



Federal Tax Rules Related to Personal Use of Employer Owned Vehicles

Substantiation Requirements for Business Use of Company Automobiles

The use of an employer-provided auto by an employee for use in the employer's business is an excludable working condition fringe benefit. Conversely, personal use of an employer-provided auto is a taxable fringe benefit. The excludable portion of the fringe benefit is determined by allocating the auto's value between the employee's business and personal use.

The business use of an employer-provided auto is considered an excludable working condition fringe benefit only if the business usage is properly substantiated. (Reg. §1.132-5(c).) An employee must substantiate the business use of the employer-provided automobile in one of three ways:

1. **Adequate Records or Other Sufficient Corroborating Evidence** – Unless a substantiation safe harbor is elected or the employer-provided vehicle is a qualified nonpersonal use vehicle, employees must substantiate business use of employer-provided autos by maintaining adequate records or by providing other sufficient evidence corroborating the employee's statement of business use. (IRC §274(d).) For this purpose, the employee must prove the following elements in order to meet the substantiation requirements: (1) the amount and date of each expenditure made by the employee with respect to the vehicle, such as the cost of gasoline, maintenance, and repairs, (2) the amount of mileage for each business use and the total mileage for the vehicle for each year, (3) the date of each business use of the vehicle, and (4) the business purpose for each business use of the vehicle. (Temp. Reg. §1.274-5T(b)(6) & (e)(1).) Automobile use not substantiated by adequate records or sufficient corroborating evidence is considered personal use. (Temp. Reg. §1.274-5T(e).) The employer should retain summaries of the employee's records substantiating business use. Under this substantiation rule, the employee has taxable fringe benefit income subject to income and employment taxes for the personal use portion of the vehicle. The valuation of the personal use portion is discussed below under the heading "Valuation Rules."
2. **Substantiation Safe Harbor** – The employer may adopt a policy that complies with one of the following four substantiation safe harbors. If one of the following four safe harbors applies to the employer, then the vehicle is deemed used for personal use only to the extent provided for under the applicable safe harbor rule, and the employee generally is not required to maintain detailed usage records. (Reg. §1.132-5(d) – (g) & Temp. Reg. §1.274-6T.)
 - a. **Solely for Business** – No personal use is allowed except for de minimis personal use, such as stopping for lunch or occasionally running personal errands between business calls. The employer must adopt a written policy to this effect and must believe that the policy has been adhered to. Under this safe harbor, there are no income or employment tax implications to the employee.
 - b. **Personal Use Permitted for Commuting Use Only** – No personal use is allowed except for commuting or de minimis personal use. Under this safe harbor, the use of the auto for commuting must be for noncompensatory reasons, such as proximity of the employee's residence to a major customer or in order for the employee to remain available for business duties at night and on weekends. The employer must adopt a written policy to this effect and must believe that the policy has been adhered to. It should be noted that this method is not available for automobiles provided to "control employees," which are defined to include all directors of the employer, any officer of the employer whose compensation is at least \$115,000 for 2021 (as adjusted for inflation annually) or any other employee whose compensation is at least \$235,000 for 2021 (as adjusted for inflation). Alternatively, instead of applying this definition of "control employee," an employer may treat all, and only, employees who are "highly compensated" as control employees for purposes of determining whether this safe harbor is available. (The term "highly compensated" for this purpose means any employee whose total annual compensation exceeds \$130,000

for 2021 (as adjusted for inflation).) Under this safe harbor, the employee has taxable fringe benefit income subject to income and employment taxes for the commuting portion of the vehicle's use. A special commuting valuation rule can be used for purposes of determining the amount of the taxable fringe benefit to the employee. Under this rule, the value of each round-trip commute can be deemed to be \$3 per day per employee.

- c. Vehicles Used in Farming – This safe harbor applies to owned or leased vehicles when used in connection with the business of farming during most of the normal business day. Business use by the employer is deemed to be 75%, plus that percentage, if any, attributable to an amount included in the employee's income (equal to his/her allocable share of the vehicle's deemed personal use).
 - d. Total (Full) Value Inclusion – Under this safe harbor, 100% of the annual lease value of the vehicle is reported to the employee as income.
3. Qualified Nonpersonal Use Vehicle – All use of a qualified nonpersonal use vehicle is considered business use, and the employee generally is not required to maintain detailed usage records. The term "qualified nonpersonal use vehicle" means any vehicle which, by reason of its nature (i.e., design), is not likely to be used more than a de minimis amount for personal purposes. Examples of qualifying vehicles include: clearly marked police and fire vehicles, ambulances, hearses, school buses, delivery trucks with seating only for the driver, and passenger buses with a capacity of at least 20 passengers.

Valuation Rules

Unless the employer elects one of three special valuation rules discussed below, personal use of an employer-provided automobile is valued at fair market value based on the facts and circumstances. (This is the "general valuation rule using facts and circumstances.") Fair market value equals the amount that an individual would have to pay in an arm's-length transaction to lease the same or comparable vehicle on the same or comparable conditions in the geographic area in which the vehicle is available for use. An example of a comparable condition is the amount of time that the vehicle is available to the employee for use, e.g., a one-year period. Unless the employee can substantiate that the same or comparable vehicle could have been leased on a cents-per-mile basis, the value of the availability of the vehicle cannot be computed by applying a cents-per-mile rate to the number of miles the vehicle is driven. (Reg. §1.61-21(b)(4)(i).)

In lieu of the general valuation rule discussed above and subject to certain conditions, an employer can elect to value personal use of company-owned automobiles under one of three special valuation rules: (1) the automobile lease valuation rule, (2) the vehicle cents-per-mile valuation rule, or (3) the commuting valuation rule. (Reg. §1.61-21(c).) The commuting valuation method is available only when commuting is the sole personal use and it is required for noncompensatory reasons and is not generally available for control employees (as defined in item 2b above). (Reg. §1.61-21(f)(1)(ii).) Since this method is available only in limited circumstances, it will not be addressed here.

Vehicle cents-per-mile valuation rule:

For 2021, the vehicle cents-per-mile valuation rule can be used only for automobiles (including trucks and vans) whose fair market value when first made available to the employee does not exceed \$51,100, adjusted annually for inflation (for vehicles placed in service in 2020, the fair market value threshold was \$50,400). (Notice 2021-02, 2021-02 IRB, 12/22/2020; Notice 2020-5, 2020-4 IRB, 12/31/2019.) In addition, to use the vehicle cents-per-mile valuation rule, the employer must provide a vehicle that passes one of two threshold tests for business usage:

1. The employer reasonably expects the vehicle will be regularly used in its business during the calendar year. This determination is based on all of the facts and circumstances. However, a vehicle is considered regularly used for business purposes if one of the following safe harbors is satisfied:
 - a. At least 50% of the vehicle's total annual mileage is for the employer's business, or
 - b. The vehicle generally is used each workday to transport at least three employees of the employer to and from work in an employer-sponsored commuting vehicle pool.
2. The vehicle is actually driven primarily by employees at least 10,000 miles during the year (reduced proportionately by any part of the year in which the employer did not own or lease the vehicle).

If an employer chooses to use this method for qualifying vehicles, the amount of the taxable fringe benefit to the employee is calculated by multiplying the total number of miles the employee drove the vehicle for personal purposes by the business standard mileage rate (\$0.56 per mile for 2021 and \$.575 per mile for 2020). The cents-per-mile rate includes

the fair market value of fuel provided by the employer. If fuel is not provided by the employer, the cents-per-mile rate may be reduced by no more than 5.5 cents per mile.

An employer must generally adopt the vehicle cents-per-mile valuation rule for a vehicle by the first day on which the vehicle is used by an employee for personal use. Once the vehicle cents-per-mile valuation rule has been adopted for a particular vehicle by an employer, the rule generally must be used by the employer for all subsequent years in which the vehicle qualifies for use of the rule.

However, for 2020, the IRS has provided an exception to the general rule that the vehicle cents-per-mile valuation method must be chosen on the first day the vehicle is used by an employee for personal use, and that once the method is chosen, it must be used in subsequent years (Notice 2021-7, 2021-3 IRB, 01/04/2021). The Notice indicates that an employer that has historically used the automobile lease valuation rule (described below) may instead use the vehicle cents-per-mile rule beginning on March 13, 2020. The employer may make this change if, at the beginning of the 2020 calendar year, the employer reasonably expected that an automobile with a fair market value not exceeding \$50,400 would be regularly used in the employer's trade or business throughout the year (as described above), but due to the COVID-19 pandemic the automobile was not regularly used in the employer's trade or business throughout the year.

Employers may choose to revert back to the automobile lease valuation rule for 2021 or continue using the vehicle cents-per-mile valuation method in 2021, provided the arrangement otherwise meets the requirements for valuation under the vehicle cents-per-mile valuation method. However, the method chosen for 2021 must generally be used for all subsequent years (assuming the vehicle continues to qualify for the use of the chosen method under the rules described in this whitepaper).

Automobile lease valuation rule:

Under the automobile lease valuation rule, the amount of the taxable fringe benefit to the employee is calculated as follows (Reg. §1.61-21(d)):

1. Determine the auto's fair market value when the auto is first made available to the employee for personal use. Fair market value is the amount that would be paid for the car in an arm's-length purchase. The fair market value is used to determine the annual lease value (see item 2 below) for each of the first four full calendar years of use by an employee. In the fifth full calendar year the auto is used, the fair market value is redetermined and a new annual lease value is calculated, which is then used for the second four-year period. In addition, the fair market value is redetermined if the vehicle is transferred to another employee.
2. Establish the lease value using the lease value tables found in Reg. §1.61-21(d). A copy of the lease value table is attached herewith as **Exhibit 1** for your convenience. For periods of continuous availability of at least 30 days, but less than an entire calendar year, the annual lease value is prorated using the number of days of availability as the numerator and 365 as the denominator. For periods of continuous availability of less than 30 days, the annual lease value is prorated using four times the number of days of availability as the numerator and 365 as the denominator. Note that employers that choose to take advantage of the special 2020 COVID-19 relief provision described above to switch to the vehicle cents-per-mile valuation method as of March 13, 2020, must pro-rate the value of the vehicle for January 1, 2020 through March 12, 2020 (72 days/365 days).
3. The lease value as determined in item 2 above is prorated between business and personal use of the auto based on mileage.
4. An additional amount for company-provided fuel used for personal miles is then added to the amount determined in item 3 above. A rate of 5.5 cents per mile may be used for this purpose or the actual fair market value of the fuel provided.

Attached herewith as **Exhibit 2** is a worksheet that can be used by the employer to determine the amounts to be included in employees' W-2's with regard to personal use of employer-owned autos using the automobile lease valuation rule.

Covered Period

Employers may elect, for employment tax and withholding tax purposes, to treat fringe benefits (including the use of employer-provided vehicles) as paid on a pay-period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually. (IRS Announcement 85-113, 1985-31, IRB 31.) Employers do not have to make the same election for all employees and may change their election as frequently as they desire so long as they treat all the benefits provided in a calendar year as paid no later than December 31 of the calendar year. No formal election is required and the IRS need not be notified of the employer's election.

The requirement that fringe benefits must be treated as paid no later than December 31 of the calendar year can be difficult for employers, since the information needed to calculate the amount to be included in the employee's pay is often not available until after year-end. Recognizing this as a problem, the IRS provides a special accounting rule to allow employers adequate time to accumulate the information to meet reporting deadlines. Employers may use any 12-month period that begins between November 1 and December 31 inclusive, rather than the calendar year, to compute personal use income for the calendar year. The employer must notify its employees of its use of a different 12-month period than the calendar year at or near the time the employer provides the employee with the Form W-2. The notification may not be provided to the employee earlier than with the employee's last paycheck of the calendar year.

In practical terms, this means that an employer can use a 12-month period from November 1 to October 31 of each year to track personal miles and total miles for use in computing the amount that must be included in the employee's W-2 for the calendar year. This gives the employer and its employees additional time to compute the personal use portion of the employer-provided auto and to make the required payroll tax deposits in a timely fashion.

Withholding, Deposits, and Reporting Requirements

The amount added to an employee's pay in connection with the personal use of a company-provided auto is generally treated in the same manner as regular wages paid to the employee. In general, the employer must withhold the applicable income, social security, and Medicare taxes on the date or dates it elects to treat the benefits as paid and must deposit the withheld taxes, and the employer taxes, under the regular rules for tax deposits. The fringe benefit amount is included in the wage amount on the quarterly Form 941 for the period in which the fringe benefit is treated as paid and is reported on the employee's W-2 in box 1 as wages paid to the employee and, if applicable, in boxes 3 and 5 as social security and Medicare wages. In addition, the amount of taxable fringe benefits included in box 1 of the W-2 must be separately stated in box 14 of the W-2 or in a separate statement to the employee.

In determining the amount of income tax to withhold from the employee's pay in connection with the personal use of a company-provided auto, the employer may add the value of the fringe benefit to the regular wages for a payroll period and compute the withholding taxes on the total, or may withhold from regular wages federal income taxes on the value of the fringe benefit at the flat rate applicable to supplemental wages (22% for amounts deemed paid after February 15, 2018). In addition, the employer may elect not to withhold income taxes on the value of an employee's personal use of an employer-provided automobile. (IRC §3402(s).) The employer must notify the affected employee of its election not to withhold by January 31 of the year for which the election is to apply.

This sample document is provided for general information purposes. It does not constitute professional advice. It is a generic document that is not specifically designed for your organization. We have provided it as a matter of professional courtesy for you to consider, together with your legal counsel, as you determine policies and/or provisions of your governing documents that are appropriate for your organization. In establishing your organization's policies or provisions of your governing documents, you should consider, together with your legal counsel, your unique operational, financial, and legal circumstances.

Reg. §1.61-21(d)(2)(iii)

Annual lease value table

Annual Automobile fair market value (1)	Lease value (2)
\$ 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 vehicles having a fair market value in excess of \$59,999, the Annual Lease Value is equal to: $(.25 \times \text{the fair market value of the automobile}) + \500 .

**Worksheet for Use in Determining Fringe Benefit
Compensation Value for Employer-Provided Automobiles**

Covered period: _____ to _____

Employee: _____

Auto description: _____

Date acquired: _____

1. Fair market value (e.g., purchase price or value per NADA book)
as of auto acquisition date or as of beginning of accounting period
following the end of the deemed four-year lease term \$ _____

2. IRS annual lease value factor for line 1 \$ _____

3. Prorate to cover period less than 12 months (if applicable) × _____ %

4. Annual lease value for reporting year (line 2 × line 3) _____

5. Personal-use percentage:

a. Personal miles for covered period _____

b. Total miles for covered period _____

Ratio (5a divided by 5b) × _____ %

6. Annual personal-use value (line 4 × line 5 percentage) \$ _____

7. Plus: additional amount for employer-provided gas used personally:

a. Total personal miles per 5a above _____

b. Less mileage when gas paid for personally (_____)

c. Total personal miles on company-paid gas _____

× 5.5 cents/mile

d. Additional value for employer-paid gas \$ _____

8. Total additional compensation for covered period (line 6 + line 7d) \$ _____