



JANET
LETOURNEAU

ACFCI, is the compliance manager at WageWorks. She draws upon more than 20 years of experience with flexible benefits plans and tax laws to perform consulting services and monitor quality control.

LeTourneau is a frequent speaker to employer groups and conferences and was formerly on the board of directors for the Employers Council on Flexible Compensation (ECFC) and is a current member of the ECFC Technical Advisory Committee (TAC). She is the lead instructor for the Section 125 administrators training workshop.

LeTourneau was one of the first people in the country to earn the Advanced Certification in Flexible Compensation Instruction designation sponsored by the Employers Council on Flexible Compensation. She is a certified trainer in the ACFCI program.

LeTourneau can be reached by telephone at 262-236-3021 or by email at jan.letourneau@wageworks.com.

The Benefits Brief...

State Taxation Complexities

We've found when administering flexible benefits plans that it's easy to find out the federal tax treatment of the different benefits, although not quite so easy to stay on top of all the complex rules and regulations for the various components of flexible benefits plans—but that's a whole different article.

Although we don't normally comment on state taxation issues, including the District of Columbia, we'll outline some deviations of federal exclusions from income which may be able to help your employer clients keep on track.

State tax changes are not easy to track. State tax changes can happen any time during the tax year and can deviate from federal treatment. States don't generally make a national announcement—and that's why most articles shy away from the subject.

If your employer clients think that every state that withholds for state income tax purposes would unquestionably just follow the federal withholding rules for their states, they would be wrong. There are complexities with state withholding for many states. Although this article cannot pinpoint every deviation for every state, we will give you a general summary of states to keep an eye on.

No State Income Taxes

Let's start with an easy question: *What are the states that do not collect state income taxes?*

As of this article, Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming do not collect state income taxes.

No worries about flexible benefit withholdings in these states!

For New Hampshire and Tennessee, there is no withholding on personal income tax, only on interest and dividends. *Again, a no-brainer—no state withholding for flexible benefits.* However, keep in mind that health savings accounts (HSAs) may accumulate interest or dividends if invested. This information should be clearly summarized on forms sent from the HSA custodian.

Flexible Benefits Plans

New Jersey and Pennsylvania are the last holdouts and do not completely conform to federal tax withholding laws when it comes to cafeteria plans. For instance, Pennsylvania taxes dependent care expenses for employees that are provided outside of a cafeteria plan.

For health reimbursement arrangements (HRAs), every state is on board with federal withholding practices. Some states may tax payments made to providers, so employers need to carefully understand state laws in those states where they have employees.

Health savings accounts (HSAs) are not recognized in every state; for example, while some states follow federal guidelines for HSAs in general, they do not allow COBRA continuation premiums to be paid on a nontaxable basis. This means there is a great deal of opportunity for employer and employee education.

Transit, Parking and Bike Expenses

California does not cap the amount of

benefits that may be excluded for qualifying ride-sharing arrangements. Just be aware that this arrangement has a more expansive definition of transit expenses than the federal definitions.

Some states limit amounts that may be excluded from state income and are less than federal levels. An example is Mississippi, which does not follow federal withholding for transit, parking or bike expenses. Still other states don't allow for

salary reduction at all for these types of expenses.

In Summary

The world of consumer-directed benefit accounts, including health FSAs, dependent care FSAs, HRAs, HSAs as well as transit, parking and bike benefits have very complex administrative regulations and taxation rules. The best source of the most up-to-date information for state withhold-

ing questions is a state's Department of Revenue. Contact them with questions to obtain updates on state tax laws.

It is critical that employers understand the tax treatment of the products they offer their employees. 🌐

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