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2017 TAX CUTS AND JOBS ACT: EFFECT OF TRANSPORTATION FRINGE BENEFITS ON UNRELATED BUSINESS TAXABLE INCOME (UBTI)

BENEFITS, INTERNAL REVENUE SERVICE, TAX REFORM
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Under the 2017 Tax Cuts and Jobs Act, Section 274(a) of the Internal Revenue Code includes a new provision that expressly disallows deductions for “the expense of any qualified transportation fringe (as defined in section 132(f)) provided to the employee of the taxpayer.”

A “qualified transportation fringe benefit” includes anything provided by the employer to an employee for commuter transportation including buses, vanpools, transit passes, parking passes or reimbursements, and bicycle commuting reimbursements.

The new provision requires tax-exempt organizations that provide such benefits to their employees to report as Unrelated Business Taxable Income (“UBTI”) the value of those benefits. This new rule is effective for amounts incurred after December 31, 2017.

In addition, the newly-added Section 274(l) of the Code generally disallows deductions for any expense incurred for the purpose of providing transportation, payment or reimbursement to an employee related to travel between the employee’s residence and his or workplace.

The stated purpose of the rule is to put tax-exempt organizations on par with taxable organizations, since under the new tax law, for-profit entities are no longer allowed to deduct the fringe benefits listed above that are provided tax-free to their employees.

Section 132(f) of the Internal Revenue Code, which governs qualified transportation fringe benefits remains relatively unaffected by the Tax Cuts and Jobs Act; but the bill does suspend qualified bicycle commuting reimbursement from the definition of qualified transportation fringe benefits until January 1, 2026.

Under the old rules, not-for-profit employers were able to provide these benefits to employees as tax-free items. Starting in 2018, however, if a tax-exempt organization wants to continue providing these benefits tax-free, the organization is required to include the value of the benefits in UBTI and pay tax on them. These transportation benefits will continue to be non-taxable fringe benefits to employees under the new Act.

If the tax-exempt organization wants to avoid the new tax, either (i) it can provide

the benefits as taxable items to the employees (and include the cost of the benefits in the employees' Forms W-2) or (ii) it can stop providing these benefits. If the organization chooses to treat these benefits as taxable wages, it will be subject to higher FICA and Medicare payroll taxes and the employees will have increased personal income taxes.

Two small exceptions to Section 274(l) exist for employers that lets them avoid the UBTI: (i) expenses that are "necessary for ensuring the safety of the employee" between the employee's residence and workplace will continue to be deductible (although the bill does not state what expenses qualify as necessary to ensure an employee's safety); and (ii) between December 31, 2017, and before January 1, 2026, employers will be able to deduct qualified bicycle payments or reimbursements to employees only if this method of transportation is regularly used for travel between the employee's residence and place of employment." (This benefit, however, will no longer be a tax-free benefit to the employee.)

Employers may need to amend their Section 125 Cafeteria Plan and / or Section 132(f) Qualified Transportation Plan documents as well as any other informative documents to reflect changes in benefit offerings. These changes can only be effectuated prospectively.

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