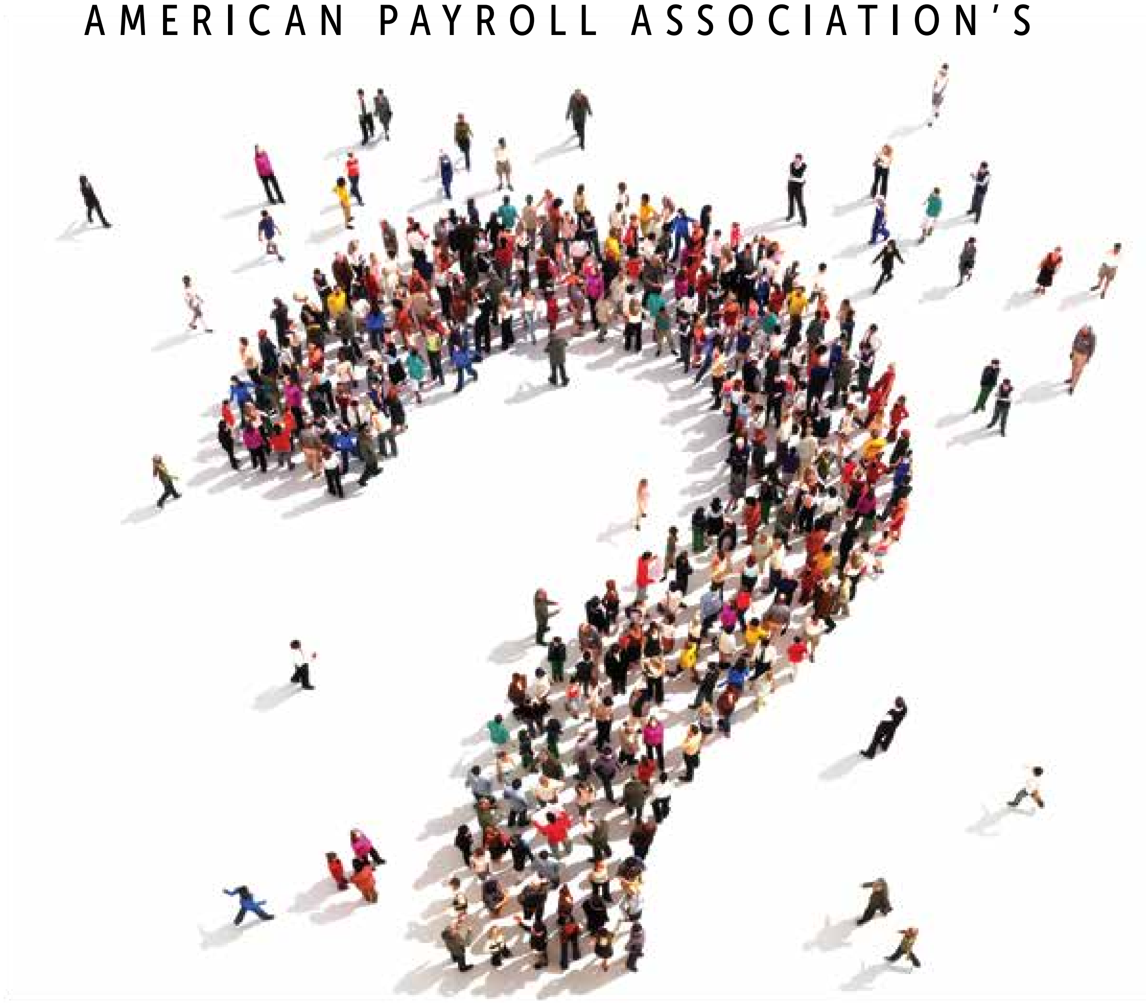
AMERICAN PAYROLL ASSOCIATION'S



TOP PAYROLL QUESTIONS &

ANSWERS

for 2018

Money Network
A First Data Company

In the preparation of this text, every effort has been made to offer the most current, correct, and clearly understandable information possible. Nonetheless, inadvertent errors can occur, and tax rules and regulations are constantly changing.

This text is intended to provide authoritative information in regard to the subject matter covered and can be used as a training tool. As such, it is not an evaluation device upon which to base performance reviews and/or promotions.

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Introduction

Payroll is a dynamic area. So whether you have been in payroll for a short time or have lots of experience, there will always be questions for which you need answers. *APA's Top Payroll Questions & Answers for 2018* contains helpful responses to interesting and important questions that came to APA through several avenues over the past year. Learn from the experts at federal government agencies (named in parentheses and below), from fellow APA members who have responded through the APA ListServ and APA's LinkedIn page, and from questions posed to APA's publications. Answers have been reviewed and edited by APA staff.

A wide range of topics are covered in this book, including tax withholding and reporting, unemployment insurance, paying the employee, wage-hour laws, and other deductions from pay such as child support and garnishments. This book is presented in an easy-to-read question and answer format. You will be sure to find instructive answers to both your common payroll questions and those that give you the most trouble. Remember that the answers in this book do not provide a legal opinion or official agency guidance, so you should always contact a legal or accounting professional before acting on anything stated in the book.

The federal government agencies are the Office of Child Support Enforcement (OCSE), Social Security Administration (SSA), U.S. Citizenship and Immigration Services (USCIS), and U.S. Department of Labor (DOL). The answers to many of the questions in this book include links to the websites of these government agencies and to state agencies where appropriate.

This book also includes citations to relevant sections of *The Payroll Source*® and *APA's Guide to State Payroll Laws* for more information. *The Payroll Source*® is available in print and online as part of the APA Bookshelf (https://bookshelf.americanpayroll.org/), which is regularly updated and accessible across desktops, laptops, tablets, and smartphones in a responsive format. *APA's Guide to State Payroll Laws* is also available as a print book and as part of the APA Bookshelf.

Do you still have payroll questions? Experts from federal agencies will answer your most perplexing questions about how federal payroll law should be applied at the "Forum on Federal Payroll Issues." This session will be presented at APA's 37th Annual Congress at the Long Beach Convention and Entertainment Center in Long Beach, California, May 14-18, 2019. Email your payroll puzzlers by March 1, 2019, to federalforum@americanpayroll.org so they can be forwarded to the panel for research and complete answers.

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Automatic extensions of EADs (USCIS)

Q.

In January 2017, an amendment to Department of Homeland Security regulations went into effect. The new amendment provides for automatic extensions of the validity periods of certain Employment Authorization Documents (EADs) for up to 180 days. Where do we go to find out which EADs and which categories have been automatically extended and under what circumstances?

A.

Within the past 10 years, employers have not been able to accept any expired documents. But now, some EAD cards, as of January 2017, have been auto-extended up to 180 days. You will not see that information on I-9 Central itself or in the M-274 handbook. Instead, use the search box on I-9 Central and type in "EAD automatic extensions." The fact sheet will pop up in the list, and it will give you more in-depth information about some of the categories (Automatic Employment Authorization Document (EAD) Extension, 2-1-17; https://www.uscis.gov/working-united-states/automatic-employment-authorization-document-ead-extension).

You can also call the USCIS customer care number – 800-375-5283, Monday through Friday, 8 a.m. to 5 p.m. in your time zone.

As a reminder, USCIS redesigned the Permanent Resident Cards in May 2017. The cards no longer have a signature underneath the picture. On I-9 Central, click on the "Acceptable Documents" tab and then the "Form I-9 Acceptable Documents" tab to see the new Permanent Resident Card.

Avoiding mistakes (USCIS)

Q.

As employment and payroll management systems become more advanced technologically, including increased integration of new hire programs, what should employers consider to avoid mistakes in employment verification?

A.

Probably the most common thing we tell everybody is you might use an electronic system, but the electronic system is only as good as what you enter. You need to follow the rules on how you get that information. Let me give you an example. When you are ready to complete Section 2 of Form I-9, where employees need to provide one List A or B and C documents, you need to show them the list and let them select those documents. You do not hint to them which ones to provide. If an employee asks you which documents to provide, do not answer that question. The U.S. Department of Justice's Immigrant and Employee Rights Section says that is a big no-no.

Cleaning up data in the NDNH (OCSE)

Q.

How does a company clean up data reported to the National Directory of New Hires (NDNH)? The NDNH has our company listed under different names and addresses. Is there a way to tell whether the misinformation stems from state quarterly wage reports or from our new hire reports?

A.

When an employer reports new hires or quarterly wages, that information is fed into the NDNH. For example, when The ABC Company submits information as The ABC Company, 123 Main Street and the next time as The ABC Company Inc., 123 Main Street, this creates two records. OCSE looks for the unique name and address combination. Algorithms in our system will remove exact duplicates. Because those are not exact duplicates, they stay in our system. We encourage employers when they report new hires for an individual and then report quarterly wages for that same individual to make sure to use the same Federal Employer Identification Number (FEIN) because it is an issue when there is a mismatch.

OCSE has a child support portal (https://www.acf.hhs.gov/css/employers/child-support-portal), and one of the applications available allows employers to access our system. Once you register, you can enter your FEIN and see the information OCSE has for your company in the NDNH. You can see the source and whether the information is from new hires or quarterly wage reports. You can update that information. If you see six addresses, but only one should be used by child support agencies for IWOs, you can identify that address and tag it or label it as the IWO address. If you have an address where verifications of employment should be sent, you can provide that information. You can also provide contact information for different areas within your organization.

Contractors receiving Forms W-2

Q.

I was always under the assumption that a person on the payroll receiving a Form W-2 is considered an employee of the company. However, my manager wants us to put contractors on the payroll, withhold taxes, pay them, and issue Forms W-2 to them at the end of the year yet still list them as contractors. Shouldn't contractors receive Forms 1099? What do you think?

A.

You are correct. Your manager appears to be making a mistake either by misreporting the payments made to independent contractors or by misclassifying employees as independent contractors.

Form W-2 is used to report wages, and payments to contractors are not wages. Contractors are responsible for paying their own income and social security taxes. With the exception of backup withholding, if required, you should not be withholding any taxes from their payments. Further, they should be submitting invoices for payment and receiving Forms 1099 at the end of the year.

You do not mention what taxes are being withheld. Often, employees are treated as contractors in order to avoid paying the employer portion of FICA. Whether that is happening here is unclear, but red flags will fly for both the employer and the individuals come tax time.

You might remind your manager that, to the IRS, issuing a Form W-2 to a worker is seen as a significant indication that the company considers the worker an employee, not a contractor. That opens the door to further requirements relating to employees such as employment eligibility verification, new hire reporting, timekeeping, minimum wage, overtime pay, health insurance, and other benefits.

According to the IRS, facts that provide evidence of the degree of control and independence fall into three categories:

1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. Financial: Are the business aspects of the worker's job controlled by the payer? (These include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
3. Type of Relationship: Are there written contracts or employee type benefits (i.e., pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

You can find more on the IRS website at https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee.

Different names on social security card and driver's license (SSA)

Q.

In the past, most new hires would show us a social security card and a driver's license as proof of identity and proof of work authorization to complete the Form I-9. We routinely captured the information from the social security card to ensure that we also had it right for tax purposes, like the Form W-2. More new hires are not using their social security cards as proof of work authorization. As a result, I am not exactly sure how their names are listed with the SSA. Can I trust that the name on different government documents will be the same? For example, is there any reason a person's name might be different on a passport than it is on the social security card?

A.

It depends on the documents you are looking at. There is a natural order of events when people change their names – where they go first and then next. It is hard to change your name on your passport if you have not changed it on your social security card yet.

You cannot necessarily trust that the name on those other documents is going to be the name that the SSA has. Run that name through SSNVS. One of the things the SSA looks for is making sure things are going to post correctly and that is the most important aspect for the SSA, not necessarily which name is used. The SSA is interested in making sure it can appropriately post to the individual's earnings record. SSNVS will do that for you. It will check to make sure the name you are using is going to pass through our systems, make it through the filters, and be able to post to the individual's records.

You do not necessarily have to see an SSN card. It is not one of the requirements. It is helpful, but it is not required.

E-Verify shutdowns (USCIS)

Q.

Twice in early 2018 the federal government shut down while they worked out budget issues. Each time this happened, E-Verify shut down as well. Fortunately, the shutdowns didn't last very long, but what if they had? What happens to cases we have submitted through E-Verify for which we have not received answers? Do we need to comply with the deadlines, or can we wait for the government to reopen and then resume submitting forms electronically?

A.

During a government shutdown, like other programs, E-Verify basically shuts down. Employers are not going to be able to run a case through E-Verify. Employers can click on the "other" tab and enter "E-Verify was shut down for a week" for a reason why cases were late. Employers will not be notified with case updates during a shutdown.

Once the government is running and E-Verify comes back on, continue business as usual. If you have a bunch of cases you need to run, run them. You also can call customer service – 888-464-4218.

Form I-9 documents (USCIS)

Q.

As part of the Form I-9 process, new hires must present original identity and work authorization documents to their employer to prove they are authorized to work in the United States. What are I-9 supporting documents? Are employers required to retain copies of these documents? What are some of the advantages and disadvantages of copying and/or storing these documents?

A.

If you visit I-9 Central (https://www.uscis.gov/i-9-central) and print page three of Form I-9, Employment Eligibility Verification, there is a list of acceptable documents.

You can either maintain copies or not. It is one or the other. If you want to start making copies and you have not done so in the past, you should create a memorandum for your file or record. You could write a memo on company letterhead and date it stating that "Effective this date moving forward, we will change our policy. Our previous policy was that we did not make any copies of documents, but we will now start making copies of documents." File it. If you have an internal or an external audit, the memo would address that issue.

USCIS does not list advantages and disadvantages. An advantage for one company with 50 employees might differ from a company with 5,000 employees. Do what is best for your business.

However, if you are enrolled in and use E-Verify, you must copy these four List A documents if they are shown during the Form I-9 process: a U.S. passport or U.S. passport card, a permanent resident card, or an employment authorization document (EAD).

How to handle Forms I-9 with mergers and acquisitions (USCIS)

Q.

In a merger or acquisition situation, can we use the Forms I-9 from the previous employer? Do we consider employees from an acquired company as new hires? Is there a different answer depending on whether the transaction is a merger or acquisition or whether the employer has changed its name or articles of incorporation? If new forms are required, how much time do we have to get this done?

A.

First, when you have a merger or acquisition – it does not matter which it is – you have a decision to make. Are you going to treat all individuals as new hires? If so, you would do new Forms I-9. You have to be uniform.

Your legal counsel should address whether a business needs to complete new Forms I-9 with a company name change.

When companies merge or are bought out, there is no change in the time period to complete Forms I-9. You still have no later than three days after you hired an individual to complete the Form I-9. Obviously, if companies are merging or being purchased, it was not in an instant. If the new company is going to consider those employees as new hires, the company would have offered them the jobs well in advance.

Once you offer individuals the job and they accept the job, you can have them complete a new Form I-9. That might be a month or two in advance of them actually starting under the new company name. Do not feel you have to wait until the first day they start working for pay to complete the Form I-9 process.

Incorrect SSNs on Forms W-2 (SSA)

Q.

A former employee says his social security number (SSN) is wrong on his Form W-2. I reviewed all the paperwork he provided when hired. He wrote the wrong number on all of the forms. I even asked employees to verify their SSNs and addresses in October, which he OK’d. He made the error, and I know we need to provide him with a Form W-2c, but do I need to be in a rush? Is there a deadline?

A.

Through Business Services Online (BSO), you can set up the Social Security Number Verification Service (SSNVS; https://www.ssa.gov/employer/ssnv.htm). There are two versions. Essentially, with one you can go on and get instant results for up to 10 SSNs at a time. It is very handy for onboarding. When you are bringing new folks on, you get the information and load them into your payroll system. You can check to make sure you have the right information with us to head off some of these issues as you go along. As you get closer to the end of the year, you can run them again.

The second option allows you to upload a file of up to 250,000 SSNs at a time. The SSA will give you the responses back the next day. It is a good idea to do that in the October range instead of just asking employees to verify them.

There is no specific, hard and fast deadlines on Forms W-2c. The intention is to make those corrections as soon as possible. The idea is to get them updated and correct within a reasonable timeframe. Technically, the form is owned by IRS. You can refer to the official Form W-2c instructions.

Even if your payroll service provider (PSP) charges you for a Form W-2c, on BSO, as the employer, you can still submit a Form W-2c online for free. That can sometimes be the easiest option rather than coordinating with your PSP. Obviously, you want to get correct SSNs to your PSP so things are square for the next year. But if you are doing a one-off Form W-2c, you can certainly do that online. The SSA will give you a PDF, so you can print the actual Form W-2c that you would hand to the individual.

Multiple employee name changes for SSA and USCIS (SSA and USCIS)

Q.

An employee told us her legal name is Sansa Megan Hope Jones. Through trial and error, we found that E-Verify and SSNVS recognize her as Megan H Jones, and she has since told us that this is the name on her social security card. She filled out her employment paperwork using the name Sansa and said that once she is married she will be changing her last name. I do not know what her "real" name is. USCIS has rules regarding the use of aliases. How do they work? When is it OK to use one? How does it affect employment verification?

A.

SSA. Dealing with names is a fairly tough issue. The legal name is what you should be using and is also the name that SSA should have. If she has not shared that with the SSA, she should do that. Our system basically looks for name matches for the purpose of posting W-2 earnings to the individual. It is in her best interest, your best interest, and our best interest to make sure that when we report something that is going to belong to her in our records, we can post it appropriately rather than simply using what she likes to be called.

If the alias is the only thing you have, then use it because it may end up in our Earnings Suspense File.

A.

USCIS. Everything starts with the I-9. As the instructions state, use a full, legal name. On the Form I-9, on the top line, all the way to the right, there is a box for "Other Last Names Used" where individuals can enter that information. It is an optional field.

If an individual, such as in this case, has been using one name, and then you find out her true legal name, you do not need to redo the Form I-9. You can have her update her name on the Form I-9, but remember the employee needs to make that correction in Section 1. You do not run her through E-Verify again. Remember, E-Verify is just a tool to basically check the information from the Form I-9 against what is in the databases at SSA and the Department of Homeland Security. If it is in SSA and the other government databases as Megan Jones, then it is obviously going to match.

In regard to accepting a document, as long as the document looks genuine and relates to the individual, then you *must* accept the document.

New hire reporting for rehires

Q.

Employers must report new hires and rehires within 20 days. Does official guidance stipulate a maximum number of non-work days after which an employee becomes a rehire and has to be reported again? One of our companies does theater management and has some employees who work on an as-needed basis (ushers, stagehands, etc.). Some of these employees could go weeks or even months without working for us. Is there a point at which we need to report such an employee as a rehire if he returns and works an event?

A.

Under federal law, a "newly hired employee" is defined as (i) an employee who has not previously been employed by the employer; or (ii) was previously employed by the employer but has been separated from such prior employment for at least 60 consecutive days (Trade Adjustment Assistance Extension Act of 2011, Pub. L. 112-40, Sec. 253). States are free to impose shorter time periods, and eight state have done so (i.e., Alaska, Iowa, Louisiana, Massachusetts, Missouri, Pennsylvania, South Dakota, and West Virginia). If you report all your new hires to one state then follow that state's guidelines.

The federal Office of Child Support Enforcement adds that if the employee returning to work is required to complete a new W-4 form then you should report the individual as a new hire to the State Directory of New Hires (SDNH). If, however, the returning employee has not been formally terminated or removed from payroll records, or returns to employment within 60 consecutive days of separation, there is no need to report that individual as a new hire.

One-name employees (SSA)

Q.

We are hiring an employee from Indonesia who has only one name. SSA issued her social security card that way. Our payroll system requires a first and last name. One of our vendors also requires a first and last name and tells us that they register such employees as "NFN" (No First Name) in the First Name field and enter the mononym in the Last Name field. If we do the same for consistency, will this cause any issues with SSA on her Form W-2?

A.

Even though the card is issued with only one name, the SSA databases are exactly the same and require first and last names. The federal government runs into this a lot.

The good news is that SSA is not the first agency that talks to these people and registers them into a database. They start at the Department of Homeland Security when they are entering the country. Typically, the first name is usually "UNK" for unknown because those documents still require something in the first name field. When they come to the SSA, that agency actually uses that first name (usually UNK), and puts that into the SSA database as the first name in the background. When SSA produces the social security card, the name will print without that added acronym. If your payroll system requires that information, ask the individual what was on the immigration document.

When the SSA issues her a receipt and when the card comes in the mail, it will come in the mail as UNK with a single last name. She will know what her fake first name is on her government documents. If you only have one name and your system allows you to have one name, put it in the last name field. The SSA system, when it does name matching, looks for some common acronyms for mismatches and uses that for the name if there is no first name. In SSNVS, you cannot leave the first name blank.

Outsourcing employee verification (USCIS)

Q.

The employee who managed our immigration-related employment verification process retired, and we are considering outsourcing. What should we ask third-party vendors? Is there a certification program?

A.

I would ask some questions of vendors. How do they handle the I-9 process? Who can make a correction in Section 1? Only the employee can make a correction in Section 1 because they complete that section of the form. What is the three-day rule? How early can the Form I-9 be completed? How do you handle obtaining documents from employees? A lot of employers and, unfortunately, some vendors tell the employee which documents they have to present. Remember, the employee selects which documents to present.

If you are looking for additional questions, you can always go to the FAQ section on I-9 Central. You should really quiz vendors on some of that information.

USCIS does not provide any kind of certification program.

Possible immigration changes (USCIS)

Q.

The Trump administration is changing immigration programs that appear to affect the legal status of immigrants. Some of these actions have been in and out of court. This legal status could impact employment verification, such as the dates on registration documents to show whether someone can work. What should employers do? Do we wait on notices from UCSIS about changed status? Are employers responsible for knowing about these changes?

A.

The administration may be changing immigration programs, but those changes have not happened yet. Follow the guidelines we have today.

If you do that, you will have no issues. Additionally, remember the Form I-9 is not an immigration form; it is an employment eligibility form.

You can always stay current with the changes on the Form I-9 and E-Verify by visiting the websites and clicking on the "What's New" tab (https://www.uscis.gov/i-9-central/whats-new and https://www.e-verify.gov/about-e-verify/whats-new). On I-9 Central, USCIS has short vignettes on topics (https://www.uscis.gov/i-9-central/learning-resources).

Rehiring employees (USCIS)

Q.

In June 2017, we hired an engineer to work on a project that lasted six months and he completed a Form I-9. We plan to hire the same engineer for another project in June 2018. Does the engineer need to complete another Form I-9?

A.

In regard to leaves of absence, layoffs, or other interruptions of employment, refer to section 8.0 of the Handbook for Employers M-274 (https://www.uscis.gov/i-9-central/handbook-employers-m-274). In the past couple of versions of the handbook, we added situations like this.

Companies should be uniform with anything in regard to the Form I-9. If the rehire occurs within three years from the date the original Form I-9 was completed, you have an option to complete a new form or rely on the original one.

Social security card versions (SSA)

Q.

I've read that there are more than 30 versions of the social security card in circulation. While we ask employees to show us their cards at the time of hire so we can transcribe the numbers accurately, we are not able to tell if the card itself is valid or fraudulent. Is there something in particular we might look for? What is the best way to verify that a card an employee shows is official and actually belongs to the individual?

A.

On the SSA website history section, there are details about each variation of the social security card (https://www.ssa.gov/history/ssn/ssn-versions.html). There are 34 variations of the cards. Some of the older ones look really weird. One of the interesting things about social security cards is they do not expire. More information might be on the card as far as when it was issued or if there is any sort of work authorization. It does not necessarily mean older cards are not valid. It can be tricky. It might have been in someone's wallet for 15 years and you can barely read it, but it is still a social security card. We suggest you verify it back with us to make sure the name and number match because that is the important part.

Social security number and change of name

Q.

One of our employees has asked us to change her name in our payroll system. I was told it was because of a protective order but I have not seen the order and the employee has not made a change of name with the SSA. I have been asked to see if there are any exceptions for a situation like this to wage reporting when the name and SSN do not match. Has anyone had this situation and if so how did you handle it?

A.

Employers are required to enter into their records each employee's name and SSN exactly as shown on the employee's social security card. As a best practice you should not change the employee's name in your payroll system until the employee has presented a new social security card with the new name for you to confirm. If the employee has not obtained a new card, give her a Form SS-5 for completion and submission to the SSA. As an alternative, you can use the Social Security Number Verification System (SSNVS) to determine whether the employee's name has been changed in the SSA database. Employers may photocopy an employee's social security card to reduce the change of name/mismatch errors.

There are no exceptions for extraordinary personal situations that will alter the effects of a name/SSN mismatch. If your company makes the name change in its payroll system before a new social security card is obtained or before the name has been changed in the SSA database, errors in posting earnings to the employee's social security account and in preparing the employee's Form W-2 could occur, which would lead to possibly lower social security benefits for the employee and penalties for the employer imposed by the IRS.

SSN mismatches and fraud (SSA)

Q.

When we discover a mismatch in an employee's name and SSN, should we assume that some sort of fraud is taking place? What does SSA do when there's a mismatch? What should the employer do?

A.

Mistakes happen. The first thing is not to jump to the assumption that fraud is involved. There are a lot of legitimate reasons why something might not match. Maybe a name change has not been recorded with us. It is usually something that can be resolved.

Do not take any adverse actions based on information you get from SSNVS. You should investigate and make sure everything is correct and go forward from there. Document your efforts, but do not necessarily assume that a name/SSN mismatch is fraud or some sort of mischievous activity.

If you are checking mismatches before you submit Forms W-2 to the SSA, the best suggestion is to try to get the correct information. Talk to the employee. Ask for the correct social security number. If you still cannot resolve it, the employee may have to come in and see the SSA so that the records may be corrected.

If there are a whole lot of mismatches on your W-2 file, the SSA will send it back. If they are all wrong, the SSA will assume there is something wrong with your file, like everything down a column is mismatched. If there are a few mismatches, we will file those W-2s and post everyone's W-2s to their records, except for the mismatches. Those folks are sent into the Suspense file.

Calculating overtime for different shift rates for the same employee in two departments (DOL)

Q.

One of our employees is paid out of budgets belonging to two different departments. His manager wants to pay him two different rates of pay for the same shift. The employee is supposed to work 20 hours per week in each department, for 40 total hours. The manager wants to pay the employee $20 an hour from one department and $22 an hour from the second department. I'm not sure whether this is an FLSA issue or merely a problem for our accounting department to sort out, but how do I determine the regular rate of pay?

A.

The answer to that question can be found in 29 C.F.R. §778.115. When you have two different rates of pay, you want to combine the total amount of what is actually being received. Let us say it is $20 for 20 hours, and then $22 at 25 hours. You are going to take the total compensation and divide it by the total amount of hours worked, which would be 45. It is going to be somewhere between $20 and $22. You take the total amount of compensation to compute the regular rate. There is also a provision if you can determine the exact time which an employee actually worked over 40 hours. Let us say the 41st hour. You can pay at what we call the "rate in effect." If you can make that specific determination at 41 hours, that employee could be paid at that particular rate.

In most cases, employers cannot make that determination. When they cannot, they pay overtime based on the average wage. This happens even with nonexempt employees who are paid a salary.

California overtime pay calculation for a flat sum bonus

Q.

Does California follow the federal law when it comes to calculating overtime for a bonus?

A.

A recent California Supreme Court decision changed the calculation of a nonexempt employee's regular rate of pay for overtime purposes when a flat sum bonus is earned during a single pay period. The bonus must be divided by the number of *nonovertime* hours worked during that pay period. This interpretation differs from the calculation required under the federal Fair Labor Standards Act (FLSA), which directs employers to divide the bonus by *all* hours worked during the workweek – nonovertime *and* overtime hours [*Alvarado v. Dart Container Corp. of Calif.*, No. S232607 (Calif., 3-5-18)].

The court limited its decision to flat sum bonuses that do not change as a factor of number of hours worked or productivity. In the California court case, the company paid employees an attendance bonus of $15 for being scheduled for and completing a full work shift on a weekend. In other words, the bonus is incentive pay for completing a full work shift on an unpopular day to work (a Saturday or a Sunday) and is paid regardless of whether an employee works any overtime hours.

Another example of a flat sum bonus would be a safety bonus given if an employee adheres to safety requirements during a shift. Similar to the attendance bonus, it is not dependent on number of hours worked or whether any overtime hours are worked. The court specifically stated that the decision does not affect other types of nonhourly compensation – such as a production or piecework bonus or a commission, which may increase in size in rough proportion to the number of hours worked, including overtime hours, and therefore might warrant a different analysis.

Commuting time for overnight trips (DOL)

Q.

If an employee is traveling overnight on business, may an employer count the time it takes to get to the airport as normal commuting time, such that this time need not be paid for or taken into consideration when calculating the regular rate of pay?

A.

If an employee is traveling to the airport or overnight during their normal scheduled time, once again, 8 a.m. to 5 p.m., then that employee would cut across their normal work time and should be compensated.

There are also caveats with the DOL. If employees are closer to their worksite, meaning their office station or their actual official duty station, there is some commute time that can be taken out, meaning that if it is more convenient for the employee to leave from the office site than the home site, you can make that reduction. If it is a 10-minute deduction, that time could be reduced because it would be more convenient to leave from a different station. As a general rule, if it crosses the regular work time, from 8 a.m. to 5 p.m., it should be regular time.

Exempt and nonexempt employees (DOL)

Q.

We have an associate who earns a salary as an exempt employee for his job Monday through Friday and who also works for us on weekends and some nights in a separate job as an hourly paid nonexempt employee. His nonexempt job is compensated at a lower rate. Is it OK to calculate any overtime in his second job using just his lower hourly rate?

A.

There are definite criteria required for a salaried individual. If your person meets that particular exemption and is primarily in exempt status, it is not a problem to have an additional position. When you combine both jobs, if that second job is the primary responsibility or duty of that particular individual that you believe is exempt, it could affect the exempt status. If the second job is strictly part-time and the exempt position and duties and occupations would still allow that individual to maintain his exemption, it is not a problem to have an additional position and pay. You still have to make sure that person definitely meets the exemption and, once you add the additional positions or responsibilities or the second job itself, that second responsibility does not take that person away from the exempt status.

If they are not exempt, you would be looking at combining both pays and you could have a weighted average issue. You could be paying overtime. Make sure you are in compliance first before adding that responsibility.

Hiring bonuses (DOL)

Q.

We're offering a $1,000 hiring bonus to nonexempt employees, paid out as follows: $200 after three months, $300 after six months, and $500 after 12 months. How do I calculate the regular rate of pay? Does it only apply to the one pay period in which it is paid? For the first bonus payment, must I recalculate overtime pay back to the date of hire? For the second and third payments, would I need to recalculate back to the date of hire or back to the previous bonus payment?

A.

If a particular hiring bonus is based upon production, a promise – an employee must work for this particular period of time or it is contingent upon an employee producing this amount of work or sales – then it has to be included in the regular rate of pay. You can spread these payments out over a 12-month period – $200, $300, and $500. However, if an employee works overtime within that first three-month period, then the particular bonus paid for that three-month period would have to be included each and every workweek the employee worked over 40 hours.

There is an easier way of getting there. For the three-month period, find the total amount of hours worked, including the overtime hours and the actual bonus that was paid for that three-month period. Once you have those figures, divide the actual bonus by the total hours worked to find the regular rate of pay. Once you have that regular rate of pay, then you would make the determination of how many hours were worked over 40 hours within that three-month period, and you would do that for each period in which you've paid the bonus. You would not have to go back to the original payment date for the very first date if you have made the actual interim overtime payments in that period.

When you want to include bonuses based upon promises, efficiency, and productivity, they have to be included in overtime calculations. Once you make those payments, you either have to pay it that particular workweek or if you pay it for an extended period of time, then you have to retroactively go back for that period in which you are paying that bonus and then make the appropriate computation.

Holiday double-time pay (DOL)

Q.

Our company pays double time for holiday pay to our security officers. When calculating their regular rate for overtime, do we need to include that double-time pay?

A.

When there is double pay, premium pay for holiday time, Saturday, or Sunday work, that particular double pay does not have to be included in the regular rate of pay because it has already been established at a premium above the time-and-a-half rate. The Fair Labor Standards Act (FLSA) §207(e)(6) allows for those double payments not to be included in the regular rate of pay and no overtime has to be paid on top of that particular double pay.

How to calculate FLSA tip credit

Q.

I am a payroll manager for a hospitality company with hotels in multiple states. We are in the process of moving our payroll system from one software provider to another. During one of our training sessions, the question was raised about how the Fair Labor Standards Act (FLSA) requires us to determine the amount of a tip adjustment when overtime hours are involved. What is the correct approach?

A.

Here is how to calculate overtime pay for tipped employees. Like other nonexempt employees covered by the FLSA's overtime pay requirements, tipped employees must be paid one-and-one-half times their regular hourly rate for hours worked in excess of 40 per week. Under the FLSA, employers are required to pay "tipped employees" only $2.13 per hour in wages, so long as the employee's tips are enough to make up the remainder of the minimum hourly wage then in effect ($7.25 per hour). This means that the employer can take a "tip credit" of up to $5.12 ($7.25 - $2.13). If the employee's tips do not bring the employee's total wages up to the current minimum wage, the employer must make up the difference. Also, employers cannot take an increased tip credit for overtime hours worked.

Moreover, the FLSA defines a tipped employee's wage rate as the cash amount paid (at least $2.13 an hour), plus an amount of tips sufficient to bring the employee to the minimum wage. Tips are included in the regular rate of pay only to the extent they are used to satisfy the minimum wage requirement. Even if the tips received by an employee exceed the maximum tip credit the employer needs to claim toward payment of the minimum wage, these excess tips are not wages for FLSA purposes.

Suppose a restaurant server is a tipped employee whose employer pays him $2.13 and takes the full tip credit of $5.12. In one workweek the server works 45 hours and collects $210 in tips. His total pay for the workweek is calculated as follows:

Regular rate of pay: $7.25 per hour for tipped employee

Overtime premium rate of pay: $7.25 x .5 = $3.63 per hour

$7.25 x 45 hours worked = $326.25 regular pay

$3.63 x 5 overtime hours worked = $18.15 overtime pay

$326.25 + $18.15 = $344.40 total pay due employee under FLSA

Employee's cash wages without tip credit: $2.13 x 45 hours worked = $95.85

Tip credit amount: $5.12 per hour x 45 hours worked = $230.40

Tips received by employee: $210.00

$230.40 – $210.00 = $20.40 additional to be paid by employer to make up the full tip credit

$95.85 cash wages paid by employer + $210.00 tips received + $20.40 tip credit make-up = $326.25 regular pay

$326.25 regular pay + $18.15 overtime pay = $344.40 total pay due

Note that the above discussion and example assumes the employee only receives a base wage and tips with no other income types (like a nondiscretionary bonus) that might bring the regular rate of pay above the FLSA minimum wage. If the employee works in a state or locality with a higher minimum wage than the federal minimum wage, the higher state or locality minimum wage becomes the employee's regular rate of pay.

For more information about the minimum wage and overtime pay requirements for tipped employees, check *The Payroll Source®*, especially §§2.5-1, 2.6-4, 2.11-1, and 2.11-2.

Managing overtime hours during a change in workweek

Q.

My company was acquired by another company that will be managing payroll going forward. Our current workweek runs Monday through Sunday. The new company's workweek is from Sunday to Saturday. In the transition, we have one day (Sunday) from the current pay period that will fall into the new pay period, essentially shortening our workweek by one day. For hourly, non-exempt employees who work on that transition day, how should we manage overtime hours? Do we pay the overtime rate or should those hours be paid under the new company's workweek at the regular rate of pay?

A.

While the Fair Labor Standards Act encourages employers to establish permanent workweeks, a change may be necessary to meet changing business needs. But if a change is made, the employer must be careful when determining hours worked where the new and old workweeks overlap. Several steps must be taken to ensure that employees receive all overtime pay to which they are entitled:

1. Add the overlapping days to the old workweek.
2. Calculate the overtime hours and pay due for the old and new workweeks on this basis.
3. Add the overlapping days to the new workweek.
4. Calculate the overtime hours and pay due for the old and new workweeks on this basis.
5. Pay the employee the greater amount from step 2 or step 4.

The last step is worth emphasizing here. The change in workweeks and the overlap between old and new workweeks cannot negatively affect the employees working during those times. For more information about this, see *The Payroll Source®*, §2.6-1.

Overtime hours worked on a holiday

Q.

Our company pays hourly employees who work on a holiday and one and one-half times their regular hourly pay. If the employee were to work overtime hours on the holiday (more than eight hours on that day) should the extra time on the holiday be considered double time or triple time under the Fair Labor Standards Act (FLSA)?

A.

No. Under the FLSA your company must pay an employee overtime pay at 1½ times an employee's regular rate of pay for all hours over 40 in a workweek. It does not matter whether the hours worked by an employee fall on a regular workday or on a holiday for the purposes of determining overtime pay.

Generally, the regular rate of pay is an hourly pay rate determined by dividing the total regular pay actually earned by the employee for the workweek by the total number of hours worked. This means that other compensation received by an employee in addition to hourly wages (such as a nondiscretionary bonus) must be included when determining the employee's regular rate of pay.

There are some types of pay that can be excluded from the calculation of regular rate of pay, one of which applies here. Extra pay provided to an employee for working on a Saturday, Sunday, holiday, or other regular day of rest (but not for working more than 40 hours in the workweek) need not be included in the employee's regular rate of pay if it is at least 1½ times the rate for similar work done during the normal workweek. Such pay may also be used to offset any overtime pay due the employee for the workweek.

Keep in mind that your company must always be in compliance with the requirements of the FLSA so if there is a situation in which the amount computed for the employee falls short of the FLSA-required amount, your company must nonetheless pay the employee at least the amount required by the FLSA.

The preceding discussion applies to FLSA requirements. Your state may have more stringent requirements for paying employees, such as the requirement for paying daily overtime for hours worked in excess of 8 in a day. You must pay the employee according to the requirements most beneficial to the employee. For more information about correctly paying employees under the FLSA and state law, check out *The Payroll Source®*, §2 and *APA's Guide to State Payroll Laws*, §1.

Probationary period pay and holiday pay

Q.

At my company, the probationary period for new hires is 90 days. During that time, and in accordance with company policy, we do not pay for holidays. A supervisor wants to know whether a new hire can work an extra 8 hours during a workweek with a holiday to receive a full week's pay, so the employee actually works 40 hours in that workweek. For purposes of the Fair Labor Standards Act (FLSA), does it matter whether the employee is hourly or exempt?

A.

The FLSA does not recognize probationary periods nor does it require employers to provide paid vacations. Exempt employees generally must be paid their full salaries for any week in which they perform any work, regardless of quantity or quality. There are limited exceptions where you may reduce an exempt employee's salary in full-day increments, such as beginning or terminating employment in the middle of a workweek, or the employee takes a full vacation or personal day off when no paid time off is available.

The FLSA only requires nonexempt employees to be paid for hours worked, which is the reason why the Act does not require pay for vacation time. In the scenario you pose, the nonexempt employee would work a total of 40 hours that week and would not be entitled to overtime pay based on the holiday.

What your company *cannot* do is attempt to "even out" the nonexempt employee's pay by having him or her work 32 hours in one workweek and then 48 hours in the second workweek without receiving overtime pay. Under the FLSA each workweek stands alone and the employee in that situation would be entitled to 8 hours of overtime pay for the second workweek.

Salaried nonexempt employees (DOL)

Q.

We have a number of salaried nonexempt employees. They are paid semimonthly and record their hours weekly. My impression has been that their salary covers their working hours up to 40, and that any vacation time, sick time, or holiday pay do not count toward overtime. For example, if one of these employees works 40 hours in four days and there is an eight-hour paid holiday, they only get paid their salary. Is that right? If we do need to pay for 48 hours, do any hours need to be paid at time and a half?

A.

The simple answer is no. If you have a nonexempt employee who is paid on a salaried basis, it means he is entitled to overtime at either time and a half or half time. Time and a half is when an employee's salary is only based on 40 hours. If that employee worked over 40 hours of actual work time, then that employee would receive time-and-one-half of that particular amount of the salary based upon the hours. If the that nonexempt employee's salary is based upon all work hours, then only the additional half-time would be due for hours worked over 40. So, in this particular situation, if an employee did not work over 40 hours and there's a holiday in that particular period, or vacation time, then that employee's salary would only be paid. And then from an internal payroll perspective, you could then make your determinations or your allocations away from that particular PTO bank.

If you have any questions, you can always visit https://www.dol.gov/whd/. The DOL has over 54 district offices throughout the United States. You can call (866) 487-9243, which is (866) 4-US-Wage.

Show-up pay for work shift

Q.

We are a company in Massachusetts. I have been told that the federal Fair Labor Standards Act (FLSA) requires our company to pay employees who show up for their assigned work shifts a minimum of 2 hours pay for showing up, even if they are sent home shortly thereafter or are told to go home on arrival for lack of work. The employees I am asking about are all hourly nonexempt employees. Where can I find out more about this requirement?

A.

The FLSA does not address the "show up" pay issue about which you are asking. The Act does these four things: (1) sets the minimum wage and overtime rates employees must receive for their work; (2) requires recordkeeping by employers; (3) places restrictions on the types of work children can do and the hours they can work; and (4) mandates equal pay for equal work. (Note, however, that the FLSA requires an employee to be paid for all hours worked and that includes time "engaged to be waiting" (as opposed to "waiting to be engaged," which is not compensable.)

Matters not addressed by the FLSA in many cases are regulated by the individual states. Some of these other areas include paid vacation or sick leave, sick days, jury duty leave, holidays, and how often employees must be paid.

Although the FLSA does not require this type of pay, states and cities have begun regulating this area with predictive scheduling laws that include show-up pay. These laws tend to apply to the retail and food service industries and to large employers, including franchises. Most predictive scheduling laws include on-call and split shift-related provisions, and govern aspects of scheduling that include how far in advance an employee must be notified of the employee's work schedule, an employee's right to refuse last-minute changes to the posted work schedule, and compensation for schedule changes if the employee agrees to the schedule change. Nine states and five cities, including Massachusetts, have call-in time or other predictive scheduling requirements. In Massachusetts, when an employee who is scheduled to work three or more hours reports for duty at the time set by the employer, and is not provided with the expected hours of work, the employee must be paid for at least three hours at the minimum wage rate.

It is likely that more states and cities will enact predictive scheduling laws. Find out more about the in *APA's Guide to State Payroll Laws*, §1.9.

Timecard rounding rules (DOL)

Q.

We are getting ready to move from paper time cards to an electronic time and attendance system that will allow us to adjust early and late punches when employees are clocking in and out. Are there specific rules about rounding that we need to follow? Can I round up all the early punch-ins and round down all the late punch-outs?

A.

Rounding is not a problem. However, you have to round in the same manner, whether it's up or down. For example, if you round on a quarter-hour basis and you have a system where you are supposed to arrive to work at 8:00 and you get there 8:07, it is still going to keep you in the 8:00 time basis. If you arrive at 8:08, or anything after that seven-minute period, it's going to place you in at 8:15. The same thing would happen when you leave. Our enforcement rules (under 29 C.F.R. §785.48) state you are able to round as long as the rounding eventually gets to the actual hours of work so it doesn't result in loss of time or loss of work. You cannot round up or down for your own purposes one way or the other.

Timekeeping for salaried nonexempt workers

Q.

Is it true that salaried employees need only complete a time card when they use benefit time? I would like to apply this rule to our nonexempt workers who are paid on a salary, but I'm not clear about how overtime would be calculated. My proposal would be only for full-time nonexempt employees. Part-time and seasonal workers would still submit weekly timecards.

A.

It is not true that all salaried employees "need only complete a time-card when they use benefit time." Under the Fair Labor Standards Act (FLSA), you must have detailed timekeeping records including clock-in and clock-out times for any nonexempt employee, whether the pay basis is hourly or salary. For more on the recordkeeping required by the FLSA, see *The Payroll Source*®, §10.1.

A regular hourly rate of pay would be determined by dividing the employee's salary by the number of hours the salary is intended to compensate (also factoring in nondiscretionary bonuses, commissions, shift differentials, and any other payments that affect the regular rate). Hours worked in excess of 40 need to be paid at 1.5 times the employee's regular hourly rate of pay.

Tool allowance for nonexempt employee

Q.

Our company is working on an arrangement to pay our mechanic an annual tool replacement allowance of $500. We have not decided on whether to pay this allowance on each biweekly payroll or payout in a lump sum during the first pay period of the calendar year. If we pay this allowance on each biweekly payroll, should this payment be included in the calculation of a mechanic's regular rate of pay for overtime rates under the Fair Labor Standards Act (FLSA)? Would this allowance be includable in the employee's income for federal income tax withholding purposes?

A.

The allowance you describe would have to be included in the calculation of an employee's regular rate of pay for FLSA overtime calculations. It allowance would have to be allocated as it is "earned" over the 26 payroll periods in the year. A $500 allowance allocated over 26 weeks would come to less than $20 a pay period.

Your description of the allowance is as a cash add-on to the mechanic's compensation without the necessity of any sort of accounting. A cash payment, regardless of the reason for it, is includable in an employee's income. Also, the IRS has ruled that tool allowances like this are merely a recharacterization of wages by an employer. This tool allowance would therefore be includable in the mechanics' income and would be subject to federal income tax withholding, as well as social security, Medicare, and FUTA taxes.

Since you are in the planning stage for this benefit, consider setting this up as a tool reimbursement under an accountable plan. Where an employer pays an allowance to employees who use their own tools or heavy equipment on the job, the allowance is not included in the employee's wages and is not subject to federal income tax withholding or social security, Medicare, or FUTA taxes. But the employer must be sure to keep the allowance payment separate from the employee's wages. The exclusion is not allowed if the allowance is paid to all employees regardless of whether they use the employer's tools or their own. Reimbursements be matched against specific expenses incurred by the employee in order to be excluded from income.

In 2009, the IRS ruled that an employer's tool expense reimbursement arrangement was an accountable plan because the plan only reimbursed covered costs that a technician substantiated to the employer with written evidence and certified that the expenses incurred were necessary for the performance of services for the employer, the tools and equipment were required to be kept on site, and all claimed expenses were verified as necessary for the performance of services for the employer by the technician's manager. The reimbursements were provided in addition to, and not in place of any other employee compensation.

Learn more about reimbursement plans and their treatment under the IRS accountable plan rules in *The Payroll Source®*, §§3.4-12 and 3.3-5.

Travel time to another state (DOL)

Q.

We are a staffing agency and have a group of temporary folks travelling from all over the country to work a six-day event for a client in Texas. For some of the employees, this event will be the first time they work for us. Payroll and HR are debating how and whether to pay for travel time. Payroll says these employees should be paid an hourly rate for travel that occurs during their normal working hours, with their pay reduced to minimum wage for the travel hours. HR says we do not need to pay for travel since it is pre-shift/post-shift for this job and, therefore, is not compensable time. HR added that as an at-will employer, we only need to be concerned that these folks arrive at the event to work and are paid for working there. Which is correct?

A.

Neither. I'm going to start with the at-will employer statement. It does not matter as the "at-will" relates only to terminations. Being at-will is your right, per se, but it will not lessen any particular responsibilities as it relates to hours worked.

As you are dealing with travel time, you look at what is the employee's normal work time. For example, if it truly is 8 a.m. to 5 p.m. and an employee travels on Saturdays or Sundays, which is not normally his workday, that particular employee should receive payment as if it were Monday through Friday because it crosses his normal schedule. The pre- and post-shift is not a factor when travel will actually occur during the normal work time. If the employee is traveling on Saturday and Sunday, between 8 a.m. and 5 p.m., and that's his normal work time or normal work schedule, that particular employee would receive travel time or travel pay for hours worked.

Reducing the payment to minimum wage would be concerning for the DOL. As soon as the DOL hears "reduce" or "deduct" for hours worked, that just automatically makes us wonder why there is a reduction. As an employer, you have to be very mindful that you are not evading paying the right rate of pay or overtime just because you want to save money. The travel is not for the convenience of the employee. It is for the convenience of the employer. So be very mindful when making those types of reductions, especially when the employee is still doing the same position and traveling for the employer at the employer's request. I would caution you with making that reduction because it is not a different pay. It is not a different job.

When to include bonuses in calculations of overtime pay

Q.

We have always figured overtime pay on the basis of an employee's hourly rate of pay multiplied by 1.5. Our new finance director says that overtime should be calculated based on all of an employee's pay during the workweek, including bonuses and she cites the Fair Labor Standards Act (FLSA) as her authority. Is she correct? The particular bonus in question here involves a performance bonus we pay to some of our hourly employees every six months.

A.

In this case, the finance director is correct. A nonexempt employee's regular rate of pay is based on all includable earnings during a workweek. Payments are includable in the regular rate of pay unless they are excluded by the FLSA itself. *The Payroll Source®*, §2.6-3 outlines many types of compensation includable in the regular rate, as well as those items of pay specifically excluded from the calculation.

For purposes of calculating overtime pay, the FLSA (29 USC §207(e)) provides that nondiscretionary bonuses must be included in the regular rate of pay. Nondiscretionary bonuses include those that are announced to employees to encourage them to work more steadily, rapidly or efficiently, and bonuses designed to encourage employees to remain with a facility. The U.S. Department of Labor (DOL) cautions that few bonuses are discretionary under the FLSA, allowing exclusion from the computation of the nonexempt employee's regular rate of pay for overtime calculation (see 29 C.F.R. §§778.200 and 778.208).

Regular rate of pay calculations involving bonuses can get involved. It sounds as if the bonus you are describing is earned by the employee for a six-month period, so the amount of the bonus would be prorated equally over the 26 workweeks in the period with overtime recalculations required for workweeks in the six-month period during which the employee worked more than 40 hours. The DOL has a fact sheet with specific examples that provide guidance (https://www.dol.gov/whd/StateandLocalGovernment/media/OT%20Examples%20final.htm).

California waiting time penalty for late payment of final wages

Q.

Our company is in California, which requires employers to pay the final paycheck of an employee who terminates employment within a certain period of time. If the payment is not made within the required time under California law, the employer is required to pay the terminating employee and additional amount as a "waiting time penalty." Under federal law, would the penalty payment be considered wages for purposes of federal income tax withholding, and FICA and FUTA taxes?

A.

No. The employee's final paycheck is taxable wages but the waiting time penalty itself is not.

In 2015, the IRS Office of Chief Counsel issued a memorandum concluding that the waiting time penalty is not considered wages for federal tax purposes (Number 201522004; UILC 3401.01-00; https://www.irs.gov/pub/irs-wd/201522004.pdf). The IRS explained that wages as defined for FICA purposes include all remuneration for employment, with certain exceptions. Under FICA, employment is any service of whatever nature performed by an employee for the employer, again with certain exceptions. The definitions of wages and employment for FUTA tax and federal income tax withhold are similar to the FICA definitions.

As long as remuneration is paid for employment, it is considered taxable wages regardless of whether it is designated salaries, fees, bonuses, or commissions on sales or on insurance premiums. In addition, any payments made by an employer to an employee on account of dismissal (severance pay – involuntary separation from the service of the employer) constitute wages regardless of whether the employer is legally bound by contract, statute, or otherwise to make such payments. This means that the actual wages owed to the company's terminating employee as final payment of compensation are taxable wages.

The IRS explains that the California waiting time penalty differs from taxable severance pay because it is not based on the employee's employment but rather the employer's failure to pay those wages on a timely basis. The waiting time penalty is imposed by state law because of the employer's action or inaction with respect to the final paycheck.

The employee has no right to payment of the late payment penalty based on the service of the employee; it only applies if the employer fails to pay wages on a timely basis

Extra money for employees to spend

Q.

My company is offering $200 a month to our employees who decide what to spend it on, such as paying down student loans, or for training and studies. If we do not know what they are spending the money on, isn't the $200 just federal-taxable income like a gift card? If they put the money towards education, wouldn't this mean the money is not taxable since it is only $2,400 a year, right? If they are putting it towards paying off a student loan, is it taxable?

A.

Under the plan you describe, the $200 provided to your employees is compensation subject to federal income tax withholding, and social security and Medicare taxes. The employee determines what to spend the $200 on, which can be anything and is no different than how they might spend their other compensation. If your company would like to provide tax-advantaged education benefits to your employees, some requirements are outlined below.

Employer-paid education related to an employee's current job is excluded from income as a working condition fringe benefit if: (1) the courses are not required to meet the education requirements of the current job; (2) the courses are not taken to qualify the employee for a promotion or a transfer to a different line of work; and (3) the education is related to the employee's current job and helps to maintain or improve the knowledge or skills for the employee's current job. Generally, graduate-level courses are not considered by the IRS to be job related.

Under IRC §127, employers may reimburse employees up to $5,250 in nonjob-related educational expenses under a qualified educational assistance program without including it in employees' income. This figure may be why you thought the $2,400 figure was excludable from the employee's income but under the facts you indicate here, the amount is still taxable.

Tax-advantaged nonjob-related educational assistance must be provided through an Educational Assistance Program (EAP), which, among other things: limits excludable nonjob-related education reimbursement to $5,250 a year; requires that the education be for the exclusive benefit of the employee; requires a separate written plan that provides only educational assistance benefits; does not discriminate in favor of highly compensated employees; limits benefits for shareholders or owners with more than 5% of the stock or capital of the employer; and provides notification of employees. Your company's plan does not meet the requirements for an EAP.

If your company makes payments on an employee's student loan debt, those payments would be subject to federal income tax withholding, and social security and Medicare taxes, because they would be compensation for services. The payments would be supplemental wages that could be taxed at either the optional flat rate of 22% (assuming year-to-date supplemental wages of less than $1 million) or could be aggregated with the employee's wages for the applicable pay period.

For more information about education benefits for your employees, see *The Payroll Source®*, §3.3-3.

Gift cards for holiday gifts

Q.

During the holidays, our company gives each employee a $25 gift card to a local grocery store that can be redeemed for a turkey or ham. How should this be treated? Are employees taxed for the $25?

A.

These gift cards are a cash equivalent, regardless of whether they are general purpose or for a specific store (see *The Payroll Source®*, §3.4-13), and they must be included in employees' wages. Each employee receives a known value of $25. The $25 is taxable wages per IRS Reg. §1.132-6(c), which states: "a cash equivalent fringe benefit (such as a fringe benefit provided to an employee through the use of a gift certificate or charge or credit card) is generally not excludable under section 132(a) even if the same property or service acquired (if provided in kind) would be excludable as a de minimis fringe benefit." IRS regulations use this example: providing cash to an employee for a theatre ticket (that would itself be excludable as a de minimis fringe) is not excludable as a de minimis fringe.

A gift certificate that allows an employee to receive a specific item that is minimal in value, provided infrequently, and administratively impractical to account for might be a de minimis fringe, depending on the facts and circumstances. If, in your case, each employee received a gift certificate for a free turkey or ham with no dollar amount, it might qualify as a de minimis fringe.

IRS Publication 15-B, *Employer's Tax Guide to Fringe Benefits*, also provides examples of de minimis fringes on page 9 (https://www.irs.gov/pub/irs-pdf/p15b.pdf).

Housing allowance or stipend for employees

Q.

We are a hospital that employs temporary staff for generally a 12-week commitment. We are considering offering a housing stipend or allowance in addition to the hourly rate. We do not have housing on campus. Can the stipend be excluded from employee income for federal income tax purposes as employer-provided lodging?

A.

No. In order for the value of employer-provided housing to be excluded from income for federal income tax purposes, all of these conditions be met:

- The lodging is furnished on the employer's business premises (including a camp provided by the employer near the work site, if it is in a remote area of a foreign country).
- The lodging is furnished for the employer's convenience.
- The employee is required to accept the lodging as a condition of employment.

The allowance does not qualify for the exclusion. Your hospital has no on-premises lodging. In addition, the exclusion for lodging does not apply to cash allowances for lodging (which is what you are proposing in your question), as opposed to lodging furnished in kind.

Although the allowance is not excludable from income as employer-provided housing, it may be excludable as an advance or reimbursement for business-related employee expenses.

In general, if the reimbursement is made under an "accountable plan," the amount is excluded from income and is not subject to federal income tax withholding or social security, Medicare, or FUTA taxes. If the reimbursement is made under a "nonaccountable plan" or exceeds the amount substantiated by the employee, the reimbursement or the excess amount is included in income and is subject to federal income tax withholding and social security, Medicare, and FUTA taxes. See *The Payroll Source®*, §3.3-5 for more details about employee travel expense reimbursements.

Lottery tickets and taxable income

Q.

If we buy lottery scratch-offs for our employees, are they taxable and, if so, to whom? If the lottery ticket recipient wins money, are the winnings posted to their payroll record as taxable income?

A.

If you furnish lottery tickets to your employees because they are your employees, in other words, furnishing the tickets is tied to the employment relationship, the amount you pay for the tickets is taxable wages to the employee. Note that if you sought to qualify the purchase price of a lottery ticket a *de minimis* fringe benefit excludable from an employee's income, you would have to show that the following conditions are met:

1. The value of the benefit is so small that accounting for it would be unreasonable or impracticable.
2. The employer must take into account the frequency with which it provides the benefit to all its employees in making this determination.
3. The term employee means anyone to whom the benefit is provided.

See *The Payroll Source®*, §3.2-1 for more information about determining when a fringe benefit is excludable from employee income.

Since the lottery is open to the general public, winnings would be taxable income to recipients but would not be taxable wages. The lottery commission would issue Forms 1099, as appropriate.

Productivity rewards earned through a point system

Q.

My employer is initiating a program where employees can earn points by hitting certain productivity metrics. These points may be used by the employees to purchase gift cards. For example, an employee who receives 1,000 points can obtain a $10 gift card. Do we add the value of the points to income when the points are earned, or only when the gift cards are purchased?

A.

The gift cards are cash equivalents, and they should be included in income at the time they are received or purchased. Assuming the points by themselves are not cash equivalents and do not have any intrinsic value until they are exchanged for a gift card, then the employer should include the face value of the gift card in employee income and wages at the time of receipt or purchase, which means when it is handed to the employee.

Employer-paid travel for employee's spouse to attend award ceremony

Q.

If an employer is paying air fare for an employee to attend an award banquet put on by the company in another city and also paying the air fare of the employee's spouse to join him at the banquet, would the spouses' airfare be federally taxable income?

A.

Based on the facts provided in the question, the employer's payment of travel expenses for the employee's spouse would be taxable income. The Omnibus Budget Reconciliation Act of 1993 (OBRA 1993) added IRC §274(m), which generally disallows a business deduction for travel expenses paid for a spouse, dependent, or other individual accompanying the taxpayer.

In spite of this disallowance, amounts paid or reimbursed by an employer for spousal travel expenses might still qualify as a working condition fringe benefit for the employee to the extent the employee can substantiate the business purpose of the dues or expenses. The employer reimbursements or payments for these expenses qualify as working condition fringe benefits only if:

- The employer does not treat them as wages
- The expenses would be deductible by the employee if IRC §274(m)(3) had not been added by OBRA '93
- The employee substantiates the expenses

In essence, the employer can exclude the spousal travel expense payments or reimbursements from the employee's income if the employee can show that there was a legitimate business purpose for a spouse's, dependent's, or other individual's presence on the trip and the employee substantiates the expenses. This rule applies to all employers, even those who are exempt from federal taxation and are not subject to the deduction disallowance of IRC §274(a)(3).

If the travel does not qualify as a working condition fringe benefit, the employer-paid amounts must be included in the employee's income and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

For more information about the treatment of travel expenses for employee spouses and other employer-paid expenses, see *The Payroll Source®*, §§3.2-1, 3.3-5, and 3.5-2.

Retirement gift to executive employee

Q.

Our company is giving a work of art to one of our executives as a retirement gift. Do we have to include the gift in the executive's income as imputed income? If so, is any part of the gift excludable?

A.

All or part of the gift could be includable in the employee's income depending on its market value and other factors.

Gifts provided to employees must generally be included in employees' income and are subject to federal income tax withholding, FICA and FUTA taxes. However, employers do not include awards for length of service in an employee's income if the amount of the award is deductible to the employer as a business expense. The extent to which the award is deductible to the employer depends on whether the award meets several general and specific requirements and whether it is granted under a qualified or nonqualified plan.

To qualify as deductible to the employer, a length of service award must be an award of "tangible personal property," which does not include cash or cash equivalents, stocks, bonds, vacations, meals, lodging, or tickets to theater or sporting events. Also, the award must be presented in a "meaningful presentation" that need not be elaborate but must emphasize the employee's achievement (e.g., presentation by a supervisor at a gathering of employees). Finally, the award must not be "disguised compensation," which might be shown by an award made at the time of a salary review or by an award that cost the employer much less than its fair market value.

Retirement awards are a type of length of service achievement award. To qualify as a deductible achievement award, a length of service award must not be presented for less than five years on the job and must not have been awarded to the same employee within the last four years.

If your company has a "qualified plan" for giving out achievement awards, the employer can deduct (and the employee can exclude from income) up to $1,600 of the award value. The plan is qualified if the rules for awards and gifts are written and the plan does not discriminate in favor of highlight compensated employees.

If the retirement gift is not made as part of a qualified plan, the employer's deduction (and employee's income exclusion) is limited to $400 per year. In either case, if the value of the award exceeds the applicable limit, the excess is included in the employee's income. (If a length of service award is given before the required number of years of service, the entire amount is taxable and included in income.) Keep in mind that your company can always gross up the taxable portion of the retirement gift to give it to the executive without tax liability on the executive's part.

For more information about retirement gifts and other employee awards, see §3.4-2 of *The Payroll Source®*.

Taxability of research grants

Q.

We have research fellows who receive grants that are not part of the National Research Service Award (NRSA) program. Should these grants be taxed?

A.

Yes, if they are compensatory in nature, these grants should be taxed as wages. In PLR 200607017, a Private Letter Ruling (PLR) dated March 5, 2005, the IRS had held that the stipends a taxpayer paid to its research fellows using grants similar to those authorized under the NRSA program did not constitute "wages" for employment tax purposes and were not subject to social security taxation. This is no longer the case.

In a 2017 PLR, the IRS determined that PLR 200607017 is no longer in effect [IRS PLR No. 201705001, 2-3-17; https://www.irs.gov/pub/irs-wd/201705001.pdf]. The 2017 PLR states: "Amounts paid to research fellows under non-NRSA grants that are compensatory in nature constitute a payment for services, are 'wages' for employment tax purposes, and are subject to social security taxation."

The 2017 PLR revoked PLR 200607017 but limited the retroactive effect of the revocation to taxable periods beginning on or after February 3, 2017. Accordingly, compensatory non-NRSA grants are considered wages for employment tax purposes.

401(k) contributions of Pennsylvania employees

Q.

I was told that the 401(k) contribution that is deducted pre-tax should not be pre-tax in Pennsylvania. Is this true? Are there any other states that do this, too?

A.

Pennsylvania is the only state in which employee elective deferrals to a 401(k) plan are subject to income tax. Says the Pennsylvania Department of Revenue, "Unlike the federal income tax law, contributions to a 401(k) or contributions to other types of retirement plans are considered part of the employee's taxable compensation and are subject to withholding requirements. The contributions are treated the same, whether made inside or outside of a cafeteria plan. However, when you retire and start receiving distributions, the amount you withdraw from your 401(k) plan is not subject to Pennsylvania personal income tax."

401(k) plan deduction from severance pay

Q.

Our company will be laying off employees and will be paying them severance pay in a lump-sum payment after their employment has terminated. One of our employees has been participating in our 401(k) plan and would like to have a 401(k) contribution taken from her severance payment. Is this allowable?

A.

No. For a participant's compensation to be deferred into a 401(k) plan, the payment must meet the 401(k) plan's definition of "compensation" and that definition of compensation must comply with IRC §415. The severance payment to the employee here would not count as 401(k)-compliant compensation.

An employee's severance from employment occurs when the employee ceases to be an employee of the employer maintaining the

401(k) plan. Generally under IRC §415 compensation must be paid or treated as paid to the employee before the employee separates from employment. However, compensation that would have been paid if the employee had not undergone severance from service (e.g., a commission earned by a salesperson while employed but paid to her after termination of her employment) must be included in a 401(k) plan definition of compensation pursuant to IRC §415 if it is paid after an employee's severance but before whichever of these is later:

- Two and one-half months after separation from employment; or
- End of the plan's limitation year that includes the date of severance from employment

A post-termination payment that does not meet one of the exceptions to that general rule does not qualify as compensation under IRC §415 from which a contribution to a 401(k) plan may be made. A severance payment like the one you describe here made to the employee after her employment has ended would not be compensation from which a 401(k) deduction can be taken.

The interplay of employee pay and benefits is complex. Sections 3 and 4 of *The Payroll Source*®, also contains detailed information about the payroll implications of 401(k) plans and variety of benefits.

Employee-paid health insurance premiums during FMLA leave

Q.

We offer benefits to our employees on both a pre-tax and post-tax basis. Health insurance benefits provided to our employees are paid partly by our company and partly by the employee. The employee-paid part of the health insurance benefits is paid on a pre-tax basis through our cafeteria plan. When employees go out on a leave of absences under the Family and Medical Leave Act (FMLA), they are still responsible for making payments on their share of the health insurance. If the employee has paid leave coming and it is used during FMLA leave, the premium is deducted pre-tax. Once the paid time off is exhausted, the employee is required to mail in a check. Our software company has told us that when an employee sends a check, the payment is made outside of income and we must reduce the employee's taxable income by the amount paid towards the pre-tax benefit. Is this option elective or required by federal law?

A.

No. The reason why employee contributions to a cafeteria plan for a qualified benefit such as health insurance are made on a pre-tax basis is because they are offered on a salary reduction basis – that is, the employee has a choice between receiving cash or agreeing to a reduction of his or her pay to obtain the qualified benefit. Salary reduction requires the payment of wages that can be reduced.

Amounts paid by check are not a salary reduction, so taxable wages are not reduced by those amounts.

Group-term life insurance over $50,000 excluded from employee income

Q.

A disagreement has arisen in our payroll department about including the value of group-term life insurance over $50,000 in an employee's income. Most of us say it is always included. A few in our department think there are exceptions. If so, what are they?

A.

The group in your office who say there are exceptions are correct but first here are the general rules. The value of employer-provided group-term life insurance up to $50,000 is excluded from an employee's income. The value of coverage in excess of $50,000, minus any amount paid for the coverage by the employee after taxes, must be included in the employee's income. The value of the excess coverage is subject to social security and Medicare taxes, but is not subject to federal income tax withholding or federal unemployment (FUTA) tax. At their option, employers may withhold federal income tax on the value. The employee must pay the federal income tax owed on that value with his or her personal income tax return.

The value is reported on the employee's Form W-2 in Boxes 1, 3, 5, and 12 (with Code C), and on the employer's reporting Forms 940 (Part 2, Lines 3 and 4) and 941 (Lines 2, 5a, 5c, and 5d).

Here are the exceptions. The value of group-term life insurance over $50,000 is not included in an employee's income in any of these situations:

- The beneficiary is the employer
- The beneficiary is a charitable organization
- The employee terminates employment during the year because of a permanent disability

For additional information about calculating and including group-term life insurance coverage in an employee's income see *The Payroll Source*®, §3.3-1.

Leave bank for sick employees

Q.

Our company is looking into letting our employees donate their sick leave to other employees who need additional time because of extended illnesses or serious health conditions. Are these sanctioned by the IRS? What are federal tax consequences to employees? Do you have suggestions about how can we determine the leave to be shared?

A.

Such plans are sanctioned under IRS Rev. Rul. 90-29 for medical emergencies. Under an employer's leave sharing plan, employees donate a certain number of paid leave days, which are then "deposited" in a leave bank. Employees who participate in the plan and have medical emergencies can then use paid days from the bank when their own paid leave has been exhausted. The plan may restrict the number of days that can be deposited or used for medical emergencies.

Compensation paid to employees using paid days from the leave bank is wages subject to federal income tax withholding and social security, Medicare, and FUTA taxes. Employees who donate paid leave days and then do not use any of the banked days do not receive wages related to the amount of leave they donated, but they also cannot deduct the compensation donated from their income.

In IRS Private Letter Ruling 200720017, 2-9-07, the IRS discussed an employer's leave-sharing plan that resulted in income and withholding to the recipient employee. Under that plan, if the recipient employee received paid leave hours under the plan from a donor employee with a different pay rate, the leave time would be converted based on the recipient employee's pay rate, so that the dollar value of the surrendered leave remains the same, but leave taken by the recipient employee is paid at the recipient employee's regular rate of pay. For example, if the donor employee is regularly paid $15.00 per hour and surrenders eight hours of paid leave to a recipient employee who is regularly paid $10.00 per hour, the recipient employee receives 12 hours of paid leave, paid at $10.00 per hour (8 hours x $15.00 = $120 value, and $120.00 value/$10.00 per hour = 12 hours).

See *The Payroll Source®*, §3.4-17 for more information about employer leave-sharing plans.

Loan repayments to 401(k) plan

Q.

Our company has a 401(k) plan and an employee has wants to take out a loan against the balance in his account. This is the first time an employee has asked for a loan and I need to set up a repayment schedule. What do I need to know? Is the loan repayment pre-tax like a regular 401(k) contribution or post-tax? Can the payment of principal and interest be shown as a single deduction?

A.

First, you need to be familiar with your company's 401(k) plan. A qualified plan may, but is not required to provide for loans. If a plan provides for loans, the plan may limit the amount that can be taken as a loan. The maximum amount that the plan can permit as a loan is either: (1) the greater of $10,000 or 50% of the employee's vested account balance; or (2) $50,000, whichever is less. For example, if a participant has a vested account balance of $60,000, the maximum the participant can borrow from the account is $30,000.

A plan may require the spouse of a married participant to consent to a plan loan. A plan that provides for loans must specify the procedures for applying for a loan and the repayment terms for the loan. Generally, repayment of the loan must occur within 5 years (although loans for purchasing an employee's personal residence may be paid back over more than 5 years), and payments must be made in substantially equal payments that include principal and interest and that are paid at least quarterly.

A 401(k) loan repayment is an after-tax deduction. The loan does not increase taxable wages and the repayment does not reduce taxable wages. Whether or not you need a separate deduction for the loan principal and loan interest is something you should clarify with the plan administrator. You can find out more information about loans taken out against retirement plans on the IRS website (https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-loans).

Uncollected funds in an FSA

Q.

Under our flexible spending arrangement (FSA) plan, employees' debit card accounts get funded in full at the beginning of the year, and we deduct evenly throughout the year. If an employee terminates and has used more of their FSA money than we have collected, can we collect from their final paycheck as long as they don't go below minimum wage? Either way, do we need to tax the excess (amount used less what was deducted)?

A.

No you can't collect from the final pay. That's one of the risks with offering medical FSA: it's fully available at the beginning of the year, and both the employer and the employee have the risk of loss.

Think of it this way: If the employee doesn't spend it all, can he or she get a refund? No! The employee forfeits the excess he or she contributed.

In all of the years I've been in payroll management, never once have I seen the employer come out on the short end of medical FSA funding at year-end. In my experience, the number of employees who leave money on the table by not using their full FSA amounts more than offsets the ones who use it all and leave before year-end.

Changing pay periods: salary current to hourly arrears

Q.

Approximately a third of our employees receive a salary but are eligible for overtime. Over the last year, we have identified many employees who are paid for 40 hours of work per week but work less than 40 hours. We are thinking about changing them from salary to hourly employees to cut the overpayments. One issue we face is that our hourly employees are paid in arrears; so, once we make the change, they will miss a payroll. How can we best move employees from salary current to hourly arrears?

A.

We've done this for a few groups of employees. At the time we moved them back a week from current to arrears status, we paid a flat advance of one week of their previous salary amounts. Then we deducted one-fifth of the advance from gross wages for each of the next five pay periods. When possible, we made the switch in a month with three paydays (we pay biweekly) to further help reduce negative impact.

Note that wage advances paid in this kind of scenario are not loans and must be treated as taxable wages at the time paid. Then make sure that recovery of the advances is done as a reduction of future gross pay, not as after-tax deductions.

Direct deposit authorization

Q.

Our employees seem to have a hard time filling out our direct deposit authorization form. We've tried to make it easy to understand yet employees still have questions or fill it out incorrectly. Our payroll system has the capability for employee self-service, but we're reluctant to turn it on out of concern that employees will enter incorrect information into the system.

A.

We encourage employees to use employee self-service and the fear of employee errors should not discourage you from implementing it. Beyond simply putting the form online, an employee self-service system can also allow you to provide supplemental help information to aid the employee in authorizing direct deposit that may cut down on questions employees may have when working with the form.

Our employee self-service system allows employees sign up for direct deposit, but the payroll department reviews and approves all changes before the system is updated. That allows us to check that the routing number entered is an active number. To verify the account number, we ask employees for a voided check (voided or canceled checks are preferred, since deposit slips may have different bank numbers on them) or a statement from the bank that includes the printed number. If the employee doesn't provide that, we submit a prenote to the bank.

Paper or electronic pay statements

Q.

I'm seeking advice and clarification on the requirements to distribute paper copies of employee paystubs. We are based in New Hampshire with employees who live in New Hampshire and Vermont. If paystubs can be obtained online through our payroll system, which all employees use to clock their hours, are we still required to provide and distribute paper paystubs? Some employees have opted to "go green" and no longer receive the paper copies by choice. We like this and wonder if we can stop providing printed copies for all employees since they can view and print right from the payroll site.

A.

Electronic paystubs are allowed in all states, but varying conditions apply to their use. The rules are based on where the employees work, not where they live. If all your employees are working in New Hampshire, you need only concern yourself with the rules that apply in New Hampshire. Under New Hampshire law, employers are not required to provide paper statements, but they must ensure that employees have access to their paystubs on payday. That can be a challenge for employees who do not work at a desk or have access to a computer. Nearly everyone (but not everyone!) has a smartphone nowadays, and your payroll provider may have an app that could help your company reach complete compliance.

Other states may be more or less restrictive. For example, Alabama does not require pay statements (though providing them is certainly a best practice). In Virginia, employers must provide paper statements upon request by the employee. If you were to expand your operations into Vermont, you would need to provide not only access to the statements but also a way for employees to print them. Further, you would be required to protect employees' confidential information from access by anyone other than the employee.

Seeking employees' consent to electronic pay statements would be a wise move, even though their consent is not strictly required in the state where you operate. For more information about providing employees with electronic pay statements, see *APA's Guide to State Payroll Laws,* §2.4.

Aggregate method instead of flat rate withholding on supplemental wages

Q.

Currently, we use the flat rate method for federal income tax withholding on supplemental wage payments. For some employees, the 22% rate is much higher than their regular tax bracket rate, depending on their tax elections and salary. We are considering switching from the flat rate method to using only the aggregate method to reduce the federal income tax withholding for our employees. What should we consider before making this change?

A.

The impact of supplemental wage withholding will vary with the employee. For some employees the optional flat 22% supplemental wage withholding rate may be significantly less than an employee's usual withholding tax bracket, while for others it may be more. It depends on the circumstances for each employee, each time. However, it is also important to know that there are circumstances in which you simply cannot avoid flat rate withholding on some supplemental wage payments.

Here is a quick summary of the rules. IRS regulations provide that if an employee has not received cumulatively more than $1 million in supplemental wages during the calendar year, there are two withholding methods available to an employer with respect to a payment of supplemental wages: the aggregate method and optional flat rate method.

Under the aggregate method, the employer calculates the amount of withholding due using the employee's current Form W-4 by aggregating the amount of supplemental wages with the regular wages paid for the current payroll period or for the most recent payroll period of the year of payment, and treating the aggregate as if it were a single wage payment for the regular payroll period. If the supplemental wages are paid concurrently with wages for the current payroll period, then they must be aggregated with the wages paid for the current payroll period. The employer must use the aggregate method if the optional flat rate method cannot be used.

Under the optional flat rate method, the employer disregards the amount of regular wages paid to an employee as well as the withholding allowances claimed or any additional withholding amount requested by the employee on his/her Form W-4, and uses a flat percentage rate (22% for 2018) to calculate the amount of withholding on the supplemental wage payment. This method is available only if both of these two conditions are met: (1) the employer has withheld income tax from regular wages paid to the employee during the same year as the payment of supplemental wages or during the preceding calendar year; and (2) the supplemental wages are either not paid concurrently with regular wages or are separately stated on the payroll records of the employer (i.e., on the employee's pay stub).

For most employees, the aggregate method is available for federal income tax withholding on supplemental wage payments. However, an employer is *required* to use a higher flat rate for withholding on supplemental wages over $1 million. Specifically, if a supplemental wage payment, when taken together with all other supplemental wage payments paid by an employer to an employee during the calendar year, exceeds $1,000,000, then the employer must withhold federal income tax from the supplemental wages in excess of $1 million at a flat rate equal to the maximum rate of tax in effect that year. In 2018, this mandatory flat rate for supplemental wages in excess of $1,000,000 is 37%.

It may be best to be as consistent with the withholding method as possible so employees know what to expect. It is ultimately up to employees to monitor their year-to-date withholding and file a new Form W-4 to adjust federal income tax withholding from future regular wages if they think it is appropriate. See *The Payroll Source*®, §6.4-4 for more information about supplemental wage payments and the methods of federal withholding applicable to them.

Gifts as income

Q.

Are an employer's gifts to an employee that have a value over $25 taxable to the employee? If so, would you treat these just like gift cards, which are treated as taxable wages? Our company treats cash or gift cards worth $25 or less as de minimis fringes. The gifts are typically given at year end, for recognition at reviews, or as parting gifts at termination. One employee who left after more than 10 years of service was given a gift worth $250. Our company has been purchasing gifts in place of gift cards, so I want to be sure we are handling these correctly.

A.

Gifts provided to employees must be included in the employees' income and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes unless they can be excluded as a de minimis fringe benefit or as a gift between relatives that is not based on the employer-employee relationship. Gifts excluded as de minimis fringe benefits include Christmas or other holiday gifts of small value, so long as they do not consist of cash or a cash equivalent. As you correctly point out, gift certificates and gift cards do not meet this test since they are considered cash equivalents, even if the property or service bought with the gift certificate or gift card (if provided in kind) would qualify as a de minimis fringe benefit.

A de minimis fringe benefit one with a value so small and awarded so infrequently that accounting for it would be unreasonable or administratively impractical. A bona fide de minimis benefit may be excluded from an employee's income. Note, though, there is no specific dollar limit at which a benefit is considered de minimis. The idea that anything less than $25 (or some other fixed dollar value) may automatically be treated as a de minimis fringe is a longstanding payroll myth. Typical bona fide de minimis benefits include things such as: traditional holiday gifts (e.g., turkeys, candy) with a small value (but not cash or cash equivalents); flowers, fruit, or similar items provided under special circumstances like an employee's illness or for outstanding performance; coffee and doughnuts for employees; and occasional use of company telephones for local personal calls. See *The Payroll Source*®, §3.2-1 for more information about de minimis fringe benefits.

Your company should carefully consider classifying a benefit as de minimis and then excluding it from wages. If your company chooses to establish a dollar threshold, it indicates that you're tracking the amount each employee receives, which argues against the unreasonableness or impracticality of accounting for the benefit.

Effect of federal tax reform law on states

Q.

How does the 2017 federal tax reform law effect the states?

A.

The Tax Cuts and Jobs Act (TCJA; Pub. L. 115-97) affects the states in many ways.

- *Conformity.* Most states with a state income tax use the federal Internal Revenue Code (IRC) as a basis for calculating state taxable income. There are 22 states that are following the current version of the IRC. These states will be directly impacted by changes to the IRC on the state level. Other states follow the IRC that was in effect as of a specific date. The state tax codes of these states do not automatically reflect changes that are made to the IRC.
- *Employee withholding allowance certificates.* The TCJA suspends the deduction of personal exemptions from taxable income for tax years 2018 through 2025. The TCJA also limits or repeals the ability to reduce taxable income by using several popular itemized deductions on a taxpayer's personal income tax return. These changes could impact employee elections on withholding allowance forms. The 2019 draft Form W-4 is radically different than the 2018 Form W-4, in ways that will likely require most states to make significant changes of their own.
- *State tax reform.* Some states are considering ways to offset the negative effects of the TCJA. Certain provisions of the TCJA, including a cap on the amount of state and local income and property taxes that individuals can deduct from their federal taxable income, will effectively raise federal taxes in "high-tax" states like New York.

Preventing restart of social security withholding for new high-earning employee

Q.

We have an employee who met the social security wage limit for the year and has been transferred to one of our component companies, in a different state, with a different FEIN. Does anyone know how we can stop withholding social security taxes since he met the limit for the year?

A.

Generally, each employer must withhold and pay social security and Medicare taxes for its employees on a year-to-date (YTD) basis. When an employee begins work with a new employer during the year, the new employer withholds these taxes based on the employee's YTD earnings with that employer. It does not matter that the employee's YTD wages with a previous employer exceeded the social security wage base ($128,400 for 2018); the new employer will withhold social security tax until the employee exceeds the social security wage base with the new employer.

Despite the general rule requiring each employer to withhold and pay social security and Medicare taxes for employees who work for more than one employer, related corporations can reduce that burden considerably if the common paymaster option applies. Under the common paymaster option, one of the corporations acts as a common paymaster and the total social security and Medicare taxes that must be paid will be determined as if the corporations' employees had one employer — the common paymaster — paying all their wages. (Use of the common paymaster option has no application to the withholding of federal, state, or local income taxes.)

The common paymaster option requires that an employee be concurrently employed by two or more related corporations paid through one of the corporations as a common paymaster. To be concurrently employed, an employee must be employed by two or more related corporations at the same time and performing services for each one separately, not just as a group. As the employer-employee relationship exists, the fact an employee is working for only one employer at any one time does not destroy concurrent employment status.

To be considered related corporations must meet any one of the several conditions at any time in a calendar quarter, such as being part of a "controlled group of corporations" under IRC §1563, which generally means one of the corporations owns at least 50% of the others' stock or the same five or fewer persons own at least 50% of the stock of each corporation. See *The Payroll Source®*, §6.7-4 for information about the other conditions that may qualify for common paymaster treatment.

If the common paymaster option is not applicable to you company, you can advise employees who exceeded the social security wage base in the current year with a previous employer that they will get a credit when they file their personal income taxes.

Income tax withholding for New Jersey residents working in New York

Q.

Our company has an office in New York. We do not currently have a physical location in New Jersey but we do have employees working in New York who live in New Jersey. Up to now, we have been withholding New York state income tax for these employees, but nothing for New Jersey. We will be opening up a branch location New Jersey in a few months and once we do must we withhold New Jersey taxes for our employees living in New Jersey who will continue working in New York? What if we have employees from New York who will work in the New Jersey office?

A.

Your company must withhold New York state income tax from your New Jersey employees working in your New York location (Publication NYS-50, *Employer's Guide to Unemployment Insurance, Wage Reporting, and Withholding Tax*, p. 27; https://www.tax.ny.gov/pdf/publications/withholding/nys50.pdf?_ga=2.11867447.2092122736.1531770013-694604405.1531770013). Assuming your company does not presently have a business connection (nexus) to New Jersey, you are not required to withhold New Jersey income tax for your New Jersey employees working in your New York location (see Publication NJ-WT, *New Jersey Income Tax Withholding Instructions,* p. 6; https://www.state.nj.us/treasury/taxation/pdf/current/njwt.pdf).

Your situation changes when your company opens the New Jersey location. With the opening of a New Jersey location, your company will be required to register with the state, file, and pay New Jersey employer withholding taxes for New Jersey residents working in your New Jersey office. For your company's New Jersey residents working at your company's New York location, you will not have to withhold New Jersey income tax if: (1) the employee is employed totally outside New Jersey; (2) the employee is subject to withholding tax in New York state; and (3) the withholding tax required by New York equals or exceeds the withholding required by New Jersey. (Note that if the New Jersey resident employee works only part of the time outside of New Jersey and the other state's withholding tax rate is lower than New Jersey's, your company must withhold New Jersey taxes in addition to the other state's to offset the employee's resident income tax liability.)

All wages paid to a resident of New York State are subject to withholding even when earned outside New York State. This means that when a New York resident is employed at your company's New Jersey location, your company will have to withhold both New York and New Jersey state income taxes. To prevent employees who live in one state and work in another from being subject to this sort of double taxation, some states have entered into "reciprocity agreements" that require employers to withhold only for their employees' states of residence. Unfortunately, New York and New Jersey do not have reciprocity agreements with each other.

For more information about state income tax withholding requirements for residents, nonresidents, and expatriates, see *APA's Guide to State Payroll Laws*, §3.1.

Nexus for state withholding purposes

Q.

What is nexus? How do I know if my employer has nexus with a certain state for state income tax withholding purposes?

A.

Nexus is established by having a business presence in a state or locality. An office, store, or factory will create nexus, as will the mere entry of an employee into a state or locality to make a sale or perform a service call. A telecommuter who works from home, in a different state or locality than the location of the office to which he or she reports, creates nexus for the employer in the resident state and locality. An employer that has nexus with a state or locality subjects the employer to its tax laws.

Example: A Texas employer has an office in Dallas with 50 employees. The employer also has two employees who work remotely from their homes in Georgia and Oklahoma. Clearly, the employer has nexus with Texas because its facilities are located there. However, the employer also has nexus with Georgia and Oklahoma because it has two employees performing services in those states.

New York Employer Compensation Expense Tax

Q.

How does an employer opt-in to the New York Employer Compensation Expense Tax (ECET) Program? What are the consequences if an employer chooses not to participate?

A.

The New York Department of Taxation and Finance will provide a web-based registration system for employers to opt-in to the ECET. The ECET is optional. There is no penalty or other consequences for not participating. The deadline to opt in for 2019 is December 1, 2018. The ECET is being phased in over three years (1.5% in 2019; 3% in 2020; and 5% in 2021 and after). It is an employer-paid tax. An employer may not deduct or withhold the ECET from an employee's wages. For more information see TSB-M-18(1)ECEP, *Employer Compensation Expense Program*, 7-3-18, at https://www.tax.ny.gov/pdf/memos/ecep/m18-1ecep.pdf.

People who are receiving social security benefits (SSA)

Q.

We have older employees who tell us they are already receiving Social Security benefits. Do we still pay social security taxes on their wages?

A.

Everybody still pays social security taxes, even if they are receiving social security benefits. There are some exceptions for specific jobs with state or local agencies where employees are exempt from paying social security taxes because they pay into a separate fund. In those cases, those folks don't have to pay social security tax after they start receiving benefits. Otherwise, all the rest of us do.

The good news is that the SSA continues to recalculate benefits based upon earnings. We take the highest 35 years of earnings and we index them. Someone who continues to work might receive a social security benefit increase because of later wages.

Correcting pretax health care deductions

Q.

If an employer makes a mistake and fails to deduct health insurance from all employees' pay during the year, may pretax deductions be made in the following year to correct the error?

A.

Deductions cannot be taken pretax in the next year. They are not allowable after the year ends if the deductions were for the prior year. This is true if the employer either does not withhold from the employee at all or withholds after tax. And when it is reported, it is still going to be reported on a Form W-2 for the year in which the withholding was made.

Withholding Taxes

Resuming withholding on expiration of Form W-4 exempt status

Q.

Our company has almost 1,200 employees who have declared exempt status on their Forms W-4. If they do not again claim exemption from withholding for the next year do I need to change them to single and zero unless they file a new Form W-4?

A.

If employees do not renew their claim of exemption from withholding on Forms W-4 by the deadline, the employer should not automatically change them to a status of single with zero withholding allowances. According to Publication 15, *(Circular E), Employer's Tax Guide*, and APA's *The Payroll Source*®, §6.3-1, the employer should "begin withholding based on the last Form W-4 for the employee that didn't claim an exemption from withholding." The employer should begin withholding at single and zero if the employee did not provide a Form W-4 previous to claiming exemption from withholding.

State income tax withholding when there is reciprocity, but no nexus

Q.

State A and State B have a reciprocal withholding agreement. My company's facility is located in State A. An employee lives in State B and wants me to withhold that state's income tax from her wages. But the company does not do any business in State B and I do not want to open a withholding account there. The employee is claiming that I must withhold State B tax because of the reciprocity agreement. Is this true?

A.

No. The reciprocal withholding agreement requires an employer not to withhold income tax for a nonresident employee's work state (in this case State A) when the employer does not have nexus (a business connection or presence in a state) with that nonresident employee's state of residence (in this case State B). It does not require the employer to withhold income tax for the state where the employee lives when the employer does not have nexus with the resident state.

The employer can choose to establish a withholding account in the resident state and begin withholding as a courtesy to the employee, but payroll professionals are advised to first check with their company's corporate tax and legal departments because courtesy withholding can subject the employer to additional responsibilities and legal liability. If the employer does not provide courtesy withholding, the employee will need to make estimated payments to her resident state.

Withholding state income taxes for nonresidents traveling

Q.

We have employees who travel to sites we operate in other states. If one of our staff travels to one of our other sites, are they also subject to nonresident income taxes? How do these laws work?

A.

Whenever an employee travels out of state for work, he or she becomes subject to the rules of that state. The rules for withholding nonresident income taxes from an employee's pay are complex and vary by state. The requirement for compliance may depend on where the employee travels, how long the employee stays, how much the employee earns while in the nonresident state, and the type of work the employee is performing (e.g., nonresident employees who perform disaster or emergency-related work during a declared disaster period may not be subject to withholding).

Without knowing the specifics of your company's location, the only reasonable answer to your second question is, "maybe." Here are examples that illustrate the complexity behind your first question:

1. Tom works for Company and travels from Virginia to Maryland for work. Maryland requires employers to withhold income taxes from nonresident employees beginning on the first day the employee works in the state. However, Virginia and Maryland have a reciprocity agreement, so Company does not need to withhold Maryland taxes from Tom's pay.
2. Tom travels from Virginia to Texas for work. Texas has no state income tax, so Company doesn't need to withhold nonresident taxes.
3. Tom travels from Virginia to Arizona for a three-month assignment. After 60 days, Arizona requires Company to begin withholding nonresident income taxes. Tom will likely need to file a state income tax return with Arizona.
4. Tom travels from Virginia to New York for a week-long assignment. Tom is responsible for paying New York State income taxes on the amount he earns there, but Company is not required to withhold until Tom has been in the state for 14 days.
5. Tom travels from Virginia to Minnesota for work. Company must withhold nonresident taxes if Tom is expected to earn at least the minimum amount that would require him to file a state income tax return ($10,650 for 2018).

See *APA's Guide to State Payroll Tax Laws*, §3.1, for guidance on the current rules for withholding state income from nonresidents. To reduce the complexity and introduce uniformity, the proposed federal Mobile Workforce State Income Tax Simplification Act would create a 30-day safe harbor for employees traveling between states. You can read more about that on the APA website at https://www.americanpayroll.org/compliance/government-relations/issues, or from APA's partners at the Mobile Workforce Coalition, www.mobileworkforcecoalition.org.

401(k) contributions subject to California unemployment insurance taxes

Q.

Are salary reductions or contributions to a 401(k) plan subject to California state unemployment insurance (SUI) taxes? What if the 401(k) plan is part of a §125 cafeteria plan?

A.

In California, the general rule is that employee contributions to a 401(k) plan are subject to California SUI taxes (see *The Payroll Source®*, §4.7). There is an exception if the 401(k) plan is part of a §125 cafeteria plan. In that situation, the salary deferral is not unemployment insurance taxable in California. So contributions to a 401(k) plan are subject to SUI for California, but not if the 401(k) plan is part of a §125 cafeteria plan.

More detailed information is available in California Employment Development Department (EDD) Information Sheets DE 231EB, Taxability of Employee Benefits, pages 2 and 4: www.edd.ca.gov/pdf_pub_ctr/de231eb.pdf (Cafeteria Plans and Retirement Plans – Deferred Compensation) and DE 231TP, Types of Payments, page 9: www.edd.ca.gov/pdf_pub_ctr/de231tp.pdf (Retirement and Pension Plans, subsection B).

FUTA credit reduction states for 2018

Q.

Which states will be FUTA credit reduction states for 2018?

A.

The 2018 determination will be made after November 10, 2018. However, the U.S. Department of Labor (DOL) lists California and the Virgin Islands as potential FUTA credit reduction states for 2018. California has paid off its Federal Unemployment Account (FUA) loans, so the Virgin Islands might be the only state/territory subject to a FUTA credit reduction for 2018. Both California and the Virgin islands were subject to a credit reduction for 2017.

If states have outstanding loans on January 1 of two consecutive years and have not paid off the balance by November 10, they are subject to a credit reduction on their Federal Unemployment Tax rate until the balance has been paid off. Each year a loan continues to be unpaid, the credit reduction increases by 0.3%, though states that have made an effort to keep their balances in check have some opportunities to avoid the reduction (see *The Payroll Source*®, §7.1-6).

Once a state has had outstanding FUA loans for several years, additional types of credit reduction might also be added, including a 2.7% add-on and/or a Benefit Cost Rate (BCR) add-on. States may apply to the DOL for a waiver of the BCR by July 1 of a tax year. Both California and the Virgin Islands applied for and received waivers of the BCR add-on for the 2017 tax year. Both applied for the waiver again in 2018 by the July 1, 2018, deadline. California applied for the waiver again even though it was projected that it would not be subject to the add-on (and has currently paid off its loans).

For 2018, the total credit reduction for California would be 2.4% and for the Virgin Islands it would be 3.7%, unless the 1.3% BCR add-on is waived, in which case it would be 2.4%.

FUTA tax deposit threshold

Q.

In reviewing our records, I found that our company should have paid federal unemployment insurance (FUTA) tax for the last quarter but did not. The amount we should have paid comes to $283. What penalties will the company have to pay?

A.

The good news here is that your company will not have a penalty to pay for that quarter. No deposit is necessary when the employer's FUTA tax liability for a calendar quarter is $500 or less. The liability is merely carried over and added to the employer's liability for the next quarter when that quarter's liability is calculated. The liability will roll over to the next quart and if the total FUTA tax for that quarter (including the $283 from the prior quarter) exceeds $500, a deposit will be owed for that quarter. Find out more in *The Payroll Source*®, §7.1-5.

SUI and income tax withholding for employee living in Oregon, working in Washington State

Q.

An employee of ours works in Washington and lives in Oregon. We are paying Washington state unemployment insurance taxes (SUI) for this employee since he is working in that state. Washington does not have an income tax but Oregon does. We are not withholding Oregon state income taxes from his paycheck.

Are we correct to be paying Washington SUI and not Oregon SUI? Also, is it OK that we are not withholding Oregon state taxes? The employee said he will take care of the Oregon taxes when he files his taxes at the end of the year.

A.

Your approach with respect to SUI is correct. When employees perform services all in one state, the employer pays unemployment taxes to that state. You should also be covering the employee for Washington workers' compensation since that is where he works.

Washington state does not have an income tax and Oregon does not have reciprocal tax agreements in force. This does not necessarily mean you are not obligated to withhold Oregon income tax for this employee, though. If an employer has a business connection with the state in which the employee resides, also referred to as a "nexus," or any operations in the state in which the employee resides, then the employer is subject to the laws of that state, and may be required to withhold that state's income tax, in addition to the tax for the state in which the employee is working. An office, store or factory in a state will create nexus there, as well as the mere entry of an employee into a state to make a sale or perform a service call. See *APA's Guide to State Payroll Tax Laws*, §3.1 for more information about state income tax withholding on nonresidents.

You may want to consult with your company's legal counsel to determine if your company has a nexus with the state of Oregon. If there is no nexus, there would be no need to withhold Oregon taxes from the employee but you could do it as a courtesy to the employee.

When Form 940 is considered filed

Q.

We have had some issues with the mail and the IRS with respect to getting our annual Form 940 to the IRS by the due date. What are the rules for determining when the form (which is on paper) is actually filed with the IRS? How do we prove this?

A.

If Form 940 is sent through the U.S. Postal Service it is considered timely filed if it is postmarked by the U.S. Postal Service on or before the due date with sufficient postage. The postmark indicates the form as timely filed even if the IRS receives it after the due date. Registered mail is considered postmarked as of the registration date. Certified mail is considered postmarked as of the date the sender's receipt is post-marked by the postal employee. In order to prove the postmark date, employers should use certified or registered mail and get a postmark date stamped on the mailing certificate by a postal employee. This will serve as proof of mailing in case the envelope arrives late at the IRS.

If the IRS has no record that it ever received an employer's Form 940, an employer can establish a presumption that delivery was made by showing that it properly used registered or certified mail through the U.S. Postal Service or a private delivery service that is "substantially equivalent" to registered or certified mail. The mail or delivery service receipt establishes a presumption of delivery. The IRS list of designated private delivery services includes services offered by Federal Express, DHL Express, and United Parcel Service (see https://www.irs.gov/filing/private-delivery-services-pds).

Note that this answer about timely filing paper Forms 940 also applies to other employment tax forms that may be filed on paper, such as the Form 941.

Voluntary SUI contributions

Q.

Our payroll department is always trying to run a more efficient operation. A colleague of mine at another company suggested that we might be able to reduce our state unemployment insurance (SUI) tax liabilities by making a voluntary contribution to our company's SUI tax account. Is this for real? If so, how does paying more money save our company money?

A.

Employers in 26 states (nearly all using the reserve ratio method of experience rating) can make voluntary contributions to their SUI tax accounts. These contributions increase the balances in those accounts, which in turn increases the employers' reserve ratios (or, in Michigan, decrease their benefit ratios) and decreases their unemployment tax rates.

The goal of a voluntary contribution is to increase the reserve ratio to the next higher bracket on the state's unemployment tax rate table, which corresponds to the next lower tax bracket. The voluntary contribution may make it possible for an employer to save on SUI tax, but it does not always work out that way. Before making a contribution, the employer must determine if the amount of the contribution be less than the taxes caused by the higher rate. If not, the contribution should not be made. Some states help with the decision by including the voluntary contribution amount on the employer's state unemployment contribution rate notice. You can get more information about voluntary contributions, as well as examples for to help determine if it is cost-effective for your company in *The Payroll Source*®, §7.2-4.

Correcting older social security records (SSA)

Q.

Are employers legally required to correct an employee's social security record for a pay period older than three years when an employee's taxes have been underwithheld or not withheld by their employer? How does the employer go about reporting and remitting underwithheld social security and Medicare taxes?

A.

There is a statute of limitations on how far back Forms W-2 and W-2c can be filed. It is based on three years, three months, and 15 days after the end of the calendar year, which happens to be Tax Day, April 15.

You can still correct amounts for the individuals if they actually did work and were eligible for those wages and should have paid those taxes and so forth. Issue a Form W-2c to them. You would not send it to the SSA because it is past the statute of limitations. Individuals can bring in Forms W-2c to the SSA, and the SSA can make corrections to their earnings records. Their earnings record is essentially what the SSA uses to calculate their benefits to be paid out later on. It is important that it is accurate so they get the full credit for what they actually did.

FICA and FUTA taxes for child paid by family-owned business

Q.

A business owner has had one of his children working for the company for the past couple of years. No social security or Medicare or unemployment taxes have been calculated or withheld relating to the child's wages. The child is under 18 years of age. The owner says that this is allowable, but I am not sure. Can you point me to any documentation that would address this?

A.

This is allowable if the business involved is a sole proprietorship or a partnership in which each partner is a parent of the child. IRC §3121(b)(3)(A) addresses employment and provides that "service performed by a child under the age of 18 in the employ of his father or mother" is excluded from the definition of employment.

The IRS website (https://www.irs.gov/businesses/small-businesses-self-employed/family-help) explains and qualifies the exemption by noting that "[p]ayments for the services of a child under age 18 who works for his or her parent in a trade or business are not subject to social security and Medicare taxes if the trade or business is a sole proprietorship or a partnership in which each partner is a parent of the child." Payments to a child under age 21 employed by his or her parents is exempt from Federal Unemployment Tax Act (FUTA) tax.

The key to this exemption is the nature of the business entity involved. The wages of a child working in a family-owned business are subject to income tax withholding as well as social security, Medicare, and FUTA taxes if the family-owned business is any of the following entities:

- A corporation, even if it is controlled by the child's parent.
- A partnership, even if the child's parent is a partner, unless each partner is a parent of the child.
- An estate, even if it is the estate of a deceased parent.

FICA tax credits and responsibility under standard and alternate procedures

Q.

In using the standard procedure for under the predecessor/successor rules for when one employer acquires another, do you have to automatically restart FICA or can the successor employer get a credit for past FICA and still use standard procedure? Is it necessary to use the alternate procedure to obtain credit for FICA previously paid by the predecessor? What are the rules under each procedure?

A.

Where a successor employer acquires substantially all the property used in the trade or business of a predecessor employer (or a separate unit of the predecessor), and as part of the acquisition hires the predecessor's employees, there are two methods for dealing with reporting wages on Form W-2 in a successor-predecessor relationship: (1) the standard procedure and (2) the alternative procedure. Here are the requirements for both procedures.

Standard procedure. When using the standard procedure, FICA withholding starts anew with the successor employer. Under the standard procedure, the predecessor performs all the reporting duties for the wages and other compensation that it pays. These duties include the filing of quarterly Forms 941 and the furnishing and filing of Forms W-2.

In connection with the successor's acquisition of property and hiring of employees from the predecessor under the standard procedure, the predecessor may cease to pay any wages required to be reported on Form 941 (e.g., the predecessor may go out of business). In that case, the predecessor must file the Form 941 for the quarter of the acquisition as a final Form 941. Accelerated Form W-2 deadlines also apply if the predecessor employer ceases paying wages.

Alternate procedure. The successor, under the standard procedure, performs all the reporting duties for the wages and other compensation that that it pays. An employee who is overwithheld on social security tax can get credit for the overage when the employee files a personal income tax return.

Under the alternate procedure, the successor and predecessor agree that the predecessor will not have to report any wages paid to and taxes withheld from its employees who were hired by the successor on Form W-2. However, the predecessor is not relieved from reporting such wages and taxes on its Form 941. Therefore, there will be a discrepancy between the amounts reported on its Forms 941 and its Forms W-2 for the year. The predecessor should complete a Schedule D (Form 941), *Report of Discrepancies Caused by Acquisitions, Statutory Mergers, or Consolidations*, to explain the discrepancies in the totals of social security wages, Medicare wages and tips, social security tips, Additional Medicare Tax wages and tips, and federal income tax withheld. Schedule D should also include the date of the acquisition and the name, trade name, address, telephone number, and EIN of the successor. The predecessor's Schedule D should be filed after Forms W-2, *Wage and Tax Statement*, are prepared for the year of the acquisition and should be filed with the predecessor's first quarter Form 941 for the year after the year of the acquisition or with the predecessor's final Form 941 if that is due earlier.

To learn more about the predecessor and successor procedures, see *The Payroll Source®,* especially §8.8-1.

Filing a Form W-2c early (SSA)

Q.

If I need to file a Form W-2c, *Corrected Wage and Tax Statement*, for an employee, can I use SSA's Business Services Online (BSO) to process it before we file the year's Forms W-2 with the SSA? Or, must I wait until the SSA has received the first file before processing a Form W-2c?

A.

If you can fix the Forms W-2 before they get to SSA, great. If you cannot, the best practice is to let the Forms W-2 process run and then follow it with a Form W-2c. SSA systems can detect some duplicates and can look for Forms W-2c filed before Forms W-2, but do not depend upon that to happen.

If you have a BSO account, you can go in and look at the report. If a third party reports for you, you can see that your process went through our system from "pending" to "complete" status. Then you can follow that up with a W-2c.

Group-term life insurance

Q.

My company offers a group-term life insurance (GTL) benefit at 1½ times base salary or $50,000 up to a maximum of $600,000 (whichever is higher). Are we are supposed to enter this information on the Form W-2? If so, how do I: (1) determine the total coverage cost for my employees, and (2) calculate GTL – based on annual salary or year-to-date gross wages?

A.

The most common type of employer-provided life insurance is GTL, which usually provides a death benefit payable in a lump sum to the employee's designated beneficiary (see *The Payroll Source®*, §3.3-1). Special rules in the Internal Revenue Code govern GTL.

The value of employer-provided GTL up to $50,000 is excluded from an employee's income. The value of coverage in excess of $50,000, minus any amount paid for the coverage by the employee after taxes, must be included in the employee's income. The value of the excess coverage is subject to social security and Medicare taxes, but it is not subject to federal income tax withholding or federal unemployment (FUTA) tax.

The employee must pay the federal income tax owed with his or her personal income tax return. The amount included in income must be reported on the employee's Form W-2 in Boxes 1, 3, 5, and 12 (with Code C), and on the employer's reporting Forms 940 (Part 2, Lines 3 and 4) and 941 (Lines 2, 5a, 5c, and 5d).

The value in excess of $50,000 can be determined by using IRS Section 79 Table I and the uniform premiums it provides, rather than the actual cost to the employer (see *The Payroll Source®*, §3.3-1). Table I lists the value of each $1,000 of GTL coverage per month, broken down into five-year age brackets.

Because most plans calculate coverage as a multiple of an employee's base salary, many employers use the employee's base salary as of January 1 of each year as the base amount for determining insurance coverage. Calculate the monthly total value of excess GTL to include in an employee's income by following these steps:

1. Determine the total amount of the employee's GTL under the employer's plan (include coverage purchased by the employer and the employee).
2. Subtract $50,000 from the total amount of GTL coverage, to get the amount of excess coverage.
3. Divide the amount of excess coverage by $1,000.
4. Determine the employee's age as of December 31 of the calendar year during which the benefit is taxable.
5. Use IRS Table I to calculate the fair market value of one month of excess insurance per $1,000 and multiply it by the answer determined in Step 3.

6. Deduct any after-tax contributions by the employee from the value of the insurance.
7. Add the excess amount to the employee's income, withhold and pay social security and Medicare taxes, and report the amount as required.

Payment of back overtime pay

Q.

We just discovered that a pay code in our time and attendance system was not accurately counting hours worked as overtime-eligible when it should have. We did an entire company audit going back three years, which is when the pay code was established and have identified the wages our company owes. Are we required to go back and correct the Forms W-2 from prior years for affected employees? We are talking about minimal amounts of pay, less than $100 in most cases. Can we pay it in one lump sum retroactive pay adjustment in 2018? What about employees who have terminated employment with us already? We have two employees that terminated in 2017. Am I correct in thinking we can issue a payment in 2018 for retroactive pay and generate a Form W-2 at the end of the year that reports this payment?

A.

Yes, your understanding is correct. Your company's payment of back pay in 2018 for overtime hours that were missed by your system in the previous three years is considered a special wage payment to your employees. A special wage payment is an amount paid by an employer to an employee (or former employee) for services performed in a prior year.

Employers must report special wage payments for income tax purposes and social security and Medicare taxes in the year they are received by the employee. As you indicate, the correct approach here is to report income, social security, and/or Medicare taxes for special wage payments made in 2018 on Form W-2 for 2018. You should not go back and correct W-2 forms issued to these employees in prior years. Your procedure for making special payments to the two employees who terminated in 2017 would be the same.

In addition to the Form W-2 reporting, your company must report to SSA any special wage payments made during the year to retired employees and employees who are still working while collecting social security benefits. Special wage payments can have a significant impact on these employees unless the SSA is notified about such payments. Under the annual earnings test, the amount of social security benefits that a retiree under the retiree's full retirement age can earn annually is limited. In 2018, the annual earnings limits are $17,040 for retirees age 62 until their full retirement age and $45,360 for retirees in the year they reach full retirement age, but only until the month they reach full retirement age. Once the retiree attains full retirement age, there is no earnings limit.

Submit reports for retired employees after the close of the tax year. To avoid delays in processing, submit reports in time to reach the SSA by April 1. Use one of the following methods for reporting the back pay of your retired employees: (1) electronic reporting using SSA's Business Services Online service (https://www.ssa.gov/bso/bsowelcome.htm); (2) a paper listing in the format specified in Publication 957, *Reporting Back Pay and Special Wage Payments to the Social Security Administration*; or (3) Form SSA-131, which is used to report a special wage payment to a single employee (each affected employee would require a separate Form SSA-131).

You should also review your state's laws in connection with this this back pay because state provisions may be different or there may be additional requirements for you to consider. See *The Payroll Source®* for more information, especially §8.15, and *APA's Guide to State Payroll Laws.*

Reporting cafeteria plan contributions

Q.

There is some confusion in my department about how we should report pre-tax contributions to a cafeteria plan that are deducted from employee wages. What are the rules?

A.

Generally, pre-tax contributions to a cafeteria plan need not be reported by an employer on its quarterly Form 941 or an employee's Form W-2 as taxable wages. On the employer's annual Form 940, such contributions are included in Part 2, Line 3 in total payments and then in Part 2, Line 4 as an exempt payment, and Box 4a should be checked.

While pre-tax contributions to a §401(k) cash or deferred arrangement are not subject to federal income tax withholding, they are subject to social security, Medicare, and FUTA taxes. They must be reported on the employee's Form W-2 in Boxes 3 and 5, respectively, with the amounts withheld reported in Boxes 4 and 6. The elective deferrals must also be reported in Box 12, preceded by Code "D." On Form 941, the employer must report the pre-tax contributions on Lines 5a, 5c, and 5d, since they are subject to social security and Medicare taxes.

If an employee contributes to a dependent care assistance FSA through either pre-tax contributions or flex credits, the employer must report the amounts on the employee's Form W-2 in Box 10, with any amount over $5,000 reported as well in Boxes 1, 3, and 5. The amount reported on Form W-2 is the total amount of cash reimbursement furnished to the employee during the calendar year. However, if the employer does not know the actual total amount of cash reimbursement at the time the Form W-2 is prepared, then the employer may report a reasonable estimate of the total amount. The amount an employee elects to contribute for the year (plus any employer matching contributions) is considered a reasonable estimate. An employer with a cafeteria plan that provides a grace period for dependent care assistance may report in Box 10 of Form W-2 the salary reduction amount elected by the employee for the year for dependent care assistance (plus employer matching contributions).

See *The Payroll Source®*, §4.5-9, for more information about the reporting requirements in connection with cafeteria plans.

Reporting employer-paid disability insurance benefits on Form W-2

Q.

Are long-term disability payments to an employee based on premium payments that are 100% employer-paid reportable on Form W-2?

A.

Yes. Benefits that are attributable to employer contributions or to employee pre-tax contributions through a cafeteria plan are taxable income to the employee and may be subject to federal income tax withholding and social security, Medicare, and FUTA taxes. The responsibilities for reporting income and employment taxes withheld and deposited depend on the sick pay agreement and who made the payments to employees.

Where disability payments are made by the employer under a self-insured plan, the taxable amounts must be reported to the employee on Form W-2 in Boxes 1, 3, and 5 (nontaxable amounts attributable to employee contributions would be reported in Box 12, preceded by Code "J"), and the amounts withheld on Lines 2, 4, and 6. The employer can combine the sick pay with other wages and prepare a single W-2 for each employee or prepare separate Forms W-2 for each employee, one reporting sick pay and the other reporting regular wages. A Form W-2 must be completed even if all the sick pay is nontaxable because the employee paid the premiums with after-tax contributions.

Where an agent is retained by the employer to make payments under its disability plan, the employer generally retains the responsibility for reporting disability payments when its third-party agent administers the payments, and the employer's name and EIN are used on all forms. However, if the agency agreement shifts the responsibility from the employer to the agent, the agent should use its own name and EIN on reporting forms. The agency agreement shifting responsibility must be filed with the IRS using Form 2678, *Employer/Payer Appointment of Agent*.

When there is a third-party insurer involved that makes disability payments to the employee and no liability has been transferred to the employer, the employer and the third party insurer each have reporting responsibilities when the third party insurer bears the insurance risk and makes the benefit payments. If the third party insurer does not properly transfer the liability for the employer's share of social security, Medicare, and FUTA taxes to the employer, the taxable amounts also must be reported by the third party to the employee on Form W-2 in Boxes 1, 3, and 5 (again, nontaxable amounts attributable to employee contributions in Box 12, preceded by Code "J"), and the amounts withheld in Boxes 2, 4, and 6, with the third party's name, address, and EIN instead of the employer's information. The checkbox "third-party sick pay" must be checked off in Box 13 of Form W-2.

For more details about the requirements and considerations for federal withholding, depositing, and reporting of sickness and disability payments to employees, see IRS Publication 15-A, *Employer's Supplemental Tax Guide*. Also check out *The Payroll Source*®, §4.3.

Reporting Florida wages on Form W-2

Q.

We are a nonprofit with one retiring employee who has relocated to Florida. I spoke with someone in the Florida Department of Revenue who verified that no Florida state wages are required to be reported on Form W-2 at year end. Will Boxes 15, 16, and 17 all be blank? Or do I populate the boxes with Florida state wages, no withholding of course, and then not report the wages at year end to Florida per their instructions?

A.

Florida is one of nine states that does not have an income tax (the other states are Alaska, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming). It is correct that there is no requirement for filing a Form W-2 with the state.

Depending on the software provider, your Forms W-2 will either have the state abbreviation and wages but no withholding, or Boxes 15, 16, and 17 will be blank. Since you are not reporting to the state, any information in those boxes will be ignored.

Your software provider may or may not print anything in Boxes 15 and 16. Since Florida has no income tax, no income will be reported to the state of Florida when you submit Form W-2 to SSA even if the boxes have data in them.

The Earnings Suspense File demystified (SSA)

Q.

What exactly is the Earnings Suspense File? I heard that there are trillions of dollars sitting in an account and not being paid out. Is that true?

A.

When taxes get paid, they come in to the government and then they get attributed to different funds and then they get paid out based on obligations. When we get the Forms W-2, we record that information against an individual's Master Earnings File record. Each person has a record, and we try to keep track of how much they earned in those periods.

When the names and SSNs do not match and we cannot actually credit an individual with those earnings, they go into a Suspense File, which is essentially to keep track of how much was earned in which time period so that we can do those calculations for what goes out. The Suspense file is not a place where "money" goes; it is a place where credits go. We want to eventually find out who those credits belong to – they might be erroneous, duplicates, or real -- and attribute them to the right person.

Wrong states on Forms W-2 (SSA)

Q.

I have some Forms W-2 that show state wages with no state withholding because we entered the wrong state during a systems conversion. I tried to fill out Forms W-2c online but the SSA site will not let me enter the information because I am not changing federal information. Do I need to file these on paper, or is there a way to correct this mistake electronically?

A.

We strive very, very hard to move all of our filings electronically. But, unfortunately, in this situation, we direct employers to file them on paper. Ultimately, that is state information. The SSA has certain limitations on its system where it is looking to make sure changes are made within the W-2c online before we let you submit it to us. In the situation where you are not making any federal or Medicare changes, those do need to come in on paper.

Acquisitions and managing garnishments

Q.

My company acquired another company, adding 2,000 employees to our payroll roster. Two hundred of those employees have their wages garnished for child support. In transferring the employees to our payroll system, do we honor the existing garnishments or do we wait for new orders? Do we need to notify the appropriate child support enforcement agency about the company change?

A.

According to the federal Office of Child Support Enforcement, "The acquiring company has the same legal responsibilities, including the responsibility to withhold wages for the child support income withholding orders of its 'acquired' employees. The company should continue to honor the income withholding orders but also notify the issuing child support agency as soon as possible about the acquisition and its intent to continue the withholding. The agencies may provide a new income withholding order, depending on state law."

Child support withholding after acquiring a company (OCSE)

Q.

We are about to acquire a company with 2,000 employees. Are we immediately responsible for withholding child support from the employees' pay? Or do we wait for the agency to send a new request addressed to our company?

A.

When you are acquiring another company, you have the same legal responsibilities, including honoring IWOs, for those employees. You should continue to honor those IWOs and remit the payments to the child support agencies.

There are a couple of things you can do to make sure that the child support agencies are aware that this merger or acquisition has happened. You can let OCSE know. OCSE has a distribution list of all of the child support agencies, and it can issue an e-flash. The agencies may issue a new IWO with your company's name and FEIN.

You can also report the employees as new hires under the new company FEIN and name. This is not required, but it is an option.

Colorado IWOs (OCSE)

Q.

For some time Colorado was issuing income withholding orders (IWOs) requiring employers to withhold the same amount regardless of whether the employee was paid biweekly or semimonthly. I understand OCSE intervened on behalf of employers, and I heard that the state stopped that practice. Can you confirm that Colorado is no longer issuing such orders?

A.

Colorado has reprogrammed its system, so it is generating IWOs with the correct amount in the weekly, biweekly, monthly, and semimonthly fields.

Deduction to recover negative PTO balance of terminated employee

Q.

If a terminated employee is in arrears on his or her balance of personal time off for the year are we allowed to collect those arrears on the employee's last paycheck? My company is located in Florida. In this case, the employee owes the company 40 hours and only has worked 32 hours. Are we allowed to collect on the 32 hours they have worked, which would leave the employee with no final pay check? If we are allowed to collect, how much can we collect? Is there a percentage limit?

A.

Florida law prohibits deductions from an employee's pay if they would bring the worker's pay below minimum wage, unless permitted by federal or state law. Florida doesn't appear to have any restrictions on the type of deduction you would like to take from this employee's final pay. However, the federal Fair Labor Standards Act (FLSA) places its own restrictions on such deductions when they bring an employee's wages below the minimum wage and overtime pay guaranteed by the FLSA. Under the FLSA, you must pay at least the minimum wage for the hours that were worked, so you may only deduct amounts earned in excess of the minimum wage for the time worked.

Deductions to replace lost property

Q.

My company is relocating to a new building where each employee will be provided a security pass to enter the parking garage and the building itself. These passes are provided to the company by the building management. If an employee loses his or her pass, the building manager would charge the company $50 to replace it. If we obtain a written and signed agreement from our employees, can the company recoup this charge from an employee who loses the pass?

A.

The building management company is imposing the fee on the company, which in turn is seeking to pass that fee onto the employee. For wage payment purposes, this is an employer-imposed fee that would be subject to the rules of the Fair Labor Standards Act (FLSA) regarding involuntary employer deductions: (1) it cannot reduce an employee's wages below minimum wage, (2) it cannot reduce the amount of overtime to which an employee working more than 40 hours in a workweek is entitled (see *The Payroll Source®,* §9.1-7).

Also check your state's laws because deductions from an employee's check are regulated by the individual states. In Virginia, for example, the signed agreement would be sufficient to allow the employer to recoup the cost of the lost pass, but other states are more restrictive.

In fact, "wage theft prevention" laws in some states (see *APA's Guide to State Payroll Laws*, §2.3) might prohibit such deductions altogether.

Department of Education garnishments

Q.

For the first time, I have received a garnishment from the U.S. Department of Education. The employer letter states the Debt Collection Improvement Act (DCIA) permits federal agencies to garnish wages without a court order. This sounds suspicious and I am having trouble finding information to verify that.

Also, the wage garnishment worksheet limits the withholding to 25% of disposable pay, but the employer page says it is limited to the lesser of: (1) 15% of the employee's disposable pay, or (2) 25% of the employee's disposable pay less the amounts withheld under the withholding orders with priority. How do I make sense of that? I want to make sure this is a valid order and also make sure we garnish the correct amount.

A.

Under the DCIA, agencies of the federal government are allowed to garnish wages without obtaining a court judgment. These are known as administrative wage garnishments (AWG), as opposed to court-ordered wage garnishments. Debts owed to the federal government are sorted into two types: tax debts and nontax debts. Tax debts are collected by the IRS, through tax levies. Garnishments for nontax debts are collected by various agencies through AWGs. The DCIA also preempts state laws governing garnishments.

The amount of a federal agency loan garnishment is limited by the Consumer Credit Protection Act as well as the DCIA. For the purposes of federal agency garnishments, disposable pay is defined as earnings minus amounts required to be deducted by law and to pay for health insurance. The maximum amount to be garnished is the lesser of:

The amount indicated on the garnishment order up to 15% of the employee's disposable pay, or

The amount by which the employee's disposable pay exceeds 30 times the federal minimum hourly wage then in effect.

The instructions on the amount to withhold can be a little confusing. The key is understanding that more than one garnishment may be in effect at the same time. The maximum amount that may be withheld for *any one* federal agency nontax garnishment is 15% of disposable pay. The maximum amount that may be withheld for *all* garnishments is 25% of disposable pay. (This limit does not apply to tax levies, child support, or bankruptcy).

So if you have been served with multiple garnishments for an employee, you might (depending on priority) withhold 15% for the Department of Education garnishment and then 10% would be available to withhold for another garnishment. Or if another garnishment takes priority but you withhold less than 25% for it, up to 15% (but not exceeding a total of 25% for all garnishments) may be withheld for the Department of Education garnishment.

With student loan garnishments, you need to be sure whether the garnishment is from a federal agency or a state guaranty agency. If the latter, health insurance deductions are not subtracted from disposable wages.

Find out more about federal agency garnishments in *The Payroll Source*®, §9.1-6.

Disposable income and garnishments (DOL)

Q.

When calculating disposable income for creditor garnishments, mandated payments for state employee retirement systems are an allowable deduction but voluntary pension or retirement contributions are not. Our pension contributions are required by our city ordinance and so are neither voluntary nor required by the state. Does a city or county pension count as a state pension for purposes of the Consumer Credit Protection Act? How do we calculate disposable income?

A.

Federal wage garnishment restrictions are applicable to an employee's disposable earnings, not gross earnings. When we calculate disposable earnings, we look at them after legally required deductions. If the deduction is legally required by federal, state, or local municipal law, it would be excluded. You would take that out of the earnings.

Garnishments for a shorter pay period (DOL)

Q.

One of our employees who is subject to a wage garnishment quit 30 hours into an 80-hour pay period. Is he entitled to the full limitations on withholding for a garnishment if he did not work the full pay period?

A.

Yes. The garnishment restrictions do apply the same way no matter how many hours the employee worked during the week or the pay period. Title III of the Consumer Credit Protection Act (CCPA) limits the amount of an individual's earnings that may be garnished. NOTE: DOL Fact Sheet #30 explains this in detail: https://www.dol.gov/whd/regs/compliance/whdfs30.pdf.

For example, assuming that the 80-hour workweek is a biweekly pay period, if the employee's earnings were $435 or less, there would be no withholding. If the earnings were more than $435 but less than $580, the amount above $435 could be garnished. If the earnings were $580 or more, then you would apply the maximum limit of 25%. It does not matter the hours an employee worked for that biweekly pay period. You look at the amount of earnings.

Garnishment of tips

Q.

I am seeing conflicting results when searching for information on calculating child support withholding when tips are involved. One says that tips should only be included as earnings if they are mandatory tips imposed by the employer (service charges) for larger parties. Another says all tips should be included in the calculations as an employee's earnings. Our employees are tipped directly by the customer. We take the tip credit allowed by the Fair Labor Standards Act (FLSA). What are the rules?

A.

The treatment of tips is the same whether for child support or other garnishments. The basic rules are found in the Consumer Credit Protection Act (CCPA). For the purpose of income and earnings under the CCPA, mandatory tips imposed by the employer are NOT tips; they are a service fee, and they are considered earnings (see *The Payroll Source®*, §9.1-3).

The rules governing tips and the CCPA are explained by the U.S. Department of Labor in Fact Sheet #30 (https://www.dol.gov/whd/regs/compliance/whdfs30.pdf) as follows: "For employees who receive tips, the cash wages paid directly by the employer and the amount of the tip credit claimed, if any, by the employer are earnings for the purposes of the wage garnishment law. Tips received in excess of the tip credit amount or in excess of the wages paid directly by the employer (if no tip credit is claimed or allowed) are not earnings for purposes of the CCPA."

So, tips paid directly to the employees by your customers that are in excess of the tip credit claimed by your company and wages paid to your employees are not considered earnings for purposes of the CCPA. Note that you should also check the laws of the state in which your company operates for any additional guidance or restrictions.

Handling refund of overpaid creditor garnishment

Q.

We withheld for a garnishment and remitted the payment to the creditor. Shortly after we sent the payment, the creditor responded to us with a letter releasing the debt. The creditor said the debt had been overpaid and enclosed a check payable to the employee. Do I need to adjust the employee's record in payroll? Should I process a void adjustment reducing the garnishment code and increasing net pay?

A.

Since the garnishing creditor issued a refund directly to the employee, leave your data as it stands. If the creditor had refunded the payment to you, the employer, you could have adjusted the totals in your payroll system. In either case, however, the payment is not new income to the employee. You had already withheld taxes from the payment to the employee at the time you processed the garnishment.

Illinois wage assignment faxed to employer

Q.

Our company is located in Illinois. We often get wage assignments for employees from Illinois companies, which our company honors. Today I received a wage assignment from a collection company based in Utah that was faxed to me. I faxed back a letter saying that a Notice of Intent had to be sent to our company by registered or certified mail at least 20 days before serving the demand on us. They responded by faxing a document labeled "Wage Assignment Intent," which is just a letter that has "Wage Assignment Intent" in bold letters at the top and states that they intend to send a voluntary wage assignment to be set up for my employee. Do I need to honor these faxes?

A.

No. One of the requirements under Illinois law (740 ILCS 170/2) for serving a demand for a wage assignment of an employee on the employer is that not less than 20 days before serving the demand, notice has been served upon the employee, and an advice copy sent to the employer, by two methods: (i) first class mail; and (ii) registered or certified mail (740 ILCS 170/2(3)). Service of any demand without complying with 740 ILCS 170/2 has no legal effect. Under Illinois law, proof of certified mail is prima facie evidence of service of the demand on the employer.

Because of the different treatment of wage assignments provided by the states, employers must be sure to check their own state's laws when faced with a wage assignment. Notifying legal counsel might also be a good idea, at least when there are any questions regarding the validity of a wage assignment or its priority if the employee involved has any other proceedings against his or her wages. See *APA's Guide to State Payroll Laws*, §7.2 for more information about voluntary wage assignments.

Improving state reporting (OCSE)

Q.

One of the best things about child support withholding is the amount of consistency among states (just one IWO, etc.). That is not so true for withholding from lump-sum payments, and I hear a lot of child support is going uncollected because of it. How is OCSE working with the states to improve this type of withholding?

A.

We are excited to say that we have been able to work with the National Council of Child Support Directors. They are hosting a work group that includes representatives from OCSE, child support agencies, and employers. The work group is discussing lump-sum payments and working to identify some state best practices. About a third of the states have mandatory reporting or notification requirements for employers. If you have employees under an IWO in one of those states and you are going to issue a lump-sum payment, you are required to let those states know. Depending upon state law, you may have to hold that payment for 10, 30, or 45 days. There is no real consistency with the lump-sum reporting and withholding process.

If you have received an order from a child support agency to withhold 100% from a lump-sum payment, look at the DOL opinion letter and follow the CCPA limits (https://www.dol.gov/whd/opinion/CCPA/2018/2018_04_12_1NA_CPPA.pdf). OCSE worked very closely with APA on the letter to the DOL asking for clarification. OCSE also issued an information memorandum to child support agencies to let them know about this guidance (https://www.acf.hhs.gov/css/resource/dol-opinion-on-ccpa-and-lump-sum-payments).

Locating IWO dates (OCSE)

Q.

Priority between a child support order and a federal tax levy is based on whichever was issued first (as opposed to received first). As an employer, how do you know when the original child support order was issued? We do business in Texas and Nevada. All of the Texas orders have a cover letter with the same date as the date on the IWO. The orders from Nevada are generally dated soon after the employee was reported as a new hire. Is the state child support agency supposed to put the date of the original divorce decree on the IWO?

A.

There is nowhere on the Office of Management and Budget (OMB)-approved form for the child support agency to put the date of the underlying order. If the employee has an IRS tax levy in place and you receive an IWO from the child support agency or a court, contact the child support agency to find out the date of the underlying order. If it predates the IRS tax levy, the child support order takes priority.

Lump-sum payments (OCSE)

Q.

We pay a monthly bonus to employees that is processed as a separate payment. The week's earnings of one employee did not allow us to withhold the entire amount owed for child support. We withheld the remainder of the payment from his second check. Do we need to report the lump sum and wait on the state?

A.

I will start with the withholding. If an individual is paid weekly and does not earn enough to cover one week's withholding amount, you should withhold up to the Consumer Credit Protection Act (CCPA) limits and send in that payment. In the next week, you should not make it up. Withhold the amount for that pay cycle indicated on the income withholding order (IWO).

Some states require employers to notify them about bonus payments. Reporting lump-sum or bonus payments is challenging for employers. The good news is the DOL issued an opinion letter identifying and addressing 18 types of payments that could potentially be garnished for child support (https://www.dol.gov/whd/opinion/CCPA/2018/2018_04_12_1NA_CPPA.pdf). The CCPA limits apply to15 of the payment types that were analyzed. There are three types of payments where the withholding limits did not apply to a portion of each.

Multiple garnishments (OCSE)

Q.

I have an employee in Maryland paying off a creditor garnishment. This same employee is being ordered to pay child support, but I have not received the paperwork yet. The garnishment order states: "If another garnishment or judgment is received, follow the same procedures, but remittance to a second or subsequent creditor is not made until the first judgment is paid in full. When one judgment is paid, the lien on the next one is in effect." Does this mean I should not withhold for child support until the employee pays off the creditor garnishment?

A.

Child support IWOs take priority over any other garnishment except an IRS levy that predates the child support order.

Reporting rehires and new hires (OCSE)

Q.

I know employers are required to report new hires and rehires within 20 days or sooner. But is there official guidance stipulating a maximum number of nonwork days after which an employee becomes a rehire and has to be reported again? One of our companies has employees who work on an as-needed basis. Some employees could go weeks or even months without working for us. Is there a point at which we need to report such an employee as a rehire?

A.

Several years ago federal law was amended, and the definition of new hire was changed to include rehires. Rehires are considered new hires if they were separated for at least 60 consecutive days.

The caveat to this is it could be less, depending upon state law. You can find information about state new hire reporting requirements on the OCSE website at https://www.acf.hhs.gov/css/resource/state-income-withholding-contacts-and-program-requirements.

If you receive an IWO for an individual who might work a little and then be off for a few weeks or months and then come back, you need to keep that IWO on file. Also look at state law about how long you need to keep that order on file. You may be required, depending on state law, to begin withholding as soon as that person comes back.

Requirements for recovery of overpaid wages in North Carolina

Q.

Our company is in North Carolina. Due to a time miscalculation we have an employee who received a paycheck that included pay for 3 hours the employee did not work. We need to reverse that overpayment to be in compliance with our policy. Can we deduct this overpayment of wages from the employee's future check? What are the requirements?

A.

North Carolina law (N.C.G.S. §95-25.8) governs the ability of an employer to take deductions from an employee's wages. An employer is allowed to withhold or deduct amounts from an employee's wages when the employer is required by federal or state law to do so (N.C.G.S. §95-25.8(a)(1)). Required deductions include withholding for federal and state income taxes, FICA taxes, and court-ordered garnishments.

N.C.G.S. §95-25.8 also addresses the circumstances under which an employer may take other deductions from an employee's pay. Deductions are allowed when the amount of a proposed deductions is known and agreed upon in advance, the employee signs a written authorization on or before the day in which the deduction is to be made, and the authorization includes the reason for the deduction and the specific dollar amount or percentage of wages to be withheld (N.C.G.S. §95-25.8(a)(2)).

If the amount of a proposed deduction is not known in advance, the employer must obtain written authorization from the employee that is signed before the payday from which the deduction is to be made and that states the reason for the deduction. Before actually making a deduction, the employer must provide the employee with a written notice stating the actual amount to be withheld and the employee must be informed in writing of the right to withdraw the authorization (N.C.G.S. §95-25.8(a)(3)).

N.C.G.S. §95-25.8 does not apply to recovery for the overpayment of wages because of a bona fide employer error, which is the situation described in your question. A bona fide employer error that results in an overpayment of wages to an employee is considered a "pre-payment" of wages and may be recouped from subsequent wages without a written authorization from the employee for the recoupment and there is no limit to the amount of the pay-back by the employee. Note, however, that if your company sought to charge the employee interest or seek a fee for the repayment, a signed authorization would have to be obtained from the employee before a deduction for the interest or fee may be made. Find out more information about North Carolina wage deductions at https://www.labor.nc.gov/workplace-rights/employee-rights-regarding-time-worked-and-wages-earned/deductions-wages.

The federal Fair Labor Standards Act (FLSA) also imposes restrictions on an employer's ability to take deductions from an employee's pay when they bring the employee's wages below the FLSA's minimum wage and overtime requirements. In this case, however, the FLSA does not limit on your company's ability to recover the overpayment. Deductions to recover salary advances or overpayments due to bookkeeping errors may be taken by the employer even if they reduce the employee's current wage below the required minimum, but employers should consider spreading out the recovery of amounts overpaid or advanced to reduce the economic hardship on the employee. See *The Payroll Source, §9.1-7* for more information about the FLSA and wage deductions.

Terminating private IWOs

Q.

We have been withholding child support since 2006 based on an income withholding order (IWO) sent by an attorney. The employee has given us a copy of the original divorce decree that states, "The husband's obligations for child support payments shall terminate for each child upon the child first experiencing one of the following contingencies: (1) marriage, (2) ceasing to reside primarily with one of the parents, or (3) attaining the age of 18 years, or the month following graduation from high school if any child reaches the age of 18 before graduation from high school." One child covered by the order is 22, another turned 18 last month, and the third is 16. Should we withhold only for the youngest?

A.

Since the order was issued by an attorney, follow the underlying order, the divorce decree, for when to terminate support. There is no requirement for a private entity to issue a termination notice. If this was from a child support agency, you would wait until you received the termination notice or termination order to stop withholding.

Because this is a private order, follow the terms and ask the employee for verification that the 18-year-old has graduated from high school before terminating and continue to withhold for the 16-year-old.

Terminating state agency IWOs (OCSE)

Q.

I'm withholding child support according to an income withholding order (IWO) from a state child support agency. The obligor-employee has shown us a signed court order to stop the withholding. If I obey the court order, will I be in trouble with the state agency?

A.

You need to follow the terms of that IWO from the child support agency. That IWO tells you to continue to withhold until you receive a termination notice from the child support agency.

You should instruct the employee to reach out to the child support agency to ask the agency to let the employer know about the court order. Or, you could ask the child support agency about issuing a termination.

Child support agencies can send terminations in different ways. They can use the OMB-approved IWO, although they are not required to. On the last page of the IWO, there is a termination section. You could receive a letter from the child support agency instructing you to terminate the order.

Terminations for employees paying child support (OCSE)

Q.

One of our employees paying child support recently terminated. Do we need to keep the child support income withholding order (IWO) active on the employee's record in case he is rehired someday? If we rehire an employee, do we not need to wait for a new IWO?

A.

It really depends on state law on how long an employer has to keep IWOs on file in the event an employee terminates and is rehired. You are required to report rehired employees if they have been separated at least 60 consecutive days on the federal end, but that timeframe may be shorter, depending on state law.

Ideally, if an employer keeps IWOs on file for a period of time and the person comes back, you can start withholding immediately, which helps not only the family but also the employee because it will help to avoid him or her from falling behind or getting into arrears. There is an Income Withholding Matrix on the OCSE website (https://www.acf.hhs.gov/css/resource/state-income-withholding-contacts-and-program-requirements), which provides state-specific information on numerous requirements, including the length of time an employer must retain an IWO after an employee's termination.

Affordable Care Act information returns

Q.

Our department has an excellent system for keeping most payroll records. One fairly new area of records we could use some guidance with is the retention and storage requirements for filings under the Affordable Care Act (AC), such as Forms 1094-C and 1095-C. What are our obligations for retaining ACA information returns?

A.

Under the ACA, employers are required to file Forms 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*, and 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, with the IRS. Entities that provide minimum essential health coverage must file Forms 1094-B, *Transmittal of Health Coverage Information Returns*, and 1095-B, *Health Coverage*.

In addition to filing these information returns with the IRS, filers of the forms must retain copies of the forms and supporting documentation, or maintain the ability to reconstruct the data on the forms for at least three years from the from the due date of the returns. The time period begins to run from the due date of filing, not the date the filer actually filed the form with the IRS.

Here is an example. The due date for filing 2017 Forms 1094-C and 1095-C with the IRS was April 2, 2018 (because March 31, 2018, fell on a Saturday). ABD Company filed the forms with the IRS on March 21, 2018. ABD is required to keep copies of the forms or be able to reconstruct them until at least April 2, 2021.

Correcting timesheet errors (DOL)

Q.

I work at a mechanics shop. We do not have a time clock. We have paper weekly timesheets where the mechanics write in the date, start and stop time, job number, and what work they performed on which piece of equipment. People sometimes make mistakes on their timesheets. Say a mechanic writes in his time as 7:00 a.m. to 2:30 p.m. but, in fact, he worked 7:30 a.m. to 2:00 p.m. Our manager will correct the timesheet before approving it. An employee is saying it is illegal to do that without talking to the employee first. Is that true?

A.

Ultimately, the employer is responsible for accurate times of work and keeping accurate work records. It is not illegal for the employer to make that notation, especially if it results in accuracy related to the actual hours of work. However, notations and communications with the employee would be a good practice so that you will be able to distinguish why there was an infraction or why there was an error.

Destroyed records (USCIS)

Q.

My company was located in Puerto Rico when a hurricane blew through and knocked down our building and destroyed our computers and files. Luckily, we were able to move the entire operation to the mainland, including bringing our employees with us. What do we need to do for employment verification?

A.

We answer this question on our I-9 Central website "Questions and Answers" tab (https://www.uscis.gov/i-9-central/questions-and-answers). It is always good to go to that site and read the FAQs.

USCIS's response is: Employers whose Forms I-9 are missing and/or destroyed as a result of a natural disaster or any other unforeseen occurrence should complete new Forms I-9 to the extent reasonably possible and attach a memo stating the reason new Forms I-9 were redone or why it was not possible to redo the Forms I-9.

The example in this question is a hurricane with Puerto Rico, but it applies to a flood, a fire, a break in, and other instances.

Recording time worked by the minute and sick leave

Q.

Our company currently uses rounding but is considering going to minute-by-minute recording of hours worked by our employees. We are wondering how other companies that use this timekeeping method to apply paid sick time for a partial day's absence. For example, an employee is scheduled to work from 8:00 a.m. to 5:00 p.m. The employee clocks in at 8:02 a.m., goes to lunch at 12:13 p.m., clocks back in from lunch at 1:15 p.m., and leaves work at 3:23 p.m. to go to a doctor's appointment. In this example, the employee worked 6 hours and 19 minutes. What does the Fair Labor Standards Act (FLSA) say about timekeeping and how much paid sick would you enter for the doctor's appointment? For the two minutes at the start of the day and the two minutes they went over at lunch, would they need to use vacation time off to make up their 8 hours for the day or would you not pay the employee?

A.

The FLSA allows rounding to the nearest tenth or quarter of an hour if done consistently and, of course, allows to-the-minute timekeeping. Where time clocks or other mechanical or automated devices are used to record hours worked, employees will often punch in or log in early and punch out or log out late.

You do not mention whether your present or proposed timekeeping methods apply to nonexempt employees only or to both exempt and nonexempt employees. (Under the FLSA, exempt employees can be required to record hours worked and to work a specified schedule.) Employers are required to pay nonexempt employees only for time worked, so any time the employee is not actually working is not compensable under the FLSA. Paid sick leave or paid personal time off is not required by the FLSA but note that deductions from the salary of an exempt employee for a partial day's absence (such as coming in late or taking an early lunch) is not allowed; an employer can use available personal time off or sick time to make up the difference but if there is none of that time available the exempt employee must be paid for the day. (In order for an employer to make a deduction from an exempt employee's salary for full days due to sickness or disability, the deduction must be made under a bona fide sickness or disability plan; see *The Payroll Source*®, §2.4-1).

Employers can handle the situation described in the question for nonexempt employees in the way that makes sense according to their sick leave/personal time off policies but the policy followed should be consistent. Some employers might pay for sick time for the doctor appointment from 3:23 until their scheduled end of the day, but not to exceed the employee's scheduled 8 hours for the day; if the employee was short a few minutes due to a late arrival or longer lunch employee would not be paid for that time. A second approach would be for an employer's payroll system to analyze the clock time and calculate the paid time off needed to go on the time card to make the day match the number of hours that the employee was scheduled to work that day.

The FLSA should not be the only consideration in making the determination. Although the FLSA does not require employers to provide paid sick leave to employees, more and more states and localities are requiring employers to provide some paid sick leave (see *APA's Guide to State Payroll Laws*, §9.2).

Retention period and format of Form I-9 of terminated employee

Q.

We had an employee who started with our company on March 18, 2014. She resigned her position and left the company on July 20, 2018. Please settle a disagreement in our department about how long to keep the employee's Form I-9, *Employment Eligibility Verification*. I say we could have gotten rid of it March 18, 2017, after she had been with the company three years. My colleague says we have to keep the Form I-9 for at least three years after she terminated employment. Which one of us is correct?

Also, must we continue to store Forms I-9 on paper? Our department is getting cramped for space and sometimes these records get misplaced.

A.

Unfortunately, neither of you are correct as to your first question. Employers must retain the completed Form I-9 for at least three years after the date of hire or one year after the date of termination, whichever is later. In this case, one year after the employee's termination is July 20, 2019, which is later than March 18, 2017. You must therefore keep the former employee's Form I-9 until July 20, 2019.

Regarding your second question, there are allowable alternatives to paper storage of Forms I-9. The recordkeeping responsibilities for Form I-9 includes the obligation to make the forms available for inspection by the U.S. Department of Labor or Immigration and Customs Enforcement within three days of a request by those agencies. Forms I-9 may be made available on microfilm or microfiche if they are clear and readable and viewing and printing equipment is made available to the inspector.

The forms also may be stored electronically. If Forms I-9 are stored electronically, employers should consider an electronic storage system that includes an indexing system and the ability to reproduce legible and readable hard copies of electronically stored Forms I-9. Electronic storage rules are explained in USCIS Publication M-274, *Handbook for Employers – Guidance for Completing Form I-9*, which is available at https://www.uscis.gov/sites/default/files/files/form/m-274.pdf.

Internal controls in a one-person payroll department

Q.

Ours is a small tech company about to be formed and we will begin our business with someone to act as our payroll/HR person. The prospective hire we have in mind has the payroll experience we need but will be running the payroll operation by herself until our operation grows sufficiently. What should we know about running a payroll operation with a one-person setup?

A.

As a start-up company, you will likely have various employees wearing many different hats, e.g., a programmer doubling as a database administrator. You will be doing that with your new hire by giving her payroll and HR duties.

Although your company will only have one payroll hire, it is important that you not rest all of the payroll duties in that one person. Although your company is starting out small, start out right by applying the best practice of segregation of job duties.

The principle of segregation of job duties means that critical job processes are not totally the responsibility of one person or department. Segregation of job duties greatly reduces the opportunities for fraud or embezzlement of company funds. Many companies and many payroll practitioners will never face an embezzlement problem, but the failure to segregate job duties makes the company vulnerable to theft and is a "red flag" for outside auditors and potential shareholders that a serious security problem exists.

The urge not to segregate duties is often the greatest in small companies like yours where the payroll department may consist of only one individual. You should not give in to this tendency, though. Even with a one-person payroll department, some critical duties can be given to employees outside the department. Here are some examples:

- The accounting department completes all payroll bank account reconciliations.
- Department heads are asked to check employee lists against the list of employees who received paychecks.
- Store paychecks outside the payroll department, but keep the key in the payroll department.

To learn about implementing sound internal controls in your new company, see *The Payroll Source*®, §11.8.

Payroll transactions explained

Q.

I am moving into the payroll department of our company from our customer service department. Can you give me an overview of how are payroll transactions are recorded and tracked?

A.

Payroll transactions include a variety of tasks such as paying wages to employees, making deductions from those wages, and remitting withheld taxes and withheld child support payments. Payroll transactions are generally recorded initially in the payroll register. Typically, the payroll register lists each employee along with the wages paid and each amount deducted for each payroll period, and may also contain the quarter-to-date and year-to-date totals.

Relevant or current information from the payroll register is then posted to the company's journal. The journal is a record of the transactions of a company during the accounting period. For each transaction, the journal shows debits and credits to be entered in specific accounts, as well as a description of the transaction. Payroll-related journal entries are: Payroll Expenses; Payroll Deductions; Payroll Cash Distribution; and Employer Tax Liabilities.

Payroll expenses may be recorded in one of two ways: functionally or by type of pay. If payroll expenses are recorded functionally, entries must be based on the processes supported by the expenses (e.g., manufacturing, sales, or administration). Recording payroll expenses by type of pay breaks down employees' wages into regular and overtime pay.

Payroll deductions are amounts deducted from employee wages that must be paid to a third party such as the IRS or a state revenue agency, and they become a liability to the employer. The date the employer makes the deductions from the employees' wages is the date the liability is incurred. For easy reconciliation and balancing, each type of liability incurred by making a deduction from wages is recorded into the payroll deduction journal under a separate account. Such accounts include Federal Income Tax Withheld, Social Security Tax Withheld, Medicare Tax Withheld, etc.

When the employees are paid (payroll cash distribution – net pay), entries must be made into the payroll cash distribution journal debiting the accrued salaries/wages liability account and crediting the payroll checking (cash) account. Entries made to the payroll cash distribution journal are recorded in the accounting period in which the employees are paid, since that is when the liability for paying the wages is discharged. Therefore, if a pay period runs from June 14 to June 27, but employees are not paid until July 2, the payroll cash distributions are recorded as journal entries in July.

Employer tax liabilities relates to taxes imposed on employers for their share of social security and Medicare taxes and federal and state unemployment taxes. These liabilities are based on the amount of wages paid to the employees that are subject to each type of tax. The payroll register must contain the amount of wages on which each tax is imposed. Because employer taxes are not deducted from employees' wages, the employer incurs additional expenses based on its liability for each type of tax, and these are recorded into the employer tax liabilities journal. Entries made into the journal will debit an expense account for the amount of the expense and credit a liability account. Entries made to the employer tax liabilities journal are recorded in the accounting period in which the employees are paid, since that is when the liability is incurred.

This is an overview of what payroll transactions are and how their place in the system of payroll accounting. To get a broader understanding of this topic and payroll accounting in general, start with *The Payroll Source®*, §11 (especially §11.3).

Sarbanes-Oxley Act and small companies

Q.

Our company is not large and operates in one state. I've recently been told that our company may have to comply with the Sarbanes-Oxley Act. Is this true? What can you tell me about SOX?

Payroll Accounting

A.

Depending on the type and status of the business entity of your company, it may be subject to the Sarbanes-Oxley Act (SOX). In 2002, the Public Company Accounting Reform and Investor Protection Act, also known as SOX, was enacted in response to the corporate finance scandals at Enron, WorldCom, Adelphia, and other public companies. Although SOX applies only to companies whose stock is publicly traded and whose finances are governed by the Securities Exchange Act of 1934 (SEC Act), several states continue to consider their own versions of SOX that may apply more broadly to smaller companies and non-profit organizations.

In general, SOX requires public companies to have a framework for identifying, documenting, and evaluating their internal controls over financial reporting, and it provides a logical way to analyze a company's control system. SOX also prohibits a public accounting firm from providing both external auditing and most non-auditing services to the same client, and it requires audit partners to rotate every five years.

SOX requires a public company's chief executive officer and chief financial officer to certify each annual or quarterly report filed under the SEC Act. The certifications represent that these officers have reviewed the report and that as far as each officer knows, the report does not misstate the truth of any material fact or omit a material fact, and addresses the state of the company's internal controls.

Even if your company is not presently covered by SOX, as a matter of best practice your payroll department should strive to be SOX-compliant. Here are some of the things the payroll department should do to aid the company in being SOX compliant:

- Develop process and workflow maps that show each function
- Create written documentation for each step in the payroll process and update documentation where it already exists
- Audit recordkeeping and retention procedures to make sure that records are organized and can be retrieved easily
- Identify gaps and risks that can lead to a lack of control and security (e.g., inadequate separation of duties)
- Communicate the gaps and risks to management
- Prepare an action plan to address the gaps and risks through adequate internal
- Develop a way to measure progress in addressing the gaps and risks

- Document the design, evaluation, and testing of the internal controls, which will form the basis for management certification of the internal controls and attestation by the outside auditor.

You can find out more about SOX and payroll by consulting *The Payroll Source*®, §11.8.

IT department access to payroll data

Q.

Our company is converting to a new payroll provider. Our IT department is demanding that several of their staff be given "Super User" access to every item of data in the new payroll system, which would also allow them to view, modify, or delete the payroll data. They want to be the only point of contact for password resets for the new payroll system (instead of the payroll department for the payroll system, as is now the case in our company). Our payroll and human resources department do not like this idea. What is the best practice here?

A.

In the development of a payroll system consideration must be given to those who will use the system and the access they have to the data in the system – authentication and authorization. Authentication is a way by which a user satisfactorily identifies himself or herself to the system. Authorization is the degree of access (permissions) that an authenticated user has to the system and its data.

The Principle of Least Privilege (PLP) is a best practice that should be used when granting permissions to users of the system. This means granting only the minimum permissions necessary to a user to accomplish a given task. Only those employees who must use the system should have access, and passwords should be changed frequently (ideally by the payroll department). Determine if only certain employees can input new data or update specific data elements. Where employees from other departments must have access to the payroll system or the integrated payroll/human resources/benefits system (e.g., electronic changes to W-4 information or benefit elections), the system must allow access only for those limited purposes. The use of a Super User role should therefore be strictly limited.

It sounds like the access sought by your IT department is more than it would need. It may be that the IT department is approaching this from the perspective that development and testing the new system using the PLP approach makes development more difficult. However, granting excessive authorizations to users increases the risk of leaving the system vulnerable to attacks and data breaches. PLP is an important part of a comprehensive security strategy and this means users log on with accounts that limit their authorized actions. If your new system is designed and implemented from the start with a PLP approach, the result will be more consistent security planning that will keep the payroll data safe. It will also limit the temptation to grant excessive privileges for quick workarounds.

Addresses: 22 spaces only (SSA)

Q.

Our payroll system allows 22 spaces for addresses. What happens when an employee's address requires more than 22 spaces? Do we need to increase the lettering spaces to fit, or will SSA accept truncated addresses?

A.

SSA's system accepts 22 characters, and that is where I suspect your payroll systems are coming from. The EFW2 file format has 22 spaces for Lines 1 and 2.

The best practice might be to abbreviate the address where you can. Make sure you use "St" for street. It is not always possible though. Someone might live on a very long street name, where you cannot necessarily truncate or reasonably abbreviate. In that situation, we will take an address as we can get it.

Time of year for change to new payroll system

Q.

We are thinking of changing payroll systems and are interviewing vendors. I was told it does not matter when during the year we cut over our payroll processing from the old system to the new system. I have always thought that the ideal time for implementing a new system was the beginning of the year. One payroll vendor has told me implementation can happen anytime of the year and there is nothing I should be concerned about. What should I consider in determining whether implementation should happen at the beginning of the year, beginning of a quarter, or middle of a quarter?

A.

There are a number of things to consider when timing a system conversion. One of these is the amount of payroll system history from your old system to convert. This amount of data to convert depends on the overall database size and the business need for online access to older information. Implementation of a new system occurring on January 1 will require less history to be converted than a mid-year implementation.

Although a go-live date of January 1 is ideal in many ways, there are other reasons and advantages for going live at the beginning of a quarter, such as these.

1. Your vendor may have limited availability to implement a new system on January 1. If you cannot get one of vendor's time slots you would need to wait a full year before you can go live and your existing system may not wait that long.
2. Year-end is the busiest time of year for payroll. You have open enrollment, year-end reconciliations, and the preparation and issuance of Forms W-2, 1094, and 1095, among other things. Having to work with an existing system and plan a cutover to occur in this time frame will be a significant undertaking. For 2019, January 1 may also mean obtaining new Forms W-4 from employees.
3. If you pick a different quarter of the year to implement the new system it will likely not be as busy as year-end and you can devote more time to reconciling the converted data, making sure all the calculations are correct in the new system, and getting comfortable with the new way of processing payroll so you can be comfortable with questions from employees about the changes in their pay stubs.

Attempting to implement a conversion during the middle of a quarter could be problematic for a number of reasons. One factor is the number of taxing authorities (state and local) with which you must file. Many tax services groups will not accept a mid-quarter handover from an external vendor because tax balances (collected versus remitted wages and taxes) can be messy. In general, going live mid-quarter leaves less time for error corrections to year-to-date values. A go-live at the beginning of a quarter would leave as much as three months to for corrections that may be needed.

Whatever time of year you choose to go live do not do so until you are sure the year-to-date history, employee master data (correct pay rate, correct taxes and withholding information, correct pre- and post-tax deductions), and net pay (within a penny or two of the old system) are correct.

Avoiding quarterly adjustments

Q.

I started a new job and discovered that the company exercises some rather creative payroll practices to avoid making adjustments for a prior pay period. My experience and gut tell me that the following scenario is incorrect, but I'd like verification.

The deadline for our third quarter payroll payments/adjustments was September 26. Two days later we issued a termination check. I was instructed to print a check dated October 1 but then to scratch that date off the check and handwrite in "September 28." Of course, I let my manager know that this was not the way it should be processed; but, he said that the department had never made a quarterly adjustment and didn't intend to now.

A.

Tax and reporting liabilities are incurred when wages are actually or constructively paid (available to the employee without unreasonable restriction imposed by the employer). The date printed on the check, dates of the pay period, or the date the employee would otherwise normally have been paid the wages are all irrelevant factors. If the check is given to the employee on September 28 then it is to be treated as third-quarter wages.

At the end of the day, upper management makes the decisions. You should explain to them the correct procedures and then document your objections if directed otherwise. (See *The Payroll Source*®, §13.2-5 for information about reporting to upper management). Be sure to keep copies of that correspondence. If compliance is not important at your company, you may wish to seek employment at another company that wants to maintain payroll compliance and values your expertise.

Establishing and enforcing payroll deadlines

Q.

We pay weekly, on Fridays. Our deadline for making changes to an employee's direct deposit is noon the previous Friday. The payroll department enforces this policy strictly. If an employee misses that deadline (even by a few hours) and tells us that their bank account is closed, we still send money to the account we know is closed. The employee will receive a paper replacement check the following Friday, pending the return from their bank. What are your policies surrounding direct deposit changes?

A.

Deadlines are important to establish routines and expected behaviors. However, your company's hardline on the deadline appears to be at odds with the customer relations mission of payroll departments. (See *The Payroll Source*®, §13.3-7.) One question worth asking is whether that deadline is reasonable.

A one-week deadline for changes is not uncommon among payroll departments, but those departments often do not require an entire week to accommodate the changes. Some will accept direct deposit changes up to the time they lock the system to run payroll. This may be especially effective when relying on employee self-service. In the example you cite, accommodating a late change would prevent you from sending a transaction to the bank that you know could cause financial hardship to the employee.

Reissuing paychecks through accounts payable

Q.

Whenever we issue a stop payment on a paycheck, the reissued check to the employee comes through the accounts payable department. This is also the case for any reimbursements to the employee for a prior year. Are there disadvantages to this?

A.

Yes. When paychecks are reissued through the accounts payable department, a piece of history isn't properly recorded in the payroll system. When it's all in the payroll system, one can easily determine that, for example, a paycheck was issued to an employee in February, voided and reissued to the employee in October, and if it is still outstanding. If the reissued check comes from the accounts payable department, the payroll department may not know that the check was reissued unless the departments communicate effectively (see *The Payroll Source®*, §13.4-4).

The way to a reissue in payroll is to void the original check and then, at the same time, issue a new check where everything (gross, net, all incomes, deductions, and taxable bases) exactly cancels out between the void and reissue so there is no effect in the current period. Your payroll system may have an option to do this automatically, regardless of the employee's current tax setup and income/deduction authorizations.

Employee qualification for foreign earned income exclusion

Q.

One of our employees is being transferred to our London office as of October 1.The employee's assignment at that location is open-ended. He is asking about whether the wages he is paid while working in the U.K. will be subject to U.S. employment taxes while he is there. I've deferred answering him until I can find out more. Is this so? If so, what are the rules?

A.

Under IRC §911, U.S. citizens and resident alien employees working outside the U.S. (i.e., expatriates) who qualify for the foreign earned income exclusion can choose to exclude the first $103,900 of foreign earned income in 2018 from their gross income. These employees may also exclude certain housing cost amounts from their gross income.

To qualify for the foreign earned income or housing cost exclusion, the employee must: (1) have foreign earned income; (2) have a "tax home" in a foreign country; and (3) meet either a bona fide residence or physical presence test that proves the employee is not living in the U.S. during the year in question.

The employee's tax home must be in a foreign country for the entire period of residence or physical presence in that country during the year. In general, an employee's tax home is the location of his or her regular or principal place of business or employment. If there is no regular or principal place of business, the employee's tax home is where the employee regularly lives (i.e., has an abode). Employees wishing to qualify for the §911 exclusions can do so by proving they have been bona fide residents of a foreign country for an uninterrupted period that includes at least one full taxable year (January 1 through December 31 for calendar year taxpayers). Whether an employee is a bona fide resident of a foreign country depends on several factors such as:

- Whether the employee brings his or her family and they intend to make the foreign country their home for the duration of the assignment
- Purchase of a home or signing a long-term lease in the foreign country

- Involvement in the culture and social life of the foreign country
- The terms of the employment agreement regarding the foreign assignment
- The type of visa or residence permit secured by the employee

Here is an example of bona fide residence qualifying for the foreign earned income housing exclusion:

Employee Divya arrives with her family in Tokyo on October 1, 2018. The assignment is indefinite, and Divya and her family establish residence immediately, intending to live in Tokyo until she is transferred elsewhere. If Divya remains on assignment in Tokyo and maintains her residence there through December 31, 2019, she becomes a bona fide resident and is eligible for the foreign earned income and housing cost exclusions.

This is a broad outline of the topic and considerations involved. For all of the details, see *The Payroll Source*®, §14.1-4.

Helping expatriate employees cope with higher foreign country taxes

Q.

Our company will be opening an overseas office in France next year and we are planning to post a couple of our executives from our U.S. offices there. This will be our first expansion into another country. We expect the tax bite for these transferees to be more than they are now subjected to in the U.S. What can our company do to make the transfer of these executives more attractive (or at least neutral) from a tax standpoint?

A.

Most U.S. companies sending U.S. citizens and resident alien employees abroad have compensation policies designed to ensure these employees receive total compensation that will provide for a standard of living comparable to what they would have had if they were still living and working in the U.S. Such compensation policies take into account additional costs of living abroad, including income taxes.

Income and social security taxes are often higher in foreign countries than in the U.S., even more so because they tax the extra compensation provided to U.S. employees to offset the higher cost of living in the foreign country. Most compensation and tax reimbursement policies are designed to ensure the employee will not have to pay combined taxes on income in the two countries in excess of the amount that would have been paid if the employee had remained in the U.S. Two approaches U.S. companies use to neutralize the tax burden on expatriate employees are tax protection and tax equalization.

Under a tax protection plan, the employee is reimbursed by the employer to the extent the employee's combined income and social security taxes in the U.S. and the foreign country exceed "hypothetical taxes" the employee would have paid if living and working in the U.S. The goal is to ensure that the employee is no worse off in terms of taxes as a result of the foreign assignment. If the employee's actual total taxes are lower because the foreign taxes are low or nonexistent (e.g., Saudi Arabia, the Bahamas) or the employee qualifies for exclusions from U.S. tax, the employee can keep the excess tax reimbursement. In practice, the employee files the U.S. and foreign tax returns and pays the taxes. If the expatriate's actual taxes are higher than hypothetical taxes, the employee files a request for reimbursement. After a reconciliation is made, the employer reimburses the employee for the excess of actual over hypothetical taxes.

Tax equalization, a more popular alternative to tax protection now used by the majority of U.S. companies with tax reimbursement policies, is designed to make taxes a neutral factor when determining an expatriate employee's compensation package. Under this method, the employee gets no tax benefit, while the employer can take advantage of the employee's assignment to a low tax country. Under a tax equalization plan, the employer pays the employee's actual U.S. and foreign taxes and collects hypothetical taxes through reductions in the employee's salary payments. These reductions are made on a periodic basis similar to income tax withholding amounts.

Whether a company decides to use tax protection or tax equalization, it must determine the tax the employee would have paid if the employee had remained in the U.S. This is known as the hypothetical or stay-at-home tax. Small employers with few expatriates may do this based on the individual circumstances of each employee. Larger companies with more extensive expatriate assignments may opt to create a formula that includes a standard allowance for normal deductions rather than tailor an individual amount for each employee.

Employer tax reimbursement for expatriate employees has many more facets. See *The Payroll Source*®, §14.1-6 for complete details.

Late notification of F-1 visa status

Q.

Our company hired an employee in the country on an F1-Visa, but the payroll department did not know about this at the time he was brought on board. We processed a payroll and completed a quarter end before we were aware. Do we need to do an amendment? We have one employee with only one check in a prior quarter, and I'm not sure it's worth the labor and time involved to try to recoup the social security and Medicare tax for the employer portion.

A.

From an employee relations/customer service standpoint, it would be best to make the payroll adjustments in the payroll system, refund the employee for any incorrectly withheld FICA taxes, and file an amendment/request for refund of employee and employer FICA taxes.

Otherwise, the employee can certainly file a refund request directly with the IRS using Form 843, *Claim for Refund and Request for Abatement*, after he files his 2018 income taxes. He will likely need to submit Form 8316, *Information Regarding Request for Refund of Social Security Tax Erroneously Withheld on Wages Received by a Nonresident Alien on an F, J, or M Type Visa*, along with the claim for refund, and he'll either need an employer statement from you, or he may request additional information from you in order to complete the form. In case you don't provide the employer statement, he'll need to provide an explanation as to why he cannot get the employer statement concerning his request. Again keeping employee relations and customer service in mind, you shouldn't make an employee wait too long to receive the refund for something that should have been handled upon hire.