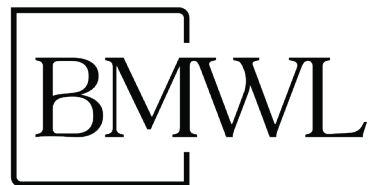


TAX IMPLICATIONS OF EMPLOYER-PROVIDED PERSONAL SECURITY

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With the political unrest and acrimony that exists in our culture today, more organizations are addressing security needs...including the possibility of providing personal security services for leaders or other employees.

The tax treatment of employer-provided personal security is an area of law that is not commonly cited or referenced.

This area of law is governed primarily by Section 132 of the Internal Revenue Code and the related Treasury Regulations. We start with the premise that anything of value provided to a person is taxable income (pursuant to Section 61 of the Code) unless an exemption or exclusion applies elsewhere in the Code. Section 132 of the Code relates to “certain fringe benefits” which are excluded from taxable income. One category of fringe benefit that is excludible pursuant to Section 132 is a “working condition fringe.”

The Regulations related to working condition fringes are in Treasury Regulation § 1.132-5. The relevant subsection is § 1.132-5(m), and the somewhat misleading descriptive header is “Employer-provided transportation for security concerns.” In reality, this subsection of the Regulations addresses the exclusions for employer-provided security services in a context that is broader than transportation.

Executive Summary

Treasury Regulations (§ 1.132-5(m)) address the taxability of security measures provided by employers to employees. Employers should carefully analyze the Regulations and apply them under the advice of their tax counsel to ensure compliance. Noncompliance could have severe adverse consequences (e.g., possible automatic excess benefit transactions for organizational leaders.)

In order for personal security services (transportation-related security, chauffeurs specially trained in evasive driving techniques, bodyguards, home alarm systems, etc.) provided by an employer to an employee to be excluded from the employee’s taxable wages, the employer organization must provide such services in response to “**bona fide business-oriented security concerns**” (i.e., specific threats as described in the Regulations.)

A bona fide business-oriented security concern will not be deemed to exist unless the employer implements an “**overall security program**” that is either:

- 24/365 full security (bodyguards, drivers specially trained in evasive driving techniques, armored cars, metal detectors, alarm systems, special air transportation, etc.) at all times, at all locations, and at all events, or
- Security measures provided pursuant to an **independent security study** that is followed completely.
 - An industry exists around providing independent security studies specifically for purposes of complying with these Regulations.

Key Terms

Bona fide business-oriented security concern – A bona fide business-oriented security concern exists only if the facts and circumstances establish a specific basis for concern regarding the safety of the employee.

A generalized concern for an employee’s safety is not a bona fide business-oriented security concern.

Once a bona fide business-oriented security concern is determined to exist with respect to a particular employee, the employer must periodically evaluate the situation for purposes of determining whether the bona fide business-oriented security concern still exists. Examples of factors indicating a specific basis for concern regarding the safety of an employee are:

- A threat of death or kidnapping of, or serious bodily harm to, the employee or a similarly situated employee because of either employee's status as an employee of the employer; or
- A recent history of violent terrorist activity (such as bombings) in the geographic area in which the transportation is provided, unless that activity is focused on a group of individuals which does not include the employee (or a similarly situated employee of an employer), or occurs to a significant degree only in a location within the geographic area where the employee does not travel.

No bona fide business-oriented security concern will be deemed to exist unless the employee's employer establishes to the satisfaction of the Commissioner that an overall security program has been provided with respect to the employee involved.

Overall security program – (Default definition) An overall security program is one in which security is provided to protect the employee on a 24-hour basis. The employee must be protected while at the employee's residence, while commuting to and from the employee's workplace, and while at the employee's workplace. In addition, the employee must be protected while traveling both at home and away from home, whether for business or personal purposes. An overall security program must include the provision of a bodyguard/chauffeur who is trained in evasive driving techniques; an automobile specially equipped for security; guards, metal detectors, alarms, or similar methods of controlling access to the employee's workplace and residence; and, in appropriate cases, flights on the employer's aircraft for business and personal reasons.

There is no overall security program when, for example, security is provided at the employee's workplace but not at the employee's residence.

In addition, the fact that an employer requires an employee to travel on the employer's aircraft, or in an employer-provided vehicle that contains special security features, does not alone constitute an overall security program. The preceding sentence applies regardless of the existence of a corporate or

other resolution requiring the employee to travel in the employer's aircraft or vehicle for personal as well as business reasons.

Effect of an "independent security study" on the definition of an "overall security program"

– An overall security program with respect to an employee is deemed to exist if the following conditions are met:

1. A security study is performed with respect to the employer and the employee (or a similarly situated employee of the employer) by an independent security consultant;

[Note – there is an industry around providing independent security studies specifically for purposes of complying with these Regulations.]

2. The security study is based on an objective assessment of all facts and circumstances;

3. The recommendation of the security study is that an overall security program (as defined in the default definition) is not necessary, and the recommendation is reasonable under the circumstances; and

4. The employer applies all of the specific security recommendations contained in the security study to the employee on a consistent basis.

A bona fide business-oriented security concern is deemed to exist for the spouse and dependent children of the employee only if the requirements described above for employees are applied independently to such spouse and dependent children. (But see special rule for transportation of spouses and dependent children below.)

Tax Implications Under an "Independent Security Study" Scenario

The value of transportation-related security provided pursuant to an independent security study may generally be excluded from income. (The value of the core transportation benefit is not excluded if the transportation is personal...e.g., commuting from home to work and back or other

personal transportation – but just the value of the core transportation benefit is taxable – not the added security elements.)

If a working condition fringe is excludible due to a bona fide security concern with respect to an employee, the value of transportation of an employee's spouse and dependent children in the same vehicle or aircraft as the employee... at the same time... is generally excludible, even if there is not an independent bona fide security concern specifically with respect to the spouse and dependent children.

If an employer provides an employee with vehicle transportation and a bodyguard/chauffeur for a bona fide business-oriented security concern, and but for the bona fide business-oriented security concern, the employee would not have had a bodyguard or a chauffeur, then the entire value of the services of the bodyguard/chauffeur is excludable from gross income as a working condition fringe. For purposes of this section, a bodyguard/chauffeur must be trained in evasive driving techniques. An individual who performs services as a driver for an employee is not a bodyguard/chauffeur if the individual is not trained in evasive driving techniques. Thus, no part of the value of the services of such an individual is excludible from gross income under this subsection. (Note that the Regulations separately address non-security-related chauffeur services provided by an employer to an employee.)

Security Measures Other than Transportation

If an employer provides an employee with security measures other than transportation-related security (e.g., bodyguards, an alarm system for the employee's home, etc.) as part of an **overall security program** and for a **bona fide business-oriented security concern**, such measures are nontaxable working condition fringes.

Specific Examples from the Regulations

Example (1). Assume that in response to several death threats on the life of A, the president of X, a multinational company, X establishes an overall security program for A, including an alarm system

at A's home and guards at A's workplace, the use of a vehicle that is specially equipped with alarms, bulletproof glass, and armor plating, and a bodyguard/chauffeur. Assume further that A is driven for both personal and business reasons in the vehicle. Also, assume that but for the bona fide business-oriented security concerns, no part of the overall security program would have been provided to A. With respect to the transportation provided for security reasons, A may exclude as a working condition fringe the value of the special security features of the vehicle and the value attributable to the bodyguard/chauffeur. Thus, if the value of the specially equipped vehicle is \$40,000, and the value of the vehicle without the security features is \$25,000, A may determine A's inclusion in income attributable to the vehicle as if the vehicle were worth \$25,000. A must include in income the value of the availability of the vehicle for personal use.

Example (2). Assume that B is the chief executive officer of Y, a multinational corporation. Assume further that there have been kidnapping attempts and other terrorist activities in the foreign countries in which B performs services and that at least some of such activities have been directed against B or similarly situated employees. In response to these activities, Y provides B with an overall security program, including an alarm system at B's home and bodyguards at B's workplace, a bodyguard/chauffeur, and a vehicle specially designed for security during B's overseas travels. In addition, assume that Y requires B to travel in Y's airplane for business and personal trips taken to, from, and within these foreign countries. Also, assume that but for bona fide business-oriented security concerns, no part of the overall security program would have been provided to B. B may exclude as a working condition fringe the value of the special security features of the automobile and the value attributable to the bodyguards and the bodyguard/chauffeur. B may also exclude the excess, if any, of the value of the flights over the amount A would have paid for the same mode of transportation but for the security concerns. As an alternative to the preceding sentence, B may use the working condition safe harbor described [elsewhere in] this section and exclude as a working condition fringe the excess, if any, of the value of personal flights in the Y airplane over the safe harbor airfare determined

under the method described [elsewhere in] this section. If this alternative is used, B must include in income the value of the availability of the vehicle for personal use and the value of the safe harbor.

Example (3). Assume the same facts as in example (2) except that Y also requires B to travel in Y's airplane within the United States, and provides B with a chauffeur-driven limousine for business and personal travel in the United States. Assume further that Y also requires B's spouse and dependents to travel in Y's airplane for personal flights in the United States. If no bona fide business-oriented security concern exists with respect to travel in the United States, B may not exclude from income any portion of the value of the availability of the chauffeur or limousine for personal use in the United States. Thus, B must include in income the value of the availability of the vehicle and chauffeur for personal use. In addition, B may not exclude any portion of the value attributable to personal flights by B or B's spouse and dependents on Y's airplane. Thus, B must include in income the value attributable to the personal use of Y's airplane.

Example (4). Assume that company Z retains an independent security consultant to perform a security study with respect to its chief executive officer. Assume further that, based on an objective assessment of the facts and circumstances, the security consultant reasonably recommends that 24-hour protection is not necessary but that the employee be provided security at his workplace and for ground transportation, but not for air transportation. If company Z follows the

recommendations on a consistent basis, an overall security program will be deemed to exist with respect to the workplace and ground transportation security only.

Example (5). Assume the same facts as in example (4) except that company Z only provides the employee security while commuting to and from work, but not for any other ground transportation. Because the recommendations of the independent security study are not applied on a consistent basis, an overall security program will not be deemed to exist. Thus, the value of commuting to and from work is not excludible from income. However, the value of a bodyguard with professional security training who does not provide chauffeur or other personal services to the employee or any member of the employee's family may be excludible as a working condition fringe if such expense would be otherwise allowable as a deduction by the employee under section 162 or 167.

Concluding Thoughts

A stark present reality is that more nonprofit organizations are addressing the potential need to provide security services to protect the lives of their leaders and the family members of their leaders. Federal tax law provides guidance addressing the circumstances in which such security services may be provided by an employer without being taxable to the employee. The tax rules must be followed carefully to achieve that result. We at BMWL stand ready to help our clients in this area if and when needed.

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