

The Ins & Outs of Fringe Benefits


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Table of Contents

01	Introduction	2
02	The Basics of Fringe Benefits	3
03	Justworks Can Help	15



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Click a section title to skip to it, and click the  icon in the header of any page to return to the Table of Contents.



INTRODUCTION

What Are Fringe Benefits?

As an employer, you've heard about benefits before. But what exactly are fringe benefits?

To understand fringe benefits, first it's important to understand how employees are paid. Employees are normally paid wages via direct deposit, written or printed checks, payroll cards, or sometimes cash. All wages paid to employees are taxable income, and subject to income tax withholding.

Employers are also required to provide certain benefits to their employees (i.e., [workers' compensation coverage](#), and contributions to state disability programs), and some employers want to offer other benefits as a way to reward, attract, or retain quality employees. This is where fringe benefits might come into play.

So back to the question, what are fringe benefits, and are they subject to income taxes as well?

This helpful guide will walk you through the basics of fringe benefits, best practices, and some common employee fringe benefits that can be excluded from income.



The Basics of Fringe Benefits

What Is A Fringe Benefit, Exactly?

[IRS Publication 15-B](#), Employer's Tax Guide to Fringe Benefits, defines a fringe benefit as “a form of pay for the performance of services.” The employer is the provider of the fringe benefit, even if a third party provides or manages the actual benefit. For example, an employee may receive legal services through an attorney that is paid by the employer, but the employer is still the provider of the fringe benefit. Or, an employer might pay for an employee to enroll in a



program at an educational institution, but the employer is the provider of the fringe benefit.

Similarly, the employee is considered the recipient of the fringe benefit in exchange for services, even if the fringe benefit is provided to someone who isn't that employee. For example, if an employee's family member benefits from a company-sponsored gym membership, the employee will still be considered the fringe benefit recipient.

Here are some other examples of fringe benefits:

- [Transportation benefits](#)
- Employee stock options
- [Health Savings Accounts](#)
- Meals
- Athletic facilities
- Tuition reduction
- Adoption assistance
- [Achievement awards](#)

Fringe Benefits are Taxable, But There Are Exceptions

So, as an employer, how do you know what counts as reportable fringe benefits? Nearly all fringe benefits are taxable. The value of a fringe benefit is subject to federal income tax, Social Security tax, Medicare tax, and FUTA, and the value must be included in Boxes 1, 3 and 5 of Form W-2, and on line 3 of Form 940. However, the taxable portion of a fringe benefit may be reduced by the following amounts:



- Any amount that the law excludes from compensation, such as low-cost holiday gifts or achievement awards; and
- Any amount that the recipient pays for the benefit.

It's a mistake to assume that a fringe benefit may not be taxable because it isn't specifically listed anywhere in the tax law or one of the IRS publications. In fact, the only fringe benefits that are listed in the tax laws are those that can be excluded from income, either in whole or in part. It's best practice and, in many cases, required by IRS guidelines to record fringe benefits as they are provided to employees throughout the year.

Additionally, any or all of a fringe benefit is not subject to income tax withholding if the recipient is not an employee. If the recipient of a fringe benefit is not an employee, then the benefit is not subject to any income tax withholding, but it may have to be reported as income elsewhere — such as on a Form 1099-NEC for independent contractors or a Schedule K-1 for partners.

Special Fringe Benefits rules for certain Employees

For certain fringe benefits, an individual who is normally treated as an employee, may be classified by definition as a non-employee and subject to special fringe benefit rules.

The following is a list of employees who may not be treated as employees for certain specific benefits:

- An employee who owns 2% or more of the stock in an S-Corporation [S2%].



- A highly compensated employee (HCE) who is either an officer, a shareholder who owns more than 5% of the voting power or value of all classes of the employer's stock, highly compensated based on the facts and circumstances, or a spouse or dependent of a person described above [HCE5%].
- An HCE who is either one of the five highest paid officers, owns more than 10% in value of the employer's stock, or is among the highest paid 25% of all employees. [HCE10%]
- An HCE who is either a 5% owner at any time during the year or the preceding year, or received more than \$135,000 in pay for the preceding year. [HCE\$135]
- A key employee who is either an officer having annual pay of more than \$215,000, or an employee who is either a 5% owner of the business or a 1% owner of the business whose annual pay is more than \$150,000. [Key]

Common Fringe Benefits That are Tax-Free

Some fringe benefits can be excluded from taxable income. Let's take a deeper dive into the most common fringe benefits that can be excluded from gross income in the overview below. For more information, please review [IRS Publication 15-B](#), Employer's Tax Guide to Fringe Benefits.

* **NOTE:** While the following information is current for 2023, the IRS makes changes annually. Check with a tax professional to be sure you're using the most up-to-date information, and to understand what needs to be reported.

Accident & Health Benefits (Fully Insured)

What it is:

Accident & health plans. Also applies to payments made to an employee under an accident plan.



Accident & Health Benefits (Fully Insured) Cont'd

Who's exempt from income tax withholding:

Most employees, with the exception of greater than 2% shareholders of an S-corporation.

Accident & Health Benefits (Self-Insured)

What it is:

Self-insured plans that do not favor highly compensated employees. Includes medical care reimbursement plans.

Who's exempt from income tax withholding:

Most employees, with the exception of greater than 2% shareholders of an S-corporation, provided that the benefit does not discriminate in favor of highly compensated employees.

Achievement Awards

What it is:

This is an award that is given to an employee for either length of service or a safety achievement. These awards cannot include cash or intangible property such as vacations, meals, lodging, tickets, stocks, or securities and are limited to a value of \$1,600 per year for qualified plan awards (\$400 for nonqualified awards). See chapter 2 of [IRS Publication 535](#), Business Expenses, for more details.

Who's exempt from income tax withholding:

Most employees, with the exception of greater than 2% shareholders of an S-corporation.



Adoption Assistance

What it is:

An employer may pay or reimburse adoption expenses an employee incurs. An employer shouldn't pay more than 5% of its qualifying adoption expense payments during the year for shareholders or owners (or their spouses or dependents) and the benefit should not favor highly compensated employees. All payments must be reported on Form W-2 in Box 12 with Code "T". For more information see [Instructions for Form 8839](#), Qualified Adoption Expenses.

Who's exempt from income tax withholding:

Most employees with the exception of greater than 2% shareholders of an S-corporation, provided that the benefit does not discriminate in favor of highly compensated employees.

Athletic Facilities

What it is:

An employer can provide an athletic facility to its employees tax-free provided that (i) the facility is located on premises the employer owns or leases, and (ii) it is operated by the employer exclusively for the use of current or retired employees, their spouses, and dependent children. Partners in a partnership are treated as employees for this benefit.

Who's exempt from income tax withholding:

All employees, as well as former employees, partners and widows or widowers of former employees, provided it satisfies the necessary requirements.

De Minimis Benefits

What it is:

IRS Publication 15-B states that "a de minimis benefit is any property or service you provide to an employee that has so little value (taking into account how frequently you provide similar benefits to your employees) that accounting for it would be



De Minimis Benefits Cont'd

unreasonable or administratively impracticable.” Cash or cash equivalents (such as gift cards) are never excludable. Specific types of de minimis benefits are included later in this list and can be found in [IRS Publication 15-B](#).

Who's exempt from income tax withholding:

All employees, provided it satisfies the necessary requirements.

Dependent Care Assistance

What it is:

An employer can pay for or provide dependent care assistance to employees, exempt up to certain limits, \$5,000 (\$2,500 for married employees filing separate return) per year. The value of all payments must be reported in Box 10 of Form W-2. Excess payments must be included in Boxes 1, 3 and 5. The benefit may not discriminate in favor of highly compensated employees.

Who's exempt from income tax withholding:

All employees, provided that the benefit does not discriminate in favor of highly compensated employees and it satisfies the necessary requirements.

Educational Assistance

What it is:

An employer may provide educational assistance to an employee up to \$5,250 per year; if you provide an employee with assistance exceeding \$5,250, you must include the value of these benefits as wages, unless the benefits are working condition benefits. Graduate courses may also satisfy this exclusion. Educational assistance may include the cost of books, equipment, fees, supplies, and tuition. Employer must have a qualified written plan. Value of the benefit is based on when a course begins, not when the benefit is paid. The benefit may not discriminate in favor of highly compensated employees. For payments made after March 27, 2020, and before January 1, 2026, education assistance rules also apply to



Educational Assistance Cont'd

student loan payments from the employer to either the student or lender. See chapter 10 of [Publication 970](#) for the definition of qualified education loans.

Who's exempt from income tax withholding:

All employees, provided that the benefit does not discriminate in favor of highly compensated employees and it satisfies the necessary requirements.

Employee Discounts

What it is:

Employee discounts are a price reduction given to employees on property or services you offer to customers. The discount may not be more than a 20% reduction on the price charged to non-employees customers. The benefit may not discriminate in favor of highly compensated employees.

Who's exempt from income tax withholding:

All employees, provided that the benefit does not discriminate in favor of highly compensated employees and it satisfies the necessary requirements.

Employee Stock Options

What it is:

There are three kinds of stock options—incentive stock options, employee stock purchase plan options, and nonstatutory (nonqualified) stock options. Different rules apply to each, so it's best to check sections 83, 421, 422, and 423 of the Internal Revenue Code and their related regulations for more information about employee stock options.

Who's exempt from income tax withholding:

It depends on a number of factors.



Employer- Provided Cell Phone

What it is:

The value of an employer-provided cell may be excluded from taxable income as a working condition fringe benefit if the employer-provided cell phone is primarily for noncompensatory, substantial business reasons. Personal use of an employer-provided cell phone that is provided for noncompensatory, substantial business reasons, is also excludable from an employee's income as a de minimis fringe benefit.

Who's exempt from income tax withholding:

Most employees, provided the cell phone is provided for noncompensatory business purposes for substantial business reasons, as defined in IRS Publication 15-B. Often employer-provided cell phones will not satisfy the noncompensatory business purpose requirement, so the value of the personal use of a cell phone will be considered taxable.

Group-Term Life Insurance

What it is:

An employer can generally exclude up to \$50,000 of the cost of group-term life insurance policies up to \$50,000. Excess value of coverage is subject to federal income tax and FICA, but not subject to FUTA. The value of the excess coverage must be reported on the Form W-2 in Boxes 1, 3, and 5 and in Box 12 with Code C. For more information on how to calculate the value of the coverage, see Table 2-2 of IRS Publication 15-B.

Who's exempt from income tax withholding:

Most employees, provided that the benefit satisfies the necessary requirements, with the exception of greater than 2% shareholders of an S-corporation and certain key employees under a plan that favors those employees.



Health Savings Account (HSA)

What it is:

Employer contributions up to specified dollar limits are exempt from federal income tax withholding, FICA taxes, and FUTA. (For 2023, employers can contribute up to \$3,850 for self-only coverage under an HDHP or \$7,750 for family coverage under an HDHP to a qualified individual's HSA. Individuals who are age 55 or older may contribute an additional \$1,000 a year.) For more information refer to [IRS Publication 969](#), Health Savings Accounts and Other Tax-Favored Health Plans.

Who's exempt from income tax withholding:

Most employees, with the exception of greater than 2% shareholders of an S-corporation, provided that the benefit does not discriminate in favor of highly compensated employees.

Lodging

What it is:

The value of employer provided lodging can be excluded only if (1) it is furnished on business premises, (2) it is furnished for the employer's convenience, and (3) the employee must accept it as a condition of employment.

Who's exempt from income tax withholding:

Most employees, with the exception of greater than 2% shareholders of an S-corporation.

Meals (De Minimis)

What it is:

Meal or meal money that has so little value that accounting for it would be unreasonable. Includes such things as coffee, doughnuts, soft drinks, and occasional meals that enable an employee to work overtime. The benefit may not discriminate in favor of highly compensated employees. This exclusion from taxable income also applies to employer-operated eating facilities for employees and certain meals on your business premise.



Meals
(De Minimis)
Cont'd

Who's exempt from income tax withholding:

For de minimis meals, most employees, provided that the benefit does not discriminate in favor of highly compensated employees. For meals on your business premise, most employees with the exception of greater than 2% shareholders of an S-corporation.

No-Additional-Cost Services

What it is:

Services that are offered to customers in the ordinary course of business that can be offered to employees without incurring any substantial additional costs. Includes excess capacity services, such as airline, bus, or train tickets; hotel rooms; or telephone services provided free or at a reduced price to employees working in those lines of business. The benefit may not discriminate in favor of highly compensated employees.

Who's exempt from income tax withholding:

All employees, provided it satisfies the necessary requirements and provided that the benefit does not discriminate in favor of highly compensated employees.

Retirement
Planning Services

What it is:

You may exclude from an employee's wages the value of any retirement planning advice or information you provide to your employee or their spouse if you maintain a qualified retirement plan. Does not include services for tax preparation, accounting, legal, or brokerage services.

Who's exempt from income tax withholding:

All employees, provided it satisfies the necessary requirements.



Qualified
Transportation
(Commuting)
Benefits

What it is:

An employer can provide qualified parking, transit passes, and/or rides in a commuter highway vehicle. In 2023, there is an exclusion for transportation benefits up to \$300 a month. See [IRS Publication 15-B](#) for details.

Who's exempt from income tax withholding:

Most employees with the exception of greater than 2% shareholders of an S-corporation.

Tuition Reduction

What it is:

An educational institution can exclude tuition reductions for qualified employees, dependents, and those retired or on disability. The exclusion applies to undergraduate education (or graduate education if the employee performs teaching or research activities). See chapter 1 of [Pub. 970](#) for more information on this exclusion.

Who's exempt from income tax withholding:

All employees, provided it satisfies the necessary requirements provided that the benefit does not discriminate in favor of highly compensated employees.

Working
Condition
Benefits

What it is:

Property and services provided to an employee so that the employee can perform his or her job.

Who's exempt from income tax withholding:

All employees, provided it satisfies the necessary requirements.



Justworks Can Help

Justworks takes the busyness out of growing a business and alleviates the unknown. We've combined a simple platform and exceptional 24/7 customer service with the power of a PEO, so all teams have more time to focus on what matters.

Get access to corporate-level benefits, seamless payroll, HR tools, and compliance support — all in one place.



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