

# Withholding Taxes

## CHAPTER 6

2016 CPP Study Group



## **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 1<sup>st</sup> 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 3<sup>rd</sup> 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 \$118,500 (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 \$118,500  
 $6.2\% + 6.2\% + 2.9\% = 15.3\%$
- 2.9% on earnings over \$118.5K 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