Internal Revenue Service
Office of Federal, State and Local Governments
http://www.irs.gov/govt/fslg

FSLG Newsletter – July 2013

This is the semiannual newsletter of the office of Federal, State and Local Governments (FSLG) of the Internal Revenue Service. Our mission is to ensure compliance by Federal, state, and local governmental entities with Federal employment and other tax laws through educational and compliance review activities.

For more information, visit our web site at www.irs.gov/govt/fslg. For account-related assistance, contact Customer Account Services at 1-877-829-5500. To locate an FSLG Specialist in your area, see the directory at the end of this newsletter.

The explanations and examples in this publication reflect the interpretation by the IRS of tax laws, regulations, and court decisions. The articles are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances. You may contact the IRS for additional information. You may also want to consult a tax advisor to address your situation.

Federal, State and Local Governments

Paul Marmolejo, Director
Dwayne Jacobs, Manager, Compliance and Program Management (CPM)
Stewart Rouleau, Newsletter Editor (send comments and questions to Stewart.G.Rouleau@irs.gov)

Contents

IRS Guidance on Sick Leave Plans
Severance Pay and FICA
Taxpayer Identification Number (TIN) On-Line Matching
Recorded Webinars for Government Employers
EHR Reporting
Directory of FSLG Specialists

IRS GUIDANCE ON SICK LEAVE PLANS

In our contacts with governmental entities in recent years, FSLG has encountered a variety of employer plans that provide a retirement benefit for employees based on credit for accumulated unused sick leave. If you administer a plan with this feature, or are considering adopting a plan of this type for your employees, you should be aware of how different features of these plans may affect the tax treatment of these benefits.

General Rule for Recognizing Income

In general, all compensation is included in wages at the time the employees receive it, unless a specific exception applies. One such exception, Internal Revenue Code section 106, provides that employer contributions to a health or hospital insurance plan for employees or former employees, their spouses and dependents, are excludable from the income of employees, and exempt from withholding for income tax, social security, and Medicare purposes.

When is income considered received? Under IRC section 451, individuals recognize income as soon as they have effective control over it; that is, when the funds are made available to the taxpayer without substantial limitations. This is known as the "constructive receipt" rule. Employer-provided health insurance benefits under section 106 are excludable because, when paid directly by the employer, the employees are not considered to have constructive receipt of income through this benefit.

Generally, Section 106 of the Code provides that health and medical benefits can be provided tax-free by an employer. However, if there is an ***option/choice*** to receive cash or another benefit, this may result in taxable wages, even if the employee does not elect to receive the cash. If you have a plan or are considering a plan that provides for such a feature, you may want to review the IRS analysis, discussed below, that addresses whether or not such amounts can be excluded from an employee's or former employee's wages.

Note: Section 125 ("cafeteria") plans provide a partial exception to the constructive receipt rules. These plans provide a choice between cash wages and a salary reduction to receive an excludable benefit. If the benefit is selected, the value is not included in wages. A section 125, or cafeteria plan, cannot provide for deferred compensation. Only those benefits specifically indicated in section 125 are eligible for tax-free treatment.

Revenue Ruling 75-539

Revenue Ruling 75-539 addresses the constructive receipt rules with specific reference to plans involving benefits for accumulated sick leave. This ruling

remains the basis for the determining the tax treatment of various plans and has been cited many times since it was issued in 1975.

The ruling analyzes and distinguishes two labor contracts.

Situation 1: Upon retirement an employee will receive either a cash payment representing a part of unused sick leave, or may elect to apply to the employee's share of the cost of participation in a health plan until the funds are exhausted. The ruling concluded that, because in the employee had a choice to receive the benefit in cash, it was constructively received as income, even if the employee chose not to use the cash option. Therefore, the value of the benefit is included in gross income.

Situation 2: Upon retirement, the value of a portion of accumulated unused sick leave is placed in an escrow account to pay the full premiums of continued participation in the health plan until the funds are exhausted. No funds may be received in cash, and any unused part of the escrow amount reverts to the employer. Because these amounts were not made available to the employee directly, they constituted employer contributions to a health plan and are excludable from income under section 106.

Private Letter Rulings

Two recent private letter rulings address sick leave plans and whether the benefits received from such a plan results in the recognition of income by the employee. It should be noted that a private letter ruling (PLR) interprets the law in response to a written request relating to a specific situation presented by a taxpayer, and cannot be cited as precedent or relied upon in another situation. However, these rulings may provide an indication of how the IRS will interpret the law in a similar situation.

PLR 200724008 involved a school district's early retirement incentive plan. This plan provided that certain eligible employees could choose permanent retirement, and elect to either:

(1) receive health benefits up to a certain amount each year until eligible for Medicare; or
(2) receive a one-time payment based on unused sick leave, plus a retirement bonus.

The ruling concluded that, because employees had a choice between nontaxable compensation (the retiree health benefits) and taxable compensation (the cash value of accumulated sick leave), they had constructive receipt of the taxable compensation, regardless of which option they chose. For income tax purposes, employees who chose (1) would be taxed on the amount they could have received had they chosen option (2).

PLR 201245010 involved mandatory contributions to a trust account for employee retirement health accounts, but did not involve a choice on the part of the employees. The trust made distributions payable to the city's health plans to subsidize retiree medical coverage. Because the employer contributions were mandatory, and employees could not elect to receive salary in lieu of making the contributions, there was no constructive receipt. Therefore the contributions were not included in gross income.

It may be beneficial for you to review your current or proposed retirement incentive plan to determine whether the benefits being offered will result in taxable compensation to former employees. If you have questions about the inclusion or exclusion of benefits in the taxable income of your former employees, you may want to contact an FLSG Specialist for general information. You can also request a PLR to address your specific plan.

SEVERANCE PAY AND FICA

Government entities faced with reduction of their employment force sometimes make payments to employees who are terminated. Government entities refer to these payments by a variety of terms, including severance pay, dismissal pay, separation pay, or some other term. In this article, we will refer to all of these payments as severance pay.

Under Internal Revenue Code (IRC) section 61, severance pay is included in the gross income of the recipient, and the income tax withholding rules apply. In addition, severance pay is generally wages for purposes of FICA taxes (OASDI/social security and HI/Medicare). Some employers question the FICA tax liability in an audit or in a claim for refund on Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund.

The Service's position that severance pay is generally wages for purposes of FICA taxes is based on the Code, revenue rulings, and court cases. Section 3121(a) defines "wages" for FICA purposes as all remuneration for employment, with certain limited exceptions. The Code does not provide an exception for severance pay. Revenue Ruling 90-72 provides a limited administrative exception for certain payments that supplement state unemployment compensation, sometimes referred to as SUB-pay. The revenue ruling provides for an exception for a stream of payments coordinated with the receipt of unemployment compensation. It specifically points out that a lump-sum payment would not qualify for the exception.

Recent Legal Developments

The Court of Appeals for the Federal Circuit held that various kinds of severance payments CSX made to its employees and former employees were wages subject to FICA tax. *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008). The Court of Appeals for the Sixth Circuit subsequently held that severance payments Quality Stores made to former employees who were terminated in a downsizing were not wages subject to FICA tax. *United States v. Quality Stores, Inc. (In re Quality Stores, Inc.)*, 693 F.3d 605 (6th Cir. 2012). The Sixth Circuit's holding directly conflicts with the Federal Circuit's holding, thus creating a split in the circuits.

On May 3, 2013, the Solicitor General of the United States filed a petition for writ of certiorari with the United States Supreme Court in *Quality Stores*. If the Supreme Court grants the government's petition, it could still take a year or more before there is a decision that settles the question for the whole United States.

Until the issue is resolved, the Service is suspending claims for refund of FICA taxes from taxpayers within the Sixth Circuit (Michigan, Ohio, Kentucky, and Tennessee). The Service is disallowing claims for refund of FICA taxes from all other taxpayers.

If a taxpayer files a claim for refund and the Service disallows the claim, the taxpayer has two years to file a refund suit in a United States district court or the Court of Federal Claims. If the Service does not disallow the claim, the taxpayer can file a refund suit after waiting six months. The Service may agree to extend the two-year period to file suit using Form 907, Agreement to Extend Time to Bring Suit. If the Service disallows the claim, the taxpayer may file a protest to Appeals, but that will not extend the two-year period to file a refund suit.

If you have questions about severance pay, you may contact your local FSLG Specialist. A directory is provided at the end of this newsletter.

TAXPAYER IDENTIFICATION NUMBER ON-LINE MATCHING

Taxpayer Identification Number (TIN) Matching is part of a suite of internet-based, pre-filing e-services that allows "authorized payers" the opportunity to match 1099 payee information against IRS records prior to filing information returns.

An authorized payer is one who has filed forms 1099-B, 1099-DIV, 1099-INT, 1099-K, 1099-MISC, 1099-OID, or 1099-PATR with the IRS in at least one of the two past tax years.

Matching requests may be submitted on either an interactive or a bulk processing basis. Interactive TIN Matching will accept up to 25 payee TIN/Name combinations on-screen, while Bulk TIN Matching will allow up to 100,000 payee TIN/Name combinations to be matched via a text file submission.

Both programs will:

- Match the payee name and TIN with IRS records;
- Decrease backup withholding and penalty notices; and
- Reduce the error rate in TIN validation.

Individuals who are authorized to act for the federal, state, local, or tribal government must first register to use e-services and select a username, password and PIN. Then they can register to use TIN Matching from the suite of e-service products available.

The TIN Matching system is accessible 24 hours a day, seven days a week. Support services include on-line tutorials to assist customers with the registration, application and TIN Matching process. You do not need to be a registered user to access and view these tutorials. Customer assistance is also available toll-free at 1-866-255-0654, 7:30 a.m. to 7 p.m., Eastern Time, Monday through Friday.

Please also see Pub 2108-A, On-Line Taxpayer Identification Number (TIN) Matching Program for more information.

You can also view a 2012 Federal, State, Local Government (FSLG) webinar that includes an illustration of the TIN Matching program.

RECORDED WEBINARS FOR GOVERNMENT EMPLOYERS

The office of Federal, State and Local Governments, and other IRS offices, produces webinars on a variety of tax topics. Recordings of these presentations are archived at the IRS videos site and may be viewed at any time. A list of these webinars that may be of interest to government employers is provided below, along with the date of original presentation. Each recording is about one hour in length.

Audio Presentations

- ACA Provisions: What You Need to Know (April 30, 2012)
- Unique Employment Tax Classification issues in Government Entities (September 5, 2012

- Requirements for Furnishing Form 1099-G Electronically (September 11, 2012)

Webinars

- Avoiding Information Reporting Problems for Government Entities (September 20, 2012)
- Social Security Section 218 Agreements and Government Entity Restructuring (August 8, 2012)
- Payments Made to Foreign Persons: A Basic Overview for Government Entities (May 12, 2011)
- Section 218 Tools, Tips and Compliance for Government Entities (January 27, 2011)
- Taxability of Certain Fringe Benefits for State and Local Governments (August 25, 2010)
- 1099 MISC Filing Requirements for State & Local Governments Webinar (March 30, 2010)

To access any of the above presentations, use this link:
http://www.irsvideos.gov/Governments/Employers

For information about upcoming live presentations, see the FSLG website.

TAXABILITY AND REPORTING OF ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

Government sponsored healthcare providers should be aware of the taxability and reporting requirements for Electronic Health Record (EHR) incentive payments from the Department of Health and Human Services Centers for Medicare and Medicaid Services (CMS).

Under the American Recovery and Reinvestment Act of 2009, CMS may make incentive payments to eligible professionals (EPs) and hospitals that meaningfully use EHR technology. EPs include several categories of individual health care professionals, but do not include "hospital-based" professionals who provide 90 percent or more of their covered professional services in either an inpatient hospital setting or an emergency room. Practices and groups are not eligible to receive EHR incentive payments in their own right. However, an individual EP who is eligible for an EHR incentive may assign the payment to the group, practice or hospital that provides the EHR system used by the EP. Consult the CMS website for additional information on EHR incentive payments.

EHR incentive payments may be includible in gross income, depending on the recipient's circumstances. Such payments are not covered by any exclusion under the Internal Revenue Code, and they are not a return of capital. However, if the EP receives incentive payments as an agent or conduit of a group, practice or hospital, the EP is not required to include the payment in his/her gross income as long as he/she turns the payment over to the other entity as required.

Section 6041 of the Internal Revenue Code requires that payments to a payee aggregating to more than $600 per year must be reported to the IRS, usually on one of the Form 1099 series. Thus, CMS must report EHR payments to an EP if they exceed $600 in a year. For purposes of reporting, it is immaterial whether the EP assigned payment of the EHR incentive to someone else. The fact that CMS transfers control of the EHR incentive payment to the EP constitutes payment to the EP and must be reported by CMS as such. If the payment goes to a third party under an assignment by the EP, the EP is the payer with respect to the third party assignee, and the EP may be required report the payment.

Example: Doctor A works in the outpatient clinic of Hospital M maintained by State X. Hospital M provides EHR technology used by Dr. A. Dr. A applies for EHR incentive payments from CMS, but is contractually obligated to assign those payments to Hospital M, under circumstances that meet CMS's requirements for a valid assignment. Subsequently, CMS makes Dr. A's assigned payments to Hospital M. The payments aggregate to more than $600 in one year. Although Dr. A does not have gross income for the payment, CMS should report the payments on Form 1099-MISC as payments to Dr. A. Dr. A should then use Form 1099-MISC to report the payments to Hospital M.

DIRECTORY OF FSLG SPECIALISTS

Alabama	Deishun Garmon-Robinson	(251) 341-5921
	John Givens	(251) 341-5993
Alaska	Gary Petersen	(775) 325-9721
Arizona	Wayne Woods	(602) 636-9124
Arkansas	Jan Germany	(501) 396-5816
California	Ronald Coleman	(619) 744-7169
	Jay Gonzales	(619) 744-7160
	Alice Huang	(626) 927-1238
	Thomas Mansell	(707) 535-3830
	Lilian Masters	(408) 817-6784
	Nimfa Pegram	(619) 744-7161
Colorado	Chuck Sandoval	(720) 956-4407
Connecticut	Mary Rogers	(508) 559-4584
Delaware	Hilton Finney	(215) 861-3732
	Veronica Bell-Green	(215) 861-1562
District of Columbia	Christina Chang	(703) 462-5971
Florida	Fernando Echevarria	(954) 423-7406
	Michael Moore	(561)-616-2092
Georgia	Angie Sanderlin	(404) 338-8218
Hawaii	Clark Fletcher	(425) 489-4042
Idaho	Chris Casteel	(208) 363-8818
Illinois	Paula Graham	(618) 242-5603
Indiana	Raelane Hoff	(812) 231-6502
Iowa	Paula Graham	(618) 242-5603
Kansas	Gary Decker	(316) 352-7475
	Allison Jones	(316) 352-7443

	Dena Jones	(816) 966-2346	
Kentucky	Talaka Whitlock	(502) 420-1586	
	Crystal Fitzgerald-Evans	(502) 420-1597	
Louisiana	Claire Bullock	(318) 683-6311	
	Lynette Thibodaux	(504) 558-3144	
Maine	Frank Lungarelli	(603) 527-9325	
Maryland	Christina Chang	(703) 462-5971	
	Hilton Finney	(215) 861-3732	
Massachusetts	John Hart	(603) 433-0732	
	Mary Rogers	(508) 559-4584	
Michigan	Lori Hill	(906) 228-7831	
Minnesota	Steven Haupt	(651) 726-1488	
	Lori Stieber	(651) 726-1421	
Mississippi	John Givens	(251) 341-5993	
Missouri	Sharon Boone	(417) 891-1458	
	Dena Jones	(816) 966-2586	
Montana	Bruce Gilbert	(307) 672-7425	x 43
Nebraska	Ryan W Johnson	(402) 233-7412	
Nevada	Gary Petersen	(775) 325-9721	
New Hampshire	John Hart	(603) 433-0732	
New Jersey	Pat Regetz	(908) 301-2119	
	Vincent Urciuoli	(908) 301-2660	
New Mexico	Carl Chavez	(505) 837-5610	
	Bob Ching	(505) 424-5984	
	Toni Holcomb	(505) 527-6900	x 232
New York	Dave Coulon	(315) 233-7305	
	Jean Redman	(607) 734-1063	x 108
	Fran Reina	(315) 793-2932	
	Granville Shannon	(212) 719-6537	
North Carolina	Jammie Owens	(336) 574-6161	

North Dakota	Rhonda Kingsley	(701) 237-8324	
Ohio	John Darr	(419) 526-2886	
	Wendy Speelman	(419) 526-2607	
Oklahoma	Brenda Hollingsworth	(405) 297-4959	
Oregon	Clark Fletcher	(425) 489-4042	
Pennsylvania	Hilton Finney	(215) 861-3732	
	Veronica Green Bell	(215) 861-1562	
Puerto Rico	Fernando Echevarria	(954) 423-7406	
Rhode Island	Mary Rogers	(508) 559-4584	
South Carolina	Clifford Brown	(803) 253-3523	
South Dakota	Rhonda Kingsley	(701) 237-8324	
Tennessee	Wally Reimold	(615) 250-6051	
Texas	Robert Jackson	(281) 721-7993	
	Steve O'Brien	(512) 339-5508	
	Michelle Pringle	(214) 413-5448	
	Todd Weidner	(512) 499-5285	
Utah	Chris Casteel	(208) 363-8818	
US Virgin Islands	Clifford Brown	(803) 253-3523	
Vermont	Fran Reina	(315) 793-2932	
	Stephen Polak	(802) 859-1049	
Virginia	Christina Chang	(703) 462-5971	
	James Driver	(859) 244-2449	
Washington	Clark Fletcher	(425) 489-4042	
West Virginia	James Driver	(859) 244-2449	
	Patsy Kerns	(304) 561-3010	
Wisconsin	David Rasmussen	(262) 513-3424	
Wyoming	Bruce Gilbert	(307) 672-7425	x 43