

Reg. Section 1.132-2

No-additional-cost services

(a) In general.

(1) definition. Gross income does not include the value of a no-additional-cost service. A "no-additional-cost service" is any service provided by an employer to an employee for the employee's personal use if-

(i) The service is offered for sale by the employer to its customers in the ordinary course of the line of business of the employer in which the employee performs substantial services, and

(ii) The employer incurs no substantial additional cost in providing the service to the employee (including foregone revenue and excluding any amount paid by or on behalf of the employee for the service).

For rules relating to the line of business limitation, see section 1.132-4. For purposes of this section, a service will not be considered to be offered for sale by the employer to its customers if that service is primarily provided to employees and not to the employer's customers.

(2) Excess capacity services. Services that are eligible for treatment as no-additional-cost services include excess capacity services such as hotel accommodations; transportation by aircraft, train, bus, subway, or cruise line; and telephone services. Services that are not eligible for treatment as no-additional-cost services are non-excess capacity services such as the facilitation by a stock brokerage firm of the purchase of stock. Employees who receive non-excess capacity services may, however, be eligible for a qualified employee discount of up to 20 percent of the value of the service provided. See section 1.132-3.

(3) Cash rebates. The exclusion for a no-additional-cost service applies whether the service is provided at no charge or at a reduced price. The exclusion also applies if the benefit is provided through a partial or total cash rebate of an amount paid for the service.

(4) Applicability of nondiscrimination rules. The exclusion for a no-additional-cost service applies to highly compensated employees only if the service is available on substantially the same terms to each member of a group of employees that is defined under a reasonable classification set up by the employer that does not discriminate in favor of highly compensated employees. See §1.132-8.

(5) No substantial additional cost.

(i) In general. The exclusion for a no-additional-cost service applies only if the employer does not incur substantial additional cost in providing the service to the employee. For purposes of the preceding sentence, the term "cost" includes revenue that is forgone because the service is provided to an employee rather than a nonemployee. (For purposes of determining whether any revenue is forgone, it is assumed that the employee would not have purchased the service unless it were available to the employee at the actual price charged to the employee.) Whether an employer incurs substantial additional cost must be determined without regard to any amount paid by the employee for the service. Thus, any reimbursement by the employee for the cost of providing the service does not affect the determination of whether the employer incurs substantial additional cost.

(ii) Labor intensive services. An employer must include the cost of labor incurred in providing services to employees when determining whether the employer has incurred substantial additional cost. An employer incurs substantial additional cost, whether non-labor costs are incurred, if a substantial amount of time is spent by the employer or its employees in providing the service to employees. This would be the result whether the time spent by the employer or its employees in providing the services would have been "idle," or if the services were provided outside normal business hours. An employer generally incurs no substantial additional cost, however, if the services provided to the employee are merely incidental to the primary service being provided by the employer. For example, the in-flight services of a flight attendant and the cost of in-flight meals provided to airline employees traveling on a space-available basis are merely incidental to the primary service being provided (i.e., air transportation). Similarly, maid service provided to hotel employees renting hotel rooms on a space-available basis is merely incidental to the primary service being provided (i.e., hotel accommodations).

(6) Payments for telephone service. Payment made by an entity subject to the modified final judgment (as defined in section 559(c)(5) of the Tax Reform Act of 1984) of all or part of the cost of local telephone service provided to an employee by a person other than an entity subject to the modified final judgment shall be treated as telephone service provided to the employee by the entity making the payment for purposes of this section. The preceding sentence also applies to a rebate of the amount paid by the employee for the service and a payment to the person providing the service. This paragraph (a)(6) applies only to services and employees described in section 1.132-4(c). For a special line of business rule relating to such services and employees, see section 1.132-4(c).

(b) Reciprocal agreements. For purposes of the exclusion from gross income for a no-additional-cost service, an exclusion is available to an employee of one employer for a no-additional-cost service provided by an unrelated employer only if all of the following requirements are satisfied-

(1) The service provided to such employee by the unrelated employer is the same type of service generally provided to nonemployee customers by both the line of business in which the employee works and the line of business in which the service is provided to such employee (so that the employee would be permitted to exclude from gross income

the value of the service if such service were provided directly by the employee's employer);

(2) Both employers are parties to a written reciprocal agreement under which a group of employees of each employer, all of whom perform substantial services in the same line of business, may receive no-additional-cost services from the other employer; and

(3) Neither employer incurs any substantial additional cost (including forgone revenue) in providing such service to the employees of the other employer, or pursuant to such agreement. If one employer receives a substantial payment from the other employer with respect to the reciprocal agreement, the paying employer will be considered to have incurred a substantial additional cost pursuant to the agreement, and consequently services performed under the reciprocal agreement will not qualify for exclusion as no-additional-cost services.

(c) Example. The rules of this section are illustrated by the following example:

Example. Assume that a commercial airline permits its employees to take personal flights on the airline at no charge and receive reserved seating. Because the employer forgoes potential revenue by permitting the employees to reserve seats, employees receiving such free flights are not eligible for the no-additional-cost exclusion.