

Providing Certain Fringe Benefits Now Results in UBIT for Tax-Exempt Organizations

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FEBRUARY, 2018



The Tax Cuts and Jobs Act (the “Act”) contains a provision that requires tax-exempt organizations to recognize unrelated business income tax (UBIT) on certain fringe benefits offered to their employees. This change became effective January 1, 2018. It is important for tax-exempt organizations to understand how and why these fringe benefits will now result in UBIT.

UBIT is an income tax that must be paid by tax-exempt organizations on income from an ongoing trade or business that is not substantially related to the charitable, educational, or other purpose that is the basis of its tax-exempt status. UBIT is taxed at the then-current corporate rate on income taxes, which is currently a flat 21%. Section 13703 of the Act amended Section 512(a) of the Internal Revenue Code (the “Code”) to add a new paragraph (7), which provides that nonprofits must recognize UBIT on the value of the following fringe benefits:

- Qualified transportation fringe benefits (e.g., transit passes and transportation in a commuter highway vehicle),
- Parking facilities used in connection with qualified parking, or
- On-premises athletic facilities.

Prior to the Act, both nonprofit and for-profit employers could provide these fringe benefits without recognizing the amounts as income, and employees receiving these benefits would also not be subject to taxation. (For a discussion of tax reform changes affecting employees’ taxation, see our [article](#) dated December 27, 2017). The Act eliminated the ability of for-profit employers to deduct these amounts and, apparently to create parity between nonprofit and for-profit employers, required nonprofits that provide these fringe benefits to be taxed on the amounts as UBIT.

As an example, take a university which provides its 1000 employees free access to the university’s athletic center, which normally charges a membership fee of \$1,200/year. Under the Act, the university will now be taxed on these fringe benefits at a 21% rate, for a total tax bill of \$252,000.

In light of this change, employers will need to determine the increased cost of the fringe benefits created by the UBIT treatment and evaluate whether these benefits can be restructured with a

more favorable design. For example, with respect to qualified transportation benefits, employees can have the amount necessary to pay for these benefits deducted from their pay on a pre-tax basis. If an employer increased employee compensation in the amount of the fringe benefit, employees could still receive the same benefit and the same cost through payroll deduction. That revised benefit structure would avoid UBIT treatment for qualified transportation benefits.

Please contact us if you have any questions about the tax treatment of fringe benefits for your tax-exempt organization.

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