

# Publications

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## Tax and Disclosure Considerations Related to Executive Security Benefits

### Key Takeaways

- Executives and companies may deduct the cost of security benefits that meet certain requirements under the Treasury Regulations
- Public companies are generally required to disclose the cost of security benefits they provide to their executive teams in certain filings with the Securities and Exchange Commission

As individual executives are attracting increased attention for their roles in high-profile consumer-facing companies, their employers are establishing or expanding executive security programs. An executive security program allows key employees to focus on the business and protects shareholder value from stock price fluctuations associated with a security incident. All employers establishing an executive security program should be familiar with the tax consequences of these benefits for both the employer and the executive and public company employers should be aware of the related rules for disclosure of executive perquisites in their proxy statements.

### Certain security benefits may be deductible by the employee and employer

Generally, any benefit provided to an employee is includible in taxable income. Certain fringe benefits, including “working condition fringes,” are excludible from income if properly structured. Employer-provided transportation may be excluded from income if it addresses a bona fide business-oriented security concern and the employer establishes an overall security program with respect to the relevant executive. An “overall security program” is a comprehensive program that provides 24-hour security to the executive subject to the following rules:

- The executive must be protected while traveling for business or personal purposes; and
- The program must include the provision of:
  - A bodyguard or chauffeur trained in evasive driving techniques;
  - An automobile with security equipment installed;

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### Related Capabilities

- Employee Benefits & Executive Compensation

- Guards, metal detectors, alarms or similar methods of controlling access to the executive's workplace and residence; and
- Flights on the employer's aircraft for business and personal reasons, where appropriate.

Employers may find that such an exhaustive security program is unnecessary for their needs. In this situation, the Treasury Regulations also provide that the employer may engage an independent security consultant to perform a security study. If the study demonstrates that the default 24-hour security program is not required to address the employer's security concerns, the cost of a less comprehensive transportation security program may still be deductible from the employee's income.

These tax benefits may also extend to the executive's spouse and dependents. If there is a bona fide business-oriented security concern with respect to an executive, that concern also extends to the executive's spouse and dependents. The cost of transporting the executive's spouse and dependents in the same vehicle or aircraft at the same time as the executive remains deductible as a working condition fringe. Deductions for personal travel are limited, however, to the excess of the transportation cost with additional security measures over the transportation cost absent the security concern. For example, if an executive purchases an automobile with bulletproof glass, the executive may only deduct the difference between the cost of the vehicle with and without bulletproof glass.

Despite the elimination of the general commuter expense deduction for employers under the Tax Cuts and Jobs Act, employers may still deduct the cost of providing transportation between the executive's residence and place of employment if the cost is necessary to ensure the safety of the executive. The standard for a transportation security expense to be deductible by the employer is much lower than the standard that the expense must meet to be excludible from the employee's income. Transportation expenses are deductible by the company if a reasonable person would consider it unsafe for the employee to commute during the applicable time of day.

### **Executive security benefits are considered perquisites that must be disclosed with other executive compensation**

Under Item 402 of Regulation S-K, companies must disclose executive perquisites with an aggregate value over \$10,000 in their proxy statements. The SEC has stated that an item is not a perquisite if it is integrally and directly related to the performance of an executive's duties. A benefit that is not integrally and directly related to the performance of an executive's duties is then considered a perquisite if it confers a personal benefit regardless of whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees. The SEC has specifically listed "personal travel using vehicles owned or leased by the company" and "security provided at a personal residence or during personal travel" as benefits that constitute perquisites and has brought enforcement actions against companies and executives for failure to disclose or properly value these benefits in recent years. Companies that provide security benefits often take the position that these benefits are integrally and directly related to the performance of the executive's duties but disclose the value of the benefits in an abundance of caution.

Institutional Shareholder Services (ISS) also scrutinizes executive perquisite disclosures. Listed among ISS' examples of problematic pay practices that could cause ISS to recommend a vote against an executive pay package are "excessive or extraordinary perquisites," which include personal use of corporate aircraft and any associated tax gross-ups. Filers must carefully draft their disclosures to explain that these security programs are necessary for the business.

If you have questions about how to properly structure and disclose your executive security program, contact the authors listed above or another member of Polsinelli's Employee Benefits & Executive Compensation team.