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Social Security Administration and Internal Revenue Service:
State and Local Compliance Issues for 2000

By Ralph Cross, MTAS Finance Consultant
and
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In recent weeks, representatives from the Social Security Administration (SSA) and the Internal Revenue Service (IRS) have conducted seminars across the state. Their purpose was to clarify employee taxation and reporting issues with local government agencies before the end of the calendar year reporting to minimize employer exposure to penalties for noncompliance. The following is a summary of those issues of utmost importance to cities.

Social Security

Although Social Security coverage is universal in the private sector, there are various combinations of coverage for the approximately 86,000 state and local government workers in Tennessee. Any government employer can:

a. not cover employees under Social Security or Medicare;
b. cover personnel under Social Security, by agreement or mandate;
c. cover workers under Medicare only, by agreement or mandate;
d. not cover employees under Social Security and in a retirement system;
e. cover workers under Social Security and not in a retirement system; or
f. cover personnel under Social Security and in a retirement system.

To avoid noncompliance penalties, local governments are encouraged to pay close attention to the requirements of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), the Omnibus Budget Reconciliation Act of 1986 (OBRA 86), and the Omnibus Budget Reconciliation Act of 1990 (OBRA 90). These acts provide the platform for the various conditions outlined above. If you have any questions about your city's status regarding Section 218 Social Security Agreements, please call: Mary Smith, state director, Old Age and Survivors Insurance Agency, (615) 741-7902.

Yearly earnings, which are used to calculate benefits, are processed by the SSA based on an employee's W-2 form. The W-2 report is compared with the 941 form — the Employer's Quarterly Federal Tax Return — submitted to the IRS. If these reports can't be processed due to errors, they will be returned for corrections. This exposes the employer to late-submission penalties, even though the original report was filed on time.
Employee vs. Independent Contractor

Cities often struggle with classifying individuals as employees or independent contractors. Since employers don’t pay Social Security and Medicare taxes on independent contractors, there’s a tendency to stretch that definition to cover individuals who are really employees. When deciding between independent contractor and employee, the IRS considers numerous factors. Most relate to the employer’s level of behavioral and financial control over the worker and the nature of the relationship between the two parties.

The city, as the employer, will be liable for unpaid taxes and additional penalties for improper classification. According to IRS officials, if cities have inaccurately classified certain employees, they have until Dec. 31 each year to correct the situation or risk back taxes and penalties. Please note that the IRS classifies elected city officials as “hired employees” who earn taxable wages. They should receive W-2 forms. Issuing a 1099 to anyone who earns wages will not be compliant. If you have a question on an individual’s employment status, file IRS form SS-8: Determination of Employee Work Status.

Incorrect W-4 Filings

To file for income tax exemptions, an employee completes a W-4 form with the employer. The employer must honor the employee’s W-4 when it is submitted, even if the information is known to be false. An employer is obligated to inform an employee of the penalties associated with improperly filing a W-4, but the employer is not liable for such penalties.

Also, if an employee claims exemption from taxation on a W-4, that person must file a new W-4 every year.

Valuation and Taxation of Fringe Benefits

The actual value of an employee’s noncash fringe benefits received during a calendar year must be determined and the correct amount withheld from wages paid no later than Dec. 31. The actual value must be reported on a 941 form and the employee’s W-2. IRS Publication 535 can provide information on applying an alternate accounting period for valuing taxable fringe benefits.

Personal use of a city-owned vehicle by an employee or official is a taxable fringe benefit unless the vehicle is exempt from IRS taxation requirements. The taxable value should be determined by one of three valuation rules: the Annual Lease Value Rule, the Vehicle Cents-per-Mile Rule, or the Commuting Valuation Rule. The rules have specific conditions and requirements that may prevent applying them to certain situations. For more information on taxation of personal use of city-owned vehicles, please ask your local MTAS office for the agency’s Technical Bulletin entitled IRS Regulations on Personal Use of City-Owned Vehicles: Complying With the Final 1989 Rules.

Another concern for cities is meal reimbursements or per diems for one-day trips. Both are considered taxable wages if an employee’s or official’s business trip does not include an overnight stay, according to the IRS. More information regarding the employee taxable situations can be found in IRS Publication 15, Circular E, Employer’s Tax Guide and Publication 15-A, Employer’s Supplemental Tax Guide.

Free printed materials are available from the SSA by calling 1-800-772-1213 or writing to the Social Security Administration, Public Information Distribution Center, P.O. Box 17743, Baltimore, Md., 21235. With a personal computer and modem, you can access the SSA’s online Wage Reporting Service at 1-410-965-8450. Up-to-date wage reporting information is available on the Internet at http://www.ssa.gov. IRS information can be found at http://www.irs.ustreas.gov.
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