Proskauer

American Taxpayer Relief Act Affects Mass Transit Benefits and Other Employee Benefits

January 18, 2013

On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 ("ATRA") into law.[1] ATRA, adopted as an alternative to stepping over the "fiscal cliff," preserves most of the Bush-era tax cuts and reinstates several other lapsed tax provisions. Several provisions of ATRA are of particular interest to employers, employees, and employee benefit administrators, because they offer new options for retirement planning or extend certain existing benefits options. Even more recently, the IRS has issued guidance with respect to certain key aspects of ATRA related to qualified transportation fringe benefits.

Roth 401(k) In-Plan Rollovers

Before ATRA, the Internal Revenue Code permitted employees to transfer amounts in a traditional 401(k) (pre-tax) account to a Roth 401(k) account through an "in-plan rollover" only if they were eligible to take a distribution from the employer's 401(k) plan (e.g., after the employee terminated employment, retired, or attained age 59½). ATRA allows 401(k) plan participants to make in-plan Roth rollovers even when they may not be eligible for a plan distribution. Thus, employers that offer both a traditional 401(k) feature and a Roth feature in their plans may allow employees to transfer amounts in their traditional 401(k) accounts to Roth accounts at any time, whether or not the employees are eligible to take plan distributions. If an employee elects an in-plan rollover, he or she will have to pay federal income tax on the amount transferred to the Roth account at the time of conversion. Also, employers will need to amend their 401(k) plans if they wish to offer this option to participants.

Employer-Provided Educational Assistance

Section 127 of the Internal Revenue Code permits employees to exclude from their gross income up to $5,250 of employer-provided education costs for undergraduate and graduate courses that are provided under a compliant educational assistance plan. This exclusion was introduced in 2001 and has been extended periodically since then. ATRA makes permanent the current allowable gross income exclusion for Section 127 employer-sponsored educational assistance programs.

Mass Transit Benefit

ATRA increases the maximum pre-tax contribution limit for employees' mass transit commuting expenses to the level allowed for parking expenses, as provided under Section 132(f) of the Internal Revenue Code. Effective for 2012, mass transit commuters, such as those who ride trains and buses or who participate in van-pools, were only able to contribute a maximum of $125 per month on a pre-tax basis toward their transit expenses (a reduction from $230 per month permitted in 2011). ATRA raised the monthly cap for mass transit commuters to $240 a month for 2012, and $245 a month for 2013, which brings it in line with the maximum amount that commuters can contribute on a pre-tax basis for parking expenses. This increased monthly cap on mass transit benefits is set to expire on December 31, 2013, unless Congress extends it further.[2]

ATRA also provides that this increase in the monthly cap on pre-tax contributions for mass transit commuters will be retroactive to January 1, 2012. This means that employees can potentially recoup some of the taxes assessed on amounts they paid for commuting expenses over the previous monthly cap of $125. To explain how to implement this retroactive adjustment process, the IRS issued Notice 2013-8 on January 16. In this Notice, the IRS refers to "excess transit benefits," which are transit benefit expenses for 2012 either paid by an employer or through a salary reduction arrangement over the prior monthly cap of $125 up to the new monthly cap of $240.

Under the Notice, employers **must** facilitate implementing retroactive adjustments using one of the two processes described below:

The first process is a special administrative procedure for employers that have not yet filed their Form 941 for the fourth quarter of 2012. Employers using this special procedure must repay or reimburse their employees the overcollected FICA tax on the excess transit benefits for all four quarters of 2012 on or before filing their fourth quarter Form 941. An employer, in reporting amounts on its fourth quarter Form 941, may reduce the fourth quarter amounts reported on line 2 (Wages, tips and compensation), line 5a (Taxable Social Security wages), and line 5c (Medicare wages and tips) by the excess transit benefits for all four quarters of 2012. However, when repaying or reimbursing overwithheld Social Security tax and the corresponding reduction for wages reported on Form 941, line 5a (Taxable Social Security wages), employers must note that refunds or credits of Social Security tax are limited to amounts paid on that portion of the excess transit benefits that, when added to other wages for the year, did not exceed the Social Security wage base for 2012 ($110,100).

The second administrative method of effecting retroactive adjustments applies if an employer has already filed its fourth quarter Form 941. In that case, it must file a Form 941-X to make an adjustment or claim a refund for any amounts in 2012 with regard to the overpayment of tax on the excess transit benefits after the employer repays or reimburses the employees, or for refund claims. In addition, employers will be required to obtain a written statement from each affected employee that he or she has not, and will not, make a claim for a refund of FICA tax overcollected in a prior year.

Employers that have not yet provided employees with Form W-2s for 2012 must reflect the increased exclusion for 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 associated with the retroactive transit benefit before providing employees with the W-2 should 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. However, whether or not the employer has repaid or reimbursed the employees for the overpaid taxes, the employer must report in box 2 (Federal income tax withheld) the amount of income tax *actually* withheld during 2012.

If an employer has repaid or reimbursed its employees for the overcollected FICA taxes after providing employees with Forms W-2 but has not yet filed the Forms W-2 with the Social Security Administration ("SSA"), the employer should check the "Void" box at the top of each affected Form W-2 (Copy A), and send a corrected Form W-2 (Copy A) to the SSA. Employers should write "CORRECTED" on the employees' new copies (B, C, and 2) of the corrected Forms W-2 and provide them to employees.

If an employer has already filed the 2012 Forms W-2 for its employees with the SSA, it will need to file Forms W-2c, Corrected Wage and Tax Statements, that reflect the increased exclusion for transit benefits.

Please contact your Proskauer lawyer or any of the lawyers listed in this client alert should you have questions regarding the above.

* * *

[1] The text of the law can be found at http://www.gpo.gov/fdsys/pkg/BILLS-112hr8eas/pdf/BILLS-112hr8eas.pdf.

[2] Employers should be aware that certain states may not adopt the federal law treatment. Accordingly, treatment of specific state law should also be confirmed.

Related Professionals

- **Steven D. Weinstein**
  Partner