



# Mobility Matters

## Navigating the U.S. Tax Implications of Employer-Provided Executive Security

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**Although executive security has been of interest for many years, recent tragic events have brought into focus the potential need for personal security beyond the occasional business trip to particular countries or cities perceived as dangerous. Rather, increasing public awareness and recognition of individuals as the “face” of a company, or a leader in a particular industry, may put the individual at risk even domestically, and warrant the need for an employer to provide personal security. What many employers and executives find surprising is that certain aspects of that employer-provided security benefit generally will be taxable for U.S. tax purposes, because they provide a personal benefit that if paid for by the employee would not be deductible as an employee business expense. Although there are certain exceptions under the U.S. Internal Revenue Code (I.R.C.) and implementing regulations<sup>1</sup> that help mitigate some of the related personal income, the same tax rules may not allow the elimination of the resulting compensation income.**

**Employers and employees should understand the U.S. taxation of these benefits before entering into any arrangements, to avoid unwelcome surprises (including requests for gross ups relating to the additional tax liabilities).**

### Background

Treasury Regulation section 1.132-5(m) (“the Regulation”) provides for the exclusion from income the value of certain benefits provided by an employer as part of a security program. To qualify for the exclusion, the security program must be based on a “bona fide business-oriented security concern” and generally must include 24-hour protection at home, work, and during travel, or follow the conclusions of an independent security study that 24-hour protection is not required, but then consistently apply the recommendations for when and what security is needed. Other key components of executive security often involve trained bodyguards, secure vehicles, and employer-provided flights on private aircraft.

In addition, employers and employees should understand the administrative issues involved in substantiating various aspects of the benefits and the requirement to consistently apply the security recommendations even when potentially viewed as intrusive that are part of the process necessary to obtain the more favorable tax treatment.

Finally, it is important to be aware that certain aspects of employer-provided security might not be deductible employee business expenses if paid for by the employee, and therefore would not support the treatment of an

employer covering those expenses as an excludible working condition fringe benefit. For example, the provision of an automobile and/or a driver, or a plane, for personal travel, even as part of securing the executive during that travel, would not qualify for an exclusion as a working condition fringe benefit under I.R.C. section 132(a)(3). The Regulation that is relevant (section 1.132-5(m)) addresses this issue by permitting, in certain circumstances, for the additional value provided by the security aspects of the transportation to be excluded from compensation income, but requiring that the basic benefit of employer-provided personal transportation be included in compensation income.





## Favorable Tax Treatment under the Regulation: Requirements

### *A Bona Fide Business-Oriented Security Concern*

To receive favorable tax treatment under the Regulation, employer-provided security must be responding to a “bona fide business-oriented security concern.” For this purpose, a bona fide business-oriented security concern may not relate solely to a generalized concern for safety but instead must have a specific basis for concern. The Regulation provides examples such as a threat of kidnapping or serious bodily harm to the individual based on his or her status as an employee of the employer, or a recent history of terrorist activity (such as bombings) in the area of travel. Note that this would not include a security concern related solely to the individual’s wealth or general notoriety, rather the security concern must relate to the danger inherent in the area of travel or the threats must relate to the status of the individual as an employee of that employer.

### *An Overall Security Program*

The next requirement to establish a bona fide business-oriented security concern is that the employer must have established an “overall security program.” The Regulation provides that absent an independent security study (as described below), an overall security program must provide protection to the employee on a 24-hour basis, including protection while at the employee’s residence, while commuting to and from the employee’s workplace, and while at the employee’s workplace. This includes protection while traveling both at home and away from home, whether for business or personal purposes, and cannot be selectively avoided at the employee’s request. This protection must consist of:

- a secure driver to operate the vehicle who is a bodyguard/chauffeur and is trained in evasive driving techniques;
- an automobile specially equipped for security;

- guards, metal detectors, alarms, or similar methods of controlling access to the employee’s workplace and residence; and
- in appropriate cases, flights on the employer’s aircraft for business and personal reasons.

### *An Independent Security Study*

Employers typically utilize the provision in the Regulation that an overall security program may be established by obtaining and following the recommendations of an independent security study. To qualify under the Regulation, the security study must meet specific requirements, including that the study:

- be tailored to the specific employee;
- be performed by an independent security consultant;
- be based on an objective assessment of the facts and circumstances;
- conclude that the employee does not require all facets of an “overall security program” and that conclusion must be reasonable; and
- make specific security recommendations that the employer follows on a consistent basis.

### *Family Members of the Employee*

Family members may be included in an employee’s security needs. Specifically, the Regulation deems a spouse and/or dependent child accompanying an employee on travel to have the same security concerns as the employee. Furthermore, a spouse or dependent child may have a separate bona fide business-oriented security concern if that individual spouse or dependent child is analyzed independently by the security study and is determined to also have a security concern.





## Federal Tax Consequences

### *Travel in a Secured Vehicle with Secure Driver*

Even if an independent security study concludes that a vehicle must be provided to the executive for personal travel, this benefit will remain a taxable fringe benefit to the employee under the Regulation. However, in determining the value of the benefit, the additional value of the vehicle due to the security features – bulletproof glass, etc. – may be disregarded when determining the lease value of the vehicle used to value the benefit. In addition, the value of the secure driver may be disregarded as an excludable benefit (meaning not treated as the taxable provision of a chauffeur).

Because commuting is considered personal travel, the use of the vehicle for that purpose will be a taxable fringe benefit to the employee. However, the prohibition for U.S. tax purposes on the deduction of commuting expenses under I.R.C. section 274(l) may not be applicable because the deduction is available if the vehicle used for commuting is provided for a bona fide security concern.

Note that the taxation of the personal use of the vehicle and secure driver will need to be determined using the process for determining the compensation (if any) derived from employer-provided vehicles. This generally means that the employer will need to track the number of miles and the purpose of each use of the vehicle. Typically, that data will be provided by the security firm as part of the vehicle and secure driver service, but for executives who are not used to this type of tracking, the process may be seen as overly invasive. This means that the requirements should be thoroughly explained prior to implementation to avoid potential misunderstandings.

### *Travel in a Private Airplane*

Like travel by an employer-provided secured vehicle, the employer's provision of a private plane to the executive for personal travel will remain a taxable fringe benefit to the employee even if it is recommended by an independent security study. However, the Regulation generally allows for a lower multiple of the Standard Industry Fare Level ("SIFL") rates to be used to calculate the value of private plane use if the plane use is part of a qualifying overall security program, generally decreasing the includible compensation income by 50 percent. In addition, the deduction prohibition for U.S. tax purposes for employer-reimbursed commuting expenses under section 274(l) may not be applicable if the plane was provided due to a bona fide security concern.

### *Other Security – Home Security and Bodyguards*

Whether an independent security study is required to exclude employer-provided home security or bodyguards is not entirely clear. The legislative history to I.R.C. section 132 supports that an exclusion from income may be available if provided due to bona fide business-oriented security concerns, while the regulations include home security (or access) in the definition of an "overall security program" but then do little to further address their taxation.<sup>2</sup> Due to this risk, many employers choose to include home security needs as part of the independent security study, and follow the recommendations provided. Even if not required to exclude the benefits from compensation, the independent security study determining the need for home security will buttress the employer's position that it is being provided in response to a bona fide business-oriented security concern, and so is an excludable fringe benefit. Note that in particular with home security, the recommendations may involve changes to the residence that may not be easily removed and so may outlast the employee's employment and/or the particular security concern, for example the installation of bulletproof windows or security fences. This is another area that a review by a tax professional may be warranted to help ensure that the benefit provided is viewed as primarily responsive to the security concern rather than as providing a significant personal benefit to the executive in the form of a home improvement.



## Requirement to Follow the Recommendations of the Independent Security Study

For the independent security study to serve its purpose of establishing an overall security program, the employer must follow its recommendations consistently. This may sometimes surprise an executive and/or family members of the executive who may feel a loss of autonomy. For example, if the independent security study provides that the employee may not drive in the metropolitan area of the residence or office other than in a secured vehicle with a driver, then the employee must understand that there will be no midnight runs for ice cream or other deviations from this process.





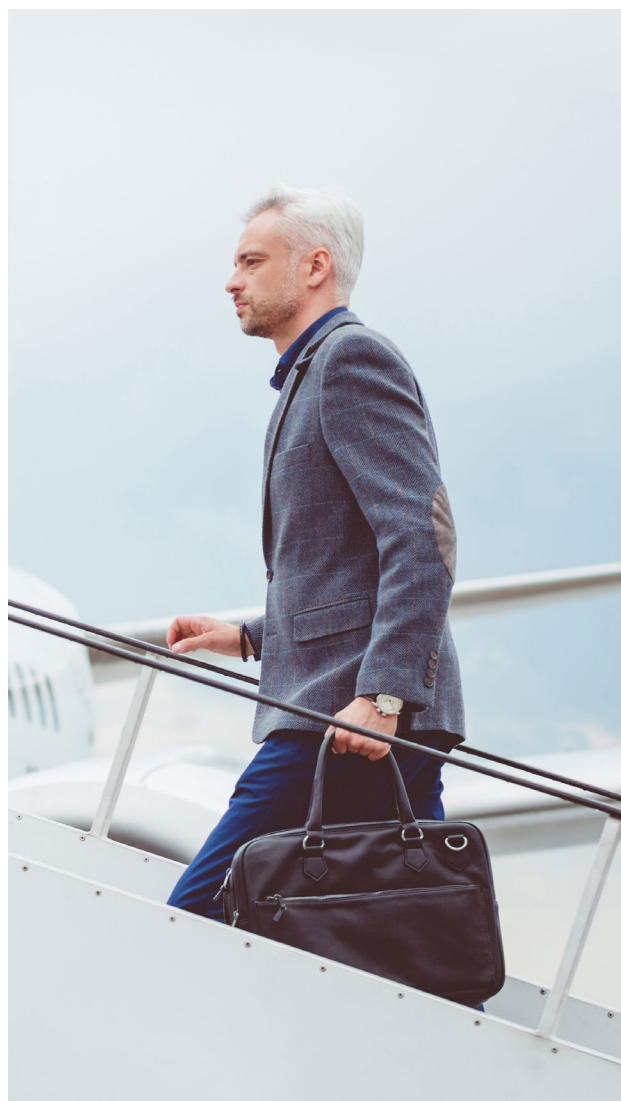
Conceptually, the independent security study process does not appear complicated – the employer provides sufficient information for the consultant to conduct the study and the consultant arrives at his or her own independent conclusions. In reality, however, the process rarely works that smoothly. First, while there are many qualified security consultants who provide quality security studies, including KPMG LLP (U.S.), there also are consultants in the market who are not qualified, or are qualified but do not understand the relevant requirements that the study must meet to comply with the Regulation. The prevalence of these market players has increased recently in response to the growing demand for studies. Because the main purpose of the study is to satisfy the regulatory requirements that enable more favorable tax treatment, a review of a draft study by a qualified tax professional is recommended.

Second, there often is an inherent tension in the process because there is pressure on the consultant to provide the client what it expects, earn future business and referrals, and also seemingly provide independent, unbiased conclusions that will determine the level of security needed. In practice, it is rare for a security consultant to conclude that an executive does not need personal security, although in some cases the support for that in the study is lacking. And in some cases, the security recommendations are so extravagant or bespoke that it appears to have been requested by the employee rather than recommended by an independent security consultant. This is another area where a review by a qualified tax professional is recommended, to help ensure that the security concerns noted are adequately supported by the underlying factual findings, and that the specific security recommendations address those security concerns in a reasonable manner that will be respected as evidencing the consultant's own independent and reasonable conclusion.

Finally, an independent security consultant will not want to make recommendations that the employer cannot or will not follow, because in such case the security study is useless. Accordingly, it is not unusual to receive initial draft studies with less-than-specific recommendations that may require continuous (and expensive) interactions with the consultant to operate. For example, a requirement that the employer have the consultant analyze the security concerns each time the executive is traveling outside the U.S. may not be a feasible or economical process for an executive who routinely travels to foreign offices. In some ways this is an invitation for a more iterative process to fully flesh out the specific security recommendations that the employer must apply consistently; however, care should be taken to avoid the process devolving into a negotiation over the terms of the contract, which could endanger the "independent" nature of the study that is required by the Regulation.

### *Frequency of Independent Security Studies*

There is no guidance on the amount of time an independent security study may be relied upon. Three years is often mentioned with the notion that using such a cycle would help ensure that any IRS audit would involve a reasonably fresh study for the year under audit according to the normal statute of limitations. But a study also is only relevant as long as the conditions related to the security concern do not materially change; so employers will need to take into account whether acquisitions or divestitures of certain lines of businesses, relocations of corporate headquarters, openings or closings of foreign offices, corporate scandals or other news items, etc., may alter the conclusions reached in an independent security study and thus necessitate a new request.





## Summary

In a world increasingly fraught with safety challenges for cross-border business executives (and their families), employers may decide it is in the interest of the business to provide personal security for the employee and his or her family members. But there are important tax and administrative considerations tied to doing so. The process of implementing an employer-provided security program that meets the regulatory requirements for favorable tax treatment is not overly burdensome, but care should be taken to avoid missteps and meet the expectations of all the parties. In general, the process will involve hiring an independent security consultant. Best practice would be to hire a reputable and responsible consultant, but even so, the report should be reviewed by a tax professional to

help determine that it fulfills the regulatory requirements. Furthermore, the executive should understand the nature of the program, including that the executive must follow the recommendations consistently and that there will be individual tax consequences (although significantly lower tax consequences if the regulatory requirements are met). However awkward, conversations are needed between the executive and the employer to make sure the security consultant chosen can act independently, and that the supporting documentation will reflect that. And as a final reminder, employer-provided security is an ongoing process that will need to be routinely reevaluated and monitored for compliance.

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### Footnotes:

<sup>1</sup> Unless otherwise indicated, all references to “section” herein are to the Internal Revenue Code of 1986, as amended, and all references to “Treasury Regulation section” are to U.S. Treasury Department Regulations, as most recently adopted or amended through the date of this article.

<sup>2</sup> H.R. Rep. No. 98-432, pt.2, at 1602 (1984), Supplemental House Report to the *Tax Reform Act of 1984*.

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