Employer's Guide to

Fringe Benefit Rules

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Decision Offers FICA Tax Refund Opportunities for Severance Pay

Any employer that implemented reductions in force or layoffs after 2008 should consider filing refund claims for the Social Security taxes paid on severance benefits based on a recent 6th U.S. Circuit Court of Appeals decision. In *United States v. Quality Stores, Inc.*, No. 10-1563 (Sept. 7, 2012), the 6th Circuit held that severance payments paid to employees due to an involuntary reduction in force were not "wages" for FICA tax purposes. Contributing Editor Vicki M. Nielsen reviews the case. For many employers this could represent a significant FICA-tax refund opportunity. The amount at stake is considerably higher than the actual taxes because interest is paid on successful refund claims. ***Page 2***

IRS Issues Alternative Per Diems For 2013

Employers and plan administrators have more options now in choosing a way to reimburse the expenses their employees incur for lodging, meals and incidentals during business travel. The IRS in Notice 2012-63 issued per diem rates that are an alternative to the CONUS per diem rates the U.S. General Services Administration issues. The rates are in effect for the federal fiscal year, Oct. 1, 2012-Sept. 30, 2013. The "high" rate is for reimbursement of eligible expenses incurred for travel to places the IRS deems to be high-cost locations. The "low" rate is for reimbursement of expenses incurred for travel to all other locations in the continental United States. ***Page 3***

No Changes to Blended M&IE Rates For Transportation Industry

The special rates for reimbursing the amounts transportation industry workers spend on meals and incidentals while traveling to perform their jobs — commonly referred to as the "blended" rates for the transportation industry — will be unchanged for the fourth year in a row.

The rates, announced in IRS Notice 2012-63, will continue to be $59 for travel within the continental United States, or CONUS, and $65 for travel outside the continental United States, or OCONUS, in federal fiscal year 2013. FY 2013 began Oct. 1 and ends on Sept. 30, 2013. Transportation industry employers that use the blended rates must apply them to all amounts subject to the rules governing per diem allowances for M&IE incurred during an employee's business travel. ***Page 6***

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- ¶105 — Updated Fig. 105-A with latest alternative per diem rates.
- ¶754 — Updated discussion of alternative federal per diem rates for the continental United States for fiscal year 2013.
- ¶754-¶756 — Updated footnotes.
- App. B — Updated table of contents.

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Payroll Taxes

6th Circuit Decision Offers FICA Tax Refund Opportunities for Severance Pay

By Vicki M. Nielsen

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Any employer that implemented reductions in force or layoffs after 2008 should consider filing refund claims for the Social Security taxes paid on severance benefits based on a recent 6th U.S. Circuit Court of Appeals decision. In *United States v. Quality Stores, Inc.*, No. 10-1563 (Sept. 7, 2012), the 6th Circuit held that severance payments paid to employees due to an involuntary reduction in force were not "wages" for FICA tax purposes.

Factual Background

Quality Stores, a debtor in bankruptcy, closed a number of stores and distribution centers and through its severance plans paid periodic and lump sum severance to employees on account of the involuntary separation resulting directly from a reduction in force or the discontinuance of a plant or operation.

The payments were not conditioned on the receipt of state unemployment compensation and did not relate to the rendering of any particular employment service. Quality Stores reported the severance payments as wages on W-2 forms and withheld federal income tax and employment taxes from them.

IRS rulings at that time exempted only certain involuntary severance payments from FICA taxes, provided that those payments satisfied the IRS' administrative definition of supplemental unemployment benefits compensation, commonly referred to as "SUB Pay" or "Sub payments." The IRS required that receipt of severance be conditioned on an employee's receipt of unemployment compensation benefits and payment of the benefits in installments rather than a lump sum. According to the IRS, FICA applied to all other severance payments.

Quality Stores challenged the IRS' position that traditional severance payments are subject to FICA and subsequently filed refund claims to recover more than one million dollars in FICA taxes. Quality Stores argued that FICA does not apply to any severance satisfying the broader statutory definition of SUB Pay provided in Code Section 3402(o).

See *Severance Pay,* p. 7

Employer's Guide to

Fringe Benefit Rules

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Travel and Entertainment Expenses

IRS Issues Alternative Per Diems for 2013

Plan administrators have options in choosing a way to reimburse expenses employees incur on business travel, and now those options — the "alternative per diems" — are out for fiscal year 2013. The IRS in Notice 2012-63 issued per diem rates that are an alternative to the CONUS per diem rates the General Services Administration issues, and like the GSA rates, the alternative per diems are unchanged from FY 2012.

High-low Rates

The per diem rates the IRS issued — commonly known as the high-low rates — can be used instead of the CONUS rates. Unlike the CONUS rates, which are set for hundreds of locations in the continental United States, the high-low rates only provide two rates. The "high" rate is for reimbursement of eligible expenses incurred for travel to places the IRS deems to be high-cost locations. The "low" rate is for reimbursement of expenses incurred for travel to all other locations in the continental United States.

The rates for 2013 are the same as the high-low rates the IRS set for 2012 — the high rate is $242 and the low rate is $163. There are 43 locations in 19 states (including the District of Columbia) to which the high rate applies for 2013. Two locations were added since 2012: Virginia Beach, Va. and Seattle, Wash. In many of the high-cost locations, the high rate only applies seasonally. (See box, right, for a list of the locations; see table on p. 4 for a list that includes the dates to which the high rates apply.)

The high-low rates cover reimbursement of expenses for meals, lodging and incidentals. Incidental expenses include only tips given to porters, baggage carriers, hotel staff and staff on ships. Incidentals do not include the following:

- transportation between places of lodging or business and places where a traveler has a meal;
- the cost of mailing travel vouchers; and
- the cost of paying bills for purchases made on employer-sponsored credit cards.

Also in Notice 2012-63, the IRS announced the blended rates for workers in the transportation sector (see p. 6).

Quick Reference Chart of High-rate Locations for FY 2013
(For chart with seasonal data, see next page) **Arizona:** Sedona
California: Monterey, Napa, San Diego, San Francisco, Santa Barbara, Santa Monica, Yosemite National Park
Colorado: Aspen, Denver/Aurora, Steamboat Springs, Telluride, Vail
Florida: Ft. Lauderdale, Fort Walton Beach/De Funiak Springs, Key West, Miami, Naples
Illinois: Chicago
Louisiana: New Orleans
Maine: Bar Harbor
Maryland: Baltimore, Cambridge/St. Michaels, Ocean City, Washington, D.C. metropolitan area (Montgomery and Prince George's Counties)
Massachusetts: Boston/Cambridge, Falmouth, Martha's Vineyard, Nantucket
New Hampshire: Conway
New York: Floral Park/Garden City/Great Neck, Glens Falls, Lake Placid, New York City, Saratoga Springs/Schenectady, Tarrytown/White Plains/New Rochelle
North Carolina: Kill Devil Hills
Pennsylvania: Philadelphia
Rhode Island: Jamestown/Middletown/Newport
Utah: Park City
Virginia: Virginia Beach, Washington, D.C. metropolitan area (Arlington and Fairfax Counties and the cities of Alexandria, Fairfax and Falls Church)
Washington: Seattle
Washington, D.C.
Wyoming: Jackson/Pinedale

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High-cost[a] Locations Under the IRS 2013 High-rate Schedule

Including seasonal information

Key City (Season)	County or other defined location
Arizona	
Sedona	City limits of Sedona
California	
Monterey	Monterey
Napa (Oct. 1-Nov. 30 and April 1-Sept. 30)	Napa
San Diego	San Diego
San Francisco	San Francisco
Santa Barbara	Santa Barbara
Santa Monica	City limits of Santa Monica
Yosemite National Park (June 1-Aug. 31)	Mariposa
Colorado	
Aspen (Dec. 1-March 31 and June 1-Aug. 31)	Pitkin
Denver/Aurora	Denver, Adams, Arapahoe and Jefferson
Steamboat Springs (Dec. 1-March 31)	Routt
Telluride (Dec. 1-March 31)	San Miguel
Vail (Dec. 1-Aug. 31)	Eagle
District of Columbia	
Washington, D.C. (also the cities of Alexandria, Fairfax and Falls Church and the counties of Arlington and Fairfax, in Virginia; and the counties of Montgomery and Prince George's in Maryland)	
Florida	
Fort Lauderdale (Jan. 1-May 31)	Broward
Fort Walton Beach/De Funiak Springs (June 1-July 31)	Okaloosa and Walton
Key West	Monroe
Miami (Dec. 1-March 31)	Miami-Dade
Naples (Jan. 1-April 30)	Collier
Illinois	
Chicago (Oct. 1-Nov. 30 and April 1-Sept. 30)	Cook and Lake
Louisiana	
New Orleans (Oct. 1-June 30)	Orleans, St. Bernard, Jefferson and Plaquemines Parishes
Maine	
Bar Harbor (July 1-Aug. 31)	Hancock
Maryland	
Baltimore City (Oct. 1-Nov. 30 and March 1-Sept. 30)	Baltimore City
Cambridge/St. Michaels (June 1-Aug. 31)	Dorchester and Talbot
Ocean City (June 1-Aug. 31)	Worcester
Washington, D.C. Metro Area (See District of Columbia)	
Massachusetts	
Boston/Cambridge	Suffolk, City of Cambridge
Falmouth (July 1-Aug. 31)	City limits of Falmouth
Martha's Vineyard (July 1-Aug. 31)	Dukes
Nantucket (June 1-Aug. 31)	Nantucket
New Hampshire	
Conway (July 1-Aug. 31)	Carroll
New York	
Floral Park/Garden City/ Great Neck	Nassau
Glens Falls (July 1-Aug. 31)	Warren
Lake Placid (July 1-Aug. 31)	Essex
New York City (includes boroughs of Manhattan, Brooklyn, the Bronx, Queens and Staten Island)	Bronx, Kings, New York, Queens, Richmond
Saratoga Springs/ Schenectady (July 1-Aug. 31)	Saratoga and Schenectady
Tarrytown/White Plains/ New Rochelle	Westchester
North Carolina	
Kill Devil Hills (June 1-Aug. 31)	Dare
Pennsylvania	
Philadelphia	Philadelphia
Rhode Island	
Jamestown/Middletown/ Newport (Oct. 1-Oct. 31 and May 1-Sept. 30)	Newport
Utah	
Park City (Jan. 1-March 31)	Summit
Virginia	
*Virginia Beach	Virginia Beach
Washington, D.C. Metro Area (See District of Columbia)	
***Washington**	
Seattle	King
Wyoming	
Jackson/Pinedale (July 1-Aug. 31)	Teton and Sublette

[a]Defined as any location with a per diem of $202 or higher. IRS Announcement 2011-81 (Sept. 30, 2011).

Ed. Note: GSA announced Aug. 27, 2012, in Per Diem Bulletin FTR 13-01 that it would freeze all CONUS rates for FY 2013 (see App. B). A GSA press release dated Aug. 22 stated that the action was intended to help federal agencies save an estimated $20 million in avoided costs in FY 2013.

*New locations for FY 2013

Source: IRS Notice 2012-63 (Sept. 26, 2012); GSA Per Diem Bulletin FTR 13-01 (Aug. 27, 2012). Rev. Proc. 2011-47 (Sept. 20, 2011) provides rules for using a per diem rate to substantiate, under Code Section 274(d) and Treas. Reg. §1.274-5, the amount of ordinary and necessary business expenses paid or incurred while traveling away from home. Taxpayers using the rates and list of high-cost localities provided in Notice 2011-81 must comply with Rev. Proc. 2011-47.

More Employers Encourage Wellness Through Incentives

Employer-provided wellness programs have proliferated for many years, and more employers are encouraging participation through incentives. In a recent study of 2,000 U.S. employers, Aon Hewitt found that the majority offer such inducements.

Some wellness programs might involve such benefits as on-site fitness facilities (see ¶111 of the *Guide*) or gym memberships (see ¶410 for club memberships as a working condition fringe), or serving healthy food at the company cafeteria (¶111). Wellness programs may incorporate nutrition education or smoking cessation classes, or the program may include *de minimis* benefits such as small gifts or rewards for making certain achievements (more about that later).

Wellness programs are a way for an employer to encourage employees to adopt healthier lifestyles and achieve and maintain good health. They can incorporate expenditures by an employer, but don't have to — an employer can accomplish that goal by simply providing information and access to professionals who can provide wellness-related services.

An employer may find it worthwhile to offer wellness benefits for many reasons. Facilitating a healthier workforce can help an employer's bottom line by enhancing productivity, increasing presence in the workplace and encouraging employees to accept job offers and stay.

Employers now have even more incentive to offer wellness benefits, since the Patient Protection and Affordable Care Act encourages them to do so.

Aon Hewitt found that some wellness program incentives are more widespread than others. The study says that:

- 84 percent offer incentives to employees to provide answers to a health risk questionnaire;
- 76 percent offer programs to manage health conditions;
- 64 percent use them to foster participation in biometric screenings;
- 59 percent offer monetary incentives to encourage employees to participate in wellness and health improvement programs;
- 54 percent offer monetary incentives to participate in programs to manage diseases and health conditions; and
- 51 percent encourage participation in wellness and health improvement programs that incorporate more than monetary incentives.

Among employers that offer incentives, more than half — 58 percent — encourage participation in lifestyle modification programs such as weight control and smoking cessation.

Employers' heightened use of wellness programs will continue, the study suggests. Sixty-two percent say they want employees to make better choices affecting their health, and 70 percent say health and wellness improvement are part of their strategy.

Tax Treatment of Incentives

Some employers offer incentives for employees to participate in wellness programs, and many favor the use of gift cards for such purposes.

The IRS has given limited guidance on the subject, but one of the few certainties about *de minimis* benefits is that cash is always taxable.

How do employers report this income, which can be in relatively small increments which some people might deem trivial? Gift cards can come in small denominations.

An IRS official addressed that issue to members of the American Bar Association in 2008. (See December 2008 newsletter, p. 8.)

An employee can be taxed on gift cards he or she receives from a wellness program provider for completing a health risk assessment or scheduling a follow-up physical exam, the IRS official suggested during a meeting of the Employee Benefits Committee of the ABA's Tax Section.

Under the scenario posed, the provider sends the employee a $50 gift card if an employee completes the assessment. If, in addition, the employee schedules the exam at which the employee's physician discusses the assessment with the employee and returns it to the provider with the physician's signature, he or she receives a $100 gift card from the provider. The question was whether, if the employee completes both actions, the gift cards are taxable income, and — if so — whether the employer or the provider must report the gift cards as taxable income.

See *Wellness Benefits,* p. 7

Blended M&IE Rates for Transportation Industry Unchanged

The special rates for reimbursing the amounts transportation industry workers spend on meals and incidentals while traveling to perform their jobs — commonly referred to as the "blended" rates for the transportation industry — will be unchanged for the fourth year in a row.

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The rates, announced in IRS Notice 2012-63, will continue to be $59 for travel within the continental United States, or CONUS, and $65 for travel outside the continental United States, or OCONUS, in federal fiscal year 2013. FY 2013 began Oct. 1 and ends on Sept. 30, 2013.

Transportation industry employers that use the blended rates must apply them to all amounts subject to the rules governing per diem allowances for M&IE incurred during an employee's business travel. However, the rates need not apply to all employees who travel for the company.

The blended rates are available to employers directly involved in moving people or goods. (See ¶754 of the *Guide* for more on using the rates; see ¶105 for current rates.)

Computing the Figures

Employers must compute the amounts deemed substantiated under those rules at least monthly, but need not do so daily.

To compute the figures, employers compare the total per diem allowance paid for the period to the sum of the amounts computed at the federal M&IE rates for the places to which an employee traveled. The amount deemed substantiated will be equal to the lesser of the total per diem allowance paid or the number of days traveled multiplied by the blended CONUS or OCONUS rates.

Finding out More

Employers with questions about Notice 2012-63 may contact its principal author, Eric D. Brauer, of the IRS' Office of Associate Chief Counsel (Income Tax & Accounting), at (202) 622-4970.

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Severance Pay (continued from p. 2)

Legal Analysis

The 6th Circuit agreed with Quality Stores, concluding that severance that meets the following five requirements of Section 3402(o) is exempt from FICA if it is paid:

1) to an employee;
2) under an employer's plan;
3) because of an employee's involuntary separation from employment, whether temporary or permanent;
4) due to a reduction in force, the discontinuance of a plant or operation, or other similar conditions; and
5) if it is included in the employee's gross income.

Significantly, the Section 3402(o) requirements do not require that SUB payments be tied to the employee's receipt of unemployment compensation benefits and do not distinguish between periodic or lump sum payments. In effect, the 6th Circuit's ruling rejects the additional limitations the IRS imposed and represents a substantial expansion of the types of severance exempt from FICA.

The 6th Circuit rejected the government's arguments and IRS rulings on SUB Pay as inconsistent with congressional intent. The 6th Circuit reasoned that severance that satisfies the statutory definition of SUB Pay provided in Section 3402(o) is SUB Pay and that SUB Pay is exempt from wages for both income tax and FICA tax purposes. (The court's decision did not alter Quality Stores' obligation to withhold federal income taxes on the payment of SUB Pay or change the fact that SUB Pay is includible in an employee's gross income.)

The court relied on the U.S. Supreme Court's ruling in *Rowan Cos. v. United States*, 452 U.S. 247 (1981), in its conclusion that the statutory term "wages" should be interpreted consistently in the statutes governing FICA and federal income tax. The 6th Circuit reasoned that because Congress treated SUB payments as if they were "wages" for federal income tax withholding purposes, the same definition must apply under FICA. The 6th Circuit concluded that because SUB Pay is not wages for federal income tax purposes, SUB Pay also is not wages for FICA purposes.

The *Quality Stores* decision creates a conflict in the circuit courts. In *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008), the Federal Circuit Court of Appeals held that severance payments at issue were not SUB Pay and were wages for FICA taxes because the payments did not satisfy the IRS' more restrictive definition of SUB Pay (described above).

The ultimate resolution of this issue is several years away. The federal government has not announced whether it will appeal the *Quality Stores* decision to the Supreme Court, but it likely will. It also is possible that the decision could prompt the development of a coordinated settlement program.

FICA Refund Opportunity

For many employers this could represent a significant FICA-tax refund opportunity. The amount at stake is considerably higher than the actual taxes because interest is paid on successful refund claims.

Employers residing within the 6th Circuit's jurisdiction (that is, Kentucky, Michigan, Ohio and Tennessee) that paid involuntary severance payments to employees after 2008 should file FICA-tax refund claims. Employers that are anticipating providing severance payments that qualify as SUB Pay in 2012 and future years should consult with their tax advisors to determine whether to pay and withhold FICA taxes on those benefits.

Employers residing outside the 6th Circuit's jurisdiction should continue to withhold FICA taxes and, if not facing imminent statute of limitations issues, should consider carefully their procedural options (including filing refund claims for years not closed by the statute of limitations (2009-2012), participating in a coordinated settlement with the IRS if proffered, and/or litigation).

This article was drafted by the attorneys of Ogletree Deakins, a national labor and employment law firm that represents management. This information should not be relied upon as legal advice.

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Wellness Benefits (continued from p. 5)

The committee's proposed answer was that the gift cards would be taxable income and that because the provider gives the cards to the employee, it would report the cards on Form 1099-MISC. However, if the cumulative value of the cards is less than $600, the provider need not file the form on a card given the employee. The gift cards are not compensation the employer pays to the employee.

The IRS official agreed that the cards are taxable income, but not that they should be reported on Form 1099-MISC. According to the official, this is compensation the original employer should report on Form W-2, not the provider that acts as an agent in providing compensation to the employees.

Subject Index Vol. 19

This index covers the *Employer's Guide to Fringe Benefit Rules* newsletter for Vol. 19, Nos. 1-5. It is arranged by subject. The numbers following each entry refer to the volume, issue and page numbers of the newsletter in which information on that topic appears. For example, the designation "19:5/2" indicates Vol. 19, No. 5, page 2.

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