

PKF PERSPECTIVES

TAX FACTS

REMINDER TO E-FILE FOR LARGE CORPORATIONS AND EXEMPT ORGANIZATIONS



As many of you are aware (and may have already completed), certain large corporations are required to file their tax returns electronically for tax years ending **after** December **30**, 2006. Thus, many 2006 calendar year corporate taxpayers must file their first electronic returns for 2006. A similar requirement is also in effect for calendar year 2006 tax-exempt organizations.

A corporation required to file a corporate income tax return on Form 1120, *U.S. Corporation Income Tax Return*, must file its corporate income tax return electronically if the corporation:

1. is required to file at least 250 returns during the calendar year ending with or within its tax year; (A return is considered any form filed with the IRS. Each W-2 and Form 1099 counts as one filing for this 250-return test.) and
2. was required to file a corporate income tax return on Form 1120 for the preceding tax year; and
3. has been in existence for at least one year before the due date (excluding extensions) of its corporate income tax return; and
4. for tax years ending after December 30, 2006 and later, reports total assets at the end of the corporation's tax year of **\$10 million or more** on Schedule L of its Form 1120.

250-Return Requirement

A corporation or controlled group of corporations is required to file electronically if, during the calendar year ending with or within the tax year of the corporation or the controlled group, the corporation or the controlled group is required to file at least 250 returns of any type, including information returns.

Illustration: The tax year of Corporation X, a fiscal year taxpayer with assets in excess of \$10 million, ends on September 30. During the calendar year ending December 31, 2007, X was required to file one Form 1120, 100 Forms W-2, 146 Forms 1099-DIV, one Form 940, and four Forms 941. Because X is required to file 252 returns during the calendar year that ended within its tax year ending September 30, 2008, X is required to file its Form 1120 electronically for its tax year ending September 30, 2008.

If the corporation is a member of a controlled group, the determination of the number of returns includes all returns required to be filed by all members of the controlled group during that calendar year. All members of a controlled group of corporations must file their corporate income tax returns electronically if the aggregate number of returns required to be filed by the controlled group of corporations is at least 250.

Exempt Organizations

An organization required to file a return on Form 990, *Return of Organization Exempt from Income Tax*, or Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation*, must file its Form 990 or 990-PF electronically if the organization:

1. is required to file at least 250 returns during the **calendar** year ending with or within its tax year; and
2. was required to file a Form 990 or Form 990-PF for the preceding tax year; and
3. has been in existence for at least one calendar year before the due date (excluding extensions) of its Form 990 or Form 990-PF; and
4. for a tax year ending after December 30, 2006, the organization has total assets as of the end of the tax year of \$10 million or more.

Thus, similar to corporations, for tax year 2006 returns that are due in 2007, tax-exempt organizations with total assets of \$10 million or more and which file at least 250 returns will have to file their tax year 2006 Form 990 electronically.

In addition, private foundations and charitable trusts which meet criteria 1, 2 and 3 above will have to file their Form 990-PF electronically regardless of their asset size.

PKF Procedures

PKF has implemented procedures for its affected clients to make the transition to electronic filing as seamless as possible.

PKF will prepare tax returns utilizing our standard tax software and each return will go through our normal review process (i.e., we will have an initial review by a tax senior with a technical review by one of our tax directors). After the return has been approved by a tax director, the preparer will transmit the return to the E-File Queue awaiting client approval. Our Tax Administrator will send our client a "copy" of the return to be filed along with Form 8879. The client, upon reviewing and approving the copy of the return provided, will sign Form 8879 and E-File approval forms and return them to PKF's Tax Administrator.

When the Tax Administrator receives the signed approval forms, the returns will be given to the person in charge of the account to transmit the

return to our software vendor, who electronically files the return. At the beginning of each day, a review of the system will be made for rejection notices and acceptance by the IRS. If a return is rejected, the individual in charge of the account will give the return to the preparer to make the necessary corrections. After the corrections are made, the person in charge of the account will resubmit the return to our software vendor.

When the IRS has accepted the return, the person in charge of the account will notify the Tax Administrator, who will indicate that the return has been filed. Once PKF has been notified by the IRS the return has been accepted, we will inform our client that the return has been successfully filed.

If anyone has any questions about e-filing, please contact us and we will be happy to assist you.

ACCOUNTABLE PLANS FOR EMPLOYEE EXPENSE REIMBURSEMENT

In Revenue Ruling 2006-56, the IRS ruled on employer expense allowance arrangements that cannot track per diem allowances paid to employees in excess of federal per diem rates. ***The ruling concluded that the entire reimbursement for business-travel-related meals and incidental expenses (M&IE) is a nonaccountable plan payment (and, thus, is wages) if an employer does not track expenses and does not require employees either to actually substantiate expenses or pay back amounts in excess of the deemed substantiated amount.***

Although the excess reimbursement issue frequently arises in the transportation and construction industries, it may impact **any** employer using per diems to reimburse employee expenses.

In light of this ruling, the IRS has issued guidance for field examiners explaining how auditors should

apply the new tough standards that went into effect after 2005.

Background

Reimbursements are tax-free to an employee and are not subject to withholding or payroll taxes if made under an accountable plan. To be treated as made under an accountable plan, a reimbursement must meet **all** of the following requirements:

1. the reimbursed expense must be allowable as a deduction and must be paid or incurred in connection with performing services as an employee, and
2. each reimbursed expense must be adequately accounted for to the employer within a reasonable period of time, and
3. any amounts in excess of expenses must be returned within a reasonable period of time.



A noncomplying reimbursement is treated as paid under a nonaccountable plan (and, therefore, is fully subject to withholding and employment taxes). If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse, **all** payments made under the arrangement are treated as made under a nonaccountable plan.

An arrangement is acceptable if it provides a per diem allowance for bona fide business-related travel expenses computed on a basis similar to that used in computing the employee's wages or other compensation (e.g., the number of miles traveled). The arrangement meets the business connection requirement only if the per diem allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the per diem allowance. Also acceptable is a per diem allowance based on standard industry practice.

An employer may pay a per diem amount to an employee on business-travel status instead of reimbursing actual substantiated expenses. If the rate paid does not exceed IRS-approved maximums, and the employee provides simplified substantiation (time, place and business purpose), the reimbursement is treated as made under an accountable plan. Receipts of expenses are not required.

Under special transportation industry rules, a fixed amount per day (\$52 for post-September 30, 2005 travel within the continental U.S.) may be treated as the federal M&IE rate. The amount deemed substantiated may be computed on a periodic basis (but not less frequently than monthly) rather than daily.

Recent Tough Ruling

Revenue Ruling 2006-56 deals with a trucking company that reimbursed drivers for M&IE through an allowance for each day a driver is on the road for the company. The allowance was paid on the basis of average daily miles (based on reliable industry data and the company's own data) typically traveled by drivers, but actual mileage was not documented (although drivers did document time, place, and business purpose of away from home overnight travel).

For 2006, the M&IE allowances paid to many of the drivers routinely exceeded \$52 per day. Drivers were not required to return the portion of the allowance paid for business-travel days that exceeded the \$52 per day deemed-substantiated amount. The company could not track the amount of the cents-per-mile M&IE allowance paid to each driver on a per diem basis and could not determine when the allowances exceeded the \$52 per diem.

Revenue Ruling 2006-56 concluded that the trucking company's reimbursement evidenced a pattern of abuse and as a result all of its M&IE reimbursement to each driver—not just the excess of reimbursements over \$52 per day—was paid under a nonaccountable plan. It held broadly that

all reimbursements are treated as made under a nonaccountable plan where

1. there is no mechanism or process to determine the excess of payments over the deemed substantiation amount, and
2. the employer “routinely pays” excess reimbursements with no substantiation of all the expenses or a return of the excess amount.

Although Revenue Ruling 2006-56 was effective immediately upon issuance, IRS recognized that employers may need some time to adjust their systems. In IR 2006-175, IRS agents were told not to apply the ruling's results for tax periods ending on or before December 31, 2006 in the absence of intentional noncompliance.

IRS Field Examiner Guidance

Field guidance tells auditors that the threshold consideration in determining if there is a pattern of abuse is whether an employer routinely makes payments in excess of the deemed substantiated amount.

Agents are told to determine if the employer has implemented and utilizes a system to track allowances and compute whether per diem allowances exceed the deemed substantiated amount, and to treat the excess as wages. If an employer uses such a system, then the fact that it routinely pays excess allowances not treated as wages—due to errors in its system—generally does not, on its own, evidence a pattern of abuse.

If there is no “pattern of abuse” then only the excess of the employer's reimbursement over the deemed substantiated amount is treated as made under a nonaccountable plan (and, therefore, subject to withholding and employment taxes). The field guidance stresses that each case stands on its own, and that a determination must be made based on the facts and circumstances of a particular case.

PKF Comment

Although the field memo is more lenient than the revenue ruling since it allows for system errors, it does reinforce the IRS' initiative in this area.

* * *

IN THE WORDS OF ...

Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.

Ronald Reagan (1911-2004)
40th President of the United States

The nation should have a tax system that looks like someone designed it on purpose.

William E. Simon (1927-2000)
U.S. Secretary of the Treasury

Taxes: Of life's two certainties, the only one for which you can get an automatic extension.

Author Unknown

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a professional advisor. This information is not intended to be, nor can it be, used by any taxpayer for the purpose of avoiding tax penalties. For more information, please contact tax directors Leo Parmegiani or Joe Lee.

PKF

**Certified Public Accountants
A Professional Corporation**

29 Broadway ♦ New York, NY 10006
Telephone: (212) 867-8000 ♦ Telefax: (212) 687-4346
www.pkfnewyork.com ♦ E-mail: info@pkfnyc.com

June 2007