

Certain fringe benefit expenses treated as unrelated business taxable income

If a tax-exempt organization pays or incurs expenses for certain transportation and athletic facility fringe benefits, that organization's unrelated business taxable income (UBTI) will be increased by the amount of those expenses as a result of new Section 512(a)(7) of the Internal Revenue Code.¹ This applies to any amounts paid or incurred after December 31, 2017, regardless of the tax year. Thus, even for fiscal year entities, this tax is already effective.

Organizations should consider modeling the impact of the tax and taking steps to limit it.

¹All Section references are to US Internal Revenue Code of 1986, as amended.

How should an organization model the impact of the tax?

- ▶ Step 1: Is the employer providing something of value to employees that is excluded from the employees' income under Section 132 as a qualified transportation fringe, qualified parking or on-premises athletic facility fringe?
- ▶ Step 2: If yes, would Section 274 deny a deduction for those amounts?
- ▶ Step 3: If yes, what does the employer spend on the benefits? In the taxable context, the expense will not be deductible, and, in the tax-exempt context, the employer has UBTI in the amount of the expense.

What are some potential strategies to minimize the financial impact of the excise tax?

- ▶ Treating amounts as taxable to employees
Providing a benefit to employees on a taxable basis may be less costly than continuing to offer the benefit on a tax-exempt basis but may be contrary to local law or poorly received by employees. Analyzing the financial and nonfinancial impact of this course of action will be important in determining the path forward.
- ▶ Determining whether the benefit being provided is a value that is being excluded from income
Certain parking facilities might be properly valued at \$0 under existing IRS guidance, based on the location of and access to the facility. In this case, no exclusion under 132(f) would apply and the expense would not be UBTI.
- ▶ Opening up a managerial gym to all employees
In the case of an on-site athletic facility that would be nondeductible under Section 274, it may be that access to the facility could be restructured to allow the gym to qualify as a recreational expense for employees, allowing the expense to be shielded from unrelated business income tax.

What are the challenges involved?

- ▶ Determining whether there is a Section 132 exclusion
 - 1) Is the employee receiving something of value?
 - 2) For example, is the parking free to the public such that the employee has not actually received a benefit?
- ▶ Determining whether an exception to 274 can apply
 - 1) Would the benefit be eligible for an exception from Section 274?
 - 2) For example, is the expense exempt as a recreational expense for employees?
- ▶ Hurdles to limiting the impact
 - 1) Could the benefit be provided to the employee on a taxable basis?
 - 2) If the benefit is provided in kind, how to value the benefit to impute income?
 - 3) Is the benefit required by state or municipal law to be provided to employees?
- ▶ Allocation of expenses
 - 1) What costs must be allocated to the benefit?
 - 2) For example, in the case of parking, what costs are in-scope and how should those costs be allocated to qualified transportation fringe?
 - 3) Can some amount be excluded if some of the benefit is funded by the employee with post-tax dollars?



Ernst & Young LLP (EY US) can help

EY US can assist organizations to assess the impact of the new UBTI rules. Our services include:

- ▶ Identifying employee benefits that may be subject to the new rules
- ▶ Performing (or reviewing) UBTI calculations
- ▶ Identifying, quantifying and implementing alternatives to possibly lessen or eliminate the tax exposure
- ▶ Identifying, quantifying and claiming tax credits to possibly reduce or entirely offset the tax exposure
- ▶ Assisting with tax reporting requirements
- ▶ Advising with respect to the design of compensation programs
- ▶ Assisting with communicating challenges and recommendations to the Treasury Department and the IRS as regulations and other guidance are developed

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