Working at home may have consequences for taxpayers

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In brief

Many employees who normally work in an office are working at home as a result of the need for social distancing during the COVID-19 crisis. Employees may be incurring additional expenses, for example for supplies and equipment, that employers may be paying or reimbursing. Other expenses normally incurred, such as for commuting, are saved. Some individuals working at home have created a home office space. These and other activities may have significant tax consequences for taxpayers.

In detail

Employee expenses

Working condition fringe benefits

An employee required to work from home may incur expenses for supplies such as paper and printer toner or for equipment such as a printer. An employee who bears these costs may be incurring employee business expenses. Before the 2017 tax reform act (the Act), an employee may have been eligible to deduct these expenses as a miscellaneous itemized deduction to the extent the expenses exceeded 2% of the employee’s adjusted gross income. The Act suspended miscellaneous itemized deductions for tax years beginning after 2017 and before 2026.

If the employee’s employer provides the supplies or materials, however, the employee may be able to exclude the value from income as a working condition fringe benefit. A working condition fringe benefit is property or services an employer provides to an employee that the employee would be able to deduct under Section 162 (dealing with business expenses) or Section 167 (dealing with depreciation) if the employee bore the expense. The expenses must be related to the employee’s business as an employee of the employer and not to an unrelated business.

Observation: The suspension of the employee business expense deduction does not affect the availability of the working condition fringe exclusion, and the test remains whether the expense would be a deductible expense under Section 162 or Section 167.

If an employer provides a benefit to an employee working at home that is not excludable as a working condition fringe or on another basis, for example for a personal item, the fair market value of the benefit is included in the employee’s gross income and subject to employment taxes. Fair market value is the amount an individual would have to pay for the benefit in an arm's-length transaction.
Accountable plans

The regulations on working condition fringes also provide rules for cash payments an employer makes to reimburse an employee for a business expense the employee pays. However, when an employer makes a cash payment to an employee for an expense, generally the accountable plan rules, and not the working condition fringe rules, apply to determine whether the cash payment may be excluded from gross income and wages.

**Note:** Cash payments generally are subject to the same requirements under the working condition fringe regulations as reimbursements under an accountable plan.

An accountable plan is a reimbursement or other expense allowance arrangement established by or for an employer to reimburse employees for deductible business expenses an employee pays in connection with the performance of services as an employee of the employer.

**Observation:** Employees may be familiar with accountable plans from being reimbursed for travel or entertainment expenses, but other expense reimbursements to an employee, including for expenses related to working at home, must be paid under an accountable plan to be excluded from the employee’s income.

An accountable plan must meet the requirements of business connection, substantiation, and return of amounts the employer pays that exceed substantiated expenses. The employee must substantiate the expenses to the employer under the rules of Section 162 or Section 274(d), depending on the type of expense. For example, expenses for equipment that is listed property (generally, passenger automobiles, other means of transportation, and property used for recreation or entertainment) must be substantiated under the more specific rules of Section 274(d).

**Observation:** The Act deleted computers and peripheral equipment from the listed property provisions for property placed in service in tax years beginning after 2017. In addition to listed property, Section 274(d) applies only to expenses for gifts and travel. Therefore, most expenses related to working at home are subject to substantiation under Section 162.

A payment or reimbursement to an employee that meets these requirements is paid under an accountable plan, is excluded from the employee’s income, and is not subject to employment taxes. A payment that fails one of these requirements is not paid under an accountable plan, is taxable to the employee, and is subject to employment taxes. However, if the failure is to return the excess over the substantiated amount within a reasonable time, the amount substantiated may be treated as paid under an accountable plan, and the unsubstantiated amount would be treated as taxable wages to the employee.

A reimbursement arrangement of an employer that demonstrates a pattern of failing these requirements is treated as a nonaccountable plan, and all payments and reimbursements made under that plan will be taxable to the employees and subject to employment taxes. However, an employer may purposefully maintain separate arrangements to reimburse employees for deductible expenses and for nondeductible expenses, such as for commuting. The arrangement to reimburse nondeductible expenses would be a nonaccountable plan.

**Employer expenses for providing fringe benefits**

An employer generally may deduct expenses for providing fringe benefits to employees, including amounts that qualify as working condition fringes and amounts reimbursed under accountable or non-accountable plans. However, the Act disallows deductions for expenses for qualified transportation fringe benefits, including qualified parking expenses, excluded from an employee’s income. ‘Qualified parking’ generally is parking an employer provides to an employee on or near the employer’s business premises or on or near a location from which the employee commutes to work.

**Observation:** An employer that provides qualified parking for employees may be continuing to incur the expenses for parking while the employer’s entire workforce works at home. Recently published proposed regulations on the parking expense disallowance do not address this situation and whether the expenses may be allowed because the employer is not ‘providing parking’ to employees.

For additional information on the disallowance for expenses for qualified transportation fringe benefits and commuting, see [Proposed regulations provide guidance on qualified transportation fringe benefits](#).
If a fringe benefit is taxable to the employee, the employer must treat the value as compensation subject to employment taxes.

Home office deduction
Section 280A generally disallows deductions to an individual or S corporation for a dwelling unit used as the taxpayer’s residence. A taxpayer uses a dwelling unit as a residence if the taxpayer uses the unit or a portion for personal purposes for more than 14 days or 10% of the number of days the unit is rented at a fair rental, whichever is greater.

However, expenses for the use of a portion of the residence, such as an office, for business purposes may be deductible to the extent allocable to the portion of the premises used exclusively and on a regular basis (1) as the principal place of business for a trade or business of the taxpayer, (2) as a place where patients, clients, or customers meet or deal with the taxpayer in the normal course of the taxpayer’s trade or business, or (3) if the space is a separate structure, in connection with the taxpayer’s trade or business. If the taxpayer is an employee, the use also must be for the convenience of the employee’s employer, for example because the employer has closed its offices and requires employees to work remotely.

For these purposes, a principal place of business may be a location where the taxpayer conducts substantial administrative or management activities of the trade or business if there is no other fixed location for the taxpayer to conduct these activities.

If a residential space qualifies under these rules, deductible expenses may include an allocable share of mortgage interest, taxes, insurance, depreciation, utilities, repairs, and costs for a security system.

Qualified disaster relief
Employees and other individual taxpayers who incur expenses or suffer losses or hardship as a result of the COVID-19 pandemic may receive benefits or assistance from their employers or other parties that are excludable from income under Section 139 as ‘qualified disaster relief payments.’ Qualified disaster relief payments include amounts paid to or for the benefit of an individual for reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster.

A qualified disaster includes a federally declared disaster. The COVID-19 pandemic is a federally declared disaster for all US states and territories and the District of Columbia.

Qualified disaster relief payments do not include payments for:

- Expenses otherwise paid for by insurance or other reimbursements; or
- Income replacement payments, such as payments of lost wages, lost business income, or unemployment compensation.

A qualified disaster relief payment from an employer to an employee is not subject to employment taxes and is fully deductible by the employer.

Observation: Personal expenses incurred by employees as a result of being required to work from home, or for example as a result of schools being closed, during the COVID-19 pandemic may qualify as Section 139 expenses. For example, employer payments to employees for expenses incurred for childcare may qualify as Section 139 payments excludable from income and wages.

Under Rev. Rul. 2003-12, qualified disaster relief payments under Section 139 are not subject to general recordkeeping requirements. Individual taxpayers are not required to account for actual disaster-related expenses if they receive payments reasonably expected to be commensurate with their expenses.

The takeaway
Working at home as a result of the COVID-19 pandemic may have tax consequences that employers, employees, and other individual taxpayers should be aware of.
Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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