

Nominal Fee

A nominal fee cannot be a substitute for compensation or tied to productivity. In FLSA2005-51 (November 10, 2005), the DOL said a fee paid by a school district to a volunteer coach is likely to be nominal if it does not exceed 20% of the prevailing wage for a job and there is no incentive pay for participation in playoffs or tournaments or for winning championships.



Practitioner Note Source of 20% Rule

Child labor legislation defines the term *occasional and incidental* as no more than one-third of an employee's work time in any workday and no more than 20% percent of an employee's work time in any workweek [29 U.S.C. § 213(c)(6)(G)]. The DOL applied a similar 20% rule in determining whether a stipend paid to a volunteer is nominal.

The prohibition against a stipend being tied to productivity does not preclude paying a nominal amount on a per call or similar basis to volunteer firefighters. Whether an amount is nominal depends on the distance the volunteer travels and the time and effort he or she expends, whether the volunteer has agreed to be available around-the-clock or only during certain specified time periods, and whether the volunteer provides services as needed or throughout the year.



Practitioner Note Payments Can Be Taxable Wages

Although DOL rules determine whether the minimum wage and overtime laws apply to an individual's activities, they do not change the federal tax treatment of payments made to volunteers, which may be subject to social security and Medicare taxes as well as income taxes under the usual rules for compensation.

The SSA explains in its operations manual that regardless of being termed a volunteer, when a worker receives payments and an employer-employee relationship exists (under the common law rules), his or her pay is wages subject to social security and Medicare tax.

Example 13.25 Volunteer Firefighter

Karl Kendall is a volunteer firefighter who is paid \$10 for each run and is also reimbursed for the cost of his protective clothing. In 2013 Karl received \$520 for going to 52 fires plus a \$300 clothing allowance. Karl is a volunteer under the DOL rules because \$520 is a small percentage of an employee firefighter's pay and the clothing amount is an expense reimbursement. However, the fire department has the right to direct and control his work, so he is a common law employee (albeit low-paid).

Question 1.

How much, if any, of the funds Karl received is taxable?

Answer 1.

The \$300 reimbursement is not taxable if it is paid to him under an accountable plan. Reimbursements that are unsubstantiated are taxable wages. The \$520 is not based on the actual expenses Karl incurs, so it is taxable wages. Karl's mileage to and from the fires qualifies as an out-of-pocket expense for a charitable deduction (14¢ per mile for 2013 or actual vehicle expenses) on Schedule A (Form 1040), Itemized Deductions.

Question 2.

Will Karl receive any type of information document that reports his earnings?

Answer 2.

The fire department must issue a Form W-2, Wage and Tax Statement, reporting the \$520 and any part of the \$300 that Karl did not substantiate as spent for protective clothing as taxable wages. The department is required to withhold and pay social security and Medicare taxes on the taxable amount. Income tax withholding is based on Karl's completion of Form W-4, Employee's Withholding Allowance Certificate.



Practitioner Note Online Resources

More information about payments to firefighters is accessible on the SSA and IRS websites:

- “Employment Status of Volunteer Firefighters,” SSA POMS RS 02101.260, is at <https://secure.ssa.gov/poms.NSF/1nx/0302101260>.
- “Issues for Firefighters” is at www.irs.gov/Government-Entities/Federal,-State-&-Local-Governments/Issues-for-Firefighters.



Observation Volunteer Protection Act

If an organization or government agency does not provide liability insurance for its volunteers, the volunteers must be aware of their personal liability potential if they receive stipends of more than \$500 per year.

The Volunteer Protection Act of 1997 (VPA), Pub. L. 105-19, 42 U.S.C. §§ 14501–14505, generally protects a volunteer from liability for harm caused by the volunteer’s act or omission if the volunteer is acting within the scope of his or her responsibilities (unless the harm was caused by the volunteer’s willful or criminal misconduct; gross negligence; reckless misconduct; or a conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer).

That protection does not apply if the volunteer receives a taxable benefit that exceeds \$500.

Meals and Lodging

I.R.C. § 119 excludes certain meals furnished by an employer from the employee’s gross income if the meals are furnished on the employer’s business premises for the employer’s convenience. Lodging can be excluded from the employee’s income only if it is furnished on the employer’s business premises for the convenience of the employer **and** the employee is required to accept the lodging as a condition of employment.

Volunteers and interns are treated as employees for purposes of the meals and lodging exclusion. If the I.R.C. § 119 requirements are met, the FMV of the meals and lodging is not included in the recipient’s income. If the requirements are not met, the FMV is treated as compensation.

Example 13.26 Meals and Lodging

Lee Ann Lopez is a summer volunteer for a non-profit organization that repairs homes for needy individuals and families. Lee Ann works full-time coordinating the activities of volunteers who come for 1-week periods to work on the homes, making sure that the volunteers have the necessary supplies and equipment, and arranging their housing (generally cots provided in a church gym). Most of the volunteer groups bring supplies with them, but the organization also maintains a central warehouse with additional supplies.

The organization pays for Lee Ann’s room and board at a local college, and she also receives a \$500 stipend for her 8 weeks’ work. She had the option to receive a cash allowance and find her own lodging.

Question 1.

Is Lee Ann a volunteer under the DOL rules?

Answer 1.

Yes, she is. She is providing services to a non-profit organization that substantially exceed the value of the benefits she receives in return. However, the \$500 is taxable compensation subject to social security and Medicare tax withholding, and it must be reported on Form W-2.

Question 2.

Can Lee Ann exclude the cost of room and board from her income?

Answer 2.

She does not meet the qualifications to exclude the cost under I.R.C. § 119 because she has the option to receive cash compensation, neither the meals nor the housing is provided on the employer’s business premises, and staying there is not a condition for her volunteer position. However, if Lee Ann is away from her usual home, the cost could be excluded as business travel expense.

Question 3.

How is the FMV of Lee Ann’s room and board determined?

Answer 3.

The college has a fixed amount that it charges for summer housing. If someone who does not usually rent rooms provides free room and board for Lee Ann, comparisons are needed to determine the fair rental value.

Question 4.

What amount is taxable if Lee Ann is paid a room and board allowance?

Answer 4.

If Lee Ann is in travel status, the allowance is excludable if it does not exceed the federal per diem for the area. If Lee Ann has no other home, the allowance is taxable income reportable on Form W-2.

Special Rules

IRS Publication 525, *Taxable and Nontaxable Income*, provides special rules for certain volunteers.

Peace Corps

Living allowances received as a Peace Corps volunteer or volunteer leader for housing, utilities, household supplies, food, and clothing are tax-exempt, but the following allowances are taxable wages:

- Living allowances paid to a volunteer's spouse and minor children during volunteer leader training in the United States
- Living allowances designated as basic compensation that are intended to pay for personal expenses such as domestic help, laundry and clothing maintenance, entertainment and recreation, transportation, and other miscellaneous expenses
- Leave allowances
- Readjustment allowances or termination payments, when they are credited to the volunteer's account

Example 13.27 Readjustment Allowance

Gary Carpenter, a Peace Corps volunteer, receives \$175 a month during his period of service as a readjustment allowance to be paid to him in a lump sum at the end of his tour of duty. Although the allowance is not available to him until the end of his service, Gary must include this amount in his income on a monthly basis as it is credited to his account.

Volunteers in Service to America

Meal and lodging allowances paid to Volunteers in Service to America (VISTA) volunteers are treated as wages.

National Senior Service Corps

Amounts individuals receive for supportive services or reimbursements for out-of-pocket expenses incurred in volunteering for the following programs are excluded from income:

- Retired Senior Volunteer Program (RSVP)
- Foster Grandparent Program
- Senior Companion Program

Service Corps of Retired Executives

Amounts received for supportive services or reimbursements for out-of-pocket expenses from the Service Corps of Retired Executives (SCORE) are not included in income.

Volunteer Tax Counseling

Volunteers in the Tax Counseling for the Elderly (TCE) program may receive nontaxable reimbursements for transportation, meals, and other expenses incurred during training for or while actually providing volunteer federal income tax counseling.

Unreimbursed out-of-pocket expenses a volunteer incurs while taking part in the Volunteer Income Tax Assistance (VITA) program are deductible as a charitable contribution on Schedule A (Form 1040).

ISSUE 7: DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

The I.R.C. § 199 deduction provides a significant tax benefit for some taxpayers. For others, the benefit does not justify the cost of calculating it.

The domestic production activities deduction (DPAD) is limited to **employers with production activities within the United States**. For tax years beginning after 2009, the domestic production activities deduction equals the **smallest** of three amounts:

1. 9% of taxable income derived from a qualified production activity (QPAI)
2. 9% of adjusted gross income (AGI) for the tax year (for corporations, this is taxable income)
3. 50% of the Form W-2 wages paid by the taxpayer during the calendar year that ends with or within the tax year



Practitioner Note DPAD for Oil and Gas

For tax years beginning after 2009, the DPAD is reduced by 3% of the smallest of the following three amounts [I.R.C. § 199(d)(9)]:

- The taxpayer's oil and gas QPAI (including production, refining, transportation, and distribution)
- The taxpayer's QPAI
- The taxpayer's total taxable income

For some taxpayers, calculating the DPAD is quite simple. QPAI for a taxpayer who is engaged exclusively in the production of qualified property within the United States and who has no other source of income is likely to equal overall taxable income. If the taxpayer has a sizeable payroll, the DPAD is likely to be 9% of QPAI.

For other taxpayers, calculating the DPAD can be so complicated, time consuming, and expensive that the tax benefit does not justify the cost of calculating it. Figure 13.15 presents a flow chart to help tax practitioners determine whether a taxpayer may be eligible for a DPAD that is large enough to justify the cost of computing it.



Practitioner Note DPAD from Other Entities

If a taxpayer has more than one business, calculating the DPAD may be cost-justified for one business and not for another. If the taxpayer is an owner of a partnership, S corporation, or LLC taxed as a partnership or S corporation, and receives information on Schedule K-1 (Form 1065 or 1120S) about a DPAD that flows through from the entity to the taxpayer, it is relatively easy to calculate the flow-through DPAD on Form 8903, Domestic Production Activities Deduction. That calculation is likely to be cost-justified whether or not the taxpayer has a DPAD from another trade or business. A DPAD allocated to a member of an agricultural cooperative is even easier to report on Form 8903 and is almost always cost-justified.

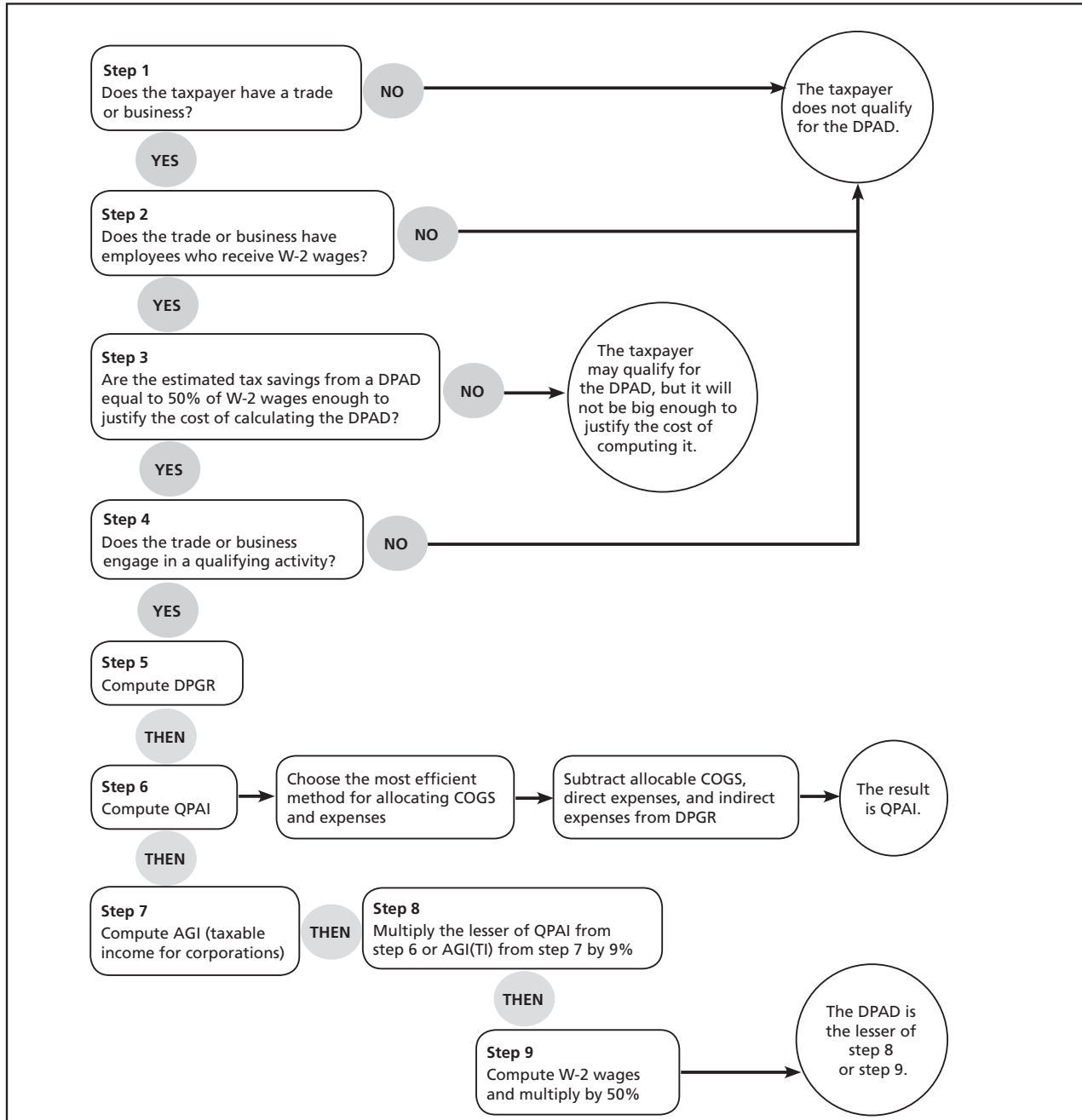


Cross-Reference DPAD Information

More detailed information about the DPAD is included in other chapters of this book and prior years' *National Income Tax Workbooks*:

- The "Construction Contractors" chapter of this book discusses and illustrates the DPAD for general contractors, subcontractors, builders, and developers.
- Pages 311–324 in the *2007 National Income Tax Workbook* provide a comprehensive discussion of the DPAD rules and examples that illustrate it, and pages 507–509 in the *2010 National Income Tax Workbook* update that material.
- Pages 478–488 in the *2007 National Income Tax Workbook* apply the rules to farmers.
- Pages 402–406 in the *2009 National Income Tax Workbook* discuss the DPAD rules for agricultural cooperatives and their members, and pages 457–459 in the *2010 National Income Tax Workbook* update that material.

FIGURE 13.15 Flow Chart for DPAD



Footnotes

Step 1. I.R.C. § 199(d)(5) limits the DPAD to only items attributable to the actual conduct of a trade or business. See also Treas. Reg. § 1.199-8(c)(1). The taxpayer does not have to personally participate in the business; qualifying for the I.R.C. § 162 deductions is sufficient.

Step 2. I.R.C. § 199(b)(2) defines “W-2” wages as amounts that meet all of the following requirements:

1. They are paid by the taxpayer during the year.
2. They are attributable to domestic production.
3. They are reported to the Social Security Administration on or before 60 days after the due date of Form W-2.
4. They are either:

a. Subject to income tax withholding under I.R.C. § 3401(a). Wages not subject to withholding and therefore *excluded* from W-2 wages include:

- i. Wages paid in kind for agricultural labor [I.R.C. §§ 3121(a)(8)(A) and 3401(a)(2)]
- ii. Wages paid for agricultural labor to a child (under age 18) of the proprietor or to a child (under age 18) who is the child of all the partners in a partnership [I.R.C. §§ 3121(a)(8)(A) and (b)(3) and 3401(a)(2)]

b. Elective deferrals such as employer contributions to 401(k) plans, SEPs, 403(b) plans, or SIMPLEs [I.R.C. § 402(g)(3)]; compensation deferred under I.R.C. § 457

FIGURE 13.15 Flow Chart for DPAD (continued)

Step 4. Qualifying activities are:

1. Leasing, renting, selling, exchanging, or otherwise disposing of:
 - a. Tangible personal property, computer software, or sound recordings, if they are manufactured, produced, grown, or extracted (MPGE) in whole or significant part in the United States. I.R.C. § 199(c)(4) defines this as **qualified production property (QPP)**.
 - b. Films that are not sexually explicit, if at least 50% of the total compensation for production is compensation for specified production services performed in the United States
 - c. Electricity, natural gas, or potable water produced by the taxpayer in the United States
2. Constructing or substantially renovating real property in the United States, including residential and commercial buildings and infrastructure such as roads, power lines, water systems, and communications facilities
3. Performing engineering and architectural services in the United States that relate to construction of real property
4. Exceptions
 - a. Sale of food and beverages prepared by the taxpayer at a retail establishment
 - b. Transmission or distribution of electricity, natural gas or potable water
 - c. Gross receipts from leasing, licensing, or renting property to a related party. For purposes of this provision, related parties are defined as the following:
 - i. Corporations that are members of a controlled group
 - ii. Other trades or businesses that are under common control
 - iii. Members of an affiliated service group

Step 5. Domestic production gross receipts (DPGR) are gross receipts from qualifying activities

Step 6. To compute QPAI, a taxpayer must subtract costs of goods sold (COGS) and other expenses that are attributable to DPGR from the amount of DPGR. The final regulations provide four methods for making this allocation, discussed next. The more exact method may produce a bigger DPAD, but it may not increase the tax savings enough to justify the extra time (and therefore cost) of using that method.

1. Safe harbor method

All of a taxpayer's gross receipts may be treated as DPGR if less than 5% of the taxpayer's total gross receipts are non-DPGR [Treas. Reg. § 1.199-1(d)(3)]. If the taxpayer uses that safe harbor, then all expenses must be deducted from DPGR to calculate QPAI, which avoids the need to allocate cost between DPGR and non-DPGR. This safe harbor may decrease QPAI by increasing expenses that must be deducted, but the simplification of the QPAI calculation may justify the reduced QPAI and the resulting decrease in the DPAD.
2. Small business simplified overall method

Under this method, COGS and deductions can be ratably apportioned between DPGR and other receipts based on relative gross receipts [Treas. Reg. § 1.199-4(f)]. Qualifying taxpayers are

 - a taxpayer that has average annual gross receipts of \$5,000,000 or less;
 - a taxpayer engaged in the trade or business of farming that is not required to use the accrual method of accounting under I.R.C. § 447; and
 - a taxpayer that is eligible to use the cash method as provided in Rev. Proc. 2002-28, 2002-1 C.B. 815 (certain taxpayers with average annual gross receipts of \$10,000,000 or less that are not prohibited from using the cash method under I.R.C. § 448, including partnerships, S corporations, C corporations, or individuals).

3. Simplified deduction method

Deductions (but not COGS) can be ratably apportioned between DPGR and other receipts based on relative gross receipts [Treas. Reg. § 1.199-4(e)]. Qualifying taxpayers are:

- A taxpayer that has average annual gross receipts of \$100,000,000 or less
- A taxpayer that has assets that are \$10,000,000 or less

4. Other methods

- Treas. Reg. § 1.199-4(b)(2)(i) allows taxpayers to use any reasonable method of allocating COGS between DPGR and other gross receipts. Any taxpayer can use this method.
- Treas. Reg. § 1.199-4(c)(1) requires taxpayers who do not qualify for the small business simplified overall method or the simplified deduction method to allocate other expenses using the method set out in I.R.C. § 861 for allocating income from sources within the United States. Any taxpayer can choose to use this method.

Step 9. Methods for computing W-2 wages

Because no single box on Form W-2 satisfies the definition of W-2 wages under I.R.C. § 199(b)(2), Rev. Proc. 2006-22, 2006-22 I.R.B. 1033, provides three options for calculating W-2 wages only for purposes of I.R.C. § 199. The first option is a simplified calculation, while the other two provide greater accuracy.

1. Unmodified box method

An employer may use the lesser of the total entries in box 1 or in box 5 of all Forms W-2 filed with the Social Security Administration.

2. Modified box 1 method

An employer may modify the amounts reported in box 1 of the Forms W-2 by:

- a. Subtracting both amounts that are not subject to federal income tax withholding and amounts that are treated as wages under I.R.C. § 3402(o). Amounts treated as wages under I.R.C. § 3402(o) include:
 - i. Supplemental unemployment compensation benefits paid under a plan because of the employee's involuntary separation from employment due to a reduction in workforce or other similar condition
 - ii. Pension or annuity payments for which a withholding request is in effect
 - iii. Sick pay benefits paid under a plan to which the employer is a party in lieu of remuneration for any period the employee is temporarily absent from work on account of sickness or personal injury and, at the time the payment is made, a withholding request is in effect
- b. Adding elective deferrals reported in box 12 of Form W-2 with codes D [an I.R.C. § 401(k) arrangement], E [an I.R.C. § 403(b) arrangement], F [an I.R.C. § 408(k)(6) salary reduction SEP], G [an I.R.C. § 457(b) arrangement], and S [an I.R.C. § 408(p) SIMPLE]

3. Tracking wages method

An employer may track the actual amount of wages subject to federal income tax withholding and then modify it by

- a. subtracting supplemental unemployment compensation benefits paid under a plan because of the employee's involuntary separation from employment due to a reduction in workforce or other similar condition; and
- b. adding elective deferrals that are reported in box 12 of Form W-2 with codes D [an I.R.C. § 401(k) arrangement], E [an I.R.C. § 403(b) arrangement], F [an I.R.C. § 408(k)(6) salary reduction SEP], G [an I.R.C. § 457(b) arrangement], and S [an I.R.C. § 408(p) SIMPLE].