MAY 2019

A PUBLICATION OF LAW BULLETIN MEDIA

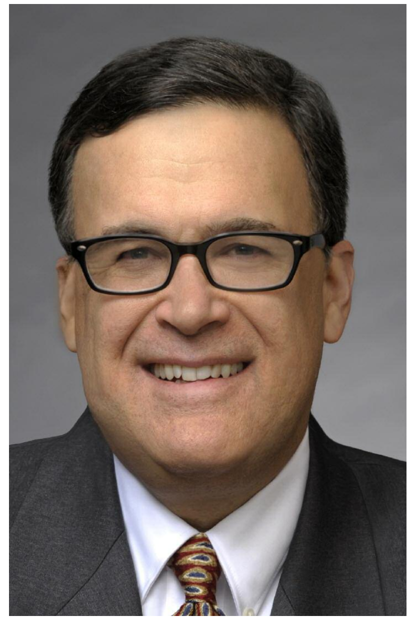
CHICAGO LAWYER®

GUEST COLUMN

NEW EXPENSE RULES

Reimbursement policies your firm must comply with

By PAUL E. STARKMAN



Employers in Illinois must now make sure their expense reimbursement policies comply with new requirements of the Illinois Wage Payment and Collection Act, while also taking into account recent changes to the Internal Revenue Code and laws in other states.

The wage payment act has long included business expenses in the definition of wages, but a new amendment went into effect on Jan. 1, which now provides that a company "shall reimburse employee[s] for all necessary expenditures or losses incurred by the employee[s] within the employee's[s'] scope of employment and directly related to services performed"

This new Illinois law came in the wake of 2018 changes to the deduction of unreimbursed business expenses under the U.S. Internal Revenue Code. It also exists along with California's and Massachusetts' expense reimbursement laws, which are similar enough to provide some guidance to the new amendment, but different enough to contain traps for unwary Illinois employers.

The federal Tax Cut and Job Act of 2018 eliminated the deduction for W-2 employees for unreimbursed business expenses previously allowed employees to deduct up to 2 percent of their adjusted gross income when they itemized deductions.

Even though employees can no longer deduct unreimbursed expenses, they do not have to report them as wages or income on their federal tax returns if (1) the employer establishes a written "accountable plan" and (2) the employees submit properly documented expenses under that plan.

In order to have an "accountable plan," an expense reimbursement policy or advance payment program must meet the following three conditions:

1. Business connection: The expense must occur in the performance of services as an employee of the employer.

2. Substantiation: The employee must substantiate the business expenses with the details of the expense. This must be done in a timely manner.

3. Returning excess amounts: If any amounts paid by the employer exceed the amount spent, employees must return excess amounts to the employer within a reasonable period of time. IRS Publication 15, (Circular E), Employer's Tax Guide.

An Illinois employee expense reimbursement policy can meet the "business connection" element of an "accountable plan" under IRS rules by complying with the act's new admonition that the policy "shall reimburse employee[s] for all necessary expenditures or losses [that are] incurred by the employee[s] within the employee's[s'] scope of employment and directly related to services performed for the [company]." 820 ILCS 115/9.5(a).

An Illinois policy can also meet the "substantiation" element of an "accountable plan by imposing a requirement allowed by the IWPCA Amendment that employees submit reimbursement requests within 30 days of incurring the expense," although Illinois employers can provide longer time limits to submit expense reimbursement requests if they wish.

The act amendment allows employers to obtain further substantiation by allowing Illinois policies to require that employees submit expense reports with supporting documents, such as receipts. If an employee loses a receipt or never receives one, the employer must accept other substantiation in form of the employee's signed statement as sufficient documentation for the expense.

The "returning excess amounts" element of an "accountable plan" can be met by the new Illinois expense reimbursement requirement that allows Illinois employers to establish policies that set specific limits on the amounts that will be reimbursed, even if the limits do not fully reimburse for every dollar spent on the expense. This will be done as long as the policy limitations do not provide only "minimal" or no reimbursement on necessary expenditures. 820 ILCS 115/9.5(b).

The act amendment requires that employers go beyond merely meeting the elements of an "accountable plan" under the IRS Code. Illinois employers may be required to re-examine common policies and practices, such as Bring-Your-Own-Device, or BYOD, policies, for employees using their personal electronic devices for work.

As recognized in Massachusetts and other states, BYOD policies essentially require employers to pay, indefinitely, expenses related to their personal devices for their employers' benefit. Employers in Illinois, California and elsewhere may have to cover some percentage of the business-related usage of employee-owned electronic devices.

It remains to be seen whether the reimbursement requirement will extend to situations where employees use their personal devices for business purposes, but actually incur no extra expenses because they have unlimited call plans or do not pay their own cellphone bills (because of bundled family plans).

There are ambiguities. Illinois employers will need to be cautious because guessing wrong about expense reimbursements can have serious consequences. Failing to maintain an "accountable" plan may result in expense reimbursement becoming a taxable event for employees subject to employer and employee payroll taxes.

Moreover, noncompliance with the act's expense requirements may become quite expensive because the act allows recovery of the amount of unreimbursed expenses and a penalty of up to 2 percent per month as well as attorney fees and costs.

After a demand or final wage order from the Illinois Department of Labor, the penalties increase to 20 percent of the underpayment and 1 percent per day until the amount is paid.

Until the Illinois law becomes clearer, employers may want to adopt a California practice of treating employees' failures to comply with expense reimbursement policies as disciplinary issues rather than grounds for refusing to reimburse the expense. CL

Paul E. Starkman is one of the directors in the labor and employment practice group in Clark Hill's Chicago office.
pstarkman@clarkhill.com