

Clarity Regarding Taxability of Transportation Fringe Benefits

March 27, 2018

Dear Clients and Friends,

As you know, certain provisions of the recent federal income tax reform legislation may have a significant impact on tax-exempt organizations. Currently, one of the most controversial of these provisions is the tax treatment of employer-paid expenses for transportation and parking benefits. Many organizations offer these types of benefits to their employees, in one form or another.

The new law states the following:

“ Unrelated business taxable income of an organization shall be increased by any amount for which a deduction is not allowable under this chapter by reason of section 274 and which is paid or incurred by such organization for any qualified transportation fringe (as defined in section 132(f)), any parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C))..... ”

The debate revolves around the intended meaning of the phrase, “...paid or incurred by such organization.” The tax community’s interpretation of this provision has been evolving, and in fact, IRS has just announced guidance on this issue. Accordingly, our latest guidance regarding commonly asked questions is presented below.

What if an organization makes direct payments for transportation and parking costs?

It is clear that in the cases where a tax-exempt employer pays directly for an employee’s tax-free transportation and parking benefits, the employer will now incur an income tax liability based on the value of the benefits.

What if an organization offers a compensation reduction agreement as an option to its employees?

Many employers offer employees a tax-free benefit via a compensation reduction agreement (CRA). From a practical perspective, the CRA allows employees to shield the portion of their compensation used to pay for transportation or parking from income taxes and payroll taxes. Thus, most employers and employees have not viewed this type of arrangement as a fringe benefit. Rather, it has been viewed as simply a reclassification of salary expense.

However, the IRS has just announced that guidance included in the 2018 version of Publication 15-B, *Employer’s Tax Guide to Fringe Benefits*, makes it clear that tax-exempt employers should now pay income tax based on the amounts included in employee CRAs.

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So, tax-exempt organizations should begin planning for payment of federal and state income taxes on any tax-free transportation and parking benefits utilized by their employees.

Recommended Steps Exempt Organizations Should Take Now:

1. Determine the amount of transportation and parking costs that are currently provided on a tax-free or tax-sheltered basis. Amounts paid on or after January 1, 2018 are subject to the tax. It does not matter if the entity has a calendar year end or fiscal year end – any payments made on or after January 1, 2018 will be subject to the tax.
2. Plan on having to report this total as unrelated business taxable income. The federal corporate income tax rate that will apply to these amounts is 21%. Jurisdictions such as the District of Columbia, Maryland, New York, and Virginia generally adhere to the federal definition of unrelated business taxable income. Therefore, state income taxes will likely apply as well.
3. Plan on making estimated income tax payments to both federal and state jurisdictions, beginning in 2018. Estimated income taxes are paid in installments by the 15th day of the fourth, sixth, ninth, and twelfth month of the tax year. A sample payment schedule is shown below.

	Tax Year-End			
	March	June	September	December
Payment 1	July 15	October 15	January 15	April 15
Payment 2	September 15	December 15	March 15	June 15
Payment 3	December 15	March 15	June 15	September 15
Payment 4	March 15	June 15	September 15	December 15

4. If the organization has not previously had to file federal income taxes, it will need to enroll in the “EFTPS” payment system in order to remit its taxes. The enrollment process for EFTPS may be found at this link:

<https://www.eftps.gov/eftps/>

In addition, many jurisdictions either require, or highly encourage, the use of electronic income tax payments. So, tax-exempt entities should check to see if they have enrolled in the appropriate states’ electronic tax payment programs.

In certain instances, entities may have been registered for electronic tax payments by their payroll providers. Thus, an organization that is unsure whether it is registered may want to first check with its payroll provider.

5. Incorporate the impact of this new tax, along with potentially increased tax preparation fees, into budgets and financial projections. If the impact is going to be significant, alert the Board and other appropriate stakeholders.

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What if we just stop offering tax-free transportation and parking options for our employees?

Another option would be to cease offering employees any type of tax-free transportation or parking benefit. Employers could pay employees additional, grossed-up, compensation to account for the income taxes the employees would have to pay. However, entities should keep in mind that in most cases, additional employer and employee payroll taxes and retirement expenses would also be incurred.

Concluding thoughts

We understand the great importance of this issue to tax-exempt organizations. As additional information becomes available, we will continue to communicate the latest interpretations of this provision.

Please do not hesitate to contact the members of your Tate & Tryon service team with any questions.