Providing Certain Fringe Benefits May Create UBTI and Trigger New Filing Requirements for Tax-Exempt Organizations

The Tax Cuts and Jobs Act includes a provision that changes the treatment of Qualified Transportation Fringe (QTF) benefits for tax-exempt organizations, who now may be required to recognize the costs of these benefits as Unrelated Business Taxable Income (UBTI). UBTI is income from activities not related to the organization's primary mission or purpose, and the term QTF refers to costs incurred by an employer providing the following benefits to an employee:

- Transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment
- Any transit pass
- Qualified parking – provided to an employee on or near the business premises of the employer, or on or near a location from which the employee commutes to work in a commuter highway vehicle

Note: Bicycle commuting reimbursements are NOT considered QTFs and are deductible.

This change, effective for amounts paid or incurred after December 31, 2017, affects organizations that deducted fringe benefit costs in the past, and it may also cause some organizations to owe tax for the first time.

Summary

The new tax law eliminated the deduction for QTF costs for for-profit businesses, and it changed the treatment of QTF costs for tax-exempt organizations. QTF costs are now treated as a disallowed deduction for arriving at UBTI. Consequently, expenses incurred by a tax-exempt organization for providing QTF benefits to employees will now increase or create UBTI, which could result in a tax liability requiring the organization to file a tax return and pay taxes.

In other words, , tax-exempt organizations may now have to recognize income and pay tax on the ***expense*** of providing QTF benefits to employees, because that expense is no longer deductible.

Details

UBTI is income from activities not related to a tax-exempt organization's primary mission or purpose. For example, any gain or loss from selling or disposing of office furniture would be deemed unrelated business income or expense because selling furniture is probably not the primary purpose of the organization. If UBTI is over $1,000 in a given tax year, then the organization is required to file Form 990-T and pay taxes on that unrelated business income.

Expenses associated with unrelated business activities can typically offset UBTI, but some deductions are disallowed by the tax code. The new tax law now includes the cost of providing QTF benefits to employees in the pool of disallowed deductions. This means that if an organization provides reimbursement to employees for transit and parking passes, leases a parking lot or garage, pays to reserve parking spots, incurs costs to maintain a parking facility it owns, or incurs some other qualified parking expense, then the annual cost of those benefits is now treated as a disallowed deduction. This will increase UBTI, or in some cases create UBTI for organizations that didn't have any before, and it will likely result in a tax liability.

However, if these costs are treated as compensation to employees and are included in the employees' W-2s, then the costs are deductible by the organization and there is no longer any disallowed deduction for UBTI purposes. It should be noted that this approach would increase the taxable income of employees who receive the increased compensation.

It should also be noted that for 2018 only up to $260 worth of QTF received per employee per month can be excluded from an employee's income. Any excess amount is required to be included in the employee's income as taxable compensation and would, therefore, be deductible by the organization. Only the amount up to $260 per employee per month not treated as compensation would be considered a disallowed deduction for UBTI purposes.

Please contact your tax advisor if you need assistance calculating the taxable amount of any QTF provided to employees.

IRS Relief of Underpayment Penalty

Typically, if an organization is going to owe tax, then quarterly estimated tax payments are required, each in an amount equal to 25% of the estimated tax due for the year. Many tax-exempt organizations will owe tax for the first time in 2018 due to the QTF changes in the new tax law, but they have not been making estimated tax payments. Normally, not making estimated tax payments would cause taxpayers to incur an underpayment penalty in addition to the tax due. However, since so many tax-exempt organizations are now incurring tax liabilities for the first time, the IRS is waiving the underpayment penalty for certain organizations. Please note that the tax due is still due; only the underpayment penalty is being waived.

The underpayment penalty for not making required estimated tax payments will be waived for tax-exempt organizations that meet the ALL of the following criteria:

- The organization provides QTF benefits to employees;
- The cost of the QTFs cause the organization to owe tax on its UBTI;
- The organization was not required to file Form 990-T in 2017;
- The organization timely files its 2018 Form 990-T; and,
- The organization timely pays its 2018 tax due.