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I.R.S. LOWERS 2006 STANDARD AUTO MILEAGE REIMBURSEMENT RATES

As reported in the October, 2005 TAX RESEARCHER newsletter, the I.R.S. responded to nation-wide increases in the price of gasoline by increasing the auto reimbursement mileage rates for September 1 through December 31, 2005. Meanwhile, the nation-wide cost of gasoline has trended lower, prompting the I.R.S. to adjust downward the reimbursement rates authorized for 2006, as shown in the following table:

<u>Mileage Type (per mile)</u>	<u>Effective 1/1/2005</u>	<u>Effective 9/1/2005</u>	<u>Effective 1/1/2006</u>
<u>Business Standard</u>	\$0.405	\$0.485	\$0.445
<u>Charitable:</u>			
--- General	\$0.140	\$0.140	\$0.140
--- Katrina Deduction	N/A	\$0.340	\$0.320
--- Katrina Reimbursement	N/A	\$0.485	\$0.445
<u>Medical and Moving</u>	\$0.150	\$0.220	\$0.180

Seeking to reduce recordkeeping, the I.R.S. allows taxpayers who use no more than four vehicles at the same time for business purposes, to use the standard mileage rate instead of requiring them to document the actual expenses for each vehicle.

Any of the standard automobile mileage rates are a "short cut" authorized by the I.R.S. when taxpayers substantiate the cost of automobile usage. The flat mileage rate does not cover parking or tolls. The I.R.S. considers that the substantiation and adequate accounting requirements for employer-reimbursed BUSINESS expenses, for example, are satisfied by employers and employees who merely use the \$0.445 a mile rate (for 2006). It is not necessary to provide sales receipts or other documentation, as long as the time, place, business purpose of the expense, and the number of miles traveled, are evident.

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MERGERS AND JOB CHANGES: Being Hired By A "New" Employer Does Not Always Mean Re-Starting Tax W/H

My friend Charlie was a little anxious about his job. He works for a graphic design company that is being acquired by a competitor. As we talked, Charlie told me his real concern was that by "starting over" with a new employer, he thought he would become subject again to Social Security and perhaps other employment taxes, as if nothing had been withheld already this year . . . in effect, he would duplicate his tax payments.

I told Charlie that the answer depended entirely on whether the "new" employer and the "old" employer were related; and if related, how that had come about. Here is how I explained it with respect to Federal employment taxes. If time had permitted, we also would have discussed the impact on state unemployment insurance taxable wage limits and on successor-employer unemployment insurance experience rates.

Employees Who Work For Two or More UNRELATED Employers In The Same Year

Charlie acknowledged that one of his options was simply to quit working for his present employer, and start doing graphic design for another company. If he were to start working for a second, UNRELATED employer in the same year, prior taxable wages would not be carried forward to the second employer. Each unrelated employer must withhold the employee's full share of Social Security and Medicare taxes, and is liable for the employer's matching share on the wages each pays to the worker, up to the limit of the employee's taxable wage limit. Each employer also would duplicate the FUTA tax paid by the other.

However, where the combined wages from two or more employers exceed the employee's annual taxable wage limit, a refund or credit can be obtained for any excess Social Security taxes withheld. On the other hand, neither of the employers would be entitled to a refund of the employer's portion of the Social Security taxes paid. Note that the 2006 taxable wage limit for Social Security is \$94,200, while there is no annual wage limit for Medicare tax. The 2006 taxable wage limit for FUTA tax is \$7,000.

Working Sequentially For RELATED Employers In the Same Year

This situation can occur in several ways. First, the employee may be transferred from one business unit of the employer to another, but if both of them are reported under the same Employer Identification Number (EIN) for purposes of Form 941, the I.R.S. deems that only one employer is involved, even though the employee may feel he or she has a new employer. Therefore, the employee's wages continue being applied against the same taxable wage limit, and no duplicate withholding occurs.

The second situation involves businesses and/or corporations actually combining their operations. In effect, the employee continues doing the same job, but the entity for which he or she works undergoes some change, and the question is whether that imposes a NEW taxable wage base on the transferred employees. There are three ways that companies may combine: 1.) purchase of stock, 2.) purchase of assets, or 3.) statutory merger or consolidation. Each method has its own implications for the employees' taxable wage limits.

Returning to Charlie's situation, the acquiring employer may simply PURCHASE THE STOCK of Charlie's present employer. In this way a change of ownership occurs, but the separate operations of the two companies continue as before. This method will cause no change to the EIN of either the purchased company or the acquiring company, so the employees of each continue to accrue wages against their respective taxable wage limits as though nothing had happened.

Alternatively, the successor might simply purchase the assets of the predecessor. Such a PURCHASE OF ASSETS may or may not involve the hiring of any predecessor company employees by the successor. But, if two conditions exist concurrently, the purchase of assets will create a "successor/predecessor" relationship between the two companies, which permits the carry-forward of prior wage balances. The two required conditions are: 1.) that the acquiring company must gain possession of substantially all the property used in the trade of the acquired employer, AND 2.) the acquiring company must immediately employ the employees of the predecessor company.

Third, is a STATUTORY MERGER or CONSOLIDATION between the two companies, with the acquiring company being the survivor. With one entity absorbed by the other, the surviving entity is considered the "original" employer. The surviving entity continues using its own EIN. Although technically not a "successor/predecessor" relationship because the absorbed

predecessor entity ceases to exist, the result is the same because prior balances can be carried forward to the surviving company.

Special Rules For
"Successor/Predecessor" Relationships

Because the transferred employees and business of a predecessor company are reported under the EIN of the successor company, the latter may apply the prior wages and taxes toward the satisfaction of the Social Security and FUTA wage limits of the successor company.

For example, suppose Charlie had earned \$50,000 while working for the predecessor employer, before being employed by the successor company in a "successor/predecessor" relationship. The successor employer is only required to withhold (and match) Social Security tax on the next \$44,200 (\$94,200 - \$50,000) that Charlie earns this year. Medicare tax has no taxable wage limit, so that withholding will continue on all wages paid to Charlie. However, the FUTA wage base (\$7,000) already has been met and does not need to be satisfied again.

The Special Rules For
Statutory Merger or Consolidation Situations

If a corporation or business is absorbed by another firm in a statutory merger or consolidation, the resulting entity is considered the same employer for Social Security and FUTA tax purposes. Often this consolidation is accomplished by an exchange of shares. Based on a negotiated value ratio, some shares of the acquiring corporation may be exchanged for all the outstanding shares of the company to be absorbed.

Under I.R.S. rules, the surviving corporation following a statutory merger or re-incorporation that qualifies as a re-organization under the Internal Revenue Code, should use its previously assigned EIN. For example, suppose corporations X and Y have different EINs. X is merged into Y in a statutory merger. X files a final return and its EIN is discontinued. The surviving corporation (Y) should continue using its previously assigned EIN.

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"S" CORPORATIONS

The shareholders of certain qualifying small corporations may elect, under Sub-Chapter "S" of the Internal Revenue Code, to have the income and expenses of the corporation divided among the shareholders directly, as if it were a partnership. The shareholders then report the income and expense on their own income tax returns --- but at the corporate level no income tax is paid. To qualify, the corporation must have no more than 100 shareholders and only one class of stock, held only by designated types of U.S. citizens or entities. All of the shareholders must agree to the election of "S" corporation status.

Although the business revenues and expenses of an "S" corporation are allocated directly to the shareholders, the "partnership" analogy is limited to the corporate reporting of Federal income tax. It does not follow that an owner of an "S" corporation should not be on the payroll because the partners in a partnership should not be on payroll. The "S" corporation is a legal entity separate from the owners, so an owner/employee who performs substantial services for the "S" corporation is treated as an employee, and the compensation for the services is wages. At the same time, as a shareholder, he or she receives the "pass-through" of corporate revenues and expenses, somewhat like receiving a dividend.

However, for some fringe benefit purposes, such as employer-paid medical insurance, "S" corporation shareholder/employees owning more than 2% of the outstanding shares, are treated the same as partners. That is, they are considered self-employed for health insurance benefit purposes, since this is a "guaranteed" payment. Courts have held that such employer-paid premiums should be included as wages on the Form W-2 of more-than-2% shareholder/employees, even though it would NOT be taxable for employees who do not own more than 2% of the outstanding shares.

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STATE UNEMPLOYMENT INSURANCE:
Year 2006 Taxable Wage Limits

Some states have increased their taxable wage limit for 2006, which is a factor in determining the employer's contribution to the state's unemployment compensation insurance program. Alaska and New Jersey also require an employee deduction based on the same wage limit. Pennsylvania requires a deduction from all employee wages. South Dakota had not announced their 2006 wage limits before our deadline for this month's newsletter. States with changes from 2005 are in bold and underlined in the table below:

STATE	2006	2005	2004
Alabama	8,000	8,000	8,000
Alaska	28,700	27,900	27,100
Arizona	7,000	7,000	7,000
Arkansas	10,000	10,000	10,000
California	7,000	7,000	7,000
Colorado	10,000	10,000	10,000
Connecticut	15,000	15,000	15,000
Delaware	8,500	8,500	8,500
District of Col.	9,000	9,000	9,000
Florida	7,000	7,000	7,000
Georgia	8,500	8,500	8,500
Hawaii	34,000	32,300	31,000
Idaho	29,200	28,000	27,600
Illinois	11,000	10,500	9,800
Indiana	7,000	7,000	7,000
Iowa	21,300	20,400	19,700
Kansas	8,000	8,000	8,000
Kentucky	8,000	8,000	8,000
Louisiana	7,000	7,000	7,000
Maine	12,000	12,000	12,000
Maryland	8,500	8,500	8,500
Massachusetts	14,000	14,000	14,000
Michigan	9,000	9,000	9,000
Minnesota	24,000	23,000	22,000
Mississippi	7,000	7,000	7,000
Missouri	11,000	11,000	8,000
Montana	21,600	21,000	20,300
Nebraska	8,000	7,000	7,000
Nevada	24,000	22,900	22,000
New Hampshire	8,000	8,000	8,000
New Jersey	25,800	24,900	24,300
New Mexico	17,900	17,200	16,800
New York	8,500	8,500	8,500
North Carolina	17,300	16,700	16,200
North Dakota	20,300	19,400	18,500
Ohio	9,000	9,000	9,000
Oklahoma	13,500	13,800	14,300
Oregon	28,000	27,000	27,000
Pennsylvania (ER)	8,000	8,000	8,000
(EE)	unlimited	unlimited	unlimited
Puerto Rico	7,000	7,000	7,000
Rhode Island	16,000	16,000	14,000
South Carolina	7,000	7,000	7,000
South Dakota	_____	7,000	7,000
Tennessee	7,000	7,000	7,000
Texas	9,000	9,000	9,000
Utah	24,000	23,200	22,700
Vermont	8,000	8,000	8,000
Virgin Islands	20,000	18,600	18,400
Virginia	8,000	8,000	8,000
Washington	30,900	30,500	30,200
West Virginia	8,000	8,000	8,000
Wisconsin	10,500	10,500	10,500
Wyoming	17,100	16,400	15,900

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