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Tax Act: Taxation of Fringe Benefits After Tax Reform

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The Tax Act makes changes to the tax treatment of fringe benefits that impact both employers and employees. Employers are now denied certain deductions to which they were previously entitled, including expenses for parking and mass transit benefits, entertainment expenditures, and certain food and beverage expenses. Employees must now include in income both moving expenses and bicycle commuting reimbursements. The Tax Act also modifies the treatment of fringe benefits for tax-exempt organizations, clarifies the definition of employee achievement awards, and provides employers with a limited paid leave credit. These changes certainly modify employers' incentive to provide fringe benefits to their employees. However, the extent to which employers will alter their behavior is not clear.

Changes to deductibility of transportation benefits. Under prior law, employers were allowed a deduction for the cost of qualified transportation fringe benefits provided to employees. Such benefits included transit pass programs, as well as certain transportation in a commuter highway vehicle, qualified parking expenses, and qualified bicycle commuting reimbursement. The Tax Act amends Section 274 of the Code to provide that employers may not deduct the expense of any qualified transportation fringe benefits provided to employees, effective for amounts paid or incurred after December 31, 2017. In addition, a further amendment to Section 274 provides that no deduction is allowed for the provision of any transportation, or any payment or reimbursement, to an employee for travel between the employee's home and place of work. There are two discrete exceptions: 1) the deduction limitation does not apply to transportation expenses necessary to ensure the safety of the employee; and 2) the employer deduction for qualified bicycle commuting reimbursement remains available through tax year 2025.

Employees generally maintain their ability to exclude qualified transportation fringe benefits from their income under Section 132. However, elimination of the deduction for transportation fringe benefits may cause employers to change the balance between providing non-deductible fringe benefits and deductible cash compensation.

Changes to deductibility of meals and entertainment expenses. Prior law permitted taxpayers to deduct 50% of entertainment, amusement, or recreation expenses that were directly related to the active conduct of the taxpayer's trade or business (and prohibited the deduction entirely if the “directly related” standard was not satisfied). The restrictions on the deductibility of entertainment

expenses applied to most business entertaining (for example, attendance at sporting events or rounds of golf) but did not apply to the specific list of expenses in Section 274(e), which includes expenses for recreational or social activities primarily for the benefit of non-highly compensated employees. The Tax Act modifies Section 274 to provide that no deduction is allowed for entertainment expenses with the exception of those listed in Section 274(e), which remains unchanged. Thus, while employers may continue to deduct expenses related to certain recreational or social activities for the benefit of their rank-and-file employees, most entertainment expenses, even if clearly directly business related, may no longer be deducted, effective for amounts paid or incurred after December 31, 2017.

Prior law also permitted taxpayers to deduct 50% of certain employer food and beverage expenses. A full 100% employer deduction was permitted for food or beverage expenses that were excluded from the employee's income as a *de minimis* fringe benefit, which included meals provided to employees for the convenience of the employer at certain employer-operated eating facilities. The Tax Act modifies Section 274 of the Code to provide that the 50% deduction limitation now applies to expenses for the provision of food and beverages qualifying as a *de minimis* fringe benefit. That is, employers are now permitted to deduct only 50% of the cost of providing meals to employees at an employer-operated facility for the convenience of the employer. Furthermore, the Tax Act eliminates this deduction entirely after tax year 2025.

Changes to qualified moving expenses. The Tax Act imposes new temporary restrictions on employees' ability to exclude from their income employer-provided qualified moving expense payment or reimbursement. Such payment or reimbursement must be included in employees' taxable income beginning in tax year 2018, except in the case of members of the U.S. Armed Forces, for whom the exclusion remains available. Similarly, the personal deduction for moving expenses is eliminated (other than for U.S. Armed Forces). The new restrictions last through tax year 2025. Payments by employers remain deductible.

Creation of employer paid leave credit. The Tax Act creates a new tax credit for eligible employers that offer paid family and medical leave to their employees. The amount of the credit scales from 12.5% to 25% of the wages paid to the employee during the leave based on the level of wages paid during such time. The credit is available for only twelve weeks of paid leave and only with respect to amounts paid to employees that earned $72,000 or less in the preceding year. Furthermore, the credit is available only for tax years 2018 and 2019, after which time the provision terminates. The limited scope of this provision raises the question of whether it will sufficiently incentivize employers to put new paid leave policies into place, although those employers who have paid leave policies already in place may benefit from the new credit.

Clarification of employer deduction for employee achievement awards. Prior law permitted employers to deduct the value of tangible personal property provided to employees in recognition of length-of-service or safety achievements. The Tax Act maintains this achievement award deduction but adds a definition of “tangible personal property.” The term explicitly excludes cash, gift certificates, vacations, meals, and lodging, among other things.

Changes to fringe benefits for tax-exempt organizations. Tax-exempt organizations are generally

taxed on income they receive from trades or businesses unrelated to their exempt purpose. Effective tax year 2018, the Tax Act requires that tax-exempt organizations include in their unrelated business income amounts paid by the organization for certain fringe benefits for which a deduction under Section 274 is not allowed. Specifically, organizations must include, and will be taxed upon, expenses related to qualified transportation fringe benefits, parking facilities, and on-premises athletic facilities. (Read our discussion on how the new laws affect tax-exempt organizations.)

Read more commentary from WilmerHale lawyers on the Tax Act.

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