Taxable and Nontaxable Compensation

Section 3 – Part 1

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Introduction

Welcome to Section 3 of the CPP study group. Section 3 – Taxable and Nontaxable Compensation - covers content that is at the heart of payroll and consequently covers the biggest consolidated content for the CPP exam. Section 3 will build the foundation for future chapters when you will be calculating tax withholdings and net pay.

Throughout this document you'll be given highlighted content to supplement *The Payroll Source*. While this content will not cover everything you need for the exam, it is a good tool to help facilitate studying. Different icons will point out special items

- Example
- Form to know
- Legislation to know
- Number to know
- Test your knowledge

Topics from Content Outline

Principles of Paycheck Calculations

Compensation/Benefits

Knowledge, Skills and Abilities

Employee Benefits

- Knowledge of impact of taxable benefits
- Knowledge of impact of non-taxable benefits
- Knowledge of a qualified plan (i.e. retirement plans, sec. 125, awards, moving)
- Knowledge of a non-qualified plan (i.e. retirement plans, sec. 125, awards, moving)
- Knowledge of imputing fringe benefits

Regulatory

- Knowledge of IRS regulations impacting payroll
- Knowledge of IRS sec 129 (components of exclusion and limitations)
- Knowledge of IRS sec 132 (components of exclusion from income)
- Knowledge of accountable and non-accountable plans (e.g. business expense)
- Knowledge of federal tax requirements for stock awards and purchases
- Knowledge of taxation of wages paid to deceased employees
- Knowledge of taxationof imputed income (e.g. GTL, moving expense, etc.)
- Knowledge of allocated tips
- Knowledge of adoption assistance
- Knowledge of repayment of employer provided loans
- Knowledge of supplemental wages

Reporting

- Knowledge of Form 4070 requirements
- Knowledge of Form 8027 requirements

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Knowledge of employee tip reporting

Compensation/Benefits

Ability to calculate gross pay

Ability to calculate gross pay for tipped employees

Knowledge of impact of stock awards

Knowledge of impact of stock purchases

Knowledge of special accounting rule

Knowledge of federal standard mileage rates

Knowledge of educational assistance income inclusion

Knowledge of educational assistance income exclusion

Knowledge of awards and prizes income inclusion

Knowledge of awards and prizes income exclusion

Knowledge of transit/parking/commuting taxation/limits

Ability to calculate employer paid taxes (gross-up)

Ability to calculate imputed income (e.g. GTL, personal use of company car, mileage)

Knowledge of taxable income (e.g., fringe benefits, personal use of company car, mileage, relocation, awards and prizes)

Knowledge of non-taxable income (e.g., fringe benefits, personal use of company car, mileage, relocation, awards and prizes)

Ability to calculate federal taxable wages (fit, social security, Medicare)

Ability to calculate supplemental income

Ability to calculate hours worked (e.g. regular, overtime)

Net, Disposable, Take Home Pay

Ability to calculate net pay

Ability to calculate disposable earnings

Ability to calculate take home pay

Ability to calculate total payroll (gross pay, voluntary/involuntary deductions, employer cost)

Part 1: Gross Income and Wages under the IRC

Think logically: If the benefit received is a result of employment relationship and is not business-related, the benefit is likely taxable, unless a specific rule exempts it from taxation

Taxable defined is generally

- Included in taxable wages (W-2)
- Subject to federal income tax withholding
- Subject to social security withholding
- Subject to Medicare withholding
- Subject to employer-paid federal unemployment tax (FUTA)

Fringe Benefits under the IRC

Taxable includes but not limited to…

- Wages
- Bonuses

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- Stock
- Awards/Prizes
- Personal use of a company car

Nontaxable includes but not limited to…

- No additional cost services
- Working condition fringe
- De minimis fringe
- Qualified expenses

📄 A great resource to use for studying or research is the IRS publication on benefits, Publication 15-B.

Fair Market Value

Fair Market Value = Amount someone would pay for the item/benefit in an "arms length transaction"

Use FMV to record the value of a taxable fringe benefit unless special valuation rules apply

FMV for "non cash" fringe benefit becomes "wages"

Non taxable Fringe Benefits

No Additional Cost Services

A service regularly offered for sale by the company, offered to employees for free

The employer can bear *no substantial additional cost*

- 🕮 Empty seat in an airplane for airline employers
- 🕮 empty room in hotel for hotel employees
- 🕮 Free park admission for park employees

Qualified Employee Discounts

Price reduction given employees on property/services a company offers

Property or stock – excluded

- 💰 Discount cannot be more than 20% of regular customer price

or

- 💰 Discount cannot be more than gross profit percentage
- 💰 Cannot offer discount *only* to highly compensated employees

Working Condition Fringe

Property/services provided to employee to do their job

📖 training)

📖 *business* use of a car

📖 T&E reimbursements for *business* activity

De minimis fringe benefit

Value is so small & use is infrequent that accounting for it would be unreasonable

📖 Personal use of copy machine

📖 Occasional party/picnics

📖 Personal use of a cell phone

📖 Cash/gift cards or any cash equivalent is *never* de minimis!

Some More…
Non Taxable Fringe Benefits

📖 On premise athletic facility

When used primarily by employees & their families

📖 Qualified retirement planning

For employers who offer a qualified retirement plan

Qualified Transportation Fringes

💰 Combined commuter highway vehicle & transit passes 2014 up to $130/mo

💰 Parking 2014 Up to $250/mo

💰 Bicycle 2014 $20 per qualified bicycle commuting month

- Must us bicycle for substantial commuting from home to work
  - Not eligible if receive commuter or parking benefit
  - If reimbursed at a higher rate, difference is taxable

✎ M. I. Favorite Employer is located in NYC & reimburses Sally Staffer $275/mo for a subway pass in July 2014.

- What amount is included in her taxable wages for the reimbursement?

  $275 reimbursed

  $130 qualified reimbursement allowed

  $145 reportable/subject to withholding

✎ A downtown employer reimburses Joe Slacker $200/mo for a parking pass in September 2014

- What amount is included in Joe's taxable wages for the reimbursement?
- What portion is subject to tax withholding?

  $200 reimbursed

  $250 qualified reimbursement allowed

  $ 00 reportable/subject to withholding

📖 Qualified (only certain) moving expense non taxable – as defined by IRS

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📖 Business Expenses – nontaxable as long as it is reimbursed via an accountable plan and expenses are substantiated

Taxable Fringe Benefits

- Personal Use of a company car
- Group Term Life Insurance
- Relocation (except for qualified expenses)

Personal use of a company car

Generally a fully taxable benefit

Can be de minimis if…

- Car primarily used for business
- Very infrequent personal use
- Qualified non-personal use vehicles (police cars, delivery trucks, buses)

Valuation Methods

General Valuation Method

Fair Market Value: price an individual would pay in an arms length transaction

Hard to define if auto used for both personal and business

Commuting Valuation

Value: $1.50 per one way or $3.00 per round trip

Can be used if:

- Owned/leased by employer
- Employee is required to commute in vehicle
- Other than commuting, personal use is prohibited
- Not a control employee

Rigid, Inc. required Sam Driver to commute to work 6 days per week in his company vehicle. During the 13 week quarter ending 6/30, Sam had perfect attendance. Using this method, determine how much should be added to Sam's W-2 as taxable wages for personal auto use for the quarter?

- What amount is included in Sam's taxable wages for commuting in a company vehicle?

  $ 3 per day round trip commute

  x 6 days per week

  $18 per week taxable value

  x 13 weeks

  $234.00 taxable to employee

Cents per mile

Value: $0.56 cents per mile – 2014 Can be used if:

- Auto regularly used for business
- Is driven > 10,000 miles per year by employee
  - To use Cents Per Mile valuation method, the FMV cannot exceed cannot exceed $16,000 for a car or $17,300 for truck or van placed in service in 2014
  - Reduced by $0.055/mile if employee pays for fuel

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Dan Speedy drove 18,000 business and 12,000 personal miles during the first 6 months of 2014 in his Stingy Corp company car. It was placed in service in 2014 & valued at $15,900. His employer paid for only the gasoline for the business use. Using the cents per mile method, calculate the related value of this taxable fringe benefit.

$0.560 2014 Cents per mile rate
-$0.055 reduction for employee paid fuel
$0.505 net cents per mile rate
x12,000 personal miles driven
$ 6,060 taxable value to employee

Annual Lease Value

- Based on fair market value of the auto
- Uses the annual lease value table found in IRS Pub 15-B (2014 pg 25) and the Payroll Source on page 3-21
- Percentage of "personal" use of the vehicle
- If employer pays for fuel, add $0.055 per mile or actual fuel cost

Steps for processing:

- Determine percentage of total use which is personal
- Determine annual lease value from IRS table (based upon FMV of auto)
- Multiply percentage of personal use by annual lease value
- Add cost for employer paid fuel (if applicable)

Bob Ledfoot drives a co car valued at $26,000. He drove 15,000 business miles and 5000 personal miles in 2014. Bob paid for the gas for his personal use. What amount is taxable to Bob for his personal auto use?

15,000 business miles driven
+5,000 personal miles driven
20,000 total miles driven
5000 / 20,000 = 25% personal use
$26,000 value = $7250 annual lease value
$7250 x 25% = $1812.50 taxable

G. I. Speed drives a company car valued at $23,000. He drove 4000 personal and 16,000 business miles. His employer paid for all gasoline. On what value should Dale's tax withholding for this fringe benefit, be calculated?

16,000 business miles driven
+4,000 personal miles driven
20,000 total miles driven
4000/20,000 = 20% personal use
$23,000 value = $6350 annual lease value
$6350 x 20% = $1270
4000 personal miles x $0.055 fuel = $220
$1270 + $220 = $1490 taxable value

Personal Plane Use

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- General Valuation – Fair market value
  OR
- Non-commercial flight valuation
  - Based upon SIFL (standard industry fare level) rates
  - Aircraft multiples - plane weight
  - If >50% capacity is business, non taxable

Additional Employer-Provided Benefits

Group Term Life Insurance

- Coverage up to $50,000, excluded
- For value of benefit >$50,000:
  - Do include in federal taxable wages (W-2 box 1)
  - Do not pay FUTA
  - Federal tax withholding not required
    - employer may withhold if they so choose
  - Do include in Social Security & Medicare taxable wages (W-2 boxes 3 & 5)
  - Do withhold Social Security & Medicare
    - Do report on W-2 box 12, code "C"

Steps for calculation:

1. Determine value (include ee paid benefit)
2. Calc benefit over $50,000
3. Divide excess by $1000
4. Determine employee's age as of 12/31
5. Use IRS table (Source pg 3-29 or Pub 15-B pg 13) to find FMV of benefit *per month* & multiply by result of step 3
6. Subtract "employee pd" "after tax" contributions



Stella Worker will be 42 in November. Her employer provides an employer fully paid Group Term Life policy equal to three times her annual salary. Stella earns 25,000.00 per year. What GTL amount should be included in her social security & Medicare taxable wages on her W-2?

$25,000 x 3 = $75,000 benefit
$75,000 - $50,000 = $25,000 taxable
$25,000 / $1000 = $25 monthly benefit cost
IRS Table equiv cost: 42 year old = $0.10/mo
$25 benefit x $0.10 = $2.50 monthly benefit
$2.50 x 12 months = $30.00 FICA taxable



Bob Rich started a new job at the WRM Fuzzy Corp on 12/1/2014. He was given a GTL benefit of 2 times his annual salary. He earns $75,000 per

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year. He will be 53 years old as of 12/31. He pays $10/mo for his life insurance benefit. What amount should be added to box 1 on his 2014 W-2? How much federal tax should be withheld for this benefit?

$75,000 x 2 = $150,000 GTL Benefit
$150,000 - $50,000 = $100,000 taxable
$100,000 / $1000 = $100 monthly benefit cost
IRS Table equiv cost: 53 year old = $0.23/mo
$100 benefit x $0.23 = $23.00 monthly benefit
$23.00 - $10/mo paid by Bob = $13 taxable
Benefit for December added to box 1: $13.00

Dependent Life Insurance

- Benefit up to $2000 for spouse or children
  - *Not* includable as income
  - Benefits greater than $2000, use same valuation method
- Benefits for ex employees & retirees
  - Same valuation
  - Uncollected SS & Med reportable on W-2 in box 12 codes M & N
- If benefits is in favor of key employees
  - Entire value is taxable (no exclusion for first $50K)
  - Entire value is subject to Fed, Med & SS withholding

Relocation - Non taxable

To meet the qualifications to be nontaxable, relocation expense reimbursements must meet time and distance test:

1. New work place >50 miles farther from old residence than old job was
2. Ee must work full time > 39 weeks during next 12 months

Moving household goods

- Packing
- Moving
- In transit storage (within 30 days of move)

Travel to new home

- Up to $0.235 per mile 2014
- Lodging (must be reasonable)
- Meals are *not* excluded (relocation related meals are always taxable)

Reporting of qualified non taxable moving/travel expenses to new home

- "Qualified" moving expenses excludable under IRC Section 132
- W-2 Box 12, code "P" if paid directly to the employee
- If paid directly to Third Party - not reported on W2 at all

Taxable Relocation

Everything else = fully taxable, reportable & subject to withholding for all statutory taxes

- Meals
- House hunting trips
- Temporary living

John Vagabond moved from OH to MO (1000 miles) to take a new position with his company. John moved on June 15 2014. His employer reimbursed John for the following:

- $8,000.00 to pay the moving co for transporting his household goods 1000 miles
- $500.00 for lodging for house hunting trips
- $0.15 per mile for his final trip to his new home
- $400.00 for lodging for his final move to his new home
- $50.00 for meals for his final move to his new home

What amounts would be added to John's W-2 for these payments in boxes 1 and 12? What amount is subject to tax withholding?

W-2 Box 1:

Box 1 – Federal Taxable

$500 for lodging for house hunting trips

$ 50 for meals (final move) to his new home

$550 Federal Taxable & subject to withholding

W-2 Box 12 (code P) [Qualified]

$8,000 to pay the moving co*

$ 150 ($.15 per mile for his final trip)

$ 400 lodging for his final move

$8,550 Non Taxable Moving Exp (box 12, code P)

*if the employer paid the moving co directly, then this amt would be excluded from box 12

Sarah took a new position for her company 400 miles from her previous work location & her company paid the following moving expenses:

- $4000 directly to the moving company for packing and storage
- $575 for lodging & meals for house hunting trips
- $0.50 per mile for her final move to her new home

What amounts would be added to Sarah's W-2 for these payments?

– In Box 1?

– In Box 12?

What amount is subject to tax withholding

Box 1 Federal Taxable Wages & subject to withholding

$575 lodging/meals

$106 mileage ($0.265/mile times 400 miles)*

$681 Federal taxable

**Only $0.235/mile is excludable ($0.50 - $0.235 = $0.265/mile is taxable)*

Box 12, code P ("qualified" / non taxable)

400 miles

$0.235 per mile*

$ 94.00

*$0.235 of the $0.50/mile is excludable for her final trip

**as employer paid $4000 to the moving co directly, then this amt is not reported in box 12

Continued next week…..

Validate Your Progress

Employee Benefits

- ☐ Knowledge of impact of taxable benefits
- ☐ Knowledge of impact of non-taxable benefits
- ☐ Knowledge of a qualified plan (i.e. retirement plans, sec. 125, awards, moving)
- ☐ Knowledge of a non-qualified plan (i.e. retirement plans, sec. 125, awards, moving)
- ☐ Knowledge of imputing fringe benefits

Regulatory

- ☐ Knowledge of IRS regulations impacting payroll
- ☐ Knowledge of IRS sec 129 (components of exclusion and limitations)
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  Knowledge of accountable and non-accountable plans (e.g. business expense)
- ☐ Knowledge of federal tax requirements for stock awards and purchases
- ☐ Knowledge of taxation of wages paid to deceased employees
- ☐ Knowledge of taxation of imputed income (e.g. GTL, moving expense, etc.)
- ☐ Knowledge of allocated tips
- ☐ Knowledge of adoption assistance
- ☐ Knowledge of repayment of employer provided loans
- ☐ Knowledge of supplemental wages

Reporting

- ☐ Knowledge of Form 4070 requirements
- ☐ Knowledge of Form 8027 requirements
- ☐ Knowledge of employee tip reporting

Compensation/Benefits

- ☐ Ability to calculate gross pay
- ☐ Ability to calculate gross pay for tipped employees
- ☐ Knowledge of impact of stock awards
- ☐ Knowledge of impact of stock purchases
- ☐ Knowledge of special accounting rule
- ☐ Knowledge of federal standard mileage rates
- ☐ Knowledge of educational assistance income inclusion
- ☐ Knowledge of educational assistance income exclusion
- ☐ Knowledge of awards and prizes income inclusion
- ☐ Knowledge of awards and prizes income exclusion
- ☐ Knowledge of transit/parking/commuting taxation/limits
- ☐ Ability to calculate employer paid taxes (gross-up)
- ☐ Ability to calculate imputed income (e.g. GTL, personal use of company car, mileage)
- ☐ Knowledge of taxable income (e.g., fringe benefits, personal use of company car, mileage, relocation, awards and prizes)
- ☐ Knowledge of non-taxable income (e.g., fringe benefits, personal use of company car, mileage, relocation, awards and prizes)
- ☐ Ability to calculate federal taxable wages (fit, social security, Medicare)
- ☐ Ability to calculate supplemental income
- ☐ Ability to calculate hours worked (e.g. regular, overtime)

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Net, Disposable, Take Home Pay

- ☐ Ability to calculate net pay
- ☐ Ability to calculate disposable earnings
- ☐ Ability to calculate take home pay
- ☐ Ability to calculate total payroll (gross pay, voluntary/involuntary deductions, employer cost)

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