

Uncle Sam Wants His "Fair" Share: The IRS & DOL and Local Government Employment

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Taxation of Fringe Benefits

- Introduction
  - Common assumption:
    - Cash compensation is taxable and fringe benefits are nontaxable.
  - Have you heard the old saying about *ass*umptions…?
  - Better assumption:
    - Anything provided to an employee is taxable unless there is a specific exclusion.
  - Risks of getting it wrong.

Taxation of Fringe Benefits

- Basic concepts:
  - What is considered a “fringe benefit”…?
  - Cash vs. non-cash (or in-kind) benefits.
  - Anything taxable is generally a W-2 wage.
  - Application of Social Security and/or Medicare taxes tracks the application to cash compensation.
  - Generally, no such thing as a “gift” to an employee.
  - Concept of “de minimis” is very limited.
  - Be careful with giving choices.
  - Don’t forget about the basic concepts of “constructive receipt” and “assignment of income.”
  - Very few governmental employer exceptions or special rules.
  - Tax rules prevail over collective bargaining agreements and other contracts.

Taxation of Fringe Benefits

- General rules:
  1. §61 – All compensation is taxable, unless a specific exclusion applies.
  2. Time of taxation is when paid, made available or credited to an employee's account, unless a specific provision for deferred taxation applies.
  3. Taxable amounts are generally subject to withholding and applicable payroll taxes at the time of taxation.

- IRS Publication 5137.

Taxation of Fringe Benefits

- Specific exclusions:
  - §62 – Business travel and other trade or business expenses
  - §79 – Group term life insurance up to $50,000
  - §105 – Benefits received through employer health or accident insurance
  - §106 – Health insurance premiums paid by employer
  - §117(d) - Qualified tuition reductions
  - §119 - Meals or lodging provided for the employer's convenience
  - §125 - Cafeteria plans
  - §127 - Educational assistance program
  - §129 - Dependent care assistance program

Taxation of Fringe Benefits

- Specific exclusions (continued):
  - §132(b) - No additional-cost service
  - §132(c) - Qualified employee discounts
  - §132(d) - Working condition fringe
  - §132(e) - De minimis benefit
  - §132(f) - Qualified transportation fringe
  - §132(g) - Qualified moving expense reimbursements
  - §132(j)(4) - On-premises athletic facilities
  - §132(m) - Qualified retirement planning services
  - §132(n) – Qualified military base realignment and closure fringe
  - §137 – Adoption assistance programs

Taxation of Fringe Benefits

- Some exclusions have very specific requirements:
  - Written plan / program documents.
  - Dollar limitations.
  - Nondiscrimination requirements.
  - “Accountable plan” requirements.
  - “For the convenience of the employer” requirements.
- Some fringe benefits are tax-deferred, as opposed to excluded from taxation:
  - Pension benefits
  - Deferred compensation (generally, a 457(b) plan)

Taxation of Fringe Benefits

- Common compliance issues:
  - Interplay with pension and other retirement plan benefits.
  - Cafeteria plan (or 125 plan) compliance.
    - Death, taxes and pre-tax premiums…?
    - Written plan requirement.
    - Administering elections.
    - Waiver benefits, opt-out benefits and “cash in lieu” options.
    - Pre-tax elections for voluntary life and disability insurance benefits.
  - Group term life insurance in excess of $50,000.
  - Personal use of employer vehicles and commuting expenses.
  - Travel and moving expenses.
  - Educational assistance.
  - 457(f) deferred compensation (generally, executive-level).

Taxation of Fringe Benefits

- Compliance issues generally result from “systems” issues:
  - Gaps in coordination among payroll, benefits and/or HR departments.
  - Over-reliance on payroll systems and/or vendors.

- Recommendations:
  - Payroll code audit.
  - Review current tax treatments of all fringe benefits.
  - Don’t forget state and local tax laws, as well as interplay with pension and other retirement plan benefits.
  - Don’t forget about new Healthcare Reform (ACA) compliance obligations:
    - Employer “play or pay” mandate.
    - Information reporting and furnishing requirements.
    - Future “Cadillac tax.”

Questions?



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