

**STATE OF WISCONSIN
STATE ACCOUNTING MANUAL**

SECTION:	V Expenditures	EFFECTIVE DATE:	June 1, 2012
SUB-SECTION:	20 - Employee Taxable Fringe Benefits	REVISION DATE:	July 1, 2012
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I. INTRODUCTION

This section covers situations that under Internal Revenue Service (IRS) rules could be considered taxable fringe benefits to employees. It applies where employees are reimbursed for these expenses or where these expenses are either charged by the employee to a state purchasing card (p-card) or where the agency pays the vendor directly on behalf of the employee for the expense. It does not cover payments or reimbursements to non-employees. This section identifies some of the more common expenses that could be considered taxable fringe benefits under certain conditions. It is not an all inclusive list and there are other taxable benefits that are not included in this section. The section explains how to record these expenses so they will be included on the employee's W-2 and appropriate withholdings will be deducted.

II. GENERAL RULE

The general rule under IRS regulations is that fringe benefits for employees are taxable wages to the employee unless specifically excluded by a section of the IRS Code. **If the fringe benefit is taxable and not excludable it must be included as wages on the employee's W-2 and is subject to withholdings for federal income tax, state income tax and employment taxes (social security and Medicare).**

Note: The IRS notified the State of Wisconsin in 1994 that reimbursements to employees of taxable travel expenses must be reported on a W-2. The IRS also stated that the State, as an employer, must withhold federal income and employment (social security and Medicare) taxes on employee taxable travel reimbursements. Also in 1994 the Wisconsin Department of Revenue instructed the State Controller's Office that it must withhold state income tax on reimbursements of taxable travel.

Section V in this document discusses De minimis Fringe Benefits. The section should be reviewed because some benefits that would normally be considered taxable benefits might be excluded as a de minimis benefit.

III. DOCUMENTATION REQUIREMENTS - ACCOUNTABLE PLAN

Even if a fringe benefit can be excluded from income by a section of the IRS Code it must also meet the "accountable plan" requirements or it is considered a taxable benefit to the employee.

To qualify as a reimbursement or payment under an "accountable plan" the IRS indicates that the following requirements must be met:

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- There must be a business connection for the expense. This means that the expense would qualify as a deductible business expense in relation to the employee's job duties. It would be a deductible expense by the employee if the employer had not reimbursed or paid for the expense.
- There must be adequate accounting by the employee and the accounting must occur within a reasonable period of time after the expense was incurred. Adequate accounting means that the expense is supported by a description of the date, time, place, amount and business purpose of the expense. Receipts are required to support the expense unless the IRS rules provide for an exception. For example, meals that are less than the IRS per diems do not require receipts but they still require a business purpose, date, time, place and amount. The IRS has indicated that a "Safe Harbor" rule for timely accounting for the expense means the required information and receipts are provided within 60 days after the expense is paid or incurred. This does not mean that timely reporting does not occur if the information and receipts are provided more than 60 days after the expense was incurred. Under IRS rules a reasonable period of time depends on the facts and circumstances for each situation. DOA recommends that 60 days be used as the time period for timely reporting.
- Any excess reimbursement or advance must be returned within a reasonable period of time. The excess should be repaid to the employer within 120 days after the expense is incurred or paid.

Example - Business related lodging is non-taxable, however if the lodging is charged on a p-card and the employee does not provide a receipt and indicate the business purpose of the lodging within a reasonable period of time then the lodging expense should be considered a taxable fringe benefit. It must be included as wages on the employee's W-2 and withholdings must be deducted.

IV. LIST OF TAXABLE BENEFITS (partial)

The following list shows some of the types of expenses that if paid/reimbursed by the agency would be considered a taxable fringe benefit to the employee. This is not an all inclusive list and there are other taxable benefits that are not included. The listed items are discussed in more detail later in this document.

- Non-overnight Meals - Meals where the employee is not required to be away from their tax home overnight for rest.
- Mileage reimbursement that is in excess of the rate allowed by the IRS. The IRS has different rates for different types of travel. There is a rate for business travel and a different rate for mileage related to an employee move. Normally under Wisconsin travel rules, the state reimbursement rate for business travel is less than the IRS rate and would not be taxable. The IRS rate for an employee move is normally much lower than the rate a state employee is reimbursed for a move. Therefore, the excess is a taxable reimbursement to the employee.
- Temporary lodging related to an employee move.

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- Moving expenses covered by the stipend that are either non-deductible moving expenses or are deductible moving expenses where adequate accounting is not provided.
- Moving expenses in situations where the IRS distance rule of 50 miles is not met. The state allows moving reimbursement under a 35 mile distance rule while the IRS uses a 50 mile rule.
- Clothing given to employees that is suitable for general usage as ordinary clothing.
- Reimbursements for educational assistance that are not job related and exceed an allowable exclusion.
- Employee recognition awards that are not excluded by IRS Codes.
- Cash allowances.
- Expense reimbursements or charges to the p-card where adequate accounting rules are not met.

A. Non-overnight Meals

In order for meals to be a deductible business expense, the IRS requires an employee to be away from home to obtain a substantial amount of sleep. Therefore, reimbursement of employee meals or direct payments of meals, that are not preceded or followed by an overnight stay are considered taxable income to the employee. These reimbursements are subject to withholdings of federal and state income taxes and employment taxes.

B. Taxable Mileage

Employees are reimbursed for mileage at a set rate per mile. If the per mile rate that is reimbursed is greater than the rate allowed by the IRS the excess (amount above the IRS rate) is taxable income to the employee.

Example: As of July 1, 2012 the state's reimbursement rate is \$.51 per mile while the IRS rate is \$.555 per mile for business travel. Therefore reimbursement for business miles is non-taxable.

However, the IRS has a separate rate for reimbursement of mileage related to an employee move. The difference between the state reimbursement rate and the allowable IRS rate times the miles reimbursed for the move is taxable to the employee. The mileage rates change periodically but the concept remains the same. If the per mile rate that is reimbursed is greater than the rate allowed by the IRS then the excess is taxable.

Example: Effective January 1, 2012 the allowable IRS moving rate is \$.23 per mile. The state mileage reimbursement rate for a move is the same as the business mileage rate. On July 1, 2012 this rate is \$.51. The difference of \$.28 times the miles reimbursed is taxable to the employee.

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C. Temporary Lodging Related to an Employee Move

State moving reimbursement rules allow an agency to authorize an employee to be reimbursed for up to 45 days of temporary lodging in situations where the employee has to establish a temporary residence at the new place of employment. This usually means the employee has to maintain residences at both the old and new places of employment. See Chapter 774 of the Wisconsin Human Resources Manual for more information on temporary lodging. The IRS does not consider temporary lodging to be a deductible moving expense. Any reimbursement or direct payment on behalf of the employee for temporary lodging is a taxable fringe benefit to the employee and must be included on their W-2. Withholdings of state and federal income taxes and employment taxes are required. See also Section V, Subsection 10 of the State Accounting Manual for more information on the reporting of non-taxable moving reimbursements on the W-2.

D. Moving Expenses Paid by the Stipend

State reimbursement rules related to an employee move are included in the state statutes, Compensation Plan, collective bargaining agreements and Chapter 760 of the Wisconsin Human Resources Manual. These rules require an agency to provide a stipend for mandatory moves and allow an agency to provide an employee with a stipend for permissive moves. The stipend is intended to cover some of the moving expenses that are not considered allowable moving expenses under the state policies. However, the stipend may cover some expenses that the IRS considers deductible moving expenses. For example, state policy does not allow reimbursement of lodging costs enroute between the old and new residence however, the IRS considers these lodging costs to be a deductible moving expense. If the stipend is used to cover deductible moving expenses and the employee provides adequate accounting (see section III above) of these expenses then the portion of the stipend related to these expenses is not a taxable reimbursement. If the employee is paid the stipend and does not provide adequate accounting for the expenses then the stipend is a taxable reimbursement. If the stipend is for non-deductible moving expenses then the stipend is taxable even if the adequate accounting rule is met. See also Section V, Subsection 10 of the State Accounting Manual for more information on the reporting of non-taxable moving reimbursements on the W-2.

E. Moves That Don't Meet the 50 Mile IRS Rule

State moving reimbursement rules allow an employee to be reimbursed for moving expenses if a 35 mile rule is met. This means the distance between the employee's new place of employment and the old residence is at least 35 miles farther than the distance between the old place of employment and the old residence. Under IRS rules, to be a deductible moving expense this distance must be at least 50 miles. Therefore, any expenses related to moves that do not meet the IRS's 50 mile rule are taxable reimbursements. Any reimbursements or direct payments that do not meet this distance test must be included as income on the employee's W-2 and are subject to withholdings. See also Section V, Subsection 10 of the State Accounting Manual for more information on the reporting of non-taxable moving reimbursements on the W-2.

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F. Employer Provided Clothing

The IRS views clothing provided to employees as a taxable fringe benefit unless certain conditions are met. The following two sections (1) Work Clothes and Uniform Allowances and Reimbursements and (2) Safety Equipment are taken directly from the 2012 Taxable Fringe Benefit Guide that is available on the IRS Website.

"Work Clothes and Uniform Allowances and Reimbursements

Clothing or uniforms are excluded from wages of an employee if they are:

- Specifically required as a condition of employment, and
- Are not worn or adaptable to general usage as ordinary clothing.

The accountable plan rules must be met for reimbursements or clothing allowances. *IRC § 162; Reg. § 1.62-2(c)(1)*

Note: If the clothing qualifies as excludable, then the cleaning costs are also excludable.

Periodic allowance payments made to employees for the purchase and maintenance of specific articles of *employer required* uniforms are not taxable to the employees provided that the uniforms are not adaptable to general use, and, in fact, are not worn for general use. In addition, the employees must substantiate the expenses. If the employer does not require substantiation, the allowance is taxable as wages and subject to withholding when paid.

Example: An agency is required to reimburse certain employees for shoes under a union contract. The shoes are not safety shoes. If the shoes are not safety shoes and are adaptable for general wear, the reimbursements are included as wages to the employees even if the employer is required to make the payment.

Safety Equipment

Safety equipment is excludable from employee wages if the equipment is provided to help the employee to perform his/her job in a safer environment. To be excludable, it is not necessary that the equipment be required by the employer. However, the accountable plan rules must be met for reimbursements for safety equipment. *IRC § 162; Reg. § 1.62-2(c)(1)*

Common examples include a hardhat, an anti-glare screen for computer, or safety shoes.

Example: A government entity pays employees on an annual basis for part of the cost of safety equipment not required by employer. The payments may be excludable even though the safety equipment is not required by the employer. If the equipment helps the employee perform his/her job in a safer environment, it may qualify as an employee business expense. If the expenses are substantiated, the reimbursement would be excludable to the employee."

SCO Comments:

The website for the Taxable Fringe Benefit Guide is as follows. This site also has several other publications that may be useful.

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<http://www.irs.gov/govt/fslg/content/0,,id=117706,00.html>

IRS Publications 17 and 529 also have brief sections on work clothes and uniforms.

These rules apply to clothing purchased by the agency and issued to the employee, clothing purchased by the employee and reimbursed by the agency and clothing purchased by the employee using a state purchasing card. In order for the clothing to be excluded from an employee's wages the following three conditions must all be met.

1. The clothing or uniforms must be specifically required as a condition of employment (Safety equipment does not have this requirement).
2. The clothing is not worn or adaptable to general usage as ordinary clothing. It is not enough that the employee does not wear the work clothes away from work. The clothing must not be suitable for taking the place of their regular clothing.
3. Proper substantiation of the clothing purchased has occurred. This means the IRS' accountable plan rules (section III above) have been met.

Applying the second requirement will be a matter of opinion. Agencies should apply a reasonable person approach (what would a reasonable person say) when deciding whether the clothing can be worn for every day use.

Note: It is our understanding that an EMT organization that provided polo type shirts with the organization logo was cited by the IRS for not including the value of these shirts as taxable income to the employees. The IRS viewed these shirts as suitable for taking the place of regular clothing.

These rules need to be applied individually to the different types of clothing purchased to determine whether they are excludable from an employee's wages. As an example, in one court case the individual worked outdoors in very cold weather and purchased insulated coveralls and insulated work shoes. The court ruled that the insulated coveralls met the requirements because it was unlikely that they would be worn for everyday use (very bulky and utilitarian fashion) but they felt that the insulated shoes were suited for informal personal use and therefore did not meet the second requirement and were a taxable fringe benefit.

Agencies should evaluate the clothing that they purchase or reimburse to the employee to decide whether it qualifies as taxable or non-taxable based on the IRS rules. If something is determined to be non-taxable the agency must justify why this determination was made. This justification must be retained in case the IRS audits the agency for proper implementation of taxable benefits. Because of the wide range and style of clothing a list of clothing that is specifically non-taxable cannot be included in this document.

If it is determined that the clothing qualifies as a taxable fringe benefit then the IRS requires that the fair market value be included on the employee's W-2 and withholdings be deducted. See section VI below that describes how to record the fringe benefit as a taxable benefit.

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G. Educational Assistance Benefits

Generally education courses that qualify an employee for a new trade or business or are required to meet the minimum educational requirements of an employee's current job are considered taxable reimbursements. However, if the employer has a written educational assistance plan then up to \$5,250 per year of the cost of these courses may be excluded from the employee's wages.

Educational courses that are job related can be excluded as a "working condition" fringe benefit. This is a separate exclusion and does not count against the \$5,250 exclusion.

Agencies should keep track of the amounts paid for the taxable educational courses. This includes amounts reimbursed to the employee as well as amounts paid to the educational institution. Once the \$5,250 exclusion has been exceeded for the year any remaining payments must be included as taxable income on the employee's W-2 (box 1). See also Section V, Subsection 10 of the State Accounting Manual for additional information.

H. Employee Recognition Awards

Section V, Subsection 16 of the State Accounting Manual defines state policy on awards to employees. This section includes information on determining whether these awards are considered taxable income to the employee. Review Section V, Subsection 16 to determine which awards to employees are taxable and subject to withholdings and which awards can be excluded.

I. Cash Allowances

The Compensation Plan and applicable collective bargaining agreements include provisions for cash allowances for items such as, safety shoes, black belts, black shoes, etc. Some of these items, such as the safety shoes, are excludable from an employee's wages under IRS rules provided adequate accounting occurs. However, if the employee is paid the cash allowance and does not substantiate (meet the adequate accounting rules) that this allowance was actually used to purchase the excluded items then the cash allowance must be included as taxable income to the employee and is subject to withholdings.

Items such as black belts and black shoes are not excludable as safety equipment and are considered suitable for general usage as ordinary clothing. The cash allowance for these items, provided in the Compensation Plan or applicable collective bargaining agreements, would be considered taxable income even if the employee substantiates that the allowance was actually used to purchase these items. These allowances are subject to withholdings.

J. Expenses Without Adequate Accounting

See section III above on Documentation Requirements.

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Employee reimbursements or direct payments for fringe benefits that can normally be excluded from income are considered taxable income to the employee if adequate accounting for these items is not met within a reasonable period of time (see section III).

While most normal travel expenses (other than non-overnight meals) are considered non-taxable business expenses to the employee, the reimbursement of these expenses becomes taxable income if the requirements for an accountable plan (section III) are not met. For example, if an employee charges travel or other expenses to a p-card and does not provide the adequate accounting required under section III (receipts, business purpose, etc.) then these charges should be considered taxable income to the employee. Employees should be asked to provide the required documentation by a specific date and if it is not provided the employee should be notified that the undocumented amounts will be added to their taxable income per IRS requirements. See section VI below for methods to include these amounts as taxable income to the employee.

V. DE MINIMIS FRINGE BENEFITS

The IRS publication Taxable Fringe Benefit Guide has a section that discusses de minimis fringe benefits. If a fringe benefit qualifies as de minimis then the benefit is excludable from the employee's income. Excerpts from this section of the 2012 Taxable Fringe Benefit Guide follow.

"De minimis fringe benefits include property or services, provided by an employer for an employee, with a value so small that accounting for it is unreasonable or administratively impractical. The value of the benefit is determined by the frequency it is provided to each individual employee, or, if this is not administratively practical, by the frequency provided by that employer to the workforce as a whole. *IRC § 132(e); Reg. § 1.132-6(b)*

Example: An employer gives employees snacks each day valued at one dollar. Even though small in amount, the benefit is provided on a regular basis and is, therefore, taxable as wages.

The law does not specify a dollar threshold for benefits to qualify as de minimis. The determination will always depend on facts and circumstances. The IRS has given advice at least once (ILM 200108042) that a benefit of \$100 did not qualify as de minimis. However, this technical advice addresses a specific situation and cannot be relied upon in addressing another specific situation.

Definition of Employee for De Minimis Fringe Benefits

Any individual receiving a de minimis fringe benefit is treated as an employee for this purpose *Reg. § 1.132-1(b)(4)*

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Examples of Excludable De Minimis Fringe Benefits: *Reg. § 1.132-6(e)(1)*

All of the following may be excludable if they are occasional (infrequent), **not routine:**

- Personal use of photocopier (with restrictions)
- Group meals, employee picnics
- Theater or sporting event tickets
- Coffee, doughnuts, or soft drinks
- Flowers or fruit for special circumstances
- Local telephone calls
- Traditional birthday or holiday gifts (not cash) with a low FMV
- Commuting use of employer's car if no more than once per month
- Employer-provided local transportation
- Personal use of cell phone provided by employer primarily for a business purpose”

“Benefits That Do Not Qualify as De Minimis

The following are common examples of benefits that do not qualify as de minimis:

- Cash - except for occasional and infrequent meal money to allow overtime work
- Cash equivalent (i.e., savings bond, gift certificate for general merchandise at a department store)
- Certain transportation passes or costs
- Use of employer's apartment, vacation home, boat
- Commuting use of employer's vehicle more than once a month. *Reg. § 1.132-6(d)(3)*
- Membership in a country club or athletic facility

Some of these benefits may be excludable under other provisions of the law.”

SCO Comments

To be de minimis the benefit must be infrequent, small in value and accounting for it is unreasonable or administratively impractical. All these conditions must be met before the benefit can be excluded from inclusion as taxable income to the employee. Also, cash or cash equivalent benefits given to employees do not qualify as de minimis.

Note: The list of items above that are identified as de minimis fringe benefits is an IRS list. Just because an item is on this list does not mean that an agency can use state funds to provide this benefit to its employees.

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VI. METHODS FOR RECORDING TAXABLE FRINGE BENEFITS

Taxable fringe benefits might be paid in any of the following manners. The expense might be paid by the employee who then submits a claim for reimbursement. The expense might be charged to a state p-card. The agency might pay the vendor directly for the expense. Depending on which payment method was used the options for including the taxable fringe benefit in the employee's taxable income and withholding on this benefit can vary. The general approach to be used is to include the taxable benefit in the employee's taxable earnings in the payroll system. This allows the payroll system to calculate the appropriate withholdings, deduct these withholdings from the employee's paycheck and report the earnings and withholdings on the year end W-2. The following options are available to accomplish this approach.

A. Taxable Fringe Benefit Paid by Employee and a Reimbursement Claimed

The ideal situation is if the employee incurred the expense and is claiming reimbursement. In this situation a TL should be processed similar to the reimbursement of taxable meals on a travel voucher (see Section V, Subsection 10 of the State Accounting Manual). The taxable fringe benefit should be coded as a credit to taxable travel payable (balance sheet account 5080). The actual expense coding (object code) for the fringe benefit will depend on the type of expense involved and agencies should select the object code that most appropriately identifies the expense. Using this method will allow the payroll system to reimburse the employee for the expense, add the amount to the employee's taxable earnings and calculate appropriate withholdings. The payroll system will then include these amounts on the employee's W-2 issued at the end of the calendar year. The reimbursement for the taxable fringe benefit can be included on a TL by itself or along with any of the employee's regular travel claims.

B. Agency Paid for Taxable Fringe Benefit (either on p-card or directly to vendor)

If the agency identifies that something is a taxable fringe benefit and it has been paid for either by a charge to a state p-card or directly to the vendor then the following options are available to include the benefit in the employee's taxable earnings and withhold applicable taxes.

1. A TL can be processed with the amount of the taxable benefit coded as a debit to balance sheet account 5090 - Non-taxable Travel Payable and a credit to balance sheet account 5080 - Taxable Travel Payable. Nothing would be coded to an object code because the expense has already been recognized when paid for by the agency. In the WiSMART system the result of this entry is a debit and a credit to two different liability accounts, no object code is used and nothing would be charged against an agency budget from this transaction. However, the payroll system will pick up these entries. In the payroll system the taxable earnings will be increased for the 5080 entry and the non-taxable earnings will be decreased for the 5090 entry for the payperiod (net increase in earnings is zero). However, this will cause the payroll system to calculate withholdings on the combination of, the employee's wages for the payperiod plus the amount coded as taxable travel. The new withholdings (normal

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payroll withholdings plus withholdings on the taxable benefit) will be deducted from the normal gross wages for the payperiod because the increase in taxable travel will be reduced by the decrease in the non-taxable travel amounts, which are equal. The employee will not be paid the value of the fringe benefit on their paycheck as a result of these entries. The payroll system will create entries on a PR transaction in WiSMART that will debit the 5080 balance sheet account and credit the 5090 balance sheet account. The result in WiSMART of these two entries (the TL and the PR) is a zero balance in these two accounts.

TL transaction in WiSMART - Assumes \$100 in taxable fringe benefits already paid for by the agency.

Title	Fund	Agcy	Appr	B/S	DR	CR
Non-taxable Travel Payable	xxx	xxx	967B	5090	100.00	
Taxable Travel Payable	xxx	xxx	967B	5080		100.00

xxx is agency determined.

When the employee's paycheck is generated the payroll system will create a PR transaction that will include as some of the entries a debit to the 5080 balance sheet account and a credit to the 5090 balance sheet account.

Caution: This method can cause problems if the additional withholdings on the taxable fringe benefit exceeds the employee's net paycheck prior to including the benefit as taxable. If this occurs, withholdings would be deducted in a specific order and once the net check reaches zero no additional withholdings will be taken. This means some normal deductions would not be made for this paycheck. If the agency believes this entry may cause problems with the withholdings, the agency should manually calculate the amount of the withholdings on the fringe benefit to see if it exceeds the employee's normal net check. If the additional withholdings exceed the normal net check, the agency should consider the following method.

If the amount of the taxable fringe benefit is large enough that it will cause problems (see previous paragraph) with the withholdings from an employee's paycheck then including the benefit in the employee's taxable earnings and withholding on these amounts can be split over several paychecks within the calendar year. This is accomplished by processing TL transactions in several different payperiods (different TL processing periods using the Tuesday cutoff dates) where the combined total of these transactions equals the amount of the benefit. For example if the employee has taxable moving of \$2,000, that was paid by the agency directly to the vendor, and the withholdings on the \$2,000 would exceed the net paycheck then the amount could be split into two TL's of \$1,000 each (or other combinations, 4 TL's of \$500 each depending on the employee's net paycheck). **The TL's must be processed in different cycles so they appear on different paychecks.**

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2. Another alternative is to have the employee repay the agency for the amount of the taxable fringe benefit and then submit a claim for the reimbursable expenses. A TL transaction would then be processed in the same manner as if the employee had purchased the item directly (see method A above). While it may seem unreasonable to have the employee pay the agency for the benefit and then have the agency reimburse the employee for the same benefit, it allows the payroll system to include the full amount as a taxable benefit and withholdings can be deducted without causing problems with the net paycheck because the employee is also being reimbursed for the amount of the benefit which increases the amount of the net check.

VII. REFERENCES

The following reference materials provide additional information on taxable fringe benefits.

- Taxable Fringe Benefit Guide - For Federal, State and Local Governments - Issued by the IRS - <http://www.irs.gov/govt/fslg/content/0,,id=117706,00.html>
- Quick Reference Guide for Public Employers - Issued by the IRS - <http://www.irs.gov/govt/fslg/content/0,,id=117706,00.html>

The following publications can be accessed from the IRS Website - <http://www.irs.gov/app/picklist/list/publicationsNoticesPdf.html>

- IRS Publication 15-B - Employer's Tax Guide to Fringe Benefits
- IRS Publication 17 - Your Federal Income Tax
- IRS Publication 463 - Travel, Entertainment, Gift and Car Expenses
- IRS Publication 521 - Moving Expenses
- IRS Publication 525 - Taxable and Nontaxable Income
- IRS Publication 529 - Miscellaneous Deductions
- IRS Publication 535 - Business Expenses

Wisconsin State Accounting Manual Sections:

- Section V, Subsection 10 - Employee Travel & Other Reimbursements
- Section V, Subsection 16 - Employee Recognition Awards