

AN ALERT FROM THE BDO EXECUTIVE AND HR SERVICES PRACTICE

BDO KNOWS:

COMPENSATION & BENEFITS



► SUBJECT

FRINGE BENEFIT ITEMS TO INCLUDE ON 2014 FORMS W-2

As 2014 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 that 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.

Please note that 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.

► 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. Although 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 payment 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

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company, is considered to have been provided under a non-accountable plan and is 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). 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, federal income tax withholding (FITW), and state income tax withholding (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.

Value of personal use of company aircraft

This fringe benefit (unless reimbursed by the employee [to the extent permitted under Federal Aviation Administration rules]) 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 ten-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 the 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 items 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 2014, the statutory limits are \$250 per month for qualified parking. The statutory limits for transit passes and vanpooling are substantially lower at \$130 per month for 2014.

The statutory limits for 2015 will remain unchanged at \$250 per month for qualified parking, and \$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.

Value of personal use of employer-provided cell phone

The passage of the Small Business Jobs Act of 2010, H.R. 5297, relieved employer-provided cell phones from the strict substantiation requirements for “listed property.” For tax periods beginning after December 31, 2009, the fair market value of the personal use of an employer-provided cell phone that is predominately used for business purposes is properly excluded from the employee’s gross income.

In addition, the Service issued Notice 2011-72 clarifying that the value of the business use of an employer-provided cell phone is excludable from the employee’s income as a working condition fringe benefit, provided 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.

Rules require taxation of certain 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 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. *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.

According to Notice 2008-1, any health insurance premiums that are not included in the shareholder’s Form W-2 are not eligible to be deducted 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. In that case, employees cannot make pre-tax 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. Two-percent 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 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 a 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 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.

▶ 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.

Table 2-1 from IRS Publication 15-B that summarizes most of the information discussed in this alert is attached to this document.

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Material discussed in this tax alert is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.

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Table 2-1. Special Rules for Various Types of Fringe Benefits
(For more information, see the full discussion in this section.)

Treatment Under Employment Taxes			
Type of Fringe Benefit	Income Tax Withholding	Social Security and Medicare (including Additional Medicare Tax when wages are paid in excess of \$200,000)	Federal Unemployment (FUTA)
Accident and health benefits	Exempt ^{1,2} , except for long-term care benefits provided through a flexible spending or similar arrangement.	Exempt, except for certain payments to S corporation employees who are 2% shareholders.	Exempt
Achievement awards	Exempt ¹ up to \$1,600 for qualified plan awards (\$400 for nonqualified awards).		
Adoption assistance	Exempt ^{1,3}	Taxable	Taxable
Athletic facilities	Exempt if substantially all use during the calendar year is by employees, their spouses, and their dependent children and the facility is operated by the employer on premises owned or leased by the employer.		
<i>De minimis</i> (minimal) benefits	Exempt	Exempt	Exempt
Dependent care assistance	Exempt ³ up to certain limits, \$5,000 (\$2,500 for married employee filing separate return).		
Educational assistance	Exempt up to \$5,250 of benefits each year. (See Educational Assistance , later in this section.)		
Employee discounts	Exempt ³ up to certain limits. (See Employee Discounts , later in this section.)		
Employee stock options	See Employee Stock Options , later in this section.		
Employer-provided cell phones	Exempt if provided primarily for noncompensatory business purposes.		
Group-term life insurance coverage	Exempt	Exempt ^{1,4,7} up to cost of \$50,000 of coverage. (Special rules apply to former employees.)	Exempt
Health savings accounts (HSAs)	Exempt for qualified individuals up to the HSA contribution limits. (See Health Savings Accounts , later in this section.)		
Lodging on your business premises	Exempt ¹ if furnished for your convenience as a condition of employment.		
Meals	Exempt if furnished on your business premises for your convenience. Exempt if <i>de minimis</i> .		
Moving expense reimbursements	Exempt ¹ if expenses would be deductible if the employee had paid them.		
No-additional-cost services	Exempt ³	Exempt ³	Exempt ³
Retirement planning services	Exempt ⁵	Exempt ⁵	Exempt ⁵
Transportation (commuting) benefits	Exempt ¹ up to certain limits if for rides in a commuter highway vehicle and/or transit passes (\$130), qualified parking (\$250), or qualified bicycle commuting reimbursement ⁶ (\$20). (See Transportation (Commuting) Benefits , later in this section.) Exempt if <i>de minimis</i> .		
Tuition reduction	Exempt ³ if for undergraduate education (or graduate education if the employee performs teaching or research activities).		
Working condition benefits	Exempt	Exempt	Exempt

¹ Exemption does not apply to S corporation employees who are 2% shareholders.
² Exemption does not apply to certain highly compensated employees under a self-insured plan that favors those employees.
³ Exemption does not apply to certain highly compensated employees under a program that favors those employees.
⁴ Exemption does not apply to certain key employees under a plan that favors those employees.
⁵ Exemption does not apply to services for tax preparation, accounting, legal, or brokerage services.
⁶ If the employee receives a qualified bicycle commuting reimbursement in a qualified bicycle commuting month, the employee cannot receive commuter highway vehicle, transit pass, or qualified parking benefits in that same month.
⁷ You must include in your employee's wages the cost of group-term life insurance beyond \$50,000 worth of coverage, reduced by the amount the employee paid toward the insurance. Report it as wages in boxes 1, 3, and 5 of the employee's Form W-2. Also, show it in box 12 with code "C." The amount is subject to social security and Medicare taxes, and you may, at your option, withhold federal income tax.

Exception for S corporation shareholders. Do not treat a 2% shareholder of an S corporation as an employee of the corporation for this purpose. A 2% shareholder is someone who directly or indirectly owns (at any time during the year) more than 2% of the corporation's stock or stock with more than 2% of the voting power. Treat a 2% shareholder as you would a partner in a partnership for fringe benefit purposes, but do not treat the benefit as a reduction in distributions to the 2% shareholder.

Exclusion from wages. You can generally exclude the value of accident or health benefits you provide to an employee from the employee's wages.

Exception for certain long-term care benefits. You cannot exclude contributions to the cost of long-term care

insurance from an employee's wages subject to federal income tax withholding if the coverage is provided through a flexible spending or similar arrangement. This is a benefit program that reimburses specified expenses up to a maximum amount that is reasonably available to the employee and is less than five times the total cost of the insurance. However, you can exclude these contributions from the employee's wages subject to social security, Medicare, and federal unemployment (FUTA) taxes.

S corporation shareholders. Because you cannot treat a 2% shareholder of an S corporation as an employee for this exclusion, you must include the value of accident or health benefits you provide to the employee in the employee's wages subject to federal income tax withholding. However, you can exclude the value of these