

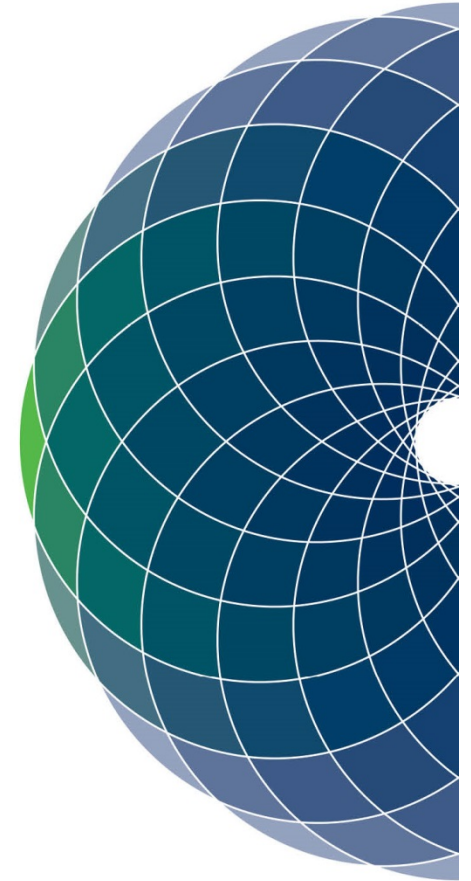


IRS Compliance Issues: Spotlight on Fringe Benefits

Denise P. Hill

Senior Manager

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Why Discuss Fringe Benefits?

- Employment audits generate significant income for the IRS – considered to be an untapped source of revenue – made up 44% of all IRS collections in 2009
- 2010 Project for small employers – results will help IRS identify potential audit targets - IRS is examining 6,000 employment tax returns and has discovered that under reporting fringe benefits is a wide-spread problem
- Audits and IRS analysis supposed to be completed in the summer of 2014
- The benefits are no longer a minor part of compensation – they now represent close to 40% of the total cost of compensation
- The employer is “secondarily liable” for failing to withhold



- 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: 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.
 - Finance/payroll not aware of the benefit
 - Overall departmental differences



Topics of Discussion

- Define Fringe Benefits
- Discuss Taxable versus Nontaxable
- Components of an Accountable Plan
- Managing Written Guidelines and Policies



What is a Fringe Benefit?

- A fringe benefit is a **form of pay** for the performance of services:
 - Property
 - Services
 - Cash or Cash Equivalent

All fringe benefits are taxable and must be included in the recipients' pay unless the law **specifically** excludes it.



Examples of Fringe Benefits

- Airline club memberships
- Automobile allowances
- Awards or prizes
- Back pay awards
- Bonuses (cash or noncash)
- Cafeteria plans
- Cell phones and other telecommunications devices
- Chauffeur service
- Club memberships
- Company aircraft
- Disability payments
- Discounts on property or service
- Discounted airline passes
- Educational reimbursements
- Executive dining rooms
- Estate planning
- Financial counseling
- Financial seminars
- Free or subsidized lodging (including campus lodging)
- Golden parachute payments



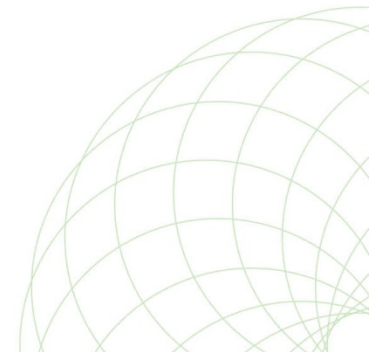
Examples of Fringe Benefits Continued

- Company cars
- Credit cards (employer-provided)
- Dependent care assistance programs
- Group-term life insurance over \$50,000
- Holiday gifts
- Home security systems
- Income tax preparation
- Laptop computers
- Legal counseling
(low-interest or interest-free)
- Local transportation for commuting purposes
- Reimbursements of expenses on meal money because of overtime
- Sale of personal residence
- Meal allowances/reimbursements (not away overnight)
- Memberships in athletic facilities
- Military differential pay
- Moving expense reimbursements
- Nonqualified stock bonus plans
- Nonqualified stock option plans
- Outplacement services
- Parking
- Personal liability insurance
- Physical examinations and/or loans
- Use of health/medical facilities



Examples of Fringe Benefits Continued

- Retirement gifts
- Safety or length of service awards
- Severance pay
- Scholarships or fellowships
- Sick pay
- Spousal travel
- Uniform allowances
- Use of recreation vehicles or boats
- Use of vacation homes
- Vacations (all expense paid or discounted)



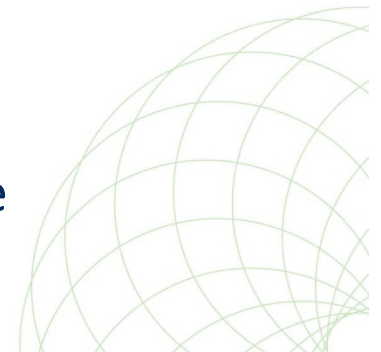
Nontaxable Fringe Benefits

- Specifically excluded by law:
 - IRC 79 – Group Term Life Insurance
 - Note: This exemption is for the first \$50K of coverage
 - IRC 105 & 106 – Employer Health Benefits
 - IRC 119 – Meals or Lodging for the Employer's Convenience
 - IRC 125 – Cafeteria Plans
 - IRC 127 – Educational Assistance Programs
 - IRC 129 – Dependent Care Assistance



IRC Section 132

- Fringe Benefits excluded under certain conditions (the “Workhorse” of Statutory Exclusions):
 - No additional cost service
 - Qualified employee discounts
 - ***Working condition fringe***
 - ***De minimis fringe***
 - On-premises athletic facilities
 - Qualified transportation fringe
 - Qualified moving expense reimbursements
 - Qualified retirement planning services
 - Qualified military base realignment and closure fringe



Working Condition Fringe Benefits

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 if he/she had to pay for it during the process of getting an employee's job done.

- Examples:

- Professional dues and subscriptions
- Supplies
- Business meal
- Cash reimbursement for business travel
- Job training
- Uniforms that are not adaptable to general use



De Minimis Benefits

- Excluded from the employee's income when the employer-provided property or services have such a small value and frequency that accounting for them would be impractical
- De minimis benefits can be provided on a discriminatory basis
- De minimis rules do not apply to – cash and cash equivalents (including gift cards) and memberships in private country clubs or athletic facilities
 - Examples:
 - Employee cocktail parties
 - Company picnics
 - Coffee and doughnuts / bottled water and soft drinks
 - Occasional use of the copy machine/fax machine/phones



Common Fringe Benefits

- Gifts and Awards
 - Employers may give employees cash or noncash awards and prizes as a reward for achievements within the organization
 - The fair market value of the reward are included in gross income of the employee – IRC Section 74

Cash gifts and awards are always included in gross income, including gift cards which are considered cash equivalents. No matter how small the amount, even \$5, gift cards presented to an employee should be reported in their wages.



Common Fringe Benefits

- Gifts and awards may be excluded from income under certain exceptions:
 - De minimis fringe benefits (turkey/pin/flowers/coffee mugs/plaques)
 - Recognition awards that are given for charitable/other achievement such as the Nobel Peace Prize
 - 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 retirement awards presented upon completion of lengthy term of service (gold watch regardless of value because no expectation of future services, i.e. not compensatory)



Common Fringe Benefits

- Meals on Business Premises- Nontaxable
 - 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

TAXABLE: The value of food provided on a regular, expected basis (not just occasionally) should be included in taxable wages.



Common Fringe Benefits

- Cell Phone/ Tablets

- For tax years after 2009, cell phones and related devices are no longer considered listed property, meaning that employers no longer need to meet substantiation requirements to deduct the equipment (i.e. no need for a contemporaneous detailed activity log)
- Business use of the cell phones (or other similar telecommunications equipment) are considered a *working condition* fringe benefits (i.e. provided for non-compensatory business reasons) and are therefore not taxable
- The personal use, however, is still considered taxable compensation, unless provided for non-compensatory business reasons, then the personal use will be considered excludable as a de minimis fringe benefit



Common 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
- Personal use cannot be changed to business use by attaching display material that advertises business while the employee is driving
- Business use must be properly substantiated with adequate records (i.e. using an accountable plan with documentation)
- 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



Common Fringe Benefits

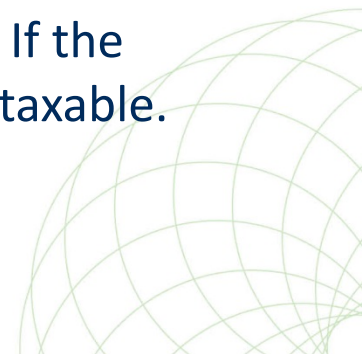
- Spousal Travel
 - Employer-provided spouse or dependent travel is generally taxable income to the employee
 - The expense will qualify as a working condition fringe benefit only if the employer:
 - Can adequately demonstrate that spouse's presence on the business trip has a bona fide business purposes and
 - If the employee substantiates the travel and
 - If the companion is also an employee



Common 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
- Good News! In March 2015, the IRS clarified that the cost of clothing ***provided to wear on duty*** is not subject to taxation. You must change your policies on clothing to specify that certain items of clothing are required as part of a uniform (tshirts and baseball caps included) and are prohibited from being worn off-duty.
- Previously, embroidered logos and patches on polo shirts are almost always taxable (i.e. considered an informal work uniform). If the clothing /shoes are adaptable to normal wear, the value is taxable.



Common Fringe Benefits

- **Employer Issued Credit Cards**

Many companies allow employees to use credit cards to buy items for the company. Some companies issue credit cards to executives and pay the bills without requiring the executive to show business purpose. Personal expenses paid through these credit cards to executives are considered taxable fringe benefits and they cannot be deducted as business expenses.

If executives are not required to substantiate that the expenses charged to the corporate credit card were for business expenses, the reimbursement is considered to have been made under a non-accountable plan and the entire reimbursement is taxable to the executive, and wages for employment tax purposes.



Common Fringe Benefits

- Awards Funded by Third Party

If funds or a noncash prize are provided by an outside party, the award is taxable in the same way as if provided directly by the employer.

If the third party selects and distributes the award directly to the agency employee without any direction or decision making from agency personnel, then the award is income to the recipient and must be reported. The outside party would be required to furnish a Form 1099-MISC to the recipient if the amount is \$600 or more in a calendar year.



Employee Business Expense Reimbursements

- Provided under an Accountable Plan

Must meet **all three** of the following to be non-taxable:

- 1. There must be a business connection
- 2. Must be adequate accounting by the recipient within a reasonable period of time – receipts required for lodging and for expenses in excess of \$75 or more
- 3. Excess of expenses must be returned within a reasonable period of time

The Accounts Payable function is essentially administering a payroll tax body of law – so communication and written policies are critical.



Business Connection

- The plan must provide reimbursements or advances only for business expenses that would otherwise qualify as a trade or business expense under IRC Section 162
- Section 162 allows deductions for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business
- The IRS looks to whether or not the expenditure secured a business benefit when evaluated if the expense is ordinary and necessary



Adequate Accounting

- Employees are required to provide sufficient information to satisfy a “business connection” of the expenditure – i.e. the 5 “W”’s:
 - What – amount
 - When – time, date, etc.
 - Where – business location, destination, etc.
 - Why – business purpose
 - Who – for entertainment purposes

Written contemporaneous recordkeeping has more values than oral evidence.



Written Guidelines and Policies

- When is it time to update your policy handbook/procedures/guidelines?
 - Given the recent publicity regarding fiscal mismanagement in state and county agencies (due to lack of coordination and information sharing) – it may be time to re-write your policies in order to provide:
 - Better audit measurements to access compliance within the Agencies departments
 - To provide clarification of the Agencies position and specific guidance for employees that may have resulted in confusion or non-compliance in the past
 - To ensure there are no gaps in the *public's* understanding



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.

Explain the fringe benefit that is received by the employee when the benefit is used/received for non-business (i.e. personal) reasons.



Consider a Fringe Benefit Plan Review

- Identifying all fringe benefits
- Confirming that the benefit is properly reported and that taxes are withheld and deposited in a timely manner
- Identifying and implementing statutory fringe benefit rules / reviewing and/or re-writing current guidelines and policies that will pass IRS scrutiny
- Identifying and implementing the special valuation rules that apply to fringe benefits
- Employment Tax audits are expensive – in addition to any penalties imposed by the IRS, increased costs in administrative and financial resources will be incurred during an audit
- Costs can be alleviated by conducting a comprehensive review before you are contacted by the IRS



Denise Hill

Email: denise.hill@elliottdavis.com

Phone: 803.255.1479

Website: www.elliottdavis.com

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