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Year-End 2020 May Not Be The "Same as Last Year" for Payroll Taxes and Compensation and Benefits

As 2020 draws to a close, we would like to remind you that this year-end may not be the same as 2019 when it comes to payroll taxes and compensation and benefits matters. This alert highlights various areas of change and what employers should be focusing on.

New Form for Reporting Non-Employee Compensation

A new form (Form 1099-NEC) is to be used to report 2020 non-employee compensation, replacing Form 1099-MISC. Entities of all sizes and types that would typically provide a Form 1099-MISC to independent contractors and the IRS need to be aware of new IRS Form 1099-NEC. Persons who paid income to non-employees during 2020 must provide the income recipient with a Form 1099-NEC and the form must be submitted to the IRS no later than January 31, 2021. Form 1099-MISC will continue to be used to report payments of certain royalties, rents, prizes and other payments of income (other than non-employee income). The form has been redesigned, so entities that use Form 1099-MISC should expect that reporting may differ somewhat from past years.

W-2 Reporting of FFCRA Qualified Sick and Family Leave Wages

Employers with 500 or fewer employees may wish to review IRS Notice 2020-54 (issued in July 2020) regarding how to report on employees' 2020 Form W-2 the amount of mandatory, federal paid sick and family leave that the employer paid to employees under the Families First Coronavirus Response Act (FFCRA). Employers must report such wages on Form W-2 or on a separate statement, even though the employer's out-of-pocket cost is zero after the employer receives federal payroll tax credits. The reporting requirement can be satisfied via Form W-2, Box 14 or on a separate statement.

Discriminatory Flexible Spending Accounts

Entities with health care or dependent care flexible spending accounts (FSA) that usually operate in a nondiscriminatory manner might be surprised by 2020 nondiscrimination testing if the highly compensation employees (HCE) had disproportionate usage of those benefits due to COVID-19 changes in work arrangements. For example, perhaps HCEs continued to pay third parties to care for their children while rank and file employees working from home did not, causing the average benefit provided to non-highly compensated employees to fall below the 55% level that is required to avoid taxation to the highly compensated employees. The results of discriminatory FSA can result in taxable compensation reportable on the HCE's 2020 Form W-2.

Personal Credits for Unused Nonrefundable Airline Tickets

During 2020, many employees obtained nontransferable credits from airlines for nonrefundable airline tickets that were originally purchased for a business trip that was canceled due to the coronavirus pandemic. Since the employee now has a personal credit with the airline that can only be used by the employee, employers may wish to consider whether they should tax this as property transferred to the employee in connection with the performance of services under Internal Revenue Code (IRC) Section 83, since the employee has unrestricted use of the airline credit (i.e., use of the credit is not limited to a business purpose). The answer depends on the facts and circumstances of the situation, so please contact your local advisor for more information.

COVID-19 Qualified Disaster Payments to Employees

Generally, anything of value that an employer provides to an employee is deemed to be taxable wages to the employee, unless an exception applies. Since COVID-19 was declared a national emergency on March 13, 2020, employers can use IRC Section 139 to make tax-free, tax-deductible "qualified disaster payments" to employees. Such payments can be made on tax-free basis until the national emergency is lifted.

With respect to COVID-19, employers can pay for, reimburse or provide in-kind benefits reasonably believed by the employer to result from the COVID-19 national emergency that are not covered by insurance. For example, employers could pay for, reimburse or provide employees with tax-free payments for over-the-counter medications, hand sanitizers, home disinfectant supplies, child care or tutoring due to school closings, work-from-home expenses (e.g. setting up a home office, increased utilities expenses, higher internet costs, printer, cell phone, etc.), increased costs from unreimbursed health-related expenses and increased transportation costs due to work relocation (such as taking a taxi or ride-sharing service from home instead of using public mass transit).

There is no Form W-2 or Form 1099 reporting for IRC Section 139 payments.

Leave Donation

Due to COVID-19, many employees canceled vacations, doctors' appointments, planned medical procedures, etc., leaving them with unused but accrued paid time off (PTO). Some employers allow employees to donate unused PTO to other employees who may need it. If not handled correctly, both the donating employee and the recipient employee may have taxable income. However, if IRS rules are followed, employers would not include the donated PTO in the donor's Form W-2 but would include it in the recipient employee's 2020 Form W-2. Also, Notice 2020-46 provides that cash payments that employers make to charities that provide relief to COVID victims in exchange for employees forgoing PTO are not taxable wages for the donor-employees and would not be included in the donor's 2020 Form W-2.

Higher Imputed Income for Personal Use of Company Cars

Personal use of a company car is imputed wage income for an employee. Employers can choose not to withhold federal income tax if the employee is properly notified by January 31 of the election year or 30 days after a vehicle is provided and the value is properly reported on a timely filed Form W-2. However, employers must withhold FICA taxes on such benefits.

Due to COVID-19 restrictions during 2020, some employees who use company cars may have experienced an unexpected shift in the percentage of business versus personal use of company-provided vehicles. As a result, some employees may have significantly higher imputed income because the company car was not used as much for business during 2020. For example, if the company car was parked at the employee's home (even if unused), the employee had personal use of the car for the period of time that the car was not used for business. This may come as a surprise to many employers and employees. The IRS has not yet published any relief that would change the normal imputed income inclusion rules for these circumstances.

Employer-Paid Student Loan Debt

During 2020, the CARES Act allows employers to pay up to $5,250 of their employees' student loan debt and not treat such payments as taxable wages. The payments can only be made under a non-discriminatory, written tuition assistance plan that complies with IRC Section 127.

Year-End Employee Benefit Plan Elections

Due to COVID-19 uncertainties, employees should carefully consider irrevocable elections that may have to be made by year-end with respect to certain 2021 employee benefits, such as health and welfare benefits provided under a flexible benefits plan (also known as a "cafeteria" plan under IRC Section 125). These elections could include dependent care flexible spending accounts or health care flexible spending accounts (both of which have "use it or lose it") rules. Employees should also consider whether any adjustments are needed to their qualified transportation fringe benefit elections for tax-free payments of parking, mass transit or other commuting benefits available under IRC Section 132(f). Although those elections can generally be changed monthly, year-end is a good time to carefully review any elections that employees may have in place.

Payroll Tax Deferrals

The CARES Act allows employers to defer the deposit of the employer's share of FICA on wages earned from March 27 to December 31, 2020, with 50% of the deferred amount required to be repaid by December 31, 2021 and the other 50% repaid by December 31, 2022. A presidential executive order allows employers to defer deposit of the employee's share of FICA on wages earned from September 1 to December 31, 2020, with repayment due ratably from January 1 to April 30, 2021. Both deferral opportunities expire on December 31, 2021, so employers should ensure that regular FICA tax withholding and deposit rules apply to wages earned on January 1, 2021.

Businesses should begin gathering data to analyze the potential impacts to property values. Consideration should be given to factors associated with any reduced revenue, increase in expenses, changes in the workforce, non-utilization of assets, deferred maintenance and additional requirements as a result of COVID-19. Detriments to value should be incorporated through personal property filing on the 2021 renditions, as well as through reviews of real property assessments to potentially lower real property values for the appeal deadlines throughout 2021.

Unclaimed Property

All states have laws regulating the reporting and remittance of unclaimed property (also referred to as abandoned property or escheat). Unclaimed property can include various types of intangible property, as well as some tangible personal property, depending on state law. Common types of unclaimed property include uncashed payroll or commission checks; uncashed vendor checks; unresolved voids, unredeemed gift certificates and gift cards; customer credits, layaways, deposits, refunds and rebates; overpayments and unidentified remittances; and accounts receivable credits, including credits that have been written off and recorded as income or expense (e.g., bad debt, miscellaneous income, etc.).

A holder of unclaimed property is required to report the property to the appropriate state after the time prescribed by the state has passed (the dormancy period). The purpose is to ensure that the property is returned to its rightful owner, the premise being that the state is in a better position to hold the property and return it to the rightful owner, and, in the interim, property held and derivative funds earned on the property may be used for the public good. Jurisdiction over unclaimed property is in the state of the rightful owner's address, and if the owner's address is unknown, the state where the holder is incorporated/formed; thus, even organizations that operate in only one state can have unclaimed property obligations in multiple states.

COVID-19 has significantly impacted how businesses address unclaimed property compliance for two main reasons.

First, many businesses have furloughed staff or implemented reduction in workforce measures that have created delays in complying with escheat compliance deadlines. Escheat compliance filings are categorized into (a) spring filings, January 1 through July 1, and (b) fall filings, October 31 or November 1. Some states, including California, Illinois, Michigan, Pennsylvania and Vermont, have granted extensions or waived penalties or interest (automatically or upon request) for the spring filings. However, no extensions or automatic waivers of penalties or interest have been provided for fall filings. Instead, most states have provided holders with online filing and payment instructions. Missed deadlines could result in penalties and interest or create additional audit risk.

The risk of penalties and interest is potentially increased based on the 2019 New York high court decision in New York ex. rel. Raw Data Analytics LLC v. JPMorgan Chase & Co., N.Y. Supp. Ct., No 100271/2015 (August 30, 2019, appealed October 3, 2019), in which the court ruled that JP Morgan was not entitled to judgment as a matter of law for its failure to self-assess and pay interest on late-reported unclaimed property. Presumably, if this case stands, holders in New York will be required to self-assess interest. Failure to do so could result in additional costs. Other states will likely follow suit.

Second, many businesses' finance, treasury and/or accounting functions operate on a remote work or hybrid platform. This makes reviewing state mailings or notices in a timely fashion or accessing manual records or ancillary systems to assist in escheatment projects difficult. For example, Delaware sends notices to holders requiring them to enter into the state's Voluntary Disclosure Agreement (VDA) program or risk being audited. Many holders missed the opportunity to enroll in the Delaware VDA program by failing to file the form within 60 days of receiving an initial letter from the state. This is largely because individuals were not in the office to receive and review the letter and distribute to appropriate management. Delaware sent letters February 20, 2020, and extended the VDA deadline to July 18, 2020, but many businesses still missed the deadline and received audit letters the following week. Furthermore, the inability to be in the office where necessary records are kept can result in delays in compliance with voluntary disclosure and audit requirements. To date, most states and auditors have been flexible with the timing of requests due to COVID-19, but this flexibility is expected to decrease in Q4 2020 and into 2021

Businesses are likely to continue to operate in understaffed capacities and in a remote environment for an indeterminate period of time. Notwithstanding, holders of unclaimed property should consider dedicating some internal resources to address escheat compliance obligation or outsource the function to a third party to avoid the significant costs associated with non-compliance.

Insights

In summary, businesses should consider the following when navigating the complexities resulting from the effect of COVID-19 on their workforce:

- Be aware of and understand the tax legislation, regulations and guidance released at the state and local levels. While some states have announced that they will not assert nexus simply because employees are working remotely during the pandemic, in other cases businesses may have additional state tax filing obligations, such as income, sales and use, and payroll tax filings.
- Take advantage of state legislation and programs designed to assist businesses during the pandemic, such as new sales and use tax exemptions for PPE, new or revamped credit and incentive programs to expand training grants to include COVID-19, opportunities to reduce personal and real property tax assessments due to reductions in value as a result of the pandemic, and any additional opportunities to participate in unclaimed property VDA programs.
- Take advantage of filing extensions granted by the states, such as for state income tax, sales and use tax, credit and incentives, compliance reporting and unclaimed property filings. Businesses should be aware of and request penalty and interest abatements in cases where they have filed late; in some instances, an abatement may be automatic due to COVID-19 but in other cases the abatement must be requested.

Two of the most formidable hurdles businesses face are limited resources and competing priorities. Addressing risk, while understanding potential savings opportunities, will prepare businesses to emerge stronger from the uncertainty created by the pandemic.