



And You Get Your Own Car—Cars Provided to Employees
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Dealing With Employer Provided Vehicles

While working condition fringes are generally designed to be provided to the employee on a basis to be totally excluded from income, automobiles fall into a different class. An employer may provide a “mixed use” automobile to the employee that will be used for business purposes, but is also allowed to be used by the employee for personal purposes. In this case, there are number of issues that arise the employer and employee need to be concerned with.

In generally, the personal use portion of the automobile benefit is includable as income to the employee. An allocation must be made between the excludable working condition fringe benefit and the portion that is going to be included in the income of the employee. Note that any use of the automobile by the employee for a purpose not related to the employer’s business is not excludable—even if the employee is using the auto for

business purposes related to another business [Reg. §1.132-5(a)(2)(i)].

Requirements to Exclude a Portion from the Employee's Income

The employee must meet the substantiation requirements imposed for auto use in order for a portion of the benefit to be treated as an excludable working condition fringe, which includes the requirements for substantiation under §274(d) for auto usage, even if such rules do not directly apply to the employer (such as for a tax exempt organization or governmental unit) [Reg. §1.32-5(c)(1)]. The employer will need to obtain the necessary records to substantiate the employee's claimed business use, as determined by the regulations established under §274(d) [Reg. §1.32-5(c)(2)].

If the employee fails to provide the necessary documentation, the all of the use of the vehicle will be deemed to be personal use [Reg. §1.274-5T(e)(1)(i)]. The employer may rely upon a statement submitted by the employee of the business use, unless the employer has reason to believe that records do not exist to substantiate the business use. If such a statement is used in lieu of copies of records, the employer must maintain the employee statements in its records. Otherwise, the employer must maintain copies of the employee submitted records in its files. [Reg. §1.274-5T(e)(2)(ii)]

Note that if a vehicle is a "qualified nonpersonal use vehicle" all use is considered business use. [Reg. §1.132-5(h)]. Such vehicles are ones not likely to be used for personal purposes which are included in the list found in Reg. §1.274-5T(k)(2)(ii), including vehicles such as:

- Clearly marked police and fire vehicles
- Ambulances
- Hearses
- Vehicle designed to carry cargo with a gross vehicle weight of over 14,000 pounds
- Bucket trucks ("cherry pickers")
- Cement mixers
- Combines
- Delivery trucks with seating only for the driver, or only for the driver plus a folding jump seat
- Passenger buses with a capacity of at least 20 passengers

Special Options to Reduce Recordkeeping

The employer can adopt one of the following four policies to eliminate the detailed recordkeeping.

1. The employer can adopt a written policy that no personal use of the vehicle is

permitted except for *de minimis* personal use (such as a stop for lunch between business deliveries) and the employer reasonably believes that such personal use is not taking place. [Reg. §1.274-6T(a)(2)(i)] The written policy must conform with the requirements of Reg. §1.274-6T(a)(1). The employer must maintain sufficient records to demonstrate compliance with the limitations on the use of vehicle outlined in Reg. §1.274-6T(a)(2)(i).

2. The employer adopts a policy that allows no personal use except for commuting and the same types of *de minimis* personal use allowed for exception 1. [Reg. §1.274-6T(a)(3)] As for the first exception, this exception requires a written policy statement meeting the requirements of Reg. §1.274-6T(a)(1).
3. If a vehicle is used primarily directly in the business of farming in the course of a normal business day, the employer may treat 75% of the use of the automobile as business use, plus any amount included in the income of the employee. [Reg. §1.274-6T(b)]. The regulation notes that “the phrase “directly in connection with the business of farming” means that the vehicle must be used directly in connection with the business of operating a farm (i.e., cultivating land or raising or harvesting any agricultural or horticultural commodity, or the raising, shearing, feeding, caring for, training, and management of animals) or incidental thereto (for example, trips to the feed and supply store).” [Reg. 1.274-6T(b)(2)]
4. The employer may elect, for all but a greater than 5% owner or a related party [Reg. §1.280F-6T(d)(2)], to treat 100% of the use of the automobile as nonbusiness use. In that case, the employer will get a full deduction for the expenses related to the auto.

A taxpayer that elects to use one of these methods on a return and it is later determined that the employer failed to meet the requirements of the provision in question, cannot then choose to another of these methods to satisfy its recordkeeping obligations for the year in question [Reg. §1.274-6T(d)].

Computing the Employee' Compensation for Personal Use

Unless the employer elects to make use of one of the three special valuation rules found in Reg. §1.61-21, the vehicle must be valued at the fair market value of the benefit conferred, based on the facts and circumstances. The value would be based on the amount the employer would pay to lease a comparable vehicle for a period comparable to the period the vehicle is available for the employee's use. The total fair market value is multiplied by the percentage of personal use to overall use, based on the employee's substantiation.

Three special valuation rules are available to be used in lieu of the facts and circumstances test to value the personal use of the auto. The three methods are detailed below:

- **Cents per mile method [Reg. §1.61-21(e)].** If a vehicle qualifies for the use of

this method, the personal use is valued on a cents per mile basis, based on figures the IRS publishes each year. For 2006, the per mile amount is 44.5 cents per mile [Revenue Procedure 2005-78]. However, the amount can only be used for vehicles valued at less than an amount published annual by the IRS. For 2006 the maximum value is \$15,000 for a passenger automobile and \$16,400 for a truck or van. [Revenue Procedure 2006-15] As well, to be eligible for the use of this rule, the vehicle must be driven at least 10,000 miles during the year, and the vehicle must be primarily used during the year by employees [Reg. §1.61-21(e)(1)(ii)]

- **Automobile lease valuation rule [Reg. §1.61-21(d)]** The annual lease valuation tables can be used to value the automobile for the employee. Different methods apply depending on whether the vehicle is available to the employee the entire year (the ALV method [Reg. §1.61-21(d)(1)]), is available for at least a 30 day continuous period during the year (prorated ALV method [Reg. §1.61-21(d)(4)]), or is available for less than 30 days (the Daily Lease Value method [Reg. §1.61-21(d)(4)]). As well, the vehicle is revalued after the fourth full year of inclusion in the employee's wages. The lease value is determined by using the table found at Reg. §1.61-21(d)(2)(iii). If the employer provides fuel for the vehicle, an additional 5.5 cents per mile must be added to the value computed.
- **Commuting valuation rule [Reg. §1.61-21(f)]** The commuting valuation rule applies a value of \$3.00 per day to each commuting round trip (or \$1.50 for a one way trip if certain conditions are met) if personal use is limited to commuting and *de minimis* personal use. This method cannot be used by certain "control employees" which includes those employees who are directors, greater than 1% shareholders, certain officers of the corporation whose income exceeds an inflation adjusted amount announced each year by the IRS (for 2005 the amount was \$85,000 [Notice 2004-72]) or any employee whose income exceeds a second inflation adjusted amount announced annually by the IRS (for 2005 that amount was \$170,000 [Notice 2004-72]).

Note that if an employer fails to strictly comply with the requirements of a special valuation rule, the facts and circumstances rule must be applied instead. [*BMW of North America*, 99-1 USTC ¶50,255; 83 AFTR2d ¶99-413; 39 FSupp2d 445, Reg. §1.61-21(c)(5)]

As well, it is important to remember that any use by a 5% owner or a person related to such an individual within the meaning of §267(b) for nonbusiness purposes will not be considered "qualified business use" for purposes of the limitations on depreciation found in §280F even if the amount is included in the compensation of the individual or the vehicle is leased to that individual. [IRC §280F(d)(6)(C)] Note that if qualified business use falls below 50%, the vehicle will not be eligible for §179 deductions, MACRS depreciation and any benefits of those provisions made use of in earlier years may be subject to recapture under §280F. Employers considering providing vehicle to such

employees need to be aware of this exposure if business use drops below 50% for any reason.

However, for other employees such use will be qualifying business use if the amount is properly included in the employee's compensation and any required withholding handled properly. [IRC §280F(d)(6)(C)(i)(III)] In this case, if personal use is greater than 50%, it is crucial that the payroll reporting be properly handled every year. A failure in the payroll accounting system could have significant negative consequences to the employer in this situation, especially if the vehicle in question is one where §179 expensing was used in the prior year and the vehicle was one not subject to the luxury auto depreciation limits of §280F(a).

The Employee's Considerations on Taking Up the Offer

An employee needs to make sure his/her employer is properly following the rules outlined above to substantiate the business use, since a failure of the employer to follow those rules could cause the IRS to include the entire value of the automobile use in the employee's income for the year, using the "facts and circumstances" rule—generally not a good result for the employee.

Most employers will likely decide to rely upon the employee's statement on business use rather than require the submission of detailed documentation to meet the §274(d) documentation rules. An employee needs to remain aware that even though his/her employer is not going to need to see the substantiation, the employee will be required to produce such documentation if the employee faces an IRS examination on the issue—and a failure to maintain such documentation will again cause the entire value of the automobile use in the employee's income for the year in question.

If the rules are properly followed, the employee will have a significant benefit in obtaining an automobile at the cost of only the income and payroll taxes on the personal benefit portion of the use—but it's important to insure those rules are followed