Patterson Belknap Webb & Tyler LLP

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Tax Reform: Impact on Commuter Benefits Programs

The tax reform bill (H.R. 1) approved by the House and Senate this week (available here) eliminates the deduction available to employers for the provision of qualified transportation fringe ("QTF") benefits to their employees beginning on January 1, 2018. The bill is expected to be signed by the President (and is referred to in this alert as the "new law").

Under current law, QTF benefits under Internal Revenue Code ("Code") Section 132(f) (which generally include payments for commuter transportation in a commuter highway vehicle, transit passes, qualified parking, as well as certain qualified bicycle commuting reimbursements) provided by an employer to an employee (whether employer funded, through cash reimbursements to the employee, or through employee pre-tax salary deductions) are excluded from an employee's gross income, subject to applicable dollar limitations. In addition, under current law, employers are allowed a deduction under Code Section 162 for salaries and other compensation paid to their employees, including the cost of QTF benefits.

While some of the terms of the statutory language in the new law are not as precise as we would prefer, it is clear that the new law impacts both taxable and tax-exempt employers.

The new law eliminates the deduction available to employers for QTF benefits, whether paid as an employer-funded benefit or, it appears, through employee pre-tax salary deductions, but allows employees to continue to exclude most QTF benefits from their income.[1] Qualified bicycling commuting expense payments or reimbursements, however, will not be excluded from an employee's income for the next eight years.[2]

The new law provides that a tax-exempt organization's unrelated business taxable income ("UBTI") will be increased in the amount the organization pays or incurs for any QTF (here too, it appears, even if paid through employee pre-tax salary deductions), any parking facility used in connection with qualified parking (as defined under the QTF rules), or any on-premises athletic facility. This may result in liability for unrelated business income tax ("UBIT") for tax-exempt employers that provide, or facilitate pre-tax employee contributions, for QTF benefits.[3]

One direct consequence of these changes is that absent any countervailing lower tax rates that may apply to an employer, the provision of QTF benefits to employees can effectively cost more for employers who were previously

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1 The elimination of the employer's deduction for QTF benefits is effected through an addition to Code Section 274(a)(4) disallowing deductions for the expense of any QTF benefits provided to employees. No change is being made to Code Section 132(f) which excludes from an employee's income QTF benefits, except for the elimination of the income exclusion for qualified bicycling commuter reimbursements. The new law also does not eliminate the exclusion of QTF benefits (other than qualified bicycling commuter reimbursements) from FICA wages. The new law includes some limited exceptions from certain of its non-deductibility provisions for certain transportation expenses incurred to ensure the safety of an employee.

2 The new law eliminates the exclusion from income under Code Section 132(f) for qualified bicycling commuter reimbursements for years after December 31, 2017 and before January 1, 2026, and adds a corresponding exception to the broad disallowance of the deduction for employer provided transportation benefits in Code Section 274(l) for these reimbursements over the same time period. Under current law, qualified bicycling commuter benefits can only be employer-funded (and cannot be provided through employee pre-tax salary deductions).

3 There is an exception for amounts paid or incurred that are directly related to an unrelated trade or business that is regularly carried on by the organization. However, under the general rule applicable to all employers, it would seem that no deduction would be available against UBTI related to the provision of these benefits.

taking a deduction on their tax returns for such QTF benefits or who may now be obligated to pay UBIT for providing such QTF benefits. These adverse tax consequences should be factored in as an additional cost to the employer in any compensation and benefits planning for 2018 and future years. For example, some employers may want to consider adjustments to their QTF benefit programs if maintaining such programs would lead to the adverse tax consequences described above for the employer.

It is noted that some local or municipal laws or ordinances (such as New York City's Affordable Transit Act, which is described in our prior client alert, available here, and similar laws in Washington D.C., and municipalities in the Bay Area in California) require certain employers in those jurisdictions to offer to their employees a commuter benefits program (which may include QTF benefits). Employers considering changes to their QTF benefit programs should take into account those local laws or ordinances, and any penalties or concerns regarding non-compliance with those laws.

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