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Inside this issue...

<i>Senate Finance Committee Votes for Health Insurance Reform</i>	<i>2</i>
<i>Daylight Saving Time Ends November 1</i>	<i>3</i>
<i>IRS Highly Unlikely to Require ISO, ESPP Information Reporting for 2009</i>	<i>3</i>
<i>USCIS Redesigns Website</i>	<i>3</i>
<i>IRS Updates Electronic Filing Requirements for Form 1042-S</i>	<i>3</i>
<i>IRS Releases 53 Q&As on Proper Worker Classification</i>	<i>4</i>
<i>Wage & Hour Roundup</i>	<i>4</i>
<i>IRS Discusses FICA Tax Treatment of NQDC Plan Payments to Retirees</i>	<i>5</i>
<i>IRS Offers Guidance on Automatic Enrollment in SIMPLE IRA Plans</i>	<i>6</i>
<i>State and Local News</i>	
<i>California – new withholding tables released; supplemental wage tax rates increased</i>	
<i>Connecticut – catch-up withholding required for certain employees</i>	
<i>Indiana – county income tax rates changed</i>	
<i>Minnesota – reciprocal withholding agreement with Wisconsin terminated</i>	
<i>New York – MTA payroll tax online filing and payment available</i>	<i>8</i>

Social Security Wage Base Remains at \$106,800 in 2010

The Social Security Administration (SSA) announced on Thursday, October 15, 2009, that the 2010 social security wage base will be \$106,800, unchanged from 2009 (the SSA Fact Sheet is available at www.americanpayroll.org/members/Forms-Pubs/#guide). As in prior years, there is no limit to the wages subject to the Medicare tax; therefore all covered wages are still subject to the 1.45% tax.

The FICA tax rate, which is the combined social security tax rate of 6.2% and the Medicare tax rate of 1.45%, remains at 7.65% for 2010. The maximum social security tax employees and employers will each pay in 2010 is \$6,621.60. This is unchanged from the 2009 maximum.

The social security wage base for self-employed individuals in 2010 will also be \$106,800. There is no limit on covered self-employment income that will be subject to the Medicare tax. The self-employment tax rate remains 15.3% (combined social security tax rate of 12.4% and Medicare tax rate of 2.9%). In 2010, the maximum social security tax for a self-employed individual will be \$13,243.20. This is unchanged from the 2009 maximum.

Quarters of coverage; retirement earnings test

The SSA has also announced that the amount of earnings needed to qualify for a quarter of coverage in order to receive full social security benefits will be \$1,120 in 2010, up from \$1,090 in 2009.

Retirees who will not reach full retirement age in 2010 can earn up to \$14,160 a year (\$1,180 a month) without losing any benefits, unchanged from 2009; for these retirees, \$1 in

benefits will be withheld for every \$2 in earnings above the applicable limit.

Retirees who reach full retirement age in 2010 will lose \$1 in benefits for every \$3 earned above \$37,680, unchanged from 2009, but only counting earnings before the month they reach full retirement age. Starting with the month retirees reach full retirement age, they will receive full benefits with no limit on earnings.

REMINDER – For retirees born in 1937 or earlier, “full retirement age” is 65. Note, however, that full retirement age gradually increases for retirees born thereafter – from 65 and 2 months (for retirees born in 1938) to 67 (for those born in 1960 and later). To find your full retirement age, go to www.socialsecurity.gov/retire2/agereduction.htm.

Social security benefits

As this article went to press, SSA had not yet released information on the maximum monthly social security benefit a worker could get after retiring at full retirement age in January 2010. Current social security benefit recipients will not automatically receive a cost-of-living adjustment in their benefits in January.

FICA coverage threshold unchanged for domestic, election workers

The threshold for coverage under social security and Medicare for domestic employees will be \$1,700 in 2010, unchanged from 2009; the coverage threshold for election workers will be \$1,500 in 2010, also unchanged from 2009. ■

Senate Finance Committee Votes for Health Insurance Reform

On October 13, the Senate Finance Committee voted to send the America's Healthy Future Act (AHFA) to the full Senate for consideration. Before that happens, however, it will be reconciled with another bill approved by the Senate Health, Education, Labor, and Pensions Committee in July. Then the final Senate version of the legislation must be reconciled again with any bill passed by the House of Representatives, where varying versions of a health insurance reform bill have been approved by three different committees. The AHFA has several provisions that would significantly impact payroll processing.

Health insurance reporting on Form W-2. Employers would be required to report the value of the benefit provided by the employer for each employee's health insurance coverage on the employee's Form W-2. If an employee receives employer-provided coverage under multiple plans, such as a major medical plan, a dental plan, and a vision plan, the employer would have to report the total value of the coverage provided by the employer.

Employers would generally use the same value for all similarly situated employees receiving the same category of coverage (e.g., single or family coverage). The method of determining the value of employer-provided health insurance coverage would be the same used to calculate the employer-provided portion of the applicable premiums for COBRA continuation coverage purposes. This new reporting requirement would take effect for the 2010 tax year.

Health FSA deferral limitations. The bill would limit salary reductions by an employee into a health flexible spending arrangement (FSA) to \$2,500. It would not limit the exclusion for health coverage offered through a health reimbursement arrangement (HRA). This provision would take effect in tax year 2011.

No more non-prescription drug reimbursement through an FSA. The bill would conform the definition of "medical expense" for purposes of health FSAs, HRAs, Health Savings Accounts (HSAs), and Archer Medical Savings Accounts (MSAs) to the definition used in determining the itemized deduction for medical expenses. Using this more limited definition would mean that the cost of over-the-counter medicine (unless prescribed by a doctor) could not be reimbursed at all through a health FSA or HRA or on a tax-free basis through an HSA or Archer MSA unless the medicine is prescribed by a doctor. This change would take effect in tax year 2010.

Higher penalty for non-medical HSA reimbursements. The bill would increase the additional tax on distributions from an HSA that are not used for medical expenses from 10% to 20% of the distributed amount. The increase would take effect for distributions made during tax year 2011.

Payroll deductions used to purchase insurance through state exchanges. For employees who qualify to purchase health insurance through a state exchange and receive a tax credit for the premiums, the premium payments would be made through payroll deductions. This provision would take effect July 1, 2013.

Automatic enrollment if employers provide insurance. Employers with 200 or more employees would have to automatically enroll employees in health insurance plans offered by the employer. Employees would be able to opt out of this coverage if they can show they have coverage from another source (e.g., a public program such as Medicare or Medicaid, or as a dependent in a spouse or other family member's health coverage). This provision would take effect July 1, 2013.

No more corporate exemption from 1099 reporting. The bill would modify the general information reporting requirements

regarding services provided to a trade or business by eliminating the exception for payments to corporations. It would also expand the class of payments for which information reporting is required to include gross proceeds for both property and services. The current regulatory exception for payments to exempt or governmental organizations would not be affected. The changes would take effect for payments made beginning in 2012.

Excise tax for insurers on high-value health plans. The bill would impose an excise tax on insurers if the total value of employer-sponsored health coverage for an employee exceeds a threshold amount. The tax would be 40% of the excess amount and would be prorated for the insurers if the employee is covered by multiple plans. The threshold amount would be \$8,000 for single coverage and \$21,000 for family coverage – with certain adjustments in states where health care is most expensive, for retired individuals over age 55, and for plans that cover employees in high-risk professions – such as law enforcement and firefighting.

It would not matter whether the employer, the employee, or both, pay for the coverage, so long as the health coverage is offered by the employer to the employee. Where an employer acts as plan administrator to a self-insured group health plan, health FSA, or HRA, and with respect to employer contributions to an HSA, the excise tax, if any, would be paid by the employer. If an employer reports to insurers and plan administrators (and the IRS) a lower amount of insurance cost subject to the excise tax than required, the employer would be penalized an amount equal to any additional excise tax that each insurer or plan administrator would have owed if the employer had reported correctly, plus interest. The excise tax provisions would take effect in 2013.

Cafeteria plan rule changes for small businesses. The bill would provide for a safe harbor from the nondiscrimination requirements for cafeteria plans for an eligible small employer (no more than 100 employees). The safe harbor would also apply to the nondiscrimination requirements for specified qualified benefits offered under the cafeteria plan, including group-term life insurance, coverage under a self-insured group health plan, and benefits under a dependent care assistance program. The safe harbor would require that the cafeteria plan satisfy minimum eligibility and participation requirements and minimum flex-credit contribution requirements. This provision would take effect in tax year 2011.

Long-term care insurance allowed under cafeteria plans. The bill would allow a cafeteria plan to offer as a qualified benefit contributions to a qualified long-term care insurance contract to the extent the amount of such contributions does not exceed the eligible long-term care premiums (as defined in IRC §213(d)(10)) for such contract. Reimbursement for employee-paid premiums for a qualified long-term care insurance contract through an FSA would also be excludible from gross income. This provision would take effect in tax year 2011.

Tax credits for small employers providing insurance. The bill would provide a tax credit for qualified small employers for contributions to purchase health insurance for their employees. A qualified small employer could have up to 25 employees with average wages of no more than \$40,000. The maximum credit would go to employers with 10 or fewer employees whose average wages are less than \$20,000. The definition of wages would be the same as for FICA. This provision would take effect in 2013.

Employers that don't provide coverage face penalties. Under the bill, employers with more than 50 employees that do

not offer health insurance coverage would be required to pay a fee for each employee who receives a tax credit for health insurance through a state insurance exchange. The number of employees would be determined using the definition applied under COBRA to determine if an employer is required to provide continuation coverage. The fee would be set by the Secretary of Health and Human Services annually. The most an employer could pay in fees would be \$400 times the number of employees employed by the employer. This provision would take effect on July 1, 2013.

House bills have similar provisions, but different approaches

In the House, health insurance reform legislation approved

by various committees has many provisions that are similar to the AHFA, but approaches them a little differently. For example, employers that choose not to provide health insurance coverage for employees would have to pay 8% of their average wages to a trust fund for providing insurance to the uninsured, with exceptions for small employers based on the size of their payroll. Also, revenue for providing insurance for the uninsured would be raised by requiring individuals earning more than \$350,000 a year to pay an income tax surcharge that increases at income levels of \$500,000 and \$1,000,000. ■

Daylight Saving Time Ends November 1

Daylight Saving Time (DST) ends Sunday, November 1 at 2 a.m., when clocks are set back one hour throughout most of the U.S. Shift workers on duty at that time will work one hour more than usual. These employees must be paid for the extra hour, and the extra hour must be counted for purposes of

calculating the regular rate of pay and overtime (see *The Payroll Source*®, p. 2-51 for further information).

DST is not observed in the states of Arizona (other than inside the Navajo nation) and Hawaii, and in the territories of American Samoa, Guam, Puerto Rico, and the Virgin Islands. ■

IRS Highly Unlikely to Require ISO, ESPP Information Reporting for 2009

In response to APA inquiries, IRS officials have advised that it is highly unlikely that information reporting of stock transfers under IRC §6039 will be required for tax year 2009 – given that forms, instructions, final regulations, etc. have not yet been published. However, employers should be prepared to submit this information until the IRS issues a formal waiver.

IRC §6039. The Tax Relief and Health Care Act of 2006 (Pub. L. No. 109-432; see *PAYROLL CURRENTLY, Issue No. 1, Vol. 15*) amended §6039 to require an employer to file an information return with the IRS when an employee exercises an incentive stock option (ISO) or when stock that has been acquired under an employee stock purchase plan (ESPP) for an option price of 85%-100% of the stock's fair market value is later transferred to a third party.

Previously, §6039 required employers to provide information regarding such transactions only to employees. As amended by the Act, however, §6039 now requires employers to file an information return with the IRS following a stock transfer, in addition to providing employees with an information statement.

Amended §6039 applies to stock transfers occurring on or

after January 1, 2007. However, the IRS waived the obligation to file information returns for stock transfers governed by §6039 for tax year 2007 and 2008 (see *PAYROLL CURRENTLY, Issue No. 2, Vol. 16*).

Forms, regulations, and other guidance. On July 17, 2008, the IRS issued proposed regulations on information statements and returns required to be filed by employers under IRC §6039 in connection with statutory stock options (see *PAYROLL CURRENTLY, Issue No. 15, Vol. 16*). At that time, the IRS planned to issue two forms that corporate employers would be required to use to satisfy these information return and statement requirements:

- Form 3921, *Exercise of an Incentive Stock Option Under Section 422(b)*, and
- Form 3922, *Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)*.

Note: Both the recently issued *General Instructions* (see *PAYROLL CURRENTLY, Issue No. 5, Vol. 17*) and the *Electronic Filing Requirements* (see *PAYROLL CURRENTLY, Issue No. 14, Vol. 17*) for Forms 1099 now cover Forms 3921 and 3922. ■

USCIS Redesigns Website

U.S. Citizenship and Immigration Services (USCIS) recently launched a redesigned website. More than 250 pages of content have been rewritten in a plain language format to make them easier to read and understand. The website search engine has been upgraded and content reorganized to improve both the performance of the search engine and the relevance of the results.

The home page (www.uscis.gov) has been revised to highlight the most critical and often used immigration information. Employers clicking on “Information for Employers and Employees” will have easy access to a comprehensive list

of employment based forms as well as information about employment eligibility verification. The forms can also be accessed by several topic areas (e.g., “Working in the U.S.”) to make finding the correct form easier. In addition, a “Most Searched Forms” feature quickly presents users with the most commonly requested forms.

Finally, the redesign features an initial launch of USCIS content in Spanish, at www.uscis.gov/espanol. The most requested USCIS topics have been translated into Spanish, and USCIS plans to add new information on an ongoing basis. ■

IRS Updates Electronic Filing Requirements for Form 1042-S

The IRS has issued a revenue procedure providing specifications for filing Form 1042-S electronically [Rev. Proc. 2009-35, 2009-35 IRB 265; www.irs.gov/irb/2009-35_IRB/ar10.html]. The new revenue procedure supersedes Rev. Proc. 2008-44,

and is reproduced as the current version of Publication 1187, *Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically*. The new revenue procedure must be used to prepare current and prior year

information returns filed beginning January 1, 2010. Changes to note for tax year 2009 include the following:

- Editorial changes have been made throughout the publication.
- Three telephone numbers have been changed as follows: toll-free fax number 877-477-0572; international fax number 304-579-4105; TDD number 304-579-4827 (telecommunications

device for the deaf).

- The formula for determining *U.S. Federal Tax Withheld* (Part A, Sec. 8.09) has been modified.
- File size cannot exceed 899,999 records.
- Amended transactions must reflect an *Amended Code Indicator* in position 810 of the W and Q Records (see Part A, Sec. 9). ■

IRS Releases 53 Q&As on Proper Worker Classification

The IRS conducted a National Phone Forum on May 20, 2009, on Proper Worker Classification [see www.irs.gov/businesses/small/article/0,,id=209413,00.html for a transcript of the audio presentation]. Following up on the forum, the Service released answers to 53 questions posed by attendees. The APA has obtained a copy of this document, which is not currently available on the IRS website. Highlights are presented here; the full document is available on the APA website at www.americanpayroll.org/members/Forms-Pubs/#guide.

Questions 1-9 cover Form 8919 (*Uncollected Social Security and Medicare Tax on Wages*), 10-13 cover Form SS-8 (*Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*), 14-18 cover Section 530 (of the Revenue Act of 1978 – a safe harbor for employers that misclassify workers as independent contractors), 19-33 covers Form 1099-MISC (*Miscellaneous Income*) vs. Form W-2 (*Wage and Tax Statement*), 34-48 cover miscellaneous topics (e.g., clarifying other points discussed in the forum presentation), 49-50 cover casual labor, and 51-53 cover officers' compensation.

Form 8919

Q8. How far back, in tax years, can the IRS go in misclassification cases?

A8. Generally, the period of limitations on employment tax returns that have been filed is three years from the date filed, or three years from the "deemed filing date," whichever is later. Employment tax returns filed quarterly, such as Form 941, generally must be filed by the last day of the month following the end of the quarter. For purposes of determining the period of limitations for assessments, a quarterly return filed for any of the four quarters of the calendar year filed before April 15 of the succeeding calendar year has a "deemed filing date" of April 15 of the succeeding calendar year. Note that if no employment tax returns have been filed, there is no period of limitations.

Section 530

Q17. If the workers of a business were reclassified from

independent contractors to employees and the business requested and was granted Section 530 relief, does that mean they can continue to treat these workers as independent contractors or does it merely protect them from being assessed for prior periods?

A17. Once the IRS determines in an examination that a business is entitled to Section 530 relief, the IRS does not determine whether the workers are employees or non-employees. The IRS will not disturb the business's treatment of the workers so long as the business continues to qualify for relief under Section 530 with respect to such workers.

I099 vs. W-2

Q23. How should companies handle the situation where they have workers classified as independent contractors by the IRS but as employees by state agencies? Will anything be done to bring all of the differing standards in line with each other?

A23. Since state and federal laws regarding worker classification can vary, it is entirely possible to have situations where a worker may be an employee for state purposes (e.g., unemployment insurance benefits), but not for federal purposes (e.g., federal income tax withholding). The IRS does partner with state agencies to leverage resources, and the IRS does exchange information with several states, but determinations of worker classification are made independently based on the applicable law.

Miscellaneous

Q43. I was wondering if the worker is required to have a business license or insurance in order to be classified as a contractor, or is that not a consideration?

A43. Many employees and independent contractors are required to have a business license, so that is not, in itself, a determining factor. A payer must consider all factors related to the types of behavioral control, the financial control, and the relationship of the parties in determining a worker's status. ■

Wage & Hour Roundup

The U.S. Department of Labor's (DOL) Wage & Hour Division recently concluded the following Fair Labor Standards Act (FLSA) enforcement actions.

Overtime: straight time

MT Supermarket of Austin, Texas, has paid \$186,624 in back overtime wages to 34 employees. W-H investigators found that cashiers, stockers, sackers, and other workers were paid on a cash basis "without regard to any hours worked over 40 in a workweek." Some employees worked as many as 67 hours during a workweek and were not paid overtime wages.

Overtime: misclassified employees

Next Level Financial, LLC, of Atlanta, Georgia, has been ordered to pay back wages of \$63,500 plus interest to 25 employees. The workers, who were employed as loan originators,

were paid on a commission-only basis, though they did not qualify for either the administrative or outside sales FLSA exemptions. As a result, the company paid less than the required minimum hourly wage and did not compensate the employees at a rate 1½ times their regular rate for hours worked over 40 in a workweek.

Over two dozen drywall companies in Arkansas and Texas have agreed collectively to pay \$535,145 in back overtime wages to 752 employees following a series of W-H investigations. The companies misclassified workers as independent contractors, "resulting in a failure to pay required overtime."

Overtime: bonuses

Tulsa, Oklahoma-based QuikTrip Corp., has agreed to pay \$747,729 in back overtime wages to 3,819 current and former

convenience store employees. W-H investigators found that QuikTrip failed to pay the additional overtime premium due on performance-related bonuses.

Overtime: multiple worksites

Partners Healthcare Systems, Inc., and its affiliated hospitals and health care companies in eastern Massachusetts, have agreed to pay 700 employees more than \$2.7 million in back overtime wages to resolve a lawsuit filed by the DOL. According to the DOL, the problem was that employees were working for more than one Partners-affiliated hospital or health care facility during a single workweek, but their hours worked during those workweeks were not being combined to determine if overtime was due.

Child labor: hazardous order regulations

White's Foodliner, a grocery store with several locations in Kansas, has paid \$34,535 in civil money penalties for violations of FLSA child labor provisions. W-H investigators found that four minors regularly worked past 7 p.m. and/or more than three hours on school days, as well as more than eight hours on non-school days. Three minor employees operated motor vehicles to make deliveries during work hours, and 18 minors regularly loaded and/or operated paper balers, both of which are work activities prohibited under DOL hazardous order regulations applicable to workers under age 18.

Other FLSA settlements

Kaiser Permanente agrees to pay \$1.4 million to computer software employees. A proposed settlement in a class action lawsuit filed against managed care consortium Kaiser Permanente by computer software employees seeking overtime pay has received the preliminary approval of a U.S. District Court. Under the terms of the settlement, Kaiser has agreed to pay \$1.4 million to an estimated 213 "project managers" – who schedule training and provide assistance and training to other Kaiser employees in the use of "HealthConnect," a computer program used by all Kaiser employees. Although in theory Kaiser intended the project managers to schedule training, in practice they often provide the training themselves – during normal business hours, after hours, and at "lunch and learn" sessions. In addition, they perform many clerical tasks, such as providing notice of training sessions and arranging for conference rooms. In agreeing to the terms of the settlement, Kaiser denied any wrongdoing and insisted that it had properly classified the project managers as FLSA-exempt administrative and executive employees [*Mike v. Kaiser*

Permanente, No. C 08-5374 PJH (ND Cal., motion for preliminary approval of class action settlement signed 9-9-09)].

Staples agrees to pay \$790,000 to customer service employees. Staples, Inc., the office supply retailer, has agreed to pay \$790,000 to settle a class action lawsuit brought by "senior product solution specialists" seeking overtime pay. The specialists claimed that their primary job duties were to answer inbound telephone calls from new and existing customers and assist them with product purchases – duties inconsistent with exempt status under the FLSA. Under the settlement agreement, which is estimated to cover approximately 50 specialists employed in Massachusetts, Staples denies wrongdoing and asserts that the specialists were properly classified as FLSA-exempt. The agreement is awaiting court approval [*McCandless v. Staples, Inc.*, No. 1:07-cv-11850-RCL (D Mass., motion for preliminary approval of class action settlement filed 8-20-09)].

Nightclub ordered to reinstate exotic dancers fired in retaliation for filing FLSA lawsuit. On July 31, 2009, dancers at Club Onyx, an adult nightclub in Atlanta, Georgia, sued the company for violating the FLSA – misclassifying them as independent contractors and requiring them to pay (kickbacks) to come to work, and paying them no wages so that their only income was tips from customers – thereby failing to pay them the minimum wage and 1½ times their regular rate for overtime hours. On August 11, several of the dancers were told they could no longer work at the nightclub.

A U.S. District Court has now ordered that the dancers be reinstated and has prohibited the nightclub from retaliating or discriminating against them because of their participation in the lawsuit or for pursuing other claims under the FLSA. Under the FLSA's anti-retaliation provision (29 USC §215(a)(3)), it is illegal to discharge or otherwise discriminate against an employee because the employee has filed a complaint or instituted a proceeding under, or related to, the FLSA.

At the August 11 meeting, part of which was tape recorded, it was clear that the dancers' employment was being terminated because they had filed the lawsuit. Other dancers at the club were told that the dancers who sued were fired because of the lawsuit. "This type of action represents a flagrant violation of the FLSA's anti-retaliation provision" [*Clincy v. Galardi South Enterprises, Inc.*, No. 1:09-cv-02082-RWS (ND Ga., preliminary injunction granted 9-2-09)]. ■

IRS Discusses FICA Tax Treatment of NQDC Plan Payments to Retirees

The IRS Office of Chief Counsel has released a memorandum on the FICA tax treatment of nonqualified deferred compensation (NQDC) plan payments made under a plan in effect on March 24, 1983, in light of IRC §3121(v)(2) transition rules [ILM 200931045, 3-30-09; www.irs.gov/pub/irs-wd/0931045.pdf].

The plan

The employer maintained a nonqualified retirement plan. The main purpose of the plan was to encourage eligible employees who were considering retirement to accelerate their retirement plans. Eligible employees were required to apply in writing to participate in the plan by a specified date in the year prior to the year they wanted to retire. Employees participating in the plan were entitled to receive a specified percentage of their annual salary each year for a specified number of years, depending on their age at the time of retirement.

Over the years, plan terms were altered so that (1) the years of service requirement was decreased, (2) an option to receive benefits annually rather than monthly was added along with a provision that the balance would be paid to a beneficiary if the employee died before receiving all benefits due, (3) benefits were increased, (4) benefits were restated and potentially reduced, and (5) the option to receive benefits annually was removed.

§3121(v)(2) transition rules

IRC §3121(v)(2) was enacted by the Social Security Amendments of 1983, which repealed the general FICA tax exclusion for retirement payments. Under §3121(v)(2)(A), any amount deferred under a NQDC plan is taken into account as wages for FICA tax purposes as of the later of (i) when the services are performed, or (ii) when there is no substantial risk of forfeiture of the rights to such amount.

IRC §3121(v)(2) is generally effective for payments made after December 31, 1983. Regulations under that section, published on January 29, 1999, were applicable on or after January 1, 2000. These rules are used to determine whether amounts deferred and payments made are treated under §3121(v)(2) or are eligible for favorable treatment as “transition benefits.”

Transition benefits are benefits paid after December 31, 1983, attributable to services rendered before January 1, 1984.

The transition rules provide that transition benefits paid under a NQDC plan established before March 24, 1983 (a “March 24, 1983 agreement”), are not subject to FICA taxes provided that payments under the agreement would have met one of the retirement exclusions in effect on April 19, 1983 (the day before the enactment of the Social Security Amendments of 1983).

For purposes of determining the portion of total benefits under a NQDC plan that represents transition benefits, if under the plan benefit payments are not attributed to specific years of service, the employer may use any reasonable method.

IRS analysis

1. Are the deferred compensation payments made pursuant to a March 24, 1983 agreement? Yes. The plan was in existence on March 24, 1983, and meets the requirements of Reg. §31.3121(v)(2)-2(b)(6). Although it was subsequently amended after that date, those changes did not cause the plan to lose its status as a March 24, 1983 agreement.

2. Who are the individuals eligible to participate in the March 24, 1983 agreement? Transition benefits under a March 24, 1983 agreement are only available to an “individual party to [such an] agreement” as defined in Reg. §31.3121(v)(2)-2(b)(5). An individual who was eligible to participate in a March 24, 1983 agreement under the terms of the agreement on that date is treated as an “individual party,” even if the individual has not accrued any benefits and regardless of whether the individual has taken any specific action to become a party to the agreement.

Here, only those employees who had satisfied plan eligibility requirements before March 24, 1983, were “individual parties” under the regulations. Employees who had not satisfied these requirements as of March 24, 1983, are not covered by

the transitional rules. An individual who becomes eligible to participate in a March 24, 1983 agreement after that date is not an individual party under the regulations.

3. What is a reasonable method for determining the portion of total benefits under the plan that represents transition benefits? Transition benefits under the plan (i.e., those paid after December 31, 1983, that are attributable to services rendered before 1984) are not subject to FICA. Benefits attributable to services rendered after December 31, 1983, are subject to FICA.

The employer is required to allocate the transition benefit portion of payments under the plan. Reg. §31.3121(v)(2)-2(d) provides an example of a method for determining the transition benefit that would be considered reasonable. The example indicates that the method should allocate a portion of the total benefits paid to those benefit payments attributable to services performed prior to January 1, 1984. Here, the method is not reasonable because it does not provide for a reasonably accurate allocation of benefits according to this guide. The formula used suggests that the artificially small period in the denominator is the total period of accrual. A benefit is accrued under the plan when an application for participation is approved. A more accurate denominator is the total years of service.

4. What are the consequences of using a formula that is not reasonable to determine the transition benefit amount? If the use of a method that is not reasonable to determine the transition benefit portion resulted in an inaccurate calculation of the transition benefit, the result may be a failure to take an amount deferred into account. In such a case, under Reg. §31.3121(v)(2)-1(d)(1)(ii)(B), a portion of each subsequent benefit payment that is attributable to that amount is excluded from wages ... and the balance is subject to the general timing rule at the time the remuneration is actually or constructively received. The portion to be excluded from benefit payments is determined by multiplying each payment by a fraction, the numerator of which is the amount that was taken into account and the denominator of which is the present value of the future benefit payments attributable to the amount deferred, determined as of the date the portion is fixed. ■

IRS Offers Guidance on Automatic Enrollment in SIMPLE IRA Plans

The IRS has issued guidance to facilitate automatic enrollment in SIMPLE IRA plans, including questions and answers relating to the inclusion of an automatic contribution arrangement [Notice 2009-66, 9-5-09; www.irs.gov/pub/irs-drop/n-09-66.pdf].

Background

SIMPLE IRAs. Under a SIMPLE IRA, contributions are made to SIMPLE individual retirement accounts or annuities (referred to as “SIMPLE IRAs”) established pursuant to a plan adopted by the employer. A SIMPLE IRA must be maintained on a calendar year basis and is generally permitted to be established as of any date between January 1 and October 1, or as soon as administratively feasible after the employer comes into existence. Contributions under a SIMPLE IRA plan consist of salary reduction contributions as well as employer matching contributions.

Salary reduction contributions to a SIMPLE IRA are subject to a dollar limit (\$11,500 for 2009) and are also taken into account for purposes of the aggregate limit under IRC §402(g)

(\$16,500 for 2009). In the case of an individual who is at least 50 years old, these amounts are increased by the amount of permissible catch-up contributions (\$2,500 for 2009 in the case of the SIMPLE IRA limit; \$5,500 for 2009 in the case of the aggregate limit).

Eligible employees under a SIMPLE IRA must be permitted to elect – during the 60-day period immediately preceding the beginning of the calendar year (i.e., November 2-December 31, the “annual 60-day election period”) – to make salary reduction contributions for the year, or to change the amount of such contributions under a prior election (including changing the amount to \$0). A SIMPLE IRA plan may also permit elections during additional or longer election periods.

An employee must be permitted to terminate a salary reduction contribution election at any time during the year. If the employee does so outside of the election period provided under the SIMPLE IRA plan, then the plan may provide that the employee is not permitted to resume salary reduction contributions until the next year.

Immediately before an eligible employee's annual or initial 60-day election period, the employer must notify the employee of the opportunity to elect to make salary reduction contributions (or to change a prior election) and must include a copy of a summary description of the SIMPLE IRA plan. The summary description must be provided to the employer by the SIMPLE IRA trustee and must describe the benefits provided under the plan, the time and method of making elections under the plan, and the procedures for and effects of making withdrawals, including rollovers, from the plan.

An automatic contribution arrangement is an arrangement under which, in the absence of an affirmative election by an employee, a default election applies whereby the employee is treated as having elected to have a portion of his or her compensation contributed to a tax-favored retirement plan as default elective contributions rather than paid to the employee in cash.

SIMPLE IRAs and automatic enrollment. The Pension Protection Act of 2006 (Pub. L. No. 109-280) added IRC §414(w) to facilitate automatic contribution arrangements in §401(k) plans, §403(b) plans, and §457(b) plans. The Worker, Retiree, and Employer Recovery Act of 2008 (Pub. L. No. 110-458) added §408(p) SIMPLE IRA plans and §408(k)(6) salary reduction simplified employee pensions to the list of employer plans that may include an eligible automatic contribution arrangement under §414(w). However, the preamble to final regulations under §414(w), published on February 24, 2009 (see [PAYROLL CURRENTLY, Issue No. 5, Vol. 17](#)), provides that they do not reflect guidance on SIMPLE IRA plans that include an eligible automatic contribution arrangement.

Questions and answers on automatic enrollment in SIMPLE IRA plans

Cash alternative. May a SIMPLE IRA plan include an automatic contribution arrangement?

A. Yes. Although §408(p) requires that an employee eligible to participate in a SIMPLE IRA plan have an election between the employer paying cash to the employee or making a contribution to a SIMPLE IRA on behalf of the employee, it does not require that the employee receive an amount in cash in any case in which the employee does not make an affirmative election to have that amount contributed to the SIMPLE IRA.

Employee eligibility. May a SIMPLE IRA plan that includes an automatic contribution arrangement provide that default salary reduction contributions are made only for employees who are first eligible under the plan on or after the effective date of the automatic contribution arrangement and who do not make an affirmative election (including an affirmative election of zero)?

A. Yes.

Default contributions. May a SIMPLE IRA plan that includes an automatic contribution arrangement provide that the percentage of compensation at which default salary reduction contributions are made for an employee increases based on the number of years or portions of years for which default salary reduction contributions have been made for the employee?

A. Yes.

Notice requirements. What notice requirements apply to a SIMPLE IRA plan that includes an automatic contribution arrangement?

A. In addition to the information otherwise required to

be included in a SIMPLE IRA notice, the notice must explain (1) the percentage of compensation at which default salary reduction contributions will be made on the employee's behalf if the employee does not make an affirmative election, (2) the employee's right to elect not to have default salary reduction contributions made to the SIMPLE IRA or to have salary reduction contributions made at a different percentage of compensation or, if permitted under the plan, in a different dollar amount, and (3) how default salary reduction contributions will be invested in the absence of any investment election by the employee. In the case of a SIMPLE IRA plan under which all contributions are made to a designated financial institution, the notice must also explain the additional period (see below) during which an employee may elect to transfer his or her balance without cost or penalty to another SIMPLE IRA.

Balance transfer with no cost or penalty. In the case of a SIMPLE IRA plan under which all contributions are made to a designated financial institution, how does an employee's right to transfer his or her balance without cost or penalty to another SIMPLE IRA apply if the default salary reductions are made for the employee under an automatic contribution arrangement?

A. An employee must be permitted during his or her annual or initial 60-day election period to request to transfer, without cost or penalty, the balance attributable to contributions made for the next year (or for the remainder of the year in the case of an initial election period) and subsequent years to a SIMPLE IRA at another financial institution selected by the employee. If default salary reduction contributions for an employee are made to a designated financial institution, the employee must also be permitted, during the first 60 calendar days of the first year for which default salary reduction contributions are made (or the remainder of the first year in the case of an initial election period), to elect to transfer, without cost or penalty, his or her balance attributable to contributions made for that year and subsequent years to a SIMPLE IRA at another financial institution selected by the employee.

Comments

Comments are requested on whether guidance should be issued regarding SIMPLE IRA plans that include eligible automatic contribution arrangements under §414(w) and, if so, what issues it should address. Comments are also requested on whether guidance should be issued on SIMPLE IRA plans that include automatic contribution arrangements that are not eligible arrangements under §414(w).

Send written comments to: CC:PA:LPD:DRU (Notice 2009-66), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Or submit comments electronically at: notice.comments@irs.counsel.treas.gov (Notice 2009-66).

Sample plan amendment

In related guidance, the IRS has provided a sample amendment that a sponsor of a SIMPLE IRA plan can use in drafting an amendment to add an automatic contribution arrangement to the plan [Notice 2009-67, 9-5-09; www.irs.gov/pub/irs-drop/n-09-67.pdf]. Only SIMPLE IRA plans that use a designated financial institution described in §409(p)(7) can use the sample amendment. *Note:* The IRS expects to issue a revised Form 5305-SIMPLE, *Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) – for Use With a Designated Financial Institution*, that includes an automatic contribution arrangement. ■



STATE AND LOCAL NEWS

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California

New withholding tables released; supplemental wage tax rates increased. Effective 11-1-09 through 12-31-09, there are new withholding tables that reflect a 10% increase in personal income tax rates (see *PAYROLL CURRENTLY*, Issue No. 18, Vol. 17). Effective for supplemental wages paid on and after 11-1-09, the tax rate will increase to 6.6% from 6% for supplemental wages and to 10.23% from 9.3% for stock option and bonus payments (this updates *The Payroll Source*®, p. 6-36). Download the revised tables at www.edd.ca.gov/Payroll_Taxes/Rates_and_Withholding.htm. Find FAQs at www.edd.ca.gov/Payroll_Taxes/FAQ_-_2009_PIT_Table.htm [Employment Development Department, Tax Branch News No. 87, 10-1-09].

Connecticut

Catch-up withholding required for certain employees. Effective for tax years beginning on or after 1-1-09, the personal income tax rate is increased to 6.5% from 5% for single filers whose annual state taxable income is more than \$500,000; head of household filers whose annual state taxable income is more than \$800,000; and joint filers whose annual state taxable income is more than \$1 million. Employers are required to adjust the withholding amount for affected employees. To determine catch-up withholding, calculate the tax due for the annualized taxable income, subtract the withholding tax already withheld, and divide the difference by the number of pay periods remaining for 2009. Updated withholding calculation rules are available at www.ct.gov/drs/lib/drs/forms/2009withholding/2009calculationrules.pdf [H.B. 6802, L. 2009; Department of Revenue Services, E-News, 10-1-09].

Indiana

County income tax rates changed. The Department of Revenue (DOR) has issued county income tax rates, effective for wages paid on and after 10-1-09. There are three local income taxes: (1) CAGIT – county adjusted gross income tax; (2) COIT – county option income tax; and (3) CEDIT – county economic development income tax [DOR, Departmental Notice No. 1, *How to Compute Withholding for State and County Income Tax*, rev. 10-09, www.in.gov/dor/reference/files/dn01.pdf].

Minnesota

Reciprocal withholding agreement with Wisconsin terminated. Effective 1-1-10, Minnesota will terminate the income tax reciprocity agreement with Wisconsin. As a result, residents of one state who work in the other state will be required to file returns and pay taxes for both states next year and employers will be required to withhold taxes for the state in which services are performed and possibly for the employee's state of residence. Information for employers from both states is available at www.taxes.state.mn.us/taxes/other_supporting_content/wi_reciprocity.shtml and www.revenue.wi.gov/faqs/ise/mnrecipro.html [Department of Revenue, News Release, 9-18-09].

New York

MTA payroll tax online filing and payment available. The first payment of the Metropolitan Commuter Transportation Mobility Tax is due 11-2-09. Employers must file Form MTA-305, *Employer's Quarterly Metropolitan Commuter Transportation Mobility Tax Return*. Online filing and payment is available at the Online Tax Center. Frequently asked questions are also available at www.tax.state.ny.us/sbc/mta.htm [Department of Taxation and Finance, Press Release, 9-25-09, and Notice, 10-1-09].

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