



November 12, 2008

VALUING YOUR EMPLOYEE'S PERSONAL USE OF BUSINESS AUTOMOBILE

Dear *Client*:

If your company supplies business automobiles to employees as "perks" or as necessary tools to help them get their work done, their use of the automobile for personal reasons, including commuting, has tax implications for them and for your company. An employee's personal use of a company automobile generally must be treated as a non-cash taxable fringe benefit subject to income, social security and Medicare taxes. Fortunately, the tax rules give you some flexibility in valuing personal usage of the company car. You can choose from among four valuation methods, when eligible:

- 1) **General Fair Market Value Method**, which is based on what a person would pay locally to lease a comparable automobile for a period of time comparable to the period of time the employee has use of the automobile;
- 2) **Lease Value Method**, which assigns an IRS-determined annual lease value to the automobile depending on its value when first provided for the employee's personal use;
- 3) **Mileage Rate Method**, which values each personal use mile at the standard business mileage rate designated by the IRS for the year (50.5 cents a mile for all business miles driven January 1, 2008 through June 30, 2008 and 58.5 cents a mile for all business miles driven July 1, 2008 through December 31, 2008); or
- 4) **Commute Method**, \$1.50 is charged per each one-way commute.

The first two methods can be used for any auto and any employee. The mileage-rate method can be used only if the car's fair market value doesn't exceed an annually adjusted figure (the amount for 2008 is \$15,000 for a passenger auto and \$15,900 for a truck or van), and is regularly used in your business, or is driven at least 10,000 (for either personal and business use) miles during the year and used primarily by employees. The \$1.50 commuting method may only be used for vehicles covered by a written policy that allows commuting but no other personal use. In addition, the commuting method applies only to an auto used in your company's business, and only if the employee isn't highly paid, a company officer or director, or a more than 1% company owner.

Due to the restrictions on the other three methods, most employers use the second option, the Lease Value Method, in determining the employee's personal use of a company automobile. Therefore, the rest of this document focuses on some of the specifics of the Lease Value Method.

Lease Value Method

The Lease Value Method requires the employer to first obtain the Annual Lease Value or ALV by determining the car's fair market value ("FMV") as of the date the car is first used for personal reasons and then referring to the government's ALV table, which is reproduced in **Appendix B**.

Although maintenance and insurance costs are already included in the ALV table, the FMV of fuel provided by the employer is not included (regardless of whether the fuel is provided in kind or its cost is reimbursed by or charged to the employer). Any fuel provided in kind may be valued at its FMV or at 5.5 cents per mile.

If continuous personal use of a company car is for less than a year, but at least 30 days, the employee may prorate the car's ALV by multiplying the ALV figure by a fraction, the numerator of which is equal to the number of days of personal use and the denominator of which is 365 days.

The figures in the annual lease value tables are applicable for a four-year period, starting on the date on which the special rule is applied to the car by the employer or the employee and ending on December 31 of the fourth full year following that date. After that period, the annual lease value for each subsequent four-year period is calculated by determining the fair market value of the car on January 1 following the period described in the previous sentence and selecting the appropriate amount in the ALV table corresponding to the proper FMV dollar range.

Once the ALV is determined, it is multiplied by the employee's personal usage percentage (miles driven for personal use during the tax year as a percentage of total miles the vehicle is driven for that same period) to determine the amount of the taxable lease benefit. Any employer provided or reimbursed fuel cost related to the personal use miles is then added to determine the total reportable taxable fringe benefit amount. (See **Appendix A** for the worksheet to calculate income from personal use of company vehicle).

Safe harbor valuation rules. For purposes of calculating the ALV, the regulations provide safe harbor rules for determining the value of an employer-provided automobile. The safe harbor rules permit an employer to treat the cost of the vehicle as the FMV so long as the purchase was made at arm's length. The manufacturer's suggested retail price of the car, less eight percent, constitutes the FMV of the car for purposes of calculating the annual lease value. Sales tax and title fees attributable to the purchase of the car are considered

part of the purchase price. Secondly, for a leased or revalued automobile, an employer may use the retail value supplied by any nationally recognized publication that periodically reports such retail values, provided that the value with respect to such automobile is reasonable. A third safe harbor lease valuation rule allows an employer to use the manufacturer's invoice price (including options) plus four percent as a safe harbor estimation of fair market value.

Recordkeeping & Substantiation Requirements

The IRS generally requires that written records be maintained to document the business use of vehicles. Both employers and employees must substantiate expenses related to employer-provided vehicles. In general, employers are required to provide answers to certain questions on their tax returns. The questions relate to the business use of vehicles, the dates placed in service, the use of other employer-owned vehicles, the use of vehicles after work, and the kind of supporting evidence. (**See Appendix C**)

Employees may not exclude from income the value of the availability of business vehicles as a working condition fringe benefit unless they meet the substantiation requirements. Employees may, however, substantiate the business use element for employer-owned vehicles by either maintaining adequate records as to the business use of vehicles, by providing a statement regarding the use that is corroborated by other sufficient evidence, or by providing a statement only. Both the employer and the employee must have copies of the substantiating records and evidence.

Reporting

Generally, the employer must determine the value of non-cash fringe benefits no later than January 31 of the next year. Before January 31, the employer may reasonably estimate the value of the fringe benefits for purposes of withholding and depositing on time.

The employer can treat fringe benefits as paid on a pay period, quarter, semiannual, annual, or other basis for employment tax and withholding purposes, but the benefits must be treated as paid no less frequently than annually. The employer does not have to choose the same period for all employees, withholding more frequently for some employees than for others. The employer can change the period as often as desired as long as all benefits provided in a calendar year are treated as paid no later than December 31 of the calendar year. The employer can add the value of fringe benefits to regular wages for a payroll period and figure income tax withholding on the total or withhold Federal income tax on the value of fringe benefits at the flat 25% rate applicable to supplemental wages. The employer is also permitted to elect, on an individual employee basis, not to withhold income taxes on the value of an employee's personal use of an employer-provided vehicle, however, social security and railroad retirement taxes must be withheld.

If the employer chooses to pay an employee's share of social security and Medicare taxes on fringe benefits without deducting them from his or her pay, the employer must include the amount of the payments in the employee's income (which further increases the taxable income subject to social security and Medicare taxes).

Notice of the election not to withhold, or a change in the election, must be given to the affected employees by the later of (1) January 31 of the year to which the election (or change) will apply or (2) 30 days after the day on which the employee is first given the vehicle. Where the employer makes such an election, the employee can increase his withholding from regular wages by adjusting his Form W-4 withholding to avoid estimated tax payments or escape any penalty for underpayment of estimated taxes.

The value of the personal use of auto needs to be in Box 1 of Form W-2. It also needs to be included in boxes 3 and 5, if applicable. The employer may show the total value of the fringe benefits provided in the calendar year or other period in box 14 of Form W-2.

If you have any further questions regarding the Lease Valuation Method, please do not hesitate to contact the following PMN employees:

Shannon Bollin, CPA, MST 1-617-426-9440 (Extension 202)
David St. Yves, CPA, Partner (Extension 204).

Please note that this memorandum only addresses the specific's of the Lease Valuation Method, if you have questions on the other valuation methods, or calculations for the "inclusion amount" for leased vehicles or fleet valuation rules (20 or more automobiles), please contact our office.

Note: This article represents a general overview of Federal and/or Massachusetts tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

CIRCULAR 230 DISCLAIMER: In accordance with Federal regulations, we hereby notify you that any tax advice contained in the body of this e-mail, or attachments thereto, was not intended or written to be used, and cannot be used, by the recipient for the purpose of (1) avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions, or (2) promoting, marketing or recommending to another party any transaction or matter addressed herein.

APPENDIX A
Calculation of Income from Personal Use of Company Vehicle

Tax Year		_____
Description of Vehicle		_____
Number of Days Vehicle was available	1	_____
Number of Days in Tax Year	2	_____
A. % of Days Used in Tax Year	(1/2)	_____
Personal Miles Driven during year	3	_____
Total Miles Driven during year	4	_____
B. Percentage of Personal Use	(3/4)	_____
C. Fair Market Value of Vehicle	(to be determined at the Beginning of the fifth year and every four years thereafter)	_____
D. Annual Lease Value	(See Appendix B)	_____
E. % of Days Used in Tax Year	(See A above)	_____
F. Prorated Annual Lease	(D x E)	_____
G. Personal Use %	(See B above)	_____
H. Personal Annual Lease Value	(F x G)	_____
I. If fuel is provided by employer, Enter personal miles _____ x 5.5cents		_____
J. Personal Use Taxable Income	(H + I)	_____

APPENDIX B
Annual Lease Value Table

Generally, you figure the annual lease value of an automobile as follows.

- 1) Determine the fair market value (FMV) of the automobile on the first date it is available to any employee for personal use.
- 2) Using the following **Annual Lease Value Table**, read down column (1) until you come to the dollar range within which the FMV of the automobile falls. Then read across to column (2) to find the annual lease value.

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

For vehicles having a fair market value in excess of \$59,999, the Annual Lease Value is equal to: (.25 x the fair market value of the automobile) + \$500.

APPENDIX C
SUBSTANTIATION REQUIREMENTS
FOR EMPLOYEE USE OF COMPANY VEHICLE

Employee Name _____

Tax Year _____

Dates Automobile Available to Employee _____

Odometer Reading _____ Beginning _____ Ending _____

1. Total business miles driven during the year _____

2. Total commuting miles driven during the year _____

3. Total personal (noncommuting) miles driven during year _____

4. Total miles driven during year (1 + 2 + 3) _____

5. Was the vehicle available for personal use during off-duty hours? YES/ NO

6. Is another vehicle available for personal use? YES/ NO

7. Are you an officer or 1% or more owner of the business? YES/ NO

8. Did the employer pay the cost of fuel for this vehicle? YES/ NO

9. You acknowledge that the employer elects not to withhold income taxes on value of personal use of vehicle.

Employee Signature

Date

