To: Patrick Clinton and Katharine Abdoo

From: Scott O'Brien

Date: Feb. 4, 2021

Re: Qualified Transportation Fringe, Transportation and Commuting Expenses Under Section 274(*l*)

On behalf of the National Business Aviation Association (NBAA), thank you for providing final regulations on the elimination of the deduction under § 274(*l*) for expenses related to certain transportation and commuting benefits provided by employers to their employees (Treas. Reg. § 1.274-14; TD 9939; 85 Fed. Reg. 81,391). We appreciated the opportunity to provide comments on the rulemaking and thank you for carefully considering the issues we raised.

After reviewing the final regulations, NBAA's Tax Committee developed questions that we believe will arise for taxpayers and practitioners. Our questions are focused on the disallowance of commuting expenses under Section 274(*l*), which is the primary area of focus for business aviation in the final rules.

While we understand these are final regulations, we think that additional informal clarification on the questions below will assist with tax administration and provide additional certainty to taxpayers.

Compensation Fringe Benefits Reported as Taxable Compensation to the Employee

In NBAA's Aug. 24, 2020 comments to the proposed regulations, we requested that final regulations provide that if the employer properly reports the value of commuting benefits as a taxable fringe benefit to the employee (such as by including it in the employee's Form W-2), then the commuting flight will be deductible by the employer as the cost of providing a compensation fringe benefit. We explained that not allowing this deduction for the employer results in double taxation, which was not Congress's intent in enacting this statute.

Our comments note that § 274(e) lists exceptions to the entertainment disallowance under § 274(a), and that the statutory language of that subsection would preclude applying it to other disallowance rules such as the commuting disallowance under § 274(*l*). This observation would not appear to affect the availability of a compensation deduction under Treas. Reg. § 1.162-25T to an employer that provides in-kind compensation to an employee, such as paying the employee's personal, family, or living expenses (§ 262(a)), personal interest expense (§ 163(h)(1)), or personal commuting costs (§ 274(*l*)).

After our review of the final regulations, we have the following questions on the above issue:

- Does § 274(*l*) preclude an employer's compensation deduction under Treas. Reg. § 1.162-25T when the employer imputes the value of commuting benefits to the employee?
- If so, what is the basis for the conclusion that a double tax structure was intended?
- And, does this denial of a compensation deduction apply when the commuting is in a car?

Exception for Travel to Ensure the Safety of the Employee

In the proposed regulations, there was a reference to a bona fide business-oriented security concern as described in Treas. Reg. § 1.132-5(m). If these requirements were met, then the safety of the employee exception in § 274(*l*) would apply.

In our comments, we requested examples to clarify that even if the detailed requirements of Treas. Reg. § 1.132-5(m) are not met, the safety of the employee exception could apply based on relevant facts regarding personal security such as risk of kidnapping or risks due to the pandemic.

The final regulation removes the reference to Treas. Reg. § 1.132-5(m), and in its place, provides that the exception applies "if unsafe conditions, as described in § 1.61-21(k)(5), exist for the employee."

The Preamble states that this change was made in response to commentator concerns that the Treas. Reg. § 1.132-5(m) standard is "too narrow and should be expanded to apply beyond a bona fide business-oriented security concern under § 1.132-5(m)."

- Would a security study finding a "business-oriented security concern" meet this "unsafe conditions" standard?

Section 274(*l*) Applies Only to "Employees"

In our comments, we requested confirmation that § 274(*l*) does not apply to flights provided to persons other than "employees" such as sole proprietors, independent contractors, partners, and 2-percent shareholders in S corporations.

We explained that under § 274(e)(2), (9), the term "employee" has been interpreted as not including 2-percent shareholders due to § 1372. *See* CCA 2003-44-008.

The final regulations define "employee" by reference to § 3121(d)(1) and (2) and further explain that this definition means "officers of a corporate taxpayer and employees of the taxpayer under the common law rules."

However, the Preamble does not state whether Treasury accepted or rejected the rule in § 1372 that 2% shareholders of S corporations are deemed to be partners for purposes of the income tax treatment of fringe benefits.

- Please confirm that the § 3121(d)(1), (2) definition of "employee" excludes "independent contractors" and "partners."
- Assuming that it excludes "partners," please confirm that this regulatory definition of "employee" is not intended to preclude application of the statutory rule in § 1372 that 2% shareholders of S corporations are treated as partners (for income tax provisions that relate to fringe benefits)?