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Year End Reminder Regarding Common Fringe Benefits, Special Treatment for Two-Percent Shareholders and Changes Under TCJA

Summary

As 2018 draws to a close, we remind you about the proper inclusion of common fringe benefits in an employee's and/or two-percent shareholder's taxable wages, as well as changes made under the 2017 tax reform, referred to herein as the Tax Cuts and Jobs Act (TCJA).

Fringe benefits are defined as a form of pay for performance of services given by a company to its employees as a benefit and 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 information regarding the identification and tax reporting for several fringe benefits that are customarily provided. The TCJA changed the treatment of several fringe benefits as discussed below.

We also remind you that a failure to properly report to the recipient and the IRS before January 31, 2019, on Form W-2 or Form 1099 may result in lost deductions and additional tax and civil penalties.

Common Taxable Employee Fringe Benefits

Employer-Paid Group-Term Life Insurance Coverage in Excess of $50,000

Group-term life insurance coverage in excess of $50,000 is subject to only the withholding of Social Security and Medicare taxes (FICA). Though the amount is included in taxable wages, withholding of federal income tax (FIT) and state income tax (SIT) 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, are considered to have been provided under a non-accountable plan and are required to be treated as taxable wages for purposes of federal and applicable state and local income tax withholding; employer and employee FICA tax; and federal and state unemployment taxes (FUTA and SUTA).

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

The value of the company car used for personal travel must be treated (unless reimbursed by the employee) as additional wages on any frequency chosen by the employer up to and including an annual basis. Federal withholding tax on fringe benefit wage additions can be calculated as a combined total with regular wages or withheld at a flat 25-percent rate. Alternatively, employers can choose not to withhold federal income tax if the employee is properly notified by January 31 of the electing year or 30 days after a vehicle is provided and the value is properly reported on a timely filed Form W-2.

For administrative convenience, an employer can calculate the value of personal use for the current year based on 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) 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 this valuation period is elected, the same accounting period generally must be

used for all subsequent years with respect to the same automobile 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 automobile. Car allowances paid in cash without any substantiation of business use are fully taxable and subject to FICA, FUTA, FIT, and SIT withholdings.

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 IRS. 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.

Benefits That Exceed the De Minimis Exclusion

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 (FICA, FUTA, FITW, and SITW). Season tickets to sporting or theater events, use of an employer's home, apartment, boat, or vacation home, and country club or athletic facility memberships do not qualify as de minimis benefits. De minimis benefits have never included cash, gift cards/certificates or cash equivalent items, no matter how little the amount and the TCJA made that clear. 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.

Meals furnished by employers to employees often exceed the requirements for exclusion as de minimis. Still, most employer-provided meals are excluded from the employees' taxable income under the accountable plan rules for working condition fringe benefits. The TCJA did not change the rules of taxation of meals to employees, even though the limitations on an employer's deduction of meals and entertainment were modified. Under the new rules, food and beverage satisfying the de minimis fringe benefit rule and quiet business meals with customers and clients are 50-percent deductible by employers. Food or beverage expenses related to employee recreation, such as holiday parties or annual picnics, remain 100-percent deductible when provided primarily for the benefit of rank and file employees. Entertainment expenses, even with a business purpose, are no longer deductible under the TCJA.

There is no change in the federal payroll tax treatment of de minimis meals and corresponding meal facilities.

Caution: We have recently seen an aggressive position raised for businesses upon examination by the IRS, where the agent proposes that the company expenditure for on-site food and beverage regularly furnished to employees should be treated as employee compensation on account of being too frequent or extravagant to be excludible as a working condition or de minimis fringe benefit.

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: (i) achievement awards for length of service or safety and (ii) certain non-cash achievement awards, such as a gold watch at retirement or nominal birthday gifts, which fall within the exclusion for de minimis benefits.

In order to be an excludible length of service or safety award, there must be a meaningful presentation of the awards, and service being recognized must exceed five years and must not be awarded to same employee in the prior four years. 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).

Job-Related Moving Expenses Paid By Employer

Moving expenses incurred during 2018 must be included in the employee's taxable compensation under the TCJA changes, unless the employee is a member of the U.S. Armed Forces on active duty, whose move is to a permanent change of station. The exclusion from employee income will be reinstated January 1, 2026.

Value of Qualified Transportation Fringe Benefits

One of the most significant changes to fringe benefits in the TCJA is the elimination of any employer deduction for expenses incurred in providing any transportation fringe benefits to employees. Transportation fringe benefits may still be provided to employees, and the payroll tax treatment of employee parking, van pool, and transportation benefits remains unchanged.

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 2018, the statutory limits are $260 per month for qualified parking and $260 for transit passes and van pooling. An employee can be provided both benefits for a total of $520 per month, tax-free, with the excess included in Form W-2. Note that amounts exceeding the limits cannot be excluded as de minimis fringe benefits.

Under the TCJA, bicycle commuting benefits incurred on or after January 1, 2018, are included in taxable wages subject to FIT, FITW, FITA, and FUTA. The taxation to the employee as regular compensation sustains the deduction by the employer. Prior to the TCJA, $20 per month could be provided by employers to bicycle commuters, excluded from the employee's taxable income and deducted by the employer.

The value of any de minimis transportation benefit provided to an employee can be excluded from Form W-2. For example, an occasional taxi fare home for an employee working overtime or departing a business function such as a holiday party may be provided tax-free.

Pleases note that some local jurisdictions require mass transit options. For instance, the District of Columbia requires employers with 20 or more employees to offer qualified transit benefits. While D.C. employers are not necessarily required to subsidize the cost of their employees' commuting expenses under the new law, they are required to provide an arrangement for employees to make a pre-tax election to take full advantage of the maximum statutory limits for transit, commuter highway, or bicycling benefits. San Francisco and New York City have adopted similar laws in an attempt to promote the use of available mass transit options and to reduce automobile-related traffic and pollution. You should check your local requirements for each employee location.

Cell Phone Without Business Reason

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."

Similarly, the employer can exclude reimbursements to an employee for business use of a personal cell phone. According to an IRS Memorandum for All Field Examination Operations issued September 14, 2011, the analysis for exclusion is similar to the approach outlined in Notice 2011-72, provided the employer requires the employee to maintain and use their personal cell phones for substantial noncompensatory business reasons.

Employer expenses related to cell phones provided to an employee that does not have a business reason for being in contact at all times for work-related emergencies or to speak to clients when away from the office, should be included in the employee's taxable income.

Rules Require Taxation of Certain Employee Fringe Benefits to Two-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 two-percent shareholder of an S corporation. A two-percent shareholder is any person who owns, directly or indirectly, on any day during the taxable year, more than two percent of the outstanding stock or stock possessing more than two percent of the total combined voting power. These fringe

benefits are generally excluded from the income of other employees, but are taxable to two-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 two-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. Two-percent shareholders cannot use pre-tax payroll deductions to reimburse premiums paid by the S corporation.

Cafeteria Plans

A two-percent shareholder is not eligible to participate in a cafeteria plan, nor can the spouse, child, grandchild, or parent of a two-percent shareholder. If a two-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 to Health Savings Accounts and Other Tax Favored Health Plans

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

These payments should be included in line 1 of a greater than two-percent shareholder's W-2, subject to regular federal withholding. This additional compensation is also subject to employment tax withholding (FICA and FUTA). The entire premium paid on behalf of a two-percent shareholder under a group-term life insurance policy is treated as taxable, not just the premium for 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 FICA tax withholding only. The cost of the insurance coverage is not subject to FUTA, FITW, or SITW. Please note that any life insurance coverage for which the corporation is both the owner and beneficiary (e.g., key man life insurance) does not meet the definition of group-term life insurance and therefore there is no income inclusion 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, 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 two-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 two-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.