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APA Government Forms and Publications Subcommittee Offers Recommendations to IRS

APA recently made a series of suggestions to the IRS Forms and Publications division aimed at making their products easier to understand and administer. The suggestions were made by the Government Forms and Publications Subcommittee of APA's Government Affairs Task Force. This subcommittee is chaired by Nora Daly, CPP.

IRS responses will be covered in a future edition of Inside Washington.

Anyone who has an idea for improving a form or publication from IRS, SSA, or the Department of Labor is invited to join the Government Forms and Publications Subcommittee. (Forms and publications from the Office of Child Support Enforcement and the Department of Homeland Security are handled by other subcommittees.) Ideas for improvement should include: (1) an explanation of the problem with the current situation (what burden, confusion, or noncompliance does it create?), and (2) a solution to the problem. Both parts should be as specific as possible.

For more information, contact Scott Mezistrano, CPP, APA's Senior Manager of Government Relations, at smezistrano@americanpayroll.org.

Publication 15, Employer's Tax Guide

Problem. There is no guidance on calculation of tax on supplemental wages under the aggregate method for situations in which there are multiple payments of supplemental wages between payments of regular wages. We ran a scenario by John Tuzynski, Chief, Employment Tax, and he agreed with our approach.

Recommendation. Page 13, first column, item 1.b.: Add a sentence at the end: "If there was another payment of supplemental wages (after the last payment of regular wages but before the current payment of supplemental wages), then aggregate all three payments, calculate the tax on the total, subtract the tax already withheld from the regular wages and the previous supplemental wages, and withhold the remaining tax."

Publication 15-A, Employer's Supplemental Tax Guide

Problem/Recommendation. Publication 505 used to be listed under "Useful Items" (page 3), and it should be put back in the list. It is addressed to the employee, but it contains useful information for the employer as well. For example, it contains the directive from IRS that an employee may not give a check to the employer to cover federal income tax for wages from prior periods or for estimated payments (page 5, first column).

Publication 15-B, Employer's Tax Guide to Fringe Benefits

Problem 1. The instructions are worded in such a way that

employers are taxing COBRA premiums they pay or reimburse for current employees who have a waiting period before the company's medical coverage becomes effective. (The existing language clearly exempts payments on behalf of previous employees, however.)

Recommendation. Work with Chief Counsel to identify verbiage that will indicate that reimbursement for COBRA coverage to current common law employees is also not taxable. We understand that is implied based on the earlier definition of "employee," but some employers are not seeing that section.

Problem 2. There is currently no guidance for employers on how to handle gift cards, checks, or certificates. Some employers also award "points" to employees that are redeemable for goods at some future point in time – should they be included in income when the accrued value exceeds a certain amount or when the employee "cashes" them in to purchase something?

Recommendation. In 2004, the IRS issued a very clear and thorough Technical Advice Memorandum on the taxability of gift certificates. A discussion of this should be included in Publication 15-B. The timing and taxation of points is an issue we believe Chief Counsel might want to address.

Problem 3. The discussion of the Lease Value Rule (pages 19-21) does not say to prorate the value of the automobile by the percentage of personal miles out of total miles.

Recommendation. In the second paragraph under this topic (page 19, second column), add, after the first sentence: "In order to do this, the employee must account to the employer for the business use. This is done by substantiating the usage (e.g., mileage), the time and place of the travel, and the business purpose of the travel. Written records made at the time of each business use are the best evidence. Any use of a company-provided vehicle that is not substantiated as business use is defined by the IRC to be personal use and is included in income."

In the first column on page 20, add a step 3: Multiply the annual lease value by the percentage of personal miles out of total miles driven by the employee.

Form 1040, U.S. Individual Income Tax Return

Problem. The Form 1040 instructions do not give any guidance to tax filers who have received both a W-2 and a W-2c from their employer. The form and instructions (page 62) tell filers only to attach Form W-2.

Recommendation. Include instructions that tax filers should include their W-2c along with their W-2 when filing Form 1040.

Form W-2, Wage and Tax Statement

Problem 1. The instructions for employers for Box 1 read,

“Wages, tips, other compensation. Show the total wages, tips and other compensation, before any payroll deductions...” Some employers take that to mean to include the pre-tax reductions in Box 1.

Recommendation. Change the instructions to read: “Show the total taxable wages...” And, clarify: “...before any after-tax payroll deductions...”

Problem 2. Box 12, Code J – The instructions say: “Nontaxable sick pay. Show any sick pay that was paid by a third party and was not includible in income (and not shown in Boxes 1, 3, and 5) because the employee contributed to the sick pay plan.”

a. How is this information used?

b. It is not clear how this applies to employees who receive nontaxable disability payments directly from the state (nontaxable because the employee paid the premium as a tax to the state). The employer generally has no way of knowing how much the state paid the employee. This seems quite different than “third-party sick pay” because the employer and the state don’t have a contractual relationship like there exists between the employer and a third-party sick pay insurance agency. The state disability payout is similar to the situation in which an employer deducts FICA taxes, but the payout is made by the government and no W-2 reporting is required.

Recommendation. Clarify the instructions for Box 12, Code J, to specify how this information is used and whether this applies to nontaxable payments that are paid by the state.

Problem 3. Undeliverable Forms W-2 must be kept for four years. (W-2 instructions, page 3, bottom of second column.) Employers have to store this paper, and it’s not as if it provides a complete record of all W-2s that weren’t delivered to the correct person. Certainly, some W-2s are lost in the mail. This requirement necessitates the storage of more paper with confidential and sensitive data that, if stolen, could facilitate identity theft. The requirement made sense at a time when an employer could not regenerate the W-2 or make photocopies of the employer copy as easily as can be done now. As long as the employer has some way of regenerating or providing photocopies of the W-2, it should not be required to keep copies for four years.

Recommendation. Rewrite the instructions as: “Keep for four years any employee copies of Forms W-2 that you tried to deliver but could not. However, as long as you can reproduce and provide the undelivered W-2 (by electronically regenerating it or by making photocopies of the employer’s copy) through April 15 of the fourth year following the tax year to which it pertains, you do not need to keep undeliverable employee copies. Do not send undeliverable Forms W-2 to the SSA.”

Problem 4. Guidance on reporting of contributions to Health Savings Accounts is unclear. The W-2 instructions (page 6, second column) say, “An employee’s contributions to an HSA are includible in income as wages and are subject to withholding ...” However, this is referring to an employee’s post-tax contributions. Pre-tax contributions, such as through a cafeteria plan, are not includible in income. We know that IRS considers pre-tax contributions to be “employer contributions,” but that is not what most employers consider them to be.

Recommendations. Change the first paragraph under this topic to read “Employer contributions and employee pre-tax contributions to an employee’s Health Savings Account (HSA) are not subject ...”

In the paragraph after that, change the first sentence to read, “An employee’s post-tax contributions to an HSA are includible in income as wages and are subject to ...”

Page 13, first column, Code W: change to “Code

W – Employer and pre-tax contributions to a Health Savings Account (HSA). Show any employer contributions and any employee pre-tax contributions (using a section 125 cafeteria plan) to a Health Savings Account.”

Problem 5. When reporting prior-year deferrals to nonqualified deferred compensation plans because the deferrals have subsequently become subject to FICA tax, it is unclear whether the earnings on those deferrals should be included. On page 10, first column, 13th paragraph, the instructions for Box 3 make no reference to earnings. However, on page 11, first column, 6th paragraph, the instructions for Box 11 say to include deferrals.

Recommendation. Perhaps the rules are different for Box 3 vs. Box 11. If so, the instructions for Box 3 (page 10) should specifically say to exclude any earnings on those deferrals. If the rules are supposed to be the same, one set of instructions needs to be changed.

Problem 6. Page 15, column 2, last paragraph: says “Amounts reported on Forms W-2, W-3, and 941/943 may not match for valid reasons.” However, it does not suggest what the valid reasons may be.

Recommendation. It could say “W-2 Boxes 5 and 7 will be out of balance from the corresponding lines on the 941 by the amounts in W-2 Box 12 Codes a, b, m, and n. W-2 Box 2 will be out of balance from Form 941 line 3 by the amount of federal income tax withheld by the third-party administrator of sick pay.”

Problem 7. Under “Deceased employee’s wages,” there is no discussion of a check that was constructively received, but not cashed, while the employee was still alive.

Recommendation. At the beginning of this discussion on page 5, a sentence could be inserted: “Wages that were constructively received by the employee while alive are reported on Form W-2 as usual, even though you may have to reissue the net check in the name of the estate or beneficiary.”

Form W-3c, Transmittal of Corrected Wage and Tax Statements

Problem. Box b – Employer’s name, address and ZIP code – the space provided is not sufficient for employers with a long name or address or “doing business as” (dba) designation.

Recommendation. Expand Box b to allow for longer names/addresses.

Form W-4, Employee’s Withholding Allowance Certificate

Problem. The instructions state that an employee claiming exempt should “complete only lines 1, 2, 3, 4 and 7 and sign the form to validate it.” Employers are often confused when such an employee also enters something in Box 5 and/or 6. At APA’s 2004 Congress, IRS said that a Form W-4 is invalid if the employee claims single or married with some allowances in Box 5 and/or an amount in Box 6 and also writes “Exempt” in Box 7.

Recommendation. The instructions should take the next step to say that if an employee claiming “exempt” enters anything in Boxes 5 or 6, the form is invalid. If there isn’t room on the form, perhaps this could be added to Pub 15 (page 14, second column).

Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

Problem. The instructions for Form 1099-R are silent on this topic: would a distribution from a 401(k) or 403(b) plan after the age of 59½ be reported on a 1099-R with a distribution code of 7?

Form 1099-MISC, Miscellaneous Income

Problem. The instructions need to include direction on the reporting of supplemental military pay. While IRS’s Web site says that it is reported on the 1099-MISC, it doesn’t specify whether it’s Box 3, Other income, or 7, Nonemployee compensation. We imagine it should be Box 3, which does not invoke self-employment tax. ■