MILLER KAPLAN

December 31, 2019

Re: 2020 Accountants' Memorandum

Greetings from Miller Kaplan Arase LLP!

Enclosed is our annual information brief, which is primarily intended to address payroll tax matters and information reporting requirements. We also mention various tax laws and matters that we believe will be of particular interest to our clients. Below we highlighted a few of the more significant legislative, regulatory, judicial, and procedural changes.

The June 2018 U.S. Supreme Court decision in *South Dakota v. Wayfair, Inc.* allowed states to require out-of-state sellers to collect and have sales tax remitted based upon economic nexus rather than the former physical presence test. As a result, a number of states have enacted legislation to tax remote retailers based upon the customer's location and the amount of related transactions or sales, instead of the seller's location. States have put forward their own nexus tests and their own thresholds for when out-of-state sellers may need to collect and remit sales taxes.

In September 2019 the IRS issued Rev. Proc. 2019-38, which provides a safe harbor under which a rental real estate enterprise will be treated as a trade or business for purposes of the Qualified Business Income ("QBI") Deduction of IRC Section 199A. The IRS also issued new regulations with respect to Qualified Opportunity Zone Funds ("QOFs"), which were created by the 2017 Tax Cut and Jobs Act ("TCJA") as a way to defer or minimize capital gains.

In December 2019, as part of the "Disaster Act" included in the "Further Consolidated Appropriations Act, 2020," (the "Act") Congress retroactively repealed the rule implemented as part of the TCJA which required tax-exempt organizations to include certain qualified transportation fringe benefits provided to their employees as unrelated business taxable income ("UBTI"). Also, as part of this Act, several taxes that were enacted as part of the Affordable Care Act were repealed, including the so-called "Cadillac" excise tax that was set to go into effect in 2022, which would have imposed an excise tax when the value of employer provided health insurance exceeded a threshold amount.

There were also several changes to California law. In July 2019, California passed Assembly Bill 91 ("A.B. 91") which selectively conforms California's tax laws to some, but not all, of the changes made under the TCJA. In June 2019, California enacted an individual health care mandate, which takes effect on January 1, 2020, that requires all California residents to have qualifying health insurance throughout the year. Another change that will be phased in over some years starting in 2020 is the requirement for California employers to offer a retirement savings program to their employees.

The California Film Commission continues to administer the Film and Television Tax Credit Program, which has been extended to at least June 2025. Further, in November 2020 the

California electorate may be voting on a ballot measure that is intended to roll back the Proposition 13 property tax increase limitations as it applies to commercial and industrial properties.

A major change with broad based implications for payroll taxes relates to California's passage of Assembly Bill 5 ("A.B. 5"), which Governor Newsom signed into law in September 2019. The measure codifies the ruling from the California Supreme Court case *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*. It applies a three-part test, commonly known as the "ABC" test, that must be satisfied for a worker to be classified as an independent contractor rather than an employee. A.B. 5 also puts the burden of proof on employers. Ride-sharing companies and other employer groups are challenging the law and many states are grappling with similar issues regarding employee classification.

As always, we need to emphasize that any business operating as an S-Corporation should pay shareholders a fair salary. Distributing profits in the absence of salaries and payroll taxes could subject the company to penalties. Also, it may be beneficial for businesses to make an annual safe harbor election for amounts paid to acquire tangible property, thus allowing certain asset acquisitions to be expensed.

As noted last year, as a result of the Bipartisan Budget Act of 2015 ("BBA"), federal audits of partnership tax returns drastically changed starting with tax years beginning after December 31, 2017, which could result in a tax assessment being imposed at the partnership level rather than at the individual level. Many partnerships may be able to elect out of the new centralized partnership audit regime. Therefore, partners may want to discuss and review their options in this regard.

Finally, as we note each year, please take steps to complete payroll and information filings on a timely basis, as the penalties for failing to do so can be severe. Remember that the law now requires Forms 1099-MISC reporting non-employee compensation ("NEC") to be filed with the recipient and the IRS by January 31, whether filed on paper or electronically.

This memorandum is intended to provide general information. If you have any questions or need more details, please feel free to contact us.

We look forward to serving you in 2020.

Miller Kaplan Arase LLP

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I. EARNINGS REPORTS DUE IN 2020

A. Payroll Taxes

1. IRS Form 941 – Employer's Quarterly Federal Tax Return

FICA:	2020 Applicable During 2020	2019 Applicable During 2019
Social Security Wage Limit	$137,700	$132,900
Withholding Tax Rate ("OASDI" Portion Only)	6.2%	6.2%
Maximum Withholding	$8,537.40	$8,239.80
Employer Tax Rate ("OASDI" Only)	6.2%	6.2%
Maximum Employer Portion	$8,537.40	$8,239.80
Medicare Wage Limit	Unlimited	Unlimited
Tax Rate ("HI" Portion Only)	1.45%	1.45%
Maximum Withholding	Unlimited	Unlimited
Employer Matching Tax Rate ("HI" Only)	1.45%	1.45%
Maximum Employer Matching	Unlimited	Unlimited

There is an additional 0.9% Medicare surtax for certain high-income taxpayers (single individuals with income exceeding $200,000 and married filing jointly taxpayers with income over $250,000). The surtax does not apply to the employer's share.

Quarter Ending Date	Form 941 Due Dates
December 31, 2019	January 31, 2020
March 31, 2020	April 30, 2020
June 30, 2020	July 31, 2020
September 30, 2020	October 31, 2020

2. IRS Form 940 – Employer's Annual Federal Unemployment Tax Return

	2019	2018
Federal Unemployment Tax - On Annual Wage Limit to Each Employee of	$7,000.00	$7,000.00
Federal Unemployment Tax Rate - Employer Only	6.0%	6.0%
Allowable California Credit	5.4%	5.4%
Net Federal Tax Rate	0.6%	0.6%

File the Form 940 for the year ended December 31, 2019 no later than January 31, 2020. Note: Deposits for 2019 were required for any quarter when the cumulative liability for the quarter was $500.00 or more.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

A. Payroll Taxes (Continued)

2. IRS Form 940 – Employer's Annual Federal Unemployment Tax Return (Continued)

In general, payments for services of a spouse or a child under age 21 are exempt from FUTA tax. Payments for the services of a child under age 18 who works for his or her parent are exempt from social security and Medicare taxes if the trade or business is a sole proprietorship or a partnership in which each partner is a parent of the child. Federal income taxes are, however, required to be withheld. These special rules generally do not apply to family owned partnerships or corporations or to an estate, even if the estate is of a deceased parent. For California purposes, family employees are generally exempt from Unemployment Insurance ("UI"), Employment Training Tax ("ETT"), and State Disability Insurance ("SDI"). However, they are subject to California personal income tax withholding.

All employers conducting business in California are subject to the employment tax laws of the California Unemployment Insurance Code ("CUIC"). Once a business hires an employee, the business is considered an employer subject to state payroll taxes and must register with the Employment Development Department ("EDD") within 15 days after paying wages in excess of $100 in a calendar quarter.

3. California Form DE 9

All employers are required to electronically submit employment tax returns, wage reports, and payroll tax deposits to the California Employment Development Department. Employers may be charged penalties for non-compliance.

Required Forms

The following forms must be submitted electronically under the e-file and e-pay mandate:

- *Quarterly Contribution Return and Report of Wages* (DE 9)
- *Quarterly Contribution Return and Report of Wages (Continuation) (DE 9C)*
- *Employer of Household Worker(s) Quarterly Report of Wages and Withholdings (DE 3BHW)*
- *Employer of Household Worker(s) Annual Payroll Tax Return (DE 3HW)*
- *Quarterly Contribution Return (DE 3D)*
- *Payroll Tax Deposit (DE 88)*

Employers can use e-Services for Business to comply with the e-file and e-pay mandate and avoid penalties. The e-Services for Business function is a fast, easy, and secure way to manage your employer payroll tax accounts online. With e-Services for Business, you can do the following:

- Register for an employer payroll tax account number.
- File, adjust, and print returns/reports.
- Make payments.
- View and update account information.
- Close or re-open an employer payroll tax account.
- View notices and letters regarding registration, payments, returns, and more.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

A. Payroll Taxes (Continued)

3. California Form DE 9 (Continued)

Employers may request a waiver from the mandate due to lack of automation, severe economic hardship, current federal exemption from filing electronically, or other good cause. To obtain an E-file and E-pay Mandate Waiver Request (DE 1245W):

- Download the DE 1245W from the EDD website. Visit www.edd.ca.gov/EfileMandate for more information.
- Visit the nearest Employment Tax Office listed on the EDD website at www.edd.ca.gov/Office_Locator/.
- Contact the Taxpayer Assistance Center at (888) 745-3886.
- An approved waiver will be valid for one year. Upon expiration of the approval period, an employer must start to electronically file and pay, or submit a new waiver request to avoid a non-compliance penalty.

A summary table is as follows:

	2020 Applicable During 2020	2019 Applicable During 2019
SUI Tax - Annual Wage Limit	$7,000.00	$7,000.00
(Tax Rate Assigned to Employers Based on Experience)	*	*
ETT - Annual Wage Limit	$7,000.00	$7,000.00
Tax Rate	0.1%	0.1%
SDI Tax - Annual Wage Limit	$122,909.00	$118,371.00
Tax Rate	1.0%	1.0%
Maximum Amounts to be Withheld	$1,229.09	$1,183.71

* See Form DE 2088, Notice of Contribution Rates and Statement of UI Reserve Account mailed to all employers in December. If you need rate information, call the Tax Rate information at (916) 653-7795. Or do an online rate search at eddservices.edd.ca/gov/tap/open/rateinquiry/_/#1. Employers have 60 days from the date of notification to dispute their UI contribution rate. The General EDD Telephone Assistance Line is (888) 745-3886. To simplify matters, the state encourages use of their e-services for business function. Log onto www.edd.ca.gov/ for details.

4. Washington State Requirements

Washington State requires businesses to register with the state's Department of Revenue ("DOR") if the business meets any of the following conditions:

- The business is required to collect sales tax.
- Gross income is $12,000 a year or more.
- The business is a buyer or processor of specialty wood products.
- The business is required to pay taxes or fees to the DOR.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

A. Payroll Taxes (Continued)

4. Washington Requirements (Continued)

Washington State does not have an income tax, but it does have a Business & Occupation ("B&O") tax based on gross receipts. This means there are no deductions from the B&O tax for labor, materials, taxes, or other costs of doing business. The B&O tax rate varies by which classification the business fits into. There are a few B&O credits available. Go to dor.wa.gov for more details.

B. Wage and Tax Statement – 2019 Form W-2 (Furnish to Employees by January 31, 2020)

22222	a Employee's social security number	OMB No. 1545-0008		
b Employer identification number (EIN)		1 Wages, tips, other compensation	2 Federal income tax withheld	
c Employer's name, address, and ZIP code		3 Social security wages	4 Social security tax withheld	
		5 Medicare wages and tips	6 Medicare tax withheld	
		7 Social security tips	8 Allocated tips	
d Control number		9	10 Dependent care benefits	
e Employee's first name and initial Last name Suff.		11 Nonqualified plans	12a Code	
		13 Statutory employee / Retirement plan / Third-party sick pay	12b Code	
		14 Other	12c Code	
			12d Code	
f Employee's address and ZIP code				

15 State Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** Wage and Tax Statement 2019 Department of the Treasury—Internal Revenue Service

Copy 1—For State, City, or Local Tax Department

Notes Per Form Instructions:

1. **Military Differential Pay –** Payments made to employees while they are on active duty for more than 30 days in the Armed Forces or other uniformed services are treated as wages. Report differential wage payments in box 1 of Form W-2.

2. **Nonqualified Deferred Compensation Plans –** Section 409A, added by the American Jobs Creation Act of 2004, provides that all amounts deferred under a nonqualified deferred compensation ("NQDC") plan for all taxable years are includible in gross income unless certain requirements are satisfied.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

B. Wage and Tax Statement – 2019 Form W-2 (Give to Employees before February 1, 2020) (Continued)

Notes Per Form Instructions: (Continued)

Additional Note:

3. **S Corporation Fringe Benefits –** An S corporation treats taxable fringe benefits paid on behalf of its 2% shareholder-employees as additional compensation to them. The corporation deducts the additional compensation on page 1, line 7 ("Compensation of officers") or line 8 ("Salaries and wages") of its Form 1120S. The corporation reports the additional compensation to the shareholder-employees on Forms W-2. The additional compensation is subject to federal tax withholding and is generally subject to employment taxes (FICA and FUTA). However, payments made pursuant to a plan providing accident and health coverage are only subject to income tax withholding; they are *not* subject to any other employment taxes.

4. **Qualified Transportation Fringe Benefits –** The TCJA changed the laws with regards to qualified transportation fringe ("QTF") benefits. QTF benefits include transportation in commuter vehicles between the employee's residence and place of work, transit passes, qualified parking, and any qualified bicycle commuting reimbursements. Employers may still provide tax-free QTF benefits to employees for transit and parking up to a monthly maximum amount ($265 for 2019). However, beginning with amounts paid or incurred on or after January 1, 2018, employers cannot deduct the expenses if the employees receive the tax-free QTF benefits. Beginning January 1, 2018, employees are no longer able to exclude qualified bicycle commuting reimbursements from their income.

5. **Employer Provided Educational Assistance –** Employers can exclude from an employee's wage up to $5,250 of educational assistance provided to an employee only if it is provided under an educational assistance program under Section 127.

6. **Deceased Employee's Wages –** The IRS has special instructions for reporting wages if an employee dies during the year. Consult the instructions to the 2019 Form W-2.

7. **Group-Term Life Insurance –** Employers must include in their employees' wages subject to social security and Medicare taxes, the cost of group-term life insurance that is greater than the cost of $50,000 of coverage, reduced by the amount the employee paid toward the insurance. Report this as wages in boxes 1, 3, and 5 of the employee's 2019 Form W-2. Also report the amount in box 12 with code "C."

   Figure the monthly cost of the insurance includible in the employee's wages by multiplying the number of thousands of dollars of all insurance coverage over $50,000 (figured to the nearest $100) by the cost shown in the following table from Treas. Reg. section 1.79-3, Table I. For all coverage provided within the calendar year, use the employee's age on the last day of the employee's tax year. Employers must prorate the cost from the table if less than a full month of coverage is involved.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

B. Wage and Tax Statement – 2019 Form W-2 (Give to Employees before February 1, 2020) (Continued)

Notes Per Form Instructions: (Continued)

COST PER $1,000 OF PROTECTION FOR ONE MONTH

Age	Cost
Under 25	$ .05
25 through 29	.06
30 through 34	.08
35 through 39	.09
40 through 44	.10
45 through 49	.15
50 through 54	.23
55 through 59	.43
60 through 64	.66
65 through 69	1.27
70 and older	2.06

Employers figure the total cost to include in the employee's wages by multiplying the monthly cost by the number of full months coverage at that cost. For example, for a 50-year old employee with $500,000 of group-term coverage, the total cost to include is $1,242, as follows:

$450 (insurance coverage over $50,000 in thousands of dollars) x .23 (cost per table) x 12 months = $1,242

8. Selected notes for particular boxes follow:

Box b – Provide the Federal Employer Identification Number ("FEIN") assigned by the IRS. Do not use a prior FEIN once a FEIN is changed.

Box d – Control Number: This is optional. Employers may use this box to identify individual Forms W-2.

Box 3 – Social Security Wages: Cannot exceed $132,900 for 2019.

Box 4 – Social Security Tax Withheld: Cannot exceed $8,239.80 for 2019.

Box 5 – Medicare wages and tips: Unlimited for 2019.

Box 6 – Medicare tax withheld: Unlimited for 2019.

Box 11 – Report total distributions made to the employee from a non-qualified deferred compensation plan or a nongovernmental section 457(b) plan during 2019, here and in Box 1. Report deferred amounts that are no longer subject to a substantial risk of forfeiture in Boxes 3 and 5. Do not report in Box 11 deferrals included in Boxes 3 and/or 5 and deferrals for current year services (such as those with no risk of forfeiture). Payments to beneficiaries of deceased employees are reportable on Form 1099-R.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

B. Wage and Tax Statement – 2019 Form W-2 (Give to Employees before February 1, 2020) (Continued)

Notes Per Form Instructions: (Continued)

Box 12 – Enter a code (A through EE) for items such as cost of group term life insurance over $50,000 (Code C), elective deferrals to a section 401(k) arrangement (Code D), etc. Do not enter more than four items in box 12. If more than four items are needed, use a separate W-2.

The Affordable Care Act ("ACA") requires employers with 250 or more employees to disclose on Forms W-2 the value of the employee's health insurance coverage.

Box 13 – Checkboxes. Statutory Employees. Mark this checkbox for statutory employees whose earnings are subject to social security and Medicare taxes but not subject to federal income tax withholding. Statutory employees are workers who are independent contractors under common-law rules but are treated by statute as employees.

Box 14 – Other. The lease value of a vehicle provided to your employee and reported in box 1 must be reported here or in a separate statement to your employee. You may also use this box for any other information you want to give your employee.

Boxes 15 through 20 – State and local income tax information. For California employers, enter in Box 19 the amount of State Disability Insurance ("SDI") actually withheld, and in Box 20 the letters "CASDI". The 2019 SDI maximum was $1,183.71.

In a new regulation issued in an effort to combat identity theft, the IRS eliminated the automatic 30-day extension for Forms W-2 or 1099-MISC reporting nonemployee compensation that had been available with the filing of Form 8809. Thus, extensions will only be granted due to extraordinary circumstances.

The TCJA suspended the exclusion for qualified moving expenses. However, the exclusion will still apply to certain employees in the military.

C. Transmittal Form Addresses

The Following Form is Due by January 31, 2020:

1. 2019 Forms W-2 and W-3 (Federal)

The IRS no longer mails paper tax packages. If you file 250 or more Forms W-2 or W-2c, then you must file them electronically. If you are required to e-file but fail to do so, you may incur a penalty. The Social Security Administration ("SSA") encourages you to file electronically even if you are filing fewer than 250 Forms W-2. For more information about e-filing Forms W-2 or W-2c, visit the SSA's Business Services Online ("BSO") website at www.ssa.gov/bso/bsowelcome.htm.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

C. Transmittal Form Addresses (Continued)

The Following Form is Due by January 31, 2020: (Continued)

1. 2019 Forms W-2 and W-3 (Federal) (Continued)

File Copy A of Form(s) W-2 with the Form W-3 at the following address:

If Using United States Postal Service:

Social Security Administration
Data Operations Center
Wilkes-Barre, PA 18769-0001
(For certified mail use Zip Code 18769-0002)

For Other IRS Approved Private Delivery Services:

Social Security Administration
Data Operations Center
Attn: W-2 Process
1150 E. Mountain Dr.
Wilkes-Barre, PA 18702-7997

2. 2019 Form DE 9 (California)

The Quarterly Return and Report of Wages must be e-filed to the EDD. Visit www.edd.ca.gov/payroll_taxes/e-services_for_business.htm.

D. Information Forms

1. Taxpayer Identification Number Solicitation. Forms W-8 and W-9 series.

a. All US payers of reportable payments are required to solicit taxpayer identification numbers on a Form W-9 or a substitute W-9; or in the case of nonresident aliens ("NRAs") one of the W-8 series Forms. Solicitation is the only safe harbor method of collection authorized by the IRS Regulations.

b. Tax Identification Number ("TIN") Matching. The IRS has established a free on-line TIN matching program that allows payors of reportable payments and their agents to verify the payee TINs required to be reported on information returns and payee statements. The IRS maintains a name/TIN data base specifically for the matching program. Before a program participant files an information return, it may check the TIN furnished by the payee against the name/TIN combination in the data base. The IRS will inform the payor whether there is a match. A name/TIN match may serve as reasonable cause that will avoid a penalty for failure to file correct information returns or furnish correct payee statements. The IRS will waive the penalty if the payor documents the match as set forth in IRS Publication No. 2108-A, *On-Line Taxpayer Identification Number ("TIN") Matching Program*.

c. New Forms W-9 and W-8 series.

i. The IRS issued a revised version of Form W-9 in October 2018.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

D. Information Forms (Continued)

1. Taxpayer Identification Number Solicitation. Forms W-8 and W-9 series. (Continued)

c. New Forms W-9 and W-8 series. (Continued)

Purpose of Form:

An individual or entity (Form W-9 requester) who is required to file an information return with the IRS must obtain a payee's correct taxpayer identification number ("TIN") which may be the payee's social security number ("SSN"), individual taxpayer identification number ("ITIN"), adoption taxpayer identification number ("ATIN"), or employer identification number ("EIN"), to report on an information return the amount paid to the payee, or other amount reportable on an information return.

ii. Forms W-8 are used to certify foreign status. The IRS issued revised W-8 series forms in 2017, splitting the single Form W-8 into Form W-8BEN for individuals, Form W-8BEN-E for entities, Form W-8IMY foreign intermediaries, flow-through entities, or certain U.S. branches, and Form W-8EXP for foreign governments or other foreign organizations. The revised W-8BEN is dated July 2017. https://www.irs.gov/pub/irs-pdf/fw8ben.pdf. The Instructions for the W-8 series forms were last revised in July 2017.

2. Foreign Account Tax Compliance Act Requirements

The Foreign Account Tax Compliance Act ("FATCA") requires U.S. withholding agents paying FATCA withholdable income to withhold 30% on certain U.S. source payments made to foreign entities, if the agent is unable to document the entities for purposes of FATCA. Current FATCA regulations, and the regulations that coordinate FATCA withholding (Chapter 4 withholding) with the regulations addressing withholding on nonresident aliens (Chapter 3 withholding), require the withholding agent to presume that certain payees (apart from certain pre-existing obligations) are foreign, unless there is documentation establishing the entity to be a U.S. person.

The W-8 series forms have been revised to conform to the new FATCA rules, and all new solicitations should be made using these new forms.

3. Eyeball Test

The "eyeball test" is no longer available. The fact that an entity name includes "Incorporated," "Inc.," "Corporation," or "Corp." is no longer sufficient to establish U.S. exempt status. Form W-9 is the only documentation that will suffice to prove U.S. status and to avoid applicable Chapter 3 or Chapter 4 withholding and penalties.

4. IRS Form 1099 Series – U.S. Information Returns

Generally, you need to file Form 1099 for any individual, partnership, or trust (non-corporate entity) to whom you paid rents, dividends, interest, commissions, fees, payments for services (not wages), etc. See the instructions to determine what type and amount of payments must be reported in the

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

D. Information Forms (Continued)

4. IRS Form 1099 Series – U.S. Information Returns (Continued)

boxes and the correct type of Form 1099 to use. There are certain filing thresholds for depending on the type of payment. For example, you need to file Form 1099-MISC for each person to whom you have paid during the year at least $600 in rents, non-employee compensation, prizes and awards, payments to an attorney, and other income payments.

Note: Generally you have to issue a Form 1099 for payments made to limited liability companies. However, there is an exception if the LLC has filed Form 8832 with the IRS to elect to be taxed as a corporation. (Many LLCs choose to be taxed as partnerships or sole proprietorships.) The only safe harbor method for determining this election is by soliciting a Form W-9 or a substitute W-9.

Prepare in triplicate (no photocopies allowed): Copy A to be transmitted to IRS with Form 1096, a copy for the recipient, and a copy for the employer's files. Give the recipient their copy no later than January 31, 2020. Forms 1099 should be typed or machine printed, although most Forms 1099 may now be furnished electronically to taxpayers with their consent. Please remember to include a telephone number below the address in the payer's section. If you have questions concerning filing requirements and procedures for information returns (any Form 1099) or Form W-2, contact the Martinsburg Computing Center toll-free at (866) 455-7438.

Important Notice regarding Forms 1099-MISC with Non-Employee Compensation ("NEC"):

The PATH Act of 2015 requires Forms 1099-MISC reporting NEC in box 7 to be filed by January 31. Therefore, a Form 1099-MISC is due as follows:

- Reporting NEC, whether filed on paper or electronically: January 31
- Not reporting NEC and filed on paper: February 28
- Not reporting NEC and filed electronically: March 31.

If any of your Forms 1099-MISC reporting NEC will be filed after January 31, file them in a separate transmission from your Forms 1099-MISC without NEC. Filers should anticipate that if transmissions sent after January 31 include both Forms 1099-MISC reporting NEC and Forms 1099-MISC that do not report NEC in a single transmission (on paper with a single Form 1096 or electronically through FIRE with a single payer "A" record), the IRS will treat every form in the single transmission as if it is subject to the section 6721 penalty for failure to file by January 31. The IRS may send you a Notice 972CG, *A Penalty is Proposed for Your Information Returns,* to which you may respond and clarify the content of the submission, indicating the number of Forms 1099-MISC that did not report NEC.

Please note that on July 24, 2019 the IRS posted a draft Form 1099-NEC, *Nonemployee Compensation*, for the 2020 tax year, which will be filed in 2021. The IRS requested comments on the Form 1099-NEC and plans to add instructions. At the time of this publication, the IRS had not yet finalized the Form 1099-NEC.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

D. Information Forms (Continued)

5. When to File the IRS Copies

Where to File

File the 2019 Form 1098 and the 1099 series forms by February 28, if filing on paper, or March 31, if filing electronically. But if there is nonemployee compensation reported in Form 1099-MISC Box 7, the due date is January 31 for both paper and electronic returns. If you are filing 250 or more returns of the same type, you must file electronically. See IRS Publication 1220 for specifications in that regard. Form 1096 must accompany all paper submissions.

The mailing address for California paper filers is:

Department of the Treasury
Internal Revenue Center
Ogden, UT 84201

Payments made with a credit card or through third party network transactions such as PayPal, should be reported on Form 1099-K by the payment settlement entity. They are not subject to reporting on Form 1099-MISC, even if the total exceeds $600.

Also note that for most reportable payments there will not be any extension beyond the January 31 due date for mailing forms to recipients. (Previously an automatic extension was available providing an additional 30 days for both mailing to recipients and filing with the IRS for all Forms 1099). There are strict qualification requirements for those extensions that are available. See IRS Form 8809 and related instructions for details.

E. Rules on 2019 Withholding from Supplemental Wage Payments

1. General Requirements (Note: Rate Changes from 2017, as a result of the TCJA)

The following discussion provides guidance on the proper way to withhold federal income tax from supplemental wage payments made in addition to regular wages:

Supplemental wages are compensation paid to an employee in addition to regular wages. Supplemental wage payments include, but are not limited to, bonuses, commissions, overtime pay, accumulated sick leave, severance pay, awards, prizes, back pay, retroactive wage increases for current employees, and payments for nondeductible moving expenses.

The payments may be made at a different time from regular wage payments or may be based on a different wage rate or a different payroll period from regular wages, or on no particular payroll period at all. The federal supplemental withholding rate is generally a flat 22%. However, supplemental wage payments exceeding $1M are subject to withholding at the highest federal tax rate for the year, currently 37%. See 2019 IRS Publication 15 (Circular E) for more details.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

E. Rules on 2019 Withholding from Supplemental Wage Payments (Continued)

1. General Requirements (Continued)

You must decide whether to treat supplemental wage payments as regular wages or to separate them from regular wages before you withhold. The IRS provides computation rules that explain when supplemental wages must be included with regular wage payments and when they must be reported separately. The rules apply to supplemental payments made in the same calendar year that regular wages are paid.

The State of California classifies supplemental and bonus payments into three categories for tax purposes as follows:

a. Regular Pay – If the supplemental wages are paid at the same time as the employee's regular wages, you are required to withhold taxes based on the employee's DE-4 in effect at the time the payment is made.

b. Supplemental Wages (such as overtime, severance pay, and housing allowance) – The supplemental flat tax rate will be used if the payments are not paid with the employee's regular wages. If the payment is made with regular pay, the taxes are withheld based on the employee's DE4; otherwise, the taxes are withheld at the supplemental flat tax rate in effect at the time the payment is made, currently 6.6%.

c. Bonuses and Stock Options – The bonus and stock options flat tax rate will be used if the payments are not paid with the employee's regular wages. If the payment is made with regular pay, the taxes are withheld based on the employee's DE4; otherwise, the taxes are withheld at the bonus flat tax rate in effect at the time the payment is made, currently 10.23%.

A payer is required to withhold on reportable payments, such as interest and dividends, under the following circumstances:

a. The payee fails to furnish his TIN to the payor in the manner required;

b. The IRS notifies the payor that the TIN furnished by the payee was incorrect;

c. The IRS notifies the payor that backup withholding is required because the payee failed to properly report interest or dividends; or

d. The payee fails to certify, under penalties of perjury, that the payee is not subject to backup withholding when such certification is required.

2. IRS Form 945 - Annual Return of Withheld Federal Income Tax

Use this Form to report nonpayroll income tax withholding. These nonpayroll items include backup withholding and withholding on pensions, annuities, IRAs, and gambling winnings. Semi-weekly depositors are required to file Form 945-A, a summary of the tax liability, with their Forms 945.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

E. Rules on 2019 Withholding from Supplemental Wage Payments (Continued)

2. IRS Form 945 - Annual Return of Withheld Federal Income Tax (Continued)

Federal tax deposits must be made by electronic funds transfer. Generally, electronic funds transfers are made using the Electronic Federal Tax Payment System ("EFTPS"). However, if a taxpayer's total taxes for the year are less than $2,500, the taxpayer is not required to make deposits during the year and can pay the taxes with the Form 945.

3. California Form 592 - Return for Tax Withheld at Source

Withholding agents must remit payments of tax withheld on California source payments to the Franchise Tax Board ("FTB") using Form 592, *Resident and Nonresident Withholding Statement*, by the required due dates in order to avoid interest and penalties. Withholding must begin as soon as the total payments of California source income for the calendar year exceed $1,500. The withholding agent must provide Form 592-B to each payee which shows the total amount withheld and reported for the tax year. Additionally, if the FTB issued Form 594, *Notice to Withhold Tax at Source*, complete the form as indicated in the instructions and send the voucher with payment of tax withheld to the FTB.

F. Affordable Care Act Reporting

Congress has rescinded the penalty for the Affordable Care Act beginning on January 1, 2019. That means that starting with the 2019 federal tax returns (to be filed in 2020), you will no longer be subject to a fee called the Individual Shared Responsibility Payment if you can afford health insurance but choose not to buy it. However, some states, such as California, have enacted their own requirements and exchanges and employers will still need to file Forms 1094-B and 1095-B or 1095-A and 1095-C so that premium subsidies can be reconciled on tax returns.

Employers with 50 or more full-time employees (including full-time equivalent employees) must use Form 1095-C, Employer Provided Health Insurance Offer and Coverage, to report 2019 health insurance information for each full time employee to both the IRS and the employee. Those employers must also file Form 1094-C to report additional information to the IRS. Employers with less than 50 employees will use Form 1094-B and 1095-B to report 2019 health coverage information to employees and the IRS. Those small employers will use Form 1094-B to transmit Forms 1095-B to the IRS.

The due date for furnishing Forms 1095-B and 1095-C to employees is extended from January 31, 2020 to March 2, 2020, for the 2019 calendar year. Whereas the due date to file the return and transmittal form with the IRS remains February 28 if filing on paper (or March 31 if filing electronically).

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

F. Affordable Care Act Reporting (Continued)

Form **1095-B**
Department of the Treasury
Internal Revenue Service

Health Coverage
► Do not attach to your tax return. Keep for your records.
► Go to *www.irs.gov/Form1095B* for instructions and the latest information.

☐ VOID ☐ CORRECTED

OMB No. 1545-2252
2019

Part I Responsible Individual

1 Name of responsible individual–First name, middle name, last name		2 Social security number (SSN) or other TIN	3 Date of birth (If SSN or other TIN is not available)
4 Street address (including apartment no.)	5 City or town	6 State or province	7 Country and ZIP or foreign postal code
8 Enter letter identifying Origin of the Health Coverage (see instructions for codes): ►		9 Reserved	

Part II Information About Certain Employer-Sponsored Coverage (see instructions)

10 Employer name			11 Employer identification number (EIN)
12 Street address (including room or suite no.)	13 City or town	14 State or province	15 Country and ZIP or foreign postal code

Part III Issuer or Other Coverage Provider (see instructions)

16 Name		17 Employer identification number (EIN)	18 Contact telephone number
19 Street address (including room or suite no.)	20 City or town	21 State or province	22 Country and ZIP or foreign postal code

Part IV Covered Individuals (Enter the information for each covered individual.)

	(a) Name of covered individual(s) First name, middle initial, last name	(b) SSN or other TIN	(c) DOB (If SSN or other TIN is not available)	(d) Covered all 12 months	(e) Months of coverage											
					Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
23				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
24				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
25				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
26				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
27				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
28				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 60704B Form **1095-B** (2019)

Form **1095-C**
Department of the Treasury
Internal Revenue Service

Employer-Provided Health Insurance Offer and Coverage
► Do not attach to your tax return. Keep for your records.
► Go to *www.irs.gov/Form1095C* for instructions and the latest information.

☐ VOID ☐ CORRECTED

OMB No. 1545-2251
2019

Part I Employee / **Applicable Large Employer Member (Employer)**

1 Name of employee (first name, middle initial, last name)	2 Social security number (SSN)	7 Name of employer	8 Employer identification number (EIN)
3 Street address (including apartment no.)		9 Street address (including room or suite no.)	10 Contact telephone number
4 City or town	5 State or province / 6 Country and ZIP or foreign postal code	11 City or town	12 State or province / 13 Country and ZIP or foreign postal code

Part II Employee Offer of Coverage — **Plan Start Month** (enter 2-digit number):

	All 12 Months	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
14 Offer of Coverage (enter required code)													
15 Employee Required Contribution (see instructions)	$	$	$	$	$	$	$	$	$	$	$	$	$
16 Section 4980H Safe Harbor and Other Relief (enter code, if applicable)													

Part III Covered Individuals
If Employer provided self-insured coverage, check the box and enter the information for each individual enrolled in coverage, including the employee. ☐

	(a) Name of covered individual(s) First name, middle initial, last name	(b) SSN or other TIN	(c) DOB (If SSN or other TIN is not available)	(d) Covered all 12 months	(e) Months of Coverage											
					Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
17				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
18				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
19				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
20				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
21				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
22				☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 60705M Form **1095-C** (2019)

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

G. Household Employee Taxes

If you paid a household employee cash wages of $2,100 or more in 2019 (this threshold increases to $2,200 in 2020), you must withhold 6.2% of social security and 1.45% of Medicare taxes from all cash wages you pay to that employee. Unless you prefer to pay your employee's share of social security and Medicare taxes from your own funds, you should withhold 7.65% from each payment of cash wages. Instead of paying this withheld amount to your employee, pay it to the IRS with a matching amount for your share of the taxes. The specified dollar amount and percentages can be found under the topic "Do You Need To Pay Employment Taxes?" in IRS Publication 926, *Household Employer's Tax Guide*. If you pay your employee's share of social security and Medicare taxes from your own funds, these amounts must be included in the employee's wage for income tax purposes. However, they are not counted as social security and Medicare wages or as federal unemployment wages.

You are not required to withhold federal income tax from wages you pay to a household employee. However, if your employee asks you to withhold federal income tax and you agree, you will need a completed Form W-4, *Employee's Withholding Allowance Certificate* from your employee. See IRS Publication 15, (*Circular E*), *Employer's Tax Guide*, which has tax withholding tables that are updated each year.

If you withhold or pay social security and Medicare taxes, or if you withhold federal income tax, you will need to file Form W-2, *Wage and Tax Statement*, for each employee. You will also need a Form W-3, *Transmittal of Wage and Tax Statement*. To complete Form W-2 you will need both an employer identification number ("EIN") and your employee's social security number. Your EIN is a nine-digit number issued by the IRS and is not the same as a social security number. If you do not already have an EIN, you can request one by submitting a Form SS-4 *Application for Employer Identification Number.*

If you paid cash wages to all your household employees totaling more than $1,000 or more in any calendar quarter of the current or prior year, you generally must pay federal unemployment tax under the Federal Unemployment Tax Act ("FUTA") on the first $7,000 of cash wages you pay to each household employee. For updated dollar amounts and wages not counted, look under the heading "Do You Need To Pay Employment Taxes?" in IRS Publication 926.

If you must file Form W-2 or pay FUTA tax, you will also need to file a Form 1040, Schedule H, *Household Employment Taxes,* after the end of the year with your individual income tax return to report household employment taxes.

In California, a household employer must report when he/she employs one or more individuals to perform work and pays cash wages of $750 or more in a calendar quarter. You must register with the Employment Development Department ("EDD") by submitting an *Employers of Household Workers Registration and Update* Form (DE1 HW) within 15 days after you pay $750 in total cash wages. Register online using e-Services for Business.

For more information on withholding, call the California FTB's Withhold at Source Unit at (916) 845-4900.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

H. Penalties

1. Trust Fund Recovery Penalty

Federal income taxes, social security, and Medicare taxes along with certain excise taxes withheld by an employer and held in trust until paid to the U.S. Treasury are called trust fund taxes. If trust fund taxes are willfully not collected, not truthfully accounted for, and not paid, the IRS may charge a trust fund recovery penalty. The penalty is equal to 100% of the trust fund taxes evaded and may apply to a person or persons the IRS determines is responsible.

2. Failure to File Correct Information Returns by Due Date

This penalty applies to the failure to file timely returns and the failure to include all required or correct information (including missing or incorrect taxpayer identification numbers). The penalty also applies for filing on paper when required to file on electronic media or for failing to file forms that allows them to be processed.

3. Information Return Penalties

P. L. 114-27 increased the penalties for failure to file correct information returns and provide correct payee statements for information returns required to be filed after December 31, 2015.

Information Return penalties are discussed in the IRS Publication, *General Instructions for Certain Information Returns*. The penalties and maximums in for not filing correct information returns under IRC Section 6721 and/or for not furnishing correct payee statements under IRC Section 6722, are revised as follows:

- $50 per information return if you correctly file within 30 days (by March 30 if the due date is February 28); maximum penalty $556,500 per year ($194,500 for small businesses).

- $110 per information return if you correctly file more than 30 days after the due date but by August 1; maximum penalty $1,669,500 per year ($556,500 for small businesses).

- $270 per information return if you file after August 1 or you do not file required information returns; maximum penalty $3,339,000 per year ($1,113,000 for small businesses).

You are considered a small business and subject to the lower maximum penalties if your average annual gross receipts for the 3 most recent tax years (or for the period you were in existence, if shorter), was less than or equal to $5 million.

Also, the penalty is increased to $270 per information return if you do not file corrections and you do not meet any of the exceptions to the penalty.

If you fail to file a correct information return and/or fail to furnish correct payee statements due to intentional disregard of the requirements, the penalty is at least $550 per payee statement with no maximum penalty.

I. EARNINGS REPORTS DUE IN 2020 *(Continued)*

H. Penalties (Continued)

3. Information Return Penalties (Continued)

Generally, no information return is required to be filed with the FTB unless the California amounts are different from the federal amounts.

California has its own unique provision that provides that the FTB may disallow a deduction to a taxpayer for amounts paid as remuneration for personal services if that business fails to report the payments on a Form W-2 or Form 1099.

4. Failure to Furnish Correct Payee Statements

The penalty for failing to provide correct payee statements apply if you fail to provide the statement by the due date. The payee statement must include all the information furnished to the IRS and, in some cases, additional information. Different rules apply to furnishing statements to recipients depending on the type of payment (or other information) you are reporting and the form you are filing.

I. Electronic Federal Tax Payment System (EFTPS)

EFTPS is a free, secure payment system provided by the U.S. Treasury Department. The following information on EFTPS is from the irs.gov website:

Every user must have a secure Internet browser with 128-bit encryption in order to access the site. To log on to the system, an enrolled user must be authenticated with three pieces of unique information: Taxpayer Identification Number (EIN or SSN), EFTPS Personal Identification Number (PIN), and an internet password.

Businesses and Individuals can schedule payments up to 365 days in advance. Scheduled payments can be changed or cancelled up to two business days in advance of the scheduled payment date.

You can use EFTPS® to make all your federal tax payments, including income, employment, estimated and excise taxes.

You can check up to 16 months of your EFTPS® payment history online or by calling EFTPS® Customer Service.

By 8 p.m. ET at least one calendar day in advance of the due date, submit your payment instructions to EFTPS® to move the funds from your account to the Treasury's account for payment of your federal taxes. Funds will not move from your account until the date you indicate. You will receive an immediate acknowledgement of your payment instructions, and your bank statement will confirm the payment was made.

To enroll, or for more information on enrollment, visit EFTPS® or call EFTPS® Customer Service to request an enrollment form: 1-800-555-4477

II. AUTO MILEAGE AND EXPENSE REIMBURSEMENT INFORMATION

A. Employer Reimbursement Plan Rules

Unreimbursed expenses, or expenses paid under a "nonaccountable" expense reimbursement arrangement must be reported as salary or wages on Form W-2. An employee is eligible to deduct the related expenses as miscellaneous itemized deductions subject to the 2% adjusted gross income and standard deduction limitations. Reimbursements paid under an "accountable" plan will generally not be reported on Form W-2. Under an "accountable" plan the employee may deduct otherwise allowable expenses which are in excess of the reimbursement as miscellaneous itemized deductions subject to the limitations previously stated.

For tax years beginning after December 31, 2017 and before January 1, 2026, the TCJA suspended the ability for taxpayers to take miscellaneous itemized deductions subject to the 2% adjusted gross income limit. Thus, during those years, employees cannot deduct unreimbursed employee expenses or expenses paid under "nonaccountable" expense reimbursement arrangements.

B. Accountable Plan Defined

A reimbursement or other expense allowance arrangement constitutes an accountable plan if it has the following three elements:

1. The related expense has a business connection;
2. the employer requires the employee to substantiate the expenses; and
3. the employer requires the employee to return any amount paid in excess of the substantiated expenses.

A nonaccountable plan is a reimbursement or expense allowance arrangement that does not meet one or more of the three rules listed above.

We strongly recommend that the plan be in writing. If an arrangement meets the three main requirements of an accountable plan, but the employee fails to return the excess amount, only the amount that has been substantiated is treated as paid under an accountable plan. Special deemed substantiation rules apply to mileage allowances and meal and incidental per-diem expense allowances.

The requirements stated above are applied on an employee-by-employee basis. Failure by one employee to fulfill one of the criteria does not cause amounts paid to other employees under the arrangement to be treated as paid under a nonaccountable plan. A payer may have more than one arrangement with a particular employee without running afoul of the accountable plan requirements.

Expenses subject to these rules include business meals, travel expenses, auto expenses, and other similar expenses of the employee which are ordinary and necessary to the business of the employer and reimbursed to employees. Further, so called "expense allowances" are also covered. Expenses should clearly indicate what they are, the amount of each expense, date incurred, persons for whom the expense was incurred, place where expense was incurred, and the business purpose of the expense. Certain expenses such as meals and entertainment require more information than automobile expenses.

II. AUTO MILEAGE AND EXPENSE REIMBURSEMENT INFORMATION *(Continued)*

B. Accountable Plan Defined (Continued)

Although advances remain a problem under the accountable plan rules, the Treasury Regulations provide a safe harbor method. The requirements are treated as met within a reasonable time if an advance is made within 30 days of when an expense is paid or incurred, an expense is substantiated within 60 days after it is paid or incurred, and any excess amount is returned within 120 days after the expense is paid or incurred. If the first two parts of the safe harbor are met, but the excess monies are not returned within the 120-day period, only the excess must be treated as taxable compensation. If either of the first two parts is not met, the entire amount advanced is taxable compensation.

One major exception relates to per-diem type allowances. Here, only the amounts received in excess of government allowances are treated as compensation and are subject to employment taxes and withholding. Other than not being required to verify actual costs incurred, employees using the per-diem method must still meet the same substantiation tests as with other reimbursement plans in order to avoid inclusion of the entire allowance as compensation subject to employment taxes and withholding.

C. IRS Automobile Reimbursement Mileage Rates

1. For 2019, you may elect to reimburse employees for substantiated business mileage at 58 cents for every business mile driven. This rate is used to calculate the tax deduction for business travel as an alternative to deducting actual costs of maintaining an automobile. The rate is also used by many companies to reimburse workers who use their own cars on company business.

2. Beginning January 1, 2020, the standard mileage rates for the use of a car (also vans, pickups, or panel trucks) will be:

    - 57.5 cents for every mile of business travel driven.
    - 17 cents per mile driven for medical or moving purposes.
    - 14 cents per mile driven in service of charitable organizations.

3. Accountable plan. These reimbursements may only be made free of a wage characterization if the reimbursement is made under an accountable plan. The accountable plan rules are addressed above and also in IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

D. Changes to Fringe Benefits Under TCJA

1. Employer payment or reimbursement of an employee's business expenses (so-called working condition fringe benefits) will continue to be tax-free to the employee and tax deductible by the employer. But certain fringe benefits, such as qualified transportation fringe benefits as discussed below, that still can be provided tax-free to an employee will no longer be tax deductible by the employer. If an employer chooses to provide the affected fringe benefits on a taxable basis to the employee (i.e., as W-2 wages subject to income tax), the employer may still be able claim a tax deduction for the taxable benefits.

II. AUTO MILEAGE AND EXPENSE REIMBURSEMENT INFORMATION *(Continued)*

D. Changes to Fringe Benefits Under TCJA (Continued)

2. Employees Can No Longer Deduct Unreimbursed Business Expenses. Prior to the TCJA, an employee who itemized tax deductions could deduct unreimbursed employee business expenses as a miscellaneous itemized deduction (to the extent that the aggregate miscellaneous itemized deductions exceeded 2% of the employee's adjusted gross income). However, beginning January 1, 2018 miscellaneous itemized deductions are no longer allowed. That means that if an employer reimburses an employee for a business expense, the reimbursement is tax-free to the employee. However, if the employer does not reimburse the employee's business expense, the employee will no longer be able to claim a tax deduction for the expense.

3. Moving Expenses. Prior to TCJA, an individual could claim an above-the-line deduction (a non-itemized deduction) for moving expenses paid in connection with commencement of work at a new principal place of work. Alternatively, an employer could pay or reimburse an employee for moving expenses as a tax-free fringe benefit. For tax years beginning after December 31, 2017 and before January 1, 2026, an employee cannot deduct moving expenses nor can an employer pay or reimburse an employee's moving expenses on a tax-free basis. If an employer treats the payment or reimbursement of an employee's moving expenses as taxable W-2 wages, the employer may be able to deduct the payment as a compensation expense.

4. Qualified Transportation Fringe Benefit. Prior to the TCJA, the value of a qualified transportation fringe ("QTF") benefit provided by an employer to an employee was treated as tax-free, subject to monthly limits ($265 for 2019). A "qualified transportation fringe" is defined as:

    - transportation in a commuter highway vehicle for travel between the employee's residence and place of employment;
    - transit passes;
    - qualified parking; and
    - qualified bicycle commuting reimbursement.

    Employers can still provide tax-free qualified transportation fringe benefits to employees (although employees can no longer exclude qualified bicycle commuting reimbursements from their income). However, an employer cannot deduct the expenses for providing tax-free QTF benefits. Further, tax-exempt employers that provide QTF benefits to its employees may need to pay unrelated business income tax ("UBIT") on the value of that QTF benefit.

5. Commuting Benefits. The TCJA provides that an employer cannot deduct any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer for travel between the employee's residence and place of employment, except as necessary for ensuring the employee's safety.

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT

A. Taxation of Value of Automobile

Fringe Benefit Received in 2019

For 2019, vehicle use must be supported by the general substantiation rules that require a taxpayer to prove eligibility for, and the amount of, any deduction claimed for business use. Also, the taxable personal portion of vehicle use must be included in the "Employee Wage and Tax Statement" (Form W-2) with all applicable income and payroll taxes withheld from 2019 wages. In order to compute the taxable portion of vehicle use, the following should be done:

1. The employee should complete a "Summary Statement" (see sample copy enclosed) and submit this to the employer at the end of each calendar year.

2. The personal portion of vehicle use must be valued and included in fourth quarter 2019 payroll tax returns.

3. The employee's 2019 Form W-2 must include the taxable portion of vehicle use and related withholdings.

B. Employer Provided Vehicle

1. Safe Harbor for Commuting Use Only

There is a limited safe harbor for the benefit of an employee who is required by the employer to use a company vehicle for commuting purposes. Under the safe harbor, the employee can exclude the availability of the vehicle (other than for commuting) as a working condition fringe benefit, provided the employee is entitled to value the commuting benefit in the amount of $1.50 per one-way commute. The commuting safe harbor may be used if all of the following five criteria are met:

a. The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is actually used in that trade or business.

b. For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle.

c. The employer has established a policy that the vehicle may not be used for personal purposes other than commuting. Such policy must be in writing (an example of such written policy is attached) and be given to applicable employees (or posted).

d. The employer reasonably believes that the employee does not use the vehicle for any purpose other than commuting except for de minimis personal use.

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

B. Employer Provided Vehicle (Continued)

1. Safe Harbor for Commuting Use Only (Continued)

e. The employee required to use the vehicle for commuting is not a highly compensated "control employee" of the employer.

For 2019, a "control employee" of a nongovernment employer is generally an employee who meets any of the following:

- A board or shareholder-appointed, confirmed, or elected officer whose annual compensation equals or exceeds $110,000.
- A director.
- An employee whose pay is $225,000 or more.
- An employee who owns 1% or more equity, capital or profits interest in the business.

Example A - Commuting Valuation Rule

Employee Y works for employer X. X provides a company vehicle to Y for the performance of Y's duties and requires Y to commute to and from work in the vehicle for noncompensatory but valid employer business purposes. X does not allow Y to use vehicle for any purpose other than that described and X reasonably believes that Y does not use the vehicle for other purposes. X provided Y a written policy statement and Y acknowledged receipt of the policy in writing. Y is not a "control" employee.

Based on the information presented above, the five criteria necessary for the commuting only use exception are met. The taxable fringe benefit received would be calculated by multiplying $3 times the total commuting days used by the employee. (A one-way commute would be valued at $1.50) Additionally:

a. The employer must deduct all applicable payroll taxes and withhold income taxes from wages paid in the year that the benefit is received. (The withholding of income taxes, but not payroll taxes, can be waived at the employee's discretion.)

b. The computed amount must be added to compensation records for that employee and included on Form W-2.

c. The employee can reimburse the employer in January 2020 for all Social Security (FICA) and State Disability Insurance (SDI) required to be withheld if the employer was unable to timely withhold as stated in a.

2. Sample Notice to Employees When Using Commuting Use Only Safe Harbor

TO: (Employee)
FROM: (Employer)
DATE: _____
RE: Employer-Provided Vehicle

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

B. Employer Provided Vehicle (Continued)

2. Sample Notice to Employees When Using Commuting Use Only Safe Harbor (Continued)

We have elected to use a special valuation rule for 2019 in computing the value of personal use of the vehicle which has been assigned to you. The special rule will value personal use by an automobile lease valuation rule, vehicle cents-per-mile rule, or a commuting valuation rule. We will attempt to use the method (which is available to you) that results in the least amount of additional taxable income.

In order to use the above special valuation rule, you must provide us with a written statement substantiating your personal use of the vehicle. This statement must include your total mileage for the year, broken down between business, commuting, and other personal miles. Attached is a statement which should be used in substantiating the information to us.

In general, if you do not submit a written statement to us, the value of other personal use will be computed as if no portion of your driving was for business purposes.

Instructions to Employer

The above sample notice should state which of the three methods applies to the specific employee to which the notice is written. Any one of the methods may apply to any employee; thus, an employer could utilize all three methods during the same calendar year.

3. Other Than Commuting Use Only

If one or more of the five criteria listed previously are not met, the following valuation methods, as described in examples B and C, may be used.

Example B - Vehicle Cents Per Mile

The value of any personal use by an employee of your vehicle may be calculated by multiplying the standard mileage rate (58¢ in 2019 and to be determined in 2020), by the number of miles driven by an employee for personal purposes, if you provide your employee with the use of a vehicle that either:

- you reasonably expect will be "regularly used" in your business throughout the calendar year (or a shorter period that the vehicle is owned or leased by you); or
- is driven primarily by employees for at least 10,000 miles in a calendar year.

A vehicle is considered "regularly used" in an employer's business if either: (i) at least 50 percent of the vehicle's total mileage for the year is for the employer's business; or (ii) it is generally used each workday in an employer-sponsored car pool to transport at least three employees to and from work. You may not use the cents-per-mile rate if the vehicle's value when you first make it available to any employee for personal use is more than an amount determined by the IRS as the maximum automobile value for the year. For example, you cannot use the cents-per-mile rule for an automobile that you first made available to an employee in 2019 if its value at that time exceeded $16,500 for a

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

B. Employer Provided Vehicle (Continued)

3. Other Than Commuting Use Only (Continued)

Example B - Vehicle Cents Per Mile (Continued)

passenger automobile. The IRS and the Treasury Department did not publish a separate maximum value for trucks and vans for use with the vehicle cents-per-mile valuation rule. Once the cents-per-mile rate has been adopted for a vehicle, you must continue to use that valuation method until the vehicle no longer qualifies.

The value of maintenance and insurance are included in the standard mileage rate. However, no reduction in the rate is allowed if you do not provide these services. The rate includes the fair market value of employer-provided fuel for miles driven in the United States, its territories and possessions, Canada, and Mexico. If fuel is not provided by you as the employer, the rate may be reduced by no more than 5.5 cents per mile.

Example C - Automobile "Lease" Valuation Rule

Generally, you figure the annual lease value of an automobile as follows:

1. Determine the fair market value ("FMV") of the automobile as of the first date the automobile is available for personal use.

2. Using the IRS Annual Lease Value Table, read down column 1 until you come to the dollar range within which the FMV of the automobile falls. Then read across to column 2 to find the corresponding annual lease value.

To obtain the Annual Lease Value ("ALV"), the FMV of the vehicle must be determined as of the first day it was made available to the employee. The value remains applicable for a four-year period. In the fifth year that the auto is used, the FMV is redetermined and a new annual lease value is calculated from the table. That redetermined value is then used for the second four-year period.

Also, if the employer provides fuel, the value of the fuel must be separately included in the employee's wages. The fuel can be valued at FMV or at 5.5¢ per mile for all personal miles driven by the employee. The value of insurance, maintenance, and repairs is included in the annual lease value table amount. If, however, the employer does not supply maintenance or insurance, the ALV table figure cannot be reduced by reason of such omission. Further, if the employer provides any service other than maintenance and insurance, the FMV of that service must be added to the ALV of the automobile to figure the value of the benefit.

Given an annual lease value of $6,600 for a vehicle available all 365 days of the year and driven 5,000 personal and commuting miles out of 20,000 total miles, the taxable fringe benefit to be included as employee compensation would be calculated as follows:

(1) Vehicle usage

$$\$6{,}600 \times \frac{365}{365} \times \frac{5{,}000}{20{,}000} = \$1{,}650$$

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

B. Employer Provided Vehicle (Continued)

3. Other Than Commuting Use Only (Continued)

Example C - Automobile "Lease" Valuation Rule (Continued)

(2) Fuel

5,000 miles	X	5.5¢	=	275
Total			=	$1,925

C. Employee Uses Own Vehicle

In this circumstance, the submission of the "Summary Statement" is crucial as will be explained in the following example.

If an employer elects to use the special valuation rules shown in Examples A through C, the employer must notify the employee of the election by the later of January 31 of the calendar year for which the election is to apply or 30 days after the employer first provides the benefit to the employee.

Example D

Employee D works for employer X. D drives a personal vehicle for the performance of D's duties on behalf of X. X provides 100% of the upkeep and maintenance ($4,000) and D's Summary Statement indicates 25% personal use.

The taxable fringe benefit received would be calculated as follows:

1. The amount X has paid ($4,000) times D's personal usage (25%).

   (a) In this example, $4,000 X 25% = $1,000.
   (b) Only the personal portion is included as additional income.

2. Follow procedures a through e as outlined in Example A.

The above examples present the application of the special vehicle valuation regulations in a few generalized situations. It is not possible to cover all situations as the regulations covering valuation of employee fringe benefits are long and detailed. If you feel the above examples do not cover your specific situation, please contact the partner at Miller Kaplan Arase LLP in charge of your account for further guidance.

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

D. Summary Statement

Employee Name: _____
Social Security Number: _____

Employer: _____

Vehicle: _____ _____ _____ _____
Make Model Year ID Number

Period of Usage: From_____ to_____ (include month, date and year)

- Total miles driven for the period: _____
- Total business miles driven for the period: _____
- Total commuting miles driven for the period:_____
- Total other personal miles (but not commuting miles) driven during the period:_____
- Have you maintained sufficient evidence to support the business use?* Yes_____ No_____
- Is the evidence written? Yes_____ No_____
- Do you have another car available for personal use? Yes____ No_____

  If yes, year, make and model _____

I hereby attest that the information listed above is true and correct to the best of my knowledge.

_____ _____
Employee Date

*Note: Your records are not to be submitted with this statement to us; however, you are required to retain the supporting documents for a minimum of six years. The requirements for recordkeeping are solely your responsibility and not ours, as your employer. Please refer to IRS recordkeeping requirements if you have any questions.

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

E. Policy Statement "Commuting Only Use" - Special Rule

If an employer and employee elect to adopt the special rule ("Commuting Use Only"), a written policy must be established.

The policy could be worded as follows:

> Employees who are provided with company owned automobiles must take those automobiles home at night to provide safe parking. Employees may not, however, use such automobile for personal purposes, other than for commuting or de minimis personal use.

F. Annual Lease Value Table for Employer Provided Autos

The purpose of this table is to establish the annual value of personal use of employer provided autos. Take the table value times the personal use percentage. The product is the personal use value includable as additional wages subject to withholdings (including FICA and SDI).

For automobiles with an FMV of more than $59,999, the annual lease value equals (0.25 x the FMV of the automobile) + $500.

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT *(Continued)*

F. Annual Lease Value Table for Employer Provided Autos (Continued)

Automobile fair market value when first provided to employee	Annual lease value*
$ 0 to $ 999	$ 600
1,000 to 1,999	850
2,000 to 2,999	1,100
3,000 to 3,999	1,350
4,000 to 4,999	1,600
5,000 to 5,999	1,850
6,000 to 6,999	2,100
7,000 to 7,999	2,350
8,000 to 8,999	2,600
9,000 to 9,999	2,850
10,000 to 10,999	3,100
11,000 to 11,999	3,350
12,000 to 12,999	3,600
13,000 to 13,999	3,850
14,000 to 14,999	4,100
15,000 to 15,999	4,350
16,000 to 16,999	4,600
17,000 to 17,999	4,850
18,000 to 18,999	5,100
19,000 to 19,999	5,350
20,000 to 20,999	5,600
21,000 to 21,999	5,850
22,000 to 22,999	6,100
23,000 to 23,999	6,350
24,000 to 24,999	6,600
25,000 to 25,999	6,850
26,000 to 27,999	7,250
28,000 to 29,999	7,750
30,000 to 31,999	8,250
32,000 to 33,999	8,750
34,000 to 35,999	9,250
36,000 to 37,999	9,750
38,000 to 39,999	10,250
40,000 to 41,999	10,750
42,000 to 43,999	11,250
44,000 to 45,999	11,750
46,000 to 47,999	12,250
48,000 to 49,999	12,750
50,000 to 51,999	13,250
52,000 to 53,999	13,750
54,000 to 55,999	14,250
56,000 to 57,999	14,750
58,000 to 59,999	15,250

* Add 5.5 cents per mile for gas if reimbursed by employer.

IV. NEW LAWS AND OTHER CHANGES

FEDERAL

A. Taxpayer First Act

The Taxpayer First Act of 2019 (the "TFA"), was signed into law on July 1, 2019. The TFA enacted changes to the IRS's organizational structure, customer service, enforcement procedures, cybersecurity and identity protection, management of information technology, and the use of electronic systems, with the aim of improving taxpayers' interactions with the IRS. The TFA codifies the requirements of an independent administrative appeals function at the IRS, which is intended to resolve tax controversies and review administrative decisions of the IRS in a fair and impartial manner and renames the IRS Office of Appeals as the IRS Independent Office of Appeals. The TFA also requires the Treasury Department to develop a comprehensive strategy for customer service, that includes customer expectations, long-term improvements, and plans to update guidance and submit its plan to Congress within one year of enactment. The TFA has a host of other provisions, but the most significant as it relates to information reporting is that, by January 1, 2023, the Treasury Department must develop an internet platform that facilitates taxpayers filing Forms 1099 with the IRS. The internet platform will provide taxpayers with access to resources and guidance provided by the IRS, and allow taxpayers to prepare, file, and distribute Forms 1099, and created and maintain taxpayer records.

B. Rental Real Estate Safe Harbor for Section 199A

The TCJA provides the new section 199A qualified business income ("QBI") deduction. This deduction allows non-corporate taxpayers to deduct up to 20% of QBI from each of their qualified trades or businesses, including those operated through a partnership, S corporation, or sole proprietorship and some trusts and estates. In September 2019, the IRS released Rev. Proc. 2019-38, which finalizes the rules that the IRS proposed in January in Notice 2019-17, that provides a safe harbor under which a rental real estate enterprise may be treated as a trade or business solely for purposes of the section 199A deduction. Under Notice 2019-07, a taxpayer must satisfy all of the following requirements to fall within the safe harbor: (1) maintain separate books and records for each rental enterprise; (2) spend 250 hours or more of rental services during the year; and (3) maintain contemporaneous books and records including hours, description, date(s), and person(s) performing services. The taxpayer must submit a statement with its federal income tax return, under penalties of perjury, on which it claims the section 199A deduction or passes through section 199A information that these requirements have been satisfied. Real estate that the taxpayer uses as a residence for any part of the year and triple net leases are specifically excluded from this safe harbor.

C. TCJA Related Tax Law Changes that Tax-Exempt Organizations Should be Aware of

In December 2019, as part of the "Disaster Act" included in the "Further Consolidated Appropriations Act, 2020," (the "Act") Congress repealed the rule implemented as part of the TCJA which required tax-exempt organizations to include certain qualified transportation fringe benefits provided to their employees as unrelated business taxable income ("UBTI"). The repeal of Section 512(a)(7) is effective retroactively to December 22, 2017, the date of its enactment. This means that organizations should seek a refund for any taxes paid related to qualified transportation fringe benefits. Unfortunately, it is unclear at the moment whether the IRS will establish a separate, consolidated refund process for organizations to claim refunds or if organizations will need to file amended Forms 990-T to claim a refund. Note, however, that other provisions of the TCJA related to tax-exempt organizations still apply, as follows:

IV. NEW LAWS AND OTHER CHANGES *(Continued)*

FEDERAL (Continued)

C. TCJA Related Tax Law Changes that Tax-Exempt Organizations Should be Aware of (Continued)

The TCJA requires that tax-exempt organizations that carry on more than one unrelated trade or business separately calculate unrelated taxable income for each trade or business. This effectively prohibits a tax-exempt organization from using deductions and losses from one unrelated trade or business to offset income from a separate unrelated trade or business.

With some exceptions, for tax years beginning after December 31, 2017, the TCJA imposes a 21% excise tax on compensation in excess of $1 million paid to an applicable tax-exempt organization's five-highest paid employees for a tax year.

For tax years beginning after 2017, the TCJA imposes a 1.4% excise tax on net investment income of certain private colleges and universities and their related organizations. The tax applies to private institutions that have at least 500 tuition-paying students during the previous tax year, more than 50% of the tuition-paying students are located in the United States and have an aggregate fair market value of assets of at least $500,000 per full-time student.

Finally, effective for charitable contributions made in after December 31, 2017, the TCJA eliminated the 80% deduction for contributions that a donor made that entitled the donor the right to purchase tickets to seating at university athletic events.

D. Use of R&D Credits to Offset Federal Payroll Taxes

Certain small start-up businesses can potentially utilize up to $250,000 of qualified research expenses to offset payroll taxes instead of income taxes. This was a change that began for 2016 tax return filings. Since most start-up businesses are not immediately profitable, this is a real benefit that start-ups could be taking if they have R&D costs. A qualified small business is a corporation that are not publicly traded (including an S corporation), partnership, or sole proprietorship with gross receipts of less than $5 million for the tax year and no gross receipts for any tax year before the 5-year tax period ending with the tax year. There are also some other restrictions. Tax-exempt organizations under Section 501 do not qualify. Research credits are generated for work undertaken for discovering information that is technological in nature and intended to develop a new or improved business component. For more details, see the instructions for IRS Form 6765.

E. New IRS Partnership Audit Rules

As part of the Bipartisan Budget Act of 2015 ("BBA"), new partnership audit rules went into effect on January 1, 2018 that are intended to create a more efficient audit process. Historically, IRS adjustments to partnership income have flowed through to the partners/LLC members. These new rules effectively create an entity-level tax on partnerships by imposing a tax on the partnership level at the highest individual or corporate tax rate should the audit result in additional reportable income. Furthermore, the new rules require the IRS to assess the partnership for the current year rather than the audited year. This may impact current partners who were not partners of the partnership in the year under review.

IV. NEW LAWS AND OTHER CHANGES *(Continued)*

FEDERAL (Continued)

E. New IRS Partnership Audit Rules (Continued)

Partnerships with fewer than 100 partners that do not have any trusts or other partnerships/LLCs as partners may make an annual election to opt out of the new audit regime. One more significant change in the law is that previously the IRS had to notify all partners of a partnership audit. However, under the new BBA, the IRS only needs to notify the partnership representative.

F. Opportunity Zones

The TCJA added "Opportunity Zones" to the tax code. Congress intended for Opportunity Zones to be economic development tools designed to generate economic development and job creation by providing tax benefits to investors. Specifically, investors can defer any gains invested in a Qualified Opportunity Fund ("QOF") until the earlier of the date on which the investment in a QOF is sold or exchanged, or December 31, 2026. There is a graduated increase in the rate of exclusion of the deferred gain depending upon how long the investor holds the investment. See Notice 2018-48 for a list of designated Qualified Opportunity Zones in which a Fund may invest to meet the program requirements.

Opportunity Zones were intended to assist economically depressed communities by attracting new qualified businesses, housing, and other real estate projects. However, some in Congress are seeking to scale back the program to prohibit its application to luxury housing and projects that were already in process before the tax incentive was created. The press reports that at least two House committees are planning to hold oversight hearings with regard to the tax incentive.

G. More Online Purchases Subject to Sales Tax

On June 21, 2018, the Supreme Court issued its decision in *South Dakota v. Wayfair, Inc.* holding that states had the right to impose sales taxes on e-commerce companies even if those companies did not have any property, such as stores or warehouses, or employees within the state's borders. The Court upheld a South Dakota law that required remote sellers with at least $100,000 in sales or 200 or more transactions annually in South Dakota to collect sales tax from buyers in the state. As a result, new taxes on e-commerce sales have gone into effect in multiple states. These changes will require significant research into the economic nexus standards for sales, use, and income tax laws in various states. Please contact us for further advice on this topic.

H. Form 1099-NEC to Replace Form 1099-MISC, Box 7

For information return filings starting in 2021, the IRS plans to issue Form 1099-NEC to address the fact that non-employee compensation ("NEC") reported in Box 7 of the present-day Form 1099-MISC are due by January 31, while the deadline to file Forms 1099-MISC that do not report NEC continues to be March 31. In 2015, the Protecting Americans from Tax Hikes Act ("PATH Act") accelerated the due date for reporting nonemployee compensation from February 28 to January 31, for both paper and electronic filing. The PATH Act also eliminated the automatic 30-day filing extension for forms that include nonemployee compensation. As a result, taxpayers have had to separate Forms 1099-MISC with NEC from those without it because if a taxpayer submitted a Form 1099-MISC that included NEC after January 31, along with other forms not containing NEC, the IRS might treat all submitted forms, including those not reporting NEC, as late returns. As such, the IRS is planning to reinstate the Form 1099-NEC to alleviate these issues.

IV. NEW LAWS AND OTHER CHANGES *(Continued)*

FEDERAL (Continued)

I. Tax Treatment of Cryptocurrency

In July 2019, the IRS began sending letters to more than 10,000 taxpayers with virtual currency transactions that potentially failed to report income and pay the resulting tax from virtual currency transactions or did not report their transactions properly. Further, in October 2019, the IRS issued Rev. Rul. 2019-24, which provides additional guidance on the tax treatment of transactions involving virtual currency that supplements the basic guidance on the tax treatment of virtual currency that the IRS issued in 2014 (Notice 2014-21). The 2014 guidance provided that for federal tax purposes, virtual currency is treated as property, and it should be treated like any other capital asset, such as stocks or real estate. A taxpayer who receives virtual currency as payment for goods or services, must include in income the fair market value of the virtual currency, measured in U.S. dollars. Further, the basis of virtual currency that a taxpayer receives as payment for goods or services is the fair market value of the virtual currency in U.S. dollars as of the date of receipt.

J. Revised Form W-4

The IRS releases revisions of the Form W-4 each year. Thus, employees hired after 2019 and employees who want to adjust their income tax withholding should submit the 2020 version of the Form W-4 to his/her employer. With all the recent changes to the tax laws, taxpayers may want to adjust their paycheck withholding to avoid having too much or too little taxes withheld. The fewer withholding allowances a taxpayer enters on Form W-4, the more taxes will be withheld on his/her paycheck. The IRS has posted a new online estimate to help taxpayers determine whether they have the right amount of income tax withheld from their paychecks.

CALIFORNIA

K. New California Law Regarding Worker Status as Independent Contractor vs. Employee

In September 2019 Governor Newsom signed Assembly Bill 5 ("A.B. 5"), which codifies and clarifies the 2018 California Supreme Court decision in Dynamex Operations West, Inc. v. Superior Court of Los Angeles. In that case, Dynamex, a national package delivery company, reclassified some of its workers as independent contractors. The Court ruled that workers must be classified as employees, not independent contractors, if their jobs are central to the company's core business and if the management directs the way the work is to be done. The Court applied a three-part test, commonly known as the "ABC" test, that must be satisfied for a worker to be classified as an independent contractor rather than an employee. This new law will take effect January 1, 2020.

The implications of A.B. 5 are that many workers who were previously classified as independent contractors will now be classified as employees and will receive labor protections and benefits that all employees receive. Several industries will be affected by this new law, including workers in the trucking, news publishing, cleaning, and software industries. A.B. 5, however, exempts over 50 professions or types of businesses, including certain licensed professionals such as doctors, dentists, insurance agents, lawyers, accountants, real estate agents, licensed hairstylists and barbers who can meet certain conditions such as setting their own rates, and a variety of creative professionals, such as freelance writers and photographers. Other states are expected to follow suit with implementing similar employment laws.

IV. NEW LAWS AND OTHER CHANGES *(Continued)*

CALIFORNIA (Continued)

K. New California Law Regarding Worker Status as Independent Contractor vs. Employee (Continued)

Although labor unions support A.B. 5, in October 2019, Uber, Lyft, DoorDash and other on-demand companies announced a California ballot measure that would exempt them from the new law, which Californians are likely to vote on in the November 2020 election. If you have questions about the classification of workers, please contact your employment law counsel.

L. California Tax Law Conformity to Federal Tax Law

On July 1, 2019, Governor Newsom signed Assembly Bill 91 ("A.B. 91") into law, which selectively conforms some, but not all, of California's tax laws to changes made under the TCJA. California does not conform to all of the changes made under the TCJA, as it conforms to the Internal Revenue Code as of January 1, 2015, but the following are some of the more consequential changes made under A.B. 91:

- California now conforms to the TCJA's accounting method simplification requirements for small businesses. California now follows the TCJA in the increase of average annual gross receipts to $25 million for purposes of using the cash method of accounting.
- California now conforms to the disallowance of Net Operating Loss ("NOL") carrybacks attributable to taxable years beginning after December 31, 2018. This disallowance applies to individual and corporate taxpayers.
- A.B. 91 eliminates like-kind exchanges of tangible personal property by limiting like-kind exchange treatment only to real property, except for individual taxpayers with adjusted gross income of less than $250,000 for a single filer and $500,000 for those filing jointly or filing as Head of Household.
- California adopts the federal limitation on excess business losses for noncorporate taxpayers for taxable years beginning after December 31, 2018. A.B.91 disallows deductions under the Personal Income Tax law for excess business losses over $250,000 for a single filer and $500,000 for a joint filer. It provides that losses cannot be carried forward as NOL at an amount greater than the limits listed above and establishes these limits in perpetuity. This differs from the TCJA provisions, which expire in 2026 and allows any disallowed excess business losses to be carried forward as NOLs.
- California repeals the partnership technical termination provision to conform to federal income tax law, as amended by the TCJA, applicable for tax years beginning January 1, 2019. Partnerships may elect to apply conformity to partnership taxable years beginning after December 31, 2017, and before January 1, 2019.

M. California Individual Health Care Mandate

On June 27, 2019, Governor Newsom signed Senate Bill 78 ("S.B. 78") which, among other provisions, requires California residents to maintain minimum essential coverage ("MEC") for themselves and their dependents, which include spouses, dependent children and registered domestic partners, for each month beginning on or after January 1, 2020. The law imposes a tax penalty on any state resident who fails to maintain MEC, unless they qualify for an exemption. Some of the exemptions available are a

IV. NEW LAWS AND OTHER CHANGES *(Continued)*

CALIFORNIA (Continued)

M. California Individual Health Care Mandate (Continued)

hardship exemption, an exemption for incarcerated individuals, and a religious-conscience exemption. S.B. 78 also establishes a program to provide state subsidies and financial assistance to help certain qualifying households purchase coverage through Covered California, the state's public exchange. There are also options for no- and low-cost coverage through the Medi-Cal program.

N. California's New Use Tax Collection Requirements

As a result of the June 2018 United States Supreme Court decision in *South Dakota v. Wayfair, Inc.*, wherein the Court overturned the physical presence rule for sales and use tax nexus, on April 25, 2019 the Governor signed Assembly Bill 147 ("A.B. 147") into law to amend California Revenue and Taxation Code ("RTC") section 6203, effective April 1, 2019, to provide that a retailer engaged in business in California includes any retailer that, in the preceding or current calendar year has total combined sales of tangible personal property for delivery in California by the retailer and all persons related to the retailer that exceed $500,000. Accordingly, effective April 1, 2019, any retailer whose sales of tangible personal property for delivery in California meet the $500,000 sales threshold in the preceding or current calendar year is a retailer engaged in business in California and, as such, is required to register with the California Department of Tax and Fee Administration ("CDTFA"), collect California state use tax, and report and pay the tax to the CDTFA. These retailers include remote sellers located outside of California that sell tangible goods for delivery into California through the internet, mail-order catalogs, telephone, or by any other means. Retailers with a physical presence in California are still generally required to register with the CDTFA as well.

A.B. 147 also amended California RTC section 7262 to provide that a retailer engaged in business in a district includes any retailer that, in the preceding or the current calendar year, has total combined sales of tangible personal property in California or for delivery in California by the retailer and all persons related to the retailer that exceed $500,000. Accordingly, beginning April 25, 2019 (the date A.B. 147 was signed into law), any retailer required to be registered with the CDTFA, whether located inside or outside of California that meets the $500,000 threshold in RTC section 7262 is engaged in business in every district in California, whether or not they have physical presence in those districts. Retailers that do not meet the $500,000 threshold are still engaged in business in any district(s) in which they have a physical presence.

Go to www.cdtfa.ca.gov for more information.

As mentioned above, many states have enacted or announced economic nexus legislation for out-of-state or remote sellers, similar to California's rules. These changes will require significant research into the economic nexus standards for sales, use, and income tax law in various state so please contact us for further advice on this topic.

O. California Film and Television Tax Credit Program

The California Film Commission administers the Film & Television Tax Credit Program, which provides tax credits against income and/or sales and use taxes based upon qualified expenditures for films and

IV. NEW AND OTHER CHANGES *(Continued)*

CALIFORNIA (Continued)

O. California Film and Television Tax Credit Program (Continued)

television shows that are produced in California. On June 27, 2018, then Governor Jerry Brown signed legislation extending California's film and TV incentive program to 2025. For application dates and more information visit the California Film Commission's website at http://film.ca.gov/. Additional information and assistance may be available through FilmLA, a non-profit organization and the official film office of the City and County of Los Angeles. Their website is www.filmla.com.

P. New State Retirement Program for Private Workers

California has enacted a state-sponsored retirement program for private sector employees. The CalSavers Retirement Savings Program requires private employers with five or more employees that do not already offer a workplace retirement plan to either provide a retirement plan for their employees or enroll their employees in a a CalSavers account unless the employee opts out. CalSavers is an automatic enrollment payroll deduction IRA, which offers some tax benefits and consequences. Beginning in July 2019, all eligible employers could register for the program. The deadline for businesses to comply with the rules depend on business size. California employers with more than 100 employees will be required to comply by June 30, 2020, employers with more than 50 employees will be required to comply by June 30, 2021, and employers with 5 or more employees will be required to comply by June 30, 2022. More details about this program is available at www.calsavers.com.

Q. Proposal to Downsize Proposition 13

In November 2020 California voters may be voting on a ballot measure that is intended to roll back the Proposition 13 property tax increase limitations as it applies to commercial and industrial properties. Proposition 13 was an amendment to the California Constitution that was approved by California voters on June 6, 1978. Under Proposition 13, all real property, including residential, commercial, and industrial properties, have established base year values, a restricted rate of increase on assessments of no greater than 2% each year, and a limit on property taxes to 1% of the assessed value. On August 13, 2019, proponents of an initiative to change the applicability of Proposition 13 announced a campaign to collect signatures to put a measure on the November 2020 ballot that would exclude commercial and industrial properties from the property tax increase limitations. The ballot initiative would amend the California Constitution to require commercial and industrial properties to be taxed based on their market value, while residential properties would continue to be assessed taxes based on purchase price. The revenue from the change in taxation would generally be distributed to local governments and special districts and to school districts and community colleges rather than go to the state's General Fund. Passage of the ballot measure would result in commercial and industrial property owners paying more in property taxes than they currently do.

V. IDENTITY THEFT

The IRS has some suggestions to reduce identity theft as follows:

- Always use security software with firewall and anti-virus protections. Use strong passwords.
- Learn to recognize and avoid phishing emails, threating calls and texts from thieves posing as legitimate organizations such as your bank, credit card companies and even the IRS.

V. IDENTITY THEFT *(Continued)*

- Do not click on links or download attachments from unknown or suspicious emails.
- Protect your personal information and that of any dependents. Don't routinely carry Social Security cards, and make sure your tax records are secure.

The IRS does not initiate contact with taxpayers by email to request personal or financial information. This includes any type of electronic communication, such as text messages and social media channels.

The Federal Trade Commission makes consumer information available on www.consumer.ftc.gov. They have various recommendations regarding steps to take to prevent identity theft as well.

The following are certain tips to protect yourself from identity theft that we published in prior years as well.

- Avoid sending sensitive personal information like your credit card or Social Security number through chat lines, email, or other online posts. Assume your communications are not private unless encrypted.
- Shred all unwanted pre-approved credit card offers.
- Order your credit report annually from the three credit bureaus to check for inaccuracies and fraudulent use of your accounts.
- Do not carry your Social Security card or number, passport, or birth certificate.

We also suggest that you file your tax returns early – as soon as you have all of the tax information required. Also, you should respond promptly to any letters or notices from the IRS and state taxing agencies.

If you are a victim of identity theft:

- Close your credit card accounts and request they be processed as "account closed at the customer's request" instead of "lost or stolen." This will not reflect negatively on your credit report. Follow up with a written request.
- Notify your bank of the theft and change all account numbers. Also, request that the bank assign you a secret password to be used in all future transactions.
- Keep a log of all contacts you make in the resolution of your theft.

VI. IRS TANGIBLE PROPERTY REGULATIONS

The Internal Revenue Code allows a deduction for ordinary and necessary expenses incurred in carrying on a trade or business. The code also requires you to capitalize costs incurred for acquiring, producing, and improving tangible property. In order to reconcile or establish a framework to determine how such costs are to be treated, taxpayer friendly regulations took effect in 2014 which contains simplifying provisions and allows taxpayers to elect to currently deduct expenses for the purchase of tangible property that would otherwise have to be capitalized.

Under these regulations you may elect to apply a de minimis safe harbor to amounts paid to acquire or produce tangible property to the extent such amounts are deducted by you for financial accounting purposes. If you have what is known as an applicable financial statement ("AFS") you may use the safe harbor to deduct amounts paid for tangible property up to $5,000 per invoice or item. If you do not have such a statement, you may use the safe harbor to deduct up to $2,500 per item or invoice.

VI. IRS TANGIBLE PROPERTY REGULATIONS *(Continued)*

An AFS includes a financial statement required to be filed with the Securities and Exchange Commission ("SEC") as well as other types of certified audited financial statements accompanied by a CPA report. If you don't have an AFS you must expense amounts on your books and records in accordance with a consistent accounting policy which exists at the beginning of the taxable year. The annual election is not a change in accounting method and does not require a filing of Form 3115. Contact us should you have further questions.

VII. CALIFORNIA COMPETES TAX CREDIT

The California Competes Tax Credit is an income or franchise tax credit available to businesses that come to California or stay and grow in California. Tax credit agreements will be negotiated by the Governor's Office of Business and Economic Development (GO-Biz) and approved by a statutorily created "California Competes Tax Credit Committee." The committee consists of Director of GO-Biz (Chair), State Treasurer, Director of the Department of Finance, and one appointee each by the Speaker of the Assembly and Senate Committee on Rules.

Of the aggregate amount of tax credit available each fiscal year, 25% of the total credit amount is reserved for small businesses. A small business is defined as one that had less than $2M in gross income in the prior year. Any credit amount not awarded during the application period will carry over to the next application period.

For fiscal year 2019-20, GO-Biz will accept applications online at www.calcompetes.ca.gov for the California Competes Tax Credit during the following periods:

- July 29, 2019, through August 19, 2019 ($90 million available)
- January 6, 2020, through January 27, 2020 ($75 million available)
- March 9, 2020, through March 30, 2020 ($71.8 million plus any remaining unallocated amounts from the previous application periods)

Go to business.ca.gov/Programs/CaliforniaCompetesTaxCredit and www.calcompetes.ca.gov for more information on the California Competes Tax Credit.

VIII. CALIFORNIA INDEPENDENT CONTRACTOR REPORTING REQUIREMENTS

The purpose of these reporting requirements is to increase child support collection by helping to locate parents who are delinquent in their child support obligations. This law requires businesses and government entities to report specified information to the Employment Development Department ("EDD") on independent contractors.

Any business or government entity (defined as a "service-recipient") that is required to file a federal Form 1099-MISC for services performed by an independent contractor (defined as a "service-provider") must comply with these reporting requirements. A "service-recipient" means any individual, person, corporation, association, or partnership, or agent thereof, doing business in this State, deriving trade or business income from sources within this State, or in any manner in the course of trade or business subject to the laws of this State. An independent contractor is defined as an individual who is not an employee of the business or government entity for California purposes and who receives compensation or executes a contract for services performed for that business or government entity either in or outside of California.

VIII. CALIFORNIA INDEPENDENT CONTRACTOR REPORTING REQUIREMENTS *(Continued)*

You must report independent contractor information to the EDD within twenty (20) days of either making payments totaling $600 or more or entering into a contract for $600 or more with an independent contractor in any calendar year, whichever is earlier.

You are required to provide the name of your business, the federal employer identification number, the California employer payroll tax account number (if applicable), Social Security number, and the service-recipient's name/business name, address, and telephone number.

You are also required to provide the independent contractor's (service-provider's) first name, middle initial, last name, Social Security number, address, and start date of contract, along with the amount of contract, contract expiration date, and an indication if it is an ongoing contract (check box if applicable).

Use e-Services for Business to submit the *Report of Independent Contractor(s)* form (DE 542) online or submit a paper report by mail or fax. To obtain forms and/or information, call (888) 745-3886. You may also visit your local Employment Tax Office or access the Internet site at www.edd.ca.gov/.

IX. EARNED INCOME CREDIT

The Earned Income Credit ("EIC") is a refundable tax credit available to certain low-income workers. Although the Education Jobs and Medicare Assistance Act repealed the Advanced Earned Income Credit, effective with tax year 2011, which eliminated the Form W-5, employers are still required to notify employees who have no federal income tax withheld that they may be able to claim a tax refund because of the EIC. Employers, however, are not required to notify employees who claimed exemption from withholding on Form W-4, *Employee's Withholding Allowance Certificate*, about the EIC. If employers give an employee a timely Form W-2, no further notice is necessary if the Form W-2 has the required information about the EIC on the back of the employee's copy. Eligible employees who qualify for the EIC can still claim the EIC when filing their federal personal income tax return, Form 1040.

California also has an Earned Income Tax Credit, which employees can claim by preparing and filing a California tax return.

X. PAYROLL TAX DEPOSIT SYSTEM

All employers are either federal "monthly depositors" or "semiweekly depositors." Prior to the beginning of each calendar year, employers must determine which of the two deposit schedules they are required to use. An employer's status is determined by reference to the employer's deposit history during a "lookback period." The lookback period for a Form 941 filer begins July 1 and ends June 30 of the preceding year.

An employer is a monthly depositor for a calendar year if the aggregate amount of employment taxes reported on its quarterly returns, Forms 941, for the four consecutive quarters ending June 30 of the preceding year is $50,000 or less. An employer is a semiweekly depositor if the aggregate is more than $50,000. Initially, new employers are treated as monthly depositors. A monthly depositor must deposit employment taxes accumulated within the calendar month by the 15th day of the following month. For a semiweekly depositor, if the depositor's payday is on a Wednesday, Thursday, and/or Friday, taxes must be deposited on or before the following Wednesday. For all other paydays, the deposit is due on the Friday following the payday. A special one-day rule applies to any employer that has $100,000 or more in undeposited employment taxes on any day during a monthly or semiweekly deposit period.

X. PAYROLL TAX DEPOSIT SYSTEM *(Continued)*

If a deposit is required to be made on a day that is not a business day, the deposit is considered timely if it is made by the close of the next business day. Semiweekly depositors have a minimum of three (3) business days following the close of the semiweekly period to make a deposit. Thus, a semiweekly depositor with a Friday payroll will have until the following Thursday to deposit employment taxes if the Monday, Tuesday, or Wednesday following the payday is a legal holiday.

An employer is treated as having made the required deposit if any deposit shortfall does not exceed the greater of $100 or two (2) percent of the amount required to be deposited and the shortfall is deposited on or before prescribed shortfall makeup dates. For a monthly depositor, the shortfall makeup date is the return due date for the return period in which the shortfall occurs. For a semiweekly depositor, the shortfall makeup date is the earlier of the first Wednesday or Friday (whichever is earlier) that falls on or after the 15th day of the month following the month in which the shortfall occurred, or the due date of the return for the period of the tax liability.

XI. EMPLOYEE OR INDEPENDENT CONTRACTOR

Some companies have attempted to avoid the burden of the employers' share of employment taxes by classifying their workers as independent contractors when in fact they were employees. The state and federal taxing authorities have been aggressively auditing companies to find such abuses. IRS Publication 1779 is a helpful resource for determining whether a worker is properly classified as an independent contractor or an employee.

The Voluntary Classification Settlement Program ("VCSP") is an optional program that provides taxpayers an opportunity to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from federal employment taxes. To participate in this voluntary program, the taxpayer must meet certain eligibility requirements, apply to participate in the VCSP by filing Form 8952, *Application for Voluntary Classification Settlement Program*, and enter into a closing agreement with the IRS.

When determining worker classification, certain factors carry more weight than others depending upon specific industry practices. Generally, the business has the initial burden of proof on worker classification. However, the burden of proof shifts to the IRS has if the taxpayer can cite judicial precedent or long-standing industry practice for not treating a worker as an employee. Filing Forms 1099-MISC consistent with the taxpayer's treatment of a worker as a non-employee is imperative but not definitive. Worker classification is an area of increasing IRS enforcement and the target of litigation. Therefore, given the penalties associated with the Statutory Employer statutes and regulations for failing to withhold and pay taxes associated with wages, employers should be aware of the risks associated with misclassifying workers.

On April 30, 2018, the California Supreme Court issued a decision in the matter of *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* that has broad implications in this regard. The Court held that a worker is an independent contractor only if the hiring party can establish the following: (a) the worker is free from control and direction of the hiring entity; (b) the worker performs work outside the usual course of the hiring entity's business; and (c) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity. See the California Law Changes section above for a detailed discussion of Assembly Bill 5 that was signed into law in September 2019, which clarifies and codifies the ruling from this case.

XI. EMPLOYEE OR INDEPENDENT CONTRACTOR *(Continued)*

A. Worker Classification: The IRS' Approach

1. Do behavioral controls over the worker exist?

Behavioral control focuses on whether the business has the right to direct or control how the work is done, e.g., how the worker performs the specific task for which he was hired. Factors include:

a. To what extent are instructions given and taken?
b. What training does the business give the worker?

2. Do financial controls over the worker exist?

These factors illustrate whether there is a right to control how the business aspects of the worker's activities are conducted:

a. Can the worker realize a profit or incur a loss?
b. Is the worker's investment significant?
c. To what extent does the worker make services available to the general public?
d. How does the business pay the worker?

3. What type of relationship between the parties exists?

These factors illustrate how the worker and the business perceive their relationship.

a. Does a written contract exist that describes the relationship the parties intend to create?
b. Does the business provide the worker with employee-type benefits?
c. How permanent and ongoing is this relationship?
d. To what extent are the services performed by the worker a key aspect of the regular business of the company?

XII. DBA – FICTITIOUS BUSINESS NAMES

You must file a fictitious name registration within 40 days of starting a company in the county where you have your principal place of business. In Los Angeles County, visit rrcc.lacounty.gov/Clerk. In Orange County, start at egov.ocgov.com/ocgov/ and search for "fictitious business." In San Francisco County, go to https://sfgov.org/countyclerk/fictitious-business-name-fbn.

You do not have to file if you use your surname in the name of the business. So "Tim Parker Plumbing" or "Parker's Plumbing" are both exempt from registering, but "Tim's Plumbing" is not. Also, if you use something like "Parker and Sons Plumbing" you do not have to file, because the name suggests additional owners.

In Los Angeles County, the first-time filing fee for one business name and one registrant is $26, plus an additional $5 more for each additional business name and/or each additional registrant. The base fee is $23 in Orange County, $55 in San Bernardino County, $66 in Riverside County, $53 in Ventura County, and $55 in San Francisco County. Filings are good for five years, then it can be renewed.

XII. DBA – FICTITIOUS BUSINESS NAMES *(Continued)*

Within 30 calendar days from the date of filing your fictitious business name statement, you must publish it in a legally adjudicated newspaper in your area once a week for four (4) consecutive weeks. The county clerk can provide you a list of which newspapers you must use.

You don't want to create confusion by choosing a business name that's already being used, so most county clerks offer an online search form so you can check if a name is already taken. In Los Angeles County, visit rrcc.lacounty.gov/clerk/fbn_search.cfm.

XIII. REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR)

If you have a financial interest in or signature authority over a foreign financial account, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account, the Bank Secrecy Act may require you to report the accounts annually by electronically filing a Financial Crimes Enforcement Network ("FinCEN") Form 114, *Report of Foreign Bank and Financial Accounts ("FBAR")*. The FBAR must be filed electronically through FinCEN's BSA E-Filing System. The FBAR is not filed with a federal tax return. You are required to file an FBAR if the aggregate value of all foreign financial accounts exceeded $10,000 at any time during the calendar year reported.

Reporting and Filing Information

If you who hold a foreign financial account, you may have a reporting obligation even though the account produces no taxable income. The reporting obligation is met by answering questions on a tax return about foreign accounts (for example, the questions about foreign accounts found on Form 1040, Schedule B) and by filing an FBAR.

The FBAR is a calendar year report, which has had to be filed with the Department of Treasury on or before April 15 of the year following the calendar year reported with no extension. FinCEN will grant filers failing to meet the FBAR annual due date of April 15 an automatic extension to October 15 each year. Accordingly, specific requests for this extension is not required.

Those required to file an FBAR who fail to properly file a complete and correct FBAR may be subject to civil monetary penalties. For penalties that are assessed after January 15, 2017 the IRS may assess an inflation-adjusted civil penalty not to exceed $12,921 per violation for non-willful violations that are not due to reasonable cause. For willful violations, the inflation-adjusted penalty may be the greater of $129,210 or 50 percent of the balance in the account at the time of violation, for each violation.

Help with electronic filing technical questions is available at BSAEfilinghelp@fincen.gov or through the BSA E-Filing Help Desk at (866) 346-9478. For questions regarding BSA regulations contact FinCEN's Regulatory Helpline at (800) 949-2732.

Taxpayers with specified foreign financial assets that exceed certain thresholds must also report those assets to the IRS on Form 8938, *Statement of Specified Foreign Financial Assets*, which is filed with an income tax return. The Form 8938 filing requirement is in addition to the FBAR filing requirement. A chart providing a comparison of Form 8938 and FBAR requirements may be accessed on the IRS Foreign Account Tax Compliance Act Web page.

XIV. REPORTING OF CASH TRANSACTIONS IN EXCESS OF $10,000

Generally, if your business receives more than $10,000 in cash in a single transaction or two or more related transactions, you must file a Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business*. In addition, you may file this form voluntarily for any suspicious transaction, even if the transaction does not exceed $10,000. Cash includes the coins and currency of the United States and a foreign country, cashier's checks, bank drafts, traveler's checks, and money orders. The civil penalties for failure to comply with the filing and payer reporting requirements are the same as those for failure to file or correctly file Forms 1099. You may be subject to criminal penalties, including up to five years imprisonment, for willfully failing to file a Form 8300, willfully filing a false or fraudulent Form 8300, stopping, or trying to stop, a Form 8300 from being filed, or setting up, helping to set up, or trying to set up a transaction in a way that would make it seem unnecessary to file Form 8300.

When a business is required to file a Form 8300, the business must also provide a written statement to each person(s) named on the Form 8300 on or before January 31 of the year that immediately follows the year the cash payment was made. The statement must include the name and address of the cash recipient's business, the name and telephone number of a contact person for the business, the total amount of reportable cash received in a 12-month period, and a statement that the cash recipient is reporting the information to the IRS. The statement must be mailed to the payer's last known address.

A business must file Form 8300 by the 15th day after the date of the transaction. Businesses can file Form 8300 electronically using the Bank Secrecy Act ("BSA") E-filing System. E-fining is free and secure. Businesses can also mail the Form 8300 to the IRS at: IRS Detroit Computing Center, P.O. Box 32621, Detroit, Michigan 48232. California also requires you to send a copy of Form 8300 to: Franchise Tax Board, P.O. Box 1468, Sacramento, California 95812-1468.

XV. WHEN HIRING NEW EMPLOYEES

A. Compliance with U.S. Immigration Laws

Federal law requires that every employer who recruits, refers for a fee, or hires an individual for employment in the U.S. must complete Form I-9, *Employment Eligibility Verification.* Within three days of starting work for pay, the employee must present the employer an original document or documents that establishes their identity and employment authorization. We strongly suggest you contact your legal advisor with regards to the form and the timing of requesting documentation, since incorrect steps could result in being found liable for discrimination practices.

There is no associated filing fee for completing Form I-9. This form is not filed with the United States Citizenship and Immigration Services ("USCIS") or any government agency. Form I-9 must be retained by the employer and made available for inspection by U.S. Government officials.

Employers hiring foreign nationals should always check for the individual's Form I-94, which controls the terms of an individual's stay in the country. The Form I-94 serves as the "work permit." Once it expires, the period of lawful stay in the U.S. is over. (The visa, which establishes a specific length of stay, is permission to present oneself at the border). See details regarding the U.S. Department of Homeland Security's E-Verify Department program on the uscis.gov website.

Nonimmigrant visa categories are arranged according to proposed activities in the U.S. Some typical work visas are E (persons with essential skills), H-1B (temporary professional worker), L-1 (permits international companies to transfer key employees), O (for outstanding individuals), and TN or NAFTA (for Mexicans or Canadians entering to work in the U.S. for one year as architects, scientists or other professionals).

XV. WHEN HIRING NEW EMPLOYEES *(Continued)*

B. E-Verify

U.S. law requires employers to employ only individuals who have legal authority to work in the United States – either U.S. citizens or foreigners who have the proper authorization. E-Verify is an online system maintained by the Department of Homeland Security that checks information provided by potential new hires against government records. The program was created by the Illegal Immigration Reform Act of 1996. Businesses in many states as well as federal contractors are required to use E-Verify.

California law states that no state agency, city, or county can require private employers to use the federal E-Verify system to confirm the legal immigration status of workers they hire, except when required by federal law or as a condition of receiving federal funds. However, private employers may still choose to use the system.

To enroll go to www.e-verify.gov/.

C. Income Tax Withholding

When you hire an employee, you must have the employee complete Form W-4, *Employee's Withholding Allowance Certificate*. The amount of income tax that an employer must withhold from wages is based on the filing status and number of withholding allowances claimed by the employee. Employers should retain the Form W-4 and should not transmit it to the IRS.

The amount of money withheld as federal income tax is reduced for each allowance claimed. If an employee fails to properly complete a Form W-4, the employer must withhold federal income tax as if the employee was single and claiming no withholding allowances. According to the IRS, the form should be retained for at least four (4) years after an employee's departure.

D. New Employee Registry

California requires all employers to report all of their new or rehired employees who work in California to the EDD's New Employee Registry within 20 calendar days of an employee's start-of-work day. This information will be cross-matched against child support records to locate parents who are delinquent in their support payments and it will also be used to detect unemployment insurance fraud. Use e-Services for Business to submit Form DE 34, *Report of New Employee(s),* online to report this information.

You may also report the new employee by submitting a copy of the employee's Form W-4, but you must include the employee's start-of-work date, your California employer payroll tax account number, and federal employer identification number ("FEIN") on the Form W-4.

You can order the forms on the EDD's website through the Online Forms and Publications page. You can also order forms or obtain additional information by contacting the Taxpayer Assistance Center at (888) 745-3886 or by visiting your local EDD Employment Tax Office.

XVI. BASIS IN S CORPORATIONS AND PARTNERSHIPS

We want to make you aware of the importance of keeping track of basis in your S corporation and partnership investments, as the IRS may disallow losses unless there is proof of sufficient basis.

XVI. BASIS IN S CORPORATIONS AND PARTNERSHIPS *(Continued)*

S Corporation Stock and Debt Basis

Many corporations elect S corporation status. The impact of electing S corporation status is that the items of income and loss, etc. flow through to the shareholders. There are three shareholder loss limitations, relating to the following issues:

1. Stock and debt basis;
2. the amount "At Risk"; and
3. the Passive Activity rules.

The following information relates to stock and debt basis. The fact that a shareholder receives a K-1 reflecting a loss does not necessarily mean that the shareholder is entitled to claim the loss. The shareholder must have basis to claim the loss. Basis should be computed each year.

To compute stock basis, the shareholder begins with their initial capital contribution to the S corporation or the initial cost of the stock they purchased (the same as a C corporation). That amount is then increased and/or decreased based on the flow-through amounts from the S corporation. An income item will increase stock basis while a loss, deduction, or distribution will decrease stock basis.

A shareholder's stock is **increased** by:

1. Ordinary income
2. Separately stated income items
3. Tax exempt income
4. Excess depletion

A shareholder's stock is **decreased**, but not below zero, by:

1. Ordinary loss
2. Separately stated loss items
3. Nondeductible expenses
4. Non-dividend distributions
5. Depletion for oil and gas

Most distributions from an S corporation are non-dividend distributions. Dividend distributions can occur in a company that was previously a C corporation or acquired C corporation attributes in a non-taxable transaction (i.e., merger, reorganization, QSub election, etc.).

For loss and deduction items, which exceed a shareholder's stock basis, the shareholder may include its debt basis to determine the deductibility of these items. Debt basis is generally the loans that the shareholder personally made to the S corporation. Debt basis is computed similarly to stock basis, but there are some differences.

The bottom line is that it is not the corporation's responsibility to track each shareholder's stock and debt basis, but rather, it is the shareholder's responsibility.

XVI. BASIS IN S CORPORATIONS AND PARTNERSHIPS *(Continued)*

Partnership Basis

Basis has two separate meanings in partnership taxation. Outside basis is the basis of the partner in their partnership investment. Inside basis is the basis of the partnership in its assets. Outside basis determines how much a partner can withdraw or deduct from a partnership for tax purposes without recognizing additional gain or without being limited with respect to the deductibility of their share partnership losses.

In determining outside basis, each partner's acquisition costs for their partnership interest, contributions, and distributions along with their share of profits and losses must be accounted for. Basis is increased by additional contributions of money, property, services, and the partner's share of liabilities and partnership income.

Here again, as with S-corporation investments, it is the partner's responsibility, and not that of the partnership, to keep track of basis.

XVII. CAFETERIA PLANS

A Cafeteria Plan is a separate written plan maintained by an employer for employees that meets the specific requirements of and regulations of section 125 of the Internal Revenue Code. It provides participants an opportunity to receive certain benefits on a pretax basis. Participants in a cafeteria plan must be permitted to choose among at least one taxable benefit (such as cash) and one qualified benefit.

A qualified benefit is a benefit that does not defer compensation and is excludable from an employee's gross income under a specific provision of the Code, without being subject to the principles of constructive receipt. Qualified benefits include the following:

- Accident and health benefits (but not Archer medical savings accounts or long-term care insurance);
- Adoption assistance;
- Dependent care assistance;
- Group-term life insurance coverage;
- Health savings accounts, including distributions to pay long-term care services.

Prior to this provision, there was no statutory limit for employee contributions to a health FSA; that amount was dictated by the employer either as a maximum dollar amount or maximum percentage of compensation. For taxable year 2019, the limit is $2,700. For taxable years beginning in 2020, the limit is $2,750.

A section 125 Plan is the only means by which an employer can offer employees a choice between taxable and nontaxable benefits without the choice causing the benefits to become taxable. A plan offering only a choice between taxable benefits is not a section 125 Plan.

The plan may make benefits available to employees, their spouses and dependents. It may also include coverage of former employees but cannot exist primarily for them.

Employer contributions to the Cafeteria Plan are usually made pursuant to salary reduction agreements between the employer and the employee in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. Salary reduction contributions are not actually or constructively received by the participant. Therefore, those contributions are not considered wages for federal income tax purposes. In addition, those sums generally are not subject to FICA and FUTA. See sections 3121(a)(5)(G) and 3306(b)(5)(G) of the Internal Revenue Code.

XVII. CAFETERIA PLANS *(Continued)*

A flexible spending arrangement ("FSA") is a form of cafeteria plan benefit, funded by salary reduction, that reimburses employees for expenses incurred for certain qualified benefits. An FSA may be offered for dependent care assistance, adoption, and medical care reimbursements. The benefits are subject to an annual maximum and are subject to an annual "use-or-lose" rule. An FSA cannot provide a cumulative benefit to the employees beyond the plan year.

The above discussion from the irs.gov website provides only the most basic rules governing a cafeteria plan. For a complete understanding of the rules, see the Regulations under section 125.

The Affordable Health Care Act, which became law in March 2010, included a provision that limits the annual amount of salary reductions that an employee may contribute to a health FSA. The limit is effective for taxable years beginning after December 31, 2012. Prior to this provision, there was no statutory limit for employee contributions to a health FSA; that amount was dictated by the employer either as a maximum dollar amount or maximum percentage of compensation. For taxable year 2019, the limit is $2,700. For taxable years beginning in 2020, the limit is $2,800.

XVIII. USE TAX

If you purchase an item out-of-state or from an internet seller that will be used, consumed, or stored in California, then you may owe use tax. If the out-of-state merchant or internet seller charges you the correct amount of sales or use tax on your purchase, then your use tax requirement has been fulfilled. Out-of-state companies that are "engaged in business" in California must register with the California Department of Tax and Fee Administration ("CDTFA") and collect sales or use tax on their retail sales of personal property to California customers. However, if no sales or use tax was collected on your purchase, then you are required to compute and pay the amount of use tax due.

How do you compute the use tax? First, add the amount of all purchases made from out-of-state or internet sellers made without payment of California sales or use tax. Next, multiply that amount by the applicable use tax rate. The use tax rate and the sales tax rate are the same. The use tax rate is determined by where the property will be used, consumed, or stored in California. Subtract any sales or use tax you paid to another state for the items you purchased from the use tax due.

XIX. RECORDS RETENTION

WARNING: Your circumstances may require that you retain records for a longer period of time than shown in the table below. The schedule provides general guidelines. Statute of limitations vary from state to state and companies should have record retention policies for computer files, word processing, and email in addition to traditional ledger and paper documents. Prior to formalizing a policy, we recommend consulting your attorneys and accountants for further information. See the chart on the next page for recommended holding periods for specific types of documents.

XIX. RECORDS RETENTION *(Continued)*

	Retention Period
Accident reports and claims (settled cases)	7 yrs.
Accounts payable ledgers and schedules	10 yrs.
Accounts receivable ledgers and schedules	10 yrs.
Audit reports of accountants	Permanently
Bank reconciliations	1 yr.
Canceled checks for important payments, i.e. taxes and purchases of property	Permanently
Canceled checks, bank statements and deposit slips	10 yrs.
Capital stock and bond records; ledgers, transfer registers, stubs showing issues, record of interest coupons, options, etc.	Permanently
Cash receipts and disbursements journals	Permanently
Charts of accounts	Permanently
Contracts and leases	10 yrs. (after expiration)
Correspondence (routine) with customers or vendors	1 yr.
Correspondence (general)	3 yrs.
Correspondence (legal and important matters only)	Permanently
Deeds, mortgages and bills of sale	Permanently
Depreciation schedules	Permanently
Duplicate deposit slips	1 yr.
Employment applications and employee contracts	7 yrs. (after termination)
Expense reports	7 yrs.
Financial statements (end-of-year, other months optional)	Permanently
General and private ledgers (and end-of-year trial balances)	Permanently
INS I-9 Forms	Greater of 3 yrs. From date of hire or 1 year after termination
Insurance documents	(1 - 10 yrs. after expiration or settlement)
Internal audit reports (in some situations, longer retention periods may be desirable)	7 yrs.
Inventories of products, materials and supplies	7 yrs.
First year	Permanently
Invoices to customers	7 yrs.
Invoices from vendors	7 yrs.
Journals	Permanently
Minute books of directors and stockholders, including by-laws and charter	Permanently
Notes receivable ledgers and schedules	7 yrs. (after expiration)
Payroll records and summaries, including payments to pensioners	7 yrs.
Personnel data	7 yrs.
Petty cash vouchers	3 yrs.
Physical inventory tags	3 yrs.
Plant cost ledgers	7 yrs.
First year	Permanently
Property appraisals by outside appraisers	Permanently
Property records - including blueprints, appraisals, and penalties	Permanently
Purchase orders or requisitions (copy)	5 yrs.
Receiving sheets	1 yr.
Requisitions	1 yr.
Sales records	7 yrs.
Scrap and salvage records (inventories, sales, etc.)	7 yrs.
Stenographer's notebooks	1 yr.
Subsidiary ledgers	7 yrs.
Tax returns and worksheets, revenue agents' reports and other documents relating to determination of income tax liability	Permanently
Time reports	7 yrs.
Trademark registrations	Permanently
Voucher register, schedules and backup	7 yrs.
Warranties and service agreements	3 yrs. (after expiration)

XX. CALIFORNIA STATE CONTROLLER'S OFFICE UNCLAIMED PROPERTY PROGRAM

California's Unclaimed Property Law requires corporations, businesses, associations, financial institutions, and insurance companies (collectively referred to as "Holders") to annually report and deliver property to the State Controller's Office after there has been no activity on the account or contact with the owner for a period of time specified in the law—generally three (3) years. Common types of unclaimed property are bank accounts, stocks, bonds, uncashed checks, insurance benefits, wages, and safe deposit box contents. Often, contact is lost when the owner forgets that the account exists, or moves and does not leave a forwarding address, or the forwarding order expires. In some cases, the owner dies and the heirs have no knowledge of the property.

The Unclaimed Property Law was passed to protect consumers. It prevents businesses with unclaimed property from keeping money and using it as business income. The law provides California citizens a single source, the State Controller's Office, to check for unclaimed property that may be reported by businesses from around the nation and enables the State to return property, or the net proceeds from any legally required sale of the property, to its rightful owner or their heirs.

Prior to this provision, there was no statutory limit for employee contributions to a health FSA; that amount was dictated by the employer either as a maximum dollar amount or maximum percentage of compensation. For taxable year 2019, the limit is $2,700. For taxable years beginning in 2020, the limit is $2,750.

Go to www.sco.ca.gov for more details.

XXI. INFORMATION AVAILABLE ON THE INTERNET

Federal:	
Department of Health and Human Services	www.hhs.gov
Department of Homeland Security	www.dhs.gov
Department of Labor	www.dol.gov
Health Insurance Information	healthcare.gov
U.S. Citizenship and Immigration Services	www.uscis.gov
Internal Revenue Service	www.irs.gov
Social Security Administration	www.ssa.gov
United States Postal Service	www.usps.com
California:	
Film Commission	www.film.ca.gov
Franchise Tax Board	www.ftb.ca.gov
Employment Development Department	www.edd.ca.gov
Health Insurance Information	coveredca.com
State Controller (Unclaimed Property)	www.sco.ca.gov
Board of Equalization	www.boe.ca.gov
Department of Tax and Fee Administration	www.cdtfa.ca.gov
Office of Tax Appeals	www.ota.ca.gov
Secretary of State	www.sos.ca.gov
Local:	
Los Angeles County Clerk	www.lacounty.info
Other States:	
Colorado Department of Revenue	www.colorado.gov/revenue
Idaho State Tax Commission	www.tax.idaho.gov
Washington State Department of Revenue	www.dor.wa.gov

Energy Research and Credit Information:

Federal	www.energystar.gov
California	Gosolarcalifornia.ca.gov

Foreign exchange rates at www.federalreserve.gov/releases/h10/hist (1990 to present).
Consumer information at www.pueblo.gsa.gov.
Stock Market Quotes at www.dailystocks.com or www.moneycentral.msn.com.
General Government Information at www.usa.gov

XXII. TYPES OF PAYMENTS

Types of Payments
Below is an alphabetic list of some payments and the forms to file and report them on. However, it is not a complete list of all payments, and the absence of a payment from the list does not indicate that the payment is not reportable. For instructions on a specific type of payment, see the separate instructions in the form(s) listed.

Type of Payment	Report on Form
ABLE accounts:	
Contributions	5498-QA
Distributions	1099-QA
Abandonment	1099-A
Accelerated death benefits	1099-LTC
Acquisition of control	1099-CAP
Agriculture payments	1099-G
Allocated tips	W-2
Alternate TAA payments	1099-G
Annuities	1099-R
Archer MSAs:	
Contributions	5498-SA
Distributions	1099-SA
Attorney, fees and gross proceeds	1099-MISC
Auto reimbursements, employee	W-2
Auto reimbursements, nonemployee	1099-MISC
Awards, employee	W-2
Awards, nonemployee	1099-MISC
Barter exchange income	1099-B
Bond tax credit	1097-BTC
Bonuses, employee	W-2
Bonuses, nonemployee	1099-MISC
Broker transactions	1099-B
Cancellation of debt	1099-C
Capital gain distributions	1099-DIV
Car expense, employee	W-2
Car expense, nonemployee	1099-MISC
Changes in capital structure	1099-CAP
Charitable gift annuities	1099-R
Commissions, employee	W-2
Commissions, nonemployee	1099-MISC
Commodities transactions	1099-B
Compensation, employee	W-2
Compensation, nonemployee	1099-MISC
Contributions of motor vehicles, boats, and airplanes	1098-C
Cost of current life insurance protection	1099-R
Coverdell ESA contributions	5498-ESA
Coverdell ESA distributions	1099-Q
Crop insurance proceeds	1099-MISC
Damages	1099-MISC
Death benefits	1099-R
Accelerated	1099-LTC
Debt cancellation	1099-C
Dependent care payments	W-2
Direct rollovers	1099-Q, 1099-R, 5498
Direct sales of consumer products for resale	1099-MISC
Directors' fees	1099-MISC
Discharge of indebtedness	1099-C
Dividends	1099-DIV
Donation of motor vehicle	1098-C
Education loan interest	1098-E
Employee business expense reimbursement	W-2
Employee compensation	W-2
Excess deferrals, excess contributions, distributions of	1099-R
Exercise of incentive stock option under section 422(b)	3921
Fees, employee	W-2
Fees, nonemployee	1099-MISC
Fishing boat crew members proceeds	1099-MISC
Fish purchases for cash	1099-MISC
Foreclosures	1099-A
Foreign persons' income	1042-S
401(k) contributions	W-2
404(k) dividend	1099-DIV
Gambling winnings	W-2G
Golden parachute, employee	W-2
Golden parachute, nonemployee	1099-MISC
Grants, taxable	1099-G
Health care services	1099-MISC
Health coverage tax credit (HCTC) advance payments	1099-H
Health savings accounts:	
Contributions	5498-SA
Distributions	1099-SA
Income attributable to domestic production activities, deduction for	1099-PATR
Income tax refunds, state and local	1099-G
Indian gaming profits paid to tribal members	1099-MISC
Interest income	1099-INT
Tax-exempt	1099-INT
Interest, mortgage	1098
IRA contributions	5498
IRA distributions	1099-R
Life insurance contract distributions	1099-R, 1099-LTC
Liquidation, distributions in	1099-DIV
Loans, distribution from pension plan	1099-R
Long-term care benefits	1099-LTC
Medicare Advantage MSAs:	
Contributions	5498-SA
Distributions	1099-SA
Medical services	1099-MISC
Mileage, employee	W-2
Mileage, nonemployee	1099-MISC
Military retirement	1099-R
Mortgage assistance payments	1098-MA
Mortgage interest	1098
Moving expense	W-2
Nonemployee compensation	1099-MISC
Nonqualified deferred compensation:	
Beneficiary	1099-R
Employee	W-2
Nonemployee	1099-MISC
Original issue discount (OID)	1099-OID
Tax-exempt OID	1099-OID
Patronage dividends	1099-PATR
Payment card transactions	1099-K
Pensions	1099-R
Points	1098
Prizes, employee	W-2
Prizes, nonemployee	1099-MISC
Profit-sharing plan	1099-R
Punitive damages	1099-MISC
Qualified longevity annuity contract	1098-Q
Qualified plan distributions	1099-R
Qualified tuition program payments	1099-Q
Real estate transactions	1099-S
Recharacterized IRA contributions	1099-R, 5498
Refund, state and local tax	1099-G
Rents	1099-MISC
Reportable policy sale	1099-LS
Retirement	1099-R
Roth conversion IRA contributions	5498
Roth conversion IRA distributions	1099-R
Roth IRA contributions	5498
Roth IRA distributions	1099-R
Royalties	1099-MISC, 1099-S
Timber, pay-as-cut contract	1099-S
Sales:	
Real estate	1099-S
Securities	1099-B
Section 1035 exchange	1099-R
Seller's investment in life insurance contract	1099-SB
SEP contributions	W-2, 5498
SEP distributions	1099-R
Severance pay	W-2
Sick pay	W-2
SIMPLE contributions	W-2, 5498
SIMPLE distributions	1099-R
Student loan interest	1098-E
Substitute payments in lieu of dividends or tax-exempt interest	1099-MISC
Supplemental unemployment	W-2
Tax refunds, state and local	1099-G
Third party network transactions	1099-K
Tips	W-2
Traditional IRA contributions	5498
Traditional IRA distributions	1099-R
Transfer of stock acquired through an employee stock purchase plan under section 423(c)	3922
Tuition	1098-T
Unemployment benefits	1099-G
Vacation allowance, employee	W-2
Vacation allowance, nonemployee	1099-MISC
Wages	W-2