



# Commonwealth of Massachusetts

## OFFICE OF THE COMPTROLLER

ONE ASHBURTON PLACE, 9<sup>TH</sup> FLOOR  
BOSTON, MASSACHUSETTS 02108  
TELEPHONE (617) 727-5000  
WWW.MACOMPTROLLER.ORG

ANDREW W. MAYLOR  
COMPTROLLER

**MMARS Policy: Payroll**

**Issue Date: July 1, 2004**

**Date Last Revised: October 5, 2018**

## **Types of Payments: Employee Reimbursements and Allowances**

### **Executive Summary**

Employee Reimbursements and allowances are payments to state employees for certain approved expenses paid out of pocket by the employee. Examples of approved expenses include out of state travel and tuition reimbursements and clothing allowances. Please refer to the Expenditure Classification Handbook for further definitions of approved employee reimbursements. Certain payments may be considered wages and require tax withholdings and reporting on an employee's W-2. All wages and reimbursement for regular and contractor employees will be paid through HR/CMS / LCM.

### **Considerations**

This policy applies to all Commonwealth Branches and Departments.

### **Policy**

#### Wages and Compensation: Employee Business Expense Reimbursements.

Employers determine remuneration for employment, including wages and other compensation. The IRS determination of whether reimbursements or allowances paid to employees are considered taxable "wages" is based upon whether the employer uses an "Accountable plan" or a "Non-accountable plan" when disbursing employee business expense reimbursements, as outlined in IRS Publication 15 Circular E Employers Tax Guide. Accountable or Non-Accountable Plans.

Cash disbursements, such as reimbursement and allowances, will be considered issued under a "Non-accountable plan" if employees are not required to substantiate the expenses with invoices or other proof of expenditures, and return any unused amounts. The Commonwealth is required under IRS tax rules to report reimbursement and allowance disbursements under "Non-accountable plans" as taxable wages for amounts paid in each calendar year.

A reimbursement or allowance arrangement is a system by which you pay the advances, reimbursements, and charges for your employees' business expenses. How you report a reimbursement or allowance amount depends on whether you have an accountable or a non-accountable plan. If a single payment includes both wages and an expense reimbursement, you must specify the amount of the reimbursement.

These rules apply to all ordinary and necessary employee business expenses that would otherwise qualify for a deduction by the employee.

### Accountable plan.

To be an accountable plan, an employee reimbursement or allowance arrangement must require employees to meet all three of the following rules.

1. They must have paid or incurred deductible expenses while performing services as your employees. The reimbursement or advance must be payment for the expenses and must not be an amount that would have otherwise been paid to the employee as wages.
2. They must substantiate these expenses to you within a reasonable period of time.
3. They must return any amounts in excess of substantiated expenses within a reasonable period of time.

Amounts paid under an accountable plan aren't wages and aren't subject to income, social security, Medicare, and FUTA taxes.

If the expenses covered by this arrangement aren't substantiated (or amounts in excess of substantiated expenses aren't returned within a reasonable period of time), the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a non-accountable plan. This amount is subject to income, social security, Medicare, and FUTA taxes for the first payroll period following the end of the reasonable period of time.

A reasonable period of time depends on the facts and circumstances. Generally, it is considered reasonable if your employees receive their advance within 30 days of the time they incur the expenses, adequately account for the expenses within 60 days after the expenses were paid or incurred, and return any amounts in excess of expenses within 120 days after the expenses were paid or incurred. Also, it is considered reasonable if you give your employees a periodic statement (at least quarterly) that asks them to either return or adequately account for outstanding amounts and they do so within 120 days

### Non-accountable plan.

Payments to your employee for travel and other necessary expenses of your business under a non-accountable plan are wages and are treated as supplemental wages and subject to income, social security, Medicare, and FUTA taxes. Your payments are treated as paid under a non-accountable plan if:

- Your employee isn't required to or doesn't substantiate timely those expenses to you with receipts or other documentation,
- You advance an amount to your employee for business expenses and your employee isn't required to or doesn't return timely any amount he or she doesn't use for business expenses,
- You advance or pay an amount to your employee regardless of whether you reasonably expect the employee to have business expenses related to your business, or
- You pay an amount as a reimbursement you would have otherwise paid as wages.

Employees have an independent tax obligation, separate from their employer, to report business expenses received under a "Non-accountable plan" as taxable income, even if their employer did not report these amounts as wages. All employer payments received by the employee which are not detailed on the W-2 must be (and should have always been) part of the employee's tax compliance analysis when filing their annual Federal and State tax returns.

### **Form W-2**

Employee reimbursement payments that are tax reportable will be added to each employee's year to date totals on their Form W-2, eliminating the need for two separate tax documents at the end of the calendar year.

## **Direct Deposit Functionality**

If an employee currently receives their regular salary payment by direct deposit, their reimbursement payment will also be by direct deposit. If an employee currently receives their regular salary payment by check, their reimbursement payment will be included with the check mailed to their home address.

Reimbursement for regular and contractor employees will be paid through HRCMS/LCM. HRCMS/LCM uses earnings codes and time reporting codes to enable departments to process employee/contractor reimbursements within the HR/CMS weekly elapsed time panel.

Employee/contractor reimbursements will be included on pay advices. New pay advice priorities have been established for reimbursements. Employee reimbursements will be summarized and included with other pay during the funds availability process. Checks will be held if employee/contractor expenses are insufficiently funded for either payroll or reimbursement. Funds availability reports will assist the Payroll Directors and the CTR Statewide Payroll Team to identify the cause for insufficient funding. If it is determined that paychecks are being held for insufficient employee reimbursement funding, departments can act to have additional funds made available or, in extraordinary circumstances, request the Statewide Payroll Team release checks.

With the implementation of LCM/MMARS, employee reimbursements will follow the payroll cycle and will process once every bi-weekly pay period.

## **Internal Controls**

Departments must ensure sufficient internal controls are in place to ensure compliance with this policy in the payment and reporting of reimbursements and allowances, which are subject to quality assurance reviews and audit.

## **Information Sources**

- Related Procedure – None
- Legal Authority
  - I.R.S Publication 15
  - Massachusetts General Laws, Chapter 7A, Sections 3, 7 and 8 – State Accounting
  - Massachusetts General Laws, Chapter 7, Section 27A – Travel Related Services
  - Massachusetts General Laws, Chapter 7, Section 28 – Rules and Regulations of The Human Resources Division
  - Massachusetts General Laws, Chapter 30, Section 25 – Expenses of State Officers
  - Massachusetts General Laws, Chapter 30, Section 25B – Outside Travel Expenses
  - Massachusetts General Laws, Chapter 30, Section 45 – Classification of State Offices and Positions
  - Massachusetts General Laws, Chapter 30, Section 46H – Vacation, Sick, Personal Leave Benefits
- Attachments - None
- Links - None

- [Contacts – CTR Help Desk](#)

#### Revisions

- **October 5, 2018** – Added language related to tax reporting for reimbursements and allowances.
- **November 1, 2006** – Removed language referencing Knowledge Center and updated relevant links to Mass.gov/osc portal site.