

IRS Continues Scrutiny of Staffing Industry Per Diem Policies

Recent IRS Revenue Ruling highlighted Staffing Agency reimbursement policies

Revenue Ruling 2012-25, issued September 10, 2012, addressed *wage recharacterization* in reimbursement policies using hypothetical examples of a cable contractor, healthcare staffing agency, construction firm and cleaning services. These examples reflect exam activity and represent the IRS' application of the tax code.

Recent Cases involving Wage Recharacterization

In *Gagnon v United Technisource Inc* US Court of Appeals, Fifth Circuit, May 2010 (07 F.3d 1036; 2010 U.S. App), the court added per diems to base wages for the purpose of overtime, unemployment and workers compensation. Employee received a raise in per diem, not wages. Wage + per diem approximated the prevailing wage for similar tradesmen in the area. Additionally, per diems were paid based on hours worked. When the amount of per diem varies with the amount of hours worked the per diem payment is part of the regular rate in its entirety.

In *Readylink Healthcare v. Dave Jones/Workers Compensation Insurance Rating Bureau* (November 6, 2012, California Court of Appeals 2nd District), recharacterized wages and a poorly constructed reimbursement policy contributed to an adverse premium determination.

Low wages can be an indicator *Wage Recharacterization*.

Attempts to "recharacterize wages" can cause an employer's entire reimbursement program to be classified as a "non-accountable" plan which treats all payments as taxable wages. Some of the following scenarios can be construed as an effort to recharacterize wages:

- Contracts that offer a choice between wages OR reduced wages and tax-free travel allowances.
- Contracts that offer the option to have a travel reimbursement item taxed when it is offered to all that qualify.
- Recruiters that negotiate rates by liberally offering more tax-free amounts in lieu of a wage.
- Wages differing between professionals in the same facility with proportional differences in reimbursements.

Tres Regs §1.62-2(j) Example 1, Letter Ruling 9052002, Chief Counsel Advice 200745018, Dicta Stubbs, Overbeck and Associates v United States 313 F Supp 23 (1970), Shotgun Delivery v United States 85 F. Supp. 2d 962, Revenue Ruling 55-196, FSA 002985, Feb 10, 1998, updated January 31, 2004, Gagnon v United Technisource May 2010

Do not mingle wages and reimbursements – they are separate components Hourly per diems are problematic

Wages are paid for work - reimbursements are paid for expenses incurred in performing the work. Hourly per diems should be avoided as they are daily rates. If paying per diems based on hours worked, clarify that the amounts are a daily reimbursement and not a wage. Penalties for missed time should be in the form of "claw backs," not in the form of forfeited hourly per diems. Hourly per diems are not completely disallowed when they anticipate the actual expenses of the employee (*Worldwide Labor Support of Mississippi v US*) but the practice invites unnecessary IRS scrutiny and conflicts with the goals of state labor and unemployment boards. *Tres Regs §1.62-2(j), Example 2, Gagnon v United Technisource, May 2010.*

Other Items of Audit Focus

Transportation allowances must have substantiation

Only meal and lodging amounts can be paid on a per diem (daily) basis. All other expenses, including transportation reimbursements must be evidenced (substantiated) by receipt, mileage log or report from the employee.

A Tax Residence and a Permanent Residence are two separate items

A *tax home* and a *permanent residence* are different. Legal ties only point to a permanent residence. A tax home is an economic base.

Train Recruiters to understand basic tax principles

Recruiters do not need to become agents of IRS enforcement; but they should understand basic tax laws to positively contribute to tax compliance. Ask us how we can help.

Review how you assess an employee's eligibility for tax-free reimbursements

Combined with employment history and information procured during the employment application, a *Tax Home Declaration* will provide significant due diligence in assessing a traveler's eligibility for tax-free allowances. Tax home statements help shift the burden of proof to the employee and encourage the advice of a tax professional. At a minimum, the statement should address previous work in the area of the proposed assignment, whether the traveler will incur overnight stays at the assignment location, whether they have a financial responsibility maintaining a primary residence or have significant employment income in the area of their home. Tax Home Declarations should avoid suggestive wording like "50 mile rules" and other popular benchmarks which are self-serving and not part of the tax regulations.. *IRC §62, Tres Regs. §1.62-2. For the "50 mile rule": IRC §162(h), Tres Regs. §1.162-24, Rev Ruling 73-529, IRS Publication 463*

No tax home – no tax-free travel reimbursements

Without a qualifying tax home, all transportation, lodging and meal per diems, allowances, stipends AND the value of any provided housing are taxable. Property (lodging) for services is constructive receipt of income. *IRC §119*

Lodging only or 100% deductible per diems not allowed except under specific conditions

Under *accountable plan* rules, an alternative to actual receipts for lodging and meals is the *Per Diem* method of reimbursement. This allows the employer to pay a fixed amount for lodging and meals OR a fixed amount for meals (M&I) when the lodging is provided or paid at actual costs. The rules do not provide for a lodging/housing only payment without an allocation to meals. If the allowance is less than the full amount of the prevailing Meals + Incidentals + Lodging rate for the locality, the allowance is deemed to be 60% for lodging and 40% for meals. One may have a lodging *only* reimbursement (no meal allowance) if the lodging is reimbursed at actual costs. This is an important tax planning item as meals are only 50% deductible to the payer and should be evident in the tax return. Only when the meal per diem is specifically billed to the client is it 100% deductible. *Revenue Procedure 2007-63, Revenue Ruling 2008.23.*

Use *minimum break* policies for assignments nearing 12 months in the same area

IRS Chief Counsel Advice to appeals agents and IRS audit staff recommends breaks of at least 7 months between 12 month contracts. In our practice, we encourage clients to avoid working in one general area > 12 months in any 24 month time window. Since audits can be expanded to 3 years, this rule of thumb provides a safer approach for audit defense. *Chief Counsel Advice 200226025, 200025052 and 200018052, Revenue Ruling 93-86*

Suggestions

- Establish clear limits as to how far a recruiter can negotiate wages and reimbursements.
- Establish a wage/salary first and then add reimbursements if qualified or taxable if not qualified.
- Remember that "tax advantage" is a marketing term for reimbursements.
- Consider the effects of your policies on travelers. Reimbursements are not counted as income for loans.
- Do not market your reimbursement plan as a way to increase take home pay.
- Encourage the traveler to seek the services of a tax advisor familiar with mobile professionals.
- Contact us and arrange a recruiter workshop or reimbursement/per diem policy consultation.