



# Tax Planning Notebook



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## Tax Treatment of Employer-Provided Automobiles

IRS Regulations require employers, as well as employees, to document business and personal usage of automobiles. Employers are required to include as taxable income on employees' W-2 forms the value of the personal use of employer-provided vehicles. To assist in determining the appropriate amount of taxable income, we are providing you with our annual **Auto Fringe Benefit Tax Planning Notebook**. Please note that the attached worksheets can help you to properly compute the taxable income. If you have any questions about your responsibilities as discussed in this report, please do not hesitate to contact our office.

### Record Keeping Requirements

An employee who is provided with a car for use in his or her employer's business must be able to substantiate business use and expense. Without substantiation, the value of such usage may be considered fully taxable. An employee must maintain adequate records or

sufficient evidence to corroborate oral statements. In all cases, we recommend written evidence as it is more credible than oral evidence alone. The value of written evidence is greater the closer in time it relates to the expenditure or use. Contemporaneous records are not required, but our experience indicates the more timely the records, the more accurate they will be and more

acceptable to the IRS should an examination occur. The following elements of an expense related to the business use of a car must be substantiated:

- Amount of separate expenses (i.e. repairs)
- Amount of total use (miles)
- Amount of business use (miles)
- Date of business use
- Business purpose for the expense or use
- Tolls and parking ex-

penses should be segregated as they are separately deductible

The taxability of the personal usage will be determined by the employer based upon the ratio of personal miles as they relate to total miles driven. It should be noted that in most cases the employer will have to indicate these miles on his business or corporate tax return. In addition, he must indicate on that return if written evidence exists. Accordingly, it is imperative that the resulting taxable fringe benefit agree with the ratio of miles indicated on the employer's return, and the question concerning evidence is answered properly.

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**Highlights**

- Fringe Benefit Valuation Methods (Page 2)
- Reimbursement of Employee Expenses and Types of Plans (Page 4)

*Don't forget to use the attached worksheets to calculate employee automobile fringe benefits.*

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**YOUR NOTES:**

The IRS will consider the following as being "adequate records" with respect to this discussion:

- Account books, diaries, and logs
- Documentary evidence (i.e. receipts and paid bills)
- Trip sheets, expense reports or written statements of witnesses

The level of detail will be dictated by the facts and circumstances of the business usage.

The employer, as well as the employee, is required to actively participate in this record keeping responsibility. It is the employer's obligation to implement procedures and to solicit records from the employees. An employer can avoid this responsibility by declaring all use by employees as strictly personal, and, therefore, 100% of this fringe benefit would constitute taxable income. The employee would then claim an individual business expense deduction on Form 1040.

#### **Fringe Benefit Valuation Methods**

Once the percentage of personal usage has been determined, the taxable value of the fringe benefit must be computed using one of the following three methods:

- Annual lease value method
- Cents-per-mile method
- Commuting value method

#### **Annual Lease Value Method**

This is an alternative method of valuing the fringe benefit which is based on the fair market value of the car when it is first available for personal use. The taxable fringe benefit is determined under the annual lease value table provided by the IRS (this table is reproduced in the attached worksheets). The IRS table is based on a four-year lease term. The annual lease value determined from the table must therefore be used for each of the three subsequent calendar years. If still held at the beginning of the fifth year, the annual lease value may be redetermined based on the fair market value at January 1 of that year. The proper fair market value used in determining the lease value from the table is usually considered to be equal to the employer's cost of purchasing the car. For purposes of calculating fair market value of a car that is leased or is being revalued after four years of use, such value may be determined by using the retail value of the car as reported in a nationally recognized pricing source that regularly reports new or used car values. A special fleet-average valuation rule applies to employers that have 20 or more qualifying cars, as does the calculation of the fuel provided.

Maintenance and insurance are included in the annual lease value. Neither the employer nor the employee may reduce the annual lease value for any

such service not provided by the employer. The annual lease value table does not include the value of employer-provided fuel. It must be included in the employee's gross income in addition to the annual lease value in an amount equal to the fair market value of the fuel, or in the alternative, 5.5 cents-per-mile. If the cost of fuel is reimbursed by or charged to the employer, the additional inclusion in the employee's gross income is the amount reimbursed or charged.

The use of the annual lease valuation rule is optional. An employer may not use the annual lease valuation rule unless it is adopted when the car is first made available to an employee for personal use. Once the rule is elected for a particular vehicle, it must be used for all subsequent periods.

The following fact pattern will serve as an example of this method: An employee is provided with an automobile on April 1 with a fair market value of \$22,500. The employee reports total miles driven for the nine-month period of 15,000 miles, of which 11,250 are business and 3,750 are personal. The taxable fringe benefit under this method is detailed in the chart on Page 3:

***(Continued on Page 3)***

Annual Lease Value (From IRS Table for \$22,500 auto)	\$ 6,100
Personal Use % 3,750/15,000	<u>25 %</u>
Personal Use Value (Full Year)	\$ 1,525
Proration for 9 months (275/365)	<u>75 %</u>
Prorated Personal Use Value	\$ 1,144
Personal Miles	3,750
Rate (gasoline)	<u>.055</u>
	\$ 206
Total Fringe Benefit (\$1,144 + 206)	\$ 1,350

**YOUR NOTES:**

**Cents-Per-Mile Method**

This method can be used if the employer reasonably expects that the automobile will be "regularly used" in his business or is driven primarily by employees for at least 10,000 business miles in a calendar year. A car is considered "regularly used" if at least 50 percent of its total mileage for the year is for the employer's business or it is generally used each workday in an employer sponsored car pool to transport three employees to and from work.

This cents-per-mile method may be used only for cars that are not considered luxury cars. For 2009, cars costing in excess of \$15,000 are considered luxury automobiles. For cars having a value in excess of this amount, the fringe benefit value must be determined under the annual lease value method.

Under this method, the value of the benefit is calculated by multiplying the standard mileage rate (i.e. cents-per-mile) by the number of miles driven for personal purposes. The reimbursement rate for January 1 through December 31, 2009 was 55 cents per mile. Again, maintenance and insurance are included in this method. No reduction in the cents-per-mile rate is allowed, however, if an employer does not provide these services. This method also includes the fair market value of employer-provided fuel. If fuel is not provided by the employer, the cents-per-mile rate may be reduced by no more than 5.5 cents.

See the attached worksheets for a useful guide to the qualifications and calculations under this method.

**Commuting Value Method**

This method is limited to

employees who are not officers or shareholders. It also requires a written policy limiting the use of the auto to strictly business purposes. If such a written policy is in effect, a \$1.50 per day for each way of commute is added to the employee's income.

*(Continued on Page 4)*

**Please use the attached worksheets to calculate employee automobile fringe benefits.**

**YOUR NOTES:****Employment & Payroll Tax Consequences**

Whenever an employer provides an employee with an automobile for the employee's use, the employer is required to:

- Report the value of the employee's use of the car as income on Form W-2. You may use box 14 on Form W-2 to report this value. If you do not use Box 14, employers must report the lease value of a vehicle to an employee in a separate statement provided to the employee.
- Withhold income tax on the value of the fringe benefit using a flat 25% rate or the normal withholding method for supplemental wages
- Withhold and pay employment tax (FICA and FUTA), where applicable, on the value of the fringe benefit

An employer may elect not to withhold income tax on the value of personal use if he notifies the employee and includes the value of the personal use of the car on the employee's W-2. An electing employer must provide the employee written notice of non-withholding no later than January 31 of the year for which the election applies. An electing employer is still required to withhold FICA taxes. If an employer withholds tax, he or she may elect to treat the personal usage as paid on

a pay period, quarterly, semi-annual, or annual basis. The benefit is treated as if cash wages were actually paid on the date or dates selected. Normal depository rules apply to the remittance of withheld tax on this fringe benefit, based upon the selection of the date the benefit is deemed paid. In most cases, we recommend a date sometime in December, as the social security ceiling (there is no Medicare ceiling) is often met by this time-frame.

Employers should also be aware that they may elect to treat the value of employees' personal use of employer automobiles provided to those employees in the last two months of the calendar year as income to the employees in the first quarter of the following year. To qualify for this "special accounting rule," each affected employee must be notified between the time of his or her last paycheck and the time W-2s are issued.

**Reimbursement of Employee Expenses and Types of Plans**

When an arrangement exists where an employee is directly reimbursed for expenses (including auto related) incurred in the employer's business, or receives an "expense allowance," the tax treatment depends on whether the arrangement is an "accountable plan."

Reimbursements paid under an accountable plan are excluded from the employee's gross income. Reimbursements or allow-

ances paid under a non-accountable plan are included in taxable wages on Form W-2, and the employee may claim a miscellaneous itemized deduction for the expenses he or she can substantiate (deductible, however, only to the extent they exceed 2% of AGI).

**Reimbursements under an Accountable Plan**

Three general requirements must be met in order for a reimbursement arrangement to be considered an accountable plan:

- The reimbursements must be for deductible business expenses of the employer paid by the employee in the performance of services.
- The employee must be required to substantiate the elements of time, use and business purpose of the reimbursed expenses to the employer. The employee should submit an account book, diary, log, statement of expense, trip sheet or similar record. The employee should also submit supporting documentation. An employee who receives a mileage allowance is considered to have substantiated the amount of the expenses if he or she further substantiated the time, place (or use) and business purpose of the travel.

*(Continued on Page 5)*

- The employee must be required to return to the employer any excess reimbursements over substantiated expenses within a reasonable period of time. Under safe harbor rules, the employee may provide substantiation within 60 days or return unsubstantiated amounts within 120 days after an expense is paid or incurred.

#### **Reimbursements or Allowances under a Non-Accountable Plan**

A non-accountable plan is one that does not meet any one of the three requirements of an accountable plan, as noted above. Further, reimbursements under an accountable plan that are not returned within a reasonable time are treated as made under a non-accountable plan, and thus taxable. Employers must withhold income taxes and employment taxes on reimbursements or allowances paid or considered paid under a non-accountable plan.

For the employee, an accountable plan for the direct reimbursement of expenses is preferable to a non-accountable plan. If the latter is chosen, the reimbursement will be subject to withholding taxes and the only relief to the employee is a possible employee business expense deduction on Form 1040.

These business expenses will be deductible to the extent that they exceed 2% of adjusted gross income (AGI). For example, if AGI is \$50,000, the first \$1,000

of expenses will not be deductible. Employees with AGI in excess of \$166,800 face an additional shrinkage as a result of the phase-out of itemized deductions (reduced to the extent of  $\frac{2}{3} \times 3\%$  of AGI in excess of \$166,800 for 2009).

#### **Recommendation**

We recommend that employers and employees alike institute a formal record keeping and substantiation program. It is important that the mileage figures reported on the employer's income tax return coincide arithmetically with the resulting fringe benefit on the employee's W-2. Additionally, if the employer considers the automobile to be a 100% personal use vehicle, or if he or she is reimbursing under a non-accountable plan, the employee should be informed that he or she must maintain adequate records individually in order to claim a deduction on Form 1040.

#### **Possible Exemptions**

Any vehicle that, by reason of its nature, is not likely to be used more than a very limited amount for personal purposes is exempt from the substantiation requirements. The term "qualified non-personal use vehicle" is applied to these types of vehicles. The regulations cite eighteen specific types, most of which are quite obvious such as dump trucks, police vehicles, etc. Vans and pickup trucks are not automatically exempted because they can easily be used for personal purposes. However, if a van or pickup truck is substantially modified with the result that it is

not likely to be used more than a de minimis amount personally, it will be classified as a "qualified non-personal use vehicle."

#### **State and Local Tax Issues**

With respect to the taxability of this fringe benefit to state and local authorities, the only jurisdiction within the surrounding geographical area which considers this benefit to be non-taxable is the Commonwealth of Pennsylvania.

**YOUR NOTES:**

**Please use the attached worksheets to calculate employee automobile fringe benefits.**

**Annual Lease Value Table**

<u>Automobile Fair Market Value</u>	<u>Annual Lease Value</u>
\$ 0 to 999.....	\$ 600
1,000 to 1,999.....	850
2,000 to 2,999.....	1,100
3,000 to 3,999.....	1,350
4,000 to 4,999.....	1,600
5,000 to 5,999.....	1,850
6,000 to 6,999.....	2,100
7,000 to 7,999.....	2,350
8,000 to 8,999.....	2,600
9,000 to 9,999.....	2,850
10,000 to 10,999.....	3,100
11,000 to 11,999.....	3,350
12,000 to 12,999.....	3,600
13,000 to 13,999.....	3,850
14,000 to 14,999.....	4,100
15,000 to 15,999.....	4,350
16,000 to 16,999.....	4,600
17,000 to 17,999.....	4,850
18,000 to 18,999.....	5,100
19,000 to 19,999.....	5,350
20,000 to 20,999.....	5,600
21,000 to 21,999.....	5,850
22,000 to 22,999.....	6,100
23,000 to 23,999.....	6,350
24,000 to 24,999.....	6,600
25,000 to 25,999.....	6,850
26,000 to 27,999.....	7,250
28,000 to 29,999.....	7,750
30,000 to 31,999.....	8,250
32,000 to 33,999.....	8,750
34,000 to 35,999.....	9,250
36,000 to 37,999.....	9,750
38,000 to 39,999.....	10,250
40,000 to 41,999.....	10,750
42,000 to 43,999.....	11,250
44,000 to 45,999.....	11,750
46,000 to 47,999.....	12,250
48,000 to 49,999.....	12,750
50,000 to 51,999.....	13,250
52,000 to 53,999.....	13,750
54,000 to 55,999.....	14,250
56,000 to 57,999.....	14,750
58,000 to 59,999.....	15,250

For automobiles with a fair market value greater than \$59,999,  
the annual lease value is: (.25 x fair market value) +\$500.

**Calculating Employee Automobile Fringe Benefit Under The Annual Lease Value Method**

(1) *FAIR MARKET VALUE OF Automobile: As of date the vehicle is made available to the employee	_____	
(2) Annual lease value - per table attached	_____	
(3) Personal - Non-business miles driven (including commuting miles)	_____	
(4) Total miles driven during year	_____	
(5) Personal use percentage (3) / (4)		_____
(6) (2) x (5)		_____
(7) Number of days vehicle was available for employee's use (full year enter 365) Note: (If vehicle is available for the employee's use for less than 30 days, multiply the number of days available by 4 and enter here but do not enter more than 30	_____	
(8) (7) / 365		_____
(9) (6) x (8)		_____
(10) Does employer provide fuel for the automobile? If "no" enter -0- If "yes" enter personal miles from (3)	_____ x .055=	_____
(11) Automobile fringe benefit to be included in Employee's W-2 (9) + (10)		=====

\* For purchased autos use purchase price, including sales tax, title charges and other acquisition costs.  
For leased autos use manufacturers suggested retail price x 92%.  
Use the same fair market value for the next 3 succeeding years. Revalue after each 4-year period.

**Calculating Employee Automobile Fringe Benefit Under The Cents-Per-Mile Method**

Was the fair market value of the automobile on the date it was first made available for the employee's personal use greater than \$15,000 (if yes, this Method may not be used)<sup>1</sup> (YES or NO)

Enter number of days vehicle was owned or leased by the employer \_\_\_\_\_

(Enter 365 for a full year) (A) \_\_\_\_\_

Divide (A) by 365 (B) \_\_\_\_\_

Multiply (B) times 10,000 miles (C) \_\_\_\_\_

If the total miles all employees drove the auto were less than Line C, was business usage less than 50% \_\_\_\_\_

If total business miles exceed 10,000 answer no \_\_\_\_\_

Note: If you answered yes to either of the above questions, you cannot use the cents-per-mile method.

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(1) Enter total personal (non-business) miles driven (including commuting) \_\_\_\_\_

(2) If fuel is provided multiply by  
x .55 \_\_\_\_\_<sup>2</sup>

If fuel is not provided multiply  
x .495 \_\_\_\_\_<sup>2</sup>

<sup>1</sup> Value in 2008 and 2009 is \$15,000

<sup>2</sup> Automobile fringe to be included on employee's W-2.