

Volume No. 1—Policies & Procedures	TOPIC NO.	50535
Function No. 50000—Payroll Accounting	TOPIC	EMPLOYER PROVIDED FRINGE BENEFITS
Section No. 50400—Deductions	DATE	September 2014

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Overview

Introduction Fringe benefits include any compensation or perquisite received from an employer outside of monetary compensation or wages. Fringe benefits **are taxable wages unless specifically excluded** by the Internal Revenue Code (IRC).

The IRC may provide that fringe benefits are nontaxable (excludable), partially taxable, or tax-deferred. Determination of taxability may depend on whether the plan to provide the benefit is considered to be an Accountable or Qualified Plan. Qualified health plan benefits (premiums paid by the employer) are an example of a nontaxable fringe benefit. Qualified Transportation benefits are an example of partially-taxable benefits because there is a limit to the amount that is considered nontaxable. Finally, employer contributions to an employee's pension plan may not be taxable when made, but may be taxed when distributed to the employee so are considered tax-deferred. A few of the more commonly-used benefits are discussed in the following pages. For more information please refer to *Publication 15b, Employer's Tax Guide to Fringe Benefits or the Taxable Fringe Benefit Guide for FEDERAL, STATE, AND LOCAL GOVERNMENTS* available from the IRS.

Any employer paid fringe benefits may be limited or disallowed entirely based upon Commonwealth policy.

Fringe Benefits

Accountable Plans An accountable plan is an allowance or reimbursement policy under which amounts are nontaxable to the recipient if the following requirements are met:

- There must be a **business connection** to the expenditure. The expense must be a deductible business expense incurred in connection with services performed as an employee and could be deducted by the employee on the employee's 1040 income tax return as a business expense if not reimbursed by the employer.
- There must be **adequate accounting** by the recipient within a reasonable period of time to include substantiation of amount (bills, receipts, canceled checks, etc.), date and time, place, and business purpose.
- **Excess reimbursements or advances must be returned** within a reasonable period of time. *IRC §62(c)*

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Fringe Benefits, Continued

Awards/Prizes Generally, the value of an award or prize given by an employer is **taxable** to an employee as wages, included on the Form W-2, and subject to Federal income tax withholding, social security and Medicare [IRC 74; IRC 3121(a)(20)]. This includes awards/prizes provided to the employer by outside sources. The Fair Market Value of the award or prize is used to determine the amount added to taxable wages. **Special Pay 049 Non-Cash Awards** should be used to increase the employee's taxable income.

Nontaxable awards and prizes: A prize or award that is not cash or cash equivalent, of *nominal value* and provided *infrequently* is excludable from an employee's wages. Prizes or awards that are given frequently to employees do not qualify as an excludable *de minimis* award, even if awards are low in value. IRC §132(e). Achievement awards for safety or length-of-service may also be excludable if given under specific conditions.

See DHRM Policy 1.20—*Employee Recognition Programs* for more information.

Gift Cards Gift cards given by an employer are considered cash-equivalents and are taxable to an employee as wages, included on the Form W-2, and subject to Federal income tax withholding, social security and Medicare regardless of the value of the gift card [IRC 74; IRC 3121(a)(20)].

Special Pay 049 Non-Cash Awards should be used to record the value of the card as taxable income to the employee.

See DHRM Policy 1.20—*Employee Recognition Programs* for more information.

Employee Tax Paid by Employer If the employer pays the employee's share of taxes for any reason, the amount of taxes paid are additional wages to the employee and are subject to all payroll taxes: FIT, SIT, and FICA. **Special Pay Code 071 Employer Paid Tax** has been established for this use.

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Fringe Benefits, Continued

Equipment, Uniforms and Allowances

Allowances paid or reimbursed by an employer on behalf of an employee that do not meet the rules of an accountable plan are included in taxable income. This includes, but is not limited to, reimbursements or allowances for work clothes, uniforms, and certain electronic equipment ("listed property") for use outside of the employer's premises in the performance of the employee's duties.

Clothing and Uniforms

Clothing or uniforms are not excluded from wages of an employee if they are:

- Not specifically required as a condition of employment, and
- Are worn or adaptable to general use as ordinary clothing.

Note: If the clothing does not qualify as excludable, then the cleaning costs are also not excludable.

Listed Property

Listed property includes computers and recreational equipment and requires strict substantiation to remain nontaxable. Accurate records of business and personal use must be kept and personal use is considered taxable income. If records are not kept, the entire amount becomes taxable.

The Small Business Act of 2010 was signed into law in September / October 2010 and was effective immediately. Per this Act, cellular telephones and other similar telecommunications equipment are no longer classified as "listed property"; however, this does not mean that the value may be automatically excluded from income. In order to avoid including the value in employees' taxable income, employers must still have an accountable plan.

Note: Further information related to cell phone fringe benefits is discussed later in this topic.

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Fringe Benefits, Continued

Educational Reimbursement and Allowances

Job-related educational expenses, reimbursed to or paid on behalf of employees and needed to meet the minimum educational requirements of the employee's current job or qualify the employee for a new trade or business are taxable income. Courses needed for acquiring a license or certificate are considered taxable courses leading to a new trade or business (e.g., Accountant to CPA).

Educational assistance (does not have to be job-related) provided when the employer does not have a written plan or educational assistance under a written plan that is in excess of \$5,250 per calendar year is taxable income.

See DHRM Policy 5.10—*Educational Assistance* for more information.

Transportation Fringe Benefits

Qualified transportation benefits (*QTB*—commuter vehicle, transit passes, qualified parking, qualified bicycle commuting expenses) provided to employees for the employee's personal transportation are subject to statutory limits and may require substantiation based upon the type of benefit and the manner in which it is provided. Benefits provided in excess of the monthly limit are considered taxable, whether one transportation benefit or a combination of transportation benefits is provided.

Pre-tax deductions for transportation benefits are actually *salary reduction agreements*. **Unused qualified transportation benefits may not be refunded** to employees and may only be revoked before the beginning of the period for which the *QTB* is to be provided.

See CAPP Topic No, 50450, *Parking/Transportation*, for more information.

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Fringe Benefits, Continued

Taxable Supplemental Compensation

Supplemental wages are compensation paid in addition to the employee's regular wages and are fully taxable:

- Performance bonuses
- Signing and recruiting bonuses
- Awards for outstanding service or performance
- Back pay
- Severance pay
- Administrative leave
- Payments in recognition of exceptional work and performance
- Certain legal settlements and/or damages related to employment
- Grossed-up wages to pay for the employee's share of taxes.

See IRS Publication 15, *Employers Tax Guide*, and Publication 15-A, *Employers Supplemental Tax Guide* as well as DHRM Policies 1.20— *Employee Recognition Programs*, 1.57— *Severance Benefits*, and 3.05— *Compensation* for more information.

Teleworking Expenses

When certain expenses are necessary to perform the requirements of the employee's position from an alternate location, agencies may pay for allowable telework expenses either through a direct bill to the agency or reimbursement to the employee.

See DHRM Policies 1.61—*Telework* and 1.75—*Use of the Internet and Electronic Communications Systems* for more information.

See details on allowable and excluded teleworking expenses on DOA's website at the the following URL—

http://www.doa.virginia.gov/General_DOA/Telework_Expense.cfm

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Fringe Benefits, Continued

Mobile Device Provisions

IRS Notice 2011-72 addresses the treatment of employer-provided cell phones as an excludible fringe benefit. It provides for when an employer supplies an employee with a cell phone primarily for noncompensatory business reasons, the business and personal use of the cell phone is generally nontaxable to the employee. The notice further clarifies there must be substantial reasons relating to the employer's business for providing the cell phone.

A September 14, 2011, *memorandum to field auditors* (not a Notice or Regulation) entitled "Interim Guidance on Reimbursement of Employee Personal Cell Phone Usage in light of Notice 2011-72" states the following regarding employer remuneration to cover an employee's cost of a personal cell phone used for business purposes:

Specifically, in cases where employers have substantial business reasons, other than providing compensation to the employees, for requiring the employees' use of personal cell phones in connection with the employer's trade or business and reimbursing them for their use, examiners should not necessarily assert that the employer's reimbursement of expenses incurred by employees after December 31, 2009, results in additional income or wages to the employee.

The Commonwealth has determined a monthly stipend/reimbursement not to exceed \$45 for a smart phone as defined by VITA policy (i.e., voice and data capable, not voice-only device) and authorized pursuant to VITA's *Enterprise Architecture Standard, Mobile Communication Use Technical Topic* will be deemed nontaxable. The VITA policy applies to all non-higher education Executive Branch agencies. Any mobile device allowance paid by higher education or non-Executive Branch agencies pursuant to documented agency policies beyond the allowance established by the VITA policy is taxable income to the employee. (**Special Pay 034** has been established for the non-taxable portion. Contact DOA if a taxable special pay is needed by your agency for this purpose.) *Agencies are prohibited from providing a stipend/ reimbursement to an employee or authorized user who has been assigned an employer provided cell phone.*

Mobile Device Allowance Agreement

Prior to establishing a mobile device stipend for an employee the VITA Mobile Communication Technical Topic must be reviewed and a COV Mobile Device Allowance Agreement must be completed and signed by the employee, the employee's supervisor and the Agency Head (or designee). The agreement form is located as follows:

http://www.doa.virginia.gov/General_DOA/DOA_Forms_Alpha.cfm .

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Fringe Benefits, Continued

Recording Taxable Fringes Taxable fringe benefits may be recorded through non-paid special pays, paid special pays or payroll deductions depending on the type of benefit and associated plan. Contact DOA for assistance in determining the most appropriate method.

Internal Control

Internal Control Agencies should ensure all required employee authorizations are obtained before the deduction is established in CIPPS.

Records Retention

Time Period Supporting payroll documents should be retained for a period of 5 years or until audited, whichever is later.

Contacts

DOA Contact Director, State Payroll Operations
Voice: (804) 225-2245
E-mail: Payroll@doa.virginia.gov

Payroll Business Analyst/Trainer
Voice: (804) 225-3065 or (804) 225-2004
E-mail: Payroll@doa.virginia.gov

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Subject Cross References

References

CAPP Topic No. 50450, *Parking/Transportation*
 DHRM Policy 1.20—*Employee Recognition Programs*
 DHRM Policy 5.10—*Educational Assistance*
 DHRM Policy 1.57—*Severance Benefits*
 DHRM Policy 3.05—*Compensation*
 DHRM Policy 1.61—*Telework*
 DHRM Policy 1.75—*Use of the Internet and Electronic Communications Systems*
 VITA Enterprise Architecture Standard, Mobile Communications Technical Topic
 Internal Revenue Code §62(c)
 Internal Revenue Code §74
 Internal Revenue Code §132(e)
 Internal Revenue Code §3121(a)(20)
 Internal Revenue Notice 2011-72
 IRS Publication 15, *Employer’s Tax Guide*
 IRS Publication 15-A, *Employer’s Supplemental Tax Guide*
 IRS Publication 15-B, *Employer’s Tax Guide to Fringe Benefits*
