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Reimburse Corporate Owner-Employee for Depreciation

Question

I have your tax course.

Before purchasing your tax course, I bought a business SUV and then incorporated.

Your tax course says that my corporation can reimburse me for actual expenses on the SUV, including the Section 179 deduction and five-year MACRS depreciation.

My CPA says that I may not reimburse Section 179 or depreciation. Who's right? (J.D.S., Springfield, Mass.)

Answer

Nice setup: Thanks! Guess who's right? Your course, of course, and here are the facts.

IRS Reg. Section 1.62-2(d)(1) allows as reimbursements the expenses in part VI, subchapter B, chapter 1 of the Internal Revenue Code.¹ These expenses include, among others,

1. trade or business expenses,
2. interest expenses,
3. taxes,
4. losses,
5. bad debts,

 6 depreciation,

7. cost recovery,
8. research and development,
9. amortization of lease acquisition costs,
10. Section 179 expensing,
11. deductions for clean fuel vehicles,
12. amortization of costs for removing barriers to handicapped workers,
13. start-up expenditures, and
14. goodwill.

Taxpayers Who Did This

The Ralph M. Parsons Company reimbursed Milton Lewis \$14,007 to cover 60 percent of the depreciation and maintenance expenses on the home that he used for business entertainment.² (Home entertainment no longer qualifies for the home-office deduction, but this case does illustrate the depreciation reimbursement.)

In IRS Private Letter Ruling 6406174570A, the IRS ruled that a college could reimburse a professor for his home-office expenses, including depreciation.³

Overview of the Rules

In technical terms, your corporation reimburses you under the accountable-plan rules.⁴ Under these rules, you, the owner-employee, must

- incur these expenses in the performance of your duties for the corporation,⁵ and
- substantiate the expenses to the corporation in accordance with any specific conditions imposed by the Internal Revenue Code.⁶



For example, if your corporation reimburses travel, entertainment, automobile, computer, or airplane expenses, then you (the employee) must submit the documents that support these deductions in accordance with the rules for the deductions.

Travel. For travel, you must submit to the corporation receipts for expenses of \$75 or more, and you must justify the business reason for the trips, etc.

Vehicle. For an automobile, the employee must prove the business use of the vehicle, like keeping a three-month log of use, and have receipts for expenses of \$75 or more.

Home office. If you are reimbursed for the home-office deduction, your corporation must demand proof that substantiates administrative use, regular use, and exclusive use.

In other words, the corporation acts like an auditor for the IRS, making sure that the expenses meet the requirements of the law.

Failure Is Not an Option

If you, the owner-employee, fail to submit adequate proof, your corporation must include the expense reimbursements in your W-2.⁷ Incorrect treatment causes payroll tax penalties, such as the 100 percent trust fund penalty.⁸

With proper proof, your corporation gets the tax deduction for what it reimburses you. You, the owner-employer who receives the reimbursement, have no taxable income.⁹

The reason you have no taxable income is that the reimbursement is from an accountable plan; therefore, the reimbursement is¹⁰

- excluded from your gross income,
- not reported as wages on your Form W-2, and
- exempt from withholding and payment of employment taxes such as FICA and FUTA (federal unemployment).

Result You Want



You do not want to claim the expenses personally as employee business expenses on your IRS Form 1040. If you do claim employee business expenses, two bad things can attack your deductions:

- The 2 percent of adjusted gross income floor, which can reduce your deductions
- The alternative minimum tax (AMT), which totally disallows your employee business expense deductions

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1 Reg. Section 1.62-2(d)(1).

2 Milton Lewis v. Commr., TC Memo 1974-59 rev.d as to percentage by 40 AFTR 2d 77-5817, 560 F2d 973, 77-2 USTC ¶9673 (CA9, 9/13/1977).

3 Private Letter Ruling 6406174570A.

4 Reg. Section 1.62-2(c)(2).

5 Reg. Section 1.62-2(d)(1).

6 Reg. Section 1.62-2(e).

7 Reg. Section 1.62-2(c)(5).

8 IRC Section 6672.

9 Reg. Section 1.62-2(c)(4).

10 Ibid.

