Office of Chief Counsel
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Memorandum

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to: Area Counsel Mid-Atlantic, Baltimore, CC:TEGE:FS:MABAL
(Tax Exempt & Government Entities)

from: Branch Chief, Branch 7, CC:ITA:7
(Income Tax & Accounting)

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subject: Application of certain provisions of the per diem revenue procedure to transportation industry employees' meal and incidental expense reimbursements and whether the arrangement satisfies the accountable plan rules.

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer	=	
Date1	=	
Date2	=	
$a	=	
A	=	
B	=	

ISSUES

(1) Whether Taxpayer has paid a per diem allowance, as defined in section 3.01 of Rev. Proc. 2008-59, 2008-2 C.B. 857, or Rev. Proc. 2009-47, 2009-2 C.B. 524, for the payments for meals and incidental expenses (M&IE) paid: (a) to employees that report for training at the duty location (non-travelers); (b) to employees that arrive at the duty location for flight duty but return to the duty

location in the same day (day-travelers); and (c) to employees that arrive at the duty location for flight duty and have an overnight stay away from the duty location (overnight travelers)?

(2) Should the M&IE allowances paid to crew members during the Date1 and Date2 taxable years be considered paid under an accountable plan, as defined in § 1.62-2(c)(1) of the Income Tax Regulations, if Taxpayer failed to maintain any mechanism or process to track allowances paid to its crew members for the purpose of determining whether some portion of the M&IE allowance should have been included in employee wages?

(3) Does the periodic rule in section 4.04(3) of Rev. Proc. 2008-59 permit Taxpayer to average the number of meals provided in kind to an employee in determining whether the M&IE allowance provided to employees is includible in wages?

(4) Can Taxpayer correct its Federal employment tax return to apply the periodic rule in section 4.04(4) of Rev. Proc. 2008-59 to average retroactively the number of meals provided in kind to an employee in determining whether the M&IE allowance provided to employees is includible in wages?

(5) Does Taxpayer's travel reimbursement arrangement properly apply the "meals provided in kind rule" in section 6.03 of Rev. Procs. 2008-59 and 2009-47 if the arrangement specifies that the M&IE allowance provided to an employee for a day of travel is not includible in wages if the employee receives 2 or fewer meals provided in kind for that day during the duty assignment?

CONCLUSIONS

(1) The M&IE allowances paid by Taxpayer to (a) non-travelers and (b) day-travelers are not per diem allowances as defined in section 3.01 of Rev. Proc. 2008-59 or 2009-47, because the amounts are not deductible travel expenses under § 162. However, the M&IE allowances paid by Taxpayer to overnight travelers may be per diem allowances as defined in section 3.01 of Rev. Proc. 2008-59 or 2009-47 if they otherwise meet the requirements of § 162 and the remaining requirements of the definition of "per diem allowance" under section 3.01 of Rev. Proc. 2008-59 or 2009-47.

(2) For the Date1 taxable year, Taxpayer's per diem allowance arrangement does not meet the accountable plan requirements under § 62(c) and the accompanying regulations because the arrangement fails the business connection requirement. In addition, the arrangement had no tracking mechanism to determine whether per diem allowances paid exceeded the amount that could be deemed substantiated, and routinely paid allowances in excess of the deemed substantiated amount without requiring actual substantiation of all the expenses or repayment of the excess amount such that it

evidenced a pattern of abuse under § 1.62-2(k). Accordingly, payments made under the arrangement for Date 1 are treated as made under a nonaccountable plan.

For the Date2 taxable year, to the extent Taxpayer made per diem payments to non-travelers and day-travelers and did not treat the amounts as taxable wages, Taxpayer's per diem allowance arrangement failed to satisfy the business connection requirement, and payments made under the arrangement should be treated as paid under a nonaccountable plan.

(3) The periodic rule in section 4.04(3) of Rev. Proc. 2008-59 does not permit Taxpayer to average the number of meals provided in kind to an employee in determining whether the M&IE allowance provided to employees is includible in wages.

(4) The issue of whether Taxpayer can correct its Federal employment tax return to use the periodic rule in the manner described in Issue 3 is moot because we have determined that Taxpayer's methodology described in Issue 3, above, is an improper application of the per diem revenue procedure.

(5) Under the facts presented, Taxpayer reasonably applies section 6.03 of Rev. Procs. 2008-59 and 2009-47 because, under Taxpayer's meal tracking system, Taxpayer has a reasonable belief that an overnight traveler will incur M&IE for each day of the overnight traveler's duty assignment if 2 or fewer meals provided in kind in a given day during the duty assignment.

FACTS

Taxpayer is in the air transportation industry and employs personnel (crew members). Taxpayer provides employees with an M&IE allowance using a flat, hourly amount for each hour a crew member is on duty ("duty time"). In taxable years Date1 and Date2, Taxpayer paid its crew members an M&IE of $a/hour. Crew members were employees of Taxpayer and are hereinafter referred to as "employees." The maximum M&IE allowance paid to employees for any given travel day during the Date1 and Date2 taxable years was below the special transportation industry rates described in section 4.04(3) of Rev. Procs. 2008-59 and Rev. Proc. 2009-47.

Duty time in the air transportation industry is usually defined as the time the employee reports for duty at his or her assigned domicile or home base airport until the time the employee returns to his or her assigned domicile or home base airport and is released from duty to return to his or her residence. Employees are usually required to report for duty up to A hours before the flight is scheduled to take off and released from duty a half-hour after the flight arrives. A flight duty assignment is the time period in which the crew member reports for duty at the airport until the employee is released from duty either at a hotel or returns to his or her residence.

Under the Union contract with its employees, Taxpayer provided an M&IE allowance to employees if they report to their airport duty station for work. For example, Taxpayer provides an M&IE allowance under 3 situations: (1) to employees that report for training at the duty location (non-travelers); (2) to employees that arrive at the duty location for flight duty but return to the duty location in the same day (day-travelers); and (3) to employees that arrive at the duty location for flight duty and have an overnight stay away from the duty location (overnight travelers).

Taxpayer provides its employees with meals during their duty period (meals provided in kind) in addition to the M&IE allowance. For taxable years Date1 and Date2, Taxpayer permitted employees to order up to B meals provided in kind during each flight duty assignment. The employees typically consumed the delivered meals either prior to boarding the plane or during the course of the assigned flights. The employees would often eat at restaurants or their hotel at the end of their workday.

During the Date1 taxable year, Taxpayer did not track the number of meals provided in kind to its employees during a duty flight assignment for the purpose of determining whether some portion of the M&IE allowance should have been included in the wages of employees[1]. As a result, Taxpayer did not determine whether a reduction in the M&IE allowance was required, or, if some portion of the M&IE allowance was properly includible in the wages of employees.

During the Date2 taxable year, Taxpayer implemented a system designed to identify the number of meals provided in kind to employees on each day of the travel period as well as the daily M&IE allowance paid. Taxpayer reported as wages the M&IE allowances paid to an employee on days in which 3 or more meals were provided in kind to the employee. Conversely, if an employee received 2 or fewer meals provided in kind, Taxpayer did not include the M&IE allowance in the wages of the employee because Taxpayer had a “reasonable belief” that the employee incurred an M&IE for at least one meal for each day of travel. Taxpayer’s tracking system relies on section 6.03 of Rev. Procs. 2009-47 and Rev. Proc. 2010-39, 2010-42 I.R.B. 459, respectively, to determine when the M&IE allowance should be included in the wages of its employees.

Taxpayer proposes to correct its Date1 Federal employment tax return in order to account for days when employees received 3 or more meals provided in kind in a day during their duty flight assignment. Taxpayer proposes to include the M&IE allowance in the wages of employees when the employee received 3 or more meals provided in kind in a day during their duty flight assignment. For the Date1 taxable year, Taxpayer did not maintain records of the actual number of meals provided to employees on any given day during a duty flight assignment for the purpose of determining whether some portion of the M&IE allowance should have been included in the wages of the

[1] Although Taxpayer tracked meals provided in-kind to its employees on a daily basis, it did not have a system in place for using the data, and in fact did not use the data, to determine whether any portion of the M&IE allowance was taxable to its employees.

employees. In order to estimate the number of days in which the M&IE allowance should have been treated as wages to employees, for Date1 taxable year, Taxpayer proposes to use the periodic rule in section 4.04(4) of Rev. Procs. 2008-59 and 2009-47 in the manner described in the next paragraph. The facts presented do not state whether Taxpayer filed an amended Federal income tax return for the Date1 taxable year.

For Date1 taxable year, Taxpayer proposes to perform an analysis of each travel period for each employee. First, Taxpayer would determine the number of days for which M&IE allowances were paid to employees, and the number of meals provided in kind to the employee for the entire travel period. Second, Taxpayer, would apply the periodic rule to in-kind meals, averaged the number of meals provided to the employee per duty day to determine the average crew meals received per day. Third, Taxpayer would then allocate the meals provided in kind over the number of days in the travel period. Taxpayer would never allocate more than 3 meals provided in kind to any single travel day. If an employee received an average of 3 meals, Taxpayer would include the M&IE allowance for that day in the employee's wages.

LAW

Section 61 of the Internal Revenue Code defines gross income as all income from whatever source derived. Section 62 defines adjusted gross income as gross income minus certain deductions. Section 62(a)(2)(A) provides that, for purposes of determining adjusted gross income, an employee may deduct certain business expenses paid by the employee in connection with the performance of services as an employee of the employer under a reimbursement or other expense allowance arrangement.

Section 62(c) provides that, for purposes of § 62(a)(2)(A), an arrangement will not be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or (2) the arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 1.62-2(c)(1) provides that a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan. See § 1.62-2(c)(2). Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not reported as wages or other compensation on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes. See § 1.62-2(c)(4). Conversely, if the arrangement fails any one of these requirements, amounts paid under the arrangement are treated as paid under a nonaccountable plan

and are included in the employee's gross income, must be reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. See § 1.62-2(c)(3) and (5).

Section 1.62-2(d)(1) provides that, except as provided in § 1.62-2(d)(2) and (d)(3), an arrangement meets the business connection requirement if it provides advances, allowances (including per diem allowances, allowances only for meals and incidental expenses, and mileage allowances), or reimbursements only for business expenses that are allowable as deductions by part VI, subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer.

Under § 1.62-2(d)(2), if an arrangement provides advances, allowances, or reimbursements for nondeductible business expenses (*e.g.*, travel that is not away from home), the payor is treated as maintaining two arrangements. The portion of the arrangement that provides payments for deductible employee business expenses is treated as one arrangement that satisfies the business connection requirement. The portion of the arrangement that provides for payments for nondeductible employee expenses is treated as a second arrangement that does not satisfy the business connection requirement and all amounts paid under the second arrangement are treated as paid under a nonaccountable plan.

Under § 1.62-2(d)(3)(i), if a payor arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) business expenses, the arrangement does not satisfy the business connection requirement.

Section 1.62-2(j) Example 3 illustrates a failure to satisfy the reimbursement requirement of § 1.62-2(d)(3)(i). In this example, Corporation R pays all its salespersons a salary. Corporation R also pays a travel allowance under an arrangement that otherwise meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. The allowance is paid to all salespersons, including salespersons that Corporation R knows, or has reason to know, do not travel away from their offices on Corporation R business and would not be reasonably expected to incur travel expenses. Because the allowance is not paid only to those employees who incur (or are reasonably expected to incur) expenses of the type described in § 1.62-2(d)(1) or (d)(2), the arrangement does not satisfy the reimbursement requirement of § 1.62-2(d)(3)(i). Thus, no part of the allowance Corporation R designated as a reimbursement is treated as paid under an accountable plan. Rather, all payments under the arrangement are treated as paid under a nonaccountable plan. Corporation R must report all payments under the arrangement as wages or other compensation on the employees' Forms W-2 and must withhold and pay employment taxes on the payments when paid.

With regard to the business connection requirement, under § 1.62-2(d)(3)(ii), an arrangement providing a per diem allowance that is computed on a basis similar to that

used in computing the employee's wages or other compensation (such as the number of hours worked or miles traveled) meets the business connection requirement only if, on December 12, 1989, the per diem allowance was identified by the payor either by making a separate payment of by specifically identifying the amount of the per diem allowance, or a per diem allowance computed on that basis was commonly used in the industry in which the employee is employed.

With regard to the substantiation requirement, pursuant to Rev. Procs. 2008-59 and 2009-47, the amount of M&IE that is deemed substantiated for each calendar day is equal to the lesser of the per diem allowance for that day or the amount computed at the federal M&IE rate. See section 3.01(3) of Rev. Procs. 2008-59 and 2009-47. Under these rules, employees must continue to actually substantiate the elements of time, place, and business purpose relating to the travel expenses. See section 7.01 of Rev. Procs. 2008-59 and 2009-47.

For purposes of the return of excess requirement, § 1.62-2(f)(2) permits the Commissioner of Internal Revenue to prescribe rules under which an arrangement that provides a per diem allowance is treated as satisfying the requirement of returning amounts in excess of expenses so long as the allowance is reasonably calculated not to exceed the amount of the employee's expenses and the employee is required to return any portion that relates to days of travel not substantiated. However, the portion of the allowance that exceeds the amount deemed substantiated will be treated as paid under a nonaccountable plan, must be reported as wages or other compensation, and is subject to withholding and payment of employment taxes. See § 1.62-2(c)(5).

Section 1.62-2(h)(2)(i)(B)(*1*) provides that if a payor pays a per diem allowance that meets the requirements of § 1.62-2(c)(1), the portion, if any, of the allowance that relates to days of travel substantiated in accordance with § 1.62-2(e) and that exceeds the amount of the employee's expenses deemed substantiated for the travel pursuant to rules prescribed under § 274(d) and the relevant regulations is treated as paid under a nonaccountable plan. Such amount is wages subject to withholding and payment of employment taxes. See § 1.62-2(c)(5). See also §§ 31.3121(a)-3(b)(1)(ii), 31.3306(b)-2(b)(1)(ii), and 31.3401(a)-4(b)(1)(ii).

Section 1.62-2(k) provides that if a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments made under the arrangement are treated as made under a nonaccountable plan. Thus, these payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. See § 1.62-2(c)(5), and (h)(2).

If an arrangement satisfies all three requirements of an accountable plan, but an allowance is paid under the arrangement that exceeds the amount that may be deemed substantiated, no actual substantiation is provided for the M&IE covered by the allowance, and the excess allowance is not returned, the excess allowance is treated as wages. See § 1.62-2(h)(2)(B)(*1*). However, if the facts and circumstances evidence a

pattern of abuse of the rules of § 62(c) and the regulations thereunder, including the rule to treat excess allowances as wages, all payments made under the arrangement are treated as wages. See § 1.62-2(k).

Rev. Rul. 2006-56, 2006-2 C.B. 874, provides that where an expense allowance arrangement has no mechanism or process to determine when an allowance exceeds the amount that may be deemed substantiated and the arrangement routinely pays allowances in excess of the amount that may be deemed substantiated without requiring actual substantiation of all the expenses or repayment of the excess amount, the failure of the arrangement to treat the excess allowance as wages for employment tax purposes causes all payments made under the arrangement to be treated as made under a nonaccountable plan.

Section 162(a) allows a deduction for ordinary and necessary business expenses paid or incurred during the taxable year in carrying on a trade or business, including expenses for travel away from home. However, under § 262, a taxpayer may not deduct personal travel or living expenses.

Section 274(d) provides that no deduction shall be allowed under §§ 162 or 212 for any traveling expense (including meals and lodging while away from home) unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense, (B) the time and place of the travel, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer. This section also authorizes the Secretary to prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed a particular amount.

Section 1.274-5(g) authorizes the Commissioner to prescribe rules under which reimbursement arrangements or per diem allowances are regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of travel expenses for purposes of § 1.274-5(c), and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of travel expenses for purposes of § 1.274-5(f).

Rev. Procs. 2008-59 and 2009-47 provide rules for substantiating, under § 274(d) and § 1.274-5, the amount of ordinary and necessary business expenses paid or incurred while traveling away from home (*i.e.*, lodging, meals and incidental expenses).

Section 3.01 of Rev. Procs. 2008-59 and 2009-47 defines a per diem allowance as a payment under a reimbursement or other expense allowance arrangement that is (1) paid for ordinary and necessary business expenses incurred, or that the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses, for travel away from home performing services as an employee of the employer, (2) reasonably calculated not to exceed the amount of the expenses or the

anticipated expenses, and (3) paid at or below the applicable federal per diem rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

Section 3.02(1) of Rev. Procs. 2008-59 and 2009-47 provides that the federal per diem rate is equal to the sum of the applicable federal lodging expense rate and the applicable federal meal an incidental expense (M&IE) rate for the day and locality of travel.

Section 3.03(1) of Rev. Procs. 2008-59 and 2009-47 provides that an allowance may be paid at a flat rate or stated schedule if it is provided on a uniform and objective basis for the expenses described in section 3.01 of the revenue procedure, and it satisfies the limitations set forth in section 3.03(2). Section 3.03(1) further provides that an hourly payment to cover meals and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

Section 4.04 of Rev. Procs. 2008-59 and 2009-47 provides special substantiation rules for the transportation industry. Section 4.04(1) of Rev. Procs. 2008-59 and 2009-47 provides, in relevant part, that the special rules in section 4.04 apply to a payor that pays a per diem allowance only for M&IE for travel away from home to an employee in the transportation industry and computes the amount under section 4.02 of the revenue procedure. Section 4.04(2) provides that an employee is in the transportation industry if the individual's work (a) is of the type that directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and (b) regularly requires travel away from home which, during any single trip away from home, usually involves travel to localities with differing federal M&IE rates. Section 4.04(3) provides special federal M&IE rates for individuals in the transportation industry.

Section 4.04(4) of Rev. Procs. 2008-59 and 2009-47 provides a periodic rule for the transportation industry. The periodic rule provides that a payor described in section 4.04(1) [a payor that pays an M&IE only per diem allowance] of the revenue procedure may compute the amount of the employee's expenses that is deemed substantiated under section 4.02 [the M&IE only substantiation method] of this revenue procedure periodically (not less frequently than monthly) rather than daily by comparing the total per diem allowance paid for the period to the sum of the amounts computed either at the federal M&IE rate(s) for the localities of travel, or at the special rate described in section 4.04(3) [the special transportation rate], for the days or partial days the employee is away from home during the period.

Section 6.03 of Rev. Procs. 2008-59 and 2009-47 provides that a payor is not required to reduce the federal per diem rate or the federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that the employee incurred or will incur meal and incidental expenses during each day of travel.

(1) Per diem allowance under section 3.01 of Rev. Proc. 2008-59 or 2009-47

In the instant case, a threshold question is whether Taxpayer has paid a per diem allowance, as defined in section 3.01 of Rev. Proc. 2008-59 or 2009-47, to its employees in the following situations: (1) to non-travelers; (2) to day-travelers; and (3) to overnight travelers. Hereinafter, these situations will be individually referred to as Situation 1, Situation 2, and Situation 3.

Section 3.01 of Rev. Procs. 2008-59 and 2009-47 provides, in part, that a "per diem allowance" requires the travel expenses to be deductible. Section 162(a)(2) allows a deduction for ordinary and necessary business expenses paid or incurred during the taxable year in carrying on a trade or business, including expenses for travel away from home. However, under § 262, a taxpayer may not deduct personal travel or living expenses. For travel expenses to be deductible under § 162(a)(2), a taxpayer must satisfy the following three conditions: (1) the expenses must be ordinary and necessary; (2) the expenses must be incurred away from home; and (3) the expenses must be incurred in pursuit of a trade or business. See Commissioner v. Flowers, 326 U.S. 465 (1946).[2] The nature of the travel must be such that it is reasonable for the taxpayer to need and to obtain sleep or rest during release time on such trips in order to meet the demands of the job. See United States v. Correll, 389 U.S. 299 (1967). See also Rev. Rul. 75-168, 1975-1 C.B. 58, and Rev. Rul. 68-663, 1968-2 C.B. 71. In addition, a taxpayer's "home" for purposes of §162(a)(2) is generally considered to be located at (1) the taxpayer's regular or principal (if more than one regular) place of business, or (2) if the taxpayer has no regular or principal place of business, then at the taxpayer's regular place of abode in a real and substantial sense. See Rev. Rul. 93-86, 1993-2 C.B. 71. If a taxpayer comes within neither category (1) nor category (2), the taxpayer is considered to be an itinerant whose "home" is wherever the taxpayer happens to work. See Rev. Rul. 73-529, 1973-2 C.B. 37, and Rev. Rul. 60-189, 1960-1 C.B. 60.

Whether or not a taxpayer is away from home is a question of fact that must be answered taking into account all the facts and circumstances for each individual taxpayer. See Rev. Rul. 73-529. However, in each of the three situations described above, it is likely that the employee's duty station is the employee's principal place of business and therefore the employee's tax home. Thus, in Situations 1 (non-travelers) and 2 (day-travelers), the employee is likely not away from home and therefore would not incur travel expenses deductible under § 162. In Situation 3 (overnight travelers), the employee likely is away from his or her tax home overnight, so the employee may incur travel expenses deductible under § 162 if the expenses otherwise meet the requirements of that section.

[2] We assume that the expenses are ordinary and necessary, and that they are incurred in pursuit of a trade or business.

In sum, the M&IE payments that Taxpayer made to its employees under Situations 1 (non-travelers) and 2 (day-travelers) are not per diem allowances as defined under section 3.01 of Rev. Proc. 2008-59 or 2009-47 because they are not deductible travel expenses under § 162. However, the M&IE payments made to its employees under Situation 3 (overnight travelers) may be per diem allowances if they otherwise meet the requirements of § 162 and the remaining requirements of the definition of "per diem allowance" under section 3.01 of Rev. Proc. 2008-59 or 2009-47.

(2) Whether the per diem allowances are paid under an accountable plan

The second issue presented is whether the M&IE allowances paid to employees during the Date1 and Date2 taxable years should be considered paid under an accountable plan, as defined in § 1.62-2(c)(1), if Taxpayer failed to maintain any mechanism or process to track M&IE allowances paid to crew members.

For the Date1 taxable year, Taxpayer's per diem arrangement fails to meet the business connection requirement of an accountable plan and fails the requirements of Rev. Rul. 2006-56. We are not specifically addressing whether the arrangement meets the substantiation and return of excess requirements of an accountable plan.

Taxpayer's per diem allowance arrangement in Date1 fails the business connection requirement because it paid amounts regardless of whether employees incurred or were reasonably expected to incur deductible business expenses, such that Taxpayer's arrangement fails the reimbursement requirement of § 1.62-2(d)(3)(i). Taxpayer paid M&IE allowances to all crew members, including day-travelers and non-travelers who Taxpayer knew or had reason to know did not travel away from home and therefore were not reasonably expected to incur travel expenses. Further, Taxpayer provided its employees with an M&IE allowance and also furnished the employees with in-kind meals. Because Taxpayer did not track the number of in-kind meals provided to its employees for the purpose of determining whether some portion of the M&IE allowance should have been included in the employees' wages and did not require actual substantiation of expenses incurred, Taxpayer was unable to determine whether deductible business expenses were incurred by its employees. In light of the fact that the employees were permitted up to B in-kind meals per day, it was not reasonable for Taxpayer to expect that an employee would incur meal expenses on all days an employee reported for duty.

Further, in Date1, Taxpayer had no tracking mechanism to determine whether per diem allowances paid exceeded the amount that could be deemed substantiated, and routinely paid allowances in excess of the deemed substantiated amount. Because Taxpayer did not require actual substantiation of all expenses or repayment of excess amounts, and did not include the excess as wages for employment taxes, Taxpayer's per diem allowance arrangement did not meet the requirements of Rev. Rul. 2006-56. The failure to track the excess allowances and the employer's routine payment of excess allowances that were not treated as wages evidences a pattern of abuse under

§ 1.62-2(k). Accordingly, all payments under the arrangement in Date1 should be treated as paid under a nonaccountable plan.

For the Date2 taxable year, Taxpayer's per diem arrangement fails to meet the business connection requirement of an accountable plan. We are not specifically addressing whether the arrangement meets the substantiation and return of excess requirements of an accountable plan.

In Date2, Taxpayer's per diem allowance arrangement fails the business connection requirement because it paid amounts regardless of whether employees incurred or were reasonably expected to incur deductible business expenses, such that Taxpayer's arrangement fails the reimbursement requirement of § 1.62-2(d)(3)(i). Taxpayer paid M&IE allowances to all crew members, including day-travelers and non-travelers who Taxpayer knew or had reason to know did not travel away from home and therefore were not reasonably expected to incur travel expenses. Accordingly, all payments under the arrangement in Date2 should be treated as paid under a nonaccountable plan.

(3) The periodic rule in section 4.04(4) of Rev. Proc. 2008-59 averages the amount of a per diem allowance that is deemed substantiated

For purposes of analyzing this question, it is assumed that the employees are traveling away from home with an overnight stay and are conducting business on behalf of Taxpayer.

The third issue presented is whether the periodic rule in section 4.04(4) of Rev. Proc. 2008-59 can be used to average the number of meals provided in kind to an employee in order to determine whether the M&IE allowance paid to that employee is includible in wages. Here, Taxpayer tracked the total number of meals provided in kind to employees during the Date1 taxable year but failed to track the number of meals provided in kind to employees on each day of travel for the purpose of determining whether some portion of the M&IE allowance should have been included in the employees' wages. Taxpayer proposes to correct their Date1 Federal employment tax return in order to use the periodic rule to average the number of meals received by an employee. Once the average number of meals was determined, Taxpayer would apply section 6.03 of Rev. Proc. 2008-59 to ascertain whether the M&IE allowance paid to the employee was required to be included in the employee's wages.

Taxpayer misinterprets the per diem revenue procedure and, in particular, the periodic rule in section 4.04(4) of Rev. Proc. 2008-59 because it uses a substantiation provision to determine whether an employee has a reimbursable travel expense under § 162. If a deduction is claimed for a travel expense, Taxpayer must first establish that it is "otherwise allowable as a deduction under chapter 1 of the Code before the provisions of section 274 become applicable." Section 1.274-1. Therefore, Taxpayer

must establish that the per diem allowance paid to employees are deductible expenses under § 162 before applying § 274(d) or section 4.04(4) of Rev. Proc. 2008-59.

The per diem revenue procedure is intended to substantiate solely the amount of a per diem allowance under § 274(d) and § 1.274-5. See generally section 1 of Rev. Proc. 2008-59. Section 274(d)(1) provides that a travel expense (including M&IE and lodging while away from home) under §§ 162 or 212 is not deductible unless it satisfies specific substantiation requirements. See § 274(d). Sections 4 and 5 of Rev. Proc. 2008-59 provide the deemed substantiation methods permitted under the revenue procedure to substantiate the amount of certain travel expenses (*e.g.*, M&IE) for each day of travel. The periodic rule in section 4.04(4) of the revenue procedure permits the employer to compute the amount of M&IE incurred by employees in the transportation industry that are deemed substantiated under the revenue procedure on a basis periodically (but not less frequently than monthly) rather than daily. See section 4.04(4) of Rev. Proc. 2008-59. Thus, sections 4.02 and 4.04(4) of Rev. Proc. 2008-59 are methods of substantiating the amount of travel expenses under § 274(d) and § 1.274-5, and the provisions of the revenue procedure should not be viewed as rules that create a reimbursable travel expense. See § 1.274-1 (providing that "section 274 is a disallowance provision exclusively, and does not make deductible any expense which is disallowed under any other provision of the Code").

Taxpayer has failed to establish that all the per diem allowances paid to its employees were deductible expenses under § 162 in the Date1 taxable year. Under section 6.03 of Rev. Proc. 2008-59, Taxpayer is required to reduce the amount of the per diem allowance if it does not reasonably believe that the employee will incur, or has incurred, M&IE. See Johnson v. Commissioner, 115 T.C. 210 (2000) (employee entitled to deduction only for incidental expenses when employer has provided the employee with all meals and lodging); Ballas v. Commissioner, T.C. Memo. 2008-18 (holding that an employee is not entitled to deduct the full M&IE amount under the revenue procedure if he receives all his meals in kind). In taxable year Date1, Taxpayer provided its employees, on some days, with all their meals for the day in addition to a per diem allowance. Thus, Taxpayer was required to reduce or treat as taxable wages the per diem allowances on days that Taxpayer provided its employees with all their meals because Taxpayer would not have had a reasonable belief that its employees would incur M&IE. The per diem revenue procedure does not deem an expense to be deductible under § 162 when no reimbursable travel expense has been incurred by an employee. See Johnson, 115 T.C. at 227.

As such, the periodic rule in section 4.04(4) of Rev. Proc. 2008-59 cannot be used by Taxpayer to average the number of meals provided in kind to its employees. Taxpayer must determine whether an employee has a reimbursable travel expense under § 162 before applying the deemed substantiation methods and accompanying rules of section 4.

(4) Application of the periodic rule under § 4.04(4) of Rev. Proc. 2008-59 on a corrected federal employment tax return

The fourth issue presented is whether Taxpayer can correct its Federal employment tax return to apply the periodic rule described in section 4.04(4) of Rev. Proc. 2008-59 in the manner described in Issue 3, above, to determine whether a travel reimbursement paid to its employees should be includible in that employee's wages. In light of our conclusion in Issue 3 that Taxpayer cannot use section 4.04(4) of Rev. Proc. 2008-59 to average the number of meals provided in kind to employees in order to determine whether a per diem allowance paid to employees is includible in wages, we will not address the question of whether Taxpayer can correct its Date1 Federal employment tax return to use the periodic rule in the manner described in Issue 3.

(5) Application of section 6.03 of Rev. Procs. 2008-59 and 2009-47

For purposes of analyzing this question, it is assumed that the employees are traveling away from home requiring an overnight stay and are conducting business on behalf of Taxpayer.

The last issue presented is whether Taxpayer's meal tracking system properly applies the meals provided in kind rule in section 6.03 of Rev. Procs. 2008-59 and 2009-47. Taxpayer applied this meal tracking system for the Date2 taxable year, and proposes to apply this system for correcting its Federal employment tax return for the Date1 taxable year. Taxpayer argues to the Examination Team that it has a reasonable belief that its employees will incur expenses for at least one meal each day if Taxpayer's meal tracking system shows that an employee has received 2 or fewer meals provided in kind in a given day during the employee's duty assignment. As such, if Taxpayer's meal tracking system shows that an employee received 2 or fewer meals in a single travel day, the M&IE allowance provided to the employee for a day of travel is (a) not reduced by the amount of the meals provided in kind, and (b) excluded from the employee's wages. Under the facts and circumstances presented, Taxpayer's meal tracking system is a reasonable application of section 6.03 of Rev. Procs. 2008-59 and 2009-47.

Section 6.03 of Rev. Procs. 2008-59 and Rev. Proc. 2009-47 provides that a payor is not required to reduce the federal per diem rate or the federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that the employee incurred or will incur meal and incidental expenses during each day of travel. Moreover, the meals portion of the federal M&IE amount consists of a breakfast, lunch, and dinner. See § 41 C.F.R. 301-11.18; § 1.274-5T(b)(2)(i). Consequently, if Taxpayer's meal tracking system shows that an employee has received 2 or fewer meals provided in kind in a given day during the employee's duty assignment, we conclude that Taxpayer has a reasonable belief that the employee will incur M&IE expenses for that day of the employee's duty assignment that requires an overnight stay. Therefore, based on the facts and circumstances presented, Taxpayer's

meal tracking system is a reasonable application of section 6.03 of Rev. Procs. 2008-59 and 2009-47. However, section 6.03 of Rev. Procs. 2008-59 and 2009-47 is a facts and circumstances test and other factors should be considered in evaluating whether a payor's meal tracking system is reasonable, such as how the system accounts for meals provided in kind on partial days of travel or during duty periods with varying lengths.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATION

[redacted]

No opinion is expressed or implied as to whether the per diem allowances paid by Taxpayer to its employees has otherwise satisfied the substantiation requirements of § 274(d). The issues presented focus exclusively on the interpretation of the deemed substantiation rules under the per diem revenue procedure. Moreover, no opinion is expressed or implied as to the application of § 274(n).

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Please call (202) 622-4930 if you have any further questions.