

## Update and Recommendations for School Districts for 3% Refunds

*3% retiree health contributions for the period from July 1, 2010, through September 3, 2012*

Below is guidance provided by Yeo & Yeo based on information currently available to us. This guidance is subject to interpretation and future change. Many of the issues below are dependent on the initial treatment of the 3% retiree health contributions. In addition, schools will need to make decisions at the district level as to what is best for their district, as well as consideration to the cost/benefit of their decisions.

We will send updates as we receive them and continue to keep you posted on the guidance.

**This guidance is intended to provide general communication for purposes of discussion and district decision-making.**

3% Refunds are subject to both Federal/State & FICA Withholding. We recommend the 3% Refunds are treated as **Supplemental Wages**. Supplemental Wages can be paid using two methods, the **Aggregate Approach** or the **Flat Rate Method**.

3% Refunds Handled Initially		Check Type	Individual Group	Tax Reporting
Included in Federal/State wages	Included for FICA wages	Accounts Payable Check	All	None in 2018
	Excluded for FICA wages	Payroll*	1. Current/Active	W-2, 3% Refund report in FICA wages for 2018
Excluded for Federal/State wages	Included for FICA wages	Payroll*	2. Retiree/Inactive	W-2, 3% Refund report in Federal/State wages for 2018
	Excluded for FICA wages	Payroll*	3. Deceased	W-2, 3% Refund report in Federal/State and FICA wages for 2018

\*In most circumstances - see group type below.

**Group 1. Current/Active Employees - 3 Options:** Includes any employee paid during calendar year 2018

	Option	Response
A)	Issue payment with regular wages through payroll	Process payment with another regular pay (total equal to combined amount) subject to regular wage withholding tables.
B)	Issue payment separate of regular wages through payroll	Process payment separate, use the "Aggregate Approach" calculation ( <a href="#">See Q.2.</a> )
C)	Issue payment as a separate payment using the "Flat Rate Method" through payroll	Process payment separate, use 22% for employee's withholding.

**Group 2. Retirees/Inactive Employees - 2 Situations to Consider:**

	Situation	Response
A)	If NO payments were made to the employee in the current or previous year (2018 or 2017)	Process payment separately through payroll, use the "Aggregate Approach" calculation ( <a href="#">See Q.2.</a> )
B)	If any payments were made to the employee in the current or previous year (2018 or 2017)	Process payment as a separate payment using the "Flat Rate Method" through payroll, use 22% for employee's withholding ( <a href="#">See Q.4.</a> )

**Group 3. Deceased Employees – In general, no withholding is required ([See Q.3.](#)):**

We recommend payment with an AP check, and a subsequent issuance of a 1099-MISC for the 2018 reporting period. The check should be made payable to "the Estate of XXX" or to the employee's heirs according to Michigan Law ([See Q.5.](#)) Please note that every deceased employee (former employee) situation can be different. If you are unsure how to handle a particular employee, please contact your legal and accounting firms for assistance.

Interest Earned on 3% Refund
No year-end tax reporting is necessary (i.e., no 1099-INT or 1099-MISC) ( <a href="#">See Q.6.</a> )
The interest payment can be remitted through either an AP check or a payroll check as a pass-through reimbursement.

**General Recommendations:**

We recommend issuing payments in batches based on the type of refund. An example scenario for batch issuance:

- Active employees: Flat Rate Method at 22%
- Inactive employees: Aggregate Approach (use most current W-4)
- Deceased: Work through each individual situation with legal/accounting professional

## ORS 3% HEALTH CARE CONTRIBUTIONS FAQ

### **Q.1. What should I tell my Board and my employees regarding a timeline for payment?**

A.1. This is an individual district decision. Each district should read the guidance and contact their audit and/or legal firm to help them as they deem necessary. We recommend trying to complete this as efficiently as possible and consider payments in batches.

Several items will affect timing, such as changes in district software, payroll system capabilities, number of deceased former employees, etc. Also affecting the timeline will be any options the district adds to its handling of such items as 403(b) contributions, etc. We do recommend that once the district has a timeline, they communicate it to their personnel.

### **Q.2. What is the “Aggregate Approach” calculation?**

A.2. To calculate withholding on the 3% Refund, it should be aggregated (combined) with regular wages to determine the total withholding on the aggregated (combined) amount. Then the regular wage at the regular withholding is backed out, to determine what the withholding will be on the refund only.

*Note: If used for inactive/retirees, the withholding will only be on the refund. The District should use the daily miscellaneous withholding table when the only payment during the year will be the 3% Refund.*

### **Q.3. What if the employee died in 2018?**

A.3. If the employee died in the current year, the district should remit payment similar to that of the retiree/inactive employees category above depending on that employee's situation.

In this case, the final tax return most likely would not be completed for the deceased, and the payment can be remitted directly to the deceased.

### **Q.4. Limitation of use of Flat Rate?**

A.4. The Flat Rate method can be used only if the employer has withheld income tax from the employee's regular wages during the current calendar year or previous calendar year (2018 or 2017).

### **Q.5. What if the Estate is no longer open?**

A.5. If the Estate is closed, make the check payable to the first living person in the following order: spouse, children, parents, siblings. If you find it challenging to locate the heirs, contact your legal counsel for assistance.

### **Q.6. Who is responsible for the reporting of the interest?**

A.6. At this time, it has still not been determined legally who is responsible for year-end reporting. However, in this instance each individual will be below the reporting limits. The reporting threshold for both the 1099-INT (for a non-financial institution) and 1099-MISC is \$600.

### **Q.7. What if I don't have a W-4 on file?**

A.7. Circular E - Publication 15 states that the W-4 default is Single Filing -0-.

### **Q.8. Should we try to obtain a new W-4?**

A.8. We recommend using the most current W-4 on file.

### **Q.9. What happens if the former employee no longer lives in Michigan? Am I still required to withhold Michigan tax?**

A.9. Yes, the 3% Refund is a refund of wages that were earned in Michigan. The non-resident will have to file a non-resident tax return for 2018.

**Q.10. What about 403(b) plans, 457(b) plans, HSAs, garnishments, child support, etc? Can other reductions apply?**

A.10. In most situations, this is dependent on plan documents and bargaining agreements, and it will be a district decision. In general, refunds are subject to garnishments including alimony and child support.

However, all plans have to be reviewed and each district will need to make their own decision.

**Q.11. The FICA rate has changed since 2011. Which one should we use?**

A.11. We recommend using the current rate.

**Q.12. When did I be receive the funds and how do I know if the payment is correct?**

A.12. The payment was sent to districts on January 22. It was a separate deposit from the monthly State Aid amount, but distributed in the same manner. The amount should match the report the district received in early January. Districts can reconcile this report to prior records, and/or the ORS will provide amounts by pay period for each district if requested.

**Q.13. What is the initial journal entry?**

A.13. Once the money is received, initial accounting should be straightforward. Below is an example journal entry for the initial payment.

**Debit** – Cash

**Credit** – Liability (Recommend function code “491”)

(It is recommended that the cash be placed in a non-interest bearing account.)

**Q.14. Will there be an impact on revenue accounts?**

A.14. There will be no impact on revenue accounts.

**Q. 15. Will there be an impact on expenditure accounts?**

A. 15. Expenditure accounts may have an impact depending on the treatment of the 3% Refund. If the amount being received for previous wages (3% Refund) was not initially taxed for FICA, Districts will have an expenditure for FICA in the current year. The 1022 Committee is looking into a recommendation as to account number and allocation of this expenditure, taking into account the effect of other reporting and calculations, such as COE or indirect cost rates, etc. At this time, the 1022 Committee is recommending spreading the cost to multiple functions. However, we recommend using your largest functions and allocating. Of course, each District can choose how much detail and to what extent they want to spread the cost. We recommend the District considers the cost/benefit of the allocation.

*Note: Avoid charging FICA expense to a federal program in the current year. Although, the expense will be an expenditure current year expense; however, it is related to prior year amounts.*

**Q.16. Is the 3% Refund subject to retirement?**

A.16. No, it is a refund of wages and has already been subject to retirement.

**Q.17. Do the 1 year Unclaimed Property laws for payroll checks apply, and when does the timeline start?**

A.17. Yes, if you are unable to find contact information of a former employee the unclaimed property rules do apply. The start of the one-year mark is from the date of last activity or when the funds are available to be issued to the individual.

**Below are the links to the other resources:**

- [3% Contribution Ruling](#)
- [ORS 3% Health Care Contributions FAQ](#)