legislativeUPDATE

November 17, 2011

IRS Audits Focus on Fringe Benefits

IRS Audits Focus on Fringe Benefits

The Internal Revenue Service (IRS) has informally indicated that it will audit 6,000 randomly selected U.S. companies to determine whether they pay required employment taxes – with a focus on several areas, including the employment taxation of fringe benefits. Auditors will likely focus on the most misreported fringe benefits, like personal use of employer-owned aircraft or personal use of a corporate vehicle. However, there are a significant number of fringe benefits they could examine.

Under the IRS income tax laws, certain benefits provided by employers to employees are not taxable because they are statutorily excluded as "fringe benefits." Common non-taxable fringe benefits include: personal use of company vehicles; employer provided housing and meals; accident and health benefits; educational assistance qualified employee discounts; moving expenses; and benefits with a *de minimis* value. Where a benefit provided to an employee is improperly treated as a fringe benefit, the employer would not include the value of such benefit as compensation paid to the employee and, therefore, would not properly withhold income tax or pay employment taxes on the value of the mischaracterized benefit.

What are Fringe Benefits?

The term "fringe benefits" has no universally accepted meaning. The tax code and practitioners use the term to define all benefits as well as incidental benefits. The IRS 2011 version of Publication 15-B (Employer's Tax Guide to Fringe Benefits), contains information for employers on the employment tax treatment of various fringe benefits, including: accident and health coverage; adoption assistance; company cars and other employer-provided vehicles; dependent care assistance; educational assistance; employee discount programs; group-term life insurance; moving expense reimbursements; health savings accounts (HSAs); and transportation (commuting) benefits. Publication 15-B, which is a supplement to IRS Publication 15 (more commonly known as Circular E), refers readers to other IRS publications, guidance, and websites for more detailed coverage of certain aspects of these fringe benefits.

One focus of the IRS initiative is on *de minimis* fringe benefits tax rules for things like employee discount programs and on-site athletic facilities. These rules also come into play when employers provide gift cards, employee raffles and awards, occasional meals, sports tickets and items considered "too valuable" to be *de minimis*. While employers can give employees small benefits in the form of property and services that are not taxed, the *de minimis* fringe benefits tax rules

determine when such benefits are small enough to avoid income taxation. The *de minimis* rules are complicated and are not based on a simple dollar-value threshold.

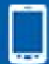
Health and Wellness Related Incentives

Some employer-sponsored wellness incentives have tax consequences under these *de minimis* fringe benefits tax rules. The general rule is that any compensation provided by an employer to its employees is taxable unless a specific tax code provision excludes it from income. Some wellness programs provide financial incentives such as gift certificates, cash, premium reductions, or dollars in a health reimbursement arrangement (HRA), flexible spending account (FSA) or HSA. Generally, when the incentive is cash or a cash equivalent - such as a gift certificate, gift card, check, coupon or cash bonus - the incentive is to be treated as fully taxable wages. The amount is to be reported as taxable income on the employee's Form W-2 for the year, and federal employment taxes must be paid. However, certain employer-provided *de minimis* fringe benefits, such as water bottles, t-shirts, baseball caps or one-day health club passes, are generally not treated as taxed (as it would be unreasonable or administratively impractical to account for them). To be sure, employers that offer cash or cash-equivalent incentives should review the potential tax consequences of these incentives with legal counsel. Incentives related to a group health plan are excludable from tax, such as reduced cost-sharing (premium reduction) or contributions or a payment into a health FSA, HRA or HSA.

Employer Compliance Steps

In light of the IRS audit initiative, many employers are considering reviewing their compliance with the fringe benefit taxation rules. Employers should be aware that although the audits are apparently focused on 2007 and 2008 calendar year tax returns, the IRS may expand the scope of these audits to years earlier or later. There is nothing that an employer can do to avoid being targeted under an audit, but there are certain measures that employers can take in response to the dramatic shift in the way the IRS will be policing employment tax compliance. Because many employer documents could be scrutinized during the audit process, employers should consider proactively reviewing their current payroll procedures with their tax advisers, specifically focusing on the targeted tax areas.

As additional information becomes available on this topic, Conner Strong & Buckelew will issue updates. We encourage you to contact your Conner Strong & Buckelew account representative toll-free at 1-877-861-3220 for assistance with wellness programs and design. For a complete list of Legislative Updates issued by Conner Strong & Buckelew, visit our online [Resource Center].

connerstrong.com  877-861-3220 news@connerstrong.com Change My Preferences

CONNER STRONG & BUCKELEW

INSURANCE | RISK MANAGEMENT | EMPLOYEE BENEFITS

in

Click here to change your email preferences or unsubscribe from all communication.