable plan are wages subject to federal income tax, and employer and employee Social Security and Medicare taxes. The payments are included in wages in boxes 1, 3 and 5 on Form W-2.

Example: An employee regularly travels as part of her job requirements. The employer provides her with a monthly per diem allowance based on an estimate of the number of days traveled. The employer does not require the employee to return any of the allowance that exceeds substantiated business expenses. Because the employer does not require the employee to return excess advances or allowances, this is not an accountable plan and the entire amount of the allowance is taxable to the employee as wages.

Other Per Diem Methods

The following are alternative per diem methods that may be applied to travel expenses.

Meals-Only Substantiation Method

An employer may reimburse actual lodging expenses and use the M&IE per diem allowance plan for the meals and incidental expenses. Treas. Reg. Section 1.62-2; Rev. Proc. 2011-47; Notice 2019-55

High-Low Substantiation Method

“High-low substantiation” is another deemed substantiation method that may be used in place of the per diem method. The IRS designates key cities or localities as “high-cost” areas. All other localities are considered “low-cost” areas. Use of this method eliminates the need to keep records of the current rate for each city. A single per diem rate is assigned to all high-cost areas and all other areas are assigned another rate. An employer that uses the high-low method for an employee must use the high-low method for that employee for all travel in the continental

United States that year, unless an actual expenses method or the meals and incidental expenses method is used. See the [GSA per diem rate page](#) and [Rev. Proc. 2011-47](#) for more information and [Notice 2019-55](#) for current high-low rates.

Transportation Expenses

Transportation expenses are costs for **local** business travel that is **not** away from the tax home area overnight, and that is in the general vicinity of the principal place of business. Transportation expenses do not include commuting costs, which are not deductible business expenses and cannot be excluded from wages if provided by the employer. To be excludable, reimbursements for transportation expenses must meet the accountable plan requirements. IRC Section 162(a); IRC Section 62(c); Rev. Rul. 99-7

Reimbursements for transportation expenses between a residence and a work location are excludable from income if they are provided for:

- Daily transportation between one work location and another, neither one being the employee's residence.
- Daily transportation between the employee's residence and a temporary work location outside the metropolitan area where the employee generally works.
- Daily transportation between the employee's residence and a temporary work location in the same business (regardless of distance) if the employee has a regular work location away from the residence.
- Daily transportation between the employee's residence and another work location in the same business (regardless of whether the work location is temporary and regardless of distance), if the residence is the employee's principal place of business (the residence is exclusively used on a regular basis for the convenience of the employer).

If none of these situations apply, the transportation expenses are commuting costs and are taxable if reimbursed to the employee. See Transportation Expenses and Commuting, below. Rev. Rul. 55-109; Rev. Rul. 99-7

Transportation expenses may include:

- Air, train, bus, shuttle and taxi fares in area of tax home
- Mileage expenses or costs of operating a vehicle
- Tolls and parking fees

Transportation expenses do not include:

- Meals and lodging
- Commuting costs to regular or principal place of business
- [Travel expenses](#)

Transportation Expenses and Commuting

It's important to distinguish expenses for transportation from commuting costs. "Commuting" refers to travel between an employee's personal residence and main or regular place of work. Reimbursements for these expenses are never excludable. However, reimbursements of transportation expenses for getting from one workplace to another in the course of the employer's business within the general area of the tax home may be excludable from wages. Treas. Reg. Sections 1.162-2(e) and 1.262-1(b)(5); Rev. Rul. 99-7

The following illustrate commuting situations, for which reimbursements are taxable:

- An employee drives from his residence to his principal or regular workplace (during or after work hours, whether required or not by employer).

- An employee drives from her residence to her regular workplace on the weekend because of an urgent meeting convened by her employer.
- An employee has an office in the home that qualifies as a principal place of business and drives between the home and another work location in a different trade or business.
- An employee with no regular or main place of business drives between his residence and his first business stop, and from last business stop and home.

The rules for commuting are illustrated by the following examples:

Example: An employee drives from her home to her main office in the morning. In the afternoon, she drives to a satellite office in another town and then returns to her residence. The trip between the employee's home and place of business is personal commuting and any reimbursement for this part of the trip is taxable to her as wages. If the accountable plan rules are met, employer reimbursement for the travel from her main office to the satellite work site and the return trip home is excludable.

Example: A fish and game warden lives in a remote area and does not have a regular place of business. He drives daily to various temporary job locations and is reimbursed for his mileage. Reimbursements for the daily travel between the employee's residence and the first work location and last work location and home are taxable as wages because the game warden does not have a regular place of business and he is not driving to a work site outside of the general area of his residence. Reimbursements for travel between the work sites are not taxable.

Example: An employee travels from his residence to a temporary work site for the day, driving past his official duty station on the way. Reimbursements for transportation between the residence and a temporary work site may be excludable to the extent of the actual distance traveled. Rev. Rul. 99-7; Chief Counsel Advice (CCA) 199948018; CCA 200027047

Example: A high school music teacher is permanently assigned to two schools. She works at the first school in the morning and drives from the first to the second school in the afternoon. She is reimbursed for driving between the two locations. The travel is not taxable to the teacher because she is driving between work sites.

Temporary vs. Indefinite Assignments

For transportation expenses, as with travel expenses, it's important to note the distinction between "temporary" and "indefinite" assignments. Rev. Rul. 99-7; CCA 199948019

Note: The distinction between temporary and indefinite work locations only applies to determining whether expenses for transportation between an employee's residence and a work location are taxable. It doesn't apply to expenses for transportation between one work location and another. However, if the employee's residence is their principal place of business, all reimbursements for transportation between the residence and other work sites in the same trade or business are excludable.

Temporary Assignment - Transportation Expenses

Reimbursements of transportation expenses for temporary assignments in the general area of the tax home are generally taxable to the employee. However, if an employee has one or more regular work locations away from the employee's residence, the employer may reimburse the

employee for expenses for transportation between the employee's residence and a temporary work location in the same trade or business, regardless of distance.

Additionally, if the employee's principal place of business is their residence (the residence is exclusively used on a regular basis for the convenience of the employer), reimbursed expenses (paid under an accountable plan) for transportation between the employee's residence and another work location in the same business (regardless of whether the work location is temporary and regardless of distance) is not a taxable reimbursement. A temporary assignment exists under these circumstances:

- Duration at a single location is realistically expected to last, and does last, one year or less.
- Assignment is away from the main place of work. Rev. Rul. 99-7

Indefinite Assignment - Transportation Expenses

Reimbursements of expenses for indefinite assignment transportation expenses generally are taxable. If an assignment is indefinite, this generally precludes exclusion for reimbursement of transportation expenses. An indefinite assignment exists under these circumstances:

- Duration at a single location is realistically expected to be longer than one year.
- The assignment location is away from the main place of work.

A break in service of seven months at an assignment location generally results in the beginning of a new assignment for purposes of determining whether an assignment is temporary or indefinite. Rev. Rul. 99-7; CCA 200026025; CCA 200025052

“Temporary” Transportation Assignment Becomes “Indefinite”

If an assignment at a single location, initially is realistically expected to last one year or less, and then later is realistically expected to last longer than one year, the assignment is considered temporary until the date the expectations change. At that time, the transportation is considered “indefinite” and any reimbursements from this date are taxable.

The decision of whether an assignment is realistically expected to last more than one year is made when the assignment begins.

The IRS considers all the facts to determine whether the travel assignment was truly intended to be temporary.

Example: Tom, a state auditor, is assigned to an audit of another agency that is expected to take, and does take, 18 months to complete. The agency he is auditing is in the same town as his regular place of business. Tom travels daily from his residence to the office of the agency he is auditing and is reimbursed for his mileage by his employer.

The travel is considered “indefinite” because the audit is expected to take more than one year, Tom is not traveling away from his tax home area and, therefore, the transportation is considered commuting. The reimbursements for mileage are taxable wages to Tom.

If Tom had traveled from his main place of business rather than from his residence, the reimbursements could be excludable because he was not traveling from his residence, so the “temporary vs. indefinite” rules do not apply.

Substantiation of Transportation Expenses

Transportation expenses are subject to the same accountable plan rules as those for travel expenses. Excludable transportation expense reimbursements can only be excluded when paid under an accountable plan. The following requirements must be met:

- Business connection
- Substantiation
- Excess returned within a reasonable time

Treas. Reg. Section 1.62-2(c)

Substantiation requires that the employees be able to prove amount, date and time, place and business purpose of expenses, and keep contemporaneous records such as receipts. Expenses must not be lavish but must be reasonable based on circumstances. Treas. Reg. Section 1.62-2; IRC Section 274(d)

Moving Expenses

Payments or reimbursements for moving expenses are generally not considered fringe benefits; however, many employers provide compensation or reimbursement for these expenses and a brief discussion is included here. For more information, see [Publication 521, Moving Expenses](#).

Section 11048 of the Tax Cuts and Jobs Act suspends the exclusion for qualified moving expense reimbursements from employees' income for tax years beginning after December 31, 2017, and before January 1, 2026. However, the exclusion is still available in the case of a member of the U.S. Armed Forces on active duty who moves because of a permanent change of station. The exclusion applies only to reimbursement of moving expenses that the member could deduct if they had paid or incurred them without reimbursement. See Moving Expenses in [Publication 3, Armed Forces' Tax Guide](#), for the definition of what constitutes a permanent change of station and to learn which moving expenses are deductible; see Nondeductible Expenses in [Publication 521](#) for a list of expenses that are not deductible as moving expenses.

For payments or reimbursements made in 2018 in connection with a move that occurred prior to January 1, 2018, the suspension does not apply if the payments would have otherwise satisfied the requirements under IRC Section 217 for qualified moving expense reimbursements. Notice 2018-75

Accordingly, the following discussion only applies for tax years prior to 2018, or for members of the U.S. Armed Forces on active duty who move because of a permanent change of station. In all other cases, until 2026, reimbursements received by an employee for moving expenses are included in the employee's wages.

Generally, moving expenses incurred to change residences are personal expenses. Reimbursements or payments to cover them are included in wages, unless the move is directly related to work and the expenses meet the criteria under IRC Section 217. Personal expenses for moving are not deductible under IRC Section 262. If the moving expenses qualify under IRC Section 217, they may be taken as a deduction on the individual's federal income tax return. If the expenses are paid or reimbursed by an employer, the moving expense payment can be treated as an excludable fringe benefit to the employee under IRC Section 132(g).

General Rule for Employees

A moving expense reimbursement received directly or indirectly from an employer (under an accountable plan) is excludable to the employee if the following tests of IRC Section 217 are met (IRC Sections 82 and 217):

- Individual must be an employee.
- Employee must actually incur or pay the expenses.
- Expenses are in connection with the commencement of work at a new principal place of work.
- Move must bear a reasonable proximity both in time and location to starting work at the new job location (generally moving expenses incurred within one year of the date the employee first reports to work at the new location qualify; moving expenses incurred after this one-year period may be considered reasonably proximate if it can be shown circumstances prevented these costs from being incurred within the one-year period).
- The move must meet the time and distance tests (however, see note below):
 - **Time test** - The employee must work at least 39 weeks full-time in the first year after arriving in the new location.
 - **Distance test** - The new job is at least 50 miles farther from the former home than the old job location was from the former home.

Note: Members of the U.S. Armed Forces on active duty who move because of a permanent change of station are not required to meet the time and distance tests.

Allowable Expenses

Moving expenses are the reasonable expenses for:

- Moving household goods and personal effects from the former to the new residence;
- The travel costs between the former and the new residence by the shortest and most direct route; and
- Certain in-transit storage expenses incurred within a period of 30 consecutive days after the day the goods and effects are moved from the former residence and prior to deliver at the new residence.

IRC Section 217(b); Treas. Reg. Section 1.217-2(b)(3)

Moving expense payments can be direct or indirect. Direct payments are made directly to the employee for moving expenses. Indirect payments are made to a third party on behalf of the employee (for example, a moving and storage company, an airline or travel agency). Treas. Reg. Section 1.82-1(a)(3)

Period for Traveling Expenses

Employees can be reimbursed for the cost of transportation and lodging for themselves and members of their household while traveling from their former home to their new home. This includes expenses for the day they arrive. Employees can include any lodging expenses they had in the area of their former home within one day after they could not live in their former home (the furniture had been moved). Employees can be reimbursed for traveling expenses for only one trip to their new home for themselves and members of their household. However, all family members do not have to travel together or at the same time.

The period for travel begins one day after former residence is no longer suitable for occupancy and includes one-night lodging at prior residence and ends on the date the employee secures lodging at the new place of residence. The qualified expenses are deductible only for the first day the employee arrives at the new location.

Any relocation allowances paying for more days than established by the guidelines above are taxable as wages to the employee. Treas. Reg. Section 1.217-2(b)(4)

Delayed Moving

There is no fixed time limit for incurring or reimbursing excludable moving expenses. As noted above, generally moving expenses incurred within one year of the date the employee first reports to work at the new location are considered to be reasonably proximate in time; moving expenses incurred after this one-year period may be considered reasonably proximate if it can be shown circumstances prevented these costs from being incurred within the one-year period). For example, the employee may be waiting for dependents to finish school. Rev. Rul.78-200; Treas. Reg. Section 1.217-2(a)(3)

These rules are further illustrated in [Publication 521](#).

Meals and Lodging

The fair market value of meals or lodging furnished by an employer may be nontaxable to the employee. IRC Section 119 provides an exclusion for the value of meals and lodging provided by the employer under certain circumstances. Cash provided for meals is not excludable under this IRC Section. However, under certain circumstances cash for meals can be excluded as a [de minimis fringe benefit](#).

In-Kind Requirement

“In-kind” refers to payments made in something other than cash. Meals or lodging paid in the form of cash equivalent, do not qualify for this exclusion.

Meals are excludable from wages of the employee if they are provided:

- On the employer’s business premises, and
- For the employer’s convenience.

Lodging is excludable from the employee’s wages if it is provided:

- On the employer’s business premises,
- For the employer’s convenience, and
- As a condition of employment.

Federal law takes precedence over a state statute or an employment or union contract in determining the federal tax liability for furnished meals or lodging. The facts and circumstances and the requirements of IRC Section 119 determine the liability for federal income, Social Security and Medicare taxes. IRC Section 119(b)(1)

Example: An employee of a state institution is required by his employer to reside at the institution to be available for duty at all times. Under the state statute, the employee’s lodging is regarded as part of the employee’s compensation. Although the amount may be subject to state tax, for federal tax purposes, the amounts are excludable.

If an employee has an option to receive additional compensation in place of actual meals or lodging, then the meals and lodging, if chosen, are taxable. Treas. Reg. Section 1.119-1(e)

Meals

To be excludable, meals must be provided on the business premises and for the convenience of the employer.

Meals on the Business Premises of the Employer

“On the business premises of the employer” means that the meals must be provided either at:

- A place where the employee performs a significant portion of duties, or

- The premises where the employer conducts a significant portion of his or her business.

Treas. Reg. Section 1.119-1(c)

Example: Meals are provided at no cost to employees on a state ferry. The ferry qualifies as the employer's business premises and the employee performs a significant portion of duties there. If the meals are furnished for the employer's convenience (because the employer cannot stop the ferry to allow the employees to go to lunch) the meals are not taxable.

Meals for the Convenience of the Employer

Meals are provided for the convenience of the employer if they are provided for a substantial noncompensatory business reason; that is, the intention is not to provide additional pay for the employee. This determination depends on the facts and circumstances of the case.

Meals provided in the following situations are furnished for substantial noncompensatory business reasons:

- Workers need to be on call for emergencies during the lunch period.
- The nature of the business (not merely a preference) requires short lunch periods.
- Eating facilities are not available in the area of work.
- Meals are furnished to restaurant employees before, during or after work hours.

Example: Meals are furnished during working hours so that the employee is available for emergency calls during the meal; for example, firefighters at the firehouse. You must have evidence that emergencies occur.

Example: Meals are furnished to employees in a remote site because there are insufficient eating facilities in the area, such as at a remote logging camp.

Example: Meals are furnished by a bank that experiences highest customer demand during the lunch hour and, therefore, establishes a short meal period to meet this need (not to allow the employee to leave earlier).

Meals provided to improve general morale or goodwill, or to attract prospective employees, are not provided for a substantial noncompensatory business reason and are taxable. Treas. Reg. Section 1.119-1(a)(2)

If meals are furnished to over half an employer's employees for the convenience of the employer, then meals furnished to all employees will be considered furnished for the convenience of the employer. IRC Section 119(b)(4)

Meals Provided Before or After Working Hours

Meals provided before or after working hours are not for the employer's convenience, unless:

- They are provided for a restaurant or cafeteria employee, or
- Duties prevent the employee from taking a meal until immediately after working hours. Treas. Reg. Section 1.119-1(a)(2)(ii)(f)

Meals Furnished With a Charge

The fact that an employer charges for meals and employees may accept or decline the meals isn't taken into account in determining whether or not meals are furnished for the convenience of the employer. IRC Section 119(b)(2)

If an employer periodically charges an employee a fixed amount for meals, regardless of whether the employee takes the meal, the employee's regular taxable wages are reduced by the amount of the charge, if the meals are furnished for the convenience of the employer. If not provided for the convenience of the employer, the FMV of the meals is included in the employee's wages. Generally, the FMV of the meal will be the amount charged for the meal to the employee. IRC Section 119(b)(3)

De Minimis Meals

Infrequent meals of minimal value may be excludable as a [de minimis fringe benefit](#), regardless of the tests above.

Meals and Lodging While Traveling

Reimbursements for meals and lodging expenses incurred while traveling away from home overnight for business reasons may be excludable. These expenses generally fall under the rule for [travel expenses](#).

The taxability of these reimbursements or allowances depends on whether the meals and lodging expenses are connected to the business travel and whether the expenses are substantiated. Reimbursements or allowances must meet the accountable plan rules to be excludable. For travel meals and lodging reimbursements to be excludable from wages, employees must be traveling away from their tax home on their employer's business. As with other travel-related expenses, the general area of work, not the employee's residence, determines the tax home.

The requirements of "traveling away from home" are met when:

- The employee must be traveling away from the general area of the tax home substantially longer than an ordinary day's work, and
- The employee requires an overnight stay or substantial sleep or rest to meet the demands of the work while away from home. IRC Section 162(a)(2); U.S. v. Correll, 389 U.S. 299, 302-303 (1967); Rev. Rul. 75-170; Rev. Rul. 75-432 (See [Transportation Expenses](#))

Meals Away From Tax Home But Not Overnight

Generally, these meals are taxable as wages to the employee because travel expenses must be away from home overnight to be excludable.

Example: An employee is required to travel out of town to work for the day. The employer agrees to pay for the employee's meals while away. The employee leaves home at 7:00 a.m. and returns home at 9:00 p.m. Before the employee returns in the evening, the employee takes a nap in his car for an hour.

Although the employee is away from his tax home for substantially longer than a normal work day and even stops for rest, the rest is not considered to be substantial. The employee is not considered to be away from home overnight. Any meal money that the employee receives is taxable as wages.

For more information, see [Transportation Expenses](#).

Business Meals

Reimbursements or allowances provided to employees for business meals may be excludable if the expenses are ordinary and necessary, the expense is not lavish or extravagant under the circumstances, and the taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages. IRC Section 274(k)

Substantiating Employee Meal Expense Reimbursements

Meal expense reimbursements or allowances must meet the [accountable plan rules](#) to be excludable from wages. There must be a business connection, expense documentation and a requirement to return excess advances or reimbursements to qualify as an accountable plan. An employer may reimburse employees using an actual expense or per diem method.

Meals **while not traveling**, such as meals with meetings or overtime meals, must be substantiated using the actual expense method.

Lodging

For lodging to be excludable from wages, it must be for the convenience of the employer, on the employer's premises and furnished as a condition of employment. Treas. Reg. Section 1.119-1(b)

Lodging provided to a state governor is considered to be for the convenience of the employer. Rev. Rul. 75-540

Rent-subsidized living quarters provided to state legislators do not satisfy the convenience of the employer or condition of employment tests where the legislator is not required to accept them.

However, legislators may make an election to have their personal residence within the legislative district which they represent to be treated as their tax home, allowing the value of the lodging to be excludable as a [qualified travel expense](#). IRC Section 162(h); Treas. Reg. 1.162-24; TAM 9127009

Lodging Required as Condition of Employment

Lodging is required as a condition of employment if the employer requires the employee to live on the premises to be able to perform the job duties. Common examples may include park rangers, firefighters or apartment managers. For the exclusion to apply, the employee must be required to accept lodging. Where lodging is provided as a condition of employment, meals, if provided, may qualify as excludable. Treas. Reg. Section 1.119-1(f)-Example 5

Example: An employee of a state is employed at an institution. The employer requires the employee to be available for duty at all times. The employer furnishes the employee with meals and lodging at the institution without charge. Under the state statute, his meals and lodging are regarded as part of the employee's compensation. The employee would nevertheless be entitled to exclude the value of the meals and lodging from his gross federal income.

Example: An employee at a prison is given the choice of residing at the institution free of charge, or residing elsewhere and receiving a cash allowance in addition to the employee's regular salary. If the employee elects to reside at the prison, the value of the lodging is taxable as wages to the employee because the employee is not required as a condition of employment to reside on the premises.

Example: A full-time executive works for a city but lives in another community. The city provides a rented apartment locally to help defray the executive's personal commuting costs. The requirements for lodging to be excluded from income have not been met. The lodging is not on the business premises of the employer, and therefore, does not qualify for an exclusion.

Lodging Furnished by Certain Educational Institutions

Employees of an educational institution or an academic health center provided with lodging that isn't furnished for the convenience of the employer, as a condition of employment and on the employer's premises may still be able to exclude the value of the lodging from income if the lodging is qualified campus lodging and the employee pays an adequate rent.

Qualified Campus Lodging

Qualified campus lodging is lodging furnished to the employee by an educational institution for use as a home. The benefit applies to employees of an educational institution and their spouses and dependents. The lodging must be located on or near a campus of the educational institution or an academic health center.

Adequate Rent

The amount of rent the employee pays for the year for qualified campus lodging is considered adequate if it is at least equal to the lesser of:

- 5% of the appraised value of the lodging, or
- The average of rentals paid by individuals (other than employees or students) for comparable lodging held for rent by the educational institution.

If the employee pays annual rent that is less than the lesser of these amounts, the difference is included in wages. IRC Section 119(d)

Appraised value is the value determined as of the close of the calendar year and must be reviewed annually.

Example: Carl Johnson, a professor for State University, rents a home from the university that is qualified campus lodging. The house is appraised at \$200,000. The average rent paid for comparable university lodging by persons other than employees or students is \$14,000 a year. Carl pays an annual rent of \$11,000. Carl does not include in his income any rental value because the rent he pays equals at least 5% of the appraised value of the house ($5\% \times \$200,000 = \$10,000$). If Carl paid annual rent of only \$8,000, he would have to include \$2,000 in his income ($\$10,000 - \$8,000$).

See [Publication 525, Taxable and Nontaxable Income](#), for more information.

Reimbursements for Use of Employee-Owned Vehicles

Government employees often use their personal automobiles for official use. An employee can deduct the costs of operating a vehicle for work as an employee, using either actual expenses or a standard mileage rate. If an employer reimburses these expenses under an accountable plan, they are not deductible by the employee, but may be excludable from the employee's income. If reimbursements are not consistent with accountable plan rules, or exceed the allowable amounts, they may be taxable as wages. See [Publication 463, Travel, Gift, and Car Expenses](#), for more information.

Standard Federal Mileage Rate

In most situations, an employer can choose to reimburse the employees through a standard mileage rate allowance in lieu of actual automobile expenses and meet the accountable plan rules. A standard mileage rate is considered to cover all expenses of operating a vehicle, including insurance, maintenance, tires, oil and so on. It does not include parking or toll charges.

Mileage-rate reimbursements for allowable business travel are excludable from the wages of the employee if equal to or less than the standard federal mileage rate and the employee accounts for the business miles driven. IRC Section 274(d)

As of January 1, 2020, the standard mileage rate is 57.5 cents per mile. The rate for the current year can be found on [IRS.gov](https://www.irs.gov). Notice 2020-05

Reimbursements for **non-business travel**, including commuting, are always taxable even if paid at or below the federal mileage rate and are to be included in regular wages and subject to all income and employment taxes. (But see De Minimis Nontaxable Personal Use, later.)

[Personal commuting](#) between the residence and the principal place of business is considered non-business travel or personal use.

Employer Reimbursements in Excess of Federal Mileage Rate

Reimbursements in excess of the federal mileage rate are taxable as regular wages to the employee. When there is an excess reimbursement, both the nontaxable and taxable amounts are reported on Form W-2:

- Amounts up to federal mileage rate: box 12, code L.
- Amounts in excess of federal mileage rate (taxable): boxes 1, 3 and 5 (withholding reported in boxes 2, 4 and 6).

Employer Reimbursement Paid at or Less than the Federal Rate

If an employer reimburses an employee's business mileage under an accountable plan, at or below the federal mileage rate and the employee substantiates the business mileage, then:

- The reimbursement is not taxable to the employee.
- No income tax is withheld.
- No reporting is required on Form W-2.

Reimbursement for Actual Expenses

If the employer reimburses the employee for actual expenses, such as fuel purchased in connection with the performance of work, including repairs, depreciation and parking, those expenses are excludable if made under an accountable plan. The employee must be able to document the amount of the expenses and their connection to the business. Any expenses that are personal in nature (for example, commuting) are never excludable and reimbursements for these must be included in taxable wages. Reimbursement for actual expenses cannot be excluded from wages if a standard mileage rate reimbursement is being provided.

See [Publication 463](#) for more information on allowable vehicle expenses.

Employee Deduction

The Tax Cuts and Jobs Act P.L. 115-97 suspended all miscellaneous itemized deductions that are subject to the 2% of adjusted gross income floor under Section 67, including unreimbursed employee travel expenses. The suspension applies to tax years beginning after December 31, 2017, and before January 1, 2026. Therefore, the business standard mileage rate listed in Notice 2018-3 cannot be used to claim an itemized deduction for unreimbursed employee travel expenses during the suspension.

Substantiation Requirements

The employee is required to provide substantiation to the employer. Substantiation rules require the employee to record the date, business purpose and place of each trip. IRC Section 274(d)

Mileage should be recorded at or near the time incurred. Monthly expense reports generally meet this requirement.

Example: In 2020, a state agency paid automobile mileage reimbursements at the federal rate of 57.5 cents per mile to employees for business use of their personal vehicles. The employees verified their expenses on monthly expense reports. Because the reimbursement does not exceed the federal mileage rate and the business use has been verified, the reimbursements are not included in employee wages. No reporting is required on Form W-2.

Employer-Provided Vehicles

If an employer provides a vehicle that an employee uses exclusively for business purposes and the substantiation requirements are met, there are no tax consequences or reporting required for that use. The use is treated as a working condition fringe benefit. Business use does not include commuting. Employees should maintain records to substantiate that all vehicle use was for business.

Employer Vehicle Used for Both Business and Personal Purposes

If an employer-provided vehicle is used for both business and personal purposes, substantiated business use is not taxable to the employee (see Substantiation Requirements, below). Personal use is taxable to the employee as wages. The employer can choose to include all use as wages; in this case, the employee may reimburse the employer for personal use rather than having it treated as wages. Treas. Reg. Section 1.61-21(c)(2)

What is Personal Use?

Examples of taxable personal use of an employer-provided vehicle include:

- Commuting between residence and work station
- Vacation or weekend use
- Use by spouse or dependents

Example: An employee goes into his office on the weekend. This is personal commuting, regardless of whether it's required by the employer. Any reimbursement for the transportation is taxable wages. Treas. Reg. Section 1.162-2(e)

De Minimis Nontaxable Personal Use

An exception to the limitation on personal use applies for use that qualifies as [de minimis](#).

Examples of excludable de minimis use of an employer-provided vehicle include:

- Small personal detour while on business, such as driving to lunch while out of the office on business.
- Infrequent (not more than one day per month) commuting in employer vehicle. This does not mean that an employee can receive excludable reimbursements for commuting 12 days a year. The rule is available to cover infrequent, occasional situations.

Treas. Reg. Section 1.132-6(e)(2) and 1.132-6(d)(3)

Example: An employee uses a motor pool vehicle for a business meeting. The employer requires that motor pool vehicles be returned at the end of the business day, but the employee is delayed, and the motor pool is closed when the employee arrives back at the office. The employee takes the vehicle home and returns it the next morning.

If this is an infrequent occurrence for that employee (generally happening no more than once a month) the commuting value of the trip is a nontaxable de minimis fringe benefit. If this is a frequent or routine occurrence, the commuting is taxable to the employee.

Substantiation Requirements

Under IRC Section 280F, vehicles are considered “[listed property](#)” and, therefore, to support an exclusion or deduction, separate records for business and personal mileage are required.

IRC Section 274(d)

If the employee **does not provide** records documenting business and personal mileage separately, the value of **all** use of the automobile is wages to the employee. Treas. Reg. Section 1.132-5(b)

If the employee **provides** to the employer records documenting business and personal use separately, **only** the personal use of the automobile is wages to the employee.

Exceptions to the recordkeeping requirements apply in certain situations discussed later in this section.

Valuation of Personal Use of Employer-Provided Vehicle

Personal use of an employer’s vehicle that does not qualify for an exclusion creates taxable wages to the employee. The following procedures should be used to determine how much to include in wages on the employee’s Form W-2.

Under the general valuation rule for fringe benefits, the amount to include in income is FMV, which is generally the lease value of the vehicle, but other rules may apply in certain circumstances. Treas. Reg. Section 1.132-5(b)

Three Automobile Valuation Rules

- Automobile Lease Valuation Rule -Treas. Reg. Section 1.61-21(d)
- Vehicle Cents-Per-Mile Valuation Rule -Treas. Reg. Section 1.61-21(e)
- Commuting Valuation Rule -Treas. Reg. Section 1.61-21(f)

General Requirements for Using These Special Valuation Rules

To use one of the special valuation rules, the employer and employee must timely report personal use as wages. Generally, the rules are applied on a vehicle-by-vehicle basis; the employer may use different rules for different vehicles.

Automobile Lease Valuation Rule

Compute the value for purposes of the lease valuation rule as follows:

1. Determine the fair market value of the vehicle on the first day it is made available to employee.
2. Use the table in Treas. Reg. Section 1.61-21(d)(2)(iii) or [Publication 15-B](#) to compute the annual lease value.
3. Multiply the annual lease value by the percentage of personal use computed in Step 1.
4. If fuel is provided, add 5.5 cents per mile driven by the employee to the table lease value.

Maintenance and insurance costs are included in the standard mileage rate. Treas. Reg. Section 1.61-21(d)(3)(i)

The employer's cost, including tax, title and so on, may be used to determine the FMV. See Treas. Reg. Section 1.61-21(d)(5) for information on the valuation of leased vehicles.

Example: Joe, an employee of Agency XYZ, uses an agency-provided car, for which fuel is provided. In 2020, Joe drives the car 20,000 miles, of which 4,000, or 20%, were personal miles. The FMV of the car is \$24,500, for an annual lease value of \$6,600. Personal use is valued at \$1,320: ($\$6,600 \times 20\%$) plus \$220 ($5.5¢ \times 4,000$ miles) for fuel costs. \$1,540 ($\$1,320 + \220) is included in Joe's wages.

Recalculation of Value after Four-Year Lease Term

Once computed, the annual lease value remains in effect through December 31 of the 4th full calendar year after the rule is first applied. Treas. Reg. Section 1.61-21(d)(2)(iv)

Transfer to Another Employee

If the vehicle is transferred to another employee, the employer may recalculate the annual lease value based on the FMV as of January 1 of the year of transfer. This recalculation is not allowed if the primary purpose of the transfer is to reduce federal tax liability. Treas. Reg. Section 1.61-21(d)(2)(v)

Daily Lease Value

This method is required if the vehicle is available for less than 30 days. Figure the daily lease value by multiplying the annual lease value by a fraction, using four times the number of days of availability as the numerator, and 365 as the denominator.

You can apply a prorated annual lease value for a period of continuous availability of less than 30 days by treating the automobile as if it had been available for 30 days. Use a prorated annual lease value if it would result in a lower valuation than applying the daily lease value to the shorter period of availability. Treas. Reg. Section 1.61-21(d)(4)

Fleet Average Valuation Rule

If the employer has 20 or more cars used for business and personal use by employees, a "fleet-average value" may be used to calculate the annual lease valuation. For 2020, each car must be valued at less than \$50,400. (For 2018, 2019 and 2020, there is no separate maximum amount for trucks and vans.) See [Notice 2020-05](#); Treas. Reg. Section 1.61-21(d)(5)(v)

Vehicle Cents-Per-Mile Rule

To use the vehicle cents-per-mile rule, one of the following tests must be met:

- The employer reasonably expects the vehicle to be regularly used in the trade or business throughout the calendar year.
- The mileage test is met. Treas. Section 1.61-1(e)(1)(i)

A vehicle is considered “regularly used in the business” if:

- At least 50% or more of the total annual mileage each year is in the employer’s business; or
- It is generally used each workday to transport at least three employees to and from work, in an employer-sponsored commuting vehicle pool. Treas. Reg. Section 1.61-21(e)(1)(iv)

The mileage test is met if the vehicle is:

- Driven by employees at least 10,000 miles (personal and business) per year; and
- Used primarily by employees. Treas. Reg. Section 1.61-21(e)(1)(ii)

Continued Usage Rule

You must continue using the cents-per-mile rule for the vehicle for all later years, except that the employer can use the commuting rule for any year during which use of the vehicle qualifies under that rule. If the vehicle does not qualify for the cents-per-mile rule during a later year, you can use, for that year and thereafter, any other rule for which the vehicle then qualifies.

Treas. Reg. Section 1.61-21(e)(5)(ii)

Limitation on Value

For 2019, the maximum value for use of the vehicle-cents-per mile rule is \$50,400, on the first day of use. [Notice 2020-05](#); Treas. Reg. Section 1.61-21(e)(1) and 1.280F

Multiply the standard mileage rate by the number of personal miles driven. If fuel is not provided by the employer, the standard mileage rate can be reduced by up to 5.5 cents (57.5 cents - 5.5 cents = 52 cents per mile in 2020). Treas. Reg. Section 1.61-21(e)(3)(ii); Notice 2020-05.

Example: Joe drives his agency-provided car for 2,000 personal miles in 2020. The amount included as wages is \$1,150 (57.5 cents x 2,000 personal miles) or, if no fuel is provided by his employer, the amount would be \$1,040 (52 cents x 2,000 miles).

Commuting Valuation Rule

Personal use for commuting can be valued at \$1.50 each way if all the following conditions are met:

- The vehicle is owned or leased by the employer.
- The vehicle is provided to the employee for use in the business.
- The employer requires the employee to commute in the vehicle for a bona fide noncompensatory business reason:
 - The employer has a written policy prohibiting personal use other than commuting.
 - The employee does not use the vehicle for other than de minimis personal use.
 - The employee who uses the vehicle is not a control employee (defined below).

If more than one employee commutes in the vehicle, the \$1.50 each-way rule applies to each employee. Reg. Section 1.61-21(f)

Note: The employer must require the employee to use the vehicle for a business purpose; it cannot be voluntary on the employee’s part. For example, a transportation employee, who is on call 24 hours a day to respond to road emergencies, is required by the employer to commute in

a vehicle outfitted with communications or other equipment the employee would need if called out at night.

Commuting Rule Not Available for Control Employee

Personal use of a vehicle by a “control employee” cannot be valued using the commuting valuation rule (\$1.50 rule). A control employee in a governmental organization is either an:

- Elected official; or
- Employee whose compensation is at least as great as a federal government employee at Executive Level V (Beginning January 1, 2020, this is \$160,100).
Treas. Reg. Section 1.61-21(f)(6)

Instead of the above definition of control employee, the employer may treat all employees who are “highly compensated” (generally, for 2020, those exceeding \$130,000 compensation) as their only control employees. Treas. Reg. Section 1.132-8(f); [Notice 2019-59](#)

Example: An agency in a rural area doesn’t have secure parking and has a history of vandalism to its vehicles. The employer requires employees using the vehicles for the day on business to take the vehicles home overnight. The trip home and to the office the next day is considered taxable personal commuting. The commuting may be valued at \$1.50 each way, because the employee had a valid noncompensatory business reason for commuting in the employer’s vehicle. If this was an unusual situation for the employee, that is, generally occurring no more than once a month, the commuting could also be considered a nontaxable de minimis fringe benefit.

Example: An agency requires an employee to take home a van to carry displays and equipment to a trade show the next day. In this situation, the commuting could be valued at \$1.50 for the trip from the office to home, because the agency is requiring the employee to use a specific vehicle for valid business reasons (assuming the other rules listed above are met). If this was an unusual situation for the employee, that is, generally occurring no more than once a month, the commuting could be considered a nontaxable de minimis fringe benefit, even if the commuting valuation rule is not met.

Qualified Nonpersonal Use Vehicles

Use of a qualified nonpersonal use vehicle, including commuting, is excludable to the employee as a working condition fringe benefit if the specific requirements for the type of vehicle are met. Recordkeeping and substantiation by the employee are not required by the IRS. IRC Sections 274(d) and (i); Treas. Reg. Section 1.132-5(h)

Eligible Vehicles

A qualified nonpersonal use vehicle is any vehicle that the employee is not likely to use more than minimally for personal purposes because of its design. Qualified nonpersonal use vehicles generally include:

- Clearly marked police, fire or public safety officer vehicles (discussed below).
- Unmarked vehicles used by law enforcement officers if the use is officially authorized (discussed below).
- Qualified specialized utility repair truck (discussed below).
- An ambulance or hearse used for its specific purpose.
- Any vehicle designed to carry cargo with a loaded gross vehicle weight over 4,000 pounds.
- Delivery trucks with seating for the driver only, or the driver plus a folding jump seat.

- A passenger bus with a capacity of at least 20 passengers used for its specific purpose.
- Construction or specially designed work vehicles (for example, bucket trucks, dump trucks, cement mixers, forklifts, garbage trucks).
- School buses.
- Tractors, combines and other special-purpose farm vehicles. Treas. Reg. Section 1.274-5(k)(2)

Clearly Marked Police, Fire or Public Safety Officer Vehicles

A clearly marked police, fire or public safety officer vehicle is a qualified nonpersonal use vehicle only if the following apply:

- The employee must always be on call.
- The employee must be required by the employer to use the vehicle for commuting.
- The employer must prohibit personal use (other than commuting) for travel outside of the officer or firefighter's jurisdiction.
- It is readily apparent, by words or painted insignia, that the vehicle is a public safety vehicle. A marking on a license plate isn't a clear marking for this purpose. Treas. Reg. Section 1.274-5(k)(3)

Public Safety Officer

A public safety officer is an individual serving a public agency in an official capacity, with or without compensation, as a law enforcement officer, as described above, or a firefighter, chaplain or member of a rescue squad or ambulance crew. TD 9483; Treas. Reg. Section 1.274-5

Unmarked Law Enforcement Vehicles

Unmarked law enforcement vehicles are qualified nonpersonal use vehicles only if:

- The employer must officially authorize personal use.
- Personal use must be incident to use for law-enforcement purposes; that is, no vacation or recreational use.
- The employer must be a governmental unit responsible for crime prevention or investigation.
- The vehicle must be used by a full-time law enforcement officer authorized to carry firearms, execute warrants and make arrests. The officer must regularly carry firearms, except when it is not possible to do so because of the requirements of undercover work. Treas. Reg. Section 1.274-5(k)(6)(ii)

Qualified Specialized Utility Repair Truck

A specialized utility repair truck qualifies as a qualified nonpersonal use vehicle if:

- The truck (not a van or pickup) is designed to carry tools and equipment,
- The truck has permanent interior construction, including shelves and racks, and
- The employer must require the employee to commute for emergency call-outs to restore or maintain utility services (for example, gas, water and sewer). Treas. Reg. Section 1.274-5(k)(5)

Vans and pickup trucks do not qualify as qualified nonpersonal use vehicles unless specifically modified to be unlikely to allow more than minimal personal use. For a van or pickup truck with a loaded gross vehicle weight of 14,000 pounds or less, the vehicle must be clearly marked with permanently affixed decals, special painting or other advertising associated with the trade, business or function.

Vans must have a seat for the driver only (or the driver and one other person) and either:

- Permanent shelving that fills most of the cargo area, or
- An open cargo area, and the van always carries merchandise, material or equipment used in your trade, business or function. Rev. Rul. 86-97; Private Letter Ruling 200236022

Pickup trucks must be equipped with **at least one** of the following:

- A hydraulic lift gate.
- Permanent tanks or drums.
- Permanent side boards or panels that materially raise the level of the sides of the truck bed.

Otherwise, they must be used primarily to transport a particular type of load (other than over the public highways) in a construction, manufacturing, processing, arming, mining, drilling, timbering or other similar operation for which it was specially designed or significantly modified.

Safe Harbor Substantiation Rules for Vehicles

If certain conditions are met, a safe harbor rule relieves employees of the requirement to keep detailed records of employee use of vehicles. How the safe harbor rule applies depends on whether the vehicles are used for any personal purposes, or for vehicles with no personal use other than commuting. Treas. Reg. Section 1.274-6T(a)(1)

Employees using employer vehicles are **not** required to keep detailed records of vehicle use if all the tests below are met:

For vehicles not used for personal purposes:

- The vehicle is owned or leased by the employer and is provided to the employee for use in the employer's business.
- When not in use, the vehicle is kept on the employer's premises (for example, motor pool cars).
- No employee using the vehicle lives at the employer's business premises.
- The employer has a written policy prohibiting personal use, except de minimis use (such as driving to lunch while away from the office).
- The employer reasonably believes the vehicle is not used for any personal use (other than de minimis). Treas. Reg. Section 1.132-5(e) and (f); Treas. Reg. Section 1.274-6T(a)(2)

For vehicles not used for personal purposes other than commuting:

- The vehicle is owned or leased by the employer and is provided for use in the employer's business.
- For bona fide noncompensatory reasons, the employer requires the employee to commute to and/or from work in the vehicle.
- The employer has established a written policy prohibiting personal use other than commuting and de minimis use.
- The employer reasonably believes that, except for commuting and de minimis use, no individual uses the vehicle for personal purposes.
- The employee is not a control employee (for the definition, see "Commuting Rule Not Available for Control Employee" earlier).
- The employer accounts for the commuting use by including the commuting value in the employee's wages. Treas. Reg. Section 1.274-6T(a)(3)

Written Policy Statements

The employer must maintain a written policy statement that implements a policy restricting personal use of employer-provided vehicles. The Conference Report to P.L. 99-44, Contemporaneous Recordkeeping Requirements Repeal Act, states that a resolution of a city council, or a provision of state law or the state constitution qualifies as a written policy statement for the safe harbor provisions.

Employer Monitoring Required

Although detailed recordkeeping is not required, the employer must have some way to prove that the vehicles are being used in accordance with the rules. For example, the employer may use internal controls such as requiring employees using motor pools to sign vehicles out, and signed statements by the employees agreeing to no personal use, or (if applicable) no personal use other than commuting.

Equipment and Allowances

This section discusses some common situations involving employee use of equipment and supplies, as well as cash allowances provided by an employer to pay for them. In general, any equipment the employer provides that represents ordinary and necessary business expenses, are excludable from income. Allowances paid or reimbursements made by an employer under an accountable plan to an employee are excludable. IRC Section 162

The [accountable plan rules](#) require:

- Business connection – the expenses must qualify as a business expense to the employer.
- Substantiation of amount, date and time, place and business purpose.
- Excess returned within a reasonable time. Treas. Reg. Section 1.62-2(c)(1); IRC Section 274(d)

Except where the law provides a specific exception (for example, the standard mileage rate) any allowance or reimbursement based on hours worked, units produced or other system that does not involve accounting for actual expenses, is treated as wages subject to withholding of income, Social Security and Medicare taxes. Rev. Rul. 2004-1; Rev. Rul. 2012-25

Wage Recharacterization

If an employer arranges to pay an amount to an employee, whether called an allowance, reimbursement or some other term, regardless of whether the employee incurs, or is reasonably expected to incur, deductible business expenses, the business connection requirement is not met for these payments. This constitutes “wage recharacterization” and all amounts paid are considered taxable wages for income, Social Security and Medicare tax purposes. See the discussion of accountable plans. Treas. Reg. 1.62-2(d)(3)(i); Rev. Rul. 2012-25

Example: An employer pays a premium per working hour (sometimes called a “tool allowance”) for employees who provide their own tools. The employees retain ownership and control of their tools and there is no requirement to account to the employer. The employees are not required to substantiate the cost of each item. The premium is not specifically determined by the employees’ actual expenses. Reimbursements based on the hours worked cannot meet the accountable plan requirements. Payments of this type do not meet the accountable plan rules and, therefore, are additional compensation includible in income and fully taxable as wages.

Example: An employer’s mileage reimbursement plan operates to routinely pay an amount as a mileage reimbursement to workers who have not incurred (and are not reasonably expected to incur) deductible business expenses in connection with the employer’s business. The purported mileage reimbursement is merely recharacterized wages because all workers receive an amount as a mileage reimbursement regardless of whether they incur (or are reasonably expected to incur) mileage expenses. The arrangement fails to satisfy the business connection requirement of Treas. Reg. Section 1.62-2(d) and does not meet the accountable plan rules.

Work Clothes and Uniform Allowances and Reimbursements

Clothing or uniforms are excluded from wages of an employee if they are:

- Specifically required as a condition of employment, and
- Are not worn or adaptable to general use as ordinary clothing.

The accountable plan rules must be met for reimbursements or clothing allowances. IRC Section 162; Treas. Reg. Section 1.62-2(c)(1)

Note: If the clothing qualifies as excludable, then reimbursements for the cleaning costs are also excludable.

Periodic allowance payments made to employees for the purchase and maintenance of specific articles of **employer-required** uniforms are not taxable to the employees to the extent that the allowances are used to pay for uniforms that are not adaptable to general use and are not worn for general use, and the employees substantiate the expenses. If the employer does not require substantiation, the allowance is taxable as wages and subject to withholding when paid.

Example: An agency is required to reimburse certain employees for shoes under a union contract. The shoes are not safety shoes. Because the shoes are adaptable for general wear, the reimbursements are included as wages to the employees even if the employer is required to make the payment.

Safety Equipment

Safety equipment is excludable from employee wages if the equipment is provided to help the employees perform their job in a safer environment. To be excludable, it is not necessary that the equipment be required by the employer. However, the accountable plan rules must be met for reimbursements for safety equipment. IRC Section 162; Treas. Reg. Section 1.62-2(c)(1)

Common examples include a hardhat, an anti-glare screen for computer and safety shoes.

Example: A government entity pays employees annually for part of the cost of safety equipment not required by the employer. The payments may be excludable even though the safety equipment is not required by the employer. If the equipment helps the employee perform their job in a safer environment, it may qualify as an employee business expense. If the expenses are substantiated, the reimbursement is excludable for the employee.

Mileage Allowances

Reimbursements for expenses of operating employee-owned vehicles are discussed in [Employer-Provided Vehicles](#). The tax treatment of cash allowances or reimbursements for automobile use is governed by the accountable plan rules.

Example: An employer provides an employee with a car or mileage allowance and does not require substantiation. The accountable plan rules have not been met; the car allowance is fully taxable as wages to the employee.

Listed Property

Employers often provide employees with certain equipment for use in the performance of their duties, outside of the employer's premises. Items listed in IRC Section 280F are considered "listed property" because the property by its nature lends itself to personal use. Strict substantiation requirements apply to property in this category. Employees are required to

account for business and personal use. IRC Sections 274(d), 280F(d)(4) and 132(d)

Examples include automobiles and property used for recreation.

The following rules apply to listed property:

- Business use is excludable from the wages of the employee as a working condition fringe benefit.
- Personal use is included in the wages of the employee.
- If substantiation requirements are not met, all use is included in the wages of the employee. IRC Section 280F(d)(4)

Substantiation Requirements

The employee must keep records of business and personal use of listed property to determine whether the value of any of the use is included in the employee's wages. IRC Section 274(d)

Awards and Prizes

Unless specifically excluded, prizes or awards given to employees are taxable. The following awards are **always** taxable as wages to an employee (regardless of the cost or FMV):

- Cash or cash equivalent awards, such as savings bonds or gift certificates.
- Recognition awards, cash or non-cash, for job performance, unless they are qualifying de minimis fringe benefits.
- Non-cash prizes (unless de minimis) won by employees from random drawings at employer sponsored events.
- Awards for performance, such as outstanding customer service, employee of the month or awards based on productivity.
- Achievement awards, cash or non-cash, that do not meet specific qualified plan award rules, discussed below.
- Awards for length of service or safety achievement that do not meet specific requirements, discussed below. IRC Section 274(j)

Cash awards to employees are always taxable. Generally, the value of an award or prize given by an employer is taxable to an employee as wages, includable on Form W-2, and subject to federal income tax withholding, Social Security and Medicare. IRC Sections 74 and 3121(a)(20)

If the employer pays the employee's share of taxes on an award, the amount of taxes paid are additional wages to the employee (except for agricultural and domestic services) and are subject to all payroll taxes. For information on calculating the tax on employee taxes paid by the employer, see [Publication 15-A](#), Rev. Rul. 86-14

Excludable Awards

There are three types of non-cash awards that may be excluded from income (subject to dollar limitations, discussed later). Each category has specific requirements that must be met to be excludable. These categories are:

1. Certain employee achievement awards
2. Certain prizes or awards transferred to charities
3. De minimis awards and prizes

Employee Achievement Awards

An employee achievement award is an item of tangible personal property (not cash) for **length-of-service** or **safety**. To be excludable the achievement:

- Must be given for length-of-service or safety,

- Must be awarded as part of a meaningful presentation, and
- Cannot be disguised wages or made under conditions and circumstances that create a significant likelihood that it is disguised wages.

The amount of an award that is excludable depends on whether it is considered qualified. A plan is a **qualified plan award** if:

- The award is made under an established written plan,
- The plan does not discriminate in favor of highly compensated employees (generally, for 2020, those whose compensation exceeds \$130,000), and
- The average cost of all employee achievement awards (both qualified and nonqualified awards for length-of-service and safety) made by the employer during a single year does not exceed \$1,600 (\$400 for awards that aren't qualified plan awards). IRC Section 274(j)

Safety Achievement Awards

An award will qualify as an excludable safety achievement award unless one of the following applies:

- It is given to a manager, administrator, clerical employee or other professional employee.
- During the tax year, more than 10% of the employees, excluding those listed above, have already received a safety achievement award (other than one of very small value). Eligible employees must have worked full-time for a minimum of one year prior to the award. IRC Section 274(j)

Example: If an agency has 50 eligible employees and six receive safety awards, the sixth award is taxable because 10% of the eligible employees have already received it.

Length-of-Service Achievement Awards

An award made for length-of-service may be excludable. However, it does not qualify if either of the following applies:

- The employee received the award during his or her first five years of employment.
- The employee received another length-of-service award (other than one of very small value) during the same year or in any of the prior four years.

Note: A traditional retirement award is an exception to the five-year rule. IRC 274(j)

Awards other than for safety or for length-of-service are always nonqualified awards, unless they are qualifying de minimis fringe benefits.

Dollar Limitation

The maximum amount of excludable awards to a single employee during a calendar year is limited to:

- \$400 for awards made under a nonqualified plan, or
- \$1,600 in total for awards made under both qualified and nonqualified plans.

An award is not a qualified plan award if the average cost of all the employee achievement awards given during the tax year (that would be qualified plan awards except for this limit) is more than \$400. To figure this average cost, ignore de minimis awards. IRC 274(j)

Generally, if an award is taxable to an employee, it is valued at its FMV. The taxable amount of an award to an employee depends on whether the award is made under a qualified plan, whether the cost of the award to the employer exceeds the dollar limitations and the FMV of the award. A length-of-service or safety achievement award may be a qualified plan award. IRC Section 274(j)

Example: An employer only makes awards to employees that are non-cash, qualifying length-of-service or safety awards. To avoid the extensive recordkeeping and tracking required for determining the taxability of awards, the employer has a policy of not making awards that exceed \$400 per employee annually. In this situation, none of the awards would be taxable to the employees.

Example: An employee receives two employee achievement awards during the year. For both awards, the cost and FMV of the awards were the same.

Cost and FMV

Nonqualified plan award of a watch	\$400
Qualified plan award of a stereo	+ 1,350
Total awards	1,750
Less: annual limitation	- 1,600
Taxable portion of awards	\$150

Cost Exceeds Dollar Limitations

Generally, if an award is taxable to an employee, it is valued at FMV. If the cost to an employer for an award exceeds the plan dollar limitations, either \$400 (nonqualified plan) or \$1,600 (qualified plan), then the amount included in wages is the greater of:

- The part of the employer's cost that is more than the plan dollar limitation (but not more than the FMV), or
- The amount by which the FMV exceeds the amount of the plan dollar limitation.

Example: An employer pays \$520 for golf clubs given to an employee as a nonqualified plan employee achievement award. The FMV of the award (golf clubs) at the time it is given to the employee is \$750.

	Cost	FMV
Award	\$520	\$750
Less: Limitation	- 400	- 400
Excess over limitation	\$120	\$350

The amount included in taxable wages to the employee is \$350, the greater of the cost less the limitation or the FMV less the limitation. If the award had been a qualified plan award, the employee would not have been taxed on any of the value of the award.

Example: An employer pays \$395 for golf clubs given to an employee as a nonqualified plan employee achievement award. The FMV of the clubs at the time the award is given to the employee is \$450.

	Cost	FMV
Award	\$395	\$450
Less: Limitation	- 400	- 400
Excess over limitation	\$0	\$50

Because the employer's cost of the award does not exceed the \$400 limitation for nonqualified awards, the employee is not taxed on the value of the award. Treas. Reg. Section 1.74-2(b)

Example: An agency presents employee length-of-service awards to six employees for a total cost to the employer of \$1,800. The average cost of all awards is \$300 (\$1,800/6). Since the average cost of all awards does not exceed \$400, the awards are considered qualified plan awards provided there is a written plan that does not discriminate in favor of highly paid employees.

Prizes or Awards Transferred to Charities

Certain prizes and awards given in recognition of charitable, scientific, artistic or educational achievement are not taxable if the recipient transfers them to a charitable organization. IRC Section 74(b)

The following requirements must apply for a transferred award to be excludable from wages:

- Award is for achievement.
- Recipient is selected without entering any contest.
- No substantial future services are required.
- Recipient transfers the award to a charitable organization recognized under IRC 170(c) prior to receiving the benefit.

Example: A college instructor is chosen as teacher of the year by a national education association. He is awarded \$5,000, which, before accepting the award, he directs the education association to transfer it to a college scholarship fund at the institution where he teaches. The award is not taxable to the college instructor.

De Minimis Awards and Prizes

A prize or award that is not cash or cash equivalent, of nominal value and provided infrequently is excludable from an employee's wages. Prizes or awards that are given frequently to an employee do not qualify as an excludable de minimis award, even if each award is small in value. IRC Section 132(e)

Examples of Excludable De Minimis Awards

- Nominal gifts for birthdays, holidays
- Holiday turkey and hams
- Flowers, plaques, coffee mugs for special occasions
- Gold watch on retirement
- Parking for employee of the month, if value is less than statutory limit for [qualified transportation fringe benefits](#)

"Nominal" for this purpose means small in value, relative to the value of total compensation. There is no set dollar amount in the law for nominal prizes or awards. (The IRS gave advice at least once, in 2001, that a benefit of \$100 did not qualify as de minimis.) CCA 200108042

"Cash equivalent" means readily convertible to cash, for example, a voucher for merchandise, a savings bond or a gift certificate.

Example: An employer provides dinner at an annual awards banquet for employees. The regulations specifically indicate that occasional group meals are considered nontaxable fringe benefits. Treas. Reg. Section 1.132-6(e)(1)

Cliff Provision

If an employer provides an award that exceeds either the value or frequency limitations for de minimis fringes, the entire award is included in the employee's wages, not just the portion that exceeds the de minimis limits. Treas. Reg. Section 1.132-6(d)(4)

Awards Funded by Third Party

If funds for awards or prizes are provided by an outside party, the award is taxable in the same way as if provided directly by the employer. If the funds are turned over to the employer to select and distribute the awards, the employer is responsible for all applicable payroll taxes and withholding. IRC Section 3402(d)

Example: A bank provides funds to a state agency to support a special performance award program. The agency chooses the recipients and distributes the awards. The value of the awards is additional compensation to these employees and reportable on their Forms W-2, subject to payroll taxes and withholding. The treatment would be the same if the outside party were a nonprofit organization or an educational foundation.

Example: A television set, donated by a business to a state agency, is awarded through a random drawing to an employee. The FMV of the television is considered taxable wages to the employee. Prizes in a random drawing of employees are considered wages. A television set is not considered a de minimis benefit.

In the case where the outside party selects and distributes the award directly to an agency employee without any direction or decision making from agency personnel, then the award is income to the recipient and must be reported. The outside party is required to furnish a Form 1099-MISC to the recipient for a calendar year if the total awarded to that individual in that year has a value of \$600 or more.

Example: Special duck prints donated by artists are given away as awards to employees. For purposes of determining the taxable value, the FMV can be determined by an appraisal, by establishing the sales price of similar prints by the artist or by any other reasonable method. The taxability of the value of the prints to the employees depends on the type of award, dollar limitations and other specific requirements.

Professional Licenses and Dues

Employer reimbursements to employees for the cost of their professional licenses and professional organization dues may be excludable if they are directly related to the employee's job.

Once an employee has completed the education or experience required for a professional license, the expenses necessary to maintain a license or status are considered ordinary and necessary business expenses. If paid or reimbursed by an employer for an employee, the fees are a working condition fringe benefit. If paid under an accountable plan, they are excludable from the income of the employee. If paid under a nonaccountable plan, they are included in the income of the employee and are subject to federal income, Social Security and Medicare taxes. The employee may deduct the expenses on their income tax return. IRC Section 132(d); Treas. Reg. Section 1.132-5(a)(1)(v); IRC Section 62(a)(2)(A); Treas. Reg. Section 1.62-2(c)(2); IRC Section 62(c)(1)&(2); Treas. Reg. Section 1.62-2(c)(3)

Example: An employer pays the professional dues for an employee, who is a financial officer, to a national association of finance officers. If the accountable plan rules are met, this is an excludable reimbursement to the employee.

Example: A state agency requires an employee to be a notary. The employee submits the paid receipt for the annual fee to maintain this professional license to the agency, and the agency reimburses the employee. The reimbursement is not taxable to the employee because it is an ordinary and necessary business expense under IRC Section 162 and paid by the employer under an accountable plan.

Example: A state agency pays the annual CPA license fee for the chief game warden each year. The warden does not use his CPA expertise on the job for the agency. Because the game warden does not use his CPA expertise in his capacity as game warden with this state agency, it is not a working condition fringe benefit. The reimbursement to the game warden is taxable to him and is subject to federal income, Social Security and Medicare taxes.

Business and Professional Organizations

Payment or reimbursement of dues to clubs organized for business purposes are excludable from income if:

- The organization is related to the employer's business, and
- The employee is performing duties for the employer that are related to the professional organization's focus or mission.

Examples of these organizations include business leagues, professional organizations, and trade associations such as medical, legal and accounting associations including state associations of CPAs, school officers or similar professional groups. Treas. Reg. Section 1.162-15(c); IRC Section 162(a); Treas. Reg. Section 1.132-5(a)

Entertainment and Recreational Organizations

Club dues and memberships are not allowed as business deductions. If an employer provides these benefits to an employee, they are taxable to the employee and subject to withholding for income tax, Social Security and Medicare.

Similarly, the payment of club dues by the employer is a taxable fringe benefit. No business deduction is allowed for club dues. If an employer pays or reimburses an employee for club dues, the amount is taxable to the employee and subject to income tax withholding, Social Security and Medicare taxes. IRC Section 274(a)(3)

Educational Reimbursements and Allowances

Employers frequently pay educational expenses on behalf of employees or reimburse them for educational expenses they incur. In addition, many educational institutions provide a benefit in the form of free or reduced-cost education to employees. To determine whether the reimbursement or value of the education is excludable from wages, it is first necessary to determine which provisions of the Internal Revenue Code apply. There are three sections of the IRC that permit the payments or reimbursements to be excludable from wages under certain circumstances.

The following IRC Sections apply to tuition reductions:

For all employers:

IRC 132(d) – Education as Working Condition Fringe Benefit

IRC 127 – Qualified Educational Assistance Program

For certain other employers:

IRC 117(b) – Qualified Scholarships

IRC 117(d) – Qualified Tuition Reductions

An educational payment that is not exempt from tax under one IRC section may be exempt under a different section. An educational benefit under IRC Section 132(d) (working condition fringe benefit) can be excludable only if benefits under any other IRC sections do not apply. A chart at the end of this section provides help in determining whether specific payments or reimbursements for education expenses are excludable.

This section summarizes these provisions for employer-paid education. For more detailed information, see [Publication 970, Tax Benefits for Education](#).

Education as a Working Condition Fringe Benefit (Section 132(d))

Job-related educational expenses may be excludable from an employee's income as a [working condition fringe benefit](#), which is an excludable benefit of property or services provided by an employer to an employee so that the employee can perform his or her job. It applies to the extent the cost of the property or services would be allowable as a business expense to the employee if the employee had paid for it. The exclusion is generally available for any form of educational instruction or training that maintains or improves the job-related capabilities of an employee, or meets certain express requirements of the employer, or of applicable law or regulations. IRC Section 132(d); Treas. Reg. Section 1.162-5

For governmental entities, working condition fringe benefits for education may be available to current employees or independent contractors. For purposes of working condition fringe benefits, independent contractors, directors and partners, and volunteers are considered employees. Treas. Reg. Section 1.132-5(r) and 1.132-1(b)

For educational reimbursement to qualify as a working condition fringe benefit, the education must be job-related. It is not required that the employer have a written plan or dollar limitations, and the employer may discriminate in favor of highly compensated employees. IRC Section 132(d); Treas. Reg. Section 1.132-1(f)(1)

Job-Related

The educational course must be job-related, and either maintain or improve job skills, or be expressly required by the employer or by law.

Examples of qualifying (excludable) courses include work toward an advanced degree necessary to retain the job or pay level. IRC Section 132(d); Treas. Reg. Section 1.162-5(a)(1)

To be excludable, the educational course must not:

- Be needed to meet the minimum educational requirements of the current job, or
 - Qualify the employee for a new trade or business.
- Treas. Reg. Section 1.162-5(b)(2) and 1.162-5(b)(3)

Substantiation Requirements for Cash Payments to Employees

If an employee receives cash, the employer must require the employee to:

- Use the amount provided for payment of education expenses that qualify as a working condition fringe benefit,
- Verify that the payment was used for the expenses, and
- Return to the employer any unused portion of the payment.

Treas. Reg. Section 1.132-5(a)(1)(v)

Qualifying Educational Expenses

The following may qualify for exclusion as working condition fringe benefits:

- Tuition, books, supplies, equipment -Treas. Reg. Section 1.162-5(a)
- Certain travel and transportation costs -Treas. Reg. Section 1.162-5(d)
- Graduate or undergraduate level courses -Treas. Reg. Section 1.162-5(a)

Courses Qualifying Employee for New Position

Generally, education courses that qualify an employee for a new position or specialty within their existing trade or business are not excludable as a working condition fringe benefit. These are considered to be qualifying an employee for a new trade or business. Examples of excludable courses that qualify employees for a new position rather than a new trade or business include:

- Teacher to principal
 - Elementary school teacher to secondary school teacher
 - Teacher in one subject area to teacher in another subject area
 - Teacher to guidance counselor
- Treas. Reg. Section 1.162-5(b)(3)

Often, courses needed for acquiring a license or certificate are considered to be leading to a new trade or business. Examples include the following:

- Accountant to CPA
- CPA to lawyer
- Mechanic to engineer

Minimum Job Requirements

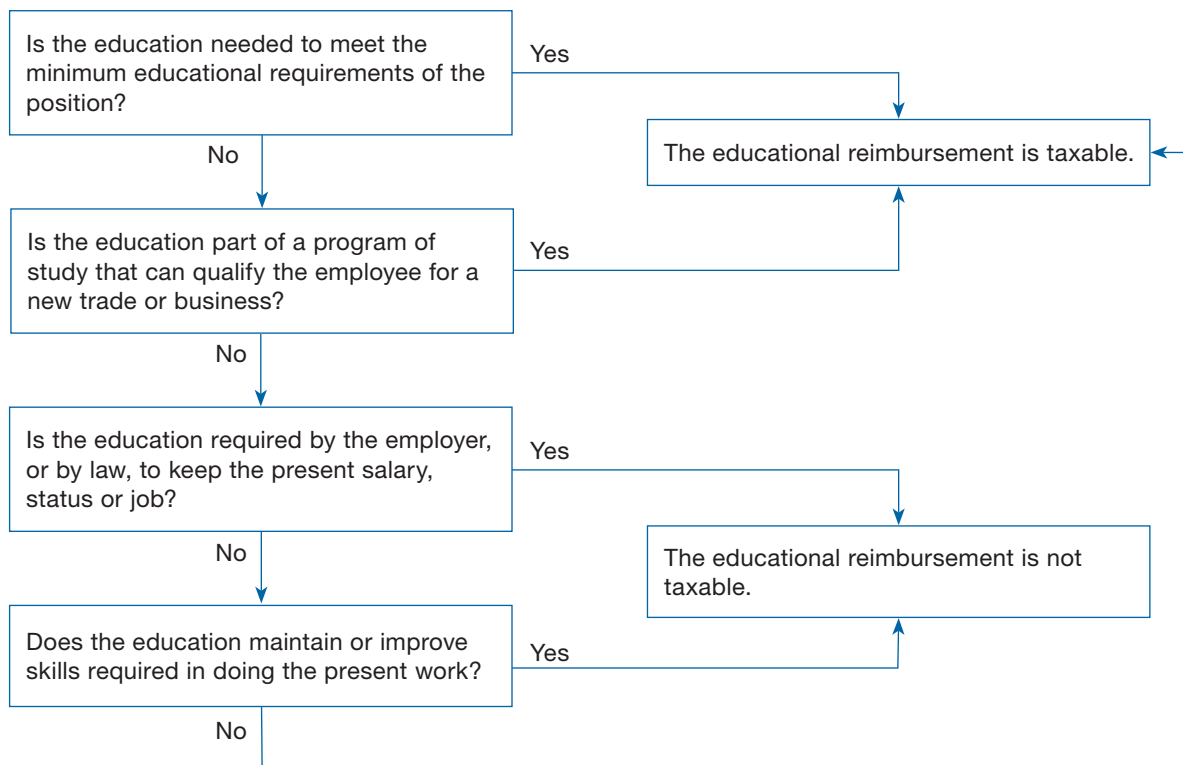
You cannot exclude payments for education to meet the minimum requirements of a job. Even if an employee is already performing service, this does not establish that the employee has met the minimum requirements of the job. Treas. Reg. Section 1.162-5(b)(2)

Example: Veronica is a computer technician at a state agency. The agency pays for her to take a graduate computer course at STU University to enhance her current job skills. The class is excludable as a working condition fringe because it is job-related and maintains or improves Veronica's skills, and it does not prepare her for a new trade or business.

Example: Due to a teacher shortage, Doug, who has 80 hours of college credits, is given a position as a teacher although the job normally requires 120 hours of credits. Doug is reimbursed by his employer for the expenses of completing the 40 credits at night school while he is teaching. The reimbursement is not excludable as a working condition fringe benefit because the courses are needed to meet the minimum requirements of his present job. (This amount may be excludable under another IRC section, for example, Section 127. See Qualified Educational Assistance, later.)

Example 3: Peter, a fiscal technician hired into an Accountant I position, does not have all the accounting credits he needs for the job. He registers for and takes the courses required for the position. The courses may improve his job performance, but the primary purpose of taking them is to acquire the minimum requirements for the position. The reimbursement for Peter's classes is not excludable under IRC Section 132(d) because the education is needed to meet the minimum educational requirements of his position. The reimbursement is included in Peter's wages, unless it is excludable under another IRC Section, such as Section 127. (See Qualified Educational Assistance, later.)

Working Condition Educational Fringe Benefit - General Guide



Qualified Educational Assistance (Section 127)

Under an educational assistance plan, an employer may exclude up to \$5,250 paid or incurred on behalf of an employee from the wages of each employee, if certain requirements are met. The education may be at undergraduate or graduate level and is not required to be job-related. IRC Section 127

The following requirements apply for a qualified educational assistance plan:

- The employer must have a written plan.
- The plan may not offer other benefits that can be selected instead of education.
- Assistance does not exceed \$5,250 per calendar year for all employers of the employee combined.
- The plan must not discriminate in favor of highly compensated employees (generally, for 2020, those receiving \$130,000 or more). IRC Sections 127(a)(2) and 127(b)(2); Notice 2019-59 for 2020

Eligible Employees

Individuals who may qualify for the Section 127 benefit include current and laid off employees, employees retired or on disability, and certain self-employed individuals. Spouses or dependents of employees are not eligible. Treas. Reg. Section 1.127-2(h)

Educational Expenses

Educational expenses include tuition, books, supplies and equipment necessary for class.

Educational expenses do not include tools or supplies that the employee may keep after the course is completed; education involving sports, games, hobbies (unless job-related), meals, lodging or transportation. IRC Section 127(c)(1)

Example: Karen is a secretary at a state agency. She wants to take an undergraduate psychology class at MNO Community College. The state agency has a written educational assistance plan. The state agency pays \$250 for the tuition to the community college for the course. Karen receives no taxable income from this benefit because the requirements for an educational assistance plan have been met under IRC 127.

Example: Joe, a janitor at a state agency, wants to take a math class toward his bachelor's degree. The state agency has a qualified educational assistance plan and reimburses Joe \$300 for the course after he verifies the cost. Joe does not have taxable wages from this reimbursement.

Example: Tom is a recreation specialist for a municipality. His employer pays for him to take courses toward a license as a soccer referee. If the employer has a qualified plan, Tom does not have taxable income from this benefit, even though the courses he is taking are sports-related. The courses have a reasonable relationship to the business of the employer, and this meets an exception to the rule that sports, games and hobby classes are not permitted under educational assistance programs.

Qualified Tuition Reduction (Section 117)

Free or reduced tuition provided by educational institutions to its employees may be excludable from their wages. At the undergraduate level, the education need not be at the same institution where the employee works. Whether a tuition reduction is a qualified tuition reduction, and therefore excludable from income, depends on whether it's for education below or at the graduate level, and whether the tuition reduction represents payment for services. IRC Section 117(d)

An "educational organization" for this purpose must:

- Maintain a faculty and curriculum, and
- Normally have a regularly enrolled student body on site. IRC Section 170(b)(1)(A)(ii)

Nondiscrimination

Generally, a qualified tuition reduction cannot discriminate in favor of highly compensated employees (for 2020, employees with total compensation exceeding \$130,000). IRC Section 117(d)(3); IRC Section 414(q)(1)(B)(i); Treas. Reg. Section 1.132-8(f); Notice 2019-59 for 2020

Qualified Tuition Below Graduate Level

A tuition reduction for education below the graduate level is excludable only if the student is associated with the educational institution as a:

- Current employee
- Former employee who retired or left on disability
- Widow or widower of an individual who died while an employee
- Widow or widower of a former employee who retired or left on disability
- Dependent child or spouse of one of the above

IRC Section 117(d)(2)(A); IRC Section 132(h)

The tuition reduction cannot represent payment for services.

Example: Carl works for ABC Community College, a division of the State University, as a physics teacher. His two children attend the State University undergraduate program at a reduced tuition. This situation meets the requirements for qualified tuition reduction and does not result in any taxable income for Carl.

Example: The facts are the same as in the above example, but in addition to reduced tuition, Carl's children are receiving free room and board. The tuition reduction remains excludable, but the value of the free room and board will be taxed as wages to Carl.

Qualified Tuition Reduction at Graduate Level

Tuition reductions for graduate education are considered "qualified" and are excludable only if they are provided by an eligible educational institution to a graduate student performing teaching or research activities for the educational institution. The courses must be taken at the school where the employee is working. The employee must include in income any other tuition reductions received for graduate education. IRC Section 117(d)(5); Section 170(b)(1)(A)(ii)

Officers, Owners and Highly Compensated Employees

Qualified tuition reductions apply to officers, owners or highly compensated employees only if benefits are available to employees on a nondiscriminatory basis. This means that the tuition reduction benefits must be available on substantially the same basis to each member of a group of employees. The group must be defined under a reasonable classification set up by the employer. The classification must not discriminate in favor of owners, officers or highly compensated employees.

Tuition Waiver for State Employees

Some state laws permit state colleges and universities to waive all or a portion of tuition, services and activities fees for state employees. For example, the benefit is made available to those employed half-time or more in certain classifications for permanent employees.

If a tuition waiver or reduction does not meet the requirements for a qualified tuition reduction, it may still qualify for an exclusion as an educational assistance plan or as a working condition fringe benefit. IRC Sections 117(d), 127 and 132(d)

Qualified Tuition Reductions and IRC 132

If the tax treatment of an educational expense is expressly provided for in a specific IRC section, then it is not covered by IRC Section 132 (except for Section 132(e), de minimis fringe benefits). Because Section 117(d) applies specifically to tuition reductions, the exclusions under Section 132, such as no-additional-cost benefits or working condition fringe benefits do not apply to **free or discounted tuition** provided to employees of an educational institution. Treas. Reg. Section 1.132-1(f)(1)

If the amounts paid (not the value of reduced or free tuition) by the employer for education relating to the employee's trade or business as an employee of the employer is such that, if the employee had paid for the education, the amount paid would be allowable as an employee business expense deduction, the costs of the education may be eligible for exclusion as a working condition fringe benefit under Section 132. Field Service Advice 200231016

Scholarships and Fellowships

Individuals pursuing a course of study or research often receive awards or funds to pay for their educational costs in the form of scholarships, fellowships, stipends or grants. Regardless of the name given the benefit, the taxability of the award depends on whether the provisions of IRC Section 117 are met.

The amount is excludable if it is a “qualified” scholarship or fellowship, discussed below, and the recipient is a candidate for degree at a qualified educational organization. IRC Section 117(a)

The amount is taxable if it represents payment for, or requires, past, present or future services, or is a payment that funds study or research primarily for the benefit of the grantor. Treas. Reg. Section 1.117-4(c)

Candidate for Degree

A candidate for degree, for this purpose, is:

- A primary or secondary school student, or
- An undergraduate or graduate student pursuing studies or conducting research toward a degree at a college or university, or
- A full- or part-time student at an accredited educational institution.

Treas. Reg. Section 1.117-6(c)(4)

Example: Jeff, a professor of anthropology, is awarded a fellowship by the college that allows him to devote 100% of his time to a research project of his choice. The fellowship is designed to award faculty for present or past services. The fellowship is taxable wages to Jeff.

Example: Tracy is granted a stipend by the city of Riverdale to attend a paramedic training program. She is required to accept employment with the grantor at the conclusion of the training. The stipend is taxable wages to Tracy.

Example: Mona is a candidate for an advanced medical degree at a university. She receives a fellowship grant of \$4,000 per month for performing surgery in a residency program at the university’s hospital and a one-time payment of \$3,000 for independent research of Mona’s choosing. The \$3,000 for research is excludable from income. The \$4,000 per month grant to perform surgery represents payment for services and is taxable as wages.

Qualified Scholarship or Fellowship

A qualified scholarship or fellowship is excludable to the extent the amounts are used for qualified tuition and related expenses. This includes fees, books, supplies and equipment required for a class. Qualified expenses do not include travel, meals or lodging. IRC Section 117(b)

An educational institution is an organization that exists for an educational purpose, maintains a regular faculty and curriculum, and has a regularly enrolled body of students on site. IRC Section 170(b)(1)(A)(ii)

Comparison of Code Sections Covering Educational Assistance

The following table is for quick reference. For more information, see the relevant IRC Sections or [Publication 970](#).

Feature	Section 127 Qualified Educational Assistance	Section 132(d) Working Condition Fringe	Section 117(d) Qualified Tuition Reduction
Written plan required	Yes	No	No
Undergraduate courses covered	Yes	Yes	Yes
Graduate courses covered	Yes	Yes	No*
Must be job-related	No	Yes	No
Courses qualifying employee for new trade or business covered	Yes	No	Yes
Courses needed to meet minimum job requirements covered	Yes	No	Yes
Can discriminate in favor of highly compensated employees	No	Yes	No
Dollar limitation	\$5,250	No	No
Definition of employee includes:			
Current employees	Yes	Yes	Yes
Family members	No	No	Yes
Laid-off employees	Yes	No	No
Employees retired or on disability	Yes	No	Yes
Independent contractors	No	Yes	No
Educational expenses covered:			
Tuition	Yes	Yes	Yes
Books, supplies, equipment	Yes	Yes	No
Tools or supplies employee may keep	No	No	No
Education involving sports, games, hobbies	No**	No**	Yes
Meals, lodging or transportation	No	Yes	No

* See text for exceptions

** Yes, if specifically job related

Note: These are general rules.

Dependent Care Assistance

Under Section 129, an exclusion is provided for household and dependent care services provided by an employer for a qualifying person's care and provided to allow the employee to work. The employer can exclude the value of these benefits from employee wages if the employer reasonably believes that the employee can exclude the benefits from gross income.

An employee can generally exclude from gross income up to \$5,000 (\$10,000 in 2021) of benefits received under a dependent care assistance program each year. However, the exclusion cannot be more than the smaller of the earned income of either:

- The employee, or
 - The employee's spouse.
- IRC Section 129(b)(2)

Nondiscrimination Rule

You cannot exclude dependent care assistance from the wages of a highly compensated employee unless the benefits provided under the program do not favor highly compensated employees (generally, for 2020, those earning \$130,000 or more). For more information, see [Publication 15-B](#). IRC Section 129(d)(2)

Reporting

Amounts that the employer does not believe will qualify for exclusion are reported as wages on Form W-2, subject to income tax, Social Security and Medicare withholding. Amounts that are excluded are shown in box 10 of Form W-2.

Dependent care assistance may be offered as part of a cafeteria plan. For more information, see Publication 15-B and [Publication 503, Child and Dependent Care Expenses](#).

Group-Term Life Insurance

An employer may exclude the imputed cost of up to \$50,000 of employer-provided coverage under a group-term life insurance plan, if the plan:

- Provides a general death benefit that is not included in income;
- Is provided to a group of employees (generally, at least 10 full-time employees at some time during the year). Certain exceptions apply to this rule (see the discussion in [Publication 15-B](#) and Treas. Reg. Section 1.79-1(b) and (c));
- Provides an amount of insurance to each employee based on a formula that prevents individual selection. This formula must use factors such as the employee's age, years of service, pay or position; and
- Benefit is provided under a policy carried directly or indirectly by the employer. Even if the employer does not pay any of the policy's cost, the employer is considered to carry it if it arranges for payment of its cost by its employees and charges at least one employee less than, and at least one employee more than, the cost of their insurance. IRC Section 79

Coverage of More Than \$50,000

The employer must include in employee's wages the imputed cost of group-term life insurance for more than \$50,000 worth of coverage, reduced by the amount the employee paid toward the insurance. To determine the amount to include in employee wages, do not use the actual cost; you must use a table designated by the Regulations. This table provides a monthly cost per \$1,000 of coverage, and may be found as Table 2-2 in [Publication 15-B](#) or Table 1 in Treas. Reg. Section 1.79-3(d)(2). Use this table to determine the value of additional coverage to include in wages.

Dependent Coverage

Group-term life insurance coverage paid by the employer for the spouse or dependents of an employee may be excludable from income as a de minimis fringe benefit if the face amount is not more than \$2,000. If the face amount is greater than \$2,000, the entire amount of the dependent coverage must be included in income unless the amount over \$2,000 is purchased with employee contributions on an after-tax basis. Notice 89-110

Former Employees

When group-term life insurance coverage of more than \$50,000 is provided to an employee or former employee (including retirees) after their termination, the employee share of Social

Security and Medicare taxes on that period of coverage is paid by the former employee with their tax return on Form 8919, Uncollected Social Security and Medicare Tax on Wages, and is not collected by the employer. The employer is not required to collect those taxes. The value of the insurance coverage is computed in the same way as with current employees, as discussed above.

Use the table providing monthly cost per \$1,000 of coverage to determine the amount of Social Security and Medicare taxes owed by the former employee for coverage provided after separation from service. Report those uncollected amounts separately in box 12 on Form W-2 using codes “M” and “N.” See the [Instructions for Form W-2 and W-3](#) and the [Instructions for Form 941](#).

See [Publication 15-B](#) for more information on how to apply the nondiscrimination tests, and other eligibility rules and reporting requirements for group-term life insurance benefits.

Fringe Benefits for Volunteers

Individuals designated as “volunteers” perform significant services for many governmental entities. Although not providing fixed salaries or wages, the entities may provide the volunteers with various reimbursements, stipends, property or other benefits. The general rules for employment tax apply to any compensation received, regardless of the title given to or used by the worker. Reimbursements made under the accountable plan rules for employees, discussed earlier, are excludable from income. In addition, volunteers may be able to deduct business-related expenses against compensation they receive.

Example: Volunteer workers for County X receive no cash payments for their services but are entitled to a reduction in their personal property taxes based on the number of hours of volunteer work provided. The value of the tax reduction constitutes taxable wages to the volunteers.

As is the case with employees generally, the treatment of the payments or reimbursements for federal payroll purposes depends on whether the volunteer is an employee or nonemployee, and on the form of payment. The same tests that are used to determine whether other workers are common-law employees apply to workers who are considered volunteers. The common-law tests are discussed in detail in [Publication 15-A](#). The discussion below illustrates how the common-law rules may apply to volunteers.

Bona fide volunteers who perform services for a government entity are covered by the rules generally applied to employees for [working condition fringe benefits](#). An individual is considered a bona fide volunteer if the volunteer does not have a profit motive. In general, if the value of the services the volunteer provides is substantially greater than the benefit received, this indicates an absence of a profit motive. Treas. Reg. Section 1.132-5(r)(3)

Right to Control

A volunteer is an employee under common law if an entity has the right to direct and control the volunteer’s performance, not only as to the results to be accomplished, but also as to the methods by which the results are accomplished. It is the right to control, even if the entity does not exercise the right, that is important. Many factors in an employment relationship may have to be considered before a decision can be made as to whether the entity has the right to direct and control. If an entity does not retain the right to direct and control the details and means of performing the work, the volunteer worker is not an employee.

Evidence of the Right to Control

In determining whether an entity retains the right to control a worker, the IRS generally looks at facts that fall into three main categories of evidence: behavioral control, financial control and relationship of the parties. The facts considered in these categories include whether the agency provides training or instructions, whether the worker can earn a profit or incur a loss, or whether benefits are provided. All these elements do not apply in every situation and the degree of importance varies depending on circumstances.

Example: An agency is required to build a watershed in a state forest. Volunteers who are experienced in forestry work have offered their services. The agency asks the volunteers to build the watershed in accordance with environmental laws to the best of their abilities and experience. The agency does not provide other instructions or supervision. These individuals are not employees.

Example: The circumstances are the same as above, except an agency employee oversees the project. The agency gives instructions, provides the tools and materials, and sets the hours of operation. In this case, the volunteers are common-law employees for tax purposes. See [Publication 15-A](#) for more information on the tests for common-law employees.

Volunteer Firefighters

Generally, “volunteer” firefighters are employees of the fire department or district for which they perform services. The usual common-law tests apply to determine their employment status. For example, the relationship between the firefighter and the fire department will generally indicate that the department provides training and direction in how the work will be performed and provides the equipment to perform the work.

Many jurisdictions provide some kind of compensation to volunteer firefighters, or emergency responders, other than payments designated as wages. For instance, in some cases, volunteer firefighters receive no amounts designated as salaries, but receive amounts intended to reimburse them for expenses. They may also receive other cash or in-kind benefits, including reductions in property or other local taxes that may be includible in gross income for federal tax purposes. They may receive no regular payment but receive a certain amount of reimbursement per call. None of these payments are automatically excluded from income. Volunteer firefighters who are employees can receive tax-free reimbursements for their expenses provided the [accountable plan rules](#) are met; any reimbursements that are provided without an accountable plan are includible in income.

Payments under Domestic Volunteer Service Act (Title II and III)

Payments for supportive services or reimbursements of out-of-pocket expenses of volunteers under Title II and III of the Domestic Volunteer Service Act are not wages or compensation and no withholding or reporting is required by the payer. Rev. Rul. 74-322; Rev. Rul. 78-80

Programs under Title II and III include:

- Retired Senior Volunteer Program (RSVP)
- Foster Grandparent Program and other older volunteer programs
- SCORE Association
- Active Corps of Executives (ACE)

Liability Insurance for Volunteers

Liability insurance provided for volunteers by an entity qualifies as a tax-free working condition fringe benefit. Treas. Reg. Section 1.132-5(r)(3)(ii)

Reporting Payments to Volunteers

If a volunteer meets the definition of an employee, the reporting rules are the same as for other employees. Therefore:

- Stipends and other payments for services are wages,
- Reimbursements paid under an accountable plan are not taxable and not reportable, and
- Reimbursements not paid under an accountable plan are taxable and reportable on Form W-2 as wages subject to withholding.

No reporting for these types of payments is necessary if the only payments are reimbursements for substantiated expenses. However, if the reimbursements are greater than the expenses, the excess is gross income (unless some other exclusion applies), and is reportable on Form 1099-MISC. Treas. Reg Section 1.6041-1; Rev. Rul. 67-30

Fringe Benefits for Independent Contractors

Generally, the taxability of fringe benefits or reimbursements paid to independent contractors is similar to that for employees. However, different withholding and reporting requirements apply to these workers. Treas. Reg. Section 1.132-1(b)(2)(iv)

Note: Independent contractors are not eligible for qualified transportation fringe benefits. Treas. Reg. Section 1.132-9(b) Q-5

Reimbursements for Travel, Transportation and Other Out-of-Pocket Expenses

Expense reimbursements or advances must meet the accountable plan rules to be excluded from reporting and income. In general, all compensation for services for an independent contractor must be reported on Form 1099-MISC when the amount (excluding reimbursements under an accountable plan) is \$600 or more in a calendar year. The amounts are not subject to income or employment tax withholding.

Example: An independent contractor is hired to perform specific services for a set fee, plus out-of-pocket expenses. If the contractor provides adequate substantiation for the out-of-pocket expenses, reimbursements for these expenses will not be reported as income by the payer on Form 1099-MISC, or by the contractor on their individual income tax return. The contractor may not deduct the expenses if they are reimbursed by the payer. If the contractor is not reimbursed, adequate substantiation of the expenses should be retained to claim expenses on the contractor's individual income tax return.

If the individual is considered an independent contractor and does not properly account to the payer for reimbursed expenses, then any advances or reimbursements are to be included on a Form 1099-MISC as taxable nonemployee compensation, along with other payments for their services.

Substantiation Requirements

[Publication 463](#) provides information on records, substantiation and reporting requirements for independent contractors.

Independent contractors are treated in the same manner as are employees for purposes of working condition fringe benefits.

Board and Commission Members

Some of the independent contractor rules and reporting requirements may also apply for board or commission members. Board or commission members of a government entity are generally considered public officials, and therefore are considered employees; however, under some circumstances, and based on local statutes, they may be independent contractors. Officers, employees and elected officials of states and their political subdivisions and instrumentalities are employees for purposes of federal income tax withholding. But for FICA (Social Security and Medicare) purposes, the common-law rules apply to determine whether an individual is an employee.

Public officials are usually subject to a degree of control that is characteristic of an employer-employee relationship. If you are not sure of the employment status of a board or commission member, it may be necessary to consult the statutes or ordinances establishing a position to determine whether that position is a public office.

In the case of school boards, the statutes or ordinances usually provide ample evidence that the school board members are public officials. Elected public officials serve a term designated by the voters and are subject to control by a supervisor, and should generally be classified as employees. Appointed public officials are generally employees, but under some circumstances may be independent contractors. See [Publication 963](#) and [CCA 200113024](#).

IRS Publications

Publication number	Title
15	(Circular E), Employer's Tax Guide
15-A	Employer's Supplemental Tax Guide
15-B	Employer's Tax Guide to Fringe Benefits
463	Travel, Gift, and Car Expenses
521	Moving Expenses
525	Taxable and Nontaxable Income
535	Business Expenses
963	Federal-State Reference Guide
970	Tax Benefits for Education
1542	Per Diem Rates

New revisions of the publications are generally available after the first of the year. Forms and publications may also be ordered by calling 800-829-3676.

Legend for Reading the Citations in this Publication

Citation Source	Example
Internal Revenue Code	IRC Section 132(a)(1)
Treasury Regulation	Treas. Reg. Section 1.162-2(a)(2)
Revenue Procedure	Rev. Proc. 2007-1
Publication	Pub. 15-B
Revenue Ruling	Rev. Rul. 2006-36
Notice	Notice 98-03
Field Service Advice	FSA 200132035
IRS News Release	IR 2007-171
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