General Employer Updates

INTRODUCTION

In 2024, FustCharles continued our commitment to talent development, innovation, and teamwork to provide our clients with a best-in-class service experience. As we turn the page on 2024, there is plenty of uncertainty in the tax landscape. Many TCJA provisions are set to expire at the end of 2025, however as Republicans hold the White House, and have a slim majority in both chambers of Congress, there is an increased likelihood that 2025 will have some level of tax legislation through the budget reconciliation process.

FustCharles tax professionals grasp the intricate connections between evolving laws, economic dynamics, and the tax implications of various business decisions, and are well-positioned to serve as strategic advisors, steering companies toward success. Tax planning remains a vital aspect for businesses seeking to optimize cash flow by managing their long-term tax obligations.

Our 2024 Year-End Tax Planning Guide delves into effective tax strategies, considering recent administrative guidance and potential legislative changes that are currently under review. For further information and assistance, please reach out to a member of our expert tax team.

Unless explicitly stated otherwise, the information provided in this guide is based on existing tax laws and policies as of the publication date, and it may be subject to adjustments in response to future legislative or tax policy changes.

1) SEC Settlement Date Change Affects Equity Compensation Plan Administration

Effective May 28, 2024, the Securities and Exchange Commission (SEC) amended the rules under the Securities Exchange Act of 1934 to shorten the securities transaction settlement cycle for most broker-dealer security transactions. As a result, companies should verify that their payroll tax procedures can meet the deposit rules for equity compensation.

Settlement dates are referred to as T+1, T+2, T+3, and so forth, and "T" stands for transaction date, the day the transaction takes place. The numbers 1,2, or 3 denote the number of subsequent days on which the transfer of money and security "settlement" takes place. Weekends and public holidays are not included in the day count.

Prior to the change, the standard settlement cycle for all stocks was T+2, but is now T+1, which accelerates the date on which participants in equity compensation plans utilizing a same-day sale arrangement become the shareholders of record entitled to appreciation, dividends, etc. Plans such as stock-settled restricted stock units (RSUs), stock options, stock appreciation rights (SARS) and Employee Stock Purchase Plans (ESPPs) will all be impacted.

The accelerated settlement date also marks the beginning of the timeline on which withheld income and employment taxes must be deposited along with the employer's share of employment taxes.

Coordination between broker, payroll department, tax department, and transfer agent is important to ensure that the employer makes timely payroll tax deposits under the accelerated timeline. While the coordination process should be reviewed in the context of tax compliance, the scrutiny also provides an opportunity to review the plan's efficiency and employee satisfaction. This will be especially important when dealing with globally mobile populations.

Planning Considerations

Automation. Given the constraint on timing and resources imposed by the new regulations, companies may evaluate opportunities for automation such as BDO's Global Equity Mobility Solution (GEMS) tool. GEMS is an automated solution that utilizes transaction data and cross-border travel information to help companies avoid risk when working through their payroll reporting and withholding obligations. To learn more about GEMS, see BDO Global Equity Mobility Solution.

Fair market value (FMV) considerations. Companies may want to revisit the FMV they use for valuation purposes. If using the closing price on the day of vesting, for example, the companies are shortening the window to execute all the steps to meet T+1 settlement and T+2 tax deposit deadlines.

Awards settlement. Share delivery would need to be initiated on the transaction date for settlement to occur on T+1. Therefore, withholding taxes will need to be finalized on the day of the transaction, which might prompt companies to revisit the alternatives they provide their employees to fund the taxes, such as net settlement, sell-to-cover, and cash payment, because some of the options may further delay settlement.

2) Wellness Plans Purporting to Avoid Payroll Taxes Might be Too Good to Be True

On two different occasions, the IRS has alerted employers to beware of companies misrepresenting nutrition, wellness, and general health personal expenses as medical care expenses for health flexible spending arrangements (FSAs), health savings accounts (HSAs), health reimbursement arrangements (HRAs), or medical savings accounts (MSAs), collectively health spending plans.

A May 2024 IRS news release – IR 2024-65 – addressed a concern that people may be misled by promoters of health spending plans as to which general health and wellness expenses will be reimbursed to employees and points out that personal expenses are not considered medical expenses under IRC Section 213(d) and therefore are not deductible or reimbursable under FSAs and other health spending plans.

In Chief Counsel Advice (CCA) 202323006, issued on June 9, 2023, the IRS makes it clear that unless participants have qualifying Section 213(d) medical expenses, the cash benefits paid to them from these wellness plans will be taxable wage income, subject to both income and employment taxes. See IRS Pub. 502 for a discussion of what is and is not a Section 213(d) medical expense. Also, the IRS has provided frequently asked questions on medical expenses related to nutrition, wellness, and general health to determine whether a food or wellness expense is a medical expense to help distinguish medical from personal expenses.

The news release reiterates the items covered in CCA 202323006 and emphasizes that only plans that pay or reimburse bona fide medical expenses as defined by IRC Section 213(d) qualify an employee to make pretax contributions to a health benefit account and that distributions not used for IRC Section 213(d) medical expenses are taxable. Thus, contributions to plans that provide for the payment of non-medical wellness expenses are not deductible and payments under the plans are not tax free under FSA, HSA, HRA, and MSA rules. If the plan does not satisfy the IRC requirements, **all payments made to all participants in the plan, even allowable reimbursements for actual medical expenses, are includible in income**.

The promoters, some of which are former employee retention credit promoters, typically provide seemingly credible materials that often include a reliable legal opinion on the validity of the tax savings generated when employees make elective deferrals to health care arrangements under IRC Section 125. However, the legal opinion usually does not opine on the type of expenses discussed by the promoter or address how the payment of "wellness" expenses impacts the intended tax benefits.

Planning Considerations

As noted in CCA 202323006 and IR-2024-65, wellness plans often do not provide the tax benefits represented by promoters. Moreover, once an employer begins operating a defective wellness plan that allows reimbursements that are not eligible for tax-free treatment, it may be years before this fact comes to light, creating significant problems for employers who must correct past Forms W-2, Forms 941, etc. for open tax years.

Accordingly, a review of the proposed wellness or any other plan offering FICA exemption by a trusted tax advisor should be obtained prior to adoption. If one of these plans has already been implemented, consideration should be given to terminating the plan. Continued operation of the plan carries the risk of an IRS payroll examination through which the IRS might seek to collect taxes, penalties, and interest related to the failure to withhold and remit taxes when due and assert penalties based on the employer's incorrect filing and issuing of its Forms W-2.

Typically, the statute of limitations is three years, but it could be six years for substantial understatements. Employee morale issues can also arise, because employees may be required to amend their past years' Forms 1040 individual income tax returns.

3) New Requirement to Cover Long-Term Part-Time Employees in 401(k) and 403(b) Plans

The Setting Every Community Up for Retirement Enhancement Act of 2019) (SECURE Act of 2019) and the SECURE 2.0 Act of 2022 (collectively, SECURE) enacted a new mandate that, starting in 2024, long-term, part-time (LTPT) employees must be allowed to make salary deferrals into their employer's 401(k) plan. Starting in 2025, 403(b) plans are subject to the LTPT rules and LTPT employee eligibility is reduced from three years of service to two years of service.

The systems used by many 401(k) and/or 403(b) plan service providers may not be ready for the required implementation starting with the first plan year beginning on or after January 1, 2024, for 401(k) plans (i.e., January 1, 2024, for calendar year 401(k) plans) and the first plan year beginning on or after January 1, 2025, for 403(b) plans (i.e., January 1, 2025, for calendar year 403(b) plans).

Some executives may view this change as an issue that does not require their attention and that will be handled by their human resources (HR) staff and the 401(k) plan service providers. But not complying with the rules might be costly for the employer if corrective contributions for LTPT employees who were not allowed to participate are required, along with ancillary costs.

New Mandate

For decades, 401(k) plans could exclude employees who work fewer than 1,000 hours of service per year, even if the employee worked for the employer for many years. Employees who worked over 1,000 hours generally could not be excluded from the plan (with certain non-hours-based exceptions). In contrast, 403(b) plans are subject to the so-called "universal availability" rule, which makes almost all employees eligible to make elective deferrals into the plan, with certain exceptions.

To improve access to workplace retirement savings plans, the 2019 SECURE Act required 401(k) plans to allow employees who have worked at least 500 hours in three consecutive years (based on employment with the employer from January 1, 2021, onward) to make elective deferrals to the plan. Thus, if an employee had 500 hours of service in 2021, 2022, and 2023 (but never had 1,000 hours of service per year), that employee must be allowed to make salary deferrals into the employer's 401(k) plans starting with the first plan year beginning on or after January 1, 2024. For plan years beginning in 2025 and later, SECURE 2.0 of 2022 reduces the three-year measurement period to two years. In addition, 403(b) plans become subject to the LTPT employee rules starting with the first plan year beginning on or after January 1, 2025.

Why Should Employers be Concerned?

While employers are not required to match the LTPT employee deferrals and LTPT employees are excluded from the annual tests that otherwise apply to all employees (e.g., coverage, nondiscrimination, and top-heavy requirements), there might be some increased cost to the plan sponsor for including LTPT employees in the 401(k) plan.

Planning Considerations

While plan sponsors might rely on their plan service providers to identify eligible LTPT employees, liability for noncompliance remains on the employer. The risk associated with not allowing LTPT employees to make elective deferrals to a 401(k) or 403(b) plan can be avoided if the plan lowers the plan's eligibility rules or determines eligibility on the elapsed time method instead of the counting hours method of determining eligibility to make salary deferrals under the plan.

SECURE provides numerous exceptions from coverage, nondiscrimination, and top heaviness tests for employees who participate in the plan solely on account of the LTPT employee provisions. Any employee that satisfies the more generous plan document provisions will not qualify for the confusing rules that otherwise apply to LTPT employees. Still, avoiding LTPT employee status altogether might be cost effective.

BDO can assist your review of your 401(k) and/or 403(b) plan provisions to evaluate the cost benefit analysis of implementing the LTPT employee rules.

4) IRS Drastically Expands Electronic Filing Requirement for Most Tax and Information Returns

Almost all federal tax and information returns filed on or after January 1, 2024, must be submitted to the IRS electronically instead of on paper.

Under the new rules, filers of 10 or more returns ***of any type*** for a calendar year generally will need to be filed electronically with the IRS. Previously, electronic filing was required if the taxpayer filed more than 250 returns ***of the same type*** for a calendar year.

Who is affected? Practically all filers with the IRS of 10 or more information returns -- when counting any type, such as Forms W-2, Forms 1099, Affordable Care Act Forms 1094 and 1095 and Form 3921 (for incentive stock options) and other disclosure documents -- are impacted by this change for 2023 returns that will be filed in 2024. Even workplace retirement plans may need to file Form 1099-Rs (for benefit payments) and other forms electronically with the IRS starting in 2024, for the 2023 plan or calendar year.

Which returns are affected? In addition to the information returns that are the primary focus of this article, the new rules cover a broad variety of returns, including partnership returns, corporate income tax returns, unrelated business income tax returns, withholding tax returns for U.S.-source income of foreign persons, registration statements, disclosure statements, notifications, actuarial reports and certain excise tax returns.

How to count to 10? The 10-return threshold for mandatory electronic filing is determined on the aggregate number of different types of forms and returns. The aggregation rules are confusing because the filings included in the count change depending on which form the determination is made. Also, some filers must be aggregated with all entities within the controlled or affiliated service group to determine if 10 or more returns are being filed for the tax year. For instance, Form 5500 employee benefit plan filers (but not Form 8955-SSA employee benefit plan filers) must count the filings of the employer who is the "plan sponsor" and other entities in the employer's controlled and affiliated service group.

Example 1: Company A is required to file five Forms 1099-INT (Interest Income) and five Forms 1099-DIV (Dividends and Distributions), for a total of 10 information returns. Because Company A is required to file a total of 10 information returns, Company A must file *all* of its 2023 Forms 1099-INT and 1099-DIV electronically, as well as any other return(s) that are subject to an electronic filing requirement. The reason for this result is that "specified information returns" such as Forms 1099 and W-2 must be aggregated when counting to determine whether the new 10-or-more threshold for electronic filing is met.

Example 2: Corporation X, a C corporation with a fiscal year end of September 30, was required to file one Form 1120 (U.S. Corporation Income Tax Return) during the calendar year ending December 31, 2023, six Forms W-2 (for employees), three Forms 1099-DIV (for dividend distributions), one Form 940 (Employer's Annual FUTA Tax Return) and four Forms 941 (Employer's Quarterly Federal Tax Return). Because the Form 1120 aggregation rules include returns of *any type* during the calendar year that ends with or in the taxable year and Corporation X is required to file more than 10 returns of any type during calendar year 2023, Corporation X is required to file its Form 1120 electronically for its taxable year ending September 30, 2024.

Planning Considerations

The new mandatory electronic filing rules are complicated and penalty exposure may be significant.

Filers must, for the first time, pay particular attention to the total number of returns across all return types, because the new electronic filing threshold is determined based on the aggregate total, not the number of returns per return type. This might require coordination between different departments within an organization and immediate consultation with the IT department and/or software provider to ensure there is adequate time to implement technology solutions or software upgrades before the filing deadline.

Affected employers may need significant lead time to implement new software, policies, and procedures to comply with the new rules. Simply doing the "same as last year" will not work for many employers.

FustCharles can help employers understand and comply with the new rules, which could include facilitating electronic filing.

Even if filers are not required to file electronically under the new rules, they may want to consider doing so, as electronic filing has become more common, accessible, and economical. Electronic filing may reduce administrative efforts compared to paper filing, increase accuracy, and improve record retention.

Proactive tax planning and seamless tax compliance are essential components of financial success. At FustCharles, we are dedicated to providing year-round support, ensuring you stay informed about emerging opportunities, evolving tax laws, and optimal strategies. Our commitment is to guide you towards the most advantageous course of action aligned with your objectives, ultimately contributing to your business's financial well-being.

For more information, please reach out to our Tax Team Leaders:

Thomas J. Giufre, CPA
tgiufre@fustcharles.com

Patrick A Capella, CPA
pcapella@fustcharles.com

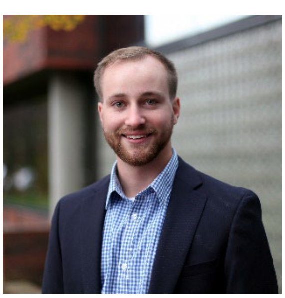
Kelly A. Redmond, CPA
kredmond@fustcharles.com

Joseph L. Charles, CPA
jcharles@fustcharles.com

Desireé M. Bennett, EA
dbennett@fustcharles.com

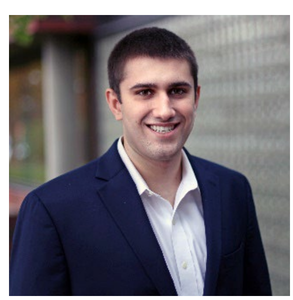
Ellie Luker, CPA, JD, LLM
mluker@fustcharles.com

Christian Snyder, CPA
csnyder@fustcharles.com



Michael W. Hartwell, CPA
mhartwell@fustcharles.com

Candice M. Pack, CPA, EA
cpack@fustcharles.com



Marek M. Gonzalez, CPA
mgonzalez@fustcharles.com

Erin Morford, CPA
emorford@fustcharles.com

FustCharles

FustCharles

fustcharles.com