



Legislation Text

File #: 33412, Version: 1

Fiscal Note

This resolution would authorize payments to the Internal Revenue Service and the Wisconsin Department of Revenue for back taxes associated with underreporting of wages due to a misinterpretation of federal tax law as it relates to life insurance premiums for coverage above \$50,000. Over many years, the city had been interpreting the federal tax law to mean that employee wages paid for premiums for life insurance, regardless of coverage level, were exempt from taxes if the city had a section 529 (“cafeteria”) plan in place. This interpretation was incorrect. As a result, employees were not taxed on wages allocated to pay for premiums on life insurance for coverage amounts above \$50,000, and, therefore, had higher take-home pay than would have otherwise occurred if taxes on these wages had been withheld.

The estimated payment to the Internal Revenue Service is \$582,000. The amount to be paid to the Wisconsin Department of Revenue is yet to be finalized but is estimated at \$250,000 for financial statement purposes. The City has also engaged its auditor, Baker Tilly, to assist with reviewing the calculations of taxable income and liability, reviewing applicable federal tax laws, and working with the Internal Revenue Service and Department of Revenue to establish a settlement agreement. The maximum expected cost for professional services assistance is \$60,000. The entire liability is expected to be less than \$900,000, but could change depending on final resolution of the state tax liability.

This agreement absolves the city and its employees for any further tax and reporting requirements associated with this wage underreporting. The city has avoided any future tax liability by treating wages allocated toward employer-sponsored life insurance premiums as taxable income.

The respective expenditures and liabilities were recorded with the 2013 Financial Statements. There is sufficient expenditure authority in the fringe benefits accounts appropriated within the final 2013 and 2014 adopted budgets to pay the settlement and the professional assistance costs. The City can access a “Premium Stabilization Fund” that is held at Hartford Insurance to cover these costs. This fund is currently used to mitigate the rate of increase in premiums paid for life and disability insurance. Use of these funds for this tax settlement may result in higher employee life insurance premiums in future years. The resolution would authorize the Finance Director to allocate up to \$900,000 from the Hartford Premium Stabilization Fund, or from the General Fund, as necessary to fund the settlements and related costs.

GN01-52430-9200000 (life insurance benefits)	+\$60,000
GN01-52300-9200000 (unemployment benefits)	-\$60,000
GN01-57525-9200000 (tax settlement expense)	+840,000
GN01-52100-9200000 (sick leave escrow)	-\$840,000

Title

Authorizing and appropriating funds for settlements with the Internal Revenue Service and the Wisconsin Department of Revenue, including professional services engagements, for a total amount not to exceed \$900,000, to resolve long-term underreporting of employee wage income for prior tax years and authorizing the Mayor and Clerk to sign Closing Agreements with those agencies.

Body

This resolution authorizes and appropriates funds for settlements with the Internal Revenue Service, the Wisconsin Department of Revenue, and related professional services, for a total amount not to exceed \$900,000, to resolve long-term underreporting of employee wage income for prior tax years and authorizing the Mayor and Clerk to sign Closing Agreements with those agencies. Funds to support the settlement would

be provided from the Premium Stabilization Fund held on behalf of the city by the Hartford Insurance Company, or the General Fund, as necessary. This settlement will be paid from the 2013 benefits budget, which has sufficient expenditure authority due to actual expenditures coming in at less than budgeted amounts.

WHEREAS, as a result of a misinterpretation of the federal tax code, the City has historically treated payments of employee/dependent life insurance premiums for coverage in excess of \$50,000 as a pre-tax deduction as if it were an Internal Revenue Code section 125 cafeteria plan. The payment of such life insurance premiums should have been treated as post-tax expenditures and the sole responsibility of the employees for coverage in excess of \$50,000 (“the Misinterpretation) and;

WHEREAS, as a result of the Misinterpretation, the City understated reportable wage income for the employees (“the Employees”) and sent incorrect Form W-2s to the Employees and;

WHEREAS, the City filed incorrect Form 941s with the Internal Revenue Service (“the Service”), as a result of the Misinterpretation and;

WHEREAS, the City has voluntarily approached the Service for a final resolution, based on taxable years 2011, 2012 and 2013, regarding any and all liability of the City and the Employees to the Service arising from the Misinterpretation and;

WHEREAS, the City has determined it is in its best interests to enter into a Closing Agreement with the Service that resolves all obligations the City may have arising from the Misinterpretation and absolves the City employees of any tax liability;

WHEREAS, the City will engage in similar discussions with the Wisconsin Department of Revenue to determine the state tax liability associated with the Misinterpretation;

WHEREAS, the money due and owing to the federal and state governments from the City and the professional assistance engagements necessary to assist the City in interpreting and resolving the tax law issues, in an amount not to exceed \$900,000, will be supported from the Hartford Premium Stabilization Fund, or, if necessary, from the General Fund;

WHEREAS, the settlement amounts will be expensed from the 2013 benefits budget which has sufficient expenditure authority and costs for professional services engagements will be paid from already appropriated amounts in the 2013 and 2014 benefits budget;

NOW, THEREFORE BE IT RESOLVED, by the Common Council of the City of Madison, that the Finance Director is authorized to transfer funds from the Hartford Premium Stabilization Fund, in an amount not to exceed \$900,000, to resolve all obligations the City may have arising from the Misinterpretation, including professional services engagements of up to \$60,000, and the Mayor and Clerk are authorized to enter into the Closing Agreements with the Internal Revenue Service and Wisconsin Department of Revenue.