



Emerging Tax Topics for Fiscal Officers – Understanding Your Agency’s Risks

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Trending Issues

- Employee Fringe Benefits
- Board Policies – Fringe Benefits
- Written Guidelines and Policies
- Employee vs. Independent Contractor

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Trending Issues

Employee Fringe Benefits

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Employee Fringe Benefits

Why discuss Fringe Benefits?

- Employment audits generate significant collections for the IRS – considered to be an untapped source of revenue
- Employment tax collections made up 33% of all IRS revenue in 2015 (Good news – only .2% of employment tax returns were audited in 2015 – approx. 54M)
- 2010 Project for small employers – IRS examined 6,000 employment tax returns and discovered that ***under reporting fringe benefits is a wide-spread problem***
- Benefits are no longer a minor part of compensation –they now represent close to 40% of the total cost of compensation

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Employee Fringe Benefits

Fringe Benefits are the most overlooked area by employers

- Difficult to identify
- Difficult to value
- Uncertainty in reporting (i.e. taxable or not?)
- Lack of clear communication to employees
- Finance/payroll not aware of the benefit
- Overall departmental differences

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Employee Fringe Benefits

What is a Fringe Benefit?

- Benefits are a wide variety of inducements offered to employees having little in common except they are not “paid” to the person each payday. This makes terminology and categorization of benefits difficult.
- **All** fringe benefits are taxable and must be included in the recipients’ pay, unless the law **specifically** excludes them.

Employee Fringe Benefits

Examples of Fringe Benefits

- Awards or prizes
- Bonuses (cash or noncash)
- Credit cards (employer-provided)
- Company cars
- Holiday gifts
- Laptop computers
- Meal allowances/reimbursements
- Retirement gifts
- Parking
- Safety or length of service awards
- Spousal Travel
- Uniform Allowances

Employee Fringe Benefits

Nontaxable Fringe Benefits – *Specifically excluded by law*

- IRC 105 & 106 – Employer Provided Health Benefits
- IRC 79 – Group Term Life Insurance (first \$50K of coverage)
- IRC 125 – Cafeteria Plans
- IRC 127 – Educational Assistance Programs
- IRC 129 – Dependent Care Assistance
- IRC 119 – Meals or Lodging for the Employer’s Convenience

Employee Fringe Benefits

Statutory Exclusions allowed by IRC Section 132 only if Certain Conditions are met:

- Working condition fringe benefit
- De minimis fringe benefit
- No additional cost service fringe benefit

Employee Fringe Benefits

Working Condition Fringe Benefit:

The entire value of the property or service provided is excludable from the employee's income if the employee would be able to deduct it as a trade or business expense during the process of getting an employee's job done.

- Examples:
 - Professional dues and subscriptions
 - Supplies
 - Business meal
 - Reimbursement for business travel
 - Job training
 - **Uniforms** that are not adaptable to general use

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Employee Fringe Benefits

De Minimis Fringe Benefit:

The entire value of the property or service provided is excludable from the employee's income when the item has such a small value and frequency that accounting for them would be impractical.

- Examples:
 - Company picnics
 - Coffee, doughnuts, bottle water and soft drinks
 - Occasional use of the copy machine, fax machine and phones
 - Coffee mugs
 - Plaques
 - Flowers

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Employee Fringe Benefits

Note: De minimis rules do not apply to cash and cash equivalents (including gift cards). Gift cards are considered cash equivalents – no matter how small the amount, even \$5. *Gift cards presented to an employee should be reported in their wages.*

Employee Fringe Benefits

Gifts and awards may be excluded from income under the following circumstances:

- Tangible *noncash* employee achievement awards given for length of service or safety:
 - Must be presented with meaningful presentation
 - FMV of award must be under \$400 per award / \$1,600 per year
 - Length of service may not be during first five years of employment
- Traditional *noncash* retirement awards presented upon completion of lengthy term of service (not taxable regardless of value because no expectation of future services, i.e. not compensatory)

Employee Fringe Benefits

Meals on Business Premises –Nontaxable under the following circumstances:

- Meals provided after hours for employees working overtime
- Meals provided during employer’s training seminars / departmental meetings
- Free meal from the cafeteria to substantially all employees during each work day so that employees may be on call at all times

Employee Fringe Benefits

Employer Provided Auto

- Use of an employer-provided auto by an employee while conducting an employer’s business is an *excludable working condition fringe benefit*
- Personal use of the company auto is a taxable fringe benefit, unless the personal use is reimbursed to the employer
- Business use must be properly substantiated with adequate records (i.e. using an accountable plan with documentation)

Employee Fringe Benefits

Take-Home Vehicles

A vehicle for take-home or 24-hour use may be assigned to certain employees for bona fide business reasons when the nature of their work requires such assignment.

There is a special rule of *\$3.00 per round trip commute that the IRS allows in all instances of take-home non-emergency vehicles* where the employee is required to be on call and report if needed at anytime, to commute to and/or from work in an assigned vehicle.

Commuting mileage to respond to an after-hours call-back or unscheduled return to work is considered official business.

Employees must assist the organization in keeping adequate mileage records on the forms and in the manner prescribed to insure compliance.

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Employee Fringe Benefits

Qualified non-personal use vehicles

- All of an employee's use of a qualified non-personal-use vehicle (such as a police car, unmarked vehicles, fire vehicles) ***is excluded from taxable income***
- These exempt vehicles are driven by employees with special training
- The vehicle being driven is equipped with specialized emergency or technical equipment used to treat and protect citizens of a County

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Employee Fringe Benefits

Uniforms

- Must be related to the employer's business and be provided so the employee can perform his/her job – such as high visibility shirts/reflective lettering for road crews or police officers and protective clothing.
- Typically, embroidered logos and patches on polo shirts or t-shirts are almost always taxable (i.e. considered an informal work uniform **by the IRS**). If the clothing/shoes are adaptable to normal wear, the value is taxable.
- ***Can this classification of an "informal work uniform" be favorably argued as a nontaxable working condition fringe benefit with the IRS?***

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Employee Fringe Benefits

IRS Clarification on Cost of Clothing

- In March 2015, the IRS sent a letter to U.S. Senator Mark Warner of Virginia announcing that firefighters and police officers will not be expected to pay taxes on common clothing items that they are required to wear while on duty.
- The Senator visited Washington, carrying a display of various uniforms used by deputy sheriffs that are being taxed to show firsthand how modern day uniforms used by deputy sheriffs are functional, less expensive than traditional uniforms, and should not be subject to taxes by the IRS. The IRS concurred, citing that these modern day uniforms come with distinctive agency logos and ***officials are prohibited from wearing them off duty.***
- <http://www.warner.senate.gov/public/index.cfm/2015/3/irs-tells-warner-uniforms-for-public-safety-officials-not-taxable>

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Employee Fringe Benefits

Employee Business Expense Reimbursements

Provided under an Accountable Plan which must meet **all three** of the following to be non-taxable:

1. There must be a business connection (the expense must qualify as a trade or business expense under IRC Section 162)
2. Must be adequate accounting by the recipient within a reasonable period of time – receipts are required for all expenses unless the IRS approved “Per Diem” rate is used
3. Excess of expenses must be returned within a reasonable period of time

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Employee Fringe Benefits


Accountable Plan / Adequate Accounting

- Employees are required to provide sufficient information to satisfy a “business connection” of the expenditure
 - What – amount
 - When – time, date, etc.
 - Where – business location, destination, etc.
 - Why – business purpose
 - Who – for entertainment purposes

Written contemporaneous recordkeeping has more value than oral evidence.


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Employee Fringe Benefits




Questions?

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Trending Issues



Board Policies – Fringe Benefits

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Board Policies – Fringe Benefits

Classification of Board Members for Payroll Tax Purposes:

- *Generally*, directors of a corporation (i.e. members of the governing board) are defined by statute as *non-employees*. This is due to the fact that a board member's responsibility for the fulfillment of an organization's mission and legal accountability for its operations typically dictate that the board be comprised of individuals from *outside of the organization*.
- While compensation paid to *corporate* Board Members would be reported on Form 1099-Miscellaneous, payments to *elected public officials serving as a Council or Board Member* would be reported on Form W-2.

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Board Policies – Fringe Benefits

Classification of Board Members for Payroll Tax Purposes:

- ***In contrast***, officials of states and their political subdivisions may or may not be classified as an employee, depending on state statute or common law rules.
- Current case law has made it clear that ***elected public officials are classified as employees*** since they are subject to a degree of control that is characteristic of an employer-employee relationship. In addition, Internal Revenue code Section 3401(c) indicates that an “officer, employee, or elected official” of government is an employee for income tax withholding purposes.
- **The key differential is that elected officials are considered responsible to the public, which has the power to vote them out of office.**

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Board Policies – Fringe Benefits

Classification of Board Members for Payroll Tax Purposes:

- If the board members of your agency or organization are elected by the state legislature, **they are classified by the IRS as an “employee”** for purposes of payroll tax reporting and remittance purposes.
- When a board member is an employee, the organization that employs them must withhold and pay employment taxes on the “taxable compensation” they receive. It is important to note that **taxable compensation can include both cash and non-cash** remuneration.
- Taxable compensation also includes any fringe benefit that are provided which must be included in the recipient’s annual Form W-2 **unless the law specifically excludes it (i.e. working condition fringe, no additional cost fringe, De minimis fringe benefit, Lodging and meals provided for the convenience of the employer).**

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Board Policies – Fringe Benefits

Typical examples of fringe benefits which may or may not be taxable, depending on the structure of the payment and the policies in place for reimbursements (i.e. written accountable business substantiation plan) include:

1. Free or discounted tickets to sponsored events
2. Transportation / **commuting** benefits
3. Per diem
4. Employer provided credit cards
5. Use of cars, vans, buses, airplanes
6. Parking
7. Spousal travel
8. and other items, such as access to gyms or entertainment facilities

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Board Policies – Fringe Benefits




Questions?




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Trending Issues



Written Guidelines and Policies



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Written Guidelines and Policies

When is it time to update policy handbooks / procedures / and guidelines?

Written policies should be in place for the following reasons:

1. To ensure that there are no gaps in the public's understanding.
2. To provide clear, concise guidance on the distinction between business and personal use. Accountability issues will arise when detailed standards are inaccurate or outdated.
3. To review the requirements for business use of the "benefit" and how to record and report the business use. Policies that do not sufficiently document processes can create varying degrees of inconsistency among the board members.

Written Guidelines and Policies

Best Practices


- Provide background of the purpose for the policy, including how the personal use will be reported via the employer's payroll process.
- Clear concise guidance on the distinction between business and personal use. Accountability issues will arise when detailed standards for conduct are inaccurate or outdated.
- Review the requirements for business use of the "benefit" and how to record and report the business use. Policies that do not sufficiently **document processes** can create varying degrees of inconsistency within each department.

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Trending Issues

Employee vs. Independent Contractor

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Employee vs. Independent Contractor

From the IRS Website: When would I provide a W-2 and a Form 1099 to the same person?

A worker's role determines which information return an entity would provide. Entities provide a Form 1099-Misc to independent contractors and Form W-2 to employees.

However, there may be instances where a worker may be serving as an independent contractor and an employee for the same entity.

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Employee vs. Independent Contractor

- The IRS generally classifies an ***independent contractor*** as a worker that performs services in which:
 - the employer controls the end result of the work; but not
 - the means and methods of how the work is accomplished
- In contrast, the IRS generally classifies ***a common-law employee*** as a worker that performs services in which:
 - the employer controls the end result of the work; and
 - the means and methods of how the work is accomplished

Employee vs. Independent Contractor


- It is very unusual for an employee to also correctly receive a Form 1099 from his employer, but it is legally possible. To qualify all of the following must exist:
 - The individual has a legitimate independent business
 - He/she has other clients not connected to the employer
 - The work as an independent contractor is not the identical, or similar, to what he does as an employee
 - When doing the work reported on Form 1099 he must meet the common law test as an independent contractor

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Employee vs. Independent Contractor

Caution

If you issue a W-2 and a 1099 to an employee be sure to clearly document and save your evidence. When a worker receives both from the same business in the same year, ***it is a red flag to the IRS***. It is likely you and the worker will be contacted to explain how this happened. You will need to be able to justify your treatment.




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Employee vs. Independent Contractor

Red Flags that may trigger an IRS payroll audit:

1. Random Audit: The IRS is devoting more time, money and efforts to examine worker classification and other non-compliance issues.
2. Employee receives both a W-2 and a Form 1099 in the same year.
3. Employee receives W-2 in one year and Form 1099 in another year.
4. Some employees covered by the retirement system and others are not.
5. Request by a Third Party: The IRS can get involved at the request of an individual hired by the district. A worker who expected to receive a W-2, but instead received a Form 1099, may contact the IRS to request tax relief or report that he or she was wrongly classified as an independent contractor, rather than an employee.




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Trending Issues



Questions?



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