

THOUGHT LEADERSHIP FROM THE BDO COMPENSATION &
BENEFITS PRACTICE

YEAR-END TAX ALERT FOR EMPLOYERS



FRINGE BENEFIT ITEMS TO INCLUDE ON 2015 FORMS W-2

As 2015 draws to a close, we would like to remind you about the proper inclusion of fringe benefits in an employee's and/or shareholder's taxable wages. Fringe benefits are defined as a form of pay for performance of services given by a company to its employees and/or shareholders as a benefit. Fringe benefits must be included in an employee's pay unless specifically excluded by law. Please note the actual value of the fringe benefits provided must be determined prior to December 31 in order to allow for the timely withholding and depositing of payroll taxes. Below you will find important information regarding the identification and accounting for several customarily provided fringe benefits.

The failure to include taxable fringe benefits in an employee's/ shareholder's Form W-2 may result in lost deductions and additional tax and civil penalties.

COMMON TAXABLE FRINGE BENEFITS

Employer-paid group-term life insurance coverage in excess of \$50,000

This fringe benefit is subject to the withholding of Social Security and Medicare taxes (FICA) only. Though the amount is included in gross wages, federal and state income tax withholding is not required.

Employee business expense reimbursements/allowances under non-accountable plans

Any payments of an allowance/reimbursement of business expenses for which the employee does not provide an adequate accounting (i.e., substantiation with receipts or other records), or return any excess allowance/reimbursement to the company, is considered to have been provided under a non-accountable plan and are required to be treated as taxable wages for purposes of federal, state and local (if applicable) income tax withholding, employer and employee FICA tax, and federal and state unemployment taxes (FUTA and SUTA).

CONTACT:

For more information on the taxation of employee fringe benefits, please contact:

IRA B. MIRSKY

Senior Director, National Tax
Compensation and Benefits
202-644-5412 / imirsky@bdo.com

JOAN VINES

Senior Director, National Tax
Compensation and Benefits
703-770-4444 / jvines@bdo.com

CARL TOPPIN

Senior Manager, Global
Employer Services
Compensation and Benefits
212-885-8331 / ctoppin@bdo.com

However, if the employee provides an adequate accounting (i.e., substantiation with receipts or other records) of the expenses incurred, or is “deemed” to have substantiated the amount of expenses under a per diem arrangement, then the reimbursement amounts are excludable from taxable income/wages.

Value of personal use of company car

This fringe benefit (unless reimbursed by the employee) is subject to FICA, FUTA, FITW and SITW. However, you may elect not to withhold FITW and SITW on the value of this fringe benefit if the employee is properly notified by January 31 of the electing year or 30 days after a vehicle is provided. For administrative convenience, an employer can elect to use the 12-month period beginning November 1 of the prior year and ending October 31 of the current year (or any other 12-month period ending in November or December) to calculate the current year’s personal use of a company car if the employee is properly notified no earlier than the employee’s last paycheck of the current year and no later than the date the Forms W-2 are distributed. Once elected, the same accounting period generally must be used for all subsequent years with respect to the same auto and employee.

Many companies have moved away from providing company cars in lieu of a cash payment to reimburse the employee for the business use of their personal auto. Car allowances paid in cash without any substantiation of business use are fully taxable and subject to all of the tax withholdings of FICA, FUTA, FIT and SIT.

Value of personal use of company aircraft

This fringe benefit (unless reimbursed by the employee [to the extent permitted under FAA rule]) is subject to FICA, FUTA, FITW and SITW. The value calculated is based on the Standard Industry Fare Level formula provided by the Internal Revenue Service. Expenses related to personal entertainment use by officers, directors and 10-percent or greater owners that are in excess of the value treated as compensation to key employees are nondeductible corporate expenses. Feel free to contact us for assistance calculating the value of the personal use of company aircraft.

Value of employee achievement awards, gifts and prizes

This fringe benefit is subject to FICA, FUTA, FITW and SITW. In general, employee achievement awards, gifts and prizes that do not specifically qualify for exclusion are only deductible for the employer up to \$25 per person per year, unless the excess is included as taxable compensation for the recipient. Any gifts in excess of \$25 per person per year to employees in the form of tangible or intangible property are includable as a taxable fringe benefit for employees. There are two exclusions from the general rule for employee achievement awards:

1. There are exclusions that exist for length of service (must be greater than five years and not awarded to same employee in the prior four years) and safety achievement awards, each of them being made as part of a meaningful presentation. The exclusion applies only for awards of tangible personal property and is not available for awards of cash, gift cards/certificates or equivalent items. The exclusion for employee achievement awards is limited to \$400 per employee for nonqualified (unwritten and discriminatory plans) or up to \$1,600 per employee for qualified plans (written and nondiscriminatory plans).
2. *De minimis* benefit amounts can be excluded when the benefit is of so little value (taking into account the frequency) that accounting for it would be unreasonable or administratively impractical. A common misconception is that if a fringe benefit is less than \$25, then it is automatically considered a *de minimis* benefit. However, there is no statutory authority for this position. If a fringe benefit does not qualify as *de minimis*, generally the entire amount of the benefit is subject to income and employment taxes as detailed above. *De minimis* benefits never include cash, gift cards/certificates or cash equivalent items no matter how little the amounts. Gift cards/certificates that cannot be converted to cash and are otherwise a *de minimis* fringe benefit, which is redeemable for only specific merchandise, such as ham, turkey or other item of similar nominal value, would be excluded from income. However, gift cards/certificates that are redeemable for a significant variety of items are deemed to be cash equivalents. Any portion of such a gift card/certificate redeemed would be included in the employees’ Forms W-2 and subject to income and employment taxes as detailed above.

Value of qualified transportation fringe benefits

Any qualified commuting and parking amounts provided to the employee by the employer in excess of the monthly statutory limits are subject to FICA, FUTA, FITW and SITW. For 2015, the statutory limits are \$250 per month for qualified parking. The statutory limits for transit passes and van pooling are substantially lower at \$130 per month for 2015.

The statutory limits for 2016 will be \$255 per month for qualified parking, and will remain unchanged at \$130 per month for mass transit and vanpool benefits.

Employers can also exclude up to \$20 per month for the reimbursement of qualified bicycle commuting expenses.

District of Columbia Requires Pre-Tax Employee Transit Arrangements Starting January 1, 2016

D.C. employers are not required to subsidize the cost of their employee's commuting expenses, but under a new law that goes into effect January 1, 2016, D.C. employers with 20 or more employees must provide an arrangement for employees to make a pre-tax election at least equal to the maximum statutory limits for transit, commuter highway, or bicycling benefits.

Value of personal use of employer-provided cell phones

Since January 1, 2010, employer-provided cell phones are no longer treated as a taxable fringe benefit as long as the cell phone is provided to the employee primarily for noncompensatory business reasons, such as the employer's need to contact the employee at all times for work-related emergencies, or the need for the employee to be available to speak to clients when the employee is away from the office. Notice 2011-72 clarifies the exclusion of the cell phone's value from the employee's income as a working condition fringe benefit.

This change in the law also eliminated the need for the rigorous substantiation of the business use of employer-provided cell phones that were otherwise required for "listed property."

Rules require taxation of certain fringe benefits to 2-percent S corporation shareholders

In addition to the adjustments previously discussed, certain otherwise excludable fringe benefit items are required to be included as taxable wages when provided to any 2-percent shareholder of an S corporation. A 2-percent shareholder is any person who owns directly or indirectly on any day during the taxable year more than 2 percent of the outstanding stock or stock possessing more than 2 percent of the total combined voting power. These fringe benefits are generally excluded from income of other employees, but are taxable to 2-percent S corporation shareholders similar to partners. If these fringe benefits are not included in the shareholder's Form W-2, then they are not deductible for tax purposes by the S-Corporation. (See Notice 2008-1.) *The disallowed deduction creates a mismatch of benefits and expenses among shareholders, with some shareholders paying more tax than if the fringe benefits had been properly reported on Form W-2.*

The includable fringe benefits are items paid by the S corporation for:

Health, dental, vision, hospital and accident (AD&D) insurance premiums, and qualified long-term care (LTC) insurance premiums paid under a corporate plan.

These fringe benefits are subject to FITW and SITW only (not FICA or FUTA). These amounts include premiums paid by the S corporation on behalf of a 2-percent shareholder and amounts reimbursed by the S corporation for premiums paid directly by the shareholder. If the shareholder partially reimburses the S corporation for the premiums, using **post-tax** payroll deductions, the net amount of premiums must be included in the shareholder's compensation. 2-percent shareholders **cannot** use **pre-tax** payroll deductions to reimburse premiums paid by the S corporation.

Cafeteria plans

A 2-percent shareholder is not eligible to participate in a cafeteria plan, nor can the spouse, child, grandchild or parent of a 2-percent shareholder. If a 2-percent shareholder (or any other ineligible participant, such as a partner or nonemployee director) is allowed to participate in a cafeteria plan, the cafeteria plan will lose its tax-qualified status, and the benefits provided will therefore be taxable to all participating employees, therefore nullifying any pretax salary reduction elections to obtain any benefits offered under the plan.

Employer contributions into health savings accounts (HSA)

This fringe benefit is subject to FITW and SITW only (not FICA or FUTA). If the shareholder partially reimburses the S corporation for the HSA contribution, using **post-tax** payroll deductions, the net amount of the contribution must be included in the shareholder's compensation. 2-percent shareholders **cannot** use **pre-tax** payroll deductions to reimburse HSA contributions paid by the S corporation. However, these 2-percent owners can take a corresponding above-the-line deduction for the cost of their HSA contributions on their personal tax return.

Short-term and long-term disability premiums

These fringe benefits are subject to FICA, FUTA, FITW and SITW.

Group-term life insurance coverage

All group-term life insurance coverage is treated as taxable, not just coverage in excess of \$50,000. The cost of the insurance coverage (i.e., the greater of the cost of the premiums or the Table I rates) is subject to the withholding of FICA taxes only. The cost of the insurance coverage is not subject to FUTA, FITW or SITW. Please note that you should not include the cost associated with any life insurance coverage for which the corporation is both the owner and beneficiary (e.g., key man life insurance) in the shareholder's Form W-2.

Other taxable fringe benefits

Employee achievement awards, qualified transportation fringe benefits, qualified adoption assistance, employer contributions to medical savings account (MSA), qualified moving expense reimbursements, personal use of employer-provided property or services, and meals and lodging furnished for the convenience of the employer must also be included as compensation to 2-percent shareholders of an S corporation. All of the above fringe benefits are subject to FICA, FUTA, FITW and SITW.

Nontaxable fringe benefits

The following fringe benefits are NOT includible in the compensation of 2-percent shareholders of an S corporation: qualified retirement plan contributions, qualified educational assistance up to \$5,250, qualified dependent care assistance up to \$5,000, qualified retirement planning services, no-additional-cost services, qualified employee discounts, working condition fringe benefits, *de minimis* fringe benefits and on-premises athletic facilities.

ACCOUNTING FOR THE ADJUSTMENTS

Once you have identified the fringe benefits subject to tax, you must choose a method to account for them. The following are methods generally used to account for fringe benefits:

- ▶ **Method 1:** Gross-up the fringe benefit to cover payroll taxes and add the grossed-up amount to the Form W-2.
- ▶ **Method 2:** Treat the fringe benefit amount as the gross pay and withhold the corresponding payroll taxes from the employee's last paycheck.
- ▶ **Method 3:** Have the employee reimburse the company for the amount of the fringe benefit.

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