Internal Revenue Service
Office of Federal, State and Local Governments

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FSLG Newsletter – July 2008
Internal Revenue Service

This is the semiannual newsletter of the office of Federal, State and Local Governments (FSLG) of the Internal Revenue Service. Our mission is to ensure compliance by federal, state, and local governmental entities with federal employment and other tax laws through review as well as through educational programs.

For more information, visit our web site at www.irs.gov/govt. For account-related assistance, contact Customer Account Services at 1-877-829-5500. To identify a local FSLG Specialist, see the directory at the end of this newsletter.

The explanations and examples in this publication reflect the interpretation by the IRS of tax laws, regulations, and court decisions. The articles are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances. You may contact the IRS for additional information. You may also want to consult a tax advisor to address your situation.

Federal, State and Local Governments

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FISCAL YEAR 2008 MID-YEAR RESULTS

BY JAYNE MAXWELL, FSLG CPM MANAGER

In FY 2008, our compliance activities continue to be focused on the two strategic initiatives: Federal agencies and large entities (entities with annual payroll in excess of $40 Million). In addition, FSLG has proceeded to completion of our community college market segment project which began in FY 2007, and initiated compliance projects focused on two additional market segments: a compliance check project, which includes 192 entities in the firefighter/fire district market segment; and an examination project, involving 95 entities identified as part of the housing authority market segment.

By the end March of 2008, we had begun 8 new examinations under our Federal agency initiative and 15 entities under our large entity initiative. Approximately 95% of the fire district compliance checks were completed. Sixty-five percent of the housing authority exams were initiated, and 9.5% of the housing authority exams were closed. The issues seen in these examinations were similar to those frequently seen in other FSLG examinations, such as: worker classification, fringe benefits, relocation payments, settlement payments, information return filings, and back-up withholding. The results of these projects will provide information on the overall level of compliance by these market segments. Information gathered from these projects will help FSLG make decisions about allocating our limited resources to address the greatest areas of non-compliance by providing focused outreach to the market segments. The data can assist in development of the Workplan, ensuring our resources are being applied appropriately.

In addition to its compliance activities, FSLG has also conducted about 83 outreach events with 5,859 participants. New this year, FSLG has initiated outreach and education seminars geared specifically towards governmental employers within the U.S. Territories. In January, events were held with various governmental entities in Guam and within the Commonwealth of the North Mariana Islands (CNMI). In February, two seminars were held in the Commonwealth of Puerto Rico both of which were conducted in Spanish. We also provided a Spanish translation of our January Newsletter to all participants.

Finally, new updates, in the form of web articles on issues specific to issues within the government employer sector, links to recent legislative activities, and updates to various publications and forms, are posted to the FSLG website on a regular basis. In February, one update included enhancements to the Taxable Fringe Benefit Guide to include new technical background concerning the firefighter exclusion provisions of PL 110-142. We would like to encourage our readers to check our website regularly, as it is an excellent tool designed to address the questions specific to our customers. For example, the site includes a Government Entity Toolkit, which includes a Public Employer's Toolkit as well as a Compliance Toolkit, which provides information to help government entities and their powers of attorney understand the enforcement process. These products are designed to concentrate essential information in one convenient place and will be updated and enhanced over time. We hope that you find this to be useful.

NEW INCOME TAX EXCLUSION FOR VOLUNTEER FIREFIGHTERS AND EMERGENCY RESPONDERS

BY STEWART ROULEAU, FSLG SENIOR ANALYST

The Mortgage Forgiveness Debt Relief Act of 2007 contained an important provision affecting firefighters and other emergency responders who receive local tax benefits or other benefits for volunteer services. This provision was further clarified by the Heroes Earnings Assistance and Relief Tax Act of 2008.

What are the New Benefits?

The new law provides that volunteer firefighters and emergency responders may exclude certain benefits from income provided on account of the performance of volunteer services.

Property Taxes

A common practice in many jurisdictions is to provide volunteers with reductions or abatements of state or local property taxes in recognition of work performed. Because this represents a benefit received in exchange for services performed, under prior law this represents compensation and gross income for Federal tax purposes under Internal Revenue Code section 61. Beginning January 1, 2008, volunteers who perform services for a qualified volunteer emergency response organization may exclude the value of property tax abatements from Federal gross income. These amounts are also excluded from social security and Medicare (FICA) tax.

Other Benefits

In general, reimbursements for expenses are included in the income of the volunteer unless they are made under the provisions of an accountable plan. An accountable plan requires that an employee timely account for all reimbursements and return any excess amounts. See Publication 15, Employer's Tax Guide.

The new law provides that the value of other benefits that qualifying volunteers receive (such as reimbursements for expenses or equipment allowances), up to $30 for each month of service during a calendar year may be excluded from income for income tax, social security and Medicare purposes. The new law does not require that these payments be made under an accountable plan. If the volunteer performs services in each month of the year, the maximum exclusion for these benefits is 12 x $30, or $360 per year.

Who Is Eligible?

Individuals who perform services for qualified volunteer emergency response organizations are eligible for these benefits. A "qualified volunteer emergency response organization" for this purpose is an entity that is organized and operated to provide firefighting or emergency medical services for persons in the state or political subdivision. The $30 per month exclusion applies to amounts not otherwise excludable as reimbursements received under an accountable plan. For more information on accountable plans, see section 5 of Publication 15.

No Double Benefit

Property taxes are generally deductible as itemized deductions, but any amounts excluded under these provisions may not be included on Schedule A as deductible taxes.

When Can the Exclusion Be Taken?

The exclusion is available for tax years 2008, 2009, and 2010.

Further Information

The IRS expects to issue further guidance on the implementation of this law in the near future. Visit www.irs.gov/govts for updated information.

ACCIDENT AND HEALTH COVERAGE FOR PERSONS NOT THE EMPLOYEE'S SPOUSE OR DEPENDENT

BY WANDA VALENTINE, FSLG ANALYST

Government employers often provide their employees with accident and health coverage under an insured or self-insured plan. These plans generally pay or reimburse substantiated medical care expenses (as defined in § 213(d) of the Internal Revenue Code) for current and former employees (including retired employees), their spouses and dependents.

Employer contributions for accident and health coverage (through a health insurance policy or a self-insured plan) covering an employee, an employee's spouse or an employee's dependents are excluded from the employee's gross income under § 106. Amounts received through an employer-provided accident and health plan for medical expenses incurred by the employee, the employee's spouse or employee's dependents are excluded from the employee's gross income under §105(b).

Who Is A Spouse?

An employee's marital status is generally determined by state law. However, "The Defense of Marriage Act" provides that for purposes of any Federal statute or regulation, "the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife."

Who Is A Dependent?

Under § 152, an employee's "dependent" means a "qualifying child" or a "qualifying relative." In general, for purposes of accident and health plans, a "qualifying child" is the employee's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister (or a descendant of any of these persons), who was:

- under age 19 at the end of the year;
- under age 24 at the end of the year and a full-time student; or
- any age if permanently and totally disabled.

The child must also have lived with the employee for more than one-half of the year and the child did not provide more than one-half of his or her own support for the year.

In general, for purposes of accident and health plans, a "qualifying relative" means an employee's son, daughter, stepchild, foster child, (or a descendant of any of these persons), an employee's brother, sister, or a son or daughter of a brother or sister; father, mother or ancestor or sibling of either of them; stepbrother, stepsister, stepfather, stepmother, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law. A "qualifying relative" cannot be a "qualifying child" of the employee, or anyone else's "qualifying child" and the employee must have provided more than one-half of the relative’s total support.

There are special rules for adopted children and children of divorced parents.

Employer-Provided Accident and Health Coverage for Persons Who Do Not Qualify as a Spouse or Dependent

The value of an employer-provided accident and health plan covering persons other than the employee, employee’s spouse or employee’s dependents as described above is includable in the employee’s gross income. In addition, amounts received through an employer-provided accident and health plan for persons other than the employee, employee’s spouse or employee’s dependents are includable in the employee’s gross income. Significantly, if an employer’s accident and health plan covers persons other than the employee, the employee’s spouse or employee’s dependents, and the employer-provided accident and health coverage has been excluded from the employee’s gross income, the plan is not an accident and health plan, and none of the amounts paid under the plan to any employee, including amounts paid for medical expenses, are excludable from any employee’s gross income.

However, if the employer’s accident and health plan covers a person who is not a spouse or dependent and the employee pays for that coverage with after-tax dollars, amounts received for medical expenses are excluded from the employee’s gross income under § 104(a)(3). Similarly, if the employer pays for accident and health coverage for a person who is not a spouse or dependent, and includes the fair market value of the accident and health coverage in the employee’s gross income, amounts received for medical expenses are excluded from the employee’s gross income under § 104(a)(3). The fair market value of the accident and health coverage for these individuals must be reported on the employee’s Form W-2 as taxable wages.

Example

A newly-enacted state law requires that all employer-provided accident and health plans cover employees’ “dependents” who are age 25 and under. In 2008, an employer’s accident and health plan covers the son of an employee. The son is age 24 and does not qualify as the employee’s dependent for Federal tax purposes under § 152. The fair market value of the son’s coverage is $5,000 per year. The employee’s Form W-2 for 2008 must include $5,000 as taxable wages.

For additional guidance on accident and health plans, you can refer to Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

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