

# **Payroll Trends**

## **1<sup>st</sup> Quarter 2006**

### **New W-4 & W-5**

Any employee claiming exemption from withholding in 2005 must submit a new W-4 to their employer by February 15, 2006. If a new W-4 is not submitted, withholding is required as single with zero exemptions.

Likewise, those employees eligible for advanced Earned Income Credits must submit a new W-5 to their employer for 2006 payment eligibility.

### **Nonresident Aliens**

IRS Notice 2005-76 announced new withholding rules for nonresident aliens, except students and business apprentices from India. Effective for wages beginning January 1, 2006, new withholding and W-4 procedures will apply. If you have applicable employees, go to [www.irs.gov](http://www.irs.gov) for complete information contained in Revenue Bulletin 2005-41.

### **State Minimum Wages**

Beginning January 1, 2006, the District of Columbia minimum wage is \$7.00 per hour, up from \$6.60. Also effective January 1, 2006, the minimum wage for Florida is \$6.15 per hour, with the minimum wage for New York being \$6.75 per hour. In Oregon the minimum wage is \$7.50 per hour beginning January 1, 2006.

### **Critical Links**

According to the latest statistics, the mismatch of Social Security number/name on W-2s continues to be the largest source of problems in our current tax system. The Social Security Administration Critical Links web page provides information on how to enter names as well as registration for the Social Security Number Verification Service now available to all employers. Go to [www.socialsecurity.gov/employer/critical.htm](http://www.socialsecurity.gov/employer/critical.htm).

### **2006 Tax Calendar**

The IRS has issued Publication 509, Tax Calendars for 2006. It is available at [www.irs.gov/formspubs/index/html](http://www.irs.gov/formspubs/index/html). The publication includes important due dates for all types of businesses. With the ever changing number of forms and due dates, this is an excellent way to always have this federal information available. State deadlines must also be considered.

Publication 15 The Employers Tax Guide, Circular E will be mailed to every employer by early January. This booklet will provide valuable information on payroll tax law

changes and answer basic questions regarding payroll related issues. When used in conjunction with the Tax Calendar and IRS web site, every employer has a vast, easy to use payroll library available to them for free.

### **IRS Enforcement**

The Commissioner of Internal Revenue released information on increased enforcement activities for the fiscal year ending September 30, 2005. Revenues collected from enforcement activities increased 10% over the prior year, to \$47.3 billion. Audits of small business corporations increased by 145%, with audits of large corporations increasing by 14%. Tax and related criminal prosecutions were flat when compared to the prior year.

Adoption Assistance For 2006, the maximum amount excluded from an employee's gross income for amounts paid or incurred relating to a qualified adoption increased to \$10,960.

### **Per Diem Rates**

With the dramatic increase in fuel cost, major disaster areas and normal price changes, there have been many adjustments to the list of federal per diem rates for travel in the United States. Employers using these rates for travel expense payments should check [www.gsa.gov](http://www.gsa.gov) for the latest approved amounts.

### **Deferred Compensation**

The IRS has issued proposed regulations for nonqualified deferred compensation plans, with comment through January 3, 2006. Final regulations are to be effective January 1, 2007. The IRS is allowing employers to continue to rely on the advice from Notice 2005-1, or the proposed regulations until the final regulation effective date.

### **Returning Veterans**

As veterans, National Guard and reservists return from active duty, employers need to be aware of the guaranteed rights contained in the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA). Returning employees have specific rights to seniority, status, rate of pay and benefits. The DOL web site, [www.dol.gov](http://www.dol.gov) and state and federal Labor Department offices can provide help in this area for both employers a

The U.S. Supreme Court has made a unanimous ruling in a long awaited case involving production employees, but it may not have the potential to impact other employers due to the narrow wording of the opinion.

In the specific case (IBP v. Alvarez), employees were required to wear protective gear and were required to store the gear in company lockers, where they changed into and out of the gear. The court ruled that the work day began with the donning of the protective

gear and ended with its doffing. Therefore, time spent walking from the locker room to the production area is compensable under the Fair Labor Standards Act (FLSA).

However, the court specifically did not overrule the lower court ruling that time spent waiting in line to get the protective gear and time spent donning non-unique protective gear, such as hard hats, eye protection, etc., was not compensable.

The ruling upheld the Department of Labor continuous workday rule, that allows for unpaid time once the workday begins and before it ends, such as unpaid break and lunch time, etc. Therefore, the narrow ruling merely emphasized that principal activities, such as moving from one location to the other during the production process is compensable.

In another case, the U.S. Supreme Court upheld the New York state "convenience of the employer" rule. Under this concept, income of a nonresident employee working for a New York employer is taxable by New York unless the work is performed outside the state for the employer's necessity.

The reasoning given by the New York courts was based on prior Supreme Court rulings that due process was established when there was minimal connection between the state and taxpayer, and the state applies a ratio related to the value of the work to the state. The states of Pennsylvania and Nebraska also have similar laws.

Cost-of living adjustments (COLA) for qualified plans and other benefits have been released for 2006. The following are the more common items of interest to employers and employees when monitoring their specific plans.

### **Pension Plans**

- The maximum elective employee deferrals for 401(k), 403(b) and 457 plans increase to \$15,000 in 2006, from \$14,000 in 2005. For a SIMPLE account, the maximum elective deferral remains \$10,000 for 2006.
- The additional elective deferral for employees age 50 and over for 401(k), 403(b) and 457 plans for 2006 increases to \$5,000 from \$4,000 in 2005. The additional elective deferral for participants age 50 or over in a SIMPLE account goes from \$2,000 in 2005 to \$2,500 in 2006.
- The limit on total additions to a defined contribution plan in 2006 will be \$44,000, up from \$42,000 in 2005.
- The maximum compensation used to determine contributions under qualified plans increases to \$220,000 for 2006.
- The maximum benefit payable under a defined benefit plan in 2006 will be \$175,000, up from \$170,000 in 2005.

- The amount for 2006 used to define a key employee is \$140,000, while the amount to define a control employee is \$85,000. A highly compensated employee for 2006 will be defined as one with \$100,000 of compensation.
- The compensation amount for coverage of an employee under a SEP account remains \$450 for 2006.

### **Transportation Fringes**

Amounts that may be excluded from income for employer-provided "qualified transportation" fringe benefits for 2006 remain \$105 per month for transit passes and commuter highway vehicles. Qualified parking benefit limits increased to \$205 from \$200 in 2005.

### **Medical Savings Accounts.**

The annual "high deductible" plan deductible amounts for 2006 must be \$1,800-\$2,700 for single coverage and \$3,650-\$5,450 for family coverage. Maximum out-of-pocket expenses can be no more than \$3,650 for single coverage and \$6,650 for family coverage.

### **Health Savings Accounts**

For 2006, the annual limit on contributions for single coverage is \$2,700 and family coverage \$5,450. A high deductible plan for single coverage has an annual deductible of \$1,050-\$5,250 and \$2,100-\$10,200 for family coverage.

As in prior years, these automatic adjustments do not require amended plan documents to be filed. Contact your plan administrator for more specific information regarding your particular benefit plans.

For 2005 the standard mileage rate was 40.5 cents per mile through August, then increased to 48.5 cents per mile for September through December to reflect the sharp rise in gas prices following hurricane Katrina.

With gas prices now at a lower rate, the 2006 standard mileage rate will be 44.5 cents per mile for determining the deductible business cost of operating an automobile if the actual cost method is not elected.

If the business purpose and mileage are properly documented, the standard mileage rate may be used to reimburse employees and by self-employed for the business use of their automobiles. Reimbursement amounts in excess of the standard rate or non-substantiated allowances must be treated as income.

In 2006, the mileage rate for medical and moving expense is 18 cents, with the charitable mileage rate set by law at 14 cents. For Katrina-related mileage, the charitable deduction

is allowed at 32 cents per mile, while reimbursement for Katrina mileage is 44.5 cents per mile.

This issue highlights 2006 changes impacting most payroll related processing. Cost-of-living increases, "normal" changes and items resulting from recent legislation will require employer attention to be in compliance for 2006. In addition to those items covered in this issue, be alert to more specific changes impacting your industry or states of operation.

The Social Security wage base for 2006 increases to \$94,200, a \$4,200 increase over 2005, or an increase of 4.67%. The tax rate will remain 6.2% for the employer and employee, or a maximum Social Security tax for each of \$5,840.40. This is an increase of \$260.40 each for the employee and employer in 2006.

The separate Medicare tax for 2006 remains at 1.45% each for the employer and employee, with no wage maximum.

Self-employed individuals must pay a 12.4% Social Security tax on the first \$94,200 of self-employed income in 2006, a maximum tax of \$11,680.80. The 2.9% Medicare tax will continue to apply to total self-employment wages with no maximum.

For those benefit recipients not yet reaching their full retirement age, benefits will be reduced by \$1 for every \$2 in earnings over \$1,040 per month (\$12,480 annually) in 2006. Benefit recipients having reached their full retirement age can continue to have unlimited earnings without benefit reductions.

In 2006, Social Security benefits will have a cost-of-living increase of 4.1%, to a maximum benefit of \$2,053 and an average benefit of \$1,002 per month.

The IRS has extended the same relief for Hurricane Wilma victims as was granted for Hurricanes Katrina and Rita.

Affected taxpayer deadlines to file returns, pay taxes and perform other time-sensitive acts after the storm have been extended until February 28, 2006. This is same date granted for relief for Katrina and Rita taxpayers.

For the latest and most specific information, there are Katrina links on most federal and state government web sites. The more prominent tax related sites are [www.irs.gov](http://www.irs.gov) and, [www.state.\\*\\*.us](http://www.state.**.us) (\*\* is the state postal abbreviation) for the impacted state.

It should be noted the due dates for filing information returns (W-2, 1099, etc.), employment tax returns, and making employment tax deposits have not been extended.

With the increase by some states in their maximum wage base, employers operating in those states will see an increase in their state unemployment taxes for 2006.

This makes the management of employee-experience tax rates even more important for most employers each year, as your unemployment tax rate is one tax area where being proactive has the potential to lower your tax bill.

For 2006, the FUTA wage base for calculation of the federal tax remains unchanged at \$7,000 per employee.

As we go to print, fifteen states have announced an increase in their maximum taxable wage base per employee for 2006. The following table indicates the new amounts. AK \$28,700 IL \$11,000 IA \$21,300 MN \$24,000 MT \$21,600 NB \$ 8,000 NV \$24,000 NJ \$25,800 NM \$17,900 NC \$17,300 ND \$20,300 OR \$28,000 UT \$24,000 WA \$30,900 WY \$17,100

Oklahoma is the only state to announce a lower wage base, going to \$13,500 per employee for 2006.

Hawaii and Rhode Island are two states that historically adjust their wage base and have not yet indicated their 2006 limits. If you have operations in either of these states, look for a later announcement from your state agency.

New York will remain the only FUTA credit reduction state for 2005 due to not repaying loans from the federal unemployment insurance fund for payment of state benefits. The additional .6% paid by New York employers with their 2005 Form 940 filings will go to reduce the loan balance.

All states have now come into compliance with federal anti-dumping legislation. This is designed to prevent employers from using "shell" companies with low turnover and better tax rates to lower their overall unemployment tax payments.