

## Part III

### Administrative, Procedural, and Miscellaneous

26 CFR 1.62-2: Reimbursements and other expense allowance arrangements.  
(Also Part I, § 62.)

Rev. Proc. 2002-41

The purpose of this revenue procedure is to provide an optional expense substantiation rule so that businesses in the pipeline construction industry can provide reimbursements under an accountable plan to employees who also furnish welding rigs or mechanics rigs as part of their performance of services as employees. This revenue procedure is not intended to suggest that all workers providing such services and equipment are employees. Rather, the method in this revenue procedure may be applied when businesses choose to use an accountable plan to reimburse individuals who are employees for rig-related expenses incurred as employees.

As part of the Industry Issue Resolution Pilot Program, announced in Notice 2000-65, representatives of the pipeline construction industry requested clarification of the proper treatment of amounts paid to employee welders and heavy equipment mechanics who provide heavy equipment in connection with the performance of services. At issue was whether the amounts should be treated as payments of rent, payments of wages, or as the reimbursement of expenses subject to the accountable plan requirements.

Employers in the pipeline construction industry encounter several challenges to reimbursing under an accountable plan the costs relating to employee-provided welding rigs and mechanics rigs, particularly in determining the proper amount of the expense incurred. Rig welders and heavy equipment mechanics work for multiple companies for relatively short periods. Therefore, the proper allocation of fixed costs related to the equipment among employers is unclear. Moreover, although the rigs are mobile, the existing mileage-based expense substantiation provision does not accurately reflect rig-related costs because rigs are used primarily while stationary. Further, these employees incur substantial expenses as employees in providing these rigs as a condition of employment. Due to these unique features, reimbursing employees for rig-related expenses under the existing accountable plan requirements is unworkable for this industry. In order to enable this industry to reimburse rig-related expenses to employees under an accountable plan, this revenue procedure provides an optional expense substantiation rule under which rig-related expenses may be treated as substantiated when reimbursing these expenses under an accountable plan.

Under this revenue procedure an employer may pay certain welders and heavy equipment mechanics an amount of up to \$13 per hour for rig-related expenses that is deemed substantiated under an accountable plan when paid in accord with this revenue procedure (up to \$8 per hour if the employer provides fuel or otherwise reimburses fuel expenses). This revenue procedure provides for an annual inflation adjustment to these amounts after 2003, if necessary and is effective for payments made on or after January 1, 2003. The rules are provided in Questions and Answers below.

The Service recognizes that employers in other industries may similarly provide payments to employees for the costs of providing equipment as employees used in the performance of services as employees. To the extent that the unique features of other industries creates similar challenges to implementing accountable plans, the Service welcomes comments regarding the appropriateness and design of similar relief. We specifically request comments concerning other categories of qualified nonpersonal use vehicles owned by employees and used by the employees in the course of providing services as employees, especially where the nature of an industry results in employees working for multiple employers during each year, for which a deemed substantiation rule would be appropriate.

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## **SECTION 1. PURPOSE AND SCOPE**

**Q - 1.           *Must an employer use this revenue procedure to reimburse employees for rig-related expenses?***

A - 1. No. Use of the rule described in this revenue procedure is not mandatory, and an employer may, outside the scope of this revenue procedure, reimburse actual expenses under an arrangement that meets the accountable plan requirements of § 62(c) of the Internal Revenue Code (Code) and regulations thereunder. Alternatively, an employer may reimburse employee business expenses under a nonaccountable plan (defined in Answer 6), or may choose not to reimburse employee business expenses.

**Q - 2.           *What is the tax treatment of amounts deemed substantiated under this revenue procedure?***

A - 2. If the other requirements described in Answer 5 are satisfied, the amounts substantiated in accordance with this revenue procedure are treated as paid under an accountable plan. Thus, the amounts are not reported as wages on Form W-2 and are exempt from the withholding and payment of income and employment taxes. Also, no



return of information (e.g., Form 1099) is required for payments made under an accountable plan. § 1.6041-3(h)(1).

**Q - 3.           Which employers may use the deemed substantiation rule provided in this revenue procedure?**

A - 3. This substantiation rule may be used by any “eligible employer.” An eligible employer is any employer that hires employee rig welders or heavy equipment mechanics and requires, as a condition of employment, that the rig welders and heavy equipment mechanics provide a welding rig or mechanics rig and use the rig in performing services as an employee employed in the construction, repair, or maintenance of transportation mainline pipeline. The business of transportation mainline pipeline construction or repair includes the construction, maintenance, or repair of transportation mainline pipeline up to the first metering station or connection. This includes mainline pipeline whether it transports coal, gas, water, or other transportable materials, vapors, or liquids. The first metering station or connection means the point where a valve, consumer connection, or town border station divides mainline transmission lines or higher pressure lateral and branch lines from lower pressure distribution systems.

**Q - 4.        *For which vehicles and equipment may eligible employers use the deemed substantiation rule provided in this revenue procedure?***

A - 4. Eligible employers may use the deemed substantiation rule in this revenue procedure only to reimburse employees for expenses related to the use of welding rigs and mechanics rigs described in Answer 9.

## **SECTION 2. BACKGROUND**

**Q - 5.        *What provisions of the tax law apply when an employer reimburses an employee for employee business expenses?***

A - 5. The tax rules that apply when an employer reimburses an employee for employee business expenses depend upon whether the reimbursement is made under an accountable plan or nonaccountable plan. An accountable plan is a reimbursement or other expense allowance arrangement that meets three requirements under § 1.62-2: business connection, substantiation, and return of amounts in excess of substantiated expenses. The business connection requirement is satisfied if the arrangement provides advances, allowances or reimbursements only for business expenses allowable as deductions under §§ 161-198 that are paid or incurred by an employee (or that the employer reasonably expects the employee to incur) in connection with the performance of services as an employee. The substantiation

requirement is satisfied if the arrangement requires each business expense to be substantiated to the employer within a reasonable period of time. The return of excess requirement is satisfied if the arrangement requires the employee to return to the payor within a reasonable period of time any amount paid under the arrangement in excess of the expenses substantiated. A nonaccountable plan is a reimbursement or other expenses allowance arrangement that does not satisfy one or more of the three requirements.

**Q - 6.            *What are the tax consequences to an employee when an employer reimburses expenses under a nonaccountable plan?***

A - 6. Generally, § 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including the trade or business of being an employee. Under § 1.62-2(c)(5), amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported as wages on the employee's Form W-2, and are subject to withholding and payment of income and employment taxes (Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), and income tax withholding). See also Employment Tax Regulations §§ 31.3121(a)-3 (FICA); 31.3306(b)-2 (FUTA); 31.3401(a)-4 (income tax withholding); and Income Tax Regulation § 1.6041-3(h)(1) (return of information exemption) (for exemption from

reporting requirements for payments made under an accountable plan before January 1, 2001, see § 1.6041-3(i)(1)). The employee may still deduct the expenses. However, those deductions may only be claimed as miscellaneous itemized deductions, which are limited by § 67 to the amount exceeding 2 percent of adjusted gross income.

**Q - 7.            *What are the tax consequences to an employee when an employer reimburses expenses under an accountable plan?***

A - 7. Section 1.62-2(c)(4) provides that 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 income and employment taxes.

### **SECTION 3. DEEMED SUBSTANTIATION FOR RIG-RELATED EXPENSES**

**Q - 8.            *What is the amount of rig-related expenses that can be deemed substantiated under this revenue procedure?***

A - 8. If an eligible employer either provides fuel or separately reimburses fuel expenses, expenses of up to \$8 per hour for welding rigs or mechanics rigs may be deemed substantiated if the other requirements in this revenue procedure are met. If

an eligible employer does not provide fuel or separately reimburse fuel expenses, rig-related expenses of up to \$13 per hour for welding or mechanics rigs may be deemed substantiated if the other requirements in this revenue procedure are met.

**Q - 9.            *For what types of vehicles may rig-related expenses be deemed substantiated?***

A - 9. Under this revenue procedure, rig-related expenses may be deemed substantiated only with respect to welding rigs and mechanics rigs. For purposes of this revenue procedure, welding rigs are  $\frac{3}{4}$  ton or heavier trucks equipped with a welding machine and other necessary equipment, such as tanks and generators. For purposes of this revenue procedure, mechanics rigs are heavy trucks equipped with a permanently installed mechanics bed and other necessary equipment that is used to repair and maintain heavy machinery on a job site. As explained in Answer 11, mechanics rigs and welding rigs are qualified nonpersonal use vehicles. The rule in this revenue procedure is not available for any other vehicles.

**Q -10.            *May expenses be deemed substantiated for pickup trucks under this revenue procedure?***

A -10. No. Expenses for pickup trucks may not be deemed substantiated as rig-related expenses under this revenue procedure unless the pickup truck is part of a welding rig

as described in Answer 9. (See Rev. Proc. 2001-54 for rules under which the amount of ordinary and necessary expenses of local travel or transportation incurred by an employee will be deemed substantiated under § 1.274-5 when an employer provides a mileage allowance under an accountable plan.)

**Q -11.        *Are welding rigs and mechanics rigs qualified nonpersonal use vehicles?***

A -11. Under the authority of § 1.274-5T(k)(2)(ii)(S), the Commissioner, solely for purposes of applying the deemed substantiation rule in this revenue procedure, designates the welding rigs and mechanics rigs as described in Answer 9 as qualified nonpersonal use vehicles.

**Q -12.        *For which employees may an eligible employer deem rig-related expenses substantiated under this revenue procedure?***

A -12. An eligible employer may deem rig-related expenses substantiated only for employee rig welders and heavy equipment mechanics who are required, as a condition of employment, to provide a welding or mechanics rig for use in providing personal services as an employee.

**Q -13. Under what circumstances may an eligible employer anticipate that an employee would incur rig-related expenses while performing services as an employee for an eligible employer under the deemed substantiation rule?**

A -13. An eligible employer's reimbursement will meet the business connection requirement of § 1.62-2(d) if the eligible employer reasonably anticipates that the employee will incur rig-related expenses in connection with the performance of services for the employer. It would not be reasonable for an eligible employer to anticipate that an employee would incur rig-related expenses for hours that it actually knew the employee's rig was not used (such as during a work stoppage for inclement weather).

**Q -14. Will the amount deemed substantiated under this revenue procedure be adjusted for inflation?**

A -14. Yes. For calendar years after 2003, the hourly rate will be adjusted annually for inflation under § 1(f)(3), except that the base year for such adjustment will be calendar year 2002 and no adjustment will be made unless the increase is at least one dollar. Any adjustment will be rounded to the nearest dollar. Any adjustment to the rates provided in this revenue procedure will be published annually.

**Q -15.        *May an independent contractor determine deductible expenses under this revenue procedure?***

A -15. No. Independent contractors engaged in the trade or business of providing welding services or services as heavy equipment mechanics may not use the deemed substantiation method in this revenue procedure to determine deductible expenses in their trade or business.

#### **SECTION 4. EMPLOYEE TREATMENT OF RIG-RELATED EXPENSES**

**Q -16.        *May an employee exclude from income amounts reimbursed and deemed substantiated under this revenue procedure?***

A -16. Yes. This is true even if the amounts reimbursed and deemed substantiated exceed the actual rig-related expenses. For example, assume an employee incurs \$20,000 in rig-related expenses, and the employer reimburses \$20,800 at the \$13 per hour rate for welding rigs provided under this revenue procedure. Because the reimbursement was paid under an accountable plan, the entire reimbursement is excluded from the employee's income.



**Q -17.        *May an employee claim deductions for rig-related expenses that exceed amounts reimbursed under an accountable plan or deemed substantiated under this revenue procedure?***

A -17. Yes. To the extent employee business expenses exceed those reimbursed under an accountable plan, they may be claimed as miscellaneous itemized deductions on Schedule A. To do this, the employee must report all reimbursed amounts, including those deemed substantiated, and must offset expenses on Form 2106.

**Q -18.        *May an employee treat payments made under a nonaccountable plan as if they were made under an accountable plan by voluntarily substantiating expenses and returning any excess to the employer?***

A -18. No. An employee cannot create an accountable plan. Under § 1.62-2(c)(3), if an employer provides a nonaccountable plan, an employee who receives payments under the plan cannot compel the employer to treat the payments as paid under an accountable plan by voluntarily substantiating the expenses or returning any excess to the employer.

**Q -19.        *May an employee deduct any rig-related expenses that exceed those reimbursed by an employer and deemed substantiated under this revenue procedure on Schedule C, Profit or Loss From Business?***

A -19. No. Expenses incurred in connection with the trade or business of being an employee may not be deducted on Schedule C.

**Q -20.        *May an employee deduct any rig-related expenses that exceed those reimbursed by an employer and deemed substantiated under this revenue procedure on Schedule E, Supplemental Income and Loss?***

A -20. No. Expenses incurred in connection with the trade or business of being an employee may not be deducted on Schedule E.

**Q -21.        *May an employee deduct expenses that an eligible employer has already reimbursed under an accountable plan?***

A -21. No.

## **SECTION 5. SPECIAL RULES FOR EMPLOYERS**

**Q -22.        *May an eligible employer establish an accountable plan to reimburse rig welders or heavy equipment mechanics for non-rig-related business expenses?***

A -22. Yes. An employer may establish a separate accountable plan to reimburse non-rig-related employee business expenses incurred by rig welders or heavy equipment mechanics in addition to the arrangement provided under this revenue procedure. For example, Rev. Proc. 2001-47 provides rules under which an employer may establish an accountable plan for which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home will be deemed substantiated under § 1.274-54.

**Q -23.        *May an eligible employer substitute a rig-related reimbursement for a portion of wages otherwise payable to an employee?***

A -23. This revenue procedure is not intended to permit the recharacterization of wages otherwise payable to an employee. For example, if an employer normally pays an employee \$35 per hour in wages and does not provide a rig reimbursement in the event of inclement weather, the employer may not recharacterize a portion of the \$35 hourly wage into rig reimbursement during inclement weather. If an employer's reimbursement or other expenses allowance arrangement evidences a pattern of abuse of the accountable plan rules, then all payments made under the arrangement will be treated as paid under a nonaccountable plan.

**Q -24.        *What are the tax consequences if an employer that uses the deemed substantiation rule in this revenue procedure provides an additional reimbursement of rig-related expenses?***

A -24. If an employer that uses the deemed substantiation rule separately reimburses an employee for any rig-related expenses, the additional payment is treated as paid under a nonaccountable plan. Thus, the additional payment is reported as wages or other compensation of the employee's Form W-2, and is subject to withholding and payment of income and employment taxes.

For example, employee A is reimbursed for rig-related expenses deemed substantiated under this revenue procedure, and A incurs expenses for cleaning the rig and an oil

change. The employer pays employee A an additional \$25 per week to cover cleaning and the oil change. Because the employer also pays a rig reimbursement under this revenue procedure, the \$25 paid by the employer is treated as paid under a nonaccountable plan. Thus, the additional payment is reported as wages or other compensation of the employee's Form W-2, and is subject to withholding and payment of income and employment taxes.

## **SECTION 6. EFFECTIVE DATE**

This revenue procedure is effective for payments made on or after January 1, 2003.

## **SECTION 7. REQUEST FOR COMMENTS**

We welcome comments regarding this revenue procedure. We specifically request comments concerning other categories of qualified nonpersonal use vehicles owned by employees and used by the employees in the course of providing services as employees, especially where the nature of an industry results in employees working for multiple employers during each year, for which a deemed substantiation rule would be appropriate.

Comments regarding this revenue procedure should be sent by September 9, 2002 in writing, and should reference Rev. Proc. 2002-41. Comments can be addressed to:

CC:ITA:RU (Rev. Proc. 2002-41), room 5226 Internal Revenue  
Service POB 7604, Ben Franklin Station Washington, DC  
20044

Comments also may be hand delivered between the hours of 8 a.m. and 5 p.m. to:

CC:ITA:RU (Rev. Proc. 2002-41) Courier's Desk Internal  
Revenue Service 1111 Constitution Avenue NW Washington,  
DC.

Alternatively, taxpayers may transmit comments electronically via the following e-mail address:

[Notice.Comments@irsounsel.treas.gov](mailto:Notice.Comments@irsounsel.treas.gov)

## **SECTION 8. DRAFTING INFORMATION**

The principal author of this revenue procedure is Joe Spires of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), IRS.

However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue procedure, call Mr. Spires on (202) 622-6040 (not a toll free number).