DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL (LMSB), CC:LM:RFP:STP

FROM: ASSOCIATE CHIEF COUNSEL, CC:ITA
by George Baker, Chief, Branch 7

SUBJECT: Trucking Company cases, DOCKET NO. 1.

This Chief Counsel Advice responds to your memorandum requesting background advice dated September 17, 2002. In accordance with § 6110(k)(3) of the Internal Revenue Code, this Chief Counsel Advice should not be cited as precedent.

LEGEND

DOCKET NO. 1 =
Lessor =
Lessees =
Lessee 1 =
Lessee 2 = .
Lessee 3 =

Workers =
Activity =
X% =
Y% =
Units =
Fiscal Year 1 =
Calendar Year 1 =
Year 2 =
Fiscal Year 3 =
Calendar Year 3 =
w =
z =
Affidavit A =

Compensation A =
Compensation B =
Compensation A1 =

Compensation A2 =
Compensation A3 =
Compensation A4 =
Activity Costs =

ISSUES

Under the facts described below, which party (Lessor or Lessee), should be subject to the § 274(n) deduction limitation relating to the reimbursement of meal and beverage expenses incurred by Workers while away from home in connection with the performance of their duties?

CONCLUSION

Under the facts described below, Lessor should be subject to the § 274(n) deduction limitation.

FACTS

This case involves Lessor's income tax for the Fiscal Year 1 through Fiscal Year 3 tax years. It also involves assorted overlapping years for the z Lessees that leased Workers from Lessor as Lessor's clients. Lessor, an employee leasing company, leased Workers to the Lessees during the relevant tax years. All of the Lessees are engaged in Activity.[1]

Whenever a Lessee agreed to lease Workers from Lessor, the parties executed a standard form lease. Section 3 of the lease provides that:

> For purposes of this Agreement and otherwise, [Workers] furnished by lessor to lessee shall in all respects be considered the employees of lessor for all purposes including but not limited to unemployment compensation, Workers' compensation, social security and other employee related duties and obligations. Lessor represents that it shall perform all the duties and responsibilities as such employer and shall in its absolute discretion, hire, fire, discipline, evaluate and direct the work and conduct on [sic] all lessor's employees assigned to lessee.

The leases provided that the Lessees would pay "compensation" to Lessor weekly for services provided by Lessor's Workers. In connection with this compensation, the lease required the Lessees to submit to Lessor "its records reflecting the services provided to it." The paperwork would establish that the total

[1] In Activity, the Workers incur business expenses while away from home.

compensation owed by a Lessee to Lessor was the sum of (1) the total compensation due the Workers plus (2) a surcharge determined as a percentage of that total compensation. The Lessees were to submit payment to Lessor along with the aforementioned documentation.

When a Lessee paid the amount owed to Lessor, it made one payment. The lease did not label any part of this payment "per diem."[2] The lease simply referred to the amount paid as "compensation" to Lessor. There was no obligation on the part of the Lessees to pay anything other than the aforementioned "compensation" (including the surcharge).

The Lessees neither required any of the payments to be used to pay per diem to the Workers, nor did they take part in setting the per diem rates. There was no written agreement between the Lessees and the Workers, although some Lessees made advance payments to the Workers. While the leases did not require the payment of advances, whenever advance payments were made, the overall amount owed to Lessor after application of the "surcharge" was determined first and the advances were subtracted from that overall amount.

Lessor typically hired all of the Lessee's existing Workers, and most new Workers were located by the Lessees and referred to Lessor for approval and hiring. However, if a Lessee no longer wanted or needed the services of a particular Worker, Lessor would try to reassign the Worker to another lessee. Lessor entered into employment contracts with the Workers. The Workers' pay, however, was not specified in the contracts.[3] Nor did the contracts obligate Lessor (or Lessees, for that matter) to pay per diem. Apparently, the Lessees determined the method of calculating pay and the pay rate (generally on a Compensation A or

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[2] The facts presented state that Lessor alleges that in negotiations with prospective customers, the customers agreed to pay the per diem amounts, and that the application of § 274(n) was discussed. We give this little weight because the lease provides in section fourteen that the parties acknowledge that any "representations that may have been made by either of them to the other are of no effect and that neither of them has relied thereon in connection with his or their dealings with the other." (See Lease, Pg. 8). In any case, the written promotional materials we have reviewed did not address whether the Workers' meal and beverage expenses while away from home would be reimbursed, and if so, who would be subject to the limitations set forth in § 274(n) of the Code.

[3] One lessee has indicated by affidavit that "the gross amount to be paid by [Lessor] with respect to each [Worker]'s services on each load is unilaterally set by [Lessee]." Affidavit A, ¶ 18.

Compensation B basis).[4] The Lessees provided the equipment, Activity assignments, and day-to-day direction. Lessor provided manuals, safety training materials, monthly newsletters, and periodic safety seminars.

Under the terms of the lease, the Lessees paid Lessor a fee calculated by multiplying the Workers' gross compensation (including amounts treated as nontaxable "per diem") by a percentage factor, generally in the range of 115 to 125 percent. Lessor alleges that the percentage factor was computed to cover the Workers' compensation, state and federal employment taxes, and Lessor's profit.

After entering into leases with Lessees, Lessor characterized X% of gross compensation paid to each Worker as per diem paid pursuant to an accountable plan (i.e., not wages, not income, and not subject to information reporting or employment tax withholding). Annually, Lessor would compare the total Units of a Lessee, and divide by w (w Units being Lessor's proxy for one day away from home). This calculation determined whether the total annual per diem paid, based on the number of "calculated days" (i.e., w Units increments, not actual calendar days) and X% of gross compensation, was at or under what could have been paid for the same number of actual days of travel under the mileage revenue procedures. (See Rev. Proc. 94-77, section 4.04(2), special rule for the transportation industry that allows the treatment of $ 32 per day as the daily Federal meals and incidental expenses (M&IE) rate for any locality traveled in the continental United States.) This generally showed that the "calculated days" was greater than the number of per diem days paid (although for Lessee 2, the per diem days paid was 946 days in excess of calculated out of town days).

Some of the Lessees also paid advances to Workers. Lessor alleges that the advances were intended to cover most of Workers' anticipated meal and incidental expenses. The Lessees deny that the advances were intended to cover meal expenses and allege that advances covered Lessees' other expenses resulting from Activity. (For a detailed description of the advance process, see Affidavit A.) Nevertheless, in all cases Lessees reported these advances to Lessor and received a "credit" for the amount of the advances against the total fee due to Lessor. It is unclear whether this credit was applied against the wage or per diem portion of the compensation.

The Lessees would send Lessor a "batch report" listing, by Worker, gross wages, advances, and reimbursable Activity Costs, and submit payment to Lessor for the amount due for the period (generally weekly). The Lessees calculated the amount due for the period by multiplying gross Workers' compensation times the

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[4]As an example, in 1996 Lessee 1 paid Workers from Compensation A to Compensation B, depending on experience. Lessee 1 Petition, ¶ 5.g (page 4).

applicable percentage factor, adding reimbursable expenses, and subtracting advances.

Lessor issued checks to Workers after receiving the batch reports. Lessor reduced the payments to Workers by any amounts advanced by the Lessees and increased the payments by any reimbursable expenses.

After receiving a batch report, Lessor also sent the Lessees a statement that included a calculation of the amount due for the period, which, inter alia, broke the Workers' gross compensation into "Employee Compensation" (gross compensation, less the amounts classified as per diem) and "Reimbursement of [Worker] Per Diem."

Lessor, having treated X% of the gross pay as non-taxable per diem (i.e., paid pursuant to an accountable plan as described in § 1.62-2), treated the remaining Y% as wages subject to the witholding of employment taxes and other withholdings. As noted above, if any advances were made by the Lessee, they were subtracted in order to reach the amount of workers' checks. Lessor filed Forms 941 consistent with this treatment. Therefore, no employment tax was paid on the portion of total compensation due Workers that Lessor treated as per diem.[5]

Beginning in January of Year 2, Lessor sent annual letters to the Lessees seemingly advising them that they were subject to the 50% percent limitation imposed by § 274(n) on an annual amount specified in the letter.[6]

To the extent the lease payments can be identified on the returns of the Lessees, they are generally reported as "lease payments" or something similar. None of the Lessees treated the amounts that Lessor classified as per diem as a separate item for book or tax purposes.

LAW

Provisions of the Internal Revenue Code and Income Tax Regulations related to accountable plans are outlined below. This is followed by an outline of the provisions related to the income tax rules at issue in this case.

I. Accountable Plan Provisions

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[5] The statute of limitations has run on the "employment tax" years.

[6] As discussed in the analysis below, we do not view this fact to be dispositive since Lessees did not agree to or establish a reimbursement arrangement to reimburse Lessor's per diem expenses. Further, the facts as we understand them, do not supply any other evidence establishing Lessees' agreement to reimburse Lessor.

Section 1.62-2(b) of the Income Tax Regulations provides that for purposes of determining adjusted gross income, § 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (section 161 and following), subchapter B, chapter 1 of the Code, 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** with a payor (the employer, its agent, or third party). (emphasis added).

Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if—

> (1) Such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the payor, or
> (2) Such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Per § 1.62-2(c)(1), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements set forth in paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of § 1.62-2. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan.[7] § 1.62-2(c)(2)(i). Amounts paid under an accountable plan are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes. §§ 31.3121(a)-3, 31.3306(b)-2, 31.3401(a)-4, and 1.6041-3(h)(1).

If an arrangement does not satisfy one or more of these requirements, all amounts paid under the arrangement are paid under a "nonaccountable plan." Amounts paid under a nonaccountable plan are included in the employee's gross income for the taxable year, must be reported to the employee on Form W-2, and are subject to withholding and payment of employment taxes. §§ 1.62-2(c)(5), 31.3121(a)-3(b)(2), 31.3306(b)-2(b)(2), 31.3401(a)-4(b)(2), and § 1.6041-3(h)(1). Additionally, § 1.62-2(k) provides that if a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments made under the arrangement will be treated as made under a nonaccountable plan.

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[7] As noted below, we have assumed the existence of an accountable plan. For completeness, we have included a discussion of the requirements for treating as paid under an accountable plan payments to employees under a reimbursement or other expense allowance arrangement.

Section 1.62-2(d)(1) provides generally that the amounts paid to the employee must be for expenses that are deductible under Part VI (beginning with section 161) of subchapter B, chapter 1 of the Code and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer.[8] "In order for the reimbursements to qualify as business expenses, the employer can pay the employee only the amount 'the employee incurs (or is reasonably expected to incur).'" Trucks, Inc. v. United States, 234 F.3d 1340 at 1343 (11th Cir. 2000) (quoting § 1.62-2(d)(3)(i)).

Under § 1.62-2(d)(3), the business connection requirement will not be satisfied if the payor arranges to pay an amount to an employee regardless of whether the employee incurs or is reasonably expected to incur expenses described in paragraphs (d)(1) or (d)(2).

Two recent circuit court cases have addressed the business connection requirement. In Trucks, Inc. v. United States, *supra*, rev'g and remanding 987 F. Supp. 1475 (N.D. Ga. 1997), a trucking company maintained an across-the-board 1/3 per diem - 2/3 wage compensation arrangement. The court found that Trucks had produced at least sufficient evidence to establish a genuine dispute of the reasonableness of its decision that expense reimbursements were per diem payments that did not exceed the amount the Worker incurred (or was expected to incur).

Trucks provided evidence that it had researched how other trucking companies reimbursed Workers for expenses, and that its per diem rate was established based on standard business practices. This was sufficient for the court to determine that it was at least possible for a reasonable jury to decide that Trucks met the business connection requirement because it could reasonably expect the Workers to incur the same expenses as other Workers in the industry. 234 F.3d at 1343. The court also noted that "[a]dditionally, the focus on the business connection test is on the employer's reasonable expectations, not the Workers' actual expenditures. These questions of reliability and state of mind fall within the purview of the jury." 234 F.3d 1343-1344. Indeed, after the trial, the district court granted the taxpayer's motion for a directed verdict. Trucks, Inc. v. United States, No. 1:96-CV-800-CC (Feb. 4, 2002); 2002 TNT 47-16.

In Worldwide Labor v. United States, No. 01-60535, 2002 U.S. App. LEXIS 23738 (5th Cir. Nov. 15, 2002), the Fifth Circuit vacated and reversed the district court and followed the Eleventh Circuit's opinion in Trucks. In Worldwide Labor,

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[8] The arrangement may reimburse, under § 1.62-2(d)(2), other bona fide expenses related to the employer's business that are nondeductible, such as travel that is not away from home, although reimbursements of these expenses are treated as paid under a nonaccountable plan.

No. 3:00CV170BN, 2001 U.S. Dist. LEXIS 8186 (S.D. Miss. May 15, 2001), the district court granted the government's motion for summary judgment, finding that the reimbursement arrangement failed the business connection requirement since the plan was in no way tied to expenses that the employees would reasonably be expected to incur (and because the expenses were not substantiated and employees were not required to return payments in excess of actual travel expenses). 2001 U.S. Dist. LEXIS 8186 at *14-*18. Worldwide's reimbursement arrangement paid an amount per hour to employees who lived more than 100 miles from the work site as a reimbursement for lodging, meals, and incidentals. After two months, local employees received fifty-cent per hour increases in their wages, while non-local employees received the fifty-cent per hour raises in their reimbursement amounts. This resulted in non-local employees, away from home for the same amount of time being reimbursed different amounts, because some worked more hours than others or had been employed by the company for more than two months.

The Fifth Circuit vacated and remanded the district court's opinion, concluding "that whether the employer reasonably anticipated and calculated its employees' travel expenses in the course of developing its reimbursement arrangement is essentially one of state of mind and that, so long as the employer produces summary judgment evidence that amounts to more than 'conclusory allegations, improbable inferences, and unsupported speculation,' the issues of reasonableness and state of mind are proper questions for the jury and should not be decided on summary judgment." Worldwide Labor, No. 01-60535, 2002 U.S. App. LEXIS 23738, at *8-*9 (5th Cir. Nov. 15, 2002) (citing Int'l Shortstop, Inc. v. Rally's, Inc., 939 F.2d 1257, 1265 (5th Cir. 1991), and quoting Medina-Munoz v. R.J. Reynolds Tobacco Co., 896 F.2d 5, 8 (1st Cir. 1990)).

Section 1.62-2(e)(2) provides that, for expenses described in § 274(d) (including travel expenses), an employee must supply the payor of the reimbursement with information sufficient to satisfy the substantiation requirements of § 274(d).

Under § 274(d), information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. With respect to travel away from home, § 1.274-5(b)(2), (c)(2), and (f) require that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. An employee may substantiate to an employer expenses incurred by the employee by adequate records, as described in §1.274-5(c)(2), or may substantiate the expenses to the extent provided in guidance promulgated under §1.274-5(g). Rev. Proc. 94-77, providing rules by which the element of the amount of an expense for meals and incidentals while traveling away from home may be treated as substantiated, is an example of such guidance.

Section 1.62-2(f)(1) provides that in general the arrangement must require that employees return to the payor within a reasonable time any amounts paid under the arrangement in excess of the expenses substantiated. The determination of whether the arrangement requires employees to return amounts in excess of substantiated expenses depends on the facts and circumstances.

Section 1.62-2(f)(2) provides a special rule for per diem and mileage allowances that authorizes the Commissioner to prescribe rules under which an arrangement will be treated as satisfying the return of excess requirement even though the allowance does not require the employee to return the portion of the amount, for day or miles of travel substantiated, that exceeds the amounts deemed substantiated pursuant to the rules prescribed under § 274(d). However, the allowance must be paid at a rate that is reasonably calculated not to exceed expenses (or anticipated expenses). Additionally, employees must be required to return within a reasonable time any portion that relates to days or miles of travel not substantiated. Further, under § 1.62-2(h)(2)(i)(B)(1) any portion relating to days or miles of travel substantiated that exceeds the amount substantiated under § 274(d) is treated as paid under a nonaccountable plan, and under (h)(2)(i)(A) is treated as wages, generally subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

Section 1.62-2(k) provides that if a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and § 1.62-2, all payments made under the arrangement will be treated as made under an accountable plan.

II. Income Tax Provisions

Turning from the accountable plan requirements to the income tax rules at issue in this case, § 162(a) allows a deduction for the ordinary and necessary expenses paid or incurred in carrying on any trade or business, including the expenses of traveling away from home.

An amount otherwise deductible under § 162(a) may be subject to disallowance or limitation by § 274.

For the years at issue § 274(n)(1) imposes a 50% or 80% limitation on the deductions otherwise allowed under § 274 for (A) any expense for food or beverages, and (B) any item with respect to an activity generally considered to constitute entertainment, amusement, or recreation.

Section 274(n) is solely a disallowance provision. That is, it can only disallow (in whole or in part) an otherwise deductible expense. The only deductible expense discussed on these facts is the meal expenses of the workers while traveling away from home overnight. If the worker returns home at the end of a single day of work,

there are no meal expenses deductible by the employee under § 162 or any other section. Section 262; see United States v. Correll, 389 U.S. 299 (1967). Consequently, if an employer reimburses those expenses, the reimbursement is treated as paid under a nonaccountable plan. Section 1.62-2(d)(2).

Section 274(n)(2) sets forth several exceptions to § 274(n)(1), the most pertinent of which relates to expenses described in § 274(e)(3).[9]

Expenses within § 274(e)(3)(A) and (B) are expenses paid or incurred by a taxpayer in connection with the performance of services for another person (the taxpayer's employer or a third party) and for which the taxpayer accounts to the other person, under a reimbursement or other expense allowance arrangement with that other person. As it applies to § 274(n), § 274(e)(3) allows a taxpayer who receives a meal and beverage reimbursement to deduct the expense (under § 62(a)(2)(A)) for which the taxpayer accounts (to the extent the reimbursement does not exceed the substantiated expense) regardless of the 50% limitation contained in § 274(n). Specifically, § 1.274-2(f)(iv) states that with respect to:

> any expenditure for entertainment paid or incurred by one person in connection with the performance by him of services for another (whether or not such other person is an employer) under a reimbursement or other expense allowance agreement, the limitations on allowability of deductions provided [above] shall be applied only once, either (1) to the person who makes the expenditure or (2) to the person who actually bears the expense, but not both.

Section 274(e)(3)(B) provides that where a taxpayer (described in § 274(e)(3)) receives reimbursement in connection with the performance of services for a person other than an employer, under a reimbursement or other expense allowance arrangement with that other person, that taxpayer must account (provide substantiation) to the person from whom he receives reimbursement.

In Beech Trucking Co. v. Commissioner, 118 T.C. 428 (2002), the taxpayer, a trucking company, claimed deductions for its per diem payments. It treated only 40% of the per diem as relating to meals and incidental expenses. The remaining 60% was treated as a lodging expense. See Rev. Proc. 96-28, § 6.05(3).

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[9] Section 274(e)(2), which exempts payments to employees that are treated by the payor as compensation to the employee on the payor's income tax return and as wages to the employees for purposes of withholding of income tax on wages, is clearly not pertinent on these facts because the amounts were not treated as compensation for purposes of withholding income tax on such wages.

Therefore, the taxpayer applied § 274(n) to only 40% of its per diem and deducted the remaining per diem in full. The sole question presented in Beech Trucking was whether the per diem payments were exclusively for meals and incidental expenses, and, therefore, subject entirely to the limitation contained in § 274(n). Based on an analysis of the form of payments and the provisions of § 4.02 of the revenue procedure, the court concluded that the petitioner's per diem payments were attributable entirely to meals and incidental expenses. After announcing its holding, the court addressed two arguments put forth by the petitioner, one of which was that § 274(n) could not apply to the petitioner because it was not the Workers' employer.[10]

The court noted that §§ 274(e)(3) and 1.274(f)(2)(iv)(a) cause the limitations on allowability of deductions in § 274(a) or (n) to be applied only once, "either (1) to the person who makes the expenditure or (2) to the person who actually bears the expense, but not both." The court reasoned that the § 274(n) limitation would, therefore, apply to either the employer or the employee. In Beech Trucking, the parties agreed that the limitation did not apply to the employees, but that "the section 274(n) limitation instead applie[d] to the drivers' employer." Beech Trucking, supra.

The court concluded that "the section 274(n) limitation applies to Beech Trucking as the common law employer of its drivers and as the party (as petitioner states on brief) that **actually bore** the expense of the expenditures for which the per diem payments were made." Id. (emphasis added).

We agree with the result reached in the Beech Trucking case, but do not read the case to mean that the common law employer test is the test to determine the party to be subjected to the limitation contained in § 274(n). Instead, we agree with the court's reliance on the fact that Beech Trucking "actually bore" the expense (i.e., that Beech Trucking was the payor of the drivers' reimbursements under the accountable plan).[11]

ANALYSIS

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[10] The court did not elaborate on the petitioner's reasoning. It is possible that the court did not view this as a true three-party leasing situation because of the relationship between Lessor and Lessee in that case. See Beech Trucking. The court entertained the taxpayer's argument despite the fact that the taxpayer had taken an inconsistent position on its prior tax returns.

[11] Accordingly, this memorandum does not analyze whether Lessor or Lessees are the Workers' common law employer.

In order to determine whether a taxpayer's deductions are subject to § 274(n), we must look at: (1) whether the party had a deductible expense; (2) whether (from that party's perspective) the expense was for food or beverage (subject to § 274(n)); and (3) whether that party "passed along" the § 274(n) limitation in accordance with § 274(e)(3).

I. Payments made by the Workers for their food and beverage while away from home

The Workers paid for expenses while in the performance of their duties away from home. Because the expenses were for food and beverages, § 274(n) limits the deduction to 50% unless an exception (e.g. § 274(e)(3)) applies.

You have asked us to assume the existence of an accountable plan.[12] Therefore, we assume that the reimbursement received by the Workers was received under that plan. Section 274(e)(3) would prevent the application of § 274(n) to the otherwise deductible meal expenses of the Workers to the extent of the lesser of the reimbursement or the substantiated expenses because reimbursements were received under the accountable plan. See § 4.02 of Rev. Proc. 94-77.

II. Payments from Lessor to the Workers to reimburse them for food and beverage expenses incurred while away from home

Lessor was responsible for paying the Workers "gross compensation." Lessor reimbursed the Workers for their food and beverage expenses. Lessor allocated X% of the Workers gross pay to wages and the other Y% to "per diem" on the Workers' pay stubs, and treated Y% as wages on the Forms 941 that it filed.[13] The Forms 941 filed by Lessor reflected Lessor's name and identification number. Neither the leases between Lessor and Lessees, nor the employment contracts required Lessor to allocate the Workers' gross compensation between taxable wages and non-taxable per diem. However, Lessor chose to do so and selected the amount of per diem to be paid. As a result of Lessor's per diem policy, Y% of the amount paid to Workers by Lessor was treated as wages and was reduced by

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[12] This assumption involves a number of underlying assumptions including proper substantiation by the Workers of all the elements the expense (time, place, business purpose, and amount) to the payor of the reimbursements (here, Lessor), whether or not the Workers delivered that substantiation directly to Lessor.

[13] Accordingly, Lessor did not withhold employment taxes on its payments that were labeled "per diem" and, presumably, did not include the per diem payments in wages on the Workers Forms W-2. See § 1.62-2(c)(4).

withheld amounts and amounts advanced by the Lessee companies while X% of the amount paid to workers was treated as per diem reimbursements. As stated earlier, for purposes of this memorandum, we assume that a valid accountable plan existed to support these facts.[14]

Based on the facts set forth above, we conclude that Lessor is the payor of the reimbursement payments under the aforementioned accountable plan.

X% of the payments from Lessor to Workers were treated as related to the food and beverage expenses incurred by the Workers while away from home. Section 274(e)(3) allowed the Workers to pass the "food and beverage" character of their payments along to Lessor by accounting (substantiating) to Lessor. Lessor is thereby apprised of an otherwise deductible food or beverage expense equal to the lesser of the reimbursement or the actual amount of the expense substantiated. Rev. Proc. 94-77 § 4.02. Therefore, the Worker escapes that character (as noted above) and Lessor will be subject to the limitations set forth in § 274(n) on those expenses unless it too can pass the 50% limitation along to another party through the operation of § 274(e)(3)(B).

Based on the facts presented, we do not believe that § 274(e)(3)(B) will be of any use to Lessor. There is no evidence of a reimbursement arrangement established or agreed to by a Lessee to reimburse Lessor's expenses (paid under its accountable plan) upon an accounting to the Lessee of those expenses (using the Workers' accountings to Lessor). We believe, in addition, that the pay period statements (listing Worker per diem amounts) and annual letters sent to the Lessees by Lessor are insufficient, standing alone, as Lessor's accounting to the Lessees of the expenses subject to § 274(n) limitations. They do not, for example, contain information on the days a Worker traveled on business (the element of time). Accordingly, § 274(e)(3)(B) would not prevent Lessor from being subject to the deduction limitations under § 274(n).

Therefore, because Lessor is the "payor" under an accountable plan and because § 274(e)(3)(B) does not apply to it, Lessor should be subject to the limitations set forth in § 274(n).

III. Amounts paid from Lessee companies to Lessor

Lessor and Lessee entered into a lease that required Lessor to provide Workers in exchange for Lessees' "lease payments." The lease did not obligate the Lessees to reimburse Lessor for any food and beverage expenses.

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[14] As noted previously, the statute of limitations for adjusting Lessor's liability on the Forms 941 it filed has expired.

Based on the facts presented there appears to be neither an accountable plan between the Lessees and the drivers, nor a reimbursement arrangement between the Lessees and Lessor.

Based on the facts presented, the Lessees payments do not relate to food and beverage expenses incurred by the drivers.[15] Accordingly, § 274(n) does not limit their deduction.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The years at issue are closed for employment tax purposes. Accordingly, for simplicity, we assumed that the Workers received reimbursements under an accountable plan. [redacted]

[redacted][16]

[redacted]

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[15] [redacted]

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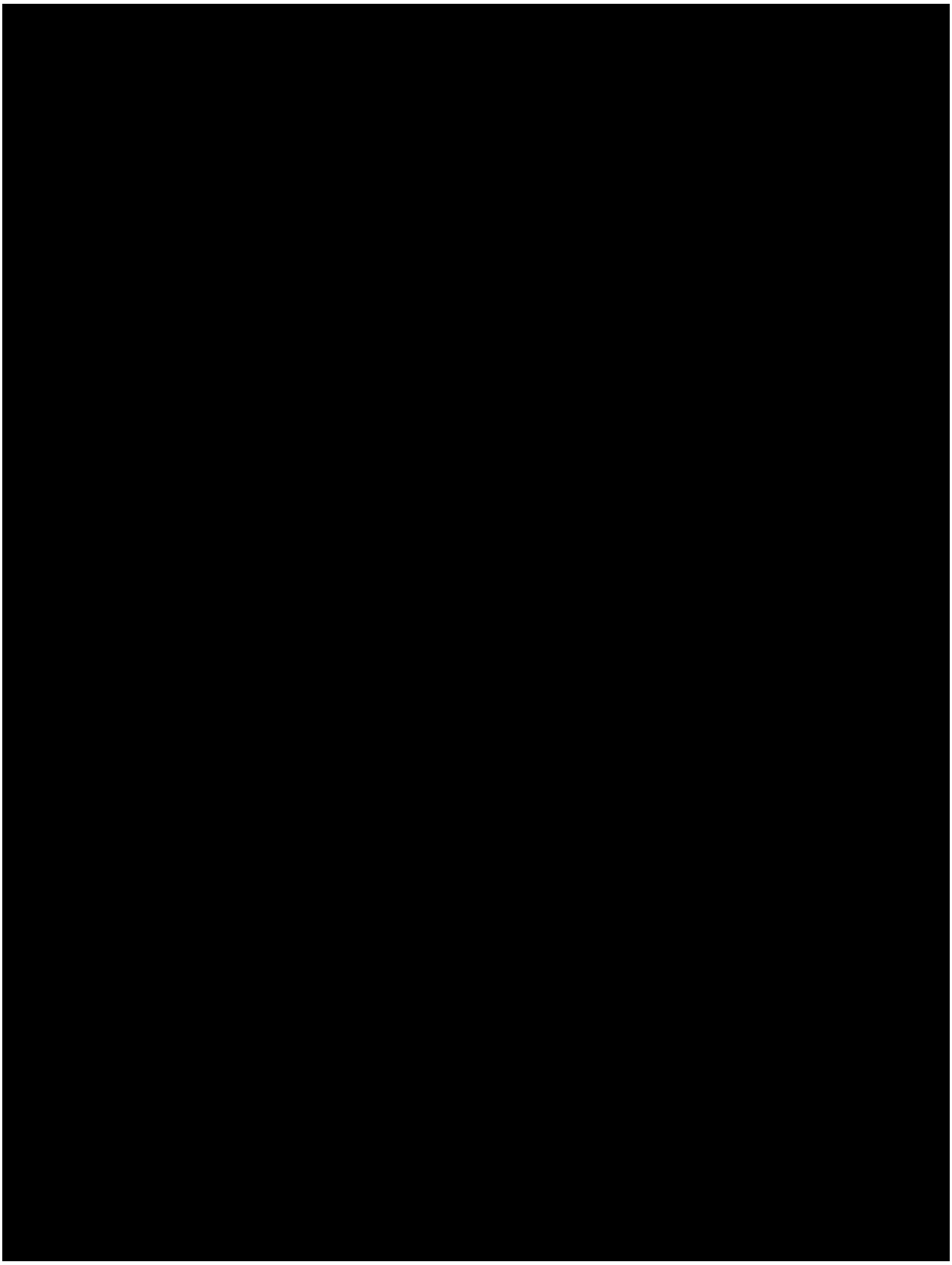
[16] [redacted]

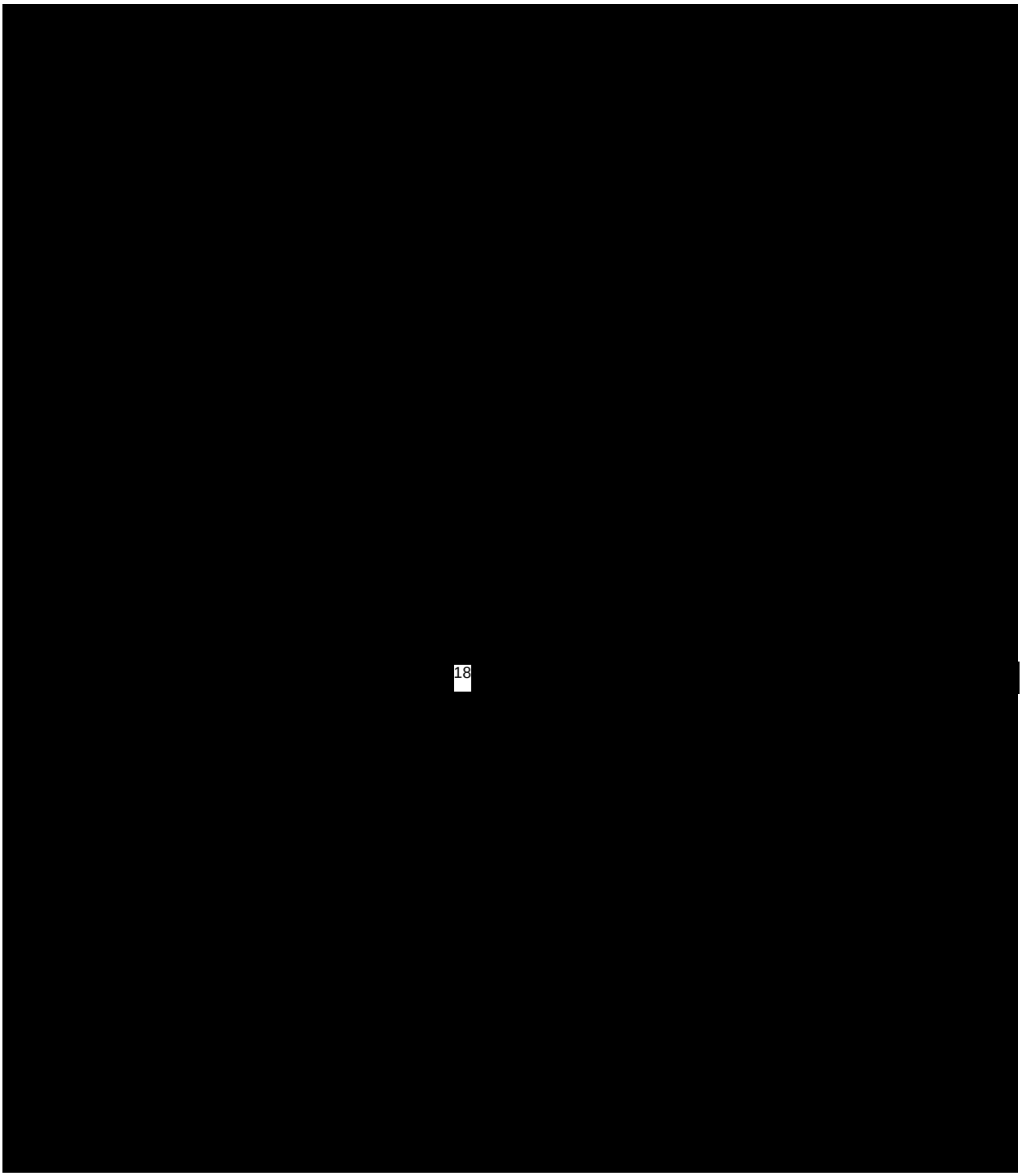
[redacted]

[redacted]

[redacted][17]

[17] [redacted]





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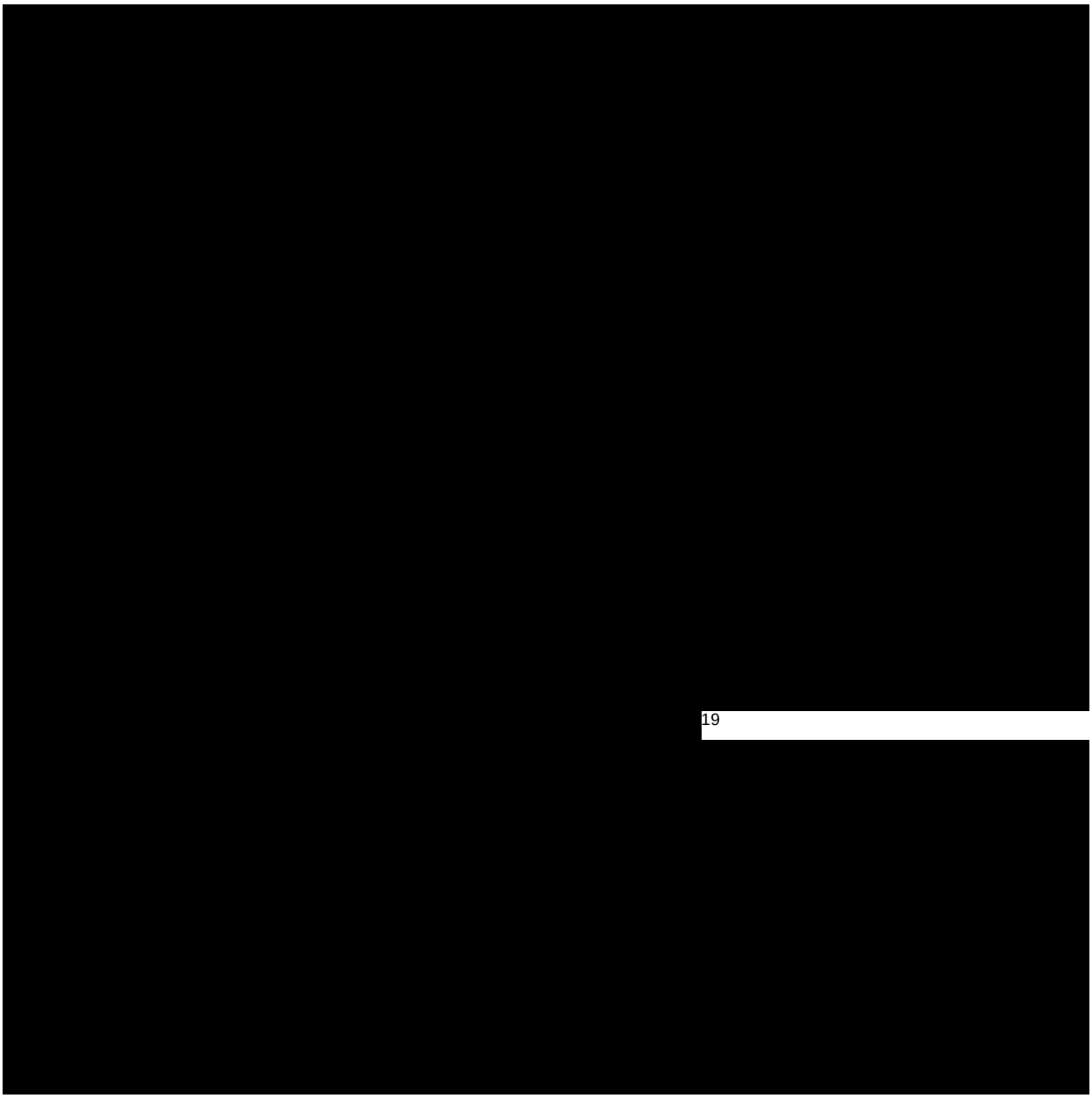

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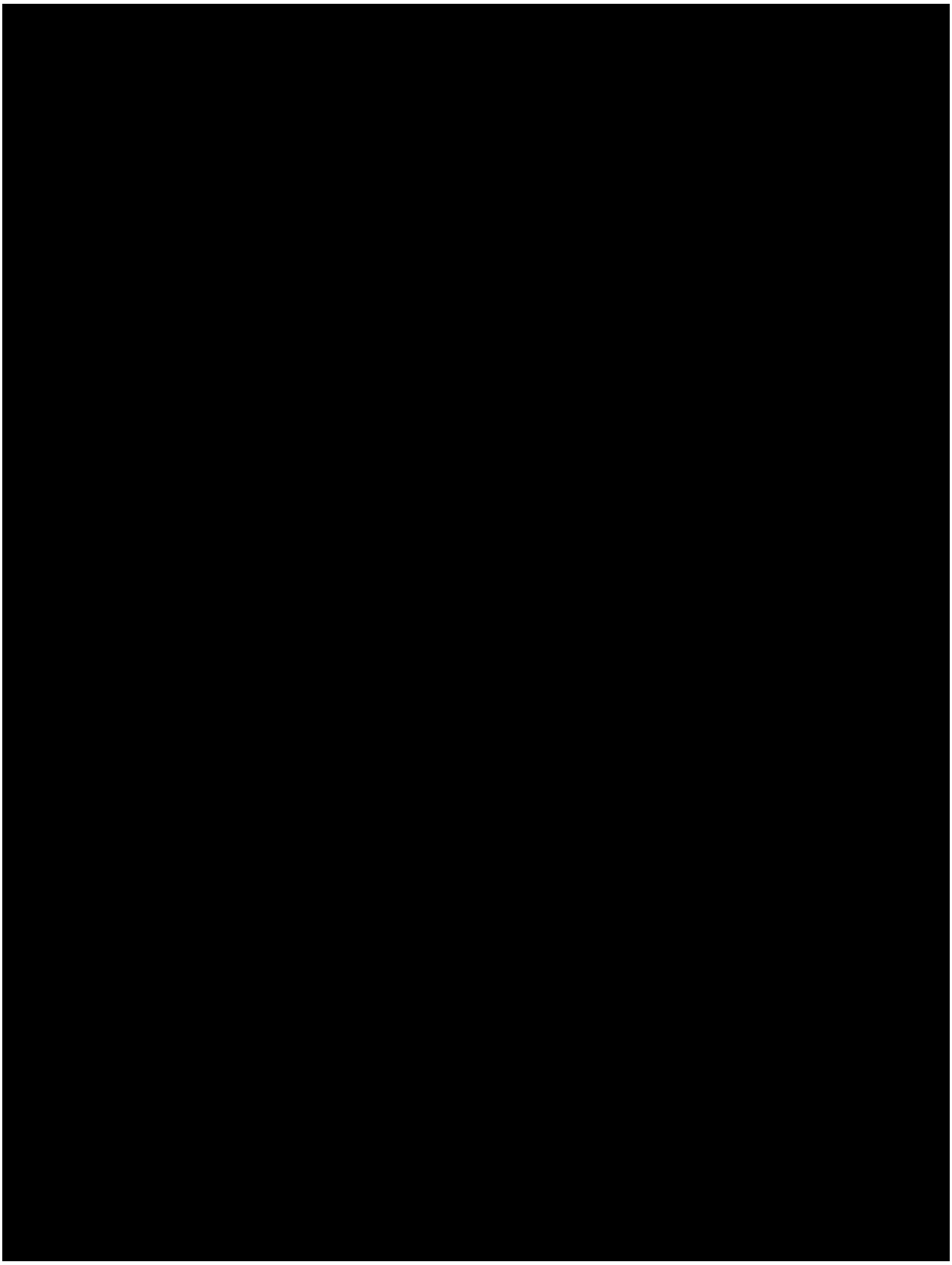

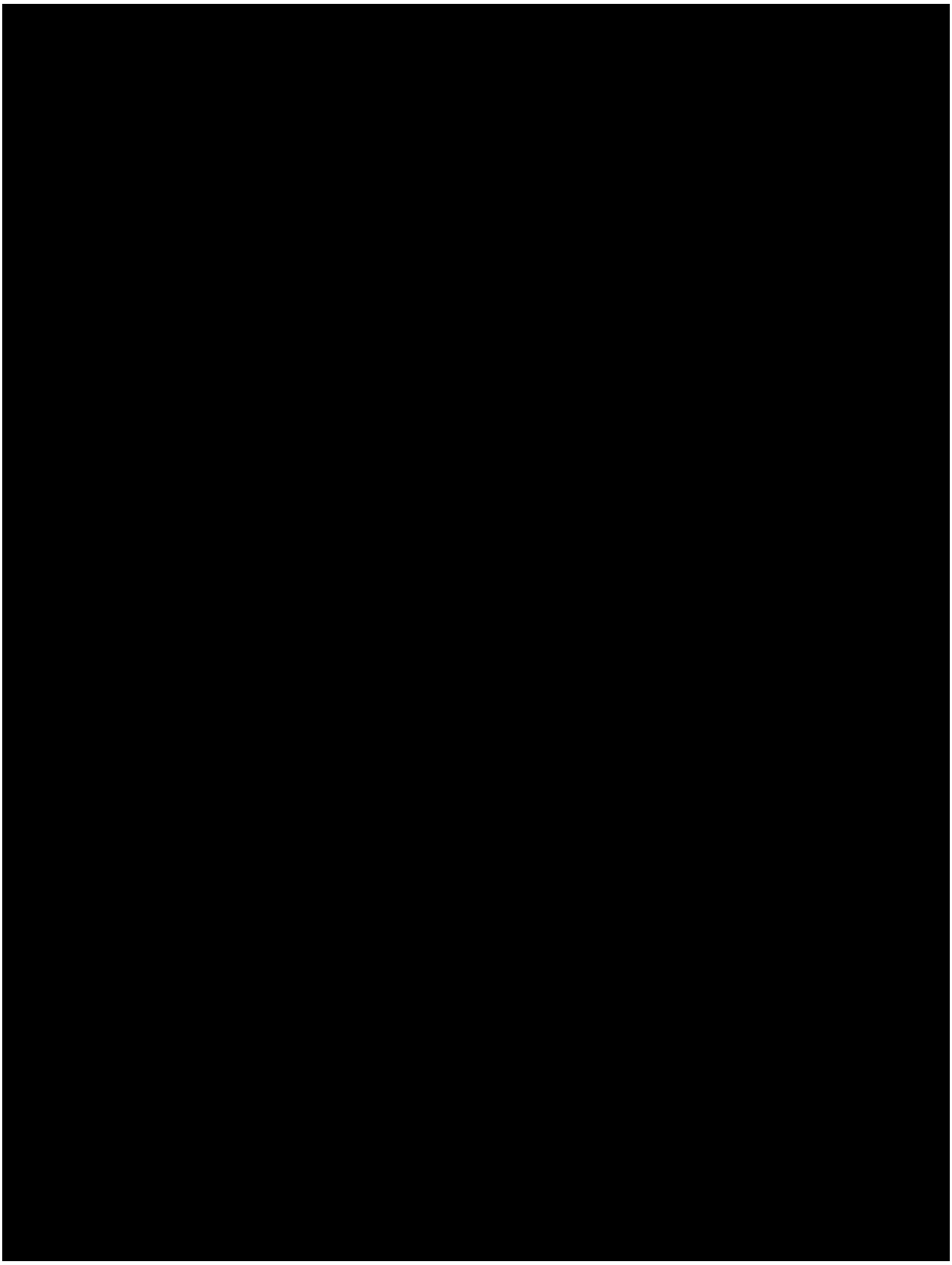

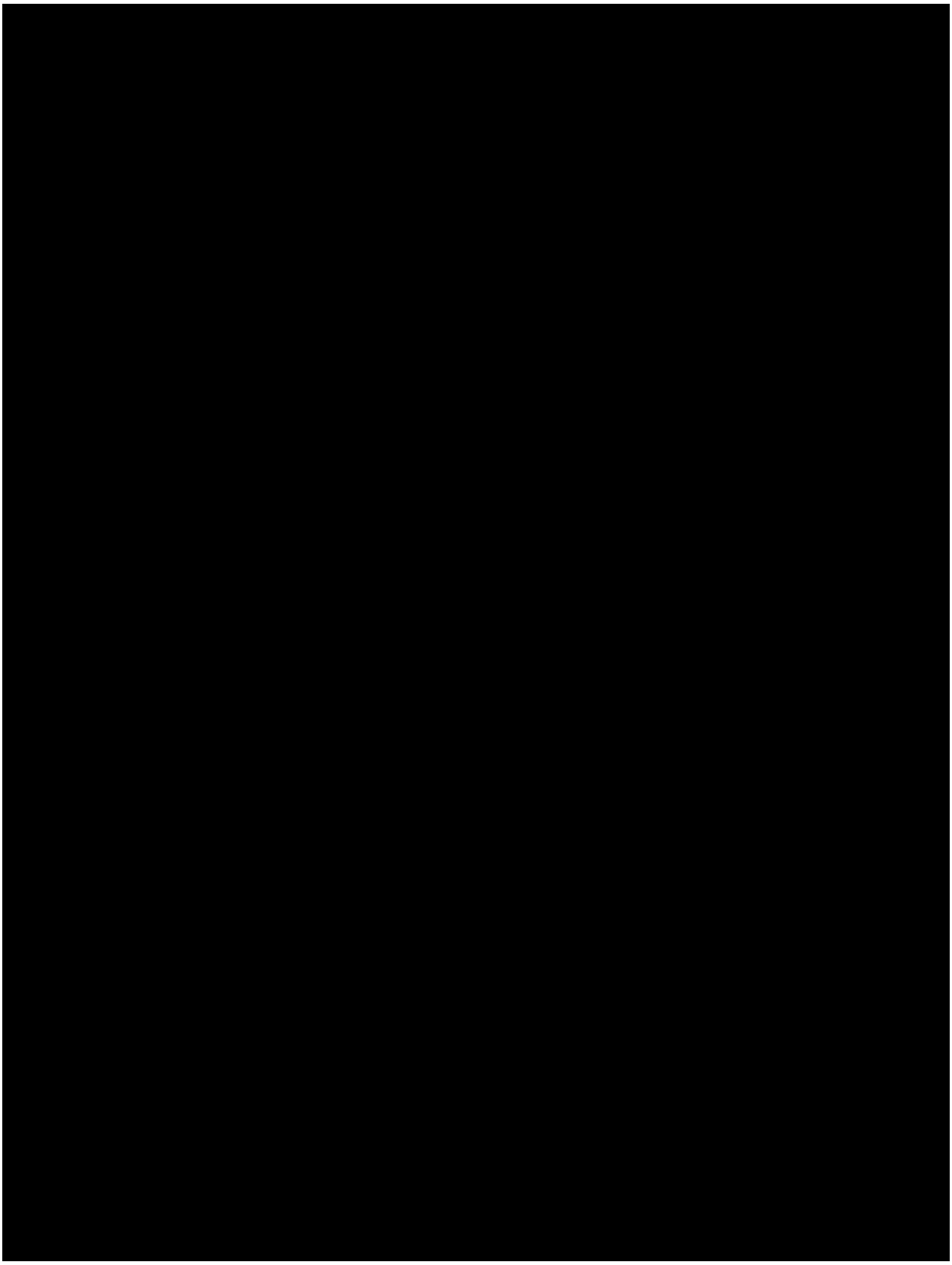

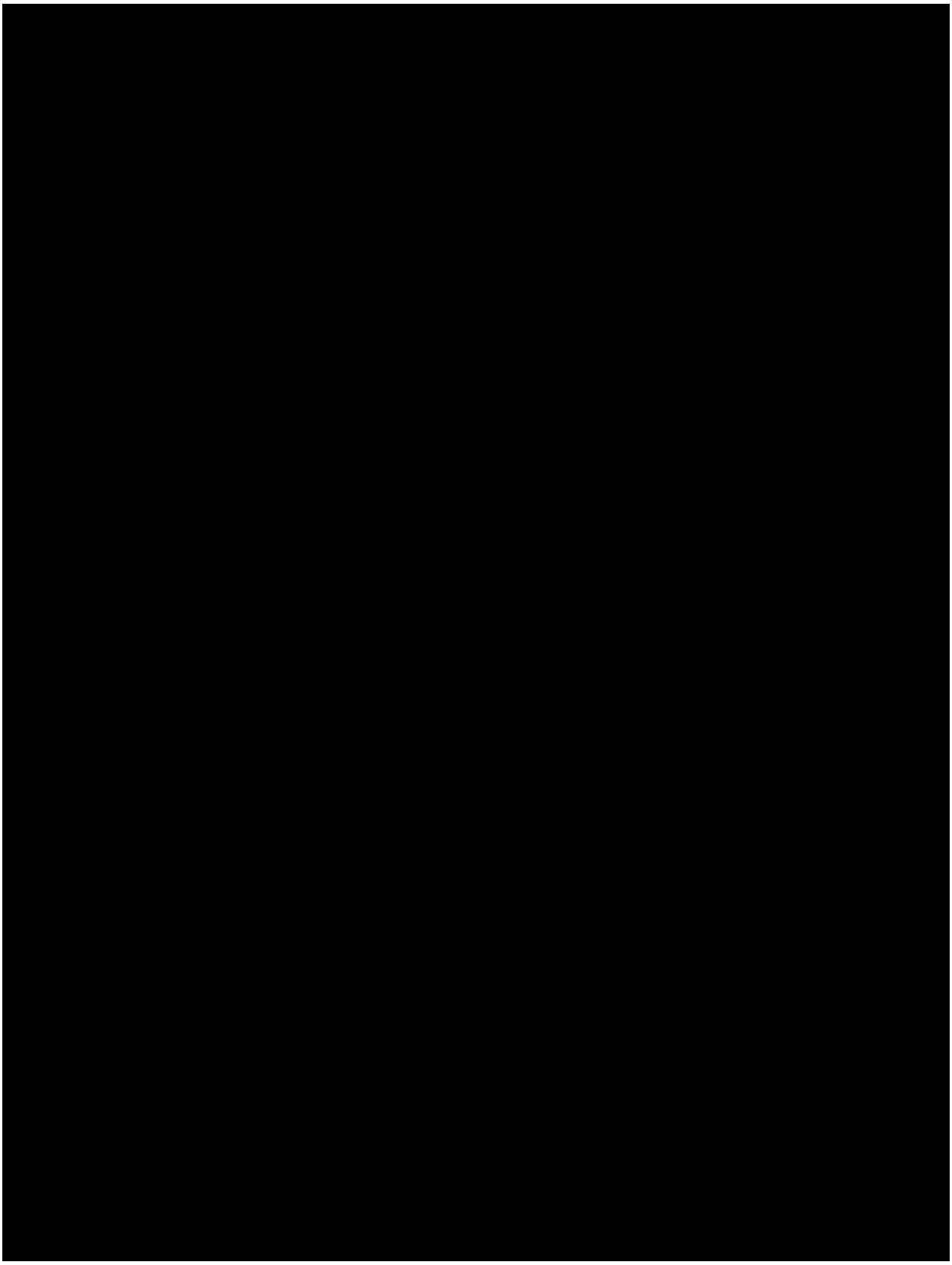

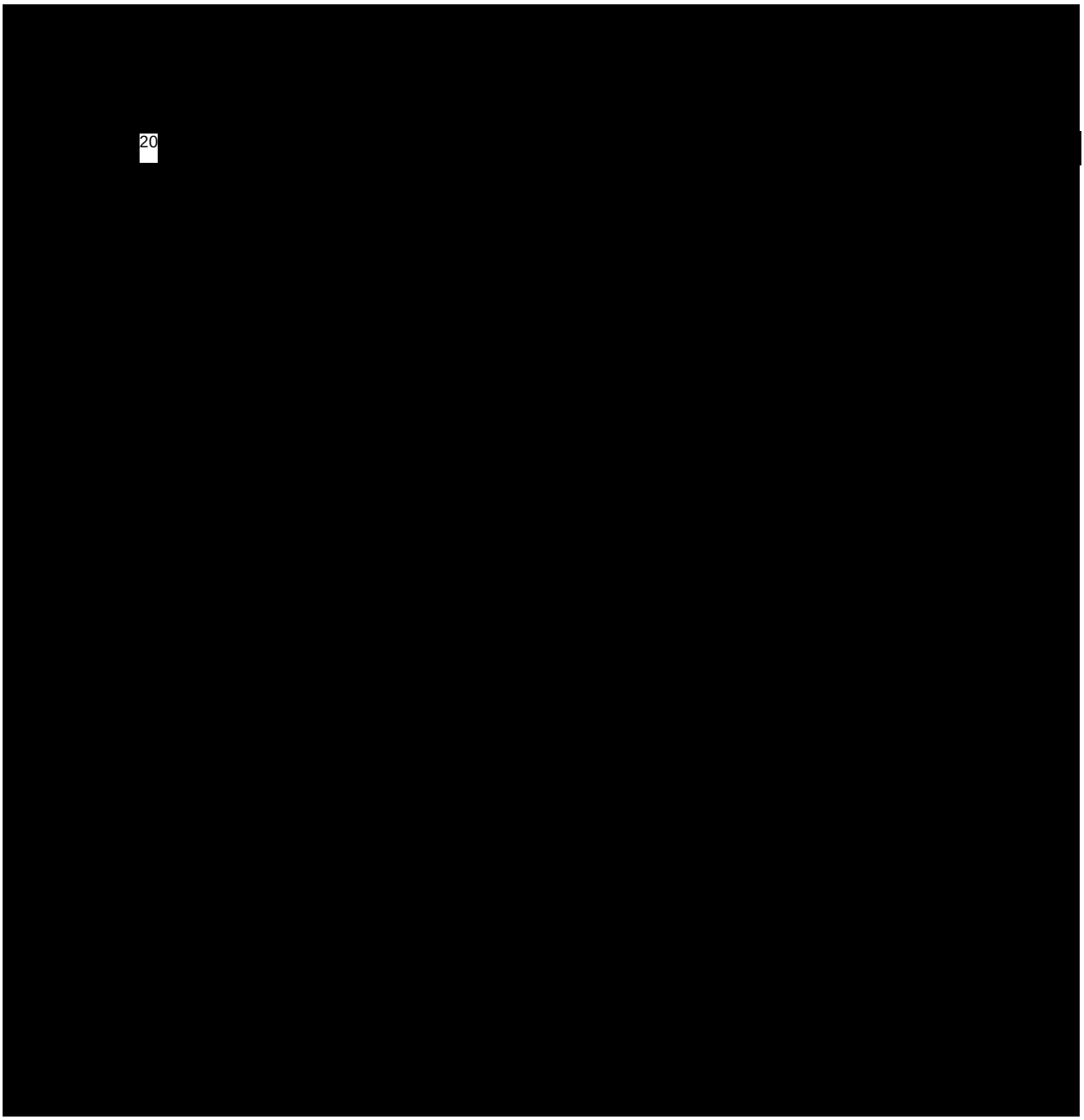

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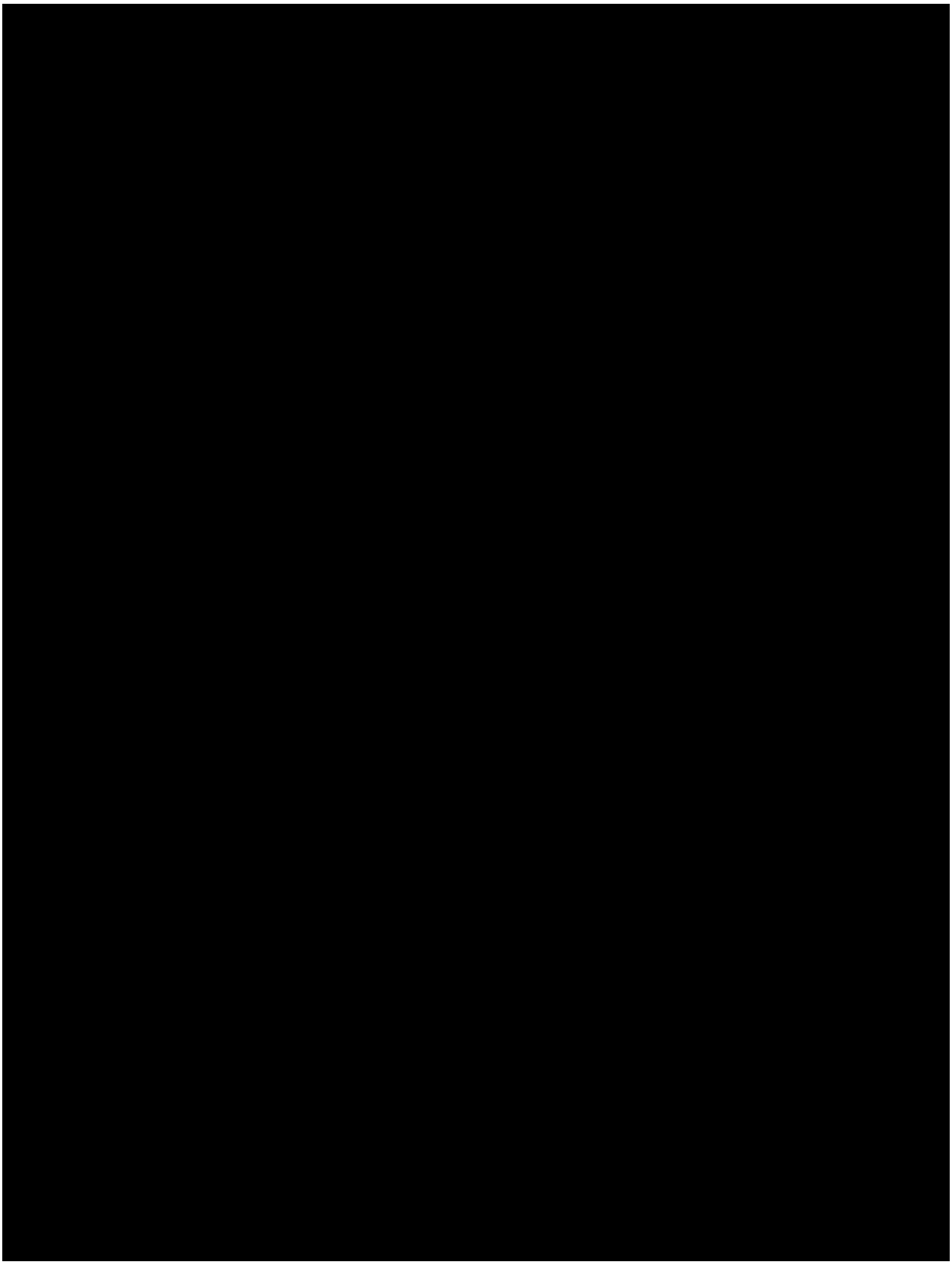

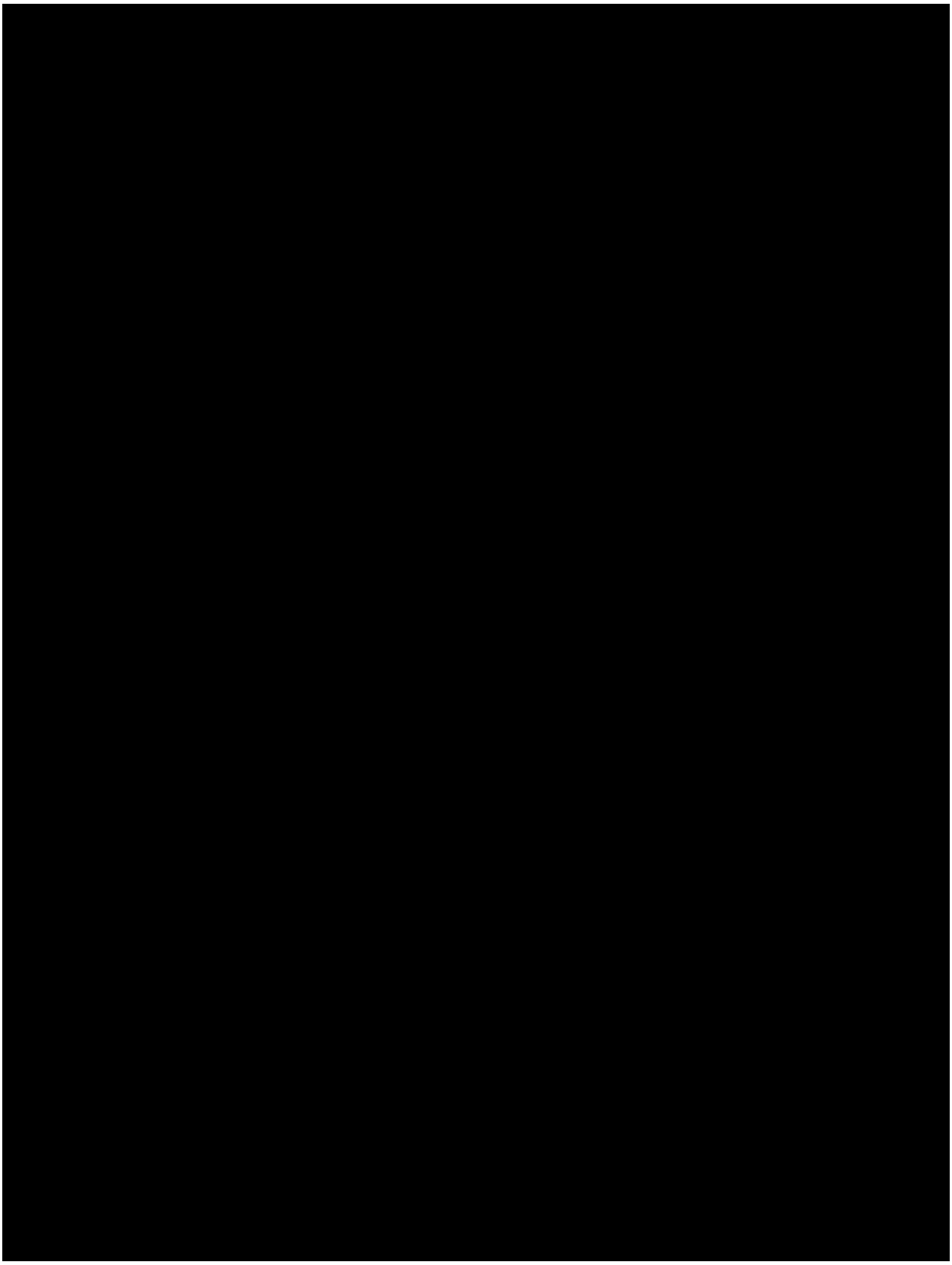

[redacted][21]

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

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21 [redacted]

Please call if you have any further questions.