

## **Taxable Fringe Benefits**

*Policy/Regulation 5.920*

### **Overview**

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Fringe benefits include any compensation other than stated wages.

- A fringe benefit includes property, services, cash or cash equivalent given for the performance of services.
- According to Internal Revenue Code (IRC) section 61, all income is taxable unless an exclusion applies. **Fringe benefits for employees are taxable wages** unless specifically excluded in the code. Fringe benefits are subject to Federal and State tax withholding as well as Social Security and Medicare taxes and must be included on the employees' W-2.
- Fringe benefit exclusions must be properly substantiated. If timely documentation is not supplied, the benefit will be considered taxable. The School Board will use the Accountable Plan rule to determine fringe benefit tax status.

### **Definitions**

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**Accountable Plan** - An allowance or reimbursement policy under which amounts are nontaxable to the recipient if the following conditions are met:

- The expense must be a deductible **business expense** incurred in connection with services performed as an employee and could be deducted by the employee on the employee's 1040 income tax return as a business expense if not reimbursed by the employer.
- There must be **adequate accounting** by the recipient within a reasonable period of time to include substantiation of amount (bills, receipts, canceled checks, etc.), date and time, place, and business purpose.
- Excess reimbursements must be returned within a reasonable time period.

**Taxable** – Includible in gross income, not excluded under any IRC section. Amount is includible in wages and reported on form W-2, Wage and Tax Statement, and generally is subject to Federal and State income tax withholding, Social Security and Medicare.

**Non-Taxable** – Excluded from wages by a specific IRC section; for example, qualified health plan benefits (premiums paid by the employer) under section 105.

**Partially Taxable** – Part is excluded by IRC section and part is taxable. Benefits may be excluded up to a dollar limit, such as a qualified transportation benefit.

**Tax-Deferred** – Benefit is not taxed when received, but is subject to tax later. For example, employer contribution to a pension plan is not taxable when made, but may be taxable when distributions are made to the employee.

### **Fringe Benefits**

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- A. **De Minimis Fringe Benefits** – Property or services provided by an employer for an employee with a value so small that accounting for it is unreasonable or impractical are considered de minimis. Rules for de minimis benefits include:
1. A de minimis benefit is occasional and unusual in frequency.
  2. The value of a de minimis benefit is small. The IRC does not specify a dollar limit. Whether an item or service is de minimis will depend on all of the facts and circumstances.
  3. The benefit must not be a form of disguised compensation.
  4. For example, a holiday lunch that is provided once a year would not be taxable because it is infrequent. A snack valued at \$1 each and provided daily would be taxable.
- B. **Cash Benefits** – Cash is generally intended as a wage and usually provides no administrative burden to account for. Cash is never a de minimis fringe benefit.

- C. **Gift Certificates/Cards** – Cash equivalent items provided by the employer are never excludable from income. Gift certificates redeemable for general merchandise or have a cash equivalent value are not de minimis benefits and are taxable.
- D. **Awards and Prizes** – Except for certain situations, prizes and awards given to employees are taxable. The following awards are always taxable as wages to an employee:
1. Cash or cash equivalent awards, such as savings bonds or gift certificates
  2. Recognition awards, cash or non-cash, for job performance, unless they qualify as de minimis fringe benefits
  3. Non-cash prizes (unless de minimis) won by an employees from random drawings at employer sponsored events
  4. Awards for performance, such as employee of the month or highest productivity
  5. Awards for length of service or safety achievement that do not meet specific requirements

If awards or funds for awards are provided by an outside party, the award is taxable in the same way as if it were provided by the School Board.

- E. **Travel Expenses** – Reimbursements received by an employee for temporary travel on business outside of the “tax home” area may be excludable from wages.
1. In order to be excludable, travel must be substantially longer than a day’s work, requiring an overnight stay or substantial sleep or rest.
  2. The travel must be away from the general area of the employee’s tax home. Tax home is defined as the metropolitan area where the main place of work is located. For our purposes, this area is defined as Augusta County, Highland County, Rockingham County, Albemarle County, Nelson County, Rockbridge County and all of the cities contained within.
  3. Expenses that qualify are costs to and from the business destination, transportation costs while at the business destination, and lodging, meals and incidental expenses. Expenses must be substantiated in order to be excludable.
  4. Payments made for overnight travel within the metropolitan area are taxable.
- F. **Meal Expenses** –
1. To be excludable from wages, meals must be on the employer’s business premises and be for the employer’s convenience. Meals are provided for the convenience of the employer if given for a substantial “non-compensatory” reason; that the intention is not to provide additional pay for the employee. Allowable situations include:
    - a. Worker needs to be on call for emergency during the lunch period (must have evidence that emergencies occur)
    - b. Eating facilities are not available in the area of work
    - c. Meals are furnished immediately after work hours because employee’s duties prevented him or her from obtaining a meal during work hours
  2. Meals provided while traveling on business overnight are excludable. Travel must be out of the tax home area as previously defined.
  3. Meals provided while attending trade or professional association meetings are excludable if the employee’s attendance is directly related to School Board business.
  4. Meals as Entertainment – Reimbursements provided for meals in the course of entertaining business associates may be excludable if the expenses are ordinary and necessary, and meet one of the following test:
    - a. Directly-Related Test – 1) main purpose of combined business and meal is the active conduct of business; 2) business is actually conducted during the meal period; and 3) there is a general expectation of deriving a specific business benefit at some future time.
    - b. Associated Entertainment Test – 1) associated with the active conduct of the employer’s business; and 2) directly before or after a substantial business discussion. These activities are not required to occur in a clear business setting.

5. Taxable meals include:
  - a. Meals provided to improve general morale or goodwill or to attract prospective employees.
  - b. Meals provided regularly before or after monthly group meetings.
  - c. Meals provided while traveling if the travel does not involve an overnight stay.
  - d. Any food provided on a regular basis.
- G. **Reimbursements for Use of Employee-Owned Vehicles** – Motor vehicle use rules are outlined in Administrative Policy 4.750. If applicable, the School Board will reimburse employees for use of their personal vehicle based on a standard mileage rate determined each fiscal year.
  1. Accountable plan rules must be followed and substantiation requirements met.
  2. Use of a Voyager Gas Card to purchase gas for an employee owned vehicle is prohibited and, if occurs, will be taxed regardless of whether it is substantiated.
  3. If employees decline mileage reimbursement, they may not claim the expenses on their personal income tax return.
- H. **Employer Provided Vehicles** – An employer provided vehicle is considered a working condition fringe benefit if used exclusively for business purposes and meets substantiation requirements. Daily commuting between home and work is considered personal use and is taxable. The School Board will use the Commuting Valuation Rule to calculate the taxable fringe.
- I. **Working Condition Fringe Benefits** – Includes property or services that, if the employee had paid for the property of service, the cost would have been deductible on the employee’s individual income tax return. To be excludable as a working condition fringe, the following must apply:
  1. The benefit must relate to employer’s business.
  2. The employee would have been entitled to an income tax deduction if expense had been paid personally.
  3. The business use must be substantiated.
  4. Examples include hard hats, safety glasses and physical examinations required by the employer.
- J. **Listed Property** – Employer provided equipment for use in performance of an employee’s job duties outside of the employer’s premises is considered listed property. Items include automobiles and any computer or peripheral equipment not used exclusively in the regular place of business. Following rules apply:
  1. Business use is excludable from the wages of employee as a working condition fringe benefit.
  2. Personal use is included in the wages of the employee.
  3. If substantiation requirements are not met, all use is included in the employee’s wages.
- K. **Professional Licenses and Dues** – Employer reimbursements to employees for the cost of their professional licenses and professional organization dues may be excludable if they are directly related to the employee’s job.
  1. If the expenses necessary to maintain a professional license or status are considered ordinary and necessary for business, then reimbursement of the associated renewal fee would be considered a working condition fringe benefit. If paid under an accountable plan, they are excludable from income.
  2. Reimbursement to employees or payments made on behalf of employees for cost of dues to clubs organized for business purposes only may be excludable if related to the School Board’s business and when the employee is performing duties related to the organization’s focus or mission.
- L. **Educational Reimbursements** – Educational expenses may be excludable as a working condition fringe benefit. The educational course must be job-related, and either maintain or improve job skills or be expressly required by the employer or by law. To be excludable, the education must not be needed to meet the minimal educational requirements of the current job or qualify the employee for a new trade or business.
- M. **Work Clothes and Uniforms** – Clothing or uniform allowances or reimbursements are excludable from wages of an employee if the clothing or uniforms are specifically required as a condition of employment and are not worn or adaptable to general usage as ordinary clothing.
  1. The accountable plan rules must be met for reimbursement or clothing allowances.
  2. Clothing items marked with the school board name/logo and the employee’s name may be taxable if the items can be worn as ordinary clothing.
  3. The following list are examples of taxable clothing items:

- a. Uniforms provided by rental company
  - b. Cleaning expense of uniform rentals
  - c. Polo shirts, t-shirts, sweatshirts, caps and jackets
  - d. Clothing allowances
4. The following list are examples of non-taxable clothing items:
- a. Safety shoes
  - b. Other safety equipment such as safety glasses or hard hats

Any clothing that is suitable for taking the place of regular clothing is to be included on the employee's W-2. It is not enough that the employee is prohibited by policy from wearing the clothing outside work. Polo shirts with County logos, scrubs, Carhart jackets, cargo pants, Dockers and blue jeans are considered to be suitable for everyday use and must be included on the W-2. For an example, Carhart outerwear worn by maintenance crews can be worn as street-wear, so it is not considered to be a UNIFORM. If a similar item of clothing can be purchased from a retail store like Wal-Mart, then the clothing is considered to be suitable for everyday use. THERE IS NO DE MINIMIS AMOUNT. Even if the clothing is required to be turned back in at the end of the employee's employment, it is still to be included on the W-2 as a benefit. Additionally, the next employee who wears the clothing also has it included on the W-2, but at the "fair market value" for that used article of clothing (similar to the price that would be charged at a thrift store).

- N. **Health and Medical Benefits** – Amounts received as reimbursements by employees under an accident or medical insurance plan (IRC section 105), and employer-provided health benefits, including reimbursements and insurance (IRC section 106), are generally excluded from the income of employees. This applies to any employer-paid system, whether the benefit is provided directly (i.e. self-insurance) to employees or through an insurance provider or a trust. Common forms of employer-provided health benefits include:
- 1. Direct reimbursement or payment – An employer may pay qualifying employee medical expenses, or reimburse those expenses, without the payment resulting in taxable income to the employee. These payments may be made with or without a written plan. This includes payments for specific illness or injuries, but not payments based on work missed (sick pay).
  - 2. Employer contributions to health plans – Contributions to the cost of accident or health insurance, including qualified long-term care insurance paid by the employer, are excludable from the income of employees. This includes employer contributions to an Archer Medical Savings Plan (MSA) account or to a health savings account (HSA).
  - 3. Flexible Spending Arrangement – Under a written employer plan, the employee may choose to reduce salary and contribute to an account for medical expenses on a pre-tax basis. Amounts in the account may be used to pay for qualifying medical expenses, generally only within that calendar year.
  - 4. Cafeteria Plan – A cafeteria plan, which may include a flexible spending arrangement, is a written benefit plan that meets the requirements of IRC section 125. Under section 125, employees can choose from among cash and any qualified benefits the plan offers, including accident and health benefits, group-term life insurance coverage, dependent care assistance, etc. Benefits provided under a cafeteria plan are subject to social security and Medicare taxes.
- O. **Group Term Life Insurance** – The imputed cost of group term life insurance in excess of \$50,000 in coverage is taxable to the employee. The amount of taxable wage is reported in on the W2 in box 12 with a code "C".

## **Substantiation and Documentation Requirements**

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### **A. De Minimis Fringe Benefits –**

1. Food or meals should be reported on the *Accounting for In-Town Meals* form. If the de minimis exclusion box is checked, AP will verify that the benefit has not been provided routinely or frequently by reviewing substantiation of business use documentation on the purchase requisition.
2. For other items purchased as a benefit to be given to employees, the purchase requisition should include a brief explanation of why the benefit is de minimis. Employee names are not required unless requested by AP.
3. Employees are not taxed if AP can verify that the de minimis rules have been met.

### **B. Accounting for awards and prizes**

1. Cash awards may be paid only through payroll.
2. Cash equivalent awards such as gift cards and gift certificates given to employees **are prohibited**.
3. For all other awards or prizes given to employees, written notification must be sent to payroll for determination of taxability. Notification should include employee name, SSN or employee number, address, award or prize description including item value.

### **C. Accounting for travel expenses –** Business travel expenses must be substantiated in order to be excludable from taxes.

1. A Travel Reimbursement Form documenting total costs, the destination, and the reason for the travel must be completed and submitted to AP.
2. Every reimbursement request submitted for travel expenses must include backup documentation such as a class or conference schedule, registration form, meeting notice or copy of the approved training application.
3. Request for reimbursements are due to the appropriate office within ten (10) days after returning from travel.
4. Please refer to Policy/Regulation 4.750 of the *Administrative Manual* for the School Board's travel policy.

### **D. Accounting for meals –**

1. Meals purchased when not on an overnight travel outside of the tax home area will be taxable to the employee(s) who consumed the meal unless an appropriate exclusion is substantiated.
2. An *Accounting for In-Town Meals* form must be completed regardless of how the meal was purchased.
  - a. The form documents the reason for the purchase in order to determine if exclusion exists and, if not, to ensure that the right employee is taxed.
  - b. Forms are due to Accounts Payable (AP) within ten days of purchase.
  - c. A copy of the itemized receipt must be attached to the form.
  - d. Meals purchased for another employee or group of employees must be documented on the form, including a list of the employees receiving the meal and the amount to be taxed.
    - 1) If the per person amount is not documented, then the taxable amount will be the total receipt amount divided by the number of people listed on the form.
    - 2) If a form is not completed, AP will assume that the purchaser consumed the meal and no exclusion is claimed. The purchaser will be taxed on the entire amount.
3. Refer to Section C for documentation requirements while on overnight travel.

### **E. Accounting for Use of Employee-Owned Vehicles**

1. Mileage reimbursements for use of a personal vehicle may be requested on a *Travel Reimbursement Form*.
2. The justification for the business use must be clearly defined before reimbursement will be made. The reason for travel must be included as well as the destination.

### **F. Accounting for Employer Provided Vehicles**

1. Per administrative manual Policy 4.750, employees who are authorized to take school board vehicles home are prohibited from personal use of the vehicle except for commuting.

2. Employees will complete the *Employee Use of Company Vehicle* form to document the commuting days in the previous month. Forms are due to payroll no later than the 10<sup>th</sup> working day of the month.

#### **G. Accounting for Working Condition Fringe Benefits**

1. Departments must substantiate the business use of working condition fringe benefits entering supporting information on the requisition.
2. Information should include the name of the employee receiving the benefit, if available.
3. Substantiated amounts are not taxable to the employee.
4. Examples include cell phones and tablet devices.

#### **H. Accounting for Listed Property**

1. Departments that provide property for employee use at home:
  - a. Must maintain a spreadsheet documenting the employee's name, SSN or employee number, item description, fair market value (FMV) at the date provided and the useful life. A copy of the spreadsheet
  - b. Employee must track the business and personal use of the property by keeping a usage log. The log should be completed from December 1 through November 30 for as long as the property is held. The log is due to the Finance Department no later than December 5<sup>th</sup> for calculation of percentage of personal use. The employee will be taxed on that percentage multiplied times the FMV as of the date of issuance divided by the years of useful life.
  - c. If no personal use occurred, the employee should provide a written statement as such to the Finance Department no later than December 5<sup>th</sup>.
2. Absent the usage log, the employee will be taxed on 100% of the equipment value.
3. The department must notify the Finance Department when the property is returned.
4. This accounting requirement does not apply to property used infrequently or for a short-term duration (week or less).

#### **I. Accounting for Professional Licenses and Dues**

1. Department heads are responsible for verifying that professional licenses and dues paid for their staff members are directly related to the employee's job.
2. Payments not directly related should be reported to payroll.

#### **J. Accounting for Educational Reimbursements**

1. *Request for Reimbursement for Continuing Education Courses* form is to be submitted with all supporting documentation no later than 30 days following the posting of grades by the institution offering the course.
2. Personnel is responsible for approving and tracking tuition reimbursements for job related courses.
3. Refer to Administrative Policy 5.530 for tuition reimbursement information.

#### **K. Accounting for Work Clothes and Uniforms**

1. Uniforms provided through a rental company:
  - a. Completion of a *Uniform Rental Service* form is required by the employee prior to receiving uniforms through a rental company.
    - 1) The clothing description and quantity provided will be completed by the appropriate department personnel.
    - 2) The employee's signature on the form acknowledges that the value of the provided uniforms will be taxed and that the cost of any uniforms not turned in at termination of employment may be deducted from the employee's final paycheck
    - 3) Completed forms will be forwarded to payroll before service is established
  - b. The employee will be taxed on the amount paid to the rental company on the employee's behalf.
    - 1) Dollar amounts charged on the rental company uniform statements will be entered into a spreadsheet by the receiving department for each calendar month.
    - 2) The amounts will be taxed in the month following payment to the rental company. If the employee terminates, payroll must be notified immediately so the employee can be taxed at the time of final payment.
    - 3) Departments must ensure that the amounts paid to the rental company are accurate to avoid over or under taxing employees.

- 4) Departments must promptly remove terminated employees from the rental company bill.
2. Clothing Allowance:
  - a. For cash clothing allowances or stipends, a signed and dated document (spreadsheet or memo) authorizing payment is required. The document must contain the employee's name, employee number and the allowance amount and is due to payroll prior to processing the employee's next paycheck.
  - b. Safety shoes are not taxable to employees.
3. Purchase of clothing items for distribution
  - a. Polo shirts, sweatshirts, jackets and other miscellaneous clothing items purchased for distribution as uniforms are taxable.
  - b. The purchase requisition must include items being purchased, name and employee number of employees receiving the items and the dollar amount assigned to each person.
  - c. Employees will be taxed the month after payment is made to the vendor.
4. Clothing issued from inventory
  - a. Clothing purchases not immediately distributed to employees must be inventoried.
  - b. Inventory control sheets for each item should include:
    - 1) The date item is purchased, PO number, item type, description, item quantity, and total cost of purchase. An average price per item can be calculated using the total cost and quantity information.
    - 2) Distribution sheets including date, employee number and name, quantity received and cost per item should be sent to payroll by the 10<sup>th</sup> day of each month. Employee must sign the sheet at the time items are received.
  - c. Clothing inventories are subject to audit at any time and will, at a minimum, be counted at fiscal year end.

#### **L. Accounting for Group Term Life Insurance**

Employees are automatically taxed on the imputed cost of group life insurance in excess of \$50,000.