In the vault with KPMG

Speaker 1:

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Elizabeth L'Hommedieu:

Hi, everyone, welcome to today's podcast. I'm Liz L'Hommedieu, a principal in KPMG's Banking and Capital Markets tax practice. And joining me today are two colleagues, John Tomaszewski and John Montgomery; they're both from KPMG's Compensation and Benefits tax practice.

So, John Tomaszewski is a managing director who focuses on the taxation of benefit plans, and John Montgomery is a partner focusing on employment taxes. John Montgomery, I'm going to call you Monty for ease of today's discussion, so welcome everyone.

Today we want to talk about fringe benefits. So we're going to talk about what they are, how we commonly see them in a banking organization, including some tax planning opportunities and pitfalls to be aware of. John, let me start with you, and why don't we just start at basics. What's a fringe benefit and what are the tax consequences of fringe benefits?

John Tomaszewski:

Thanks, Liz, happy to be here. A fringe benefit is basically any form of compensation other than salary and bonus. So, some common examples include healthcare coverage, personal use of an employer-provided airplane, gift cards, meals, employer-provided vehicles, things of that nature that are other than salary and bonus. Under the Internal Revenue Code, the general rule is that any fringe benefits are going to be taxable unless the Internal Revenue Code excludes it.

So for employees what this means is that that income constitutes wages, subject to applicable income and tax withholdings, reporting on a W-2. And then the last thing, just to be mindful of, is that even if the fringe benefit is then provided to the employee, so for example if it's provided to the employee's spouse or a child, that would still be taxable to the employee.

Elizabeth L'Hommedieu:

Got it. And I think now you say that, certainly we've all received some sort of fringe benefits. What is usually the driving force for employers to provide the benefits? Monty, can you take us through that?

John E Montgomery:

I think there are several driving forces, some that have been historical and some that are new, post-pandemic. One of the driving forces of fringe benefits has always been to provide benefits to employees, to differentiate themselves from competition. Fringe benefits help differentiate an employer to attract new talent and retain existing talent. Certainly, in the current labor market there's been a high focus on trying to retain employees as well as attain new ones.

The second is in the post-pandemic world, we're seeing certain fringe benefits as incentives for employees to come into the office as we're in this return to in-office model. Whether that's five days a week, or some type of hybrid model, trying to get employees to come in through these fringe benefits such as meals, reimbursement of transportation costs, parties, is one of the biggest drivers.

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Elizabeth L'Hommedieu:

That makes sense. And I think we're all seeing a lot of that, right? There are definitely lots of meals being offered at the office as an incentive to be there.

I also think that in this employment market, I've seen banks take a hard look at how their employees might value different fringe benefits and trying to determine what they actually place the value on, and reshape what the banks are offering.

John, can you help us understand how employers value the fringe benefits on their side?

John Tomaszewski:

You know, as you brought up, it's not going to be valued on the employee's subjective evaluation of what the fringe benefit is worth. For these purposes, the fringe benefits are valued at fair market value. And what fair market value means is, what would that price be, or what is that value in an arm's-length transaction? So, any type of subjective perception, or even what the employer's cost is not what the value is. The value is what would be the value in an arm's length transaction.

That said, there are special valuation rules for certain fringe benefits, for example, employer-provided vehicles, employer-provided aircraft. The IRS regulations provide for special evaluations, which generally are more favorable to employees, and it's not necessarily what the fair market value is.

And lastly just to keep in mind is, valuation is what's going to flow into the income to the employee, but then you're able to back out from that income recognition, any amounts that the employee pays for the fringe benefit. So, if there's a reimbursement or any other type of payment by the employee, that would reduce the ultimate taxable income to the employee.

Elizabeth L'Hommedieu:

So, what I'm hearing is, fringe benefits are taxable unless the law provides otherwise, and it's important that it gives a fair market value to what that fringe benefit is for purposes of taxation. But what are some of the typical exclusions from taxable income?

John E Montgomery:

Sure, the Internal Revenue Code has no risk provisions that provide that certain fringe benefits can be nontaxable, taxable only up to a certain point, or even taxable only after a certain point. So, when we think about the various buckets, these are the things that people probably run into every day at their own employer. One great example is the benefits that are provided through an employer health and welfare plan: think about healthcare, dental, vision. There are other buckets around qualified employee discounts, and working condition fringe benefits. There's deminis fringe benefits, which are basically benefits that are provided, that are so infrequent, and such a low dollar value, that it would be extremely difficult for any employer to track and include as income. So the IRS does give us a de minimis fringe benefit amount.

Some other examples are education assistance programs where you can have an exception up to a certain dollar threshold for qualified educational systems. We sometimes will see that where the employers will provide employees or reimbursements to get an additional degree.

Lastly, and one that's very pertinent in our new return to office world, is when employers provide onsite meals. There is an exception if the employer providing onsite meals are for the employer's convenience but not for the employee's convenience. That can be a very difficult distinction, but a very important one as to whether it's going to be taxable or not. I think because we're seeing fringe benefits being used as a push to get people to come into the office, we're seeing the meals quite a bit and that's one to certainly focus on.

Elizabeth L'Hommedieu:

Agree, we're definitely seeing that more.

Elizabeth L'Hommedieu:

If you guys don't mind, I'd love to talk to drill down on a couple specific fringe benefits.

Elizabeth L'Hommedieu:

Let us take meals. What are the tax issues we should be thinking about for this as a fringe benefit, if the employer's providing meals to the employees and what are you seeing around this Monty?

John E Montgomery:

You know, certain type of meals might fall under a taxable exclusion and others might not, and I think there's even been a change on this really since 2020 as to whether a meal should be considered compensation.

One exclusion for meals is, if it's provided at the convenience of the employer, which means that it is really for the employer's need provided on the premises and it's really because the employee has to be onsite to do their job, we do this sometimes with hospital employee. Certainly, industry to industry and even company to company, that definition could be different depending on what your employees are doing and really defining what is a true need to be onsite.

There was a period of time during 2020 and 2021 where meals were being provided because people had to be onsite and nothing was open, because we were all in a lockdown state, and so you didn't really have the ability to get food even if you wanted to. But now, meals are still being provided onsite, and really we've got to hone in on whether or not that's for the employer's convenience or not.

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You can also see examples for meals provided to employees whose break time, or ability to get food, is so short that they really don't have the time to be able to go offsite and get something.

The other large item we look at is the meal could be excludable from an employee's income if it's considered a de minimis fringe benefit which as I stated earlier is that it's such a small value, and so infrequent, that the accounting for it would be unreasonable. Even the IRS agrees, it would be unreasonable and, thus, we're going to let it go.

So, when I think of that and under the umbrella of meals, we think of the snack room. If you want to go and grab a bag of chips, or a protein bar, a bag of candy, whatever it may be, and then it's very de minimis and there's no way we're going to be able to track who took what snack. As opposed to a full meal, if I'm bringing in lunch, and I'm bringing it in every day, so that we're doing it on a regular basis it's no longer really de minimis because there's an actual larger value there and it's no longer infrequent. That's something we're seeing quite often, where the meals are being provided quite regularly, sometimes every day, where you would elude this exception on our de minimis fringe benefit.

We've historically seen a lot of IRS audit activity, when they are auditing an employer, whether it be for corporate tax or employment taxes. One of the buckets they do hone in on are fringe benefits that are provided to an employee. And meals have been a big one for several years, and there's been news activity on it, there's been IRS reviews. Some larger companies that provide three meals a day, and 24-hour food, and whether or not that really becomes a taxable event.

So, the audit activity around meals is only going to continue to go on for the next few years and I think we'll start to see more honed focus on it, as it relates to meals provided both during pandemic and post-pandemic.

Elizabeth L'Hommedieu:

That makes sense. And as usual, you have enlightened me because what I thought might be simple was actually quite nuanced.

So let's cover one more fringe benefit. How about commuting cost. I have heard some new information about this in the last couple years. So, John, can you take us through the tax issues to think about for commuting cost?

John Tomaszewski:

With respect to commuting costs, similar to the other fringe benefits, there's a couple of nuances that we need to be mindful of. Commuting costs really fall into two buckets. You have what's called qualified transportation fringe benefits, for example, you buy your train pass, or you park at the train station, you buy a bus pass, things of that nature. A lot of employers have qualified transportation fringe benefit programs, where you're allowed to defer some of your salary into your commuter plan and then that pretax money is used to buy your bus pass, train ticket, things like that, so that's one of aspect of this.

But then as Monty mentioned earlier, you're having employers also, as an incentive to get employees back into the office, providing additional commuting benefits outside of the qualified fringe benefit program. For example, "Hey, now, I'll give you $100 a month to buy your train ticket, or you could pay for your employee's gas in their car if you're driving to the office," things like that. Anything that's going to be outside of the qualified fringe benefit programs is going to be taxable, and also, we have to be mindful of the rules, with respect to deduction, disallowance, as well with commuting expenses.

Again, a lot of nuances here, a lot of different issues, just have to be very mindful of the qualified fringe benefit program rules and then other personal commuting expenses, which are going to be taxable income to the employee.

Elizabeth L'Hommedieu:

Thanks John. Given all these nuances, let's talk briefly about potential consequences for not properly applying the rules for fringe benefits. Monty, what happens if an employer isn't doing this right?

John E Montgomery:

Like any wage inclusion item, failure to properly report taxable fringe benefits as wages leads to an underreporting of wages, but it also means that we've not properly subjected all taxable wages to income, federal, and state and local income tax withholding, as well as Social Security and Medicare taxes.

Anytime an employer underreports wages and, thus, has an underwithholding on payroll taxes, under IRS regulation and state regulations, when an employer fails to report or withhold on the amount that should have been treated as compensation, the IRS and even the states can collect the underwithholding from the employer rather than the employee since it was the employer's obligation to properly treat and withhold the amounts up-front.

In addition to the tax principle, you can also face a penalty and interest from the failure to properly withhold and deposit employment taxes. The principal amount, as well as the interest, can lead to a larger exposure for employers.

In addition, as John mentioned, certain expenses of just commuting expenses are not deductible. So reimbursing an employee for commuting expenses results in income to the employee and no deduction to the employer. We see that also around entertainment expenses, where the deduction can be limited. So, some fringe benefits, including the entertainment expenses or an employer-provided aircraft, could be special valuations for the income exclusion, as well as limited deductions.

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Elizabeth L'Hommedieu:

It seems like if the employee is going to be taxed on it, you'd like to see the employer get the deduction for it. So being taxed and not getting a deduction is, like, a double whammy.

John E Montgomery:

Yeah, absolutely, I would agree.

Elizabeth L'Hommedieu:

If I boil this down to a couple of key takeaways: We think it's important that banks periodically review the fringe benefits that they're offering to their employees to determine whether those are being properly taxed to the employee and properly deducted by the corporation. And I think this could come into play both to the extent that there are benefits being offered to the employee that are not being included in income, which can lead to issues for both the employee and the employer.

But I presume that could also go the other way and maybe there are things being taxed to the employee that actually could qualify for an exception and are not subject to being treated as wages, is that right John?

John Tomaszewski:

Yes, that's right.

Elizabeth L'Hommedieu:

It's important to get it right for the taxability on the employee's side, but then also equally as nuanced, is whether or not those costs at the corporation level are deductible for the bank, and certainly we want to make sure we're not in a situation where something is taxable on one end and not deductible on the other.

Thank you John and Monty, this was a great discussion and I certainly learned a lot of complexities on this issue. I appreciate you guys taking us through this. Definitely some interesting things to think about, and I look forward to having you guys back so we can talk about a couple of more fringe benefits.

For our audience, I'd like to thank you for joining us today. This is Liz L'Hommedieu on behalf of KPMG's Banking and Capital Markets Tax practice. I look forward to talking again soon.

Speaker 1:

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