“120 Day Rule”

The OU Employee Expense Reimbursement Policy states the following:

The University operates under the Internal Revenue Service (IRS) accountable plan rules in regards to reimbursing employees for expenses incurred while conducting University business. This includes reimbursement for travel and non-travel expenses. Accountable plan rules dictate that reimbursement claims be filed within a reasonable period of time after the expense is incurred. The University has determined a reasonable period of time to be 120 days. To ensure compliance with IRS guidelines, all expense reimbursements must be received by Financial Services within 120 days after the date of the event (for travel expenses) or date of purchase (for non-travel expenses). Expense reimbursement requests received by Financial Services after 120 days may be accepted for processing but the reimbursement will generally be treated as taxable income to the individual receiving payment resulting in the reimbursed amounts being added to the employee’s W-2 at the end of the calendar year.

The IRS provides some latitude in the definition of what constitutes a reasonable period of time, based on the facts and circumstances applicable to an organization. They also suggest a minimum of 60 days could be used regardless of the particular facts and circumstances. When the University set 120 days after the trip end date for travel as the point at which reimbursements become taxable, we specifically defined “reasonable” as a greater amount time than required by the IRS in order to accommodate the summer break.

As indicated in the IRS FAQ attached, if the expenses are not substantiated OR amounts in excess of expenses are not returned within a reasonable period of time (120 days in our case), the amount is treated as paid under a nonaccountable plan. This amount is then subject to tax withholding.
ITG FAQ #1 Answer-Is an employee’s reimbursement for business travel ever taxable?

Depending upon the type of plan the employer has, the reimbursement for business travel may or may not be taxable.

There are two types of plans:

- **Accountable Plans**: An accountable plan is not taxable to your employee. Amounts paid under an accountable plan are not wages and are not subject to income tax withholding and payment of social security, Medicare, and Federal Unemployment (FUTA) Taxes.

- **Nonaccountable Plans**: A nonaccountable plan is taxable to your employees and is subject to all employment taxes and withholding.

**Accountable Plans**: (Nontaxable to your employee) In order to qualify as an accountable plan, your reimbursement or allowance arrangement must require that your employees meet all three of the following rules:

There must be a business connection to the expenditure. This means that the expense must be a deductible business expense incurred in connection with services performed as an employee. If not reimbursed by the employer, the expense would be deductible by the employee on his/her 1040 income tax return.

There must be “adequate” accounting by the recipient within a reasonable period of time. This means that your employees must verify the date, time, place, amount and the business purpose of the expenses. Receipts are required unless the reimbursement is made under a per diem plan.

Excess reimbursements or advances must be returned within a reasonable period of time. Reasonable depends upon facts and circumstances.

Amounts paid under an accountable plan are not wages and are not subject to income tax withholding and payment of social security, Medicare, and Federal Unemployment (FUTA) taxes.

**Nonaccountable Plans**: (taxable to your employees and are subject to all employment taxes and withholding) Your payments would be considered treated as paid under a nonaccountable plan if:

- Your employee is not required to or does not substantiate timely those expenses to you with receipts or other documentation.
- You advance an amount to your employee for business expenses and your employee is not required to and does not return timely any amount he or she does not use for business expenses.

If the expenses covered by this arrangement are not substantiated or amounts in excess of expenses are not returned within a reasonable period of time, the amount is treated as paid under a nonaccountable plan. This amount is then subject to income tax withholding and payment of social security, Medicare, and FUTA taxes for the first payroll period following the end of the reasonable period.

For more detailed information please refer to Publication 15, Circular E, Employer’s Tax Guide; Internal Revenue Code § 62(c); and Treasury Regulation 1.62 and 1.274.
Excerpt from Internal Revenue Service Publication 463 (full version is available at irs.gov):

**Accountable Plans**

To be an accountable plan, your employer's reimbursement or allowance arrangement must include all of the following rules.

1. Your expenses must have a business connection — that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer.
2. You must adequately account to your employer for these expenses within a reasonable period of time.
3. You must return any excess reimbursement or allowance within a reasonable period of time.

“Adequate accounting” and “returning excess reimbursements” are discussed later.

An excess reimbursement or allowance is any amount you are paid that is more than the business-related expenses that you adequately accounted for to your employer.

**Reasonable period of time.** The definition of reasonable period of time depends on the facts and circumstances of your situation. However, regardless of the facts and circumstances of your situation, actions that take place within the times specified in the following list will be treated as taking place within a reasonable period of time.

- You receive an advance within 30 days of the time you have an expense.
- You adequately account for your expenses within 60 days after they were paid or incurred.
- You return any excess reimbursement within 120 days after the expense was paid or incurred.
- You are given a periodic statement (at least quarterly) that asks you to either return or adequately account for outstanding advances and you comply within 120 days of the statement.

**Employee meets accountable plan rules.** If you meet the three rules for accountable plans, your employer shouldn’t include any reimbursements in your income in box 1 of your Form W-2. If your expenses equal your reimbursements, you don’t complete Form 2106. You have no deduction since your expenses and reimbursement are equal.

**Accountable plan rules not met.** Even though you are reimbursed under an accountable plan, some of your expenses may not meet all three rules. All reimbursements that fail to meet all three rules for accountable plans are generally treated as having been reimbursed under a nonaccountable plan (discussed later).

**Failure to return excess reimbursements.** If you are reimbursed under an accountable plan, but you fail to return, within a reasonable time, any amounts in excess of the substantiated
amounts, the amounts paid in excess of the substantiated expenses are treated as paid under a nonaccountable plan. See *Reasonable period of time*, earlier, and *Returning Excess Reimbursements*, later.

**Adequate Accounting**

One of the rules for an accountable plan is that you must adequately account to your employer for your expenses. You adequately account by giving your employer a statement of expense, an account book, a diary, or a similar record in which you entered each expense at or near the time you had it, along with documentary evidence (such as receipts) of your travel, mileage, and other employee business expenses. (See Table 5-1 in chapter 5 for details you need to enter in your record and documents you need to prove certain expenses.) A per diem or car allowance satisfies the adequate accounting requirement under certain conditions. See *Per Diem and Car Allowances*, later.

You must account for all amounts you received from your employer during the year as advances, reimbursements, or allowances. This includes amounts you charged to your employer by credit card or other method. You must give your employer the same type of records and supporting information that you would have to give to the IRS if the IRS questioned a deduction on your return. You must pay back the amount of any reimbursement or other expense allowance for which you don’t adequately account or that is more than the amount for which you accounted.

**Returning Excess Reimbursements**

Under an accountable plan, you are required to return any excess reimbursement or other expense allowances for your business expenses to the person paying the reimbursement or allowance. Excess reimbursement means any amount for which you didn’t adequately account within a reasonable period of time. For example, if you received a travel advance and you didn’t spend all the money on business-related expenses or you don’t have proof of all your expenses, you have an excess reimbursement.

*Adequate Accounting* and *Reasonable period of time* were discussed earlier in this chapter.

**Travel advance.** You receive a travel advance if your employer provides you with an expense allowance before you actually have the expense, and the allowance is reasonably expected to be no more than your expense. Under an accountable plan, you are required to adequately account to your employer for this advance and to return any excess within a reasonable period of time.

If you don’t adequately account for or don’t return any excess advance within a reasonable period of time, the amount you don’t account for or return will be treated as having been paid under a nonaccountable plan (discussed later).

**Unproven amounts.** If you don’t prove that you actually traveled on each day for which you received a per diem or car allowance (proving the elements described in Table 5-1), you must return this unproven amount of the travel advance within a reasonable period of time. If you don’t do this, the unproven amount will be considered paid under a nonaccountable plan (discussed later).