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## The Internal Revenue Code and Automobiles: A Case Study of Taxpayer Noncompliance

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# FLORIDA TAX REVIEW

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## THE INTERNAL REVENUE CODE AND AUTOMOBILES: A CASE STUDY OF TAXPAYER NONCOMPLIANCE

by

James Alm\*  
Jay A. Soled\*\*

*Over the last decade, the tax gap — the difference between what taxpayers owe in taxes and what they actually pay — has remained significantly large. A contributory factor to the tax gap's size is the fact that many taxpayers mischaracterize the tax treatment of their automobile expenses and the receipt of other employer-provided fringe benefits. This analysis explores the reasons for this phenomenon and then proposes reforms that will make taxpayers more compliant, helping to reduce the tax gap's size. Although these reforms admittedly would not solve all of the nation's tax noncompliance woes, they would help preserve the income tax base and minimize economic distortions.*

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### I. INTRODUCTION

Many taxpayers deduct all or a portion of their automobile expenses or exclude from income travel allowances and reimbursements related to the use of their automobiles. When incurred for ordinary and necessary business reasons, such deductions and exclusions are sanctioned under the Internal Revenue Code (Code);<sup>1</sup> however, those automobile expenses incurred while commuting and for personal use reasons are not allowed as deductions and exclusions.<sup>2</sup> Unfortunately, many taxpayers intentionally or mistakenly mischaracterize their automobile expenses in a tax-favored fashion. Anecdotal evidence of such practices abounds, and case law suggests the ubiquity of this phenomenon.<sup>3</sup>

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1. See I.R.C. § 162(a)(2) (travel expenses incurred while away from home are deductible) & § 62(c) (expenses that are reimbursed under an “accountable plan” are not includable in a taxpayer’s income).

2. See I.R.C. § 262; Reg. § 1.262-1(b)(5); *see, e.g.*, *Cashman v. Commissioner*, 9 T.C. 761 (1947) (expenses such as bus, trolley, subway and taxi fares and the cost of operating an automobile between home and work are nondeductible personal expenses); Chief Couns. Adv. 199948016 (Dec. 3, 1999) (nondeductible expenses include mileage, tolls and parking fees incurred by employee driving from home to work).

3. In each of the following cases, for example, the taxpayers’ commuting expenses were held to be nondeductible: *Feistman v. Commissioner*, 63 T.C. 129 (1974), *appeal dismissed*, 587 F.2d 941 (9th Cir. 1978); *Anderson v. Commissioner*, 60 T.C. 834 (1973); *Marot v. Commissioner*, 36 T.C. 238 (1961); *Donnelly v. Commissioner*, T.C. 1278 (1957), *aff’d*, 262 F.2d 411 (2d Cir. 1959); *Bruton v. Commissioner*, 9 T.C. 882 (1947); *Washburn v. Commissioner*, 992 F.2d 321 (2d Cir. 1993), *aff’g* T.C. Memo. 1991-195, *cert. denied*, 510 U.S. 866 (1993); *Verbica v. Commissioner*, T.C. Memo. 1990-584; *Clark v. Commissioner*, T.C. Memo. 1989-598, *aff’d on another issue*, 951 F.2d 1258 (10th Cir. 1991); *Dickson v. Commissioner*, T.C. Memo. 1986-182; *Brown v. Commissioner*, T.C. Memo. 1983-726; *Henderson v. Commissioner*, T.C. Memo. 1983-372; *Taylor v. Commissioner*, T.C. Memo. 1981-8; *Krambo v. Commissioner*, T.C. Memo. 1980-425; *Alexander v. Commissioner*, T.C. Memo. 1979-436; *Fisher v. Commissioner*, T.C. Memo. 1979-

Taxpayer noncompliance with respect to automobile usage is not surprising. Three bodies of tax literature offer compelling explanations for why noncompliance is commonplace. The first body of literature explains that distinguishing between deductible business expenses and nondeductible personal expenses sometimes engenders difficult line-drawing.<sup>4</sup> When the line between the two is blurry — as is often the case with automobile usage

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191; McKinley v. Commissioner, T.C. Memo. 1978-428; Gudmundsson v Commissioner, T.C. Memo. 1978-299; Clark v. Commissioner, T.C. Memo. 1978-276; Potenga v. Commissioner, T.C. Memo. 1976-151; Patti v. Commissioner, T.C. Memo. 1975-107; Beckley v. Commissioner, T.C. Memo. 1975-37; Roberts v. Commissioner, T.C. Memo. 1971-282; Pemberton v. Commissioner, T.C. Memo. 1970-194; Crist v. Commissioner, T.C. Memo. 1970-115; Hodgkinson v. Commissioner, T.C. Memo. 1968-176; Kutchinski v. Commissioner, T.C. Memo. 1968-46; Steinhort v. Commissioner, 335 F.2d 496 (5th Cir. 1964), *aff'g* T.C. Memo. 1962-233; Bodholdt v. Commissioner, T.C. Memo. 1961-87; Steele v. Commissioner, T.C. Memo. 1960-181; Walker v. Commissioner, T.C. Memo. 1959-206; Ranstead v. Commissioner, 10 T.C. Memo. 117 (1951); Thompson v. Commissioner, 15 T.C. 609 (1950), *acq. in result*, 1951-1 C.B. 3, *nonacq.*, 1951-1 C.B. 4, *rev'd*, 193 F.2d 586 (10th Cir. 1951); Rogers v. Commissioner, TC. Summary Op. 2001-188. Commissioner, T.C. Memo. 1979-436; Fisher v. Commissioner, T.C. Memo. 1979-191; McKinley v. Commissioner, T.C. Memo. 1978-428; Gudmundsson v Commissioner, T.C. Memo. 1978-299; Clark v. Commissioner, T.C. Memo. 1978-276; Potenga v. Commissioner, T.C. Memo. 1976-151; Patti v. Commissioner, T.C. Memo. 1975-107; Beckley v. Commissioner, T.C. Memo. 1975-37; Roberts v. Commissioner, T.C. Memo. 1971-282; Pemberton v. Commissioner, T.C. Memo. 1970-194; Crist v. Commissioner, T.C. Memo. 1970-115; Hodgkinson v. Commissioner, T.C. Memo. 1968-176; Kutchinski v. Commissioner, T.C. Memo. 1968-46; Steinhort v. Commissioner, 335 F.2d 496 (5th Cir. 1964), *aff'g* T.C. Memo. 1962-233; Bodholdt v. Commissioner, T.C. Memo. 1961-87; Steele v. Commissioner, T.C. Memo. 1960-181; Walker v. Commissioner, T.C. Memo. 1959-206; Ranstead v. Commissioner, 10 T.C. Memo. 117 (1951); Thompson v. Commissioner, 15 T.C. 609 (1950), *acq. in result*, 1951-1 C.B. 3, *nonacq.*, 1951-1 C.B. 4, *rev'd*, 193 F.2d 586 (10th Cir. 1951); Rogers v. Commissioner, TC. Summary Op. 2001-188.

4. See, e.g., William A. Klein, *Income Taxation and Commuting Expenses: Tax Policy and the Need for Nonsimplistic Analysis of "Simple" Problems*, 54 CORNELL L. REV. 871, 878 (1969) ("The foregoing discussion should establish that the question of whether commuting expenses should be deductible is not an easy one and that the soundness of our present rules is not self-evident"); Daniel I. Halperin, *Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem*, 122 U. PA. L. REV. 859 (1974) (sets forth an analysis to determine the sometimes hard-to-draw line between business and personal expenses).

— taxpayers tend to exploit the ambiguities in their favor.<sup>5</sup> The second body of literature avers that the Code purposefully recruits third parties, such as employers (who, for example, must annually issue a set of information returns to both their employees and to the government),<sup>6</sup> to monitor taxpayer compliance.<sup>7</sup> The success of this monitoring system, however, is predicated upon the third party acting in a self-interested fashion that precludes collusion between itself and the party that it is assigned to monitor.<sup>8</sup> In the case of automobile usage, third parties and taxpayers often act in a collusive fashion rather than as adversaries, so taxpayer compliance suffers as a

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5. Perhaps this sentiment is best expressed by Professor William A. Klein in the following quotation:

In other words, it is not reasonable to expect satisfactory results from simply asking taxpayers, “Was your combination business and pleasure trip to Florida worth anything to you personally, and if so how much?” Even if a taxpayer could answer that question meaningfully, chances are his answer would be seriously distorted by the conscious or subconscious effect of self-interest.

William A. Klein, *The Deductibility of Transportation Expenses of a Combination Business and Pleasure Trip—A Conceptual Analysis*, 18 STAN. L. REV. 1099, 1103 (1966).

6. I.R.C. § 6041(a).

7. See Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 697 (2007):

This “information reporting,” like red light cameras, provides information to the government, and it is information that the taxpayer knows the government is receiving. Moreover, in some situations, the payor, such as an employer, must also withhold taxes from the payment and remit those taxes to the government. Withholding taxes, like speed bumps, constrain compliance with the law.

8. See, e.g., IRS, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012) (IR-2012-4) <http://www.irs.gov/pub/irs-news/ir-12-004.pdf> (“Overall, compliance is highest where there is third-party information reporting and/or withholding. For example, most wages and salaries are reported by employers to the IRS on Forms W-2 and are subject to withholding. As a result, a net of only 1 percent of wage and salary income was misreported. But amounts subject to little or no information reporting had a 56 percent net misreporting rate in 2006”); Karen Setze, *Taxpayers Honest When Someone’s Checking, Say IRS Officials*, 111 TAX NOTES 1216, 1216 (2006) (“[R]esults from the recently completed individual reporting compliance study for 2001 . . . showed that only 1.2 percent of wage income was underreported, 57 percent of nonfarm proprietor income was misreported . . . and 72 percent of farm income was misreported”).

result.<sup>9</sup> The third body of literature, grounded in economic theory, presents compelling evidence that indicates that there are strong financial incentives in terms of tax savings that drive taxpayer noncompliance.<sup>10</sup>

What is surprising is the congressional response to this phenomenon. Congress has seemingly chosen to ignore how taxpayers mischaracterize their automobile usage and the receipt of other fringe benefits that do not fall within the scope of any statutory income exclusion. Demonstrating the absence of congressional vigilance is the fact that, in the last quarter of a century, there are no comprehensive studies from reputable governmental oversight agencies such as the Government Accounting Office, Congressional Research Service, or Treasury Inspector General for Tax Administration detailing the level of taxpayer noncompliance in the realm of automobile usage. From a cynical perspective, one possible explanation is that the absence of such studies allows this noncompliance to persist, financially benefiting politicians and the wealthy campaign contributors who support them.<sup>11</sup> Alternatively, from a less cynical perspective, politicians may neither appreciate the severity of the problem nor have been presented with any practical compliance solutions. Whatever one's perspective, the prospects for enhanced taxpayer compliance appear slim.

However, it is certainly possible for Congress to address the mischaracterization of automobile expenses and the receipt of other taxable fringe benefits. Historically, whenever the country has suffered a tax compliance problem, Congress has crafted a solution. For example, when taxpayers were taking advantage of abusive tax shelters, Congress instituted Code section 469 to eliminate deductions for passive activity losses;<sup>12</sup> and when taxpayers sought to manufacture fictitious losses, Congress codified the economic substance doctrine now found in Code section 7701(o).<sup>13</sup> The list of meaningful fixes to strengthen taxpayer compliance problems is a long and growing one.<sup>14</sup> In the not-too-distant future, Congress could add to its

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9. *See infra* Section II.B. (discussing why so-called accountable plans fall far short of ensuring taxpayer compliance).

10. The literature in this area of economic analysis abounds. For a comprehensive and recent review, see, e.g., James Alm, *Measuring, Explaining, and Controlling Tax Evasion: Lessons from Theory, Experiments, and Field Studies*, 19 INT'L TAX AND PUB. FIN. 54 (2012).

11. *See infra* Section IV.

12. Tax Reform Act of 1986, Pub. L. No. 99-514, § 501, 100 Stat. 2085 (1986).

13. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409, 124 Stat. 1029, 1067–68 (2010).

14. Consider one of Congress's most recent efforts to enhance taxpayer compliance. In passing Hiring Incentives to Restore Employment Act of 2010, Pub.

list of successful compliance accomplishments the accurate tax reporting treatment of automobile usage.

While the focus of this Article is primarily on the mischaracterization of automobile expenses, automobile expenses are illustrative of many other taxpayer mischaracterizations such as for the personal use of cellular telephones, frequent flyer miles, and home Internet service and their tax treatment as being business-related. Accordingly, towards the end of our analysis, we expand our discussion to include reforms that address these items of potential abuse as well.

This Article proceeds as follows. Section II summarizes the distinctions between business and personal automobile expenses and then sets forth the concomitant consequences stemming from such determinations. Section III highlights the current oversight system and its flaws. Section IV details how the tax treatment of automobile expenses is representative of a broad spectrum of taxpayer noncompliance problems and the implications associated with taxpayer noncompliance. Section V offers viable solutions aimed at addressing and eradicating taxpayer noncompliance. Finally, Section VI offers a conclusion.

## **II. BUSINESS AND PERSONAL AUTOMOBILE EXPENSES AND THEIR CONCOMITANT TAX CONSEQUENCES**

Under the Code, the tax treatment of automobile expenses is intricate. There are several steps involved in ascertaining the correct tax treatment of such expenses as well as the manner in which such treatment should be reported. The sections below (A) delineate the demarcation line between those automobile expenses that are business in nature (and hence are deductible or, alternatively, the reimbursement for which is excludable from income) and those incurred for personal reasons (and hence are nondeductible or, alternatively, the reimbursement for which is non-excludable from income) and (B) detail how the Code instructs taxpayers to report automobile expenses.

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L. No. 111-147, 124 Stat. 71, Congress enacted the Foreign Account Tax Compliance Act (FATCA). This legislation requires foreign financial institutions to disclose specific information relating to their customers' identities or else, for the first time in the Code's history, confront a withholding tax as a coercive enforcement mechanism. See generally Melissa A. Dizdarevic, *The FATCA Provisions of the HIRE Act: Boldly Going Where No Withholding Has Gone Before*, 79 *FORDHAM L. REV.* 2967 (2011).

A. *The Demarcation Line Between Business and Personal Automobile Expenses*

The basic building blocks that underpin the tax treatment of automobile expenses can be found in two Code sections: Code section 162 states that all “ordinary and necessary” business expenses are deductible<sup>15</sup> and Code section 262 states that all personal expenses are nondeductible.<sup>16</sup> In many instances, application of these two sections is fairly straightforward. For example, if an attorney drives from her office to the courthouse to argue a motion, the expenses that she incurs (e.g., gasoline) are deductible.<sup>17</sup> This is a sensible result because one of the Code’s fundamental precepts is that taxpayers should be taxed on their net profits and not upon their gross receipts.<sup>18</sup> Conversely, if an architect commutes from his suburban home to his urban office, the expenses that the architect incurs (e.g., the highway tolls) are nondeductible.<sup>19</sup> This, too, is a sensible result because another fundamental precept underlying the Code is that personal income is the sum of “the market value of rights exercised in consumption and the change in the value of the store of property rights.”<sup>20</sup> Here, because it is the taxpayer’s personal choice to live a considerable distance away from his place of work, the travel expenses that the taxpayer incurs constitute an item of consumption and, when determining taxable income, should not be deductible.

The two scenarios just posited in the prior paragraph involving an attorney and architect present a fairly straightforward black-and-white picture of those automobile expenses that are considered business-oriented and those that are personal. However, there are four important exceptions to the general business-versus-personal rule just posited. These four exceptions imbue the otherwise black and white landscape with dark shades of gray.

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15. I.R.C. § 162(a).

16. I.R.C. § 262(a).

17. *See, e.g.,* *El v. Commissioner*, T.C. Memo. 1990-182, *aff’d without op.*, 980 F.2d 723 (3d Cir. 1990) (expenses of policeman who traveled between his primary and secondary jobs were not commuting expenses but rather deductible business expenses).

18. *See, e.g.,* *Hantzis v. Commissioner*, 638 F.2d 248, 249 (1st Cir. 1981) (“[A] fundamental principle of taxation [is] that a person’s taxable income should not include the cost of producing that income”).

19. *Fausner v. Commissioner*, 413 U.S. 838 (1973); *Commissioner v. Flowers*, 326 U.S. 465 (1946); *Feistman v. Commissioner*, 63 T.C. 129, 134 (1974).

20. HENRY C. SIMONS, *PERSONAL INCOME TAXATION* (1938); *see also* ROBERT M. HAIG, *THE FEDERAL INCOME TAX* (1921).



### 1. Exceptions

Exception #1: The Home Office Exception. This exception, judicially and administratively formulated,<sup>21</sup> declares that expenses incurred traveling between a taxpayer's residence and other business locations are deductible if the residence constitutes the taxpayer's principal place of business. Code section 280A(c)(1) sets forth the conditions determining when a taxpayer's residence constitutes a principal place of business.<sup>22</sup> If the taxpayer's residence satisfies one of these conditions and thus constitutes the taxpayer's principal place of business, automobile expenses that a taxpayer incurs traveling to other business locations are deductible.<sup>23</sup> For example, if a dentist has a home office and periodically makes house calls, the travel expenses that she incurs while visiting patients are deductible.<sup>24</sup>

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21. *Strohmaier v. Commissioner*, 113 T.C. 106, 113–14 (1999); *Wis. Psychiatric Servs. v. Commissioner*, 76 T.C. 839, 849 (1981); *Curphey v. Commissioner*, 73 T.C. 766, 777–78 (1980); *see* Rev. Rul. 99-7, 1999-1 C.B. 361, 362 (“If a taxpayer’s residence is the taxpayer’s principal place of business . . . , the taxpayer may deduct daily transportation expenses incurred in going between the residence and another work location”).

22. Essentially, one of the following three conditions must be met: the residence must be used by the taxpayer (1) for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business; (2) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business; or (3) in the case of a separate structure that is not attached to the dwelling unit, in connection with the taxpayer’s trade or business. I.R.C. § 280A(c)(1).

23. *Gosling v. Commissioner*, T.C. Memo. 1999-148; *Dehr v. Commissioner*, T.C. Memo. 1998-441; *Kahaku v. Commissioner*, T.C. Memo. 1990-34; *Wicker v. Commissioner*, T.C. Memo. 1986-1; *Adams v. Commissioner*, T.C. Memo. 1982-223, *aff’d*, 732 F.2d 159 (7th Cir. 1984); *Curphey v. Commissioner*, 73 T.C. 766 (1980).

24. Conversely, if the taxpayer’s residence does not satisfy any of the conditions set forth in Code section 280A (and is thus not his principal place of business), then commuting expenses to other business locations are deemed nondeductible personal expenses. *See Strohmaier v. Commissioner* 113 T.C. 106, 114 (1999) (“Since petitioner’s residence was not his ‘principal place of business’, it follows that the expenses relating to the disallowed mileage for each year constitutes commuting expenses that are not deductible”); *see also Romer v. Commissioner*, T.C. Memo. 2001-168 (holding that because the taxpayer’s residence did not qualify as his principal place of business under section 280A(c)(1)(A), he was not entitled to

Exception #2: The Temporary Distant Work Site Exception. This exception is encapsulated in a half-century-old revenue ruling stating that when an employee

is employed for a strictly temporary (as distinguished from an indefinite) period on a construction project situated at a distance from the metropolitan area in which he is regularly employed, he may deduct ... his actual expenses incurred for daily transportation between his principal or regular place of employment and such job.<sup>25</sup>

Over the years, courts have refined this exception, providing that the qualification for this exception requires that the temporary work site has to be a meaningful distance from the area where the taxpayer lives and normally works.<sup>26</sup> The rationale for permitting this exception is simple: “it is not reasonable to expect people to move to a distant location when a job is foreseeably of limited duration.”<sup>27</sup> To illustrate, if a taxpayer is an accountant who lives and works in New York City and is sent on a two-month assignment by her employer to audit a client in Philadelphia, then she may categorize her travel expenses as business rather than personal (i.e., commuting) in nature.<sup>28</sup>

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deduct travel expenses to and from his home); *Beale v. Commissioner*, T.C. Memo. 2000-158 (same).

25. Rev. Rul. 190, 1953-2 C.B. 303. In Revenue Ruling 99-7, 1999-1 C.B. 361, the IRS, too, added a further refinement to this exception, stating thus: “A taxpayer . . . may deduct daily transportation expenses incurred in going between the taxpayer’s residence and a TEMPORARY work location OUTSIDE the metropolitan area where the taxpayer lives and normally works.” The revenue ruling defines a temporary work location as one that “is realistically expected to last (and does in fact last) for 1 year or less.”

26. Rev. Rul. 190, 1953-2 C.B. 303. In Revenue Ruling 99-7, 1999-1 C.B. 361, the IRS, too, added a further refinement to this exception, stating thus: “A taxpayer . . . may deduct daily transportation expenses incurred in going between the taxpayer’s residence and a TEMPORARY work location OUTSIDE the metropolitan area where the taxpayer lives and normally works.” The revenue ruling defines a temporary work location as one that “is realistically expected to last (and does in fact last) for 1 year or less.”

27. *Dahood v. United States*, 747 F.2d 46, 48 (1st Cir. 1984); *Kasun v. United States*, 671 F.2d 1059, 1061 (7th Cir. 1982); *Epperson v. Commissioner*, T.C. Memo. 1985-382.

28. *Kasun*, 671 F.2d at 1061.

28. *See, e.g., Daiz v. Commissioner*, T.C. Memo. 2002-192 (taxpayer who lived and normally worked in Stockton, California, and, for work, had to travel to

Exception #3: The Regular Work Location Exception (One Employer). This exception, rooted in Revenue Ruling 90-23<sup>29</sup> and subsequently reformulated in Revenue Ruling 99-7,<sup>30</sup> provides as follows: “If a taxpayer has one or more regular work locations away from the taxpayer’s residence, the taxpayer may deduct daily transportation expenses incurred in going between the taxpayer’s residence and a TEMPORARY work location in the same trade or business, regardless of the distance.” Revenue Ruling 90-23 defines a “temporary” work location as one at which the taxpayer performs services on an irregular or short-term (i.e., generally a matter of days or weeks) basis.<sup>31</sup> For example, a contractor who spends approximately 25 percent of his time at his office and, with respect to the balance of his time, regularly travels to various job sites from his residence may deduct the costs associated with the latter trips.<sup>32</sup>

Exception #4: The Regular Work Location Exception (Two or More Employers). If a taxpayer works at two (or more) different places in a day, the courts have held that the taxpayer may deduct the costs of getting from one place to the other,<sup>33</sup> and the IRS generally concurs.<sup>34</sup> For example, if a lawyer teaches at a law school and also maintains a private practice at a different location, the travel expenses that the lawyer incurs in going from the school to his private practice law office and vice versa are deemed business in nature.

## 2. Confusion Surrounding Exceptions

In theory, for tax purposes, the general rule coupled with these four exceptions constitutes a viable framework for taxpayers to account for how to treat their automobile expenses. But when taxpayers actually confront these exceptions, they get lost in their applications and mired in their subtleties. Consider the confusion that each exception engenders.

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Novato, Napa, and Yuba City — round-trip distances of 171, 141, and 174 miles, respectively — could treat such trips as noncommuting in nature).

29. Rev. Rul. 90-23, 1990-1 C.B. at 29.

30. Rev. Rul. 99-7, 1999-1 C.B. at 362.

31. Rev. Rul. 90-23, 1990-1 C.B. at 29.

32. *See, e.g.*, Priv. Ltr. Rul. 98-06-007 (exploring the tax consequences associated with a similar arrangement).

33. *See, e.g.*, *El v. Commissioner*, T.C. Memo. 1990-182, *aff’d without op.*, 980 F.2d 723 (3d Cir. 1990) (travel expenses incurred by police officer traveling between his principal place of employment at the police department and his part-time security jobs at a hospital and a supermarket were business rather than personal in nature).

34. Rev. Rul. 55-109, 1955-1 C.B. 261; IRS PUB NO. 463, at 14 (2009).

First, in this day and age, most taxpayers perform some work tasks from home.<sup>35</sup> They regularly log on to their computers and/or use their smartphones to stay in constant touch with their offices. In other words, for many taxpayers, their homes have become an extension of their offices. What many of these same taxpayers do not realize is the fact that, although they do some work each day from home or even may work a whole day or two weekly from home, this activity does not transform their home into a principal place of business qualifying them for the first exception.<sup>36</sup>

Second, as the global business environment becomes more competitive, it has become standard fare for taxpayers to go to temporary work sites to perform services. Some of these work sites are in fairly close proximity to where taxpayers are currently employed; some are not. Absent a clear definition of the term distant, taxpayers do not know exactly when the second exception applies and often benightedly think that once they leave their driveways, the automobile expenses that they incur are automatically business in nature.<sup>37</sup>

Third, throughout a particular year, taxpayers may have jobs requiring that they be at two or more different locations at different times of the year. For example, during the winter months, a taxpayer might operate a horse-breeding farm in Florida; during the summer months, the same taxpayer might operate a pool business in Connecticut. Are these different work locations temporary work locations as specified under the third exception? The IRS says no because the third exception is not designed for taxpayers who regularly commute to the same work locations (e.g., a doctor who goes between the doctor's residence and one or more offices, clinics, or hospitals at which the doctor works or performs services on a regular basis constitute nondeductible commuting expenses). However, many taxpayers may naively think that different work locations at different times of the year

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35. See Table 1-1. *All Workers, and Workers Who Worked at Home for the United States: 1960 to 2000*, U.S. CENSUS 2000, WORKING AT HOME 2000 (Oct. 20, 2004), <http://www.census.gov/population/www/cen2000/briefs/phc-t35/tables/tab01-1.pdf> (reflecting the fact that over the past two decades an increasing number of people work from home).

36. See Lauren Marini, "Simplification" Is Not Enough: *An Analysis of the Home Office Tax Deduction and the Home Office Simplification Act of 2009*, 40 U. BALT. L. REV. 107 (2010) (among other things, explaining the problems associated with the home office deduction).

37. See, e.g., *Wheir v. Commissioner*, T.C. Summary Op., 2004-117 (pointing out the difficulty associated with defining *metropolitan area*, resorting to *Webster's Third New International Dictionary* (1986), which defines *metropolitan* as follows: "relating to, or constituting a region including a city and the densely populated surrounding areas that are socially and economically integrated with it").

count as temporary places of business and may accordingly try to deduct all of their automobile expenses they incur at both locations under the third exception.<sup>38</sup>

Fourth, the incidence of taxpayers having multiple full- and part-time jobs has become increasingly common.<sup>39</sup> Taxpayers may travel to these jobs on different or the same days of the week. Such taxpayers are accordingly likely to classify all of their automobile expenses (or at least those incurred during the workweek) as business oriented under the fourth exception.<sup>40</sup>

The confusion that surrounds the application of the general rule and these four exceptions no doubt contributes to taxpayer noncompliance. Taxpayers are often at a loss to distinguish between those automobile expenses that are business in nature and those that are personal. Also, as was previously pointed out, when the distinctions between business and personal expenses are especially difficult to discern, taxpayers are apt to err on the side of treating such expenses in a tax-favored fashion.<sup>41</sup> The difficulties engendered in discerning the business-versus-personal nature of automobile expenses are bad enough, but, as the next section details, the manner in which the Code instructs taxpayers to report business-oriented automobile expenses presents its own set of unique challenges.

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38. The IRS would argue that the automobile expenses the taxpayer incurred at each location are merely commuting expenses and, as such, nondeductible. In *Andrews v. Commissioner*, 931 F.2d 132 (1st Cir. 1991), for example, the taxpayer had a horse-breeding business in Florida and a pool construction business in Connecticut at different times of the year, as described in the text. In analyzing the deductible expenses that the taxpayer incurred, the First Circuit ruled that the taxpayer had a major and minor post of duty and that the expenses the taxpayer incurred while at the minor post of duty were deductible. The First Circuit, however, failed to address whether the taxpayer's automobile expenses incurred while commuting from his living quarters at the minor post of duty to the actual job location would be nondeductible or deductible.

39. See Jim Campbell, *Multiple Jobholding in States in 2010*, MONTHLY LABOR REVIEW, Sept. 2011, at 32, <http://www.bls.gov/opub/mlr/2011/09/art3full.pdf> ("The annual average national multiple jobholding rate in 2010 was 4.9 percent. . .").

40. See, e.g., *Lopkoff v. Commissioner*, T.C. Memo. 1982-701 (holding that a taxpayer who had two jobs with two different employers was allowed to deduct the travel expenses she incurred in going between the two job locations even though the second of her two jobs was only a half-mile away from the taxpayer's home).

41. See *supra* notes 4-5.

## B. Tax Reporting of Automobile Expenses

Automobiles can serve dual purposes: they can be used as a means to produce income (e.g., a drug representative who must drive between locations to promote a drug manufacturer's product), and they can be used for personal purposes (e.g., a drug representative who, along with his family, drives to various vacation destinations). This section of the analysis explores the methodology by which the Code (1) accords deductions for the business use of automobiles and (2) requires income inclusion associated with the personal use of business-supplied automobiles.

### 1. Deductions for the Business Use of Automobiles

Automobiles can perhaps best be described as the platypus of tangible personal property — they defy easy categorization. For example, even when used strictly for business, depending upon how luxurious the model, automobiles may offer personal emoluments to their owners;<sup>42</sup> the taxpayer seeking the deduction may have stellar record-keeping habits, or, alternatively, such habits may be lackluster; and the taxpayer seeking to deduct automobile expenses may either be an employee or the owner of a business enterprise. Each one of the foregoing items — i.e., personal inurement, record keeping, and taxpayer status — plays a pivotal role in shaping the tax deductibility and reporting of business automobile expenses.

For starters, to account for personal emoluments associated with the use of automobiles, the Code caps the depreciation deductions normally associated with the use of passenger automobiles.<sup>43</sup> More specifically, the Code labels passenger automobiles as listed property<sup>44</sup> and, as such, places

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42. See H.R. REP. NO. 98-432, pt. 2, at 1387 (1984) (expressing the view that beyond a certain level, “the extra expense of a luxury automobile operates as a tax-free personal emolument which the committee believes should not qualify for tax credits and deductions”).

43. The normal depreciation rule classifies automobiles as five-year property. I.R.C. § 168(e)(3)(B)(i). As such, the prescribed depreciation method is 200 percent declining balance method (and switching to straight-line when it produces a greater deduction (I.R.C. § 168(b)(1)) that ignores salvage value (§ 168(b)(4))) and is subject to the half-year convention. *Id.* § 168(d)(1).

44. See I.R.C. § 280F(d)(5)(A) (the term *passenger automobile* is defined as “any 4-wheeled vehicle which is manufactured primarily for use on public streets, roads, and highways, and which is rated at 6,000 pounds unloaded gross vehicle weight or less”).

significant limitations on how much depreciation is annually allowable.<sup>45</sup> For example, automobiles placed in service that cost \$30,784 (the average cost of a new automobile in 2012)<sup>46</sup> would take ten years to fully depreciate; but

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45. I.R.C. § 280F(a). If the purchase price exceeds an annually adjusted monetary threshold, automobiles are subject to special depreciation limitations. *Id.* § 280F(d)(4)(A)(i). Here's how the depreciation limitation applies: it caps the allowable depreciation amounts in accordance with annually published tables. *Id.* § 280F(a)(1)(A). In 2012, for example, the amount of allowable depreciation for each year that an automobile remains in service is as follows:

<u>Allowable Depreciation</u>	
First year	\$11,160
Second year	\$ 5,100
Third year	\$ 3,050
Each succeeding year	\$ 1,875

*See* Rev. Proc. 2012-23, 2012-14 I.R.B. 1. Note that in 2012, Code section 168(k)(2)(F)(i) permits an additional \$8,000 of depreciation deductions the first year that an automobile is placed into service.

When it comes to depreciating tangible personal property, there are potential opportunities for enhanced depreciation deductions. That is, Code section 179 permits taxpayers to take bonus depreciation deductions that, depending upon the tax year involved, can be quite significant. For example, the bonus depreciation figure for 2012 is \$500,000. I.R.C. § 179(b)(1). Code section 168(k) next permits an additional depreciation allowance. I.R.C. § 168(k)(1)(A). For example, in 2012, in addition to the normal deduction that a taxpayer may take, taxpayers can deduct 50 percent of the purchase price of tangible personal property placed into service, including the purchase of any new passenger automobile. *Id.* The listed property restrictions found in Code section 280F nullify the utility of these enhanced deductions. This is because Code section 280F(d)(1) provides that the depreciation ceiling amounts apply even if a taxpayer elects to apply Code section 179 bonus depreciation. Furthermore, even though a taxpayer may not be able to fully utilize the Code section 179 bonus depreciation, an automobile's adjusted basis is nevertheless reduced by the full amount of the Code section 179 allowance. Reg. § 1.280F-2T(e), ex. 4. In succeeding years, this basis reduction will curtail the availability of future depreciation deductions. Finally, taxpayers must reduce the tax basis of any business use automobile by the full amount of allowable depreciation deduction, even if a portion of the depreciation deduction is denied because of the taxpayer's personal use of the automobile. I.R.C. § 280F(d)(2).

46. *See, e.g., Zach Bowman, Average Price for a New Car Sales Transaction Hits \$30,784, an All-Time Record, AUTOBLOG* (April 11, 2012, 4:01 PM) ("According to TrueCar.com's data, the average selling price of a new car sold here in the U.S. last month was \$30,748, marking an all-time record (last year's

more luxurious automobiles, say a \$50,000 Lexus, would take twenty years to fully depreciate. To circumvent the application of these depreciation deduction limitations, taxpayers cannot simply lease their automobiles; stringent deduction limitations also apply to automobile lease payments.<sup>47</sup>

Aside from a restrictive depreciation regime, taxpayers seeking to deduct their business automobile expenses have a fundamental choice: they can deduct the actual expenses they incur, or, alternatively, they can deduct a standard rate based upon the business miles they travel. Under the actual expense method, those taxpayers who wish to deduct the actual costs of operating their vehicle for business purposes must catalog such expenses.<sup>48</sup>

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figure was just \$28,771”), <http://www.autoblog.com/2012/04/11/average-price-of-new-cars-hits-all-time-record>.

47. Taxpayers may deduct their lease payments (or, if less, the business use percentage of such lease payments). This percentage is found by dividing the mileage incurred that is qualified business use by the automobile’s total mileage. I.R.C. § 280F(d)(6)(A). As listed property, however, if the annual lease payments exceed a particular monetary threshold (which is adjusted each year for inflation), there is an income add-back feature associated with such lease payments. I.R.C. § 280F(c)(2). The purpose of this add-back — a sum referred to as an *inclusion amount* — is to ensure that taxpayers not avoid the depreciation deduction limitations that are set forth above. Computation of the inclusion amount is a complex process that entails multiple steps and a familiarity with the automobile leasing process. Computing the actual inclusion amount essentially engenders three steps: (1) the taxpayer must ascertain the automobile’s fair market value; (2) based upon the number determined in step (1) and using a table supplied by the IRS, the taxpayer must determine the includable amount; and (3) the taxpayer must prorate over the number of days leased. Reg. § 1.280F-7(a)(2). Once this dollar figure is determined, the taxpayer must adjust it for the taxpayer’s percentage of business/investment use. Reg. § 1.280F-7(a)(2)(iii).

48. The actual expense method requires taxpayers to distinguish between business and personal use of their automobiles. To assist in this bifurcation process, Treasury Regulations prescribe that taxpayers may use a mileage measurement test (Reg. § 1.274-5T(b)(6)(i)(B)), albeit taxpayers are at liberty to use an alternative method to accomplish the same task as long as the method chosen is reasonable. H.R. CONF. REP. NO. 98-861, at 1028 (1984) (“[R]egulations could provide that if an automobile is used 5 days a week for business purposes and is available 2 days a week for personal purposes, in no event may the taxpayer consider more than five-sevenths of the use to be allocable to business purposes”).

As listed property, distinctions drawn between business and personal use of automobiles are critical. By way of background, the Code defines *qualified business use* to be “any use in a trade or business of the taxpayer.” I.R.C. § 280F(d)(6)(B). However, the ambit of qualified business use does not include investment activities under Code section 212 (Reg. § 1.280F-6(d)(2)(i)) and certain other delineated activities specified in Code section 280F(d)(6)(C)(i). If the qualified business use of



Such costs generally include items like gasoline, tolls, repairs, regular maintenance, and insurance. Under the standard rate method (designed to alleviate the administrative burden of keeping accurate records of cash disbursements and computing their depreciation expenses), taxpayers are allowed instead to compute their business automobile expenses using a standard rate for the business miles they travel.<sup>49</sup> For example, in 2013, this rate is 56.5 cents per mile;<sup>50</sup> accordingly, a taxpayer who drives ten thousand miles related to business in 2013 may deduct \$5,650 (i.e., 10,000 x 56.5 cents).<sup>51</sup> There are, however, several rules that limit the availability of the standard mileage deduction.<sup>52</sup>

Finally, deduction limitations may turn upon whether the taxpayer seeking an automobile expense deduction is an employee. Subject to limitations,<sup>53</sup> employee taxpayers who incur unreimbursed “ordinary and necessary” business expenses may deduct them,<sup>54</sup> including business automobile expenses. Because automobiles constitute listed property,<sup>55</sup>

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an automobile is fifty percent or less, then the taxpayer must, on a going-forward basis, use the straight-line method of depreciation (I.R.C. § 280F(b)(2)(A)) and, furthermore, recapture in the current year as income the difference between the depreciation deductions the taxpayer was allowed in prior years versus what straight-line depreciation would have yielded. I.R.C. § 280F(b)(2)(B).

49. Reg. § 1.274-5(j)(2).

50. Notice 2012-72, 2012-50 I.R.B. 673, § 2 (2013 rates), Notice 2012-1, 2012-2 I.R.B. 260, § 2 (2012 rates); Notice 2010-88, 2010-51 I.R.B. 882, § 2, *as modified by* Ann. 2011-40, 2011-29 I.R.B. 56 (2011 rates); Rev. Proc. 2009-54, 2009-51 I.R.B. 930, § 5.01 (2010 rates).

51. A corollary to using the standard mileage rate is a deemed depreciation rule. Application of this rule requires that the adjusted basis of the automobile used for business driving purposes be downwardly adjusted by multiplying each business mile by a standard rate. For example, in 2012, this deemed rate of depreciation is equal to 23 cents per mile; in 2011, this rate was 22 cents per mile; and in 2010, this rate was 23 cents per mile. Notice 2012-1, *supra* note 50, § 3. In the prior illustration of the taxpayer who drove his automobile ten thousand miles for business in 2012, the taxpayer must downwardly adjust the tax basis he has in his automobile by \$2,300 (i.e., 10,000 x .23).

52. For example, this method is not allowed if the taxpayer had claimed a Code section 179 deduction, previously used a depreciation method other than straight-line, or had used or leased simultaneously five or more vehicles in business (such as fleet operations). Rev. Proc. 2010-51, 2010-51 I.R.B. 883, § 4.05.

53. *See* I.R.C. § 67(a) (limits miscellaneous deductions to the amount that exceeds two percent of the taxpayer’s adjusted gross income); I.R.C. § 68(a) (in certain instances, limits the amount of a taxpayer’s itemized deductions).

54. I.R.C. § 162(a).

55. *See supra* note 44.

however, the Code disallows all depreciation and lease expenses associated with business automobile usage “unless such use is for the convenience of the employer and required as a condition of employment.”<sup>56</sup> Definitions for the phrases “the convenience of the employer” and “condition of employment” have the same meaning under the listed property limitations as they do under Code section 119.<sup>57</sup> Application of this stringent test curtails the ability of most employee taxpayers to deduct their unreimbursed depreciation or lease expenses because, as practical matter, they cannot satisfy these conjunctive conditions.

In sum, deductions are said to be the product of legislative grace.<sup>58</sup> In the realm of business automobile expenses, Congress has rightfully chosen to be circumspect because when it relates to their business automobile expenses, many taxpayers tend to be highly aggressive in taking tax deductions.<sup>59</sup>

## 2. *Personal Use of Business-Supplied Automobiles and Its Tax Implications*

The starting point for tax implications associated with the personal use of a business-supplied automobile is Code section 61, which essentially declares that all accretions to wealth are taxable.<sup>60</sup> Congress has decided, however, that certain enumerated fringe benefits should be excluded from income.<sup>61</sup> In the subsections below, this analysis explores whether the personal use of a business-supplied automobile will result in either (a) income inclusion or (b) income exclusion.

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56. I.R.C. § 280F(d)(3)(A).

57. Reg. § 1.280F-6(a)(2)(i).

58. See *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934) (“Whether and to what extent deductions shall be allowed depends upon legislative grace. . . .”); *Helvering v. Indep. Life Ins. Co.*, 292 U.S. 371, 381 (1934) (“Unquestionably Congress has power to condition, limit, or deny deductions from gross income in order to arrive at the net that it chooses to tax”). See generally David I. Walker, *Suitable for Framing: Business Deductions in a Net Income Tax System*, 52 WM. & MARY L. REV. 1247 (2011); Erwin N. Griswold, *An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142 (1943).

59. *Treasury’s Temporary and Proposed Regulations Relating to Recordkeeping for Automobiles and Certain Other Property: Hearings Before the Comm. on Ways and Means*, 99th Cong., 1st Sess. 80-84, 87, 92 (1985).

60. I.R.C. § 61(a).

61. I.R.C. § 132(a).

a. *Income Inclusion*

When taxpayers receive an accretion to wealth, including an in-kind fringe benefit secured as part of their employment, the item's fair market value is includable in income.<sup>62</sup> In the context of employer-supplied automobiles, ascertaining the fair market value of an automobile and its usage for non-business purposes is particularly challenging, involving a myriad of intertwining rules. Elaborated below, applicable Treasury Regulations provide a general valuation rule coupled with three elective alternatives.

Under the general valuation rule, the amount includable in an employee's income is equal to the amount that an "individual would have to pay in an arm's-length transaction to lease the same or comparable vehicle on the same or comparable conditions in the geographic area in which the vehicle is available for use."<sup>63</sup> For example, if an employer supplies an employee with an automobile that has a lease value of \$10,000 per year and one-quarter of the employee's use is nonbusiness in nature, the employee would have to include \$2,500 in gross income. In lieu of the general valuation rule, if one of four specified conditions is met,<sup>64</sup> an employee can elect one of the three alternative valuation methods for purposes of computing the amount includable in an employee's income:<sup>65</sup> the annual lease rule,<sup>66</sup> the cents-per-mile rule,<sup>67</sup> or the commuting valuation rule.<sup>68</sup>

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62. Reg. § 1.61-21(b)(1).

63. Reg. § 1.61-21(b)(4)(i).

64. These conditions are specified in Reg. § 1.61-21(c)(3)(ii). They are as follows:

(A) The employer treats the value of the benefit as wages for reporting purposes within the time for filing the returns for the taxable year (including extensions) in which the benefit is provided; (B) The employee includes the value of the benefit in income within the time for filing the returns for the taxable year (including extensions) in which the benefit is provided; (C) The employee is not a control employee as defined in paragraphs (f)(5) and (f)(6) of this section; or (D) The employer demonstrates a good faith effort to treat the benefit correctly for reporting purposes.

65. No notice of this election must be supplied to the IRS. *See* Reg. § 1.61-21(c)(3)(i) ("Neither the employer nor the employee must notify the Internal Revenue Service of the election").

66. When the annual lease value rule applies, it includes the costs of maintaining the automobile plus the costs of insuring it. Reg. § 1.61-21(d)(3)(i). Utilization of this valuation rule requires the application of a multistep process.

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Step 1 involves determining an automobile's fair market value. The general rule is that an automobile's fair market value is the amount an individual would pay locally to purchase a comparably equipped automobile. Reg. § 1.61-21(d)(5)(i). In ascertaining an automobile's value, there are several alternative methods available, including, in the case of a purchased automobile, the employer's cost of purchase, Reg. § 1.61-21(d)(5)(ii)(A); and in the case of a leased automobile, the manufacturer's suggested retail price less eight percent (including sales tax, title, and other purchase expenses), Reg. § 1.61-21(d)(5)(ii)(C).

Step 2 involves taking the fair market value established in Step 1 and then using it and a table provided under the Treasury regulations to ascertain the so-called Annual Lease Value of the vehicle. Reg. § 1.61-21(d)(2)(i)(B). The table itself is found in Reg. § 1.61-21(d)(2)(iii).

The final step involves taking the Annual Lease Value and multiplying it by the ratio of the taxpayer's annual personal mileage over the annual total mileage (i.e., business-related miles driven plus personal miles driven). Reg. § 1.132-5(b)(1)(i). Special rules apply if the automobile is (i) available for less than the full calendar year (*see* Reg. § 1.61-21(d)(4)(i) (the annual lease value is prorated, based on the ratio of use days to total days in the year) or continuously available to the taxpayer for less than thirty days (Reg. *id.* § 1.61-21(d)(4)(iii)); (ii) used beyond a defined period of time (*see* Reg. § 1.61-21(d)(2) (permitting a recalculation of the lease value if the taxpayer uses the automobile past December 31 of the fourth full calendar year that the automobile is placed into service); Reg. § 1.61-21(d)(2)(v) (likewise permitting a recalculation of the lease value if the automobile is assigned to another employee (as long as the primary purpose of the switch was not tax motivated)); or (iii) is part of a larger fleet of employer-owned automobiles. *See* Reg. § 1.61-21(d)(5)(v) (describing in elaborate detail how taxpayers who own twenty or more automobiles may use the average of the fair market values of each automobile in the fleet).

If an employer also covers fuel expenses, such expenses must be independently accounted for. Reg. § 1.61-21(d)(3)(ii)(A). As a rule of convenience, taxpayers can generally elect to value such fuel at 5.5 cents per mile. Reg. § 1.61-21(d)(3)(ii)(B).

67. This method permits employers to value an employee's personal use of an automobile at a fixed rate (e.g., in 2012, 55.5 cents per mile (*see supra* note 50)). Reg. § 1.61-21(e)(1). This monetary figure covers the entire use of an automobile, including its gas, maintenance, and insurance. Reg. § 1.61-21(e)(3)(i). If an employer does not cover gasoline expenses, the stated monetary amount is reduced by 5.5 cents per mile. Reg. § 1.61-21(e)(3)(iii)(A).

For taxpayers to qualify to use this valuation method, two conditions must be met. First, the fair market value of the automobile cannot exceed a certain ceiling amount (e.g., in 2012, \$15,900, *see* Rev. Proc. 2012-13 § 3.01, 2012-3 I.R.B. 295). *See also* Reg. § 1.61-21(e)(1)(iii) (the fair market value of the automobile when it is first placed into service cannot exceed the sum of the maximum depreciation deduction allowance under Code section 280F(a)(2) for the first five years of use). Second, either the employer reasonably expects that the automobile will be regularly

*b. Income Exclusion*

When an employer supplies an employee with the use of an automobile, the starting point of analysis is that the value of such use is fully taxable.<sup>69</sup> However, the Code provides that certain specified fringe benefits are excluded from income.<sup>70</sup> Among the many fringe benefits that the Code excludes from income, the two with the most salience insofar as business automobile usage is concerned are those that qualify as working condition fringe benefits<sup>71</sup> and de minimis fringe benefits.<sup>72</sup>

A working condition fringe benefit is a payment for property or a service that would have been deductible as an ordinary or necessary business

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used in its trade or business or the automobile is driven at least ten thousand miles in a calendar year and is used primarily by employees. Reg. § 1.61-21(e)(1)(ii).

68. If several rigorous conditions are met, a taxpayer's use of an employer-supplied automobile for commuting purposes can be valued at \$1.50 per one-way commute. Reg. § 1.61-21(f)(3). All five of the following conditions must be met:

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

(ii) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle;

(iii) The employer has established a written policy under which neither the employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home);

(iv) Except for de minimis personal use, the employee does not use the vehicle for any personal purpose other than commuting; and

(v) The employee required to use the vehicle for commuting is not a control employee of the employer (as defined in paragraphs (f)(5) and (6) of this section).

Reg. § 1.61-21(f)(1).

Due to the stringent nature of the conditions specified in the Treasury Regulations and the fact that an employer and an employee must both agree to adhere to this rule, Reg. § 1.61-21(c)(2)(i), it is not frequently utilized.

69. I.R.C. § 61(a).

70. I.R.C. § 132(a).

71. I.R.C. § 132(d).

72. I.R.C. § 132(e).

expense or would have been depreciable had the employee paid for it.<sup>73</sup> For example, if an employer supplies an employee with an automobile to make deliveries, the value of the employee's use of this automobile would be excluded from the employee's gross income except to the extent that the employee used the automobile for personal purposes.<sup>74</sup> The scope of the working condition exclusion is fairly broad. For example, there is a safe harbor from income for vehicles that are not used at all for personal purposes<sup>75</sup> and another safe harbor for automobiles not available to employees for personal purposes other than commuting.<sup>76</sup>

A de minimis fringe benefit is "any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable."<sup>77</sup> Frequency of the benefit being conferred on an employee is an important factor in determining whether a benefit qualifies under this exception.<sup>78</sup> In terms of automobiles, the regulations specifically state that, if an employer provides an employee the use of a vehicle more than one day a month for commuting purposes, then its value would not be excludable from income under this exception.<sup>79</sup>

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Properly categorizing the correct tax treatment and reporting of business automobile expenses is challenging, as evidenced by the number of interwoven variables. Many taxpayers and tax practitioners fail to understand the impact of these variables and their interrelationships. This leaves compliance outcomes in doubt.

### III. COMPLIANCE OVERSIGHT AND ITS FLAWS

In theory, oversight of taxpayers' accounting of their automobile expenses is rigorous. Estimations of such expenses and business usage under the so-called *Cohan* rule<sup>80</sup> are eschewed in favor of documented

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73. I.R.C. § 132(d).

74. Reg. § 1.132-5(b)(1).

75. Reg. § 1.132-5(e). To fall within the protections of this safe harbor, several stringent required conditions specified in Reg. § 1.274-6T(a)(2) must be met.

76. Reg. § 1.132-5(f). The stringent required conditions to meet this safe harbor are specified in Reg. § 1.274-6T(a)(3).

77. Reg. § 1.132-6(a).

78. Reg. § 1.132-6(b).

79. Reg. § 1.132-6(e)(2).

80. See *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930) (under certain circumstances, permitting taxpayers to estimate the amount of their expenses). See

substantiation that delineates the amount and nature of each expenditure, the date that each expenditure is incurred, and the business purpose underlying the expenditure.<sup>81</sup> Subsection A sets forth the supposed rigor of these rules is set forth; Subsection B's analysis explains why such rules fall far short of ensuring taxpayer compliance.

A. *Supposed Rigor of the Taxpayer Compliance Rules*

As set forth in the Treasury Regulations, taxpayers should keep a set of records such as a diary, account book, trip sheet, or the like detailing the amount and business nature of each trip they take; such records are permitted to be recorded "at or near the time" when expenses are incurred.<sup>82</sup> In addition, accompanying these records should be receipts for every out-of-pocket expense that under current law equals or exceeds seventy-five dollars.<sup>83</sup> The legitimacy of taxpayers' expenses is questioned if taxpayers' records fall short of reaching these delineated benchmarks.<sup>84</sup>

To ease the record-keeping burdens associated with automobile usage, the Treasury Department has promulgated a series of regulations that permit several simplified record-keeping methods, including the use of the standard mileage rate.<sup>85</sup> Under the standard mileage rate, the taxpayer must

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generally Jay A. Soled, *Exploring and (Re)defining the Boundaries of the Cohan Rule*, 79 TEMP. L. REV. 939 (2006).

81. Temp. Reg. § 1.274-5T(b)(6).

82. *Id.*

83. Reg. § 1.274-5(c)(2)(iii)(A)(2).

84. *See, e.g.*, Tyler v. Commissioner, T.C. Memo. 1982-160 (taxpayer's reliance upon his own testimony together with summaries prepared by him during audit failed to meet the rigorous substantiation requirements of § 274(d)); Rembusch v. Commissioner, T.C. Memo. 1979-73 (diaries verifying taxpayer's expenditures prepared several years after the actual events occurred were held unreliable); Silverton v. Commissioner, T.C. Memo. 1978-22 (failure to maintain an "account book, diary, statement of expense or similar record" resulted in the disallowance of taxpayer's expenditures).

85. In lieu of the standard mileage rate, if an employer prefers, it can instead provide for a general mileage allowance. This allowance can equal the lesser of the following: (1) an amount the employer deems appropriate (a.k.a. mileage allowance) or (2) the standard mileage rate multiplied by the number of miles substantiated by the employee. Rev. Proc. 2010-51 § 7, 2010-51 I.R.B. 883. As an alternative to the general mileage allowance, employers can utilize a much more complex employee reimbursement method known as the fixed and variable rate (FAVR) allowance which, in certain instances, may more accurately compensate employees for the business use of their automobiles. Albeit greatly oversimplified, under this method an employer determines what it considers to be a "standard"

substantiate the nature of the expense (i.e., the time, place, business purpose of the travel, and the amount of mileage traveled).<sup>86</sup> Once this is done, the taxpayer can then multiply the number of business miles traveled by the standard mileage rate in effect during the calendar year incurred (in 2013, 56.5 cents).<sup>87</sup> Use of this rule obviates the need for taxpayers to maintain actual receipts and records of their operating and fixed costs.<sup>88</sup>

In order to monitor whether taxpayers are fulfilling their compliance obligations, the Code and Treasury Department permit two reporting methods: the first requires a tax return submission and the second requires the establishment of a so-called accountable plan.

### 1. Return Submissions

Application of the first method requires that taxpayers make information disclosures on certain designated forms. Self-employed individuals are supposed to accompany their tax returns with a Schedule C, enumerating in Part IV the nature and extent of their automobile expenses.<sup>89</sup> Employees who choose to deduct their business automobile expenses may do so as an unreimbursed deduction on Schedule A of their tax returns; these employees must also complete a Form 2106 and enumerate the nature and extent of their business automobile expenses.<sup>90</sup> Finally, any taxpayer (including a proprietor, partner, or corporate entity) wishing to depreciate the automobiles that are owned must complete a Form 4562; Part V of this form asks many detailed questions regarding automobiles that are placed into service and their business percentage usage.<sup>91</sup>

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automobile for its employees and then estimates the fixed costs (e.g., depreciation and insurance) and variable costs (e.g., gasoline and maintenance) associated with its use. Based upon these estimates, an employer can then reimburse its employees based upon their business-use percentage of their automobiles. Rev. Proc. 2010-51, § 6. There are several significant limitations to the use of this method, including that it cannot be paid to control employees (as defined in Reg. § 1.61-21(f)(5)), management employees cannot constitute a majority of the reimbursed employees, and at all times during the calendar year, at least ten employees must be covered. *Id.*

86. Reg. § 1.274-5(j)(2).

87. Notice 2012-72, § 2, I.R.B. 2012-50 673 (2013 rates).

88. Rev. Proc. 2010-51, 2010-51 I.R.B. 883, § 4.02.

89. IRS PUBLICATION NO. 17, at 187 (2011).

90. *Id.*

91. IRS PUBLICATION NO. 946, at 13–14 (2011).



## 2. *Accountable Plans*

To fulfill their compliance obligations, taxpayers engaged in business are able to establish so-called “accountable plans.”<sup>92</sup> Payments under such plans are not includable in the participant’s income;<sup>93</sup> furthermore, such plans obviate the need to make return submissions specified in the prior paragraph, including the need to provide information returns to those participating in the plan.<sup>94</sup> To be considered an accountable plan, the plan must fulfill three requirements:<sup>95</sup> (1) the expenses submitted to the plan for reimbursement have a “business connection” (i.e., the expenditures themselves would constitute deductible expenses under Code section 162),<sup>96</sup> (2) the business expenses incurred must be substantiated to the payor within a reasonable time of their occurrence,<sup>97</sup> and (3) the employee must return to the payor within a reasonable period of time any amount paid under the arrangement in excess of the expenses substantiated.<sup>98</sup> If a participant fails to meet any or all of the foregoing conditions, the plan is deemed to be a non-accountable plan,<sup>99</sup> and payments under such a plan must be included in the participant’s income.<sup>100</sup>

### B. *Flaws in the Taxpayer Compliance Rules*

Given the stringency of the rules specified above, the expectation might be that taxpayers will be compliant and that the IRS can readily detect the derelictions of any taxpayer who is noncompliant. The reality is far different, however. This section reveals that (1) taxpayers are apt to be noncompliant, and (2) the IRS has little or no ability to detect taxpayer noncompliance.

#### 1. *Taxpayers’ Proclivity to Be Noncompliant*

There are several reasons why taxpayers are apt to mischaracterize their automobile expenses in a tax-favored fashion.

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92. I.R.C. § 62(a)(2)(A).

93. Reg. § 1.62-2(c)(4).

94. Reg. § 1.6041-3(b).

95. Reg. § 1.62-2(c)(2).

96. Reg. § 1.62-2(d).

97. Reg. § 1.62-2(e).

98. Reg. § 1.62-2(f).

99. Reg. § 1.62-2(c)(3)(i).

100. Reg. § 1.62-2(c)(5).

Let us begin by examining the tacit endorsement of accountable plans (described in the prior section) under the Code and Treasury Regulations.<sup>101</sup> The reason underpinning this endorsement is clear: in theory, employers should be willing to reimburse only legitimate business expenses incurred by their employees. The Code and Treasury Regulations both presume a zero-sum environment in which there is one less dollar of business profits for every dollar that an employer reimburses an employee. To illustrate, suppose that an employee incurs \$100 of automobile expenses and submits the corresponding expense receipts to his employer for reimbursement. The employer will presumably verify the legitimacy of the \$100 expense and its business connection lest the business enterprise accords undeserved remuneration to the employee, thereby having correspondingly less money available for other employees, working capital, and/or investors (e.g., shareholders).

But the theory behind accountable plans does not match reality. In numerous business enterprises, a Faustian bargain is struck between employees and employers in which both sides readily conspire against the government. The anatomy of the Faustian bargain is as follows: employees “wash” personal expenses through accountable plans and bear no income tax; simultaneously, self-interested employers, in their quest to avoid paying employment taxes<sup>102</sup> and to award their employees tax-free perks, honor these reimbursement requests. The employers then account for such expenses at the back end in the form of a salary or distribution reduction. The transformation of accountable plan reimbursement accounts into mini-tax shelters is not rocket science.

To illustrate, suppose an employee travels on vacation for two weeks in Maine and attends one business meeting while there. Suppose further that the travel expenses incurred are \$5,000 and that the employee’s annual compensation package is normally \$100,000. Even though the travel expenses under the Code are nondeductible because they were not incurred primarily for business,<sup>103</sup> the employee submits them for reimbursement. The employer honors this reimbursement request and correspondingly reduces the employee’s annual salary package by \$5,000. Admittedly, by

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101. See Ridgeley A. Scott, *Reimbursed Employee Expenses: New Tales from the Grimm Brothers*, 28 WILLAMETTE L. REV. 1, 25 (1991) (“Treasury proposed a system to complete the bias in favor of reimbursed employee expenses”); see also *supra* notes 56–57 and accompanying text (delineating those rules that make it virtually impossible for individual employees to take deductions for their depreciation expenses or lease payments).

102. I.R.C. § 3111(a), (b).

103. Reg. § 1.162-2(b).

orchestrating this salary reduction, this otherwise accountable plan is transformed into a non-accountable plan; nevertheless, if this arrangement goes unaudited, the employee is able to receive \$5,000 of tax-free income (i.e., the employee avoids paying income taxes from this arrangement equal to his marginal tax rate times the value of his personal travel expenses), and the employer saves paying employment taxes on an equivalent dollar amount. Both parties to this arrangement, namely, the employee and employer, are economic winners; the only slighted party is the one not invited to join in the arrangement at all, the government.

Aside from such deliberate violations, the lack of clear rules is another contributory factor in taxpayer noncompliance. A healthy number of taxpayers who commute to work and who must occasionally use their automobiles during the course of a workweek to perform necessary business tasks mistakenly (or purposefully) group many of their automobile expenditures under the deductible category. Why would otherwise honest taxpayers benightedly delude themselves? In instances when tax dollars are at stake, taxpayers' minds tend to play funny tricks.<sup>104</sup> Commuting to work, traveling from an office to a courtroom, visiting a patient in a local hospital, and framing a new house — all entail the exact same act of turning the ignition key or pushing a “start” button and doing something work-related. The synapses in many taxpayers' brains apparently fire in a lockstep manner, causing them to group all such expenses as deductible.<sup>105</sup> Along these same lines is the fact that taxpayers are charged with the duty of deciding their own fate. More specifically, taxpayers are often the ones assigned the duty of deciding if their automobile usage is business or personal in nature, with little or no corresponding “paper trail” of transactions to document the usage. If, for example, the owner of a small business enterprise takes a family trip from New Jersey to vacation in Florida and visits a client or two along the way, the taxpayer must decide for himself whether the trip was primarily business or personal in nature. One does not have to be a psychology expert to guess that the taxpayer will probably decide this tax issue in his favor.<sup>106</sup> This is common practice: study after study shows that when taxpayers are left to their own devices, they often do not wear halos, and tax compliance plummets.<sup>107</sup> Admittedly, the taxpayer generally bears the initial burden to

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104. *See supra* note 5.

105. By way of contrast, when taxpayers incur other expenses, such as payments made to home landscapers to cut their lawns or to plumbers to fix their kitchen sinks, the same sense of ambiguity is nonexistent. The demarcation line is clear: such expenses are clearly not deductible. I.R.C. § 262.

106. *See supra* note 5.

107. *See supra* note 8.

present credible evidence of the deductible expenses he incurred,<sup>108</sup> but if the taxpayer maintained a set of compliance records — albeit distorted — the IRS is apt to have a difficult time challenging the veracity of the taxpayer's claims.

A final contributing factor to taxpayer noncompliance is that the stakes on a per-taxpayer basis are almost uniformly small. For many taxpayers, automobile expenditures are not major components of their overall tax returns. As such, taxpayers tend to deduct their automobile expenses in an aggressive fashion or use accountable plans to camouflage the nondeductible nature of such expenses because they believe they can get away with it (i.e., the dollar amounts are too small to attract an IRS audit).<sup>109</sup>

## 2. *The Inability of the IRS to Detect Noncompliance*

There are several reasons why the IRS lacks the ability to detect taxpayers' mischaracterizations of their automobile expenses.

First, the IRS lacks the funds and staffing to audit a large percentage of taxpayers' returns;<sup>110</sup> indeed, by historical standards, the IRS's audit rates continue to hover at fairly low levels.<sup>111</sup> Therefore, many taxpayers believe — and usually rightfully so — they can cheat on their taxes with impunity. One strong piece of evidence of the IRS's inability to rein in taxpayer noncompliance is that the tax gap (i.e., the difference between taxpayers owe

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108. I.R.C. § 7491(a)(1).

109. In all likelihood, taxpayers also believe that even if they are audited, they can use the disallowance of their automobile expenses as a potential distraction to mask larger noncompliance concerns.

110. See, e.g., William Hoffman, *Nearly 1 in 8 High-Income Taxpayers Audited*, *IRS Reports*, 134 TAX NOTES 174 (2012) (“Yet the IRS started 2012 with about 3,000 fewer enforcement personnel than it had a year earlier, mainly because of hundreds of millions of dollars in budget cuts. . . . Total enforcement staff is down from more than 52,000 in late 2010 to about 49,000 in 2012. . . .”).

111. See *IRS Releases Fiscal 2011 Enforcement Statistics*, 2012 TAX NOTES TODAY 4-21 (depicting statistics that indicate that over the past decade the national audit rate averages approximately 1 percent of all tax returns); Jim Abrams, “*Historic Collapse*” of IRS Audit Rates of Big Companies, *SEATTLE TIMES* Apr. 14, 2008, [http://seattletimes.nwsourc.com/html/nationworld/2004346994\\_audits14.html](http://seattletimes.nwsourc.com/html/nationworld/2004346994_audits14.html) (indicating a plunge in the audit rates of large companies); *IRS Audit Rates: Rate for Individual Taxpayers Has Declined but Effect on Compliance Is Unknown*, GAO 01-484 (Apr. 2001), [www.gao.gov/new.items/d01484.pdf](http://www.gao.gov/new.items/d01484.pdf) (showing a steep decline in the audit rate for individual taxpayers).

in taxes and what they actually pay) continues to be a sizable figure, roughly \$450 billion in the most recent IRS estimates.<sup>112</sup>

Furthermore, automobile usage presents the IRS with several unique micro- and macro- challenges. On the micro-level, there is no single form designed to address the deductibility of automobile expenses; instead, as previously pointed out,<sup>113</sup> there is a series of different forms upon which taxpayers, depending upon their tax-filing status, are supposed to record their automobile expenses. Likewise, when it comes to accountable plans, the IRS has not designated a specific form that the taxpayer submits to the government. The absence of a designated form creates the impression that the government has adopted a laissez-faire approach to the tax treatment of expenses of this sort because there is no designated “toggle switch” designed to put the IRS on notice that something may be amiss.

On a macro-level, automobile usage compliance also presents the IRS with challenges. Unlike some audits that can be conducted automatically, monitoring taxpayer compliance with respect to automobile usage is a labor-intensive endeavor.<sup>114</sup> The IRS must examine the taxpayers’ actual books and records and determine their accuracy. Apart from being labor-intensive, the revenue associated with the IRS’s audit efforts will likely be small relative to other audit exercises.<sup>115</sup> True, a key feature of accountable plans is that employers bear financial risk in the form of taxes, interest, and penalties if the IRS successfully challenges such a plan’s bona fides.<sup>116</sup> Yet, the blade of this supposed sword of Damocles is extraordinarily dull: if delinquent tax dollars must be paid, the same taxpayers who benefited from such misreporting (e.g., the taxpayer in the prior example who took his family to Florida and deducted his travel expenses) will often be the very

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112. *IRS Estimates \$450 Billion Gross Tax Gap for 2006*, 2012 TAX NOTES TODAY 5-51.

113. *See supra* notes 89–91 and accompanying text.

114. *See* Ridgeley A. Scott, *Reimbursed Employee Expenses: New Tales from the Grimm Brothers*, 28 WILLAMETTE L. REV. 1, 8 (1991) [hereinafter Scott, *Reimbursed Employee Expenses*] (explaining how time intensive IRS audits involving travel and entertainment expenses tend to be).

115. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-620T, INTERNAL REVENUE SERVICE: ASSESSMENT OF THE 2009 BUDGET REQUEST 10 n.14 (2008), <http://www.gao.gov/new.items/d08620t.pdf> (“In FY 2007 correspondence audits took, on average, 1.4 hours to conduct compared to the 30.8-hour average for field audits done at taxpayers’ locations and the 7.8-hour average for field audits done at IRS offices”).

116. *See, e.g.,* Peoples Life Ins. Co. v. United States, 373 F.2d 924 (Ct. Cl. 1967) (employer has liability for its failure to withhold on taxable wages); *Acacia Mut. Life Ins. Co. v. United States*, 272 F. Supp. 188 (D. Md. 1967) (same).

same people who bear the associated costs of the audit. More specifically, employers will pass the burden of the additional taxes resulting from the IRS audit squarely upon those employees whom directly benefited from such mischaracterizations in the form of reduced salaries, bonuses, and the like.

On a final note, with its limited budget, the IRS must choose whom to audit, based at least in part on predicted revenue yields. More specifically, the IRS uses the results of its previous experience with audited tax returns to devise a formula called the “Discriminant Index Function” (DIF) that determines which tax returns to audit based upon historical tax return reporting patterns.<sup>117</sup> This formula estimates a “DIF score” for each tax return, with a higher DIF score indicative of a tax return with a higher likelihood of additional tax assessments in excess of audit costs. These DIF scores lie behind the so-called “audit flags:” individuals who deviate from the average behavior of their assigned cohort indicate possible low compliance and suggest an audit response may be in order. The IRS does not reveal the details of this audit rule, but many tax professionals routinely publish guides that provide information about which deductions (and other reporting strategies) they believe are allowed and which they think are likely to be challenged.<sup>118</sup> IRS audits based upon a tax return’s DIF score generate significantly more additional assessments than purely random tax audits;

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117. See U.S. GEN. ACCOUNTING OFFICE, HOW THE INTERNAL REVENUE SERVICE SELECTS INDIVIDUAL INCOME TAX RETURNS FOR AUDIT. REPORT TO THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, CONGRESS OF THE UNITED STATES (1976).

118. Tax professionals have long recognized the broad outlines of the IRS audit process. Nearly every year, especially around April 15th, articles and books appear with titles such as “How to Avoid a Tax Audit,” most arguing that taxpayers should try to avoid waving a red flag in front of the IRS. For example, one professor argues that large deductions relative to income increase the likelihood of an audit, with over ninety percent of all audits triggered by the size of deductions relative to income. AMIR D. ACZEL, HOW TO BEAT THE I.R.S. AT ITS OWN GAME: STRATEGIES TO AVOID—AND FIGHT—AN AUDIT (1995). Professor Aczel claims that his analysis shows that the audit probability goes up significantly when deductions are between thirty-five and forty-four percent of adjusted gross income and that a ratio in excess of forty-four percent is almost certain to trigger an audit. Other, more specific flags identified by tax professionals include larger than typical medical deductions, mortgage interest deductions, travel and entertainment expenses, home office deductions, charitable donations, dependent exemptions, casualty losses, or tax shelter losses. Websites are widely available that indicate the levels of itemized deductions or Schedule C business expenses relative to income that make a taxpayer “unlikely,” “likely,” or “almost certain” to be flagged for an audit. The basic advice of these tax professionals is quite simple and easily summarized: “Don’t be different.” See FREDERICK W. DAILY, STAND UP TO THE IRS (1999); JULIAN BLOCK, JULIAN BLOCK’S TAX AVOIDANCE SECRETS (1996).

roughly one-half of all audited returns in the United States are now selected by this approach.<sup>119</sup> Unlike items such as robust charitable deductions and significant paper losses (i.e., commonplace “audit flags”), there is no data indicating that automobile expenses are major determinants of these DIF scores.

#### IV. THE RECEIPT OF TAXABLE FRINGE BENEFITS, NONCOMPLIANCE, AND ITS IMPLICATIONS

Having explored why and how taxpayers mischaracterize their automobile expenses, it is important to realize that taxpayer noncompliance likely does not stop there. To the contrary, there is every reason to assume that if the same conditions are present (i.e., confusing rules, lack of third-party or IRS oversight, and the absence of substantiation requirements), taxpayers will mischaracterize the receipt of other taxable fringe benefits as well.

Several decades ago many on-the-job benefits (aka fringe benefits) that employees received were generally considered nontaxable.<sup>120</sup> However, as these benefits increasingly substituted for taxable income and the tax base was at risk of erosion,<sup>121</sup> Congress took note and decided to curb these practices.<sup>122</sup> In 1984, Congress enacted Code section 132, which specifically delineated those fringe benefits that were exempt from tax;<sup>123</sup> by default, all other non-designated fringe benefits were subject to income tax.<sup>124</sup>

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119. See U.S. GEN. ACCOUNTING OFFICE, GAO/GGD-98-40, TAX ADMIN.: IRS' USE OF RANDOM SELECTION IN CHOOSING TAX RETURNS FOR AUDIT. REPORT TO THE HONORABLE PAUL COVERDELL, U. S. SENATE 4-5 (1998); see also UNITED STATES GEN. ACCOUNTING OFFICE, GAO/GGD-99-30, TAX ADMIN.: IRS' RETURN SELECTION PROCESS. REPORT TO THE CHAIRMAN, COMMITTEE ON WAYS AND MEANS; AND THE CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES 2 (1999).

120. See, e.g., Ira B. Stechel, *Current Planning for Fringe Benefits—An Administrative Shambles*, 40 N.Y.U. ANN. INST. ON FED. TAX'N. 35-1 et seq. (1981) (describing the lack of clarity in then-existing state of the law).

121. Richard L. Doernberg, *A Workable Flat Rate Consumption Tax*, 70 IOWA L. REV. 425, 436-37 (1985) (“The advantages of fringe benefits relative to cash wages, combined with increasing marginal rate taxation, help explain the dramatic rise in fringe benefit use over the past fifty years. In 1929 fringe benefits accounted for 1.2% of total compensation; in 1981 the percentage was 16.3.”).

122. See *Rules for the Federal Tax Treatment of Fringe Benefits: Hearing on H.R. 3235 Before the Subcomm. on Select Revenue Measures of the Comm. on Ways and Means*, 98th Cong (1983).

123. Pub. L. 98-369, §§ 531-32, 98 Stat. 877-87 (1984). For a complete description of these rules and their effects, see Wendy Gerzog Shaller, *The New*

When Code section 132 became law, cellular telephones, frequent flyer mile awards, and home Internet service were, for all intents and purposes, nonexistent. All three of these items, however, currently enjoy immense and growing popularity. Thus, it is important to examine the tax treatment of these items. Clearly, employer-provided cellular telephones, frequent flyer mileage awards, and home Internet service fall squarely within the scope of being fringe benefits; since none of these items is specifically excluded from gross income, the personal use of these employer-provided items should give rise to taxable income,<sup>125</sup> unless a specific fringe benefit exemption applies (e.g., they qualify as working condition or de minimis fringe benefits).<sup>126</sup> Notwithstanding the clarity of this obvious conclusion, IRS rulings and pronouncements pertaining to the tax treatment of each of the foregoing employer-provided fringe benefits do not always follow this line of reasoning.

In the case of cellular telephones, the most informative pronouncement to date is found in IRS Notice 2011-72.<sup>127</sup> In this notice, the IRS declared that employer-provided cellular telephones furnished for noncompensatory reasons are not taxable and that any personal use within this context would constitute a de minimis fringe benefit excludable from income. Consistent with this notice, in IRS Publication 15-B, the IRS states that employer-provided cellular telephones that are furnished for compensatory reasons and/or to establish goodwill constitute taxable income.<sup>128</sup>

In the case of employer-provided frequent flyer miles, the IRS has adopted a more hands-off approach. In Announcement 2002-18, the IRS declared that it “will not assert that any taxpayer has understated his federal tax liability by reason of the receipt or personal use of frequent flyer miles or other in-kind promotional benefits attributable to the taxpayer’s business or official travel.”<sup>129</sup> This declaration was made over a decade ago and, to date, the agency has not articulated any further refinements.

With respect to the tax treatment of employer-provided home Internet service, the IRS has maintained complete silence. This silence is

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*Fringe Benefit Legislation: A Codification of Historical Inequalities*, 34 CATH. U. L. REV. 425 (1985).

124. I.R.C. § 61(a)(1); Reg. § 1.61-21(a)(1).

125. *Id.*

126. I.R.C. § 132(d) & (e).

127. Notice 2011-72, 2011-38 I.R.B. 407.

128. IRS PUBLICATION 15-B (2012), <http://www.irs.gov/pub/irs-pdf/p15b.pdf>.

129. Announcement 2002-18, 2002-1 C.B. 621.



particularly surprising given the fact that once Internet service is in a taxpayer's home, via computer routers, it can be shared with family members who reside at that same location. Indeed, IRS Publication 15-B — the agency's go-to guide on the taxability of fringe benefits — does not mention the phrase "Internet service."

Consider how the IRS has responded to taxpayers misreporting the receipt of their taxable fringe benefits. With respect to automobile expenses, the IRS has said and written a lot; however, with respect to employer-provided cellular telephones, frequent flyer miles, and home Internet service, the agency has said little or nothing. In terms of enforcement efforts, the IRS has made tepid attempts to stem taxpayer noncompliance insofar as the mischaracterization of automobile expenses is concerned;<sup>130</sup> insofar as other taxable fringe benefits are concerned, however, IRS enforcement efforts are virtually nonexistent. Evidence for the latter point can be made only by negative inference: despite the widespread personal use of employer-provided cellular telephones, frequent flyer miles, and home Internet service, there are no reported court cases pertaining to cell phones and frequent flyer miles and only one reported court case pertaining directly to the taxability of frequent flyer miles.<sup>131</sup> Unless virtually every one of the nation's taxpayers is a saint, the absence of adjudicated court cases regarding the receipt of taxable fringe benefits does not suggest that there is a lack of tax mischaracterizations but rather that there is a lack of noncompliance oversight.

Taxpayer noncompliance results in revenue loss to the government. To counteract this loss, the government must raise taxes for other taxpayers, reduce government spending, borrow to make up for the shortfall, or some combination of the foregoing. When it comes to automobile expense mischaracterizations and the receipt of other fringe benefits that go misreported or unreported, the effects are often particularly pernicious and far-reaching. More specifically, if taxpayer noncompliance is pervasive in one area of the law, it likely has a corrosive effect upon other areas of taxpayer compliance.<sup>132</sup> For example, if taxpayers routinely submit

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130. *See supra* note 3.

131. *Charley v. Commissioner*, 91 F.3d 72 (9th Cir. 1996) (frequent flyer miles transformed into cash are taxable).

132. *See, e.g.*, Ernst Fehr & Urs Fischbacher, *The Economics of Strong Reciprocity*, in *MORAL SENTIMENTS & MATERIAL INTERESTS: THE FOUNDATIONS OF COOPERATION IN ECONOMIC LIFE* 167 (Herbert Gintis ed. 2005) ("[I]f people believe that cheating on taxes, corruption, or abuses of the welfare state are widespread, they themselves are more likely to cheat on taxes, take bribes, or abuse welfare state institutions").

illegitimate business automobile expenses for reimbursement to a supposed accountable plan and this process goes unchallenged, there is undoubtedly a two-fold effect. First, the perpetrator taxpayer will probably seek other illegitimate avenues in which to reduce his taxes; second, those taxpayers who cannot avail themselves of this tax-savings device will harbor contempt for the tax system, causing them to search for their own illegitimate tax-savings devices.<sup>133</sup>

In the case of the mischaracterization of automobile expenses and the receipt of taxable fringe benefits, there is an equity concern as well. The financial benefits associated with noncompliance of the sort expounded upon in this analysis are likely to inure more to those taxpayers who are generally in high-income brackets. That is, the taxpayers who are most apt to use and receive employer-provided automobiles, cellular telephones, frequent flyer miles, and home Internet services are business owners and upper management; they are best situated to take advantage of their positions, and the tax benefit associated with such fringe benefits (regardless of whether such fringe benefits are legitimately business in nature or not) increases with the taxpayer's marginal tax rate. For example, business owners and those taxpayers in the upper echelons of management likely have much more latitude in submitting questionable business expenses to accountable plans and reaping the corresponding purported tax savings. Even if business owners, upper-echelon management, and the rank-and-file employees equally participate in the (mis)use of accountable plans, those whose incomes are subject to higher marginal tax rates will save more on a dollar-for-dollar basis than those taxpayers whose income is subject to lower marginal tax rates. Consistent with the foregoing inequities, businesses that save employment taxes by utilizing accountable plans as a tax-saving device will likely use the savings that such plans achieve to award their already highly compensated employees with more remuneration rather than according such benefits to their rank-and-file employees.

A direct effect of taxpayers mischaracterizing the receipt of their fringe benefits is that they enjoy an economic windfall, and certain industries are subsidized over others. For example, the mischaracterization of automobile expenses enables participating taxpayers to enjoy deep purchase

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133. See, e.g., Joshua D. Rosenberg, *The Psychology of Taxes: Why They Drive Us Crazy, and How We Can Make Them Sane*, 16 VA. TAX REV. 155, 199 (1996) (theorizing that "when we hear about Leona Helmsley evading taxes and going to jail, some of us say to ourselves 'we had better pay our taxes,' but many others tend to engage in an internal dialogue that sounds more like 'this rich woman evaded her taxes; from what I hear, most other rich people do, and probably I should or I'll be losing out'").

price discounts and simultaneously subsidizes the automobile and oil industries. To illustrate, assume that taxpayers who mischaracterize their automobile expenses are in the forty-percent marginal tax bracket (when state income taxes are taken into account). With respect to every automobile and gasoline purchase that participating taxpayers make, they enjoy a tremendous purchase price discount. Translated into dollars and ignoring the tax value of money issues and depreciation deduction limitations, if the fair market value of an automobile is \$50,000, the taxpayer will effectively pay \$30,000 for it after receiving a \$20,000 discount ( $0.40 \times \$50,000$ ); similarly, if the price for gas is \$4 per gallon, the taxpayer will effectively pay \$2.40 per gallon after receiving a \$1.60 discount ( $0.40 \times \$4$ ). Other factors being equal, simple laws of economics declare that the lower an item's purchase price, the higher the demand.<sup>134</sup> Increasing the slope of the demand curve enables the automobile and oil industries to charge higher prices and, as a result, reap greater profits.<sup>135</sup>

As evidenced by this analysis, the implications associated with taxpayer noncompliance are grim not only in terms of the tax system but also in terms of the overall economic health of the United States. It is a problem that Congress therefore must not ignore. Section V proposes several reform measures that Congress should institute.

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134. See ROBERT COOTER & THOMAS ULEN, *LAW & ECON.* 31 (3d ed. 2000) (discussing the relationship between price and demand); see also Harold J. Leavitt, *A Note on Some Experimental Findings About the Meanings of Price*, 27 J. BUS. 205, 205 (1954) (“Conventional price analysis takes the generalized view that demand curves are negatively sloped. The purchase of a product is expected to decline as its price increases and to increase as its price declines—other factors being equal”).

135. An indirect effect of taxpayer noncompliance insofar as automobile expenses are concerned is that it likely is a contributing factor to global climate change. Once again, in accordance with general principles of economics, if taxpayers are able to secure gasoline at deeply discounted prices, there will be an increase in this item's use. Admittedly, it is well beyond the scope of this analysis to delve into the whole issue of climate change supposedly caused by the use of fossil fuel by humans; however, scientists universally agree that there is a direct correlation between fossil fuel usage and airborne pollutants. For more on the issue of how the Code's structure may be a contributory factor in generating pollution, see Roberta F. Mann, *On the Road Again: How Tax Policy Drives Transportation Choice*, 24 VA. TAX REV. 587 (2005).

## V. REFORM MEASURES THAT CONGRESS COULD INSTITUTE

In order to curtail the taxpayer noncompliance problem, Congress could institute a series of reforms. The nature of these reforms varies: some attempt to simplify the system; others seek to provide the IRS with a more strategic vantage point; some impose penalties upon plan administrators who fail to fulfill their oversight duties; still others impose a strict liability accuracy-related penalty upon taxpayers who lack substantiation of their business automobile expenses; and some try to capitalize upon new technologies. Notwithstanding their differing natures, these reforms all share common goals, namely, to (1) simplify taxpayer compliance; (2) curtail taxpayers' mischaracterizations of their business automobile expenses in order to preserve equity between and among taxpayers; (3) reduce the distortions in economic behavior that result from taxpayer noncompliance; and (4) ensure that taxpayer mischaracterizations of their automobile expenses (and their receipt of other taxable fringe benefits) do not further erode the income tax base.

### A. *Simplify and Clarify Certain Tax Compliance Rules*

Taxpayer confusion commonly reigns as to the correct tax treatment of automobile expenses and the receipt of other taxable fringe benefits. In light of this situation, based upon how the majority of taxpayers use their automobiles, cellular telephones, frequent flyer miles, and home Internet service, Congress should draft black-and-white rules that are easy to implement, understand, and monitor.

First, consider taxpayers' use of automobiles. The vast majority of taxpayers use their automobiles for personal use (i.e., commuting).<sup>136</sup> In the face of this reality, Congress should craft several hard-and-fast rules: (1) unless an automobile is used eighty percent or more in business, its cost should not be depreciable nor should any lease payments be deductible;<sup>137</sup>

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136. See generally BRIAN MCKENZIE & MELANIE RAPINO, U.S. CENSUS BUREAU, COMMUTING IN THE UNITED STATES: 2009 (Sept. 2011), <http://www.census.gov/prod/2011pubs/acs-15.pdf>.

137. A common practice among many taxpayers who mischaracterize their automobile expenses is that they benightedly believe that that week days when they commute to work are deductible and weekend days when they use their automobiles for pleasure are nondeductible. The business-use percentage these taxpayers report is 71.4 percent (i.e., five work days divided by seven (number of days in the week)). Raising the business use percentage threshold to eighty percent before depreciation and lease payments would be deductible would presumably eliminate this common taxpayer practice.

(2) with respect to those automobiles that are neither depreciable or whose lease payments are not deductible, deductible business automobile expenses should be limited to gas, tolls, and parking (and the standard mileage allowance should be limited corresponding to these items); and (3) in order to authenticate the business nature of their trips, audited taxpayers would have to substantiate their business miles driven by means of contemporaneous electronic data entries (*see* subsection D. *infra*).

Next, consider cellular telephone expenses. In those instances in which employees have both a personal and a business cellular telephone, the Code should state that (a) in cases when the business cellular telephone and service are provided by the employer, taxpayers should have no income (i.e., there is no accretion to the taxpayer's wealth because the business cellular telephone is not being used for personal consumption); and (b) in cases when the business cellular telephone and service costs are borne by the employee, employee taxpayers should be able to deduct the cost of the business cellular telephone and its associated service. In those instances when taxpayer employees have only one cellular telephone for both personal and business use, the Code should impose a rigid rule, namely that (a) in cases when the cellular telephone and service are employer provided, fifty percent of the value of each be included in the taxpayer's income; and (b) in cases when the cellular telephone and service costs are borne by the employee, the lesser of the business percentage use or fifty percent of the cost of each should be allowed as a deduction from the employee's income.

Third, consider frequent flyer miles earned while on business travel. The rule should be that frequent flyer miles subsequently used for personal travel constitute income.<sup>138</sup> Taxing frequent flyer miles engenders timing and valuation issues, but these issues can be overcome: frequent flyer miles should not be taxed when earned but rather upon their personal use. Additionally, the value of such frequent flyer miles should be set at a fixed, low-dollar amount (adjusted annually by the IRS) to account for the typical limitations and restrictions associated with the use of such miles.<sup>139</sup>

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138. *See generally* M. Bernard Aidinoff, *Frequent Flyer Bonuses: A Tax Compliance Dilemma*, 31 TAX NOTES 1345 (1986); Joseph M. Dodge, *How to Tax Frequent Flyer Bonuses*, 48 TAX NOTES 1301 (1990); Jonathan Barry Forman, *Income Tax Consequences of Frequent Flyer Programs*, 26 TAX NOTES 742 (1985); Lee Garsson, *Frequent Flyer Bonus Programs: To Tax or Not to Tax—Is This the Only Question?*, 52 J. AIR L. & COM. 973 (1987); George Guttman, *IRS Moves Slowly on Frequent Flyer Issue*, 38 TAX NOTES 1309, 1309 (1988); Lee A. Sheppard, *Collecting the Tax on Frequent Flyer Benefits*, 59 TAX NOTES 1140 (1993).

139. *See* David Lazarus, *Citibank Deems Frequent-Flier Miles Taxable, but Does the IRS?*, L.A. TIMES (Jan. 25, 2011), <http://www.latimes.com/business/la-fi->

Fourth, high-speed home Internet service is fast becoming a ubiquitous feature of many U.S. households.<sup>140</sup> In those cases in which this service is provided by the employer, it is probably fair to assume that a healthy percentage of the Internet service will be for personal and family use, unless the employer's Internet policy specifically prohibits personal use. Erring on the conservative side, in instances when employer-provided Internet service is available for personal use, Congress should mandate that fifty percent of its value be includable in the employee's income.

Although these simplification and clarification measures would not entirely eliminate taxpayer confusion insofar as the receipt of taxable fringe benefits are concerned, they would go a long way toward erasing the current latitude that taxpayers enjoy in gaming the system. These simplification and clarification measures thus constitute a positive step toward enhancing taxpayer compliance.

*B. Mandate the Submission of Information Returns for Accountable Plans*

As previously described, accountable plans generally do not live up to their moniker of being accountable.<sup>141</sup> Accordingly, Congress should institute rules that make plan administrators truly accountable for the verification of employees' putative business expenses.

In theory, accountable plans appear to function efficaciously and as intended. Consider employees who incur legitimate business expenses by traveling to client meetings. The employees submit their receipts to the plan administrator, who verifies the authenticity of these expenses and then issues reimbursements. With the business entity's profitability at stake (and presumably the plan administrator's job on the line as well), the plan administrator's role as gatekeeper is important, and the IRS can theoretically

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lazarus-20120124,0,1228880.column (for income tax purposes, Citibank accorded each frequent flier mile it awarded a value of 2.5 cents); Trivedi Shamik, *Promotional Frequent Flier Miles Are Taxable Income, IRS and Citibank Say*, 2012 TAX NOTES TODAY 21-4 (Jan. 31, 2012).

140. See, e.g., Joelle Tessler, *U.S. Broadband Figures Show 40 Percent Lack High-Speed Internet: STUDY*, HUFFINGTON POST (Feb. 16, 2010), [http://.huffingtonpost.com/2010/02/16/us-broadband-figures-how\\_n\\_463849.html](http://.huffingtonpost.com/2010/02/16/us-broadband-figures-how_n_463849.html) ("FCC Chairman Julius Genachowski said . . . he wants 100 million U.S. households to have access to ultra high-speed Internet connections, with speeds of 100 megabits per second, by 2020").

141. See *supra* Section III.B.

rely upon her judgment to evaluate with disinterested accuracy the legitimacy of the purported business nature of the submitted expenses.<sup>142</sup>

But the Code's blind reliance on the plan administrator — as is currently the case — is misplaced. In particular, this compliance model suffers from a fundamental flaw, namely that the plan administrator is a neutral, disinterested party. In large business enterprises, a plan administrator is usually an employee who is beholden to her employer, aiming to secure employment stature and monetary gains. Therefore, the plan administrator is apt to be acquiescent to upper management and owners, willing to kowtow to their demands and turn a blind eye to questionable business reimbursement submissions. In the closely held business enterprise context, the plan administrator and the business owner are often one and the same person. This alter ego relationship undermines the supposed disinterested, unbiased nature of the process of distinguishing between legitimate business and personal expense claims.

Under current law, accountable plans operate far below the radar screen of IRS scrutiny. Due to requests for reimbursement under these accountable plans, billions of dollars of putative business expense submissions are presumably made annually to plan administrators of such plans. Notwithstanding the size and scope of these requests, plan administrators are not required to submit any concomitant documentation to the IRS.<sup>143</sup> Absent an IRS field audit, this absence of documentation leaves the agency in the dark about the inner workings of such plans and whether they are truly compliant with the requisites of the Code and Treasury Regulations.<sup>144</sup>

To enable the IRS to better monitor the bona fides of accountable plans and to determine whether plan administrators are adhering to their obligations as set forth in the Treasury Regulations, the status quo is unacceptable. The Treasury Department should instead promulgate regulations that mandate the submission of a dedicated accountable plan information return.<sup>145</sup> This annual information return should be signed by the plan administrator, under penalty of perjury, that it is accurate and complete and should detail the business nature and amounts of all of the reimbursed expenses. In those instances when the reimbursement figures on the face of

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142. *See supra* note 6.

143. *See supra* Section III.B.2.

144. *Id.*

145. The use of such “third party” sources of information has proven immensely useful in ensuring compliance with income taxes and payroll taxes, even personal exemptions. Joseph A. Pechman, *FEDERAL TAX POLICY* (5th Ed. 1987).

this submitted return seem suspect or abnormally large, the IRS could target its limited audit resources in a strategic fashion.<sup>146</sup>

*C. Impose Penalties upon Derelict Plan Administrators and Taxpayers*

Under current law, third parties participating in the tax return filing process who are derelict in fulfilling their duties may be penalized. For example, tax practitioners who are negligent or reckless in preparing tax returns face stiff monetary penalties,<sup>147</sup> censure, and possible suspension from practice.<sup>148</sup> Likewise, appraisers who negligently or recklessly prepare inaccurate appraisals face penalties of a similar nature.<sup>149</sup> The goal underlying these third-party penalties is to make parties who participate in the tax return filing process more attentive in their responsibility to be accurate.

Accountable plan administrators currently do not bear the same risks as other third parties who participate in the tax return filing process. If plan administrators allow personal expenses to be reimbursed, even if they are negligent or reckless in allowing such expenses to pass supposed business muster, they face no downside risks. To illustrate, suppose a business owner takes a two-week vacation in Hawaii and then submits these personal expenses for reimbursement to the plan administrator. If the plan administrator receives no verification that such a trip was business related but, nevertheless, reimburses these expenses from the plan, the Code attaches no third-party culpability to the plan administrator's actions.

Congress must reform the Code and "deputize" plan administrators to be plan enforcers. In those instances when plan participants submit expenses that a plan administrator knows or should have known were personal in nature and permits them to be reimbursed, the plan administrator should be penalized. The penalty should be equal to a percentage (say, ten percent) of the reimbursed personal expense. To illustrate, if the Hawaiian trip described in the prior paragraph cost \$10,000, the corresponding penalty should be \$1,000 (i.e., \$10,000 x .10). Correlating the amount of the penalty

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146. IRS agents are specifically instructed to look for "large, unusual, or questionable items." IRS, INTERNAL REVENUE MANUAL: AUDIT ¶ 4.90.8.2 (2012), [http://www.irs.gov/irm/part4/irm\\_04-090-008.html](http://www.irs.gov/irm/part4/irm_04-090-008.html) (last visited September 20, 2013).

147. I.R.C. § 6694(a).

148. See 31 C.F.R. § 10.50 (2012) (detailing sanctions applicable to attorneys, certified public accountants, enrolled agents, and other persons who represent taxpayers before the IRS and who fail to adhere to proscribed ethical standards).

149. I.R.C. § 6695A; 31 C.F.R. § 10.50(b) (2012).



to the size of the claimed business reimbursement amount makes sense: the larger the claim, the more circumspect the plan administrator should be in evaluating the legitimacy of the submitted expense amount.

Aside from plan administrators, taxpayers, also, must be held accountable for accurately report the business nature of their automobile expenses. If taxpayers have little or no downside risk to mischaracterizing such expenses, there is every reason to expect that taxpayers' mischaracterization practices will continue unabated. Congress should, therefore, resurrect its prior strict liability negligence penalty for taxpayers who fail to substantiate the business nature of their automobile expenses.<sup>150</sup>

Imposing a strict liability penalty for automobile expense mischaracterizations would have two salutary effects. First, it would send a message to the general public that Congress has no tolerance for those taxpayers who want to put their financial interests ahead of those of the general public. Taxpayers must stand ready to present credible evidence regarding the business nature of their automobile expenses or risk being penalized. Period. This would be another way of Congress saying that it does not want to subsidize the purchasing power of those taxpayers who are business owners, professionals, and part of upper management who currently exploit the mischaracterizations of their automobile expenses (and the receipt of other fringe benefits) at the expense of compliant taxpayers.

Second, a strict liability penalty would give the IRS the upper hand during audits. If taxpayers failed to produce substantiation of their business automobile expenses (i.e., a "paper trail"), then the audit process would reach a quick conclusion. The IRS would no longer have to pour further resources into demonstrating that taxpayers were negligent or reckless. Moreover, imposition of this proposed strict penalty would deprive taxpayers of a key bargaining chip (i.e., a quick settlement in return for a penalty reduction).

#### *D. Capitalize Upon Technological Changes*

It is a vast understatement to say that over the past quarter century technology has changed at a lightning pace. In particular, computers have become faster, lighter, and more efficient. Furthermore, internet usage has blossomed into a staple of most taxpayers' lives. It is not a stretch to say that feats of technology, which were unimaginable just a decade or two ago (e.g., an electronic device that provides real-time destination instructions and traffic reports) have quickly become woven into the fabric of our society.

Such technological advancement provides the setting for Congress to revisit the substantiation requirement it instituted in 1984 and then

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150. Pub. L. No. 98-369, § 179(b)(3), 98 Stat. 464 (1984).

retroactively repealed. In 1984, Congress passed legislation that would have required taxpayers to maintain a contemporaneous travel log documenting the business miles that a taxpayer traveled.<sup>151</sup> This legislation gave rise to a popular uproar leading to the retroactive repeal of this legislation.<sup>152</sup> In its place, Congress left intact a requirement that taxpayers must be able to substantiate the business miles driven via an account book, diary, log, expense statement, or trip sheet,<sup>153</sup> dropping the requirement that such documentation be recorded contemporaneously with the business travel.

Let us now fast-forward to the twenty-first century. This is a time period during which smartphones and GPS systems have become commonplace in the business world. With the simple touch of a button, these devices enable taxpayers to readily track miles traveled with pinpoint accuracy in ways that were unthinkable a decade or two ago. In particular, taxpayers can now purchase smartphone applications that record when a taxpayer starts and stops a trip and can tag such a trip with a description. Gone are the days when taxpayers would have to pull out a log book, review their mile odometers, and then provide a written description of their business trips.

Congress should capitalize upon the use of this technology.<sup>154</sup> Accordingly, it should reinstitute its 1984 requirement that taxpayers document their business automobile miles via contemporaneous electronic records. Using available technology, taxpayers can collect important information (i.e., date of travel, location to which traveled, and exact mileage between locations), organize it, and readily transfer it to their tax returns. If and when the submitted returns are audited, taxpayers can present this information to the IRS auditor. On the web, several existing companies currently advertise apps that permit users to track business miles for business purposes.<sup>155</sup> To induce taxpayers to capitalize upon this technology, Congress might also consider offering a tax credit to offset all or a portion of the purchase price of this technology.

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151. Pub. L. No. 98-369, § 179(b)(1), 98 Stat. 464 (1984).

152. Pub. L. No. 99-44, 99 Stat. 77 (1985).

153. *See supra* note 82.

154. *See generally* Jeremiah Coder, *Securities Basis Reporting May Signal More Technology in Tax Administration*, 2009 TAX NOTES TODAY 25-4 (discussing how technology is reshaping the process of tax administration).

155. *See, e.g.*, TAXBOT, <https://taxbot.com/z/2f14/> (last visited Sep. 1, 2013) (promoting its ability to track business travel expenses); ZONE WALKER LLC, <http://www.zonewalker.com/acar> (last visited Sept. 1, 2013) (same).

## VI. CONCLUSION

Taxpayers' mischaracterizations of their business automobile expenses are not limited to one or two renegade taxpayers. To the contrary, this Article demonstrates such mischaracterizations are commonplace.<sup>156</sup> Further, this Article illustrates that taxpayer mischaracterizations of fringe benefits are not confined to the realm of automobiles. Rather, taxpayer mischaracterizations of automobile usage are emblematic of a larger noncompliance problem and constitute a useful case study of what Congress should do to enhance overall taxpayer compliance.

The effects of taxpayer noncompliance are far-reaching. Not only does it erode the income tax base, it severely distorts economic choices. For example, in the case of taxpayers mischaracterizing the tax treatment of their automobile expenses the economic impact is seen in the form of purchase price discounts generally benefiting high-income taxpayers and windfall profits inuring to the automobile and oil industries.

There is a time-honored adage that states, "If it isn't broke, don't fix it." When it comes to automobile expenses and the receipt of other taxable fringe benefits, however, the system is in dire need of repair. The good news is that this is not a problem that lacks a solution. There are several possible reform measures Congress could and should adopt that would enhance the Code's integrity, lessen economic distortions, and enable the IRS to perform its oversight mission more prudently and proficiently.

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156. *See supra* note 3.

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