Federal Income and Employment Tax on Legislator Reimbursements

Prepared for the Legislative Council
Montana Legislature

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“The hardest thing in the world to understand is income taxes.”*

-- *Albert Einstein, physicist.*

Executive Summaries

A. Summary of Memorandum

The purpose of this memo is to provide guidance to the Legislative Council when formulating policy regarding the taxation of advances and expenditures that legislators receive during a legislative session and the interim. There is a general lack of questions regarding how living expenses are taxed during a legislative session. As such, this memorandum only scratches the surface on reimbursements during a legislative session. The difficult concept that is addressed in detail in this memorandum is the applicable federal tax laws that govern the tax treatment of legislator advances and reimbursements that are received during the interim.

Travel expenses are straightforward since the Legislative Services Division (LSD) already has Internal Revenue Service procedures in place for reimbursement of lodging, documented mileage, and meals. However, the process of receiving reimbursements for technology, computers, cellular phones, stationery, Internet service, constituent services, and any other items that are necessary for a legislator to properly carry out the trade or business of being a legislator is complex. If tax-free treatment is desired, then the reimbursement process must follow a federally mandated procedure for all legislators. This procedure is referred to as an accountable plan.

An accountable plan is a federally approved expense arrangement that has specific deadlines and procedures that must be followed or the LSD risks losing the ability to issue tax-free reimbursements for all employees. At the end of this memorandum a hypothetical fact pattern shows the monetary difference between following accountable plan procedures and issuing a stipend that does not follow accountable plan procedures.

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* “One year while I was at his Princeton home preparing his return, Mrs. Einstein, who was then still living, asked me to stay for lunch. During the course of the meal, the professor turned to me and with his inimitable chuckle said: ‘The hardest thing in the world to understand is income taxes.’ I replied: ‘There is one thing more difficult, and that is your theory of relativity.’ ‘Oh, no,’ he replied, ‘that is easy.’ To which Mrs. Einstein commented, ‘Yes, for you.’ ” Time Magazine, *Letters: Feb. 22, 1963* digital archive (last visited May 21, 2026). *See also* Quote Origin: The Hardest Thing in the World to Understand Is Income Taxes.

B. Summary of Findings

This memorandum concludes that the Legislature should consider revision of current policy so that specific expense items are required to be reimbursed through an accountable plan. Federal tax law does not allow taxpayers to choose between receiving a stipend or a tax-free reimbursement through an accountable plan. The reasoning is that when money or benefits are available regardless of substantiation, the IRS treats this arrangement as wage recharacterization.

The Legislature is not required to use an accountable plan for all expenses, and a stipend is still an option. However, the Legislature should classify expenses so that specific expenses fall under accountable plan procedures while stipend expenses do not need to follow accountable plan procedures. The Legislature could also require that all expense reimbursements follow accountable plan procedures. Any expense reimbursement that does not follow accountable plan procedures must be classified as wages and be taxed accordingly.

When an advance or expense reimbursement is classified as wages, the value of the advance or reimbursement must be included on the legislator's W-2 as gross income for the taxable year and the amount received is subject to withholding and payment of employment taxes. Additionally, the LSD must pay an additional amount of 7.65% on the amount received by the legislator in employment taxes.

Analysis

A. Income

1. Federal Law Taxes Everything Unless There is an Exception

Section 61(a) of the Internal Revenue Code of 1986 (I.R.C.)[2] provides that unless provided otherwise gross income "means all income from whatever source derived." The United States Supreme Court, in Commissioner v. Glenshaw Glass Co., determined that the definition of gross income is broad and that Congress intended to exert "the full measure of its taxing power".[3] The federal system is one that taxes gains and profits, not gross receipts. As applied to legislators, compensation in all forms received from the LSD for being a member of the Legislature is classified as income that is taxable unless there is an applicable exclusion or exemption. Additionally, a fringe benefit or reimbursement provided to a legislator from LSD is presumed to be income unless the benefit is specifically excluded from gross income by another section of the Code.[4] Congress has enacted a variety of income tax exclusions that impact the total amount of income and employment taxes a legislator is required to pay the federal government, which also

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[2] The Internal Revenue Code is codified in Title 26 of the United States Code.
[3] *Commissioner v. Glenshaw Glass,* 348 U.S. 426, 429 (1955).
[4] 26 C.F.R. 1.61-21(a).

extends to the state of Montana by virtue of the way in which the Montana income tax is calculated.[5] This memorandum covers these exemptions and exclusions.

B. Expenses

1. Reimbursements for Living Expenses During a Legislative Session are Treated Differently

Perhaps the most important federal income tax benefit for most legislators is the ability of a legislator who lives more than 50 miles from the Capitol building to have reimbursements for living expenses not be subject to taxation. This group of legislators is able to make an election to retain per diem reimbursements for living expenses received during a legislative session out of taxable income.[6] This provision is unique, since Congress allows deemed living expenses that are set in federal tax law to be excluded from income without the requirement of submitting substantiation (*i.e.* receipts) to the LSD. This reimbursement concept has worked well for legislators in the past, and the LSD reminds legislators at the start of each legislative session about the election. Per diem payments to legislators who live within 50 miles of the Capitol are not considered substantiated reimbursements. Thus, these payments are reported as income on the legislator's W-2 form, and taxes are withheld on these payments. The LSD cannot change the taxation of legislative session expense reimbursements since it is governed by federal law.

2. Stipends Are Taxable If Every Legislator Receives the Same Amount Regardless of Documented Expenses

Obtaining tax-free treatment of expenses is more difficult during the interim. Federal tax law requires more paperwork for certain expense reimbursements, as well as various deadlines for getting paperwork submitted to LSD.

Section 62(a) of the I.R.C. defines adjusted gross income (AGI) as gross income minus certain deductions. Section 62(a)(2)(A) of the I.R.C. 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 (an accountable plan). Section 62(c) provides that, for purposes of Section 62(a)(2)(A) of the I.R.C., an arrangement will not be treated as a reimbursement or other expense allowance arrangement if:

[5] Sections 15-30-2103 and 15-30-2120, MCA.
[6] A legislator who desires to claim this tax preference is required to make an election under I.R.C. 162(h)(1), (3).

(1) such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or

(2) such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

The Treasury Regulations provide further that the expenses that are being reimbursed must have a business connection. This can be established if advances, allowances, or reimbursements are allowable as deductions by Subtitle A, chapter 1, subchapter B, part VI, of the I.R.C., and are paid or incurred by the employee in connection with the performance of services as an employee of the employer.[7] In other words, the expense must be connected to employment. It is impermissible to reimburse an employee for an expense without a business connection.

The Treasury Regulations provide that a business connection cannot be established when an employer pays an employee regardless of whether the employee incurs or is reasonably expected to incur deductible business expenses.[8] When this occurs, the amount received by the employee is considered wage recharacterization, even if the actual expenses are later substantiated.[9] The IRS published the following explanation of this principal:

> Section 1.62-2(d)(3)(i) provides that the business connection requirement will not be satisfied ***if a payor pays an amount to an employee regardless of whether the employee incurs or is reasonably expected to incur deductible business expenses***. Failure to meet this reimbursement requirement of business connection is referred to as wage recharacterization because the amount being paid is not an expense reimbursement but rather a substitute for an amount that would otherwise be paid as wages.[10]

As applied here, Section 62(c) of the I.R.C and the associated Treasury Regulations prevent a legislator from choosing between a stipend and a reimbursement that is substantiated. This is the case since all legislators would receive the same amount, regardless of the federally required substantiation. In other words, even though all legislators undoubtedly incur a multitude of out-of-pocket expenses, the federal government treats this type of guaranteed payment as wages.

If a legislator desires to claim a reimbursement that is not subject to income and employment taxes, then the reimbursement must be substantiated by using what is called an accountable plan.

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[7] 26 C.F.R. 1.62-2(d)(1).
[8] 26 C.F.R. 1.62-2(d)(3)(i).
[9] Dept. of the Treasury, Internal Rev. Serv., Pub. 5137: Fringe Benefit Guide, p. 4. (Rev. 10-2022).
[10] Rev. Rul. 2012-25.

3. Fringe Benefits and the Concept of an Accountable Plan

Congress has specifically allowed a variety of exclusions from gross income in Subtitle A, chapter 1, subchapter B, part III, of the I.R.C. One such exclusion is certain working condition fringe benefits that qualify under section 132(d) of the I.R.C, which means a property or service provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under section 162 or 167 of the I.R.C.[11] As applicable to legislator employees, this includes work-related travel expenses, such as meals, lodging, and mileage-based vehicle use while away from home for legislative activities during the interim.[12] It also includes reimbursements for certain trade or business expenses associated with being employed as a legislator. However, in order to receive this preferential treatment, the LSD must utilize an allowance or reimbursement policy for legislators that is an IRS-approved method of reimbursement, otherwise referred to as an accountable plan. The Treasury Regulations provide that:

> If, under section 274 or any other section, certain substantiation requirements must be met in order for a deduction under section 162 or 167 to be allowable, then those ***substantiation requirements apply*** when determining whether a property or service is excludable as a working condition fringe.[13]

A cash payment (*i.e.,* advance) or expense reimbursement made to a legislator during the interim does not qualify as a working condition fringe benefit unless the advance is made as part of an accountable plan. An expense reimbursement arrangement is considered an accountable plan if:

1. there is business connection to the expenditure
   (*i.e.,* business of being a legislator);
2. an adequate accounting by the recipient legislator occurs within a reasonable period
   (*i.e.,* the legislator provides adequate accounting to the LSD of the date, time, place, amount paid, and business purpose); and
3. excess reimbursements or advances are returned within a reasonable period as defined by IRS guidelines.[14]

i. Special Rules for Travel Expense Documentation

For the purposes of substantiating the amount that must be returned to an employer for travel expenses, the IRS is granted authority to allow certain per diem allowances for meals and incidentals. However, to be considered reasonable the allowance should not exceed anticipated

[11] I.R.C. 132(d); *see also* Dept. of the Treasury, Internal Rev. Serv. Pub. 5137, p. 1 (Rev. 10-2022).
[12] 26 C.F.R. 1.274-5(j)
[13] 26 C.F.R. 1.132-5(a)(1)(ii) (emphasis added).
[14] 26 C.F.R. 1.62-2(c)(2) (reimbursements and other expense allowance arrangements); Pub. 5137, p. 4.

expenses (*i.e.* published meals, incidental expense per diem payments).[15] If a reimbursement for meals and incidentals exceeds the per diem amount, then the amount of the excess that is not returned is reported as wages.[16] Additionally, an employer is authorized to pay the per diem rate for lodging based on IRS guidelines, or the actual cost of lodging when receipts are provided to the employer.[17] The LSD follows accountable plan rules for these categories, and there does not appear to be any questions regarding this process.

ii. Legislator Trade or Business Expenses

Legislators have a variety of expenses that are incurred during the tax year in carrying on with the trade or business of being a legislator. At the outset, it is important to note that campaigning or lobbying is a political expense that cannot be reimbursed as part of an accountable plan.[18]

If a legislator desires to receive a reimbursement on a tax-free basis, then the LSD must ensure that the reimbursement is made as part of an accountable plan.[19] Indeed, federal tax law provides that reimbursements from nonaccountable plans to an employee are "are wages and are subject to withholding and payment of employment taxes when paid."[20] The expense reimbursements that fall under an accountable plan should be for specific legislator business expenses that will only be reimbursed as part of an accountable plan. This would prevent the business expense from being treated as wage recharacterization by the IRS.

If a legislator does not follow the accountable plan rules for an expense that is subject to the accountable plan, federal law requires that the reimbursement be denied. Additionally, if there is a pattern in which the accountable plan rules are not followed, then the LSD could lose the ability to use an accountable plan for other employee expenses in the legislative branch.[21]

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[15] 26 C.F.R. 1.62-2(f)(2).
[16] Pub. 5137, p. 7.
[17] 26 C.F.R. 1.62-2; IRS Rev. Proc. 2011-47, sec. 4.02.
[18] I.R.C. 162(e).
[19] There is no exemption for state government employees. The Treasury Regulations provide: "The substantiation requirements of section 274(d) apply to an employee even if the requirements of section 274 do not apply to the employee's employer for deduction purposes (such as when the employer is a tax-exempt organization or a governmental unit)." 26 C.F.R. 1.132-5(c).
[20] 26 C.F.R. 1.62-2(h)(2)(ii).
[21] Federal law provides that "[i]f a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of section 62(c) and this section, all payments made under the arrangement will be treated as made under a nonaccountable plan." 26 C.F.R. 1.62-2(k).

From a policy perspective, the Legislature may desire to consider using a hybrid approach, with some expenses subjected to accountable plan rules, while other expenses are paid as part of a nonaccountable plan. Expenses for legislative business can be reimbursed under the accountable plan rules, so long as the items or services purchased have a business connection and are not for personal use.[22] Legislative business is unique, and the determination of what qualifies as an expense can be based on the type of business expenses that a general employer is entitled to take.[23] The following expenses are the type of expenses that could be paid out of an accountable plan or paid for directly by LSD without a corresponding tax consequence:

- ✓ services provided at no additional cost to LSD, such as the MCA on Folio;[24]
- ✓ subscriptions to publications that are relevant to the position of being a legislator;[25]
- ✓ cell phones used for noncompensatory legislative business reasons, so long as the reimbursement amount does not exceed the documented cost of a cell phone;
    - o NOTE: The reimbursement also cannot exceed the cost of the cell phone service as documented by receipts;[26]
- ✓ laptop computers and peripherals like cameras, microphones, printers, monitors, scanners, and fax machines used for noncompensatory legislative business, so long as the

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[22] I.R.C. 262(a) provides that, "except as otherwise expressly provided, no deduction shall be allowed for personal, living, or family expenses."

[23] Internal Revenue Service Publication 15 describes some of the common nontaxable fringe benefits that can be part of an accountable plan. These include services provided at no additional cost to the employer, subscriptions to publications that are relevant to the position of the employee, and employer provided cell phones used for noncompensatory business reasons. Internal Revenue Service Publication 5137 is also a good resource, as it was issued specifically "to help government entities determine the correct tax treatment of employee fringe benefits, including using the appropriate withholding and reporting procedures." Publication 5137 has a section regarding "equipment and allowances." This section reiterates the provisions of a revenue ruling that states "any allowance or reimbursement based on hours worked, units produced or other system that does not involve accounting for actual expenses, is treated as wages subject to withholding of income, Social Security and Medicare taxes". Pub. 5137, p. 43 (citing Rev. Rul. 2004-1; Rev. Rul. 2012-25). The publication also provides examples for the expensing of professional licenses and dues, payments of dues to clubs organized for business purposes, and educational instruction or training that maintains or improves the job-related capabilities of an employee.

[24] 26 C.F.R. 1.132-2(a)(2).

[25] Dept. of the Treasury, Internal Rev. Serv. Pub. 15: Employer's Tax Guide, p. 21 (2026).

[26] Notice 2011-72 and Dept of the Treasury Memorandum Regarding Interim Guidance on Reimbursement of Employee Personal Cell Phone Usage in light of Notice 2011-72 (Sept. 14, 2011) ("Treasury Memorandum"). The Treasury Memorandum guidance stated that "the employee must maintain the type of cell phone coverage that is reasonably related to the needs of the employer's business, and the reimbursement must be *reasonably calculated so as not to exceed expenses the employee actually incurred in maintaining the cell phone*." Treasury Memorandum, p. 3 (emphasis added). These rules were extended to allow reimbursements for cell phones when taxpayers are being audited by the I.R.S. through the Internal Revenue Manual 4.23.5.15.3.2 (11-22-2017)

reimbursement amount does not exceed the documented cost of the computer and peripheral equipment; [27]

   - NOTE: Off-the-shelf software that is purchased must also be used for noncompensatory legislative business reasons as documented by receipts;

- ✓ professional licenses and dues that directly relate to the job of being a legislator;[28]
- ✓ payments of dues to clubs organized for legislative business purposes;[29]
- ✓ educational instruction or training that maintains or improves the job-related capabilities of being a legislator;[30]
- ✓ incidental materials and supplies that are consumed by a legislator for legislative business, such as pens, paper, letterhead, envelopes, business cards, ink toner cartridges, printing of educational materials for constituents, and postage; [31]
- ✓ United States Post Office boxes that are used for noncompensatory legislative business reasons; [32] and
- ✓ home Internet expenses when used ***exclusively*** for legislative business based on the need to participate in remote meetings and for constituent correspondence, as documented by the legislator and submitted to LSD;
   - NOTE: Federal law is evolving regarding Internet reimbursements, especially after COVID-19. If Internet access is used for both legislative business and personal use, then the portion of the expense attributable to personal use should not be claimed under accountable plan rules. This leads to a situation in which legislators would need to report the percentage of use for business purposes to LSD with each Internet bill,

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[27] I.R.C. 132(a)(3), (d); I.R.C. 162(a). *See also* Tax Cuts Jobs and Acts of 2017 (TCJA), sec. 13302(b), amending I.R.C. 280F(d)(4). There is no directly applicable IRS guidance on whether an employer can reimburse an employee for a laptop computer and peripheral equipment that is used for noncompensatory business purposes. However, computers and peripheral equipment were removed from the listed property definition by the TCJA. This factual situation became analogous to when cell phones were removed from the definition of listed property by Congress in Section 2043 of the Small Business Jobs Act of 2010, which is referenced in IRS Notice 2011-72. LSD is in constant contact with legislators for work-related emergencies and questions using email and what is referred to as the legislative portal software. This includes questions related to bill drafting services and branch-wide agency correspondence regarding audit and fiscal issues. Moreover, LSD needs to provide legislators with a platform to respond to constituents and download voting software. It is also noteworthy that computers are often cheaper than a cellular phone and can be routinely expensed in one year as part of a safe harbor election for property with a value under $2,500. IRS Notice 2015-82; *see also* 26 C.F.R. 1.263(a)-1(f)(1)(ii). Given all the specific facts involved when applied towards the activities of a Montana legislator, it is my legal opinion that computers and peripheral equipment are excludable from a legislator's income as a working condition fringe benefit to the extent that, if the legislator paid for the use of the computer and peripheral equipment themselves, such payment would be allowable as a deduction under I.R.C. 162 for the employee.

[28] 26 C.F.R. 1.132-5(a)(1)(v).

[29] 26 C.F.R. 1.162-15(c); *see also* 26 C.F.R. 1.132-5(a).

[30] 26 C.F.R. 1.162-5.

[31] 26 C.F.R. 1.162-3.

[32] *See* I.R.C. 132(a)(3), (d) and I.R.C. 162(a).

and then LSD could only reimburse for the prorated amount that is attributable to legislative business.[33]

Section 262(a) of the I.R.C. provides that, except as otherwise expressly provided, "no deduction shall be allowed for personal, living, or family expenses."[34] As applied here, the following expenses are the type of expenses that are difficult to pay from an accountable plan given that the products and services can be used for personal activities other than legislative business, which requires an allocation between personal and business activities:

- ✓ home Internet access that is used for legislative business, but also used on a personal basis;[35]
- ✓ home security systems and cameras that are needed because of the public nature of a legislator's job;[36]
- ✓ general home office expenses, such as the cost attributable to having a dedicated office in a legislator's home for legislative business and office equipment and

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[33] The IRS has applied a "primary business use" standard to exclude both business and personal use of property or services not subject to I.R.C. 274(d) recordkeeping regarding travel, gifts, and listed property. See I.R.S. Notice 2011-72, p. 4 (phone used for primarily noncompensatory business reasons). It may be possible to rely on a "primary business use" standard as opposed to "exclusive use," but a more cautious approach is safer until there is specific IRS guidance that catches up with current business practices. Indeed, the United States Tax Court recently applied a usage test by only allowing the percentage of Internet that was used for business use as part of an accountable plan expenditure. *Simpson v. Comm'r*, Docket No. 16923-16, T.C, Memo 2023-4, 22-23.

[34] I.R.C. 262(a).

[35] *Simpson v. Comm'r*, T.C, Memo 2023-4, 22-23 ((U.S. Tax Court Docket No. 16923-16) (requiring a sufficient evidentiary basis between home use and business use)).

[36] I.R.C. 280A(a) generally prohibits a taxpayer from claiming a deduction that is related to a dwelling unit. There is an exception for dwellings that are the principal place of business or offices that are not attached to the dwelling. I.R.C. 280(A)(c). The I.R.S. has applied this code section in the past to deny an attorney from deducting the purchase price and maintenance of a burglar alarm. *See* I.R.S. Private Ltr. Ruling 8333020 (May 12, 1983).

There are potential options for expansion of this topic in the future using Treasury Regulation 1.132-5(m)(2), which provides that "a generalized concern for an employee's safety is not a bona fide business-oriented security concern." Currently this regulation provides the following examples for factors indicating that a security concern exists: "(A) A threat of death or kidnapping of, or serious bodily harm to, the employee or a similarly situated employee because of either employee's status as an employee of the employer; or (B) A recent history of violent terrorist activity (such as bombings) in the geographic area in which the transportation is provided, unless that activity is focused on a group of individuals which does not include the employee (or a similarly situated employee of an employer), or occurs to a significant degree only in a location within the geographic area where the employee does not travel." There is also a subparagraph of the regulation that allows a government agency to conduct an independent security study in order to claim expense reimbursements for a "security program". 26 C.F.R. 1.132-5(m)(2)(v). This is an area where the federal tax regulations have not caught up with the low cost of a security alarm and the existing political environment in certain state legislatures.

furniture that is generally subject to depreciation rules (not including laptop computers and peripheral equipment mentioned above);
- ✓ food purchased during constituent meetings while discussing legislative business;
- ✓ property that is used for legislative business that is subject to deprecation and is not permitted to be expensed within one year;[37] and
- ✓ miscellaneous legislative business expenses when substantiation is too burdensome to maintain and therefore does not satisfy the accountable plan rules;
  - NOTE: This would be a situation in which a stipend is expended for legislative business, but the burden of complying with the federal substantiation requirements is not worth the tax savings, or expenses with mixed business and personal use that are difficult to monitor.

iii. Safe Harbor Provisions for Accountable Plans

For the expenses that the Legislature desires to have treated as tax-free reimbursements, the LSD can follow the "safe harbor" provisions for meeting the test of what is timely reporting. This can occur using a fixed date method or a periodic statement method. The Treasury Regulations provide that:

> **(g) Reasonable period**—(1) In general. The determination of a reasonable period of time will depend on the facts and circumstances.
>
> **(2) Safe harbors**—(i) *Fixed date method*. An advance made within 30 days of when an expense is paid or incurred, an expense substantiated to the payor within 60 days after it is paid or incurred, or an amount returned to the payor within 120 days after an expense is paid or incurred will be treated as having occurred within a reasonable period of time.
>
> **(ii) Periodic statement method.** If a payor provides employees with periodic statements (no less frequently than quarterly) stating the amount, if any, paid under the arrangement in excess of the expenses the employee has substantiated in accordance with paragraph (e) of this section, and requesting the employee to substantiate any additional business expenses that have not yet been substantiated (whether or not such expenses relate to the expenses with respect to which the original advance was paid) and/or to return any amounts remaining unsubstantiated within 120 days of the statement, an expense substantiated or an

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[37] I.R.C. 167(a) (providing for depreciation deduction for property used in a trade or business); I.R.C. 168(k) (providing a special expensing allowance for computer system property); *see also* 81 New York University Annual Institute on Federal Taxation § 2A.01.(1)(a) (2026).

amount returned within that period will be treated as being substantiated or returned within a reasonable period of time.[38]

I recommend that the Legislature defer to LSD regarding how the accountable plan and safe harbor provisions are implemented. The accounting rules are likely to change as time passes.

C. Tax Consequences Between Accountable Plan and Nonaccountable Plan

If the LSD advances money without following the accountable plan rules, then amounts paid under the arrangement are treated as paid under a nonaccountable plan. The amounts must be included in the employee's gross income for the taxable year, are subject to withholding and payment of employment taxes, and must be reported as wages or other compensation on the employee's Form W-2.[39] Additionally, the employer must pay an additional 7.65% on the amount received by the employee in employment taxes. A simplified example of this concept with a hypothetical $100 employer payment to an employee is as follows:

Feature	**$100 Accountable Plan Payment**	**$100 Nonaccountable Plan Payment**
Tax Status	**100% tax free** to the employee	**Fully taxable** as ordinary income
IRS Reporting	Not reported on Form W-2	Reported on Form W-2 in Box 1 (Wages)
Payroll Tax	Exempt from FICA/FUTA	Subject to Social Security and Medicare taxes of 7.65%, until wage income exceeds $184,500
Net to Employee	Employee receives the full **$100.00**	Employee receives approx. **$53.00–$79.00** (after tax). The federal income tax rates vary from 10% to 37%, while Montana income tax rates are either 4.7% or 5.65%. (Calc. 1.a: $100 - $7.65(employment tax) = $92.35 (wages after employment tax) / Calc. 1.b: $92.35 * 37% (highest fed rate) = $34.17 (Fed Tax) / Calc. 1.c: $92.35 * 5.65% = $5.22 (highest state tax)/ Calc. 1.d: $7.65 + $34.17 + $5.22 = **$47.04 (total taxes**

[38] 26 C.F.R. 1.62-2(g).
[39] 26 C.F.R. 1.62-2(h)(2)(ii).

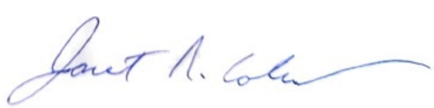
		highest rates) | (Calc. 2.a: $100 - $7.65(employment tax) = $92.35 (wages after employment tax) / Calc. 2.b: $92.35 * 10% (lowest fed rate) = $9.24 (Fed Tax) / Calc. 2.c: $92.35 * 4.7% = $4.34 (lowest state rate) / Calc. 2.d: $7.65 + $9.24 + $4.34 = **$21.23 (total taxes lowest rates**).
Employer Cost	Exactly **$100.00**	**$107.65** (due to employer-paid 7.65% FICA and FUTA tax)

This table illustrates how both an employee and employer are treated based on whether an expense arrangement satisfies the test for an accountable plan. There is no tax consequence for an employee who receives the $100 as part of an accountable plan. However, when the $100 does not satisfy the accountable plan requirements, there are additional taxes that could reach a high of $55 and a low of $29 between the employee and employer on the $100 payment. The actual amount that will be paid depends on the income tax rates that are applied towards the taxpayer's taxable income.

Conclusion

Navigating the tax consequences of reimbursements during the interim is complex, and typically tax laws do not get simpler with the passage of time. I hope this memorandum assists you in the formulation of expenditure reimbursement policy. Please let me know if you have any additional questions or concerns.

Sincerely,



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