Introduction
This publication supplements Circular E, Employer’s Tax Guide. It contains specialized and detailed employment tax information supplementing the basic information provided in Circular E. It also contains:

• Alternative methods and tables for figuring income tax withholding.
• Combined income tax, employee social security tax, and employee Medicare tax withholding tables.
• Tables for withholding on distributions of Indian gaming profits to tribal members.

Telephone help. You can call the IRS with your tax questions. Check your telephone book for the local number or call 1–800–829–1040.

Help for people with disabilities. Telephone help is available using TTY/TDD equipment. You can call 1–800–829–4059 with your tax question or to order forms and publications. You may also use this number for problem resolution assistance.
Employee Stock Options
There are three classes of stock options—(1) incentive stock options, (2) nonqualified options, and (3) employee stock purchase plan options. Generally, incentive stock options and employee stock purchase plan options are not taxable to the employee when the options are granted or when they are exercised (unless the stock is disposed of in a disqualifying disposition). However, the spread (between the exercise price and fair market value of the stock at the time of exercise) on employee stock purchase plan options is subject to social security, Medicare, and FUTA taxes when the options are exercised. Additionally, the spread on nonqualified options normally is taxable to the employee as wages when the options are exercised (see Regulations section 1.83-7). These wages are subject to social security, Medicare, and FUTA taxes, and income tax withholding.

Tax-Sheltered Annuities
Employer payments made by an educational institution or a tax-exempt organization to purchase a tax-sheltered annuity for an employee are included in the employee's gross income if the payments are made because of a salary reduction agreement. They are not included in box 1 on Form W-2 and are not subject to income tax withholding.

Contributions to a Simplified Employee Pension (SEP)
An employer's SEP contributions to an employee's individual retirement arrangement (IRA) are excluded from the employee's gross income. These excluded amounts are not subject to social security, Medicare, and FUTA taxes, or income tax withholding. However, any SEP contributions paid under a salary reduction agreement (SARSEP) are included in wages for purposes of social security and Medicare taxes and FUTA. See Pub. 560, Retirement Plans for Small Business (SEP, SIMPLE, and Keogh Plans), for more information about SEPs.

Salary reduction simplified employee pensions (SARSEP) repealed. You may not establish a SARSEP after 1996. However, SARSEPs established before January 1, 1997, may continue to receive contributions.

SIMPLE Retirement Plans
Employer and employee contributions to a savings incentive match plan for employees (SIMPLE) retirement account (subject to limitations) are excludable from the employee's income and are exempt from Federal income tax withholding. An employer's nonelective (2%) or matching contributions are exempt from social security, Medicare, and FUTA taxes. However, an employee's salary reduction contributions to a SIMPLE are subject to social security, Medicare, and FUTA taxes. For more information about SIMPLE retirement plans, see Pub. 560.

6. Employee Fringe Benefits
The following fringe benefits provided by an employer are excluded from the employee's gross income. The benefits are not subject to social security, Medicare, and FUTA taxes, or income tax withholding.

1) A no-additional-cost service, which is a service offered for sale to customers in the course of the employer's line of business in which the employee works. It is provided at no substantial additional cost, including lost revenue, to the employer. Examples include airline, bus, and train tickets and telephone services provided free or at reduced rates by an employer in the line of business in which the employee works.

2) A qualified employee discount that, if offered for property, is not more than the employer's gross profit percentage. If offered for services, the discount is not more than 20% of the price for services offered to customers.

3) A working condition benefit that is property or a service the employee could deduct as a business expense if he or she had paid for it. Examples include a company car for business use and subscriptions to business magazines. Under special rules, all of the use of a demonstrator car by an auto salesperson is excluded if there are substantial restrictions on personal use.

4) A de minimis benefit that is a service or an item of such small value (after taking into account how frequently similar benefits are provided to employees) as to make accounting for the benefit unreasonable or administratively impracticable. Examples include typing of a personal letter by a salesperson is excluded if there are substantial restrictions on personal use.

5) A qualified transportation benefit, which includes transit passes, transportation in a commuter highway vehicle to and from work, and qualified parking at or near the place of work. The combined exclusion for the transit passes and transportation cannot
exceed $65 per month for 2000. The exclusion for parking cannot exceed $175 per month for 2000. Effective January 1, 1998, employees may be given a choice of any qualified transportation benefit or cash without losing the exclusion of the transportation benefit from income and employment taxes. If an employee chooses the cash option, the cash is includible in the employee’s income and subject to employment taxes. For more information on this transportation fringe benefit, see chapter 4 in Pub. 535.

6) A qualified moving expense reimbursement, which includes any amount received, directly or indirectly, by an employee from an employer as a payment for, or reimbursement of, expenses that would be deductible as moving expenses, if paid or incurred by the employee. For more information on expenses that qualify for a deduction, see Pub. 521, Moving Expenses.

7) An on-premises gym or other athletic facility provided and operated by the employer if substantially all the use is by employees, their spouses, and their dependent children.

8) A qualified tuition reduction, which an educational organization provides its employees for education, generally below the graduate level. For more information on a qualified tuition reduction, see Pub. 520, Scholarships and Fellowships.

Do not exclude the following fringe benefits from the income of highly compensated employees unless the benefits are available to employees on a nondiscriminatory basis.

- No-additional-cost services (item 1).
- Qualified employee discounts (item 2).
- Meals provided at an employer-operated eating facility (included in item 4).
- Qualified tuition reduction (item 8).

For more information, including the definition of a highly compensated employee, see Pub. 535.

Special fringe benefit rules for airlines and their affiliates. Employees of a qualified affiliate of an airline (a member of a group in which another member operates the airline) who are directly engaged in providing airline-related services may exclude from their income as a no-additional-cost service the fair market value of air transportation provided by the other member. Airline-related services means providing any of the following services in connection with air transportation: catering, baggage handling, ticketing and reservations, flight planning and weather analysis, service at restaurants and gift shops located at an airport, and similar services.

Any use of air transportation provided by an airline to parents of the airline’s employees is also treated as use by the employees. The employees are entitled to exclude the fair market value of such transportation from their income as a no-additional-cost service.

More information. For more detailed information on nontaxable fringe benefits, see chapter 4 in Pub. 535.

Taxable Noncash Fringe Benefits

Use the following guidelines for withholding, depositing, and reporting taxable noncash fringe benefits.

Valuation of fringe benefits. Generally, you must determine the value of noncash fringe benefits no later than January 31 of the next year. Prior to January 31, you may reasonably estimate the value of the fringe benefits for purposes of withholding and depositing on time.

Choice of period for withholding, depositing, and reporting. For employment tax and withholding purposes, you can treat fringe benefits (including personal use of employer-provided highway motor vehicles) as paid on a pay period, quarter, semiannual, annual, or other basis. But the benefits must be treated as paid no less frequently than annually. You do not have to choose the same period for all employees. You can withhold more frequently for some employees than for others.

You can change the period as often as you like as long as you treat all the benefits provided in a calendar year as paid no later than December 31 of the calendar year.

You can also treat the value of a single fringe benefit as paid on one or more dates in the same calendar year, even if the employee receives the entire benefit at one time. For example, if your employee receives a fringe benefit valued at $1,000 in one pay period during 2000, you can treat it as made in four payments of $250, each in a different pay period of 2000. You do not have to notify the IRS of the use of the periods discussed above.

Transfer of property. The above choice for reporting and withholding does not apply to a fringe benefit that is a transfer of tangible or intangible personal property of a kind normally held for investment, or a transfer of real property. For this kind of fringe benefit, you must use the actual date the property was transferred to the employee.

Withholding and depositing taxes. You can add the value of fringe benefits to regular wages for a payroll period and figure income tax withholding on the total. Or you can withhold Federal income tax on the value of fringe benefits at the flat 28% rate applicable to supplemental wages.

You must withhold the applicable income, social security, and Medicare taxes on the date or dates you chose to treat the benefits as paid. Deposit the amounts withheld as discussed in section 11 of Circular E.

Amount of deposit. To estimate the amount of income tax withholding and employment taxes and to deposit it on time, make a reasonable estimate of the value of the fringe benefits provided on the date or dates you chose to treat the benefits as paid. Determine the estimated deposit by figuring the amount you would have had to deposit if you had paid cash wages equal to the estimated value of the fringe benefits and withheld taxes from those cash wages. Even if you do not...
know which employee will receive the fringe benefit on the date the deposit is due, you should follow this procedure.

If you underestimate the value of the fringe benefits and deposit less than the amount you would have had to deposit if the applicable taxes had been withheld, you may be subject to a penalty.

If you overestimate the value of the fringe benefit and overdeposit, you can either claim a refund or have the overpayment applied to your next Form 941.

If you deposited the required amount of taxes but withheld a lesser amount from the employee, you can recover from the employee the social security, Medicare, or income taxes you deposited on the employee’s Form W-2. However, you must recover the income taxes before April 1 of the following year.

**Special accounting rule.** You can treat the value of benefits provided during the last 2 months of the calendar year, or any shorter period within the last 2 months, as paid in the next year. Thus, the value of benefits actually provided in the last 2 months of 1999 would be treated as provided in 2000 together with the value of benefits provided in the first 10 months of 2000. This does not mean that all benefits treated as paid during the last 2 months of a calendar year can be deferred until the next year. Only the value of benefits actually provided during the last 2 months of the calendar year can be treated as paid in the next calendar year.

**Limitation.** The special accounting rule cannot be used, however, for a fringe benefit that is a transfer of tangible or intangible personal property of a kind normally held for investment, or a transfer of real property.

**Conformity rules.** Use of the special accounting rule is optional. You can use the rule for some fringe benefits but not others. The period of use need not be the same for each fringe benefit. However, if you use the rule for a particular fringe benefit, you must use it for all employees who receive that benefit.

If you use the special accounting rule, your employee also must use it for the same period as you use it. But your employee cannot use the special accounting rule unless you do.

You do not have to notify the IRS if you use the special accounting rule. You may also, for appropriate reasons, change the period for which you use the rule without notifying the IRS. But you must report the income and deposit the withheld taxes as required for the changed period.

**Special rules for highway motor vehicles.** If an employee uses the employer’s vehicle for personal purposes, the value of that use must be determined by the employer and included in the employee’s wages. The value of the personal use must be based on fair market value or one of three special valuation rules:

- The automobile lease valuation rule.
- The commuting valuation rule (for commuting use only).
- The vehicle cents-per-mile rule.

See Pub. 535 for information on these special valuation rules.

**Election not to withhold income tax.** You can choose not to withhold income tax on the value of an employee’s personal use of a highway motor vehicle you provided. You do not have to make this choice for all employees. You can withhold income tax from the wages of some employees but not others. You must, however, withhold the applicable social security and Medicare taxes on such benefits.

You can choose not to withhold income tax by:

1) Notifying the employee as described below that you choose not to withhold and

2) Including the value of the benefits in boxes 1, 3, 5, and 12 on a timely furnished Form W-2. For use of a separate statement in lieu of using box 12, see the Instructions for Forms W-2 and W-3.

The notice must be in writing and must be provided to the employee by January 31 of the election year or within 30 days after a vehicle is first provided to the employee, whichever is later. This notice must be provided in a manner reasonably expected to come to the attention of the affected employee. For example, the notice may be mailed to the employee, included with a paycheck, or posted where the employee could reasonably be expected to see it. You can also change your election not to withhold at any time by notifying the employee in the same manner.

**Amount to report on Forms 941 and W-2.** The actual value of fringe benefits provided during a calendar year (or other period as explained under Special accounting rule earlier) must be determined by January 31 of the following year. You must report the actual value on Forms 941 and W-2. If you choose, you can use a separate Form W-2 for fringe benefits and any other benefit information.

Include the value of the fringe benefit in box 1 of Form W-2. Also include it in boxes 3 and 5 if applicable. Show the total value of the fringe benefits provided in the calendar year or other period in box 12 of Form W-2. If you provided your employee with the use of a highway motor vehicle and included 100% of its annual lease value in the employee’s income, you must also report it separately in box 12 (or provide it in a separate statement). If there is not enough space on the Form W-2, you must report the value to the employee on a separate schedule so that the employee can compute the value of any business use of the vehicle.

If you use the special accounting rule, you must notify the affected employees of the period in which you used it. You must give the notice at or near the date you give the Form W-2 but not earlier than with the employee’s last paycheck of the calendar year.