608 Taxability of Employee Benefits

Approved by President

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I. Purpose

Per the Internal Revenue Service (IRS), a fringe benefit is “a form of pay for the performance of services.” Any fringe benefit an employer provides is taxable and must be included in the recipient’s pay unless the law specifically excludes it. This policy outlines certain taxable fringe benefits that Middle Tennessee State University (MTSU or University) may encounter and provides information for the reason for the taxation.

The policy provides the following guidance to assist MTSU employees and departments in understanding the tax treatment of various fringe benefits, as well as the reporting and withholding rules that MTSU must follow as the employer. The University does not provide personal tax advice. For specific concerns or questions relative to an individual tax situation, University stakeholders should consult their personal tax accountants or advisors.

II. Fringe Benefits

A fringe benefit is a type of compensation that employers may provide to employees, including certain independent contractors. Generally, a fringe benefit is taxable unless the IRS excludes it from taxable income. Employers typically provide fringe benefits as "in kind," meaning that they are typically paid in a medium other than cash. Under nearly all circumstances, a payment in cash will be taxable wages to the employee. Fringe benefits may include the use of automobiles or cell phones, tickets, moving expenses, or a variety of other benefits. The taxability of a fringe benefit will depend on whether it falls within an exception and meets the requirements for excludability. An employer must include all taxable fringe benefits in an employee’s gross income, as they are subject to federal and state tax withholding, FICA, and Medicare.

For a fringe benefit to be taxable, the University does not need to furnish it directly to an employee, as long as the benefit is in connection with the performance of services for the University. A fringe benefit may be taxable to a person even though the person did not actually
receive it. For example, the IRS treats taxable fringe benefits that employers provide to an employee’s spouse or child as a benefit to the employee.

III. Tax Withholding and Reporting

As required by federal law, the University must report taxable fringe benefits for employees as taxable wages on IRS Form W-2. Most taxable fringe benefits are subject to federal and state income tax withholding, as well as social security and Medicare taxes. The University may spread tax withholding on fringe benefits over multiple pay periods during the tax year, depending on when a department submits the reportable benefits. Benefits provided in the last two (2) months of the year may have taxation carried into the following year.

Taxable fringe benefits for non-employees are not subject to tax withholding, but may be reportable on IRS Form 1099-MISC.

A. Non-Taxable Fringe Benefits

1. The IRS defines no-additional cost services as any service provided for use by an employee if the service is primarily for sale to students and third parties and the University incurs no substantial additional cost in providing the service to an employee. Examples are recreational facility use and tickets to events that have not sold out. IRC § 132(b)

2. Working condition fringe benefits are any property or service provided to an employee that if the employee had paid, the payment would be deductible as a business expense. To be excludable as a working condition fringe benefit, all of the following must apply:

   a. the benefit must relate to the employer’s business,

   b. the employee would have been entitled to an income tax deduction if expense had been paid personally, and

   c. the business use must be substantiated with records.

Examples are business use of the following: wireless communication devices, University provided automobiles, airplanes and chartered flights, club memberships, professional dues, publications and meetings. With the exception of University provided wireless communication devices, the IRS deems that any personal use of these items is taxable income. Effective January 1, 2011, the IRS ruled the value of any personal use of an employer-provided cell phone primarily for non-compensatory business purposes is excludable from the employee’s income as a de minimis fringe benefit. IRC § 132(e), Notice 2011-72
3. De minimis fringe benefits include any property or service provided to an employee infrequently and has a value so small that accounting for it is unreasonable and administratively impractical. Examples include occasional theater or sporting event tickets, group meals or picnics, awards and gifts. IRC § 132(e); IRC §1.132-6(b)

4. A qualified employee discount allows an employee to obtain property or services from the University at a price below that charged to the public. Generally, a qualified employee discount cannot exceed 20%. Otherwise, it may be taxable. IRC § 132(c)(1)(B)

5. Lodging and meals provided to an employee may be non-taxable under certain circumstances. To qualify as non-taxable, the benefits must be in-kind (cash allowances do not qualify), provided for the University’s convenience and on the University’s business premises. An additional requirement for University-provided lodging is it must be required as a condition of employment for the employee to fulfill the duties of his/her employment.

   a. Lodging must meet the following requirements to be considered non-taxable:

      (1) The employer provides the lodging for its convenience. A written statement in the employment contract is not sufficient to meet this test. For the lodging to be non-taxable, a direct nexus between the lodging furnished and the business interests of the employer must exist.

      (2) The employer provides the lodging as a condition of employment. The employee must accept the lodging to perform the duties of employment, and he or she cannot have an option to accept cash in lieu of the lodging. Examples include lodging furnished because the employee is required to be available for duty at all times or because the employee would not be able to perform the service without the lodging.

      (3) The employer provides the lodging on its business premises. The IRS defines the business premises as the place of employment. Mere ownership of the premises by the employer is not sufficient. Courts have ruled that the lodging needs to be living quarters that constitute an integral part of the employer’s business property.

   b. Meals must meet the following requirements to be considered non-taxable:

      (1) Provided to an employee, or employee’s spouse or tax dependent;

      (2) Provided by or on behalf of the employer;

      (3) Provided on the business premises of the employer; and
(4) Provided for the convenience of the employer.

6. The University may consider certain uniform expenses and allowances as working-condition fringe benefits. The acquisition and maintenance of employee uniforms are tax-deductible or tax-exempt as ordinary and necessary business expenses if the uniforms are: (1) specifically required as a condition of employment and (2) of a distinctive nature and not of a type that is adaptable to general or continued usage as ordinary clothing. Both parts of the definition are necessary for the exemption.

Non-taxable clothing also includes protective clothing. Protective clothing should follow the U.S. Office of Safety and Health Administration (OSHA) Code of Federal Regulations (CFR) (29 CFR 1910.132.d) with the employer assessing the hazards of the workplace. In such an instance where the University purchases protective clothing, the supervisor shall identify and justify the specific items of clothing that are required for the safety of the employee in performing the job. The clothing must serve as a matter of employee protection and safety under OSHA rules to qualify as exempt from taxation.

Departments often purchase low-cost clothing items for employees running summer camps or for orientation type events. The University will consider clothing purchases costing $100 or less per employee, per calendar year as a de minimis fringe benefit and will thus be non-taxable to the employee.

Apparel allowances, or the value of merchandise credit provided to certain employees that allows them to acquire apparel and goods directly from an outside vendor, is a taxable fringe benefit.

If any questions arise regarding the exclusion (or inclusion) of clothing in an employee’s taxable wages, please contact the Tax Compliance Office in Business and Finance for a final determination.

7. Educational tuition assistance (both undergraduate and graduate level) provided to employees is often nontaxable, subject to certain parameters. If a department provides an employee with assistance exceeding $5,250.00, the University must include the value of these benefits as wages, unless the benefits are working condition benefits. The University may exclude this working condition benefit from wages. IRC 117(d); IRC 127; IRC 132(d)

8. Reimbursement to an employee for meals and entertainment generally will not be included in an employee’s income provided there is a business purpose for such expenses. The employee is required to timely substantiate the reimbursed expenses and return within a reasonable period of time any amounts reimbursed which exceed the amount of substantiated expenses. Expenses must be ordinary and
necessary and incurred in the regular course of business, and the activities should relate to, or be in association with, the active course of business.

9. Travel advances paid to employees must be accounted for within 180 days after the trip ends, or the advance is considered taxable income to the employee. Accounting for the advance includes completing a Claim for Travel Expenses form with an itemization of travel expenses, providing required receipts and supporting documentation for travel expenses, and returning any portion of the advance that is greater than the allowable out-of-pocket travel expenses.

10. The University treats cell phone allowances as non-taxable compensation and processes them through payroll. The IRS does not deem reasonable allowances as taxable compensation. Employees who receive a cell phone allowance must subscribe directly with cellular service providers and pay the providers directly. The cellular phone allowance is for professionals who are on-call or frequently work outside of normal office locations, and who need cellular access to fulfill their job duties. The stipend is also for critical decision-makers who must perform their duties during crises. The stipend is not for convenience or casual use. The cell phone allowance should cover the cost of an individual's basic phone and data plan for business needs. Refer to MTSU Policy 667 Wireless Telephone and Data Service.

11. Employer reimbursements to employees for the cost of their professional licenses/certificates and professional organization dues may be excludable if they are directly related to the employee's job. Once an employee has completed the education or experience required for a professional license, the IRS deems the expenses needed to maintain a license or status as ordinary and necessary business expenses and therefore are not taxable to the employee, when paid directly or reimbursed by the University subject to substantiation requirements (i.e., receipts). When the University directly pays or an employee receives a reimbursement, the fees are a working condition fringe benefit. The expense, however, cannot qualify the employee for a new trade or business or assist them in meeting the minimum qualifications for their current job.

For example, the University pays the annual CPA license fee for the facilities director each year. The facility director does not use his CPA expertise on the job for the University. Because the facility director does not use his CPA expertise in his capacity, it is not a working condition fringe benefit and is subject to Federal income, social security and Medicare taxes. Furthermore, if the CPA license is a minimum requirement for the position, the payment for review courses or other expenses associated with obtaining this license would also be considered taxable.

12. Any payments made by the University for professional dues, publications used by employees in their work activities, or attendance at professional/training meetings are excludable to the employee as working condition fringe benefits. This exclusion
is due to the fact that if the employee had paid for such items on his/her own, they would be deductible to the employee under IRC §162.

B. Taxable Fringe Benefits

1. Cash fringe benefits, such as gift cards and gift certificates, are generally always taxable.

2. Apparel allowance. Per IRS code regulations, the value of employer-provided apparel (including items donated by outside parties, such as vendors or other donors) is taxable to an employee unless both of the following two (2) conditions are met:
   a. The employee must wear the clothing as a condition of employment; and,
   b. The clothing is not suitable for everyday wear.

   The IRS deems all clothing as a taxable fringe benefit to an employee unless it meets the above two conditions. The value of a merchandise credit provided to certain employees that allows them to acquire apparel and goods directly from an outside vendor is taxable.

3. The value of an employee’s personal use of an automobile provided by the University must be included in the employee’s income. A University-provided automobile is one which is owned or leased by the University, or owned or leased by a third party and made available for an employee’s use, or owned or leased by the employee and for which the University is responsible for payments to purchase or lease the automobile.

   Each employee who receives a vehicle must document all business and total miles driven. The documentation must include the date and business mileage of each business trip. All business mileage must be supported by written records (e.g., logs, calendars, or other means) reflecting the date, place, and nature of business. The employee is responsible for retaining copies of all written records and must present the documents upon demand in the event of internal or external audits. The institution must maintain the documents for five (5) years from the year in which it reports the personal mileage on the employee’s W-2.

   The annual lease valuation rule values the personal use based on the cost of the vehicle or its fair market value (Blue Book or equivalent) on the first day it is available for personal use. The University should revalue the fair market value of the vehicle as of January 1 after each full four (4)-year period. The University should derive the annual lease value for the vehicle by comparing the vehicle’s fair market value to an IRS table. The lease value from the IRS table is multiplied by the total
personal use percentage (total personal miles divided by total miles driven) to determine the taxable vehicle income.

4. The value of University-paid club memberships and related expenditures are taxable to the extent such activities do not serve a bona-fide University business purpose. The University should divide club memberships into those for business, pleasure, recreation, or other social purpose. IRC § 1.274-2 defines those for business, pleasure, recreation or other social purpose as including country clubs, golf and athletic clubs, airline clubs, hotel clubs, and clubs operated to provide meals under circumstances generally considered to be conducive to business discussion.

Those clubs not included in this definition are business leagues, trade associations, chambers of commerce, boards of trade, real estate boards, professional organizations, and civic or public service organizations, unless a principal purpose of the organization is to conduct entertainment activities for members or guests or to provide members or guests with access to entertainment facilities. IRC § 274(a) prohibits employers from deducting payments for the business, pleasure, recreation or other social purpose club memberships, but such payments made for business or trade purposes are still excludable from the employee’s gross income as a working condition fringe benefit, as the employee is not prohibited from deducting such expenses him/herself under IRC §162.

To be deductible under § 162, the employee should substantiate the percentage of club dues used for a valid business purpose with the time and place of the use, the amount of the dues, the business purpose of the use, and the name and business relationship of the person who was met or entertained. Any personal use by the employee of the club membership will be included in the employee's gross income.

The following example is provided in IRC § 1.132-5(s)(3) for illustration: Ex 1. Assume that Company X provides Employee B with a country club membership for which it paid $20,000. B substantiates that the club was used 40 percent for business purposes. The business use of the club (40 percent) may be considered a working condition fringe benefit, notwithstanding that the employer’s deduction for the dues allocable to the business use is disallowed by § 274(a)(3), if X does not treat the club membership as compensation under § 274(e)(2). Thus, B may exclude from gross income $8,000 (40 percent of the club dues, which reflects B’s business use). X must report $12,000 as wages subject to withholding and payment of employment taxes (60 percent of the value of the club dues, which reflects B's personal use). B must include $12,000 in gross income. X may deduct as compensation the amount it paid for the club dues which reflects B's personal use provided the amount satisfies the other requirements for a salary or compensation deduction under § 162.

5. The market value of lodging provided by the University that does not meet the tests for exclusion as identified above.
6. The value of tickets/passes to events for which there is no bona-fide business purpose or the no-additional cost service exclusion does not apply.

7. The value of University-paid travel and meals for the spouse of a University employee when the spouse's attendance serves no documented official University business purpose (if spouse’s attendance is primarily social in nature, this does not qualify as a bona-fide business purpose). However, when the aircraft is a University-provided plane (University owned or chartered), and 50% or more of the regular passenger seating capacity of the plane is filled with employees flying for substantiated business reasons, the value of the flight will not be included in the income of those employees who are flying for personal reasons. This also applies to spouses and dependent children, surviving spouses, and retired employees. IRC § 1.61-21(g)(12)

8. The University provides certain MTSU employees with a monthly non-accountable expense allowance. Per IRS Code, amounts treated as paid under a non-accountable plan are included in the employee's gross income, reported as wages or other compensation on the employee’s Form W-2, and are subject to withholding and payment of employment taxes. IRC § 1.62-2(c)(3)

9. In some cases, the University permits certain employees to use facilities at a cost that is less than the fair market value (FMV) rental cost of the facility to the public. Per the earlier discussion on qualified discounts, the term “qualified property or services” means any property (other than real property and other than personal property of a kind held for investment) or services which are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services. IRC § 132(c) Employee discounts on rental of real property does not qualify as a fringe benefit exclusion. When an employee rents a facility at less than FMV, the difference between the cost the employee pays and the FMV rental price of the facility should be included in taxable income and reported on the Form W-2.

10. The value of University-paid tuition credits taken by an employee enrolled in a graduate degree program, where the total tuition benefit exceeds $5,250.00 in a calendar year and does not qualify as job-related education. Exception: Graduate education benefit provided to graduate students who are performing research or teaching for the University is not subject to tax. If the University requires courses to maintain or improve skills for a current job or requires the education to keep a present salary, status, or job, the graduate tuition waiver would not be taxable. To document this, the employee is required to complete the Employee Fee Waiver Form.
11. Generally, if a third party pays or provides a fringe benefit to a University employee in connection with the employee’s performance of services for the University, the payment is considered taxable income to the employee. University imposed withholding and reporting requirement occurs when the benefit is part of the employee’s employment contract, contemplated during the employment process, or provided by a third party via agreement with the University. Where a third party provides a benefit to a University employee on its own and without University approval, the taxable value of this fringe benefit is not considered taxable wages reportable by the University on the employee’s W-2. The employee should be aware that there still may be income tax consequences from such an arrangement; however, in this case, the University has no withholding or reporting obligations with regard to the benefit.

IV. Processing

Due to the many types and methods of providing fringe benefits, an important aspect of tax compliance is the tracking of fringe benefits as they occur. When arranging to provide a taxable benefit to an employee, a department should complete the Taxable Fringe Reporting Form and submit the information to the Tax Compliance Office in the Office of Business and Finance. To complete the form, departments must provide the employee’s M#, name, and a description of the fringe benefit.

Example: A department will be providing temporary housing for a new employee. When arranging for the employee housing, whether it is a hotel, apartment, or on-campus housing, the department must complete the Taxable Fringe Reporting Form and submit to the Tax Compliance Office. The department should include as much information as it has, even if it has to estimate when the temporary housing will end.

Example: A department purchases departmental shirts to distribute to personnel to represent the University at University events. Although required to wear the clothing while representing the department, it is suitable for general or personal wear and the cost to purchase the clothing does not constitute a deductible business expense. The department must complete the Taxable Fringe Reporting Form listing the employee’s M#, name, and the description and value of the clothing. Upon completion, the department must submit the form to the Tax Compliance Office and include a copy of the form as an attachment when submitting its payment-initiating documentation.

Forms: none.

Revisions: none

References: IRC § 117; 127; 132; 162; 274; IRC § 1.61-21(g)(12); § 1.62-2(c)(3); § 1.132-5(s)(3); §1.274-2; OSHA Code of Federal Regulations (CFR) (29 CFR 1910.132.d); IRC § 1.61-1.62.