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GENERAL BUSINESS UPDATE

This newsletter provides you with information concerning the federal income tax treatment of certain "nonstatutory"fringe benefits under Code § 132.

Under Code § 132, an employee's gross income generally does not include an employer-provided benefit that falls into any one of these eight general categories.

- no-additional-cost services;
- qualified employee discounts;
- working condition fringes;
- de minimis fringes;
- qualified transportation fringes;
- qualified tuition reductions;
- qualified moving expense reimbursements; and
- qualified retirement planning expenses.

If a benefit does not qualify under one of the above exemptions and is not given tax-favored status elsewhere in the tax Code, the employee must include it in his or her gross income.

1. No-Additional-Cost Services

A "no-additional-cost service" is any service provided by an employer for an employee's use if the service is offered for sale to customers in the ordinary course of the employer's line of business in which the employee is performing services and the employer incurs no substantial additional cost (including foregone revenue) in providing the service to the employee (determined without regard to any amount paid to the employee for the service). One common example of a no-additional-cost service is the practice of an airline allowing its personnel free flights to the extent that there is empty space.

2. Qualified Employee Discounts

A "qualified employee discount" is any employer-provided employee discount with respect to qualified property or services to the extent that the discount does not exceed:

- in the case of property, the "gross profit percentage" of the price at which the employer offers the property to customers; or
- in the case of services, 20% of the price at which the employer offers the services to customers.

The “gross profit percentage” is the percentage that the total sales price of property sold by the employer to customers exceeds the employer's total cost for the property. Gross profit percentage is determined on the basis of all property offered to customers in the ordinary course of the employer's business in which the employee is performing services (or a reasonable classification of property selected by the employer) and the employer's experience during a representative period.

An “employee discount” is the amount by which the price at which the employer offers the property or services to customers exceeds the price at which it offers the property or services to the employee. For this purpose, “qualified property or services” means any property (other than real property or personal property of the type held for investment) or services that are offered for sale to customers in the course of the employer's business in which the employee is performing services.

3. Working Condition Fringes

A “working condition fringe” is any property or services provided by an employer to an employee to the extent that, if the employee paid for the property or services personally, the payment would be deductible as an ordinary and necessary trade-or-business expense or as depreciation. An example of this would be the use of a company car by an employee whose employment requires extensive travel.

A special rule recognizes the practice in the automobile industry of providing a demonstration use car for automobile salespersons. Such use is considered a working condition fringe if it satisfies certain requirements.

The value of employer-provided transportation to an employee for security reasons is excludible as a working condition fringe to the extent that the employee could deduct the payment for the service as an ordinary and necessary business expense or as depreciation.

4. De Minimis Fringes

“De minimis fringes” are exempt from taxation largely due to the administrative burden associated with keeping track of such benefits. A de minimis fringe is any property or service the value of which (after taking into account the frequency with which similar fringes are provided by the employer to its employees)is so small as to make accounting for it unreasonable, or impractical.

The operation by an employer of an employee eating facility is a de minimis fringe if the facility is located on or near the employer's business premises and the revenue derived from the operation normally equals or exceeds the direct operating costs of the facility. Such eating facilities are a de minimis fringe benefit with respect to highly compensated employees only if access to the facility is available on substantially the same terms to non-highly compensated employees.

For this purpose, a highly compensated employee is one who:

- was a five-percent owner of the employer at any time during the year or the preceding year; or
- had compensation for the preceding year in excess of $80,000 (indexed for inflation) and, if the employer so elects, was in the top 20% of employees by compensation for such year.

The value of local transportation fare is totally excludible from gross income as a de minimis fringe for any employee (regardless of income) if the benefit is reasonable and is provided on an occasional basis because overtime requires an extension of the employee's normal work schedule.

A partial de minimis exclusion is provided for local transportation furnished to "noncontrol" employees for use in commuting to and from work because of unusual circumstances or because it is unsafe to use other available means.

Note that working condition and de minimis fringe benefits may be provided exclusively to executives.

5. Qualified Transportation Fringes

A qualified transportation fringe is (1) transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of business,(2) a transit pass, or (3) qualified parking. Cash reimbursements made by the employer for such expenses under a bona fide reimbursement arrangement also may qualify for the exclusion.

Each year, the dollar amounts excluded from gross income are subject to adjustment for inflation. The exclusion does not apply to any qualified transportation fringe unless such benefit is provided in addition to (and not in lieu of) any compensation otherwise payable to the employee. The exclusion does not apply to self-employed individuals.

6. Qualified Moving Expense Reimbursements

A qualified moving expense reimbursement is any amount an individual receives directly or indirectly from an employer as a payment for or reimbursement of moving expenses which would be deductible as an employee moving expense if the individual paid or incurred the expenses directly. This does not include any payment or reimbursement which the employee actually deducted in a prior taxable year.

7. Tuition Reductions

Qualified tuition reductions are excludible from gross income. A qualified tuition reduction is the amount of any reduction in tuition that is provided to an employee of an educational institution for pre-graduate level education at that institution or at any other educational institution. The reduction also can be provided to the broader range of individuals treated as employees for purposes of the no-additional-cost fringe benefit rules, including retirees, widows, widowers, spouses and dependents. To qualify, a tuition reduction plan must meet nondiscrimination standards. The reduction must be available on substantially the same terms to each member of a group of employees defined under a reasonable classification set up by the employer and that does not discriminate in favor of highly compensated employees.

8. Qualified Retirement Planning Services

Qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified employer retirement plan are excludible from income. "Qualified retirement planning services" are retirement planning advice or information provided to an employee and his spouse by an employer maintaining a "qualified employer plan." A "qualified employer plan" includes qualified plans under § 401(a), governmental plans, § 403(a) annuity plans, § 403(b) tax-deferred annuities, SEPs, and SIMPLE retirement accounts.

9. Special Rules

For purposes of the no-additional-cost service and qualified employee discount rules, certain retired and disabled employees and the surviving spouses of employees are treated as employees. In addition, for purposes of all § 132 fringe benefits, use of the benefit by the employee's spouse or dependent children is considered use by the employee. The exclusion from gross income provided by § 132 applies only to a highly compensated employee with respect to a no-additional-cost service or a qualified employee discount if the benefit is provided on substantially the same terms to a group of employees that constitutes a reasonable classification and that does not discriminate in favor of highly compensated employees.

IRS regulations also provide special rules for the treatment of certain individuals who are non-employees. For instance, partners performing services for a partnership will qualify for all of the fringe benefit exclusions. Under a special administrative convenience rule, directors and independent contractors may qualify for tax-free treatment of certain working condition fringe benefits.

10. Reciprocal Agreements

The law allows for reciprocal agreements between employers to provide fringe benefits for each other's employees. A reciprocal agreement will allow the benefits provided by one employer for the employees of the other party to the agreement to qualify for the exclusion if the services are provided pursuant to a written agreement between employers and neither of the reciprocating employers incurs any substantial additional cost (including foregone revenue) in providing such services or pursuant to such agreement. An example of such an agreement would be an agreement between an airline and a hotel chain to provide free airfare and free hotel accommodations to the employees of the other when such airfare or accommodations go unbooked.

11. Related Employers Aggregated

For purposes of Code § 132, certain related employers are treated as if they were a single employer. The law also contains special rules for leased sections of department stores, parking on or near the employer's business premises (which is treated as a working condition fringe), and on-premises gyms and other athletic facilities.

12. Employment Taxes

If a fringe benefit is excludible from an employee's income under § 132 at the time the benefit is provided, it is also not subject to Social Security (FICA) and unemployment (FUTA) taxes and income tax withholding.

Gardner, Willis, Sweat & Handelman, LLP hope you find the information in this newsletter helpful. This information is intended to be general in nature and is not a substitute for competent legal advice. If you have questions on these or other general business issues, please give us a call at 229-883-2441.

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