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JOANNA BOLSKY, CPA
RONALD D. CHANDLER, CPA
MICHAEL G. KAPLAN, CPA
MICHAEL J. QUACKENBUSH, CPA
EDMOND AVANESS, CPA
CRANE CURRAN, CPA
BRIAN J. HARRIS, CPA
GREGORY E. KLEIN, CPA
LINDA BECKER, MBA
ANDREW B. KOSKI, MBA
GRANT K. MILLER, CPA

STANLEY L. MILLER, CPA (1921-1995)
PAUL ARASE, CPA (RETIRED)

Miller, Kaplan, Arase & Co., LLP
CERTIFIED PUBLIC ACCOUNTANTS
SINCE 1941
4123 LANKERSHIM BOULEVARD
NORTH HOLLYWOOD, CALIFORNIA 91602-2828
(818) 769-2010
FAX (818) 769-3100

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January 20, 2012

Re: 2012 Accountants' Memorandum Update

Congress Extends Payroll Tax Holiday through February 29, 2012

Late in 2011 Congress voted to extend for two months the reduced payroll tax rate that applied in 2011. The Temporary Payroll Tax Cut Continuation Act of 2011 extends the two percentage point payroll tax cut for employees, continuing the reduction of their Social Security tax withholding rate from 6.2 percent to 4.2 percent of wages paid through February 29, 2012. This reduced Social Security withholding will have no effect on employees' future Social Security benefits. The reduced self-employment tax rate is also extended through February 29, 2012.

Under the terms negotiated by Congress, the law also includes a new "recapture" provision, which applies only to those employees who receive more than $18,350 in wages during the two-month extension period (the Social Security wage base for 2012 is $110,100, and $18,350 represents two months of the full-year amount). This provision imposes an additional income tax on these higher-income employees in an amount equal to 2 percent of the amount of wages they receive during the two-month period in excess of $18,350 (and not greater than $110,100).

This additional recapture tax is an add-on to income tax liability that the employee would otherwise pay for 2012 and is not subject to reduction by credits or deductions. The recapture tax would be payable in 2013 when the employee files his or her income tax return for the 2012 tax year.

Before February 29, 2012, Congress will need to decide whether to terminate or further extend the payroll tax holiday.

The IRS has announced that it will issue guidance as needed to implement the provisions of this new two-month extension, including revised employment tax forms and instructions and information for employees who may be subject to the new "recapture" provision.

Miller, Kaplan, Arase & Co., LLP

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I. EARNINGS REPORTS DUE IN 2012

A. Payroll Taxes

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

FICA:	2012 Applicable During 2012	2011 Applicable During 2011
Social Security Wage Limit	$110,100	$106,800
Withholding Tax Rate ("OASDI" Portion Only)	6.2% *	4.2%
Maximum Withholding	$6,826.20	$4,485.60
Employer Tax Rate ("OASDI" Only)	6.2%	6.2%
Maximum Employer Portion	$6,826.20	$6,621.60
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

In 2012, Form 941 is due as follows:

Quarter Ending Date	Form 941 Due Dates
December 31, 2011	January 31, 2012
March 31, 2012	April 30, 2012
June 30, 2012	July 31, 2012
September 30, 2012	October 31, 2012

Note: Discussions are underway to keep the present 4.2%.

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

	2012	2011	
Federal Unemployment Tax - On Annual Wage Limit of	$7,000.00	$7,000.00	
Federal Unemployment Tax Rate - Employer Only	6.0%	6.0%	*
Allowable California Credit (5.4%-.3% credit reduction)	TBA	5.1%	
Net Federal Tax Rate	TBA	0.9%	

File the Form 940 for the year ended December 31, 2011 by no later than January 31, 2012. Note: Deposits for 2011 were required for any quarter when the cumulative liability for the quarter was $500.00 or more. ***The .2% surtax expired at the end of June 2011 leaving the rate at 6%. Twenty states, including California, are subject to a credit reduction until they repay all federal advances to cover unemployment benefits.**

In general, family members are exempt from federal unemployment insurance and, those under 18, from social security taxes. Federal income taxes are, however, required to be withheld. These special rules do not apply to family owned partnerships or corporations. 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 personal income tax withholding.

I. EARNINGS REPORTS DUE IN 2012 *(Continued)*

A. Payroll Taxes *(Continued)*

3. California Form DE 9

The 2011 tax year saw the establishment of new quarterly reporting forms and processes. Employers now file the *Quarterly Contribution Return and Report of Wages* (DE 9) and the *Quarterly Contribution Return and Report of Wages (Continuation)* (DE 9C) each quarter. This will allow EDD to identify overpayments and underpayments as early as possible throughout the year, resulting in faster refunds and reducing the possibility of an unplanned tax liability at year-end. The DE 9 replaces the *Quarterly Wage and Withholding Report* (DE 6) which will no longer be filed in 2011. Also, there was the elimination of the Annual Reconciliation Statement (DE 7), effective with the 2011 tax year. The 2010 Annual Reconciliation Statement (due January 31, 2011) was the last one you filed.

The Employment Development Department's (EDD) *Quarterly Contribution and Wage Adjustment Form* (DE 9ADJ) is used to make changes to the *Quarterly Contribution Return and Report of Wages* (DE 9) and the *Quarterly Contribution Return and Report of Wages (Continuation)* (DE 9C).

Complete the DE 9ADJ when you are filing a claim for refund, adjusting the subject wages or taxes, adjusting Personal Income Tax (PIT) wages or withholding, correcting employee(s) Social Security Number(s) (SSN) or name(s), or reporting employee(s) previously not reported to EDD.

Note: Mandatory Electronic Funds Transfer (EFT) filers must remit all SDI/PIT funds by EFT to avoid noncompliance penalties.

The Forms DE 9 are due in 2012 as follows:

Quarter Ending Date	Form DE 9 Due Date
March 31, 2012	May 2, 2012
June 30, 2012	August 1, 2012
September 30, 2012	October 31, 2012

A summary table is as follows:

	2012 Applicable During 2012	2011 Applicable During 2011
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	$95,585.00	$93,316.00
Tax Rate	1.0%	1.2%
Maximum Amounts to be Withheld	$955.85	$1,119.79

* 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 EDD Contribution Rate Group at (916) 653-7795. 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.

I. EARNINGS REPORTS DUE IN 2012 *(Continued)*

B. Wage and Tax Statement - 2011 Form W-2 (Give to Employees before February 1, 2012)

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
f Employee's address and ZIP code		12d 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 **2011** Department of the Treasury—Internal Revenue Service

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

Notes Per 2010 Form Instructions:

1. **Military differential pay -** Payments made after 2009 to former employees while they are on active duty for more than 30 days in the Armed Forces or other uniformed services are now treated as wages. Report these 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 (NODC) plan for all taxable years are includible in gross income unless certain requirements are satisfied.

Additional Note:

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.

I. EARNINGS REPORTS DUE IN 2012 *(Continued)*

B. Wage and Tax Statement - 2011 Form W-2 *(Continued)*

Notes: ***(Continued)***

3. **Qualified Transportation Fringe Benefits -** For 2011 up to $230 per month of qualified parking and up to $230 per month of the combined value of transit passes and transportation by commuter highway vehicle may be excluded from gross income. Report any excess over the exclusion amount as wages in boxes 1, 3 and 5 of the employee's 2011 Form W-2. Note: Employers may also exclude $20 per month paid to employees who commute to work by bicycle. For 2012 the parking limit goes up to $10 and the transit pass limit drops to $125.

4. **Employer Provided Educational Assistance -** There is a personal income tax exclusion of up to $5,250 for employees' educational assistance programs annually.

5. **Deceased Employee's Wages -** The IRS has special instructions for reporting wages if an employee dies during the year. Consult the instructions to 2011 Form W-2.

6. **Group-Term Life Insurance -** You must include in your employees wages subject to social security and Medicare taxes the cost of group-term life insurance that is more than the cost of $50,000 of coverage, reduced by the amount the employee paid toward the insurance. Report it as wages in boxes 1, 3, and 5 of the employee's 2011 Form W-2. Also, show it in box 12 with code C.

   Figure the monthly cost of the insurance to include in the employee's wages by multiplying the number of thousands of dollars of insurance coverage over $50,000 (figured to the nearest 10th) by the cost shown in the following table. Use the employee's age on the last day of the tax year. You must prorate the cost from the table if less than a full month of coverage is involved.

   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

   You 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

7. **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 Forms W-2.

I. EARNINGS REPORTS DUE IN 2011 *(Continued)*

B. Wage and Tax Statement - 2011 Form W-2 *(Continued)*

Notes: *(Continued)*

Box 3 – Social Security Wages: Cannot exceed $106,800 for 2011.

Box 4 – Social Security Tax Withheld: Cannot exceed $4,485.60 for 2011.

Box 5 – Medicare wages and tips: Unlimited for 2011.

Box 6 – Medicare tax withheld: Unlimited for 2011.

Box 11 – Show total distributions to the employee from a non-qualified deferred compensation plan or a Sec. 457 plan during 2011, here and in Box 1 (but not if reported in Boxes 3 or 5). Also include in Box 11 amounts under a nonqualified plan or a Sec. 457 plan that became taxable during the year for social security and medicare tax purposes, but were for services performed in a prior year. Payments to beneficiaries of deceased employees are reportable on Form 1099-R.

Box 12 – Enter a code (A through Z) codes 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.

Box 13 – Checkboxes. Mark all checkboxes that apply.

- **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. There are workers who are independent contractors under the common-law rules but are treated by statute as employees. They are called statutory employees.

- **Retirement Plan.** Mark this checkbox if the employee was an active participant (for any part of the year) in any pension plan.

- **Third-party sick pay.** Mark this checkbox only if you are a third-party sick pay payer filing a Form W-2 for an insured's employee.

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 – For State information. Enter in Box 19 the amount of SDI actually withheld, and in Box 20 the letters "CASDI". The 2011 SDI maximum was $1,119.79.

C. Transmittal Form Addresses

The Following Form is Due by March 1, 2012:

1. 2010 Form W-3 (Federal)

IRS Publication 393, entitled, "2011 Federal Employment Tax Forms," which was mailed to employers in November 2011, contains 2011 Form W-3 and specific instructions for completing that form. If you are required to file 250 or more Forms W-2, you must file them electronically, unless the IRS granted you a waiver. Otherwise see the mailing addresses on the following page.

I. EARNINGS REPORTS DUE IN 2011 *(Continued)*

C. Transmittal Form Addresses *(Continued)*

1. 2011 Form W-3 (Federal) *(Continued)*

File Copy A of Form W-2 with the entire first page of 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

Form W-3, Kind of Employer. To improve document matching compliance, box b of the 2011 Form W-3 has been expanded to include a new section, Kind of Employer, which contains five new checkboxes. Filers are required to check one of these new checkboxes. Be sure to check the "None apply" checkbox if none of the other checkboxes apply.

D. Information Forms

1. IRS Form 1099 Series - U.S. Information Returns

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

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 recipient their copy no later than February 1, 2012. Forms 1099 should be typed or machine printed, although for 2011 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. A toll-free number has been implemented for IRS's Information Reporting Call Site. In response to requests from many employers, the new toll-free number is 866-455-7438.

2. IRS Form 1096 - Annual Summary and Transmittal U.S. Information Returns

Fill in name and address of payer. Indicate the number and type of Forms 1099 attached. Sign and mail to **Internal Revenue Service, Kansas City, Missouri 64999** (if company is located in California) before March 1, 2012. If not filed by the due date, significant penalties apply. If you file electronically, the due date is now March 31.

Filers and transmitters of information returns can obtain an extension of time to file by submitting a signed paper Form 8809, Request for Extension of Time to File Information Returns. The extensions are most often for a period of 30 days. Filers and transmitters may thereafter request an additional 30-day extension. The extensions apply only to filing with the government. The filer or transmitter must still provide statements to the recipients by the required due date.

If you are filing 250 or more returns of the same type, see IRS Publication 1220, Specifications for Filing Information Returns Electronically. The law requires such returns to be filed electronically.

Payees who file paper returns with the IRS need not send a paper copy to the California FTB; the IRS forwards the information to the FTB.

I. EARNINGS REPORTS DUE IN 2011 *(Continued)*

D. Information Forms *(Continued)*

3. Guide to Information Returns *(If any date shown falls on a Saturday, Sunday, or legal holiday, the due date is the next business day.)*

				Due Date	
Form	**Title**	**What To Report**	**Amounts To Report**	**To IRS**	**To Recipient (unless indicated otherwise)**
1042-S	Foreign Person's U.S. Source Income Subject to Withholding	Income such as interest, dividends, royalties, pensions and annuities, etc., and amounts withheld under Chapter 3. Also, distributions of effectively connected income by publicly traded partnerships or nominees.	See form instructions	March 15	March 15
1097-BTC	Bond Tax Credit	Tax credit bond credits to shareholders.	All amounts	February 28*	On or before the 15th day of the 2nd calendar month after the close of the calendar quarter (on or before May 15; August 15; November 15; February 15 of the following year)
1098	Mortgage Interest Statement	Mortgage interest (including points) and certain mortgage insurance premiums you received in the course of your trade or business from individuals and reimbursements of overpaid interest.	$600 or more	February 28*	(To Payer/Borrower) January 31
1098-C	Contributions of Motor Vehicles, Boats, and Airplanes	Information regarding a donated motor vehicle, boat, or airplane.	Gross proceeds of more than $500	February 28*	(To Donor) 30 days from date of sale or contribution
1098-E	Student Loan Interest Statement	Student loan interest received in the course of your trade or business.	$600 or more	February 28*	January 31
1098-T	Tuition Statement	Qualified tuition and related expenses, reimbursements or refunds, and scholarships or grants (optional).	See instructions	February 28*	January 31
1099-A	Acquisition or Abandonment of Secured Property	Information about the acquisition or abandonment of property that is security for a debt for which you are the lender.	All amounts	February 28*	(To Borrower) January 31
1099-B	Proceeds From Broker and Barter Exchange Transactions	Sales or redemptions of securities, futures transactions, commodities, and barter exchange transactions.	All amounts	February 28*	February 15**
1099-C	Cancellation of Debt	Cancellation of a debt owed to a financial institution, the Federal Government, a credit union, RTC, FDIC, NCUA, a military department, the U.S. Postal Service, the Postal Rate Commission, or any organization having a significant trade or business of lending money.	$600 or more	February 28*	January 31
1099-CAP	Changes in Corporate Control and Capital Structure	Information about cash, stock, or other property from an acquisition of control or the substantial change in capital structure of a corporation.	Over $1000	February 28*	(To Shareholders) January 31
1099-DIV	Dividends and Distributions	Distributions, such as dividends, capital gain distributions, or nontaxable distributions, that were paid on stock and liquidation distributions.	$10 or more, except $600 or more for liquidations	February 28*	January 31**
1099-G	Certain Government Payments	Unemployment compensation, state and local income tax refunds, agricultural payments, and taxable grants.	$10 or more for refunds and unemployment	February 28*	January 31
1099-H	Health Coverage Tax Credit (HCTC) Advance Payments	Health insurance premiums paid on behalf of certain individuals.	All amounts	February 28*	January 31
1099-INT	Interest Income	Interest income.	$10 or more ($600 or more in some cases)	February 28*	January 31**
1099-K	Merchant Card and Third-Party Network Payments	Merchant card	All amounts	February 28*	January 31
		Third-party network payments.	$20,000 or more (and 200 or more transactions)		
1099-LTC	Long-Term Care and Accelerated Death Benefits	Payments under a long-term care insurance contract and accelerated death benefits paid under a life insurance contract or by a viatical settlement provider.	All amounts	February 28*	January 31

*The due date is March 31 if filed electronically. **The due date is March 15 for reporting by trustees and middlemen of WHFITs.

* Complete a separate Form 8865 for each foreign partnership for which you qualify under the categories of filers described in the form instructions. U.S. persons must also file Form 3520 to report certain transactions with foreign trusts and receipt of certain large gifts or bequests from foreign persons.

I. EARNINGS REPORTS DUE IN 2011 *(Continued)*

D. Information Forms *(Continued)*

3. Guide to Information Returns *(Continued)*

Form	Title	What To Report	Amounts To Report	Due Date: To IRS	Due Date: To Recipient (unless indicated otherwise)
1099-MISC	Miscellaneous Income	Rent or royalty payments; prizes and awards that are not for services, such as winnings on TV or radio shows.	$600 or more, except $10 or more for royalties	February 28*	January 31**
	(Also, use to report direct sales of $5,000 or more of consumer goods for resale.)	Payments to crew members by owners or operators of fishing boats including payments of proceeds from sale of catch.	All amounts		
		Section 409A income from nonqualified deferred compensation plans (NQDCs).	All amounts		
		Payments to a physician, physicians' corporation, or other supplier of health and medical services. Issued mainly by medical assistance programs or health and accident insurance plans.	$600 or more		
		Payments for services performed for a trade or business by people not treated as its employees. Examples: fees to subcontractors or directors, rental property expense payments, and golden parachute payments.	$600 or more		
		Fish purchases paid in cash for resale.	$600 or more		
		Crop insurance proceeds.	$600 or more		
		Substitute dividends and tax-exempt interest payments reportable by brokers.	$10 or more		February 15**
		Gross proceeds paid to attorneys.	$600 or more		February 15**
1099-OID	Original Issue Discount	Original issue discount.	$10 or more	February 28*	January 31**
1099-PATR	Taxable Distributions Received From Cooperatives	Distributions from cooperatives passed through to their patrons including any domestic production activities deduction and certain pass-through credits.	$10 or more	February 28*	January 31
1099-Q	Payments From Qualified Education Programs (Under Sections 529 and 530)	Earnings from qualified tuition programs and Coverdell ESAs.	All amounts	February 28*	January 31
1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.	Distributions from retirement or profit-sharing plans, any IRA, insurance contracts, and IRA recharacterizations.	$10 or more	February 28*	January 31
1099-S	Proceeds From Real Estate Transactions	Gross proceeds from the sale or exchange of real estate and certain royalty payments.	Generally, $600 or more	February 28*	February 15
1099-SA	Distributions From an HSA, Archer MSA, or Medicare Advantage MSA	Distributions from an HSA, Archer MSA, or Medicare Advantage MSA.	All amounts	February 28*	January 31
3921	Exercise of an Incentive Stock Option Under Section 422(b)	Transfer of an employer's stock to an employee pursuant to the exercise of an incentive stock option under section 422(b).	All amounts	February 28*	January 31
3922	Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)	Transfer(s) of stock acquired through an employee stock purchase plan under section 423(c).	All amounts	February 28*	January 31
5498	IRA Contribution Information	Contributions (including rollover contributions) to any individual retirement arrangement (IRA) including a SEP, SIMPLE, and Roth IRA; Roth conversions; IRA recharacterizations; and the fair market value (FMV) of the account.	All amounts	May 31	(To Participant) For FMV/RMD Jan 31; For contributions, May 31
5498-ESA	Coverdell ESA Contribution Information	Contributions (including rollover contributions) to a Coverdell ESA.	All amounts	May 31	April 30
5498-SA	HSA, Archer MSA, or Medicare Advantage MSA Information	Contributions to an HSA (including transfers and rollovers) or Archer MSA and the FMV of an HSA, Archer MSA, or Medicare Advantage MSA.	All amounts	May 31	(To Participant) May 31
W-2G	Certain Gambling Winnings	Gambling winnings from horse racing, dog racing, jai alai, lotteries, keno, bingo, slot machines, sweepstakes, wagering pools, poker tournaments, etc.	Generally, $600 or more; $1,200 or more from bingo or slot machines; $1,500 or more from keno	February 28*	January 31
W-2	Wage and Tax Statement	Wages, tips, other compensation; social security, Medicare, and withheld income taxes. Include bonuses, vacation allowances, severance pay, certain moving expense payments, some kinds of travel allowances, and third-party payments of sick pay.	See separate instructions	**To SSA** Last day of February*	**To Recipient** January 31

*The due date is March 31 if filed electronically. **The due date is March 15 for reporting by trustees and middlemen of WHFITs.

I. EARNINGS REPORTS DUE IN 2012 *(Continued)*

E. Rules on 2011 Withholding from Supplemental Wage Payments

1. General Requirements

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 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 supplemental withholding rate is generally 25%, effective retroactively to January 1, 2004 by federal law. Payments over $1 million are subject to withholding at the highest tax rate, currently 35%.

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 now classifies supplemental and bonus payments into three categories for tax purposes as follows:

1. Regular Pay - All wages in the regular pay category are taxed based on the employee's W-4 in effect at the time the payment is made.

2. Supplemental Wages (such as overtime, severance pay and housing allowance) - The supplemental flat tax rate will be used if the payments are <u>not</u> paid with the employee's regular wages. If the payment is made with regular pay, the payment is taxed based on the employee's W-4; otherwise, the payment is taxed at the supplemental flat tax rate in effect at the time the payment is made, now 6.6% as of November 1, 2009.

3. Bonus Wages - The bonus flat tax rate will be used if the payments are <u>not</u> paid with the employee's regular wages. If the payment is made with regular pay, the payment is taxed based on the employee's W-4; otherwise the payment is taxed at the bonus flat 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.

I. EARNINGS REPORTS DUE IN 2012 *(Continued)*

E. Rules on 2011 Withholding from Supplemental Wage Payments *(Continued)*

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.

Deposit withheld income tax (including backup withholding) with an authorized financial institution or the Federal Reserve Bank or branch that serves your area. Include Form 8109, Federal Tax Deposit Coupon. For 2010, file Form 945 no later than February 1, 2012.

If a taxpayer's total taxes for the year are less than $2,500, the taxpayer is not required to make deposits, and can pay the taxes with the Form 945.

3. California Forms 592 and 597 - Returns for Tax Withheld at Source

Withholding agents must remit payments of tax withheld at source to the Franchise Tax Board by the required due dates in order to avoid interest assessments. Additionally, if Form 594, "Notice to Withhold Tax at Source" is issued by the California Franchise Tax Board, it must be completed as indicated in the instructions to that form. Starting in 2010, the state added a new voucher that must be included with all payments.

F. Household Employee Taxes

If you pay a household employee cash wages of more than the amount specified by law in a tax year, $1,800 in 2011, you must withhold social security and 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 a certain percentage set by law from each payment of cash wages. The specified dollar amount and percentages can be found under the topic "Do You Need To Pay Employment Taxes?" in Publication 926. Instead of paying this amount to your employee, pay it to the IRS with a matching amount for your share of the taxes. 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 Form W-4, *Employee's Withholding Allowance Certificate*, and Publication 15, (*Circular E*), *Employer's Tax Guide*, which has tax withholding tables.

If you withhold or pay social security and Medicare taxes, or withhold Federal income tax, you will need to file Form W-2, *Wage and Tax Statement* after the end of the year. 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 and your employee's social security number. If you do not already have an employer identification number (EIN), one can be requested by submitting Form SS-4 *Application for Employer Identification Number.*

If you paid cash wages to household employees totaling more than the specified dollar amount in any calendar quarter of the prior two years, you generally must pay Federal unemployment tax on a portion of the specified amount of cash wages you pay to each of your household employees in the current and following taxable years. For specific amounts look under the heading "Do You Need To Pay Employment Taxes?" in Publication 926.

If you must file Form W-2 or pay Federal unemployment 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.

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

I. EARNINGS REPORTS DUE IN 2012 *(Continued)*

G. Penalties

Withheld federal income taxes, social security and Medicare taxes along with certain excise taxes are called trust fund taxes. If trust fund taxes willfully aren't collected, not truthfully accounted for and paid, the IRS may charge a trust fund recovery penalty. The penalty is equal to the trust fund taxes evaded and may apply to a person or persons the IRS decides is responsible. Information return penalties (filing of Forms W-2, 1099, etc.) fall into three categories, as follows:

1. Failure to File Correct Information Returns by Due Date:

The penalty applies to failing to file timely returns, failing to include all information required to be shown on a return, and including incorrect information on a return (including taxpayer identification numbers). The penalty also applies for filing on paper when required to file on magnetic media, or failing to file paper forms that are machine readable.

2. Failure to Furnish Correct Payee Statements:

The penalty applies for failing to provide the statement by January 31, failing to include all information required to be shown on the statement or including incorrect information on the statement.

The penalties for failure to timely file information returns is increased, effective for returns required to be filed on or after January 1, 2011.

New Failure to File Forms 1099 Penalties				
	Defined	Per Return Penalty	Calendar-year Maximum	Calendar-year Maximum Small Business
First Tier	Filed after deadline but not more than 30 days	Increase from $15 to $30	Increase from $75,000 to $250,000	Increase from $25,000 to $75,000
Second Tier	Filed more than 30 days late but before August 1	Increase from $30 to $60	Increase from $150,000 to $500,000	Increase from $50,000 to $200,000
Third Tier	Not filed before August 1	Increase from $50 to $100	Increase from $250,000 to $1.5 million	Increase from $100,000 to $500,000
Intentional Disregard		Greater of $250 or 10% of aggregate of items to be reported.		
Note: A small business is a business filer with gross receipts of not more than $5 million.				

Form 8809 can be used to request for extension of time to file information returns of the government copy with the IRS. There are specific instructions that come with the form. If the instructions are not followed, the IRS can deny the extension request. The extension is only for 30 days but if more time is required, taxpayers can request an additional 30 days to file. If an extension is needed to file the payee copy, see the instructions for Form 1099.

I. EARNINGS REPORTS DUE IN 2012 *(Continued)*

G. Penalties (*Continued)*

2. Failure to Furnish Correct Payee Statements: (*Continued)*

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

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 W-2 or 1099.

H. Electronic Federal Tax Payment System (EFTPS)

Individuals, businesses, and tax professionals can now make a wide variety of payments via the Electronic Federal Tax Payment System (EFTPS) using the Internet or the phone. The new EFTPS initiative was launched in 2004 by way of an information release and the on-line release of a number of new IRS publications that explain the new system. IRS also launched a new on-line site devoted to EFTPS (www.eftps.com).

- **EFTPS for Businesses and Entities**

A business may use EFTPS to make all federal tax payments, including income, estimated and excise taxes.

Effective January 1, 2011, the Financial Management Service, a Bureau of the Treasury Department, is eliminating the system that allows Federal Tax Deposits to be made using paper coupons at government depositary banks. On August 23, 2010, the Treasury Department and the Service published a notice of proposed rulemaking (REG-153340-09), 2010-42 I.R.B. 469 (74 FR 51707), to require electronic funds transfer for all Federal Tax Deposits and to eliminate the rules regarding Federal Tax Deposit coupons. The Electronic Federal Tax Payment System is available 24 hours a day, seven days a week.

A business can enroll for EFTPS on-line, or by completing Form 9779 (Business Enrollment Form) and mailing it to the EFTPS Enrollment Center. The enrollment steps (e.g., receipt of PIN and internet password) essentially are the same as they are for individuals.

Businesses (as well as other types of entities such as tax-exempts) have two choices: EFTPS-Direct and EFTPS-Through a Financial Institution.

- **EFTPS - Direct**

A business that uses EFTPS-Direct may initiate electronic payments via EFTPS-Online, EFTPS-PC Software (supplied by IRS at no charge), or EFTPS-Phone. The three methods can be used interchangeably. Businesses use the same procedure for making EFTPS payments as individuals (see discussion above).

- **EFTPS - Through a Financial Institution**

If its financial institution offers the service (for which it can levy a charge), a business may instruct it to electronically move funds from the business's account to the Treasury's. The tax payment must be initiated at least one day before payment is to be made. The tax payment must be made before the financial institution's ACH (Automated Clearing House) processing deadline. The financial institution then originates an ACH credit transaction to the Treasury's account, and the tax records of the business are updated at IRS.

Those businesses that use payroll companies are told to check with them for fees, deadlines and EFTPS enrollment instructions. Additionally, a business must enroll in EFTPS to initiate those tax payments not handled by its payroll company.

I. EARNINGS REPORTS DUE IN 2012 ***(Continued)***

H. Electronic Federal Tax Payment System (EFTPS) ***(Continued)***

- **EFTPS - Through a Financial Institution** ***(Continued)***

NOTE: On October 19, 2007, the IRS sent out a notice regarding its new EFTPS "batch provider" software that will be necessary to download in order to continue using the system. Before making payments, you need to register via the software at www.eftps.com/eftps/ext/hds/html. According to the IRS, the process takes about two weeks, so if this concerns you, we recommend that you download the User's Manual at the link above or contact the IRS at 1 (800) 945-0966.

II. AUTO MILEAGE AND EXPENSE REIMBURSEMENT INFORMATION

A. Employer Reimbursement Plan Rules

Reimbursements that do not meet IRS "accountable" standards 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. If the reimbursements meet IRS rules, the plan is called "an accountable plan" and the reimbursements 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 various limitations previously stated.

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.

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 non-accountable 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.

Although advances remain a problem under the accountable plan rules, the IRS has provided a three-part test so that if all three parts are met, advances will not be treated as compensation. Part one of the test requires that an employer may not advance an employee monies earlier than 30 days before expenses are anticipated to be paid or incurred. Part two states that the employee must make adequate accounting for the expenses paid or incurred no later than 60 days after the expenses are paid or incurred. Finally all monies in excess of those properly accounted for as employee expenses must be returned within 120 days of paying or incurring such costs. If the first two parts of this test 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 are not met, the entire amount advanced is taxable compensation.

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

B. <u>Accountable Plan Defined</u> *(Continued)*

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. <u>IRS Automobile Reimbursement Mileage Rates</u>

For 2011, you may elect to reimburse employees for substantiated business mileage at 51¢ for all business miles driven through June 30 and 55.5¢ a mile for all business miles driven from July 1, 2011 to December 31, 2011. 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 also is used by many companies to reimburse workers who use their own cars on company business. The 2012 optional standard mileage rate will remain at 55.5¢ per mile.

III. AUTO RULES OTHER THAN MILEAGE AND EXPENSE REIMBURSEMENT

A. <u>Taxation of Value of Automobile</u>

<u>Fringe Benefit Received in 2011</u>

For 2011, 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 <u>must</u> be included in the "Employee Wage and Tax Statement" (Form W-2) with all applicable income and payroll taxes withheld from 2011 wages. It is mandatory to withhold payroll taxes and income taxes. 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 attached) 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 2011 payroll tax returns.

3. The employee's 2011 Form W-2 must include the taxable portion of vehicle use and related withholdings.

B. <u>Employer Provided Vehicle</u>

1. <u>Exception for Commuting Use Only</u>

There are several exceptions to the general vehicle substantiation rules. The commuting only exception 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 <u>noncompensatory</u> 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 <u>must be</u> in writing (an example of such written policy is attached) and be given to applicable employees (or posted).

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

B. Employer Provided Vehicle *(Continued)*

1. Exception for Commuting Use Only *(Continued)*

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; and

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

A control employee is any employee who meets any of the following:

- Is an appointed or elected officer whose compensation is $95,000 or more.
- Is a director of the employer.
- Owns 1% or more equity, capital or profits interest in the employer.

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 has given Y a written policy statement and Y acknowledged receipt of 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) and:

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 2012 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 Exception

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

We have elected to use a special valuation rule for 2011 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.

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 Exception *(Continued)*

In order to use the above special valuation rule, you must provide us with a written statement substantiating your personal use of the vehicle during 2011. 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 have all three methods being utilized 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 (51¢ or 55.5¢ in 2011), 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)
- 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 at least 50 percent of its total mileage for the year is for the employer's business or 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 unless the same or comparable vehicle could be leased on a cents-per-mile basis. 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.

For 2010, the cents-per-mile method can be used only for cars that had a fair market value of $15,500 or less on the day they were first made available to an employee. This dollar amount is adjusted periodically to reflect inflation. For cars having a value in excess of that amount, the value of the availability of the car is to be determined under the general fair market value rule or the annual lease value method.

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 also includes the fair market value of employer-provided fuel for miles driven in the United States, 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.

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

B. Employer Provided Vehicle *(Continued)*

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 ALV, the FMV of the vehicle must be determined as of the first day it was made available to the employee. 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 gas and oil, an additional taxable amount of 5-1/2¢ per mile of personal use must be added. The value of insurance, maintenance and repairs is included in the annual lease value table amount. 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

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

(2) Gas and oil

5,000 miles X 5-1/2¢ = 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.

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

C. Employee Uses Own Vehicle *(Continued)*

Example D (Continued)

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 & Co., LLP in charge of your account for further guidance.

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.

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

If an employer and employee elect to adopt the special rule ("Commuting Only Use"), 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.

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

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).

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 FEDERAL LAWS AND OTHER CHANGES

A. Highlights of the 2010 Tax Relief Act

1. Deferral of Sunset Provisions

A two-year deferral of sunset provisions in three previous tax laws. As a result of this deferral, through 2012: the current favorable tax rate structure for individuals remains in place; the standard deduction for marrieds filing jointly won't be hit by a marriage penalty; higher-income taxpayers won't face a reduction in their itemized deductions or a phaseout of personal exemptions; long-term capital gains and qualified dividends will continue to be taxed at a maximum rate of 15%; alternative minimum tax (AMT) exemptions for individuals won't drop; and nonrefundable personal credits will continue to be available to offset AMT as well as regular tax. Numerous other tax breaks remain in place, including many education-related incentives and liberalized child tax credit rules.

2. New Economic Stimulus Measures

Major new economic stimulus measures, including: a 100% writeoff in the placed-in-service year of the cost of property eligible for bonus depreciation (applies for property acquired and placed in service after September 8, 2010, and before January 1, 2012); a 50% bonus first-year depreciation allowance for property placed in service after December 31, 2011, and before January 1, 2013; and for 2011, a two-percentage-point payroll/self-employment tax holiday for employees and self-employeds (employees will pay only 4.2% Social Security tax on wages, and self-employed individuals will pay only 10.4% Social Security self-employment taxes on self-employment income, up to $106,800).

3. Estate Tax Relief

Significant estate tax relief. Among other changes, the 2010 Tax Relief Act reduces estate, gift and generation-skipping transfer taxes for 2011 and 2012 and continues a host of other estate and gift tax relief provisions that were set to expire after 2010. It preserves estate tax repeal for 2010, but in a roundabout way: estates wanting zero estate tax for 2010 must elect that option, along with the modified carryover basis rules that were set to apply for 2010. Otherwise, by default, the estate tax is revived for 2010, with a $5 million exemption, a top tax rate of 35%, and a step-up in basis. Also for estates of decedents dying after December 31, 2010, a deceased spouse's unused exemption may be shifted to the surviving spouse.

B. Hiring Incentives for Veterans

As part of legislation signed by the President on November 21, 2011…

- Employers that hire veterans who have been looking for employment for more than six months may be eligible for a Returning Heroes Tax Credit of up to $5,600 per employee; employers that hire veterans who have been looking for employment for less than six months may be eligible for a credit of up to $2,400 per employee.

- Employers that hire veterans with service-connected disabilities who have been looking for employment for more than six months may be eligible for a Wounded Warriors Tax Credit of up to $9,600 per employee.

The Returning Heroes Tax Credit and the Wounded Warriors Tax Credit apply to individuals who begin work for the employer after November 21, 2011, the date of enactment of the new law and are scheduled to expire after December 31, 2012.

The new law also makes the Returning Heroes Tax Credit and the Wounded Warriors Tax Credit available to tax-exempt employers. A tax-exempt employer for purposes of this extension is an organization described in Code Sec. 501(c) and exempt from taxation under Code Sec. 501(a). Additionally, HR 674 includes special rules for applying the enhanced WOTC for veterans in possessions of the U.S.

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

C. Changes Since Last Year

1. Cancellation of Additional Information Reporting Requirements

The President has signed H.R. 4, the "Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011." This new law retroactively repeals both the expanded unpopular Form 1099 information-reporting requirements mandated by previously enacted health care legislation and also new 1099 reporting requirements imposed on taxpayers who receive rental income enacted as part of last year's Small Business Jobs Act.

Specifically, here are the main areas repealed:

- The expanded 1099 reporting requirements that would have required businesses to issue Form 1099s for payments to corporations for services or goods exceeding $600.

- The requirement of landlords, or those persons collecting rent, to report property expense payments to independent contractors exceeding $600.

2. Deferral of Form W-2 Health Care Coverage Reporting

The requirement to report the cost of employer-sponsored health coverage on Forms W-2 that was to be mandatory for years beginning after December 31, 2010 has been deferred. As it stands now, the requirement will apply to 2012 Form W-2 (the forms filed in January 2013).

3. Repeal of Withholding on Government Vendor Payments

President Obama signed the Three Percent Withholding Repeal and Job Creation Act on November 21. The new law repeals three percent withholding on government contractors that was scheduled to take effect in 2012.

4. Prohibition Against Logos, Slogans and Advertising on Information Returns

For amounts paid after 2010, logos, slogans, and advertising will not be permitted on Forms 1096, or Copy A of Forms 1097, 1098, 1099, 5498, W-2G, 1042-S, or any payee statements. For exceptions, see Pub. 1179, which provides the general rules and specifications for substitute forms.

5. Change of Address

Beginning in 2012, employers must use Form 8822-B, Change of Address - Business, for any address change notification to the IRS.

D. New California Law

1. Wages and Health Insurance Conformity

In our mailed version of this memorandum we stated that California was in non-compliance with the Federal income exclusion for employer-paid health insurance for nondependent adult children. Consequently we indicated that there may have to be a Federal/state wage reporting difference. We have subsequently been informed that California retroactively conformed to Federal law. Now employer provided health insurance for nondependent adults under the age of 27 is excluded from California income and payroll tax as well as from Federal taxes.

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

D. <u>New California Law</u> *(Continued)*

2. Misclassification of Independent Contractors

California's SB 3459, recently signed into law by Governor Jerry Brown, effective January 1, 2012 will impose significant fines and other remedial actions on employers and others who misclassify employees as independent contractors. "Willful rnisclassification" of an individual as an independent contractor will be unlawful per se, as will be charging such a misclassified person a fee, or making any deductions from his compensation for any purpose including for any goods, materials, space rental, services, government licenses, repairs, equipment maintenance, or fines), if any such charge or deduction would not be legally permitted from an employee's pay.

"Willful misclassification" is broadly defined as "avoiding employee status for an individual by voluntarily and knowingly misclassifying that individual an independent contractor."

3. New Wage Notice

- **Pay Rate Notices Required for New Hires/AB 469**

  The Wage Theft Protection Act of 2011 amends the California Labor Code by adding a section that requires employers to provide employees with a <u>"written notice at the time of hiring"</u> (in English or in the employee's primary language) and must contain the following:

  - The rate or rates of pay and basis thereof, whether paid by the hour, shift, day, week, salary, piece, commission, or otherwise, including any rates for overtime.
  - Any allowances claimed as part of the minimum wage, including meal or lodging allowances.
  - The regular payday designated by the employer.
  - The name of the employer, including any "Doing Business As" names used by the employer.
  - The physical address of the employer's main office or principal place of business and the mailing address, if different.
  - Telephone number of the employer.
  - The name, address, and telephone number of the employer's workers' compensation insurance carrier.
  - Any other information the labor commissioner deems material and necessary. <u>The labor commissioner will be providing a template of the notice which may include additional requirements.</u>

- **California Wage Notice**

  The employee should sign and date a copy of the wage notice and any change notices, which should become a part of his or her personnel file to provide proof of compliance with this new law.

  No notice is required for legitimate overtime-exempt employees, or for non-exempt employees covered by a collective bargaining agreement (CBA) that expressly provides for wages, hours of work and (undefined) working.

4. Limits to Use of Credit Checks

In October Governor Jerry Brown signed a bill prohibiting most businesses from using credit scores and credit history in making hiring decisions. Supporters of the bill argued that many job applicants have low scores due to bad loans, overdue mortgage payments and large credit card debt. "These factors should not prevent an otherwise eligible candidate from a job."

Jobs including those in the state's department of justice and law enforcement, managerial positions and those who control $10,000 or more during their workday are exceptions.

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

E. Effect of Health Care Act

Many of the provisions of Health Care Reform are quickly coming upon us. Here are the most important:

1. Refundable Income Tax Credit

A refundable income tax credit to help low-incomers afford health coverage, once the insurance exchanges are up and running in 2014. The credit will be available for households with income up to 400% of federal poverty levels. The Revenue Service will have a lot of work to do to define exactly how household income is determined.

2. Penalty on Individuals Who Remain Uninsured

A penalty tax on individuals who remain uninsured after 2013. In 2014, the tax will be the greater of $95 or 1% of income above the filing threshold...the income amount below which an individual is not required to file a tax return...but not more than $285. Special rules will be required to apportion the penalty among uninsured people in a household. The fines increase sharply after 2014.

3. Reporting of Insurance Coverage

Reporting of insurance coverage to the Service also will be required so it can determine which individuals owe the penalty tax for not having coverage.

4. Excise Tax on Firms with 50 Employees

An excise tax on firms with 50 or more full-timers but no health plan. As of 2014, the tax is due if one or more employees get the insurance tax credit. IRS regulations will have to spell out how to compute the number of full-time workers, since the excise tax is based on that figure. Part-timers complicate the calculation.

5. Medicare Surtax on Unearned Income

A special 3.8% Medicare surtax on unearned income of high-incomers… singles with adjusted gross incomes over $200,000 and marrieds over $250,000. Starting in 2013, the surtax is levied on the lesser of the filer's net investment income or the excess of AGI over the thresholds. Unearned income includes interest, royalties, dividends, capital gains, annuities and passive rental income, but not tax-free interest and retirement plan payouts. IRS rules will clarify in which cases rents are hit.

6. Excise Tax on High Value Health Plans

And further down the road: An excise tax on high-value health plans. Starting in 2018, insurance companies and self-insurers owe a 40% excise tax on the value of plans in excess of $10,200 for individual coverage and $27,500 for family coverage. Higher thresholds apply to policies for retirees over age 55 and folks in high risk jobs, such as first responders. IRS is preparing for this now.

F. Online Selling and New Third-Party Network Reporting

The payment settlement reporting requirements of new IRS § 6050W, go into effect this year, and apply broadly to transactions conducted by debit or credit card, as well as third-party network transactions.

The reporting requirement was introduced by the Housing Assistance Tax Act of 2008 (PL 110-289). Banks or other "merchant acquiring entities" such as e-bay, will report aggregate amounts of payment card transactions to payees and the IRS, and third-party networks likewise will report aggregate payments.

Section 6050W(e) provides relatively high de minimis threshold for transactions settled by third-party networks: Reporting is required when the total gross reportable amount to a payee exceeds $20,000 and the aggregate number of transactions exceeds 200 (both conditions must be met).

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

F. Online Selling and New Third-Party Network Reporting *(Continued)*

The IRS has drafted a new Form 1099-K for this purpose, which effects online transactions beginning January 1, 2011. The first reports will go to the IRS in January 2012.

G. Information Reporting for Incentive Stock Options

Companies will have to file information returns with the IRS for incentive stock options (ISO) and employee stock purchase plan (ESPP) transactions. The returns must be filed on Form 3921 for ISOs and Form 3922 for ESPPs. The deadline for filing these forms on paper is February 28, 2012 and March 31, 2012, if filing electronically. The deadline for distributing the statements to employees is still January 31.

V. CALIFORNIA INDEPENDENT CONTRACTOR REPORTING REQUIREMENTS

In an effort to increase child support collection by helping to locate parents who are delinquent in their child support obligation, California State Senate Bill 542 was passed during the 1999-2001 legislative session and signed into law. This law, effective January 1, 2001, 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 report. 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.

You must report to 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, California employer account number, social security number, address and telephone number.

You are also required to provide 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 an ongoing contract (check box if applicable).

Report independent contractor information on the *Report of Independent Contractors* form (DE 542). To obtain forms and/or information, call (916) 657-0529. You may also contact your local Employment Tax Customer Service Office listed in your local telephone directory in the State Government section under "Employment Development Department" or access the Internet site at www.edd.ca.gov. For magnetic media filing, please call (916) 651-6945.

VI. EARNED INCOME CREDIT

The law continues to require employers to notify employees of their eligibility for the advance payment of the Earned Income Credit (EIC) through payroll. The EIC is a tax credit available to certain low income workers *even though no income tax withholding is required on their wages*. Eligible employees may elect to receive EIC through reduced federal income tax withholding (or negative federal income tax withholding) throughout the year rather than waiting to claim it on an income tax return. An employee makes the election by submitting a completed Form W–5, Earned Income Credit Advance Payment Certificate, with the employer.

VI. EARNED INCOME CREDIT *(Continued)*

The Form W-5 eligibility certificate verifies to the employer that (1) the employee is eligible for the EIC, (2) the employee has one or more qualifying children, (3) the employee has no other certificate in effect with another employer, and (4) states whether the employee's spouse has an eligibility certificate in effect. Even though persons without children are eligible for the EIC, they are not eligible for the advance payments of EIC. The election can be revoked or modified any time the individual's circumstances change. A new Form W-5 is required for each year the election is in effect.

VII. PAYROLL TAX DEPOSIT SYSTEM

All employers are either federal "monthly depositors" or "semi-weekly depositors". The IRS notifies taxpayers of their status prior to the beginning of each calendar year. Status is determined by reference to the employer's deposit history during a "lookback period." The lookback period for a given calendar year is the 12-month period ending the preceding June 30.

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 ended the preceding June 30 is $50,000 or less. An employer is a semi-weekly 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 semi-weekly depositor, if the depositor's payday is on a Wednesday, Thursday or Friday, taxes must be deposited on or before the following Wednesday. For all other paydays, the deposit is due on the Friday following payday. A special one-day rule applies to any employer which has more than $100,000 undeposited employment taxes.

The deposit timetable is extended to the immediate next banking day when the deposit obligation falls on a non-banking day. Semi-weekly depositors have additional relief; they have a minimum of three banking days after the end of the semi-weekly period to deposit their taxes. Thus, a semi-weekly 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 banking holiday.

An employer is treated as having made the required deposit if any shortfall does not exceed the greater of $100 or two percent of the amount required to be deposited and the shortfall is deposited on or before prescribed make-up dates. For a monthly depositor, the shortfall make-up date is the return due date for the return period in which the shortfall occurs. For a semi-weekly depositor, the shortfall make-up date is the first Wednesday or Friday (whichever is earlier) falling on or after the 15th day of the month in which the deposit must be made.

VIII. EMPLOYEE OR INDEPENDENT CONTRACTOR

Many companies have attempted to avoid taxes by calling their workers independent contractors when in fact they were really employees. The state and federal taxing authorities have been auditing companies to find such abuses. The following is an updated and edited list of factors from the IRS' approach to worker classification. These factors should be considered general guidelines. Certain factors carry more weight than others depending upon specific industry practices.

After 1996, the IRS has the burden of proof on classification of workers 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.

The IRS is developing criteria on an industry-by-industry basis as to which factors weigh more heavily than others and which should not be applied at all. Even though the new law has placed more responsibility on the IRS to substantiate that independent contractors are employees, we believe that based on the success that the IRS has obtained in its audits on the independent contractor issue, they will continue and intensify their industry classification projects.

VIII. 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:

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

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

B. Factors the IRS Now Considers of Lesser Importance

The IRS de-emphasized its focus on several other factors that were previously used in the old 20-factor test, including:

1. Does the client/customer have the right to discharge the worker?
2. Does the worker have the right to terminate the relationship?
3. Can the worker work part time or is full time required?
4. Must the work be performed on the employer's premises?
5. Who sets the hours to be worked?
6. Must the work be performed in an order or sequence?

Federal law and California law are not the same. California puts less emphasis on common industry practices.

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

If your business receives $10,000 in cash in one transaction or two or more related transactions in a 24-hour period you must file federal Form 8300. In addition, this form may voluntarily be filed for any suspicious transaction, even if it does not exceed $10,000. The term cash includes a cashier's check, bank draft, travelers check and money order. 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. Criminal penalties including up to five years imprisonment are provided for failure (or causing the failure) to file a report, for filing (or causing the filing) of a false or fraudulent report, and for structuring a transaction.

IX. REPORTING OF CASH TRANSACTIONS IN EXCESS OF $10,000 *(Continued)*

Recipients of reportable cash payments must also provide each payer with an annual written statement by January 31 of the following year containing the name and address of the recipient, the aggregate amount of reportable cash received from that payer during the year, and a notice that the information in the statement is being furnished to the IRS. The statement must be mailed to the payer's last known address.

File Form 8300 by the 15th day after the date of the transaction with the Internal Revenue Service, Detroit Computing Center, P.O. Box 32621, Detroit, Michigan 48232, or with your local IRS office. California also requires that a copy of Form 8300 be sent to: Franchise Tax Board, P.O. Box 1468, Sacramento, California 95812-1468.

X. WHEN HIRING NEW EMPLOYEES

A. Compliance with Immigration and Nationality Act

Every time any person is hired to perform labor or services in return for wages or other remuneration, Form I-9 must be completed. Employees can be requested to present to you an original document or documents that establish identity and employment eligibility within three business days of the date employment begins. As to the form and timing of the request, we strongly suggest you seek the help of your legal advisor, since incorrect steps could result in being found liable for discrimination practices.

There is no associated filing fee for completing Form I-9. Form I-9 must be retained by the employer and made available for inspection by U.S. Government officials. Use the new version revised 08/07/09.

Employers hiring foreign nationals should always check for the individual's I-94 card, which controls the terms of an individual's stay in the country. The 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).

Nonimmigrant visa categories are arranged according to proposed activities in the U.S. Some typical work visas are E (persons with essential skills), H1-B (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).

B. Income Tax Withholding

After the first of the year, ask each new employee to complete the year 2011 Form W-4, the "Employee's Withholding Allowance Certificate" which should be available before the first of the New Year. 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. The employee must provide this information on Form W-4.

The requirement to submit copies of the W-4 to the IRS has been eliminated (see Item IV, Section I.) Also, on November 14, 2005, the IRS announced a new procedure for determining the amount of income tax employers are required to withhold from wages paid for services performed by nonresident alien (NRA) employees within the United States, along with new instructions for use by NRA employees in completing Form W-4.

C. New Employee Registry

As part of federal welfare reform, a new law took effect in California on July 1, 1998 requiring all employers to report all new employees to EDD within 20 calendar days of an employee's first day of work. This information will be cross-matched against child support records to locate parents who are delinquent in their support payments and also will be used to detect unemployment insurance fraud.

The correct reporting form is the DE 34. You may also report the new employee by submitting a copy of the employee's W-4 form, as long as you add the start to work date and your California Employer Account number.

To order forms, call the California New Employee Registry at (916) 322-2835. Or if you have questions concerning reporting requirements, call your local EDD office or the Registry at (916) 657-0529.

XI. 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:

- 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.

The written plan must specifically describe all benefits and establish rules for eligibility and elections.

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. See the questions below for treatment of benefits made available to individuals who are not spouses or dependents of the employee.

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.

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 Regulations under Code Section 125.

XII. USE TAX

If you purchase an item out-of-state that will be used, consumed, or stored in California, then you owe use tax. If the out-of-state merchant 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 Board of Equalization 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, multiply the cost of the property purchased from an out-of-state merchant times 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. Then, look to determine if any sales or use tax was collected from the out-of-state merchant and subtract this amount from the use tax due.

XIII. RECORDS RETENTION

WARNING: Your circumstances may require that you retain records for a longer period of time than shown below. This is a general schedule. Statute of limitations vary from State to State. Companies should have record retention policies for computer files, word processing and e-mail in addition to the traditional ledger and paper documents. Prior to formalizing a policy, we recommend consulting your attorneys and accountants for further information.

	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)

	Retention Period
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.
Trade mark registrations	Permanently
Voucher register, schedules and backup	7 yrs.
Warranties and service agreements	3 yrs. (after expiration)

XIV. USEFUL IRS PUBLICATIONS AND INTERNET ACCESS

Pub. #	Name/Description
15	*Employer's Tax Guide (Circular E)* - Coverage of employer responsibilities to withhold, deposit, report, etc. Supplements, Pub. 15-A and 15-B are also available.
334	*Tax Guide for Small Businesses.*
463	*Travel, Entertainment, and Gift Expenses* - Useful information in determining what is Taxable/nontaxable in the areas of travel, entertainment and gifts.
505	*Tax Withholding and Estimated Tax* - Withholding information for employees. Also includes information on making estimated tax payments on Form 1040-ES.
508	*Educational Expenses* - Includes information on what is job-related versus non-job-related. Helpful for employers in determining taxable/nontaxable reimbursement rules.
510	*Excise Taxes* - It covers the excise taxes reported on Form 720.
535	*Business Expenses* - Information on business expenses, fringe benefits, and employee benefit programs.
575	*Pension and Annuity Income* - Explains how to report pension and annuity income on federal income tax returns.
926	*Household Employer's Tax Guide* - Household employers who pay cash wages of $1,800 or more per year to an employee are liable for social security taxes on the wages.
966	*Electronic Federal Tax Payment System* - Answers common questions as to how to pay your federal business taxes.
1679	*A Guide to Backup Withholding* - Information for payors required to do backup withholding.
1779	*Independent Contractor or Employee?*
3823	*Employment Tax e-file System Implementation and User Guide*.

Information Available on the Internet

Federal:	
Center for Disease Control	www.flu.gov
Department of Health and Human Services	www.hhs.gov
Department of Labor	www.dol.gov
Immigration and Naturalization Service	www.bcis.gov
Internal Revenue Service (Primary Address)	www.irs.gov
Internal Revenue Service (Small Business Help)	www.irs.gov/business/index.html
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
State Controller (Unclaimed Property)	www.sco.ca.gov
Board of Equalization	www.boe.ca.gov
Secretary of State	www.ss.ca.gov
Local:	
Los Angeles County Clerk	www.lacounty.info

Energy Research and Credit Information:

Federal	www.energystar.gov
State, Local and Utility Credit Incentives	www.dsirusa.org
Solar Energy Panels	Solar.coolerplanet.com

Foreign exchange rates at www.federalreserve.gov/releases/h10/hist (1990 to present) or oanda.com.

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

XV. TYPES OF PAYMENTS

Below is an alphabetic list of some payments and the forms to file and report them. 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
Abandonment	1099-A
Accelerated death benefits	1099-LTC
Acquisition of control	1099-CAP
Advance health insurance payments	1099-H
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 insurance 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

Type of Payment	Report on Form
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
Merchant card payments	1099-K
Mileage, employee	W-2
Mileage, nonemployee	1099-MISC
Military retirement	1099-R
Mortgage insurance premiums	1098
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
Patronage dividends	1099-PATR
Pensions	1099-R
Points	1098
Prizes, employee	W-2
Prizes, nonemployee	1099-MISC
Profit-sharing plan	1099-R
Punitive damages	1099-MISC
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
Rental property expense payments	1099-MISC
Rents	1099-MISC
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
Timber, pay-as-cut contract	1099-S
Sales:	
Real estate	1099-S
Securities	1099-B
Section 1035 exchange	1099-R
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 payments	1099-K
Tips	W-2
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