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How Certain Fringe Benefits are Taxed

An employee fringe benefit can take many forms. At its essence, a fringe benefit is a form of payment (i.e., property, services, cash, or cash equivalents) that is made in connection with the performance of services. As such, these benefits are taxable under Sec. 61, unless they are specifically excluded.

A benefit provided on an individual's behalf is taxable to that individual even if the benefit is received by someone else (such as a spouse or a child) (Regs. Sec. 1.61-21(a)(4)).

Tax treatment of fringe benefits:

Generally, taxable fringe benefits are included in wages at their fair market value (FMV). In general, for purposes of fringe benefits, FMV is determined on the basis of all the facts and circumstances. Specifically, the FMV of a fringe benefit is the amount that an individual would have to pay for the particular fringe benefit in an arm's-length transaction (Regs. Sec. 1.61-21(b)). Neither the amount the employee considers to be the value of the fringe benefit nor the cost the employer incurs to provide the benefit determines its FMV.

The taxable amount of a benefit is reduced by any amount paid by (or for) the employee and any amount specifically excluded by a Code provision (Regs. Sec. 1.61-21(b)(1)). In addition, special valuation rules apply for certain fringe benefits (e.g., autos, other vehicles, and airline flights).

Some specifically excluded fringe benefits:

As noted, fringe benefits are taxable unless specifically excluded. Sec. 132 is one such exclusion provision; it deals with a variety of benefits that may not be taxable. Among the benefits covered are:

No-additional-cost services (Sec. 132(b)): These are services provided by an employer to an employee for his or her personal use if (1) the

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services are ordinarily offered for sale to (nonemployee) customers in the employee's line of business; (2) the employer incurs no substantial additional cost in providing the services to the employee; and (3) special nondiscrimination rules are followed.

Note that in determining whether an employer incurs substantial additional cost in providing a service to employees, any revenue the employer forgoes must be considered (Regs. Sec. 1.132-2(a)(5)(i)).

Generally, no-additional-cost services are excess capacity services, such as airline, bus, or train tickets; hotel rooms; or telephone services provided free or at a reduced price to employees working in those lines of business.

Qualified employee discounts (Sec. 132(c)): This exclusion applies to a price reduction given to an employee on property or services that are also offered to customers in the ordinary course of the line of business in which the employee performs substantial services. However, it does not apply to discounts on real property or discounts on personal property of a kind commonly held for investment (such as stocks or bonds).

Generally, the value of an employee discount can be excluded from the employee's wages, up to the following limits:

- For a discount on services, 20% of the price charged nonemployee customers for the service.
- For a discount on merchandise or other property, the employer's gross profit percentage times the price charged nonemployee customers for the property (Regs. Sec. 1.132-3(c)(1)(i)).

Working condition benefits (Sec. 132(d)): This exclusion applies to property and services provided to an employee so that the employee can perform his or her job. It applies to the extent the employee could deduct the cost of the property or services as a business expense or depreciation expense if he or she had personally paid for it.

The employee must meet any substantiation requirements that apply to the deduction. Examples of working condition benefits include an employee's use of a company car for business, an employer-provided cellphone provided primarily for noncompensatory business purposes, and job-related education for an employee.

This exclusion also applies to a cash payment provided for an employee's expenses for a specific or prearranged business activity for which a deduction is otherwise allowable to the employee. The employee must be required to verify that the payment is actually

used for those expenses and to return any unused part of the payment.

The exclusion does not apply to:

- A service or property provided under a flexible spending account in which the employer agrees to provide the employee a certain level of unspecified noncash benefits with a predetermined cash value over a period of time;
- A physical examination program provided by the employer (even if the program is mandatory); or
- Any item, to the extent the employee could deduct its cost as an expense for a trade or business other than the employer's trade or business.

De minimis benefits (Sec. 132(e)): A *de minimis* benefit is any property or service provided to an employee that has so little value (taking into account how frequently similar benefits are provided to employees) that accounting for it would be unreasonable or administratively impracticable. Cash and cash-equivalent fringe benefits (e.g., gift cards, charge cards, or credit cards), no matter how small, are *never* excludable as a *de minimis* benefit, except for occasional meal money or transportation fares.

Examples of *de minimis* benefits include:

- Personal use of employer-provided cellphones provided primarily for non-compensatory business purposes;
- Occasional personal use of a company copying machine, if the employer sufficiently controls its use so that at least 85% of its use is for business purposes;
- Holiday gifts (other than cash) with a low FMV;
- Group-term life insurance payable on the death of an employee's spouse or dependent, if the face amount is not more than $2,000;
- Occasional parties or picnics for employees and their guests; and
- Occasional tickets for theater or sporting events.

Commuting benefits (Sec. 132(f)): This involves benefits provided to employees for their personal transportation, such as commuting to and from work. These rules apply to the following transportation benefits:

- De minimis *transportation benefits*. A *de minimis* transportation benefit is any local transportation benefit provided to an employee if it has so little value (taking into account how frequently the employer provides transportation to its employees) that accounting for it would be unreasonable or administratively impracticable. For example, it applies to occasional transportation fare given an employee because the employee is working overtime, if the benefit is reasonable and is not based on hours worked.

- *Qualified transportation benefits*. This exclusion applies to the following benefits:
    1. A ride in a commuter highway vehicle between the employee's home and workplace;
    2. Transit passes;
    3. Qualified parking; and
    4. Qualified bicycle commuting reimbursements.

The exclusion applies whether the employer provides only one or a combination of these benefits to employees.

Qualified transportation benefits can be provided directly by an employer or through a legitimate reimbursement arrangement. However, cash reimbursements for transit passes qualify only if a voucher (or a similar item) that the employee can exchange only for a transit pass is not readily available for direct distribution by the employer to its employee. A voucher is readily available for direct distribution only if an employee can obtain it from a voucher provider that does not impose charges (or other restrictions) that effectively prevent the employee from obtaining vouchers (Regs. Sec. 1.132-9(b), Q&As 16-19)).

Qualified moving expense reimbursements (Sec. 132(g)): This exclusion applies to any amount directly or indirectly given to an employee (including services furnished in-kind) as payment for, or reimbursement of, moving expenses.

The exclusion applies only to reimbursement of moving expenses that an employee could deduct if he or she had paid or incurred them without reimbursement. However, it does not apply if the employee actually deducted the expenses in a previous year.

Deductible moving expenses include only the reasonable expenses of moving household goods and personal effects from the former home to the new home and traveling (including lodging) from the former home to the new home.

Deductible moving expenses do not include any expenses for meals and must meet both distance and time tests. The distance test is met if the new job location is at least 50 miles farther from the employee's old home than the old job location. The time test is met if the employee works at least 39 weeks during the first 12 months after arriving in the general area of the new job location.

Employer-provided retirement advice (Sec. 132(m)): An employer may exclude from an employee's wages the value of any retirement planning advice or information provided to an employee (or his or her spouse) if the employer maintains a qualified retirement plan (as defined in Sec. 219(g)(5)). In addition to employer plan advice and information, the services provided may include general advice

and information on retirement; however, the exclusion does not apply to services for tax preparation, accounting, legal, or brokerage services.

Note that the value of these services can be excluded by highly compensated employees only if the services are available on substantially the same terms to each member of a group of employees who normally receive education and information about the employer's qualified retirement plan (Sec. 132(m)(2)).

Other excludable fringes:

In addition to those benefits described, Sec. 132 also deals with certain military base realignment and closure benefits (Sec. 132(n)); company-run cafeterias (Sec. 132(e)(2)); and on-premises gyms and athletic facilities (Sec. 132(j)(4)).

This survey of employee benefits available tax-free under Sec. 132 is just a portion of the types of fringe benefits whose tax treatment is determined under the Code.