

MEMORANDUM

PERSONNEL MANAGEMENT LIAISONS

DATE: March 22, 1994
Reference Code: 94-18

THIS MEMORANDUM SHOULD BE DISTRIBUTED TO:

Personnel Officers, Labor Relations Officers
Accounting Officers

FROM: Department of Personnel Administration

SUBJECT: State Owned Housing - Taxable Fringe Benefit

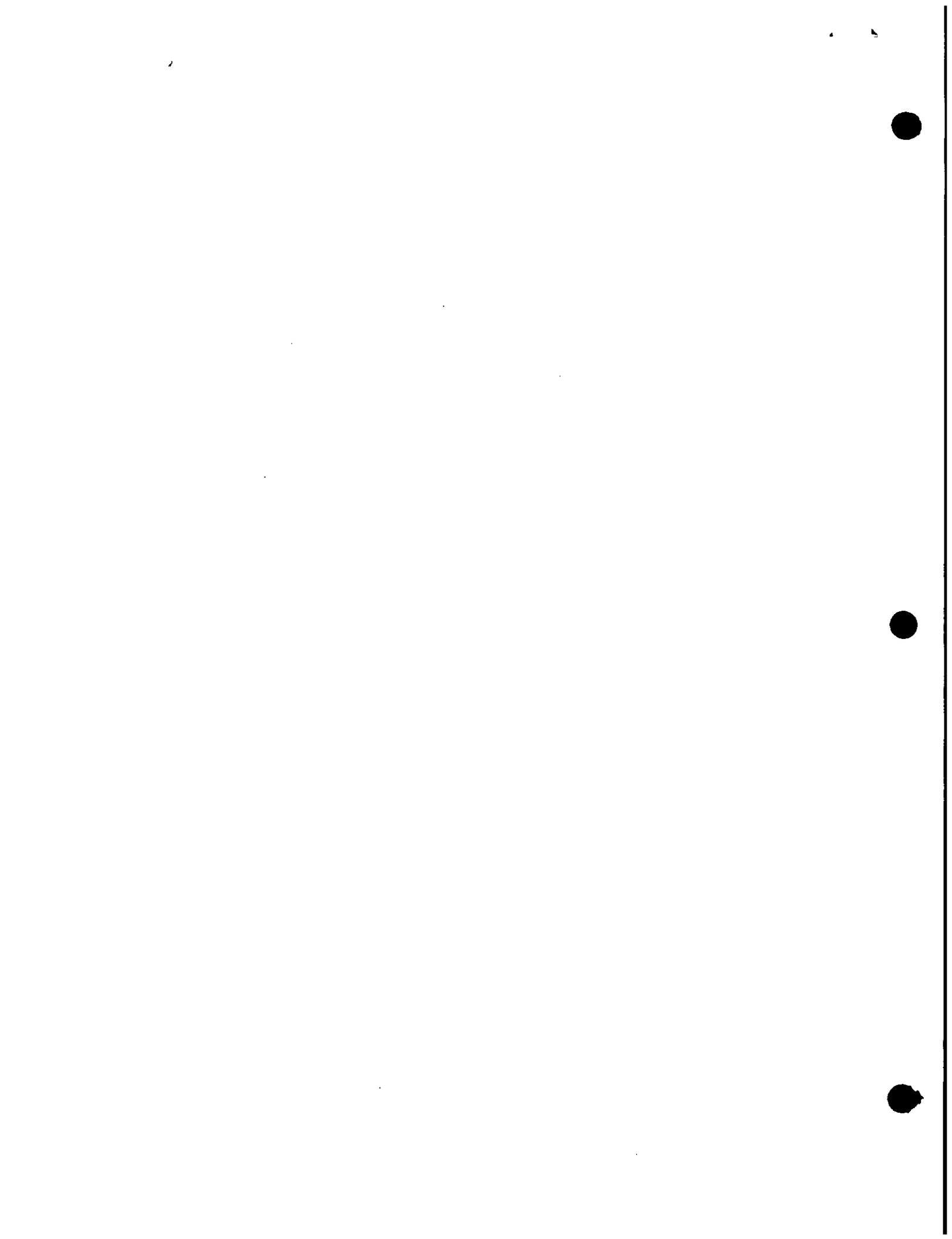
As you are probably aware, the State Controller's Office (SCO) recently issued Payroll Letter 94-06 which details the reporting and tax withholding requirements associated with employer-provided housing/lodging. State departments are required to immediately begin reporting to the SCO the value of taxable housing/lodging on a monthly basis. The SCO will withhold all applicable taxes from this taxable value.

This memorandum provides policy guidance regarding the assessment of fair market value and reporting of taxable income associated with employer-provided housing. Since this issue deals with the tax liability of individual employees, it is crucial that departments establish processes and procedures to comply with the reporting requirements specified in the SCO payroll letter.

The DPA has overall responsibility for administration of the State Owned Housing Program. This responsibility entails making decisions on problems which are referred by line departments and for adjusting applicable State regulations. Each State agency which provides housing accommodations for employees has been delegated the authority and responsibility for applying rental rates, making adjustments to the rates, maintaining the housing in good condition and disposing of housing which cannot be economically maintained. In addition, department heads may further delegate this responsibility to institution superintendents, wardens, district officers, etc. pursuant to DPA rule 599.646.

The process for adjusting rental rates for represented employees is dictated by the negotiated Memoranda of Understanding (MOU) for each bargaining unit. Non-represented employees are covered by State regulations. In applying rental rates, there is a tax liability issue which surfaces if employees are not paying a rent which is determined to be "fair market value". Internal Revenue Codes and Regulations require that specific criteria be met in order to exempt the value of employer-provided housing from taxation. When these criteria are not met and the employer provides housing at less than fair market value, then the value difference is deemed by the IRS to be taxable.

In order for departments to address the reporting requirements discussed in the SCO Payroll Letter, processes and procedures should be established immediately to: (1) evaluate whether each employer-provided housing unit meets the IRS' criteria for a tax exemption (2) determine fair market value (FMV), (3) compare the FMV against the



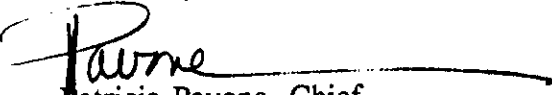
rental rate charged to the employee to identify the taxable value, and (4) over time, adjust rates for each unit/renter consistent with applicable DPA rules or MOU provisions.

Based on the experience of some appointing authorities, the DPA suggests that departments have the FMV determinations made by local appraisers or real estate services. This approach appears to have the advantage of utilizing trained, independent professionals who are familiar with the value of property and rental rates in the community. Using such persons facilitates a timely completion of the property survey/assessment process and ensures a more accurate and consistent assessment of actual fair market value. The IRS Regulations Section 1.61-21(b) provides guidance in the definition of fair market value. In addition, such factors as the property's extreme isolation or seasonal inaccessibility, the close proximity to disturbing noises or offensive odors, lack of privacy, age, overall size and physical condition etc., may impact the value of the property and the rental rate charged.

The following DPA policy shall guide appointing authorities on housing administration and reporting of any taxable fringe benefit generated from the difference between Fair Market Value and rents actually paid.

- 1) Timely and aggressively apply the housing/lodging requirements of Internal Revenue Code (IRC) Section 119-1 (b), including the "criteria" and the "definitions" contained therein.
- 2) Document the department's interpretation and application of Section 119-1 (b), including full justification and explanation of:
 - a) "business premises";
 - b) "convenience of the employer"; and
 - c) "condition of employment".
- 3) When taxable, report timely to the State Controller regarding the difference between determined Fair Market Value of rental properties occupied by employees and actual rents paid (ie., taxable value).
- 4) Consistent with MOUs and State Regulations, adjust all rents under the jurisdiction of the appointing authority.

Once appointing authorities have analyzed the issues addressed in SCO Payroll Letter 94-06, department staff who require DPA staff assistance regarding Fair Market Value questions, may call the Benefits and Training Division at (916) 322-0300 (Calnet 492-0300).


Patricia Pavone, Chief
Benefits and Training Division

cc: Department Directors

