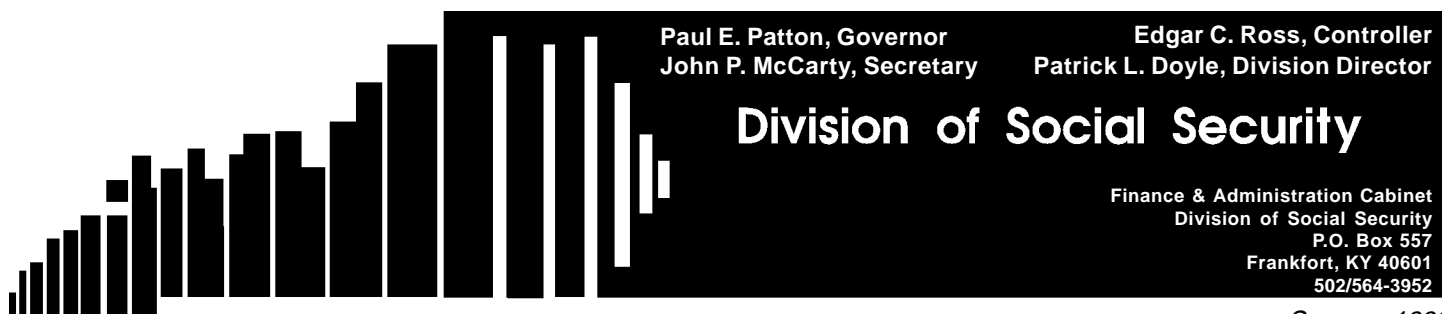


Please distribute this informational release to all appropriate payroll or finance officials within your organization.



Summer 1999

When and How to Change Withholding on Wages

Employees who found that they either owed income tax or had a large tax refund for 1998 may want to consider adjusting their withholding amount for 1999. A withholding adjustment should also be made if events occurring during 1999 will change and employee's marital status, credits, deductions or number of exemptions. Recent changes in tax law, such as the repeal of the 18-month holding period for capital gains and the increase in the child tax credit from \$00 in 1998 to \$500 for 1999, may also affect an employee's tax liability.

To make an adjustment, employees must give their employers a new Form W-4, "Employee's Withholding Allowance Certificate." The form includes three types of information that the employer uses to figure the appropriate withholding amount: whether to withhold at the single rate or the lower married rate, how many withholding allowances the employee claims and whether the employee wants an additional amount withheld.

Kentucky governmental employees can obtain a Form W-4 from the website of the Division of Social Security at <http://www.state.ky.us/agencies/finance/depts/ss/divss.htm>. A person can, using the Adobe Acrobat Reader, view and print the Form W-4, as well as other on-line forms.

Check Amount Withheld—Even if an employee has already given a Form W-4 to the employer for 1999, the worker still should check to see if enough tax will be withheld for the year. Employees will need to compare the total tax to be withheld from the pay during 1999 with what they expect their tax to be. When they receive a wage statement for a full pay period in 1999 showing tax withheld based on 1999 tax rates, they should work out both their total

Elected and Appointed Officials are Employees for Tax Purposes

Most political subdivisions of the Commonwealth (conservation districts, water districts, cities counties and special districts, for example) have entered into a Section 218 Agreement sometime in the past. (For more information on 218 Agreements, see 42 USC 418 and KRS 61.410-61.500 or contact the State Division of Social Security.) Some of the political subdivisions opted for the elected official exclusion in their Section 218 Agreements, which means the elected officials of that political subdivision were not covered for social security purposes.

For those political subdivisions that did not choose the elected official exclusion, the services of their elected and appointed officials (i.e. board and commission members) are covered by social security and, therefore, FICA taxes should be withheld on all services performed by the officials.

Mandatory social security, however, officially came into existence July 1, 1991, and required FICA withholding and reporting for all elected and appointed officials who were not covered by an employer-provided, qualified retirement system or by a Section 218 Agreement. The proper reporting medium for elected and appointed officials is the Form W-2, not Form 1099.

Some have argued that elected and appointed officials are not "employees" and should be exempt from social security coverage, reporting and withholding. An "employee" is defined by Section 218(b)(3) of the Social Security Act, however, as "an officer of a state or political subdivision."

KRS 61.420(3), in addition, defines an "employee" as "any person in the service of the Commonwealth, a political subdivision...and shall include all persons designated officers, including those which are elective and those which are appointed."

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Form W-4 *continued from page 1...*

anticipated tax and their withholding for the year to see if they are having the right amount of tax withheld.

If too little tax will be withheld under the existing method, employees should give their employer a 1999 Form W-4 showing an additional amount to be withheld from their pay. Employees may have too little tax withheld if they have more than one job during the year, if their spouse also works, or if they have income not subject to withholding. If too much tax is withheld, they may receive a refund when they file their tax return. Employees who do not want to wait for a refund, however, may decrease their withholding by giving their employer a 1999 Form W-4 that reflects the proper amount. The Instructions to the form indicate whether employees can decrease withholding by claiming more withholding allowances. Some employees may be able to change their Form W-4 electronically.

Corrections—Any additional amount that an employee desires the employer to withhold should be entered on line 6 of the 1999 form. If this amount is withheld from the employee's pay each payday; the employee will avoid owing a large amount of tax at the end of the year. The employee must be sure, however, to enter the same number of withholding allowances on the new Form W-4 that the employer now uses for withholding. The completed form should then be given to the employer so that the additional amount will be withheld by the next payday.

Discretionary Changes—An employee can file a new Form W-4 at any time to change withholding allowances for any reason, such as a change in the number of amount of tax credits or deductions expected to be claimed for the year. The proper number of allowances may be determined by using the deductions and adjustments worksheet that is part of the form.

Also, if an employee has more than one job (or is married filing jointly with a working spouse), the withholding for one or more of the jobs can be increased. The two-earner/two-job worksheet on the back of the form can be used for this purpose. If too little tax is being withheld, the underwithheld amount may be applied to only one job or divided between the jobs as the employee wishes. After this decision is made, the amount applied to any of the jobs must be divided by the number of paydays remaining in 1999 for that job. That calculation will give the employee the additional amount to enter on line 6 of the 1999 Form W-4 that will be filed for that job.

Required Changes—Under certain circumstances, a new Form W-4 must be filed whether or not the employee desires to change the withholding amount. An employee is required to give an employer a new Form W-4 within 10 days after a divorce if the employee has been claiming married status, or after any event that decreases the number of withholding allowances an employee can claim. Situations in which

the withholding allowances an employee can claim will decrease include the following: (1) an employee has been claiming an allowance for a spouse but is now divorced, or the spouse is now personally claiming an allowance on a separate Form W-4; (2) an employee has been claiming an allowance for a dependent but no longer expects to provide more than half of the dependent's support for the year; (3) an employee has been claiming an allowance for a child, but the child will earn \$2,750 during 1999 and will be at least 24 by the end of the year and will not be a full-time student.

Social Security Prepares for Annual Mailings to Workers

The Social Security Administration has just completed mailing a Personal Earnings and Benefit Estimate Statement to approximately 30 million workers who are between the ages of 40-47. A series of statement mailings to older workers has taken place over the last three years as SSA prepares to implement the law that requires sending a statement each year beginning October 1, 1999 to all workers age 25 and older.

The annual statements are intended to help workers better understand what social security means to them and their families. They will also help workers make sure the earnings posted to their social security record are accurate. This is especially important because benefit amounts are based on the earnings posted to a worker's record. If SSA's record is incorrect, the worker may not receive all of the benefits he or she has earned.

The statements urge workers to use their own documents (pay stubs, W-2 forms and tax returns) to check to make sure their posted earnings record is correct. Workers are also encouraged to contact SSA at 800/772-1213 if they think any of their earnings are recorded incorrectly.

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The Commonwealth of Kentucky does not discriminate on the basis of race, color, national origin, sex religion, age or disability in employment or the providing of services and will provide, upon request, reasonable accommodation including auxiliary aids and services necessary to afford individuals with disabilities an equal opportunity to participate in all programs and activities.



SSA Reconciles New IRS Structure W-2s and 941s Taking Shape

SSA began its process to reconcile employer wage reports for tax year 1997 on November 6, 1998. At that time, notices were sent to those employers who have a history of sending only one wage report to SSA each year and have reported less wages to SSA than taxes reported to IRS for 1997. The bulk of the SSA-produced notices were mailed in the first calendar quarter of this year.

A change for tax year 1997 reconciliation is that employers whose Employer Identification Numbers beginning with the first two digits of 01 through 53 received reconciliation notices at the end of February 1999. Those employers with EINs beginning with the numbers 54 through 99 will receive initial reconciliation notices the end of March 1999. This split was done so that SSA can better respond to employers who have questions about the reconciliation notices.

Employers who have questions about a SSA reconciliation notice should contact SSA at the employer toll-free number, 800/772-6270 between 7 a.m. and 7 p.m., Eastern Time, Monday through Friday.

SSA sends reconciliation notices when their records show that they processed no wages or less wages than taxes were reported to the IRS. Employers are requested to provide the missing information so that the earnings records for their employees can be updated with all wages.

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Furthermore, the definition of "wages" for FICA purposes is found in IRC Section 3121(a) and, in general, is defined as all remuneration for employment except those items that are specifically excluded in that section. Per diem payments made as compensation for services are considered wages by the IRS.

Self-employment income, as detailed in IRC 1402(c) does not include the payment for services of a public official that are covered under a Section 218 Agreement. The IRS has also ruled that elected and appointed officials are considered employees and are not to be considered as self-employed (no Form 1099).

It should be noted that any expense payments to public officials are covered by IRS Regulation 1.62-2 to determine if the payments are made under a non-accountable plan and, therefore, subject to withholding.

The IRS reorganization—mandated by the IRS Restructuring and Reform Act of 1998 and pressed forward by continuing Congressional and public pressure—is beginning to take on a more definite shape. The IRS has just released specifics of its operating structure, designed around four operating divisions "organized into units to serve particular groups of taxpayers with similar needs."

The four divisions are as follows:

1) Wage and Investment Income—The vast majority of taxpayers (88 million filers, for a total of 116 million individual taxpayers) will be dealing with this division, which will be based in Atlanta and will have approximately 21,000 IRS employees. Within this division, most taxpayers will have contact with "account services," which will include the pre-filing, filing and post-filing processes.

2) Small Business and Self-Employed—The Small Business and Self-Employed Division (SB/SE) would include all corporations, S corporations and partnerships with assets valued at less than \$5 million, as well as Form 1040 Schedules C, E, F and Form 2106 filers. In addition, the Fiduciary and Estate and Gift tax programs, and the Employment and Excise tax program would be placed within the new division. SB/SE will be based in New Carrollton, Maryland, with a staff of approximately 39,000 IRS employees. The IRS estimates that about 40 million filers will be handled by this division, which will consist of a headquarters department and three separate functional areas: Taxpayer Education and Communication; Customer Account Services; and Compliance.

3) Large and Midsize Business—This unit would service approximately 170,000 filers and would be headquartered in north central New Jersey. It would have about 9,500 IRS employees and would be divided into the following industry groups: financial services, food and beverages, energy and chemicals, communications and technology and manufacturing and construction.

4) Tax-Exempts—This division will handle approximately 1.9 million tax-exempt filers and be based in Washington, D.C. with a staff of 2,800 employees. Its "segment-driven" program would include employee plans, exempt organizations and state and local governmental entities.

Three functional divisions—Counsel, Appeals and Taxpayer Advocate—are independent organizations reporting to the commissioner under the redesigned structure. The placement of the Criminal Investigation Division is pending review of the just-completed Webster Commission Task Force Report.

Final IRS Group-Term Life Insurance Regulations

The Internal Revenue Service has finalized its proposed regulations significantly reducing the uniform premiums used to calculate the value of employer-provided group-term life insurance. The final regulations adopt the table contained in the proposed regulations, as well as the general effective date of July 1, 1999.

Employers have the option, however, of continuing to use ten age brackets (rather than the 11 in the new table) until January 1, 2000, although they must use the new rates for those brackets. The IRS recognized that allowing this option would reduce the administrative burden on employers whose payroll systems are "hard-coded" for ten age brackets and would have incurred significant burden in trying to make modifications during 1999 to include the additional age bracket.

New Table Reduces Rates

The new uniform premium rates reflect increases in life expectancy measured in studies conducted by the Society of Actuaries, as well as other data on mortality trends. The table values are lower in all age groups than the rates under current regulations. The new table rates are indicated in the first column in the following chart:

Cost per \$1000 of protection for one month

Age Bracket	As of 7/1/99	Until 6/30/99
Under 25	\$0.05	\$0.08*
25 to 29	0.06	0.08*
30 to 34	0.08	0.09
35 to 39	0.09	0.11
40 to 44	0.10	0.17
45 to 49	0.15	0.29
50 to 54	0.23	0.48
55 to 59	0.43	0.75
60 to 64	0.66	1.17
65 to 69	1.27	2.10
70 and above	2.06	3.76

*single bracket "Under 30"

General Effective Date Remains July 1

After considering comments that requested effective dates ranging from January 1, 1999 to July 1, 2000, the IRS said that the originally proposed effective date of July 1, 1999 "provides the best way to balance the ability of employees to obtain the tax benefits of the lower table rates with the concerns expressed by some commentators about modifying payroll systems." In answer to those commentators who suggested a January 1, 2000 effective date, the IRS said that changes to payroll systems do not have to be put in place by July 1, 1999 because of the rules governing the taxation and reporting of group-term life insurance in excess of \$50,000.

The IRS first noted that, while the cost of group-term life insurance in excess of \$50,000 is subject to federal income tax and reporting on Form W-2, it is not subject to federal income tax

withholding. As far as social security and medicare (FICA) are concerned, the IRS relied on Revenue Notice 88-82, which allows employers to impute the taxable group-term life insurance amounts on any basis so long as they are treated as paid by December 31 and to change the method on which they impute the income at any time during the year. Therefore, employers who are currently withholding and paying FICA taxes on group-term life insurance on a pay period or monthly basis can either:

1. change methods to treat the table amounts includible in income on or after July 1, 1999 as paid on December 31, 1999, or
2. continue to withhold using the old table rates and make adjustments for the post-June 30, 1999 FICA withholding amounts by the last pay period for 1999.

Ten Age Brackets OK Through 1999

One of the most significant problems for some employers is the change from ten age brackets in the current table to 11 age brackets in the new table. (The "Under 30" age bracket is being split into "Under age 25" and "25 to 29.")

A significant number of payroll systems are "hard-coded" for ten age brackets, and making a change in that coding by July 1, 1999 was seen as a hardship by employers with such systems. In deference to that concern, the final regulations allow employers the option of using ten age brackets (with the new table values) until January 1, 2000. Employer who choose that option can continue to use an "Under 30" age bracket with the rate assigned to the "25 to 29" age bracket in the new table for the remainder of the year.

Special Transition Rule for "Employee-Pays-All" Plans

Under IRC Section 79, the cost of group-term life insurance is income to an employee only if the insurance policy is "carried directly or indirectly" by the employer. A policy is considered carried directly or indirectly by the employer if:

1. the employer pays any part of the cost of the life insurance, or
2. the employer arranges for the employees to pay the entire cost of the life insurance and charges at least one employee less than the table value and at least one other employee more than the table value.

For "employee-pays-all plans" where the premiums charged to all the employees are at or below the current table rates, no income is imputed to the employees because the new table rates are lower than the rates under the current table, the premiums charge to employees under some of these plans may straddle the new rates, resulting in income to the employees. For this reason, the final regulations contain a special effective date for such plans.

Under the special rule, if a policy would not be treated as carried directly or indirectly by an employer under table rates in effect on June 30, 1999, the employer may use that table or the new table until January 1, 2003 for determining whether the policy is carried directly or indirectly by the employer.

Beginning January 1, 2003, the employer must use the new table rates in making that determination.

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