

Creative benefits offerings could cause tax headaches down the road

HR departments are more frequently offering expansive and creative new “lifestyle” benefits, which are being packaged along with health benefits during open enrollment and marketed to mostly work-from-home employees. While there’s nothing wrong with being creative with the benefits the company offers, most will be taxable, which, you would think wouldn’t endear employees to Payroll or HR.

It's important to get things right the first time — either appropriately withholding taxes, or adjusting benefits to make them tax-free. Otherwise, you may have to make some adjustments when tax season arrives, which seems unpleasant for everyone involved.

How to think about taxes when you think about benefits

Over the years we’ve developed shortcuts when we’re analyzing whether an item is taxable. Here are four rules that will come in handy today.

Rule #1: Tax deductions exist principally to enable business. You can, for example, deduct expenses in furtherance of your business, like expenses employees incur when taking a prospective client out to lunch.

Rule #2: But the opposite is also true — purely personal expenses aren’t deductible, so you can’t write off a restaurant meal with your spouse.

Rule #3: Heightened requirements apply if you’re going to pick up employees’ personal expenses. This is usually expressed as the convenience of the employer. So you can pay for employees’ in-office meals if the meals are provided for your convenience (see IRC § 119).

Rule #4: There is no tax symmetry at all between employees who work in the office and those who work from home.

Intention is key

So handing WFH employees a bunch of money and a list of items the company will pick up (e.g., ergonomic office furniture or stipends for some nebulous service or activity), and telling them to give Accounts Payable the receipt violates Rules 2 - 4. *Reason:* Simply asking employees to substantiate their expenses isn’t enough to convert a personal item into a tax-free business expense.



Buying an ergonomic chair for an employee who's working in the office is a deductible expense—or, perhaps, a depreciable expense—for the company and not taxable to the employee because everyone needs a desk and a chair. Buying an ergonomic chair for a WFH employee may warrant a tax-free reimbursement if the employee has a disability. Otherwise, probably not, because home furnishings are personal.

Providing free snacks to employees in the office kitchen is 50% deductible for the company and not taxable to employees. (Snacks fall under the *de minimis* fringe benefit rule—small, noncash items provided to employees infrequently that are hard to keep track of.) But allowing WFH employees to sign up for meal delivery services to approximate the office snack box is taxable because eating is, well, personal and delivery services aren't *de minimis* expenses—you know who got what, how much was spent, and when they got it.

If items are taxable and you don't want to withhold the taxes from employees' pay, you'll have to gross up. Grossing up means the employer pays employees' taxes; it can get very expensive, very quickly. To gross up, apply this formula:

Taxable item ÷ 0.7035 or 0.7655 (if the employee maxed out on Social Security taxes) or 0.7565 (if the employee is subject to the 0.9% additional Medicare tax)

The result of this division will be the grossed-up pay.

Health benefits are still tax-free

Health benefits are tax-free to employees. These expenses could be considered health benefits if your group health insurer chooses to offer them:

- Doulas.
- Apps allowing employees to schedule physical and mental health appointments.
- Assistance for new moms who are having difficulty breastfeeding.

The takeaway

Taxes are complicated, and we're not giving tax advice here, just pointing out potential pitfalls and concerns that should be considered. If you're considering benefits like these, we suggest you seek the advice of the company's tax pro if you're having doubts about the taxability of some of HR's open enrollment offerings. Each situation can vary in the details, so getting expert advice tailored to you is always the safest bet.