

REIMBURSEMENT OF EMPLOYEES' EXPENSES

December 2007

By Olivia Goodkin

Employees often incur expenses on behalf of their employers. For instance, salespersons may use their automobiles and cell phones in the course of their duties. Other employees may purchase office supplies or advance payment for hotel rooms or meals. When must an employer reimburse employees for expenses incurred? Must employers reimburse employees for actual expenses---whether or not the expenses were reasonable? Alternatively, may employers give their employees a fixed amount intended to reimburse them for reasonable expenses?

Recently, many of these questions were answered by the California Supreme Court in Gattuso v. Harte-Hanks Shoppers, Inc. At issue in Gattuso was whether the employer was required to reimburse outside salespersons for the *exact* amount of the automobile expenses incurred by them, or whether the company was permitted to simply pay their outside salespersons more in salary and commissions than other employees to generally cover the expenses.

What is the Employer's Obligation Under California Law?

Labor Code Section 2802 requires employers to "indemnify" employees for all "necessary expenditures . . . incurred by the employee in direct consequence of the discharge of his or her duties . . ." Clearly, if an employer reimburses its employees for the actual amount spent on expenses, then the employer's duty under Labor Code Section 2802 is discharged. For instance, if the employee pays for a hotel room for a business-related trip and the employer reimburses the employee for the exact amount paid, then the employer has met the requirement under Labor Code Section 2802.

May Employers Reimburse Auto Expenses by Using the Mileage Reimbursement Method?

Actual automobile expenses include insurance, repairs, registration, fuel, maintenance and depreciation. It would be difficult and burdensome for employees to keep track of all such expenses and to apportion the expenses between work-related trips and personal use of the automobile. It would likewise be burdensome for employers to review all the paperwork prepared by employees in connection with their actual expenses.

Employers are under an obligation to reimburse *reasonable* expenses. Is it reasonable for one employee to drive a much more expensive car than his or her colleagues and expect the employer to cover those expenses? How does an employer determine what is reasonable?

To avoid these sticky issues, most employers use a mileage reimbursement method, applying the Internal Revenue Service rate or some other rate agreed upon between employer and employee. The IRS rate is intended to include an approximation of fuel, maintenance and other costs of automobile operation per mile driven. The Gattuso court approved this method. While the IRS mileage rate is less accurate than an actual reimbursement method, the Gattuso court noted that employees are permitted to challenge the mileage reimbursement method if they believe that their actual expenses exceed the mileage reimbursement.

May Employers Use the "Lump Sum Method" to Reimburse Employees for Auto Expenses?

Employers sometimes pay employees a fixed lump sum that may be a per diem amount, a monthly sum or some other fixed stipend which is intended to reimburse employees for expenses. The Gattuso court held that employers may use this method; however, the amount paid must be sufficient to provide full reimbursement for actual expenses necessarily incurred. This method works best when employees incur similar expenses day after day, such as the same mileage every day that they work. In the situation of predictable expenses, it would be of little value, and too much burden, for employers to require daily mileage reports of employees.

As with the mileage reimbursement method, employees retain the right to challenge the lump sum payment method if they believe the lump sum does not reimburse them for actual and reasonably incurred expenses.

Note that lump sum payments raise tax issues. If the payments are considered taxable income to the employee---as opposed to reimbursed expenses---the decrease in actual dollars received by the employee must be taken into account in determining whether the payment provides full reimbursement of actual expenses.

May Employers Add a Lump Sum Payment to Other Compensation Paid to the Employees?

This was the ultimate issue in Gattuso. The employer there paid the outside salespersons more in both salary and commissions to reimburse the employees for expenses incurred. The court concluded that employers could add a lump sum payment to wages, but because wages are subject to numerous legal requirements including deductions, paycheck stub details, etc., the employer must include the lump sum reimbursement in a manner that differentiates what is wages and what is expense reimbursement.

Some employers with sales forces reimburse employees not only through increased wages, but also commissions. If employers reimburse employees by increased commission percentages, then they run the risk of not reimbursing actual expenses. If sales are low in a particular pay period, for instance, and the employee receives low commissions but continues to incur the same expenses, then it is likely the employee will not have been adequately reimbursed for car expenses.

Guidance by the Court

The Gattuso court concluded that while employers are permitted to pay employees increased salary and/or commissions to reimburse them for expenses, some means to

identify the portion of compensation intended to reimburse expenses must be established. The employer must also ensure that the amounts are sufficient to fully reimburse employees for actual expenses incurred.

Companies should review their policies and procedures in light of the Gattuso holdings to make sure that they are in compliance with Labor Code Section 2802 obligations.

ABOUT OLIVIA GOODKIN



Olivia Goodkin has over two decades of experience representing corporations, individuals and closely-held businesses in employment law and business litigation. She advises on the termination of employees, wage and hour laws, employment contracts and other employment issues, and she defends companies in wrongful termination lawsuits. Olivia also creates trade secret programs for companies seeking to protect their valuable intellectual property. *Olivia can be reached at ogoodkin@rutterhobbs.com, or by telephone at 310.286.1700.*

ABOUT RUTTER HOBBS & DAVIDOFF

Century City-based law firm Rutter Hobbs & Davidoff Incorporated represents clients in matters involving bankruptcy and corporate reorganization, business disputes and litigation, corporate and securities, estate planning and litigation, family law, intellectual property, labor and employment, and real estate. For more than one-third of a century, the firm's experienced attorneys have represented middle market companies, early stage entities, large corporations and individuals.



Rutter Hobbs & Davidoff
(310) 286-1700
www.rutterhobbs.com

The information in this newsletter has been prepared by Rutter Hobbs & Davidoff for informational purposes only and not as legal advice. Neither the transmission, nor your receipt, of information from this correspondence create an attorney-client relationship between you and Rutter Hobbs & Davidoff.

Rutter Hobbs & Davidoff will never share, sell, or rent individual personal information, unless ordered by a court of law. You are receiving this email from Rutter Hobbs & Davidoff because you have a business relationship with our firm and/or its attorneys. To ensure that you continue to receive emails from us, add news@rutterhobbs.com to your address book today.

[Forward email](#)