GTN Newsletter – December 2018

2018 US Year-End Payroll Update

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It is that time of year again where one's thoughts go to holiday festivities, the rise or fall of a favorite football team, and, of course, year-end payroll for your mobile employees. With a number of recent US tax law updates and IRS clarifications that impact payroll, there is no time like the present to revisit the rules and ensure your company's policies and procedures are up-to-date.

There are five US payroll matters we recommend you review before finalizing the 2018 payroll for your mobile employee population.

1. Taxation of moving expenses

Prior to January 2018, the tax treatment of moving expenses was relatively straightforward. Employers could exclude certain qualified moving expenses (e.g., shipment of goods, day-of-move travel, lodging) from their employee's taxable income. Additionally, a deduction on the employee's tax return would achieve the same result.

The Tax Cuts and Jobs Act, however, changed this treatment and generally suspended both the moving expense exclusion and deduction for calendar years 2018 through 2025 (there is an exception to this change for certain active-duty members of the armed forces). For moves initiated in 2018, the rules are clear. However, there has been debate in the mobility industry on how to handle 2018 reimbursements relating to expenses incurred in a prior year.

In October 2018, the IRS issued Notice 2018-75 to clarify its position for moving expenses paid in 2018 for expenses incurred in a prior year. Specifically, the notice provided that reimbursements an employer paid to an employee in 2018 for qualified moving expenses incurred in a prior year were not subject to federal income or employment taxes (e.g., social security). The same is true if the employer paid a moving company in 2018 for qualified moving services provided to the employee prior to 2018.

For companies that treated the reimbursement of expenses relating to prior years as taxable, it is possible to correct payroll filings to address the overpayment of employment tax. These adjustments could result in tax savings. However, the time and administrative cost for making the adjustments will also need consideration in determining next steps.

To make matters more complicated, not all states have conformed to the federal tax law changes. Some states, such as Arizona, do not conform and generally allow a deduction for moving expenses incurred by an individual moving to Arizona. Other states, such as California, are still actively debating the topic of conformity. Many payroll systems are not set up to allow for different federal and state tax treatments for relocation expenses. This uncertainty, along with administrative considerations, may make it difficult for companies to revise their payroll filings to achieve any savings.

Companies need to understand both the technical US federal and state laws along with the practical considerations relating to payroll administration.

Download our tip sheet "Tips for the Collection of Global Compensation for Year-End".

DOWNLOAD GUIDE

2. Income inclusion for employer-provided tax preparation services

Tax preparation fees paid by the employer should be included in the employee's Form W-2. Historically, most companies have included an imputed amount (rather than the full cost paid by the employer) that represents the personal benefit derived by the employee from having their tax returns professionally prepared.

The IRS recently issued updated guidance on this topic (see Chief Council Advice ("CCA") 20181007). In this CCA, the IRS advised that the full amount of employer paid Home and Host country tax return preparation fees should be considered compensation and must be included in Form W-2. For tax equalized assignees, the fees for company-related services, such as hypothetical tax withholding calculations, global coordination of tax services, and preparation of tax equalization calculations remain non-taxable for US tax purposes and do not need to be included in Form W-2.

Although a CCA is not "law" and cannot be cited as legal precedence, it is a clear indication of the IRS position on this topic. For this reason, it is important to revisit your policy for US reporting purposes. It is also a good time to consider whether to make any adjustment for non-US payroll purposes (as other countries may have a different practice).

Certain exceptions can still apply for US federal and/or state withholding (i.e., tax gross-ups may not apply). If you are looking for assistance in reviewing the payroll withholding position or in obtaining documentation to support any exception, please schedule a free, 30-minute consultation with an expert from our team.

FREE CONSULTATION

3. Use of fiscal year cut-off for compensation reporting purposes

With the complexity of cross-border payroll, many employers have a difficult time accumulating worldwide income and properly applying tax gross-ups by the end of the calendar year. To cope with this complexity, many companies have considered the use of fiscal year reporting for employee benefits. For example, they may report benefits paid from November 1, 2017 through October 31, 2018 for purposes of finalizing their employee's 2018 Form W-2. Although IRS rules can allow for fiscal-year reporting, this rule is often misapplied in the context of compensation reporting for mobile employees.

The IRS allows fiscal year reporting for certain non-cash benefits (e.g., employer provided automobile) provided during the last two months of the calendar year, or any shorter period within the last two months. This rule provides companies with the time necessary to compute the income inclusion for these non-cash benefits. For example, assuming an October 31, 2018 cut-off, a company would report the imputed income relating to the twelve-month period ending October 31, 2018 in the employee's 2018 Form W-2. The company reports the imputed amount relating to November and December 2018 in the 2019 Form W-2.

As noted, this rule can only apply to specified non-cash benefits. Common benefits for mobile employees, including housing and cost-of-living allowances, and reimbursement for home leave expenses are cash benefits and are not eligible for this type of fiscal-year reporting (even if the benefit is not reimbursed or paid directly to the employee).

One possible solution is to implement a fiscal year cut-off for reimbursement of cash and non-cash benefits. For example, a company could use a December 1 – November 30 reporting period for benefits, if the company had a policy for suspending expense reimbursements in December. If implemented, this method should continue in future years.

The company should also determine if the Host location recognizes the early cut-off method. If a country does not recognize this method, the company should note these differences in their worldwide year-end compensation reports and should discuss the matter with the appropriate Home and Host country payroll teams.

4. Tax and payroll treatment for employee payments

Changes resulting from US tax reform make it important to revisit your company's payroll policies and procedures for reporting payments received from your employees. In the context of mobility, common examples include payments made to the company from tax equalization settlements and from relocation repayment agreements.

In the past, many companies would treat this type of employee payment as "negative compensation" and would net the payment against other current-year taxable income (e.g., salary, bonus, cash allowances). For example, if an employee paid a 2017 tax equalization settlement to the company in 2018, the company would report it in payroll as a reduction to US federal taxable income on the 2018 Form W-2 (effectively offsetting taxable wages, such as the 2018 base salary).

However, this practical approach is not correct and the IRS has very specific procedures (the so-called "claim of right" rule) to handle such payments from an employee. These procedures are as follows:

- The employer would file a corrected Form W-2 for the year that the wages had originally been included in taxable income (the 2017 W-2 in our above example). This corrected W-2 would adjust for social security and Medicare wages and tax amounts only. The employer would refund the employee's portion of social security and Medicare to the employee.
- The employee may then be able to take an itemized deduction or credit on their tax return to recover the US federal and/or state tax related to the payment. If the payment is greater than $3,000, the employee can consider an itemized deduction or a credit. In our example, the credit or deduction would occur in the 2018 US tax filing.

Changes under US tax reform may reduce the benefit of an itemized deduction due to increases in the standard deduction amounts. In addition, the IRS has suspended the deduction available for payment amounts of less than $3,000 through 2025. Netting is supportable if the payment can offset a related amount within the same tax year (e.g., payment of 2018 extension and receipt of 2018 refund in the 2019 calendar year).

5. Tax gross-ups through Form W-2c

Employers can have a difficult time accumulating worldwide income and properly applying tax gross-ups by the end of the calendar year. Thus, employers would provide a tax gross-up after year-end as an "administrative error" and a corrected Form W-2 (Form W-2c) could be issued to include both the taxable wage and withholding increases for the gross-up. IRS regulations and guidance seemed to support this position.

However, the IRS has issued further clarification on the definition of an "administrative error." The recent clarification indicates that an administrative error does not include prior-year adjustments to federal income tax withholding paid by the employer (a gross-up). The IRS supported this clarification by updating Form 941-X (Amended Employer's Quarterly Federal Tax Return).

The IRS guidance also eliminated the possibility of correcting prior-year federal tax overpayments (gross-downs) through use of Form 941-X. Employers must now seek repayment from employees using the "claim of right" procedures as previously noted.

Because of this IRS clarification, it is critical that a company process any tax gross-ups in a timely manner and ensure appropriate procedures are followed to recover overpayments from employees.

As can be seen from the above updates, it is critical to stay up-to-date on current tax legislation, while also considering the practical aspects of your payroll processes. Achieving this balance will allow your company to manage cost and risk for your mobility program.

We're here to help. If you would like assistance in anything covered in this article, schedule your free, 30 minute consultation with an expert from our team.

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Additionally, feel free to contact me directly at eloff@gtn.com or +1.763.252.0642, or visit our Mobility Tax Services page to see what assistance we can provide.

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