

8 Common expense reimbursement mistakes to watch out for

When employees cover work-related expenses out of pocket, employers must choose whether to reimburse the money, and if so, how. There are various regulations related to reimbursement, and some common expense reimbursement mistakes made by employers.

Whether your company regularly reimburses expenses paid by employees or not, you want to have a solid strategy in place so you can do it correctly when the time comes. Here are some common mistakes made by employers when it comes to reimbursing staff for their work-related expenses.



Not knowing which expenses are taxable

You withhold taxes when you pay your employee, but that isn't always the case when you reimburse them for expenses. Whether you do or don't will depend on whether you follow an accountable or nonaccountable plan.

Not knowing if there an accountable vs. nonaccountable plan

Concerning the previous mistake, you must know whether you are following an accountable or a nonaccountable plan. Here's the difference between the two.

Accountable Plan

These reimbursement rules must be met to be eligible for an accountable plan:

1. It's a business connection: The expenses must have been incurred while acting as an employee.
2. The expense is substantiated: Proper documentation is in place, including the date, place of purchase, the amount paid, and the purpose of the expense. It also must be requested within a reasonable time, typically 60 days.
3. You return unsubstantiated funds: Excess reimbursements must be returned within a reasonable period, typically 120 days.

Accountable expenses are not considered wages, so they are not subject to income, social security, Medicare, and FUTA taxes. You can deduct them as a business expense.

Nonaccountable Plan

If the 3 conditions above are not met, the expense is considered nonaccountable.

Employers deduct nonaccountable expenses as employee compensation since they are treated as supplemental wages subject to income, social security, Medicare, and FUTA taxes.

Not collecting receipts and invoices

You need proper documentation every time you reimburse an employee for an expense. Taking their word for it in terms of the date, the company paid, the amount spent, etc., isn't enough. You want to collect all information promptly before submitting reimbursements.

Depending on your reimbursement plan and the type of item or service being reimbursed, this might even be an IRS requirement.

Not receiving proper documentation when reimbursing for mileage and meals during travel

In many cases, the documentation needed to provide reimbursements goes beyond a receipt. Meals during travel and driving expenses are a common reimbursement for companies, and proper documentation is essential.

If you don't use a per diem allowance, the IRS requires you receive the following documentation for reimbursements for each meal:

- What was the purpose of the meal/why was it considered a business meal?
- When did the meal take place?
- Where did the meal occur?
- How much did the meal cost?
- Who was present during the meal?

The same goes for mileage reimbursements. The IRS requires you receive the following documentation for reimbursements for each trip:

- What was the purpose of the trip?
- What date did the traveling take place?
- How many miles were driven?
- What was the beginning odometer reading?
- What was the ending odometer reading?

Refusing to pay for reimbursements

Reimbursement laws vary per state, so you might not be in a position where you are required to pay for reimbursements, but if you are, refusing to do so can lead to significant trouble for your company and poor office culture in general. Even if it's not required by law to reimburse employees, it's a good company policy to reimburse money employees pay out of pocket to cover work-related expenses.

Not having an expense reimbursement policy in your employee handbook

Expense reimbursement policies should be clearly outlined in the employee handbook.

When developing your policy, consider incorporating the following points:

- The period for submitting reimbursable expenses.
- The process for submitting work-related costs to be reimbursed.
- The process for returning excess reimbursements.
- The types of costs that can be reimbursed.
- The maximum allowable reimbursement for various categories.

- The preferred supplier list if you have relationships or preferences that will allow for costs to be lower.

Having this information clearly outlined and available for employees at all times can help reduce confusion around how to submit reimbursement documentation and what's eligible to be reimbursed.

Not having rules for independent contractors

If your company works with independent contractors, you want to determine the best reimbursement strategy since there are different rules than for traditional W-4 employees.

If a contractor is paid with a form 1099, you might prefer to include the reimbursement amounts in the 1099 payment instead of reimbursing the expense yourself. In this case, the contractor can deduct the expense from their taxes.

Ultimately, you have to review the rules for 1099 employees and determine the best strategy for reimbursements.

Not complying with IRS' Rules

The IRS has rules and regulations in place for reimbursements. One of the most common expense reimbursement mistakes is simply not complying with their requirements.

It is unfair to employees to have to pocket the costs of work-related expenses that should be the employer's responsibility, and when reimbursed, they shouldn't have to pay income taxes on that money. That's why following all rules outlined by the IRS is crucial.