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# How Tax Reform Affects Your Mobile Employees

What you need to know

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## This eBook will address:

Tax code changes relevant to car allowances and reimbursements for 2022 and beyond, new challenges introduced by COVID-19, and ways to protect your company and turn tax reform into a win for both employers and employees.

## Introduction

# Tax Reform and Your Mobile Employees

**Changes in the tax code mean changes in how employers and employees go about their business. Everyone wants to fare well under the new system, and everyone takes measures to minimize losses and maximize gains.**

The passage of the Tax Cuts and Jobs Act (TCJA) in December 2017 brought a new round of adjustments for American businesses and their employees. This book is designed to help any organization with employees who drive as part of their job to navigate changes to the tax code.

We'll examine how the tax reform affects these mobile employees, why employers should carefully review their business vehicle policies in light of the tax reform, and why it's crucial to get these policies right. Whether an organization pays a car allowance, reimburses mileage or fuel, or deploys some combination, this simple guide will provide best practices for managing vehicle policies within the current tax landscape, with important updates in light of the COVID-19 pandemic.

On December 22, 2017 President Trump signed the Tax Cut and Jobs Act into law. In 2022, taxpayers will have filed returns for three years under the new law.

Chapter 1

# The Tax Cuts and Jobs Act

**The TCJA was intended to simplify the tax code while lowering tax rates, but it also removed some important tax deductions.**

The plan lowered income tax brackets for individuals. It also lowered the corporate income tax rate to 21 percent.

The tax reform legislation impacted virtually every American taxpayer and business. Mobile employees and the companies that employ them have been particularly affected by the removal of the deduction for unreimbursed business expenses.

Previously, a mobile employee could deduct unreimbursed work expenses—mileage, lodging, meals, etc.—that exceeded 2% of their adjusted gross income (AGI). They would include these expenses on their tax returns using Schedule A and Form 2106. The loss of this deduction means that driving for work has gotten more expensive.

The loss of this deduction also means that companies no longer can rely on employees writing off unreimbursed expenses during tax time. Congress essentially closed a loophole that allowed employers not to worry about whether their company car allowance or mileage rate fully covered employees' vehicle costs. They could just say, "Write it off next spring." Not anymore.

Employees first felt the effects of this income loss during the 2019 tax season as they filed their 2018 tax returns. This has prompted some to find new employers that reimburse vehicle expenses or to seek recourse via state labor codes.

Several states have laws that require indemnification of employees from work expenses. California Labor Code 2802(a) requires employers to cover 100% of each employee's work-related expenses. And in January 2019 the state of Illinois added the same rule. In total, nine states have expense indemnification codes, and others may follow as more employees realize they cannot write off unreimbursed expenses.

Now, two years of filing returns under the new tax law has caused organizations to realize that they need to be more precise with the amount of car allowance or reimbursement they provide. Many are exploring alternatives to traditional models because they do not offer sufficient precision.

In 2021 the TCJA was compounded by COVID-19. Many mobile employees that were not considered essential workers were grounded. Those employees of organizations either reimbursing at the IRS mileage rate or providing a car allowance may have seen their fixed costs to own a vehicle (insurance, license, registration, and ad valorem taxes) exceeding either their net car allowance or mileage reimbursement.  This situation has added urgency to the need for employers to find reimbursement models that are flexible enough to handle unforeseen challenges.

## Old vs. New Tax Brackets

**OLD BRACKETS**

| Married Couples Filing Jointly | | Single Filers | |
|---|---|---|---|
| Taxable Income | Tax rate | Taxable Income | Tax rate |
| Up to $19,400 | 10% | Up to $9,700 | 10% |
| $19,401–$78,950 | 12% | $9,701–$39,475 | 12% |
| $78,951–$168,400 | 22% | $39.475–$84,200 | 22% |
| $168,401–$321,400 | 24% | $84,201–$160,725 | 24% |
| $321,401–$408,200 | 32% | $160,726–$204,100 | 32% |
| $408,201–$612,350 | 35% | $204,101–$510,300 | 35% |
| $612,351+ | 37% | $510,301+ | 37% |

**NEW BRACKETS**

| Married Couples Filing Jointly | | Single Filers | |
|---|---|---|---|
| Taxable Income | Tax rate | Taxable Income | Tax rate |
| Up to $19,050 | 10% | Up to $9,525 | 10% |
| $19,050–$77,400 | 15% | $9,525–$38,700 | 15% |
| $77,400–$156,150 | 25% | $38,700–$93,700 | 25% |
| $156,150–$237,950 | 28% | $93,700–$195,450 | 28% |
| $237,950–$424,950 | 33% | $195,450–$424,950 | 33% |
| $424,950–$480,050 | 33% | $424,950–$426,700 | 35% |
| $480,050+ | 39.6% | $426,700+ | 39.6% |

The TCJA has made employers more vulnerable to employee complaints as well as labor code violations. In our 2019 survey, 62% of HR managers reported complaints about car allowances; in 2020 that number rose to 88%.

Ultimately, we recommend that you follow up with tax and legal counsel. But we also recommend that you review your organization's business vehicle policies. Failing to do so could result in undesirable consequences as mobile employees take measures to offset their reduced tax benefit. Employees that receive a fixed allowance, for example, may drive less to save gas, reducing their productivity.

Carefully reviewing your organization's policies now will pay serious dividends later by curbing distracted drivers focused on their expenses rather than their job, boosting employee satisfaction or increasing cost-effectiveness. We'll next outline various business vehicle policies that exist, identify effective business vehicle policies, and then discuss how the TCJA affects the employees governed by those policies.

**The removal of the business expense deduction has placed new pressure on employers to reimburse employees fully. Failure to respond will add long-term costs. Review your car reimbursement policies today.**

Chapter 2

# Types of Business Vehicle Policies

**Employees who drive personal vehicles for work incur a range of work-related expenses: fuel, insurance, maintenance, depreciation, tires, and more. Various methods exist to defray those costs, each with its own tax implications.**

When surveying the array of methods to address employee vehicle expenses, you must ask two important questions:

- Is the plan taxable?
- Does the plan accurately offset employee expenses?

Taxation depends on whether the employer can use an IRS-approved procedure to show that a payment does not exceed the employee's expenses. The least optimal plans fail to cover expenses yet remain taxable. The best plans accurately reimburse expenses, tax free.

## SIMPLE POLICIES

### CAR ALLOWANCE

A flat, monthly allowance that is taxed as compensation.

### MILEAGE REIMBURSEMENT

A cents-per-mile rate multiplied by mileage reported by the employee. Non-taxable if it doesn't exceed the IRS mileage rate.

## COMPLEX POLICIES

### CAR ALLOWANCE WITH MILEAGE SUBSTANTIATION

A monthly allowance checked against the employee's monthly reported mileage; the employee is charged back if the allowance exceeds the expense of the reported mileage. Complicated to administer but non-taxable.

### CAR ALLOWANCE WITH FUEL CARD

A flat, taxable car allowance plus a charge card devoted specifically to gas. Requires administrative work to make sure employees adhere to fuel card rules. Personal use of fuel must be charged back or taxed as income.

### CAR ALLOWANCE WITH MILEAGE REIMBURSEMENT

A flat, taxable car allowance combined with a mileage reimbursement rate. The mileage rate portion is non-taxable if it doesn't exceed the IRS rate.

### HOME GROWN

Any combination of policies (e.g. company pays car allowance, fuel, and insurance costs). There is quite a bit of administrative work to make sure the policy works effectively. Tax implications vary.

### CAR ALLOWANCE WITH FUEL REIMBURSEMENT

A flat, taxable car allowance plus reimbursement for reported fuel expenses. Requires administrative work to make sure fuel is used for work-related travel. Personal use of fuel must be charged back or taxed.

### FIXED AND VARIABLE RATE REIMBURSEMENT (FAVR)

A fixed monthly amount plus a variable mileage rate, all based on expense data for a standard vehicle based in the employee's home zip code. Complicated to administer but non-taxable and highly accurate.

Chapter 3

# How the TCJA Impacts Business Vehicle Policies

**Because the TCJA eliminated the deduction for unreimbursed work expenses until 2026, some mobile employees are taking new measures to protect their income.**

These measures typically come at the expense of employers. Companies with business vehicle policies that reimburse insufficiently will experience the most deleterious effects.

## No data, big risks

Any policy that's not based on data runs the risk of under-reimbursing some employees. Even if the policy sufficiently reimburses some of the employees in an organization, others may find themselves shortchanged because their expenses are higher.

A flat, taxable car allowance is particularly susceptible to shortchanging employees because taxes eat up a significant amount of the employee's take-home pay. Most mobile employees pay somewhere between 22% and 37% in taxes plus an additional 7.5% for FICA, along with 3-7% in state income taxes. A $500 allowance may be reduced as low as $300 after taxes. At the same time the IRS mileage rate, while non-taxable, may still shortchange low mileage employees, especially if they work in an expensive territory.

The simple fact is, if you aren't basing your policy on actual data derived from costs associated with each employee's territory and role, you cannot know for sure whether your policy properly reimburses all your employees. And this means you may have employees who are finding other ways to offset the loss of the tax deduction.

## No deduction, new behavior

Not all employee drivers equally benefited from the unreimbursed expense deduction. But all drivers whose employers fail to properly reimburse them will seek to find ways to recoup their expenses. Here are four actions these employees may take.

## Employees who are not reimbursed properly may...

Right now is a great time to review your business vehicle policy. But be careful. Not all policy solutions are effective, and some can create costly new problems.

1

### Leave the company

If their costs exceed their car allowance, and if additional compensation and benefits do not make up the difference, employees will leave. That's simple business 101. This is why many organizations add a fuel card or mileage rate to their allowance or substantiate mileage, since that protects most or all of the allowance from taxation. But those additional benefits cannot guarantee sufficient reimbursement.

2

### File a labor code grievance

States with expense indemnification labor codes like California Labor Code 2802(a) may experience an uptick in complaints. In the past, an insufficiently reimbursed employee may have been content to just claim the tax deduction and not go through the hassle of filing a labor code grievance. But the loss of that deduction may provide the impetus to take action.

3

### Take legal action

Because the elimination of the tax deduction affects a large number of people across the country, class action suits will likely result as employees' band together to recoup unreimbursed expenses.

4

### Adopt unproductive behavior

If they receive a fixed allowance, employees may find ways to drive less and save gas. For instance, they may undertake fewer face-to-face meetings with clients. Alternately, if they receive a mileage reimbursement, they may drive empty miles or report extra miles in order to offset under-reimbursed expenses.

## Counting the costs

These attempts to recoup unreimbursed expenses will add up at organizations across the country. Recruiting and training new employees gets expensive, as does paying fines and legal settlements due to labor code violations. Unproductive employee behavior may be the most insidious of all because it can be difficult to spot; unquestionably, it will impact a company's bottom line significantly over time.

Any organization would want to avoid these consequences of tax reform. But how?

There are challenges intrinsic to each of the business vehicle policies outlined in chapter 2. Simply boosting a monthly car allowance won't eliminate the problem of tax waste. Adding mileage reimbursement to a car allowance could lead to a new problem—overpayment. So could switching to the IRS mileage rate, which tends to overpay high-mileage drivers.

Now is a great time to review your business vehicle policy, but if you choose the wrong policy for your organization, you will create costly new problems. The key is to choose an *effective* policy that will stay effective regardless of changes in the tax code.

Chapter 4

# The Hallmarks of an Effective Business Vehicle Policy

**It's not unusual for a company to leave its business vehicle policy unchanged and unreviewed for years. It may be a small portion of an employee's benefits package, but an ineffective business vehicle policy can have massive impacts.**

An ineffective policy can be like a leaky pipe under a bathroom that goes unnoticed for months until so much damage is done that whole walls and floors have to be replaced.

An effective business vehicle policy, on the other hand, adds value, saving money while promoting employee practices that increase profits. Before evaluating the impact of the TCJA on your organization's vehicle policy, it's important to recognize the qualities of an effective policy.

As you review your company policy, avoid seeking a quick fix in response to tax reform. Instead, take time to explore options that meet all the criteria of an effective vehicle policy.

## An effective business vehicle policy:

1

### Is based on data

The fundamental problem with many policies is a mismatch between the allowance or reimbursement and the actual expense needs of the employee. Whether it's a positive or negative difference, this discrepancy can affect everything from the employee's tax burden to the employee's productivity to the company's risk of labor code violations. Companies that take the time to obtain data on their employees' actual travel costs can eliminate discrepancies and boost effectiveness.

2

### Flexible

Policies need to be flexible. In light of COVID-19 many organizations made knee jerk reactions by removing or reducing car allowances, or converting car allowances to mileage reimbursements to save money. These cost saving changes severely impacted employees that still incurred fixed costs to own their vehicle. Our annual survey found that 80% of employees reported negative impacts from these changes.

3

### Manages costs

Some policies over-reimburse employees. Others generate tax waste. Some cede a significant amount of control over costs to employees. Mileage reimbursement policies are notorious for this because many of them rely on employee-reported mileage, which may or may not be accurate. An effective policy carefully curtails costs.

4

### Promotes fairness

Different employees experience different costs. A larger territory means higher mileage. If an employee with a smaller territory receives the same monthly allowance, is that fair? Some geographic locations have higher gas prices, insurance rates, or maintenance costs. Is it fair for an employee in a less expensive territory to receive the same mileage rate as an employee in a costlier area? An effective policy equitably addresses the needs of all employees.

5

### Complies with labor codes

Several states, most notably California, indemnify employees from work-related expenses. If the employee can prove the employer does not fully reimburse all work-related expenses, that employee can take the company to court and receive a settlement. An effective policy ensures that every employee receives sufficient reimbursement, protecting the company from labor code violations.

6

### Mitigates vehicle risks

The more drivers you have on the road, the more likely an accident will occur. An effective business vehicle policy goes beyond reimbursement to verify that employees maintain sufficient auto insurance coverage and to conduct regular motor vehicle record checks. Under-reimbursed employees are more likely to reduce insurance coverage.

7

### Grows with the company

Scalability becomes crucial as a company grows. A policy that over-reimburses some employees or that leaves itself vulnerable to vehicle risks or labor code violations will expose itself to uncontrollable costs and risks as it grows. A policy that requires significant administration only grows more time consuming as the company grows. An effective policy allows the company to grow unhindered.

As you review your company policy, avoid seeking a quick fix in response to tax reform. Instead, take time to explore options that meet all the criteria of an effective vehicle policy.

Chapter 5

# Converting Tax Waste into Business Gain

**Companies that currently pay a taxable car allowance face significant pressure from the tax reform. But these companies also have a unique opportunity to gain a win-win situation.**

As we've already established, taxes eat up a significant portion of a flat, monthly car allowance. And now the TCJA prevents recipients of car allowances from deducting mileage, resulting in a significant shortfall for many mobile employees. Every organization that pays a taxable car allowance needs a plan to address the frustrations and behaviors that will result.

Fortunately, there is a proactive step these organizations can take right now to prevent the costly consequences detailed in chapter 4. This step is significant, but it will pay dividends for both the company and its employees. What is this solution?

## Adopt a Non-Taxable Plan

Besides administrative simplicity, there's no real gain from a taxable car allowance policy—except for Uncle Sam. Here are three benefits to switching to a non-taxable vehicle policy.

### Both company and employee benefit

Right now, both the company and the employee are paying taxes on that car allowance. Because a car allowance does not directly reimburse expenses, the IRS considers it compensation, and the employee pays federal and state income taxes on it. Both employee and employer pay FICA taxes as well.

By eliminating tax waste, you open the door to significant savings and re-allocation of money to more effective uses.

2

### Money is invested in employee productivity

As long as the car allowance remains taxable, the company is surrendering a significant amount of money to the government rather than investing that money in ways that align with the company's mission. By switching to a non-taxable plan, that same money can now be invested fully in the employees who drive company growth.

3

### A non-taxable plan can pay for itself

In most cases, you can efficiently leverage tax waste to boost employee benefits without increasing expenditures. Let's do the math.

Say a company pays a $500/month allowance to an employee who gets taxed at the 32% bracket. With FICA added in, the employee pays $197.50, and the company pays $37.50. If that $235 is instead invested into a non-taxable reimbursement plan, then the employee gets a benefit boost at no additional company cost.

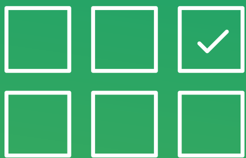
It's true that most non-taxable plans require more time to administer. However, the long-term savings through increased employee retention and satisfaction will make it worth it.

## Which non-taxable plan?

In chapter 2, we looked at several non-taxable options for reimbursing mobile employees. In the next chapter we'll discuss which non-taxable option provides the most effective long-term solution to the challenges posed by the tax reform.

Already paying a non-taxable reimbursement? Your plan may need adjustment to keep up with tax reform and rein in long-term costs.

**Read on to learn more.**



## Choosing the right policy

If you cannot say for sure that your policy fully reimburses all employees for the business use of personal vehicles, then your organization is exposed under the new tax code.

It is crucial that you take the time to develop the right business vehicle policy for your organization. Now is the perfect opportunity to make a change.

Chapter 6

# The Most Effective Policy

**To avoid insufficiently reimbursing workers, it may seem best to just increase the car allowance or mileage rate, or maybe add additional benefits such as a fuel card. But not all policy types will prove equally effective in the long run.**

As we pointed out in the last chapter, switching from a taxable car allowance to a non-taxable plan is a sensible move. But the most common non-taxable plans have their own problems.

The IRS mileage rate delivers a generous and non-taxable reimbursement. But does this approach prove cost-effective in the long run? The IRS rate is a tax deduction tool for individuals that may result in significant overpayment for high-mileage drivers.

Plus, paying a mileage rate can incentivize unnecessary driving or overestimated mileage. It may also under-reimburse low-mileage drivers.

A car allowance with mileage substantiation also avoids taxation, but it's administratively laborious and essentially caps employee mileage, which can stifle productivity.

The key is to choose a geographically-sensitive policy that is accurate and cost-effective in the long run.

## And the most effective policy is...

When you compare the different non-taxable policy types to the qualities of an effective policy, one policy type stands out as best: the fixed and variable rate reimbursement, or FAVR.

Because a FAVR policy derives both its fixed amount and its variable rate from cost data associated with each employee's geographical location, you can tailor it to the needs of each employee. This prevents shortchanging an employee yet protects the company from overpaying. Additionally, because the rate is variable, a spike in gas prices or other fluctuating expense will not result in a month in which the employee suddenly experiences a shortfall.

**Switching to FAVR will address the inequalities and uncontrollable costs associated with a standardized mileage reimbursement such as the IRS rate.**

Like the IRS mileage rate, FAVR is a tax tool—but not for deductions on individual tax returns. FAVR is designed as a reimbursement tool for organizations with five or more employees. It's simply the right tool for the job.

If your company is currently paying a car allowance or a car allowance plus mileage or fuel reimbursement, your company is also paying the IRS via withholding from the taxable allowance as well as through payroll taxes on that taxable portion. Switching to FAVR, a non-taxable plan, can allow you to leverage the eliminated tax payments into higher overall take-home pay for employees and savings to the company.

FAVR is flexible, so in the event employees are either sheltering in place or are driving significantly less the employees still receive a fixed amount to cover their car insurance and other ownership costs. And, the company will generate cost savings as a result of the reduced travel.

FAVR also complies with all state labor codes, protecting the company from violations and class action lawsuits. Unlike the IRS mileage rate, FAVR's accurate and flexible reimbursements can properly address unequal employee expenses while controlling costs.

With different employees experiencing different levels of expense that go beyond the number of miles they drive; it is vital that an employer ensure that all employees are treated fairly according to their unique needs.

Instituting a FAVR policy may sound complicated or administratively demanding. However, a number of third-party organizations exist that can administer a FAVR policy affordably and conveniently.

Conclusion

# Narrowed Options, Necessary Changes

**The Tax Cuts and Jobs Act narrowed mobile employees' options for reimbursement of work expenses. With the elimination of the unreimbursed expense deduction, employers must ensure that reimbursement policies fully cover employees' costs.**

If employers do not adjust their reimbursements, employees will take measures to offset the narrowing of their financial picture.

What will you do about it? Will it be business as usual? Will you keep paying the same car allowance or mileage rate? Will you keep the same structure but throw more money your employees' way?

Or will you switch to a more effective policy that ensures a long-term solution to the problem?

For accuracy, fairness, and flexibility, no policy approach can beat fixed and variable reimbursement (FAVR).

As you evaluate your options, take time to acquaint yourself with this highly effective program. It is the ONLY program that can meet the new challenges introduced by both the TCJA and COVID-19.

## Contact Us

Contact mBurse to learn more about how FAVR could work for your organization.

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