

STATE CONTROLLER'S OFFICE
PERSONNEL/PAYROLL SERVICES DIVISION
P. O. BOX 942850
Sacramento, CA 94250-5878

DATE: May 23, 2006

PAYROLL LETTER #06-006

TO: All Agencies/Campuses in the Uniform State Payroll System

FROM: JOHN R. HARRIGAN, Chief
Personnel/Payroll Services Division**FRINGE BENEFIT/EMPLOYEE BUSINESS EXPENSE REPORTING**

This Payroll Letter provides informational and reporting reminders regarding Fringe Benefit/Employee Business Expense (FB/EBE).

FB/EBE's generally represent taxable and reportable income. Unless FB/EBEs are fully or partially excluded by the Internal Revenue Code (IRC), they are taxable upon constructive receipt by the employee. Although the rules and regulations affecting the taxing/reporting of FB/EBEs are complex, the department/campus authorizing/providing these FB/EBEs is responsible for insuring that all requirements, including reporting of FB/EBEs are followed.

DEFINITION OF A FRINGE BENEFIT (FB):

Fringe Benefits or perks are defined as "something additional to regular pay, which an employee receives from an employer." Types of FB can be cash, cash equivalents, goods, property, and services. FBs provide immediate economic and financial benefit to employees. Taxable FBs are subject to: Federal Income (FIT) and Social Security/Medicare (SS/MED) taxes; usually subject to State Income tax (SIT) as most State tax laws mirror Federal law. Taxes are due, payable and income reportable when an employee constructively receives the FB. For example, if a department paid an employee \$20 for commute mileage (personal vs. Business expense) incurred on a weekend that the employee worked overtime, taxes must be withheld and reported.

DEFINITION OF AN EMPLOYEE BUSINESS EXPENSE (EBE):

Employee Business Expenses represent costs for conducting business and when paid by the employee vs. the department, can be claimed as a legitimate business deduction when the employee files a tax return. An EBE can be cash, goods, property, training, and services. A EBE may/may not represent taxable, reportable income. Generally, EBE reimbursements are non-taxable and non reportable when two conditions are satisfied. An expense reimbursement or an advance issued by a department/campus, must be under an IRS defined reimbursement or related allowance plan that qualifies as an "accountable plan." To be considered an "accountable plan", the department/campus must adopt an expense reimbursement arrangement that must satisfy the following three IRS conditions:

- Business Connection - Payments made under the plan must be for work related expenses for which the employee would be entitled to claim a tax deduction if not reimbursed by the employer; and
- Substantiation - Employees must substantiate, within specific time frames (as determined by the system-wide employer and consistent with IRS rules), the amount (receipts), time, place and business purpose of the allowance or expense payment. In lieu of substantiation for selected expenses, an employer can use IRS approved “deemed substantiation” methods. Deemed substantiation methods apply to only IRS selected EBEs; and
- Return of excess payments - Employees must be required to return and return timely, as specified within the employer’s selected plan, all amounts that exceed substantiated expenses. Employees failing to return surplus amounts, timely or at all, invoke an immediate tax liability for the entire amount. Failure of the employer to withhold and report these amounts timely can result in fines, penalties, etc. including IRS prohibiting the employer from providing this EBE to employees.

The IRS also requires, as an administrative requirement, that EBE reimbursements or allowances be paid separately from regular wages or, if combined with regular wage payments, separately identified as a reimbursement for expenses. The EBE must satisfy all regulatory criteria tied to that expense. Many expenses, such as uniforms, have unique criteria that determine if all/or a portion of the uniform qualifies as a legitimate business expense. Other expenses, such as relocation, specifically detail what costs are/are not taxable. When an employer applies accountable plan provisions, if all regulatory criteria are not satisfied, the reimbursement represents taxable income. Taxable EBEs are subject to: Federal Income (FIT) and Social Security/Medicare (SS/MED) taxes; usually subject to State Income tax (SIT) as most State tax laws mirror Federal law.

FB/EBE’S THAT ARE REPORTABLE

Attachment A contains a list of current State of California FB/EBE’s that are reportable. Section N of the State Controller's Office – Payroll Procedure Manual (PPM) provides:

- FB/EBE definitions, general tax information/IRS requirements, related PPM references;
- detailed reporting requirements by FB/EBE type;
- withholding requirements, Form STD 675 and 676V/P completion instructions;
- description and volume 676 processing instructions;
- correcting document instructions;
- Special Accounting Period information and,
- program contacts and phone numbers

NOTE: The PPM can be accessed at <http://www.sco.ca.gov/ppsd/ppm/index.shtml>

FB/EBE REPORTING REQUIREMENTS

The State’s goal is that all departments/campuses comply with federal and state employment tax regulations. This requires each department/campus to report FB/EBEs on a timely, accurate, and comprehensive basis.

- Timely reporting - Under federal and state tax law, taxable and reportable FB/EBEs must be reported and taxes paid based upon constructive receipt. The Department/campus need to report taxable FB/EBE benefits to the State Controller's Office by the 10th of the month following the month that an employee receives a fringe benefit.

- Accurate reporting - entails proper completion of reporting documents.
- Comprehensive reporting – the department/campus must report all applicable FB/EBEs provided to employees, as defined in the Payroll Procedure Manual (PPM) Section N 100 – 175 and corresponding Payroll Letters.

SURGE REPORTING

Tax law precludes alternative reporting practices, such as surge reporting, created by employers for administrative ease, convenient, resource consideration, etc. Surge reporting occurs in two ways: first, an employer combines several months of taxable FB/EBE income and reports that income as if it were earned in a single month. Second, an employer provides taxable FB/EBEs to employees during the tax year but does not report these benefits until year-end. In essence, an employer reports annually versus reporting based upon constructive receipt (flow basis, monthly).

Surge reporting is neither legal nor a viable business practice. Employers practicing surge reporting are subject to a variety of tax authority compliance measures (fines, penalties, etc.). Likewise, surge reporting can impose an inappropriate financial burden on employees. It also creates disproportionate tax withholding from a single payment versus proportionate withholding from multiple payments under constructive receipt processing.

By complying with these requirements, the department/campus can prevent fines, penalties, and assessments being levied by tax authorities. It also reduces direct business costs stemming from retroactivity and corrected Forms W-2.

BUREAU OF STATE AUDITS (BSA) FB/EBE OVERSIGHT AUDITS

BSA performs an annual FB/EBE Program oversight function. This oversight targets FB/EBE underreporting and provides the “Internal Control and State and Federal Compliance Audit Report” to the State legislature and Governor’s Office each March. BSA requests FB/EBE reporting information from SCO and uses this information when setting up department/campus audit priorities. These audits demonstrate an example of the State’s ongoing “Due Diligence” effort to maintain FB/EBE tax compliance.

NOTE: Should a Internal Revenue Service and/or BSA audit occur regarding FB/EBE reporting, a department/campus is responsible to assist in the compliance activity, implement corrective measures and resolution of penalties and or fines.

RESOURCES

The following list of websites and publications are provided to assist in complying with FB/EBE reporting rules.

Websites

California Employment Development Department - www.edd.ca.gov/
 California Legislative Information www.leginfo.ca.gov/calaw.html
 Forms - Forms 676 p/v - www.osp.dgs.ca.gov/StandardForms/Default.htm
 IRS www.irs.gov/
 IRS Federal State and Local Government www.irs.gov/govt/fslg/index.html
 Social Security Administration www.ssa.gov/slge

State Controller's Office www.sco.ca.gov/

Calatters - California Automated Travel Expense Reimbursement System www.calaters.ca.gov

Publications

Pub 15 Circular E, Employer's Tax Guide

Pub 15-A Employer's Supplemental Tax Guide

Pub 15-B Employer's Tax Guide to Fringe Benefits

Pub 463 Travel, Entertainment, Gift and Car Expenses

Pub 521 Moving Expenses

Pub 525 Taxable and Nontaxable Income

Pub 535 Business Expenses

Pub 515 Withholding of Tax on Non-Resident Aliens and Foreign Corporations

Pub 901 US Tax Treaties

Pub 1976 Independent Contractor or Employee

CONTACTS

If you require additional assistance regarding this letter, please contact Alita Rivas, Tax Support Section at (916) 322-8128 or arivas@sco.ca.gov.

JRH: CWE:AR

Attachment

FRINGE BENEFIT/EMPLOYEE BUSINESS EXPENSE TYPES	Cash	Non Cash	Civil Service Only	CSU Only
Aircraft Reimbursement Plans	X			
Bicycle Mileage/Miscellaneous Bicycle Fees	X			
Call Back Mileage for Cars	X			
Car/Van Pool Transportation Subsidies		X		X
Commuter Highway Vehicles Program		X		X
Commuter Mileage for Cars	X			
Discount Travel/Transit Passes	X	X		
Educational Assistance/Allowance	X	X		
Electronic Devices	X	X		
Employee Recognition and Morale Program	X		X	
Employer-Provided Parking		X		
Entertainment Expenses	X			
Executive Housing Expense	X	X		X
Fee Waiver Program - Scholarships		X		X
Forgivable Loan/Doctoral Incentive Program		X		X
Gratuities	X			
Group Term Life Insurance (Legislators)		X		
Group Term Life Insurance (Non Legislators)		X		
Health and Safety Incentive Award	X		X	
Housing/Lodging - Reimbursement Plans	X	X		
Incentives Provided by Third Parties	X	X		
Loan Assumption Program		X	X	
Loan Forgiveness Program		X	X	
Long Term Travel - Meals and Lodging	X			
Lottery Sales Recognition Program		X	X	
Meals & Lodging – Meals Less than 24-Hour Travel, Medical Officer Of The Day, Non-Receipted Lodging, State Per Diem	X	X		
Merit Award Program		X		
Miscellaneous Incentive Programs	X	X		
Moving Relocation Expenses	X			
Moving Relocation Mileage Reimbursement	X			
Out-Placement		X		
Overtime Meal Compensation	X	X		
Personal Use of State Aircraft		X		
Personal Use of State Vehicle		X		
Professional/Nonprofessional Dues/Memberships	X	X		
Remote Headquarters Mileage for Vehicles	X			
Rideshare Incentive Award Program		X		X
Safety Incentive Award Program	X		X	
Standard Mileage Allowance for Cars	X			
Tickets		X		
Tips	X			
Tool Allowances	X		X	
Uniform Allowances	X	X		
Value of State Housing		X		
Van Pool Driver	X		X	
Vehicles Provided by Third Parties		X		