

# Firehouse Lawyer

Volume 7, Number 12

December 6, 2007

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## Taxability of Fringe Benefits

Attendees at the WFCA Conference in Pasco, Washington, in late October may have attended the session in which an IRS special agent discussed (among other topics) the taxability of certain fringe benefits commonly given by fire service employers. Since the same IRS agent has recently done a "compliance check" of one of my larger fire district employers, and delved into some of the same issues, I decided it might be timely to write about this subject, which may be of interest to our increasing number of readers from other states in the nation.

While I am not a tax attorney by any stretch of the imagination, and disclaim any great expertise in this area, I **am** able to read and understand the IRS regulations and publications dealing with this subject. In this article, I will simply try to paraphrase IRS regulations and guidance, using as my primary source a recent IRS "Taxable Fringe Benefit Guide" dated January 2007. The purpose of this article, therefore, is to alert the readers about the issues surrounding taxability of fringe benefits, and your responsibilities as employers to participate in the documentation or retention of records, to support and substantiate a taxpayer's position. At times during the article my purpose is merely to set forth the IRS position on certain items, and not to agree or disagree with their position or interpretation. However, at other times I will attempt to add my thoughts. Hopefully, I will be clear in each case as to which of those two modes of expression are being used!

This article focuses on the taxability or exclusion of the following, as income to the employee: **meals paid by employer, education programs, employer-provided clothing such as uniforms, take-home vehicles, awards, cell phones and similar technological devices, safety equipment, and group life insurance.** Given this broad range of covered benefits, it should be no surprise that the whole issue of the *Firehouse Lawyer* this month is devoted to this important subject.

### Meal Allowances or Reimbursements

1. Section 119 of the Internal Revenue Code (IRC) governs meals and taxability. Meals are excludible from income if (1) served

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on employer's premises and (2) for employer's convenience, not the employee's. So what does "employer's convenience" mean? It means the meals must be provided for substantial non-compensatory reasons such as:

- Workers need to be on call or available during lunch;
- Nature of business requires short lunch periods;
- Absence of eating facilities near work;
- Meals are furnished to all employees for non-compensatory reasons
- Meals furnished immediately after work as duties prevented eating during work hours.
- Infrequent meals of de minimis value are also excludible.

2. Meal Reimbursements while traveling away from home on business of the employer are generally excludible from taxable income. Traveling away from your tax home means longer than an ordinary day's work **and** the employee needs substantial sleep or rest to meet work demands. Meals taken away from tax home but not on overnight trip are generally taxable as income/wages. To be excludible, meal reimbursements should be done under an "accountable plan", which means the expenses must have been expenses that would have been deductible business expenses, all details of the expense must be substantiated within a reasonable time, and the plan must require any excess payments to be reimbursed. Per diem payments may be excludible without substantiation of actual costs, but only if in accord with IRS allowed amounts, and the overnight rule still applies. Per diem plans are acceptable to the IRS, but only if the payments are paid for meals away from home, the amounts are reasonably calculated not to exceed actual expenses or anticipated expenses, and must be paid at the federal per diem rate, a flat rate or in accord with a stated schedule. (Thus it would seem that the typical fire district per diem plan would pass muster with the IRS, at least for overnight stays with meal plans.) The same de minimis rule mentioned in #1 above for actual meals can apply here to reimbursements as long as these are only occasional, especially if needed to work overtime.
3. Reimbursed meals while attending trade, professional, or business meetings at certain exempt organizations are excludible from wages. Typical organizations include chambers of commerce, business associations, or service clubs. For

example, the Fire Chief attends the local Rotary meeting by invitation to present a program on the fire department, which includes a meal cost, which the district reimburses. This should be excludible. However, **entertainment meals** are generally not excludible, but are taxable income if paid by the employer. The IRS rules require the "business meeting" to be directly related to business. In other words, the main purpose of the business meeting and meal is the active conduct of business; business must be actually conducted during the meal period. All facts must be considered, but the activity must be clearly in a business setting of the organization. Thus, reimbursing elected officials or commissioners for the meal cost at the association holiday party would probably not be excludible from taxable income, so it is not recommended. But reimbursing meal costs incurred at a state or county fire commissioners conference should be non-taxable, as those are business-related meals generally (except perhaps for a banquet meal, if the 'banquet meeting' includes little or no business).

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## Education Programs or College Tuition, etc.

1. There are several different sections of the tax code that apply here. This first section pertains to IRC section 127, known as a "qualified educational assistance plan". Under Section 127, an employer can provide up to \$5,250 per

year for educational assistance, which can include tuition, books, equipment, fees and supplies. This can be for college, graduate school, or other education or training. It cannot include tools or supplies that they get to keep at the end of the course, except for textbooks, of course. Lodging, meals, transportation, and costs related to sports, games or hobbies are not eligible. To be excludible from income, these payments must be (1) paid under a written plan covering only your employees or former employees (2) paid under a non-discriminatory plan, and (3) there must be no option to choose cash or other taxable benefits as an option to the educational assistance. Under this particular section, the courses do not have to be job related, but could be courses qualifying the employee for a new trade or business or even courses needed to meet the minimum job requirements. See also IRS Publication 970, Tax Benefits for Education.

2. Compare those rules to the exclusion rules for section 132(d). Unlike section 127 plans, these working condition fringe benefit plans do not require a written plan. The section does apply to both undergraduate and graduate courses. Unlike section 127, there is no dollar cap. However, if the courses would qualify the employee for a new trade or business, those are not eligible. Nor is this for courses needed to meet minimum job requirements. This exclusion is for education that improves or develops the job-related skills or capabilities of an employee, so the requirements are: (1) courses must be job-related (compare 127); (2) but no written plan is needed (compare 127 again); (3) the plan may discriminate in favor of highly compensated employees (compare 127 again) and (4) there is no dollar limit (broken record, compare 127 again). It would seem that most fire district plans would probably be most effectively implemented under Section 127.



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## Employer-Provided Clothing

1. Clothing or uniforms provided by the employer are not includible in income if they are specifically required as a condition of employment and are not worn or adaptable to general usage as ordinary clothing. That rule may be problematic for departments that buy sweatshirts or polo shirts, which seem rather ordinary, and may not be required uniforms. But if the clothing is excludible income, so is the cleaning cost. The rules on accountable plans must be satisfied (see below). It would seem prudent to have a policy in place not allowing such items to be worn as ordinary clothing or while off duty, to enhance the chances that such clothing will not be considered a taxable income item.
2. Obviously, employer-provided bunker gear, turnouts, or personal protective equipment or clothing (to use the safety regulation name) should not be taxable. Such gear also fits the definition of "safety equipment" (see below).

## Safety Equipment

Safety equipment is excludible from income/wages if it helps the employee perform his/her job more safely;

it does not have to be "required" safety equipment to qualify as non-taxable. This is another accountable plan item.

## Take-Home Vehicles and the Qualified Nonpersonal Use Vehicle Rules

1. Verified business use of employer vehicle is of course not taxable to employee, but personal use is taxable. Employer can opt to include all use as wages (and then let employee deduct the business use portion), or employee can pay for personal use, keeping a detailed record. Commuting is generally considered personal use. Driving to lunch while on business trip is not personal use, but just taking employer vehicle for lunch only would be personal.
2. Substantiation requirements are such that you need to have good records of all personal mileage and a record of the total, if the rest is all business use. If no substantiation is provided by the taxpayer (TP) then it is deemed all personal.
3. Various methods are approved by IRS for placing a value on the personal use. However, all are cumbersome administratively except for one, in my opinion. Since take-home cars and commuting to and from work is a big issue in the fire service, please consider the "commuting valuation rule". It works like this: personal use for commuting can be valued at \$1.50 each way if:
  - Vehicle is owned or leased by employer;
  - Vehicle is provided to employee for business use;
  - Employer requires the employee to commute in this vehicle for a valid non-compensatory business reason
  - Employer has a written policy (see me for model policy) prohibiting personal use other than commuting; and
  - Employee does not use the vehicle for personal use (except for some de minimis

use, such as stopping on the way home for groceries)

4. The foregoing commuter valuation rule cannot be applied to "control employees" such as elected official or an executive employee compensated at or equal to that of a federal Executive Level V (\$136,200 for 2007). (Yes, I know some Fire Chiefs are paid that much or more in base salary.)
5. This method seems simple, cost effective, and not administratively burdensome. Taxable income to employee is only \$3.00 per day, \$15 per week, or about \$750 per year. And of course those amounts could be reimbursed somehow, at least in part, by calculating the tax bracket etc.
6. The "qualified nonpersonal use vehicle" rules appear to this writer to be a fertile area for disagreement. The interpretation given by the IRS agent at the Pasco conference may not be the only one provided by the IRS, as it does not quite seem to match with the plain statements of that rule in a few IRS publications. But let us start with the actual statute, which is section 274 of the IRC. It states that commuting use of a vehicle that, "by its nature", does not lend itself easily to commuting use does not result in taxable income. The IRS regulation speaks of vehicles that "by design" are not likely to be so used, such as a hearse or ambulance. However, the regulation continues by listing examples of "qualified nonpersonal use vehicles" and in that list includes "clearly marked police or fire vehicles". The Taxable Fringe Benefit Guide I consulted then states that, to satisfy the regulations, the employee must always be on call, must be required by the employer to use the vehicle to commute, and the employer must prohibit personal use outside of the jurisdictional boundaries. See *Reg. Section 1.274-5T(k)(3)*. Please note that marking on a license plate is not considered "clearly marked". By contrast, we submit that

large letters proclaiming the vehicle is a "24-hour response vehicle" or stating that it is "for official use only" should be a clear mark. We also note that most of our clients' take-home vehicles have a fire department logo on the door or otherwise on the vehicle, and that many of them have light bars or other emergency signal lighting so they can respond with lights and siren pursuant to RCW 46.61.035 when appropriate.

We also would note that the regulation does not qualify the "police or fire vehicles" language by limiting that to ladder trucks, pumpers, engines, or ambulances. Sedans are very common fire department vehicles, just as they are very common police vehicles, so if the IRS intended some sort of limitation like the one the special agent suggested at Pasco, they simply failed to do that in the regulation. Similarly, IRS Publication 15-B (February 2007) does not suggest any such limitation (unless you consider that "design" limitation to be a clear rule, which I do not, given the inclusion of the "clearly marked police or fire vehicle" language immediately after that.)

However, my further research on this regulation shows that the IRS may soon recognize that more guidance is needed on these "qualified nonpersonal use vehicles". A January 22, 2007 letter to the Tax Exempt and Government Entities Division of the IRS from the National Association of State Comptrollers (NASC) asked the TEGE Division to consider and amend certain outdated regulations, and this was one of them. The NASC letter implied that certain state medical examiners and on-call fire chiefs (first responders) used vehicles for commuting but did not meet the above rule due to the language that the vehicle must by design be one they would be "not likely to use more than minimally for personal purposes."

Next, I found a private letter ruling of the IRS, addressed to a Representative from Kansas

(Dennis Moore). The letter seemed to be responsive to a situation not unlike the one described in the NASC letter. As readers may or may not know, private letter rulings are not considered precedential, and the names of taxpayers are redacted, so it is not easy to discern exactly who is asking for guidance. In any event, we found the June 2007 reply letter from TEGE's Lynne Camillo to be non-committal, as ultimately the letter concluded only with an assurance that the IRS and the Treasury Department will carefully consider whether a "guidance project" should be opened on the subject of "qualified nonpersonal use vehicles." The letter seemed to assume or imply that the vehicle uses were not eligible and therefore result in taxable income.

In the Kansas situation, however, it is evident that the vehicles are emergency medical service vehicles and emergency management vehicles very similar to police vehicles, i.e. they are undoubtedly sedans. While the TEGE Branch Chief wrote that such vehicles would not qualify under this rule, it was noted that:

"the regulations do provide that the Commissioner (of the IRS) can designate other vehicles as qualified nonpersonal use vehicles.

This authority is consistent with the legislative history on this issue which provides that Treasury and the IRS can issue guidance expanding the list of vehicles and identify other appropriate qualified nonpersonal use vehicles where that can be done while preserving the basic requirement that the exception be limited to vehicles that by their nature employees are not likely to use more than a minimum amount for personal purposes."

We suggest that this newer guidance needs to be issued, since it makes no sense at all to tax the value of a required take-home vehicle to a taxpayer that is required by his/her employer to

take it home so that they can respond to fires due to their job as fire marshal, fire chief, public information officer, etc. We see no logical difference between these personnel and the undercover police and others who drive sedans home as required.

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### Mileage Allowance (personal vehicle used)

If the employer provides the employee with a vehicle to use **OR** a mileage allowance, this allowance or value is not taxable if the following "**accountable plan**" rules are followed: (1) there must be a business connection to the allowance or vehicle use; (2) adequate substantiation is needed; and (3) excess amounts must be returned.

### Awards/Recognition

1. Generally awards are taxable, with some very limited exceptions. De minimis awards or recognition are non-taxable events. De minimis essentially means of nominal value. It should also be something given infrequently. These are excludible unless given in cash or a "cash equivalent", such as a gift card or gift certificate. Some examples of de minimis (excludible from income) awards would be a holiday turkey or ham, flowers, plaques, coffee mugs, or a gold watch upon retirement. Is there a threshold

amount for "nominal value"? Not really, but a state auditor recently told me \$50 is only a nominal value. The IRS has at least once opined that \$100 is NOT de minimis, and it appears that \$25 is the limit for business gifts.

2. Employee Achievement Awards have special requirements. These are **only for length of service or safety**. To be excludible, it must be awarded as part of a meaningful presentation. It cannot be cash or a "cash equivalent". Length of service awards generally cannot be given during the first five years of employment, and can only be given in five-year increments, except for retirement awards. Safety achievement awards have other special limitations. If given to managers, administrators, clerical personnel, or professional employees they do not qualify as non-taxable. During a tax year, only 10% of eligible employees can get such awards. For example, if you had 50 eligible employees, only 5 annually could get awards, as the 6<sup>th</sup> one would be taxable! The average cost of all employee achievement awards made by the employer during a single year cannot exceed \$400 per employee.

## Cell Phones

1. Cell phones are commonly provided to fire district personnel so they can keep in touch with colleagues while out of the office or away from the station. While mainly used for business use, it is common to allow some degree of personal use. These items certainly lend themselves easily to personal use. The IRS therefore considers such employer-provided (and paid for) cell phones to be "listed property". See IRC section 280F(d)(4). Business use is excludible from income as a working condition fringe benefit, but personal use is included in income/wages. If substantiation requirements are not met, all use is includible in income. Therefore, records must be kept to determine business v. personal use. This is another "accountable plan" item,

requiring details as to amounts, dates, times, places, and business purpose. The IRS suggests that the monthly cell phone invoice needs to be reviewed by the employee and each personal phone call highlighted. Employers may be better off telling the employees to purchase their own cell phone plan and submit their invoices for reimbursement, to the extent they use it for business! Of course, any time there is any split use, between personal and business, there will be substantiation requirements, so even that does not cut down on the bureaucratic red tape!

2. The rules for cell phones are the same for computers, handheld devices or PDAs, if provided by the employer for business use but used to any degree for personal use.

## Group Term Life Insurance

1. Generally, up to \$50,000 in term life insurance benefits are excludible from income. The same amount is excludible when figuring social security and Medicare contributions. So, obviously, there is also no withholding of employer contributions or taxes. The insurance must provide a general death benefit to an employee group of more than 10 employees. Insurance must be based on a formula that prevents individual selection. The formula must use criteria such as age, years of service, pay level, or position. The policy must be provided by or through the employer, directly or indirectly, although it is not necessary for the employer to be paying the premiums.

## Professional Licenses/Dues

1. An employer may reimburse an employee for the cost of professional licenses and organizational dues. These expenses are "ordinary and necessary" business expenses to the employer and are therefore deductible. The payments are then excludible from wages to the employee/taxpayer. They would be considered



a working condition fringe benefit. The licenses or dues have to be directly related to the job. Examples might be: a notary license, or a CPA or other professional license. If the employee paid these types of expenses, they would be deductible on the employee's tax return. To maintain the non-taxable status, however, the "accountable plan" rules must again be followed.

2. While social club dues are not deductible or excludible from income, organizational dues to organizations formed solely for business purposes are excludible. Examples of qualifying payments would be dues for CPA association, bar association, chiefs' associations, and service clubs such as Rotary or Kiwanis.

## Conclusion

Well, I feel almost as though I should apologize to readers for making this issue of the *Firehouse Lawyer* the longest in history. Perhaps there is some irony that the record was set while writing about IRS regulations and rules, which must be just about the most opaque, difficult-to-follow rules of any government agency. Frankly, my impression is that we have not heard the last of this topic, and one of my nefarious purposes is simply to stimulate discussion on certain issues, as only by discussion and debate will some of these less clear issues be clarified, such as the "qualified nonpersonal use vehicle" rules. Legal issues do not go away just by being ignored.

## TRAINING / CONFERENCES COMING SOON

For those who have been asking, stay tuned for training conferences suitable for commissioners and others coming up in February-March. Keep your eyes on those mail boxes! Newly elected officials can especially benefit from my annually-updated guide book to all of the applicable laws. Please check the 'Training' page on this web site to see when and

where the next Training Unlimited Seminars are scheduled and to get the registration form.

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