Department of Accounts
Payroll Bulletin

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The Payroll Bulletin is published periodically to provide CIPPS agencies guidance regarding Commonwealth payroll operations. If you have any questions about the bulletin, please call Cathy McGill at (804) 371-7800 or Email at cathy.mcgill@doa.virginia.gov

State Payroll Operations

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Tax-Related Reminders

Employees "Exempt" from Federal Withholding Tax

Employees who claim exempt from federal withholding during the prior year on their W-4 must complete a new W-4 form by February 15th to maintain their exempt status. If these employees do not provide a newly completed W-4 form by February 15th, immediately begin to withhold Federal income tax as if they are single, with zero withholding allowances. **If you do receive a new form, be sure to use FIT status "A".**

IRS regulations stipulate which employees are eligible to file a W-4 form with exempt status. Refer to Section 9 of Publication 15 (Circular E) for more information.

Employees "Exempt" from Virginia Withholding Tax

Employees who claim exempt from Virginia withholding during the prior year on their VA-4 must also complete a new VA-4 form for each calendar year for which they claim exemption from Virginia withholding. If these employees do not provide a newly completed VA-4 form by January 1st, immediately begin to withhold Virginia income tax as if they are single, with zero withholding allowances. **If you do receive a new form, be sure to use SIT status "A".**

Virginia Department of Taxation regulations stipulate which employees are eligible to file a VA-4 with exempt status. Refer to the directions for completing the VA-4 for more information.

Military Spouses Residency Relief Act

Under the Servicemember Civil Relief Act, as amended by the Military Spouses Residency Relief Act, certain employees may be exempt from Virginia income tax if the following conditions are met:

1) The employee's spouse is a member of the armed forces present in Virginia in compliance with military orders
2) The employee is present in Virginia solely to be with the spouse; **and**
3) The employee maintains their domicile in another state.

Employees who claim exemption under the SCRA must check the box on Line 4 of the VA-4 and attach a copy of their spousal military identification card. Use SIT status "A".

Tax-Related Reminders, continued

FICA Status

Don't forget to change the FICA status from 6 back to a 4 for employees whose records were adjusted by DOA during 2010 to prevent over-withholding of OASDI taxes when the employee had more than one employment record. Request Report 825 on HSRUT to identify anyone whose FICA status is not equal to 4.

Uncollected FICA

Uncollected FICA is acceptable **only** in situations where imputed life continues to be calculated for employees who are not otherwise being paid. **NEVER** enter a manual adjustment to reduce FIT and increase employee OASDI and HI taxes to clear uncollected FICA.

Uncollected FICA resulting from any other situation must be removed from uncollected and payment of the employee-FICA must be processed through the Federal Automated Deposit process (FAD):

1) Re-activate inactive employee in CIPPS with non-auto time card.
2) Enter adjustment on HTQTA for employee share of OASDI/HI. The combined total should be entered in the NET field with an adjustment indicator of "-" and the individual amount entered for OASDI and HI with an adjustment indicator of "+".
3) Enter time and attendance transaction on HUA03 for $.01 to pull the manual payset through.

Note: If this adjustment is not completed by the time your last payroll is processed for the calendar year, manual adjustment forms will be required during calendar year-end reconciliation and certification.

U092/U093 Reports

Quarterly and calendar year-end reconciliations will be much easier if the U092 and U093 reports are properly reviewed each month. Each difference appearing on the reports should be analyzed and resolved or identified as an acceptable difference. Fiscal Officers are required to certify that these reports have been reconciled as part of the quarterly and calendar year-end process.

Utility Field Auto-fills for Pre-Tax Deductions

Do not complete the utility field for pre-tax deductions. We continue to experience out-of-balance conditions for employee tax accumulations as a result of payroll technicians entering data into the utility field for pre-tax deductions. The system automatically fills a pre-tax deduction's utility field with the appropriate information when "Enter" is pressed. *A warning message will appear in the bottom left corner stating "0002w-UTILITY FIELD WILL BE POPULATED"*. Press "Enter" again to commit the information to the database.

Deductions included are:

021 – Medical Reimbursement	038 – Deferred Compensation
022 – Dependant Care Reimbursement	039 – Annuities
023 – Admin Fee	050 – Non-DGS Pretax Parking
037 – Pretax DGS Parking	051 – Pretax Transportation

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Wage Repayments

Repayment of Prior Year Wages

Repayments should be for the **gross** amount paid in error. If you receive repayments for wages paid during a prior year, you must submit a corrected copy of the employee's W-2 to DOA. **Do not correct wages (box 1) for the amount paid in error.** You may not make an adjustment for income tax withholding because the wages were wages and income to the employee for the prior year.

DOA will prepare the W-2C and make an adjustment on Form 941-X to recover the social security and Medicare taxes. In addition to the adjustment on the 941-X, DOA will submit the W-2C to the SSA to correct social security and Medicare wages and taxes. Copies of the W-2C and 941-X will be returned to the agency. Give a copy of the W-2C to the employee.

Employee Reporting of Repayment for Prior Year

The wages paid in error in the prior year remain taxable to the employee for that year. This is because the employee received and had use of those funds during that year. The employee is not entitled to file an amended return (Form 1040X) to recover the income tax on these wages. Instead, the employee is entitled to a deduction (or credit in some cases) for the repaid wages on his or her income tax return for the year of repayment and should seek help from a tax professional on how to file.

Taxable Fringe Benefits

General Information

It is understandable for employers to look for ways to maintain employee moral during times when raises are not an option. Many times employers turn to the use of "fringe benefits" to fill the gap without understanding the tax implications for the agency and the employee. Fringe benefits for employees **are taxable wages unless specifically excluded** by a section of the Internal Revenue Code (IRC*). IRC §61, IRC §3121, 3401; IRC §61(a)(1).*

The IRC may provide that fringe benefits are nontaxable (excludable), partially taxable, or tax-deferred. Determination of taxability may also depend on whether the plan to provide the benefit is considered to be an Accountable or Qualified Plan (see below). 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:

http://www.irs.gov/pub/irs-tege/fringe_benefit_fslg.pdf

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Taxable Fringe Benefits, continued

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 deductible 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, cancelled checks), date and time, place, and business purpose.
- Excess reimbursements or advances must be returned within a reasonable period of time. *IRC §62(c)*

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 an employee do not qualify as an excludable de minimis award, even if each award is small in value.** *IRC §132(e).* Achievement awards for safety or length-of-service may also be excludable if given under specific conditions.

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 should be used to record the value of the card as taxable income to the employee.

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. A new Special Pay Code, 071 Employer Paid Tax, has been established for this use.

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Taxable Fringe Benefits, continued

Equipment 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 taxable income. If there is no accountable plan, then the payments must also be 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 usage 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 Sept/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 doesn't 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; however, documentation regarding personal versus business usage is not as stringent as it was. Previously, every call on every bill had to be identified as business or personal. Now, however, it is acceptable to base the business or personal usage on a periodic review of the actual bill. If you choose to use this approach, you must have some way of substantiating the business use versus the personal use to support the amount you are or are not adding to taxable income.

It is important to note that it is still acceptable to include the entire cost of the cell phone service as taxable income to the employee. It is then up to the employee to take the business expense deduction for the business portion and provide documentation if audited by IRS. Beginning in 2010, an employee may be able to deduct job-related expenses related to using a cell phone even though the use was not for the convenience of his or her employer and required as a condition of employment.

Teleworking Expenses. See DOA's policy on teleworking expenses for specific information. http://www.doa.virginia.gov/General_DOA/Telework_Expense.cfm

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Taxable Fringe Benefits, continued

Educational Reimbursements and Allowances

Job-related educational expenses, reimbursed to or paid on behalf of employees, that are needed to meet the minimum educational requirements of the employee's current job or that 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 (ex: Accountant to CPA).

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

Transportation Fringe Benefits

Qualified transportation benefits (QTF - 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 on 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. The combined applicable statutory limit for 2011 is $460 per month ($230 for parking and $230 for commuter transportation).

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 QTF is to be provided.

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.

Recording Taxable Fringes

Taxable fringe benefits may be dealt with 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.

Garnishment Processing – Disposable Income

Disposable Income for Plan 2 Employees

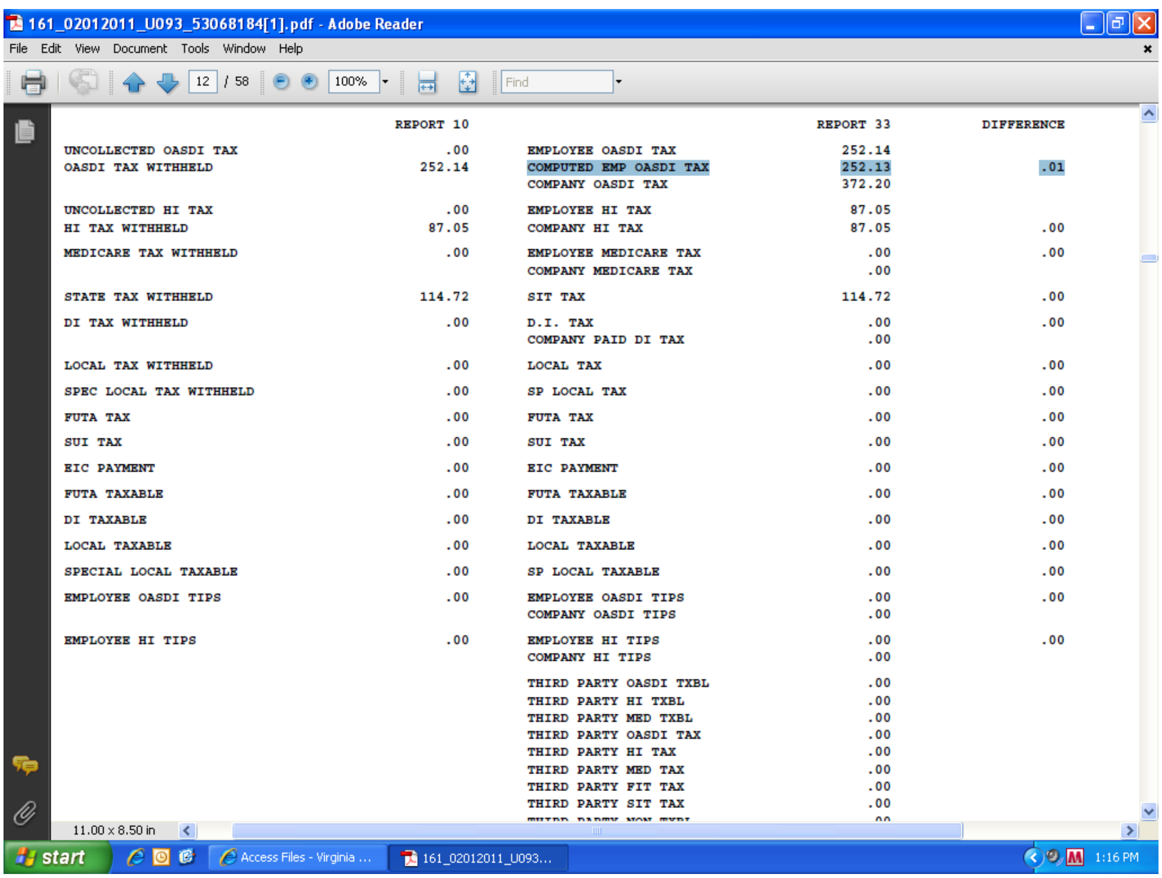
Don't forget that retirement contributions paid by Plan 2 employees (deductions 009, 011 and 012), must be deducted when calculating disposable income for garnishment purposes.

Note: Remember that garnishment deductions for a percentage amount and invoking calculation method 96 reduce gross pay by **all** pre-tax deductions to determine disposable earnings. Since percentage deductions calculated using calculation method 96 may not meet the definition of "disposable pay" per the CCPA and Code of Virginia 34-29, it is recommended for use with flat amounts only.

Employee OASDI on U093

Employee-Paid OASDI

The Reports U092 and U093 have been modified to accommodate the difference in employer and employee OASDI rates (6.2% vs. 4.2%) for 2011. Further research is necessary only if the difference between the Report 33 Employee OASDI Tax is greater than the computed EMP OASDI Tax by more than a few cents and there is a corresponding message for that employee on the U092 (for example, "EMP OASDI NOT IN PROPORTION TO CO OASDI". The view below displays the revised Report U093 format.



	REPORT 10		REPORT 33	DIFFERENCE
UNCOLLECTED OASDI TAX	.00	EMPLOYEE OASDI TAX	252.14	
OASDI TAX WITHHELD	252.14	COMPUTED EMP OASDI TAX	252.13	.01
		COMPANY OASDI TAX	372.20	
UNCOLLECTED HI TAX	.00	EMPLOYEE HI TAX	87.05	
HI TAX WITHHELD	87.05	COMPANY HI TAX	87.05	.00
MEDICARE TAX WITHHELD	.00	EMPLOYEE MEDICARE TAX	.00	.00
		COMPANY MEDICARE TAX	.00	
STATE TAX WITHHELD	114.72	SIT TAX	114.72	.00
DI TAX WITHHELD	.00	D.I. TAX	.00	.00
		COMPANY PAID DI TAX	.00	
LOCAL TAX WITHHELD	.00	LOCAL TAX	.00	.00
SPEC LOCAL TAX WITHHELD	.00	SP LOCAL TAX	.00	.00
FUTA TAX	.00	FUTA TAX	.00	.00
SUI TAX	.00	SUI TAX	.00	.00
EIC PAYMENT	.00	EIC PAYMENT	.00	.00
FUTA TAXABLE	.00	FUTA TAXABLE	.00	.00
DI TAXABLE	.00	DI TAXABLE	.00	.00
LOCAL TAXABLE	.00	LOCAL TAXABLE	.00	.00
SPECIAL LOCAL TAXABLE	.00	SP LOCAL TAXABLE	.00	.00
EMPLOYEE OASDI TIPS	.00	EMPLOYEE OASDI TIPS	.00	.00
		COMPANY OASDI TIPS	.00	
EMPLOYEE HI TIPS	.00	EMPLOYEE HI TIPS	.00	.00
		COMPANY HI TIPS	.00	
		THIRD PARTY OASDI TXBL	.00	
		THIRD PARTY HI TXBL	.00	
		THIRD PARTY MED TXBL	.00	
		THIRD PARTY OASDI TAX	.00	
		THIRD PARTY HI TAX	.00	
		THIRD PARTY MED TAX	.00	
		THIRD PARTY FIT TAX	.00	
		THIRD PARTY SIT TAX	.00	