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IRS Clarifies Treatment of Transportation Fringe Benefits for Tax-Exempt Employers

BENEFITS, HIGHER EDUCATION, NOT-FOR-PROFIT, TAX REFORM
BY

The IRS recently released subsequent guidance on an issue we discussed in a previous *Our Thoughts On* article (see [here](#)). In late March, the agency updated Publication 15-B, "Employer's Tax Guide to Fringe Benefits," which clarified its interpretation of changes made to the taxation of certain fringe benefits under the Tax Cuts and Jobs Act ("TCJA"). Specifically, the IRS confirmed its position that tax-exempt employers cannot use a qualified pretax compensation reduction agreement ("CRA") to avoid the imposition of tax under the unrelated business income rules on certain qualified transportation fringe ("QTF") benefits.

Under the TCJA, the newly added IRC Section 512(a)(7) provides that, among other things, QTF benefits "paid or incurred" by tax-exempt employers are includable in the organization's UBTI. The TCJA treats certain qualified transportation fringe benefit expenses as taxable income for tax-exempt employers. QTF includes three categories of benefits: (1) transportation in a commuter highway vehicle (e.g., commuter buses or vanpools); (2) transit passes; and (3) qualified parking.

Prior to the release of the recent guidance, some tax experts theorized that CRAs might act a mechanism to avoid inclusion of QTF in an organization's UBTI. This argument asserted that CRAs represent pretax contribution accounts funded through employee wage reduction, not expenses "paid or incurred" by tax-exempt employers. But the IRS disagrees with this argument, and has updated Publication 15-B to clarify that QTF CRAs, despite their form, represent expenses includable in UBTI for purposes of the TCJA.

At the employee level, nothing has changed. Employees may still treat QTF as pretax salary reductions under IRC Section 132(f), but a tax-exempt employer offering a QTF should be cognizant of the release of this guidance.

If you have any questions about this matter, please [reach out](#) to your Schneider Downs tax contact.

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