

Office of the State Controller

Self-Assessment of Internal Controls

Tax/Payroll Compliance Cycle

Moving Expense Reimbursement

MOVING EXPENSES FOR YEARS BEGINNING IN 1998

Qualified moving expenses paid to a third party, such as a moving company, on behalf of the employee, and services furnished in-kind to the employee will not be reported on the Form W-2. Qualified moving expense reimbursements an employer pays directly to an employee will be reported in Box 12 of Form W-2 and identified using Code P. All non-qualified (taxable) moving expenses will continue to be included in wages in Box 1 of Form W-2, whether or not paid directly to a third party. They are subject to income tax withholding and social security and Medicare taxes.

TAXATION OF MOVING EXPENSES UNDER OSBM REIMBURSEMENT POLICY

The following is a clarification of which moving expense reimbursements made under the State's Budget Policy are subject to inclusion in the employee's taxable wage and which payments are not considered compensation.

The agency must take care not to tax employees for State subsistence at the new duty station when the facts and circumstances indicated that the employee's old dwelling had not been abandoned and the employee's living expenses are being duplicated so that it could be argued that the employee was traveling away from home overnight. Expenses for travel while away from home on business overnight are not taxable to the employee if the expense substantiation rules are followed. The tax treatment of travel while away from home on business is set forth in **IRS Regulation 1.162-2(f)**. A short discussion of these rules is included so that agencies can make a more informed determination of when to tax the 40 business days of subsistence payments that are available under the State's moving expense reimbursement policy.

MOVING EXPENSES

Internal Revenue Code Section 217 allows a deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the employee. Moving expenses are defined as the reasonable cost of moving household goods and personal effects from the former residence to the new residence, and of traveling from the former residence (including lodging, but not meals) to the new residence.

No deduction is allowed for moving expenses unless the employee's new principal place of work is at least 50 miles farther from his former residence than was his former place of work, or if he had no former principal place of work, is at least 50 miles from his former residence. Also, the employee must either be a full-time employee at the new general location for at least 39 weeks following the start of work at the new location, or during the

24 month period immediately following his arrival in the general location of his new principal place of work, he is a full-time employee or is self employed during at least 78 weeks, of which not less than 39 weeks are during the 12-month period referred to previously. The 50 mile or 39 week rule does not apply if the employee is unable to satisfy the conditions due to death, disability or involuntary separation.

In general, the move must occur in connection with the commencement of work at the new location and must be incurred within one year from the time the taxpayer begins work at the new location. Moving expenses may be deductible after this one-year period if the taxpayer can show that circumstances prevented the taxpayer from incurring the expense of moving within the one-year period.

Qualified moving expenses under **Code Sec. 132(g)** are excludable from the gross wages and wages for income and employment tax purposes to the extent paid for or reimbursed by the employer, whether paid for directly or through reimbursement. The employer is required to treat the qualified moving expenses as excludable from wages unless he has actual knowledge that the employee deducted the qualified expenses in a prior year or will not meet the distance requirement or the 39/78 week test.

EXPENSES OF TRAVEL AWAY FROM HOME

For travel expenses to be excludable from the employee's income, they must be incurred while, (1) away from home, and (2) in pursuit of a trade or business. **IRS Regulation 1.162-2(f)** sets forth three objective factors that are to be used to determine if an individual's home is truly his tax home. The factors are:

1. whether the individual performs a portion of his business in the vicinity of the abode while he is using the abode for lodging;
2. whether the individual's living expenses are duplicated because his business requires him to be away from the area; and
3. whether the individual has (a) not abandoned the vicinity in which his historical place of lodging and his claimed abode are both located, (b) has a member of his family currently residing at the claimed abode, or (c) uses the abode frequently for purposes of lodging.

If the individual satisfies all three of the above criteria, the individual's abode will be treated as his tax home. If the individual satisfies two of the three criteria, then all the facts and circumstances will be considered in determining if the claimed abode is the tax home. If at least two of the three criteria are not satisfied, the individual will be classified as an itinerant who has a tax home wherever he works. Since an itinerant never leaves his tax home, he is not entitled to deductions for travel expenses.

Conversely, any employer reimbursement of travel expenses would be includable in the employee's wages, subject to employment taxes.

When employees work away from home, it is sometimes impractical for them to return home at the end of the work day. When this occurs, the employee's travel expense

reimbursements (meals and lodging) are not taxable if the period of work away from home is temporary. Should the period of work become indefinite, travel expenses are considered compensation because the employee is considered to have changed the location of his tax home to his work location. Any employment that actually exceeds one year is treated as indefinite. The inclusion in income applies to all expenses reimbursed, not just those reimbursed after one year.

DIFFERENCES BETWEEN OFFICE OF STATE BUDGET AND MANAGEMENT'S MOVING EXPENSE REIMBURSEMENT POLICY AND EXPENSES ALLOWABLE UNDER THE INTERNAL REVENUE CODE

North Carolina General Statute 138-8 authorizes the Office of State Budget and Management (OSBM) to set a policy for the reimbursement of State employees who are required to relocate their duty station, when that relocation is deemed to be in the best interest of the State. That policy, as it presently exists, conflicts in several instances with what is allowable under the Internal Revenue Code. It is important to note that the definition of taxable versus non-taxable moving expenses, per the IRC, has changed numerous times since 1993.

OSBM policy allows for the movement of household and personal goods. The weight limitations stated in that policy are not found in the IRC, so that additional cost borne by the employee in connection with the household move should be allowable as an itemized deduction to the employee on his/her tax return. The tax treatment of insurance, appliance connections, mobile home set up cost, etc. per OSBM policy would normally not be taxable compensation since it would qualify as moving household goods (personal property), unless other IRC requirements for the move are not met by the employee.

OSBM policy allows for travel and subsistence to the employee for the cost of travel in locating a new residence for a maximum of three trips at the statutory rate. The IRC does not allow the reimbursement of travel for house-hunting purposes. The house-hunting mileage reimbursement is taxable compensation to the employee. Subsistence and lodging paid while looking for a new home is taxable compensation to the employee. For the day of the move, OSBM policy allows for mileage, subsistence for meal cost for each family member, and overnight lodging. The IRC does not allow for the tax free reimbursement of meal expenses incurred while moving. Therefore, all meal subsistence reimbursements for the day of the move are taxable compensation to the employee. Mileage paid in excess of the allowable IRS rate per mile would also be taxable compensation. The overnight lodging reimbursement is not taxable income.

OSBM policy allows for the payment of subsistence at the new duty station for a period not to exceed five days a week and mileage for one-round trip per week from the employee's current residence to the new duty station, not to exceed 40 business days. IRC Section 217 rules require that all per diem reimbursements be included in the taxable wage of the employee, subject to employment taxes. While the general rule of Section 217 is that payments of subsistence will be taxable compensation to the recipient, IRC Regulation 1.162-2(f) (see above) sets forth criteria that must be met in order to exempt business travel expenses from taxable wages. When at least two of the three stated criteria are met by the employee, for instance where the employee's living expenses are duplicated and family members are still living in the claimed abode, it is our opinion that the facts and

circumstances would indicate that the employee, for IRC purposes, would qualify for being in overnight travel status and the subsistence would be a non-taxable fringe benefit, excludable from taxable wages under IRC 132(g). When two of the three Reg. 1.162-2(f) criteria are no longer being met, the subsistence for the 40 business days would be taxable compensation. This is also true for the one-round trip mileage reimbursement. Please note, the applicable mileage rate for overnight travel while on business is the Federal cents-per-mile rate, not the moving expense mileage rate discussed above.

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Control Policies and Procedures

Agency _____

Year-End _____

A. Documentation

Yes No N/A

___ ___ ___ 1. Is there a formal plan of organization under which responsibilities are assigned to identify an employee as having received moving expense reimbursements?

Name of person responsible: _____

Title: _____

___ ___ ___ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent and accurate application of State and Federal policies on moving expense reimbursements?

B. Recording and Execution of Transaction and Events

___ ___ ___ 3. Does the agency reimburse moves made as a result of internal promotions, and/or changes in assignments involving the transfer of employees for the advantage and convenience of the employing agency?

___ ___ ___ 4. If moving expense reimbursement were paid to or on behalf of an employee, were the taxable amounts includable in the gross wages and non-taxable payments included on the Form W-2 as an informational item of the employee?

___ ___ ___ 5. Did the entity review the requirements of the 50 mile/39 week test to verify if these requirements were met by each employee paid or reimbursed for moving expenses?

- 6. If the 50 mile/39 week test was not met by an employee, was the payment or moving expense assistance included in taxable income with social security and income taxes withheld?
- 7. Were all non-taxable moving expense reimbursements reported to the payable system as informational items on the employees' W-2 Forms?
- 8. For all payments other than the move of household goods, lodging and transportation on the day of the move, did the agency include in taxable wages and withhold FICA and income taxes?