Year-End Tax Guide for Compensation and Benefits

2016
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Introduction: Planning ahead

It’s that time of year again. Fall brings a flurry of activity for most compensation and benefits professionals. If you’re not busy managing an open enrollment period, you’re preparing for the next plan year and readying the company to meet all its information reporting deadlines in January, February and March.

Yes, your plate is already full, but don’t forget about taxes. This is the perfect season to assess your compensation and benefits plans and identify potential tax exposure before it’s too late. It is also a good time to look at the tax planning strategies that can help your company’s bottom line. Tax planning is more important than ever this year. The Affordable Care Act (ACA) created a tangle of new mandates and requirements, which are now fully in effect, and Congress passed several tax bills over the past two years that affect many compensation and benefits tax issues.

It sounds like a lot to worry about, but relax. This Year-End Tax Guide for Compensation and Benefits is your reference tool for understanding all the important tax issues. We’ll make you aware of critical new tax changes affecting your compensation and benefits plans and offer concrete tax planning tips that could help you and your employees right now. To make planning easy, we’ve organized the guide into five easy-to-understand sections on:

- What’s new this year
- Executive compensation
- Retirement plans
- Health care
- Information reporting

But remember, this guide can’t cover all possible strategies, and tax law changes are always possible after this guide is published. You should check for the most up-to-date tax rules and regulations before making any tax decisions. Contact your local Grant Thornton LLP professional to discuss your situation or for an update on tax legislation.
Tax law changes: What’s new this year?

Congress giveth, and Congress taketh away. Lawmakers enacted several changes last year that brought good and bad news for compensation and benefits plans. On the plus side, lawmakers made permanent a number of popular tax provisions, including the increased fringe benefit exclusion for transit benefits. Along the way, they delayed the unpopular “Cadillac tax” on high-cost health coverage and created a new safe harbor for small information reporting errors. Unfortunately, even with the relief, information reporting is getting harder. Congress accelerated the filing deadlines for wage and nonemployee compensation reporting, while the IRS said it will no longer grant automatic extensions for filing Form W-2. These changes are even more nerve-wracking when you consider that in recent years Congress dramatically increased the penalties for information return failures.

Parity for the transit fringe benefit exclusion
Congress gave employers a break on managing their fringe benefit programs. Employers can generally offer their employees transit and parking benefits without including the benefits in income, but the underlying rule in the tax code provided a higher limit for parking than transit. Congress had boosted the transit rate to create parity with parking many times, but only with a series of temporary extensions. These extensions were often enacted retroactively very late in the year, discouraging employees from taking sufficient transit benefits throughout the year and forcing employers to make last-minute changes in wage reporting and withholding. Those days are over. Congress has now made permanent the higher cap on tax-free employer-provided mass transit benefits. The allowable fringe benefit for transit now equals the parking allowance. The monthly limit for both is indexed for inflation and reached $255 in 2016.

Stricter filing deadlines
The IRS no longer allows automatic extensions for filing Form W-2. Under new temporary regulations, automatic extensions are not available for the 2016 reports due in 2017, and the IRS has indicated it will be reluctant to grant nonautomatic extensions. The change was spurred by the threat of identity thieves, who often file fraudulent electronic refund claims early in the tax filing season before the IRS has enough data-matching information to reject the claims. Congress is also sensitive to the issue and enacted legislation that goes even further. Employers must now file employee wage and nonemployee compensation statements (Forms W-2, W-3 and 1099-MISC) to the IRS and Social Security Administration by Jan. 31. The forms were previously not due to the agencies until the end of February if filing on paper and the end of March if filing electronically. The provision is effective for calendar year 2016 returns to be filed in 2017. See our section on information reporting for a full table on the new deadlines.

Safe harbor for de minimis errors on information returns
Although information reporting deadlines are tighter and penalties have increased in recent years, Congress did offer some relief. The new law creates a de minimis safe harbor so that any single reporting error of less than $100 or withholding error of $25 isn’t penalized and doesn’t need to be corrected. The provision takes effect for information returns and payee statements furnished in 2017 and later.

Cadillac tax
Congress last year postponed the 40% excise Cadillac tax on high-cost health plans that was scheduled to take effect in 2018. It’s now scheduled to take effect in 2020. However, the tax remains unpopular, and many lawmakers from both parties are calling for its repeal. Now that Congress has agreed to delay it once, it becomes easier to delay it again or even repeal it. This tax may never take effect, but you shouldn’t ignore it until another delay or a repeal is actually enacted.
Compensation without desperation

Executive compensation isn’t just about matching numbers or benchmarking anymore. Pay packages are getting more sophisticated all the time. Most companies aren’t just rewarding employees with one type of performance incentive, but several. You need to think creatively to attract top talent, and that starts with understanding your options.

Benefiting from incentive stock options
There’s nothing novel about incentive stock options (ISOs), but they remain one of the most popular types of incentive compensation. ISOs give your employees the option of buying company stock in the future. The price (known as the exercise price) must be set when the options are granted and must be at least the fair market value of the stock at that time. The exercise price is customarily set at exactly the fair market value, so the value has to rise before the ISOs have any value. If it does, your employees have the option to buy the shares for less than they’re worth.

Employees like them because in most situations they owe no tax when the options are granted or exercised, and they can benefit from capital gains treatment if they hold the shares long enough before selling them. ISOs often create a healthy incentive for employees to increase company value, but they have attributes that can limit their usefulness to employers, including the following:

• The employer receives no income tax deduction for ISOs unless the employee makes a disqualifying disposition.
• There is a per-employee limit of $100,000 on the amount of ISOs that can first be exercised for the employee during any one year. The limit is based on the value of stock at the grant date.

ISOs also come with a long list of restrictions:

• They may be granted only to employees, not board members or contractors.
• The exercise price cannot be less than the fair market value of the stock at the time the option is granted.
• The option term cannot exceed 10 years from the date the option is granted.
• The option can be exercised only by the executive and can be transferred only if the executive dies.
• When the option is granted, the executive cannot own more than 10% of the total combined voting power of all classes of stock of the employer, unless the exercise price is at least 110% of the fair market value on the grant date and the option term is five years or less.
Tie performance to pay with restricted shares or RSUs

Restricted stock and restricted stock units (RSUs) have emerged as useful tools for providing executive compensation and long-term incentives. In the past, restricted stock was often considered a giveaway. But the vesting of restricted stock doesn’t have to be based on time; it can instead be linked to company performance. In the brave new world of executive compensation, performance shares can be a key way to link pay to shareholder interests.

Performance shares link the vesting of restricted stock to company or individual performance, or both. Restricted stock allows employees to control taxation with a Section 83(b) election. And the strategy benefits from a number of potential approaches to develop meaningful but achievable performance goals that motivate participants and drive shareholder value.

- **Market performance**: based on meeting a specified target such as stock price
- **Operational performance**: based on specified operational goals such as increasing operating profits
- **Absolute performance**: based on absolute metrics such as targeted growth or return percentage
- **Relative performance**: vesting occurs if performance measures exceed those of a peer group
- **Balanced scorecard**: considers both quantitative and qualitative or strategic performance
- **Corporate focus**: vesting occurs only if corporate goals are achieved
- **Business unit focus**: vesting conditions are specific to individual business units

RSUs provide an alternative incentive similar to that of restricted stock awards. An RSU is a promise to an employee to transfer stock in the future, and you can offer employees the right to elect when to receive the stock. But be careful because RSUs are generally subject to the nonqualified deferred compensation (NQDC) rules in Section 409A.

Understanding NQDC

NQDC plans are designed to make payments to employees in the future for services being performed now. They are less about incentive awards and more about allowing your top executives to defer income and tax. Unlike tax-deferred retirement accounts like 401(k)s, NQDC plans can favor highly compensated employees, but do come with serious drawbacks.

As the employer, you cannot deduct any NQDC until the executive recognizes it as income, and NQDC plan funding isn’t protected from your creditors. You also must fully comply with IRS rules governing NQDC plans under Section 409A. The rules are strict, and noncompliance can cause severe consequences for your employees. If a plan fails to comply with the rules, plan participants are taxed on vested plan benefits immediately, with interest charges and an additional 20% tax.

Your employees generally must make an initial deferral election before the year in which they perform the services for the compensation that will be deferred. So if they want to defer 2017 compensation into a future year, they must make the election by the end of this year. Your plan must also comply with the following rules:

- Benefits must be paid either on a specified date according to a fixed payment schedule or after a specified event occurs, defined as death, disability, separation from service, change in ownership or control of the employer, or an unforeseeable emergency.
- The decision about when to pay the benefits must be made when the election to defer the compensation is made.
- Once that decision is made, the timing of benefit payments can be delayed, but generally not accelerated.
- Elections to delay the timing or change the form of a payment must be made at least 12 months before the date the original payment commences.
- New payment dates must be at least five years after the date the payment would have been made originally.
It is also important to note that employment taxes generally are due when the benefits vest. This is true even though the compensation isn’t actually paid or recognized for income tax purposes until later years. As the employer, you can postpone the payment of these payroll taxes only when the value of the future benefit payments cannot be ascertained, which is often the case when the plan uses a formula to define the future benefit rather than basing the benefit on an account balance.

**Planning tip**

**Investigate parachute payments before buying or selling**

Too often, compensation and benefits are considered an afterthought when a company is restructuring or buying or selling a business. This is a mistake. Parachute payments under Section 280G are payments made to “disqualified individuals” when there’s a change in control of a company. They exist in almost every M&A transaction and can result in unpleasant tax surprises to both the company and the executive. Individuals are subject to a 20% excise tax on so-called excess parachute payments, and your company is not permitted to deduct the payments. In addition, many employment agreements require companies to gross up individuals for the tax.

The parachute payment rules under Section 280G are complex and can create problems if you aren’t prepared. A “change in control” can be anything from a sale, a private or public offering, or even an existing shareholder’s acquisition of additional stock. Disqualified individuals include shareholders, officers and highly compensated individuals. They are not always limited to corporate executives and may include other employees, directors and independent contractors. A parachute payment itself is not always obvious and can be triggered by severance agreements, employment agreements, deferred compensation plans or bonus plans.

To plan for parachute payments, first, understand the compensation plans of any acquisition targets. You can also consider options like a “haircut,” which limits the amount of any parachute payments so you don’t end up with an excess payment. Contact your local Grant Thornton professional for help identifying or planning for a parachute payment.
Retirement plans: Golden opportunities

In many ways, your retirement plans are more important to your compensation program than your executive plans. While executive compensation helps you retain your top management talent, your retirement benefits are critical to attracting and retaining the best workers up and down your org chart.

Surveys find that three out of every four businesses are now offering retirement benefits, so it’s critical to be competitive. You also want to be efficient. If you’re still running a traditional defined benefit pension plan, Congress offered some funding relief, but most businesses find defined contribution plans vastly more efficient.

Managing your 401(k) plan
Qualified plans, such as a 401(k), and similar plans, such as a 403(b), remain among the most popular retirement plans for employers. But administering them can be costly and complex. Unless you operate your 401(k) plan under a safe harbor, you must perform nondiscrimination testing annually to make sure the plan benefits don’t favor highly compensated employees over other employees.

The safe harbors require employer contributions. If you operate under a safe harbor but need to conserve cash and cut costs by ceasing 401(k) contributions, you must amend the plan and give employees advance notice. Employees must have the option of changing their contributions during this advance notice window, and the nondiscrimination test must be performed for the entire year.

Tax law change alert
Congress eases pension funding obligations
Defined benefit plan sponsors received new relief from their pension funding obligations thanks to the Bipartisan Budget Act of 2015 (BBA). The BBA extended the higher interest rates used for valuing pension funding liabilities, but also increased premiums to the Pension Benefit Guaranty Corporation (PBGC). Funding obligations were historically calculated using a two-year average of interest rates. The lower the interest rate, the higher the funding obligations, so current low interest rates generally require higher contributions. Past legislation temporarily changed the formula to require the interest rate to fall within 90% and 110% of the 25-year average of interest rates. Because the two-year average has fallen below 90% of the 25-year average, the change had the effect of raising the interest rate, resulting in lower required contributions. The BBA now extends this provision through 2020. Unfortunately, PBGC premium rates for single-employer pension plans are increasing beginning in 2016. The flat-rate per participant premium will climb incrementally each year from just $57 in 2015 to $80 by 2019. The variable rate per $1,000 of unfunded vested benefits is climbing annually from just $24 in 2015 to $41 by 2018, plus inflation. The variable rate per participant cap ($500 per participant) for single-employer plans is unchanged, as is the flat rate for multiemployer plans.
Despite the challenges of a qualified plan such as a 401(k), it is still an attractive option for the following reasons:

- A qualified plan has significant design flexibility to allow sponsors to provide value to their top executives.
- Nonqualified plans aren’t as tax-effective for plan sponsors as qualified plans, because the employer doesn’t receive a current tax deduction for contributions to a nonqualified plan.
- Employer contributions to a qualified plan are never subject to Federal Insurance Contributions Act (FICA) or other payroll taxes.
- Distributions can be rolled over on a tax-free basis, so an employee’s taxable event is delayed until the actual payout from a tax-qualified retirement vehicle such as an IRA.
- The use of qualified retirement plans avoids Section 409A penalty risks.

Using the flexibility of a profit-sharing plan
A profit-sharing plan can give your business a lot of flexibility. It is a defined contribution plan with discretionary contributions, so there is no set amount you must contribute.

If you do make contributions, you will need to have a set formula for determining how the contributions are divided among your employees. The maximum 2016 contribution for each individual is $53,000 or, for those who include a 401(k) arrangement in the plan and are eligible to make catch-up contributions, $59,000. You can make deductible 2016 contributions as late as the due date of your 2016 income tax return, including extensions — provided your plan exists on Dec. 31, 2016.

You cannot discriminate in favor of highly compensated employees, and you must perform nondiscrimination testing. Employees cannot contribute (unless you include a 401(k) feature in the plan), and these plans can be difficult to administer. But they can be used by businesses of any size and can be offered along with other retirement plans.

Attract midcareer hires with a SERP
Traditional career paths are long gone, and dynamic organizations increasingly look outside the company to recruit executive leaders. This means bringing in midcareer hires who may be leaving behind the opportunity for significant accruals under an employer-sponsored retirement plan.

One way to compensate for this loss in benefit value is to provide a supplemental executive retirement plan (SERP). A SERP is a nonqualified retirement plan for key company employees, such as the CEO and other executives, which provides benefits above and beyond those covered in other retirement plans, such as 401(k) or other qualified retirement plans.
A SERP has many of the same characteristics of other nonqualified plans:

- Participation is limited to a select group of management or highly compensated employees.
- The company’s tax deduction is deferred until the executive receives the benefit; however, expenses are accrued and charged to earnings for financial statement purposes during the accrual period.
- Benefits are taxable to the executive for income tax purposes upon distribution. (Contributions are subject to FICA tax upon vesting.)
- The plan is subject to Section 409A compliance.

Although SERPs are technically unfunded liabilities, most companies use some type of arrangement to set aside funds. This may include mutual funds, specific stocks or company-owned life insurance. These assets aren’t guaranteed, and in the event of bankruptcy, the executive stands in line as a general creditor. To protect the SERP if there’s a change in control, many executives want the protection of a “rabbi” trust. This is an irrevocable trust that will provide protection against change in control, or change of heart, but not against the employer’s bankruptcy.

Planning tip
Consider a SEP or SIMPLE to ease growing pains
If your business is still in its early growing stages, administering a 401(k) plan can be difficult and costly. Lawmakers have given some businesses simplified ways to offer themselves and their employees the tax benefits of retirement accounts. A simplified employee pension (SEP) or a savings incentive match plan for employees (SIMPLE) may help if the costs of a more traditional plan are prohibitive based on how many people you employ.

A SIMPLE is limited to businesses with 100 or fewer employees, while a SEP is more broadly available. You adopt a SEP agreement and contribute directly to traditional IRAs for you and each of your eligible employees. SEPs do not let employees themselves contribute, but have a high limit on employer contributions. The maximum 2016 contribution is the lesser of $53,000 or 25% of eligible compensation. Employees are always 100% vested.

SIMPLE plans come in two types: the SIMPLE IRA and the SIMPLE 401(k). Unlike a SEP, a SIMPLE plan allows employees to contribute to their SIMPLE accounts, but only up to $12,500 for 2016, plus a catch-up contribution of $3,000 for employees who are 50 or older. Like a SEP, a SIMPLE plan requires employers to contribute and provides that employee contributions are immediately 100% vested. Employers are required to contribute either dollar-for-dollar matching contributions up to 3% of an employee’s compensation or fixed contributions of 2% of compensation.

### Comparison of employer tax-preferred retirement plan accounts

<table>
<thead>
<tr>
<th></th>
<th>Maximum employee contribution</th>
<th>Catch-up contributions for age 50+</th>
<th>Maximum combined employee and employer contribution</th>
<th>Tax benefit</th>
<th>Minimum distributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified plans (401(k) and others) and 403(b) plans</td>
<td>$18,000</td>
<td>$6,000</td>
<td>$53,000</td>
<td>Contributions are pretax (unless you’re making Roth contributions)</td>
<td>Age 70½</td>
</tr>
<tr>
<td>SIMPLE IRA</td>
<td>$12,500</td>
<td>$3,000</td>
<td>$53,000</td>
<td>Contributions are pretax</td>
<td>Age 70½</td>
</tr>
<tr>
<td>SEP IRA</td>
<td>Not permitted for plans set up after 1997</td>
<td>N/A</td>
<td>$53,000</td>
<td>Contributions may be made only by the employer and are not included in employee income until paid out</td>
<td>Age 70½</td>
</tr>
</tbody>
</table>
Health benefits: Adjusting to a new reality

The Affordable Care Act (ACA) has withstood constitutional and legal challenges largely unscathed, and the transition period is nearly over. The employer excise taxes for failing to meet ACA health coverage requirements are in full effect, as are all the new reporting requirements. It’s long past time to adjust to the new reality.

The ACA generally imposes excise taxes, also called shared-responsibility payments, on all employers with at least 50 full-time and full-time equivalent employees if they do not offer health care coverage to at least 95% of full-time employees or if they offer coverage that doesn’t meet minimum value and affordability requirements. These thresholds sound simple enough, but the rules are complicated and a small error can be very costly.

Who’s a full-time employee?
The first and most important threshold to examine is whether your business has 50 full-time and full-time equivalent employees so you know if you’re potentially subject to the excise taxes. It’s also important for businesses that exceed the 50-employee threshold to determine how many full-time employees they have, because potential excise tax exposure is based on the number of full-time employees and information reporting is required on the health benefits for all full-time employees.

A full-time employee is defined as an employee who works an average of at least 30 hours a week, and though this sounds simple, it can be tricky. There are varied ways to make this determination, but you have to count an employee’s paid hours, including paid time off, and you must include hours worked by the employee for any related employers. Unpaid hours don’t count, nor do hours worked outside the United States. For hourly employees, an employer has to use actual hours. For nonhourly employees, the employer can count actual hours or use one of two “equivalency methods.” You also have two alternatives for counting hours, the “lookback approach” or the “monthly measurement.” If this is beginning to sound complicated, it’s because it can be. Contact a Grant Thornton tax adviser for a full discussion of how the rules apply to your business.

**Tax law change alert**

**Cadillac tax delayed**

One of the least popular provisions in the ACA is off the books temporarily. The Cadillac tax, a 40% excise tax on high-cost health plans, was originally scheduled to take effect in 2018. The tax would have applied to costs exceeding $10,200 for employee-only coverage and $27,500 for family coverage. The thresholds would be adjusted for inflation in future years. When it was originally enacted in 2010, the excise tax was meant to hit only a small percentage of health plans that lawmakers argued encouraged overspending on health care, but general health care costs rose quicker than expected. As 2018 neared and employers realized how many plans could be affected by the tax, it became deeply unpopular. Lawmakers from both parties heard the complaints and the tax has now been delayed until 2020. There is a very good chance that lawmakers will repeal or again delay this tax, but employers should still prepare to comply with it unless and until a further delay is actually enacted.
Am I offering coverage to all my employees?
Many employers assume they are in the clear because they believe what they’re offering their employees meets the minimum coverage and affordability standards. But are you really offering this coverage to all your full-time employees? Coverage must be offered to 95% or more of all full-time employees, and companies can overlook small populations of specific employee groups that aren’t offered coverage.

An error can be costly. Falling below the 95% threshold by even one employee subjects you to penalties of up to $2,160 per full-time employee per year, regardless of whether most of them were offered coverage anyway (assuming at least one employee gets coverage on a government exchange and qualifies for a premium tax credit). You have to offer coverage to employee children, but not spouses. Each employer in a related group of employers applies the 95% threshold separately.

Reporting requirements
The new reporting requirements on health coverage are fully in effect for 2016, and employers will need to capture and report various information, including the following:

- For self-insured plans, the name, address and Social Security number of each full-time employee plus dependents enrolled in the employer’s health benefits plan
- The coverage level offered to the employee
- The coverage level at which the employee is enrolled
- The months for which the individual is covered during the calendar year
- Each full-time employee’s share of the lowest-cost monthly premium (for the employee only) for coverage providing minimum value, by calendar month
- A statement concerning which affordability safe harbor was used for each employee per month
- Total employee and full-time employee counts for each month

This information must be reported to employees on Form 1095-C by Jan. 31, 2017. The information is reported to the IRS on Form 1094-C by Feb. 28 in 2017 if using paper and March 31 if filing electronically. If the employee’s coverage is through a fully insured plan, the employee will also receive a Form 1095-B from the insurance company.

Planning tip
Confirm your worker classification
Counting your full-time employees is critical for ACA compliance, so knowing whether a worker is an employee or an independent contractor is just as critical. The IRS understands the benefits to employers of using independent contractors instead of employers and has cracked down on the practice of misclassifying employee-employer relationships as independent contractor relationships.

Misclassifying your workers can be costly. The IRS has an ongoing voluntary reclassification program that allows taxpayers to correct improper classification with greatly reduced back taxes and penalties. If the IRS discovers an issue outside of this program, it is unlikely to be lenient.

To prove the independent contractor relationship, documentation is imperative. You need to establish detailed policies, procedures and systems that employees responsible for hiring contractors can easily understand. To help establish a solid foundation for classifying workers as independent contractors, consider these suggestions:

- Develop a checklist that must be completed before hiring an independent contractor and that includes a mandatory questionnaire asking about factors that indicate the worker’s relationship to the company.
- Use a contract with specific language about the worker’s relationship to the organization.
- Avoid using contract language that establishes the “right of direction and control,” including noncompete agreements, restrictions on hiring subcontractors and payment of liability or workers’ compensation insurance.
- Create a formal internal policy document that clearly defines the required documentation and procedures, and lists the departments responsible for implementing the procedures.
Compensation and benefits work involves more than planning and implementing your programs. It also involves compliance with IRS requirements, which means payment responsibilities and information reporting. The ACA has added scores of new reporting rules, and Congress and the IRS have tinkered repeatedly with the deadlines and penalties. It’s worth revisiting the requirements before the rapidly approaching deadlines in early 2017.

**Payment responsibilities**
Corporations must make quarterly estimated tax payments based on the expected income at the end of the year. The fourth-quarter estimated tax payment for calendar year corporations is due Dec. 15, 2016, and the first-quarter payment for 2017 will be due on April 17, 2017. Payroll taxes must be remitted much more frequently. If total payroll tax liability exceeds $100,000 for any pay period, tax generally must be remitted by the next business day. If payroll taxes fall below that threshold but were more than $50,000 in the previous year, they must be remitted semi-weekly, generally within three business days. If payroll taxes were less than $50,000, they are due monthly, generally by the 15th of the following month.

**Information reporting**
The list of activities that require reports is extensive and growing, and includes all of the following (among others):

- Employee wages (Form W-2)
- Employee health coverage (Forms 1094-C and 1095-C)
- Payments to service providers (Form 1099-MISC)
- Cancellation of debt (Form 1099-C)
- Changes in corporate control or capital structure (Form 1099-CAP)
- Dividends and distributions (Form 1099-DIV)
- Distributions from pensions, annuities, retirement plans and IRAs (Form 1099-R)
- Transfer of stock acquired through an incentive stock option (Form 3921)
- Transfer of stock acquired through an employee stock purchase plan (Form 3922)

**Tax law change alert**
**New deadline for Forms 1099, W-2 and W-3**
Congress changed some important filing deadlines in an effort to battle identity thieves, who often file fraudulent electronic refund claims early in the tax filing season before the IRS has enough data-matching information to reject the claims. Employee wage and tax statements on Forms W-2 and W-3 will be due on Jan. 31 beginning in 2017. Previously they were due only to employees on Jan. 31, and not due to the Social Security Administration until Feb. 28 if filed on paper or March 31 if filed electronically. Form 1099-MISC will also be due on Jan. 31 if it includes nonemployee compensation. Similarly, under prior law these returns were not due to the IRS until Feb. 28 if on paper and March 31 if electronic.
The information reporting deadlines are also getting tighter, and the penalty amounts are increasing. It’s a bad combination, so you should be planning well in advance to meet all the early 2017 deadlines, especially as the IRS is ending its practice of allowing automatic extensions for filing Form W-2. Under the new regulations, the IRS will not grant automatic 30-day extensions in 2017 and will be reluctant to grant nonautomatic extensions. The change was compounded by new legislation adjusting the deadlines for compensation reporting.

**Practice tip**
**Protect yourself with a certified payroll tax vendor**
Many employers use a professional employer organization (PEO) to handle various payroll administration and tax reporting responsibilities. Under these arrangements, the PEOs generally file Forms W-2 in their names and take responsibility for remitting federal employment taxes. The problem arises when a PEO goes out of business or absconds with employment tax proceeds before remitting them to the IRS. The actual employer remains liable for the tax even though the employer presumably gave the funds to the PEO to remit.

Lawmakers have crafted a remedy for this situation. Under new rules, a PEO can be certified by the IRS and become a certified PEO (CPEO) after fulfilling a number of requirements relating to issues such as tax status, background, experience, business location, financial reporting and bonding. Employers using a CPEO are relieved of the ultimate responsibility for remitting payroll taxes, creating an opportunity to use these services with less worry over liability. The IRS will list CPEOs on its website once the application process is finished.

### Information return deadlines in 2017

<table>
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<tr>
<th>Date</th>
<th>Information return deadlines in 2017</th>
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| Jan. 31 | Employee wage and tax statement: Forms W-2 and W-3  
            Furnish to employee and SSA by paper or electronically | |
| Jan. 31 | Form 1099-MISC for nonemployee compensation  
            Furnish to recipient and IRS by paper or electronically | |
| Jan. 31 | All other Forms 1099 and Forms 1095, 1098, 3921, 3922  
            Furnish to recipient | |
| Jan. 31 | Furnish to IRS if paper | |
| Feb. 28 | Furnish to IRS if electronic (1096 not needed if electronic) | |
| March 31 | Calendar-year employee benefit plan report: Form 5500  
            Original due date | |
| July 31 | Extended due date | |
| Oct. 15 | |

**Dealing with penalties**

Penalties for information return failures have increased dramatically over the past several years, but there are many opportunities to abate them. The IRS can impose penalties for a variety of failures by a taxpayer. Sometimes these notices can be resolved with a simple letter to the IRS explaining that the taxpayer’s mistake was due to reasonable cause. This is essentially an argument that the taxpayer was acting responsibly and the mistake was unintentional. It can also mean that the penalty should be abated because the mistake was made by someone other than the taxpayer, like a tax adviser.

A taxpayer can use several arguments to abate penalties, including the following:

- **First-time abatement** — If you’ve never been penalized, you may be eligible for a first-time abatement. This program won’t free you from every type of penalty, but for many common failures, the IRS will waive the penalty under this program.

- **Corrective measure** — If you’ve been penalized in the past, you can still show that you’ve made changes that have prevented failures in subsequent years.

- **Acted reasonably** — You may also be able to show that you’ve exercised ordinary business care and prudence, and that the error is isolated and inadvertent.

The IRS’s own policy is to impose penalties to enhance voluntary compliance. A taxpayer who has been compliant aside from an isolated error won’t become more compliant based on a penalty. Taxpayers may be able to demonstrate that penalties in these cases don’t serve the IRS’s policy of voluntary compliance.
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