

Withholding Taxes

Chapter 6

CPP Study Class

2017

American Payroll
Association

Los Angeles
CHAPTER

Actual Payment and Constructive Receipt (Establishing payroll liability date)

- Actual Payment – The date an employer provides the employee payment of wages
- Constructive Receipt – The date an employee is considered to have been paid wages, when the wages have been made available to the employee without ‘substantial limitation or restriction’

Examples of Actual Payment and Constructive Receipt

- Check sent via mail
 - **NOT** 'constructively' paid once check is sent
 - Wages are not considered available until the EE receives the check (example of mail delay)
- Postdating or backdating checks- Focus on date provided to employee
- Year-end concerns - Payments not constructively or actually received in current calendar year will be reported in following calendar year

Social Security Numbers

- Form W-4, validate name and SSN on SSN card
- Employers may photocopy the SSN card to ensure accuracy NOT verify employment
- Invalid numbering sequences
 - SSNs beginning with number “9”
 - SSNs with the number ‘666’ or ‘000’ in positions 1-3
 - SSNs with the number ‘00’ in positions 4 & 5
 - SSNs with the number ‘0000’ in positions 6 through 9
 - SSN with the number ‘123-45-6789’
- Verification via SSNVS using BSO (Bus. Svc Online)

Social Security Numbers

- Employee name change due to marriage or divorce requires proof before changing on payroll system
- SSN is required even if the employee claims exempt

Federal Form W-4

- Submitted-on or before 1st day of work
- Federal requirement for W-4 to be effective
 - New employee: First payroll after form is filed
 - Current employee: First payroll period ending 30 days after W-4 submitted
- W-4 indicates marital status and withholding allowances
 - Allowance: reduction of wages subject to FITW
 - Exempt status: must submit annual W-4 before Feb 15
 - NRAs must submit an annual W-4 Form
- Reject W-4 if A) Altered; B) Unsigned; C) Substitute form created by employee or C) employee admits providing false information
 - Payroll would then default to Single and zero

Federal Form W-4 (cont'd)

- ER no longer submits W-4 with over 10 allowances or W-4 claiming exempt to IRS (only send W-4 to IRS upon request or IRS published guidance)
- Lock-in letters – IRS demand max number of allowances an employee may claim
 - Employers required to implement change within 60 days of letter date
 - Employers may honor subsequent W-4 changes resulting in higher withholding than Lock-In Letter
 - Employees desiring withholding less than Lock-In Letter must seek approval directly from IRS
- Employee's Form W-4 must be kept for 4 years after the employee's personal tax return was due

Federal Form W-4 (cont'd)

- Successor employer can use existing W-4 of transferred employees (Alternate Procedure)
- Electronic filing of a W-4 permitted – several requirements to be approved including authentication of employee's electronic signature
- W-4 information used for new hired reporting
- W-4P used for pension & annuity pymts
- W-4S used for sick pay paid by 3rd party
- Some states require the use of their W-4

Methods of FITW

- **Wage-Bracket Method-** Tables summarized according to payroll period and marital status to derive withholding based on employee's wage-bracket (typically manual checks). Wage limit for calculating tax, thus must resort to Percentage Method.
- **Percentage Method** – Tables include quarterly, semi-annual, and annual payroll periods. Able to compute tax liability regardless of the amount of wages paid.
- **Alternatives:** Annualized Wage, Average Estimated Wages, Cumulative Wages, and Part-year employment
- **Supplemental Wage Payments**
 - Flat
 - Aggregate

Wage-Bracket Method

- Find table for the payroll period and marital status
- Determine EE's wages subject to FITW (take out pretax deductions)
- Locate the wage brackets in the first 2 columns
- Move to the right using exemptions from W-4
- Add extra \$ from W-4 if needed
- Example pg 21

Percentage Method

- Find the number of w/h allowances (from W-4) in the IRS Table
- Locate the column with the payroll period to find the value of the allowances
- Determine the EE's wages subject to FITW by reducing the gross wages by pre-tax deductions
- Subtract the value of the w/h allowances from EE's wages
- Locate the table for the EE's payroll period and marital status
- Use the formula detailed in the table to calc the w/h tax
- Add extra amounts from W-4
- Example pg 23

Alternative Withholding Methods

- Annualize the wages and use the percentage method, see example pg 24
- Average estimated-usually estimated over a quarter, for tipped employees, true up by 30 days after quarter close.
- Cumulative wages-used for commissioned employees, see example pg 24
- Part-year employment-see pgs 25

Supplemental Wage Withholding

- NOT PART OF ORDINARY WAGES
- Can be paid at the same time or separately from regular wages
- Examples:
 - Bonus, prize, commission
 - Back or retroactive pay
 - OT
 - Severance
- TAX REQUIREMENTS
 - If combined with regular wages, and the amt is not clearly indicated, treated like a regular wage pymt
 - If paid separately, the employer MAY use the 25% supplemental rate
 - For Supplemental pymts over \$1,000,000 rate is 39.6%

Supplemental wage withholding (cont'd.)

- Aggregate

Note: If EE had no w/h from regular wages due to number of allowances, ER must use the aggregate method

- See example 2, pg 27

- State supplemental rates vary, see pg 33

Withholding on Pensions and Annuities

- Method depends on type of pymt:
 - Periodic-if made over more than 1 year, withhold as if payment is 'wages' using a W4P
 - Non-periodic-subject to 10% withholding if not eligible to rollover to a qualified plan (if the amount is at least \$200)
- If no W4P has been filed, use M and 3
- Can't claim exempt if:
 - Pymts are mailed to an address outside of the US
 - Recipient hasn't given an address
 - Recipient hasn't given a SSN or gave a 'bad' one

Withholding on Pensions and Annuities (cont'd.)

- Eligible Rollover distributions
 - If not rolled into a qualified plan, subject to 20% withholding (\$200 get out of jail free pass)
 - Reported on a Form 945

Backup Withholding

- Payments for independent contractors, dividends, interest, etc. which require 1099 reporting, require a completed Form W-9 by the payee
- Backup withholding of 28% required if the payee fails to provide a TIN (usually on a W9)
- IRS can issue “B” notice requiring backup withholding from any payments to 1099 recipients

Report the taxes on Forms 945

Advance Earned Income Credit

- Employers are required to notify employees earning less than \$52,427 a year that they may be eligible for the EIC on their personal income tax return via:
- W-2 (required notice is on the back)
- Copy of Notice 797 or written statement with same exact wording
- Seven states require notification to all of their employees

FICA – Social Security and Medicare

- Social Security – **6.2%** of \$127,200 (note: in 2011 and 2012, employee withholding reduced to 4.2%)
- Medicare (HI Tax) -1.45% on all wages; an additional 0.9% required for any employee earning in excess of \$200K of Medicare wages
- Employees working for more than one ER
- Statutory Employer consideration
- Successor Employer

Common Paymaster

- Common Paymaster reduces FICA tax
- Must be:
 - Related corporations (must meet one below)
 - Part of a 'controlled group' ie one corp owns 50% of the other's stock the same 5 or fewer people own at least 50% of the stock of each corp
 - 50% of BOD are on all Corp's boards
 - 50% officers are concurrent
 - 30% of one corps EE's are concurrent*

*EE is providing separate services to 2 or more corps

- **NOT** Common Pay Agent- Administrative ease of filing less returns

Self Employment Tax

- Self employed individuals (independent contractors) must pay both halves of FICA
- 15.3% on the first \$127,200
 $6.2\% + 6.2\% + 2.9\% = 15.3\%$
- 2.9% on earnings over \$127.2K and below \$200K
- 3.8% on earnings over \$200,000

Social Security and Medicare Exemptions

- For type of wages considered exempt – see pg 47
- Exempt Employment
 - Temporary foreign agricultural workers
 - Son or daughter under age 18 working for parents
 - Services on foreign ship/aircraft outside US by non-US citizens for non-US employer
 - Enrolled students working for the school
 - Services for a foreign or international organization
 - Student nurses
 - Nonresident aliens working under F, J, M or Q visa
 - Work by small fishing crew (less than 10 workers) receive a share of catch
 - Domestic service by worker under age of 18