Are FAVR Reimbursement Programs Non-Compliant with Sarbanes-Oxley?

By Mike Antich

There are three types of payment plans utilized to reimburse employees who drive their personal vehicles for business use. They are fixed payments (a monthly allowance), variable payment (cents per mile), and fixed and variable reimbursement (FAVR).

First established in 1992, a FAVR plan reimburses employees on a non-taxable basis through a combination of a monthly allowance and a per-mile reimbursement. In IRS Revenue Procedure 2004-64, the FAVR fixed payment includes projected fixed costs, such as depreciation (or lease payments), insurance, registration, license fees, and personal property taxes. A FAVR plan also covers projected operating (or variable) costs, such as gasoline, fuel taxes, oil, tires, and routine maintenance and repair.

To be eligible to participate in a FAVR plan, an employee must meet a number of requirements specified by the IRS 2004-64 standards. However, not all employees can meet the non-taxable standards, so companies often administer two reimbursement plans — one taxable and one non-taxable.

As a result, a FAVR plan is more complicated to implement than other reimbursement plans and requires a great deal of administrative recordkeeping to satisfy IRS regs to maintain a non-taxable payment status. Companies are required to document annual business mileage, the number of years the vehicle will be retained, model-year of the employee vehicle, the vehicle acquisition cost, and proof of employee insurance. In addition, the depreciation method used on employee tax returns must be documented by the company, and the business mile documentation must include the time, place, and purpose for which the vehicle was used.

What are the Sarbanes-Oxley Implications?

Compliance with the Sarbanes-Oxley Act of 2002 is mandatory for all publicly traded corporations, which must establish processes to ensure honest corporate disclosure and greater accountability. Sarbanes-Oxley (SOX) was the legislative reaction to the spate of corporate scandals involving companies such as Enron, WorldCom, and Adelphia. The law is named after Sen. Paul Sarbanes (D-MD) and Rep. Michael Oxley (R-Ohio), the bill's key sponsors.

How do SOX rules affect FAVR reimbursement? "Sarbanes-Oxley requires corporations to confirm that their processes are in compliance," said Jim Fredlund, director of tax management for GE Commercial Finance Fleet Services. "There are numerous requirements to set up and maintain a FAVR program, all of which must be met or a company can find itself out of compliance with IRS rules, and thus out of compliance with Sarbanes-Oxley," said Fredlund. "Most companies rely on an outside vendor to set up and maintain a FAVR program and assume the vendor will be in compliance, but, ultimately, it is the company's responsibility, from the standpoint of the law, to be in compliance."

A SOX audit typically examines the processes in place to validate the accuracy of corporate payments and ensure that calculations are done consistently and correctly. With both the setup and ongoing administrative requirements of a FAVR program, it may cause a company to become non-compliant with Sarbanes-Oxley requirements. "There are so many FAVR rules that it is difficult to be compliant with all of them. Companies are always chasing after data from employees to make sure they remain in compliance," said Fredlund. "I'd bet that if a corporation did an audit of its FAVR plan, it would discover that the plan is not in compliance."

How accurate is your FAVR reimbursement program from a Sarbanes-Oxley perspective? For instance:

- **Annual Business Mileage.** To participate in a FAVR program an employee must have a minimum 5,000 annual business miles. "Can you verify that each year the employee is over the minimum of 5,000 miles of business use by the end of the year?" asks Fredlund. "If you can't, this may be a Sarbanes-Oxley issue."
- **Insurance.** FAVR rules require employees to maintain insurance on the vehicle. "Although you may verify insurance coverage at the start of the program, can you verify that an employee didn't cancel the insurance at a later time?" said Fredlund.
- **Number of Management Employees in a FAVR Program.** At no time during the calendar year may a majority of the employees covered by a FAVR allowance be management employees. Do you have processes in place to monitor this requirement?

Some reimbursement outsourcers advise that "close counts" are adequate to comply with FAVR requirements. "However, the IRS states that failure to meet one or more of the requirements in Section .08 of the IRS revenue procedure means an employee may not be covered by any FAVR allowance," said Fredlund.

If an outside vendor is used to administer a reimbursement program, you can ask them to provide a certificate of full compliance with IRS rules, which would keep you in compliance with Sarbanes-Oxley requirements. Maybe now is the time to ask?

Let me know what you think.

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