

## Taxation of frequent flyer miles

Most employees view their frequent flyer miles as a perk that rewards them for the long hours and other hardships generally associated with business-related flying. And most employers don't try to make employees turn in their miles or charge them with compensation income for their value. IRS, of course, would like to tax business-related frequent flyer miles, but every time it raises the issue, businesses and the airlines complain that it would create a costly administrative nightmare.

The issue came to the forefront again in 1995, when IRS's National Office ruled privately that one company's air travel arrangement that specifically permitted employees to retain frequent flyer miles for their personal use wasn't an "accountable plan." Advances or reimbursements for employee travel and other business expenses that aren't paid under an accountable plan are considered to be taxable wages. In that case, employees who received advances or reimbursements under the plan would have to pick up extra compensation income, and could only deduct the expenses as employee business expenses, which are miscellaneous itemized deductions. As such, they are deductible only to the extent they cumulatively exceed 2% of the employee's adjusted gross income. For most employees, that means that some or all of their deductions would be lost, and they would be taxed on at least part of their advanced or reimbursed travel expenses. Extra FICA tax also would be owed.

The ruling met with loud protest, and IRS top management announced that it was reconsidering the analysis in the ruling, and stressed that it technically applied only to the taxpayer to whom it was issued and had no precedential value. Nonetheless it puts employers on notice that their employee travel arrangements, and especially their policies on frequent flyer miles, could be subject to close scrutiny with costly results.

There has been no additional official word on frequent flyer miles from IRS. Companies are therefore left pretty much in the dark as to how they should proceed. One admittedly unpopular option would be to require employees to turn their miles in for use in reducing company travel costs. How companies would go about requiring employees to join frequent flyer clubs and monitor their participation is a problem in itself. Some companies travel and expense plans require employees to return any excess advances, without saying anything specific about frequent flyer miles. These plans meet the technical requirements of the accountable plan rules without addressing the frequent flyer issue at all.

As you can see, there's no easy solution to the frequent flyer program. However companies should try to handle things in a way that avoids potential problems. Please call if you would like us to evaluate your company's current travel reimbursement arrangements with an eye to minimizing frequent flyer taxation problems.