Fringe Benefit Reporting

As the year draws to a close, we want to remind you about including taxable fringe benefits in all applicable employees' and/or shareholders' 2014 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. Any fringe benefit you provide is taxable and must be included in the recipient's pay unless the law specifically excludes it! If the recipient of a taxable fringe benefit is your employee, the benefit is subject to employment taxes and must be reported on their W-2. Failure to include taxable fringe benefits in an employee's/shareholder's Form W-2 may result in lost deductions and additional tax and penalties. If the recipient is not your employee, the benefit is not subject to employment taxes but may have to be reported on Form 1099-MISC (if an independent contractor) or on Schedule K-1 (if a partner).

Below you will find important information regarding the identification and accounting for several customarily provided fringe benefits. If you have a question about fringe benefits, please don't hesitate to contact us.

Common Taxable Fringe Benefits

**Employer-paid group-term life insurance in excess of $50,000**
This fringe benefit is subject to Social Security/Medicare 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**
A non-accountable plan is an allowance or reimbursement program or policy that does not meet all three requirements for an accountable plan. For a plan to be accountable:
- There must be a business connection to the expenditure.
- There must be adequate accounting by the recipient within a reasonable period of time.
- Excess reimbursements or advances must be returned within a reasonable period of time.
This fringe benefit is subject to Social Security/Medicare, FUTA, federal and state withholdings. If an employee received an allowance/reimbursement from the company for company related expenses (i.e., travel, a car, etc.), then the amount should be included in the employee's wages. If the employee gave an accounting (adequate substantiation) of the expenses incurred or used IRS per diem amounts (i.e., filled out an expense voucher and refunded any excess allowances/reimbursements to the company), then there is no amount to be added to the Form W-2. If, however, the employee kept any amounts in excess of the expenses accounted for, or did not provide an accounting (adequate substantiation) of the expenses incurred, all of the reimbursed expenses should be added to taxable wages on the Form W-2.

**Value of personal use of company car**
This fringe benefit (unless reimbursed by the employee) is subject to Social Security/Medicare, FUTA, federal and state withholdings. However, you may elect not to withhold federal and state withholdings on the value of this fringe benefit if the employee is properly notified by January 31st 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 1st of the prior year and ending October 31st of the current year (or any other 12 month period ending in November and 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 W-2 forms are distributed. Once elected, the same accounting period generally must be used for all subsequent years with respect to the same auto and employee. See separate information on how to calculate the value of personal use of company car.

**Value of qualified transportation fringe benefits**
Any qualified commuting and parking amounts provided to the employee by the employer in excess of the statutory limits are subject to Social Security/Medicare, FUTA, federal and state withholdings. For 2014, the statutory limits are $250 per month for qualified parking and $130 per month for van pooling and transit passes. Employers can also exclude up to $20 per month for qualified bicycle commuting reimbursement.

**Value of personal use of employer-provided cell phone**
The passage of the Small Business Jobs Act of 2010, H.R. 5297 eliminated the strict substantiation requirements for employer-provided cell phones. The fair market value of the personal use of an employer provided cell phone that is predominately used for business purposes is excluded from the employee’s gross income.

**S Corporation Adjustments**
In addition to the adjustments previously discussed, an S corporation must include certain fringe benefit items on the Form W-2 of any shareholder that had, directly or indirectly, a greater than 2% ownership on any day during the tax year. These fringe benefits are generally excluded from income of other employees. If these fringe benefits are not included in the shareholder's Form W-2 then they are not deductible for tax purposes. This will result in a mismatch of benefits and expenses among the shareholder and the shareholder usually ends up 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**
This fringe benefit is subject to federal and state withholdings only (not Social Security/Medicare or FUTA). This amount includes premiums paid by the S corporation on behalf of a shareholder with ownership of 2% or greater 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. A 2% or greater shareholder cannot use pre-tax payroll deductions to reimburse premiums paid by the S corporation.

**According to Notice 2008-1, any health insurance premiums that are not included in the shareholder’s W-2 are not eligible to be deducted by the S corporation.**

**Employer contributions into health savings accounts (HSA)**
This fringe benefit is subject to federal and state withholdings only (not Social Security/Medicare 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% or greater shareholders cannot use pre-tax payroll deductions to reimburse HSA contributions paid by the S corporation.

**Short-term and long-term disability premiums**
These fringe benefits are subject to Social Security/Medicare, FUTA, federal and state withholdings.

**Group-term life insurance premiums**
All group-term life insurance premiums are taxed, not just those in excess of $50,000. The premiums are subject to Social Security/Medicare only. The premiums are not subject to FUTA, federal and state withholdings. Please note that you should not include in the shareholder's Form W-2 any premiums on policies for which the corporation is both the shareholder and beneficiary.

**Other taxable fringe benefits**
Shareholders with 2% or greater ownership of an S corporation are ineligible to participate in an S corporation's cafeteria plan. All shareholder benefits derived from the cafeteria plan must be included in shareholders' compensation. A cafeteria plan may be terminated upon IRS audit, if a greater than 2% shareholder of an S corporation participates. In addition, 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, services, or meals and lodging furnished for the convenience of the employer must also be included as compensation to shareholders with greater than 2% of an S corporation. All the above fringe benefits are subject to Social Security/Medicare, FUTA, federal and state withholdings.
Nontaxable fringe benefits
The following fringe benefits are NOT includible in the compensation of shareholders with greater than 2% 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, minimal fringe benefits, and on-premises athletic facilities.

Other S Corp consideration

Compensation issue for S Corporation Shareholders
By law, a shareholder in an S Corporation who performs services for that corporation must be paid a reasonable salary. This is a current hot issue with the IRS. If the shareholder is not paid any salary or what the IRS would deem a reasonable salary, the IRS upon audit will impute the wages that should have been paid to this person. In turn the S Corporation is liable for the payroll taxes on those imputed wages, and the individual is responsible for personal income tax on those imputed wages.

If you are a working shareholder in an S corporation, be sure that you are paid a salary by the corporation to avoid this issue.

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.

Other types of benefits to consider

- Working Condition Fringe Benefits – To be excludable as a working condition fringe benefit, all of the following must apply:
  o The benefit must relate to employer’s business
  o The employee would have been entitled to an income tax deduction if expense had been paid personally
  o The business use must be substantiated with records
**De Minimis Fringe Benefits** - De minimis fringe benefits include any property or service, provided by an employer for an employee, with a value so small that accounting for it is unreasonable or administratively impracticable. The value of the benefit is determined by the frequency it is provided to each individual employee, or, if this is not administratively practical, by the frequency provided by that employer to the workforce as a whole. The law does not specify a dollar threshold for benefits to qualify as de minimis. The determination will always depend on facts and circumstances.

**No-Additional-Cost Services** - A service provided to employees that does not impose any substantial additional cost on the employer may be excludable as a no-additional-cost fringe benefit. A “no-additional-cost service” is a service offered by the employer to its customers in the ordinary course of the line of business of the employer in which the employee performs substantial services, and the employer incurs no substantial additional cost (including foregone revenue) in providing the service to the employee.

**Qualified Employee Discounts** - An excludable “qualified employee discount” generally cannot exceed:
- For merchandise or other property, the employer’s gross profit percentage times the price charged to the public for the property.
- For services, no more than 20% of the price charged to the general public for the service. For this purpose, the price charged to the general public at the time of the employee’s purchase is controlling.

**Travel expenses** – Qualifying expenses for travel are excludable if they are incurred for temporary travel on business away from the general area of the employee’s tax home. The travel must be temporary and be substantially longer than an ordinary day’s work. There are no tax consequences to reimbursements for allowable expenses if the accountable plan rules are met!

**Transportation expenses** - Transportation expenses are costs for local business travel that is not away from the tax home area overnight, and that is in the general vicinity of the principal place of business. Transportation expenses do not include commuting costs, which are not deductible expenses and cannot be excluded from wages if provided by the employer. To be excludable, reimbursements for transportation expenses must meet the accountable plan requirements.

**Moving expenses** - A moving expense reimbursement received directly or indirectly from an employer (under an accountable plan) is excludable to the employee if the following tests of IRC §217 are met:
- Individual must be an employee
- Employee must actually incur or pay the expenses
- Expenses are closely related to starting work at the new job location (generally moving expenses incurred within one year from the date the employee first report to work at the new location qualify)
The move must meet the time and distance tests:

**Time Test:** The employee must work at least 39 weeks full-time in the first year after arriving in the new location.

**Distance test:** The new job is at least 50 miles farther from the former home than the old job location was from the former home.

Note: A different time test applies to self-employed persons. See Publication 521.

- **Meals and Lodging –**

  **Meals are excludable from wages of the employee if they are provided:**
  
  o On the employer's business premises, and
  o For the employer's convenience.

  **Lodging is excludable from wages of the employee if it is provided:**
  
  o On the employer's business premises, and
  o For the employer's convenience, and
  o As a condition of employment.

- **Reimbursement for Use of Employee-Owned Vehicle** - An employee can deduct the costs of operating the vehicle for work as an employee, using either actual expenses or a standard mileage rate. If an employer reimburses these expenses under an accountable plan, they are not deductible by the employee, but are excludable from the employee's income. If reimbursements are not made under an accountable plan, or exceed the allowable amounts, they may be taxable as wages.

- **Equipment and Allowances** - In general, any equipment provided by the employer that represents ordinary and necessary business expenses, are excludable from income. Allowances paid or reimbursements made by an employer to an employee are excludable. However, these payments must be made under the terms of an accountable plan.

- **Awards and Prizes** - There are three types of non-cash awards that may be excluded from income. Each category has specific requirements that have to be met in order to be excludable. These categories are:
  
  o Certain employee achievement awards
  o Certain prizes or awards transferred to charities
  o De minimis awards and prizes

  Otherwise these are taxable, includable in Form W-2 and subject to federal and state withholdings, Social Security and Medicare!

- **Professional Licenses and Dues** – Employer reimbursements to employees for the cost of their professional licenses and professional organization dues are excludable if they are directly related to the employee’s job and reimbursed under an accountable plan.
• Educational Reimbursements and Allowances:
  
  o **Education Working Condition Fringe Benefit** – Job related educational expenses may be excludable from an employee’s income as a working condition fringe benefit.

  o **Qualified Educational Assistance** – Up to $5,250 paid or incurred on behalf of an employee under an educational assistance plan are excludable from the wages of each employee, if the following requirements are met:
    ▪ The employer must have a written plan.
    ▪ The plan may not offer other benefits that can be selected instead of education.
    ▪ Assistance does not exceed $5,250 per calendar year for all employers of the employee combined.
    ▪ The plan must not discriminate in favor of highly compensated employees (generally, for 2014, those receiving $115,000 or more or is a 5% owner at any time during the year or preceding year).

• **Dependent Care Assistance** - Under section 129, an exclusion is provided for household and dependent care services provided by an employer for a qualifying person’s care and provided to allow the employee to work. The employer can exclude the value of these benefits from employee wages if the employer reasonably believes that the employee can exclude the benefits from gross income. An employee can generally exclude from gross income up to $5,000 of benefits received under a dependent care assistance program each year ($2,500 if married filing separately). However, the exclusion cannot be more than the smaller of the earned income of either:
  o The employee, or
  o The employee’s spouse.