



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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR ALL FIELD EXAMINATION OPERATIONS

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SUBJECT: Interim Guidance (Reissued) on Field Guidance in light of Revenue Ruling 2006-56

The purpose of this memorandum is to re-issue expired Interim Guidance Memorandum SBSE-04-1106-049. Please ensure that this information is distributed to all affected employees within your organization.

Original Memorandum SBSE-04-11-06-049:

The purpose of this memorandum is to provide administrative guidelines to examiners who are auditing the Excess Per Diem Payment issue in light of Revenue Ruling 2006-56. This is not intended to be a technical position but to provide audit issue direction to effectively utilize resources and to recognize that taxpayers may need some time to come into compliance. The issue involves taxpayers who pay reimbursement allowances to employees for travel expenses in an amount exceeding the federal per diem rate without treating such excess amounts as wages for employment tax purposes. The excess payments call into question whether the employer has an accountable plan.

Payments under an accountable plan are treated as nontaxable expense reimbursements. In contrast, payments under a nonaccountable plan are wages that must be reported on Forms W-2 and are subject to employment taxes. The issue frequently arises in audits of transportation or construction businesses. Revenue Ruling 2006-56, published in the Internal Revenue Bulletin on November 13, 2006, provides guidance as to the proper employment tax treatment of expense allowance payments where an employer fails to treat amounts exceeding the federal per diem rate as wages. The ruling holds that a taxpayer's failure to track excess allowances and its routine

payment of excess allowances that it does not treat as wages evidences a pattern of abuse and causes all payments made under the expense allowance arrangement to be treated as made under a nonaccountable plan.

The Revenue Ruling is effective immediately upon issuance. However, most taxpayers who are not currently in compliance regarding the treatment of excess per diem payments will need time to update or secure accounting software enabling them to compute the proper amount of additional wages. So, for taxable periods ending on or before December 31, 2006, absent egregious circumstances or evidence of intentional noncompliance, the examiner should not treat a plan as entirely nonaccountable solely because excess per diem payments were not treated as wages. Instead, the examiner should treat only the excess amounts over the federal per diem limit as wages.

For periods ending after December 31, 2006, the examiner will determine whether the plan is abusive based on the extent of the excess payments that are not treated as wages and on whether a system for tracking excess payments is being utilized. The examiner should apply the following criteria in making these determinations:

Considerations for the examiner for periods after December 31, 2006:

- *When does an employer routinely make payments in excess of the deemed substantiated amount?* The agent should apply the criteria in LEM 4.23.5. If the LEM criteria are not met, excess payments will not constitute a pattern of abuse, absent other significant plan defects
- *When does an employer fail to track excess allowances?* If the criteria in LEM 4.23.5 above are satisfied, the agent must determine whether the employer has implemented and utilizes a system to track allowances that permits it to determine when the allowances paid to its drivers, computed on a per diem basis, exceed the deemed substantiated amount, and to treat such amounts as wages. If the agent determines the employer utilizes such a system, then the fact that the employer, due to errors in its system, routinely pays excess allowances that it does not treat as wages generally does not, on its own, evidence a pattern of abuse. Each case stands on its own, and a determination must be made based on the “facts & circumstances” of that particular case.
- *What happens if a plan evidences a pattern of abuse?* If a plan evidences a pattern of abuse, all of the per diem payments made under the plan will be treated as taxable wages.
- *What happens if a plan does not evidence a pattern of abuse?* If a plan does not evidence a pattern of abuse, but an employer has paid excess allowances without treating such amounts as wages, only the excess per diem payments will be considered taxable wages in this audit.

If you have any questions regarding these guidelines, please contact Robert Everitt, LMSB Ground Transportation Technical Advisor; Kathy Van Deventer, LMSB Senior Program Analyst; Ed Hutzmann, SBSE Senior Policy Analyst; or William Reed, TEGE Senior Policy Analyst.

cc: www.irs.gov