

CHAPTER 7 - PAYMENTS TO DIRECTORS

A Director is Not an Employee

The Internal Revenue Code specifically states that a "director" acting in this capacity is not an employee. Generally speaking, because a director is not an employee, all forms of compensation (cash, medical premiums, life insurance premiums, expense allocations, expense reimbursements, etc.) provided to a director are taxable and reported on Form 1099-MISC.

Directors report the income on Schedule C of their Form 1040 as self-employment income and can deduct related expenses. Director fees are considered earned income for IRA and Social Security benefits purposes and self-employment income for retirement plan purposes.

Director fees are subject to self-employment tax when paid. For the Social Security retirement wage-base test, these earnings are included in the year the services are performed regardless of when paid.

Tax Treatment of a Director's Expenses

If directors incur business expenses in performing their duties, for which they are not reimbursed, the expenses are deductible on Schedule C of Form 1040.

If directors perform services other than those required in their capacity as directors, they may be employees for this portion of their services. For example, if the director is engaged in performing duties commonly performed by an employee, the director would be considered an employee while performing these duties. The compensation paid for time so spent would be subject to FICA, federal and state income tax withholding and federal and state unemployment tax, and reported on Form W-2.

The reporting requirements of amounts paid to, or for, directors often vary from that for employees. The exhibit on the following page sets forth the reporting of various payments for directors.

Expenses for Spouse of a Director

The cost of a spouse accompanying a director on a business trip is nondeductible unless the following conditions are met:

- ✍ there is a bonafide business purpose for the spouse's presence;
- ✍ the spouse must be an employee of the taxpayer; and
- ✍ the expenses would otherwise be deductible by the spouse.

The nondeductible cost is the cost that exceeds what it would have cost the director to travel alone. If the nondeductible cost is treated as Directors Fees on the director's Form 1099, rather than as an expense reimbursement, it is deductible by the company.

If there is not a bona fide business purpose for the spouse to accompany the director on a business trip the cost of the spousal travel is taxable to the director. The cost should be included on Form 1099 and is deductible by the company.

If there is a bona fide business purpose for the spouse to accompany the director on a business trip and the expense is properly substantiated, the cost of the spousal travel is a working condition fringe benefit. It is not taxable to the director and should not be included on the Form 1099. However, the amount is not deductible by the company.

PAYMENTS TO DIRECTORS

	<u>No IRS Report Required</u>	<u>Reportable to IRS on Form 1099-MISC</u>
Fee for attendance at meetings		X
Reimbursement of actual expenses based upon proper record keeping ⁽¹⁾		
Mileage	X	
Lodging	X	
Meals	X	
Convention or conference	X	
Other	X	
Reimbursement of expenses without documentation ⁽²⁾		
Mileage		X
Lodging		X
Meals		X
Convention or conference		X
Medical insurance premiums ⁽³⁾		X
Life insurance premiums:		
Company is beneficiary	X	
Director names beneficiary		X

Footnotes:

- (1) Proper documentation includes the substantiation of amount, time, place, business purpose, etc. Normally this will include completion of an expense report with receipts attached. The amount element is considered substantiated if reimbursements are based on per diem amounts not exceeding the federally approved rates. **See Expense Accounts chapter for details.**
- (2) These items are reportable to the directors as taxable income; however, directors may then be able to deduct the expenses on their individual income tax returns. Business expenses, except for meals and entertainment, are deductible in full. Expenses for meals and entertainment are 50% deductible.
- (3) 60% (70% in 2002) of medical insurance premiums (limited to net self-employment earnings after the 50% SE tax deduction and any deduction for the owner's retirement plan contribution) are deductible in computing adjusted gross income. The remaining medical insurance premiums (reduced by the 60% in 2001 and 70% in 2002 deduction) are deductible as an itemized deduction to the extent that all medical expenses exceed 7.5% of adjusted gross income.

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