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May 28, 1993

To: Members of the Committee on Administrative Policies

From: The Committee Secretary

Subject: Simplification of the Procedures for Payment of Tax Equivalency Allowances for Spouse and Dependent Children

There is attached for consideration by the Committee a paper on the simplification of the procedures for payment of tax equivalency allowances for spouse and dependent children. In the absence of a request to the Committee Secretary by noon on Friday, June 11, 1993, that this matter be considered in Committee, the draft decision that appears on pages 5 and 6 will be deemed approved by the Committee for submission to the Executive Board on a lapse of time basis.

Mr. Gehringer (ext. 37046) or Mrs. Chung (ext. 37382) is available to answer questions relating to this paper.

Att: (1)

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INTERNATIONAL MONETARY FUND

Simplification of the Procedures for Payment of
Tax Equivalency Allowances for Spouse and Dependent Children

Prepared by the Administration Department
(in consultation with the Treasurer's Department)

Approved by Graeme Rea

May 28, 1993

1. Introduction

As part of the continuing effort to simplify the administration of benefits, this paper puts forward for consideration by the Committee on Administrative Policies some specific proposals to simplify the procedures for payment of tax equivalency allowances. 1/

2. Present policy and procedures

a. Present policy. The tax equivalency allowances for spouses and children are paid because most national tax systems differentiate among individuals according to their marital status and the number of their dependents. To account for this in the Fund's net-of-tax salary system, Tax Equivalency Allowances are paid separately to qualifying staff members for their spouses and children. Each year, a staff member whose spouse's income does not exceed \$30,000 per annum gross is entitled to receive tax equivalency allowances of 5 percent of salary, up to a maximum of \$3,500 for his spouse, and \$600 for each eligible child. 2/ If the spouse's income exceeds the ceiling, the tax equivalency allowances for the spouse and the children are reduced in accordance with an established formula. If a staff member has no spouse, but has eligible children, he is entitled to receive for one child the allowance which would have been payable for his spouse, and \$600 for each additional child.

b. Present procedures. At the beginning of a calendar year, a staff member whose spouse is employed is required to state the estimated earned

1/ Earlier papers dealing with the simplification of benefits were "The Simplification of Benefits (EB/CAP/92/9, 8/19/92) and "Simplification of Home Leave Policy" (EB/CAP/93/1, 3/30/93, and Supplement 1, 4/13/93).

2/ For brevity, the masculine pronoun has been used throughout this document. However, the provisions set out in this document are gender neutral.

income of the spouse when applying for the tax equivalency allowances for the year. Based on this figure, the Payroll Unit calculates the estimated entitlement to the allowances for the spouse and children. The annual estimated entitlement is divided into equal fortnightly installments and included in each paycheck throughout the year. When a staff member's salary is increased, the estimated entitlement to the allowances is recalculated to reflect the higher income. If the spouse's income changes during the year, the staff member is required to report the change, and the Payroll Unit again recalculates a new estimated entitlement based on the new estimate of the spouse's income.

At the beginning of the following calendar year, the application process is repeated. At this time, staff members are also required to report the actual earned income of the spouse during the previous calendar year. If the spouse's actual income exceeded the established ceiling for unreduced maximum allowances, a supporting document, normally a copy of the Wage and Tax Statement (W-2 Form), must be submitted. Using the actual earned income of the spouse reported by the staff member, the Payroll Unit calculates the staff member's actual entitlement for the past year, and pays or collects the necessary adjusted amount. The entitlement for the present year is again calculated on the basis of the estimated income of the spouse indicated on the new application.

The procedures described above are repeated every year.

c. Problems of administration. There are two main sources of administrative complication in the present methods of implementing the policy on tax equivalency allowances. First, the "allowances year" is on a calendar-year cycle, whereas most of staff members' salary increases are on a financial-year cycle. Second, although the allowances are paid throughout the year, the actual entitlement is determined on the basis of the actual earned income of the spouse for the same calendar year, which means that it cannot be conclusively determined until the end of the calendar year. This results, therefore, in an ongoing burden of processing amendments, and changing the amounts being paid to reflect changes in the Fund salaries of staff members and in the income of the spouse. Further retroactive adjustments are required at the start of the subsequent year when it is established that the actual spouse income differed from the estimate provided at the start of the prior year. ^{1/} These procedures require a significant effort in the Benefits Administration Section and in the Payroll Unit.

3. Main features of the proposed changes

Short of eliminating the spouse's income in determining a staff member's entitlement to these allowances, the most far-reaching way to

^{1/} The changes in spouse and children's allowances that result from income changes also create complications in the administration of the tax allowance system for U.S. staff.

simplify the payment procedures and reduce the burden of administering them would be to provide the allowances in the form of a single lump-sum payment after the end of the calendar year, when the actual incomes of both the staff member and the spouse have been conclusively determined. However, many staff are likely to object to this change as effectively reducing their net fortnightly take-home pay, in an amount which--at least for the lower-paid staff--is not insignificant. A less radical approach therefore seems preferable.

Under this approach, it is proposed (i) to change the "allowances year" from the calendar year to the Fund's financial year (i.e., May 1 through the next April 30), and (ii) to use the previous year's actual earned income of the spouse for determination of current year's entitlement. For example, the spouse's actual earned income for 1993 would be used as the basis for the allowances in the period May 1, 1994 through April 30, 1995; and the staff member's salary, in the great majority of cases, would be the level established as of May 1, 1994, which would typically remain unchanged through to April 30, 1995.

The effect of this proposal would be to eliminate, to the maximum extent possible, (i) the adjustments resulting from changes in staff members' salaries and spouse income in the course of the year, and (ii) the adjustments that result from differences between estimated and actual spouse income. Specifically, the Benefits Administration Section would no longer need to process any amendments of spouses' income during the year, while the Payroll Unit would be relieved from the burden of making adjustments to reflect differences between estimated and actual spouse income, as well as the need to make most of the recalculations that arise at present as a result of changes in the salaries of staff members and in spouse income during the year.

The costs of this change are expected to be negligible. It is expected that it will save a total of about one half of a man-year in the Payroll Unit of the Administrative Expenditures Division and in the Benefits Administration Section of the Staff Benefits Division. Although this savings may seem small, there will be additional benefits resulting from a more even spread of work throughout the year; at present, considerable resources have to be concentrated on the administration of allowances in the first four months of the year, and this peak workload is detrimental to the efficiency with which other work can be dealt with.

As regards the effects on staff members, there will be a delay in the adjustment of their allowances compared with the present system. For a staff member whose spouse's earned income increases, the consequential downward adjustment of the allowances will be delayed. For a staff member whose spouse's earned income is reduced or eliminated, there will be a delay

before the consequential increase in the allowances is implemented. 1/ These delays in adjustments are not expected to affect appreciable numbers of staff in a significant way, nor is it expected that there will be any more than minor effects on costs, either upwards or downwards.

4. Other streamlining proposals

a. Verification of spouse's income. Under the present policy, staff members who report that their spouses' earned income is less than \$30,000 gross per annum are not required to submit a supporting document. However, staff members who report that their spouse's earned income is more than this amount must submit a supporting document showing the exact level of income. There is a certain anomaly in this procedure. It is often characterized as "penalizing honest staff," and "encouraging staff to underreport their spouses' income." For equity and consistency, therefore, it is proposed that in future a staff member applying for allowances should always be required to state the specific level of spouse income and certify the accuracy of that statement, regardless of the amount. No other documentation would be required as a matter of course, but each staff member would need to be prepared to submit documents proving the accuracy of his declaration of the spouse's earned income, if called on to do so. The documentation could be a copy of the W-2 Form, an employer's certification, a copy of federal income tax return, or any other available material which could support the declared amount. Staff members who declare that their spouse has no earned income must be prepared to provide the Fund with a release so that, if the Fund chooses, an enquiry can be directed to the IRS to confirm the accuracy of the declaration.

b. Eligibility tests for staff members' natural children. Under the present system, staff members' natural children under 19 years of age are entitled to a tax equivalency allowance and other benefits without having to meet any other tests. 2/ However, staff members' natural children between the ages of 19 and 23 must meet certain criteria to be eligible for benefits. 3/ They must (i) not have an income that exceeds the established ceiling (\$8,000 for 1993: the amount is indexed), unless they are full-time students--when a subsidiary test is applicable; (ii) not be married; and (iii) reside with the staff member.

Of the three tests, the income test is reasonably clear. As regards the second test--whether the child is married--a few staff members have questioned the criterion on the grounds that some children in this age

1/ If a spouse's earned income remains less than \$30,000, a change in that income would in any event not trigger a change in the staff member's entitlement.

2/ The policy approved by the management governing eligibility for staff members' legally adopted children or step children may be obtained from the Benefits Administration Section of the Administration Department.

3/ Eligibility for all benefits ceases when a child reaches his 24th birthday except those handicapped as defined by the Medical Benefits policy.

bracket who marry are students and remain dependent on parental support. Nevertheless, the test is clear, and it is not proposed to change it. It is the third test, that of residency, that presents the most awkward administrative complications. A number of children in this age bracket attend schools and universities only intermittently. Many choose to live away from their family home and find whatever job is available to them. Often the income they earn, even with a full-time job, is not sufficient to support themselves, and they continue to receive major support from their parents; but because they do not meet the test of residing with the staff member, they are not eligible for any benefits. The test of residency itself is not a very satisfactory one, because it is very difficult for the administrative staff to determine the veracity of a staff member's claim that an older child is residing at home.

To address these problems at minimal cost to the Fund, it is proposed that the residency test be abolished in determining eligibility for benefits for staff members' natural children between the ages of 19 -23. Unmarried children in this age group with incomes below the stipulated ceiling would be eligible for the tax equivalency allowance and all other benefits. Unmarried children with incomes over the stipulated ceiling would be ineligible for the tax equivalency allowance or other benefits, unless the staff member certified, and could document upon request, that the child received more than half his annual support from the staff member. 1/ Regardless of the child's income level, if required to do so, staff members should be prepared to submit a verification of the child's income, or a release enabling the Fund to direct an enquiry to the IRS to confirm the accuracy of the declaration. Upon reaching 24th birthday, or on the date of marriage, whichever comes first, children in this age bracket will lose eligibility for benefits.

The cost of this change in eligibility is expected to be negligible. It will, however, reduce the numerous conflicts that arise in respect of the residency test.

5. Proposed decision

The following draft decision is proposed for adoption by the Committee on Administrative Policies:

The Committee on Administrative Policies recommends that the Executive Board adopt the following decision regarding changes in the procedures for payment of tax equivalency allowances and in the eligibility criteria for tax equivalency allowances and other benefits for which children are eligible.

1/ Support received from other sources, e.g., allowances from the employer of the other parent, or school stipends, would not be considered as support from the staff member.

The policy regarding tax equivalency allowances shall be changed as follows:

- a. The Fund's financial year will be used as the basis for adjustment of the base of tax equivalency allowances.
- b. The spouse's actual earned income during the previous calendar year will be used to determine the staff member's entitlement to the tax equivalency allowances for the financial year commencing after the end of that calendar year.
- c. The staff member's certification of spouse's earned income will be accepted, provided that the staff member may be required to verify the accuracy of the certification.
- d. The benefits eligibility criteria for staff members' children between 19 and 23 years of age will be changed as follows: these children will be eligible for benefits so long as the child is unmarried and the child's income is below the stipulated ceiling. Unmarried children with incomes over the ceiling will be ineligible for benefits unless the staff member certifies that the child received more than half his annual support from him. Staff members may be required to verify the accuracy of the certification regarding the children's income and the support level provided to them by the staff member.