Mobility Matters

2023: Another busy year-end for employment tax professionals

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The past few years have changed the payroll landscape and have created new challenges and obstacles for companies to navigate and overcome. 2023 has been no exception—and 2024 will continue to create challenges for employers.

In this article, we will cover a wide array of payroll topics, including remote worker wage and taxation sourcing, employee retention credit updates, year-end awards and gifts, and initial payroll expectations for the 2024 tax year.

Year-end basics

The timely processing of accurate Forms W-2 is a key function of any payroll department. However, several potential administrative pitfalls can easily derail the most basic requirements. A common mistake concerns the filing of Forms W-2:

- File with the correct year—too often the Form W-2 is labeled with the incorrect year.
- A 2023 form must be filed by January 31, 2024.
- Entries for approved print copies must be in 12-point Courier font and black ink.
- Dollar amounts must have a decimal point and two decimal places, without a dollar sign or commas.
- No negative dollar amounts may be reported.
- The US Internal Revenue Service (IRS) cautions not to use a copy of Form W-2 downloaded from the IRS website, because it is not a scannable form.

Additionally, the timely filing of accurate fourth-quarter Form 941 must occur by January 31, 2024, if a balance is due, and February 12, 2024, if there is no additional balance due. Year-end payroll processing also includes the filing of federal Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, using the same filing schedule as the fourth-quarter Form 941. This is the time to determine if amendments are needed for periods that will lapse in April 2024 to prepare for timely filing, as the statute of limitations for 2020 amendments generally ends in April 2024. During this time, employers should determine if any estimated tax deposits for adjusted payrolls are needed as year-end filings are quickly approaching. Any adjustments that affect employees should be completed before Forms W-2 are distributed.

Employee Retention Credit

The statute of limitations for claiming the 2020 Employee Retention Credit (ERC) will be ending in April 2024. Employers have three years from the date of filing their original Form 941, *Employer's Quarterly Federal Tax Return*, to file an amendment to claim the ERC. Employers claiming the 2021 ERC generally have until April 2025. As employers consider this approaching deadline, there will likely be an increase in Form 941-X filings and employers could see delays in processing through April 2025.

With the expected increase in filings, there will be added pressure on the IRS to process claims in a timely manner. Currently, the IRS has a large backlog of ERC claims to process. On September 14, 2023, the IRS announced an immediate pause on processing new ERC claims through the end of the year due to perceived fraudulent claims that may have been filed (IR-2023-169). The moratorium will give the IRS additional time to add more safeguards around the ERC program and prevent further fraudulent claims. The IRS will continue to work on ERC claims that were received prior to the moratorium; however, increased scrutiny of claims by the IRS will likely result in longer wait times for employers to receive an ERC payment.

The IRS announced a new withdrawal process to help small businesses and organizations that filed an ERC claim but have not received the credit and are concerned about the accuracy of the filed ERC claim (IR-2023-193). This new withdrawal option allows certain employers to withdraw their submission and avoid future repayment, interest, and penalties. Claims that are withdrawn will be treated as if they were never filed, and the IRS will not impose penalties or interest.

However, employers who willfully filed, assisted, or conspired in conduct tied to a fraudulent ERC claim should understand that withdrawing the ERC claim will not exempt them from potential criminal investigation and prosecution. The IRS has received approximately 3.6 million claims for the credit over the course of the program, and it has hundreds of criminal cases under review with thousands of ERC claims referred for audit.

State and local changes

The COVID-19 pandemic created a seismic shift in the structure of the workplace. Many workplaces continue to have a hybrid or fully remote workforce in response to state-required orders as well as a shift in workforce requirements and requests. Employers have spent the past few years trying to determine where employees are working in this new remote environment and how to move forward in this new normal. Hybrid and remote work situations have led to a multitude of payroll reporting and taxation issues as well as other tax implications. An employee may now be subject to state income tax withholding in their new work location, and that worksite may be one where the company previously had no presence.

The general rule of thumb, established before the pandemic, is that state income tax withholding should be performed based upon the employee's work location. Many states have set thresholds for withholding purposes, dictating that once an employee has passed that threshold, withholding should be performed. For example, New York has a 14-day rule, while California expects state withholding on the first day. An employer should look to the state's rules for state income tax withholding as well as unemployment insurance based upon whether the employee is performing services as a temporary employee in the state, traveling employee into the state, telecommuter, or permanent employee in that jurisdiction.

An exception to the general rule discussed is the "convenience of the employer" doctrine that is used by Connecticut, Delaware, Nebraska, New Jersey, New York, and Pennsylvania. Under the doctrine, if employees work from home for the employer's necessity, then the employee will be taxed in the employee's telecommuting location. If, however, the employee telecommutes from home or a remote location for their own convenience, then the employee's wages for those work-days will be classified as if the employee was working from the employer's physical office. The Connecticut and New Jersey rules only apply to employees who reside in other states that also impose the convenience of the employer rules.

The New Jersey convenience of the employer rule is retroactive to January 1, 2023. The Division of Taxation recommended that affected employers begin withholding and/or encouraged employees to make estimated payments for tax year 2023 as soon as possible. Employers should consider adjusting withholdings as an accommodation to employees so that they are not underpaid upon filing their New Jersey nonresident personal income tax return for 2023.

Multi-state reporting

Handling the wage sourcing, tax allocation, and reporting at year-end for the multi-state business traveler may be burdensome and technically challenging. Employers of multi-state workers and their third-party providers need to effectively manage the overall compliance issues associated with state-to-state remote hybrid work as well as short-term business travelers. When working through the complexities of multi-state sourcing and withholding, practitioners should also consider the different tax treatment of various types of income, such as base compensation, bonus payments, and equity compensation.

Employers must apply, by state, any de minimis treatment, reciprocity, telecommuting regulations, and specific compensation reporting methodologies. Employers need to capture all the employee-level data detailing how many days each employee performed services in the states where work was performed. If the travel data was tracked throughout the year and the employee's pay allocated accordingly, then employers may want to review and make adjustments in December. December is also a good time to communicate the issue of nonresident taxation to the affected employees.

Specific attention should be paid to local jurisdiction taxation. Localities have also faced changes with remote workforces, and some have instituted new guidelines on how they expect their tax to be implemented.

Form W-2 has space to include wage and tax amounts for up to two states. If three or more states are involved, then multiple Forms W-2 would be necessary. See the IRS instructions for Forms W-2 and W-3 for details.

Amounts in Box 16, State Wages, should consider unusual reporting requirements. For example, New York requires the amount in Box 16 to be the same as the wages in Box 1. When reporting two states including New York, the total of both Box 16s will not match Box 1. This may confuse employees, so employers should consider providing an explanation to employees when delivering Forms W-2.

Supplemental wages

Payroll professionals often handle special bonuses or other supplemental pay at year-end or early in the following year. For total supplemental pay up to $1 million in a year for any employee, employers must use either the aggregate method of withholding or the optional flat-rate withholding method.

The aggregate method combines supplemental wages with regular pay, and tax is withheld using the applicable withholding tables for the payroll period in which the aggregated wages are paid. Those applying the optional flat-rate withholding method must use a 22-percent withholding rate for supplemental wage payments less than $1 million. To use the flat-rate method, income tax must have been withheld from the employee's regular wages during the calendar year the supplemental pay was paid or in the preceding year. The supplemental wage payment must be either not paid concurrently with regular wages or separately stated on payroll records.

For accumulated supplemental wages exceeding $1 million, the employer must withhold at a rate of

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37 percent. Employers may not use the aggregate method for amounts exceeding $1 million. If the employees' accumulated supplemental amounts were less than $1 million before a supplemental payment, and this payment would cause them to exceed the $1 million threshold, then the employer has two choices:

- Tax the amount that is less than $1 million at 22 percent and the amount that exceeds $1 million at 37 percent
- Tax the entire amount at 37 percent.

Other considerations

The value of tangible employee achievement awards, such as length-of-service awards and safety awards, may be excluded from wages and reporting, provided requirements are satisfied and subject to limitations. For example, the award must be presented in a meaningful ceremony and the circumstances must not indicate a likelihood that the award is disguised pay.

Awards are made under a qualified plan or nonqualified plan, which have different requirements and carry different limitations. Awards to a single employee in a year are limited to $400 if not made under a qualified plan; the cumulative amount of awards given to an employee under a qualified plan is limited to $1,600 in one year, with the average cost of all awards made by the employer not exceeding $400.

The Tax Cuts and Jobs Act (P.L. 115-97) clarifies that cash and cash equivalents, gift cards, coupons, and certificates, vacations, meals, lodging, tickets to sporting events, stocks, bonds, and securities, or similar items, are not excluded tangible property and their value must be included as income.

A **length-of-service award** must be in recognition of at least five years of service, provided the employee did not receive an award in the previous four years. Length-of-service awards given to retiring employees may be excluded from income if they meet the rules and limitations discussed above.

For **safety awards** to be considered tax free to employees, no more than 10 percent of employees may qualify for the award. Awards to professional, administrative, and clerical employees are not eligible for tax-free treatment.

Awards for employee suggestions generally are taxable and subject to withholding and employment taxes.

Gifts to employees are included in income and reporting is required, with limited exceptions as described by the Internal Revenue Code, IRS, and Treasury Department regulations. Gift cards or gift coupons that may be redeemed for cash amounts are considered taxable compensation by the IRS.

Exceptions can occur in terms familiar to payroll professionals—de minimis benefits or working-condition fringe benefits. Many tangible items provided by employers to employees may be excluded from taxability to the employee under these criteria:

- The item is of low value (IRS does not define the term).
- The benefit is occasional and not consistently awarded, and the item's value is difficult to determine or administratively impracticable to track and apply.

What's new in 2024

The Social Security Administration has announced an increase of the 2024 Social Security wage base to $168,600, up from $160,200 in 2023 (https://www.ssa.gov/oact/cola/cbb.html). For 2024, the maximum Social Security tax payable by each employee will be $10,453.20, or 6.2 percent of the taxable wage base which is an increase of $520.80 from $9,932.40 in 2023. Employers will match with an equal contribution. The Internal Revenue Code details the limits of a defined contribution plan, including 401(k) plans, for all annual plan additions, such as employer contributions, employee contributions other than rollovers, and allocation of forfeitures. This limit is the lesser of $69,000 in 2024 ($66,000 in 2023). The elective deferral limit is $23,000 in 2024 ($22,500 in 2023). Corrections are needed when there are excess deferrals, such as when an individual defers compensation exceeding the limit that may be applied as a catch-up contribution.

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The HSA contribution limits for 2024 are $4,150 for self-only coverage and $8,300 for family coverage. Those 55 and older can contribute an additional $1,000 as a catch-up contribution.

Conclusion

Remote work and working from home, limitations of employee retention credits, complexities around multi-state reporting, and the continual "addition" of state and local tax laws across the country that created new compliance obligations for employers are just some of the challenges and obstacles that employers have dealt with in 2023 and will continue to do so into 2024.

Whether payroll is processed in-house or by a third-party provider, reconciliation is vital to accuracy and internal control. Having accurate and complete wage and tax reports will foster preparation for any employee questions or discrepancies regarding Forms W-2.

As workplace patterns and behaviors continue to evolve alongside state and local tax law changes to address the new workplace reality, employment tax professionals will continue to be kept on their toes for the foreseeable future.

Related resources

For additional related resources and information, see **2023 Payroll Year-End Report and Checklist** prepared jointly by KPMG Employment Tax and Bloomberg Tax & Accounting.

For more year-end (and other) communications and resources, explore the KPMG Employment Tax practice website.

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