

# New Payroll Reporting Obligations, Medical and Retirement Plan Amendments, and Summary of Tax Changes Affecting Individuals

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## 1. ISO and ESPP Reporting Obligations

Beginning in 2011, employers have a new IRS reporting obligation for incentive stock options (ISOs) and employee stock purchase plans (ESPPs). If an employee exercises an ISO or if employer stock under an ESPP is transferred during 2010, the employer must file an information return with the IRS by February 28, 2010 (for paper filings) or March 31, 2011 (for electronic submissions). The information is filed on Form 3921 for ISOs and Form 3922 for ESPPs. (See below for links to these forms.)

<http://www.irs.gov/pub/irs-pdf/f3921.pdf>

<http://www.irs.gov/pub/irs-pdf/f3922.pdf>

Extensions for filing these forms can be made on IRS Form 8809 before the otherwise applicable regular deadline.

In addition to the filings with the IRS, employers must provide copies of the applicable information statement to affected employees regarding ISO and ESPP transactions by January 31, 2011.

## 2. Rollover of 401(k) Deferrals to Plan Roth Account

A 401(k), 403(b) or governmental 457 retirement plan that includes a Roth option, may permit a participant after September 27, 2010, to rollover amounts from his or her non-Roth elective deferrals to a Roth account in the plan. The rollover amount is taxable to the participant in the year of the rollover, however 2010 rollovers may, at the participant's election, be taxed in equal installments over 2010 and 2011. While a plan must be amended to permit this option,

many plan administrators have been waiting for IRS guidance in this area before making any plan amendments. That guidance, however, is not scheduled to be published until December 20, 2010. Consequently, the IRS extended the deadline for adopting plan amendments to allow Roth rollovers in 2010 until the last day of the plan year in which the amendment is effective, or December 31, 2011, if later.

Plan administrators must report Roth conversions on Form 1099R. Box 1 of Form 1099R shows the amount rolled over to the Roth account, while Box 2a shows the taxable amount of that rollover.

The mandatory 20% withholding tax that ordinarily applies to retirement plan distributions does not apply to direct in-plan Roth rollovers. Rather, the amount rolled over is includible in income equally in 2011 and 2012 unless the taxpayer elects to include it in 2010.

## 3. Medical Reimbursement Plan Amendments Needed

Employers that sponsor medical reimbursement plans providing employees flexible spending accounts must amend those plans to comply with federal health reform laws. Changes include:

- Coverage of adult children up to age 27 (even if they are not tax dependents), effective 2010;
- Exclusion of nonprescription drugs from reimbursement (except insulin), beginning in 2011; and
- Dollar cap on medical reimbursements, beginning in 2013.

## 4. Other Medical Plans

An employer should determine whether it will seek grandfathering status for each medical arrangement that it offers. A grandfathered plan generally has a longer

time to comply with the new federal health reforms.

Other new changes to medical plans include:

- Eliminating pre-existing conditions for children under age 19, beginning in 2010;
- Eliminating lifetime dollar caps on certain essential health benefits, beginning in 2010;
- Providing certain dollar minimum annual coverage on essential health benefits, beginning in 2010; and
- Covering dependent adult children up to age 27 (with certain exceptions for grandfathered plans).

Insured medical plans will also be subject to new nondiscrimination rules after forthcoming regulations are issued.

## 5. Payroll Tax Changes

The new tax law, which extends the Bush tax cuts, will affect payroll withholding by reducing Social Security payroll taxes on an individual employee by 2% in 2011. Social Security taxes apply only to the first \$106,800 in wages, so the maximum savings for high earners is \$2,136. The employer's share of Social Security taxes would not be affected.

Other changes that the federal tax extender bill would make for individuals:

- Prevent higher income tax rates for individuals and small businesses for 2 years;
- Provide a \$5 million tax exemption on the estate of a deceased person (\$10 million for couples). Estates over \$5 million would be taxed federally at a 35% rate. In addition, the bill reinstates the "step-up" in basis for inherited property. (See separate *Burns & Levinson*

*Tax & Estate Planning Advisory on "New Federal Tax Law Includes Significant Estate, Gift and Generation-Skipping Transfer Tax Changes.")*

- Preserve the \$1,000 per child tax credit and marriage penalty relief;
- Preserve 15% tax rate on capital gains and dividends;
- Protection of many taxpayers from alternative minimum taxation (AMT) in 2010 and 2011; and
- Extension of unemployment benefits until the end of 2011.

The Congressional Budget Office estimates that the new tax law will cost the government \$858 billion over the next 10 years.

For questions regarding this Client Update, please contact the following attorney:

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