

Tax Notes

Federal Tax Reform: Consequences on Tax-Exempt Organizations as Employers

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The effects of the new tax law are wide-ranging and getting out information to our clients so that they can make sound business decisions is our goal. This newsletter will focus on certain benefits provided by employers at their option and how they may be affected by the new tax law.

QTF Benefits Deduction: Eliminated

Prior to January 1, 2018: The provision of qualified transportation fringe (QTF) benefits (which include payments for commuter transportation in a commuter highway vehicle, transit passes, qualified parking and certain qualified bicycle commuting) provided by an employer to an employee were excludable from employee's gross income, subject to applicable limitations regardless if the amounts were employer-funded, reimbursed to the employee by the employer or through employee pre-tax salary deductions. Additionally, employers were allowed a deduction for salaries and compensation, which included the cost of QTF benefits.

After January 1, 2018: The new tax law eliminates the deduction available to employers for the provision of QTF benefits, except as necessary for ensuring the safety of an employee. Based upon the language and code sections referenced within the new law, it would seem that this deduction is not allowed whether it is an employer-funded benefit or paid through employee pre-tax salary deductions. However, employees can continue to contribute and exclude the QTF benefits from their income using the pre-tax salary deductions. Qualified bicycling commuting expense payments or reimbursement will no longer be excluded from an employee's income.

Onsite Gym Deduction: Eliminated

Prior to January 1, 2018: The cost of on-premises athletic facilities was a deductible expense, treated as a non-taxable fringe benefit. The cost of an employee's use was excluded from taxable income.

After January 1, 2018: The deduction for onsite gyms was repealed. Employees, however, can continue to exclude the benefit from income after 2017.

QTF Repeal: Effect on Tax-Exempt Organizations as Employers

The new tax law provides that a tax-exempt organization must report these QTF benefit costs (if made available to their employees) as unrelated business taxable income (UBTI) on Form 990-T and pay tax on these amounts.

Under the general rule applicable to all tax-exempt employers, it would seem that no deduction would be available against UBTI related to the provision of the QTF benefits. [Note: For a for-profit company, these amounts are not deductible, which will increase that type of organization's taxable income, thereby leveling the "playing field."]

Depending on how the tax-exempt entity is organized, either as a corporation or trust, will determine the rate of tax the organization will pay:

- **For tax-exempt entities organized as a corporation (most public charities):** They will be able to benefit from the lowered corporate tax rates instituted in the new tax law. Corporations will pay tax at a rate of 21% over \$1,000.
- **For tax-exempt entities organized as a trust (a large number of private foundations):** They, too, will benefit from the revised rates. Tax-exempt entities organized as a trust will pay tax at the 37% rate for QTF benefits over \$12,500 (e.g., pre-tax contributions for 5 employees: \$3,120 x 5 = \$15,600). The graduated tax rates will apply to amounts below \$12,500.

Additionally, any funds used to pay for on-premises athletic facilities will also be taxed as unrelated business taxable income.

The new law affecting the QTF benefits takes effect for amounts paid or incurred after December 31, 2017.

Should Tax-Exempt Employers Continue to Offer QTF Benefits?

Because the new tax law eliminates the QTF benefits deduction for employers and subjects these amounts to UBIT for tax-exempt organizations, employers may consider providing them as a disincentive. Some employers, however, may still wish to offer these benefits to stay competitive; while others may also be required to provide them to comply with state and local laws. [For example: New York City employers are subject to the Affordable Transit Act, which may require an organization to provide these benefits to employees. There are similar laws in Washington, D.C. and municipalities in the San Francisco Bay Area in California.]

If an exempt organization is paying the cost of or providing reimbursement for its employees' QTF benefits, it might consider providing the pre-tax option to the employees in an effort to reduce the employer cost. Providing or reimbursing \$3,120 in benefits would cost an exempt organization \$655.20 annually (\$3,120 x 21%). Using a pre-tax plan would save \$238.68 in annual FICA costs per employee, thereby reducing the employer's overall cost of providing these benefits.

Updating the Tax Code and Regulations

The law will now have to be incorporated into the Internal Revenue Code and Treasury Regulations. Through this process, additional information will be provided to clarify the language used as it relates to the QTF benefits. As more guidance is provided, we will continue to keep you informed with future Thought Leadership communications.

Contact Us

If you have questions regarding how these rules will apply to your organization or how to report unrelated business income, contact partner Garrett M. Higgins, CPA, Partner at ghiggins@pkfod.com or a member of your tax-exempt client service team at PKF O'Connor Davies.

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