




# TAXABLE AND NONTAXABLE COMPENSATION

CHAPTER 3, Part II  
(2017)



# AWARDS AND PRIZES


- Generally taxable with the exception of Length of Service and Safety Achievement Awards:
  - Employer must be able to take a business expense deduction
  - Must be part of a qualified plan
  - General Requirements:
    - To qualify as deductible to employer award must be of “tangible personal property” not cash or cash equivalents, stocks, bonds, vacations, meals, lodging or tickets to theater or sporting events.
    - Must be presented in a “meaningful presentation”
    - Cannot be disguised compensation

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- Length of Service award must not be for less than five years of service to be deductible, can be retirement awards
  - Safety awards cannot be deductible if already presented to 10% of eligible employees during the taxable year and cannot be presented to managers, administrators, professional or clerical employees
  - A qualified plan is one that is written and does not discriminate in favor of highly compensated employees.
  - Average cost may not exceed \$400 in the tax year or they all lose their qualification
  - Maximum employer can write off for the tax year is \$1600 for one employee
  - Non qualified plan that meet the general requirements allow for a deduction limited to \$400 per employee per year
  - Excess of deductible amount included in income



# BACK PAY AWARDS


- Back pay subject to all taxes
- Damage awards received for personal physical injuries or physical sickness are excluded from taxation
- Punitive damages are included in taxable income less amounts attributed to medical care for emotional distress and in limited situations wrongful death
- Report on W2 except punitive damages reported on 1099-MISC box 3
- Courts and IRS don't always agree
  - Courts strictly interpreted the terms “for services performed by an employee for his employer” and “all remunerations for employment”

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- Reported in the year paid not earned for income tax withholding and reporting purposes
    - Interest and court costs are not includable as wages if distinguished from the back pay award
    - Attorneys' fees also included as wages
      - EE can take an “above-the-line” deduction on their personal tax return for unlawful discrimination law suites
  - Back pay is reported on current quarter form 941 and on form W2 in the year of award
  - Social Security and Medicare is reported in the applicable year if award is made under a statute otherwise reported in the year paid. Provide report to SSA (see page 3-73)
  - Payments under a statute are those under a court order including agreements approved by the court but not those negotiated between EE and ER



# DEPENDENT CARE ASSISTANCE

- Amounts paid by employer on behalf of employee are excluded from wages:
  - Up to \$5,000 per tax year (\$2,500 for married individuals filing separately)
  - Care must be “necessary” and must be for child under age 13 or disabled
  - Year expense is incurred not paid
  - Written plan
  - Cannot discriminate in favor of highly compensated and no more than 25% of the assistance may benefit shareholders or owners owning more than 5% interest in the company

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- Must provide annual statement by January 31 showing expenses incurred
  - W2 box 10 – full value including taxable amounts in boxes 1, 3 and 5
  - Value of Benefit – reimbursements during the year plus reimbursements after the year for assistance provided during the previous year
  - If actual facility value is based on “arms length transaction” or 125% of the direct cost of operating the facility



# GOLDEN PARACHUTE PAYMENTS

- Compensation paid to officers, shareholders, or highly compensated employees after a change in control
- Equals at least 3 times the employee's average compensation during the five most recent tax years. Excess is the portion that exceeds the employee's five year average compensation
- Payment is treated as income subject to all taxes and excess is further subject to a 20% excise tax which is reported in box 12 code "K"

# DETERMINING GOLDEN PARACHUTE AMOUNT SUBJECT TO EXCISE TAX

Golden Parachute payment of \$2,000,000			
Year	Annual Salary		
2016	640,000.00		
2015	600,000.00		
2014	574,000.00		
2013	535,000.00		
2012	500,000.00		
Total 5 years	\$2,849,000.00	Divide by 5	\$569,800.00
			Average
Golden Parachute payment of 3 times average:			\$1,709,400.00
			Parachute payment up to this amount not subject to 20% excise tax
Taxable Parachute payment is excess of average:			\$290,600.00
			Parachute payment in excess of average subject to 20% excise tax



# JURY DUTY PAY

- If full salary is paid, fully taxable
- If difference of what government pays and salary, only amount employer pays is taxable
- If full salary is paid but employee must turn over check from government to employer difference is taxed



# LEAVE-SHARING PLANS

- Medical Emergency Leave Plans
  - EE donate a certain number of PTO days that are deposited in a leave bank
  - Used in emergencies by participants when their PTO is exhausted
  - Treated as wages and subject to all employment taxes to those who use it not those who donate it
  - Individuals donating the leave cannot take charitable contribution tax deduction on their tax return



# EMPLOYEE LOANS

- Difference between interest charge and federal interest rate results in taxable income when combined amount of all outstanding loans is  $> \$10,000$
- Subject to taxation but not withholding for FIT and reported on W2 as income
- If ER forgives the debt the full amount is taxable and subject to withholding in the year it is forgiven



# MILITARY PAY

- Supplemental military pay; the difference between wages less what is received from the government:
  - Considered wages subject to all employment taxes if for temporary duty such as National Guard or Armed Forces Reserve
  - Active duty (more than 30 days) –Differential payments treated as wages except for FICA and FUTA
  - Benefits are treated same as other active employees
  - Those on active duty may continue to contribute to 401k, 403B or 457 EE deferrals are reported on W2 box 12.
  - EEs returning from active duty may make retroactive deferrals




# STOCKS AND STOCK OPTIONS

- ER provides stock as part of compensation package for services rendered
- FMV of stock transferred to EE without restriction is wages subject to all employment taxes
- Incentive Stock Options:
  - No tax withholding or recognition of income until stock is sold if:
    - Approved by corporation's shareholders
    - Exercised within 10 years
    - Price is equal to FMV at grant date



## ■ Nonqualified Stock Options (nonstatutory)

- Allows EEs to buy ER stock at a fixed price for a certain period of time without conditions
- When exercised EE receives amount equal to the excess of what EE paid and the excess value of the stock
- Treated as ordinary income for taxation and reporting purposes
- Treated as supplemental wages
- Reported in box 12 code “V”
- Constructive receipt is considered to be the settlement date; when shares are available in EE’s brokerage account, typically 3 days after exercise date

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- **Nonqualified Options Transferred as Part of a Divorce** (QDROS Qualifying Domestic Relations Order):
    - Under most state laws considered to be marital property subject to equal division
    - When non-employee spouse exercises options they are considered income to her/him in the amount excess of FMV and exercise price for FIT and SIT purposes.
    - Income reported on form 1099-MISC box 3, withholding in box 4
    - Non-employee spouse also pays FICA taxes but FICA wages are credited to EE and reported on his/her W2
    - Also FUTA taxable



# TIP INCOME AND REPORTING

- \$20 or more in cash tips per month – EE must report to ER by 10<sup>th</sup> of following month
  - Form 4070 Employee's Report of Tips to Employer
- ER must withhold taxes in the following priority:
  - SS & M/C on regular wages
  - FIT on regular wages
  - SS & M/C on tips
  - FIT on tips
  - Withholding on tips is reported in box 4 & 6 respectively.  
Uncollected SS & M/C taxes must be reported on W2
  - Box 12 code "A" for SS
  - Box 12 code "B" for M/C
  - ER pays its full share, including FUTA regardless if EE's share is collected or not



# WAGES PAID TO DECEASED EMPLOYEES

- If EE received check prior to death but is not cashed when death occurs, no impact
- Wages paid after death in the same year
  - Not subject to FIT and reported on form 1099-MISC box 3 to estate (no withholding required)
  - FICA reported on EE W-2
  - Subject to FUTA
- Wages paid after death in subsequent year
  - No wages reported on W2, reported on 1099-MISC to estate

# EXAMPLE OF DECEASED EE PAYMENT

<b>Wages Paid to Deceased Employees</b>		
<b>Paid before death but not cashed until after death</b>		
Gross Amount	4,000.00	Reported on W2 as normal. Reissue check in the name of beneficiary but no 1099MISC reporting.
FIT Taxable & Tax Withholding	4,000.00	
SS Taxable & tax Withholding	4,000.00	Up to limit
M/C Taxable & Tax Withholding	4,000.00	Keep in mind additional M/C
FUTA Taxable & ER Tax	4,000.00	Up to limit
<b>Paid after death in the same year as death</b>		
Gross Amount	4,000.00	
FIT Taxable	0.00	Full amount is reported to beneficiary on form 1099MISC Box 3
SS Taxable & Tax Withholding	4,000.00	Up to limit
M/C Taxable & Tax Withholding	4,000.00	Keep in mind additional M/C
<b>Paid after death in the year after death – No W2 Impact</b>		
Gross Amount	4,000.00	
FIT Taxable	0.00	Full amount is reported to beneficiary on form 1099MISC Box 3
SS Taxable	0.00	
M/C Taxable	0.00	

Keep in mind limitations under state laws when paying out wages to a beneficiary