



## California Supreme Court Confirms That Businesses May Increase Employee Compensation in Lieu of Reimbursing for Work-Related Expenses

The California Supreme Court recently tested the boundaries of Labor Code section 2802, ruling that employers may increase employee compensation by a fixed amount instead of reimbursing employees for work-related expenses.

California Labor Code section 2802 requires employers to indemnify (reimburse) employees for all necessary expenses incurred as a result of performing their job duties. Common reimbursements include mileage reimbursements and actual expenses for gas, lodging and work supplies.

In *Gattuso v. Harte-Hanks Shoppers, Inc.* (November 5, 2007) S139555, employees sued their employer for mileage reimbursement and other expenses. The Court found that the employer, when it established the employees' base salary and commission rate, included an additional amount for business expenses, and ruled that the employees' total compensation package satisfied the employer's obligations under section 2802. In reaching its ruling, the high court explained that employers must establish a method to identify which portion of compensation is wages versus expense reimbursement. The Court stated that employees may challenge the expense payment amount if it does not fully reimburse the employees for actual expenses necessarily incurred.

To comply with section 2802, the Court described three acceptable methods for an employer to reimburse employees for work-related expenses: (1) the actual expense method; (2) the mileage reimbursement method; and (3) the lump-sum payment method.

### 1. Actual Expense Method

The actual expense method requires employees to track their "fuel, maintenance, repairs, insurance, registration, and depreciation" for both personal and business use to submit to the employer, which the Court found to be an "onerous burden."

### 2. Mileage Reimbursement Method

Similar to the actual expense method, but less burdensome, the mileage reimbursement method requires employees to track their miles driven for business duties. The employer then reimburses a predetermined amount that reasonably accounts for the cost of owning and driving a car per mile. Employers often use the IRS mileage reimbursement rate, which is currently 48.5 cents per mile.

### 3. Lump-Sum Payment Method

A lump-sum payment generally is based on the employee's job duties and the distance he or she typically drives to perform those duties. The California Supreme Court found this method of reimbursement presumptively sufficient to comply with section 2802. That is, an employer may enhance compensation such as base pay and/or commission so long as it fully compensates the employee for actual expenses incurred.

The employee is permitted to challenge the lump-sum amount by comparing the enhanced compensation with the amount he or she would get under either the actual expense or mileage reimbursement method. If the lump-sum payment is inadequate, the employer must make up the difference.

The employer must provide some means (a method or formula) to identify the amount of the enhanced compensation that is provided as expense reimbursement. This allows employers to readily determine wages versus reimbursement for purposes of complying with other labor and tax laws.

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## IMPORTANCE TO CALIFORNIA EMPLOYERS

The California Supreme Court's decision provides a less burdensome reimbursement option for both employers and employees. While employers are still permitted to use the actual expense method or the mileage reimbursement method (typically using the IRS mileage rate), a lump-sum payment provides an alternative to onerous record keeping. Using the lump-sum payment method relieves the burden on employers imposed by the actual expense method because an employer is not required to use complex allocation calculations, keep detailed records, or exercise frequent judgment regarding the reasonableness of expenses to determine if they are "necessary." Also, the lump-sum payment method works particularly well for employers with employees who drive the same route daily because mileage does not vary.



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