

STATE CONTROLLER'S OFFICE  
PERSONNEL AND PAYROLL SERVICES DIVISION  
P.O. BOX 942850  
SACRAMENTO, CA 94250-5878

DATE: April 18, 2013

PAYROLL LETTER #13-007

TO: All Agencies/Campuses in the Uniform State Payroll System

FROM: Lisa Crowe, Chief  
Personnel and Payroll Services Division (PPSD)**RE: INTERNAL REVENUE SERVICE AUDIT – TAX YEARS 2008 AND 2009**

PLEASE PROVIDE THIS INFORMATION TO ALL ACCOUNTING, PAYROLL, AUDIT, AND LEGAL STAFF

The IRS completed an audit of the State of California's compliance with the employment tax provisions of the Internal Revenue Code for tax years 2008 and 2009 for two issues: Fringe Benefit - Employer Provided Vehicles, and; Settlement Awards - Lawsuit Awards and Settlements.

The following information summarizes the IRS findings regarding departments' errors processing these items and provides information for correct treatment:

**Fringe Benefit - Employer Provided Vehicles**

IRS rules state, "If an employer provides a vehicle that is used exclusively for business purposes and substantiation requirements are met, there are NO tax consequences or reporting required. The use is treated as a working condition fringe benefit. Business use does not include commuting.... Employees should maintain records to substantiate what portion of the vehicle use was for business use. If records are not provided by the employee, the value of all use of the vehicle is treated as wages to the employee."

Unsubstantiated business use of a State owned vehicle resulted in \$21,328.07 of unreported employer provided fringe benefit income and \$5,950.53 of unreported employee and employer taxes. The agencies identified resolved these discrepancies.

**Settlement Awards – Lawsuits Awards and Settlements**

IRS rules state, "requirements for a settlement recovery to be excludable from gross income: (1) it must be based on tort (civil wrong, where a person's behavior has unfairly caused someone else to suffer loss or harm) or tort type rights and; (2) it must be received "on account of personal injuries or sickness". If settlement proceeds are not allocated in a manner excludable from gross income then the proceeds are taxable. Any unallocated amount should be considered wages and paid via the Uniform State Payroll System.

Settlement agreements that did not allocate the proceeds of the damages that were awarded resulted in \$104,140.18 of unreported income and \$42,077.31 in unpaid taxes. The State Controller's Office resolved these discrepancies.

For concerns regarding Fringe Benefit compliance or the Internal Revenue Service audit, contact Jennifer Rocco at [jrocco@sco.ca.gov](mailto:jrocco@sco.ca.gov). For assistance with payroll related issues call the Customer Contact Center at (916) 372-7200.

LC:JD:TSS