

Rev. Proc. 2005-10

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2004-60, 2004-42 I.R.B. 682 (which supersedes Rev. Proc. 2003-80, 2003-2 C.B. 1037), revising the high-low rates in section 5 to conform to changes to the *per diem* rates released by the General Services Administration (GSA) on October 5, 2004, that are retroactively effective as of October 1, 2004. See 69 Fed. Reg. 60,152 (Oct. 7, 2004). As a result of these changes, this revenue procedure revises the high and low rates contained in section 5.02 from \$199 to \$204 and from \$127 to \$129, respectively. In addition, section 5.04 of this revenue procedure describes changes to the list of high-cost localities. This revenue procedure also revises the description of incidental expenses in section 3.02(3) relating to transportation between places of lodging or business and places where meals are taken to conform to the Federal Travel Regulations as codified in the Code of Federal Regulations.

This revenue procedure provides rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home are deemed substantiated under

§ 1.274-5 of the Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for the expenses. This revenue procedure provides an optional method for employees and self-employed individuals who pay or incur meal costs to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. This revenue procedure also provides an optional method for use in computing the deductible costs of incidental expenses paid or incurred while traveling away from home by employees and self-employed individuals who do not pay or incur meal costs and who are not reimbursed for the incidental expenses. Use of a method described in this revenue procedure is not mandatory, and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meal and incidental expenses.

SECTION 2. BACKGROUND

.01 Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct expenses paid or incurred while traveling away from home in pursuit of a trade or business. However, under § 262, no portion of the travel expenses that is attributable to personal, living, or family expenses is deductible.

.02 Section 274(n) generally limits the amount allowable as a deduction under § 162 for any expense for food, beverages, or entertainment to 50 percent of the amount of the expense that otherwise would be allowable as a deduction. In the case of any expenses for food or beverages consumed while away from home (within the meaning of § 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Trans-

portation, § 274(n)(3) gradually increases the deductible percentage to 80 percent for taxable years beginning in 2008. For taxable years beginning in 2004 and 2005, the deductible percentage for these expenses is 70 percent.

.03 Section 274(d) provides, in part, that no deduction is allowed under § 162 for any travel expense (including meals and lodging while away from home) unless the taxpayer complies with certain substantiation requirements. Section 274(d) further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by the regulations.

.04 Section 1.274-5(g), in part, grants the Commissioner the authority to prescribe rules relating to reimbursement arrangements or *per diem* allowances for ordinary and necessary expenses paid or incurred while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which these arrangements or allowances, if in accordance with reasonable business practice, will be regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of travel expenses for purposes of § 1.274-5(c), and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of travel expenses for purposes of § 1.274-5(f).

.05 For purposes of determining adjusted gross income, § 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 62(c) further provides that the substantiation requirements described therein

do not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for the expense.

.07 Under § 1.62–2(c)(1) a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) or 1.274–5(j) will be treated as substantiation of the amount of the expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing *per diem* allowances is treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of the allowance that relates to days of travel substantiated and that exceeds the amount of the employee’s expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee’s expenses or anticipated expenses and the employee is required to return within a reasonable period of time any portion of the allowance that relates to days of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that, if a payor pays a *per diem* allowance that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to days of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee’s expenses deemed substantiated for the travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g) or § 1.274–5(j), and that the employee is not required to return, is subject to withholding and payment of employment taxes. See §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this portion.

.09 Under § 1.62–2(h)(2)(i)(B)(4), the Commissioner has the discretion to prescribe special rules regarding the timing of withholding and payment of employment taxes on *per diem* allowances.

.10 Section 1.274–5(j)(1) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals paid or incurred while traveling away from home in lieu of substantiating the actual cost of meals.

.11 Section 1.274–5(j)(3) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for incidental expenses paid or incurred while traveling away from home in lieu of substantiating the actual cost of incidental expenses.

.12 On August 31, 2004, GSA published the FY 2005 domestic *per diem* rates, effective on October 1, 2004. On October 1, 2004, the Internal Revenue Service released Rev. Proc. 2004–60, the annual update of procedures for substantiating the amount of ordinary and necessary business lodging, meal, and incidental expenses incurred while traveling away from home. Section 5 of Rev. Proc. 2004–60 includes high-low *per diem* rates based on the GSA *per diem* rates published on August 30, 2004.

.13 On October 5, 2004, GSA released revised FY 2005 *per diem* rates that are retroactively effective on October 1, 2004. This revenue procedure revises the high-low *per diem* rates in section 5 based on GSA’s revised rates.

SECTION 3. DEFINITIONS

.01 *Per diem allowance*. The term “*per diem allowance*” means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62–2(c)(1) and that is —

(1) paid with respect to ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses, or for meal and incidental expenses for travel away from home in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at or below the applicable federal *per diem* rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.02 *Federal per diem rate and federal M&IE rate*.

(1) *In general*. The federal *per diem* rate is equal to the sum of the applicable federal lodging expense rate and the applicable federal meal and incidental expense (M&IE) rate for the day and locality of travel.

(a) *CONUS rates*. The rates for localities in the continental United States (CONUS) are set forth in Appendix A to 41 C.F.R. ch. 301.

(b) *OCONUS rates*. The rates for localities outside the continental United States (OCONUS) are established by the Secretary of Defense (rates for non-foreign localities, including Alaska, Hawaii, Puerto Rico, the Northern Mariana Islands, and the possessions of the United States) and by the Secretary of State (rates for foreign localities), and are published in the *Per Diem Supplement to the Standardized Regulations (Government Civilians, Foreign Areas)* (updated on a monthly basis).

(c) *Internet access to the rates*. The CONUS and OCONUS rates may be found on the Internet at www.policyworks.gov/perdiem.

(2) *Locality of travel*. The term “*locality of travel*” means the locality where an employee traveling away from home in connection with the performance of services as an employee of the employer stops for sleep or rest.

(3) *Incidental expenses*. The term “*incidental expenses*” has the same meaning as in the Federal Travel Regulations, 41 C.F.R. 300–3.1 (2004). Thus, based on the current definition of “incidental expenses” in the Federal Travel Regulations, “incidental expenses” means fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries; transportation between places of lodging or business and places where meals are taken, if suitable meals can be obtained at the temporary duty site; and the mailing cost associated with filing travel vouchers and payment of employer-sponsored charge card billings.

.03 *Flat rate or stated schedule*.

(1) *In general*. Except as provided in section 3.03(2) of this revenue procedure,

an allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 3.01 of this revenue procedure. The allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, an hourly payment to cover meal and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule. Likewise, a payment based on the number of miles traveled (such as cents per mile) to cover meal and incidental expenses paid to an over-the-road truck driver who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

(2) *Limitation.* For purposes of this revenue procedure, an allowance that is computed on a basis similar to that used in computing the employee's wages or other compensation (such as the number of hours worked, miles traveled, or pieces produced) does not meet the business connection requirement of § 1.62-2(d), is not a *per diem* allowance, and is not paid at a flat rate or stated schedule, unless, as of December 12, 1989, (a) the allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the allowance, or (b) an allowance computed on that basis was commonly used in the industry in which the employee is employed. See § 1.62-2(d)(3)(ii).

SECTION 4. PER DIEM SUBSTANTIATION METHOD

.01 *Per diem allowance.* If a payor pays a *per diem* allowance in lieu of reimbursing actual lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for that day or the amount computed at the federal *per diem* rate (see section 3.02 of this revenue procedure) for the locality of

travel for that day (or partial day, see section 6.04 of this revenue procedure).

.02 *Meal and incidental expenses only per diem allowance.* If a payor pays a *per diem* allowance only for meal and incidental expenses in lieu of reimbursing actual meals and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for that day or the amount computed at the federal M&IE rate for the locality of travel for that day (or partial day). A *per diem* allowance is treated as paid only for meal and incidental expenses if (1) the payor pays the employee for actual expenses for lodging based on receipts submitted to the payor, (2) the payor provides the lodging in kind, (3) the payor pays the actual expenses for lodging directly to the provider of the lodging, (4) the payor does not have a reasonable belief that lodging expenses were or will be incurred by the employee, or (5) the allowance is computed on a basis similar to that used in computing the employee's wages or other compensation (such as the number of hours worked, miles traveled, or pieces produced).

.03 *Optional method for meal and incidental expenses only deduction.* In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary meal and incidental expenses paid or incurred for travel away from home, employees and self-employed individuals who pay or incur meal expenses may use an amount computed at the federal M&IE rate for the locality of travel for each calendar day (or partial day) the employee or self-employed individual is away from home. This amount will be deemed substantiated for purposes of paragraphs (b)(2) and (c) of § 1.274-5, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel for that day (or partial day) in accordance with those regulations. See section 6.05(1) of this revenue procedure for rules related to the application of the limitation under § 274(n) to amounts determined under this section 4.03. See section 4.05 of this revenue procedure for a method for substantiating incidental expenses that may be used by employees or self-employed individuals who do not pay or incur meal expenses.

.04 *Special rules for transportation industry.*

(1) *In general.* This section 4.04 applies to (a) a payor that pays a *per diem* allowance only for meal and incidental expenses for travel away from home as described in section 4.02 of this revenue procedure to an employee in the transportation industry, or (b) an employee or self-employed individual in the transportation industry who computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 of this revenue procedure.

(2) *Transportation industry defined.* For purposes of this section 4.04, an employee or self-employed individual is in the transportation industry only if the employee's or individual's work (a) is of the type that directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and (b) regularly requires travel away from home which, during any single trip away from home, usually involves travel to localities with differing federal M&IE rates. For purposes of the preceding sentence, a payor must determine that an employee or a group of employees is in the transportation industry by using a method that is consistently applied and in accordance with reasonable business practice.

(3) *Rates.* A taxpayer described in section 4.04(1) of this revenue procedure may treat \$41 as the federal M&IE rate for any CONUS locality of travel, and \$46 as the federal M&IE rate for any OCONUS locality of travel. A payor that uses either (or both) of these special rates with respect to an employee must use the special rate(s) for all amounts subject to section 4.02 of this revenue procedure paid to that employee for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. Similarly, an employee or self-employed individual that uses either (or both) of these special rates must use the special rate(s) for all amounts computed pursuant to section 4.03 of this revenue procedure for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year.

(4) *Periodic rule.* A payor described in section 4.04(1) of this revenue procedure may compute the amount of the employee's expenses that is deemed substantiated under section 4.02 of this revenue

procedure periodically (not less frequently than monthly), rather than daily, by comparing the total *per diem* allowance paid for the period to the sum of the amounts computed either at the federal M&IE rate(s) for the localities of travel, or at the special rate described in section 4.04(3), for the days (or partial days) the employee is away from home during the period.

(5) *Examples.*

(a) *Example 1.* Taxpayer, an employee in the transportation industry, travels away from home on business within CONUS on 17 days (including partial days) during a calendar month and receives a *per diem* allowance only for meal and incidental expenses from a payor that uses the special rule under section 4.04(3) of this revenue procedure. The amount deemed substantiated under section 4.02 of this revenue procedure is equal to the lesser of the total *per diem* allowance paid for the month or \$697 (17 days at \$41 per day).

(b) *Example 2.* Taxpayer, a truck driver employee in the transportation industry, is paid a “cents-per-mile” allowance that qualifies as an allowance paid under a flat rate or stated schedule as defined in section 3.03 of this revenue procedure. Taxpayer travels away from home on business for 10 days. Based on the number of miles driven by Taxpayer, Taxpayer’s employer pays an allowance of \$400 for the 10 days of business travel. Taxpayer actually drives for 8 days, and does not drive for the other 2 days Taxpayer is away from home. Taxpayer is paid under the periodic rule used for transportation industry employers and employees in accordance with section 4.04(4) of this revenue procedure. The amount deemed substantiated and excludable from Taxpayer’s income is the full \$400 because that amount does not exceed \$410 (ten days away from home at \$41 per day).

.05 *Optional method for incidental expenses only deduction.* In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary incidental expenses paid or incurred for travel away from home, employees and self-employed individuals who do

not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may use, for each calendar day (or partial day) the employee or self-employed individual is away from home, an amount computed at the rate of \$3 per day for any CONUS or OCONUS locality of travel. This amount will be deemed substantiated for purposes of paragraphs (b)(2) and (c) of § 1.274–5, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel for that day (or partial day) in accordance with those regulations. See section 4.03 of this revenue procedure for a method that may be used by employees or self-employed individuals who pay or incur meal expenses. The method authorized by this section 4.05 may not be used by payors that use section 4.01, 4.02, or 5.01 of this revenue procedure, or by employees or self-employed individuals who use the method described in section 4.03 of this revenue procedure. See section 6.05(4) of this revenue procedure for rules related to the application of the limitation under § 274(n) to amounts determined under this section 4.05.

SECTION 5. HIGH-LOW SUBSTANTIATION METHOD

.01 *In general.* If a payor pays a *per diem* allowance in lieu of reimbursing actual lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home and the payor uses the high-low substantiation method described in this section 5 for travel within CONUS, the amount of the

expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for that day or the amount computed at the rate set forth in section 5.02 of this revenue procedure for the locality of travel for that day (or partial day, see section 6.04 of this revenue procedure). This high-low substantiation method may be used in lieu of the *per diem* substantiation method provided in section 4.01 of this revenue procedure, but may not be used in lieu of the meal and incidental expenses only substantiation method provided in section 4.02 or 4.03 of this revenue procedure or the incidental expenses only substantiation method provided in section 4.05 of this revenue procedure.

.02 *Specific high-low rates.* The *per diem* rate set forth in this section 5.02 is \$204 for travel to any “high-cost locality” specified in section 5.03 of this revenue procedure, or \$129 for travel to any other locality within CONUS. The high or low rate, as appropriate, applies as if it were the federal *per diem* rate for the locality of travel. For purposes of applying the high-low substantiation method and the § 274(n) limitation on meal expenses (see section 6.05 of this revenue procedure), the federal M&IE rate shall be treated as \$46 for a high-cost locality and \$36 for any other locality within CONUS.

.03 *High-cost localities.* The following localities have a federal *per diem* rate of \$167 or more and are high-cost localities for all of the calendar year or the portion of the calendar year specified in parentheses under the key city name:

<i>Key City</i>	<i>County or other defined location</i>
Arizona	
Phoenix/Scottsdale (January 1-May 31)	Maricopa
California	
Monterey (February 1-November 30)	Monterey
Napa (May 1-October 31)	Napa
Palm Springs (January 1-May 31)	Riverside
San Diego	San Diego
San Francisco	San Francisco

<i>Key City</i>	<i>County or other defined location</i>
Santa Barbara	Santa Barbara
Santa Monica	City limits of Santa Monica
South Lake Tahoe (December 1-August 31)	El Dorado
Colorado	
Aspen	Pitkin
Crested Butte (December 1-March 31)	City limits of Crested Butte (Gunnison County)
Silverthorne/Breckenridge (December 1-March 31)	Summit
Telluride (December 1-September 30)	San Miguel
Vail	Eagle
District of Columbia	
Washington D.C. (also the cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington, Loudoun, and Fairfax, in Virginia; and the counties of Montgomery and Prince George's in Maryland) (See also Maryland and Virginia)	
Delaware	
Lewes (July 1-August 31)	Sussex
Florida	
Daytona Beach (February 1-March 31)	Volusia
Fort Lauderdale (January 1-May 31)	Broward
Key West	Monroe
Miami (October 1-May 31)	Miami-Dade
Naples (January 1-March 31)	Collier
Palm Beach (October 1-May 31)	Palm Beach (also the cities of Boca Raton, Delray Beach, Jupiter, Palm Beach Gardens, Palm Beach Shores, Singer Island and West Palm Beach)
Illinois	
Chicago	Cook and Lake
Louisiana	
New Orleans (February 1-April 30 and September 1-November 30)	Orleans and St. Bernard Parishes
Maryland	
(For the counties of Montgomery and Prince George's, see District of Columbia)	
Baltimore	Baltimore
Cambridge/St. Michaels (June 1-August 31)	Dorchester and Talbot
Ocean City (July 1-August 31)	Worcester

<i>Key City</i>	<i>County or other defined location</i>
Massachusetts	
Boston	Suffolk
Cambridge	City limits of Cambridge
Hyannis	Barnstable
(July 1-August 31)	
Martha's Vineyard	Dukes
(May 1-August 31)	
Nantucket	Nantucket
Michigan	
Traverse City	Grand Traverse
(July 1-August 31)	
New Jersey	
Atlantic City	Atlantic
(May 1-October 31)	
Cape May	Cape May (except Ocean City)
(June 1-August 31)	
Ocean City	City limits of Ocean City
(June 1-October 31)	
Princeton/Trenton	Mercer
New Mexico	
Santa Fe	Santa Fe
(July 1-August 31)	
New York	
Carle Place/Garden City/ Glen Cove/Great Neck/ Plainview/Rockville Centre/ Syosset/Uniondale/Woodbury	Nassau
Lake Placid	Essex
(July 1-August 31)	
Manhattan	Includes Richmond and the boroughs of Manhattan, Brooklyn, Queens and The Bronx
Riverhead/Ronkonkoma/ Melville	Suffolk
Tarrytown	Westchester (except White Plains)
White Plains	City limits of White Plains
North Carolina	
Kill Devil	Dare
(April 1-October 31)	
Pennsylvania	
Hershey	City limits of Hershey
(May 1-August 31)	
Philadelphia	Philadelphia

<i>Key City</i>	<i>County or other defined location</i>
Rhode Island	
Jamestown/Middletown/ Newport (May 1-October 31)	Newport
Providence	Providence
South Carolina	
Hilton Head (April 1-October 31)	Beaufort
Utah	
Park City (December 1-March 31)	Summit
Virginia	
(For the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, see District of Columbia)	
Virginia Beach (June 1-August 31)	Cities of Virginia Beach, Norfolk, Portsmouth, Chesapeake, and Suffolk
Washington	
Seattle (May 1-October 31)	King

.04 *Changes to high-cost localities in Rev. Proc. 2004-60.* The list of high-cost localities in section 5.03 of this revenue procedure differs from the list of high-cost localities in section 5.03 of Rev. Proc. 2004-60 (changes listed by key cities).

(1) The following locality has been added to the list of high-cost localities: Traverse City, Michigan.

(2) The portion of the year for which the following are high-cost localities has been changed: Fort Lauderdale, Florida; New Orleans, Louisiana; and Silverthorne/Breckinridge, Colorado;

(3) The following localities have been removed from the list of high-cost localities: Las Vegas, Nevada; Mackinac Island, Michigan; Myrtle Beach, South Carolina; and Tom's River, New Jersey.

(4) The boroughs of Brooklyn, Queens, The Bronx, and Staten Island are no longer separately listed as a high-cost locality and are now combined with the borough of Manhattan.

.05 Specific limitation.

(1) Except as provided in section 5.05(2) of this revenue procedure, a payor that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid

to that employee for travel away from home within CONUS during the calendar year.

(2) With respect to an employee described in section 5.05(1) of this revenue procedure, the payor may reimburse actual expenses or use the meals only *per diem* method described in section 4.02 of this revenue procedure for any travel away from home, and may use the *per diem* substantiation method described in section 4.01 of this revenue procedure for any OCONUS travel away from home.

SECTION 6. LIMITATIONS AND SPECIAL RULES

.01 *In general.* The federal *per diem* rate and the federal M&IE rate described in section 3.02 of this revenue procedure for the locality of travel will be applied in the same manner as applied under the Federal Travel Regulations, 41 C.F.R. Part 301-11 (2004), except as provided in sections 6.02 through 6.04 of this revenue procedure.

.02 *Federal per diem rate.* A receipt for lodging expenses is not required in determining the amount of expenses deemed substantiated under section 4.01 or 5.01 of this revenue procedure. See section 7.01 of this revenue procedure for the require-

ment that the employee substantiate the time, place, and business purpose of the expense.

.03 *Federal per diem or M&IE rate.* A payor is not required to reduce the federal *per diem* rate or the federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that meal and incidental expenses were or will be incurred by the employee during each day of travel.

.04 *Proration of the federal per diem or M&IE rate.* Pursuant to the Federal Travel Regulations, in determining the federal *per diem* rate or the federal M&IE rate for the locality of travel, the full applicable federal M&IE rate is available for a full day of travel from 12:01 a.m. to 12:00 midnight. The method described in section 6.04(1) of this revenue procedure must be used for purposes of determining the amount deemed substantiated under section 4.03 or 4.05 of this revenue procedure for partial days of travel away from home. For purposes of determining the amount deemed substantiated under section 4.01, 4.02, 4.04, or 5 of this revenue procedure for partial days of travel away from home, either of the following methods may be used to prorate the federal M&IE rate to

determine the federal *per diem* rate or the federal M&IE rate for the partial days of travel:

(1) The rate may be prorated using the method prescribed by the Federal Travel Regulations. Currently the Federal Travel Regulations allow three-fourths of the applicable federal M&IE rate for each partial day during which the employee or self-employed individual is traveling away from home in connection with the performance of services as an employee or self-employed individual. The same ratio may be applied to prorate the allowance for incidental expenses described in section 4.05 of this revenue procedure; or

(2) The rate may be prorated using any method that is consistently applied and in accordance with reasonable business practice. For example, if an employee travels away from home from 9 a.m. one day to 5 p.m. the next day, a method of proration that results in an amount equal to two times the federal M&IE rate will be treated as being in accordance with reasonable business practice (even though only one and a half times the federal M&IE rate would be allowed under the Federal Travel Regulations).

.05 *Application of the appropriate § 274(n) limitation on meal expenses.* Except as provided in section 6.05(4), all or part of the amount of an expense deemed substantiated under this revenue procedure is subject to the appropriate limitation under § 274(n) (see section 2.02 of this revenue procedure) on the deductibility of food and beverage expenses.

(1) If an amount for meal and incidental expenses is computed pursuant to section 4.03 of this revenue procedure, the taxpayer must treat that amount as an expense for food and beverages.

(2) If a *per diem* allowance is paid only for meal and incidental expenses, the payor must treat an amount equal to the lesser of the allowance or the federal M&IE rate for the locality of travel for each day (or partial day, see section 6.04 of this revenue procedure) as an expense for food and beverages.

(3) If a *per diem* allowance is paid for lodging, meal, and incidental expenses, the payor must treat an amount equal to the federal M&IE rate for the locality of travel for each calendar day (or partial day) the employee is away from home as an expense for food and beverages. For pur-

poses of the preceding sentence, if a *per diem* allowance for lodging, meal, and incidental expenses is paid at a rate that is less than the federal *per diem* rate for the locality of travel for each day (or partial day), the payor may treat an amount equal to 40 percent of the allowance as the federal M&IE rate for the locality of travel for each day (or partial day).

(4) If an amount for incidental expenses is computed under section 4.05 of this revenue procedure, none of the amount so computed is subject to limitation under § 274(n) on the deductibility of food and beverage expenses.

.06 *No double reimbursement or deduction.* If a payor pays a *per diem* allowance in lieu of reimbursing actual lodging, meal, and incidental expenses or for meal and incidental expenses in accordance with section 4 or 5 of this revenue procedure, any additional payment with respect to those expenses is treated as paid under a nonaccountable plan, is included in the employee's gross income, is reported as wages or other compensation on the employee's Form W-2, "Wage and Tax Statement," and is subject to withholding and payment of employment taxes. Similarly, if an employee or self-employed individual computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 or 4.04 of this revenue procedure, no other deduction is allowed to the employee or self-employed individual with respect to those expenses. For example, assume an employee receives a *per diem* allowance from a payor for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home. During that trip, the employee pays for dinner for the employee and two business associates. The payor reimburses as a business entertainment meal expense the meal expense for the employee and the two business associates. Because the payor also pays a *per diem* allowance to cover the cost of the employee's meals, the amount paid by the payor for the employee's portion of the business entertainment meal expense is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes.

.07 *Related parties.* Sections 4.01 and 5 of this revenue procedure do not apply if a payor and an employee are related within the meaning of § 267(b), but for this purpose the percentage of ownership interest referred to in § 267(b)(2) shall be 10 percent.

SECTION 7. APPLICATION

.01 If the amount of travel expenses is deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure, and the employee substantiates to the payor the elements of time, place, and business purpose of the travel for that day (or partial day) in accordance with paragraphs (b)(2) and (c) (other than subparagraph (2)(iii)(A) thereof) of § 1.274-5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274-5(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274-5(c). See § 1.62-2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.02 An arrangement providing *per diem* allowances will be treated as satisfying the requirement of § 1.62-2(f)(2) of returning amounts in excess of expenses if the employee is required to return within a reasonable period of time (as defined in § 1.62-2(g)) any portion of the allowance that relates to days of travel not substantiated, even though the arrangement does not require the employee to return the portion of the allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance *per diem* allowance for meal and incidental expenses of \$200, based on an anticipated 5 days of business travel at \$40 per day to a locality for which the federal M&IE rate is \$31, and the employee substantiates 3 full days of business travel. The requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62-2(g)) the portion of the allowance that is attributable to the 2 unsubstantiated days of travel (\$80), even though the employee is not required to return the portion of the allowance (\$27) that exceeds the amount

of the employee's expenses deemed substantiated under section 4.02 of this revenue procedure (§93) for the 3 substantiated days of travel. However, the \$27 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 7.04 of this revenue procedure.

.03 An employee is not required to include in gross income the portion of a *per diem* allowance received from a payor that is less than or equal to the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the *per diem* allowance in accordance with section 7.01 of this revenue procedure. See § 1.274-5(f)(2)(i). In addition, that portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W-2, and is exempt from the withholding and payment of employment taxes. See § 1.62-2(c)(2) and (c)(4).

.04 An employee is required to include in gross income only the portion of the *per diem* allowance received from a payor that exceeds the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the *per diem* allowance in accordance with section 7.01 of this revenue procedure. See § 1.274-5(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. See § 1.62-2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.05 If the amount of the expenses that is deemed substantiated under the rules provided in section 4.01, 4.02, or 5 of this revenue procedure is less than the amount of the employee's business expenses for travel away from home, the employee may claim an itemized deduction for the amount by which the business travel expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business travel expenses, includes on Form 2106, "Employee Business Expenses," the deemed substantiated portion of the *per diem* allowance received from the payor, and includes in gross income the portion (if any) of the *per diem*

allowance received from the payor that exceeds the amount deemed substantiated. See § 1.274-5(f)(2)(iii). However, for purposes of claiming this itemized deduction with respect to meal and incidental expenses, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the amount computed under section 4.03 of this revenue procedure minus the amount deemed substantiated under sections 4.02 and 7.01 of this revenue procedure. The itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.06 An employee who pays or incurs amounts for meal expenses and does not receive a *per diem* allowance for meal and incidental expenses may deduct an amount computed pursuant to section 4.03 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the appropriate limitation on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67. See section 7.07 of this revenue procedure for the treatment of an employee who does not pay or incur amounts for meal expenses and does not receive a *per diem* allowance for incidental expenses.

.07 An employee who does not pay or incur amounts for meal expenses and does not receive a *per diem* allowance for incidental expenses may deduct an amount computed pursuant to section 4.05 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67. See section 7.06 of this revenue procedure for the treatment of an employee who pays or incurs amounts for meal expenses and does not receive a *per diem* allowance for meal and incidental expenses.

.08 A self-employed individual who pays or incurs meal expenses for a calendar day (or partial day) of travel away from home may deduct an amount computed pursuant to section 4.03 of this revenue procedure in determining adjusted gross income under § 62(a)(1). This deduction is subject to the appropriate limitation on

meal and entertainment expenses provided in § 274(n).

.09 A self-employed individual who does not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may deduct an amount computed pursuant to section 4.05 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.10 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. See § 1.62-2(k). Thus, these payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. See § 1.62-2(c)(3), (c)(5), and (h)(2).

SECTION 8. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES

.01 The portion of a *per diem* allowance, if any, that relates to the days of business travel substantiated and that exceeds the amount deemed substantiated for those days under section 4.01, 4.02, or 5 of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62-2(h)(2)(i)(B).

.02 In the case of a *per diem* allowance paid as a reimbursement, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the days of travel substantiated. See § 1.62-2(h)(2)(i)(B)(2).

.03 In the case of a *per diem* allowance paid as an advance, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the days of travel with respect to which the advance was paid are substantiated. See § 1.62-2(h)(2)(i)(B)(3). If some or all of the days of travel with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those days within a reasonable period of time, the portion of the allowance

that relates to those days is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.62-2(h)(2)(i)(A).

.04 In the case of a *per diem* allowance only for meal and incidental expenses for travel away from home paid to an employee in the transportation industry by a payor that uses the rule in section 4.04(4) of this revenue procedure, the excess of the *per diem* allowance paid for the period over the amount deemed substantiated for the period under section 4.02 of this revenue procedure (after applying section 4.04(4) of this revenue procedure), is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. See § 1.62-2(h)(2)(i)(B)(4).

.05 For example, assume that an employer pays an employee a *per diem* allowance to cover business expenses for meals and lodging for travel away from home at a rate of 120 percent of the federal *per diem* rate for the localities to which the employee travels. The employer does not require the employee to return the 20 percent by which the reimbursement for those expenses exceeds the federal *per*

diem rate. The employee substantiates 6 days of travel away from home: 2 days in a locality in which the federal *per diem* rate is \$100 and 4 days in a locality in which the federal *per diem* rate is \$125. The employer reimburses the employee \$840 for the 6 days of travel away from home (2 x (120% x \$100) + 4 x (120% x \$125)), and does not require the employee to return the excess payment of \$140 (2 days x \$20 (\$120-\$100) + 4 days x \$25 (\$150-\$125)). For the payroll period in which the employer reimburses the expenses, the employer must withhold and pay employment taxes on \$140. See section 8.02 of this revenue procedure.

SECTION 9.. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2004-60 is superseded (1) for *per diem* allowances that are paid both (a) to an employee on or after January 1, 2005, and (b) with respect to lodging, meal, and incidental expenses or with respect to meal and incidental expenses paid or incurred for travel away from home on or after January 1, 2005; and (2) for purposes of computing the amount allowable as a deduction for meal and incidental expenses or for incidental expenses

only paid or incurred by an employee or self-employed individual for travel away from home on or after January 1, 2005. However, taxpayers may apply Rev. Proc. 2004-60 in lieu of this revenue procedure (1) for *per diem* allowances that are paid both (a) to an employee on or after January 1, 2005, and before March 1, 2005, and (b) with respect to lodging, meal, and incidental expenses or with respect to meal and incidental expenses paid or incurred for travel away from home on or after January 1, 2005, and before March 1, 2005; and (2) for purposes of computing the amount allowable as a deduction for meal and incidental expenses or for incidental expenses only paid or incurred by an employee or self-employed individual for travel away from home on or after January 1, 2005, and before March 1, 2005.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christian Wood of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Wood at (202) 622-4930 (not a toll-free call).