

Accountable Plan or Unreimbursed Business Expenses

Cross References

- *Simpson*, T.C. Memo. 2023-4

When an S corporation is operated out of the shareholder's residence, it is typical that the shareholder/employee is reimbursed for office in home and travel expenses under an accountable plan. The shareholder/employee incurs and pays the expenses and then submits receipts to his/her S corporation for reimbursement. The S corporation then deducts the payments as business expenses and the reimbursements are excluded from the shareholder/employee wages.

If there is no accountable plan, then the S corporation treats the reimbursement as taxable shareholder/employee wages and the shareholder/employee treats the expenses as unreimbursed employee business expenses, subject to the 2% AGI limitation for miscellaneous itemized deductions (which currently are not deductible).

The taxpayers in this case were husband and wife who were equal shareholders of a wholly owned S corporation. They operated their business out of an office in their home. The taxpayers claimed that they had an accountable plan with their S corporation. Thus, reimbursements from their S corporation for their office in home and travel expenses should not be included in their gross income. The IRS claimed that they did not have an accountable plan and therefore reimbursements should be treated as wages and expenses should be treated as unreimbursed employee business expenses.

The court noted that the rules for an accountable plan fall under IRC section 62(a)(2)(A). To qualify as an accountable plan, such plan must meet the following requirements.

- 1) Reimbursements must only be for business expenses that are allowable as deductions that are paid or incurred by the employee in connection with the performance of services as an employee of the employer.
- 2) Each business expense must be substantiated to the payor within a reasonable period of time.
- 3) Reimbursements for travel, entertainment, use of a passenger auto or other listed property, or other business expenses governed by IRC section 274(d) must meet the strict substantiation requirements of IRC section 274(d) and related regulations.
- 4) Reimbursements not subject to IRC section 274(d) requires information to be submitted to the payor that is sufficient to enable the payor to identify the specific nature of each expense and to conclude that the expense is attributable to the payor's business activities.
- 5) Any amount reimbursed in excess of the expenses substantiated must be returned to the payor within a reasonable period of time.

IRC section 62(c) further clarifies that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of IRC section 62(a)(2)(A) if it:

- 1) Does not require the employee to substantiate the expenses covered by the arrangement to the person providing reimbursement, or
- 2) Provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

At trial, the taxpayer's sister who was vice president of the tax preparation firm that prepared the S corporation tax returns testified that the S corporation had an unwritten accountable plan. The taxpayer affirmed in his testimony that, although he may have discussed an accountable plan with his accountants, his S corporation did not have any formal thing.

The court noted that while an accountable plan does not necessarily have to be in writing, there must be, at the very least, some extrinsic evidence that indicates that such a plan exists. For example, if the taxpayers engaged in a formal process whereby they collected all relevant documentation to substantiate the purported expenses and then reimbursed themselves from the corporate account with the exact amounts associated with the expenses, such evidence might be sufficient to corroborate the existence of an unwritten accountable plan.

The court stated the record here notably lacks any such occurrence. Aside from the taxpayer and his sister's testimony regarding their subjective intent to establish an accountable plan, there is no evidence in the record to suggest that the S corporation required the taxpayer to substantiate his expenses or return any amounts received that exceeded those expenses. In fact, the taxpayer testified that with respect to instances in which he transferred money from the S corporation to his personal account, such occurrences could have been for a reimbursement as well as a distribution. Moreover, of the numerous documented transfers between the S corporation's checking account and the taxpayer's checking account, there are no records that identify the purpose of any specific transfer.

Thus, there is no credible evidence in the record to indicate that the S corporation had an accountable plan that meets all the requirements under the regulations. Because the S corporation did not have an accountable plan, all expenses incurred personally by the taxpayer in connection with his employment with his S corporation are considered unreimbursed employee business expenses.