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Massachusetts issues draft regulations conforming the tax treatment of certain fringe benefits to the federal Internal Revenue Code

Summary

- The Massachusetts fiscal year (FY) 2003 budget changed Massachusetts law (Section 62) to conform to the federal Internal Revenue Code as amended January 1, 2022.
- Effective January 1, 2022, Massachusetts law will follow the federal Internal Revenue Code in its tax treatment of certain fringe benefits.
- In most instances, the Massachusetts law change means that Massachusetts taxable wages may have been overstated on the 2022 Massachusetts Form W-2.
- Employers will need to update their tax treatment of these fringe benefits for 2023 and going forward.
- The fringe benefits affected include (1) the employer's payment of employee student loan principal and interest, (2) employer-provided transportation fringe benefits, (3) qualified moving expense reimbursements, (4) the business expenses deduction for pretax contributions made for qualified transportation benefits, and (5) employer-provided adoption assistance.

Due to [legislation](#) enacted as part of the Massachusetts fiscal year (FY) 2023 budget, the Massachusetts Department of Revenue issued a [draft](#) (see [final TIR 23-5](#) released March 1, 2023) Technical Information Release (TIR) explaining the state's tax treatment of certain fringe benefits which, effective January 1, 2022, conform to the Internal Revenue Code (IRC) as amended on January 1, 2022. Prior to the passage of the FY 2023 budget, Massachusetts law (Section 62) generally conformed to the IRC as amended on January 1, 2005.

The draft TIR identifies the following fringe benefits as impacted by the law change.

- **Employer payments of student loans**

IRC Section 127 allows an exclusion from gross taxable income of up to \$5,250 for employer-provided qualified educational assistance. After 2005, IRC Section 127 was amended to include in the definition of educational assistance an employer's payment, through December 31, 2025, of the principal and interest of an employee's qualified student loan.

Massachusetts did not recognize the exclusion of employer payments of student loan principal and interest because it was not in IRC Section 127 as amended January 1, 2005.

Under the new law, Massachusetts conforms to IRC Section 127 for employer payment of an employee's qualified student loan principal and interest made on or after January 1, 2022, and before January 1, 2026.

- **Employer-provided transportation fringe benefits**

As previously reported ([EY Tax Alert 2022-1942](#)), the Department announced in [TIR-22-15](#) that Massachusetts law conforms to IRC Section 132 in determining the tax-free limit that applies to employer-provided parking, transit passes and commuter highway vehicles. Accordingly, effective January 1, 2023, the Massachusetts monthly exclusion for employer-provided parking is \$300 and \$300 for the combined total of transit pass and commuter highway vehicle benefits. (See [IRS Revenue Procedure 2022-38](#) and [EY Tax Alert 2022-1636](#).)

The draft TIR further adds that there is a retroactive adjustment for 2022 because under the Massachusetts FY 2023 Budget, the monthly maximum exclusion for both Massachusetts and federal purposes for 2022 is \$280 for employer-provided parking and \$280 for combined transit pass and commuter highway vehicle transportation benefits.

Under prior Massachusetts law, the Massachusetts monthly exclusion amounts for 2022 were \$285 for employer-provided parking and \$150 for combined transit pass and commuter highway vehicle transportation benefits. ([Massachusetts TIR 21-12](#).)

- **Qualified moving expense reimbursements**

IRC Sections 132(g) and 217 were amended under the Tax Cuts and Jobs Act of 2017 to suspend from 2018 through 2025 the exclusion from gross income for employer reimbursement of qualified moving expenses, except for expenses incurred by active-duty members of the US Armed Forces. ([IRS Employer Update](#).)

Because prior Massachusetts law conformed to the IRC as amended on January 1, 2005, employer payment of qualified moving expenses continued to be exempt from Massachusetts income tax and withholding.

Because Massachusetts law now conforms to the IRC as of January 1, 2022, for tax years beginning on or after January 1, 2022, through tax years beginning on or before December 31, 2025, Massachusetts will no longer allow most taxpayers to either (i) exclude qualified moving expense reimbursements from their

Massachusetts gross income or (ii) deduct qualified moving expenses. During that period, this deduction and this exclusion will be available only to qualifying members of the Armed Forces.

- **Limitation on deduction by employers of expenses for fringe benefits**

IRC Section 274(a)(4) prevents employers from deducting amounts reimbursed to employees and excluded from employees' income under qualified transportation fringe benefit plans.

Under prior law, Massachusetts did not conform to IRC Section 274(a)(4) because the provision was not part of the IRC as amended January 1, 2005. Therefore, employers could deduct as a business expense qualified transportation fringe benefits provided to employees that were excluded from employees' taxable income.

Under the new law, Massachusetts conforms to IRC Section 274(a)(4). Accordingly, for tax years beginning on or after January 1, 2022, employers may not deduct as a business expense qualified transportation fringe benefits provided to employees.

- **Employer-provided adoption assistance**

IRC Section 137 allows an exclusion for qualified adoption expenses paid on behalf of employees. For taxable years beginning on or after January 1, 2022, the maximum amount of the exclusion was \$14,890, which phased out for taxpayers with federal modified adjusted gross income over \$223,410, and completely phased out for taxpayers with federal modified adjusted gross income of \$263,410 or more. ([Revenue Procedure 2021-45](#).)

Under the IRC as amended January 1, 2005, IRC Section 137 was set to expire for tax years beginning after December 31, 2010. Accordingly, under prior Massachusetts law, Massachusetts did not follow the adoption assistance exclusion for tax years beginning on or after January 1, 2011, even though Congress extended IRC Section 137 permanently in 2012.

Under the new law, Massachusetts conforms to IRC Section 137 for adoption expenses paid or treated as paid by an employer on or after January 1, 2022.

Public comment period

The Department is accepting public comments concerning this draft TIR through close of business February 15, 2023. Comments can be emailed to rulesandregs@dor.state.ma.us.

Ernst & Young LLP insights

The draft TIR does not specifically mention how employers should address adjustments to employees' Massachusetts taxable wages for 2022. In most instances, the changes identified in the draft TIR would likely result in the overstatement of taxable wages and potential refunds of 2022 Massachusetts income tax.

It is hoped that the Department will expand its guidance to provide specific instructions for employers and employees, and perhaps offer a simplified method for employers and employees to resolve 2022 wage and tax differences.

In the meantime, employers should review their 2022 wage and tax records, and identify employees who may require a Massachusetts Form W-2c for 2022.

Contact us for more information

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