

The background of the entire page is a photograph of the United States Capitol building in Washington, D.C., rendered in a monochromatic green color. The building's iconic dome and classical architecture are clearly visible. A dark blue wavy shape at the bottom of the image frames the text.

# The tax reform and your mobile employees

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What your business needs to know.

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# Introduction:

## The Tax Cut and Jobs Act and Your Mobile Employees

Changes in the tax code always mean changes in the ways employers and employees go about their business. Everyone wants to know how they'll fare under the new system, and everyone takes measures to minimize losses and maximize gains.

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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 the new 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 landscape of the new tax code.

### **This eBook will address:**

Changes most relevant to car allowances and car reimbursements for 2019 and beyond, how employers can protect their company from new challenges, and how to turn tax reform into a win for both employers and mobile employees.





On December 22, 2017 President Trump signed the Tax Cut and Jobs Act into law. In 2019, taxpayers begin filing returns for the first time under the new law.

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# Chapter 1:

## The Tax Cuts and Jobs Act

The TCJA was intended to simplify the tax code while lowering individual tax rates on wages, investments, and business income.

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The plan also lowered the corporate income tax rate to 21 percent by changing the United States from a worldwide to a territorial tax system.

From 2018 onward, the tax reform legislation has impacted virtually every American taxpayer and business. The new tax code particularly affects mobile employees and the companies they work for by removing 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), submitting them through Schedule A and Form 2106. The loss of this deduction means that driving for work just got more expensive—except for drivers whose employers already fully reimburse expenses.

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.

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

# Old vs. New Tax Brackets

## Married Couples Filing Jointly

New brackets	
Taxable Income	Tax rate
Up to \$19,050	10%
\$19,050–\$77,400	12%
\$77,400–\$165,000	22%
\$165,000–\$315,000	24%
\$315,000–\$400,000	32%
\$400,000–\$600,000	35%
\$600,000+	37%

Old brackets	
Taxable Income	Tax rate
Up to \$19,050	10%
\$19,050–\$77,400	15%
\$77,400–\$156,150	25%
\$156,150–\$237,950	28%
\$237,950–\$424,950	33%
\$424,950–\$480,050	33%
\$480,050+	39.6%

## Single Filers

New brackets	
Taxable Income	Tax rate
Up to \$9,525	10%
\$9,525–\$38,700	12%
\$38,700–\$82,500	22%
\$82,500–\$157,500	24%
\$157,500–\$200,000	32%
\$200,000–\$500,000	35%
\$500,000+	37%

Old brackets	
Taxable Income	Tax rate
Up to \$9,525	10%
\$9,525–\$38,700	15%
\$38,700–\$93,700	25%
\$93,700–\$195,450	28%
\$195,450–\$424,950	33%
\$424,950–\$426,700	35%
\$426,700+	39.6%



The TCJA will make employers more vulnerable to employee complaints about labor code violations.

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 in light of these changes. 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.

Taking the time to carefully review your organization's policies now will pay serious dividends later on, whether through employee satisfaction or through increased cost-effectiveness.

The removal of the business expense deduction will have far-reaching consequences. Failing to respond to this change could prove costly in the long run. We recommend that you review your car reimbursement policies immediately.

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We'll start by outlining the various business vehicle policies that exist, discuss how the TCJA affects the employees governed by those policies, and recommend effective policy changes that will benefit both company and employee.

# Chapter 2:

## Types of Business Vehicle Policies

Employees who drive personal vehicles for work experience a range of work-related expenses that go beyond fuel to include insurance, maintenance, depreciation, tires, and more.

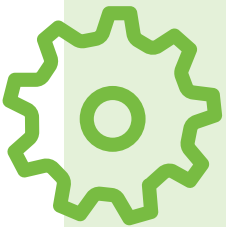
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Various approaches exist to offset or reimburse those expenses, each with its own tax implications.

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.



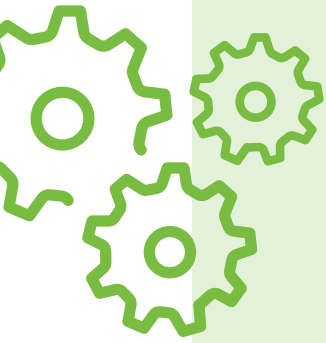
### Simple policies

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

### Car allowance with mileage reimbursement

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

### 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.

### 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.

### 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.

### Fixed and Variable Rate Reimbursement (FAVR)

A fixed monthly amount plus a variable mileage reimbursement rate, all based on expected expenses 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 has eliminated the deduction for unreimbursed work expenses until 2026, some mobile employees will take new measures to protect their income.**

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These measures will likely come at the expense of their employer. 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/Medicare. 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 considering ways to offset the loss of the unreimbursed expense deduction.

**Employee Business Expenses**

▶ Attach to Form 1040 or Form 1040NR.

▶ Go to [www.irs.gov/Form2106](http://www.irs.gov/Form2106) for instructions and the latest information.

Your name	Occupation in which you incurred expenses	Social security number
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**Part I Employee Business Expenses and Reimbursements**

**Step 1 Enter Your Expenses**

	Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
<b>1</b> Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.) . . . . .	524.58	
<b>2</b> Parking fees, tolls, and transportation, including train, bus, etc., that <b>didn't</b> involve overnight travel or commuting to and from work . . . . .	402.95	
<b>3</b> Travel expense while away from home overnight, including lodging, airplane, car rental, etc. <b>Don't</b> include meals and entertainment. . . . .		
<b>4</b> Business expenses not included on lines 1 through 3. <b>Don't</b> include meals and entertainment . . . . .	715.61	
<b>5</b> Meals and entertainment expenses (see instructions) . . . . .		501.85
<b>6 Total expenses.</b> In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5 . . . . .		

**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...**

**1. Leave the company**

It's a simple equation: If their costs are higher than their car allowance, and if

additional compensation and benefits do not make up the difference, employees are going to leave. That's simple business 101. This is why many organizations add a fuel card or mileage rate to their allowance or even substantiate mileage, since that protects most or all of the allowance from taxation. But even 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.

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.

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## 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.

Right 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. The next chapter will examine the qualities of an effective vehicle policy.

# 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 and even decades. It may be a small portion of an employee's benefits package, but an ineffective car allowance or reimbursement policy can have massive impacts.**

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As taxpayers file under the TCJA for the first time in 2019, easily overlooked vehicle policies are being exposed. 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.

### **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. Manages costs.

Some policies over-reimburse employees. Others generate substantial tax waste. Some cede a significant amount of control over costs to the 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.

### 3. 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? Similarly, some geographic locations come with 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.

### 4. Complies with labor codes.

Several states, most notably California, indemnify employees from work-related expenses. If an employee can prove that his or her employer does not fully reimburse for 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.

### 5. 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. Employees being under-reimbursed are also more likely to reduce insurance coverage.

### 6. 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 increasingly 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.**

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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.

#### 1. 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/Medicare 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/Medicare 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 benefits 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.

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## 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 the negative consequences of insufficient reimbursement, it may seem that companies should simply just increase their car allowance or mileage reimbursements, or maybe add additional benefits such as a fuel card. But not all policy types will prove equally effective in the long run.**

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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.

A car allowance with mileage substantiation also avoids taxation, but it's administratively laborious and essentially

caps employee mileage, which can stifle productivity.

Finally, any vehicle policy that pays the same fixed amount or rate to all employees regardless of territory or role will wind up overpaying some and underpaying others.

### And the most effective policy is...

When you compare the different non-taxable policy types in chapter 2 to the qualities of an effective policy in chapter 4, 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.

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 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.

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

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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 just narrowed mobile employees' options when it comes reimbursement of work expenses. With the elimination of a tax deduction these employees relied on, it is incumbent on employers to ensure that their reimbursement policies fully cover their employees' costs.

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

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.

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?

### Contact Us

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



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