Fringe Benefits 2017: What's Taxable, How to Report It & How to Avoid the IRS Crackdown

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AGENDA

➢ Cafeteria Plans
➢ IRC § 132 Fringes
➢ Working Condition Fringes
➢ Work-Related Fringes
➢ Taxable Fringes
➢ Taxing Fringes
Cafeteria Plans

➢ Pretax Deductions

■ Cafeteria plan requirements:
  ■ Plans must be written
  ■ Employees choose between qualified benefits or taxable benefits (e.g., cash)
  ■ Remittances to plan
    ■ 401(k) contributions: Latest date is 15th day of the next month after withholding; but 7 days after withholding for plans with fewer than 100 participants
    ■ health/welfare contributions: not later than 90 days after the withholding, but 7 days after withholding for plans with fewer than 100 participants
  ■ IRS and DOL have audit authority over plans
Cafeteria Plans

➢ Pretax Deductions

■ Cafeteria plan requirements:

■ **Allowable benefits**: accident and health benefits, adoption assistance, dependent care assistance, group-term life insurance coverage, health savings accounts

■ **Prohibited benefits**: Archer MSAs, athletic facilities, *de minimis* benefits, educational assistance, employee discounts, employer-provided cell phones, lodging, meals, moving expense reimbursements, no-additional-cost services, working condition fringes

■ **Mid-year changes OK if**: FMLA leave, HIPAA special enrollment, or changes in status
IRC § 132 Fringes

➢ Exclusions From Gross Income

■ No-additional cost services
  ■ Employees work in that line of business
  ■ Employers incur no *additional* cost in offering the service to employees
  ■ Nondiscrimination rules apply

  ■ **Excess capacity services:** Airline employees who fly standby for free; hotel accommodations for hotel employees when there are spare rooms available; train tickets to railway employees; and last-minute tickets to a pro sports event provided to team employees, if the game hasn’t sold out by game time
IRC § 132 Fringes

➢ Exclusions From Gross Income

■ Qualified employee discounts
  ■ Merchandise or services are offered for sale to customers
  ■ Discount on merchandise can’t exceed the gross profit percentage multiplied by the sale price to customers
    ■ Maximum discount on services can’t exceed 20% of the sale price to customers
  ■ Nondiscrimination rules apply
  ■ Gross profit percentage: gross receipts minus the cost of goods sold divided by gross receipts
    ■ Must be figured for a representative period
IRC § 132 Fringes

➤ Exclusions From Gross Income

■ Qualified employee discounts
  ✗ Discounts should not be bargained-for benefits
  ✗ Discounts aren’t rebates
  ✗ Taxable discounts are reported in W-2s
IRC § 132 Fringes

➢ Exclusions From Gross Income

■ *De minimis* fringes
  ■ No set dollar amount
  ■ *Noncash* fringes of nominal value, which are provided infrequently to employees and which makes them, overall, administratively difficult to account for
  ■ Examples: occasional cocktail parties or picnics; traditional holiday gifts of property with a low fair market value; occasional theater or sporting event tickets; coffee and doughnuts; or local telephone calls; fruit, books, or similar gifts given to employees under special circumstances; company computer that’s set up so that employees can retrieve tax forms
  ■ Occasional meal money and local transportation may be provided in cash
Exclusions From Gross Income

- De minimis fringes
  - Not de minimis fringes: expensive tickets to a pro sporting event are taxable, even if provided on an occasional basis; season tickets; the commuting use of an employer-provided car more than once a month; membership in a private country club or gym, regardless of how often employees use the club or gym; employer-provided group-term life insurance for employees’ spouses or children with a face value of more than $2,000
IRC § 132 Fringes

➢ Exclusions From Gross Income

■ *De minimis* fringes
  × Don’t manufacture administrative difficulty
  × Don’t substitute cash
  × Pricey door prizes aren’t *de minimis*, even if provided once a year
IRC § 132 Fringes

➢ Exclusions From Gross Income

■ Qualified transportation fringe benefits
  ■ Mass transit expenses may be reimbursed or paid for with pretax dollars, up to $255 a month; employer-provided parking may be reimbursed tax-free, up to $255 a month
  ■ Can’t be part of your cafeteria plan
  ■ Employees may carryover pre-tax contributions for mass transit benefits into succeeding months
IRC § 132 Fringes

➢ Exclusions From Gross Income

■ Qualified moving expense reimbursements
  ■ Expenses employees could have deducted: direct moving expenses, 30 days’ worth of storage and insurance expenses; traveling expenses, including lodging, but not meals; payments for utility connections and disconnections
  ■ Time test: New job must be at least 50 miles farther from the old home than the old job was from the old home
  ■ Distance test: Employees must work for at least 39 weeks at the new location
  ■ Reasonable belief: You reasonably believe employees can able to deduct expenses when you cut checks, no withholding is required
Exclusions From Gross Income

- Qualified moving expense reimbursements
  - Report reimbursement for qualified moving expenses in Box 12, Code P
  - No W-2 reporting of payments made directly to third parties (e.g., moving companies)
  - Employees submits substantiation their expenses; no substantiation = tax
  - Reimbursement to employee for all other expenses is taxable; report in Boxes 1, 2, 3, 4, 5, and 6 of W-2
IRC § 132 Fringes

➢ Exclusions From Gross Income

■ Qualified retirement planning services
  ■ Fringe can be offered only in conjunction with a qualified retirement plan
  ■ Examples: Retirement planning advice and information, including general retirement income planning, how a pension plan fits into employees’ overall retirement income schemes
  ■ Not covered: Services that are related to retirement planning, including tax preparation, accounting, legal, or brokerage services
  ■ Nondiscrimination rules apply
  ■ Caveat: IRS has never issued any clarifying guidance on this fringe
IRC § 132 Fringes

➤ Exclusions From Gross Income

■ On-premises gyms
  ■ The facility is located on your premises or property
  ■ You operate the facility or contract with another to operate it
  ■ Facility’s use is limited to employees, spouses, and dependents
    × Don’t bring in trainers
    × Don’t pick up employees’ costs to join gyms
    × Use the fair market value; not corporate discount rate
Working Condition Fringe Benefits

- **Definition:** Property and services you provide to employees so they can perform their jobs. It applies to the extent employees could deduct the cost of the property or services on their 1040s as a business expense or depreciation expense if they had paid for it themselves.

- **Examples:** Employees’ use of a company car for business, employer-provided cell phones or business use of personal cell phones provided primarily for noncompensatory business purposes, job-related education provided to employees.
Working Condition Fringes

➢ Substantiation Requirements

■ Accountable plan rules
1. Employees must have paid or incurred deductible expenses while working for you (i.e., there must be a business connection)
2. Employees adequately account for those expenses within a reasonable period of time
   ■ Employees must complete a detailed expense report showing the expenses incurred, when expenses were incurred, with whom they met, etc.
   ■ Employees must submit receipts, canceled checks, or other detailed bills
3. Employees return excess reimbursements or allowances within a reasonable period of time
Working Condition Fringes

➤ Cell Phone Expenses

- Employees’ business use of their own phones or employer-provided equipment may be reimbursed tax-free if you have a substantial noncompensatory reason for requiring them to use cell phones
  - **Substantial noncompensatory business reason:** Employees must be able to contact employees in emergencies, or employees must be able to contact clients after-hours
    - No records are required
- Employees who use their own phones may be reimbursed for their basic monthly calling/data charges, provided their plan is reasonably related to their employer’s needs
Working Condition Fringes

➢ Cell Phone Expenses

■ Traps with Cell phones/Smartphones/Tablets
  ■ Phones provided for compensatory reasons (e.g., to increase morale) don’t qualify; employees personal use is taxable and they must keep records
  ■ Reimbursements for employees’ use of their own phones can’t be completely arbitrary. *Tip:* Have employees submit their monthly bills
  ■ Employees must buy their phones *specifically* for employment with your company for your reimbursements to be tax-free; employees who trade in their phones can’t be reimbursed tax-free
-working-condition-fringes

_company-cars_

- Substantiated business use is a tax-free working condition fringe benefit; personal use is taxable
  - Employees must show where they drove, whom they saw, the business they conducted
  - Optional rule for company cars only: Treat the entire value of employees’ use as personal, and, therefore, taxable
    - Basic methods to value personal use:
      - Standard mileage rate for low-cost cars
      - General valuation method
      - Lease valuation method: Determined from IRS tables; see IRS Pub.15-B
Working Condition Fringes

➤ Employer-Provided Education

■ Treas. Reg. § 1.162-5
  ■ Education is required by you or by law for employees to keep their present salary, status, or job
  ■ Education maintains or improves skills needed in the job
  ■ Not qualifying education if it’s needed to meet the minimum educational requirements or is part of a program of study that will qualify employees for a new trade or business
    ■ Could do vs. Intend to do

■ IRC § 127
  ■ Up to $5,250 a year in non-job-related educational assistance
  ■ No hobbies
Working-Related Fringes

➤ Dependent Care Assistance

■ Maximum of $5,000 a year can be excluded from employees’ incomes

■ Benefits must be provided on a nondiscriminatory basis

■ Employees’ expenses must be work-related for qualified dependents
  ■ Qualified dependents: Children under the age of 13
  ■ Qualified expenses: Pre-school, nursery school, or other pre-kindergarten programs; before- or afterschool care; day camp, including specialty camps; transportation provided by the care provider; indirect expenses

■ On W-2: Total amount of dependent care benefits is shown in Box 10 of employees’ W-2s
Working-Related Fringes

➢ Employee Achievement Awards

■ IRC § 74
  ■ Length of service awards: 5, 10, or 15-year anniversaries
  ■ Plans must be written
  ■ Nondiscrimination rules apply
  ■ Award must be noncash and tangible
  ■ Must be part of a meaningful ceremony
  ■ Monetary limits: Maximum that can be excluded from an employee’s income is $1,600; the average cost of all awards per year can’t exceed $400
Working-Related Fringes

➢ Group-Term Life Insurance

■ IRC § 79

■ Up to $50,000 in GTL is tax-free to employees
■ Excess is taxable, subject to FICA and FUTA, but not income tax withholding
■ Show excess on employees’ W-2s in Box 12, with Code C
■ Policies with face value of up to $2,000 on employees’ dependents is a tax-free *de minimis* benefit
■ Code M for uncollected Social Security portion of FICA; Code N for uncollected Medicare portion of FICA for ex-employees receiving more than $50,000 in GTL
Working-Related Fringes

➤ Group-Term Life Insurance

- IRC § 79

Cost Per $1,000 of Protection For 1 Month

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<th>Age</th>
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<td>70 and older</td>
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Taxable Fringes

➢ **Concierge Services**
  ■ Not *de minimis* benefit because you know which employees received which services, which are valued on the bill

➢ **Gift Cards**
  ■ Gift cards are cash equivalents, so they always have a value

➢ **Repayment of Student Loans**
  ■ Taxable bonus payment

➢ **Door Prizes**
  ■ Value is fully taxable, even if vendor provides the merchandise with the company delivering it to the employee
Taxable Fringes

➤ Tax-free Meals

■ Substantiated meal expenses incurred when employees are traveling away from home overnight are 100% deductible

■ Employees who are attending an all-day seminar may be reimbursed tax-free for their substantiated meal expenses only if they have a business reason for picking up the tab for someone else’s meal

■ Substantiated business meals
  ■ Expenses are ordinary and necessary, not lavish
  ■ Meal are directly related or associated with business
  ■ Value of spouses’ meals are taxable to employees, unless there’s a bona fide business reason for the spouse to attend

■ Corporate deductions are limited to 50%
Taxable Fringes

➢ Tax-free Meals
■ IRC § 119
  ■ The value of meals provided to employees on the premises and for your convenience may be excluded from their income
  ■ Examples: Meals provided so employees are available for emergencies, employees work in remote areas
  ■ For your convenience depends on all the facts and circumstances

➢ Taxable Meals
■ Gourmet meals provided to employees are taxable
■ IRS planning an initiative to crack down on taxable meals
Taxable Fringes

➢ Best Practices

3 Think through the payroll tax consequences first
× Don’t stick employees with the tax bill
× Don’t shoehorn benefits into the working conditions fringe or *de minimis* fringe category

3 Determine whether the fringe is specifically excluded from income; if it isn’t, it’s taxable

3 Determine whether the fringe is personal; if it is it’s nondeductible and nonreimbursable tax-free
Taxing Fringes

➢ Special Accounting Rule

■ Treat the value of taxable **noncash** fringe benefits provided during last two months of a calendar year, or any shorter period within the last two months, as paid in the next year

■ Employees must also use the special accounting rule for personal tax purposes and can’t use it unless you use it

■ Notify employees by January 31 of the following year if you’re using the rule

■ Can’t be used for cash fringes or a transfer of tangible or intangible personal property of a kind normally held for investment or a transfer of real property
Taxing Fringes

➤ Valuing Taxable Fringes

- Fair market value, less what employees pay for it
  - **FMV**: what an individual would pay to an unrelated third party in an arm’s length transaction
  - Neither the amount employee considers to be the value of the fringe nor the cost you incur to provide the fringe determines its FMV

- Google, Craig’s List, e-Bay
Taxing Fringes

➤ Withholding Taxes

■ Combined with regular wages: use regular withholding method as if it were a single wage payment

■ Paid separately or separately indicated:
  ■ 25% flat rate method if employees have income taxes withheld from regular pay during current or preceding year
  ■ Aggregation method if employees have no income taxes withheld or aren’t paid regular wages
Taxing Fringes

➤ Withholding Taxes

■ Aggregation method

■ Example: Sharon is paid $2,000 on the 1st of the month. Using the percentage method tables, withhold $182.81 from her regular salary.

On May 14 she receives $1,000 moving expense reimbursement:

1. Add the reimbursement to regular wages for the most recent pay date (May 1): $2,000 + $1,000 = $3,000.

2. Determine withholding on the combined $3,000: $332.81

3. Subtract the amount withheld from wages on May 1 from the combined amount: 332.81 - 182.81 = $150

4. Withhold $150 from the reimbursement
Taxing Fringes

➢ Withholding Taxes

● Withholding from non-cash items

● Find fair market value, consider item “paid,” impute value of the item into income, withhold, subtract tax and value of item

● Example: $12,000 non-cash benefit; employer withholds $1,000 monthly

1. Add imputed income to regular wages: $4,000 + $1,000 = $5,000

2. Figure withholding on the total:

   Wages subject to withholding: $5,000.00
   Less withholding allowances: - $311.60
   Net wages subject to withholding: $4,688.40
   Income tax to withhold: $1,020.64
   FICA withholding: + $382.50
   Total withholding: $1,403.14

3. Figure take home pay: $5,000 - $1,403.14 - $1,000 = $2,596.86 in take-home pay
Taxing Fringes

➢ Grossing Up

- Basic formula:
  
  \[
  \text{Fair market value of item} \\
  0.6735, \ 0.7355, \text{ or } 0.7265
  \]

- Be sure to include state income taxes in the denominator

- Example: $5,000 in taxable prizes:
  
  \[
  \frac{$5,000}{1 - .25 - 0.765 \text{ (or } .6735)}
  \]

Grossed-up pay: $7,423.90
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