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# **Chapter 3**

***Taxable and Non-***

***Taxable***

***Compensation***



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***Everything the  
Employer provides is  
Taxable Income***

**Except.....**



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# Taxable Means....

- FIT – Federal Income Tax
- Social Security
- Medicare or FICA –Federal Ins. Contribution Act
- FUTA – Federal Unemployment Tax

In general, it means they are subject to some or all of these taxes.



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## Gross Income & Wages Under The IRC.....

The IRC (Internal Revenue Code) uses the term “gross income” as the starting point for determining a taxpayer’s federal tax bill and it broadly defines the term as including “compensation for services, including fees, commissions, fringe benefits, and similar items. The Code does not define the term “fringe benefits” but does include several examples

- page 3-3



# Fair Market Value

- What it would cost in an “arms length transaction”
- $IFBA = FMV - (EPA + AEL)$
- Some fringes are valued using special rules (e.g. personal use of co. cars, GTL)



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$$\text{Ex: IFBA} = \text{FMV} - (\text{EPA} + \text{AEL})$$

Lisa's employer pays for her parking space in a commercial lot next to the employer's premises.

The ER cost for this space is \$300.00 per month which is the same fee as all monthly payers.

This is at no cost to Lisa and she can access it every day.

Up to \$255.00 per month is excluded from income by law for 2016

The taxable income to Lisa is determined as follows:

$$\text{IFBA} = \$300.00 \text{ FMV} - (\$0 \text{ EPA} + \$255.00 \text{ AEL})$$

$$\text{IFBA} = \$300.00 \text{ FMV} - \$255.00 \text{ EPA+AEL}$$

$$\text{IFBA} = \$45.00 \text{ per month}$$



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# Non-Taxable Fringe Benefits

- **No Additional Cost Services** – free services offered to employees if the following conditions are met.
  1. Service is regularly offered for sale to customers. (not employees)
  2. ER bears no substantial cost in providing this to the EE.
  3. The term employee includes current and former ee's who left for retirement or disability.
  4. Equal terms for all employees who's classification does not favor HCE's.

HCE is defined as 5% owner or ER's stock or capital (if not a corporation) in current or preceding year or for 2016 received more than \$120,000 in the preceding year. (Can limit this to top 20% paid in company)



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# Non-Taxable Fringe Benefits

- **Qualified Employee Discounts** - offer of discounted goods if the following conditions are met.
  1. The discount cannot exceed the gross profit % when the goods are sold to customers. Gross profit % is: (total sales – cost of goods sold) / total sales.
  2. Discount cannot exceed 20% of price offered to customers. If it does that portion is taxable
  3. Goods or services must be offered to customer in employees line of business.
  4. Equal terms for all employees who's classification does not favor HCE's.
  5. Real estate does not qualify for employee discount.
  6. The term employee includes current and former ee's who left for retirement or disability.





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# Non-Taxable Fringe Benefits

- **Working Condition Fringes** - offer of certain work-related property or services if the following conditions are met.
  1. The EE use must be work related
  2. The EE would be able to take a business deduction on their personal tax return if the EE paid for the benefit.
  3. The term “employee” means current employee, partner, director or independent contractor performing services for the ER.
  4. The ER must keep required records to substantiate the business deductions.

Examples of these types of fringes are on page 3-6.



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# Non-Taxable Fringe Benefits

- **De Minimis Fringes** – Employers may provide property or services of small value if the following conditions are met.
  1. The value of the benefit is so small that accounting for it would be unreasonable or impractical.
  2. The employer must take into consideration the frequency which it provides the benefit in determining the decision.  
(infrequent)
  3. Employee in this case means anyone that is receiving the benefit.

What do you think are examples of De Minimis fringes.....



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# Non-Taxable Fringe Benefits

- **Qualified Transportation Benefits** – An employer may provide transportation fringe benefits to their employees which include:

1. Transportation from home to work in a commuter highway vehicle provided by the employer. Rules that apply...
2. Transit passes, vouchers, tokens, fares passes or reimbursements for them up to the \$255.00 per month.
3. Parking provided on or near premises or a “park and ride” where the employee uses mass transportation up to \$255.00 per month.

The 2016 limit of \$255.00 is applied whether the benefits are provided separately or combined.

In 2015 Congress enacted permanent equality among mass transit in the Protecting Americans Tax Hike Act (PATH) pg,3-11



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# Non-Taxable Fringe Benefits

- **On-Premises Athletic Facilities** – This can be offered if it is located on the premises and operated by the employer with its own employees or another entity. Most all use must be by employees or spouses and dependent children. It must not be a resort or residential facility.
- **Retirement Planning Services** – These services include all qualified retirement plans except the 457 plan.
- **Qualified military base realignment and closure fringe** - Certain payments made to offset the effects on housing values as a result of military reassignment or closure.



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# Non-Taxable Fringe Benefits

- **Qualified Moving Reimbursements -**  
The Omnibus Budget Reconciliation Act of 1993 made significant changes to the rules regarding employer reimbursed moving expenses.

Current rules severely limit the types of moving expenses that are deductible.

Full details on the tax treatment will be discussed in a later slide.



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# Personal Use of Company Vehicles

One of the most common fringe benefits provided to employees.

When it is used for business-related purposes the value of use is non-taxable. All other use is considered taxable unless an exception applies.

These exceptions include:

- De Minimis Fringe benefit – If most use is for the employer, short side trips are considered De Minimis.
- Qualified non-personal use vehicle – If unlikely to be used for personal travel due to its special design, it is excluded from income. Police, fire, public safety, unmarked law enforcement, ambulances or hearses. \*



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# Valuation Methods

## Annual Lease Valuation

**Determine % personal use**

**Determine lease value – based on car value on first day made available to employee**

**Multiply % x Lease value**

**Does not include employer provided fuel. Value can be actual cost or 5.5¢ per mile for gas**



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# Annual Lease Value Example

**Total Mileage**                      **17,000**

**Personal Mileage**                      **4,700**

**Percent of Personal Miles** **27.65%**

**Annual Lease Value**                      **\$6,600**

**Taxable Income**      **27.65% x \$6,600 =**  
**\$1,824.90**





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## Valuation Methods cont....

General Valuation Method – FMV of vehicle is the price an individual would pay to lease the same or comparable vehicle in an arm's length transaction.

Commuting valuation -

Commuting valuation - \$1.50 per one-way commute and \$3.00 per round trip



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# Personal Use of Aircraft

**General Valuation Rule** – personal flight on ER provided craft also providing the pilot is the amount – comparable to the cost of chartering a flight.

**Non – Commercial Valuation Rule** – value is calculated by using an aircraft multiple based on weight of the aircraft and a cents-per-mile rate known as Standard Industry Fare Level – see page 3-23 and 3-24.

**Formula:** SIFL X weight-based aircraft + terminal charge  
= value



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# Free or Discounted Commercial Flights

Applies to flights for relatives of airline employees when they do not qualify for the no-additional-cost services. Exclusion is 25% of the highest unrestricted coach fare. The 25% of the fare must be included in the employee's income and is subject to taxes



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## Discounts on Property or Services

- Qualified employee discounts qualify as nontaxable fringe benefits. Employee discounts on goods or services sold to customers that do not qualify must be included in income –
- Residential or commercial real estate bought
- Personal property held for investment – stocks, bonds, currency



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## Discounts 3.2-5 cont.

- Discounts on property or services sold through a company store
- Discounts on sale of services that exceed 20% of the sales price to customers who are not employees
- Discounts on sales of goods that exceed the gross profit on sales to customers
- Discounts provided by another employer under a written reciprocal agreement with the employee's employer



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## Club Memberships 3.2-6

- The “Omnibus Budget Reconciliation Act of 1993 amended IRC 274(a) to deny a business deduction for amounts paid for membership in a club organized for business, pleasure, recreation or other social purpose.
- Club may be a “working condition fringe” – used for social or can be business related also.
- Country clubs, golf and athletic clubs, airline clubs, hotel clubs; clubs operated to provide meals that are conducive to business discussions.



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## Club Memberships cont....

- Organizations exempt from definition of a club – principal purpose is NOT to conduct entertainment activities
  - business leagues
  - trade associations
  - chamber of commerce
  - boards of trade or real estate boards
  - professional organizations – GAPP
  - civic or public service – Rotary, Kiwanis



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# Additional Employer-Provided Benefits

- 3.3-1 Life Insurance
- Life Insurance – completely provided by and paid for by employer
- Group Term Life Insurance – excess of \$50,000 is taxable income;  
Box 12 code C
- Dependent Life Insurance – excess of \$2,000 is taxable
- GTL table is located on pg. 3-29





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# Group Term Life Insurance

**Determine Amount of Insurance Coverage**

**Subtract \$50,000 from Total Coverage**

**Divide Adjusted Coverage Amount by 1,000 [# Units]**

**Determine Employee's Age as of 12/31/16**

**Review Rate Table for Correct Rate**

**Multiply Rate x # Units of Coverage**

**Result is MONTHLY amount of taxable income**



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# GTL Example

**\$200,000 Coverage**

$$\text{\$200,000} - \text{\$50,000} = \text{\$150,000}$$

$$\text{\$150,000} / 1,000 = 150 \text{ Units}$$

**Age = 46**

**Rate = \$.15**

$$.15 \times 150 \text{ Units} = \text{\$22.50 per Month}$$



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# Relocation – Moving Expenses

**Non-Taxable (Deductible) if:**

- **50 Miles** (Distance test) &
- **39 Weeks** (Time test) are met.



**Only 2 types of expenses are deductible**

- 1) Transportation of household goods**
- 2) Travel Expenses from old home to new home (except meals, mileage rate of \$ .19 cents) for all members of the family. Pets too 😊**

W2, code “P”



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# Relocation

**Taxable (Non-Deductible)**

**Everything Else pg. 3-37**

W2 – boxes 1,3,5



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# Educational Assistance



Job-Related  
(Working Condition Fringe)

Non-Job Related  
(Annual Non-Taxable Limit = \$5,250)



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# Group Legal Services

- As of 7/1/1992 ER paid group legal services insurance provided under a separate, written plan of the ER became **FULLY** taxable.
- Plan cannot favor HCE's
- Must be for exclusive benefit of the employee.
- Congress keeps trying to reinstate the exclusion but none has been enacted into law.



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# Business Travel Reimbursements



- Must be away from home - overnight
- Temporary – not more than a year away from home
- Accountable or Non-accountable plans determine whether or not reimbursements are taxable
- Mileage rate for 2016 - \$0.54 per mile



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# Per Diems

- Flat rate instead of individual actual expenses
- Substantiated, as long as the IRS-established rates are not exceeded. Rates are determined by the GSA (General Services Administration)
- High/Low Cost Localities





# Meals and Lodging



- Furnished for the convenience of the employer
- Meals have to be on the employer's premises
- Lodging has to be on the employer's premises



# Adoption Assistance



- Max exclusion \$13,460
- Phased out for individuals with modified adjusted gross of more than \$201,920
- Totally lost for individuals with modified adjusted gross of \$241,920

W2 – box 12, code “T”



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# Advances and Overpayments

- Must be included in the employee's income for the pay period received.
- Taxable according to when repaid



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# Awards and Prizes

- Service awards – at least 5yrs, not cash, and a meaningful presentation
- Safety awards
- Not taxable to employee if is deductible to the employer as a business expense



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## \$\$ Back Pay Awards \$\$

- When EE's win lawsuits or settlements against ER's for alleged violations of Federal and State employment laws (e.g., wage-hour, anti-discrimination, labor-mgmt.), the amounts awarded are often considered back pay for wages unlawfully denied.
- The IRS generally ruled that these are subject to FIT, FICA and FUTA taxes.



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# Bonuses

- Signing bonuses are taxable
- Contract cancellation payment made to an employee is taxable
- Push money exception – a manufacturer pays a bonus to salespeople working for a retailer to “push” its products – not wages since payment is from a third-party.



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# Commissions

- Subject to taxes
- Remember life insurance salespeople are governed by special rules applicable to statutory employees and are not subject to FIT but are subject to FICA. Payment is excluded from FUTA if paid solely by commission.



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# Conventions

- Attendance at a seminar or convention related to an employee's job is not taxable. Employee must account for expenses related to attendance.





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# Gross-Up Calculation

Employer paid taxes

NET PAY

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100% - Total Tax %



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# Typical Gross-Up Question

Your boss wants to give you a \$5,000 net payment for attending the CPP Study group. Your State tax rate is 3% and this is the first pay period of the year. What is the gross?

- A.     \$ 7,587**
- B.     \$ 8,149**
- C.     \$ 10,124**
- D.     \$ 3,217**



**Net Pay = \$5,000**

			Net Pay \$5,000
Tax	Fed	25%	<hr/>
	SS	6.2%	
	Med	1.45%	
	St	6%	
			<b>100% - 38.65% = 61.35%</b>
Total		<b>38.65%</b>	

**\$ 8,149.96**



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# Death Benefits

Death benefits paid to an employee's estate or beneficiary must be reported on 1099-Misc when paid under a qualified or non-qualified deferred compensation plan and on 1099-R when not paid under such plan. Not subject to social security or Medicare taxes.



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# Dependent Care Assistance Programs

- Excluded amount cannot exceed \$5,000/year (\$2,500 for married individuals filing separately)
- Dependent care must be “necessary” for a child under age 13 or other dependent who cannot take care of them self so the employee can work.
- Must be a written plan and designed solely for the EE’s benefit.
- The program must not discriminate in favor of HCE’s.



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# Director Fees

- ❖ Fees paid to nonemployee directors of a corporation for service preformed as Directors are not subject to FIT, FICA and FUTA.
- ❖ Director is responsible for reporting payments on their personal tax return and for paying self-employment tax. (Section 6.7-5)
- ❖ The employer must report fees paid on Form 1099-MISC



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# Disaster Relief Payments

- ❖ The Victims of Terrorism Tax Relief Act added IRC 139 which provides that gross income does not include any amount received by an individual as a qualified disaster payment.
- ❖ Qualified disaster payment means any amount paid to or for the benefit of an individual.
- ❖ A “Qualified Disaster” includes:
  - A disaster that results from a terrorist or military action
  - A federally declared disaster
  - A disaster from any event the Secretary of State determines to be a catastrophic event.
  - A disaster determined by Fed, State or Local authority to warrant government assistance.



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# Equipment Allowances

- ❖ ER that pay an allowance to EE's who use their own tools are not subject to taxability.
- ❖ ER must keep the allowance payment separate from wage payments
- ❖ This is **NOT** allowed if the allowance is paid to all EE's regardless if they use the ER's tools or their own.





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## \*\*\*\*\*Gifts\*\*\*\*\*

- ❖ Gifts provided to EE's must be included in income unless they can be excluded as a de Minimis fringe or as a gift between relatives that is not based on the EE-ER relationship.
- ❖ De Minimis gift examples are Christmas or other Holiday gifts of small value so long as they do not consist of cash or cash equivalent.



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# Golden Parachute Payments

- Payments made to officers, shareholders, or highly compensated employees after a change in ownership to “soften the landing” in case they are termed
- Excess over 5-year avg. comp subject to 20% excise tax
- W2, Box 12, Code “K”



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# Guaranteed Wage Payments

- Agreement with an employee to pay an annual income even if work is not available
- Payment is wages and subject to all taxes
- GAW – guaranteed annual wage



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# Jury Duty

- If employee is allowed to keep jury duty pay, the payment must be included in income
- If employer pays the difference of employee's salary and jury duty pay – only the difference paid by employer is subject to tax
- EX – employee receives weekly wage of \$400 – receives jury duty pay of \$150. employer pays balance of \$250. The \$250. is subject to taxes



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# Leave Sharing Plan

- Employees donate a certain number of paid leave days to leave bank to use in medical emergency when his/her paid leave is exhausted may receive pay from the leave bank. Compensation is subject to taxes.



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# Loans to Employees

- Loans made to employees are interest rates lower than the applicable federal interest rate are below-market compensation related loans. The amount representing the difference between the employee interest and applicable federal interest must be included in the income on any day the loan is more than \$10,000



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# Military Pay

- Compensation paid to employees while on military duty is subject to different tax rules
- Based on type of tax and length of service
- Heroes Earnings Assistance and Relief Tax Act of 2009
- Combat Zone Pay
- Reported W2 Box 12 Code Q “Quantico”



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# Outplacement Services

- Excluded from income as a working condition fringe-substantial business benefit, doesn't have choice of cash equivalent, and employees could deduct cost as business expense on personal tax return





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# Security Provided

- ❑ Employees who have security provided due to nature of position with the company – that is not considered income or taxable.
- ❑ Can be considered a working condition fringe
- ❑ Employee working in a foreign country may have a chauffeur as a security concern



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# Severance and Dismissal Pay

- Severance or dismissal pay is taxable.
- May also be considered supplemental income and subject to supplemental income tax



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# Stocks & Options

- Stocks paid in lieu of cash is considered taxable according to the Fair Market Value of the stock
- Exercising of options – can be excludable from income
- Depends on type of option – qualified or nonqualified



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# Stock Options

*Dear Employee:*

*You are entitled to purchase 1000 shares of Our  
Company Stock at \$50 per share.*

*Expires 10 years from today.*

*Thank you for being a valued employee.*

*Your Boss*



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# Strike Benefits

- ❑ Payment of strike and lockout benefits by unions to its members are not wages
- ❑ These wages are to assist employees with living costs while the company is on strike
- ❑ Exception – if union pays employees an hourly wage to walk picket, the payments are considered wages



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# Supplemental UE Benefits

- Supplemental unemployment benefits are paid in addition to state unemployment compensation benefits and tax treatment is dependent on several factors – see list on 3-98
- Lump sum payments are not excluded from income for social security, Medicare and FUTA tax purposes.
- Where unions provide supplemental payments to employees – these payments are not considered wages and not subject to taxes.



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# Tips

- Employees must report tips to employer
- Service charge added to a bill is not considered a tip. When turned over to the employee – it is regular wages
- Tip income is subject to withholding if the employee reports more than \$20. in tips per month
- Remember tip credit of \$2.13/hour!!!



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# Uniforms

- Not considered wages if required as part of employment
- Cannot be worn as street clothes
- Employee is required to account to the employer for amount spent on the uniform
- Employee must return excess amount not spent





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# Vacation Pay

- Payment for vacation leave taken is taxable income
- Payment received for vacation that is not taken may be treated as supplemental wages – taxable at the supplemental rate.



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# Payments After an Employee's Death

- **Wages paid before death, but the paycheck is not cashed before the employee's death:**
  - **Reissue the check with the same net amount payable to the employee's personal representative.**
  - **Make no changes in the withholding as they are accurate and should be reported as normal on the employee's W2,**



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# Payments After the Employee's Death

- **Wages paid after death, but in the same calendar year as the employee's death:**
  - **Make check payable to the estate or beneficiary**
  - **FICA & FUTA taxable, but not FIT taxable**
  - **Send a 1099 to the beneficiary for FIT taxable amount in Box 3**



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# Payments After an Employee's Death

- **Wages paid after death, but in the following calendar year:**

- ☐ **Make check payable to the estate or beneficiary**
- ☐ **Exempt from FIT, SIT, FICA, & FUTA**
- ☐ **No W-2 is completed**
- ☐ **All income reported on Box 3 of the 1099-MISC to the beneficiary (have A/P write the check)**



# Questions?

