

Communiqué

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TRACKING PER DIEM TRAVEL EXPENSE ALLOWANCES

As a small businessperson, you or your employees are likely to hit the road on business at various times during the year. If you've ever taken a long trip, you know that keeping track of what you spent, where you spent it and what you spent it on can be a real burden. For that reason, the Internal Revenue Service provides employers with an alternative. They can elect to reimburse their employees based on actual expenses incurred or they can choose per diem allowances.

Ordinary and necessary expenses incurred in traveling away from home are deductible so long as they are not lavish or extravagant. The amounts reimbursed under an accountable (substantiated) plan are deductible by the employer but not included in the income of the employee, except to the extent the reimbursements exceed the substantiated expenses.

Since the tax law covering per diem rates can be complicated, the following information is designed to give you a basic understanding of the law so you can discuss your situation with your Fiducial tax professional. Here are some key areas identified by business experts regarding per diem travel expense allowances:

1. Types of Per Diem Methods

Each year the IRS issues a new Revenue Procedure and Publication 535 with respect to the per diem travel expense allowances that are paid to employees. The Revenue Procedure and Publication are of importance to every employee in the United States because they update the conditions and rates necessary for an employer to reimburse an employee for ordinary and necessary business expenses away from home without having to treat part of the per diem allowance as wages for tax purposes.

A per diem allowance is defined as a payment under a reimbursement or other travel expense allowance arrangement reasonably calculated not to exceed the amount of the travel expenses and calculated at or below the applicable federal per diem rate. There are two types of these allowances.

The first provides a daily allowance for meals and incidental expenses (M&IE). It's used in situations when lodging is provided or when lodging expenses will not be incurred. You must still keep records that show the time, place, and business purpose of your travel but you do not need to keep the receipts for the meals. The second type of allowance includes lodging as well as meals and incidental expenses (Lodging plus M&IE). If you



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are self-employed, you cannot use the lodging per diem rate and must use the actual per diem rate.

High-low Method

The IRS publishes a detailed listing of high-low cost locations. The average expense allowed for most high-cost locations is \$204 per day, \$45 for meals and incidental expenses while \$159 (or more, depending on the location) is allowed for lodging. The average expense allowed for most low-cost locations is \$125 per day, \$35 for meals and incidental expenses with \$90 for lodging. If a city is not listed as a low cost city, then an employer should use the standard per diem rates. An employer that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid to that employee during the calendar year for travel away from home. However, with respect to that employee, the employer may still reimburse actual expenses or use the meals-only per diem method for any travel away from home, and may use the per diem substantiation method for any travel away from outside the continental U.S.

Regular Method

The regular federal per diem rates are published in the Federal Register by the General Services Administration (GSA) with separate rates listing meals and incidental expenses for each locality. The standard per diem rate within the continental United States for all cities that are not listed is \$85, \$55 applicable to lodging and \$30 for meals and incidental expenses. To obtain a list of the updated per diem rates for a specific city, go to www.policyworks.gov/perdiem.

2. Standard Mileage Rates

Business — The standard mileage rate for transportation is 36 cents per mile for all miles used for business purposes. This rate is one-half a cent less than the amount allowed in 2002. A taxpayer (this includes a company or individual) may use the business standard mileage rate with respect to an automobile that is either owned or leased by the taxpayer. You can generally deduct an amount equal to either the standard business mileage rate times the number of business miles traveled or the actual costs incurred by the taxpayer that are allocable to traveling the business miles, but not both.

Charitable — The standard mileage rate is 14 cents per mile for purposes of computing the charitable use of an automobile in connection with transportation for a charitable organization. There was no change in this rate from 2002.

Medical and Moving — The standard mileage rate is 12 cents per mile for use of an automobile to obtain medical care, or as part of a move for which expenses are deductible. This rate decreased by one cent from 2002.

3. Temporary Employment Deductions

Employees who accept temporary employment away from home may deduct travel expenses, including the costs of meals and lodging. An employee won't be treated as temporarily away from home during any period of employment if the period is more than one year. For the travel expenses to be deductible, you've got to have a home to be away from – and not just any home, but a "tax home." The term "tax home" is a unique tax term with specific meaning. An employee's tax home is generally considered to be located at the taxpayer's regular (main) place of business or post of duty, regardless of where the employee's family lives. It includes the entire city or general area in which the employee's business or work is located.



TAX CALENDAR HIGHLIGHTS FOR JULY 2003

- 15** File 2002 trust estate and partnership returns if not filed April 15th and an approved three-month extension was filed
- 31** File Form 941 for second quarter of 2003 Deposit second quarter
- Federal Unemployment Taxes if more than \$100
- File calendar year 2002 Forms 5500, 5500-EZ, for employee benefit plans

Top Tax Questions of the Month

Listed below are general tax questions that may be applicable to you and your business. Understand that tax law is fluid and always changing; the answer that is correct today may be incorrect tomorrow. Please call our office to discuss your particular tax circumstances before you try to apply an answer from Communiqué to your personal situation.

- 1. A client wants to deduct a contribution to an IRA. Her W-2 is checked indicating she participates in a pension plan, and she is over the AGI limit. She swears she did not defer anything, and her employer did not make a contribution last year for her. How can this be?**

It is possible that forfeitures were allocated to her account. When employees leave a plan and are not fully vested, the unvested portion of their plan is divided among the remaining participants. Any allocation of forfeitures for a plan year is treated in the same manner as an employer contribution or deferral for purposes of participation in the plan.

- 2. A client inherited a house that she converted to a rental property. She was not certain of her basis, so she did not depreciate it. She has since found out what her basis was but still did not depreciate the property. She may sell the property in the near future. Can she continue not depreciating the property to maintain her basis?**

The client will be subject to taking the depreciation allowed or allowable into account when she sells the property. She is not adding to her basis on the sale of the property by foregoing depreciation. She can catch up and reclaim the depreciation she was entitled to take by filing Form 3115. If you need

someone to prepare the Form 3115, contact the Fiducial Research Department at 800-283-1040, and they would be happy to prepare it for you.

- 3. I just obtained a new corporate client. The books and records for the corporation are maintained using a cash method of accounting. The tax returns for prior years do not take into account any accounts receivable or payable, which I know are there. The tax returns are marked "accrual." Do I need to file amended returns?**

As long as the returns have been consistently prepared using the cash method of accounting (double check the balance sheet and make sure no "book to tax" adjustments have been made), your client may correctly check the "cash" accounting method box. Your client should attach a statement to the current return that prior returns were marked "accrual" in error and that the cash method was the accounting method actually used.

- 4. A client is the sole shareholder of an S corporation. He is taking a relatively small salary, and the corporation has a relatively small profit. He wants to take regular distributions from the S corporation. Does this present a problem?**

The client should be careful to preserve proof of the value of the services rendered. The potential problem your client faces is IRS challenging the regular distributions as additional compensation. If your client can show he is being paid compensation that is reasonable for the services rendered, the distribution should not be a problem.

- 5. A client died during 2002. His return is on extension already because of the situation on his return. He had \$10,000 of suspended passive losses when he died and no passive income for the year. What happens to those losses?**

If a taxpayer dies and owns an interest in a passive activity with suspended losses, generally those losses are allowed to be taken on the taxpayer's final return. The losses are reduced to the extent of the step-up in basis of the assets under IRC §1014. For example, if the assets were worth \$4,000 more than their adjusted basis at the time of death, \$6,000 of the passive losses (\$10,000-\$4,000) would be allowed on the decedent's final return.