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MEMORANDUM OF LAW

DATE: February 23, 2012

TO: Kenton C. Whitfield, City Comptroller
Eduardo Luna, City Auditor

FROM: City Attorney

SUBJECT: Tax Status of Take-Home City Vehicles

INTRODUCTION

The Office of the City Auditor conducted an audit of the take-home use of City vehicles by City employees. Among the issues raised by the audit was the extent to which this take-home use results in taxable income to employees. This Memorandum addresses this issue, and updates the Memorandum of Law issued by the City Attorney on August 25, 1992, entitled *Tax Implications of Take Home City Vehicles*.[1]

Based upon the information provided to this Office,[2] City take-home vehicles fall into the following general categories: (1) Fire-Rescue Department utility vehicles; (2) marked vehicles issued to Fire-Rescue, Police, and Lifeguard Officers; (3) unmarked Police Department vehicles driven by law enforcement officers; (4) unmarked Police Department vehicles driven by civilian employees; (5) unmarked vans driven by Police Department crime lab employees; (5) pickup trucks driven by members of the Fire-Rescue Department Bomb Squad, and (6) unmarked sedans and sports utility vehicles driven by civilian employees in various departments.

The take-home use of an employer-provided vehicle is a taxable fringe benefit to the employee, unless the vehicle is a "qualified nonpersonal use vehicle" under the applicable Internal Revenue Code (IRC) provisions and Treasury Regulations (Regulations). A take-home vehicle may qualify as a nonpersonal use vehicle if it is: (a) a clearly marked police, fire or public safety vehicle driven by a public safety officer who is on 24-hour call; (b) a specialized utility repair truck driven by an employee on 24-hour call to respond to emergencies; (c) an

[1] 1992 City Att'y MOL 578 (92-77; Aug. 25, 1992). A copy of the 1992 Memorandum of Law is attached to this Memorandum as Attachment A.
[2] This Office received information from the Auditor, and the Fire-Rescue and Police Departments in preparing this Memorandum.

unmarked law enforcement officer vehicle; (d) a qualified specialized utility repair truck that is not a van or pickup truck; or (e) a van or pickup truck that is specially modified such that it is unlikely to be used more than minimally for personal purposes.

As discussed below, the Fire-Rescue Department's utility vehicles probably already qualify as nonpersonal use vehicles. The marked vehicles issued to Fire-Rescue, Police, and Lifeguard Officers would most likely qualify if they were more clearly marked and driven home only when the officers are on 24-hour call to respond to emergencies. Similarly, the unmarked vans driven by Police Department crime lab employees, and the pickup trucks driven by members of the Fire-Rescue Department Bomb Squad, may already qualify as nonpersonal use vehicles. They would easily qualify if they were clearly marked with City or departmental insignia – they need not be identified as "bomb squad" or "crime lab" vehicles. Finally, the unmarked sedans and sports utility vehicles driven by civilian employees in the Police Department, and various other departments, do *not* qualify as nonpersonal use vehicles, and must be included in the employees' gross income.

ANALYSIS

I. AS A GENERAL RULE, THE VALUE OF THE PERSONAL USE OF A TAKE-HOME VEHICLE PROVIDED BY AN EMPLOYER TO ITS EMPLOYEE IS A TAXABLE FRINGE BENEFIT.

The Tax Code defines "Gross Income" as "all income from whatever source derived, including (but not limited to) . . . Compensation for services, including fees, commissions, fringe benefits, and similar items," except as otherwise provided.[3] A "fringe benefit" is a form of pay for the performance of services. IRS Publication 15-B gives the following example of a fringe benefit:

> For example, you provide an employee with a fringe benefit when you allow the employee to use a business vehicle to commute to and from work.[4]

As provided in IRC section 61, fringe benefits are taxable, absent a specific exclusion in the law. The employer must report the value of the fringe benefit in the employee's pay on a Form W-2, and withhold income and Federal Insurance Contributions Act (FICA) taxes on this amount from the employee's wages, in addition to paying the employer share of employment taxes.[5] In the case of a take-home vehicle, the employer must report the annual value of the personal use of the vehicle, which includes the use of the vehicle to commute between the employee's home and place of work. As discussed later in this Memorandum, unless the employee documents the personal and business use of the vehicle, the entire annual fair market value of the use of the vehicle must be reported as income. The valuation rules for take-home vehicles are discussed in section IV of this Memorandum.

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[3] Internal Revenue Code (IRC) § 61.
[4] Publication 15-B, Employer's Guide to Fringe Benefits (2011), http://www.irs.gov/pub/irs-pdf/p15b.pdf.
[5] IRC § 6041; Treas. Reg. § 1.6041-1(a).

A fringe benefit is excluded from income if it is a "working condition benefit," which is defined as "any property or services provided to an employee of an employer to the extent that, if the employee paid for such property or services, the payment would be allowable as a deduction under IRC section 162 or 167."[6] IRC section 162 outlines business expenses and section 167 deals with depreciation; therefore, under most circumstances the *personal* use of an employer's vehicle is a taxable benefit for the employee. However, as discussed in the following section, a vehicle that meets the requirements of a "qualified nonpersonal use vehicle" under sections 1.132-(5)(e)-(f) and 1.274-6T(a)(2) of the Regulations, is considered a "working condition benefit," and both the personal and business use of the vehicle is excluded from the employee's income.

II. IF A TAKE-HOME VEHICLE IS A "QUALIFIED NONPERSONAL USE VEHICLE," THE FULL VALUE OF ITS USE IS EXCLUDED FROM THE EMPLOYEE'S GROSS INCOME AS A WORKING CONDITION FRINGE.

Although the personal use of an employer-provided take-home vehicle is generally included in an employee's gross income, a "qualified nonpersonal use vehicle" is exempt from the substantiation and recordkeeping requirements imposed by IRC section 274(d), and the full value of the vehicle's use, including personal use, is excluded from the employee's gross income.[7] Under the Regulations issued under IRC section 274(d), a nonpersonal use vehicle is one that is not likely to be used more than minimally for personal purposes because of its design.[8]

Section 1.274-5(k)(2)(ii) of the Regulations provides, in pertinent part, that qualified nonpersonal use vehicles include the following:

> (A) Clearly marked police, fire, and public safety officer vehicles (as defined and to the extent provided in paragraph (k)(3) of this section),
>
> * * *
>
> (N) Qualified specialized utility repair trucks (as defined in paragraph (k)(5) of this section),
>
> * * *
>
> (R) Unmarked vehicles used by law enforcement officers (as defined in paragraph (k)(6) of this section) if the use is officially authorized, and
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> (S) Such other vehicles as the Commissioner may designate.[9]

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[6] Treas. Reg. § 1.132(d).
[7] Treas. Reg. §§ 1.132-(5)(e)-(f), 1.274-6T(a)(2).
[8] Treas. Reg. § 1.274-5(k).
[9] Treas. Reg. § 1.274-5(k)(2).

In addition, section 1.274-5T(k)(7) of the Regulations provides that a pickup truck or van may qualify as a nonpersonal use vehicle if it has been "specially modified" to the extent it is unlikely to be used more than minimally for personal purposes. The example given in the Regulation is a van that: (1) has only a front bench for seating, (2) has permanently installed shelving filling most of the cargo area, (3) constantly carries merchandise or equipment, *and* (4) has been specially painted with advertising or the company's name.[10]

In summary, a vehicle may qualify as a nonpersonal use vehicle if it falls under one of the following categories:

(1) The vehicle is a *qualified specialized utility repair truck* that is not a van or pickup truck, which the employer requires the employee to drive home because the employee is on call "at all times."[11]

(2) The vehicle is a *clearly marked police, fire or public safety vehicle* driven by an officer, which the employer requires the employee to drive home because the officer is on call "at all times."[12]

(3) The vehicle is a *specially modified van or a pickup truck* whose modifications make it unlikely to be used more than minimally for personal purposes.[13]

(4) The vehicle is an *unmarked law enforcement vehicle*, which is driven by a law enforcement officer, provided the use is officially authorized.[14]

Sections II. A. through D. of this Memorandum analyze whether specific City take-home vehicles qualify under any of these categories.

A. Do the Fire-Rescue Department Utility Vehicles Qualify as "Specialized Utility Repair Trucks"?

The City provides take-home utility vehicles to maintenance employees in the Fire-Rescue Department who are required to respond at all hours to calls for emergency repairs to fire and rescue facilities and equipment. These vehicles qualify as nonpersonal use vehicles if all of the following requirements are met:

(1) The truck is not a van or a pickup;

(2) The truck is specifically designed to carry heavy tools or equipment;

(3) The truck has permanent interior construction, including shelves and racks, such that it is unlikely that the truck will be used more than minimally for personal purposes;[15] and

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[10] Treas. Reg. § 1.274-5(k)(7).
[11] Treas. Reg. § 1.274-5(k)(2)(ii)(N).
[12] Treas. Reg. § 1.274-5(k)(2)(ii)(A).
[13] Treas. Reg. § 1.274-5(k)(7).
[14] Treas. Reg. § 1.274-5(k)(2)(ii)(R).
[15] Treas. Reg. § 1.274-5(k)(5).

(4) The employer requires the employee to drive the truck home in order to use it to respond to emergency situations to restore or maintain services, e.g., gas, water, sewer, electricity, steam or telephone services.[16]

The Fire-Rescue Department utility vehicles are specially and permanently equipped to carry and store heavy items, making it unlikely that they will be used more than minimally for personal purposes. The City requires the maintenance employees to drive the vehicles home in order to respond to emergency repairs, 24 hours per day. The employees are not allowed to drive the vehicles home when they are not on call. Based on these facts, the vehicles would most likely be considered "qualified specialized utility repair trucks" under section 1.274-5(k)(5) of the Regulations, and employees would not be required to document the personal and business use of the vehicles. None of the value of these vehicles would be considered a taxable benefit to employees.

B. Do the Sedans and Sports Utility Vehicles Driven Home by Fire, Police and Lifeguard Officers Qualify as "Clearly Marked Police, Fire or Public Safety Vehicles"?

The City provides take-home sports utility vehicles (SUVs) and sedans to certain high ranking Fire-Rescue and Lifeguard officers. On alternating days, these employees are on call to respond to emergencies at all hours. The doors of the vehicles are not painted with any words or insignia, but the back of the vehicles have small decals of letters spelling "Fire" and "LG" along with the City's vehicle numbers. Some of the vehicles also have small decals of the City's seal. Some of the employees are allowed to drive the vehicles home, and use them for personal errands, both when they are on and off call.

Passenger automobiles such as sedans and SUVs are generally not exempt from taxation as qualified nonpersonal use vehicles, because by design they can easily be used for personal purposes. There are two exceptions, for unmarked law enforcement vehicles and clearly marked police, fire and public safety officer vehicles.

The Fire-Rescue sedans and SUVs do not qualify as unmarked law enforcement vehicles under section 1.274-5(k)(2)(R) of the Regulations, because the personnel who drive them are not law enforcement officers as defined in the Regulations. Nonetheless, the use of the vehicles is exempt from taxation if the vehicles qualify as "clearly marked police, fire, or public safety officer vehicles."

The following criteria must be met to qualify under this category:

(1) The Vehicle is owned or leased by a governmental unit or an agency or instrumentality of a governmental unit;

(2) The fire, police or public safety officer is required to use the vehicle for commuting because the officer is on call at all times when not on a regular shift;

[16] Treas. Reg. § 1.274-5(k)(5).

(3) The governmental unit prohibits any personal use of the vehicle, other than commuting, outside the limit of the police officer's arrest powers or the fire fighter's or public safety officer's obligation to respond to an emergency; and

(4) The vehicle is clearly marked.[17]

These criteria are analyzed in more detail below.

1. Who Qualifies as a Public Safety Officer?

The Tax Code provides that the term "public safety officer" has "the same meaning given such term by the Omnibus Crime Control and Safe Streets Act of 1968, as codified at 42 U.S.C. 3796b(9)(A)."[18] Section 3796b(9)(A) defines "public safety officer" as "an individual serving a public agency in an official capacity, . . . as a law enforcement officer, as a firefighter, as a chaplain, or as a member of a rescue squad or ambulance crew."[19]

A "firefighter" includes any individual who (1) is trained in fire suppression or hazardous-material response, and (2) has the legal authority and responsibility to engage in the suppression of fire or hazardous-material response as an employee of the public agency he serves.[20]

A "rescue squad or ambulance crew" is "a squad or crew whose members are rescue rescue workers, ambulance drivers, paramedics, health-care responders, emergency medical technicians, or other similar workers" who:

(1) Are trained in rescue activity or the provision of emergency medical services; and

(2) As such members, have the legal authority and responsibility to:

(i) Engage in rescue activity; or

(ii) Provide emergency medical services.[21]

"Rescue activity" means search or rescue assistance in locating or extracting from danger persons lost, missing, or in imminent danger of serious bodily harm.[22]

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[17] Treas. Reg. § 1.274-5(k)(3).
[18] IRC § 401(1)(4)(C). The definition of public safety officer is part of the Public Safety Officer's Benefits Act (PSOB), which was enacted as part L of Title I of the Omnibus Crime Control and Safe Streets Act of 1968.
[19] 42 U.S.C. § 3796b(9)(A).
[20] 28 C.F.R. § 32.3.
[21] *Id.*
[22] *Id.*

Fire-Rescue and Lifeguard employees who are trained to engage in fire suppression, hazardous-material response, rescue activities or emergency medical services, and have the legal authority and responsibility to engage in these activities as City employees, and qualify as public safety officers, are exempt from taxation if: (1) the vehicle is driven home *only* when the officer is on call, (2) the City prohibits personal use of the vehicle at times when the officer is not obligated to respond to emergencies, and (3) the vehicle is "clearly marked."

2. What Vehicle Markings Satisfy the "Clearly Marked" Requirement?

A public safety officer vehicle is "clearly marked" if, through painted insignia or words, it is readily apparent that the vehicle is a public safety officer vehicle.[23] The supplementary information provided by the IRS to the final Regulations, under "Summary of Comments and Explanation of Provisions," states that the "clearly marked" requirement is intended to ensure that the vehicle is "readily distinguishable from vehicles routinely used for personal purposes."[24]

Beyond this, IRS guidance is very limited – and none of it addresses the question of how much marking is enough. The IRS has issued Private Letter Rulings[25] (PLR) in which the multiple factors for the clearly marked vehicle category are considered together to determine whether a public safety vehicle is a clearly-marked vehicle. Factors include the nature of the emergencies; whether the vehicle, due to its design, is able to be used for personal purposes for more than a minimal amount of time; whether the insignia indicates that the vehicle is a police, fire or public safety vehicle; and whether personal use of the vehicle is officially prohibited by the government entity.

For example, in one 1987 PLR, the IRS concluded that certain firefighting vehicles did not qualify, even though they were marked with state government insignia and the employees were required to drive them home when they were on 24-hour call:

> [a]lthough the Division employees do engage in some fire fighting activities, they also spend a substantial amount of time in other activities that are not directly related to firefighting such as distribution of tree seedlings and management of timber. . . . In addition, the insignia currently on the vehicles do not identify the vehicles as being fire vehicles.[26]

In another 1987 PLR, the IRS concluded that vehicles provided to deputy sheriffs were clearly-marked police vehicles, provided that personal use other than commuting was prohibited.[27] In that situation, the jurisdiction that provided the vehicles required its deputy sheriffs to commute to and from their homes in the vehicle, as they were on 24-hour call to respond to emergencies. The emergencies included responding to jail riots, homicides, and

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[23] Treas. Reg. § 1.274-5(k)(8).
[24] Supplementary information provided by the IRS to the final Regulations, §1.275-5(k) (2010 WL 1975836).
[25] A Private Letter Ruling (PLR) is a written determination published by the IRS relative to its position concerning the tax treatment of a specific transaction. A PLR is issued only to the taxpayer who requested the ruling, but, PLRs do indicate how the IRS may treat a similar transaction. In addition, PLRs are included in the list of authorities that constitute "substantial authority" that a taxpayer may rely upon to avoid certain statutory penalties. Treas. Reg. § 1.6662-4(d)(3)(iii).
[26] I.R.S. PLR 8748009.
[27] I.R.S. PLR 8725053.

escape attempts. The vehicles were marked with sheriff's department insignia on both doors and the deputy sheriffs were prohibited from using the vehicles for personal purposes, except for commuting. Based on this information, the IRS concluded that these vehicles were clearly marked public safety vehicles.

The SUVs and small sedans used by some of the City's high-ranking Fire-Rescue and Lifeguard officers are not "painted" with any words or insignia. The only markings are small decals of letters spelling "Fire" and "LG" on the backs of the vehicles, along with the City's vehicle numbers. Some of the vehicles also have small decals of the City's seal. The vehicles could easily be mistaken for personal vehicles, and the markings do not readily distinguish or prevent them from being used more than minimally for personal purposes. Therefore, it is likely that the IRS would conclude that these vehicles are not "clearly marked." The City should either paint the vehicles with City insignia and words or begin reporting the personal use of the vehicles as gross income to the employees who drive them.

3. Are the Public Officers On Call and is Personal Use Limited?

Even if a vehicle is clearly marked and driven by a public safety officer who is sometimes on 24-hour call, the vehicle will not qualify as a nonpersonal use vehicle if the officer is allowed to drive it home when he or she is not on 24-hour call. The vehicle must be left at work when the employee is not on call, otherwise the personal use of the vehicle must be documented by and reported as gross income to the employee. In addition, personal use of the vehicle while the employee is on call should be limited to commuting, errands on the way to and from work, and to times when the employee is required to drive the vehicle on personal errands because he or she is required to respond directly to emergencies.

C. Do the Unmarked Police Crime Scene Investigation Vans and Fire Department Bomb Squad Pickup Trucks Qualify as "Specially Modified Vans or Pickup Trucks"?

Section 1.274-5(k)(7) exempts from the substantiation requirements (and thus from taxation) a pickup truck or van that has been specially modified such that it is not likely to be used more than minimally for personal purposes. This exemption applies to the use of the vehicle because of its design and not because of the nature of the employee's services, such as being on 24-hour call.[28] Also, this exemption applies only to pickup trucks and vans, and not to vehicles such as sedans, SUVs, or station wagons.[29]

An example given by the IRS of a vehicle that would fit within this exemption is a van that: (1) is marked with a permanently affixed decal, special painting, or other advertising associated with the business or function, (2) has a seat only for the driver (or the driver and one other person), and (3) has either of the following items: (a) permanent shelving that fills most of the cargo area; or (b) an open cargo area that always carries merchandise or equipment used in the trade, business, or function.[30]

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[28] Rev. Rul. 86-97, 1986-2 C.B. 42.
[29] I.R.S. PLR 8730062.
[30] I.R.S. Publ'n 15-B; *see* Qualified Nonpersonal Use Vehicles, 75 Fed. Reg. 27,934-01 (May 19, 2010) (to be codified at 26 C.F.R. pt. 1).

If the van or pickup truck does not meet all of the above criteria, the van may still qualify if it satisfies requirements "similar" to those above.[31] In such cases, however, the IRS advises that the taxpayer contact the local district director for guidance.

The City's Police Department crime scene investigators (CSI) are required to commute home in lab vans because they are on call at all hours. The vans are unmarked, but have exempt license plates. The interiors of the vans are completely outfitted with lab equipment. All personal use of the vehicles, other than commuting to and from work, is prohibited by policy, and employees do not drive the vehicles home unless they are on call. The CSI are not sworn officers and the van is not a maintenance vehicle. The members of the Fire-Rescue Bomb Squad are required to commute home in pickup trucks that are permanently modified to carry "day boxes" and robots, and actually carry these items. The City does not wish to mark the vehicles in a way that identifies them as "CSI" or "Bomb Squad" because of the sensitive nature of their cargo.[32]

Although the lab vans used by CSI and the pickup trucks used by the Bomb Squad do not have exterior markings or painting identifying them as City vehicles, they may still meet requirements similar to those set forth in section 1.274-5(k)(7) of the Regulations. The vehicles are unlikely to be used more than minimally for personal purposes because of their design. The interiors of the CSI vans are completely outfitted with crime scene processing equipment including cameras, ladders, boxes, bags, radios, lighting equipment, fingerprint supplies, and casting materials. The Bomb Squad pickup trucks are also specially and permanently modified to carry necessary equipment. However, because the vehicles are not marked, they do not meet all of the requirements in the Regulations. To ensure that the vehicles qualify as nonpersonal use vehicles, the City should either seek guidance from the IRS local district director, or mark the sides of the vehicles with permanently affixed decals or special painting, indicating that they are City Police or Fire-Rescue Department vehicles. At a minimum, the vehicles should be marked with City insignia. There is no requirement that they be specifically identified as CSI or Bomb Squad vehicles.

D. The Take-Home Use of an Unmarked Sedan is Taxable if the Employee is not a "Law Enforcement Officer"

An unmarked passenger vehicle such as a sedan, SUV, or station wagon will not qualify as nonpersonal use vehicle unless it is driven by a "law enforcement officer." This is because a passenger vehicle is, by reason of its design, likely to be used more than minimally for personal purposes.

The value of the use of an unmarked police vehicle is excluded from income when the following conditions are met:

(1) the vehicle is used by a "law enforcement officer";

(2) the use is "incident" to law enforcement functions;

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[31] Rev. Rul. 86-97, 1986-2 C.B. 42.

[32] The CSI and Bomb Squad members do not qualify as law enforcement officers or public safety officers and therefore could not satisfy the requirements of driving an unmarked police vehicle or clearly marked vehicle.

(3) the City authorizes the personal use; and

(4) the use is not for vacation or recreational trips.

A "law enforcement officer" is defined as a full-time employee responsible for the prevention or investigation of crime involving injury to persons or property. The officer must be authorized by law to carry firearms, execute search warrants, and make arrests. Also the officer must, *in fact*, regularly carry firearms—except when it is not possible to do so because the officer is undercover.[33]

Personal use of the vehicle must be authorized by the governmental agency or department that owns or leases the vehicle, and the authorizing body must specifically prohibit the use of the vehicle for recreational purposes and vacations. The authorizing body may be the City Council, the Mayor, or the department head.

The use of the vehicle must be incident to law enforcement functions, meaning that the vehicle is provided to allow the officer to report directly from home to a stakeout, surveillance site, or emergency. Use of the unmarked vehicle for commuting between the workplace and home and for personal errands is "incident" if the car is needed to enable the officer to report directly to stakeouts, surveillances, or emergencies.[34] The employee's take-home use of the vehicle is a taxable benefit if any of these requirements is not met (unless the vehicle qualifies under another nonpersonal use vehicle category).

1. Unmarked Sedans Driven by Civilian Police Department Employees

Based on the information provided to the City Attorney's Office, there are three unmarked take-home police vehicles that are driven by Police Department employees who are not "law enforcement officers" or "public safety officers." All three vehicles are unmarked sedans, but are equipped with police radios and exempt license plates. As discussed below, none of these vehicles qualifies as a nonpersonal use vehicle.

One of the unmarked police vehicles is driven by the Director of the STAR/PAL program (Director), which is a nonprofit organization that provides youth services to inner-city neighborhoods throughout the City and County of San Diego. Personal use of the vehicle is prohibited, other than commuting to and from work. The Director is not a police officer and is not on 24-hour call, but she is regularly required to attend meetings outside of office hours. The Director is required to use the City-provided vehicle because she goes into unsafe areas and needs to have the police radio. The trunk of the car is filled with materials needed for the employee's presentations and programs, but the vehicle is not permanently modified to carry these materials. The other two vehicles are driven by high-ranking civilian employees of the Police Department. There is nothing about the design of the vehicles that makes them unlikely to be used more than minimally for personal purposes.

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[33] Treas. Reg. § 1.274-5(k)(6)(ii).
[34] Treas. Reg. § 1.274-5(k)(8), examples (1) and (2).

Because the employees are not law enforcement officers, the unmarked vehicle exception does not apply. Even if the vehicles were to be clearly marked with Police Department insignia, they still would not qualify under the clearly marked vehicle exception, because the employees who drive them are not police or public safety officers.

The vehicles also would not qualify for the exception for specially modified vans and pickup trucks. Although the vehicles are equipped with police radios and one is filled with materials needed for presentations, the vehicles are not vans or pick-up trucks and are not modified in such a way that personal use is unlikely. Accordingly, the vehicles are not exempt from the substantiation requirements, and any personal use of the vehicle, including commuting to and from work, will have to be recorded. Otherwise, the entire value of the use of the vehicle must be reported as income to the employees.

2. Unmarked Sedans Driven by Employees in Other Departments

Information provided to this Office indicates that there are a number of unmarked sedans and other passenger vehicles driven home by employees in various City departments, other than Police, Fire-Rescue and Lifeguards. None of the employees who drive these vehicles is a law enforcement officer or a police, fire, or public safety officer. The vehicles are not permanently modified vans or pickup trucks, and they are not specialized utility repair trucks. Therefore, regardless of whether or not the employees are on call or are required to drive the vehicles home, the vehicles do not qualify under the Regulations, and the employees driving them must begin documenting their personal and business use of the vehicles. Otherwise, the City must report the entire value of the use of the vehicles as income to the employees.

III. IF A TAKE-HOME VEHICLE DOES NOT FIT UNDER THE DEFINITION OF A "QUALIFIED NONPERSONAL USE VEHICLE," WHAT IS THE REQUIRED METHOD OF RECORDING THE USAGE THAT IS REPORTED AS TAXABLE AND HOW SHOULD THE TAXABLE BENEFIT BE COMPUTED?

The amount included in income for fringe benefits is the fair market value of the benefit, which usually means the lease value of the vehicle.[35] The fair market value of a car is based on all the facts and circumstances, and in general, is the amount a hypothetical person would have to pay a hypothetical third party to lease the same or comparable vehicle for one year on the same or comparable terms in the geographic area in which the car is used. Accordingly, any special relationship between the employer and the employee must be disregarded, and an employee's subjective perception of the value of the car is irrelevant to the determination of the vehicle's fair market value. A valuation based on the fair market value of the benefit must be used unless a permitted special valuation rule is used.

[35] Treas. Reg. §§ 1.162-2(d), 1.132-5(b).

There are three methods for computing the fringe benefit value of the use of an employer's vehicle: (1) the "annual lease value" of the car (i.e., based on the "special rule");[36] (2) the cents-per-mile method;[37] and (3) the commuting value method.[38] 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 for the car cannot be determined by reference to the cents-per-mile method. For this reason, only the annual lease value and commuting value methods are discussed in this Memorandum.

A. The Annual Lease Value Method

Under the annual lease value method, the annual value of the employee's personal use of the vehicle is the amount it would cost an employee to lease a like vehicle for the tax year less the amount of use which would be considered a working condition fringe to the employee. To qualify as a working condition fringe, the business use of the vehicle must be deductible as a business expense by the employee. Thus, the employee must keep a record of the miles that were driven for personal and business purposes.[39] For these purposes, commuting between the employee's home and place of business is considered personal use, even if it is done outside the employee's regular work hours.[40]

The amount included in income for fringe benefits is the fair market value of the benefit, which in the case of a vehicle, means its annual lease value.[41] The fair market value of a vehicle is based on all the facts and circumstances and, in general, is the amount a hypothetical person would have to pay a hypothetical third party to lease the same or comparable vehicle for one year on the same or comparable terms in the geographic area in which the car is used.[42] The City must report the full annual value of leasing the vehicle, unless the employee provides records documenting the personal and business use of the vehicle.

The annual lease value of an automobile is calculated by determining its fair market value and then referring to the Annual Lease Value Table in the Regulations.[43] The employer may use a "safe harbor value" to determine the fair market value of the automobile. The "safe harbor value" of an automobile *owned* by the employer is the employer's cost of buying the vehicle, provided the purchase is made at arm's length.[44] This includes sales tax, title, and other expenses

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[36] Treas. Reg. § 1.61-21(d)(2).
[37] Treas. Reg. § 1.61-21(e).
[38] Treas. Reg. § 1.61-21(f).
[39] *See* I.R.S. Publ'n 15-B.
[40] On the IRS website, the IRS explains that if a fire chief uses his own truck to travel to and from the fire station outside of his regular work schedule, this commute is still considered a personal expense and is taxable to the employee. But, if the employee is going to a meeting on the way to the office, the employee may deduct the additional mileage over that required to get to work. http://www.irs.gov/govt/fslg/article/0,,id=112717,00.html#3.
[41] Treas. Reg. §§ 1.162-2(d), 1.132-5(b).
[42] To the extent it would affect the cost of purchasing or leasing the vehicle, any special relationship between the employer and the employee (or between the employer and the provider of the vehicle), must be disregarded.
[43] Reg. § 1.61-21(d)(2)(iii).
[44] Treas. Reg. § 1.61-21(d)(5)(ii)(A).

attributable to the purchase. The "safe harbor value" of an automobile *leased* by the employer is either the manufacturer's suggested retail price less 8% or the retail value of the automobile as reported in a nationally recognized publication that regularly reports new or used automobile retail value.[45]

B. The Computing Method

The City may be able to use the commuting value method to determine the annual value of the employee's personal use of the vehicle, provided the following requirements are met:

(1) the vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business;

(2) the employer, for bona fide non-compensatory business reasons,[46] requires the employee to commute to or from work in the vehicle;

(3) the employer has established a written policy under which the employee may not use the vehicle for personal purposes other than for commuting or *de minimis* personal use (e.g. a stop for a personal errand on the way home from a business delivery);

(4) the employee, except for *de minimis* personal use, does not use the vehicle for any personal purposes other than commuting; and

(5) the employee who is required to use the vehicle is not a control employee.[47]

The commuting use of an employer-provided car is valued at $1.50[48] per one-way commute (that is, from home to work or from work to home). The $1.50 commuting value includes goods and services directly related to the vehicle, such as fuel. If more than one employee commutes in the car, such as an employer-sponsored carpool, the amount includible in the income of each employee is still $1.50 per one-way commute. No difference exists between the reporting methods of valuation for sworn or non-sworn officers.

Employees are required keep records to substantiate the business use of the employer provided vehicles.[49] If an employer provides a vehicle that is used for both business and personal purposes, the substantiated business use is not taxable to the employee. However, the personal use is taxable to the employee as wages.[50] If the employee does not have records, all of the use of the vehicle is considered wages to the employee.[51]

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[45] Treas. Reg. § 1.61-21(d)(5)(iii)(C).
[46] "Bona fide non-compensatory business reasons" means that employees are required to commute in the vehicle for purposes that benefit their employer.
[47] As of 2011, a control employee of a government employer is an elected official or an employee who is compensated $145,700 or more for the year. Treas. Reg. § 1.61-21(f)(6).
[48] *Id.*
[49] Treas. Reg. § 1.132-5(2010); I.R.C. § 274(d).
[50] Treas. Reg. § 1.61-21(2010).
[51] Treas. Reg. § 1.132-5(b).

The regulations make clear that approximations or unsupported testimony regarding the business use of a car will not be considered in determining the accuracy of a tax deduction or credit.[52] The IRS will consider the following as being "adequate records" in order to substantiate a claimed deduction for expenses related to the use of a vehicle: (1) account books, diaries, and logs; (2) documentary evidence (e.g., receipts and paid bills); (3) trip sheets; (4) expense reports; or (5) written statements of witnesses.

IV. THE CITY IS LIABLE TO THE UNITED STATES GOVERNMENT FOR FAILING TO CORRECTLY REPORT WITHHOLDINGS ON EMPLOYEE W-2s

Both employers and employees are responsible for reporting, withholding, and transmitting federal income and FICA taxes to the IRS. Generally, the employer withholds these taxes on behalf of their employees, but where the employer does not do so, the employee is responsible for paying withholding taxes. Employees who do not have taxes withheld and do not remit them to the IRS personally, are still liable to the IRS.

"Federal law requires employers to withhold income, social security, and Medicare taxes from employee wages and remit those taxes to the United States."[53] These taxes are referred to as trust fund taxes.[54] An employer may, however, elect not to withhold income taxes on the taxable use of an employer's vehicle if the employer notifies the employee and includes the benefit in the employee's wages on the W-2. The IRS imposes penalties on employers who fail to withhold trust fund taxes.[55] This liability is in favor of the United States, not for the employee.[56]

Therefore, an action for failure to withhold lies with the government; there is no right of action allowing employees to sue their employers for failing to withhold taxes.[57] However, if a mistake on an employee's W-2 form is brought to the employer's attention, the employer should promptly correct the information to avoid exposing the City to a negligence cause of action by the employee.[58]

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[52] Treas. Reg. § 1.274-5T.

[53] *Rumfelt v. Jazzie Pools, Inc.*, 2011 WL 2144553, at *4 (E.D. Va. May 31, 2011) (quoting *Newbill v. United States*, No.1:10cv41, 2010 WL4852652, at *1 (E.D.Va. Nov. 22, 2010)). No City of San Diego employees are currently covered by Social Security.

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] *Id.* (citing *Arvin v. Go Go Inv. Club*, No. 97-15307, 1997 WL 709329, at *1 (9th Cir., Nov. 13, 1997)); *Ford v. Troyer*, 25 F. Supp. 2d 723, 726 (E.D. La. 1998) ("It is without question that there is no express right of action for an employee to sue his employer under the IRC for failure to comply with federal tax statutes"); *see DiGiovanni v. City of Rochester*, 680 F. Supp. 80 (W.D.N.Y. 1998) (finding there is no private cause of action for an employee under the federal income tax withholding statutes).

[58] There are few published decisions addressing employer liability to an employee for failure to report accurate information on a W-2. One such case is *Clemens v. USV Pharmaceutical*, 838 F.2d 1389 (5th Cir. 1988), in which the court found the employer liable for not correcting a W-2 that falsely stated that the employee had received income when in fact the employee was retired. The employer failed to correct the W-2 for two years after the former employee brought it to the employer's attention. As a consequence of the employer's actions, the employee was forced to endure a costly and time-consuming IRS investigation.

Here, the City did not withhold income or Medicare taxes on its employees' use of take-home vehicles, some of which may not be exempt from taxes as a working condition fringe. Further, the City did not include the benefit in the employees' wages on their W-2s. If some of the City's take-home vehicles for the past years did not fall under any of the categories for "qualified nonpersonal use vehicles," described below, the City may have to pay back taxes, penalties, and interest.

A. The Statute of Limitations for an IRS Audit of a Tax Return is Generally Three Years, Unless the City Acted "Willfully"

Generally, the statute of limitations for an IRS audit of a tax return is three years.[59] However, if the IRS determines that there are significant mistakes on a return, it can review returns that were filed more than three years ago. There is no limitations period for a false or fraudulent return with the intent to evade tax. Under 26 U.S.C. § 7202, a "willful" failure to collect or pay taxes is a criminal offense. Violations include the employer's failure to withhold income taxes from employees' wages. To be liable for this offense, the employer must have a duty "to collect, truthfully account for, and pay over [the] tax," fail to "collect or truthfully account for and pay over such tax" and the failure must have been willful.[60] According to the Department of Justice Tax Division, the statute of limitations is six years if all of the elements are met.

To determine whether the limitations period for the City will be six years, it must first be determined whether the City acted "willfully." "Willfulness" under Title 26 is defined as the "voluntary, intentional violation of a known legal duty."[61] It is not required to establish an evil or bad purpose to establish willfulness.

Here, it is unlikely that the City acted "willfully" when it failed to withhold taxes for its employees' use of City vehicles. If a vehicle qualifies as a "nonpersonal use vehicle," both personal and business uses of the vehicle would be excluded from income as a working condition fringe. As discussed in this Memorandum, there is at least a colorable argument that most of the City's take-home vehicles are nonpersonal use vehicles. Therefore, it is unlikely that the City's failure to report the personal use of these vehicles would be seen as "willful," meaning that the limitations period for the City is probably three years for these vehicles.

CONCLUSION

As a general rule, the annual value of an employer-provided take-home vehicle must be included in the employee's gross income. The employer must report the full value of the vehicle's benefit, and withhold income and FICA taxes on that amount, unless the employee keeps records substantiating the business and personal use of the City-provided vehicle.

The employee is relieved from keeping records of the vehicle's use if the vehicle is a qualified nonpersonal use vehicle, in which case none of the employee's use of the vehicle is considered taxable income.

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[59] 26 U.S.C. § 6501.
[60] 26 U.S.C. § 7202.
[61] 26 U.S.C. § 7202.

The following vehicles meet the definition of a qualified nonpersonal use vehicle: (1) a clearly marked police, fire, or public safety vehicle driven by a police, fire, or public safety officer; (2) a qualified specialized utility repair truck; (3) an unmarked vehicle used by law enforcement officers if the use is officially authorized; and (4) a truck or van that has been specially modified to the extent that it is not likely to be used more than a *de minimis* amount for personal purposes.

The utility vehicles provided by the Fire-Rescue Department most likely qualify as nonpersonal use vehicles. The marked vehicles issued to Fire-Rescue, Police, and Lifeguard Officers would qualify if they were more clearly marked, provided they are driven home only when the officers are on 24-hour call to respond to emergencies. Likewise, the unmarked vans driven by Police Department crime lab employees, and the pickup trucks driven by members of the Fire-Rescue Department Bomb Squad, *may* qualify as nonpersonal use vehicles, but to ensure that they qualify, the City should have them clearly marked with City or departmental insignia – they need not be identified as "bomb squad" or "crime lab" vehicles.

Finally, unmarked sedans and sports utility vehicles driven by civilian employees clearly do *not* qualify as nonpersonal use vehicles, and must be included in the employees' gross income prospectively. In addition, the Comptroller should work with this office to correct the City's reporting and withholding for the past three tax years for these employees.

JAN I. GOLDSMITH, CITY ATTORNEY

By /s/
Roxanne Story Parks
Deputy City Attorney

RSP:ccm
Attachment
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Document #283144.doc

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MEMORANDUM OF LAW

DATE: August 25, 1992

TO: Eugene Ruzzini, Audit Division Manager

FROM: City Attorney

SUBJECT: Tax Implications of Take Home City Vehicles

Recently the issue of City employees take home use of City vehicles has raised concerns about the tax implications of this practice. This is especially true of police department personnel because of the extensive use of unmarked vehicles. As a result, an audit of the subject is being conducted by your department and a number of questions have arisen. You have asked for a legal response to those questions. The questions you have asked are numerous and involved, therefore each question will be addressed separately. The following responds to your questions.

QUESTION: 1. Is driving to and from work "commuting" in a Police or Fire vehicle a taxable benefit to the employee?

- **In a marked vehicle?**
- **In an unmarked vehicle?**
- **By a sworn officer?**
- **By a non-sworn officer?**

RESPONSE: As a general rule, personal use of an employer provided vehicle is includible in an employee's gross income. However, gross income does not include the value of a working condition fringe. "A 'working condition fringe' is any property or service provided to an employee of an employer to the extent that, if the employee paid for the property or service, the amount paid would be allowable as a deduction under section 162

or 167." Treas. Reg. § 1.132.5 (1992). (All regulation citations hereafter are to Treasury Regulations.) Internal Revenue Code ("IRC") section 162 outlines business expenses and section 167 deals with depreciation, therefore, under most circumstances the personal use of an employer's vehicle would be a taxable benefit for the employee.

However, the value of the use of a "nonpersonal use vehicle" is not taxed because it is a "working condition fringe" benefit. Treas. Reg. § 1.132-5(h) (1992).

Nonpersonal use vehicles are defined as follows:

> **Exceptions for qualified nonpersonal use vehicles - (1) In general.** The substantiation requirements of section 274(d) and this section do not apply to any qualified nonpersonal use vehicle (as defined in paragraph (k)(2) of this section).
>
> **(2) Qualified nonpersonal use vehicle - (i) In general.** For purposes of section 274(d) and this section, 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.
>
> **(ii) List of vehicles.** Vehicles which are qualified nonpersonal use vehicles include the following-
>
> (A) Clearly marked police and fire vehicles (as defined and to the extent provided in paragraph (k)(3) of this section),
>
> (B) Ambulances used as such or hearses used as such,
>
> (C) Any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds,
>
> (D) Bucket trucks ("cherry pickers"),
>
> (E) Cement mixers,
>
> (F) Combines,

(G) Cranes and derricks,

(H) Delivery trucks with seating only for the driver, or only for the driver plus a folding jump seat,

(I) Dump trucks (including garbage trucks),

(J) Flatbed trucks,

(K) Forklifts,

(L) Passenger buses used as such with a capacity of at least 20 passengers,

(M) Qualified moving vans (as defined in paragraph (k)(4) of this section),

(N) Qualified specialized utility repair trucks (as defined in paragraph (k)(5) of this section),

(O) Refrigerated trucks,

(P) School buses (as defined in section 4221(d)(7)(C)),

(Q) Tractors and other special purpose farm vehicles,

(R) Unmarked vehicles used by law enforcement officers (as defined in paragraph (k)(6) of this section) if the use is officially authorized, and

(S) Such other vehicles as the Commissioner may designate.

Treas. Reg. § 1.274-5T(k)(6) (1992) (emphasis added).

Therefore, under the regulations, commuting in a marked police or fire vehicle is not a taxable benefit to the employee. This assumes, however, that the marked vehicle is essential to the officers use for some purpose. Use of a canine car for commuting is one example because the officer and the dog must be together at all times. The value of the use of an unmarked

police vehicle is also excluded from income when the following conditions are met:

1. It is used by a "law enforcement officer."

2. Use is "incident" to law-enforcement functions.

3. The City authorizes the personal use.

4. Use is not for vacation or recreation trips. (However, see question number four.)

A law enforcement officer is defined as a full-time employee responsible for the prevention or investigation of crime involving injury to persons or property. The officer must be authorized by law to carry firearms, execute search warrants, and make arrests. Also the officer must, in fact, regularly carry firearms. Treas. Reg. § 1.274-5T(k)(6)(ii) (1992).

Use is incident to law enforcement functions when the car is required for the officer to report directly from home to a stakeout or surveillance site or to an emergency. For example, used of the unmarked vehicle for commuting between workplace and home and for personal errands is "incident" when the car otherwise is needed to report to an emergency, etc. Treas. Reg. § 1.274-5(k)(8) (1992), Examples (1) and (2).

The City Council does not have to be the authorizing body. Authorization can be granted by the police department. It clearly also is best if the police department specifically prohibits use of the car for recreational purposes and vacations. Id.

Thus, under the above rules, use of a marked police vehicle is not taxable to an employee because of the nature of the vehicle. Use of an unmarked vehicle is taxable to an employee unless the above conditions are met. Use of an unmarked vehicle by an employee who could not meet the law enforcement officer's criteria would therefore be a taxable benefit.

Recordkeeping is required for all taxable personal use of an employer's vehicle unless one of the exceptions is present. The substantiation requirements of Internal Revenue Code ("IRC") section 274(d) are satisfied by adequate records or sufficient evidence corroborating the employee's own statement. Therefore, such records or evidence provided by the employee, and relied upon by the employer to the extent permitted by the regulations promulgated under IRC section 274(d), will be sufficient to substantiate a working condition fringe exclusion.

QUESTION: 2. Is driving to and from work "commuting" in a non-Police/Fire vehicle a taxable benefit to the employee?

- **In a marked vehicle?**
- **In an unmarked vehicle?**

If the answer is no, are there any restrictions or conditions that must be met? Is any recordkeeping required?

RESPONSE: There is no difference between marked and unmarked City vehicles except for police and fire vehicles. Driving to and from work in an unmarked City vehicle, in most circumstances, is commuting. Use of a City vehicle for commuting is considered non-personal use if the vehicle is one of the vehicles specifically listed in the response to question number one and is therefore not a taxable benefit. For example, an employee who drives a City water truck home so that he or she may report directly to an offsite worksite the following day would not be receiving a taxable benefit. However, an employee who uses a pool car that is marked with a City seal and an employee using an unmarked City vehicle would each receive a taxable benefit because personal use is not precluded simply by the nature of the vehicle. Separate regulations have been promulgated for use of employer vehicles for car pool purposes. The same reporting and recordkeeping requirements as found in question number one must be met.

QUESTION: 3. If the answers to the questions 1 and 2 are yes, what is the required method of recording the usage that is reported as taxable and how should the taxable benefit be computed?

- **Is there a reporting difference between sworn officers and non-sworn officers?**
- **If an employee reimburses the City for personal usage, what rate should be used for this reimbursement?**

RESPONSE: Generally, if an employee uses an employer-provided car for personal purposes, the employer must determine the value of such use and add the value to the employee's wages as reported on his Form W-2. If the value of an employer-provided fringe benefit is considered to be part of an employee's taxable wages, the employer must generally withhold income tax and the tax under the Federal Insurance Contributions Act (FICA) from the employee's wages in addition to paying its share of

employment taxes under FICA and FUTA (i.e., the Federal Unemployment Tax Act).

There are four methods for computing the fringe benefit value of the use of an employer's vehicle. They are:

1. the fair market value of the benefit, Treas. Reg. § 1.61-2T(b)(4) (1992), or

2. the value based on the "annual lease value" of the car (i.e., based on the "special rule"), Treas. Reg. § 1.61-2T(d) (1992)

3. the value computed using the cents-per-mile method, or Treas. Reg. § 1.61-2T(e) (1992)

4. the value computed using the commuting value method. Treas. Reg. § 1.61-2T(f) (1992).

A valuation based on the fair market value of the benefit must be used unless a permitted special valuation rule is used. The fair market value of a car is based on all the facts and circumstances, and, in general, is the amount a hypothetical person would have to pay a hypothetical third party to lease the same or comparable car for one year on the same or comparable terms in the geographic area in which the car is used. Accordingly, any special relationship between the employer and the employee must be disregarded, and an employee's subjective perception of the value of the car is irrelevant to the determination of the car's fair market value. 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 for the car cannot be determined by reference to a cents-per-mile method.

Special valuation rules are available for determining the value of the use of an automobile as a fringe benefit. The use of any of the special valuation rules is optional. Furthermore, an employer need not use the same special valuation rule for all vehicles provided to all employees. For example, an employer may use the automobile lease valuation rule for automobiles provided to some employees, and the commuting and vehicle cents-per-mile valuation rules for cars provided to other employees.

If an employer uses one special valuation rule, the employee may not use another special rule. However, the employee may use the general valuation rule (see above) even though his employer is using a special valuation rule. Furthermore, if the employer and employee both use a special rule, the employee must include in gross income the same amount as determined by his employer less any amount reimbursed by the employee to the employer.

A particular special valuation rule is deemed to have been elected if the employer (and, if applicable, the employee) reports the value of the fringe benefit by applying the special valuation rule and treats such value as the fair market value for income, employment tax, and other reporting purposes. No special notification to the IRS is required.

The fair market value rule is the general rule. The fair market value of an automobile is the amount that an individual would have to pay in an arm's length transaction. The purchase price amount includes all amounts attributable to the purchase, such as sales tax and title fees.

The annual lease value rule is one of the special optional methods of valuing the use of a car as a fringe benefit. The value is determined by evaluating what it would cost an employee to lease a like car for the tax year.

Each of the above methods of valuation would be useful only if a single employee has total control and use of the vehicle for the entire year. Of more practical use to the City is the cents-per-mile value rule.

The cents-per-mile valuation rule may only be used to value the miles driven for personal purposes. Accordingly, the employer must include in the employee's income the number of personal miles driven by the employee and the appropriate cents-per-mile rate. "Personal miles" encompass all miles for which the employee used the car except those driven in the employee's trade or business as an employee of the employer.

Finally, the City may use the commuting valuation method. The commuting use of an employer-provided car is valued at $1.50 per one-way commute (that is, from home to work or from work to home) if the following requirements are met:

1. The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business.

2. The employer, for bona fide noncompensatory business reasons, requires the employee to commute to or from work in the vehicle.

3. The employer has established a written policy under which the employee may not use the vehicle for personal purposes other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home).

4. The employee, except for de minimis personal use, does not use the vehicle for any personal purposes other than commuting.

5. The employee required to use the vehicle for commuting is not a control employee of the employer.

A control employee of a government employer is either:

1. an elected official, or

2. an employee whose compensation is at least as great as a federal government employee at Executive Level V.

The $1.50 commuting value includes goods and services directly related to the vehicle, such as fuel. In the event that more than one employee commutes in the car such as an employer-sponsored car pool, the amount includible in the income of each employee is $1.50 per one-way commute. Finally, the rule may not be used to value the commuting use of passengers of chauffeur-driven cars. However, the rule may be applied to value the commuting use of the car by the chauffeur.

No difference exists between the reporting methods of valuation for sworn or non-sworn officers. Keep in mind, however, that if a sworn officer has use of the car for a qualified non-personal use (see question number one), there is no taxable benefit to the employee.

No specific information was found on the rate of reimbursement if the employee is reimbursing the City. However, the 1992 mileage rate, pursuant to the treasury regulations, is twenty-eight cents (.28) per mile. Presumably, if the employee is reimbursing the City for use of a vehicle, the same rate could be used.

QUESTION: 4. In addition to commuting what are the guidelines for personal use?

- **In a marked vehicle?**
- **In an unmarked vehicle?**
- **Are there limits or restrictions?**
- **How should the personal use be reported?**
- **What is the relationship between personal use and personal use necessary to help enforce the law?**
- **Is there a difference between usage in the City limits versus usage outside the City limits?**

RESPONSE: As indicated in question number one, it is assumed by the regulations that plainly marked vehicles will be used for only de minimis personal use because of the nature of the vehicle. Therefore, no guidelines are necessary. Personal use in an unmarked police vehicle may be permitted only for an officially authorized "law enforcement officer." To qualify for this exception, any personal use must be authorized by the Federal, State, county, or local governmental agency or department that owns or leases the vehicle and employs the officer, and must be incident to law enforcement functions, such as being able to report directly from home to a stakeout or surveillance site, or to an emergency situation.

Use of an unmarked vehicle for vacation or recreation trips cannot qualify as an authorized use. However, if the officer is "on call," careful attention must be given to the details of how "on call" is defined. To overly restrict the officers actions while on call might invoke the wage and hours provisions of the Fair Labor Standards Act ("FLSA"). For example, in Madera Police Officers Assn. v. City of Madera, 36 Cal. 3d 403, 412 (1984), the Court said if there are no restrictions on officers who are on twenty-four hour call, other than the duty to report to work, if they are reached, and the officers do not have to be available for immediate recall at a specific phone number, no FLSA problems arise. Thus, recreational use of the unmarked vehicle, such as going to the movies, would be taxable. On the other hand, if the officer must be always available by telephone through the use of a pager, and is thus carefully restricted in his or her actions, recreational use would be non-taxable. All other personal uses, such as errands, to the extent it is necessary for an officer to

be available, may be authorized without losing the tax-free status.

The substantiation rules, which apply to such business deductions as travel, entertainment and gifts, require that tax deductions and credits that are related to the enumerated types of business expenses be substantiated by either adequate records or by sufficient evidence, either oral or written, corroborating the taxpayer's own statement. The IRS regulations make clear that approximations or unsupported testimony regarding the business use of a car will not be considered in determining the accuracy of a tax deduction or credit. Thus, the Cohan rule, which permitted deductions based upon approximations and unsupported testimony, may not be relied upon.

The IRS will consider the following as being "adequate records" in order to substantiate a claimed deduction for expenses related to the use of a car:

1. account books, diaries, and logs;

2. documentary evidence (e.g., receipts and paid bills);

3. trip sheets;

4. expense reports; or

5. written statements of witnesses.

The level of detail required in an adequate record to substantiate business use of a car may vary depending upon the facts and circumstances. The same type of records should be kept to separate personal from business use.

There is apparently no distinction made between in City, and outside the City, usage. The only prohibition is that barring recreation and vacation use. Based on this prohibition, one would assume that usage would be primarily within the city or, at most, the county.

QUESTION: 5. How would you define minimal personal purposes as used for qualified nonpersonal use vehicles?

RESPONSE: The de minimis exception provides that, if the value of the employee's use of the car is so small as to make accounting for it unreasonable or administratively impracticable, then such value need not be included in the employee's wages. The de minimis exception clearly applies in situations where the employee uses the car to drive to lunch or to make an occasional

detour to go shopping. Care must be exercised, however, to ensure that such personal use does not become so frequent or significant that it is removed from the de minimis exception. IRC § 132(e).

QUESTION: 6. What are the guidelines that establish a marked vehicle?

RESPONSE: A police or fire vehicle is clearly marked if, through painted insignia or words, it is readily apparent that the vehicle is a police or fire vehicle. A marking on a license plate is not a clear marking for purposes of this paragraph (k).

Treas. Reg. § 1.274-5T (1992).

QUESTION: 7. Are motorcycles used by the Police Department considered vehicles? If not, what are the reporting requirements?

RESPONSE: Motorcycles are not specifically mentioned as a vehicle in the regulations. However, Treas. Reg. § 1.61-21(f)(4) (1992) states in pertinent part:

> (4) **Definition of vehicle.** For purposes of this paragraph (f), the term "vehicle" means any motorized wheeled vehicle manufactured primarily for use on public streets, roads, and highways. The term "vehicle" includes an automobile as defined in paragraph (d)(1)(ii) of this section.

Additionally, clearly marked police motorcycles would fit within the parameters of the qualified nonpersonal use vehicles listed in question number one.

QUESTION: 8. Is the City liable in the event of an accident in a City vehicle that is taken home by an employee?

- **While commuting?**
- **While on personal business?**

RESPONSE: Liability will always be an issue any time a City vehicle is involved in an accident. Whether liability is actually imputed to the City will depend on the individual circumstances of each case. The number of potential permutations

of the various factors is enormous. Due to the potential complexities of each variation, it is best to address each case as it arises, especially in light of the California Supreme Court's expansive view of the course and scope of employment in Mary M. v. City of Los Angeles, 54 Cal. 3d 202, 203 (1991).

JOHN W. WITT, City Attorney

By Sharon A Marshall
Sharon A. Marshall
Deputy City Attorney

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