Spring Newsletter

From the Editor

Are meals that government employees receive taxable? At what point is an employee considered away from home for tax purposes? How do you treat group-term life insurance provided by an employer?

These are a few of the many questions FSLG specialists receive related to the broad topic of fringe benefits. This issue of the Federal, State and Local Governments newsletter begins to address important topics in the fringe benefits area. We recognize the importance of fringe benefit compensation to public employers. In the future, we plan to visit a variety of topics dealing with noncash compensation and "perks" provided to public employees, and we hope we can supplement existing IRS publications with more detailed guidance on the specific problems public employers face today, particularly with payroll budgets under increasing scrutiny. Please let us know of topics you would like to see addressed in future issues of this newsletter.

As always, please contact your local FSLG Specialist for help with the questions you have. A directory is included inside this newsletter.

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INTERVIEW WITH TOP STATE PAYROLL MANAGER

By Marilee Basaraba, FSLG Specialist, Pacific Coast Group - Oregon

Recently, I interviewed Dave Barrow, newly appointed TEGE/FSLG Advisory Committee Member and Manager of California's Tax Support Section, Personnel/Payroll Services Division, State Controller's Office. For the past 11 years, Dave has led the State's $3.9 billion annual employment tax program and compliance efforts. He has represented state employers on various national tax projects including STAWRS and the 2000-01 IRS Reorganization Task Force. He has also served in elected positions in the National Conference of State Social Security Administrators (NCSSSA) and is currently the Chairperson of their Governmental Affairs Committee. Dave works directly with IRS Chief Counsel and SSA National Office policy staffs to secure tax reform regarding employer responsibilities, fringe benefits and employee business expense tax issues.

Q: Our mission at FSLG is to help Federal, State, and Local governments understand and comply with the applicable tax laws. How can we better serve FSLG taxpayers?

A: I believe FSLG's largest challenge is applying just over 100 employees to deliver meaningful and world-class service to 87,000 public sector employers. When you do the math, you have a small resource dedicated to a highly divergent and specialized employer community.

A key to FSLG's success rests with its ability to provide usable information that transcends the clients' needs and generates cost effective, voluntary compliance. If FSLG approaches deliverables from an understanding of the obstacles affecting public sector employers, success will follow. If FSLG operates independent of the employer informational platform, success will be limited.

Q: 47 of the 50 states, along with related cities and counties, are experiencing the most severe budget restrictions in years. What impact do you think this will have on employment tax compliance?

A: Budget shortfalls have plagued public sector employers for the past 36 months and the next two-year forecast looks even bleaker. Staff reductions continue at unprecedented rates, eroding expertise and resources to do the job. Remaining resources are stretched and in many cases, showing classic burn-out symptoms. Funding cuts severely curb, if not eliminate, out-service training and employers' ability to maintain tax expertise. These factors do not bode well for advancing voluntary compliance.

From a national perspective, IRS and SSA must recognize this adversarial environment and adapt strategies that do not further erode employers' ability to comply. Stated another way, business as usual will not work in today's public sector environment.

Q: How do you promote and maintain compliance in this environment in *your* state?

A: You ask a very good question. I believe it starts with separating true priorities from minutiae. We provide our clients with timely and reliable tools/information to address those priorities. We focus on securing participation that can be readily achieved without significant front-end costs. We recognize that employers face an increasingly antagonistic environment. It is not a prime time to mandate new initiatives, change inputs/outputs, etc regardless of their ultimate value. You cannot squeeze blood from a turnip, especially a dehydrated one!

A second component is consistency. Employment tax is complex and every effort is made to ensure that employers consistently receive timely and reliable data. We know through outreach, training forums and performance tracking, client compliance increases when information is provided prospectively and clients know that information is 100% reliable.

Q: What other barriers to Federal tax compliance do you see in government entities?

A: Three barriers come immediately to mind. Unlike the private sector employer, the public sector "employer role" is often not performed by a single entity. Rather, the role is fragmented and performed by multiple entities. All players, from policy makers in control agencies down to an employee's supervisor at the local level, must possess a working knowledge of basic tax rules, regulations and requirements. Fragmentation can create inadvertent compliance problems. It definitely presents massive challenges for education and coordination.

Securing support from policy makers to treat fringe benefit compliance as "critical" is most important. Support routinely occurs with programs entailing normal wage and tax collection reporting and payments. However, the complexity of fringe benefit programs, when coupled with an absence of well-known legal requirements creates an informational vacuum. Administrators and policy makers are overwhelmed by the regulations or feel that they are "unfair." They may not see the need to monitor benefits or correct program oversights—many see perks as offsetting low salaries and are not aware of the tax implications. You have created a Taxable Fringe Benefits Training Guide that has been introduced in several west coast states to alert public employers of this issue. This is an excellent resource for employers. Providing this training free at locations easily accessible to government employers eliminates budgetary

constraints to their attendance. I believe that providing this text on-line will also assist FSLG customers increase compliance during these difficult budget times.

Lastly, the era of organizational "brain drain" is starting as "baby boomers" retire. In normal business cycles, the ebb and flow of retirements is somewhat stable. In the public sector, the economic declines in the early 90s and now again in the early 2000s precluded normal hiring. With baby boomers going out the door, there will be a huge expertise gap. Though tax compliance is not quite rocket science, it is complex, extensive and challenging. Replacing the baby boomer organizational and program savvy is formidable.

Thank you, Dave, for taking the time to answer our questions. We value your input and your insight.

REIMBURSEMENTS TO EMPLOYEES FOR MEALS WHILE TRAVELING

By Sharon Boone, FSLG Specialist, Midwest Group - Missouri, and Stewart Rouleau, FSLG Program Manager

The Internal Revenue Code provides that the value of employer-provided meals and reimbursements for meals are included in employee income, unless there is some provision that allows for their exclusion.

Perhaps the most common situation involves employees receiving advances and/or reimbursements for meal expenses while traveling. In order for these to be excluded from the employee's income, certain tests must be met.

If meals are not excludable from income as travel expenses, they may still be excludable if they are provided for the convenience of the employer, or qualify as de minimis benefits or entertainment expenses. These are not discussed here – see IRS Publications 15-B and 463 for more information on these situations.

For the meal allowances, advances, or reimbursements to be excluded from income, the meals must be incurred while the employee *is traveling away from home* on business. The period of time must be sufficiently long to require a period of sleep or rest; generally, this means an overnight stay. However, whether an employee meets this test will depend on all the facts and circumstances. Employees who travel and return to their main work area within the course of a normal workday are normally not considered away from home. Payments or reimbursements for meals are includible as wages and reported on Form W-2.

For an employer to exclude payments and reimbursements from wages, the amounts must be paid under an ***accountable plan.*** An accountable plan must meet the following tests:

1. There is a business connection. To show that there is a business connection, the payment must be deductible by the employee as a business expense.

2. The employee must substantiate the expense. Records must show (a) the amount of the expense, (b) the time and place of the travel, and (c) the business purpose. Note: A ***per diem*** plan will meet this test if it is for ordinary and necessary business travel expenses, it is reasonably related to the amount of anticipated expenses, and paid at or below the Federal per diem rate (published in Publication 1542 each year).

3. The employee must be required to return excess amounts that are not substantiated to the employer.

If a plan does not meet these tests, it is a non-accountable plan and generally, the amounts paid must be included in an employee's wages and on Form 941 and Form W-2. They are subject to all employment taxes. If the employee has documentation, he or she may be able to take itemized deductions for these expenses on Form 1040, if the employee has adequate records. Generally, receipts for these expenses are necessary for lodging expenses and any expenditure of $75 or more.

Even if amounts are paid under an accountable plan, if the employee does not return excess amounts or does not properly substantiate expenses, these amounts become income and are included in wages.

Example 1. An employee is required to travel from her main place of work to another city 60 miles away to work on a project. She leaves home at 11:00 a.m. on Monday, with plans to return home the same day. She is unable to complete the project on Monday, so she spends the night. After completing the project the next day, she returns to her tax home by 10:30 a.m.

Even though the employee had not planned to spend the night and is gone for less than 24 hours, she has met the "away from home" test because she spent the night away from her tax home on business. Reimbursements for allowable expenses under an accountable plan do not have to be included in her wages.

Example 2. An employee is required to travel from the main place of work to another city 100 miles away to work for the day. The employee leaves home at 6:30 a.m. and returns for the night at 10:00 p.m. On the trip home the employee stops for dinner and rests in the car for two hours.

Even though the employee has been away from home for substantially longer than his normal work day, the employee is not considered to be in travel status. Court cases have ruled that stopping for a meal or rest in a car does not meet the "substantial sleep or rest" rule. Reimbursements for expenses are included in the employee's income.

For more information about meal reimbursements or allowances, see Circular E, Employer's Tax Guide (Publication 15); Employer's Tax Guide to Fringe Benefits (Publication 15-B); and Publication 463, Travel, Entertainment, Gift, and Car Expenses.

GROUP-TERM LIFE INSURANCE

By Stewart Rouleau, FSLG Program Manager

Total Amount of Coverage

IRC 79 provides an exclusion for the first $50,000 of group-term life insurance coverage provided under a policy carried directly or indirectly by an employer. There are no tax consequences if the total amount of such policies does not exceed $50,000. Amounts of coverage in excess of $50,000 must be included in income, using the IRS Premium Table, and are subject to social security and Medicare taxes.

Carried Directly or Indirectly by the Employer

A taxable fringe benefit arises if coverage exceeds $50,000 and the policy is considered carried directly or indirectly by the employer. A policy is considered carried directly or indirectly by the employer if:

a) The employer pays any cost of the life insurance, or
b) The employer arranges for the premium payments and the premiums paid by at least one employee subsidize those paid by at least one other employee (the "straddle" rule).

The determination of whether the premium charges straddle the costs is based on the IRS Premium Table rates, *not* the actual cost.

Because the employer is affecting the premium cost through its subsidizing and/or redistributing role, there is a benefit to employees. This benefit is taxable even if the employees are paying the full cost they are charged. You must calculate the taxable portion of the premiums for coverage that exceeds $50,000.

Not Carried Directly or Indirectly by the Employer

A policy that is not considered carried directly or indirectly by the employer has no tax consequences to the employee. Because the employees are paying the cost and the employer is not redistributing the cost of the premiums through an insurance system, the employer has no reporting requirements.

Examples of the above rules follow:

Example 1. All employees for Employer X are in the 40 to 44 year age group. According to the IRS Premium Table, the cost per thousand is .10. The employer pays the full cost of the insurance. If at least one employee is charged more than .10 per thousand of coverage, and at least one is charged less than .10, the coverage is considered carried by the employer. Therefore, each employee is subject to social security and Medicare tax on the cost of coverage over $50,000.

Example 2. The facts are the same as Example 1, except all employees are charged the same rate, which is set by the third-party insurer. The employer pays nothing toward the cost. Therefore there is no taxable income to the employees. It does not matter what the rate is, as the employer does not subsidize the cost or redistribute it between employees.

Coverage Provided by More Than One Insurer

Generally, if there is more than one policy from the same insurer providing coverage to employees, a combined test is used to determine whether it is carried directly or indirectly by the employer. However, the Regulations provide exceptions that allow the policies to be tested separately if the costs and coverage can be clearly allocated between the two policies. See Regulation 1.79 for more information.

If coverage is provided by more than one insurer, each policy must be tested separately to determine whether it is carried directly or indirectly by the employer.

Coverage for Spouse and Dependents

The cost of employer-provided group-term life insurance on the life of an employee's spouse or dependent, paid by the employer, is not taxable to the employee if the face amount of the coverage does not exceed $2,000. This coverage is excluded as a de minimis fringe benefit.

Whether a benefit provided is considered de minimis depends on all the facts and circumstances. In some cases, an amount greater than $2,000 of coverage

could be considered a de minimis benefit. See Notice 98-110 for more information.

If part of the coverage for a spouse or dependents is taxable, the same Premium Table is used as for the employee. The entire amount is taxable, not just the amount that exceeds $2,000.

Example 3: A 47-year old employee receives $40,000 of coverage per year under a policy carried directly or indirectly by her employer. She is also entitled to $100,000 of optional insurance at her own expense. This amount is also considered carried by the employer. The cost of $10,000 of this amount is excludable; the cost of the remaining $90,000 is included in income. If the optional policy were not considered carried by the employer, none of the cost of the $100,000 coverage would be included in income.

More information, including the IRS Premium Table, is in IRS Publication 15-B, Employer's Tax Guide to Fringe Benefits.

Calendar

The following upcoming national events may be of interest to you. FSLG representatives may be at these events. For more information, contact the organization.

Federation of Tax Administrators Annual Meeting
Oklahoma City, OK
June 15-18, 2003
www.taxadmin.org

National Association of Counties
Annual Conference and Exposition
Milwaukee, WI
July 11-15, 2003
www.naco.org

National Association of College and University Business Officers
Annual Meeting
Nashville, TN
July 26-29, 2003
www.nacubo.org

NCSSSA National Coference
Portland, OR
August 10-13, 2003
www.ncsssa.org

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CLOTHING PROVIDED BY EMPLOYER

By Dwayne Jacobs, FSLG Specialist, Western Group – Wyoming

Under what conditions is the value of work clothing provided by an employer nontaxable as wages?

The value of work clothing provided by the employer is not taxable to the employee if:
a) The employee must wear the clothes as a condition of employment, and
b) The clothes are not suitable for everyday wear.

To be excluded from the employee's income, it is not enough that you wear distinctive clothing. The clothing must be specifically required by your employer. Nor is it enough that you do not, in fact, wear your work clothes away from work. The clothing must not be suitable for taking the place of your regular clothing.

Example: The value of work clothes and their upkeep for firefighters, law enforcement officers, or letter carriers is excludable from income and not taxable to the employee.

However, work clothing consisting of a white cap, white shirt or white jacket, white bib overalls, and standard work shoes which a painter is required by his union to wear on the job, is not distinctive in character or in the nature of a uniform.

Similarly, the cost of buying and maintaining jeans and shirt with the company decal worn by the employee at the request of a supervisor are taxable, because these are appropriate for personal use.

The cost of protective clothing required, such as safety shoes or boots, safety glasses, hard hats, and work gloves are not taxable.

If the clothing does not qualify as a deductible expense (i.e. as a uniform), then allowances paid to the employees must be treated as taxable fringe benefits and should be included in wages, subject to all employment taxes.

For more information on fringe benefits, see Publication 15-B.

TAX EXEMPT BONDS ANNOUNCES NEW PUBLICATION

By Joseph Grabowski, Senior TEB Analyst

The office of Tax Exempt Bonds, a part of IRS Tax Exempt and Government Entities (TE/GE) Operating Division, has announced that its new Tax-Exempt Governmental Bonds Guide (Publication 4079), is available on the IRS web site at www.irs.gov/bonds. You can also get it by calling 1-800-829-3676.

The publication provides state and local governments with an overview of the key Federal tax rules that generally apply to municipal financing arrangements, commonly known as governmental bonds. It provides information about filing requirements, the basic rules related to governmental bond issuances, and an overview of the law relating to the use of bond proceeds and bond-financed property. There is also a brief introduction to the arbitrage and rebate concepts and refunding bonds.

The guide also provides bond issuers with an overview of the various outreach and educational services provided by the office of Tax Exempt Bonds.

This publication is the first of three planned by the office of Tax Exempt Bonds in an effort to provide assistance to bond issuers and those contemplating bond financing as a means of addressing community fiscal needs. Future publications will address the rules applicable to 501(c)(3) bonds and other qualified private activity bonds.

To learn more about the TEB programs available, visit its web site at www.irs.gov/bonds or contact Clifford Gannett, Manager of Tax Exempt Bonds Outreach Planning and Review at 202-283-9798.