

IRS Rulings & Other Documents (2001-Earlier), Announcement 85-113, 1985-31 IRB 31, Internal Revenue Service, (Jan. 1, 1985)

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Announcement 85-113

This announcement provides guidelines for reporting of and withholding on taxable noncash fringe benefits ("fringe benefits"). Taxpayers may rely on these guidelines until the issuance of regulations that will supersede Notice 726 issued in January 1985, and the temporary and proposed regulations published in the Federal Register on January 7 and February 20, 1985. The guidelines in this announcement may be revised by the new regulations, but any such revisions will have prospective effect only. This announcement also extends to September 1, 1985, the date by which an employer must notify its employees of its decision not to withhold income taxes on the value of the personal use of employer-provided highway motor vehicles (see section 4 below).

1. Period of withholding, deposits, and reporting.

Employers may elect, for employment tax and withholding purposes, to treat fringe benefits (including the personal use of employer-provided highway motor vehicles) as paid on a pay period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually. Employers do not have to make the same election for all employees. Therefore, the employer may withhold more frequently for some employees than for others. Employers may change their election as frequently as they desire so long as they treat all the benefits provided in a calendar year as paid no later than December 31 of the calendar year. For example, an employer may treat benefits provided in a calendar year as paid on July 31, August 31, and December 31 of the calendar year.

An employer may treat the value of a single fringe benefit as paid on one or more dates within the same calendar year, even if the employee receives the entire benefit at one time. For example, if the employee receives a fringe benefit valued at \$1,000 in one pay period, the employer may treat the \$1,000 fringe benefit as made in four payments of \$250, each in a different pay period, rather than as a \$1,000 payment in one pay period.

A formal election of payment dates is not required and the Internal Revenue Service need not be notified; rather, employers are treated as making the election or elections simply by treating the fringe benefits provided in a calendar year as paid on the date or dates the employer chooses but no later than December 31 of the calendar year in which the benefits are provided.

The election to treat fringe benefits as paid no later than December 31 of the year in which the benefit is provided does not apply when the fringe benefit is the transfer of personal property (either tangible or intangible) of a kind normally held for investment or the transfer of real property.

2. Withholding and deposits.

The employer may add the value of the fringe benefits to the regular wages for a payroll period and compute withholding taxes on the total. Alternatively, the employer may withhold from regular wages federal income taxes on the value of the fringe benefits at the flat 20 percent rate presently applicable to supplemental wages.

In general, the employer must withhold the applicable income, social security, and railroad retirement taxes on the date or dates it elects to treat the benefits as paid and must deposit the withheld taxes and the employer taxes under the regular rules for tax deposits. The employer may make a reasonable estimate of the fringe benefits provided on the date or dates it elects to treat the benefits as paid for purposes of meeting the timely deposit requirements.

The estimated deposit amount is determined by calculating the amount the employer would be required to deposit had the employer paid cash wages equal to the estimated value of the fringe benefits provided on the date or dates selected and withheld taxes from those cash wages. Thus, the employer should estimate the value of the fringe benefits provided on the date or dates selected and then calculate the amount of income and employment taxes due with respect to the estimated value of the fringe benefits. This procedure should be followed even if the employer does not know which employee is the recipient of the fringe benefit

on the date the deposit is due, as may be the case when a guest of an airline employee receives a free or discounted taxable flight at the close of the calendar year.

If the employer underestimates the value of the fringe benefits and thereby makes an underdeposit of the amount required to be deposited (that is, the amount the employer would be required to deposit if the employer had withheld the applicable taxes), the employer may be subject to the failure to deposit penalty. If the employer overestimates the value and deposits more than the amount required, the employer may claim a refund or elect to have the overpayment applied to the next Form 941, Employer's Quarterly Federal Tax Return (or other employment tax return). (Any reference in this announcement to the Form 941 is a reference to the Form 941 and any other employment tax return including Form 940, Employer's Federal Unemployment (FUTA) Tax Return.)

If the employer withholds less than the required amount of taxes from the employee, then the employer may recover from the employee the social security or railroad retirement taxes and, §31.6205-1(c)(4) of the Employment Tax Regulations notwithstanding, the income taxes paid on the employee's behalf. The recovery of income taxes must occur prior to April 1 of the following year.

3. Amount reported on Form 941 and W-2.

The actual value of the fringe benefits provided during a calendar year (or other period as provided in section 5 below) must be determined by January 31 of the following year (the date Form W-2 must be furnished to the employee), and the employer must report the actual value on Form W-2 and the Form 941 for the fourth quarter of the prior year and pay any additional tax liability. The employer must include the value of the fringe benefit and the related tax liabilities on Form 941 for the reporting period in which it treats the benefits as paid.

4. Special rule for highway motor vehicle--Election not to withhold.

Public Law 99-44 (Repeal of Contemporaneous Recordkeeping Requirements) permits an employer to elect not to withhold income taxes on the value of an employee's personal use of an employer-provided highway motor vehicle. (The employer must, however, withhold the applicable social security or railroad retirement taxes with respect to such benefit.) Employers do not have to make the election for all employees. Therefore, the employer may withhold income taxes with respect to the value of the fringe benefits from the wages of some employees but not others.

An employer elects not to withhold income taxes by (a) notifying the affected employee that the employer has made the election not to withhold, and (b) including the amount of the benefit in box 10, "Wages, tips, and other compensation" and box 13, "Social Security Wages" on a timely furnished Form W-2, Wage and Tax Statement. The notice to the employee must be in writing and must, if an election is made for 1985, be provided by September 1, 1985. For years following 1985, the employer must provide the notice to the employee by the later of January 31 of the year for which the election is to apply or within 30 days after the date the employer first provides a vehicle to the employee.

The employer must provide the notice in a manner reasonably expected to come to the attention of all affected employees. This may be accomplished by providing the notice directly to the employee, for example, in a mailing or with the employee's paycheck, or by posting the notice. Employers may change their election not to withhold at any time by notifying their employees in the manner prescribed above. Employers need not notify the Service of this election.

If the employer elects not to withhold income taxes on the value of the personal use of the vehicle and the employee does not have sufficient income tax withheld to pay the income tax attributable to the personal use of the vehicle, then the employee may increase the income tax withholding on his or her regular wages by filing a new Form W-4, Employee's Withholding Allowance Certificate. If sufficient funds are withheld, the employee will not find it necessary to make estimated tax payments in order to avoid a penalty for underpayment of estimated taxes with respect to the fringe benefit.

5. Special accounting rule.

Under the general income tax and reporting rule, the employer must determine the actual value of the fringe benefits provided in a calendar year by January 31 of the following calendar year. If the benefit is the personal use of a highway motor vehicle, the employer may either determine the actual value for the calendar year or determine the actual value as if the entire usage of the vehicle for the year by the employee

is personal (100 percent income inclusion). If the employer includes 100 percent in an employee's income, the employee may calculate the value of his or her business use of the vehicle on Form 2106, Employee Business Expenses, and deduct this amount on Form 1040, Individual Income Tax Return.

For the administrative convenience of employers, a special accounting rule is available as an alternative to this general rule. The special rule may not be used if the fringe benefit is the transfer of personal property (either tangible or intangible) of a kind normally held for investment or the transfer of real property.

(a) *Special accounting period.*

The employer may treat the value of the benefits provided during the last two months of the calendar year or any shorter period as paid during the subsequent calendar year. Under this rule, the employer may treat the value of the benefits provided in the period beginning January 1, 1985, and ending October 31, 1985, as the value of the benefits provided in 1985. For years subsequent to 1985, the value of the benefits actually provided in the last two months of the previous calendar year is treated as provided in the subsequent calendar year together with the value of the benefits provided in the first 10 months of the subsequent calendar year. (This rule does not mean that an employer who treats all benefits as provided during the last two months of a calendar year can defer including the entire value of such benefits until the subsequent year. Rather, only the value of the benefit actually provided during the last two months of the calendar year can be treated as provided in the subsequent calendar year.)

(b) *Conformity rules.*

Use of the special accounting rule is optional. An employer may use the rule for determining the value of some fringe benefits but not others. The period for which it is used need not be the same for each fringe benefit. However, an employer that uses the rule for a particular benefit must use the rule with respect to all employees who receive that fringe benefit. An employee may not use the special accounting rule unless the employer uses the rule.

If an employer uses the special accounting rule, the employee must use the special accounting rule and must use it for the same period as the employer. In addition, the employee must use the special accounting rule and the same period for all purposes. Thus, deductions of the employee with respect to a fringe benefit provided in a calendar year are allowable in that calendar year only to the extent that the employer includes the value of the fringe benefit in the employee's income for that calendar year. For example, assume that an employer provides an employee with a vehicle throughout 1985 for both business and personal use and that the employer includes 100 percent of the value of the use of the vehicle in the employee's income. Assume further that the employer elects to use the special accounting rule and treats the value of the use of the vehicle during the last two months of 1985 as paid during 1986. The employee may deduct for 1985 that portion of the value of the vehicle attributable to the employee's business use of the vehicle for the first ten months of 1985. That portion of the value of the vehicle attributable to the employee's business use of the vehicle for the last two months of 1985 must be deducted for 1986. However, any unreimbursed expenses incurred by the employee during the last two months of 1985, that relate to the employee's business use of the vehicle during those months (such as fuel, parking, etc.), may be deducted for 1985.

An employer elects to use the special accounting rule by determining the value of the benefits provided under the rule and treating the amount determined as the value for purposes of reporting and withholding and paying the applicable taxes. The employer need not notify the Service of the election. The employer may, for appropriate administrative reasons, change the period for which the rule has been used without notifying the Service and without the consent of the Commissioner provided that the appropriate amount of income is reported for the changed period, and the applicable taxes are withheld and deposited.

6. *Information reported to employees.*

Employers that provide fringe benefits to employees must include in box 10 and, if applicable, box 13 of the Form W-2 the value of the fringe benefits provided in a calendar year. Employers may, if they choose, include the value of the fringe benefits (and any other information relating to the benefits) on a separate Form W-2. Employers must report to employees the total value of the fringe benefits provided in the calendar year in box 16 of the Form W-2. In addition, if the employer provided the use of a highway motor vehicle and included 100 percent of the value of the vehicle in the employee's income, the employer must separately report this value (so that the employee can compute the value of any business use of the vehicle) in box 16.

If sufficient space is not available, employers must report this information to the employees on a separate schedule.

Employers that elect to use the special accounting rule must notify the affected employees that the special accounting rule has been used and of the period for which it has been used. Employers must provide the notice directly to the employee at or near the time the employer provides the employee with the Form W-2; it must not be provided earlier than with the employee's last paycheck of the calendar year.

7. Example.

An employee, E, receives fringe benefits during 1985. E's employer, R, collects the information regarding the fringe benefits on a quarterly basis, processes the information during the next quarter, and treats the benefits as provided on the last payday of the next quarter. R withholds the applicable taxes from E's paycheck on that date, deposits the withheld taxes together with the taxes imposed on the employer according to the regular rules for depositing payroll taxes, and files a Form 941 at the end of the quarter reporting the fringe benefits it treated as paid during the quarter. For the last quarter of 1985, R elects to use the special accounting rule provided in section 5 above for the last two months of the calendar year. Thus, R collects the information regarding the fringe benefits provided through October 31, 1985. R treats the fringe benefits actually provided during the third quarter of 1985 and during October 1985 as paid with the last paycheck of the fourth quarter of 1985, withholds the applicable taxes, deposits the withheld taxes together with the taxes imposed on the employer according to the regular rules for the deposit of payroll taxes, and files a Form 941 reporting the value of the fringe benefits it treated as paid during the quarter. On January 31, 1986, R reports the value of the fringe benefits actually provided from January 1, 1985, through October 31, 1985, on a Form W-2 furnished to E.

During 1986, R follows the same procedure and again uses the special accounting rule for the last two months of the calendar year. Accordingly, R treats the fringe benefits actually provided during the last two months of 1985 as paid with the last paycheck of the first quarter of 1986, withholds the applicable taxes, deposits the taxes as required, and files a Form 941 reporting the fringe benefits treated as paid during the quarter. On January 31, 1987, R reports the value of the fringe benefits actually provided from November 1, 1985, through October 31, 1986, on a Form W-2 furnished to E.