

Application of Retroactive Increase in Excludable Transit Benefits

Notice 2016-6

PURPOSE

This notice provides guidance related to the enactment of § 105 of the Consolidated Appropriations Act, 2016, Public Law No. 114-113 (the “Act”). Section 105 of the Act amended § 132(f)(2) of the Internal Revenue Code to create parity, for periods after December 31, 2014, between the transit benefit exclusion for the aggregate of transportation in a commuter highway vehicle and any transit pass, and the exclusion for qualified parking. As a result of this amendment, the monthly transit benefit exclusion under § 132(f)(2)(A) for the aggregate of transportation in a commuter highway vehicle and any transit pass increased from \$130 per participating employee to \$250 per participating employee for the period from January 1, 2015, through December 31, 2015. For 2016, the monthly exclusion under both § 132(f)(2)(A) (the aggregate of transportation in a commuter highway vehicle and any transit pass) and § 132(f)(2)(B) (qualified parking) is \$255.

To address employers’ questions regarding the retroactive application of the increased exclusion for 2015 and to reduce filing and reporting burdens, the Internal Revenue Service (Service) is clarifying how the increase applies for 2015 and providing a special administrative procedure for employers to use in filing Form 941, Employer’s

QUARTERLY Federal Tax Return, for the fourth quarter of 2015 to reflect changes in the excludable amount for transit benefits provided in all quarters of 2015 and in filing Forms W-2, Wage and Tax Statement.

BACKGROUND

Section 132(a)(5) provides that any fringe benefit that is a qualified transportation fringe is excluded from gross income. Section 132(f)(1) provides in relevant part that the term “qualified transportation fringe” includes (when provided by an employer to an employee): (1) transportation in a commuter highway vehicle between home and work, (2) any transit pass, or (3) qualified parking.¹ Under § 132(f)(3), cash reimbursements by employers for transit passes constitute a qualified transportation fringe only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee. Section 1.132-9(b) of the Income Tax Regulations provides guidance on the exclusion for qualified transportation fringes. See § 1.132-9(b) Q/A 16(b)(4) for the meaning of the term “readily available.”

Prior to the enactment of the Act, § 132(f)(2) provided that the amount of fringe benefits which was provided by an employer to any employee and which could be excluded from gross income under § 132(a)(5) could not exceed \$100 per month in the case of the aggregate of transportation in a commuter highway vehicle and any transit

¹ Section 132(f)(1)(D) also includes any qualified bicycle commuting reimbursement as a qualified transportation fringe, subject to a separate exclusion limit in §§ 132(f)(2)(C) and 132(f)(5)(F)(ii). The Act did not affect the qualified bicycle commuting reimbursement amount.

pass, and \$175 per month in the case of qualified parking, adjusted, in each case, for inflation. Prior to amendment by the Act, the adjusted maximum monthly excludable amount for 2015 for the aggregate of transportation in a commuter highway vehicle and any transit pass was \$130, and the adjusted maximum monthly excludable amount for qualified parking was \$250. See § 3.17 of Rev. Proc. 2014-61, 2014-47 I.R.B. 860.

The Act amended § 132(f) to create parity in the amount of the exclusion for these qualified transportation fringes. After the amendment, the applicable statutory limit on the amount of these qualified transportation fringes that may be provided by an employer to any employee and that may be excluded from gross income under § 132(a)(5) is in each case \$175 per month, adjusted annually for inflation. Accordingly, after the enactment of the Act, the maximum monthly excludable amount for the aggregate of transportation in a commuter highway vehicle and any transit pass is equal to the maximum monthly excludable amount for qualified parking.² The amendment is effective retroactively to January 1, 2015.

Amounts that are excluded from gross income under § 132 are also excluded from Federal Insurance Contributions Act (FICA) taxes (social security and Medicare, including Additional Medicare Tax) and Federal income tax withholding. Sections 3121(a)(20) and 3401(a)(19).

Generally, corrections of overpayments of FICA tax are made after an error has

² Although the Act did not amend the base year for the inflation adjustment of the excludable amount for the aggregate of transportation in a commuter highway vehicle and any transit pass in § 132(f)(6)(A), the Act provides for parity in the amount of the exclusion for these qualified transportation fringes and qualified parking, and the limits are applied accordingly.

been ascertained using the adjustment process under § 6413 or using the refund claim process under § 6402. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

Under §§ 31.6413(a)-1(a) and 31.6413(a)-2(b) of the Employment Tax Regulations, before making an adjustment of an overpayment of FICA tax, an employer generally must repay or reimburse its employee in the amount of the overcollection prior to the expiration of the period of limitations on credit or refund, and, for FICA tax overcollected in a prior year (other than Additional Medicare Tax), must also secure the employee's written statement confirming that the employee has not made any previous claims (or the claims were rejected) and will not make any future claims for refund or credit of the amount of the overcollected FICA tax. An employer repays an employee by direct payment to the employee; an employer reimburses an employee by applying the amount of the overcollection against the employee FICA tax which attaches to wages paid by the employer to the employee. Sections 31.6413(a)-1(a)(2)(ii) and 31.6413(a)-2(a)(1) provide that withheld Additional Medicare Tax can only be repaid or reimbursed and subsequently adjusted during the same calendar year in which it is withheld. Similarly, § 31.6413(a)-1(b) provides that employers cannot adjust overpayments of withheld income tax after the end of the calendar year. Rather, the withheld Additional Medicare Tax and the withheld income tax are applied against the taxes shown on the employee's individual income tax return (for example, Form 1040, U.S. Individual Income Tax Return) and any excess will be refunded to the employee.

Section 31.6402(a)-2 prescribes rules under which a refund claim for an overpayment of FICA tax (other than Additional Medicare Tax) may be made. Pursuant to § 31.6402(a)-2(a), an employer has a duty to assure that its employee's rights to recover overcollected taxes are protected by repaying or reimbursing overcollected amounts. Alternatively, an employer may obtain the employee's consent to the filing of the refund claim. Under § 31.6402(a)-2(a)(iii), no refund to the employer is permitted with regard to Additional Medicare Tax which the employer deducted or withheld from the employee. Similarly, under §§ 6414 and 31.6414-1, no refund to the employer is allowed for the overpayment of withheld income tax which the employer deducted or withheld from an employee.

To make employment tax corrections for overpayments (that is, to make adjustments or to claim refunds), an employer uses the "X" form that corresponds to the return being corrected. Thus, an employer corrects overreported taxes on a previously filed Form 941 by filing Form 941-X, Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund. A separate X form must be filed for each taxable period.

APPLICATION OF RETROACTIVE INCREASE TO TRANSIT BENEFITS PROVIDED IN 2015

For purposes of the remaining discussion, "transit benefits" refers to the aggregate benefits of transportation in a commuter highway vehicle and transit passes that meet the requirements of § 132 and the applicable regulations. Pursuant to the change made by the Act, which was retroactive to January 1, 2015, transit benefits provided during 2015 by an employer to an employee in excess of \$130 (the former

maximum monthly excludable amount) up to \$250 (the amended maximum monthly excludable amount) are excluded from the employee's gross income and wages. These excess amounts are referred to as "excess transit benefits" in this notice. The exclusion applies whether the transit benefits were provided in 2015 by the employer from its own funds or through compensation reduction arrangements as permitted by §§ 132(f)(4) and 1.132-9(b) Q/A 11-15.

For 2015, employers must reduce the taxable wages of affected employees, as reported on Forms 941 and W-2 and any equivalent forms, by the amount of any excess transit benefits. For example, if an employer gave an employee a monthly transit pass worth \$200 for the month of December 2015 and included \$70 in the employee's taxable wages for the month for withholding purposes, the employer must subtract that \$70 from the employee's taxable wages reported on Forms 941 and W-2. As another example, if an employer maintained a salary reduction plan and an employee purchased a \$200 transit pass for the month of December 2015 by way of a pre-tax deduction of \$130 and a post-tax deduction of \$70, the \$70 post-tax deduction must be treated as a pre-tax deduction for purposes of reporting the employee's taxable wages on Forms 941 and W-2.

Neither § 132 nor the change made by the Act mandates that employers provide additional transit benefits to their employees for 2015. Also, the Act does not separately provide that additional benefits provided to employees in 2016 to compensate employees for transit expenses incurred in 2015 are automatically excludable from

income under § 132(f). With regard to transit benefits provided pursuant to compensation reduction arrangements, §1.132-9(b) Q/A 13 provides that, each month, the amount of the compensation reduction may not exceed the combined applicable statutory monthly limit for transportation in a commuter highway vehicle and transit passes. Section 1.132-9(b) Q/A 14(b) provides that the compensation reduction election must be made before the employee is able to receive the cash or other taxable amount at the employee's discretion. Accordingly, employees may not retroactively increase their compensation reduction for 2015 to take advantage of the increase in the excludable amount for transit benefits in 2015. In addition, employees may not reduce their compensation by more than \$255 per month in 2016 (the applicable statutory monthly limit for 2016) in order to receive any permissible reimbursement for transit expenses incurred in 2015.

Furthermore, the Act did not change the other requirements of § 132, including the limitation on providing cash reimbursements for transit passes when transit passes are readily available for direct distribution by the employer to the employee.

Consequently, cash reimbursements to cover transit expenses up to \$250 for periods during 2015 are not excludable under § 132 if transit passes were readily available for periods in 2015 for which the cash reimbursements are provided.

SPECIAL ADMINISTRATIVE PROCEDURE FOR EMPLOYERS THAT DESIRE TO
MAKE ADJUSTMENTS FOR 2015 ON THE FORM 941 FILED FOR THE FOURTH
QUARTER OF 2015

Employers that originally reported excess transit benefits as includible in gross income and wages and withheld income taxes and FICA taxes would normally be required to file Form 941-X for each quarter to make corrections.

In view of the timing of the statutory change and the due dates for Forms 941 for the fourth quarter of 2015 and Forms W-2, and in order to reduce administrative burden, the Service is providing a special administrative procedure for employers that treated excess transit benefits as wages and that have not yet filed their fourth quarter Form 941 for 2015. Employers desiring to use this special administrative procedure must repay or reimburse their employees for the overcollected FICA tax (including any Additional Medicare Tax) on the excess transit benefits for all four quarters of 2015 upon or before filing the fourth quarter Form 941. The employer, in reporting amounts on its fourth quarter Form 941, may reduce the fourth quarter Wages, tips and compensation reported on line 2, Taxable social security wages reported on line 5a, Taxable Medicare wages and tips reported on line 5c, and Taxable wages & tips subject to Additional Medicare Tax withholding reported on line 5d by the excess transit benefits for all four quarters of 2015. By taking advantage of this special administrative procedure, employers will avoid having to file Forms 941-X, and will also avoid having to file Forms W-2c as discussed below.

This procedure can be used only to the extent that employers have repaid or reimbursed their employees for the employee share of FICA tax (including any Additional Medicare Tax) attributable to the excess transit benefits. Under this special administrative procedure, employers may correct the employer share of FICA tax only if the employees' share of FICA tax has been repaid or reimbursed to the employees. Employers using this special procedure do not need to obtain written statements from their employees confirming, for each employee, that the employee did not make a claim (or if the employee did make a claim, that the claim was rejected) and will not make a claim for refund of FICA tax overcollected in a prior year.

The repayment or reimbursement of overwithheld social security tax and the corresponding reduction for wages reported on Form 941, line 5a, Taxable social security wages, must take into account that refunds or credits of social security tax are limited to the amount paid on that portion of the excess transit benefits that, when added to other wages for the year for an employee, did not exceed the social security wage base for 2015 (\$118,500). Similarly, the repayment or reimbursement of overwithheld Additional Medicare Tax and the corresponding reduction for wages reported on Form 941, line 5d, Taxable wages & tips subject to Additional Medicare Tax withholding, must take into account that refunds or credits of Additional Medicare Tax are limited to the amount paid on that portion of the excess transit benefits that, when subtracted from the total of the excess transit benefits and other wages paid or provided to that employee for the year, leaves a balance of Medicare wages and tips equal to or

greater than \$200,000.

To ensure that use of this special administrative procedure does not result in a mismatch between the total taxes reported on Form 941, line 10, Total taxes after adjustments, and the Total liability for the quarter reported on Form 941, line 14 (for a monthly schedule depositor) or Schedule B (Form 941) (for a semiweekly schedule depositor), an employer should use the following procedure. The employer should reduce the last liability of the quarter reported (that is, Month 3 on line 14 or the last liability entry on Schedule B) by the amount of the tax reduction due to use of the special administrative procedure. If the amount of the tax reduction exceeds the last liability of the quarter reported on line 14 or Schedule B, the employer should apply the amount of the tax reduction to reduce previous liabilities in reverse order until the amount of the tax reduction is completely used. Note that negative numbers must not be entered on line 14 or Schedule B.

The same procedures are available to filers of other employment tax returns reporting FICA taxes (for example, the related Spanish-language return or return for U.S. possessions) and to filers of employment tax returns reporting taxes under the Railroad Retirement Tax Act.

NORMAL PROCEDURES FOR EMPLOYERS THAT HAVE FILED FOURTH QUARTER FORM 941 OR HAVE NOT REPAID OR REIMBURSED EMPLOYEES PRIOR TO FILING FOURTH QUARTER FORM 941

Employers that have already filed the fourth quarter Form 941 must use Form

941-X and normal procedures to make an adjustment or claim a refund for any quarter in 2015 with regard to the overpayment of tax on the excess transit benefits after repaying or reimbursing their employees or, for claims for refund, securing consents from their employees. Similarly, to the extent employers have not repaid or reimbursed their employees who received excess transit benefits in 2015 prior to filing the fourth quarter Form 941, the employers must use Form 941-X to make an adjustment or claim for refund with respect to the excess transit benefits provided to those employees and must follow the normal procedures.

Under the normal procedures, the employer must obtain the required statements under §§ 31.6413(a)-1 or 31.6402(a)-2 (subject to the exception for making reasonable efforts). Furthermore, the employer may not repay or reimburse, make an adjustment with respect to, or seek a refund of Additional Medicare Tax or income tax deducted or withheld from the employee in 2015.

EMPLOYER INSTRUCTIONS FOR FORM W-2

Employers that paid excess transit benefits in 2015 and have not furnished 2015 Forms W-2 to their employees must take into account the increased exclusion for 2015 transit benefits in calculating the amount of wages reported in box 1, Wages, tips, other compensation; box 3, Social security wages; and box 5, Medicare wages and tips. Employers that have repaid or reimbursed their employees for the overcollected FICA taxes prior to furnishing Form W-2 (whether they utilized the special administrative procedure or the normal procedures) must reduce the amounts of withheld tax reported

in box 4, Social security tax withheld, and box 6, Medicare tax withheld, by the amounts of the repayments or reimbursements. Note that under the normal procedures, the amount reported in box 6, Medicare tax withheld, will not be reduced with regard to any Additional Medicare Tax withheld on the excess transit benefits because no repayment or reimbursement of such amount is permitted after the end of 2015.

In all cases, employers must report in box 2, Federal income tax withheld, the amount of income tax actually withheld during 2015. The additional income tax withholding will be applied against the taxes shown on the employee's individual income tax return (Form 1040, U.S. Individual Income Tax Return).

Employers that repaid or reimbursed their employees for the overcollected FICA taxes after furnishing Forms W-2 to their employees but before filing Forms W-2 with the Social Security Administration (SSA) must check the "Void" box at the top of each incorrect Form W-2 (Copy A). These employers must prepare new Forms W-2 with the correct information, and send these new Forms W-2 (Copy A) to the SSA. The employers must write "CORRECTED" on the employees' new copies (B, C, and 2) and furnish them to the employees. See the 2015 General Instructions for Forms W-2 and W-3.

Employers that have already filed 2015 Forms W-2 with SSA must file Forms W-2c, Corrected Wage and Tax Statement, to take into account the increased exclusion for transit benefits and to reflect any repayments or reimbursements of the withheld FICA tax and must furnish copies of the Forms W-2c to the employees.

DRAFTING INFORMATION

The principal author of this notice is Jean M. Casey of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this notice contact Ms. Casey on (202) 317-4774 (not a toll-free call).