State Government Subcommittee on Government Integrity and Transparency Public Hearing on "Commonwealth Transparency 101: Sunshine Act, the Right-to-Know Law, the Ethics Act, and Per Diems"

My name is Cheri Freeh, and I am a certified public accountant and president and CEO of Hutchinson, Gillahan & Freeh, a public accounting firm located in Upper Bucks County, Pennsylvania.

I am here today representing the Pennsylvania Institute of Certified Public Accountants and our 20,000 members. Members provide auditing and accounting services to individuals, not-for-profit organizations, and employers of all sizes; advise clients on state, federal, and international tax matters; and prepare income and other tax returns for thousands of individuals and businesses throughout Pennsylvania. PICPA members are strategic partners and thought leaders in the area of tax policy and legislation. I will be providing you with some information about per diems.

A per diem allowance is a method employers can use to reimburse employees for travel expenses without having employees document all actual the expenses. There is generally no limitation on when a per diem allowance can be used, and employers have the option of switching between reimbursing actual expenses or using a per diem allowance at any time. There is no formal IRS election that must be made to switch methods.

Per diem allowances are considered payments under an accountable plan. An accountable plan is a plan that generally reimburses an employee for actual expenses that are reported to an employer. Payments to an employee under an accountable plan that meet certain qualifications are deductible for the employer, but they are not considered taxable income to the employee. Since per diems meeting certain qualifications are considered as paid under an accountable plan it allows the per diem payments to be paid to employees on a non-taxable basis.

Nonaccountable plans call for flat payments to an employee with no regard to the actual underlying expenses and no required substantiation by the employee. Payments under non-accountable plans must be included on an employee's W-2, and tax is then paid by the employee on the amounts received.

For payments to be considered made under an accountable plan, the allowance must be used for ordinary and necessary business expenses incurred by an employee for lodging, meals, and incidental expenses in connection with performing services as an employee while traveling away from home. (IRS Rev. Proc 2019-48, Sec. 3.01). The allowance must be reasonably calculated to not exceed the cost of the underlying expenses. This requirement is considered to be met if applicable federal per diem rates are used and the allowance is less than or equal to the applicable federal per diem rates. Payments in excess of the federal rates must be treated as a payment under a nonaccountable plan and should be included as taxable compensation reported for the employee.

For per diem payments that are equal to or less than the federal per diem rate to be considered substantiated, the business purpose, time, and place of the travel must be reported to the employer in a timely manner. Failure to provide timely substantiation can jeopardize the taxability of the per diem payment.

If an employee regularly incurs travel expenses on a trip that are above the federal per diem rates, the employee should be encouraged to submit actual travel expenses for reimbursement rather than using a per diem allowance. That way all expenses can be reimbursed on a tax-free basis.

Prior to 2017 federal tax law changes, if an employee’s actual business expenses exceeded the employer reimbursement, the excess (after certain limitations) could be deducted on federal Form 2106, which was then carried to federal Schedule A and deducted as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limitation. As a result of the law change, this deduction has been suspended for tax years 2018-2025 (with some minor exceptions).

In conclusion, there are two primary methods for an employer to reimburse employees for work-related travel expenses: an accountable plan and a nonaccountable plan. [[Previous sentence says two primary methods to reimburse employees: is that correct, or should this be two primary classes of per diem methods?]] An accountable plan is deductible by the employer and is not considered taxable income to the employee. A nonaccountable plan is deductible by the employer but is considered taxable compensation to the employee. If an employer chooses not to reimburse employees for travel expenses, the employee cannot deduct these expenses on their federal income tax return under current law.

Thank you for the opportunity to provide this information, and I will gladly answer any questions you may have on per diems.

Respectfully submitted,

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Former president of the Pennsylvania Institute of CPAs
Former member of the Internal Revenue Service Advisory Council
Current member of the Tax Executive Committee of the American Institute of CPAs