25th Annual Health Sciences Tax Conference

Employment tax update – keeping up to speed

December 7, 2015
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Agenda

► Introductions
► Fringe benefits
  ► Subsidized cafeterias
  ► Identity theft services
  ► Wellness benefits
  ► Employee loans
  ► Non-qualified deferred compensation
  ► Same-gender spousal benefits
  ► Employer-provided housing
► Business expenses
  ► Employee travel
Agenda

► US and state cross-border employment
  ► Inbound/nonresident aliens
  ► Telecommuter
  ► State unemployment

► IRS information reporting
  ► Penalty increases
  ► Honorariums
  ► Medical services
When is the company cafeteria tax-free?

- **Tax-free meals**
  - On an annual basis, revenue from the facility equals or exceeds cost

- **Subsidized meals**

- **No-cost meals**
  - Emergency personnel eat on premises for employer convenience/food service employees during hours of work
  - Business meetings of two or more and substantiation is provided
  - Overtime meals or occasional and infrequent group events or individual recognition
Identity theft services aren’t taxable

- The IRS stated in Announcement 2015-22 that identity protection services are excluded from gross taxable income when provided to customers, employees or other individuals whose personal information may have been compromised in a data breach.
- The IRS cautions that the exclusion from gross taxable income doesn’t apply to cash in lieu of identity protection services or when identity protection services are provided for reasons other than a data breach (e.g., given in connection with an employee’s compensation benefit package).
Wellness benefits

- Wellness programs include activities such as company-sponsored exercise, weight-loss competitions, educational seminars, tobacco cessation programs and health screenings that are designed to help employees eat better, lose weight and improve their overall physical health.

- Wellness programs often involve financial incentives for employees, such as lower health insurance premiums, gym membership subsidies or even gift cards.

- Most of these benefits are taxable and reportable as Form W-2 wages.
  - They are often paid by a third party, such as a health insurance provider.
    - Smoking cessation may be excludable as a medical expense.
    - Weight loss for morbidly obese persons may be excludable as a medical expense.
Employee loans
IRS rules for tax-free status

► Interest-free or below-market employer loans are tax-free if:
  ► They are provided to employees
  ► There is a promissory note between employee and employer
  ► There is an intent to collect loan payments
    ► Evidence that organization does initiate collection activities

► If the employee’s daily aggregate loan balance with the employer exceeds $10,000:
  ► Interest must be charged at no less than the federal interest rate, or imputed income is realized based on federal interest rate.

► There are no “safe harbors” or bright-line tests for employee loan programs.
Employee loans
Health industry uses of loan agreements

- The health industry frequently uses loan agreements in the context of:
  - Physician start-up practice loans
  - Relocation/housing loans
  - Medical resident/stipend loans
Employee loans
Is it a bona fide loan or simply a taxable wage advance?

Positive factors
► Documentary evidence of transaction (e.g., executed note) exists.
► There is a fixed schedule for repayment, including maturity date.
► Interest is being charged on outstanding debt.
► Collateral is obtained or requested.
► Demand for repayment is made.
► Repayments have been made.
► Transaction is reflected as debt in the books and records of the parties.

Negative factors
► It is available to employees solely as an inducement for employment (competitors are offering loans).
► Loan offer is available to every recruit.
► There are no terms or conditions for loan repayment.
► Loan is interest free or below market.
Employee loans
Case in point – physician guarantees

The Vancouver Clinic, Inc. v. United States, 111 AFTR 2d 2013-1571 (W.D. Wash., 2013)

► Facts:
  ► The clinic provided advances of the funds for the first and second years of physicians’ employment.
  ► Physicians were required to repay the loan only if they left the clinic before five years.
  ► Agreements required interest to be accrued but interest was not required to be paid unless employees left the clinic before the five-year term.
  ► The clinic did not have adequate financial accounting processes to record amounts as loans.

► Conclusion:
  ► Advance payments to newly recruited physicians in exchange for remaining with the clinic for five years were wages and not loans in year advanced, not year that “loan” was forgiven.
  ► Income tax withholding and employment tax was required at the time the “loan” was made available.
Employee loans
Leading practices

► Define use of loan proceeds in line with the bona fide purpose of the loan
► Restrict participation in the loan program so that it is not available to a majority of employees
  ► A prevalence of the employee population participating in a loan program is an indicator to taxing authorities of a taxable employee benefit.
► Keep the loan agreement separate from the offer of employment
► Maintain and retain board minutes authorizing the loan program

Board meeting details
► Document in board minutes authorization of program, including:
  ► Loan program is justified to recruit physicians for specific underserved specialty or geography
  ► Program proceeds expected to be used for appropriate purposes
    ► Enable a physician to complete training
    ► Provide affordable living in service area
    ► Meet need for specialized health service providers by relieving recruits of student loan burden, assisting them to obtain housing in safe neighborhoods, etc.
Non-qualified deferred compensation (NQDC)
Potential employee litigation risk

FICA/additional Medicare tax
► At time of vesting (special timing rule)
► Increase/decrease in balance not taken into account after vesting (non-duplication rule)
► If not taxed at vesting, taxable on balance in each year of distribution

Employee litigation for employer failure to use FICA special timing rule
► A federal district court ruled in 2015 that employer was liable for damages because of increased FICA taxes employee paid due to employer’s failure to use special timing rule (Davidson v. Henkel Corporation, DC MI, 115 AFTR 2d 2015-369, 1/6/15)
► Employees could pay more FICA and additional Medicare tax due to employer’s failure to include NQDC in wages in year of vesting

Federal income tax
► At time of distribution
► Report in Form W-2, box 11 amounts in Boxes 1 or 3 earned in a prior year

Correcting FICA timing errors
► Special timing rule may be retroactively applied for the statute of limitations (three years)
► Beyond the statute of limitations, special timing rule no longer available and FICA is computed on ending balance in each year of distribution
► When computed in year of distribution, taxable up to the Social Security wage base in the year of distribution vs. special timing rule where NQDC likely only subject to Medicare tax
Supreme Court rules states cannot ban same-gender marriage in *Obergefell*

► In *Obergefell v. Hodges*, the US Supreme Court ruled that the Fourteenth Amendment requires that all states license marriage between two people of the same gender and recognize same-gender marriages lawfully licensed and performed in another state.

► The ruling implicated 14 states that had previously taxed same-gender spousal benefits as of January 1, 2015.

► The state impact is retroactive for the entire calendar year for those married on January 1.
Same-gender spousal benefits
Six things you need to do this year

1. Correct your 2015 state/local income tax withholding rules as soon as possible and minimize year-end volume

2. Remind employees in affected states that they may need to revise their state withholding allowance certificates

3. You may have overpaid your unemployment insurance. Consider if refund claims are worthwhile

4. If you grossed-up state/local income tax, consider making adjustments for 2015 (resulting in tax credit to the employer)

5. Keep in mind that, at least for now, domestic partner benefits are tax-free in some states. Watch for changes in future years

6. Consider giving employees time to marry before terminating domestic partner benefits
Employer-provided housing

► Not taxable if:
  ► For the employer’s convenience, employee must work on or near business premises for bona fide business purposes (e.g., emergency on-call medical staff)
  Or
  ► Temporary (less than one year) work assignment away from the employee’s regular work location

► Taxable amount is fair market value of housing in an arm’s-length transaction
Business expenses
Business vs. personal travel
Personal travel is not deductible and taxable if reimbursed

- **Family home**
  - Employee’s permanent residence or where the employee incurs regular living expenses, registers a vehicle or registers to vote

- **Itinerant**
  - Has no family home and travel expense reimbursements are always taxable

- **Tax home**
  - General metropolitan area of regular work location

See IRC §132(d); IRS Reg. §1.132-5(a)(2); IRC §274(d)
Business vs. personal travel
Temporary vs. indefinite

► Travel expense reimbursements (including employer-provided housing) for job assignments expected to last one year or more are taxable.

► The taxable event is triggered on the day the expectation changes, or as of one year, whichever occurs first.

See IRC §162(a)(2). Rev. Rul. 93-86
Travel reimbursement options

- Reimburse for actual travel expenses incurred
  - Documentation of time, place and business purpose
  - Receipts

- General Services Administration (GSA) per diem reimbursement
  - Documentation of time, place and business purpose
  - Receipts are not required

- High-low per diem reimbursement
  - Same as GSA method above, except that one rate applies for areas designated by IRS as high-cost areas and another rate applies to low-cost areas

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**High-low substantiation method**

Effective October 1, 2015 (optionally effective January 1, 2016)

<table>
<thead>
<tr>
<th>Description</th>
<th>High-cost area</th>
<th>Low-cost area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lodging, meals and incidentals</td>
<td>$275</td>
<td>$185</td>
</tr>
<tr>
<td>Lodging only</td>
<td>$207</td>
<td>$128</td>
</tr>
<tr>
<td>Meals and incidental expenses</td>
<td>$68</td>
<td>$57</td>
</tr>
<tr>
<td>Incidents only</td>
<td>$5</td>
<td>$5</td>
</tr>
</tbody>
</table>

See Notice 2015-63; Rev. Proc. 2011-47
Per diem reimbursements
Audit trap or tax overpayment issues

Tax underpayment risk
► Per diem is transferred to debit card without first verifying that:
  ► There is required distance between resident and work location address
  ► Employee has a fixed residence (itinerants)
  ► Documentation is available showing the work location address and business purpose of the travel and the expense was incurred (or returned by employee)
  ► The debit card includes funds only for per diem and substantiated business expenses

Basic requirements
► A per diem is not taxable to the extent it is equal to or less than the government-specified rate and there is documentation to support that (1) distance between residence and work place requires sleep or rest and (2) there is a business purpose for the travel. Employees cannot be given a per diem and, at the same time, be reimbursed for their portion of meal expenses that they incur as part of a business meeting.

Tax overpayment risk
► Per diem is automatically included in taxable wages despite documentation showing:
  ► Distance between resident and work location
  ► Resident and work location address and business purpose for travel
  ► That amount of per diem did not exceed the government-specified rate
► This practice was observed with some of our clients this year and resulted in significant FICA tax refunds.
US and state cross-border employment
### US inbound federal employment taxes

#### Nonresident aliens in the US

<table>
<thead>
<tr>
<th>1 Social Security and Medicare (FICA)</th>
<th>2 Federal Unemployment Tax Act (FUTA)</th>
</tr>
</thead>
</table>
| - These are applicable to wages connected with services performed within the US by most employees.  
  - Special rules apply to flight crews and members of vessels.  
  - Exclusion applies to employees holding these US visas: F1, J1, M1, Q1 or Q2.  
  - Employees who pay social tax in another country may claim exclusion if there is a totalization agreement between that country and the US (generally limited to five years). Employer must have certification of social coverage in the foreign country.  
  - For 2015, employee pays 6.2% on wages up to $118,500, 1.45% on all wages and 2.35% on wages over $200,000.  
  - For 2015, employer pays 6.2% on each employee’s wages up to $118,500 and 1.45% on all wages. | - This applies to all covered employers having employment within the US.  
  - An employer (including a foreign employer) is covered if:  
    - During any calendar quarter in the calendar year, or during the preceding calendar year, paid wages of US $1,500 or more  
    - Employed at least one individual for some portion of each day for 20 days during the calendar year, each day being in a different calendar week  
  - Exclusion applies to employees holding these US visas: F1, J1, M1, Q1 or Q2.  
  - For 2015, employer pays 6.0% on wages up to $7,000 per employee. A variable credit that reduces the rate may apply for unemployment insurance paid to the state(s). |
Federal income tax withholding
Nonresident aliens in the US*

<table>
<thead>
<tr>
<th>3 Temporary employment exclusion?</th>
<th>4 US permanent establishment (PE)?</th>
<th>5 Treaty eligible?</th>
</tr>
</thead>
<tbody>
<tr>
<td>► All wages earned in the US are subject to federal income tax withholding unless:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>► The employee is present in the US for a period of 90 days or less for the taxable year</td>
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<tr>
<td>► Compensation in the aggregate for the taxable year is $3,000 or less</td>
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<tr>
<td>► Services are provided for a foreign employer that has no US permanent establishment</td>
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</tr>
<tr>
<td>► Example: business visitors attending a meeting in the US for the benefit of the foreign employer [IRC §861(a)(3)]</td>
<td></td>
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</tr>
<tr>
<td>► While the US maintains treaties with a number of countries to prevent dual taxation, those treaties will generally stipulate that they do not apply if the employer has a PE in the US.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>► PE generally exists under a treaty if:</td>
<td></td>
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<tr>
<td>► Number of days in the US for the tax year is exceeded (e.g., for Canada treaty, 183 days)</td>
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<tr>
<td>► There is a fixed US location from where work is performed</td>
<td></td>
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</tr>
<tr>
<td>► The nature of the employee’s activities in the US triggers a PE</td>
<td></td>
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</tr>
<tr>
<td>► If the employer/employee qualify for a treaty exemption, federal income tax is not required if:</td>
<td></td>
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</tr>
<tr>
<td>► The employee completes, signs and gives the employer a Form 8233 with a US taxpayer identification number</td>
<td></td>
<td></td>
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<tr>
<td>► Wages exempt under the treaty are reported on Form 1042, 1042-S, 1042-T</td>
<td></td>
<td></td>
</tr>
<tr>
<td>► Nonresident alien is required to file Form 1040NR if US-sourced income equals or exceeds one personal exemption ($4,000 in 2015)</td>
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<td></td>
</tr>
</tbody>
</table>

* US resident (rather than nonresident) status applies to green-card holders and those meeting the physical presence test.
US nonresident alien employee tax onboarding
(state income and unemployment tax rules vary)

Form I-9 indicates US nonresident alien status?

Yes

FIT/FITW

Treaty exemption

Form W-4 special rules

Form 8233 required for exempt wages

Form W-4 subject to special rules

Form 1042-S to report exempt wages

Show “NRA” on Form W-4, Line 6

Cannot claim exempt

Status is single and not > one allowance*

Certificate of coverage required

Exempt from FICA

Show exempt wages on Form 941

Exempt under US visa

Exempt from FICA and FUTA

Applies to F1, J1, M1, Q1 or Q2 visas

Show exempt wages on Form 940/941

* This requirement does not apply to nonresidents of Canada, Mexico, South Korea or student business apprentices from India.
Telecommuter considerations
The home office could be a local business office

► If employees regularly work from home, the home office could be treated as a work location of the employer in many states (and localities).

► If the home office is deemed an employer work location, the business can be subject to income tax withholding, unemployment insurance and other business taxes.

► Failure to register with the state/local department of revenue in the employee’s home office states exposes the business to monetary and reputational risk.

Learn more at www.ey.com/us/getonboard
State unemployment insurance (SUI) sourcing rules (the four-pronged test)

**Employer**
- Where wages are paid
- There is a covered employee

**Covered employee**
- Applies only in one state at a time
- Temporary work incidental to main job location is not considered

The SUI state is where the employee performs some work and (in this order):
- Where the work is localized
- The employee’s base of operations
  Or
- The employee’s place of control
- If none of the above:
  - The employee’s residence

Source: US Department of Labor, Program Letter 20-04
IRS information reporting
Information reporting penalties increase
Effective with 2015 returns filed in 2016

How much will it cost?

► **First-tier penalty**: returns filed within 30 days after due date – $50 per return with a $500,000 cap. Formerly, the penalty was $30 per return, capped at $250,000.

► **Second-tier penalty**: returns filed after 30 days from due date but on or before August 1 – $100 per return with a $1.5 million cap. Formerly, the penalty was $60 per return, capped at $500,000.

► **Third-tier penalty**: returns filed after August 1 – $250 per return up to $3 million. Formerly, the penalty was $100 per return, capped at $1.5 million.

Insights

► This applies to Forms W-2, Forms 1099 and the new ACA information returns and statements.

► The maximum penalty is doubled from $1.5 million to $3 million.

► For errors involving both the employee/payee and the IRS/SSA copies, the maximum penalty is $6 million.

► You should carefully evaluate areas of known non-compliance.

► You should verify your system taxability configurations, including return mapping.
Honorariums
What are they?

► An honorarium is a payment to an individual for a presentation-oriented, invitational event, such as:
  ► A lecture or talk
  ► A colloquium
  ► An address
  ► A grand round
  ► Continuing education presentation or similar activity given to students, staff, faculty and/or the public at large
Honorariums
Taxation for foreign nationals

Honorarium Rule ("9/5/6" Rule)

Foreign nationals in B-1, B-2, visa waiver status may accept an honorarium and/or reimbursement of travel expenses under the following conditions:

- For “usual academic activity or activities”
- Nine days or less at the institution
- The individual has accepted such payment from no more than five educational or research institutions in the previous six-month period
Honorariums
Taxation for foreign nationals (cont’d.)

► An honorarium paid to a foreign national is subject to 30% withholding, unless the person can claim a tax treaty benefit.
► This withholding also applies to a nonresident alien entity.
  ► If treaty applies, Form 8233 with a US TIN required
  ► Report on Form 1042-S
► Travel reimbursement is not subject to withholding because it is generally not considered income.
  ► Report on Form 1042-S
Reporting payments to physicians
Form 1099, Box 6 for medical services

► Form 1099, Box 6 should include:
  ► Payments made in the course of trade or business to each physician or other supplier or provider of medical health care services
  ► Payments made by medical and health care insurers under health, accident and sickness insurance payment programs
  ► If the payment is made to a corporation, list the corporation as the recipient rather than the individual providing the services
  ► Payments to persons providing health care services, which include charges for injections, drugs, dentures and similar items should report the entire payment
  ► Physicians frequently ask that their income be assigned to another entity. Generally, need to review who was contracted – the physician personally, or the entity that the physician is asking the payment to be issued to
Reporting payments to physicians
Form 1099, Box 6 for medical services (cont’d.)

► Payments **not** required to be reported on Form 1099, Box 6 include:
  ► Payments made to a tax-exempt hospital or extended care facility, or to a hospital or extended care facility owned and operated by the US (or its possessions), a state, the District of Columbia or any of their political subdivisions, agencies or instrumentalities
  ► Payments to pharmacies for prescription drugs
Reporting payments to physicians
Payments for other types of services

► Physician payments that should be reported on Form 1099, Box 7, as opposed to Box 6, include:
  ► Medical directorship fees
  ► On-call fees
  ► Honorariums
Questions?
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