[COMMITTEE PRINT]

TAXATION OF FRINGE BENEFITS

PREPARED FOR THE USE OF THE

TASK FORCE ON EMPLOYEE FRINGE BENEFITS,

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

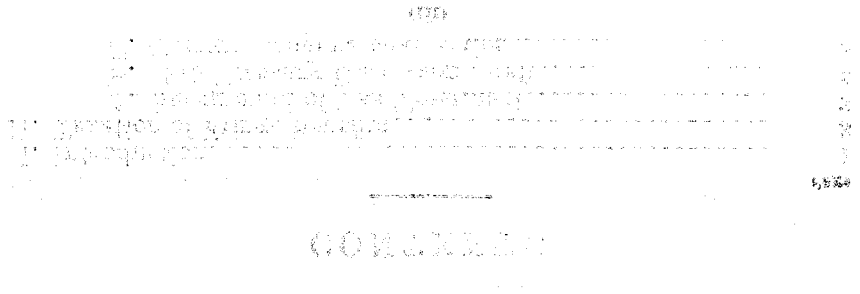
JOINT COMMITTEE ON TAXATION

AUGUST 11, 1978

U.S. GOVERNMENT PRINTING OFFICE

32-080 WASHINGTON : 1978 JCS 33-78

CONTENTS



I. INTRODUCTION

This pamphlet was prepared by the staff of the Joint Committee on Taxation for the use of the Task Force on Employee Fringe Benefits of the House Committee on Ways and Means. The pamphlet contains a brief background statement of current law concerning the taxation of fringe benefits as well as a description of legislative action in the 95th Congress affecting this issue. In addition, the pamphlet contains examples of some of the types of fringe benefits which are currently in widespread use.

II. TAXATION OF FRINGE BENEFITS

A. Background of Tax Treatment

Section 61 of the Internal Revenue Code, and the regulations issued under that section, are quite broad, providing that gross income includes income in any form. Under these rules, income may be realized in the form of services, meals, accommodations, stock or other property, as well as in cash. The Supreme Court has also interpreted section 61 broadly to mean that "all accessions to wealth" realized by taxpayers are subject to tax unless specifically exempted. See *James* v. *United States*, 366 U.S. 213 (1961).

However, there have long been certain statutory exceptions to these rules for such items as employer contributions to qualified pension plans, health and disability plans, specified amounts of group life insurance, and meals and lodging furnished for the convenience of the employer.

In addition, certain kinds of fringe benefits have been exempted by rulings or regulations. For example, in 1921, the Service issued a ruling to the effect that railroad passes issued to railroad employees were gifts and did not constitute income to the employees (O.D. 946, 4 C.B. 110). This ruling has generally been interpreted to apply to airline and bus transportation provided by those carriers for their employees. In 1920, the Service ruled that reimbursement for supper when paid to an employee in connection with voluntary overtime work is for the convenience of the employer and therefore is not income (O.D. 514, 2 C.B. 90).

Other types of fringe benefits, such as free parking furnished at the worksite by an employer, have been considered nontaxable, even though there is no statute, ruling or regulation which specifically provides this.

Issues involving fringe benefits often turn on the facts and circumstances of a particular case. For example, the IRS has successfully litigated cases holding that the personal use of an automobile provided by an employer to an employee is taxable income to the employee. *Dole* v. *Commissioner*, 351 F. 2d 308 (1st. Cir. 1965). On the other hand, the taxability of the use of demonstrator automobiles by care salesmen and free or discount cars for automobile company employees or executives has not been publicly ruled on by the National Office. Another issue which the National Office has not yet publicly ruled concerns the treatment of Federal employees who have use of a Federal car and chauffeur.

Further illustrating the continuing controversy over taxability of certain fringe benefits, the U.S. Supreme Court recently decided that amounts paid to State police officers as a cash allowance for meals consumed while on duty were includible in gross income (because such payments did not come within the statutory—meals for the convenience of the employer—exclusion adopted by Congress in sec. 119 of the code). *Commissioner* v. *Kowalski*, 98 S. Ct. 315 (1977).

Another troublesome issue which has recently come to the forefront is the treatment of tuition remission to families of university employees. In 1976, the IRS issued proposed regulations, holding that these amounts constituted taxable income. However, these proposed regulations were later withdrawn.

Other examples of types of fringe benefits which are commonly furnished to employers include employer-furnished subsidized housing, daycare centers, free schools, interest free loans provided to employees, free financial counseling, free trips to conventions for families, reimbursement for or directly furnished free commuting, subsidized cafeteria for employees or executives, health care services or medical expense reimbursement plans not exempt by statute, price discounts and rebates for employees, tickets to sporting or cultural events, and employer-paid club dues. The issue as to the taxability or nontaxability of many of these benefits has not yet been finally resolved by ruling or litigation.

The problem concerning the taxation of fringe benefits is generally considered in the context of the Federal income tax. However, other areas of the Internal Revenue Code are also affected. For example, there is the question of whether fringe benefits should be taken into account for purposes of social security (FICA) taxes, unemployment (FUTA) taxes, and Federal income tax withholding.

B. 1975 Treasury Discussion Draft

In 1975, the Treasury Department issued a "discussion draft" of proposed regulations relating to fringe benefits which was later withdrawn in December of 1976. Under this discussion draft, there would have been a "safe harbor" (nontaxable treatment) for fringe benefits meeting three tests—(1) the goods or services provided to the employee were owned or provided by the employer in connection with a regular trade or business; (2) the goods or services were furnished to the employee under such conditions that the employer incurred no substantial incremental costs; and (3) the goods or services were made available to employees on a nondiscriminatory basis.

Fringe benefits not qualifying under the safe harbor were to be evaluated in terms of a non-part facts and circumstances test. These factors included (1) the cost to the employer of providing the benefit is not significant; (2) use of the benefit occurs during, or immediately before or after the employee working hours and the benefit is provided at or near the business premises of the employer; (3) the benefit is provided under a nondiscriminatory basis; (4) the service is similar to one commonly provided by a government agency; (5) the benefit is related to the convenience of the employer; (6) the benefit constituted reimbursement for cost of living factors necessitated by employment; (7) the benefit is safety related; (8) the value of the benefit is relatively modest in comparison to the employee's regular compensation; and (9) the item is generally not thought of as constituting compensation. No one of the facts or circumstances was necessarily controlling.

In addition, the discussion draft provided a de minimis rule exempting from taxation fringe benefits of little value. Where an item was required to be taken into income under the discussion draft,

however, the amount includible in gross income constituted the amount the employee would have had to pay for the goods or services on an arm's length basis.

The Internal Revenue Service raised objections to the discussion draft, believing that in some cases the discussion draft changed prior law and would have conferred nontaxable status on items which had previously been held to be taxable. Prior to the withdrawal of the discussion draft, the Service and the Assistant Secretary for Tax Policy agreed upon a package of revenue rulings in the area of fringe benefits. On December 17, 1976, Secretary Simon announced that the rulings would not be issued. The general thrust of the rulings would have been much less favorable to taxpayers than the Treasury discussion draft. The general tenor of the Internal Revenue Service ruling package did become public, even though some of the specifics were not known. This in turn triggered a public reaction on the part of certain groups which felt that their tax position might be worsened if the fringe benefit controversy were finally resolved within the Administration.

As indicated above, the so-called discussion draft was withdrawn in December of 1976 and the Internal Revenue Service package of rulings were never published. At this point, the situation is that the National Office of the IRS is not making any new rulings in the fringe benefit area. However, fringe benefit questions continue to be raised by IRS agents upon audit, and some of these questions are currently being litigated. Until such time as Congress, Treasury, or the IRS, as the case may be, resolve some of these issues on a national basis, there is a possibility that fringe benefit cases involving similar facts and issues may be resolved differently, depending on the jurisdiction where the case is audited or litigated.

C. Current Congressional Action

The Tax Treatment Extension Act of 1978 (H.R. 9251) provided that no rulings or regulations are to be issued in final form on or after October 1, 1977, and before July 1, 1978, providing for the inclusion of any fringe benefit in gross income by reason of section 61 of the Code. That bill passed the House on October 25, 1977, and the Senate on May 11, 1978. H.R. 12841 extends the freeze on the issuance of fringe benefit regulations until January 1, 1980. This bill was passed by the House on June 28, 1978, and by the Senate on August 4, 1978 (with an unrelated amendment).

The House Committee on Ways and Means has also established the Task Force on Employee Fringe Benefits to consider the legislative aspects of the issues in the fringe benefit area.

○