An employer’s guide to the Administration’s FY 2016 budget
An employer’s guide to the Administration’s fiscal year 2016 budget

On February 2, 2015, the Treasury Department released an explanation (Greenbook) of the Administration’s fiscal year 2016 budget.

From an employer’s perspective, the fiscal year 2016 budget is substantially different from others proposed by the Obama Administration. Accelerating the Form W-2 and Form 1099 filing due date to January 31 has been proposed again, and there are a number of new items this year, including an increase in the federal unemployment insurance wage base to $40,000, a repeal of the FICA tip credit and dependent care assistance flexible spending accounts, and expanded Form W-2 reporting requirements, to name a few. (General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals, February 2, 2014.)

A matrix summarizing the employer provisions of this year’s budget begins on page 24.

Repeal of dependent care assistance flexible spending accounts

In an effort to streamline child care assistance for working families, the President proposes to eliminate the current provision for dependent care assistance flexible spending accounts (FSAs) while creating a larger credit for children under 5. Other employer-provided dependent care assistance benefits under IRC §129, such as on-site facilities or cash subsidies, would retain their tax-favored status.

Dependent care FSAs give employees the option of having up to $5,000 per year deducted from wages on a pretax basis for the reimbursement of qualified expenses. According to the “use or lose” rule, employees forfeit contributions they have not used in the plan year. That means employees must accurately estimate their dependent care expenses prior to the start of the plan year.

Starting in 2016, the budget calls for an increase in the dependent care tax credit, including a larger credit for taxpayers with children under age 5, in lieu of the tax benefit afforded by a dependent care assistance FSA.

The purpose of the proposal is to give qualified taxpayers a tax break for their dependent care costs that are not contingent on the availability of an employer-sponsored FSA or its risk of forfeiture.

Unemployment insurance costs would substantially increase

The Administration is proposing to address the continued insolvency of state unemployment insurance (UI) trust funds by raising the federal unemployment insurance (FUTA) wage base from $7,000 to $40,000 upon the law’s enactment and indexing it each year thereafter based on wage growth.

This is a substantial increase from the bump to $15,000 proposed in previous budgets.

In addition to a substantial increase in FUTA taxes, state unemployment insurance costs would also go up in all of the states, except Hawaii and Washington, with a current wage base below $40,000.

In 1976, a temporary 0.2% surtax was added to the federal unemployment insurance (FUTA) rate. The surtax was extended numerous times until it was allowed to lapse effective July 1, 2011. The Administration again proposes to reinstate the 0.2% surtax and to make it permanent effective with wages paid on or after January 1, 2016.

So that employers aren’t subject to an increase in their FUTA tax because of the increase in the FUTA wage base, the budget also calls for lowering the net FUTA tax rate from 0.8% (0.6% plus the reinstated temporary surtax of 0.2%) to 0.165% effective in 2017.

New in this year’s budget, it is proposed that beginning in 2017, states impose a minimum tax rate on employers that is equivalent to roughly $70 per employee in 2017.

For 2015 state unemployment insurance wage base information, see our report here.
Expanded employee access to retirement savings accounts

As part of an effort to help workers save for their retirement, the White House directed the US Treasury in 2014 to create a voluntary payroll deduction retirement savings plan called myRA. Currently, participation is voluntary; however, the budget proposes that effective in 2017, employers in business for at least two years and that have more than 10 employees would be required to offer an automatic Individual Retirement Account (IRA) option to employees, under which regular contributions would be made to an IRA on a payroll-deduction basis.

Illinois was the first to require that businesses offer employees enrollment in an IRA or similar retirement savings plan. The provision, if ruled by the US Department of Labor as having no unintended employer responsibilities or liability under ERISA, is effective June 1, 2017. (S.B. 2758.)

Additionally, the proposal would require that businesses with 401(k) plans expand eligibility for salary reduction participation to long-term, part-time employees that have worked 500 or more hours per year and who have worked for the employer for at least three consecutive years. (Currently, part-time employees who work less than 1,000 hours each year can be permanently excluded from making salary reduction contributions.) There would be nondiscrimination testing relief as part of this provision.

Repeal of FICA tip credit

Currently, food and beverage businesses are allowed to claim a nonrefundable business tax credit for the employer's share of Social Security and Medicare (FICA) taxes paid on the portion of employee tips in excess of $5.15 per hour (after including the employee's non-tip wages).

The budget report states that this credit is inefficient and inequitable and encourages business to pay employees in the form of tips rather than wages and has had done little to improve employer compliance with the tip reporting requirements. Accordingly, it is proposed that this business tax credit be repealed effective January 1, 2016.

Worker misclassification

The budget again includes proposals to reduce worker misclassification by repealing the prohibition on IRS worker classification guidance and requiring the IRS to issue more definitive guidance concerning worker classification. In addition, businesses would be required to provide notice to independent contractors concerning the consequences of their classification (tax, workers’ compensation, minimum wage and overtime, etc.) and to withhold a flat percentage of federal income tax if requested by payees receiving $600 or more in the calendar year.

Identity theft

The budget proposes several strategies for combatting tax refund schemes involving identity theft, including civil penalties and more jail time for fraudsters, as well as allowing employers to truncate the Social Security Number (SSN) on the Form W-2. Businesses have also requested that the law allow for the truncation of the Employer Identification Number (EIN) on Forms 1099 and Forms W-2, to reduce instances where the EIN is used to perpetuation fraud; however, this measure is not included in the 2016 budget.
Employer provisions of the Administration’s fiscal year 2016 budget

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| (A) Wage reporting | **Form W-2 reporting of defined contribution plans**  
Employers would be required to report contributions they make to employees' qualified retirement accounts on Form W-2 (e.g., §401(k); §403(b)). | January 1, 2016 |
| | **Accelerate Form W-2 filing due date**  
Information returns (including Forms W-2 and 1099) would be required to be filed with the IRS (or SSA, in the case of Form W-2) by January 31, except that Form 1099-B would be required to be filed with the IRS by February 15. The due dates for the payee statements would remain the same. | January 1, 2016 |
| | **Truncation of the Social Security Number**  
IRC §6051 would be revised giving Treasury and the IRS authority to allow for the reporting of only the last four digits of the Social Security Number (SSN) on Forms W-2 and similar wage and tax statements, thereby allowing for similar truncation currently allowed on other information statements (e.g., Form 1099). | Upon enactment |
| (B) Electronic filing | **Tax returns**  
All corporations and partnerships with $10 million or more in assets would be required to file their returns electronically. Regardless of asset size, corporations with more than 10 shareholders and partnerships with more than 10 partners would be required to file their tax returns electronically. | January 1, 2016 |
| | **Penalties**  
An assessable penalty would apply for failure to comply with a requirement of electronic (or other machine-readable) format for a return that is filed on paper. The penalty would be $25,000 for a corporation or $5,000 for a tax-exempt organization. For failure to file in any format, the existing penalties would remain, and the proposed penalty for failing to file electronically would not apply. The penalty would be waived if it is shown that the failure to file electronically is due to reasonable cause. | January 1, 2016 |
| (C) Unemployment insurance | **FUTA tax rate**  
Reinstate the FUTA surtax of 0.2% and make it permanent (increasing the minimum FUTA rate from 0.6% to 0.8%). Effective in 2017, reduce the net FUTA rate from 0.8% to 0.165%. | January 1, 2016; January 1, 2017 |
| | **FUTA wage base**  
Increase FUTA wage base from $7,000 to $40,000, and index the amount each year thereafter based on wage growth. (The state unemployment wage base cannot be less than the FUTA wage base.) | January 1, 2017 |
| | **State minimum employer tax rate**  
States would be required to impose a minimum tax rate on employers that is equivalent to roughly $70 per employee. | January 1, 2017 |
| (D) Identity theft and fraud prevention | **Stiffer criminal sanctions**  
Tax-related identity theft would fall under the Aggravated Identity Theft Statute (Title 18 and Title 26), subjecting identity thieves to longer sentences than under the current law. | Upon enactment |
| | **Civil penalty**  
The Internal Revenue Code would be amended to include a $5,000 civil penalty on individuals in identity theft cases involving a fraudulent return. A separate civil penalty would apply to each incident of identity theft with no maximum penalty. | Upon enactment |
| | **National Directory of New Hires**  
The IRS would be allowed access to quarterly wage detail available in the National Directory of New Hires (NDNH) for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for noncompliant taxpayers, and identification of levy sources.  
Currently, IRS access to the NDNH is limited to purposes of administering the earned income tax credit (EITC) and verifying employment reported on a tax return. | Upon enactment |
| (E) Employer tax credits | **Work Opportunity Tax Credit (WOTC)**  
The WOTC would be made permanent effective after December 31, 2014. | January 1, 2015 |
# An employer’s guide to the Administration’s fiscal year 2016 budget

## Subject area

### WOTC – veterans

The definition of qualified veterans for purposes of WOTC would be revised to include disabled veterans who use G.I. Bill benefits to attend a qualified educational institution or training program within one year of being discharged or released from active duty and are hired within six months of ending attendance at the qualified educational institution or training program. Qualified first-year wages of up to $12,000 paid to such individuals would be eligible for the WOTC.

**Proposed effective date:** January 1, 2016

### FICA tip credit

The current business tax credit allowed for Social Security and Medicare tax paid on tips would be repealed.

**Proposed effective date:** January 1, 2016

### Indian employment credit

The Indian employment credit would be made permanent. In addition, for tax years beginning after December 31, 2015, the credit would be equal to 20% of the excess of qualified wages and health insurance costs paid or incurred by an employer in the current tax year over the amount of such wages and costs paid or incurred by the employer in the base year. The base year costs would equal the average of such wages and costs for the two tax years prior to the current tax year.

**Proposed effective dates:** January 1, 2015; January 1, 2016

### Small-business health insurance tax credit

The current small-business health insurance tax credit would be expanded to include employers with up to 50 full-time equivalent employees and would begin the phaseout at 20 full-time equivalent employees. Modifications to the tax credit would be made to ensure that employers with fewer than 50 employees and an average wage less than $50,000 would be eligible for the credit, even if they are nearing the end of both phaseouts. The requirement that an employer make a uniform contribution on behalf of each employee would be eliminated, as well as the limit imposed by the rating area average premium.

**Proposed effective date:** January 1, 2015

### Business tax credit for insourcing jobs to the US

A general business tax credit would be available against income tax equal to 20% of the eligible expenses paid or incurred in connection with insourcing a US trade or business.

**Proposed effective date:** Upon enactment

### (F) Independent contractors

#### Certified Taxpayer Identification Number (TIN)

Businesses would be required to verify the TIN of all contractors receiving $600 or more in payments in a calendar year with the IRS. If the name and TIN supplied by the contractor on Form W-9 doesn’t match IRS records, the business would be required to withhold a flat percentage of federal income tax.

**Proposed effective date:** January 1, 2016

#### Guidelines for application of the common law test

The Department of the Treasury and the IRS would be permitted to issue general guidance on the proper classification of workers under the common law test. They would also develop guidance providing safe harbors and/or rebuttable presumptions, both narrowly defined. To make that guidance clearer and more useful for service recipients, the guidance would generally be industry- or job-specific.

**Proposed effective date:** Upon enactment

#### Required notices to independent contractors

Businesses would be required to give notices to independent contractors when first engaged to perform services that includes how they are being classified, and the consequences (e.g., tax implications, coverage for workers’ compensation, wage and hour law exclusion).

**Proposed effective date:** Upon enactment

#### Share worker reclassification information

The IRS would be permitted to disclose to the US Department of Labor information about businesses whose workers were reclassified.

**Proposed effective date:** Upon enactment

#### Voluntary income tax withholding

Independent contractors with payments totaling $600 or more in a calendar year would be permitted to request that the business withhold federal income tax at a flat percentage of gross (15%, 25%, 30% or 35%) as selected by the contractor.

**Proposed effective date:** January 1, 2016

#### Classification enforcement remedies (expansion of VCSP and more)

The reduced penalties for worker misclassification under current law (and, presumably, the existing VCSP) would be retained; however, lower penalties would apply if a business voluntarily reclassifies its workers before being contacted by the IRS or another enforcement agency and if the business met the Form 1099 reporting requirements. In addition, businesses with only a small number of employees and a small number of misclassified workers would be eligible for a waiver of if the business (1) had consistently filed Forms 1099 reporting all payments to all misclassified workers and (2) agreed to prospective reclassification of misclassified workers. Finally, future enforcement efforts would focus mainly on obtaining the proper worker classification prospectively.

**Proposed effective date:** Generally, upon enactment
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<td><strong>(G) Coordination of federal and state income tax</strong></td>
<td><strong>Extend federal statute of limitations for state and local tax adjustments</strong>&lt;br&gt;The standard three-year statute of limitations for federal tax purposes would be extended to take into consideration a longer period that may apply for state or local tax assessments. States provide the IRS with reports of potential discrepancies between state and federal returns. It is proposed that the standard three-year statute of limitations would be extended to the greater of (1) one year from the date the taxpayer first files an amended tax return with the IRS reflecting adjustments to the state or local tax return or (2) two years from the date the IRS first receives information from the state or local revenue agency.</td>
<td>January 1, 2016</td>
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<tr>
<td><strong>Federal refund offset for state income tax</strong></td>
<td>It is proposed to permit the offset of federal refunds to collect state income tax, including nonresident income tax.</td>
<td>Upon enactment</td>
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<td><strong>(H) Penalties</strong></td>
<td><strong>Punitive damages</strong>&lt;br&gt;Deductions would be disallowed for punitive damages whether paid upon a judgment or in settlement of a claim. Further, damages covered by insurance would be included in the gross income of the insured person and the insurer would be required to report those payments to the IRS.</td>
<td>January 1, 2016</td>
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<td><strong>Indexing of penalties</strong>&lt;br&gt;All IRS penalties would be indexed to inflation and rounded to the next hundred dollars.</td>
<td>Upon enactment</td>
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<td><strong>Willful failure to file return</strong>&lt;br&gt;Currently, willful failure to file a tax return is a misdemeanor punishable by a term of imprisonment of not more than one year, a fine of not more than $25,000 ($100,000 in the case of a corporation), or both. Further, it is proposed that to willfully fail to file tax returns in any three years within any period of five consecutive years, and if the aggregated tax liability for such period is at least $50,000, carry with it a new aggravated failure to file criminal penalty that would be classified as a felony. Upon conviction, a fine may be imposed of not more than $250,000 ($500,000 in the case of a corporation) or imprisonment for not more than five years, or both.</td>
<td>January 1, 2015</td>
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<tr>
<td><strong>Indexing of penalties</strong></td>
<td>All IRS penalties would be indexed to inflation and rounded to the next hundred dollars.</td>
<td>Upon enactment</td>
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<td><strong>(I) Retirement plans</strong></td>
<td><strong>Automatic enrollment mandatory employee IRA plans</strong>&lt;br&gt;Employers in business for at least two years that have more than 10 employees would be required to offer an automatic IRA option to employees, under which regular contributions would be made to an IRA on a payroll deduction basis. Employers sponsoring a qualified retirement plan, SEP or SIMPLE plan would be excluded from the requirement. Small employers (those that have no more than 100 employees) that offer an automatic IRA arrangement could claim a temporary nonrefundable tax credit for the employer’s expenses associated with the arrangement up to $1,000 for the first three years. In addition, these employers would be entitled to an additional nonrefundable credit of $25 per enrolled employee up to $250 for six years.</td>
<td>January 1, 2017</td>
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<td></td>
<td><strong>Small-employer pension plan start-up cost credit</strong>&lt;br&gt;In conjunction with the automatic IRA proposal, to encourage employers not currently sponsoring a qualified retirement plan, SEP or SIMPLE to do so, the nonrefundable “start-up costs” tax credit for a small employer that adopts a new qualified retirement plan, SEP or SIMPLE would be tripled from the current maximum of $500 per year for three years to a maximum of $1,500 per year for three years and extended to four years for any employer that adopts a new qualified retirement plan, SEP or SIMPLE during the three years beginning when it first offers (or first is required to offer) an automatic IRA arrangement. Lastly, small employers would be allowed a credit of $500 per year for up to three years for new plans that include auto enrollment (which would be in addition to the “start-up costs” credit of up to $1,500 per year). Small employers would also be allowed a credit of $500 per year for up to three years if they added auto enrollment as a feature to an existing plan.</td>
<td>January 1, 2017</td>
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<td>Expansion of salary reduction retirement</td>
<td>Section 401(k) plans would be required to expand eligibility for salary reduction contributions if the employee has worked at least 500 hours per year with the employer for at least three consecutive years. A plan would also be required to credit for each year in which such an employee worked at least 500 hours, a year of service for purposes of vesting in any employer contributions.</td>
<td>January 1, 2016</td>
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<td>contributions to part-time employees</td>
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<td>Limit on retirement savings</td>
<td>Currently, the maximum benefit permitted to be paid under a qualified defined benefit plan in 2015 is generally $210,000, adjusted for increases in the cost of living. The maximum benefit limit is reduced if distributions begin before age 62 and is increased if distributions begin after age 65. It is proposed that similar limits be applied pursuant to the combined amount an individual contributes or in accruals received in a tax-favored qualified defined contribution plan (i.e., IRAs, 401(k), 403(b), funded 457(b) plans). According to the President’s budget, the maximum permitted accumulation for an individual age 62 is approximately $3.4 million.</td>
<td>January 1, 2016</td>
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<tr>
<td>(J) Dependent care assistance</td>
<td>Repeal the provision that allows employees to contribute on a pretax basis up to $5,000 per year to a dependent care assistance flexible spending account.</td>
<td>January 1, 2016</td>
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<td>(K) Self-employment tax</td>
<td>Individual owners of professional service businesses organized as S corporations, limited partnerships, general partnerships and LLCs taxed as partnerships would all be treated as subject to SECA taxes in the same manner and to the same degree. Owners providing services who materially participate would be subject to SECA taxes on their distributive shares of partnership (or LLC or S corporation) income. Distributions of compensation to owners of professional service S corporations would no longer be treated as wages subject to FICA taxes but would be included in earnings subject to SECA taxes. Material participation standards would apply to individuals who participate in a business in which they have a direct or indirect ownership interest. Taxpayers are generally considered to materially participate in a business if they are involved in a regular, continuous and substantial way. Often this means they work for the business for at least 500 hours per year. Material participation would generally be determined as under the passive activity loss rules and associated regulations, except that the limited partner exception would not apply in the SECA context.</td>
<td>January 1, 2016</td>
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