Reg. Section 1.132-5

Working Condition Fringes

(a)In general.

(1)Definition. 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.

(i) A service or property offered by an employer in connection with a flexible spending account is not excludable from gross income as a working condition fringe. For purposes of the preceding sentence, a flexible spending account is an agreement (whether or not written) entered into between an employer and an employee that makes available to the employee over a time period a certain level of unspecified non-cash benefits with a pre-determined cash value.

(ii) If, under section 274 or any other section, certain substantiation requirements must be met in order for a deduction under section 162 or 167 to be allowable, then those substantiation requirements apply when determining whether a property or service is excludable as a working condition fringe.

(iii) An amount that would be deductible by the employee under a section other than section 162 or 167, such as section 212, is not a working condition fringe.

(iv) A physical examination program provided by the employer is not excludable as a working condition fringe even if the value of such program might be deductible to the employee under section 213. The previous sentence applies without regard to whether the employer makes the program mandatory to some or all employees.

(v) A cash payment made by an employer to an employee will not qualify as a working condition fringe unless the employer requires the employee to-

(A) Use the payment for expenses in connection with a specific or pre-arranged activity or undertaking for which a deduction is allowable under section 162 or 167,

(B) Verify that the payment is actually used for such expenses, and

(C) Return to the employer any part of the payment not so used.

(vi) The limitation of section 67(a) (relating to the two-percent floor on miscellaneous itemized deductions) is not considered when determining the amount of a working condition fringe. For example, assume that an employer provides a $1,000 cash advance to Employee A and that the conditions of paragraph (a)(1)(v) of this section are not satisfied. Even to the extent A uses the allowance for expenses for which a deduction is allowable under section 162 or 167, because such cash payment is not a working condition fringe, section 67(a) applies. The $1,000 payment is includible in A's gross income and subject to income and employment tax withholding. If, however, the conditions of paragraph (a)(1)(v) of this section are satisfied with respect to the payment, then the amount of A's working condition fringe is determined without regard to section 67(a). The $1,000 payment is excludible from A's gross income and not subject to income and employment tax reporting and withholding.

(2)Trade or business of the employee.

(i) General. If the hypothetical payment for a property or service would be allowable as a deduction with respect to a trade or business of an employee other than the employee's trade or business of being an employee of the employer, it cannot be taken into account for purposes of determining the amount, if any, of the working condition fringe.

(ii) Examples. The rule of paragraph (a)(2)(i) of this section may be illustrated by the following examples:

Example (1). Assume that, unrelated to company X's trade or business and unrelated to employee A's trade or business of being an employee of company X, A is a member of the board of directors of company Y. Assume further that company X provides A with air transportation to a company Y board of director's meeting. A may not exclude from gross income the value of the air transportation to the meeting as a working condition fringe. A may, however, deduct such amount under section 162 if the section 162 requirements are satisfied. The result would be the same whether the air transportation was provided in the form of a flight on a commercial airline or a seat on a company X airplane.

Example (2). Assume the same facts as in example (1) except that A serves on the board of directors of company Z and company Z regularly purchases a significant amount of goods and services from company X. Because of the relationship between Company Z and A's employer, A's membership on Company Z's board of directors is related to A's trade or business of being an employee of Company X. Thus, A may exclude from gross income the value of air transportation to board meetings as a working condition fringe.

Example (3). Assume the same facts as in example (1) except that A serves on the board of directors of a charitable organization. Assume further that the service by A on the charity's board is substantially related to company X's trade or business.

In this case, A may exclude from gross income the value of air transportation to board meetings as a working condition fringe.

Example (4). Assume the same facts as in example (3) except that company X also provides A with the use of a company X conference room which A uses for monthly meetings relating to the charitable organization. Also assume that A uses company X's copy machine and word processor each month in connection with functions of the charitable organization. Because of the substantial business benefit that company X derives from A's service on the board of the charity, A may exclude as a working condition fringe the value of the use of company X property in connection with the charitable organization.

(b)Vehicle allocation rules.

(1)In general.

(i) General rule. In general, with respect to an employer-provided vehicle, the amount excludable as a working condition fringe is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the availability of the vehicle. For example, assume that the value of the availability of an employer-provided vehicle for a full year is $2,000, without regard to any working condition fringe (i.e., assuming all personal use). Assume further that the employee drives the vehicle 6,000 miles for his employer's business and 2,000 miles for reasons other than the employer's business. In this situation, the value of the working condition fringe is $2,000 multiplied by a fraction, the numerator of which is the business-use mileage (6,000 miles) and the denominator of which is the total mileage (8,000 miles). Thus, the value of the working condition fringe is $1,500. The total amount includible in the employee's gross income on account of the availability of the vehicle is $500 ($2,000 − $1,500). For purposes of this section, the term "vehicle" has the meaning given the term in §1.61-21(e)(2). Generally, when determining the amount of an employee's working condition fringe, miles accumulated on the vehicle by all employees of the employer during the period in which the vehicle is available to the employee are considered. For example, assume that during the year in which the vehicle is available to the employee in the above example, other employees accumulate 2,000 additional miles on the vehicle (while the employee is not in the automobile). In this case, the value of the working condition fringe is $2,000 multiplied by a fraction, the numerator of which is the business-use mileage by the employee (including all mileage (business and personal) accumulated by other employees) (8,000 miles) and the denominator of which is the total mileage (including all mileage accumulated by other employees) (10,000 miles). Thus, the value of the working condition fringe is $1,600; the total amount includible in the employee's gross income on account of the availability of the vehicle is $400 ($2,000 − $1,600). If, however, substantially all of the use of the automobile by other employees in the employer's business is limited to a certain period, such as the last three months of the year, the miles driven by the other employees during that period would not be considered when determining the employee's working condition fringe exclusion. Similarly, miles driven by other employees are not considered if the pattern of use of the employer-provided automobiles is designed to reduce Federal taxes. For example, assume that an employer provides employees A and B each with the

availability of an employer-provided automobile and that A uses the automobile assigned to him 80 percent for the employer's business and that B uses the automobile assigned to him 30 percent for the employer's business. If A and B alternate the use of their assigned automobiles each week in such a way as to achieve a reduction in federal taxes, then the employer may count only miles placed on the automobile by the employee to whom the automobile is assigned when determining each employee's working condition fringe.

(ii) Use by an individual other than the employee. For purposes of this section, if the availability of a vehicle to an individual would be taxed to an employee, use of the vehicle by the individual is included in references to use by the employee.

(iii) Provision of an expensive vehicle for personal use. If an employer provides an employee with a vehicle that an employee may use in part for personal purposes, there is no working condition fringe exclusion with respect to the personal miles driven by the employee; if the employee paid for the availability of the vehicle, he would not be entitled to deduct under section 162 or 167 any part of the payment attributable to personal miles. The amount of the inclusion is not affected by the fact that the employee would have chosen the availability of a less expensive vehicle. Moreover, the result is the same even though the decision to provide an expensive rather than an inexpensive vehicle is made by the employer for bona fide noncompensatory business reasons.

(iv) Total value inclusion. In lieu of excluding the value of a working condition fringe with respect to an automobile, an employer using the automobile lease valuation rule of §1.61-21(d) may include in an employee's gross income the entire Annual Lease Value of the automobile. Any deduction allowable to the employee under section 162 or 167 with respect to the automobile may be taken on the employee's income tax return. The total inclusion rule of this paragraph (b)(1)(iv) is not available if the employer is valuing the use or availability of a vehicle under general valuation principles or a special valuation rule other than the automobile lease valuation rule. See §§1.162-25 and 1.162-25T for rules relating to the employee's deduction.

(v) Shared usage. In calculating the working condition fringe benefit exclusion with respect to a vehicle provided for use by more than one employee, an employer shall compute the working condition fringe in a manner consistent with the allocation of the value of the vehicle under section 1.61-21(c)(2)(ii)(B).

(2)Use of different employer-provided vehicles. The working condition fringe exclusion must be applied on a vehicle-by-vehicle basis. For example, assume that automobile Y is available to employee D for 3 days in January and for 5 days in March, and automobile Z is available to D for a week in July. Assume further that the Daily Lease Value, as defined in §1.61-21(d)(4)(ii), of each automobile is $50. For the eight days of availability of Y in January and March, D uses Y 90 percent for business (by mileage). During July,

D uses Z 60 percent for business (by mileage). The value of the working condition fringe is determined separately for each automobile. Therefore, the working condition fringe for Y is $360 ($400 × .90) leaving an income inclusion of $40. The working condition fringe for Z is $210 ($350 × .60), leaving an income inclusion of $140. If the value of the availability of an automobile is determined under the Annual Lease Value rule for one period and Daily Lease Value rule for a second period (see §1.61-21(d)), the working condition fringe exclusion must be calculated separately for the two periods.

(3)Provision of a vehicle and chauffeur services.

(i) General rule. In general, with respect to the value of chauffeur services provided by an employer, the amount excludable as a working condition fringe is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the chauffeur services. The working condition fringe with respect to a chauffeur is determined separately from the working condition fringe with respect to the vehicle. An employee may exclude from gross income the excess of the value of the chauffeur services over the value of the chauffeur services for personal purposes (such as commuting) as determined under §1.61-21(b)(5). See §1.61-21(b)(5) for additional rules and examples concerning the valuation of chauffeur services. See §1.132-5(m)(5) for rules relating to an exclusion from gross income for the value of bodyguard/chauffeur services. When determining whether miles placed on the vehicle are for the employer's business, miles placed on the vehicle by a chauffeur between the chauffeur's residence and the place at which the chauffeur picks up (or drops off) the employee are with respect to the employee (but not the chauffeur) considered to be miles placed on the vehicle for the employer's business and thus eligible for the working condition fringe exclusion. Thus, because miles placed on the vehicle by a chauffeur between the chauffeur's residence and the place at which the chauffeur picks up (or drops off) the employee are not considered business miles with respect to the chauffeur, the value of the availability of the vehicle for commuting is includible in the gross income of the chauffeur. For general and special rules concerning the valuation of the use of employer-provided vehicles, see paragraphs (b) through (f) of §1.61-21.

(ii) Examples. The rules of paragraph (b)(3)(i) of this section are illustrated by the following examples:

Example (1). Assume that an employer makes available to an employee an automobile and a chauffeur. Assume further that the value of the chauffeur services determined in accordance with §1.61-21 is $30,000 and that the chauffeur spends 30 percent of each workday driving the employee for personal purposes. There may be excluded from the employee's income 70 percent of $30,000, or $21,000, leaving an income inclusion with respect to the chauffeur services of $9,000.

Example (2). Assume that the value of the availability of an employer-provided vehicle for a year is $4,850 and that the value of employer-provided chauffeur services with respect to the vehicle for the year is $20,000. Assume further that 40 percent of the miles placed on the vehicle are for the employer's business and that

60 percent are for other purposes. In addition, assume that the chauffeur spends 25 percent of each workday driving the employee for personal purposes (i.e., 2 hours). The value of the chauffeur services includible in the employee's income is 25 percent of $20,000, or $5,000. The excess of $20,000 over $5,000 or $15,000 is excluded from the employee's income as a working condition fringe. The amount excludable as a working condition fringe with respect to the vehicle is 40 percent of $4,850, or $1,940 and the amount includible is $4,850 − $1,940, or $2,910.

(c)Applicability of substantiation requirements of sections 162 and 274(d).

(1)In general. The value of property or services provided to an employee may not be excluded from the employee's gross income as a working condition fringe, by either the employer or the employee, unless the applicable substantiation requirements of either section 274(d) or section 162 (whichever is applicable) and the regulations thereunder are satisfied. The substantiation requirements of section 274(d) apply to an employee even if the requirements of section 274 do not apply to the employee's employer for deduction purposes (such as when the employer is a tax-exempt organization or a governmental unit).

(2)Section 274(d) requirements. The substantiation requirements of 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 section 274(d), will be sufficient to substantiate a working condition fringe exclusion.

(d)Safe harbor substantiation rules.

(1)In general. §1.274-6T provides that the substantiation requirements of section 274(d) and the regulations thereunder may be satisfied, in certain circumstances, by using one or more of the safe harbor rules prescribed in §1.274-6T. If the employer uses one of the safe harbor rules prescribed in §1.274-6T during a period with respect to a vehicle (as defined in §1.61-21(e)(2)), that rule must be used by the employer to substantiate a working condition fringe exclusion with respect to that vehicle during the period. An employer that is exempt from Federal income tax may still use one of the safe harbor rules (if the requirements of that section are otherwise met during a period) to substantiate a working condition fringe exclusion with respect to a vehicle during the period. If the employer uses one of the methods prescribed in §1.274-6T during a period with respect to an employer-provided vehicle, that method may be used by an employee to substantiate a working condition fringe exclusion with respect to the same vehicle during the period, as long as the employee includes in gross income the amount allocated to the employee pursuant to §1.274-6T and this section. (See §1.61-21(c)(2) for other rules concerning when an employee must include in income the amount determined by the employer.) If, however, the employer uses the safe harbor rule prescribed in §1.274-6T(a)(2) or (3) and the employee without the employer's knowledge uses the vehicle for purposes other than de minimis personal use (in the case of the rule prescribed in §1.274-6T(a)(2)), or for purposes other than de minimis personal use and commuting (in the case

of the rule prescribed in §1.274-6T(a)(3)), then the employee must include an additional amount in income for the unauthorized use of the vehicle.

(2)Period for use of safe harbor rules. The rules prescribed in this paragraph (d) assume that the safe harbor rules prescribed in §1.274-6T are used for a one-year period. Accordingly, references to the value of the availability of a vehicle, amounts excluded as a working condition fringe, etc., are based on a one-year period. If the safe harbor rules prescribed in §1.274-6T are used for a period of less than a year, the amounts referred to in the previous sentence must be adjusted accordingly. For purposes of this section, the term "personal use" has the same meaning as prescribed in §1.274-6T(e)(5).

(e)Safe harbor substantiation rule for vehicles not used for personal purposes. For a vehicle described in §1.274-6T(a)(2) (relating to certain vehicles not used for personal purposes), the working condition fringe exclusion is equal to the value of the availability of the vehicle if the employer uses the method prescribed in §1.274-6T(a)(2).

(f)Safe harbor substantiation rule for vehicles not available to employees for personal use other than commuting. For a vehicle described in §1.274-6T(a)(3) (relating to certain vehicles not used for personal purposes other than commuting), the working condition fringe exclusion is equal to the value of the availability of the vehicle for purposes other than commuting if the employer uses the method prescribed in §1.274-6T(a)(3). This rule applies only if the special rule for valuing commuting use, as prescribed in §1.61-21(f), is used and the amount determined under the special rule is either included in the employee's income or reimbursed by the employee.

(g)Safe harbor substantiation rule for vehicles used in connection with the business of farming that are available to employees for personal use.

(1)In general. For a vehicle described in §1.274-6T(b) (relating to certain vehicles used in connection with the business of farming), the working condition fringe exclusion is calculated by multiplying the value of the availability of the vehicle by 75 percent.

(2)Vehicles available to more than one individual. If the vehicle is available to more than one individual, the employer must allocate the gross income inclusion attributable to the vehicle (25 percent of the value of the availability of the vehicle) among the employees (and other individuals whose use would not be attributed to an employee) to whom the vehicle was available. This allocation must be done in a reasonable manner to reflect the personal use of the vehicle by the individuals. An amount that would be allocated to a sole proprietor reduces the amounts that may be allocated to employees but is otherwise to be disregarded for purposes of this paragraph (g). For purposes of this paragraph (g), the value of the availability of a vehicle may be calculated as if the vehicle were available to only one employee continuously and without regard to any working condition fringe exclusion.

(3)Examples. The following examples illustrate a reasonable allocation of gross income with respect to an employer-provided vehicle between two employees:

Example (1). Assume that two farm employees share the use of a vehicle that for a calendar year is regularly used directly in connection with the business of farming and qualifies for use of the rule in §1.274-6T(b). Employee A uses the vehicle in the morning directly in connection with the business of farming and employee B uses the vehicle in the afternoon directly in connection with the business of farming. Assume further that employee B takes the vehicle home in the evenings and on weekends. The employer should allocate all the income attributable to the availability of the vehicle to employee B.

Example (2). Assume that for a calendar year, farm employees C and D share the use of a vehicle that is regularly used directly in connection with the business of farming and qualifies for use of the rule in §1.274-6T(b). Assume further that the employees alternate taking the vehicle home in the evening and alternate the availability of the vehicle for personal purposes on weekends. The employer should allocate the income attributable to the availability of the vehicle for personal use (25 percent of the value of the availability of the vehicle) equally between the two employees.

Example (3). Assume the same facts as in example (2) except that C is the sole proprietor of the farm. Based on these facts, C should allocate the same amount of income to D as was allocated to D in example (2). No other income attributable to the availability of the vehicle for personal use should be allocated.

(h)Qualified nonpersonal use vehicles.

(1)In general. Except as provided in paragraph (h)(2) of this section, 100 percent of the value of the use of a qualified nonpersonal use vehicle (as described in §1.274-5(k)) is excluded from gross income as a working condition fringe, provided that, in the case of a vehicle described in § 1.274-5(k)(3) through (8), the use of the vehicle conforms to the requirements of paragraphs (k)(3) through (8).

(2)Shared usage of qualified nonpersonal use vehicles. In general, a working condition fringe under this paragraph (h) is available to the driver and all passengers of a qualified nonpersonal use vehicle. However, a working condition fringe under this paragraph (h) is available only with respect to the driver and not with respect to any passengers of a qualified nonpersonal use vehicle described in § 1.274-5(k)(2)(ii)(L) or (P).

(i)[Reserved]

(j)Application of section 280F. In determining the amount, if any, of an employee's working condition fringe, section 280F and the regulations thereunder do not apply. For example, assume that an employee has available for a calendar year an employer-provided automobile with a fair market value of $28,000. Assume further that the special rule provided in §1.61-21(d) is used yielding an Annual Lease Value, as defined in §1.61-21(d), of $7,750, and that all of the employee's use of the automobile is for the employer's business. The employee would be entitled to exclude as a working condition fringe the entire Annual Lease Value, despite the fact that if

the employee paid for the availability of the automobile, an income inclusion would be required under §1.280F-6(d)(1). This paragraph (j) does not affect the applicability of section 280F to the employer with respect to such employer-provided automobile, nor does it affect the applicability of section 274 to either the employer or the employee. For rules concerning substantiation of an employee's working condition fringe, see paragraph (c) of this section.

(k)Aircraft allocation rule. In general, with respect to a flight on an employer-provided aircraft, the amount excludable as a working condition fringe is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the flight on the aircraft. For example, if employee P and P's spouse fly on P's employer's airplane primarily for business reasons of P's employer so that P could deduct the expenses relating to the trip to the extent of P's payments, the value of the flights is excludable from gross income as a working condition fringe. However, if P's children accompany P on the trip primarily for personal reasons, the value of the flights by P's children are includible in P's gross income. See §1.61-21(g) for special rules for valuing personal flights on employer-provided aircraft.

(l)[Reserved]

(m)Employer-provided transportation for security concerns.

(1)In general. The amount of a working condition fringe exclusion with respect to employer-provided transportation is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the transportation. Generally, if an employee pays for transportation taken for primarily personal purposes, the employee may not deduct any part of the amount paid. Thus, the employee may not generally exclude the value of employer-provided transportation as a working condition fringe if such transportation is primarily personal. If, however, for bona fide business-oriented security concerns, the employee purchases transportation that provides him or her with additional security, the employee may generally deduct the excess of the amount actually paid for the transportation over the amount the employee would have paid for the same mode of transportation absent the bona fide business-oriented security concerns. This is the case whether or not the employee would have taken the same mode of transportation absent the bona fide business-oriented security concerns. With respect to a vehicle, the phrase "the same mode of transportation" means use of the same vehicle without the additional security aspects, such as bulletproof glass. With respect to air transportation, the phrase "the same mode of transportation" means comparable air transportation. These same rules apply to the determination of an employee's working condition fringe exclusion. For example, if an employer provides an employee with a vehicle for commuting and, because of bona fide business-oriented security concerns, the vehicle is specially designed for security, then the employee may exclude from gross income the value of the special security design as a working condition fringe. The employee may not exclude the value of the commuting from income as a working condition fringe because commuting is a nondeductible personal expense. However, if an independent security study meeting the requirements of paragraph (m)(2)(v) of this section has been performed with respect to a government employee, the government employee may exclude the value of the personal use (other than commuting) of the employer-provided vehicle that the security study determines to be reasonable and necessary for local transportation.

Similarly, if an employee travels on a personal trip in an employer-provided aircraft for bona fide business-oriented security concerns, the employee may exclude the excess, if any, of the vale of the flight over the amount the employee would have paid for the same mode of transportation, but for the bona fide business-oriented security concerns. Because personal travel is a nondeductible expense, the employee may not exclude the total value of the trip as a working condition fringe.

(2)Demonstration of bona fide business-oriented security concerns.

(i) In general. For purposes of this paragraph (m), 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. Example of factors indicating a specific basis for concern regarding the safety of an employee are-

(A) 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

(B) 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.

(ii) Establishment of overall security program. Notwithstanding anything in paragraph (m)(2)(i) of this section to the contrary, 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. An overall security program is deemed to exist if the requirements of paragraph (m)(2)(iv) of this section are satisfied (relating to an independent security study).

(iii) Overall security program.

(A) Defined. 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.

(B) Application. 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.

(iv) Effect of an independent security study. An overall security program with respect to an employee is deemed to exist if the conditions of this paragraph (m)(2)(iv) are satisfied:

(A) 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;

(B) The security study is based on an objective assessment of all facts and circumstances;

(C) The recommendation of the security study is that an overall security program (as defined in paragraph (m)(2)(iii) of this section) is not necessary and the recommendation is reasonable under the circumstances; and

(D) The employer applies the specific security recommendations contained in the security study to the employee on a consistent basis.

The value of transportation-related security provided pursuant to a security study that meets the requirements of this paragraph (m)(2)(iv) may be excluded from income if the security study conclusions are reasonable and, but for the bona fide business-oriented security concerns, the employee would not have had such security. No exclusion from income applies to security provided by the employer that is not recommended in the security study. Security study conclusions may be reasonable even if, for example, it is recommended that security be limited to certain geographic areas, as in the case in which air travel security is provided only in certain foreign countries.

(v) Independent security study with respect to government employees. For purposes of establishing the existence of an overall security program under paragraph (m)(2)(ii) of this section with respect to a particular government employee, a security study conducted by the government employer (including an agency or instrumentality thereof) will be treated as a security study pursuant to paragraph (m)(2)(iv) of this section if, in lieu of the conditions of paragraphs (m)(2)(iv)(A) through (D) of this section, the following conditions are satisfied:

(A) The security study is conducted by a person expressly designated by the government employer as having the responsibility and independent authority to determine both the need for employer-provided security and the appropriate protective services in response to that determination;

(B) The security study is conducted in accordance with written internal procedures that require an independent and objective assessment of the facts and circumstances, such as the nature of the threat to the employee, the appropriate security response to that threat, an estimate of the length of time protective services will be necessary, and the extent to which employer-provided transportation may be necessary during the period of protection;

(C) With respect to employer-provided transportation, the security study evaluates the extent to which personal use, including commuting, by the employee and the employee's spouse and dependents may be necessary during the period of protection and makes a recommendation as to what would be considered reasonable personal use during that period; and

(D) The employer applies the specific security recommendations contained in the study to the employee on a consistent basis.

(3)Application of security rules to spouses and dependents.

(i) In general. If a bona fide business-oriented security concern exists with respect to an employee (because, for example, threats are made on the life of an employee), the bona fide business-oriented security concern is deemed to exist with respect to the employee's spouse and dependents to the extent provided in this paragraph (m)(3).

(ii) Certain transportation. If a working condition fringe exclusion is available under this paragraph (m) for transportation in a vehicle or aircraft provided for a bona fide business-oriented security concern with respect to an employee, the requirements of this paragraph (m) are deemed to be satisfied with respect to transportation in the same vehicle or aircraft provided at the same time to the employee's spouse and dependent children.

(iii) Other. Except as provided in paragraph (m)(3)(ii) of this section, a bona fide business oriented security concern is deemed to exist for the spouse and dependent children of the employer only if the requirements of paragraph (m)(2)(iii) or (iv) of this section are applied independently to such spouse and dependent children.

(iv) Spouses and dependents of government employees. The security rules of this paragraph (m)(3) apply to the spouse and dependents of a government employee. However, the value of local vehicle transportation provided to the government employee's spouse and dependents for personal purposes, other than commuting, during the period that a bona fide business-oriented security concern exists with respect to the government employee will not be included in the government employee's gross income if the personal use is determined to be reasonable and necessary by the security study described in paragraph (m)(2)(v) of this section.

(4)Working condition safe harbor for travel on employer-provided aircraft. Under the safe harbor rule of this paragraph (m)(4), if, for a bona fide business-oriented security concern, the employer requires that an employee travel on an employer-provided aircraft for a personal trip, the employer and the employee may exclude from the employee's gross income, as a working condition fringe, the excess value of the aircraft trip over the safe harbor airfare without having to show what method of transportation the employee would have flown but for the bona fide business-oriented security concern. For purposes of the safe harbor rule of this paragraph (m)(4), the value of the safe harbor airfare is determined under the non-commercial flight valuation rule of §1.61-21(g) (regardless of whether the employer or employee elects to use such valuation rule) by multiplying an aircraft multiple of 200-percent by the applicable cents-per-mile rates and the number of miles in the flight and then adding the applicable terminal charge. The value of the safe harbor airfare determined under this paragraph (m)(4) must be included in the employee's income (to the extent not reimbursed by the employee) regardless of whether the employee or the employer uses the special valuation rule of §1.61-21(g). The excess of the value of the aircraft trip over this amount may be excluded from gross income as a working condition fringe. If, for a bona fide business-oriented security concern, the employer requires that an employee's spouse and dependents travel on an employer-provided aircraft for a personal trip, the special rule of this paragraph (m)(4) is available to exclude the excess value of the aircraft trips over the safe harbor airfares.

(5)Bodyguard/chauffeur provided for a bona fide business-oriented security concern. 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 excludable from gross income under this paragraph

(m)(5). (See paragraph (b)(3) of this section for rules relating to the determination of the working condition fringe exclusion for chauffeur services.)

(6)Special valuation rule for government employees. If transportation is provided to a government employee for commuting during the period that a bona fide business-oriented security concern under §1.132-5(m) exists, the commuting use may be valued by reference to the values set forth in §1.61-21(e)(1)(i) or (f)(3) (vehicle cents-per-mile or commuting valuation of $1.50 per one-way commute, respectively) without regard to the additional requirements contained in §1.61-21(e) or (f) and is deemed to have met the requirements of §1.61-21(c).

(7)Government employer and employee defined. For purposes of this paragraph (m), "government employer" includes any Federal, state, or local government unit, and any agency or instrumentality thereof. A "government employee" is any individual who is employed by the government employer.

(8)Examples. The provisions of this paragraph (m) may be illustrated by the following examples:

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 in paragraph (m)(4) of 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 in paragraph (m)(4) of 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. See section 1.61-21 for rules relating to the valuation of an employer-provided vehicle and chauffeur, and personal flights on employer-provided airplanes.

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 excludable 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 excludable as a working condition fringe if such expense would be otherwise allowable as a deduction by the employee under section 162 or 167.

Example (6). J is a United States District Judge. At the beginning of a 3-month criminal trial in J's court, a member of J's family receives death threats. M, the division (within government agency W) responsible for evaluating threats and providing protective services to the Federal judiciary, directs its threat analysis unit to conduct a security study with respect to J and J's family. The study is conducted pursuant to internal written procedures that require an independent and objective assessment of any threats to members of the federal judiciary and their families, a statement of the requisite security response, if any, to a particular threat (including the form of transportation to be furnished to the employee as part of the security program), and a description of the circumstances under which local transportation for the employee and the employee's spouse and dependents may be necessary for personal reasons during the time protective

services are provided. M's study concludes that a bona fide business-oriented security concern exists with respect to J and J's family and determines that 24-hour protection of J and J's family is not necessary, but that protection is necessary during the course of the criminal trial whenever J or J's family is away from home. Consistent with that recommendation, J is transported every day in a government vehicle for both personal and business reasons and is accompanied by two bodyguard/chauffeurs who have been trained in evasive driving techniques. In addition, J's spouse is driven to and from work and J's children are driven to and from school and occasional school activities. Shortly after the trial is concluded, M's threat analysis unit determines that J and J's family no longer need special protection because the danger posed by the threat no longer exists and, accordingly, vehicle transportation is no longer provided. Because the security study conducted by M complies with the conditions of §1.132-5(m)(2)(v), M has satisfied the requirement for an independent security study and an overall security program with respect to J is deemed to exist. Thus, with respect to the transportation provided for security concerns, J may exclude as a working condition fringe the value of any special security features of the government vehicle and the value attributable to the two bodyguard/chauffeurs. See Example (1) of this paragraph (m)(8). The value of vehicle transportation provided to J and J's family for personal reasons, other than commuting, may also be excluded during the period of protection, because its provision was consistent with the recommendation of the security study.

Example (7). Assume the same facts as in Example (6) and that J's one-way commute between home and work is 10 miles. Under paragraph (m)(6) of this section, the Federal government may value transportation provided to J for commuting purposes pursuant to the value set forth in either the vehicle cents-per-mile rule of §1.61-21(e) or the commuting valuation rule of §1.61-21(f). Because the commuting valuation rule yields the least amount of taxable income to J under the circumstances, W values the transportation provided to J for commuting at $1.50 per one-way commute, even though J is a control employee within the meaning of §1.61-21(f)(6).

(n)Product testing.

(1)In general. The fair market value of the use of consumer goods, which are manufactured for sale to nonemployees, for product testing and evaluation by an employee of the manufacturer outside the employer's workplace, is excludible from gross income as a working condition fringe if-

(i) Consumer testing and evaluation of the product is an ordinary and necessary business expense of the employer;

(ii) Business reasons necessitate that the testing and evaluation of the product be performed off the employer's business premises by employees (i.e., the testing and evaluation cannot be carried out adequately in the employer's office or in laboratory testing facilities);

(iii) The product is furnished to the employee for purposes of testing and evaluation;

(iv) The product is made available to the employee for no longer than necessary to test and evaluate its performance and (to the extent not exhausted) must be returned to the employer at completion of the testing and evaluation period;

(v) The employer imposes limits on the employee's use of the product that significantly reduce the value of any personal benefit to the employee; and

(vi) The employee must submit detailed reports to the employer on the testing and evaluation.

The length of the testing and evaluation period must be reasonable in relation to the product being tested.

(2)Employer-imposed limits. The requirement of paragraph (n)(1)(v) of this section is satisfied if-

(i) The employer places limits on the employee's ability to select among different models or varieties of the consumer product that is furnished for testing and evaluation purposes; and

(ii) The employer generally prohibits use of the product by persons other than the employee and, in appropriate cases, requires the employee, to purchase or lease at the employee's own expense the same type of product as that being tested (so that personal use by the employee's family will be limited). In addition, any charge by the employer for the personal use by an employee of a product being tested shall be taken into account in determining whether the requirement of paragraph (n)(1)(v) of this section is satisfied.

(3)Discriminating classifications. If an employer furnishes products under a testing and evaluation program only, or presumably, to certain classes of employees (such as highly compensated employees, as defined in §1.132-8(g)), this fact may be relevant when determining whether the products are furnished for testing and evaluation purposes or for compensation purposes, unless the employer can show a business reason for the classification of employees to whom the products are furnished (e.g., that automobiles are furnished for testing and evaluation by an automobile manufacturer to its design engineers and supervisory mechanics).

(4)Factors that negate the existence of a product testing program. If an employer fails to tabulate and examine the results of the detailed reports submitted by employees within a reasonable period of time after expiration of the testing period, the program will not be considered a product testing program for purposes of the exclusion of this paragraph (n). Existence of one or more of the following factors may also establish that the program is not a bona fide product testing program for purposes of the exclusion of this paragraph (n):

(i) The program is in essence a leasing program under which employees lease the consumer goods from the employer for a fee;

(ii) The nature of the product and other considerations are insufficient to justify the testing program; or

(iii) The expense of the program outweighs the benefits to be gained from testing and evaluation.

(5)Failure to meet the requirements of this paragraph (n). The fair market value of the use of property for product testing and evaluation by an employee outside the employee's workplace, under a product testing program that does not meet all of the requirements of this paragraph (n), is not excludable from gross income as a working condition fringe under this paragraph (n).

(6)Example. The rules of this paragraph (n) may be illustrated by the following example:

Example. Assume that an employer that manufactures automobiles establishes a product testing program under which 50 of its 5,000 employees test and evaluate the automobiles for 30 days. Assume further that the 50 employees represent a fair cross-section of all of the employees of the employer, such employees submit detailed reports to the employer on the testing and evaluation, the employer tabulates and examines the test results within a reasonable time, and the use of the automobiles is restricted to the employees. If the employer imposes the limits described in paragraph (n)(2) of this section, the employees may exclude the value of the use of the automobile during the testing and evaluation period.

(o)Qualified automobile demonstration use.

(1)In general. The value of qualified automobile demonstration use is excludable from gross income as a working condition fringe. "Qualified automobile demonstration use" is any use of a demonstration automobile by a full-time automobile salesman in the sales area in which the automobile dealer's sales office is located if-

(i) Such use is provided primarily to facilitate the salesman's performance of services for the employer; and

(ii) There are substantial restrictions on the personal use of the automobile by the salesman.

(2)Full-time automobile salesman.

(i) Defined. The term "full-time automobile salesman" means any individual who-

(A) Is employed by an automobile dealer;

(B) Customarily spends at least half of a normal business day performing the functions of a floor salesperson or sales manager;

(C) Directly engages in substantial promotion and negotiation of sales to customers;

(D) Customarily works a number of hours considered full-time in the industry (but at a rate not less than 1,000 hours per year); and

(E) Derives at least 25 percent of his or her gross income from the automobile dealership directly as a result of the activities described in paragraphs (o)(2)(i)(B) and (C) of this section.

For purposes of paragraph (o)(2)(i)(E) of this section, income is not considered to be derived directly as a result of activities described in paragraphs (o)(2)(i)(B) and (C) of this section to the extent that the income is attributable to an individual's ownership interest in the dealership. An individual will not be considered to engage in direct sales activities if the individual's sales-related activities are substantially limited to review of sales price offers from customers. An individual, such as the general manager of an automobile dealership, who receives a sales commission on the sale of an automobile is not a full-time automobile salesman unless the requirements of this paragraph (o)(2)(i) are met. The exclusion provided in this paragraph (o) is available to an individual who meets the definition of this paragraph (o)(2)(i) whether the individual performs services in addition to those described in this paragraph (o)(2)(i). For example, an individual who is an owner of the automobile dealership but who otherwise meets the requirements of this paragraph (o)(2)(i) may exclude from gross income the value of qualified automobile demonstration use. However, the exclusion of this paragraph (o) is not available to owners of large automobile dealerships who do not customarily engage in significant sales activities.

(ii) Use by an individual other than a full-time automobile salesman. Personal use of a demonstration automobile by an individual other than a full-time automobile salesman is not treated as a working condition fringe. Therefore, any personal use, including commuting use, of a demonstration automobile by a part-time salesman, automobile mechanic, or other individual who is not a full-time automobile salesman is not "qualified automobile demonstration use" and thus not excludable from gross income. This is the case whether or not the personal use is within the sales area (as defined in paragraph (o)(5) of this section).

(3)Demonstration automobile. The exclusion provided in this paragraph (o) applies only to qualified use of a demonstration automobile. A demonstration automobile is an automobile that is-

(i) Currently in the inventory of the automobile dealership; and

(ii) Available for test drives by customers during the normal business hours of the employee.

(4)Substantial restrictions on personal use. Substantial restrictions on the personal use of a demonstration automobile exist when all of the following conditions are satisfied:

(i) Use by individuals other than the full-time automobile salesmen (e.g., the salesman's family) is prohibited;

(ii) Use for personal vacation trips is prohibited;

(iii) The storage of personal possessions in the automobile is prohibited; and

(iv) The total use by mileage of the automobile by the salesman outside the salesman's normal working hours is limited.

(5)Sales area.

(i) In general. Qualified automobile demonstration use consists of use in the sales area in which the automobile dealer's sales office is located. The sales area is the geographic area surrounding the automobile dealer's sales office from which the office regularly derives customers.

(ii) Sales area safe harbor. With respect to a particular full-time salesman, the automobile dealer's sales area may be treated as the area within a radius of the larger of-

(A) 75 miles or

(B) The one-way commuting distance (in miles) of the particular salesman from the dealer's sales office.

(6)Applicability of substantiation requirements of sections 162 and 274(d). Notwithstanding anything in this section to the contrary, the value of the use of a demonstration automobile may not be excluded from gross income as a working condition fringe, by either the employer or the employee, unless, with respect to the restrictions of paragraph (o)(4) of this section, the substantiation requirements of section 274(d) and the regulations thereunder are satisfied. See section 1.132-5(c) for general and safe harbor rules relating to the applicability of the substantiation requirements of section 274(d).

(7)Special valuation rules. See §1.61-21(d)(6)(ii) for special rules that may be used to value the availability of demonstration automobiles.

(p)Parking.

(1)In general. The value of parking provided to an employee on or near the business premises of the employer is excludable from gross income as a working condition fringe under the special rule of this paragraph (p). If the rules of this paragraph (p) are satisfied, the value of parking is excludable from gross income whether the amount paid by the employee for parking would be deductible under section 162. The working condition fringe exclusion applies whether the employer owns or rents the parking facility or parking space.

(2)Reimbursement of parking expenses. A reimbursement to the employee of the ordinary and necessary expenses of renting a parking space on or near the business premises of the employer is excludable from gross income as a working condition fringe, if, but for the parking expense, the employee would not have been entitled to receive and retain such amount from the employer. If, however an employee is entitled to retain a general transportation allowance or a similar benefit whether or not the employee has parking expenses, no portion of that allowance is excludable from gross income under this paragraph (p) even if it is used for parking expenses.

(3)Parking on residential property. With respect to an employee, this paragraph (p) does not apply to any parking facility or space located on property owned or leased by the employee for residential purposes.

(4)Dates of applicability. This paragraph (p) applies to benefits provided before January 1, 1993. For benefits provided after December 31, 1992, see §1.132-9.

(q)Nonapplicability of nondiscrimination rules. Except to the extent provided in paragraph (n)(3) of this section (relating to discriminating classifications of a product testing program), the nondiscrimination rules of section 132(h)(1) and §1.132-8 do not apply in determining the amount, if any, of a working condition fringe.

(r)Volunteers.

(1)In general. Solely for purposes of section 132(d) and paragraph (a)(1) of this section, a bona fide volunteer (including a director or officer) who performs services for an organization exempt from tax under section 501(a), or for a government employer (as defined in paragraph (m)(7) of this section), is deemed to have a profit motive under section 162.

(2)Limit on application of this paragraph. This paragraph (r) shall not be used to support treatment of the bona fide volunteer as having a profit motive for purposes of any

provision of the Internal Revenue Code of 1986 (Code) other than section 132(d). Nothing in this paragraph (r) shall be interpreted as determining the employment status of a bona fide volunteer for purposes of any section of the Code other than section 132(d).

(3)Definitions.

(i) Bona fide volunteer. For purposes of this paragraph (r), an individual is considered a "bona fide volunteer" if the individual does not have a profit motive for purposes of section 162. For example, an individual is considered a "bona fide volunteer" if the total value of the benefits provided with respect to the volunteer services is substantially less than the total value of the volunteer services the individual provides to an exempt organization or government employer.

(ii) Liability insurance coverage for a bona fide volunteer. For purposes of this paragraph (r), the receipt of liability insurance coverage by a volunteer, or an exempt organization or government employer's undertaking to indemnify the volunteer for liability, does not by itself confer a profit motive on the volunteer, provided the insurance coverage or indemnification relates to acts performed by the volunteer in the discharge of duties, or the performance of services, on behalf of the exempt organization or government employer.

(4)Example. The following example illustrates the provisions of paragraph (r) of this section.

Example. A is a manager and full-time employee of P, a tax-exempt organization described in section 501(c)(3). B is a member of P's board of directors. Other than $25 to defray expenses for attending board meetings, B receives no compensation for serving as a director and does not have a profit motive. Therefore, B is a bona fide volunteer by application of paragraph (r)(3)(i) of this section and is deemed to have a profit motive under paragraph (r)(1) of this section for purposes of section 132(d). In order to provide liability insurance coverage, P purchases a policy that covers actions arising from A's and B's activities performed as part of their duties to P. The value of the policy and payments made to or on behalf of A under the policy are excludable from A's gross income as a working condition fringe, because A has a profit motive under section 162 and would be able to deduct payments for liability insurance coverage had he paid for it himself. The receipt of liability insurance coverage by B does not confer a profit motive on B by application of paragraph (r)(3)(ii) of this section. Thus, the value of the policy and payments made to or on behalf of B under the policy are excludable from B's income as a working condition fringe. For the year in which the liability insurance coverage is provided to A and B, P may exclude the value of the benefit on the Form W-2 it issues to A or on any Form 1099 it might otherwise issue to B.

(s)Application of section 274(a)(3).

(1)In general. If an employer's deduction under section 162(a) for dues paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose is disallowed by section 274(a)(3), the amount, if any, of an employee's working

condition fringe benefit relating to an employer-provided membership in the club is determined without regard to the application of section 274(a) to the employee. To be excludible as a working condition fringe benefit, however, the amount must otherwise qualify for deduction by the employee under section 162(a). If an employer treats the amount paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose as compensation under section 274(e)(2), then the expense is deductible by the employer as compensation and no amount may be excluded from the employee's gross income as a working condition fringe benefit. See §1.274-2(f)(2)(iii)(A).

(2)Treatment of tax-exempt employers. In the case of an employer exempt from taxation under subtitle A of the Internal Revenue Code, any reference in this paragraph (s) to a deduction disallowed by section 274(a)(3) shall be treated as a reference to the amount which would be disallowed as a deduction by section 274(a)(3) to the employer if the employer were not exempt from taxation under subtitle A of the Internal Revenue Code.

(3)Examples. The following examples illustrate this paragraph (s):

Example (1). Assume that Company X provides Employee B with a country club membership for which it paid $20,000. B substantiates, within the meaning of paragraph (c) of this section, that the club was used 40 percent for business purposes. The business use of the club (40 percent) may be considered a working condition fringe benefit, notwithstanding that the employer's deduction for the dues allocable to the business use is disallowed by section 274(a)(3), if X does not treat the club membership as compensation under section 274(e)(2). Thus, B may exclude from gross income $8,000 (40 percent of the club dues, which reflects B's business use). X must report $12,000 as wages subject to withholding and payment of employment taxes (60 percent of the value of the club dues, which reflects B's personal use). B must include $12,000 in gross income. X may deduct as compensation the amount it paid for the club dues which reflects B's personal use provided the amount satisfies the other requirements for a salary or compensation deduction under section 162.

Example (2). Assume the same facts as Example 1 except that Company X treats the $20,000 as compensation to B under section 274(e)(2). No portion of the $20,000 will be considered a working condition fringe benefit because the section 274(a)(3) disallowance will apply to B. Therefore, B must include $20,000 in gross income.

(t)Application of section 274(m)(3).

(1)In general. If an employer's deduction under section 162(a) for amounts paid or incurred for the travel expenses of a spouse, dependent, or other individual accompanying an employee is disallowed by section 274(m)(3), the amount, if any, of the employee's working condition fringe benefit relating to the employer-provided travel is determined without regard to the application of section 274(m)(3). To be excludible as a working condition fringe benefit, however, the amount must otherwise qualify for deduction by the employee under section 162(a). The amount will qualify for deduction and for exclusion as a working condition fringe benefit if it can be adequately shown that the spouse's, dependent's, or other accompanying individual's presence on the employee's

business trip has a bona fide business purpose and if the employee substantiates the travel within the meaning of paragraph (c) of this section. If the travel does not qualify as a working condition fringe benefit, the employee must include in gross income as a fringe benefit the value of the employer's payment of travel expenses with respect to a spouse, dependent, or other individual accompanying the employee on business travel. See §§1.61-21(a)(4) and 1.162-2(c). If an employer treats as compensation under section 274(e)(2) the amount paid or incurred for the travel expenses of a spouse, dependent, or other individual accompanying an employee, then the expense is deductible by the employer as compensation and no amount may be excluded from the employee's gross income as a working condition fringe benefit. See §1.274-2(f)(2)(iii)(A).

(2)Treatment of tax-exempt employers. In the case of an employer exempt from taxation under subtitle A of the Internal Revenue Code, any reference in this paragraph (t) to a deduction disallowed by section 274(m)(3) shall be treated as a reference to the amount which would be disallowed as a deduction by section 274(m)(3) to the employer if the employer were not exempt from taxation under subtitle A of the Internal Revenue Code.