



A more human resource.™

ADP Added Value Services

CPP Study Group

Participant Handout

Need support after training?

To exchange tips and best practices with fellow users, get on The Bridge—an online community built exclusively for ADP clients.

Copyright © 2016–2017 ADP, LLC



Just in Time. Just Enough. Just for Me.

Table of Contents

CPP Study Group.....	2
Section 1 – The Employer-Employee Relationship	3
Section 2 – Federal and State Wage-Hour Laws	15
Section 3 Part 1 – Taxable and Nontaxable Compensation	33
Section 3 Part 2 – Taxable and Nontaxable Compensation	46
Section 4 – Health, Accident, and Retirement Benefits	69
Section 5 – Paying the Employee	88
Section 6 – Withholding Taxes	94
Section 7 – Unemployment Insurance.....	114
Section 8 – Depositing and Reporting Withheld Taxes	125
Section 9 – Other Deductions From Pay	147
Section 10 – Recordkeeping and Record Retention	160
Section 11 – Payroll Accounting.....	169 168
Section 12 – Payroll Systems and Technology	184 183
Section 13 – Managing a Payroll Department.....	197 196
Section 14 – Payroll For U.S. Employees Abroad and Aliens in the U.S.....	213 212

Revised 01/27/2017

CPP Study Group

Welcome to the ADP CPP Study Group. The purpose of this study group is to assist you in preparing for the Certified Payroll Professional examination administered by the American Payroll Association. The exam questions should be answered based on Federal laws and regulations in effect as of 1/1/2017. Therefore, this document, as well as all other study materials will be focused on Federal information only. We will be using many tools and processes throughout the coming months to help you work towards certification and included in this document are the study notes for all fourteen chapters of The Payroll Source® (2017 edition).

Contact Us

For additional support regarding this topic, please contact: Debbie Mathewson, Added Value Services, Sr. Learning Specialist – (714)266-2441 -debbie.mathewson@adp.com or Rachelle Kepler, Added Value Services, Sr. Learning Specialist – (714)266-2449 – rachelle.kepler@adp.com

Proprietary Information and Legal Disclaimer

This document may contain information that is privileged, confidential or otherwise exempt from disclosure. It must not be copied, transmitted, or distributed in any form or by any means without the express written permission of ADP. ADP provides no guarantee regarding the accuracy of the referenced site, its contents, or this tutorial.

The information provided in this document is for informational purposes only and not for the purpose of providing legal, accounting, or tax advice. The information and services ADP provides should not be deemed a substitute for the advice of any such professional. Such information is by nature subject to revision and may not be the most current information available.

ADP and the ADP logo are registered trademarks of ADP, LLC. ADP A more human resource. is a service mark of ADP, LLC. All other marks are the property of their respective owners. Copyright (c) 2016-2017 ADP, LLC. All rights reserved.

Section 1 – The Employer-Employee Relationship

Objectives

- Determine the characteristics of a worker's status
- Define the differences between various types of employees and non-employees
- Explain the Common Law and Reasonable Basis Tests
- Understand the functions of Forms SS-8, 1099-MISC, and I-9
- Describe the penalty tier for worker misclassification

Importance of the Determination

The term “worker” is a very broad term and it is the employer’s responsibility to make the correct designation. An employer’s tax withholding and reporting obligations are contingent on proper classification of the worker. There are many types of workers that provide services to employers.

Under the Internal Revenue Code (IRC), an employer has the following obligations for employees:

- _____
- _____
- _____
- _____
- _____
- _____

Types of Workers

Overall, there are several types of workers that will be reviewed in this section. They are:

- Common Law Employee
- Independent Contractor
- Statutory Employee
- Statutory Nonemployee
- Temporary Help Agency Employee
- Leased Employee

Employee vs. Independent Contractor

It is often much less expensive for a business to use independent contractors to provide services because the taxing and reporting requirements are much less costly than they are for employees. So long as the independent contractor provides the employer with a valid _____, the employer's only obligations are to give the contractor a form _____ at the end of the year stating how much the contractor was paid for the services rendered if the total was at least \$_____.

_____ and _____ need not be withheld from an independent contractor's payments or matched by the employer. Also, no _____ or _____ taxes are required.

Because misclassification of workers as independent contractors rather than employees has led to substantial losses in revenue for the federal government and the failure to properly credit earnings for social security and unemployment benefit purposes, the IRS is focusing more resources in employment tax audits and on working with other federal and state agencies to discover instances of misclassification. Therefore, it is important that employers are familiar with the tests in determining whether a new hire is an employee or an independent contractor.

Common Law Test

While there is no uniform definition of an employee under all payroll laws, most workers can be classified as either employees or independent contractors once the "common law test" has been applied.

The key is the _____. Evidence of this can be grouped into three general types or categories.

- _____
Factors that determine the right to direct and control the details and means by which the worker performs the work to be done include:

- _____
- _____

- _____
Factors that determine whether the business has the right to direct and control the economic aspects of the worker's job include:

- _____
- _____
- _____
- _____
- _____

- _____
The factors that generally indicate how the worker and the business perceive their relationship include:

- _____
- _____
- _____
- _____
- _____

Reasonable Basis Test

Even though a worker meets the definition of an employee under the common law test, an employer may treat a worker as an independent contractor exempt from federal payroll tax laws if it has a "reasonable basis" for doing so, as determined by section 530 of the Revenue Act of 1978. The reasonable basis may consist of one or more of the following, as well as any other reasonable basis:

- Court decisions, published IRS rulings, IRS technical advice
- A past IRS audit of the employer that did not result in finding of taxes owed or a penalty attributable to the employer's treatment of the worker as an independent contractor; or
- _____
- _____

Other factors to consider when treating a worker as an independent contractor:

- Consistent treatment is a must
- Employer must actually rely on the safe harbor in making classification decision
- Notice of Section 530 must be provided by IRS
- IRS auditors must be “liberal” in applying Section 530

An employer can get a definitive ruling from the IRS as to a newly hired worker’s status as an employee or an independent contractor by completing _____. While waiting for the IRS to respond, the employer should treat the worker(s) in question as an _____.

Employment Status Determined by Law

The status of some workers is determined by law, specifically the Internal Revenue Code, regardless of what their classification would be under the common law or reasonable basis test. This means that some workers who would be considered independent contractors under one of these tests are nevertheless “statutory employees” for certain purposes. And some workers who would be considered employees under one of these tests are treated as “statutory nonemployees” under the IRC.

Statutory Employees

These workers are not employees under the common law, but are treated as employees for certain employment tax purposes. Payments made by an employer to statutory employees are not subject to _____ withholding, but are subject to withholding for _____ and _____ taxes. Also the employer must pay the employer’s share of social security and Medicare taxes and, in some instances, federal unemployment tax (FUTA). Statutory employees fall into four categories.

D _____ – must be engaged in distributing meat, vegetables, fruits, baked goods, beverages (other than milk), or laundry or dry-cleaning services. They must be paid on a commission basis, or the difference between the sales price of the goods or services and the price paid by the driver.

I _____ – their principal business activity must be selling life insurance and/or annuity contracts, primarily for one life insurance company. If the earnings of a full-time salesperson are only from commission, then the employer is exempt from paying _____.

S _____ – their principal business activity must be working full-time for the employer soliciting orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments who either resell or use the merchandise in their own businesses.

H _____ – must work away from the employer's premises, according to specifications provided by the employer, and with goods or materials provided by the employer that must be returned to the employer. The earnings of a homeworker who is not an employee under the common law test are not subject to _____ tax.

Statutory Nonemployees

Certain categories of workers may qualify as employees under the common law test, but are treated as independent contractors for federal income tax withholding, social security, Medicare, and FUTA tax purposes. Employers therefore do not withhold any of those taxes from the earnings of statutory nonemployees. There are two categories of statutory nonemployees

R _____
E _____ - _____

D _____
S _____ - _____

Companion Sitters (not referenced in the Payroll Source but mentioned in IRS Publication 15-A) Companion sitters are individuals who furnish personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled.

Temporary Help Agency Employees

To help with short-term staffing needs, many employers use workers hired through temporary help agencies.

What the temporary help agency does:

- _____
- _____
- _____

The client's obligation is to:

- _____
- _____

Although the client may have the right to refuse any worker sent by the agency or to request certain workers, these rights do not make the workers employees of the client company.

Leased Employees

Leasing employees from a leasing company is another way for employers to lower their payroll and benefits expenses. This is especially attractive to smaller businesses who may not be able to obtain low group health insurance rates.

The obligations for a leased employee are somewhat different from those for a temporary help employee.

What the leasing company does:

- _____
- _____
- _____

What the client company does:

- _____
- _____
- _____
- _____

These workers are employees of the leasing company, but if a client company retains greater control, they increase the likelihood that they may be considered the employer rather than the leasing company.

Employees Under Other Federal and State Laws

Fair Labor Standards Act

The federal Fair Labor Standards Act, also known as the federal wage-hour law, regulates the following:

- _____
- _____
- _____
- _____

The FLSA broadly characterizes an employee as any individual who works for an employer. Basically, the U.S. Department of Labor's Wage and Hour Division will find an employer-employee relationship where the worker is _____ on the employer.

State Wage-Hour Laws

While the Payroll Source addresses some state-level issues throughout, neither the Certified Payroll Professional (CPP) nor Fundamental Payroll Certification (FPC) will be testing on state-level information. In future sections of these study notes, the question of how to handle conflicts between federal and state law will be addressed.

Worker Misclassification: Enforcement and Penalties

Employers that misclassify employees as nonemployees or independent contractors face substantial financial penalties as the result of not withholding income tax, failing to withhold and pay employment taxes, and failing to file the correct reports and returns with the IRS, SSA, and state government agencies.

IRS Penalties

The Internal Revenue Code provides special reduced tax assessments when an employer unintentionally misclassifies an employee as an independent contractor. They are:

- _____

- _____
- _____

If an employer intentionally misclassifies the worker as an independent contractor after determining an employer-employee relationship exists, the assessments above do not apply and the employer is liable for

- _____
- _____

IRS Enforcement Efforts

The IRS uses several different programs in trying to detect worker misclassifications.

- The 1099 Matching Program targets individuals who file _____

- The IRS also will try to spot employees who _____

Classification Settlement Program for employers under examination

This IRS program, called the Worker Classification Settlement Program (CSP), allows examiners and businesses to resolve worker classification cases as early in the enforcement process as possible.

If the examiner finds that the business is wrongfully treating employees as independent contractors, one of two CSP settlement offers can be made.

- If the business has met the reporting consistency requirement, but has no reasonable basis for treating its workers as independent contractors, or has been inconsistent, the offer will be a full employment tax assessment
- If the business has met the reporting consistency requirement, and can reasonably argue that it met the reasonable basis and consistency of treatment tests, the offer will be an assessment of 25% of the employment tax liability for the audit year.

Voluntary Worker Classification Settlement Program

Employers can voluntarily reclassify workers as employees for federal employment tax purposes and obtain relief similar to that obtained in the Classification Settlement Program.

Some other noteworthy items related to the IRS enforcement efforts are:

- The IRS conducts 6,000 random employment tax audits over three years
- The IRS shares information with state agencies to increase employer compliance
- Reclassification can mean retroactive benefits as well
- Employers can't enforce proper classification by competitors on their own

FLSA Complaints Filed With the Department of Labor

Workers who feel they are being improperly treated as independent contractors and are not being paid the minimum wages or overtime pay they are entitled to may file a complaint with the U.S. Department of Labor's Wage and Hour Division. Huge backpay and damage awards can result.

State Unemployment Agencies

Many employers' misclassification problems begin when someone who has been treated as an independent contractor stops receiving work and files a claim for unemployment benefits. When a person is denied benefits, it can lead to a full-scale investigation of the employer.

Proof of the Right to Work in the U.S.

Once an employer hires a worker as an employee, the employee must prove his or her identity and right to work in the United States. The Immigration Reform and Control Act of 1986 (IRCA) makes it illegal for an employer to knowingly hire or continue to employ an unauthorized worker.

Employers can protect themselves by:

- Having employees fill out _____ on their first day of employment.
- Making sure employees provide original documentary evidence of their identity and eligibility to work within 3 business days of the date employment begins
- Physically examine the documents to determine if they appear genuine within 3 business days of the date employment begins.
- Properly completing the employer's portion of _____ within _____

- Keeping completed _____ for at least 3 years from _____ or 1 year from _____
- Presenting _____ on request within 3 business days

Documents prove identity and/or work authorization

All newly hired employees must show evidence of their identity and right to work in the U.S. They can do this by presenting any of a number of unexpired documents listed on Form I-9 (one from List A, or one each from List B and List C).

List A – Documents proving both identity and work authorization

1. U.S. Passport or U.S. Passport Card
2. Permanent Resident Card or Alien Registration Receipt card (Form I-551) (green card)
3. Foreign passport with a temporary I-551 stamp or temporary I-551 printed notation on a machine-readable immigrant visa
4. Employment Authorization Document that contains a photograph, USCIS Form I-766
5. Foreign passport with an Arrival-Departure Record (Form I-94 or I-94A) bearing the same name as the passport and containing an endorsement of the alien's nonimmigrant status.
6. Passport from the Federated States of Micronesia or the Republic of the Marshall Islands with Form I-94 or I-94A indicating nonimmigrant admission
- 7.

List B – Documents Proving Identity Only

1. Driver's license or ID card issued by a state or U.S. possession with a photograph or identifying information
2. ID card issued by a federal state, or local government agency or entity with a photograph or identifying information
3. School ID card with a photograph
4. Voter's registration card
5. U.S. Military card or draft record
6. Military dependent's ID card
7. U.S. Coast Guard Merchant Mariner Card
8. Native American tribal document
9. Canadian driver's license
10. For persons under age 18 who cannot present one of the above documents:
 - a) School record or report card
 - b) Clinic, doctor, or hospital record
 - c) Day care or nursery school record

List C – Documents Proving Work Authorization Only

1. U.S. social security account number card issued by SSA. other than one that says on its face that the card does not authorize employment in the U.S.
2. Certification of Birth issued by the Department of State (Form FS-545)
3. Certification of Report of Birth issued by the Department of State (Form DS-1350)
4. Original or certified copy of a birth certificate with an official seal issued by a state or local government agency or U.S. possession
5. Native American tribal document
6. U.S. Citizen ID Card (Form I-197)
7. ID Card for Use of Resident Citizen in the U.S. (Form I-179)
8. Employment authorization document issued by DHS

Note: Specific documents cannot be demanded by the employer. An employee can provide any document(s) on the lists to prove identity and work authorization.

New Hire Reporting

Employers are required to report information regarding newly hired and rehired employees to state agencies. This information may be used to facilitate the collection of child support and/or to uncover fraud and abuse in unemployment compensation, workers' compensation, and public assistance (welfare) benefit programs.

Federal new hire reporting requirement

Employers are required to comply with a federal new hire reporting requirement. The information required to be reported for new hires under federal law was expanded by the Claims Resolution Act of 2010, which requires the employer to report the date that each newly hired employee first performed services for pay.

Section 2 – Federal and State Wage-Hour Laws

Objectives

- State the purpose and function of the Fair Labor Standards Act (FLSA)
- Explain the difference between exempt and non-exempt employees
- State the federal minimum wage and tip credit amounts
- Define the factors used in determining overtime pay
- Explain compensable time and the issues with compensable time
- List the child labor restrictions of the FLSA
- Identify the four public contract laws

Laws

Federal Wage and Hour Law (Fair Labor Standards Act)

The purpose of the FLSA is to protect workers by regulating employment activities of both employers and employees. The FLSA ensures that fair and equitable wages are paid to employees, discourages long workweeks by requiring a higher rate of pay for each hour worked over 40 per week and prohibits oppressive child labor.

What it covers:

- _____
- _____
- _____
- _____

What it does not cover:

- _____
- _____
- _____

- Even though these items are not covered under FLSA, they are governed under state laws or by other federal laws or regulations
- Although the FLSA does not require that wages be paid within a certain amount of time, it does require that the employer have a regularly scheduled pay date and that the employees be paid by the pay date. Delaying the pay date due to a permanent change in pay cycle does not violate the FLSA.
- The U.S. Department of Labor (DOL), Wage and Hour Division, administers the federal wage-hour law. The Equal Employment Opportunity Commission (EEOC) enforces the equal pay provisions.

Laws

Federal/State Relationship

Employers must also be aware of state wage-hour laws in the state(s) in which they operate.

- Areas left unregulated by the FLSA are likely to be regulated by the state
- Even in areas that are governed by the FLSA, the state may also have regulations and the employer must comply with the law that _____.

Examples:

- The Federal minimum wage is \$7.25 per hour. The minimum wage in Connecticut is \$10.10 per hour. What minimum wage rate must be paid to employees in Connecticut?

- FLSA does not restrict the number of hours that are worked by children ages 16-17. Michigan limits the number of hours that a 16-17 year-old can work to 48 hours per week. If a 16-year-old employee works in the state of Michigan, what is the maximum number of hours they can work?

Employer and Employee Coverage

The overall goal of the FLSA is to protect workers from conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being. Businesses with as few as one employee may be covered by the law if the tests for coverage are met. Under the FLSA, there are two types of coverage.

Laws

Enterprise Coverage – Under this coverage test, all the employees of a business are covered and protected by the FLSA if:

1. At least two of the employees of the business are employed in jobs closely related and directly essential to _____ or the production of goods for _____, and
2. The business has annual gross sales of at least \$_____

Certain businesses are specifically covered by the FLSA regardless of annual sales volume. They include:

- _____
- _____
- _____
- _____

Individual Coverage – Under the individual employee coverage test, an employee is covered by the FLSA if he or she is engaged in interstate commerce or in the production of goods for interstate commerce. It does not matter if the business is not a covered enterprise, so long as the employee's job is in interstate commerce.

Exempt and Nonexempt Employees

Not all employees of covered enterprises or who work in interstate commerce are entitled to the protections of the FLSA. While the word “exempt” can mean different things in different contexts, here it refers to an employee who is exempt from the minimum wage and/or overtime provisions of the FLSA and the employer does not have to keep certain records detailing their work. The most well-known of these exemptions is the “white collar exemption.”

White Collar Exemption

An acronym to help in remembering the five types of white collar exempt positions is CAPES. Let's look more closely at these types of employees, keeping in mind that the tests for determining status measure the actual duties and responsibilities of the employee, not the job title.

NOTE: The Department of Labor issued a new federal overtime rule, which was originally scheduled to go into effect on December 1, 2016. However this rule was blocked by a U.S. District Court judge in Texas on November 22, 2016. As a result, the information shown on the next few pages related to exempt employees was still in effect as of Jan. 1, 2017.

Laws

C _____

Primary duties include:

- Application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional specifications
- Design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications
- Design, documentation, testing, creation or modification of computer programs related to machine operating systems or
- A combination of the aforementioned duties, the performance of which requires the same level of skill

Salary Level - \$_____ per week or \$_____ per hour

A _____

Primary duties include:

- Performance of office or nonmanual work directly related to the management or general business operations of the employer or the employer's customers; and
- The exercise of _____ and _____ with respect to matters of significance

Salary Level - \$_____ per week (\$_____ annually)

P _____

Primary duties include:

- Performance of work requiring knowledge of an advanced type (defined as work which is predominantly intellectual in character, and which includes work requiring the consistent exercise of _____ and _____) in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction; or
- Performance of work requiring _____ or _____ in a recognized field of artistic or creative endeavor

Salary Level - \$_____ per week (\$_____ annually)

Laws

E _____

Primary duties include:

- Management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof;
- Customarily and regularly directs the work of _____ employees; and
- Has the authority to _____ or _____ other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion, or any other change of status of other employees are given particular weight

Salary Level - \$_____ per week (\$_____ annually)

S _____ (Not necessarily considered one of the “white collar” exemptions)

Each of the following tests must be met for this position to qualify as exempt:

1. Primary duty must be:
 - a) _____

 - or
 - b) _____

 - and
2. The employee must customarily and regularly work away from the employer's place of places of business in performing the employee's primary duty

Salary Level – _____

Determining an employee's primary duty

Primary means the principal, main, major, or most important duty that the employee performs. The determination of an employee's primary duty is based on all the facts underlying an employee's particular situation, but the major emphasis must be on the character of the employee's job as a whole.

Highly compensated employees

An employee with total annual compensation of at least \$_____ is an exempt white collar employee if the employee customarily and regularly performs one or more of the exempt duties of an exempt administrative, executive, or professional employee. The employee's compensation must include a salary of at least \$455 per week.

Laws

Retail and Service Industry Exemption

Employees in retail or service industries are exempt from the overtime pay requirements of the FLSA if:

1. Their regular rate of pay on a weekly basis (hourly rate plus commissions) is at least 1 ½ times _____; and
2. More than half of their pay for a representative period (at least one month) comes from _____

Public Sector Exempt Employees

While the FLSA generally applies to employees of the federal, state, and local governments and their agencies and political subdivisions, there are several exemptions in addition to those that apply generally. On the state and local government level, employees who are not subject to state or local civil service laws are exempt from the FLSA if they are:

- Publicly elected officials
- Persons selected by an elected official to be members of the official's personal staff, if they are directly supervised by the official
- Persons appointed by an elected official to serve in a policymaking position
- Persons who are immediate advisors to an elected official on the constitutional or legal powers of the office; and
- Persons employed by a state or local legislative branch, other than a legislative library or a school board

Minimum Wage

The current federal minimum wage is \$_____ per hour. All covered employees who are not otherwise exempt must be paid at least the minimum wage for all hours worked. Employees may be paid on a piecework, salary, or commission basis, so long as the wages at least equal the minimum hourly rate.

Lower “opportunity wage for teenagers

The minimum wage for newly hired employees under the age of 20 is 4.25 per hour for the first 90 consecutive calendar days after they are employed, unless the employee is covered by a state law requiring a higher minimum wage. If the employee reaches age 20 during the 90-day period, the employee must be paid at least the federal minimum wage in effect as of the employee's birthday.

Laws

Example: Dan's employer takes advantage of the lower opportunity or youth minimum wage. Dan was born on October 4, 1997. From Monday, October 2 through Friday, October 6, Dan worked 6 hours each day. What will his gross wages be for this workweek?

Tips and the Tip Credit

Under the FLSA, employers are required to pay "tipped employee" only \$_____ per hour in wages, so long as the employee's tips are enough to make up the remainder of the minimum hourly wage then in effect (currently \$7.25). This means that the employer can take a "tip credit" of up to \$5.12 .

If the employee's tips do not bring the employee's total wages up to the current minimum wage, the employer must make up the difference. Tipped employees are employees who work in an occupation in which they regularly receive more than \$30 per month in tips.

Equal Pay for Equal Work

In 1963, the minimum wage provisions of the FLSA were amended by the Equal Pay Act to require equal pay for men and women doing equal work under similar working conditions. "Equal work" means jobs requiring equal skill, effort and responsibility. The Equal Pay Act is enforced by the _____.

Overtime Requirements

The general rule under the FLSA is that all covered employees must be paid at least 1 ½ times their "regular rate of pay" for all hours physically worked over 40 in a workweek.

Laws

Example: Employee Joe generally works a 40-hour week at an hourly rate of \$10.25 per hour. In a week where he works 48 hours, his total weekly earnings would be calculated as follows:

Regular earnings	48 hours x \$10.25	= \$ _____
Overtime premium pay	\$10.25 x 8 x 0.5 =	= \$ _____
Total weekly earnings		= \$ _____

The Workweek

In order to determine whether an employee's wages meet the minimum wage requirement, and to determine whether an employee has exceeded 40 hours and eligible for overtime, a workweek must be established.

The employer is responsible for establishing its workweek, which is a regularly recurring period of 168 hours (7 consecutive 24-hour periods). The workweek does not have to be the same as a calendar week or begin at the start of a day. Employers may also establish different workweeks for different facilities or groups of employees, so long as each workweek remains fixed once it is established.

Exemption for hospitals and nursing homes

The FLSA contains an exemption to the workweek standard for hospitals and nursing homes that is designed to give them more flexibility in scheduling. The law allows such employers to use a 14-day period rather than the workweek for determining overtime compensation.

All of the following conditions must be met for the exemption to apply:

1. There must be an agreement or understanding between the employer and the employees before the work is performed
2. If the agreement is not in writing, the employer must keep some special record of it.
3. The employer must pay employees covered by the agreement or understanding at least 1 ½ times their regular rate of pay for all hours worked over 8 in a day or 80 in the 14-day period, whichever would result in higher pay for the employee.

Laws

Example: Nancy is a nonexempt hospital employee and has agreed to work on a 14-day work period basis. Her regular rate of pay is \$15 per hour. She works the following schedule:

Sun	Mon	Tue	Wed	Thur	Fri	Sat
0	8	8	10	0	10	0
8	10	8	12	0	8	0

How many hours of overtime would Nancy's employer have to pay her?

When workweeks are changed

While the FLSA encourages employers to establish permanent workweeks, a change may be necessary to meet changing business needs. But if a change is made, the employer must be careful when determining hours worked where the new and old workweeks overlap.

1. Several steps must be taken to ensure that the employee receives all overtime pay to which he or she is entitled:
Add the overlapping days to the old workweek.
2. Calculate the overtime hours and pay due for the old and new workweeks on this basis
3. Add the overlapping days to the new workweek.
4. Calculate the overtime hours and pay due for the old and new workweeks on this basis.
5. Pay the employee the greater amount from step 2 or step 4.

Hours Worked

The FLSA requires overtime pay only for hours physically worked over 40 in a workweek. Hours for which an employee is paid, but during which no actual work is done (e.g. paid sick day, paid vacation day, paid holiday, etc...) do not have to be counted when calculating the number of hours worked.

Regular Rate of Pay

The required overtime pay under the FLSA is 1 ½ times the employee's "regular rate of pay." In general, the regular rate of pay is an hourly pay rate determined by dividing the total regular pay actually earned for the workweek by the total number of hours worked.

Laws

What is included in the regular rate?

The following payments must be considered when calculating an employee's regular rate of pay.

- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____

What is not included in the regular rate of pay?

The FLSA exempts several types of payments to employees from inclusion in the regular rate of pay for overtime purposes:

- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____

Laws

Special Problems in Regular Rate Determinations

Employees working at more than one rate

When an employee is paid at two or more different rates by an employer for doing two or more different jobs during the workweek, the regular rate of pay must take into account the different rates. This is done by coming up with a weighted average.

Example: Jane works as a researcher for her company for 8 hours a day from Monday through Friday, earning \$15 per hour. In the same week, she works an extra 12 hours as a filing assistant earning \$10 per hour. Her pay would be calculated as follows:

40 hours x \$15 per hour	= \$ _____
12 hours x \$10 per hour	= \$ _____
Total regular earnings	= \$ _____
Regular rate of pay:	\$ _____ ÷ 52 hours = \$ _____
Overtime premium	\$ _____ x 12 x .5 = \$ _____
Total earnings	\$ _____ + \$ _____ = \$ _____

Salaried nonexempt employees

It is important to remember that not all salaried employees are exempt from the FLSA's overtime requirements. Only those employees whose salaries exceed a certain level and who meet the duties and responsibilities tests for exemption are classified as exempt. All other salaried employees must be paid overtime. The regular rate of pay for such employees is determined by dividing the employee's salary by the number of hours the salary is intended to compensate.

The easiest way to calculate this is to take the employee's annual salary and divide it by the number of hours to be compensated in a year.

Example: John works 40 hours per week and is paid a monthly salary of \$3,500.

Annual salary	\$3,500 x 12 = \$ _____
Hours worked in a year	52 x 40 = _____ hours
Regular rate of pay	\$ _____ ÷ _____ hours = \$ _____

Workweeks of less than 40 hours

For many employees, the standard workweek is less than 40 hours. So, what if an employee who typically works a 35-hour workweek happens to work more than 35, but less than 40? Most of the courts that have addressed this situation have ruled that it is not a violation of the FLSA's minimum wage or overtime provisions if the employee is not paid for that "gap" time, as long as they are receiving at least the minimum wage for the total number of hours worked. But if that employee works more than 40 hours in a workweek, they must be paid their regular rate of pay for all hours worked, plus the premium pay (1/2 the regular rate) for any hours over 40.

Laws

Example: Jessica is a nonexempt employee who is paid \$800 semimonthly for a 35-hour workweek. In a recent workweek, she worked 45 hours. Her pay for that week would be calculated as follows:

Annual salary	$\$800 \times 24 = \$$ _____
Hours worked in a year	$52 \times 35 =$ _____ hours
Regular rate of pay	$\$$ _____ \div _____ hours = $\$$ _____

Regular rate of pay	$\$$ _____ \times 45 hours = $\$$ _____
Premium pay	$\$$ _____ \times 5 \times .5 hours = $\$$ _____
	$\$$ _____ + $\$$ _____ = $\$$ _____

Pieceworkers

Under a piece-rate system, the basic method for determining the regular rate of pay is to add the weekly piece-rate earnings to any other earnings for the workweek (e.g., production bonuses, waiting time pay) and then divide the total by the number of hours worked in the workweek.

Example: John receives \$2 for each first aid kit he assembles, plus a \$1.00 bonus per kit for each kit he assembles over 300 in a regular 48-hour workweek. In one workweek, John assembled 500 kits. His earnings would be calculated as follows:

Regular piecework earnings	$\$2.00 \times 500 \text{ kits} = \$$ _____
Production bonus	$\$1.00 \times 200 \text{ kits} = \$$ _____
Total piecework earnings	$\$$ _____ + $\$$ _____ = $\$$ _____
Regular rate of pay	$\$$ _____ \div 48 hours = $\$$ _____
Overtime premium pay	$\$$ _____ \times 8 \times .5 = $\$$ _____
Total earnings	$\$$ _____ + $\$$ _____ = $\$$ _____

Tipped Employees

If a tipped employee is being paid less than the minimum wage by an employer because the employer is taking some or all of the allowable tip credit, the full minimum wage is used in determining the employee's regular rate of pay.

Laws

Example: Mary is a server at a restaurant and her employer pays her \$2.13 per hour, taking the full tip credit. In one workweek, Mary works 47 hours and collects \$152 in tips. How would her total pay for the week be calculated?

Cash wages without tip credit:	\$2.13 x 47 = \$	_____
Tip credit:	\$5.12 x 47 = \$	_____
Tips received:		\$ _____
Tip credit makeup	\$ _____ - \$ _____	= \$ _____
Regular rate of pay:	\$7.25	
Overtime premium rate:	\$7.25 x .5 = \$3.63	
Overtime premium pay:	\$3.63 x 7	\$ _____
Total earnings:		\$ _____

Fluctuating workweeks

Some employees may find it advantageous to enter into agreements with their employers to pay them a fixed weekly salary even though their hours may vary from week to week because of the availability of materials, production schedules, etc. The FLSA allows such arrangements, so long as the employees receive one-half of the regular hourly rate for the week for each hour of overtime worked during that week and the fixed weekly salary is high enough to ensure that even when the employees work a great number of hours their straight time pay will not fall below the minimum hourly wage.

Example: Bob agrees to a fixed salary of \$500 per week and generally works between 35 and 50 hours per week, with a different amount worked each week. In a week where Bob works 46 hours, his earnings would be calculated as follows:

Regular rate of pay	\$500 ÷ 46 hours = \$	_____
Overtime premium pay	\$ _____ x 6 x .5 = \$	_____
Total earnings	\$500 + \$ _____ = \$	_____

Belo-type constant wage plans

A plan similar to the fluctuating workweek plan is called a Belo plan after the name of the company involved in a High Court decision. This plan guarantees a fixed salary for irregular hours that includes a set amount of overtime pay. To qualify:

- The plan must be agreed to by the employee through an individual contract or collective bargaining agreement;
- The employee must work irregular hours (with workweeks fluctuating above and below 40 hours);
- The contract must guarantee a straight time rate of at least the statutory minimum and an overtime rate of at least 1 ½ times the regular rate; and
- The weekly guarantee must be for not more than 60 hours of work

Laws

Example: A Belo plan guarantees Cathy \$712.50 per week for 45 hours, with a straight time hourly rate of \$15 ($\15×45) and an overtime premium rate of \$7.50 ($\$15 \times .5$), plus time-and-a-half for hours worked over 45. Cathy will receive \$712.50 no matter how many hours she works each week up to 45, and will receive \$22.50 ($\15×1.5) for each hour worked over 45.

Compensatory Time off

Because the workweek is the FLSA's basic unit of time used in determining whether overtime pay is due an employee, employers generally cannot "pay" overtime earned in one workweek by giving the employee time off from work in another workweek, even if 1 ½ hours off are given for each overtime hour worked. But there are exceptions to the general rule.

Time off in the same pay period. When employees are paid either biweekly, semimonthly, or monthly, the employer can give them at least 1 ½ hours off for every hour of overtime worked, so long as the time off is given within the same pay period that the overtime is worked and the overtime premium is paid for the actual overtime hours worked.

Public sector employers can provide comp time instead of cash. If certain conditions are met, state and local government employers can give their nonexempt employees at least 1 ½ hours of paid compensatory time off for each hour of overtime worked rather than paying a premium rate for the overtime.

Compensable Time Issues

Under the FLSA, employees must be paid for all hours worked. This means all hours during which the employee is under the employer's control, even if the time is unproductive, so long as the time spent is for the employer's benefit. Here are some problem areas in determining what is working time

Unauthorized Overtime

The employee must be paid for all time spent working, even if the employer does not ask the employee to do the work or in general forbids such work. Merely having a rule against unauthorized work is not enough. The rule must be consistently enforced whenever possible.

Meal and Rest Periods

Employers do not have to consider meal periods as working time if the employee is relieved of all duties and responsibilities. Generally the meal period must be at least 30 minutes long to be considered non-work time.

Laws

Travel Time

Whether time spent traveling by an employee is compensable worktime depends on the type of travel and its purpose.

Travel from home to work. In general, the time an employee spends going from home to work and from work to home is not worktime.

Travel as part of job. Time spent traveling as part of an employee's daily work activity is compensable worktime, including travel from one job site to another or travel from a designated meeting place to a job site.

Travel to and from home in a company vehicle. Use by an employee of an employer's vehicle for commuting and other incidental travel is not part of the employee's principal activities and is not compensable time if the vehicle is used within the normal commuting area for the employer's business or establishment and its use is subject to an agreement between the employer and the employee.

Travel away from home. Travel by an employee who will be away from home overnight is worktime only during those periods that coincide with the employee's regular working hours (e.g., 9:00am – 5:00pm). Such time is counted as hours worked even if it occurs on a non-working day (e.g., Saturday or Sunday between 9:00am – 5:00pm). Travel outside regular hours as a passenger in a plane, train, boat, bus or automobile is not hours worked.

On-Call Time

Employees who must be on-call on the employer's premises or close enough to seriously curtail their use of the time for their own purposes must be paid for the time spent on-call.

Waiting Time

Whether the time spent waiting is compensable worktime depends on whether the employee is "engaged to be waiting" or "waiting to be engaged." Time spent "engaged to be waiting" is compensable worktime because it is usually short, spent on the employer's premises, and insufficient for the employee to use for his or her own purposes. Conversely, "waiting to be engaged" is not worktime because the employee is freed from all duties and responsibilities for a definite period of time and has enough time to pursue personal business before returning to work.

Laws

Time Spent at Meetings and Training Sessions

Attendance at lectures, meetings, seminars, and training sessions is worktime unless all the following conditions are met:

1. The meeting, lecture, etc., is held outside of the employee's _____
2. _____ Attendance is voluntary (not a condition of employment)
3. The meeting, lecture, etc., is not directly related to the _____;
and
4. The employee does not perform any _____ for the employer while attending.

Preliminary and Postliminary Activities

The Portal-to-Portal Act of 1947 provides that activities which are “preliminary or postliminary” to an employee’s principal work are not compensable worktime unless a contract or custom of the employer makes them compensable. This means that time spent getting ready for work or getting ready to leave for work is not work time unless the activities engaged in are essential to the employee’s principal work activity.

Receiving Medical Attention

Any time spent by an employee waiting for or receiving medical attention on the employer’s premises or at the employer’s direction during regular working hours is compensable worktime.

Child Labor Restrictions

The FLSA prohibits the employment of any “oppressive child labor” in connection with interstate commerce. Oppressive child labor is the employment of any child under age 18 in violation of the child labor restrictions of the FLSA and regulations issued under it. Here are the minimum age restrictions under the FLSA:

Minors under age 18. No minor under age 18 can work in a job that has been declared _____ by the Wage and Hour Division.

Minors age 14 and 15. Minors age 14 and 15 can work in a limited number of nonhazardous jobs in retail, food service, and gasoline service establishments. They cannot work during school hours and are limited to working ____ hours a day and ____ hours a week when school is in session. They are limited to ____ hours a day and ____ a week when school is not in session. They also can work only between 7 a.m. and 7 p.m. (7 a.m. and 9 p.m. from June 1 through Labor Day).

Minors under age 14. Employment is generally prohibited, unless the minor is working for a parent, and even those jobs cannot be hazardous or in mining or manufacturing.

Laws

Enforcement and Penalties

The Wage and Hour Division of the U.S. Department of Labor investigates employee complaints of FLSA violations or takes up investigations on its own, and can sue to gain compliance or seek damages from employers that have violated the FLSA. Employees may also sue to collect any back minimum wages or overtime due.

Public Contract Laws

Several other federal laws regulate the minimum wages and overtime pay that must be paid to employees who are working for employers performing under contracts with the federal government. They are also enforced by the Wage and Hour Division.

Walsh-Healey Public Contracts Act

This governs the wages and hours of employees of manufacturers and dealers furnishing the federal government with materials, supplies, and equipment under contracts exceeding \$10,000. This act requires covered employees to be paid 1 ½ times their basic (regular) rate of pay for all hours physically worked over 40 in a workweek. They also must be paid the prevailing minimum wage for work in the same or similar industries in the locality where the goods are manufactured or furnished.

Wage Rates for Public Buildings and Works (Davis-Bacon Act)

Under this act, the Secretary of Labor sets prevailing minimum wage standards for laborers and mechanics working on federally financed construction contracts of more \$_____ or more.

Contract Work Hours and Safety Standards Act

This act requires contractors with the federal government (not those already covered by Walsh-Healey) to pay employees overtime of at least 1 ½ times their “basic rate” for hours worked over 40 in a workweek. The law applies to contracts over \$_____.

The McNamara-O’Hara Service Contract Act

This act applies to employers that contract with the federal government to provide services to a federal agency. It applies to contracts over \$_____ and requires that employees be paid prevailing minimum wages and fringe benefits based on the wages and benefits for similar employment in the locality or on a collective bargaining agreement, but no less than the minimum wage under the FLSA.

Section 3 Part 1 – Taxable and Nontaxable Compensation

Objectives

- Understand the concepts of Gross Income and Fair Market Value
- Define fringe benefits and their taxability
- Calculate the taxable value of personal use of a company vehicle
- Calculate the taxable value of employer-provided Group Term Life Insurance

Compensation

Gross Income and Wages Under the IRC

The Internal Revenue Code (IRC) uses the term “gross income” as the starting point for determining a taxpayer’s federal tax bill, and it broadly defines the term as including “compensation for services, including fees, commissions, fringe benefits, and similar items.” And when it comes to withholding and paying employment taxes, the IRC defines wages as “all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.”

This means that wages and benefits (whether they are called fringe benefits or “perks” or something else) are generally included in income and are subject to income and employment tax withholding, deposit, and reporting requirements unless _____.

The IRC does not define the term “fringe benefit,” but throughout this section, we’ll review several examples of taxable and nontaxable fringe benefits.

Income and Employment Taxes Defined

In general, when employee compensation is described as “taxable,” this means:

- It is subject to _____ and the employer must withhold the tax from the employee’s pay and remit it to the Internal Revenue Service; and
- It is subject to _____ and _____ taxes as well as federal unemployment tax. These taxes are often referred to as _____.

Fair Market Value

When noncash fringe benefits or perks are provided by an employer to its employees, the amount of the benefit is defined as its fair market value, or what it would cost an individual to purchase the benefit on the open market in an _____.

The amount of the benefit the employer must include as income to the employee is the amount by which the fair market value exceeds the amount paid for the benefit after taxes plus any amount the law specifically excludes:

$$\text{IFBA} = \text{FMV} - (\text{EPA} + \text{AEL})$$

$$\text{IFBA} = \underline{\hspace{10em}}$$

$$\text{FMV} = \underline{\hspace{10em}}$$

$$\text{EPA} = \underline{\hspace{10em}}$$

$$\text{AEL} = \underline{\hspace{10em}}$$

Example: Frank’s employer pays for Frank’s parking space in a commercial parking lot next to his office. The employer pays \$360 per month for the space, which is the same amount charged to all monthly payers. Frank pays nothing for this space and has access to it every day. Frank’s taxable income from this parking benefit would be calculated as follows:

Compensation

IFBA = \$ _____ - (\$ _____ + \$ _____)

IFBA = \$ _____ - \$ _____

IFBA = \$ _____

Fringe Benefits Under the Internal Revenue Code

Certain employer-provided benefits are mentioned in the Internal Revenue Code as being either taxable or nontaxable.

Nontaxable Fringe Benefits

Once certain conditions are met, the Internal Revenue Code exempts certain fringe benefits from being included as income. This means they are not subject to federal income tax withholding or social security, Medicare or FUTA taxes. They include:

- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____

No-additional-cost services

An employer may offer free services to its employees without including the fair market value of those services in the employee's income if the following conditions are met:

1. The free service is one that is regularly offered for sale to customers in the normal course of the employer's "line of business" in which the employee works
2. The employer bears no substantial additional cost
3. The term employee includes current and former employees who left because of retirement or disability and their widow(er)s, spouses, and dependent children
4. The service is available on equal terms to each member of a group of employees whose classification does not discriminate in favor of highly compensated employees.

Highly compensated includes any employee who:

- Was a ____% owner of the employer's stock or capital at any time during the current or previous year; or
- Received more than \$ _____ in compensation from the employer during the preceding year.

Compensation

Qualified employee discounts

An employer may offer discounted goods or services to its employees without adding the fair market value of the discounts to the employees' income if the following conditions are met:

1. The discount on goods cannot exceed the gross profit percentage with the goods are sold to customers.
2. The discount on services cannot exceed ____% of the price at which the services are offered to customers.
3. The goods or services must be offered for sale to customers in the employer's line of business in which the employee normally works.
4. The discount is available on equal terms to each member of a group of employees whose classification does not discriminate in favor of _____.
5. Real estate, whether for investment purposes or not, does not qualify for the employee discount. Neither does personal property normally held for investment, such as stocks, bonds, or currency.
6. The term employee includes current and former employees who left because of retirement or disability and their widow(er)s, spouses, and dependent children.

Working condition fringes

An employer may offer certain work-related property or services to employees without including their fair market value in the employees' income. Working conditions may include the following:

- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____

Compensation**De minimis fringes**

An employer may provide certain property or services of small value to employees without including the value in the employees' income if the following conditions are met:

1. The value of the benefit is so _____ that accounting for it would be unreasonable or impracticable.
2. The employer must take into account the _____ with which it provides the benefit to all its employees in making this determination.
3. The term employee means anyone to whom the benefit is provided.

Qualified transportation fringes

An employer may provide certain transportation fringe benefits to its employees without including the fair market value of the benefits in their income under certain circumstances. They include:

1. Transportation between home and work in a commuter highway vehicle provided by the employer if:
 - _____;
 - _____; and
 - _____.
2. Transit passes, vouchers, tokens, or fare cards, or reimbursement for them by the employer for up to \$_____ per month.
3. Parking provided on or near the employer's premises up to a value of \$_____ per month.

Compensation

On-premises athletic facilities

An employer may allow its employees to use an on-premises gym or other athletic facility free of charge without including the fair market value of the use in the employees' income if the following conditions are met:

1. The athletic facility is located on the employer's premises, whether leased or owned by the employer.
2. The athletic facility is operated by the employer through its employees or another entity.
3. Substantially all use of the athletic facility is by employees, their spouses, and their dependent children.
4. The athletic facility is not a resort or other residential facility.

Qualified retirement planning services

Employers can provide retirement planning services to their employees and the employees' spouses without their value of the services being included in the employees' Income or subject to social security, Medicare, or FUTA tax.

Qualified moving expense reimbursements

The Omnibus Budget Reconciliation Act of 1993 made significant changes in the rules regarding the taxation of employer-reimbursed moving expenses. In Section 3, Part 2 of these handouts, more detail will be provided on the tax treatment of job-related moving expenses.

Personal Use of Employer-Provided Vehicles

One of the most common fringe benefits provided to employees is use of a company-owned or company-leased vehicle. When the vehicle is used for business-related purposes, the value of the use is excluded from income as a working condition fringe benefit. All other use of the vehicle is generally considered taxable income to the employee, unless an exception applies. Those exceptions are:

- _____ – car is used mainly for the employer's business, with infrequent and brief side trips for personal reasons
- _____ – the car is unlikely to be used for personal travel because of its special design
- _____ – use of a demonstration vehicle by a full-time automobile salesperson or sales manager within the sales area of the dealership

Compensation

Accounting for vehicle use

If an employee uses a company vehicle for both business and personal travel, they must substantiate their usage by accounting for the mileage, the time and place of the travel, and the business purpose of the travel.

Valuation Methods

Employers can determine the fair market value of taxable personal use of a company-provided vehicle by using either a general valuation method or one of three special valuation methods.

General Valuation Method

Under this method, the fair market value of a company-provided vehicle is the price an individual would pay to lease the same or a comparable vehicle in an arm's length transaction in the same geographic area for the same length of time.

Special Valuation Methods

There are three special valuation methods for determining the fair market value of the personal use of a company-provided vehicle:

- Commuting Valuation
- Cents-per-mile Valuation
- Annual Lease Valuation

Commuting Valuation Method

This method allows an employer to value an employee's personal commuting use of an employer-provided vehicle at \$_____ per one-way commute and \$_____ per round trip if certain conditions are met.

Annual Lease Valuation Method

Under this method, the fair market value of an employee's personal use of a company-provided vehicle is determined by multiplying the annual lease value of the car by the percentage of personal miles driven. Here are the steps the employer must take:

1. Determine the fair market value of the car as of the first day it was made available to any employee for personal use.
2. Find the car's fair market value on the IRS Annual Lease Value Table.
3. Calculate the percentage of personal miles driven during the year (personal miles ÷ total miles).
4. Calculate the fair market value of the employee's personal use of the car (Annual Lease Value x percentage of personal miles driven).

Compensation

IRS Annual Lease Value Table 3.1

(From 2017 IRS Publication 15b)

(1) Automobile FMV	(2) Annual Lease	(1) Automobile FMV	(2) Annual Lease
\$ 0 to 999	\$ 600		
1,000 to 1,999	850		
2,000 to 2,999	1,100		
3,000 to 3,999	1,350		
4,000 to 4,999	1,600		
5,000 to 5,999	1,850		
6,000 to 6,999	2,100		
7,000 to 7,999	2,350		
8,000 to 8,999	2,600		
9,000 to 9,999	2,850		
10,000 to 10,999	3,100		
11,000 to 11,999	3,350		
12,000 to 12,999	3,600		
13,000 to 13,999	3,850		
14,000 to 14,999	4,100		
15,000 to 15,999	4,350		
16,000 to 16,999	4,600		
17,000 to 17,999	4,850		
18,000 to 18,999	5,100		
19,000 to 19,999	5,350		
20,000 to 20,999	5,600		
21,000 to 21,999	5,850		

Example:

Dave's employer provides him with a company vehicle which has a fair market value of \$28,375 and his employer permits him to drive it for personal use. Dave drove the car 11,500 business miles and 3,850 personal miles this year. The amount that must be included in Dave's income for this year is calculated as follows:

Annual Lease Value of \$28,375 (per the IRS table)

= \$ _____

% of personal miles = $3,850 \div 15,350$ (total miles) = _____ %

Fair Market Value of personal use = \$ _____ x _____ % = \$ _____

Note about fuel – the cost of fuel is not included in the annual lease value. Therefore, if an employer is paying for the employee's fuel, they can either determine the value by using the actual cost of the fuel or an IRS-approved rate of _____.

So if Dave's employer were paying for fuel and using the IRS-approved rate, the amount that must be included in Dave's income for the year would be calculated as follows:

Personal miles driven (3,850) x \$.055 = \$ _____

\$ _____ (FMV of personal use from previous page) + \$ _____ (fuel amount)
= \$ _____

Vehicle cents-per-mile method

Using this method, the fair market value of an employee's personal use of accompany-provided vehicle is determined by multiplying the IRS's business standard mileage rate by the number of personal miles driven. The business standard mileage rate in _____ is \$ _____ per mile. The fair market value of the car cannot exceed \$ _____ for cars placed in service in _____.

Example:

Compensation

Jerry's employer provides him with a company vehicle and Jerry drives it for both personal and business use. The car's fair market value is \$14,800. During this year, Jerry drove the car a total of 15,000 miles, which included 5,500 personal miles. The amount to include in Jerry's income would be calculated as follows:

5,500 personal miles x \$_____ = \$_____

Note about fuel – the cost of fuel IS included in the cents-per-mile valuation. Therefore, if an employee is paying for the fuel, the employer would reduce the business mileage rate by the fuel rate.

\$_____ - \$_____ = \$_____

So if Jerry were to pay for the car's fuel, the amount to be included in his income would be calculated as follows:

5,500 personal miles x \$_____ = \$_____

Helpful Hint About Fuel

Annual Lease Value method assumes the employee pays for fuel

If employer pays, **add** the \$.055 per mile

Cents-per-mile method assumes the employer pays for fuel

If employee pays, **subtract** the \$.055 per mile

Compensation

Personal Use of Employer-Provided Aircraft

The value of employee business travel in a company-owned airplane or helicopter is excluded from the employee's income as a working condition fringe benefit. Travel that combines business and personal purposes must be allocated to each.

General valuation rule

The value of a personal flight on an employer-provided aircraft where the employer also provides the pilot is the amount an individual would pay in an arm's length transaction to charter a comparable aircraft and pilot for a comparable flight.

Non-commercial flight valuation rule

The value of a personal flight where the employer provides the aircraft and the pilot is calculated by using an aircraft multiple based on the weight of the aircraft and a cents-per-mile rate known as the Standard Industry Fare Level.

Free or Discounted Commercial Flights

Under the commercial flight valuation rule, the value of a space available or stand-by flight for relatives of airline employees when they do not qualify for the _____ exclusion is _____% of the airline's highest unrestricted coach fare in effect for that particular flight.

Discounts on Property or Services

Qualified employee discounts qualify as nontaxable fringe benefits. But employee discounts on good or services normally sold to customers that do not qualify for the exclusion must be included in the employee's income.

Club Memberships

Club dues may qualify as a working condition fringe benefit and would not be taxable if the following apply:

- The employer does not treat them as wages
- The expenses would be deductible by the employee and
- The employee substantiates the expenses

Compensation**Additional Employer-Provided Benefits**

Although not specifically mentioned in the Internal Revenue Code as fringe benefits, several other employer-provided benefits will be reviewed here and in the beginning of the next section of these study notes as they can have complex rules governing their taxation and reporting.

Life Insurance

One of the more popular benefits offered employees is employer-provided life insurance. The most common type of insurance is group-term life insurance, which most often provides a death benefit payable in a lump sum to the employees designated beneficiary. Other types of insurance such as whole life or split-dollar life insurance will also be reviewed, but not in as much detail as group-term life.

Group-term life insurance

The value of employer-provided group-term life insurance up to \$_____ is excluded from an employee's income. The value of coverage in excess of that amount, minus any amount paid by the employee for their coverage after taxes must be included in the employee's income.

The value of the excess coverage is subject to _____ and _____ taxes, but is not subject to _____ or _____ tax. At their option, employers may withhold federal income tax on the value.

The employee must pay the federal income tax owed with his or her personal income tax return. The value must be reported on the employee's Form W-2 as follows:

- Boxes 1, 3, and 5
- Box 12 – Code _____
- Form 940 (Part 2, Lines 3 and 4)
- 941 (Lines 2, 5a, 5c, and 5d)

Compensation

To compute the monthly value of excess group-term life insurance to include in an employee's income, the following steps should be taken:

1. Determine the amount of the employee's coverage
2. Calculate the excess benefit over \$50,000
3. Divide the excess insurance amount by \$1,000
4. Determine the employee's age as of December 31
5. Use IRS Table 2.2 from the IRS Publication 15-B (shown below) or Table I from the Payroll Source to calculate the fair market value
6. Deduct any after-tax contributions by the employee
7. Add the excess amount to the employee's income, withhold and pay social security and Medicare taxes, and report the amount as required.

Table 2-2. Cost Per \$1,000 of Protection For 1 Month

<u>Age</u>	<u>Cost</u>
Under 25	\$.05
25 through 29	.06
30 through 34	.08
35 through 39	.09
40 through 44	.10
45 through 49	.15
50 through 54	.23
55 through 59	.43
60 through 64	.66
65 through 69	1.27
70 and older	2.06

Compensation**Example:**

Michelle's employer provides her with a group-term life insurance policy equal to 3 x her annual salary. She is 52 years old and her annual salary is \$70,000. She does not contribute toward this policy.

1. $3 \times \$70,000 = \$$ _____
2. $\$$ _____ - \$50,000 = \$ _____
3. $\$$ _____ \div \$1,000 = _____
4. _____ \times \$ _____ (From table) = \$ _____ per month of taxable income

If Michelle's employer calculates this taxable amount each pay period, then another step would be needed. For example, if Michelle is paid biweekly and her employer adds this taxable amount each pay period, then the next step would be:

$\$$ _____ \times 12 months = \$ _____ (annual amount) \div 26 pay periods = \$ _____ per pay period

Dependent group-term life insurance

Group-term life insurance coverage may be provided to an employee's dependents (spouse and/or children) as well as the employee. If so, the value of up to \$ _____ of coverage is not included in the employee's income because it is a de minimis fringe benefit. If the coverage exceeds \$ _____, its entire value must be included in the employee's income after being calculated using the IRS Table and the age of each covered dependent. If the dependent's age is not known, the employee's age is used in the calculation.

Whole-life insurance

An employer may purchase individual whole-life or straight-life insurance policies for employees (usually done for key managers) or pay the premiums on policies already owned by the employees. A straight-life policy provides two types of benefits:

- Death benefit – payable at the death of the insured employee equal to the face amount of the policy
- Savings – a portion of each premium payment is applied toward the savings segment of the policy

Split-dollar life insurance

Under a split-dollar life insurance plan, an employer and an employee join in the purchase of a life insurance contract on the life of the employee subject to a contractual allocation of policy benefits between the two parties.

Section 3 Part 2 – Taxable and Nontaxable Compensation

Objectives

- Explain additional employer-provided benefits
- Define other payments and their taxability
- Calculate employer-paid taxes
- Review withholding and reporting rules for employer-provided benefits

Compensation**Additional Employer-Provided Benefits****Moving Expenses**

When employees are relocated from one workplace to another or move to begin a new job, the employer often pays for the costs of the move, either directly or by reimbursing the employee for moving expenses. Generally, if an employer reimburses an employee or pays a third party directly for moving expenses that qualify for a tax deduction, the amount reimbursed or paid is not included in the employee's income. All other amounts paid or reimbursed must be included in income and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Distance and Time Tests

Before any expenses of a job-related move can be considered deductible and reimbursements for them excluded from income, two tests must be met:

- Distance test – the new workplace must be at least ____ miles farther from the employee's old residence than the previous workplace was
- Time test – During the 12-month period immediately following the move, the employee must work full-time for at least _____ in the general location of the new workplace.

If the employer reasonably believes the employee will meet these two tests, payments made to a third party or reimbursements made to the employee for the move are not included in income as long as the expenses themselves meet the tests for deductibility.

Deductible moving expenses

There are only two types of deductible moving expenses – transportation and in-transit storage of household goods and personal effects, and traveling from the old residence to the new residence (including lodging, but not meals).

- Transportation of household goods – all reasonable expenses incurred in packing and moving household goods and personal effects to the new residence
- Expenses of traveling from old home to new home – all reasonable expenses incurred while traveling from the employee's old home to the new home, such as transportation and lodging during the trip, are deductible.
- Mileage at a rate of \$_____ per mile

Compensation

What does NOT qualify

Reimbursements for or payments of the following common nondeductible expenses are included in the employee's income:

- Cost of _____ while traveling from the old home to the new home
- Pre-move _____ expenses
- _____ living expenses after starting work in the new location
- _____ expenses incurred by the employee in selling a residence in the prior location and/or buying one in the new location.

Reporting moving expense reimbursements

Moving expense reimbursements or payments that qualify as a nontaxable fringe benefit should **not** be reported in Box 1, 3, or 5 of Form W-2.

Qualified moving expenses paid by an employer to a third party are not reported at all on the employee's Form W-2

Qualified moving expense reimbursements paid directly to the employee must be reported in Box _____, with Code _____.

Amounts reimbursed by an employer that do not qualify as a nontaxable fringe benefit are wages and must be included as such in Boxes 1, 3, and 5 of Form W-2, with the withheld amounts included in Boxes 2, 4, and 6, but not in Box 12.

Example

Tammy is starting a job with a new employer. She currently lives in New York, but her new job is in San Francisco and her new employer has agreed to reimburse her for the following expenses for her move.

Moving of her household goods and personal effects	\$ 7,500
Mileage for travel from NY to SF	340
Hotel in route	450
Meals in route	125
Hotel while house hunting	1,100
Meals while house hunting	375
Car rental on house hunting trip	300
Real estate commissions	12,000
Appraisal Fees	500
Relocation Bonus	5,000
Total	\$27,690

Compensation

What amount will be excluded from Tammy's income? _____

How much of this amount will be included in income? _____

Which boxes on the W-2 would be affected by these amounts?

Which code would be used in box 12 of the W-2 for excluded moving expenses?

Educational Assistance

A popular benefit offered by employers is employer-paid educational assistance. The taxation rules depend upon whether or not the courses are job-related.

Job-related education

If the employer pays for education that is related to the employee's current job, then it is excluded from income as a working condition fringe benefit if the following conditions are met:

1. _____
2. _____
3. _____

Non job-related education

An employer can provide non job-related educational assistance up to \$_____ per year without including it in the employee's income.

Under IRC §127, if the assistance is provided through an Educational Assistance Program (EAP), any assistance offered which is more than that amount is subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Group Legal Services

Employer-paid group legal services payments are included in the employee's income and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Compensation

Employee Business Travel Expense Reimbursements

In general, if reimbursement for business travel is made under an “_____ plan,” the amount is excluded from income and is not subject to federal income tax withholding or social security, Medicare, or FUTA taxes.

Travel must be “away from home” and “temporary”

To qualify, the employee must be away from his or her regular or principal place of business and must be away from home for no more than one year.

Reimbursements for daily transportation expenses

Reimbursements for an employee’s daily transportation expenses are not included in the employee’s income if:

- The expenses are incurred in going between the employee’s residence and a _____ outside the metropolitan area where the employee lives and normally works.
Example: John lives in Parsippany and works at his company’s location in Roseland. John is asked by his manager to spend a week at their office in New York City to train some new employees at that location. His employer reimburses him for the commute to New York City and it is not taxable.
- The employee has one or more regular work locations away from the _____ and the expenses are incurred in going between the employee’s residence and a temporary work location in the same trade or business, regardless of the distance.
Example: Jennifer is an inspector for her company and is asked to inspect three different job sites over the next three months. Jennifer drives to these sites, performs the inspections and is reimbursed for her travel. These expenses are not taxable.
- The employee’s residence is his or her principal place of business and the expenses are incurred in going between the employee’s residence and _____ in the same trade or business, regardless of whether the other work location is regular or temporary and regardless of the distance.
Example: Jack works from home. Occasionally, it is necessary for Jack to drive into the company’s office for meetings. His employer reimburses him for this commute and it is not taxable.

Compensation

Reimbursements under an accountable plan

To be an accountable plan, an expense reimbursement or advance payment program must meet the following conditions:

- Business connection – reimbursements must be for expenses that are incurred in connection with the performance of services as an employee of the employer.
- Substantiation – the employee must substantiate his or her business expenses by providing the employer with evidence of the amount, time, place, and business purpose of the expenses within a reasonable period of time after they are paid or incurred.
- Electronic and Web-based plans are approved – the IRS considers electronic and web-based documents to be adequate substantiation
- Returning excess amounts – amounts paid by the employer that exceed amounts spent by the employee must be returned to the employer within a reasonable period of time.

Payments under a nonaccountable plan

If an employer's reimbursement plan fails to meet any single requirement just mentioned, it is a nonaccountable plan and payments made under the plan are subject to federal income tax withholding and social security, Medicare, and FUTA taxes. However, if one employee substantiates their expenses and another does not, the plan does not become nonaccountable for all other employees.

Per diem allowances

Employers may provide reimbursement in the form of a per diem allowance for each day of travel. The amount of the per diem is deemed substantiated as long as it does not exceed the IRS-established federal per diem rates and the employee substantiates the time, place, and business purpose of the expenses.

High-low substantiation method

A simpler method of calculating per diem allowances is allowed by the IRS, whereby one federal per diem rate is established for hi-cost localities of travel and another rate for all other locations within the continental U.S. (CONUS). Under this high-low substantiation method, the employer may use the high-low per diem rate instead of the individual federal per diem rate of the locality of travel, so long as the allowance is for _____, _____ and _____, not just _____, _____, and the travel is within continental U.S. (CONUS).

Compensation

Mileage allowances

An employer may reimburse its employees for local travel or transportation expenses while away from home through a mileage allowance. The amount of the allowance up to the federal business standard mileage rate is deemed substantiated, so long as the employee substantiates the time, place, and business purpose of the travel. For 2017, the business standard mileage rate is \$_____ per mile.

Employer-Provided Meals and Lodging

Employer-provided meals

The value of meals furnished by an employer is excluded from the employee's income and is not subject to federal income tax withholding or social security, Medicare, or FUTA tax if:

- The meals are furnished on the employer's business premises; and
- They are furnished for the convenience of the employer

Employer-provided lodging

The value of employer-provided lodging is excluded from the employee's income if:

- The lodging is furnished on the employer's business premises
- The lodging is furnished for the employer's convenience; and
- The employee is required to accept the lodging as a condition of employment

Adoption Assistance

The IRS allows employer-provided adoption assistance to be excluded from an employee's income.

Dollar limitation

The maximum exclusion for qualified adoption expenses in _____ is \$_____ per eligible child.

Adoption of an eligible child

An eligible child is an individual who is under age 18 or is physically or mentally incapable of caring for himself or herself when the adoption assistance is provided.

Compensation

Withholding and reporting obligations

Employer-provided adoption assistance that meets the IRS requirements is not subject to federal income tax withholding, even if assistance exceeds the maximum dollar limitation. However, these amounts are subject to social security, Medicare, and FUTA taxes. It must be reported in Boxes ____ and ____ of the W-2 and the amounts withheld for social security and Medicare taxes reported in Boxes ____ and _____. The assistance must also be reported in Box _____ with Code _____.

Other Payments

Advances and Overpayments

Salary advances (prepaid wages) and overpayments must be included in the employee's income for the payroll period when received and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes at that time. The tax treatment of overpayments depends on the type of tax and when the money is repaid to the employer.

Awards and Prizes

Length of service or safety achievement awards

Is this included in income? _____

General requirements

- Must be an award of tangible personal property, which does not include cash or cash equivalents
- Must not be presented for less than _____ years on the job and must not have been awarded to the same employee within the last four years.
- Safety awards cannot be presented to more than _____% of eligible employees during a taxable year and cannot be presented to managers, administrators, professional employees, or clerical employees.
- In order for awards to be part of a qualified plan, there must be a written plan that does not discriminate in favor of highly compensated employees.

Compensation

Civic or charitable awards

Is this included in income? _____

General requirements

- Recipient cannot actively seek the award
- Award is not conditioned on performing future services
- Recipient must turn the award over to a governmental or charitable organization

Prizes for retail salespeople

Is this included in income? _____

These are noncash prizes awarded to retail salespeople paid solely on a commission basis for exceeding quotas or selling the most goods. Employers do not have to withhold _____ from such prizes, but they must be reported as income and are subject to social security, Medicare, and FUTA taxes.

Back Pay Awards

When employees win lawsuits or settlements against their employer for alleged violations of federal and state employment laws, the amounts awarded are often considered to be back pay for wages unlawfully denied.

While there can be confusion as to whether or not these awards should be included in an employee's income and subject to taxes, the IRS has stated that back pay received in satisfaction of an employment discrimination claim is included in gross income because it is not received on account of personal physical injuries or physical sickness. As a result, back pay is wages subject to _____ and _____, _____, and _____ taxes, and should be reported as such on Form W-2.

Bonuses

Amounts paid to employees as bonuses in addition to their usual compensation must be included in the employees' income and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Commissions

Commissions on sales of goods or insurance premiums are subject to federal income tax withholding and social security, Medicare, and FUTA taxes when paid to an employee.

Compensation

Conventions

If an employee's attendance at a convention, conference, or seminar is related to the employee's job and the employee accounts for his or her expenses in attending, any reimbursement by the employer up to the full amount of the expenses is excluded from the employee's income as a working condition fringe benefit.

Death Benefits

Death benefits paid upon an employee's death to his or her estate or beneficiaries must be reported on Form _____ when they are paid under a qualified or nonqualified deferred compensation plan, and on Form _____ when they are paid under such a plan or not. The benefits are not subject to social security or Medicare taxes.

Dependent Care Assistance Programs

If an employer provides some type of dependent care assistance program for their employees, whether it is an on-site or off-site day care facility or reimbursement for the employees' expenses in obtaining their own dependent care, the amount spent is excluded from an employee's income and is not subject to federal income tax withholding or social security, Medicare, or FUTA taxes.

The excluded amount of dependent care assistance cannot exceed \$_____ per year. Payments above that limit are subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Other requirements for Dependent Care Assistance:

- Dependent care must be necessary
- Expenses are treated as incurred when the care is provided, and not when payments are made to the employee or a third party
- There must be a separate written plan
- The program must not discriminate in favor of highly compensated employees
- Employer must provide a statement each year by January 31 showing the dependent care expenses incurred
- The value of the benefit is the amount reimbursed during the year and any amount reimbursed after the year for assistance provided during the previous year
- The value of the benefit must be included on the employee's Form W-2 in Box _____, with the taxable amounts in Boxes 1, 3, and 5 as necessary

Compensation

Directors' Fees

Often companies have a board of directors which may include nonemployees of that company. For nonemployees, the fees paid are not wages subject to federal income tax withholding and social security, Medicare, and FUTA taxes. The director is responsible for reporting such payments on their personal tax return. The employer must report the fees paid to the director on a Form 1099-MISC.

Disaster Relief Payments

Amounts received by an individual as a qualified disaster payment are not included in the individual's gross income.

Employer-Paid Taxes (Grossing Up)

When an employer pays an employee's taxes, the amount paid is an employer-provided benefit. The taxes paid on the employee's behalf are also taxable income to the employee. Because this could result in taxes accumulating to no end, a common procedure approved by the IRS is to "gross up" the payment to include the taxes in the gross pay.

Gross amount = [Desired net payment ÷ (100%-Total tax %)]

Assuming the payment will not push the employee's year-to-date wages over the social security wage limit for the year, here is how it would work.

Example

Paul's employer is providing him with a net bonus in the amount of \$1,000. Paul's year-to-date wages are \$48,000 and this bonus will be subject to a state income tax rate of 4.00%. As we'll see in Section 6, the standard federal supplemental rate for bonuses is 25%.

1. 25% (FIT) + 6.2% (SS) + 1.45% (Medi) + 4.00% (SIT) = _____%
2. 100 – _____% = _____%
3. \$1,000 ÷ _____% = \$_____ (Gross Bonus Amount)
4. Double check!
 - \$_____ x 25% = \$_____ (FIT)
 - \$_____ x 6.2% = \$_____ (SS)
 - \$_____ x 1.45% = \$_____ (Medi)
 - \$_____ x 4.00% = \$_____ (SIT)
 - Total Taxes = \$_____
 - \$_____ - \$_____ = \$_____

Compensation**When social security wage limit will be met**

When the bonus will put the employee's year-to-date wages over the social security limit, some extra steps must be taken.

Example

Sara's employer is providing her with a bonus in the amount of \$5,000. Sara's year-to-date wages are \$125,700 and this bonus is subject to a state income tax rate of 3.5%.

1. Determine how much of the bonus will be subject to social security
SS Limit \$127,200 - \$125,700 = \$1,500 (amount of bonus subject to SS)
2. Calculate the social security tax on that part of the bonus
 $\$1,500 \times 6.2\% = \93
3. Add the social security tax to the desired net
 $\$5,000 + \$93 = \$5,093$
4. Add remaining tax percentages
 $25\%(\text{FIT}) + 1.45\%(\text{Medi}) + 3.5\%(\text{SIT}) = 29.95\%$
5. Subtract the amount above from 100
 $100\% - 29.95\% = 70.05\%$
6. Take desired net from #3 above and divide it by amount in #5
 $\$5,093 \div 70.05\% = \$7,270.52$
7. Double check!

$\$7,270.52 \times 25\%$	$= \$1,817.63$
$\$7,270.52 \times 1.45\%$	$= \$105.42$
$\$7,270.52 \times 3.5\%$	$= \$254.47$
$\$1,500 \times 6.2\%$	$= \$93.00$
Total Taxes	$= \$2,270.52$
$\$7,270.52 - \$2,270.52$	$= \$5,000$

Compensation

Equipment Allowance

If an employer pays an allowance to employees who use their own tools or heavy equipment on the job, the allowance is not included in income and is not subject to federal income tax withholding or social security, Medicare, or FUTA taxes.

Gifts

Gifts provided to employee must be included in the employees' income and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes unless they can be excluded as a de minimis fringe benefit or as a gift between relatives that is not based on the employer-employee relationship.

Golden Parachute Payments

When companies change ownership, key executives are often provided with "golden parachutes" to soften their landing should they be terminated by the new owner. Under the IRC, a parachute payment is compensation paid to an officer, shareholder, or highly compensated employee only after a change in corporate ownership or control that is at least three times the employee's average compensation during the five most recent tax years. An excess parachute payment is the portion of the parachute payment that exceeds the employee's five-year average compensation

The entire payment is wages and is subject to federal income tax withholding and social security and Medicare taxes. The excess parachute payment is also subject to a ____% excise tax the employer must withhold. The employer must report the payment on Form W-2, with the withheld excise tax entered in Box ____, preceded by Code ____.

Example

Employee Victoria receives a parachute payment of \$1,250,000 after her company is acquired by another company and Victoria is asked to resign. Her average compensation for the last 5 years was \$400,000. What will be the amount of the excise tax on this payment?

\$ _____

Guaranteed Wage Payments

In some industries, employers have entered into agreements with employees to pay them an annual income or guarantee them a job even when no work is available. Payments provided under such guaranteed annual wage plans are wages subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Compensation

Jury Duty Pay

The tax treatment of wages received from an employer for time an employee spends on jury duty depends on the employer's policy.

- If the employee is paid their regular wage in addition to jury duty pay received from the court, those wages are subject to federal income tax withholding and social security, Medicare, and FUTA taxes.
- If the employer pays the difference between the employee's regular pay and the jury duty pay, only that difference is subject to federal income tax withholding and social security, Medicare, and FUTA taxes.
- If the employee is paid wages for time spent on jury duty, but is required to turn over the jury duty pay to the employer, only the difference between the amount paid and the amount turned over is subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Leave-Sharing Plans

Under an employer's leave sharing plan, employees donate a certain number of paid leave days, which are then "deposited" in a leave bank. Employees who participate in the plan and have medical emergencies can then use paid days from the bank when their own paid leave has been exhausted.

Compensation paid to employees using paid days from the leave bank is wages subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Loans to Employees

Loans made to employees by their employer at interest rates below the applicable federal interest rate are below-market, compensation-related loans. The difference between the interest charged to the employee and the applicable federal interest rate must be included in the income of the employee on any day in which the combined amount of all outstanding loans between the employer and the employee is more than \$10,000.

Military Pay

Differential military pay

Compensation paid to employees while they are on active military duty is subject to different tax rules depending on the type of tax involved and the length of the employee's service. These are referred to as differential wage payments and they are wages for purposes of _____. The payments are taxed as _____ wages because they are not payments for services for the civilian employer in the current payroll period. These payments are defined as

- Any payment made by an employer to an employee or any period during which the employee is performing service in the uniformed services while on active duty for more than 30 days, and
- Any payment that represents all or a portion of the wages that the employee would have received from the employer if the employee were performing services for the employer.

Compensation

This does not apply to social security, Medicare, and FUTA. For those taxes, the following rules apply:

- If the supplemental military pay is provided while the employee is on temporary assignment with the state National Guard or the Armed Forces Reserve, it is wages subject to social security, Medicare, and FUTA taxes
- If the supplemental military pay is provided while the employee is on active service with the U.S. Armed Forces or on an indefinite assignment with the state National Guard, the IRS treats the employment relationship as broken and the compensation is not subject to social security, Medicare, or FUTA taxes

Combat zone pay

Pay received by U.S. military personnel while serving in a combat zone or while hospitalized as a result of such service is excluded from income with certain limitations.

Outplacement Services

Services provided by employer to help employees find a new job after a layoff or reduction in force are excluded from income as a working condition fringe benefit.

Retroactive Wage Payments

Retroactive wage payments are treated as wages when they are made and are subject at that time to federal income tax withholding and social security, Medicare, and FUTA taxes.

Security Provided to Employees

Security provided to employees who carry large sums of money or jewelry, have access to confidential information, or have jobs involving matters of national security may be excluded from income as a _____. To qualify, the employer must have a “bona fide business-oriented security concern”.

Severance or Dismissal Pay

Severance or dismissal pay, which is provided to employees because they were terminated involuntarily through no fault of their own, must be included in the terminated employee’s income and is subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Compensation

Stocks and Stock Options

Employers often compensate employees or provide incentives in the form of company stock or an option to buy company stock at a fixed price. The tax consequences of such compensation depend on several variables, such as the form of the compensation and the conditions attached to receiving it.

Employer stock as compensation

If an employer pays employees with company stock instead of cash as compensation for services rendered, the _____ of the stock when transferred to the employee without restrictions is wages subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Stock Options

Options to buy company stock can take several forms

- Incentive stock options – gives an employee the opportunity to buy the employer corporation's stock at a fixed price for a certain period of time. To qualify for favorable tax treatment, several conditions must be met.
- Employee stock purchase plans – employees are given the opportunity to buy the employer corporation's stock at a discount. When the stock is sold, the employer has ordinary income equal to the lesser of: (1) the difference between the option price and the fair market value of the stock on the day the option was granted; or (2) the difference between the option price and the fair market value of the stock on the day of the sale.

Nonqualified stock options

A nonqualified stock option gives an employee the opportunity to buy the employer corporation's stock at a fixed price for a certain period of time, without the conditions placed on incentive stock options. When the option is exercised, the employee receives income equal to the excess of the value of the stock when the option is exercised over the price paid by the employee. This income is subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Strike Benefits

Strike and lockout benefits paid by a union to its members to provide them with money to pay bills during the strike generally are not wages and are not subject to federal income tax withholding or social security, Medicare, or FUTA taxes. However, if the union pays members an hourly wage for picketing activity, the payments are wages.

Compensation

Supplemental Unemployment Benefits

These benefits are provided by many employers with strong unions and substantial plant closings or reductions in force. The IRS regards these benefits as payments made in addition to a laid-off employee's state unemployment compensation benefits and are subject to federal income tax withholding.

The payments are excluded from wages subject to _____, and _____ taxes if certain conditions are met.

Tips

Generally, tips or gratuities provided voluntarily by customers are taxable wages to the employee receiving them. There are special rules that apply.

- Service charges are not tips
- Employees must report tip income to employers on Form _____
- The IRS allows employers to establish electronic systems for their tipped employees to use in reporting their tips
- Tip income is subject to federal income tax withholding and social security, Medicare, and FUTA taxes if the employee reports more than \$_____ in tips for the month.
- Tips are deemed to be paid when the employee furnishes the required report to the employer
- If an employee fails to report or underreports the amount of tips received, the employer is liable only for the employer share of social security and Medicare taxes and the employee is liable for the employee share.

Allocated tips

Food and beverage establishments with more than _____ employees must allocate tips if the amount of tips reported by employees for a payroll period is less than _____% of the establishment's gross sales subject to tips for that period. The difference between the amount reported by the employees and _____% must be allocated to the employees and reported on the employees' W-2 forms in Box _____.

Uniform Allowances

The amount paid by an employer for the cost of purchasing and maintaining an employee's uniform is not wages if the uniform is required as a condition of employment and cannot be worn as street clothes.

Vacation Pay

Vacation pay provided to an employee is taxable and subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Compensation

Wages Paid After Death

The tax treatment and reporting obligations for wages paid after an employee's death depend on when the wages are paid in relation to the employee's death. Here are three possible scenarios.

1. If an employee dies after receiving their check but before cashing it, the check should be issued for the same net amount to the _____. The amount is reported on the employee W-2.

Example: An employer pays wages to its employees on Friday, May 11. One of their employees receives their check on that date, but dies on Monday, May 14, before they cash that check. The employer will reissue the check for the same net amount to that employee's representative and it will be reported on the employee's W-2.

2. If the employee is paid wages following his death but in the same calendar year, the wages are not subject to FIT but are taxable for SS, Med, and FUTA. The amounts will display on the employee W-2 and the taxable amount should also be in Box ____ of the Form _____ in the name of the beneficiary.

Example: An employee dies on September 6 and the employer pays wages on September 14. The wages for this employee will not be subject to FIT, but will be taxable for SS, Med, and FUTA and will be reported on the employee's W-2. The taxable amount will also be reported in Box _____ of the Form _____.

3. If the employee is paid wages the year following his death, the amount is not subject to taxes and should only be reported in Box 3 of the Form 1099-Misc in the name of the beneficiary.

Example: An employee dies on December 21 and the employer pays wages on January 5. These wages are not subject to taxes and will only be reported in Box 3 of Form 1099-MISC in the name of this employee's beneficiary.

Withholding and Reporting Rules for Employer-Provided Benefits

After determining that a benefit provided to its employees is taxable income subject to federal income tax withholding and social security, Medicare, and FUTA taxes, the next step is to properly withhold, pay, and report on the benefit and the taxes withheld to the IRS and SSA.

Withholding on Cash Fringe Benefits

If a fringe benefit that must be included in an employee's income is provided by the employer in cash, the employer must withhold any federal income, social security, or Medicare tax due when the benefit is paid.

Compensation

Withholding and Reporting on Noncash Fringe Benefits

Fringe benefits provided in a form other than cash are known as noncash fringe benefits and get special treatment by the IRS. The employer may treat the benefit as being paid on a pay period, quarterly, semiannual, annual or other basis, but no less frequently than annually.

An employer may also treat the value of a single fringe benefit as being paid on several dates during the calendar year. The employees do not have to be told of the employer's election, and neither does the IRS.

Special accounting rule

Employers have another option for reporting noncash fringe benefits. They may treat fringe benefits provided during November and December of one year as being paid during the next year. This gives employers additional time to value noncash fringe benefits. There are some restrictions that apply.

Example

Tim's employer calculates the fair market value for Tim's personal use of a company-owned vehicle on a monthly basis. For this year, the fair market value for his personal use of the car for November was \$250 and for December it was \$300. Tim's employer uses the special accounting rule and therefore \$_____ will be reported in the following year, while the value for January through October will be reported in the current year.

Compensation

Taxable and Non-Taxable Compensation Recap

Compensation	EE Taxability	ER Taxability	Effect on Gross Pay	Reported on Form W-2?
No-additional –cost services				
Qualified employee discounts (____% - services and _____ sales)				
Working condition fringes				
De minimus fringes				
Qualified transportation benefits Trans. \$ _____ Parking \$ _____				
On-premises athletic facilities				
Qualified moving expense reimbursement (Covers _____ and _____ per mile)				
Personal use of employer vehicle				
Group Term Life (over \$ _____)				
Qualified education assistance (up to \$ _____ per year)				
Substantiated business expense reimbursement				
Unsubstantiated business expense reimbursement				

Compensation

Taxable and Non-Taxable Compensation Recap (Cont.)

Compensation	EE Taxability	ER Taxability	Effect on Gross Pay	Reported on Form W-2?
Mileage reimbursement (_____ per mile)				
Employer provided meals and lodging				
Adoption Assistance (up to \$ _____ per adoption)				

*For Personal use of employer vehicle – Box 12 Code L - Use this code only if you reimbursed your employee for employee business expenses using a per diem or mileage allowance and the amount that you reimbursed exceeds the amount treated as substantiated under IRS rules.

Compensation

Review of Other Compensation Types

Compensation	EE Taxability	ER Taxability	Effect on Gross Pay	Reported on Form W-2
Advances and Overpayments				
Awards and Prizes LOS 5 yrs + meaningful Safety < 10% of ees/year				
Back Pay Awards				
Bonuses				
Commissions				
Conventions				
Death Benefits				
Dependent Care Assistance (up to \$_____)				
Directors' Fees				
Disaster Relief Payments				
Equipment Allowances				
Gifts				
Golden Parachute Payments				
Guaranteed Wage Payments				
Jury Duty Pay				
Leave Sharing Plans				
Loans to Employees (amount exceeds 10,000)				
Military Pay				
Outplacement Services				
Retroactive Wages				
Security Provided to Employees				
Severance or Dismissal Pay				

 Compensation

Review of Other Compensation Types (Cont.)

Compensation	EE Taxability	ER Taxability	Effect on Gross Pay	Reported on Form W-2?
Stocks and Stock Options In Lieu of wages Incentive Stock Option Employee Purchase Plan				
Strike Benefits Picketing Pay				
Supplemental Unemployment Benefits				
Tips (Allocated at ____% percent)				
Uniform Allowances				
Vacation Pay				
Wages Paid After Death Pending check In year of death In year after death				

Section 4 – Health, Accident, and Retirement Benefits

Objectives

- Describe different types of health insurance plans and their taxability requirements
- Define COBRA and its qualifying events
- Explain the FMLA and what it means to employers
- Define Sick Pay and its taxability
- Describe Cafeteria Plans and their tax requirements
- Define Retirement and Deferred Compensation Plans and their components

Benefits

Health Insurance

Most mid-size and large employers provide some type of health or medical insurance for their employees. This section covers contributions to and benefits from health insurance plans that pay or reimburse employees for their medical expenses.

Types of Health Insurance Plans

There are several types of health care plans offered by employers to their employees and they can generally be categorized as one of the following:

Traditional health insurance plans

Under this plan, the employer can either self-insure or purchase coverage from a third party. If they self-insure, they would pay claims to employees or health care providers from their own insurance fund. If they buy coverage from a third-party insurance carrier, then they would then pay premiums to the insurer, which would then reimburse the employee for medical expenses.

Health maintenance organizations (HMOs)

This is a health care system that provides health care but does not directly pay for it, as does a health insurance carrier. The HMO provides these health care services on a prepaid basis with employers contributing to the plan on behalf of employees choosing the HMO option. These plans generally do not involve deductibles or complex claim procedures, but they limit members to using _____.

There are two types of health maintenance organizations. They are:

- Traditional HMO – has its own health care facility or facilities and patients have to go there to receive medical services
- Point-of-Service (POS) – this option allows covered employees and their dependents to use non-HMO health care providers, with the inclusion of deductibles and insurance copayments. Employees and their dependents must select a primary care physician from the POS network, who acts as a gatekeeper and oversee the delivery of all health care services.

Preferred provider organizations (PPOs)

This is a health care delivery system that gives participants a choice of a higher level of benefits and lower out-of-pocket costs if they use doctors who are part of the PPO's _____. If they use _____ providers, the employees' costs, in terms of deductibles and copayments, are significantly higher.

Benefits

Affordable Care Act Health Insurance Requirements

One of the major requirements of this legislation is that “applicable large employers” (ALEs) provide “affordable” health insurance to their full-time employees that provides “minimum essential coverage.” This is the Employer Shared Responsibility (ESR) requirement.

For 2015 and after, employers employing at least ____ full-time employees (including full-time equivalent employees) are subject to the ESR provisions under IRC §4980H. A full-time employee is an individual employed on average at least ____ hours per week. An employer that meets these thresholds is referred to as an “applicable large employer (ALE).

The employer may be subject to an ESR payment if at least one of its full-time employees receives a premium tax credit for purchasing individual coverage on one of the Affordable Insurance Exchanges, also called a Health Insurance Marketplace.

For purposes of determining whether an employer is an ALE, all employees are counted, regardless of whether the employees are eligible for health coverage from another source, such as Medicare, Medicaid, or a spouse’s employer. But, employees who are eligible for Medicare or Medicaid are not eligible for a premium tax credit.

New employers

The status of new employers is determined based on the average number of employees the employer is expected to have in the current year.

Affordable coverage

If an employee’s share of the premium for employer-provided coverage would cost the employee more than ____% of that employee’s annual household income, the coverage is not considered affordable for that employee. Because employers generally will not know their employees’ household incomes, employers can take advantage of one or more of the three affordability safe harbors set forth in the regulations that are based on information the employer will have available, such as the employee’s Forms W-2 wages or the employee’s rate of pay.

The three affordability safe harbors are as follows:

1. The Form W-2 wages safe harbor – which generally is based on the amount of wages paid to the employee that are reported in Box 1 of that employee’s Form W-2.
2. The rate of pay safe harbor – which generally is based on the employee’s rate of pay or salary at the beginning of the coverage period, with adjustments permitted, for an hourly employee, if the rate of pay is decreased (but not if the rate of pay is increased).
3. The federal poverty line safe harbor – which generally treats coverage as affordable if the employee contribution for the year does not exceed 9.5% of the federal poverty line for a single individual for the applicable calendar year.

Benefits

Tax Treatment of Contributions and Benefits

Employer-paid premiums excludable from income

Generally, contributions made by an employer to an accident or health insurance plan providing insurance for its employees and their spouses and dependents are not wages and are not subject to federal income tax withholding or social security, Medicare, and federal unemployment (FUTA) taxes. For employee contributions, unless they are made through a valid salary reduction plan under IRC §125, they would be included in the employees' income for income tax withholding and employment tax purposes.

Insurance benefits excludable from income

Benefits received by an employee under an accident or health insurance plan that directly or indirectly reimburses the employee medical expenses incurred by the employee and his or her spouse, dependents, and children who have not reached age 27 at the end of the taxable year are also not included in the employee's income.

Social security, Medicare, and FUTA requirements

To exclude employer contributions from employment taxes, the payments must be made under a plan, which can be shown by the following:

1. The plan is written or is otherwise made known to employees
2. The plan is referred to in an _____ involving the employees
3. Employees contribute to the plan
4. Employer contributions are made to a fund that is separate from the employer's salary accounts; or
5. The employer is required to make the contributions

W-2 reporting of employer-sponsored health coverage

Employers are required to report the total cost of employer-sponsored health coverage on employees' Forms W-2.

All employers that provide applicable employer-sponsored coverage during a calendar year are subject to the reporting requirement.

The aggregate reportable cost of employer-sponsored health insurance is reported on Form W-2 in Box ____, using code _____. The aggregate reportable cost includes both the portion of the cost paid by the employer and the portion of the cost paid by the employee, regardless of whether the employee paid for that cost through pre-tax or after-tax contributions.

Benefits

Not included in the aggregate reportable cost

The following amounts are not included in the aggregate reportable cost, but they may be reportable elsewhere on Form W-2.

- Archer Medical Savings Account (Archer MSA)
- Health Savings Account (HSA)
- Multiemployer Plan
- Health Reimbursement Arrangement (HRA)
- Health Flexible Spending Arrangement (FSA)

Medical Savings Accounts (Archer MSAs)

Employees of small employers who are covered by an employer-sponsored high deductible health insurance plan can make tax deductible contributions to a Medical Savings Accounts or to have the employer make contributions on the employee's behalf that are not included in the employee's income. These are referred to Archer MSAs.

Employers are eligible to provide MSAs for their employees if they employed no more than ____ employees during either of the two preceding calendar years.

In order to be eligible to make contributions to an MSA, or to have the employer make contributions on their behalf, the employee must be covered only by a high deductible health insurance plan, with certain limited exceptions.

For year _____, a high deductible health plan is a plan with an annual deductible of \$_____ - \$_____ for individual coverage and \$_____ - \$_____ for family coverage.

Contributions to an MSA can be made either by the employee or the employer but **not** both. Employee contributions to an MSA are deductible from income and employer contributions are excludable from income and not subject to federal income tax withholding or social security, Medicare or FUTA tax, with certain limitations.

Employer contributions to an employee's MSA must be reported in Box ____ of the employee's Form W-2, preceded by Code _____. Employee contributions to a medical savings account are subject to federal income tax withholding and social security and Medicare taxes, and must be reported as such in Boxes 1, 3, and 5 of Form W-2. The employee can take a deduction for the contributions on his or her personal income tax return.

Benefits

Long-Term Care Insurance

Long-term care insurance contracts are generally treated as accident and health insurance contracts and amounts received under such contracts are excluded from income as amounts received for personal injuries and sickness and reimbursements for medical expenses. If the contract makes per diem payments, the excludable amount will be capped at \$_____ per day for year _____.

COBRA Health Insurance Continuation

The Consolidated Omnibus Budget Reconciliation Act of 1985 requires health plan sponsors to provide employees and their beneficiaries with the opportunity to elect continued group health coverage for a given time period should their coverage be lost due to certain “qualifying events.” The requirements apply to employers with ____ or more employees on a typical business day.

Qualifying Events and Periods of Coverage

A qualifying event is any of the following that would result in the loss of group health insurance coverage for a qualified beneficiary:

Qualifying Event	Period of Coverage
Employee's termination (for reasons other than gross misconduct) or reduction in hours worked	____ months (____ months if the reason for absence from employment is the employee's military service); Extended to ____ months if another qualifying event occurs during this period.
Employer's Bankruptcy	The life of the retiree or the retiree's spouse; Once the retiree dies, the period of continuation for the retiree's spouse and children is ____ months from the retiree's death.
Employee's termination or reduction in work hours and a qualified beneficiary is disabled at any time during the first 60 days of continued coverage	____ months Extended to ____ months if another qualifying event, (other than bankruptcy) occurs during that period.
Employee's death, divorce, separation, or entitlement to Medicare, or a covered child's loss of covered child status	____ months

Benefits

Election and notice provisions

Employee and other qualified beneficiaries who wish to take advantage of continued group health plan coverage must make an election of such coverage. The election period must last for at least 60 days and can begin no earlier than the date on which coverage was terminated because of the qualifying event.

Health Reimbursement Arrangements

A Health Reimbursement Arrangement (HRA) is a type of employer-provided health benefit that:

- is paid for solely by the employer and not provided pursuant to a salary reduction election or under a §125 cafeteria plan;
- Reimburses the employee for medical care expenses incurred by the employee and the employee's spouse, dependents, and adult children until the year they reach age 27; and
- Provides reimbursements up to a maximum dollar amount for a coverage period, with any unused portion of the maximum dollar amount at the end of the coverage period carried forward to increase the maximum reimbursement amount in subsequent coverage periods

Health Savings Accounts

A Health Savings Account (HSA) is a tax-favored savings account designed to help employees save for medical expenses while they are employed and into retirement.

HSAs may be established by individuals who are covered by a high deductible health plan, which is defined as a plan with annual deductible of at least \$_____ for year _____ in the case of self-only coverage or \$_____ in the case of family coverage.

Contributions up to maximum not included in income

Contributions to an HSA made by or on behalf of an eligible individual up to the maximum annual contribution limit are deductible by the individual. In addition, employer contributions (including salary reduction and contributions made through a cafeteria plan) are excludable from gross income and wages for income tax withholding and social security, Medicare, and FUTA tax purposes if the employer reasonably believes at the time the contribution is made that it will be excludable from the employee's income.

Maximum annual contribution

The maximum annual contribution that can be made to an HSA in year _____ is \$_____ in the case of self-only coverage and \$_____ in the case of family coverage. Individuals age 55 and older can make additional "catch-up" contributions to an HSA until they are enrolled in Medicare. The additional allowable contribution for year _____ is \$_____.

Benefits

Reporting requirements

Employer contributions, including salary reduction contributions through a cafeteria plan, are required to be reported on the employee's Form W-2 in Box ____ with Code _____. Employer contributions that are not excludable from income also must be reported in Boxes 1, 3 and 5, with the taxes withheld reported in Boxes 2, 4, and 6.

Family and Medical Leave Act

The Family and Medical Leave Act (FMLA) allows employees to take up to ____ workweeks of unpaid leave in a 12 month period to be with a newborn or newly adopted child, to take care of a seriously ill child, spouse, or parent, to care for themselves if they are seriously ill, or because of any qualifying exigency arising out of the fact that the employee's spouse, son, daughter, or parent is a covered military member on active duty or has been notified of an impending call to active duty in support of a contingency operation. The law also guarantees continuation of employees' health benefits while on leave.

Employer and employee coverage

The FMLA applies to private sector employers with ____ or more employees. An employee at a facility with less than ____ employees may still be eligible for the leave benefits if the employer has at least ____ employees working within a ____-mile radius of the facility.

Additional information

Here are some additional highlights of the FMLA:

- Employers can require employees to take unpaid leave if the employee has a serious health condition that makes him unable to perform the functions of his position
- An employee who needs to take leave because of an illness suffered by the employee or the employee's child, spouse, or parent on an intermittent or occasional basis may do so.
- An employer can require an employee to use paid leave, such as vacation, personal, sick, medical, or family leave as part of the 12-week guaranteed leave.
- FMLA regulations generally require that the employer notify an employee of his/her eligibility to take FMLA leave within 5 business days after either the employee requests leave or the employer acquires knowledge that the employee's leave may be for an FMLA-qualifying reason.
- Health insurance benefits the employee enjoyed before the leave must be continued during the FMLA leave on the same basis.
- Employees returning from leave are entitled to their previous job or one that is "equivalent," with no loss of pay or benefits accruing before the leave.

Benefits

Sick Pay

Sick pay can take many forms, but its main purpose is to replace the wages of an employee because of an illness or injury. The tax treatment of such payments depends on several variables, including:

- Who makes the _____
- Who bears the _____ risk
- Who paid the _____ on any insurance involved, and
- Whether the employee is _____ or _____ unable to work

Sick Leave Pay

Most employers provide their employees with paid sick leave or sick days so they will receive their regular salaries for brief absences from work due to illness or injury. Payments are made from the regular payroll account and are taxable wages subject to federal income tax withholding and social security, Medicare, and FUTA taxes when paid.

Sick Pay Under a Separate Plan

When an employee is out for a more extended period of time but is still expected to return to work at some point then wages are usually received through some type of short or long-term disability plans.

How much is taxable?

Benefits that are attributable to employer contributions or to employee pre-tax contributions through a cafeteria plan are taxable income to the employee.

Group insurance plans that are funded by both the employer and the employee are subject to special rules to determine the taxability of the sick payment received. If the employer knows the amount of the premium they paid to the insurance company during the last three years, then the following formula applies:

$$\text{Employee's sick pay} \quad \times \quad \frac{\text{Employer-paid premiums for last 3 years}}{\text{Total premiums paid for last 3 years}}$$

Benefits

Example: Mike was injured in a non-job-related accident on March 2, 2016 and was out of work until January 1, 2017. Mike received payments of \$3,000 per month while out of work from his employer's insurance company. During the 3 policy years before 2016, Mike's employer contributed \$30,000 in net premiums to insure its employees, while the employees paid \$10,000 in after-tax dollars. The amount of Mike's monthly sick pay that is included in income is:

Taxable sick pay = \$3,000 x [$\$30,000 \div (\$30,000 + \$10,000)$]

Taxable sick pay = \$3,000 x ($\$ \underline{\hspace{2cm}} \div \$ \underline{\hspace{2cm}}$)

Taxable sick pay = \$3,000 x $\underline{\hspace{2cm}}$

Taxable sick pay = \$ $\underline{\hspace{2cm}}$

Remember: Where the employee paid the premium with pre-tax dollars, the amount is fully taxable.

Responsibility for income withholding and employment taxes

Once it's determined that payments under a sick pay or disability plan are taxable income in whole or part to an employee, the next step is to determine the federal income tax withholding and social security, Medicare, and FUTA tax responsibilities related to the taxable portion of the payments.

Payments made by employer

Where the employer's plan is self-insured, meaning the employer bears the insurance risk, and the employer makes the payments, the employer must withholding federal income tax based on the employee's most recent Form W-4. The employer must also pay its share of social security and Medicare taxes, withhold the employee's share of those taxes, and pay FUTA tax for all payments made within $\underline{\hspace{2cm}}$ after the end of the last month during which the employee worked for the employer.

Payments made by employer's agent

Where the employer contracts with a third party to administer its disability plan and pays the third party on a cost-plus-fee basis while retaining the insurance risk (i.e., no premiums are paid to the third party), payments made to disabled employees by the third party are treated as if made by the employer. The third-party agent may treat the payments as supplemental wages for federal income tax withholding purposes and withhold at the optional flat rate of $\underline{\hspace{2cm}}\%$ if it is not an agent that also pays regular wages to the employee.

Benefits

Payments made by a third party who is not an agent

Where the employer contracts with a third-party insurer to make disability payments to its employees and the third party bears the risk of insuring the employees, it assumes a greater role. The third party is not required to withhold _____ from payments made to a disabled employee unless the employee submits a Form W-4S. The third party must withhold and pay over the employee's share of _____ and _____ for each payment made within ____ months after the end of the last month the employee worked for the employer. The third party is also responsible for _____

>

Depositing withheld taxes

The general rules for depositing withheld income and employment taxes apply to sick pay, although the liability for depositing may vary depending on who is responsible.

Reporting responsibilities

If the employer makes the payments

- they must report all taxable amounts on their quarterly Form 941
- the taxable amounts must also be reported to the employee on Form W-2 in Boxes 1, 3 and 5 with nontaxable amounts attributable to employee contributions in Box ____, preceded by Code ____
- all payments must be reported on their Form 940

If the employer's agent makes the payments

- the employer retains reporting responsibility
- the employer's name and EIN are used on all forms
- If the agency agreement shifts the responsibility from the employer to the agent, the agent should use their own name and EIN

If the third-party insurer makes the payments

- The third party must report the taxable amount of sick pay on their quarterly Form 941
- The taxable amounts must be reported to the employee on Form W-2 (same requirements as those for the employer above)
- The checkbox "third-party sick pay" must be checked on Box ____ of Form W-2
- All payments must be reported on Form 940

Benefits

Permanent Disability Benefits

Payments to total and permanently disabled employees are income to the employees and are subject to federal income tax withholding by the party making the payments to the extent the employer paid the premiums or the employee paid the premiums with pre-tax dollars.

Amounts paid on or after the employment relationship has been terminated because of death or disability retirement are not subject to social security, Medicare, or FUTA tax. However, such amounts are subject to employment taxes if they would have been paid even if the employment relationship would not have been terminated for such a reason. For example, payment for unused vacation time that would have been made regardless of the reason for termination would be subject to social security, Medicare, and FUTA taxes.

Workers' Compensation Insurance

Workers' compensation is a form of insurance employers are generally required to buy to protect them should lawsuits be brought by employees who are hurt or become ill while working. Payments received as workers' compensation benefits are not included in an employee's gross income and are not subject to any employment taxes. Each state has its own workers' compensation law setting premium rates and benefits, assigning classification codes, and determining what types of employee compensation are included in the calculating premiums.

Cafeteria Plans

A cafeteria plan is a popular benefit offered by mid-size and large employers which gives employees a choice from a menu of cash compensation and nontaxable (qualified) benefits. This is a specific type of flexible benefit plan authorized by §_____ of the IRC.

IRC regulations indicate that when employees may elect between taxable and nontaxable benefits, this ability to elect results in gross income to the employees unless the election is made under a qualified cafeteria §125 plan.

Benefits

What Benefits Can Be Offered

A plan that offers any nonqualified benefits (some of which are included in the Payroll Source), is not a cafeteria plan, and allowing employees to elect them will result in income to the employees.

Some examples of qualified benefits are:

- Coverage under accident and health insurance plans other than long-term care insurance plans
- Coverage under _____ plans
- _____ on the lives of employees
- Qualified adoption assistance
- Premiums for COBRA continuation coverage
- Accidental death and dismemberment insurance
- Long-term and short-term disability coverage
- A _____ plan
- Contributions to _____

Premium-only plans

Known as POP or premium conversion plans, are used by employers who require their employees to contribute toward benefits, usually health insurance. This type of plan generally does not offer a menu of benefits to choose from, but allows employees to pay for their share of the benefit costs on a pre-tax basis through a salary reduction in the amount of the required contribution. They are permissible under §125.

Deferred compensation

The rules governing cafeteria plans generally prohibit the inclusion of any plan providing for or allowing the deferral of compensation. A cafeteria plan violates this rule if it allows employees to:

- Carry over unused contributions or benefits from one plan year to another
- Use contributions from one plan year to purchase benefits the employer will provide in a later plan year

An exception for this is for cash or deferred arrangements under a _____ plan, which allows employee to contribute part of their salary to a pension or profit sharing plan on a pre-tax basis.

Benefits

How Cafeteria Plans Are Funded

Cafeteria plans and other flexible benefit plans are generally funded by either or both of the following:

- Flex dollars or flex credits – each employee is provided with a certain amount of flex dollars or credits which they can use to buy selections from the plan menu or elect to receive them in cash
- Salary reduction – employees use part of their own salary to purchase their benefit selections through pre-tax or after-tax deductions

What the Cafeteria Plan Document Must Contain

A cafeteria plan must have a written document laying out the particulars of the plan and it must be intended to be a permanent. The details of what a plan document must contain are listed in the Payroll Source.

Benefit Elections

Generally, employees must make irrevocable benefit elections under a cafeteria plan before the benefit becomes available or the plan year begins, whichever comes first. The changes in status that allow a cafeteria plan to permit an employee to revoke or change a benefit election during a plan year include:

- Marital status changes – marriage, divorce, death of spouse, legal separation, or annulment
- Changes in the number of dependents or adult children before the year they reach age 27 – birth, adoption, placement for adoption, or death of a dependent or eligible adult child
- Employment status changes – termination or commencement of employment, strike or lockout, starting or ending an unpaid leave of absence, change in worksite, change from full-time to part-time, exempt to nonexempt, or salaried to hourly status
- Residence change – a change in the place of residence of the employee, spouse, or dependent
- Adoptions – the commencement or termination of an adoption proceeding

Rules for cost-driven changes

Election changes also may be made to reflect significant cost or coverage changes for all types of qualified benefits provided under a cafeteria plan during the plan year.

Who Can Participate in the Plan

Participation must be restricted to employees (including former employees but not self-employed individuals), and the plan must be maintained for their benefit. It may not be maintained solely for the benefit of former employees.

Benefits

Nondiscrimination Testing

To qualify for favorable tax treatment for all cafeteria plan participants, the plan must not discriminate in terms of eligibility, contributions, or benefits in favor of highly compensated individuals, or participants, or key employees.

Flexible Spending Arrangements

Many cafeteria plans offer another type of benefit program known as a flexible spending arrangement or FSA. FSAs give employees the chance to pay for certain covered health care, dependent care, and adoption expenses with pre-tax dollars provided through salary reduction. As the employees incur covered expenses, they are reimbursed up to the amount that will be contributed during the plan year through salary reduction.

Health care FSAs are governed rules, which include, but are not limited to:

- Elections cover a full plan year
- Salary reductions are capped. Employees are limited to making \$_____ of salary reduction contributions in a taxable year to their health care FSA.
- No deferred compensation (“use it or lose it”) – Any amount in a health FSA that remains unused at the end of the plan year (or the end of a grace period if applicable) is forfeited by the employee.
- Plan can allow a grace period up to 2 ½ months

Benefits

Tax Treatment of Cafeteria Plans

Employer contributions

These are excluded from the employee's income and are not subject to federal income tax withholding or employment taxes to the extent the contributions relate to nontaxable benefits selected by the employee.

Pre-tax contributions

Pre-tax contributions made by an employee to a qualified cafeteria plan are excluded from the employee's income and are not subject to federal income tax withholding or social security, Medicare, and FUTA taxes.

Group-term life insurance

In addition to offering up to \$50,000 of nontaxable group-term life insurance on the life of an employee, a cafeteria plan may offer coverage above \$50,000 as a qualified benefit.

After-tax contributions

Contributions toward benefits that are made with after-tax dollars are included in the employee's income and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes. The benefits purchased, however, are excluded from the employee's income.

Cash

If employees choose to take cash instead of purchasing benefits with their flex dollars, the payments are wages and are subject to federal income tax withholding and social security, Medicare, and FUTA taxes.

Discriminatory Plans

Cafeteria plans that discriminate in favor highly compensated individuals, employees, or participants, or key employees are not disqualified and do not have negative tax consequences for other participants.

Taxation of qualified HSA distributions

A qualified HSA distribution from the health FSA covering the participant to his or her HSA is a rollover to the HSA and thus is generally not includible in gross income.

Benefits

Reporting Requirements

Generally, pre-tax contributions to a cafeteria plan need not be reported by an employer in its quarterly Form 941 or an employee's Form W-2 as taxable wages.

Cash or deferred arrangements

While pre-tax contributions to a 401(k) plan are not subject to federal income tax withholding, they are subject to _____, and _____ taxes. Therefore, they must be reported on the employee's Form W-2 in Boxes 3 and 5, respectively, with the amounts withheld reported in Boxes 4 and 6. The elective deferrals must also be reported in Box _____, preceded by Code _____.

Dependent care assistance

If an employee contributes to a dependent care assistance FSA through either pre-tax contributions or flex credits, the employer must report the amounts on the employee's Form W-2 in Box _____, with the excess over \$_____ reported as well in Boxes 1,3, and 5.

Retirement and Deferred Compensation Plans

Along with medical insurance, one of the most important benefits employers generally provide is a plan to ensure that their employees will have a source of income after retirement. The remainder of this section in the Payroll Source details the various plans available and to summarize the plans, their taxability, contributions limits, and other pertinent information, the following pages in these study notes contain a summary table to be filled in.

Benefits

Qualified Pension and Profit-Sharing Plans (IRC § 401(a))

Type of Plan	Included in Income?	FIT Taxable	SS/Med Taxable	FUTA Taxable	Contribution Limit	Catch-up Provision	W-2 Box 12 Codes
§401(k) For profit companies with over 99 employees							
403(b) Schools & Churches							
§408(k) Simplified EE Pension – IRC							
§457 State & Local government and other tax-exempt organizations							
§501(c) (18) (D) Pension plans prior to 6/25/59							
IRAs Employee Contributions to an Employer-sponsored plan							

Benefits

Type of Plan	Included in Income?	FIT Taxable	SS/Med Taxable	FUTA Taxable	Contribution Limit	Catch-up Provision	W-2 Box 12 Codes
Nonqualified Deferred Comp. Plans (Unfunded)							
Nonqualified Deferred Comp. Plans Funded & Vested)							
SIMPLE Plans							
EE Stock Ownership Plans (ESOP)							

* The treatment of employer contributions to a nonqualified deferred compensation plan is somewhat different in relation to social security, Medicare, and FUTA taxes. It does not matter whether the plan is funded or unfunded. Employer contributions and earnings are subject to social security, Medicare, and FUTA taxes on the later of:

- The date services are performed that form the basis for the contributions; or
- When there is no substantial risk of forfeiture of the employee's interest in the funds

Section 5 – Paying the Employee

Objectives

- Define pay frequencies and rules for payments upon termination
- Discuss the different payment methods
- Describe the rules governing pay statements, unclaimed paychecks, and wages owed to deceased employees
- Review the procedures for extra pay periods caused by the calendar

Because most aspects involving the paying of employees is regulated by state law rather than federal law or in addition to federal law, there will be a lot of state-specific information in the Payroll Source that will not be addressed in these study notes. In this section, these notes will focus on the areas most likely to be included in the CPP exam.

Pay Frequency

The Fair Labor Standards Act does not regulate how often employees must be paid by their employer how soon they must be paid after performing services. These matters are left up to the individual states.

Payment on Termination

Most states have a separate set of rules governing when employees must be paid when they separate from employment, either through discharge, layoff, or resignation.

Payment Methods

The Fair Labor Standards Act does not regulate the actual methods or media used by employers to pay their employees. Individual states have assumed the task of making sure employees actually receive cash or its equivalent when they are paid for services performed.

Direct Deposit

The most popular method of paying employees is direct deposit, a type of electronic funds transfer (EFT) allowing employers to deposit employees' pay directly into their designated bank accounts without having to handle a paycheck. It helps eliminate many of the problems associates with employee paychecks, including:

- _____
- _____
- _____
- _____
- _____

How the process works

Direct deposit of payroll is the automatic deposit of an employee's pay into the employee's checking and/or savings account at a financial institution. For those employees being paid through direct deposit, here is the process:

1. The employer prepares an automated file of direct deposit records indicating where the employees' pay is to go. This file is then sent to a financial institution with the ability to process the file, known as the _____ (ODFI).
2. The ODFI makes sure the file has been prepared correctly, checks for any exceptions and entries for employees' accounts maintained by the ODFI and processes the file through the _____ (ACH) network.
3. The ACH operators deliver files to the _____ (RDFI).

Here are more details on the roles of each of these institutions:

- ODFI – delivers the file to the ACH Operator
- ACH – operates under the rules developed by NACHA, the Electronic Payments Association, and processes electronic payments between the ODFI and the financial institutions designated by the employees to receive their payments and coordinates the financial settlement between the participating financial institutions
- RDFI – designated by the employees and accepts the electronic payments, posts them according to ACH rules, and settles with the ACH Operator for their value.

Employee authorization for direct deposit

Before an employer can begin direct deposit for an employee, the employee must agree to allow the electronic transfer of funds from the employer to the employee with a direct deposit authorization.

Under the NACHA rules, authorizations to make credit entries to employees' accounts do not have to be in _____.

Authorizations of debit entries must be in _____ and _____ or similarly authenticated by the employee.

The following information must be provided as part of the employee's direct deposit authorization:

- The _____ and _____ of the financial institution designated by the employee to receive the direct deposit payments;
- The _____ into which the payments will be deposited (i.e., checking or savings); and
- The _____

Mistakes can occur with direct deposit as they can with any payroll function. According to the NACHA rule, employers can generate a _____ through the ACH network within ____ banking days from the date of the original entry. No debit authorizations are necessary from employees for these. However, the rules do require that the employee be notified of the reversal no later than the settlement date of the reversing entry.

Prenotifications

These involve sending zero dollar amounts through the ACH network as a test before the first actual direct deposit for an employee. They are optional, but if one is used, it must be sent within ____ banking days before any actual pay is sent through the network.

Electronic Paycards

For some employees, direct deposit may not be an option. Often, the main reason this is the case is the employee's lack of a banking relationship with a financial institution to which a direct deposit can be sent.

One alternative for employers that want to pay these employees through electronic funds transfer is pre-paid electronic paycards, which are stored value debit cards that the employer funds with the amount of the employee's net pay. The employee then accesses his or her pay by using the card to make purchases or withdraw cash.

How paycards work

Generally paycards work similar to any other debit card. They are pre-funded, host-based cards that the employee can use to access his or her net pay at an ATM or a bank, or to make point-of-sale purchases.

Branded vs. nonbranded paycards

Branded cards have either a Visa®, MasterCard®, or Discover Network® logo imprinted on them. They are accepted wherever these types of credit cards are accepted and require only the employee's signature for cardholder authorization. Branded cards also have a 4-digit personal identification number (PIN) the employee must use to withdraw funds from an ATM or check the card's balance.

Nonbranded stored-value paycards have the logos of one or more major ATM or POS networks imprinted on them (e.g., STAR®, Pulse®, NYCE®, etc.) and can be used to make POS purchases, access account information, or withdraw funds from an ATM. Unlike branded cards, nonbranded cards require the use of a PIN for all transactions. Also, purchases and withdrawals with a nonbranded card can only take place if the host computer has authorized them by acknowledging that there is enough in the account to fund the transaction.

Paycards benefit employers and employees

Benefits for employers

- Reduced costs for manual checks, lost and stolen checks, stop payment orders, fraudulent cashing of duplicate checks, paycheck production and handling, and bank reconciliation fees;
- Enhanced efficiency by eliminating paper paychecks and using electronic pay statements;
- _____ are eligible for electronic funds transfer, whether or not they have a banking relationship;
- Increased employee _____ as less time is spent cashing paychecks
- Reduction of _____ issues

Benefits for employees

- Reduced costs by eliminating _____
- Increased independence by eliminating need to ask relatives or friends to cash checks or pay their bills;
- Employees cannot take on debt with stored-value payroll cards, which may improve their credit status;
- Increased _____ by obtaining only the cash the employee needs rather than having to cash the entire paycheck;
- Easy to use;
- Employees are protected from loss because a lost or stolen card can be replaced with its full remaining value;
- ATM access means there are virtually no time or geographic limitations on funds access

Pay Statements Provided to Employees

It is up to each state to determine just what information must be included on an employee's pay stub or statement in the way of earnings, hours worked, tax withholdings, other deductions, pay period dates, etc.

Unclaimed Paychecks

Most states require employers to contact employees in an attempt to keep unclaimed wages from becoming abandoned property. The state laws governing abandoned property are known as _____ laws, because the property _____ to the state.

Wages Owed to Deceased Employees

Most states regulate wages owed to deceased employees, in terms of who the wages may be paid, how much may be paid before administration of the deceased employee's estate, and what conditions must be met before payment can be made.

Extra Paydays Caused by the Calendar

Because a normal year has 365 days, one day of the week will occur 53 times in a year ($52 \text{ weeks} \times 7 \text{ days/week} = 364 \text{ days}$). In leap years, which have 366 days, two days of the week will occur 53 times. For employers who pay their employees on a weekly or biweekly basis, and whose paydays fall on the extra days of the week just mentioned, an extra payday will occur – 53 rather than 52 for weekly payers, 27 rather than 26 for biweekly payers.

Employers may reduce salaried employees' pay for each pay period when faced with an extra payday, so long as there is no contract guaranteeing a certain amount of pay each weekly or biweekly payday and the employee's pay is not reduced below the minimum required by state or federal law. Hourly employees must be paid their agreed-upon hourly wage for all hours worked, regardless of the extra payday.

Section 6 – Withholding Taxes

Objectives

- Define the Principle of Constructive Receipt
- Understand the process of obtaining and verifying Social Security numbers
- Review employee withholding forms
- Define the Methods of Withholding Federal Income Tax and Social Security/Medicare Taxes
- Identify Requirements for Backup Withholding and Earned Income Credit
- Discuss Penalties for Failure to Withhold Taxes

The Principle of Constructive Receipt

Under federal regulations, employers must withhold federal income tax, social security tax, and Medicare tax when the employee is “actually or constructively paid,” not when the wages are earned and become payable.

When an employee is provided with cash or a check on payday that is dated that day and can be cashed at a local bank, it's easy to determine when they're paid. But what if they're not actually paid on payday? For example, what if the employee is out sick or on vacation on payday? Under the principle of constructive receipt, an employee is considered to have been paid wages when the wages have been made _____

Checks sent through the mail

Employees who receive paychecks sent through the mail generally are not constructively paid when the checks are sent. The wages are not available to the employee until the check is delivered to the employee's home or other mail drop or unless the employer finds another way to provide a replacement check or cash to the employee before that time.

Example: Josh works from home and is paid by check every other Thursday. His paychecks are mailed to his home. His check for this Thursday's payday gets mailed on Tuesday, but due to bad weather, the check is not expected to arrive until the following Monday. Josh's employer then decides to wire the cash for his wages on Friday. What is Josh's payday for the purpose of withholding taxes?

Postdating or backdating checks

Regardless of the date printed on an employee's check, the date it is actually or constructively provided to the employee is the date that triggers the employer's withholding and deposit obligations.

Why this is important

Short delays in making wages available to employees might not make a significant difference in the withholding, but if they occur at the end of the year, there could be an impact to the amount of tax withheld.

Example: Theresa is scheduled to receive her last paycheck of 2017 on December 30. Her biweekly wages are \$4,720 and her year-to-date wages up to this point are \$128,000, which is over the 2017 social security wage limit of \$127,200. Due to a technical problem in her company's payroll system, her employer is unable to issue her paycheck until January 2, 2018. How will this impact her withholding?

Social Security Numbers

The original purpose of a social security number (SSN) was to establish an account for an individual so wages and self-employment income could be posted to the individual's account for the purpose of receiving social security retirement benefits. The SSN still serves that purpose, but also serves others as well, including being used as an identification number by the IRS when dealing with the individual. Employers use their employees' SSNs to identify them when reports of wages paid and taxes withheld are made to the Social Security Administration and the IRS. Therefore, the employer must get each new employee's name and SSN and enter them into its records exactly as shown on the social security card. If the employer does not provide the correct name and SSN on the employee's Form W-2, it may be assessed a penalty by the IRS.

Obtaining an Employee's SSN

Employers must ask each new employee for his or her social security number and it is a good idea to require the employee to produce his or her original social security card when the employee is hired to help make sure the employee's SSN is transcribed properly onto all forms and entered properly into the employer's payroll system.

These numbers are now assigned to individuals randomly by the SSA, but there are certain numbers that the SSA will not issue and which would be considered invalid. They are:

- SSNs beginning with the number “_____”
- SSNs with the number “_____” or “_____” in positions 1-3
- SSNs with the number “_____” in positions 4-5
- SSNs with the number “_____” in positions 6-9
- An SSN with the number “_____”

Verifying Social Security Numbers

Other than asking to see the employee's original social security card, photocopying it, and making sure it is recorded properly on any forms filled out for the employee, the SSA provides employers with a way to verify employees' social security numbers.

Online – SSN Verification Service

The SSA has an Internet verification process – the Social Security Number Verification Service (SSNVS) – which allows employers to verify the name and SSN of current and former employees, as well as new hires after a commitment to hire has been made. SSNVS offers two options for name/SSN verification over the Internet:

- Verify up to ____ names and SSNs (per screen) online and receive immediate results. This method is generally used to verify newly hired employees
- Upload batch files of up to _____ names and SSNs, and usually receive the results by the next government business day. This method suits employers that are verifying their entire data base or that hire a large number of workers at one time.

When an employee changes his or her name

The employer should refuse to make a change to the employee's name until _____ with the employee's new name is presented for confirmation.

Employee Withholding Allowance Certificates

Employers, payers of pensions and annuities, and third-party payers of sick pay use certain forms to determine the proper amount of federal income tax to withhold from wages and other payments. Let's review these.

Form W-4

Every employer that pays wages is required to deduct and withhold federal income tax from those wages. Several methods can be used to calculate the correct amount of federal income tax to withhold from an employee's wages, but they all depend on information contained in Form W-4, *Employee's Withholding Allowance Certificate*. A Form W-4 must be kept on file by the employer for every employee.

When must a Form W-4 be submitted to the employer?

Newly hired employees should submit a completed signed Form W-4 to their employer _____. If the employee does not provide an original, complete, valid, signed Form W-4, the employer must withhold as if the employee were _____ with _____ withholding allowances.

When is a Form W-4 effective?

A Form W-4 filed by a newly hired employee must be put into effect by the employer for the first payroll period ending after the form is filed.

An amended Form W-4 filed by a current employee because of a change in withholding allowances must be put into effect by the employer no later than the beginning of the first payroll period ending on or after the _____ day after the form is filed with the employer.

By _____ of each year, employers should ask their employees to file an amended Form W-4 for the next calendar year if they know the number of their allowances has changed or will change at the beginning of the year.

What does a Form W-4 tell the employer?

This form is designed to tell the employer how many withholding allowances the employee is claiming, a number that will help determine the amount to withhold from the employee's wages for federal income tax. The Form W-4 also indicates the employee's _____ and tells the employer if the employee is claiming _____ from withholding. It may also indicate that the employee wants an additional dollar amount withheld beyond the amount based on the withholding allowances claimed and whether the employee is a nonresident alien.

What are withholding allowances?

For each withholding allowance claimed, the employee reduces the amount of wages subject to federal income tax withholding.

Some employees may claim exempt from withholding

Employers do not have to withhold federal income tax from an employee's wages if the employee claims on the Form W-4 that he or she is exempt from withholding. In order to be exempt in the current year, the employee must complete only lines 1,2,3,4 and 7 on the Form W-4 and certify that he or she:

- Had a right to a refund of ALL federal income tax withheld in the prior year because the employee had no tax liability; and
- Expects to have _____ in the current year.

Even if an employee had no tax liability in the prior year and expects to have none in the current year, the employee may not claim exempt status in the current year if:

- The employee's income exceeds \$_____ and includes more than \$350 of unearned income (e.g., interest and dividends) and
- The employee can be claimed as a _____ on another person's tax return.

A claim of exemption from withholding is effective for one year, and a new Form W-4 attesting to the exempt status must be filed by _____ of the following year or the employer must begin withholding based on the last Form W-4 from the employee that did not claim an exemption from withholding, or if there is none, the employer must withhold as if the employee were _____ with _____ withholding allowances.

When should an employer reject a W-4?

Although employers are not responsible for verifying the accuracy of the information on Forms W-4, an employer may not accept an invalid Form W-4 form from an employee. A Form W-4 form is invalid if:

- It has been altered in any way (e.g. striking through any of the language on the form); or
- Any unauthorized additions have been made to it (e.g. any writing other than the entries requested)

When must the employer submit Form W-4 to the IRS?

In most instances, employers must keep employees' Form W-4s in their records and are not required to send them to the IRS. However, the employer must submit a copy of the Form W-4 if:

- The IRS directs the employer to do so in a written notice to the employer; or
- The IRS directs the employer to do so in published guidance, such as a revenue procedure.

IRS Lock-in Letters

The IRS may notify the employer in writing that the employee is not entitled to claim exempt from withholding or a total number of withholding allowances greater than the maximum number specified in the notice, which is commonly referred to as a "lock-in letter." A lock-in letter setting a maximum number of allowances that an employee can claim may be issued by the IRS:

- In cases where the employer has sent a copy of the Form W-4 to the IRS and the IRS determines that the information is incorrect or that the employee fails to respond adequately to a request for verification
- In cases where the employer has not sent a copy of the Form W-4 to the IRS and the IRS determines that the employee is not entitled to claim exempt from withholding or more than a specified number of withholding exemptions based on IRS records.

How long must the employer keep Forms W-4?

They must retain each employee's Form W-4, whether filed on paper or electronically, for at least four years after the date the last return was filed using the information on the Form W-4. This is generally the employee's _____ for the last year during which the Form W-4 was in effect, which is due the following April 15.

Form W-4P

In most instances, federal income tax must be withheld from _____ and _____ payments made to retired employees. Unless directed otherwise, payers and plan administrators must withhold certain amounts, depending on whether the payments are periodic, nonperiodic, or eligible rollover distributions. By completing a Form W-4P, *Withholding Certificate for Pension or Annuity Payments*, retirees, can:

- Elect not to have any income tax withheld
- Designate a certain number of withholding allowances to be used in calculating the amount withheld; or
- Indicate an additional dollar amount to be withheld

Form W-4S

When an employee who is disabled by a non-job-related illness or injury is being paid sick pay by a third-party insurer, no federal income tax will be withheld unless the employee requests it by submitting Form W-4S., *Request for Federal Income Tax Withholding From Sick Pay* to the third party. The minimum amount that can be withheld is \$_____ per week, and after the withholding, the employee must receive at least \$_____.

Methods of Withholding Federal Income Tax

The IRC allows employers to choose from several different methods for calculating the amount to withhold from an employee's wages for federal income tax. **Note: For your exam, any questions requiring federal income tax withholding calculation will instruct you as to which method to use and you will be provided with any necessary tax tables.**

The most popular methods are the wage-bracket method and the percentage method. Employers with automated payroll systems or that use a service provider to process their payroll generally use the percentage method of withholding. For these two methods, four pieces of information are necessary in order to calculate an employee's federal income tax withholding. They are:

- Payroll period (also known as the pay frequency)
- Taxable Wages
- Marital Status (from the employee's Form W-4)
- Number of Withholding Allowances (from the employee's Form W-4)

Wage-Bracket Method

For off-cycle checks cut by employers, the easiest withholding method to use may be the wage-bracket method. Using this method, the amount to withhold is taken directly from wage-bracket tables issued by the IRS in Publication 15, *Circular E, Employer's Tax Guide*. There are two tables for each of following payroll periods (one for single and one for married persons): weekly, biweekly, semimonthly, monthly, and daily or miscellaneous.

How to use the wage-bracket tables

1. Find the table that applies to the employee's payroll period and marital status.
2. Determine the employee's wages subject to federal income tax withholding by reducing the employee's gross wages by any pre-tax deductions.
3. Locate the wage bracket in the first two columns in which the employee's federal income taxable wage payment for the payroll period can be found.
4. Move across from the wage-bracket amount to the tax amount found in the column headed by the number of withholding allowances claimed by the employee on Line 5 of his or her Form W-4.
5. Add any extra dollar amount of withholding indicated by the employee on Line 6 of the Form W-4.

Example: Employee Dolores receives \$950 in taxable compensation every two weeks. On her W-4, she claims married with three withholding allowances. Using the wage-bracket method, determine the amount of federal income tax to be withheld from her check.

Using the 2017 IRS Publication 15, locate the wage-bracket tables which begin on page 47. Next, locate the Married-Biweekly table.

The row near the top indicates the column to look at based on the number of withholding allowances. As shown below, the wages for Dolores are “at least” \$940, “but less than” \$960. Locating that row and then following that row across to the column for three withholding allowances shows that the amount of federal income tax to withhold for her is \$15.

Wage Bracket Method Tables for Income Tax Withholding													
MARRIED Persons—BIWEEKLY Payroll Period													
(For Wages Paid through December 31, 2017)													
And the wages are—		And the number of withholding allowances claimed is—											
At least	But less than	0	1	2	3	4	5	6	7	8	9	10	
The amount of income tax to be withheld is—													
\$ 0	\$340	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
340	350	1	0	0	0	0	0	0	0	0	0	0	0
350	360	2	0	0	0	0	0	0	0	0	0	0	0
360	370	3	0	0	0	0	0	0	0	0	0	0	0
370	380	4	0	0	0	0	0	0	0	0	0	0	0
380	390	5	0	0	0	0	0	0	0	0	0	0	0
390	400	6	0	0	0	0	0	0	0	0	0	0	0
400	410	7	0	0	0	0	0	0	0	0	0	0	0
410	420	8	0	0	0	0	0	0	0	0	0	0	0
420	430	9	0	0	0	0	0	0	0	0	0	0	0
430	440	10	0	0	0	0	0	0	0	0	0	0	0
440	450	11	0	0	0	0	0	0	0	0	0	0	0
450	460	12	0	0	0	0	0	0	0	0	0	0	0
460	470	13	0	0	0	0	0	0	0	0	0	0	0
470	480	14	0	0	0	0	0	0	0	0	0	0	0
480	490	15	0	0	0	0	0	0	0	0	0	0	0
490	500	16	1	0	0	0	0	0	0	0	0	0	0
500	520	18	2	0	0	0	0	0	0	0	0	0	0
520	540	20	4	0	0	0	0	0	0	0	0	0	0
540	560	22	6	0	0	0	0	0	0	0	0	0	0
560	580	24	8	0	0	0	0	0	0	0	0	0	0
580	600	26	10	0	0	0	0	0	0	0	0	0	0
600	620	28	12	0	0	0	0	0	0	0	0	0	0
620	640	30	14	0	0	0	0	0	0	0	0	0	0
640	660	32	16	1	0	0	0	0	0	0	0	0	0
660	680	34	18	3	0	0	0	0	0	0	0	0	0
680	700	36	20	5	0	0	0	0	0	0	0	0	0
700	720	38	22	7	0	0	0	0	0	0	0	0	0
720	740	40	24	9	0	0	0	0	0	0	0	0	0
740	760	42	26	11	0	0	0	0	0	0	0	0	0
760	780	44	28	13	0	0	0	0	0	0	0	0	0
780	800	46	30	15	0	0	0	0	0	0	0	0	0
800	820	48	32	17	1	0	0	0	0	0	0	0	0
820	840	50	34	19	3	0	0	0	0	0	0	0	0
840	860	52	36	21	5	0	0	0	0	0	0	0	0
860	880	54	38	23	7	0	0	0	0	0	0	0	0
880	900	56	40	25	9	0	0	0	0	0	0	0	0
900	920	58	42	27	11	0	0	0	0	0	0	0	0
920	940	60	44	29	13	0	0	0	0	0	0	0	0
940	960	62	46	31	15	0	0	0	0	0	0	0	0
960	980	64	48	33	17	1	0	0	0	0	0	0	0
980	1,000	66	50	35	19	3	0	0	0	0	0	0	0
1,000	1,020	68	52	37	21	5	0	0	0	0	0	0	0
1,020	1,040	70	54	39	23	7	0	0	0	0	0	0	0
1,040	1,060	72	56	41	25	9	0	0	0	0	0	0	0
1,060	1,080	75	58	43	27	11	0	0	0	0	0	0	0
1,080	1,100	78	60	45	29	13	0	0	0	0	0	0	0
1,100	1,120	81	62	47	31	15	0	0	0	0	0	0	0
1,120	1,140	84	64	49	33	17	2	0	0	0	0	0	0
1,140	1,160	87	66	51	35	19	4	0	0	0	0	0	0
1,160	1,180	90	68	53	37	21	6	0	0	0	0	0	0
1,180	1,200	93	70	55	39	23	8	0	0	0	0	0	0

Source: IRS Publication 15

www.irs.gov

Percentage Method

The percentage method of withholding is somewhat more flexible than the wage-bracket method and can be used for more different payroll periods. However, when calculating tax withholding manually, it's a bit more complex.

Here are the steps to use the percentage method:

1. Find the number of withholding allowances claimed by the employee
2. Locate the amount to subtract based on their pay frequency and number of withholding allowances, using IRS Table 5, "Amount for One Withholding Allowance."
3. Subtract that amount from the employee's taxable wages.
4. Locate the percentage method withholding table for the employee's payroll period and marital status and use the formula detailed in the table.

Example: Marian is paid \$2,673 in taxable wages biweekly. On her Form W-4, she claims married with four withholding allowances. Using the percentage method, calculate the amount of federal income tax to withhold from her check.

First, we look at the IRS Table 5, which can be found on page 44 of the 2016 IRS Publication 15. Based on her biweekly pay frequency, \$153.80 is to be subtracted from her taxable wages for each of her withholding allowances.

Payroll Period	One Withholding Allowance
Weekly	\$ 77.90
Biweekly	155.80
Semimonthly	168.80
Monthly	337.50
Quarterly	1,012.50
Semiannually	2,025.00
Annually	4,050.00
Daily or miscellaneous (each day of the payroll period)	15.60

$\$155.80 \times 4 \text{ withholding allowances} = \623.20

$\$2,673 - \$623.20 = \mathbf{\$2,049.80}$ (This is the amount subject to tax)

Now we'll go to the percentage method tables, which can be found on page 45 of the 2017 IRS Publication 15. We'll locate the table for a biweekly pay period.

(a) SINGLE person (including head of household)—				(b) MARRIED person—			
If the amount of wages (after subtracting withholding allowances) is:		The amount of income tax to withhold is:		If the amount of wages (after subtracting withholding allowances) is:		The amount of income tax to withhold is:	
Not over \$88		\$0		Not over \$333		\$0	
Over—	But not over—	of excess over—		Over—	But not over—	of excess over—	
\$88	—\$447	\$0.00 plus 10%	—\$88	\$333	—\$1,050	\$0.00 plus 10%	—\$333
\$447	—\$1,548	\$35.90 plus 15%	—\$447	\$1,050	—\$3,252	\$71.70 plus 15%	—\$1,050
\$1,548	—\$3,623	\$201.05 plus 25%	—\$1,548	\$3,252	—\$6,221	\$402.00 plus 25%	—\$3,252
\$3,623	—\$7,460	\$719.80 plus 28%	—\$3,623	\$6,221	—\$9,308	\$1,144.25 plus 28%	—\$6,221
\$7,460	—\$16,115	\$1,794.16 plus 33%	—\$7,460	\$9,308	—\$16,360	\$2,008.61 plus 33%	—\$9,308
\$16,115	—\$16,181	\$4,650.31 plus 35%	—\$16,115	\$16,360	—\$18,437	\$4,335.77 plus 35%	—\$16,360
\$16,181	—\$4,673.41 plus 39.6%	—\$16,181		\$18,437	—	\$5,062.72 plus 39.6%	—\$18,437

Since Marian is claiming married, we'll focus on the right half of this table. Based on her subject wages of \$2,049.80, the line we'll look at is the one labeled "Over \$1,050- But not over \$3,252."

From here, the easiest way to compute this is to work backwards. So we'll go to the far right of that line and work our way back to the left.

Over—	But not over—	of excess over—	
\$333	—\$1,050	\$0.00 plus 10%	—\$333
\$1,050	—\$3,252	\$71.70 plus 15%	—\$1,050

5. Starting with "of excess over - \$1,050," we'll subtract \$1,050 from \$2,049.80
 $\$2,049.80 - \$1,050 = \$999.80$

6. Now we'll multiply that amount by 15%
 $\$999.80 \times 15\% = \149.97

7. Finally, we'll add \$71.70 to that amount
 $\$149.97 + \$71.70 = \$221.67$

So, the amount of federal income tax to withhold from Marian's check is \$221.67

Alternative Withholding Methods

Besides the wage-bracket and percentage methods of withholding, the IRS also authorizes several other withholding methods employers might find useful depending on their situation.

Annualized Wages

Under this method, withholding is calculated based on an annual payroll period and then divided among the actual payroll periods using the following steps:

1. Multiply the employee's federal income taxable wages for a payroll period times the number of payroll periods in the calendar year.
2. Determine the amount that would be required to be withheld from the result in step #1 based on an annual payroll period using the percentage method.
3. Divide the amount of withholding determined in step #2 by the number of payroll periods in the calendar year to reach the withholding amount for each payroll period.

Example: Ben is paid \$1,000 in federal income taxable wages semimonthly, and he is single with 3 withholding allowances claimed on his Form W-4. Here's how to calculate his tax using the annualized wages method:

1. $\$1,000 \times 24 \text{ payroll periods} = \$24,000$
2. Using the percentage method:

Taxable wages	\$24,000.00
Subtracting for 3 allowances	- _____
Wages subject to tax	\$ _____
Percentage method table	\$ _____
	-\$11,625.00
	=\$ _____
	x 15%
	=\$ 33.75
	+\$ _____
Annual payroll period withholding	=\$ _____
3. Withholding per payroll period = \$ _____ $\div 24 = \$$ _____

Average estimated wages

Under this method, employer may withhold based on an employee's estimated wages during a quarter. However, the employer must make adjustments each quarter to bring the withholding on the estimated wages in line with the amount required to be withheld on wages actually paid. This can be especially useful for tipped employees, when the tips and withholding on tips are estimated and necessary adjustments are made by withholding extra amounts from the employee's regular wages.

The steps for this method are as follows:

1. Estimate the employee's total federal income taxable earnings for the quarter
2. Divide the result in #1 by the number of payroll periods during the quarter to determine the estimated average wage.
3. Calculate the tax to be withheld from each estimated average wage payment as if that were the amount actually paid and withhold it from actual wage payments
4. If the employee's wages should increase above the estimate during the quarter, an adjustment in withholding must be made with any wage payment made during the current quarter.

Cumulative wages

This is useful for adjusting withholding amounts for employees whose wage payments are inconsistently high and low. It allows for lower withholding when payments are low and higher withholding when higher wage payments are received. The employee must request this method _____ and must have been paid at the same frequency since the beginning of the calendar year.

Example:

In 2017, employee Jennifer is paid \$3,500 in federal income taxable wages monthly and is single with two withholding allowances. She generally has \$356.10 withheld from each paycheck under the percentage method. Jennifer receives a \$2,000 bonus with her May paycheck, and \$856.10 is withheld from her \$5,500 combined pay. Alarmed at the size of the withholding, Jennifer asks her employer in writing to begin withholding under the cumulative method effective with her June paycheck. How much will be withheld from her paycheck in June?

1. Total taxable wages through June	\$23,000.00
2. Average wage payment (Line #1 ÷ 6)	\$ 3,833.33
3. Withholding on #2 (percentage method)	\$ _____
4. Line #3 x 6 payroll periods	\$ _____
5. Amount withheld through May	\$ _____
6. June withholding amount (Line 4 – Line 5)	\$ _____

Part-year employment

Similar to the cumulative wages method, this method reduces withholding for employees who work only during part of the calendar year, usually on a seasonal basis or because they have been unemployed.

Supplemental Wage Payments

An employee's pay may consist of regular and supplemental wages, and in general, all wages that are not regular wages are supplemental wages. They may be paid at the same time as regular wages for a payroll period or at any other time without regard for a payroll period.

Some examples of supplemental wage payments are:

- Reported tips
- Overtime pay
- Bonuses
- Back pay
- Commissions
- Reimbursements under a nonaccountable plan
- Nonqualified deferred compensation payment included in wages
- Noncash fringe benefits
- Sick pay by a third party as an agent of the employer
- Amounts includible in gross income under IRC §409A
- Income recognized on the exercise of a nonstatutory stock option
- Wages imputed for health coverage of a non-dependent of an employee
- Wage recognized on the lapse of restrictions on restricted property transferred from an employer to an employee

There are two withholding methods available to an employer for supplemental wage payments that are less than \$ _____ in a calendar year.

Aggregate Method

Under this method, the employer calculates the amount of withholding due using the employee's current Form W-4 by aggregating (accumulating) the amount of supplemental wages with the regular wages paid for the current payroll period or for the most recent payroll period of the year of payment, and treating the aggregate as if it were a single wage payment for the regular payroll period. This method must be used if the optional flat rate method cannot be used.

Example: Employee Terry is single, claiming 3 withholding allowances and is normally paid \$1,250 in taxable wages on a biweekly basis. So far this year, Terry has received \$10,000 in wages. Between paychecks, he receives a bonus of \$250. Here's how to calculate the amount of federal income tax to withhold using the aggregate method:

Total of latest wage payment + bonus	\$1,500
Withholding on total amount (wage-bracket method)	\$ ____
Withholding on latest wage payment	\$ ____
Withholding from supplemental wage payment	\$ ____

Optional Flat Rate Method

Under this method, the employer disregards the amount of regular wages paid to an employee as well as the withholding allowances claimed or additional withholding amount requested by the employee and uses a flat percentage rate in calculating the amount of withholding. This method is available only if two conditions are met:

- The employer has withheld income tax from regular wages paid to the employee during the same year as the payment of supplemental wages or during the preceding calendar year
- The supplemental wages are either:
 - Not paid concurrently with regular wages or
 - Separately stated on the payroll records of the employer

The rate used for the optional flat rate withholding is ____%. If an employer is using the flat rate method, they must withhold at this rate.

Supplemental Payments Over \$1 million

If a supplemental wage payment, when taken together with all other supplemental wage payments paid by an employer to an employee during the calendar year, exceeds \$1,000,000, then the employer must withhold federal income tax from the supplemental wages in excess of \$1 million at a flat rate of ____%.

Payments made by agents of the employer to an employee on the employer's behalf must be considered in determining the applicability of mandatory flat rate withholding.

Withholding on Pensions and Annuities

Distributions from an employer's retirement or deferred compensation plan are subject to federal income tax withholding. The method of withholding depends on the type of payment – periodic or nonperiodic.

Periodic payments

If payments from a retirement or deferred compensation plan are made over a period of more than one year, then they are generally considered periodic. The payroll period to be used is the frequency of the payments (e.g., monthly, quarterly).

Payment recipients can use Form _____ to help determine their withholding. On this form, the recipient can decline withholding altogether, specify marital status and the number of withholding allowances, or ask that an additional dollar amount be withheld. If this form is not filed, withholding must be calculated as if the recipient had claimed _____ with _____ withholding allowances.

Nonperiodic payment not eligible for rollover

All nonperiodic payments that are not eligible for rollover to another qualified plan, and are at least \$_____, are subject to withholding at the rate of _____%. The recipient of the payments may use a Form _____ to elect no withholding and may also use that form to increase withholding by a specific dollar amount.

Eligible rollover distributions

Generally, all nonperiodic payments of all or any portion of the balance of a recipient's account in a qualified deferred compensation plan under IRC §401(a) are eligible rollover distributions. There are some exceptions listed in the Payroll Source.

Eligible rollover distributions are subject to mandatory federal income tax withholding of _____% unless the distribution is directly rolled over to another qualified plan, individual retirement account, §403(b) annuity, or governmental §457(b) plan.

Backup Withholding

When businesses make payments to individuals who are not employees (e.g., partnerships, sole proprietors, trusts and estates), these payments must be reported to the IRS if they consist of interest or dividends, payments of wages due a deceased employee, compensation (\$_____ or more for the year) for services rendered.

Payers of reportable payments must withhold _____% for federal income tax (“backup” withholding) from such payments if:

- The payee fails to provide the payer with a Taxpayer Identification Number (TIN), or provides one that is obviously incorrect;
- The payer is notified by the IRS that the TIN provided by the payee is incorrect;
- The payer is notified by the IRS that a payee has underreported interest or dividend payments; or
- The payer does not receive from a payee receiving interest or dividend payments a certification that the payee is not subject to withholding

Advance Earned Income Credit

Employees earning less than a certain amount in a year are entitled to the Earned income Credit (EIC). The EIC is a tax credit that reduces any taxes owed.

Prior to 2011, employees with qualified children who were eligible for the EIC could obtain advance payments of a portion of the credit throughout the year by submitting a Form W-5. However, the act that allowed that was repealed, effective January 11, 2011. Therefore, employees may no longer obtain advance payment of the EIC and employers are no longer required to make advance payments. Employees who qualify can still claim the credit on their personal income tax return.

Social Security and Medicare Taxes

Employers and employees both pay taxes required by the Federal Insurance Contributions Act (FICA) to fund two federal government benefit programs: Social Security and Medicare.

Social Security and Medicare Tax Rates

The employee social security tax withholding rate is _____% on an employee’s wages up to the social security taxable wage base. The employer also contributes this same amount.

Both employers and employees pay Medicare tax at a rate of _____% on all Medicare taxable wages, with employers withholding the employee share from employees’ wages.

For wages paid on or after January 1, 2013, employers must withhold an additional _____% from the wages of employees when their wages exceed \$_____ or \$250,000 for employees who are married and filing a joint return. This is known as the Additional Medicare Tax.

Social Security Wage Base

Social security tax is applied only up to a certain wage base. Wages paid beyond that amount are not taxable. For calendar year _____, the social security wage base is \$_____.

Medicare does not have a taxable wage base.

Calculating the Withholding Amounts

Based on the current rates and social security taxable wage base, these taxes would be calculated as follows

Social security - employee withholding	_____%
Medicare – employee withholding	_____%
Social security – employer share	_____%
Medicare – employer share	_____%
Total paid (assuming wages <\$200k)	_____%

Employees working for more than one employer

If an employee works for more than one employer during the calendar year, each employer is liable for withholding and paying social security and Medicare taxes. The earnings from different employers cannot be combined for purposes of determining whether the social security wage base has been reached. An employee who has had more than the maximum amount of social security tax withheld can get a refund on his or her personal income tax return for that year, but the employer is not eligible for a refund.

Related Corporations and the “Common Paymaster” Option

Where two or more related corporations concurrently employ one or more employees and pay them through one of the corporations as a “common paymaster,” the total social security and Medicare taxes that must be paid are determined as if the employees had one employer – the common paymaster – paying all their wages.

Wages Exempt from Social Security and Medicare Taxes

As discussed in previous sections, there are certain types of payments that are not considered taxable for social security and Medicare taxes. In general, all employee compensation is subject to these taxes. In the Payroll Source a list of several exempt payments is provided.

Types of Employment Exempt from Social Security and Medicare Taxes

In addition to the wage payments mentioned above, certain types of employment are also exempt from these taxes. Here is a list of some of them:

- Work done by temporary foreign agricultural workers;
- Work performed by a child under age 18;
- Work on a foreign ship or aircraft outside the U.S. by non-U.S. citizens for a non-U.S. employer;
- Work done by students who are enrolled and regularly attending classes at the school for which they are working and who are not “career employees” of the school;
- Work done for a foreign government or an international organization;
- Work one by student nurses;
- Work performed by nonresident aliens under an F, J, M, or Q visa;
- Work performed by small fishing boat crews that receive a share of the catch;
- Domestic service performed by an individual under age 18 if it is not their principal occupation.

State and Local Government Employees

Public sector employees (e.g., employees of state and local governments) have always been treated differently regarding their coverage under the social security and Medicare programs, most likely because of the prevalence of public employee retirement systems. Here are some of the highlights to be aware of:

- All state and local government employees are covered by Medicare and must pay the Medicare tax unless their state had already entered in an agreement subjecting them to both social security and Medicare coverage
- All state and local government employees who are not members of a public employee retirement system or are not subject to an agreement are subject to both social security and Medicare coverage and withholding for all work performed.
- Special exceptions and requirements have been enacted with regard to election workers, who generally work a few days a year for state and local governments.

Penalties for Failure to Withhold

The IRC focuses most of its penalties for employers on the failure either to deposit the proper amount of taxes on time or to file correct returns on time. In Section 8, there will be further discussion of the specific penalty amounts to be familiar with for the exam.

Section 7 – Unemployment Insurance

Objectives

- Define FUTA and the taxable requirements
- Identify some key areas of Form 940
- Define the relationship between FUTA and State Unemployment
- Describe the methods used by states to calculate experience rates

Federal Unemployment Insurance

To provide income for terminated employees while they are trying to secure another job, a joint federal-state system of unemployment insurance has evolved. On the federal level, employer contributions in the form of unemployment taxes are required by the Federal Unemployment Tax Act (FUTA). The FUTA tax is paid only by _____ and is calculated as a percentage of covered wages for each employee.

Who Must Pay FUTA Tax

- Nonfarm employers paying \$_____ or more in covered wages in any calendar quarter during the current or preceding calendar year;
- Nonfarm employers employing at least one employee for at least part of one day in ____ different weeks during the current or preceding calendar year;
- Farm employers paying \$_____ or more in covered wages in any calendar quarter during the current or preceding calendar year;
- Farm employers employing at least ____ employees for at least part of one day in ____ different weeks during the current or preceding calendar year; or
- Employers paying domestic employees \$_____ or more in any calendar quarter of the current or preceding calendar year for work performed in a private home, local college club, fraternity, or sorority.

Some employers are not covered even if they meet the above criteria. They are:

- Federal, state, and local government employers, including their political subdivisions, and Indian tribes; and
- Nonprofit religious, charitable, or educational organizations that are tax-exempt.

FUTA Tax Rate and Wage Base

Although most employers must pay FUTA contributions, there are several items such as qualified moving expenses, group term life, and meals and lodging that are exempt from FUTA. Some types of employment (similar to the types exempt from SS/Med) are also exempt from FUTA and several examples are listed in the Payroll Source.

FUTA Tax Rate and Wage Base

Actual FUTA Tax Rate	_____
Tentative Credit	_____
Effective FUTA Rate	_____
Taxable Wage	_____
Total Tax per Employee	_____

Depositing and Paying FUTA Tax

Employers must determine their FUTA tax liability on a quarterly basis. For the first three quarters of the year, employers assume they are entitled to the full 5.4% tentative credit. Therefore, they calculate their FUTA liability by multiplying their FUTA taxable wages by 0.6%

The deposit due dates are:

First quarter ends _____	Deposit due _____
Second quarter ends _____	Deposit due _____
Third quarter ends _____	Deposit due _____

Special rule for small amounts owed

In each of the first three quarters, if the employer's FUTA liability is more than \$_____, the full amount must be deposited. If the liability in any of the first three quarters is less than that amount, that liability is carried over to following quarter.

Example:

Fred's Fantastic Fish Emporium had FUTA taxable wages of \$37,500 in 2nd quarter. In 3rd quarter, the taxable wages were \$50,000. How would the FUTA liability be calculated and deposited?

Liability	Due
2Q	
\$37,500 x 0.6% = \$ _____	_____
3Q	
\$50,000 x 0.6% = \$ _____	_____

Final quarter liability

At the end of the year, employers file Form _____ and this is when they calculate their fourth quarter liability. This is also the form on which they'll determine how much of the tentative credit they're entitled to. If the total balance due (after taking into account previous deposits and any undeposited amounts from prior quarters) is more than \$_____ the full amount must be deposited by _____. If the balance due is \$_____ or less, payment can be attached to the employer's Form _____ when the form is filed (January 31).

Calculating the State Credits Against FUTA Tax Liability

Earlier in this section, the tentative credit of 5.4% was referenced. This credit can be taken by employers based on the amount and timeliness of the state unemployment taxes they paid.

There are two types of credits against FUTA liability.

1. **90% or Normal Credit**

The 90% or normal credit ($6.0\% \times 90\% = 5.4\%$) provides a reduction in FUTA liability for payments required and actually made under state unemployment compensation laws.

2. **Additional Credit**

Some employers have a state unemployment rate that is less than 5.4% because of a favorable employment history. An additional credit allows these employers to receive credit for the difference between 5.4% and the percentage actually paid.

To receive the full normal credit, all state unemployment taxes owed must be paid by the filing date for Form 940.

Credit Reductions

States with a high rate of unemployment and difficulty meeting their benefit obligations can borrow money from the Federal Unemployment Account to pay benefits. If loans taken out during one year are not repaid by the end of the following calendar year, the FUTA credits for employers in those states are reduced, with the extra FUTA taxes paid being applied against each state's loan balance.

Sometime after _____ of each year, the credit reductions for that year are announced by the IRS and are included in Schedule A (Form 940).

Reporting FUTA Tax on Form 940

Employers covered by FUTA must report their liability _____ on Form 940.

When a business has been sold, only the wages paid by that employer should be reported. If two companies merge or consolidate in a statutory merger, the entity that results is the employer that must file the Form 940. It must report the wages paid by both corporations.

Even though a successor employer may be allowed to include wages paid by a predecessor company to employees of both companies when determining whether the FUTA wage base has been met, generally each company must file its own Form 940 for wages it paid.

Additional Highlights of Form 940

- Form must have the employer's signature
- Must be filed by _____ of the year after the FUTA tax liability was incurred.
- Employers get an automatic extension to _____ if they have deposited their FUTA tax liability in full and on time for all four quarters.
- The completed and signed Form 940 should be mailed, sent by private delivery service, or hand delivered to the IRS processing center for the region where the employer has its principal place of business
- If an error is made on the Form 940, employers can amend by filing a new Form 940 with the correct numbers and checking the box in the upper right corner of page 1.
- Employers going out of business must file a Form 940 for the portion of the last calendar year they were in business and should check Box d in the upper right hand corner of page 1.
- Successor employers would check Box b in the upper right hand corner of page 1 and
 - The employer is reporting wages paid before it acquired the business by a predecessor that was required to file a Form 940
 - The employer is claiming a special credit for state unemployment tax paid before the employer acquired the business by a predecessor who was not required to file a Form 940

Form 940

While it's difficult to determine whether or not the CPP exam you take will require knowledge of the lines on Form 940, it's a best practice to be generally familiar with this form and with the Schedule A, which are included on the next three pages.

Form **940 for 2016: Employer's Annual Federal Unemployment (FUTA) Tax Return** 850113
 Department of the Treasury — Internal Revenue Service UMB No. 1545-0026

Employer identification number (EIN) -

Name (not your trade name)

Trade name (if any)

Address

 Number Street Suite or room number

 City State ZIP code

 Foreign country name Foreign province/county Foreign postal code

Type of Return
 (Check all that apply.)
☐ a. Amended
☐ b. Successor employer
☐ c. No payments to employees in 2016
☐ d. Final: Business closed or stopped paying wages
 Instructions and prior-year forms are available at www.irs.gov/form940.

Read the separate instructions before you complete this form. Please type or print within the boxes.

Part 1: Tell us about your return. If any line does NOT apply, leave it blank. See instructions before completing Part 1.

1a If you had to pay state unemployment tax in one state only, enter the state abbreviation . 1a
 1b If you had to pay state unemployment tax in more than one state, you are a multi-state employer . 1b ☐ Check here. Complete Schedule A (Form 940).
 2 If you paid wages in a state that is subject to CREDIT REDUCTION . 2 ☐ Check here. Complete Schedule A (Form 940).

Part 2: Determine your FUTA tax before adjustments. If any line does NOT apply, leave it blank.


3 Total payments to all employees . 3 .
 4 Payments exempt from FUTA tax . 4 .
 Check all that apply: 4a ☐ Fringe benefits 4c ☐ Retirement/Pension 4e ☐ Other
 4b ☐ Group-term life insurance 4d ☐ Dependent care
 5 Total of payments made to each employee in excess of \$7,000 . 5 .
 6 Subtotal (line 4 + line 5 = line 6) . 6 .
 7 Total taxable FUTA wages (line 3 - line 6 = line 7). See instructions . 7 .
 8 FUTA tax before adjustments (line 7 x 0.006 = line 8) . 8 .

Part 3: Determine your adjustments. If any line does NOT apply, leave it blank.

9 If ALL of the taxable FUTA wages you paid were excluded from state unemployment tax, multiply line 7 by 0.054 (line 7 x 0.054 = line 9). Go to line 12 . 9 .
 10 If SOME of the taxable FUTA wages you paid were excluded from state unemployment tax, OR you paid ANY state unemployment tax late (after the due date for filing Form 940), complete the worksheet in the instructions. Enter the amount from line 7 of the worksheet . 10 .
 11 If credit reduction applies, enter the total from Schedule A (Form 940) . 11 .

Part 4: Determine your FUTA tax and balance due or overpayment. If any line does NOT apply, leave it blank.

12 Total FUTA tax after adjustments (lines 8 + 9 + 10 + 11 = line 12) . 12 .
 13 FUTA tax deposited for the year, including any overpayment applied from a prior year . 13 .
 14 Balance due. If line 12 is more than line 13, enter the excess on line 14.
 • If line 14 is more than \$500, you must deposit your tax.
 • If line 14 is \$500 or less, you may pay with this return. See instructions . 14 .
 15 Overpayment. If line 13 is more than line 12, enter the excess on line 15 and check a box below . 15 .
 ▶ You MUST complete both pages of this form and SIGN it. Check one: ☐ Apply to next return. ☐ Send a refund.

Next 

For Privacy Act and Paperwork Reduction Act Notice, see the back of Form 940-V, Payment Voucher. Cat. No. 112340 Form 940 (2016)

Source: <https://www.irs.gov/pub/irs-pdf/f940.pdf>

850212

Name (not your trade name)		Employer identification number (EIN)	
----------------------------	--	--------------------------------------	--

Part 5: Report your FUTA tax liability by quarter only if line 12 is more than \$500. If not, go to Part 6.

16 Report the amount of your FUTA tax liability for each quarter; do NOT enter the amount you deposited. If you had no liability for a quarter, leave the line blank.

16a 1st quarter (January 1 – March 31)	16a <input type="text"/>
16b 2nd quarter (April 1 – June 30)	16b <input type="text"/>
16c 3rd quarter (July 1 – September 30)	16c <input type="text"/>
16d 4th quarter (October 1 – December 31)	16d <input type="text"/>
17 Total tax liability for the year (lines 16a + 16b + 16c + 16d = line 17) 17 <input type="text"/> Total must equal line 12.	

Part 6: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details.

☐ Yes. Designee's name and phone number

Select a 5-digit Personal Identification Number (PIN) to use when talking to IRS

☐ No.

Part 7: Sign here. You MUST complete both pages of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments made to employees. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

X Sign your name here

Date / /

Print your name here

Print your title here

Best daytime phone

Paid Preparer Use Only

Check if you are self-employed ☐

Preparer's name	<input type="text"/>	PTIN	<input type="text"/>
Preparer's signature	<input type="text"/>	Date	<input type="text"/> / <input type="text"/> / <input type="text"/>
Firm's name (or yours if self-employed)	<input type="text"/>	EIN	<input type="text"/>
Address	<input type="text"/>	Phone	<input type="text"/>
City	<input type="text"/>	State	<input type="text"/>
		ZIP code	<input type="text"/>

Page 2 Form 940 (2016)

Schedule A (Form 940) for 2016:

860312

Multi-State Employer and Credit Reduction Information

OMB No. 1545-0028

Department of the Treasury – Internal Revenue Service

Employer identification number (EIN)

 -

Name (not your trade name)

See the instructions on page 2. File this schedule with Form 940.

Place an "X" in the box of EVERY state in which you had to pay state unemployment tax this year. For each state with a credit reduction rate greater than zero, enter the FUTA taxable wages, multiply by the reduction rate, and enter the credit reduction amount. Don't include in the *FUTA Taxable Wages* box wages that were excluded from state unemployment tax (see the instructions for Step 2). If any states don't apply to you, leave them blank.

Postal Abbreviation	FUTA Taxable Wages	Reduction Rate	Credit Reduction	Postal Abbreviation	FUTA Taxable Wages	Reduction Rate	Credit Reduction
<input type="checkbox"/> AK	*	x 0.000	*	<input type="checkbox"/> NC	*	x 0.000	*
<input type="checkbox"/> AL	*	x 0.000	*	<input type="checkbox"/> ND	*	x 0.000	*
<input type="checkbox"/> AR	*	x 0.000	*	<input type="checkbox"/> NE	*	x 0.000	*
<input type="checkbox"/> AZ	*	x 0.000	*	<input type="checkbox"/> NH	*	x 0.000	*
<input type="checkbox"/> CA	*	x 0.018	*	<input type="checkbox"/> NJ	*	x 0.000	*
<input type="checkbox"/> CO	*	x 0.000	*	<input type="checkbox"/> NM	*	x 0.000	*
<input type="checkbox"/> CT	*	x 0.000	*	<input type="checkbox"/> NV	*	x 0.000	*
<input type="checkbox"/> DC	*	x 0.000	*	<input type="checkbox"/> NY	*	x 0.000	*
<input type="checkbox"/> DE	*	x 0.000	*	<input type="checkbox"/> OH	*	x 0.000	*
<input type="checkbox"/> FL	*	x 0.000	*	<input type="checkbox"/> OK	*	x 0.000	*
<input type="checkbox"/> GA	*	x 0.000	*	<input type="checkbox"/> OR	*	x 0.000	*
<input type="checkbox"/> HI	*	x 0.000	*	<input type="checkbox"/> PA	*	x 0.000	*
<input type="checkbox"/> IA	*	x 0.000	*	<input type="checkbox"/> RI	*	x 0.000	*
<input type="checkbox"/> ID	*	x 0.000	*	<input type="checkbox"/> SC	*	x 0.000	*
<input type="checkbox"/> IL	*	x 0.000	*	<input type="checkbox"/> SD	*	x 0.000	*
<input type="checkbox"/> IN	*	x 0.000	*	<input type="checkbox"/> TN	*	x 0.000	*
<input type="checkbox"/> KS	*	x 0.000	*	<input type="checkbox"/> TX	*	x 0.000	*
<input type="checkbox"/> KY	*	x 0.000	*	<input type="checkbox"/> UT	*	x 0.000	*
<input type="checkbox"/> LA	*	x 0.000	*	<input type="checkbox"/> VA	*	x 0.000	*
<input type="checkbox"/> MA	*	x 0.000	*	<input type="checkbox"/> VT	*	x 0.000	*
<input type="checkbox"/> MD	*	x 0.000	*	<input type="checkbox"/> WA	*	x 0.000	*
<input type="checkbox"/> ME	*	x 0.000	*	<input type="checkbox"/> WI	*	x 0.000	*
<input type="checkbox"/> MI	*	x 0.000	*	<input type="checkbox"/> WV	*	x 0.000	*
<input type="checkbox"/> MN	*	x 0.000	*	<input type="checkbox"/> WY	*	x 0.000	*
<input type="checkbox"/> MO	*	x 0.000	*	<input type="checkbox"/> PR	*	x 0.000	*
<input type="checkbox"/> MS	*	x 0.000	*	<input type="checkbox"/> VI	*	x 0.018	*
<input type="checkbox"/> MT	*	x 0.000	*				

Total Credit Reduction. Add all amounts shown in the *Credit Reduction* boxes. Enter the total here and on Form 940, line 11

For Privacy Act and Paperwork Reduction Act Notice, see the instructions for Form 940.

Cat. No. 16997C

Schedule A (Form 940) 2016

Source: <https://www.irs.gov/pub/irs-pdf/f940sa.pdf>

Penalties for FUTA Noncompliance

In addition to paying the FUTA tax actually owed to the IRS, there are several penalties associated with late deposits, payments, and filing of returns. Here are those penalties.

Late filing of Form 940

This results in an addition to tax due unless the employer has reasonable cause and is not guilty of willful neglect.

- ____% of the amount of the tax for each month or fraction of a month the return is late up to a maximum of ____%
- ____% per month up to a maximum of ____% of the tax if the late filing is fraudulent

Failure to pay FUTA tax

This results in an addition to tax due unless there is reasonable cause and no willful neglect.

- ____% of any unpaid tax shown on the return for each month up to a maximum of ____%
- An additional ____% per month of any unpaid tax not shown on the return but for which the IRS has issued a notice and demand, if the tax is not paid within ____ days of the notice and demand (____ business days if the amount is at least \$_____) up to a maximum of ____%

Failure to file and pay

In any month where an employer is subject to additions to tax both for a failure to file Form 940 and a failure to pay FUTA tax, the addition for failure to file is reduced by ____% of the unpaid tax.

Accuracy-related penalty

If the amount of the understatement is due to negligence or disregard of rules or regulations, the amount of the penalty is ____% of the understated amount that can be traced to the employer's negligence.

Failure to make timely FUTA deposits

Late deposits of FUTA tax are subject to a penalty in addition to the tax owed unless an employer has reasonable cause and is not guilty of willful neglect. The amounts are:

- ____% of the undeposited amount if it is paid within ____ days of the due date;
- ____% of the undeposited amount if it is paid within ____ days of the due date;
- 10% of the undeposited amount if it is paid more than 15 days after the due date; or
- ____% of the undeposited amount if it is not paid within ____ days after the employer receives its first IRS delinquency notice or on the same day a notice and demand for immediate payment is received

State Unemployment Insurance

The Federal Unemployment Tax Act provides a framework for state funding and coverage requirements. However, each state has their own methods for determining tax rates, wage bases, and benefit eligibility and amounts.

Contribution Rates and Experience Rating

Contribution rates and experience rates also vary from state to state and are determined by one of four methods depending on the state:

Reserve Ratio

Under the Reserve Ratio method, each employer is assigned an account into which it pays unemployment taxes. The account is then reduced by the amount of unemployment benefits paid to the employer's former employees during the year. The reserve ratio is the balance (reserve) in the employer's account divided by the employer's average taxable payroll for a specific number of years. The higher the ratio, the lower the tax rate. (Used by the majority of states.)

$$\text{Reserve ratio} = \frac{\text{Unemployment taxes paid} - \text{Benefits charged}}{\text{Average taxable payroll}}$$

Example:

Company had a balance of \$34,600 in their unemployment account and had \$2,200 charged to them for the previous year and an average payroll of \$800,000

$$\frac{34,600 - 2,200}{800,000} = \frac{32,400}{800,000} = .041 = 4.1\%$$

Benefit Ratio

The Benefit Ratio method considers the relationship between the unemployment benefits charged to the employer during a stated period and the employer's total taxable payroll for the same period.

$$\text{Benefit ratio} = \frac{\text{Benefits charged}}{\text{Total taxable payroll}}$$

Example:

Company had \$4,800 in benefits charged to their unemployment account over the past three years and a total taxable payroll during that time of \$400,000.

$$\frac{4,800}{400,000} = 0.012 = 1.2\%$$

Benefit Wage Ratio

Two states (Delaware and Oklahoma) use this method, which focuses on the taxable wages used to determine the benefits payable to employees who were terminated during the applicable time period, rather than the benefits themselves. These wages are then compared to the employer's total taxable payroll during the same period.

$$\text{Benefit wage ratio} = \frac{\text{Benefit wages paid}}{\text{Total taxable payroll}}$$

Example:

Company terminated 6 employees whose wages totaled \$140,000. Company had a total taxable payroll of \$900,000 during that time.

$$\frac{140,000}{900,000} = .1556 = 15.56\%$$

Payroll Stabilization

This method, which is only used in Alaska, uses fluctuations in an employer's payroll from quarter to quarter to determine the tax rate. As more employees are terminated and the payroll decreases, the employer's tax rate will increase. As long as the employer's payroll remains stable or increases, the tax rate will not be increased and may be decreased.

Section 8 – Depositing and Reporting Withheld Taxes

Objectives

- Identify Employer Identification Numbers and how to obtain them
- Define payroll tax deposit rules and deposit frequencies
- Identify the methods for depositing payroll taxes
- Review penalties for failure to file and deposit on time
- Review Form 941 and who must file this form
- Identify other types of filing forms

Employer Identification Numbers

To ensure all payments are credited to the correct employer, each employer is assigned an Employer Identification Number (EIN). This number identifies an employer to the Internal Revenue Service and the Social Security Administration. The EIN is a nine-digit number displayed in the following format: 00-0000000.

How to get an EIN

New employers that have not been assigned an EIN must apply for one online, by phone, or by completing Form _____, *Application for Employer Identification Number*.

Where there is no EIN

If an employer has not yet received its EIN before the due date of a return, the employer should write “Applied for” and the date of the application in the space provided for the EIN.

Only one Form SS-4 should be filed and only one EIN used for each business unless there are separate but affiliated corporations which each need an EIN.

After a corporate merger or acquisition, the proper EIN to use depends on its characterization under the Internal Revenue Code. If the merger or reincorporation is a reorganization under the IRC, the surviving corporation should use its previously assigned EIN. However, a new EIN is necessary if a new corporation emerges from a consolidation that does not qualify as a reorganization.

Depositing Withheld Income and Employment Taxes

Federal income, social security and Medicare taxes withheld from employee’s wages, as well as the employer’s share of social security, Medicare and FUTA generally must be deposited electronically through the Electronic Federal Tax Payment System, unless the amounts are very small.

Payroll Tax Deposit Rules

Employers that file Form 941 are assigned one of two depositor status classifications or frequencies under the deposit rules. They are _____ or _____. The determination is based on the employer’s total liability for federal income, social security, and Medicare taxes during a _____ which is the 12-month period ending the preceding June 30.

Example:

For calendar year 2017, the Form 941 lookback period is _____ through _____.

If an employer's federal tax liability during the lookback period is \$ _____ or less, they will be assigned a _____ deposit frequency for the upcoming year.

If an employer's federal tax liability during the lookback period is greater than \$ _____, they will be assigned a _____ deposit frequency for the upcoming year.

Very small employers

Employers with a total annual withheld federal income tax, social security, and Medicare tax liability of \$ _____ or less may file Form _____, rather than Form 941 and can deposit or pay their tax liability when they file this form.

New Employers

New employers are classified as monthly depositors because they have no tax liability experience during the lookback period. They continue to deposit on that basis until they accumulate more than \$50,000 in tax liability during a lookback period or trigger the one-day deposit rule.

Deposit Requirements

The chart below identifies when deposits are due for each deposit frequency.

Deposit Frequency	Check Date	Cutoff Date	Due Date
Monthly			
Semiweekly			
Next Day (One –day deposit)			

One-day deposit rule

If an employer's accumulated employment tax liability reaches \$_____ on any day during a monthly or semiweekly deposit period, the taxes must be deposited by the close of the next banking day.

Example:

One day deposit rule – SWDI, Inc. ran two out-of-cycle payrolls. One had a pay date of Wednesday, June 7th for \$80,098.00, one on Thursday, June 8th for \$20,870.00 and the regular run on Friday, June 9th for \$13,524.00. The deposits would be as follows:

\$_____ due on _____ and
\$_____ due on _____

Impact of one-day rule on monthly depositors

If a monthly depositor accumulates at least \$100,000 in tax liability on any day during a month, it not only must deposit the liability but the next day, but it also becomes a semiweekly depositor for the remainder of the current calendar year and the entire next calendar year.

Semiweekly periods bridging two quarters

A semiweekly deposit period may overlap the end of one quarterly (or annual) return period and the beginning of the next. In this situation, and if the employer pays wages on two days in different quarters during the semiweekly period, the employer will have two separate deposit obligations and must make two separate electronic deposits.

Example:

The All American Bakery Company, a semiweekly depositor, pays wages on Saturday, September 30th with an employment tax liability of \$45,000. They pay out some bonuses on Monday, October 2nd with an employment tax liability of \$3,200. Rather than a total deposit obligation of \$48,200, All American Bakery has two separate deposits of \$_____ and \$_____. They are both due on _____, _____ but will each be deposited separately.

Quarterly de minimis deposit rule

Employers with an accumulated tax liability of less than \$_____ for any quarter can deposit the liability according to their monthly or semiweekly depositor status or pay it with their Form 941 quarterly return. This safe harbor also applies if the employer's employment tax liability was less than \$_____ for the immediately preceding quarter. This helps small employers that file Form 941 and have an unexpected increase in their deposit liability for a quarter to avoid potential failure-to-deposit penalties.

Annual Form 944 deposit or payment exception

As mentioned previously, employers with an annual employment tax liability of \$1,000 or less that are notified in writing by the IRS of their qualification for the Employer's Annual Federal Tax Program can pay their liability with a timely filed Form 944.

Saturday, Sunday, and holiday extension

If the due date of a deposit is not a business day, the deposit is due on the next business day. For a semiweekly depositor, they are guaranteed three banking days to make their deposit, so if any of the three weekdays following their cutoff is not a business day, the employer has an additional day to make the deposit.

Shortfall rule

The IRS allows a "safe harbor" shortfall so employers are not penalized for depositing a small amount less than the entire amount of their deposit obligation. If the amount of the shortfall is no more than the greater of \$_____ or _____% of the entire amount due, if the original deposit was made timely, and if the shortfall is deposited by the appropriate make-up date, then the employer has satisfied its deposit obligation.

For monthly depositors, the amount of the shortfall must be deposited or remitted by the due date of the quarterly return for the quarter during which the employment tax liability was incurred.

For semiweekly depositors, the shortfall must be deposited by the first Wednesday or Friday occurring on or after the 15th of the month after the month during which the original deposit was required to be made or, if earlier, by the due date of the quarterly employment tax return for the quarter during which the original deposit was required to be made.

How to Deposit Payroll Taxes

EFTPS

Employers that are required to deposit employment and other federal depository taxes must use the Electronic Federal Tax Payment System (EFTPS) for all federal tax deposits.

New businesses indicating that they will have a federal tax obligation are automatically pre-enrolled in EFTPS.

Businesses that were previously using paper checks and coupons to make tax deposits will also be pre-enrolled in EFTPS.

For other employers who are no longer able to pay their employment taxes with their returns, they must enroll by completing and submitting Form _____, or by enrolling online at www.eftps.gov.

Penalties for Failure to Deposit on Time

Depositors that fail to deposit the entire amount of tax required by the due date (taking into consideration the safe-harbor rule) without reasonable cause for the failure are subject to the following penalties:

- ____% of the undeposited amount if it is deposited within ____ days of the due date
- ____% of the undeposited amount if it is deposited within _____ days of the due date
- ____% of the undeposited amount if it is deposited _____ days after the due date
- ____% of the undeposited amount if it is not paid within ____ days after the employer receives its first IRS delinquency notice or on the same day a notice and demand for payment is received

100% Penalty

Individuals who are responsible for collecting (withholding), accounting for, and paying over (depositing) income, social security and Medicare taxes and who willfully fail to do so are subject to an additional penalty equal to the total amount of the taxes involved. This is known as the Trust Fund Recovery Penalty or the 100% penalty.

The Employer's Employment Tax Return – Form 941

The purpose of Form 941 is to provide the IRS with a report of each employer's total taxable wages paid and payroll tax liability, which can be matched against the employer's record of tax deposits and wage and tax information provided to employees on their W-2 forms.

Who Must File Form 941

This return generally must be filed by all employers that withhold federal income tax from employee compensation and are subject to withholding and payment of social security and/or Medicare taxes. The following employers are exempt from filing Form 941:

- Seasonal employers that regularly do not pay wages in certain quarters
- Businesses that withhold federal income tax from only nonpayroll items
- Employers that report only withheld taxes on domestic workers
- Employers that report only wages for employees in U.S. territories and possessions
- Agricultural employers that have only agricultural employees
- Employers that have an annual employment tax liability of no more than \$1,000 and file Form 944

Statutory merger or consolidation of two businesses

Where two companies merge or consolidate, the surviving corporation must file Form 941 for the quarter during which the change took place, reporting the wages paid and taxes withheld by both companies.

This reporting will result in discrepancies between the amounts shown on the surviving corporation's Forms W-2 and 941 for the year of the merger or consolidation. The surviving corporation should file _____ to explain the discrepancies in the totals of social security wages, Medicare wages and tips, social security tips, and federal income tax withheld.

This should be filed after the W-2s are prepared for the year of the acquisition and should be filed with the predecessor's first quarter Form 941 for the year after the year of the acquisition or with the surviving corporation's final Form 941 if the surviving corporation goes out of business after the merger or consolidation and the final Form 941 is due earlier.

Acquisition where successor hires predecessor's employees

There are options and other requirements that apply when a successor employer acquires substantially all the property used in a predecessor's business.

Standard Procedure

- Successor and predecessor will each file a Form 941 for the quarter of the acquisition
- If the standard procedure is used, _____ should not be filed.

Alternate Procedure

- Successor and predecessor agree that predecessor will not have to report wages and taxes for the employees on Form _____
- Predecessor is still required to file Form _____
- Predecessor should also complete a _____ to explain discrepancies in totals of social security wages, Medicare wages and tips, social security tips, federal income tax withheld, and advance earned income credit payments
- The predecessor's _____ should be filed after Forms _____ are prepared for the year of acquisition and should be filed with the predecessor's first quarter Form _____ for the year after the year of the acquisition or with the predecessor's final Form _____ if that is due earlier
- The successor will have similar discrepancies. It should also complete a _____ to explain discrepancies in totals of social security wages, Medicare wages and tips, social security tips, federal income tax withheld, and advance earned income credit payments
- The successor's _____ should also be filed after Forms _____ are prepared for the year of acquisition and should be filed with the successor's first quarter Form _____ for the year after the year of the acquisition or with the successor's final Form _____ if the successor goes out of business

Additional 941 Highlights

- The 941 is scannable
- The IRS no longer sends out preprinted forms, so employers must enter their business information
- Form must have employer's signature
- New employers with no EIN assigned should type the words "Applied For" and the date of the application in the space provided for the EIN
- Employers going out of business should
 - Check the box on Line _____ along with the last date wages were paid
 - Attach a statement showing the address where the employer's records will be kept
- If an employer's total liability for the current or preceding quarter is less than \$_____, the employer has the option of paying it with the 941

When and Where to File Form 941

In general, employers must file Form 941 by the last day of the first month following the end of each calendar quarter. However, if the employer has made timely deposits of all its payroll tax liability for the quarter, an automatic extension of the filing period to the 10th day of the next month is granted.

Form 941 Filing Deadlines			
Quarter	Quarter Ends	941 Due Date	Automatic Extension
Jan. – Mar.	March 31		
Apr. – June	June 30		
July – Sept.	September 30		
Oct. – Dec.	December 31		

Saturdays, Sundays and holidays

If the due date falls on a Saturday, Sunday, or legal holiday, the due date becomes the next business day.

Where must Form 941 be filed?

Employers should file their Forms 941 with the IRS office assigned to their region.

Form 941

Like the Form 940 referenced in the previous section of these handouts, the CPP exam may or may not expect exam candidates to have knowledge of the lines on Form 941. It's a best practice to be generally familiar with the various lines on this form.

Schedule B (Form 941)

Semiweekly depositors at any time during a quarter must file an attachment to Form 941 – Schedule B. This includes monthly depositors that accumulate at least \$100,000 in employment tax liability during a month. This schedule records an employer's payroll tax liability, not deposits made, and contains three sections. Months 1, 2, and 3 correspond to each month of the quarter and are divided into 31 blocks where employers should enter the tax liability incurred on each day of the quarter.

The Form 941 and Schedule B are included on the next three pages of these study notes.

Form **941 for 2016: Employer's QUARTERLY Federal Tax Return** (Rev. January 2016) Department of the Treasury — Internal Revenue Service **950114** OMB No. 1545-0029

Employer identification number (EIN) -

Name (not your trade name)

Trade name (if any)

Address

Number Street Suite or room number

City State ZIP code

Foreign country name Foreign province/country Foreign postal code

Report for this Quarter of 2016
(Check one.)

☐ 1: January, February, March
☐ 2: April, May, June
☐ 3: July, August, September
☐ 4: October, November, December

Instructions and prior year forms are available at www.irs.gov/form941.

Read the separate instructions before you complete Form 941. Type or print within the boxes.

Part 1: Answer these questions for this quarter.

1 Number of employees who received wages, tips, or other compensation for the pay period including: Mar. 12 (Quarter 1), June 12 (Quarter 2), Sept. 12 (Quarter 3), or Dec. 12 (Quarter 4) 1

2 Wages, tips, and other compensation 2

3 Federal income tax withheld from wages, tips, and other compensation 3

4 If no wages, tips, and other compensation are subject to social security or Medicare tax ☐ Check and go to line 6.

	Column 1	Column 2
5a Taxable social security wages . . .	<input type="text"/>	<input type="text"/>
5b Taxable social security tips . . .	<input type="text"/>	<input type="text"/>
5c Taxable Medicare wages & tips . . .	<input type="text"/>	<input type="text"/>
5d Taxable wages & tips subject to Additional Medicare Tax withholding <input type="text"/>	<input type="text"/>	<input type="text"/>
5e Add Column 2 from lines 5a, 5b, 5c, and 5d . . .		5e <input type="text"/>
5f Section 3121(q) Notice and Demand—Tax due on unreported tips (see instructions) . . .		5f <input type="text"/>
6 Total taxes before adjustments. Add lines 3, 5e, and 5f . . .		6 <input type="text"/>
7 Current quarter's adjustment for fractions of cents . . .		7 <input type="text"/>
8 Current quarter's adjustment for sick pay . . .		8 <input type="text"/>
9 Current quarter's adjustments for tips and group-term life insurance . . .		9 <input type="text"/>
10 Total taxes after adjustments. Combine lines 6 through 9 . . .		10 <input type="text"/>
11 Total deposits for this quarter, including overpayment applied from a prior quarter and overpayments applied from Form 941-X, 941-X (PR), 944-X, or 944-X (SP) filed in the current quarter . . .		11 <input type="text"/>
12 Balance due. If line 10 is more than line 11, enter the difference and see instructions . . .		12 <input type="text"/>
13 Overpayment. If line 11 is more than line 10, enter the difference <input type="text"/>		Check one: <input type="checkbox"/> Apply to next return. <input type="checkbox"/> Send a refund.

► You MUST complete both pages of Form 941 and SIGN it.

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 17001Z Form **941** (Rev. 1-2016) **Next** ►

Name (not your trade name)		950214	
		Employer identification number (EIN)	

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you are unsure about whether you are a monthly schedule depositor or a semiweekly schedule depositor, see section 11 of Pub. 15.

14 Check one: ☐ Line 10 on this return is less than \$2,500 or line 10 on the return for the prior quarter was less than \$2,500, and you did not incur a \$100,000 next-day deposit obligation during the current quarter. If line 10 for the prior quarter was less than \$2,500 but line 10 on this return is \$100,000 or more, you must provide a record of your federal tax liability. If you are a monthly schedule depositor, complete the deposit schedule below; if you are a semiweekly schedule depositor, attach Schedule B (Form 941). Go to Part 3.

☐ You were a monthly schedule depositor for the entire quarter. Enter your tax liability for each month and total liability for the quarter, then go to Part 3.

Tax liability: Month 1

Month 2

Month 3

Total liability for quarter Total must equal line 10.

☐ You were a semiweekly schedule depositor for any part of this quarter. Complete Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors, and attach it to Form 941.

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

15 If your business has closed or you stopped paying wages ☐ Check here, and enter the final date you paid wages .

16 If you are a seasonal employer and you do not have to file a return for every quarter of the year . . . ☐ Check here.

Part 4: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details.


☐ Yes. Designee's name and phone number

Select a 5-digit Personal Identification Number (PIN) to use when talking to the IRS.

☐ No.

Part 5: Sign here. You MUST complete both pages of Form 941 and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.



Sign your name here

Date

Print your name here

Print your title here

Best daytime phone

Paid Preparer Use Only Check if you are self-employed ☐

Preparer's name <input style="width: 200px;" type="text"/>	PTIN <input style="width: 100px;" type="text"/>
Preparer's signature <input style="width: 200px;" type="text"/>	Date <input style="width: 80px;" type="text"/>
Firm's name (or yours if self-employed) <input style="width: 200px;" type="text"/>	EIN <input style="width: 100px;" type="text"/>
Address <input style="width: 200px;" type="text"/>	Phone <input style="width: 100px;" type="text"/>
City <input style="width: 100px;" type="text"/> State <input style="width: 30px;" type="text"/>	ZIP code <input style="width: 100px;" type="text"/>

Page 2 Form 941 (Rev. 1-2016)

Schedule B (Form 941):

960311

Report of Tax Liability for Semiweekly Schedule Depositors

(Rev. January 2014)

Department of the Treasury — Internal Revenue Service

OMB No. 1545-0029

Employer identification number (EIN) - Name (not your trade name) Calendar year (Also check quarter)**Report for this Quarter...**
(Check one.)

- ☐ 1: January, February, March
- ☐ 2: April, May, June
- ☐ 3: July, August, September
- ☐ 4: October, November, December

Use this schedule to show your **TAX LIABILITY** for the quarter; **DO NOT** use it to show your deposits. When you file this form with Form 941 or Form 941-SS, **DO NOT** change your tax liability by adjustments reported on any Forms 941-X or 944-X. You must fill out this form and attach it to Form 941 or Form 941-SS if you are a semiweekly schedule depositor or became one because your accumulated tax liability on any day was \$100,000 or more. Write your daily tax liability on the numbered space that corresponds to the date wages were paid. See Section 11 in Pub. 15 (Circular E), Employer's Tax Guide, for details.

Month 1

1	<input type="text"/>	9	<input type="text"/>	17	<input type="text"/>	25	<input type="text"/>	Tax liability for Month 1 .
2	<input type="text"/>	10	<input type="text"/>	18	<input type="text"/>	26	<input type="text"/>	
3	<input type="text"/>	11	<input type="text"/>	19	<input type="text"/>	27	<input type="text"/>	
4	<input type="text"/>	12	<input type="text"/>	20	<input type="text"/>	28	<input type="text"/>	
5	<input type="text"/>	13	<input type="text"/>	21	<input type="text"/>	29	<input type="text"/>	
6	<input type="text"/>	14	<input type="text"/>	22	<input type="text"/>	30	<input type="text"/>	
7	<input type="text"/>	15	<input type="text"/>	23	<input type="text"/>	31	<input type="text"/>	
8	<input type="text"/>	16	<input type="text"/>	24	<input type="text"/>			

Month 2

1	<input type="text"/>	9	<input type="text"/>	17	<input type="text"/>	25	<input type="text"/>	Tax liability for Month 2 .
2	<input type="text"/>	10	<input type="text"/>	18	<input type="text"/>	26	<input type="text"/>	
3	<input type="text"/>	11	<input type="text"/>	19	<input type="text"/>	27	<input type="text"/>	
4	<input type="text"/>	12	<input type="text"/>	20	<input type="text"/>	28	<input type="text"/>	
5	<input type="text"/>	13	<input type="text"/>	21	<input type="text"/>	29	<input type="text"/>	
6	<input type="text"/>	14	<input type="text"/>	22	<input type="text"/>	30	<input type="text"/>	
7	<input type="text"/>	15	<input type="text"/>	23	<input type="text"/>	31	<input type="text"/>	
8	<input type="text"/>	16	<input type="text"/>	24	<input type="text"/>			

Month 3

1	<input type="text"/>	9	<input type="text"/>	17	<input type="text"/>	25	<input type="text"/>	Tax liability for Month 3 .
2	<input type="text"/>	10	<input type="text"/>	18	<input type="text"/>	26	<input type="text"/>	
3	<input type="text"/>	11	<input type="text"/>	19	<input type="text"/>	27	<input type="text"/>	
4	<input type="text"/>	12	<input type="text"/>	20	<input type="text"/>	28	<input type="text"/>	
5	<input type="text"/>	13	<input type="text"/>	21	<input type="text"/>	29	<input type="text"/>	
6	<input type="text"/>	14	<input type="text"/>	22	<input type="text"/>	30	<input type="text"/>	
7	<input type="text"/>	15	<input type="text"/>	23	<input type="text"/>	31	<input type="text"/>	
8	<input type="text"/>	16	<input type="text"/>	24	<input type="text"/>			

Fill in your total liability for the quarter (Month 1 + Month 2 + Month 3) ►

Total must equal line 10 on Form 941 or Form 941-SS.

Total liability for the quarter

For Paperwork Reduction Act Notice, see separate instructions.

IRS.gov/form941

Cat. No. 11967Q

Schedule B (Form 941) (Rev. 1-2014)

Schedule R (Form 941)

This form is used for filing an aggregate Form 941. For IRS-approved agents filing this form on behalf of several clients, it allows them to allocate the 941 information for each client.

Annual Reporting of Nonpayroll Withholding – Form 945

This form is used for businesses to report amounts withheld throughout the year from nonpayroll items such as pensions, annuities, gambling winnings, etc., as well as backup withholding. Total deposits of these nonpayroll withheld taxes will also be reported on Form 945, and any amount withheld that has not yet been deposited when the form is completed must be paid with the form.

This form is due on January 31 with a 10-day extension for employers that have timely deposited all their nonpayroll withheld taxes for the year.

Other Federal Employment Tax Returns

Form 941-M (Monthly Reporting for Delinquent Employers) – NO LONGER USED

This form was previously used for employers that continuously failed to withhold or deposit taxes or file returns on time. Effective January 1, 2012, the IRS declared this form obsolete. Employers who were previously required to file this form will now file a Form 941.

Forms 941-PR and 941-SS (Employers Operating Outside the Continental U.S.)

The Form 941-PR is for employers that have employees in Puerto Rico and Form 941-SS is for employers operating in American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands. Each of these forms is used to report an employer's liability for social security and Medicare taxes, but not federal income tax withholding. These employers must also file Form 941 to report federal income tax withholding liability.

Employers of Domestic Employees

Individuals who hire domestic employees must report and pay both the employer and employee share of social security and Medicare taxes on wages it pays these employees on their personal tax return, Form 1040, on Schedule H.

Form 943 (Annual Reporting by Agricultural Employers)

Employers of farmworkers that must withhold federal income tax and withhold and pay social security and Medicare taxes on farmworkers' wages are required to report the wages paid and taxes withheld on this form.

This form must be filed by the last day of the first month (January 31) after the year being reported on the form. Employers that have deposited all their taxes on time are entitled to an automatic 10-day extension.

Form 944 – Annual Reporting by Small Employers

Employers with an annual estimated employment tax liability of \$1,000 or less that want to file this form must request that the IRS notify them that they qualify.

Making Adjustments, Correcting Returns, and Obtaining Refunds and Credits – Forms 941-X and 843

When errors are made in withholding or reporting federal income, social security, and Medicare taxes, employers must follow established methods set forth in the IRC to correct the errors and pay the correct amount of taxes. The procedure for correction depends on:

- The type of tax involved;
- Whether the employer withheld or reported too little or too much; and
- When the error was made and discovered

Form 941 is used as the standard reporting form in the discussion of these correction methods, and Form 941-X is used as the standard adjustment form.

Here are the various correction scenarios and how they should be addressed.

What happened?

Federal income, social security or Medicare tax **undercollected** and discovered **before** Form 941 is filed.

How is this corrected?

The employer must report on _____ and pay to the IRS the proper withholding amount

What happened?

Social security or Medicare tax **undercollected** or underpaid and discovered **after** Form 941 is filed.

How is this corrected?

If the employer makes the adjustment and reports the underpayment on _____ no later than the due date of the employer's Form 941 for the quarter during which the error is ascertained and pays the IRS at that time, they can avoid the accumulation of interest on the underpayment.

What happened?

Federal income tax **underwithheld** and discovered **after** Form 941 is filed.

How is this corrected?

If the employer reports the undercollection as an adjustment on its timely filed Form 941-X for the quarter during which the error is ascertained and pays the underpayment to the IRS at that time, they can avoid paying interest on the undercollection.

What happened?

Federal income, social security or Medicare tax **overcollected** and discovered **before** Form 941 is filed.

How is this corrected?

The employer does not have to report the overwithheld amount if it repays the overwithheld amount by the due date of _____ and keeps in its records a receipt from the employee showing the date and amount of payment. Also, if only federal income tax must be repaid to the employee, the repayment must occur before the end of the calendar year during which the error was made.

What happened?

Social security or Medicare tax **overcollected** and discovered **after** Form 941 is filed.

How is this corrected?

If this is discovered before the period of limitation on credit or refund, the employer must _____ the overwithheld amount or reimburse the employees by withholding less from their future wages before the period of limitations expires. If repayment is made in a year after the year the error was made, the employee must be issued a Form _____.

What happened?

Federal income tax **overcollected** and discovered **after** Form 941 is filed.

How is this corrected?

If this is discovered before the end of the calendar year, the employer can either _____ or _____ the employee for the overwithheld amount. They must repay the overwithheld amount before the end of the calendar year during which the error was made.

Requirements for interest-free adjustments of overpayments

Once an employer repays or reimburses an employee, the employer may report both the employee and employer portions of social security and Medicare taxes as an overpayment on Form 941-X.

Special rules for correcting errors in collecting additional Medicare tax

Adjustments of underpayments of additional Medicare tax may be made only if the error is ascertained in the same year the wages were paid, unless:

- The underpayment is attributable to an administrative error,
- IRC §3509 applies to determine the amount of the underpayment, due to the employers failure to treat the individual as an employee, or
- The adjustment is the result of an IRS examination

Penalties for Late Reporting and Paying Tax

When an employer is late filing its employment tax returns, not only must the tax that is actually owed with the return be paid, but there are additional penalties imposed by the IRS.

Late filing of employment tax returns

The amount or “addition to tax due” is ____% of the amount of tax required to be shown on the return for each month or fraction of a month that the return is late, up to a maximum of ____% (____% up to a maximum of ____% of the unpaid tax if the late filing is fraudulent)

Failure to pay employment taxes

The “addition to tax due” amounts are:

- ____% of any unpaid tax shown on the return for each month or fraction of a month that the payment is late, up to a maximum of ____%
- An additional ____% per month of any unpaid tax that is not shown on the return but for which the IRS has issued a notice and demand, if the tax is not paid within ____ days of the notice and demand ____ business days if the amount is at least _____) up to a maximum of ____%

These penalties increase to 1% of the unpaid tax for each month beginning:

- ____ days after the day the employer is notified by the IRS that it intends to levy the employer’s assets; or
- On the day after the day the employer is notified by the IRS that it demands immediate payment and will immediately levy on the employer’s assets because it feels the tax may be otherwise uncollectible.

Interest

Any withheld federal income, social security, or Medicare tax that remains unpaid by the last date allowed for payment accumulates interest from that date until the date paid at the federal short term rate plus ____%

Information Reporting for Employees – Form W-2

Once an employer has paid wages to and withheld taxes from its employees during a calendar year, it must then report to the employees the amounts paid and withheld so the employees can complete their personal income tax returns and pay any amount owed to the IRS. This is reported on Form W-2.

Furnishing W-2s after a merger or consolidation

When there has been a merger or consolidation of two employers and one surviving corporation, the survivor is considered to be the same employer as the acquired company. Therefore, it must provide Forms W-2 to all the employees who worked for the absorbed company and the survivor during the calendar year of the merger or consolidation which contain the wages paid by both companies.

When and Where to Furnish Form W-2s

Form W-2 consists of as many as six parts, each of which must be completed and provided to certain parties at a specified time.

Copy A

Beginning with 2016 Forms W-2 filed in 2017, this is due to the Social Security Administration by _____ after the year to which the form applies.

Copy B, C, and 2

These are the employee's copies of Form W-2 and must be sent to the employee by _____ of the year after the year to which the form relates.

Employers going out of business

Employers that cease paying wages face accelerated deadlines for providing Forms W-2 to the SSA and their employees. Those employers are required to file their final Form 941 by the end of the month following the end of the quarter during which they went out of business and they have to provide Copies B, C, and 2 of Form W-2 to their employees by the same date.

Filing Extension

If an employer needs an extension of the date for filing Copy A on paper or electronically with the SSA, it should complete and file Form 8809 *Application for Extension of Time to File Information Returns*.

Box-by-Box Instructions for Form W-2

Review this information in the Payroll Source and become familiar with the various boxes on the Form W-2, particularly the numbered boxes.

One tip that might help is knowing that the first 6 numbered boxes reflect FIT, SS, & Medi respectively. The odd-numbered boxes (1, 3, 5) are for the wages and the even-numbered boxes (2, 4, 6) are for the taxes. Another “tip” is knowing that box 8 is for Allocated Tips, which are reported for anything under 8% of the gross receipts.

22222		Void <input type="checkbox"/>	a Employee's social security number		For Official Use Only ▶ OMB No. 1545-0008	
b Employer identification number (EIN)			1 Wages, tips, other compensation		2 Federal income tax withheld	
c Employer's name, address, and ZIP code			3 Social security wages		4 Social security tax withheld	
			5 Medicare wages and tips		6 Medicare tax withheld	
			7 Social security tips		8 Allocated tips	
d Control number			9		10 Dependent care benefits	
e Employee's first name and initial		Last name	Suff.	11 Nonqualified plans		12a See instructions for box 12
f Employee's address and ZIP code			13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12b	
			14 Other		12c	
					12d	
15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name
<div style="display: flex; justify-content: space-between; align-items: center;"> <div> <p>Form W-2 Wage and Tax Statement</p> <p>Copy A For Social Security Administration — Send this entire page with Form W-3 to the Social Security Administration; photocopies are not acceptable.</p> </div> <div style="font-size: 2em; font-weight: bold;">2016</div> <div> <p>Department of the Treasury—Internal Revenue Service</p> <p>For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions.</p> <p>Cat. No. 10134D</p> </div> </div> <p style="text-align: center; font-weight: bold; color: red;">Do Not Cut, Fold, or Staple Forms on This Page</p>						

Miscellaneous Form W-2 Issues

Hyphenation

When submitting paper Forms W-2 to the SSA, the employer's EIN and the employee's SSN must include hyphens.

Dollar Amounts

Dollar amounts should be entered without commas or dollar signs, but with decimal points, and the cents portion must be shown.

Electronic Reporting Requirements

Employers filing _____ or more Forms W-2 must file them electronically.

Providing Wage and Tax Information to the SSA – Form W-3

If filing paper W-2 forms, the employer must send them along with Form W-3, *Transmittal of Wage and Tax Statements*. The due date for filing Form W-3 is the same as the due date for filing paper copies of Form W-2 to the SSA.

Correcting Information Statements – Forms W-2c and W-3c

When errors have been made on a previously file Form W-2 or W-3, the employer must correct them by filing Forms W-2C and W-3C.

If the only correction made is to employees' addresses, then a Form W-2c does not need to be filed.

Electronic Filing Requirement

Employers filing 250 or more Forms W-2c must file them electronically to correct forms for the immediate prior year.

Correcting more than one W-2 for an employee in a year

If an employee received more than one Form W-2 under the same employer identification number and correction is needed, the employer can

- Consider all the forms W-2 for the employee when determining what to enter on Form W-2c or;
- File a Form W-2c to correct one of the multiple Forms W-2 issued to the employee

The Reconciliation Process for Employers

With so many different aspects to the tax collection, payment, and reporting process, employers must have a way to keep track of each step and its relationship to the others. To help prevent “out-of-balance” conditions and reduce their confrontations with federal and state tax agencies, employers must periodically reconcile their wage and tax information.

Pay period, tax deposit, and quarterly reconciliations

With each pay period and tax deposit, the employer must ensure values produced by the automated payroll system agree with amounts taken from prior reconciliations.

Annual or year-end reconciliation

This is probably the most important time for reconciliation of payroll wage and tax information. If an employer’s totals from its four quarterly Forms 941 do not agree with the total from its Forms W-2, the IRS and SSA will inquire as to why. These amounts include:

- _____
- _____
- _____

Information Returns for Nonemployee Payments – 1099 Series

Employers must report certain payments they make to nonemployees, such as fees paid to independent contractors, payments from pension plans, and payments to estates and beneficiaries.

Form 1099-MISC – Miscellaneous Payments Made by Businesses

Some of the types of nonemployee payments that must be reported on Form 1099-Misc are:

- Service payments to individuals
- Payments to health care providers
- Royalty payments
- Death benefits
- Payments to individuals in medical research studies
- Payments to attorneys
- Deferrals under a section 409A nonqualified deferred compensation plan
- Income under section 409A on a nonqualified deferred compensation plan
- Other payments (e.g. prizes, awards, payments made after an employee’s death, payments of at least \$600 to jurors)

Electronic Reporting

Businesses that must file _____ or more Forms 1099-MISC are required to file them electronically.

Backup Withholding

Amounts withheld from nonemployee compensation because the payee failed to provide a valid taxpayer identification number must be reported in Box 4 of Form 1099-MISC.

Filing with the IRS

Paper copies of this form must be filed to the IRS by February 28 after the year of payment. Electronic copies must be filed by March 31.

Form 1099-R – Pension and Retirement Plan Distributions

Payer who make distributions of retirement income must report those payments and any amount withheld for federal income tax on Form 1099-R.

Filing with the IRS

Paper copies of this form must be filed to the IRS by February 28 after the year of payment. Electronic copies must be filed by March 31.

Penalties for Incorrect or Late Information Returns and Statements

Failure to File Information Returns

The general penalties are as follows:

- \$_____ per return if corrected within 30 days after the due date
- \$_____ per return if corrected more than 30 days after the due date, but before Aug. 1 of the same year the return is due.
- \$_____ per return if not corrected by Aug. 1

No penalty for errors due to reasonable cause

Penalties will be waived for an employer if it can prove there was a reasonable cause for the failure to file or to include complete or correct information on a return. The employer can prove reasonable cause by showing there were “mitigating factors” leading to the failures or by proving that the filing failures were caused by events beyond the employer’s control.

Failure to Provide Information Statements to Employees

For employers who fail to provide an employee or other payee with a required information statement on time and/or with incorrect or incomplete information, the general penalties are as follows:

- \$___ per statement if the failure to provide a complete and correct statement is corrected within 30 days after the due date
- \$___ per statement if the failure to provide a complete and correct statement is corrected more than 30 days after the due date but by August 1 of the same year the statement is due
- \$___ per statement if the failure to provide a complete and correct statement is not corrected by August 1

Electronic Reporting Requirements

- Employers that file more than _____ W2s must file them electronically.

Electronic wage reporting over the internet

Employers that are required to file electronically must file their Forms W-2 over the internet through SSA's _____.

Reporting Special Wage Payments to the SSA

This refers to payments made by an employer to an employee or a former employee that the employee earned in a prior year. These can have a significant impact on a retired employee who is currently receiving social security benefits unless the SSA is notified. A retired employee's social security benefits can be reduced when their earned income exceeds a certain limit. However, wages or payments received in one year but earned in a previous year are not counted. Examples of Special Wage Payments (SWPs) include:

- Bonuses
- Accumulated vacation or sick pay
- Severance pay
- Back pay
- Standby Pay
- Sales commissions
- Stock options
- Payments on account of retirement or deferred compensation earned in a prior year

Reporting Requirements

Employers must report special wage payments for federal income, social security, and Medicare tax purposes in the year the payments are received on Form W-2.

Section 9 – Other Deductions From Pay

Objectives

- Identify other types of involuntary deductions from pay
- Accurately calculate a federal tax levy amount
- Calculate the correct amounts for child support garnishment
- Define the difference between “take home” pay and disposable earnings
- Discuss the rules and limits for creditor garnishments
- Review the rules for bankruptcy orders
- Discuss the rules and limits for student loan collections
- Identify other types of voluntary deductions

Involuntary Deductions

These are deductions over which an employer or employee has no control. The employer is required by law to deduct a certain amount of the employee's pay and send it to a person or government agency to satisfy the employee's debt.

A common problem for employers is determining deduction amounts when several orders for involuntary deductions are received against an employee's wages. If there is not enough pay left in the employee's wages, after any exempt amounts have been taken into consideration, to pay all the orders, the employer must decide which order should be deducted first. As each type of involuntary deduction is discussed in this section, its priority in relation to other deductions will also be explained.

Tax Levies

Employees who fail to timely pay their taxes may become subject to a federal or state tax levy after other collection efforts have been exhausted. The levy requires their employer to deduct the amount owed from their wages and remit to the proper government agency. The employer is faced with the task of determining:

- The amount of the employee's wages that is subject to the levy; and
- Whether there are other claims on the employee's wages that take priority over the levy.

Federal tax levies

This is accomplished by _____ or _____ an employee's wages to the extent that they are not exempt from levy. The employer receives notice of the levy when the IRS sends _____.

This form consists of six parts:

- Part 1 – Employer's copy
- Part 2 – Employee's copy
- Parts 3-5 – Require the employee to provide information to the employer and the IRS regarding his or her tax filing status and any dependents who can be claimed as personal exemptions
- Parts 3 and 4 – must be returned to the employer within three days of the date the employer receives the form. The employer then sends Part 3 to the IRS
- Part 5 – Employee's copy of the tax filing status and exemption information
- Part 6 – Retained by the IRS

Priority vs. other attachment orders

Tax levies must be satisfied before all other garnishment or attachment orders, except for _____ withholding orders established before the date of the levy.

Figuring the amount to deduct and remit

All amounts paid to an employee are subject to levy unless specifically exempt under the IRC or IRS regulations.

The employee is entitled to an amount exempt from levy equal to the employee's standard deduction and personal exemptions. The value of the employee's standard deduction and personal exemptions is determined for the year the levy is received. If the employee does not submit Parts 3 and 4 of Form 668-W, the employer must figure the exempt amount as if the employee's filing status is _____ filing separately with _____ personal exemption. Employers cannot rely on the employee's Form W-4 to determine the filing status and number of exemptions.

The IRS issues table for figuring the exempt amount each year as IRS Publication 1494, which is displayed on the next page.

IRS Publication 1494 (2017)

1. Tables for Figuring Amount Exempt from Levy on Wages, Salary, and Other Income (Forms 668-W(ACS), 668-W(c)(DO) and 668-W(ICS))														2017
The tables below show the amount of an individual's income that is exempt from a notice of levy used to collect delinquent tax in 2017.														
Filing Status: Single							Filing Status: Married Filing Joint Return (and Qualifying Widow(er)s)							
Pay Period	Number of Exemptions Claimed on Statement						Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6		1	2	3	4	5	6	More Than 6
Daily	40.00	55.58	71.15	86.73	102.31	117.88	Daily	64.42	80.00	95.58	111.15	126.73	142.31	48.84 plus 15.58 for each exemption
Weekly	200.00	277.88	355.77	433.65	511.54	589.42	Weekly	322.12	400.00	477.88	555.77	633.65	711.54	244.23 plus 77.89 for each exemption
Biweekly	400.00	555.77	711.54	867.31	1023.08	1178.85	Biweekly	644.23	800.00	955.77	1111.54	1267.31	1423.08	488.46 plus 155.77 for each exemption
Semimonthly	433.33	602.08	770.83	939.58	1108.33	1277.08	Semimonthly	697.92	866.67	1035.42	1204.17	1372.92	1541.67	529.17 plus 168.75 for each exemption
Monthly	866.67	1204.17	1541.67	1879.17	2216.67	2554.17	Monthly	1395.83	1733.33	2070.83	2408.33	2745.83	3083.33	1058.33 plus 337.50 for each exemption
Filing Status: Head of Household							Filing Status: Married Filing Separate Return							
Pay Period	Number of Exemptions Claimed on Statement						Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6		1	2	3	4	5	6	More Than 6
Daily	51.54	67.12	82.69	98.27	113.85	129.42	Daily	40.00	55.58	71.15	86.73	102.31	117.88	24.42 plus 15.58 for each exemption
Weekly	257.69	335.58	413.46	491.35	569.23	647.12	Weekly	200.00	277.88	355.77	433.65	511.54	589.42	122.11 plus 77.89 for each exemption
Biweekly	515.38	671.15	826.92	982.69	1138.46	1294.23	Biweekly	400.00	555.77	711.54	867.31	1023.08	1178.85	244.23 plus 155.77 for each exemption
Semimonthly	558.33	727.08	895.83	1064.58	1233.33	1402.08	Semimonthly	433.33	602.08	770.83	939.58	1108.33	1277.08	264.58 plus 168.75 for each exemption
Monthly	1116.67	1454.17	1791.67	2129.17	2466.67	2804.17	Monthly	866.67	1204.17	1541.67	1879.17	2216.67	2554.17	529.17 plus 337.50 for each exemption
2. Table for Figuring Additional Exempt Amount for Taxpayers at Least 65 Years Old and/or Blind							Examples							
Filing Status	*	Additional Exempt Amount					These tables show the amount exempt each pay period from a levy on wages, salary, and other income.							
		Daily	Weekly	Biweekly	Semi-monthly	Monthly	1. A single taxpayer who is paid weekly and claims three exemptions (including one for the taxpayer) has \$355.77 exempt from levy.							
Single or Head of Household	1	5.96	29.81	59.62	64.58	129.17	2. If the taxpayer in number 1 is over 65 and writes 1 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, & 5 of the levy, \$385.58 is exempt from this levy (\$355.77 plus \$29.81).							
	2	11.92	59.62	119.23	129.17	258.33	3. A taxpayer who is married, files jointly, is paid bi-weekly, and claims two exemptions (including one for the taxpayer) has \$800 exempt from levy.							
Any Other Filing Status	1	4.81	24.04	48.08	52.08	104.17	4. If the taxpayer in number 3 is over 65 and has a spouse who is blind, this taxpayer should write 2 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, and 5 of the levy. If so, \$896.15 is exempt from this levy (\$800 plus \$96.15).							
	2	9.62	48.08	96.15	104.17	208.33								
	3	14.42	72.12	144.23	156.25	312.50								
	4	19.23	96.15	192.31	208.33	416.67								
* ADDITIONAL STANDARD DEDUCTION claimed on Parts 3, 4, and 5 of levy.														
Publication 1494 (2017)							Department of Treasury – Internal Revenue Service							

Example:

If an employee completes Parts 3 and 4 of the Form 668-W, indicating they are Married Filing Separately with two exemptions and if they are paid weekly, then according to this table, an amount of \$_____ would be exempt from the levy.

Exempt amount subtracted from “take-home” pay

The amount of an employee's wages that is ultimately subject to the federal tax levy is the amount remaining after the exempt amount has been subtracted from the employee's “take-home pay.” Here are the items that may be subtracted from an employee's gross wages when calculating take-home pay:

- Federal, state, and local taxes, even if the amounts increase while the levy is in effect
- Involuntary and voluntary deductions in effect before the employer received the levy
- Increases in preexisting deductions beyond the employee's control, including those caused by increases in the employee's pay, such as elective deferrals of a certain percentage of salary

- Deductions instituted after the levy is received and made as a condition of employment, such as a required deduction for union dues

Example:

Nancy receives wages of \$1,500 from her employer every two weeks and her employer has received a Form 668-W stating that a federal tax levy is being issued. Nancy has the following deductions from her check:

- Federal Income Tax \$140.00
- Social Security Tax \$ 86.80
- Medicare Tax \$ 20.30
- State Income Tax \$ 45.00
- 401(k) plan \$ 75.00
- Health Insurance \$100.00

Based on these deductions, what is Nancy's take-home pay?
\$ _____

On parts 3 and 4 of Form 668-W, Nancy claimed married, filing jointly with 3 exemptions. Using the table on the previous page, determine the amount exempt from levy and the amount of the levy that Nancy's employer will withhold from each paycheck.

Amount Exempt from Levy: \$ _____
Amount to be withheld \$ _____

When and where to make payments of withheld amounts

Form 668-W instructs employers to remit amounts withheld from levy on the same day wages are paid to the employee. The first payment to the IRS should accompany Part 3 of the form, after both the employer and the employee complete the information requested.

Payments should be sent to the IRS at the address shown on the front of Part 1.

When to stop withholding

The employer must continue to withhold and make levy payments until it receives Form _____. The employer may not stop withholding when the payments match the total due the IRS stated on the front of Part 1 of Form 668-W because interest and possible penalties continue to accumulate on the amount remaining due after each levy payment is made.

When employment ends

If the employee named on Form 668-W is no longer employed by the employer when the form is received, the employer must note that on the reverse side of Part 3 and return it to the IRS, along with the employee's last known address. If employment terminates while the levy is in effect, the employer should notify the IRS office where payments have been sent of the termination and the name and address of the employee's new employer, if known. The employer must deduct and remit any nonexempt amounts contained in severance or dismissal pay provided the employee.

Penalties for failing to withhold and remit

Employers failing to withhold and pay over amounts not exempt from levy after receiving Form 668-W are liable for the full amount required to be withheld, plus interest from the wage payment date. In addition, the employer is liable for a penalty equal to ____% of the amount recoverable by the IRS after the failure to withhold and remit.

Voluntary deduction agreement

An employee who owes federal taxes may be able to avoid the imposition of a federal tax levy through a _____. Under such an agreement, the employee and the IRS agree that a certain amount of federal taxes is owed and that the employee's employer will deduct an amount from the employee's wages each pay period and pay it over to the IRS until full payment is made.

Child Support Withholding Orders

Wage withholding to pay child support is becoming the rule rather than the exception. All initial orders for child support require wage withholding unless both parents or the court and one parent agree to a different method of payment. Even if such an agreement is reached, wage withholding will become automatic once the noncustodial parent owing the child support is _____ late in paying support.

Child support enforcement framework

Enforcement of child support orders is a joint federal/state responsibility, with federal laws providing standards state laws must meet or exceed in order to qualify for federal funding of state child support enforcement programs.

Maximum amount to withhold

These are the federal requirements for handling child support orders. Under the Consumer Credit Protection Act (CCPA), the maximum amount that can be withheld from an employee's wages for spousal or child support is:

- ____% of the employee's "disposable earnings" if the employee is supporting another spouse and/or children; and
- ____% if the employee is not supporting another spouse and/or children

If the employee is at least 12 weeks late (in arrears) in making support payments, the maximum amount that can be withheld is:

- ____% of the employee's "disposable earnings" if the employee is supporting another spouse and/or children; and
- ____% if the employee is not supporting another spouse and/or children

Calculating Disposable Earnings

Disposable earnings are not the same as take-home pay and are determined by subtracting all deductions required by law from an employee's gross earnings. Deductions required by law include withholding for federal, state, or local income tax, social security or Medicare tax, state unemployment or disability tax, and mandated payments for state employee retirement systems.

Voluntary deductions, such as health and life insurance premiums, union dues, and retirement plan contributions are not subtracted from earnings to calculate disposable earnings.

Wages already subject to withholding for tax levies, bankruptcy orders, other child support withholding orders, or wage garnishments are not considered deductions required by law. Therefore they should not be subtracted from gross earnings when determining the maximum amount subject to child support withholding. However, if the tax levy or other child support withholding order has priority over the current child support withholding order, the amount required to be deducted under the order having priority must be taken into account when determining whether the CCPA maximum has been reached.

Example:

George's employer receives a child support withholding order that had not been established before George's wages had already been subject to a federal tax levy under which the employer is currently withholding 40% of George's disposable earnings every two weeks (\$1,800). Assuming that George's disposable earnings and take-home pay are the same and that George is not in arrears and is not supporting another spouse and/or child, here is how the employer would prioritize this order:

\$1,800 x 40% (Federal Tax Levy)	= \$	_____
\$1,800 x _____% (Child Support)	= \$	_____
_____ % maximum withheld per the CCPA	= \$	_____

Priority of withholding orders

Orders to withhold wages for child support take priority over all other garnishments or attachments issued against the employee's wages except for _____ received by the employer before the original child support order was established.

Complying with more than one withholding order

If an employer receives more than one child support withholding order for an employee, state law governs how they must be handled. If the orders are from different states, the law in the state where the employee works applies.

Collecting arrearages

Current support obligations must be paid before any past due amounts. The total current support and arrearages may never exceed the applicable state or federal maximum withholding amount.

Medical child support orders

All states have passed laws allowing courts to require medical child support as part of a child support order and requiring employers to enroll children and withhold premiums from the employee's pay to the same extent as other employees with similar coverage.

Creditor Garnishments

When an employee has a debt that remains unpaid, a wage garnishment is one legal means by which the person who is owed the money can obtain payment. This method requires that the employee's employer withhold the unpaid amount from the employee's wages. In some states, this is known as a wage attachment or income execution.

Limit on the amount that can be garnished

The CCPA states that the maximum amount of an employee's disposable earnings that can be garnished to repay a debt is the lesser of:

- ____% of the employee's disposable earnings for the week; or
- The amount by which the employee's disposable earnings for the week exceed ____ times the federal minimum hourly wage then in effect

Example:

Stacy's employer receives a creditor garnishment. Stacy's weekly disposable earnings are \$550. What is the maximum amount that can be garnished from her wages?

\$ _____

Disposable earnings here are the same as those referenced previously in this section when reviewing child support withholding.

Limit applies to multiple garnishments

The federal garnishment maximum applies no matter how many garnishments are received for an employee. If the maximum is already being withheld when a second garnishment is received, nothing may be withheld for the second garnishment.

Employer's responsibilities when a garnishment order is received

- Check to make sure the underlying claim is valid and the amount stated on the order is correct by contacting the agency or court issuing the order;
- Tell the employee about the garnishment;
- Tell the employee about any exemptions that might apply under state or federal law;
- Tell the employee how the garnishment will affect his or her wages and net pay;
- Determine whether the amount demanded in the garnishment exceeds the maximum allowed by federal or state law;
- If the employee is already subject to one or more garnishment orders, determine their order of priority and how the available disposable earnings must be allocated; and
- Contact legal counsel to review the garnishment order and answer any outstanding questions

Bankruptcy Orders

Once an employee voluntarily declares bankruptcy or is found to be bankrupt by a court, the satisfaction of the employee's creditors is handled by the bankruptcy trustee appointed by the court. Until the employer is notified by the bankruptcy court or the trustee to do otherwise, the employer should continue to withhold. Once the employer receives a bankruptcy order from the trustee under a court-approved plan requiring a certain amount of the employee's wages to be paid to the trustee to satisfy the employee's creditors, the employer must stop withholding on any other garnishments against the employee except for _____.

Bankruptcy orders issued under Chapter XIII of the Bankruptcy Act take priority over any other claim against the employee's wages, including federal and state tax levies received before the bankruptcy order, other than child support withholding orders. Employers now have to obey a child support withholding order regardless of whether a bankruptcy petition is filed by the noncustodial parent employee either before or after the withholding order.

Student Loan Collections

The Higher Education Act (HEA) allows for garnishment of employees' wages to repay delinquent loans. Student loan garnishments are subject to the following restrictions:

- The maximum amount subject to a garnishment is the lesser of 15% of an employee's disposable earnings or the excess of the employee's disposable earnings over _____ times the federal hourly minimum wage then in effect
 - Employees may not be discharged because of a garnishment order to repay a student loan
 - Employees must receive at least 30 days' notice before withholding begins and must be given a chance to work out a repayment schedule to avoid garnishment
 - The HEA provides not guidance as to the priority of a student loan garnishment, but the Department of Education has allowed child support withholding orders to take priority
 - Employees who lose their jobs and become reemployed within 12 months after termination are given 12 months from their date of reemployment before a student loan garnishment order can be put into effect
 - Employers do not have to change their normal pay period
 - If an employer fails to comply with a lawful student loan garnishment order, it is liability for the amount not withheld from wages, as well as punitive damages, courts costs, and attorneys' fees.

Federal Agency Debt Collections

Student loans are not the only type of federal government debts that have been subject to a high percentage of nonpayment. As a result, the Debt Collection Improvement Act was enacted to allow federal government agencies to garnish the wages of individuals who fail to repay their debt according to their agreement with the agency.

Maximum amount to garnish

The maximum amount to be garnished is the lesser of:

- The amount indicated on the garnishment order up to ____ % of the employee's disposable pay, or
- The amount by which the employee's disposable pay exceeds ____ times the federal minimum hourly wage then in effect.

Priority of multiple withholding orders

Unless otherwise provided by federal law, federal agency wage garnishments have priority over other types of withholding orders served on the employer after the federal agency wage garnishment, except for family support orders. If an employee's pay is already subject to another type of withholding order when the employer receives a federal agency wage garnishment, or if a family support withholding order is served on the employer at any time, the amount subject to the federal agency wage garnishment is the lesser of:

- The amount of the order up to 15% of the employee's disposable pay or the amount of the employee's disposable pay in excess of 30 times the federal minimum wage then in effect, or
- 25% of the employee's disposable pay minus the amounts withheld under the withholding orders with priority

Federal Wage-Hour Law Restrictions on Deductions

The Fair Labor Standards Act (FLSA) places its own restrictions on certain deductions when they bring an employee's wages below the minimum wage and overtime pay guaranteed by the FLSA. Below is a summary of those deductions and a brief description of whether or not these deductions can be taken from an employee's wages even if they reduce the employee's wages below the minimum wage.

Board, lodging, and other facilities

Can be deducted and can result in the employee receiving less than the required minimum wage or overtime pay where an employee voluntarily accepts meals, lodging, or other facilities provided by an employer.

Buying and maintaining a uniform

Cannot be deducted if the employee is required to wear a uniform while at work that cannot be used as ordinary streetwear.

Loans to employees

Can be deducted if the amount is equal to the principal of the loan made to the employee.

Salary advances and overpayments

Can be deducted.

Docking pay for missed worktime

Can be deducted if the employee is docked the same amount of pay as time lost.

Cannot be deducted if the employee is docked an additional amount as a penalty.

Deductions for taxes

Can be deducted for the employee-withheld taxes

Garnishments and wage assignments

Can be deducted to satisfy garnishment orders from a court or government agency or to satisfy a voluntary assignment of wages by an employee to some third party.

Union Dues

Can be deducted if required by a union contract.

Cash shortages, bad checks

Cannot be deducted to make up for cash shortages, bounced checks, or customers who fail to pay their bills if the deductions would reduce the employee's wages below the minimum wage or overtime required under the FLSA.

Employer insurance bonds

Cannot require the employee to pay for bonds or insurance to protect against fraud or negligence attributed to the employee before starting work.

Can be spread out and deducted from the employee's wages, but only to the extent that the deductions do not reduce the employee's wages below the FLSA minimum.

Voluntary Deductions

An employee can voluntarily agree to a wage deduction that must be implemented by the payroll department. These deductions include amounts for wage assignments, charitable deductions, wages withheld to purchase savings bonds, or credit union loan repayments. Because the employee authorizes these amounts, they are permitted even if they bring the employee under minimum wage.

Wage Assignments

Wage assignments are voluntary agreements by the employee to have a portion of their wages assigned to a third party, usually to secure a debt. The assignment gives the creditor an opportunity to recover unpaid amounts of the employee defaults. Garnishment limits do not apply and federal or state laws do not restrict these items

Union Dues

In order for union dues to be deducted from an employee's wages, a written agreement must be obtained. These amounts can only be used for dues, initiation fees, and assessments.

Credit Union Deductions

When it is time to repay a credit union loan or place funds in a savings account, the employee may wish to have a portion of his or her wages deducted by the employer and paid over to the credit union. Employers must have a written authorization for the deduction.

U.S. Savings Bonds

Savings Bond deductions allow employees to purchase Series EE U.S. Savings Bonds in denominations beginning at \$100. The purchase price of the bond is $\frac{1}{2}$ of the bond's denomination or "face value." These are purchased with after-tax dollars and mature after 12 years. Taxes are then paid on the interest of the bonds when they are redeemed.

Charitable Contributions

Employers can work with national or local charities to provide their employees an opportunity to make voluntary donations to those charities through payroll deductions. Employees should obtain receipts for donations made in excess of \$_____ to a charitable organization in one lump sum. An employee's check stub can serve as proof that a donation was made on his/her behalf.

Section 10 – Recordkeeping and Record Retention

Objectives

- Define record retention requirements for the FLSA and the IRS
- Identify Federal Anti-Discrimination Laws
- Review some record retention procedures

Fair Labor Standards Act

The FLSA requires certain records to be kept by all covered employers for all employees. Different records have different retention period requirements.

Records that must be kept for each employee for at least _____
_____ include:

- Name, as it appears on the employee's social security card
- Home address
- Date of birth, if under age 19
- Sex and occupation (for Equal Pay Act compliance)
- Beginning of the employee's workweek
- Regular rate of pay for overtime weeks
- Hours worked each workday and workweek
- Straight-time earnings
- Overtime premium earnings
- Additions to and deductions from wages for each pay period
- Total wages paid for each pay period
- Date of payment and the pay period covered

Records that must be kept for at least _____
_____ include:

- Collective bargaining agreements
- Certificates authorizing the employment of industrial homeworkers, minors, learners, students, apprentices, and handicapped workers
- Records showing total sales volume and goods purchased

Records that must be kept for at least _____ include:

- Basic employment and earnings records supporting the data for each employee's hours of work, basis for determining wages, and wages paid
- Order, shipping, and billing records showing customer orders, shipping and delivery records, and customer billings
- Records substantiating additions to or deductions from employees' wages, including purchase orders, operating cost records, wage assignments, and garnishments

Records that must be kept at least _____ include:

- Wage rate tables and piece rate schedules
- Work time schedules establishing the hours and days of employment

In addition to the records listed above, certain other types of employment may have some additional recordkeeping requirements related to the type of work the employees are engaged in, and the basis upon which they're paid. Those are:

- Exempt white collar employees
- Hospital employees
- Tipped employees
- Industrial homeworkers
- Employees receiving remedial education
- Employees receiving subminimum wages under a DOL certificate

Forms of records and availability for inspection

There is no requirement in either the FLSA or its regulations that employers keep records in any particular form. It is only necessary that they be accurate, complete, and able to be understood.

The records required by the FLSA must be available for inspection by the Wage and Hour Division and kept safe and accessible by the employer either at the worksite or at a central location where its records are customarily maintained. If the records are maintained at a central location, they must be made available within _____ of a notice of inspection from the Division.

Penalties for recordkeeping violations

Willful violations of the recordkeeping requirements can bring a criminal penalty of up to \$ _____ and/or imprisonment for up to ____ months, although a jail sentence can be imposed only for second and subsequent convictions.

Government contractors

Recordkeeping requirements exist under laws regulating federal government contractors. Separate logs of occupational injuries and illnesses must be kept and preserved for _____ under the Walsh-Healey Public Contracts Act.

Internal Revenue Code

The IRC requires all employers that withhold and pay federal income tax, social security and Medicare taxes to maintain records for each employee. The documents include those associated with the employees' income tax withholding and they are listed in the Payroll Source.

Retention period

The records associated with federal taxes must be kept for at least _____ after the due date of the tax for the return period to which the records relate.

Records of allocated tips

Employers must keep records substantiating any information returns and employer statements to employees regarding tip allocations for at least _____ after the due date of the return or statement to which they relate.

FUTA tax records

Employers subject to the Federal Unemployment Tax Act (FUTA) must keep records substantiating their FUTA information for at least _____ after the due date of Form 940 or the date the required FUTA tax was paid, whichever is later.

Records processed by computer

The IRS has set up specific procedures for preserving records contained in any system that processes records other than manually, including microcomputer systems, mainframes, electronic storage systems, Data Base Management Systems (DBMS) and all systems using _____ (EDI) technology.

Electronic storage systems

The IRS allows taxpayers to use electronic storage systems to maintain books and records, provided they comply with certain requirements such as:

- Reasonable controls to ensure integrity, accuracy and reliability
- Reasonable controls to prevent unauthorized creation of , addition to, alteration of, deletion of, or deterioration of electronically stored books and records
- An inspection and quality assurance program\
- A retrieval system that includes an indexing system
- The ability to reproduce a legible and readable hardcopy

Penalties for faulty recordkeeping

The willful failure to comply with the recordkeeping requirements under the IRC is a misdemeanor punishable by a fine of up to \$_____ (\$_____ for corporations) and/or imprisonment for up to 1 year, plus the costs of prosecution.

Federal Anti-Discrimination Laws

Various federal laws that prohibit discrimination by employers in hiring, firing, disciplining, compensating, or making other decisions involving employees also have their own recordkeeping requirements.

Civil Rights Act of 1964

This act prohibits employers from discriminating against employees on the basis of:

- _____
- _____
- _____
- _____
- _____

There are no general recordkeeping requirements under the law or regulations issued by Equal Employment Opportunity Commission (EEOC). However, in order to accurately complete reports required each year by the EEOC, employers must make and keep employment records regarding hiring, promotion, demotion, transfer, layoff or termination, rates of pay, and selection for training or apprenticeship.

These records must be kept for at least _____ from the date they were made or the date of the personnel action to which they relate, whichever is later. These rules also apply to the _____.

Age Discrimination in Employment Act of 1967

Prohibits employers from making _____, _____ or other _____ decisions based on the age of individuals who are at least 40 years of age.

The following records must be retained for 3 years

- Name
- Address
- DOB
- Occupation
- Pay Rate
- Compensation earned each week

Government Contractor Regulations

Federal government contractors and subcontractors are subject to more comprehensive recordkeeping requirements than other employers to make sure that affirmative action goals have been met.

Immigration Reform and Control Act (IRCA)

Employers must maintain Form _____ (Employment Eligibility Verification) for at least _____ after the date of hire or _____ after the date of termination – whichever is greater.

The form must be available within _____ upon request from the Department of Labor.

Family and Medical Leave Act (FMLA)

This Act generally requires employers with 50 or more employees to grant employees up to 12 weeks in a 12-month period of unpaid leave to care for a newborn or newly adopted child, to care for a parent, child or spouse who is seriously ill, or due to the employee's own serious illness. The FMLA also contains military family leave provisions that include providing an employee with up to 12 weeks unpaid leave in a 12-month period due to qualifying exigencies that arise when the employee's spouse, son, daughter or parent is on covered active duty, or up to 26 weeks to care for a covered servicemember with a serious injury or illness if the employee is the spouse, son, daughter, parent, or next of kin of covered servicemember..

Some requirements are:

- Medical records for FMLA must be kept separate and confidential
- Covered employers with no eligible employees for FMLA need only keep the basic payroll and identifying employee data.
- The Department of Labor may only inspect the employer's records once during a 12-month period.
- The record format is flexible and need not be kept in any particular order or form.
- The recordkeeping requirements for these follow those of the Fair Labor Standards Act (FLSA) and can vary depending on the records. Refer back to 10.1 of this chapter for more details.

The records related to FMLA must be kept for at least _____.

Affordable Care Act

Under the Affordable Care Act, employers are required to file Forms 1094-C and 1095-C. In addition to filing these information returns with the IRS, the forms' instructions require filers to retain copies of the forms and supporting documentation or maintain the ability to reconstruct the data for at least ____ years from the due date of the returns.

Here's a helpful tip:

3 letters = 4 years
(IRS)

4 letters = 3 years
(FLSA, FMLA, or IRCA)

Payroll Processing = 2 years

While there can be exceptions to these timeframes, this tip can be helpful.

State Wage-Hour Laws

Most state wage-hour laws have recordkeeping requirements similar to those under the Fair Labor Standards Act. For the CPP exam, participants will not be tested on the individual states' laws.

Child support withholding, creditor garnishments, etc.

The federal laws that govern child support withholding orders, creditor garnishments, and other wage attachments generally do not contain specific recordkeeping and retention requirements. However, employers should preserve any records gathered or made in relation to such matters for at least _____ after the last withholding from the employee's wages. This will satisfy federal and state wage-hour law record retention requirements.

Direct Deposit Considerations

Direct deposit authorizations containing the information necessary to allow credits to be made to the employees' accounts do not have to be in writing. However, any written authorizations must be retained for _____ from the termination or revocation of the authorization, and the original or a duplicate tape recording of oral authorizations must be retained for _____ from the date of the authorization.

Record Retention Procedures

Employee Master File

To comply with the varying federal and state recordkeeping requirements, employers should create a master file of employee data that meets the most stringent of those requirements. In general, if federal requirements are met, state requirements should be met as well.

Documents Needed From New Employees

In addition to gathering information from new employees and setting them up in the master file, employers must also obtain certain documents from new employees and keep them on file for various lengths of time. They include:

- Form W-4 – must be retained for at least _____ after the last date the information on it is used to prepare the employee's tax return
- State withholding allowance certificate
- Local withholding allowance certificate
- State nonresidency certificates
- Form I-9 – must be retained for _____ after hire or one year after termination, whichever is longer

Record Retention and Storage Methods

The various federal and state laws generally do not require that records be kept in any particular form. Some of the forms that may be used are:

- Paper storage
- Micromedia storage (microfilm or microfiche)
- Media imaging
- Electronic vaulting

Health Insurance Portability and Accountability Act (HIPAA)

This act was principally designed to help employees and their families maintain health insurance coverage when the employees change or lose jobs. HIPAA's scope is much broader, however, and it includes provisions dealing with how employers, hospitals, physicians, and insurers handle confidential patient information. The Payroll Source goes into great detail about this Act.

Recordkeeping and retention requirements

A covered entity must maintain, until _____ after the later of the date of their creation or last effective date, its privacy policies and procedures, its privacy practices notices, disposition of complaints, and other actions, activities, and designations that the Privacy Rule requires to be documented.

Section 11 – Payroll Accounting

Objectives

- Define the accounting principles
- Identify account classifications and account balances
- Define journal entries
- Record payroll transactions
- Record accruals and reversals
- Review balancing and reconciling of payroll accounts
- Identify financial statements and audits
- Identify internal controls

Accounting Principles

Accounting is a way of keeping track of an organization's financial transactions by identifying and classifying those transactions. This information is then used to prepare the company's financial statements, which describe the company's cash flow, profits, losses, assets, liabilities, and net worth. They are used by management, stockholders, auditors, etc. to gauge the company's financial health and prospects for the future.

Accounting standards are not set by law, but by private organizations. Since 1974, the Financial Accounting Standards Board (FASB) has set the standards for recording financial transactions. Before 1974, a variety of organizations issued a set of concepts and principles that have come to be known as Generally Accepted Accounting Principles (GAAP). They include:

- **Business Entity Concept** – Every organization that operates separately is treated as a business entity and the transactions for each entity should be kept separate from all other transactions.
- **Continuing Concern Concept** – Assumes that a business entity will continue to operate indefinitely as a business.
- **Time Period Concept** – Each organization must determine its own 12-month accounting period based on the type of business it is engaged in (fiscal year). The end of the fiscal year for a business generally coincides with their least busy time of year.
- **Cost Principle** – Because each business is considered an ongoing concern, goods and services purchased (assets) are recorded at their cost.
- **Objectivity Principle** – Transactions must be recorded objectively and without bias to insure that the information is useful to lenders and investors.
- **Matching Principle** – Expenses and revenue are recorded in the accounting period in which they are incurred or earned.
- **Realization Principle** – Revenue is recognized (or realized) and reported when earned, which is during the accounting period when the good have been transferred or the services provided. The amount realized is the actual cash received or the fair market value of goods or services received.
- **Consistency Principle** – Transactions must be recorded in a consistent manner based on the particular accounting method, principle, or period.

Account Classifications

All of a company's transactions are recorded and classified into various accounts using a "double entry" accounting system that is based on two equations:

Equation #1 – Balance Sheet

$$\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$$

Equation #2 – Income Statement & Statement of Retained Earnings (2 equations)

$$\text{Revenue} - \text{Expenses} = \text{Net Income}$$

$$\text{Net Income} - \text{Income Distributed} + \text{Contributed Capital} = \text{Equity}$$

In order for each equation to remain in balance, each entry must have two sides where one account is increased while the other is decreased.

Types of accounts

There are generally five types of accounts used by businesses to classify transactions: assets, liabilities, expenses, revenue, and equity. Asset, liability, and expense accounts generally are the only ones affected by entries from the payroll department.

- _____ Accounts – An Asset is anything that provides an economic benefit or value to the company over a period of time. The three types of assets include: Current; Property, Plant, and Equipment; and Intangible or Deferred.
- _____ Accounts – Expense accounts show the cost of goods and services incurred over the accounting period.
- _____ Accounts – Liability accounts hold debts that must be paid in the future.
- _____ Accounts – Revenue accounts identify the amounts received for goods sold or services rendered during the accounting period.
- _____ Accounts – Equity accounts represent the owner's investment in the company.

Account Balances

Debits, credits, and “T”-accounts

The double entry accounting system is used to keep the accounting equation in balance. This does not mean that each account will not balance, but that all the company's accounts, when considered as a whole, will balance at any point during an accounting period.

Each type of account has a “normal” balance, either debit or credit. Do not think about a debit being positive and a credit being negative – the balance of an account actually depends on the type of account. Think of debit as left and credit as right.

Using the chart below, place an **X** in the column to indicate where each account's normal balance would be.

Normal Balances		
Account Type	Debit	Credit
Assets		
Liabilities		
Income/Revenue		
Capital/Owners Equity		
Expenses		

Posting entries

Whether a transaction is posted or recorded as a debit or credit in a T-account depends on the type of account. For example, the cash account is an asset with a normal debit balance. When a check is written from the account it creates a credit entry and when a deposit is made to the account it creates a debit entry. The other side of the entry will depend on what is being paid or where the deposit is coming from.

Another way to look at this is to define the increase or decrease to each account type.

Any Asset or Expense Account

Debit	Credit
increases	decreases

Any Liability, Income, or Equity Account

Debit	Credit
decreases	increases

Chart of Accounts

The Chart of Accounts lists each account by name and number with the number being used to identify the account. The numbering also identifies the type of account.

- 1 - Assets
- 2 - Liabilities
- 3 - Owners Equity
- 4 - Income
- 5 - Expenses

Journal Entries

The Journal is known as the “book of original entry” and is where all financial transactions are recorded in the double entry method. All journal entries are made up of at least one debit and one credit. Entries with multiple debits or credits are called Compound Entries.

Subsidiary ledgers are used to record specific types of entries. These subsidiary ledgers may include a Payroll Register for recording all payroll entries.

After all entries have been recorded in the journal they are posted to the General Ledger, which is also known as “the book of final entry.” Financial statements are then prepared from the balances in the general ledger.

Recording Payroll Transactions

Payroll transactions are generally recorded first to the payroll register and then to the various accounts.

Payroll Expenses

Payroll expenses are recorded when the pay period ends, not necessarily when it is paid because the payroll becomes a liability to the company at period end date. The following is an example of a payroll processing:

Gross Pay	\$6,000
Federal income tax withheld	1,200
State income tax withheld	300
Social Security tax withheld	372
Medicare tax	87
Health insurance premiums	200
Employer Social Security	\$ 372
Employer Medicare	87
FUTA	48
SUI	324

Recording an individual payroll is really a multi-step process. The first step is to record the gross pay for the period.

Account/description	Debit	Credit	Type of Account
Salary expense	6,000		Expense
Salaries/wages payable		6,000	Liability

Payroll Deductions

The next step is to record the amounts that were withheld from the employee and will be paid to a third party. These items include taxes, insurance premiums, garnishments, etc.

Account/description	Debit	Credit	Type of Account
Salaries/wages payable	2,159		Liability
Federal income tax withheld		1,200	Liability
State income tax withheld		300	Liability
Social Security tax withheld		372	Liability
Medicare tax		87	Liability
Health insurance premiums		200	Liability

Payroll cash distribution/net pay

When the employees are actually paid, an entry must be made to reduce the liability and reduce the amount of cash.

Account/description	Debit	Credit	Type of Account
Salaries/wages payable	3,841		Liability
Payroll checking account		3,841	Asset

Employer tax liabilities

The employer taxes must also be recorded in order for the company to incur the expense and show that they have taxes due.

Account/description	Debit	Credit	Type of Account
Payroll tax expense	831		Expense
Social Security tax payable		372	Liability
Medicare tax payable		87	Liability
FUTA tax payable		48	Liability
SUI tax payable		324	Liability

The final step would be to record the payment of taxes and other liabilities. Assuming that all of these items were paid at once, the entry would be:

Account/description	Debit	Credit	Type of Account
Federal income tax withheld	1,200		Liability
State income tax withheld	300		Liability
Social Security tax withheld	372		Liability
Medicare tax	87		Liability
Health insurance premiums	200		Liability
Social Security tax payable	372		Liability
Medicare tax payable	87		Liability
FUTA tax payable	48		Liability
SUI tax payable	324		Liability
Payroll checking account		2,990	Asset

Accounting Periods

For most individuals, their tax year or accounting year is the same as the calendar year – January 1 to December 31. But there is nothing in the IRC requiring either individuals or businesses to choose the calendar year as their accounting year. While some companies do end their accounting year on December 31, many have chosen an accounting year ending on another day when they are less busy. Any 12-month accounting period adopted by a business that ends on a day other than December 31 is called a fiscal year.

An accounting period is any length of time covered by an income statement, which could be a month, a quarter, a half-year, or a year. Regardless of the accounting periods or fiscal year a company uses, payroll taxes are always reported on a calendar year basis. Therefore, the payroll department may have two year-end reconciliation processes, one at fiscal year-end and one at calendar year-end.

Many of a company's transactions will overlap several accounting periods or fiscal years. When this occurs, the company's accountants must allocate a portion of the asset to expense each accounting period.

Accruals and Reversals

Cash basis accounting records revenue when it is received and expenses when they are actually paid for. This method of accounting is used by only a limited amount of small companies.

Most companies use the accrual method of accounting, which attempts to place earnings and expenses in the same accounting period, based on the Matching Principle. Under this system, revenue is recognized when earned and expenses are recognized when incurred.

Paydays, the last day of pay periods, and the last day of accounting periods generally do not all occur on the same day. For this reason, companies must accrue or account for payroll expenses through the end of each accounting period. This accrual is designed to satisfy the Matching Principle, under which any revenue, expenses, and liabilities must be matched to the accounting period in which they were earned or incurred.

Example:

Fred's Fishing Supplies fiscal year ends on June 30. The last pay period ended June 20. The company must accrue 10 days of payroll in order to show the proper payroll expenses for the fiscal year. Considering a payroll of \$3,000 per day, the following accrual entries would be made:

Account/description	Debit	Credit
Accrued Payroll Expenses	30,000	
Accrued Payroll Liability		30,000

The above entry records the estimated salaries due from June 21 through June 30. They will be reversed in the next accounting period.

The entry below records the estimated tax expenses on wages from June 21 through June 30. The entry will be reversed in the next fiscal period.

Account/description	Debit	Credit
Accrued Payroll Tax Expense	\$3,375	
Accrued Social Security Tax Payable		\$1,860
Accrued Medicare Tax Payable		\$ 435
Accrued FUTA Tax Payable		\$ 180
Accrued SUI Tax Payable		\$ 900

Based on the June 30 accrual entries, the following reversing entries will be made on July 1. The entry below reverses estimated salaries from June 21 through June 30 recorded in the previous fiscal period

Account/description	Debit	Credit
Accrued Payroll Expenses		\$30,000
Accrued Payroll Liability	\$30,000	

Account/description	Debit	Credit
Accrued Payroll Tax Expense		\$3,375
Accrued Social Security Tax Payable	\$1,860	
Accrued Medicare Tax Payable	\$ 435	
Accrued FUTA Tax Payable	\$ 180	
Accrued SUI Tax Payable	\$ 900	

Vacations

An organization's vacation policy will determine the entries needed to accurately record vacation expenses and liabilities. If employees accrue vacation leave which can be used at some later date, the employer incurs a liability at the time of the leave accrual. When the employee uses vacation time, the liability is reduced by the payment to the employee.

Example: At the start of the year, employees of Bud's Burgers accrue vacation amounting to \$3,500 for the month. During the third week in January, an employee uses vacation time amounting to \$900.

Here's how those entries would be made when the vacation is accrued:

Account/description	Debit	Credit	Type of Account
Vacation Expense	\$3,500		Expense
Vacation Liability Payable		\$3,500	Liability

Here's how those entries would be made when the vacation is paid:

Account/description	Debit	Credit	Type of Account
Vacation Liability Payable	\$900		Liability
Payroll Checking Account		\$900	Asset

Balancing and Reconciling Payroll Accounts

In order to make sure that all payroll entries have been recorded and are in balance, periodic checking of each account, along with reporting at the end of the accounting periods, must be performed. This is done by comparing general ledger accounts to the records for taxes withheld and paid.

The following steps should be taken:

- Check against the _____
- Verify checks issued by accounts payable
- Verify the end-of-the-month balance

Periodic Balancing and Reconciliation

Certain verification procedures should be carried out to check the accuracy of payroll records at each significant stage of the payroll process – paying wages, depositing taxes, and reporting wages and withheld taxes. These should be carried out:

- Every payroll period
- Before filing Forms 941 and 940
- Before sending _____

Payroll Bank Account Reconciliation

Most companies have a special bank account just for payroll. Money will be transferred from the employer's general bank account immediately before payday to the payroll bank account to cover employees' paychecks. If the account is not at zero after the employees cash their checks, a reconciliation must be completed to research and explain any difference.

Internal and external auditors will advise employers that employees who issue or control checks on an account should not be responsible for the reconciliation of that account. An employee outside the payroll department should be responsible for the payroll bank account reconciliation.

Financial Statements and Audits

Most organizations publish financial statements after they have been audited by independent certified public accountants. These statements generally include:

- Balance sheet at the end of the most recent fiscal year and the preceding fiscal year
- Statement of revenue and expenses (Income Statement)
- Statement of cash flows
- Notes to financial statements
- Report of the independent accountants

Balance Sheet

On a typical balance sheet, the order of items listed is:

1. _____
2. _____
3. _____

Each major portion of the balance sheet is further divided into smaller segments – the types of assets and liabilities.

- Current assets
- Plant, property, and equipment
- Deferred assets
- Current liabilities
- Long-term liabilities
- Shareholders' equity (net worth)

Income Statement

This summarizes the organization's revenues and expenses, determining the organization's earnings for the current and preceding fiscal years. All companies whose shares are traded on a stock exchange and which sell bonds must prepare annual income statements, and most prepare them more often, usually at least quarterly.

- Gross margin on sales
- Operating income
- Nonoperating revenue
- Net earnings (net income/loss)
- Earnings per share

Calculating Earnings Per Share:

Earnings = Revenue – (Expenses + Taxes)
Earnings ÷ shares of stock = earnings per share

Example:

Company has total revenue of \$10 million, expenses of \$7 million and paid taxes of \$1 million. They have 300,000 shares of common stock outstanding.

$\$10,000,000 - (\$7,000,000 + \$1,000,000) = \$$ _____ (Earnings)

$\$$ _____ ÷ _____ shares = $\$$ _____ earnings per share

Notes to Financial Statements

The Financial Statement notes explain various elements of the financial statements, how they were constructed, and the company's accounting policies that have an impact on the financial statements.

Auditing Financial Statements

All financial statements are audited by an independent CPA who determines if they accurately depict the company's financial condition. The payroll department is also audited to make sure that all information gathered to report payroll is accurate and in compliance.

Internal Controls

Internal controls are checks and balances used to make sure that financial data is accurate and that the company's assets are secure. Some internal controls that affect the payroll department include:

- _____ of job duties
- _____ of job duties
- Payroll distribution
- _____ employees
- Negative pay deductions
- Payroll bank account
- Blank checks
- Time reporting
- Computer system _____
- Using an internal auditor
- _____ Act

Controlling Check Fraud

Check fraud has become more prevalent in recent years, as technological advances have made it easier to reproduce or overcome most security features. There are different levels of check security features and there are benefits and drawbacks to each.

Group 1 security

These features are manufactured into the check paper.

- Mould Made and Fourdriner Watermarks
- Overt Fibers and Planchettes
- Covert Fibers
- Chemical Reactants
- Toner Bond Enhancers

Group 2 security

These features are printed onto the paper either when the paper is converted from raw material to check stock or when the check MICR or OCR lines, payee, and amount information is completed.

- Screened Printing
- Microprinting
- Simulated Watermarks
- Warning Bands and Security Icons
- VOID Features
- Prismatic Printing
- Anti-Splice Lines
- Aniline Dye
- Holograms and Foils
- Thermochromic Ink
- Nonnegotiable Backer
- Security Lock Icons and Descriptions

Group 3 security

Also called Positive Pay, this is bank sponsored electronic data checking.

Training bank personnel in detection is a problem

Bank tellers must process hundreds of checks in short periods of time and they are generally untrained in the identification of fraudulent checks beyond checking the payee's identification.

Check 21 and Its Impact on Payroll

The Check Clearing for 21st Century Act was designed to promote innovation in the U.S. payments system while updating and eliminating some of the legal barriers governing how banks process paper checks.

Substitute checks used in clearing process

Check 21 permits the use of a paper reproduction of an original check that contains an image of the front and back of the original check.

Regulatory changes

As a result of Check 21, the Federal Reserve Board had to modify its Regulation CC, the Availability of Funds and Collection of Checks.

Impact on payroll

As financial institutions begin to process electronic images of checks, those checks are clearing much faster than they did in the past. As a result, payroll departments are feeling the loss of check "float" or interest.

Section 12 – Payroll Systems and Technology

Objectives

- Identify the objectives of a payroll system
- Describe the importance of interfacing and integration
- Review the pros and cons of hardware and software alternatives
- Identify the steps in selecting an automated payroll system
- Describe the controls and security needed
- Review disaster recovery
- Review automated time and attendance
- Describe self-service, the internet, and mobile applications

Payroll System Objectives

Payroll is often the largest expense a business will have. Therefore, it's important to have a system that's efficient and accurate. While we may often think that employees are the customers most impacted by payroll, a payroll department's customers include:

- Employees
- Other departments
- The company's leadership
- The federal, state, and local government agencies to which withheld taxes, child support, etc., are paid and reported

In order to successfully meet the expectations of these customers, a payroll system must:

- Provide for compliance with federal, state, and local withholding, depositing, and reporting requirements
- Issue timely and accurate _____, _____, and _____
- Maintain adequate records of all data and transactions
- Prepare _____
- Satisfy cost-saving objectives
- Guarantee the _____ of the system

Interfacing and Integration

The payroll system must also be able to interface or integrate with other systems including Human Resources, Benefits, and other departments within the company.

Interfacing – Working With Other Systems and Departments

An Interface is the point where two systems meet. Interfacing allows for entry of information just once and then the sharing of that information directly to other system, which cuts down on cost and the chances for errors. The internal and external systems which benefit from a direct interface with the payroll system include:

- Labor cost data collection
- Payroll bank accounts
- Direct deposit/EFT/paycards
- Time and attendance
- Accounts payable
- General ledger/cost accounting
- Outside benefit plan administrators

- Social Security Administration
- State unemployment insurance
- Tax deposits
- State disbursement units
- Executive Dashboards

Integration of Payroll and Human Resource Systems

An Integrated Human Resource Management System (IHRMS) provides a shared database for human resources, payroll, and benefits information

Reasons for integration

Some of the common reasons for integrating data rather than interfacing systems include:

- Integration supports _____ of the payroll, human resources, and benefits functions, which make up the largest percentage of costs in most organizations
- Interfaces may result in _____ or _____ data when multiple databases must be supported, which means the information needed to make intelligent business decisions is often unavailable, provided in different versions, or contains different data because of the timing of interfaces
- Significant improvements in _____ are often impossible when a lot of time and energy is required to support interfaces among the multiple systems and databases
- Integration can provide a more _____ that can serve as the foundation for the implementation of an employee and/or manager self-service application

Hardware and Software Alternatives – Pros and Cons

There are generally three alternatives for the payroll manager or team looking to acquire a new payroll system:

- Third-party Service Provider
- In-house computer with vendor-supplied software
- A combination of these elements

Service Providers – Outsourcing the Payroll

A service provider is an independent company that processes its clients' payrolls for a fee. It takes the raw data provided by the employer and processes it so that paychecks and direct deposits can be created and reports can be generated.

Advantages of a Service Provider

- _____
- _____
- _____
- _____
- _____
- _____

Disadvantages of a Service Provider

- _____
- _____
- _____
- _____

In-House Payroll Systems

This is a computerized system that is located on company premises, with the hardware controlled by the employer.

Advantages of an In-House Payroll System

- _____
- _____
- _____
- _____

Disadvantages of an In-House Payroll System

- _____
- _____
- _____
- _____
- _____
- _____
- _____
- _____

Selecting an Automated Payroll System

There are several steps that should be followed during the process of selecting a payroll system and it's important to know the order of these steps as well as what's involved in each step.

Build a Project Team

Selecting and implementing a computerized payroll system should be a job for a team of people representing all the potential end users of the system and its information.

When selecting members for the project team, look for employees from _____ who have a working knowledge of _____ regarding payroll and human resources data as well as knowledge of _____ in general.

Analyze What the System Needs to Do

The project team's first and most important job is to complete a thorough "Needs and Wants Analysis." This involves documenting the current system and any associated issues.

Define the objectives surrounding implementation of a new system

There are several questions to answer at this stage.

- Scope – What do you want to accomplish with the new system?
- Time – How much time is required to select and implement a new system?
- Resources – Who will be involved in the process?
- What calculations must be performed?
- What reports must the system generate?
- How much information should be included on output from the system and should the information be sent to more or fewer individuals?
- What integration and interfaces are required in the new system?

- What training will be provided?
- What will be the organization's future systems needs?
- What type of initial and ongoing support will be needed?
- Should the system be integrated for all employee information used by payroll, human resources and benefits?

Prepare a Request for Proposal

This is a document that asks for bids from potential vendors of hardware or software, as well as service providers. It should provide a detailed explanation of what the employer wants from the system to enable a vendor to determine whether its hardware and/or software can meet those needs or whether its software can be customized to the employer's satisfaction.

It should include the following information about the employer:

- _____ of issuing the proposal
- Why a new system is needed and what has been done so far
- Specific HR-payroll information
- Total number of _____ required
- Any _____ requirements
- Whether human resources and benefits will be integrated with the payroll system
- Whether the vendor should include the cost of initial and ongoing training in the bid
- Level of system and implementation support expected
- RFP and contract terms and conditions
- Instructions to the vendor on how to submit the proposal

Select a System

Once the proposals or bids have been received from the vendors, the services offered must be analyzed and evaluated. The steps taken during this part of the selection process include:

- Select the vendors who best match your _____
- Ask for various _____

Mistakes to avoid

Mistakes that are commonly made during the system selection process include:

- Failing to provide project team members time to do the job right
- Failing to include representatives of all potential user departments
- Failing to prioritize needs and desires
- Making decisions without sufficient input

Know your available budget

Budget is often one of the major decision factors and it can be tempting to go for the lowest cost solution, regardless of how well it suits the needs of the organization.

Verify feasibility before making a final recommendation

All information that goes into making the decision should be checked and double checked.

If an integrated system is contemplated

If an organization is considering an Integrated Human Resource Management System (IHRMS) as an option for a new computer system, the selection and implementation procedures would have to be applied to the human resources function as well as the payroll function.

Implement the System

After the system has been selected and the purchase approved, the next step in the process is implementation. It too, is made up of many small steps.

- Prepare for implementation
- Train team members and payroll staff
- Conduct a _____
- Convert old data and add new data
- Test the new system
- Conduct _____ testing
- Convert the system

Evaluate the System's Performance

Once the new system has been used to produce an actual payroll, the results must be examined very carefully for accuracy and completeness. Problems that must be watched for are:

- New or old _____ that were missed
- Unexpected _____
- Radical changes in _____ plans
- A new union is elected or an existing union negotiates contract changes
- System expansion is necessary

Controls and Security for the Automated Payroll System

The project team's final responsibility is to develop and institute procedures to make sure errors are kept to a minimum and the system and the data stored there are secure.

Putting Controls Into the Process

While the goal of all payroll departments is 100% accuracy, no payroll system is perfect. The project team can make sure certain control procedures are built into the system to detect errors and make certain employees are properly trained in spotting potential problems.

System Edits

This is a warning or alert built into the system that checks for errors and either corrects the error or notifies the operator. Some commonly used system edits are:

- A report that alerts the operator that a check is being generated for a terminated EE.
- A report that alerts the operator to new hires so their pay and hours can be verified.
- An error message when the system fails to generate a paycheck for an active EE.
- An error message with the system calculates negative net pay for an EE.
- An error message when the system calculates negative deductions for an EE.
- A report for the operator when gross earnings exceed a certain amount.
- A report for the operator when an EE's overtime hours exceed a certain amount, or for all overtime hours if no EEs are supposed to be working overtime.

Periodic Data Auditing and Sampling

Data that falls within the acceptable system edit parameters may still be invalid. Periodic audits can identify such data invalidity.

Batch Controls

Batching the data into groups of similar data, developing totals of the data to be entered, and then comparing the totals of the data entered is one method of batch controls.

Correction procedures

If system-generated totals do not agree with the batch control totals, procedures must be in place to determine the error, how it was caused, and how it should be corrected.

Balancing and Reconciliation

Accounting control procedures involving balancing and reconciliation also serve as controls. These procedures include:

- Pre-tax deposit reconciliation to verify company's unpaid tax liability
- Balancing liability accounts for payroll deductions to the payroll registers
- Monthly reconciliation of the payroll bank account
- Per payroll cycle balancing of year-to-date and month-to-date amounts for each type of tax
- Quarterly reconciliation of tax withholding amounts on Form 941
- Annual reconciliation of wages and tax withholding amounts on Forms W-2

System Documentation

Documentation is a very important part of a company's overall control mechanism. The documentation should be simple and complete enough to allow an employee to perform functions described in the documentation with little or no other assistance.

What to include:

- Schedules
- Time entry
- Adjustment and corrections entry
- Check calculations
- Payroll History
- Production Cycle
- Taxes
- Employee database management
- Reports

What to leave out:

- _____
- _____

Providing Security for the System

Personnel concerns

Some personnel-related security measures include:

- Segregation of job duties
- Rotation of job assignments
- Paychecks go only to employees
- Physical payouts – EEs required to show ID
- Segregation of duties between departments in companies where the payroll departments are small
- Background checks

System Security

Some automated system security measures include:

- Limit system access
- Secure files
- Develop audit trails
- Protect against computer viruses
- Back up data regularly and off site

Physical Plant Issues

The hardware for the payroll system must be protected against fire, temperature extremes, and other physical stressors that can damage the equipment. Such precautions include:

- Climate-controlled rooms
- Keep terminals from overheating
- Do not store in cold area
- Protect against power surges
- Keep dirt out of components
- Keep the humidity down
- Check for adequate power

Disaster Recovery

As part of the security measures for a payroll system, the project team needs to develop a plan that includes the following disaster recovery procedures.

- Identify recovery time objectives and document them
- Identify critical resources that will be required and document them
- Can any part of the process be performed manually?
- Find and secure interim office space
- Arrange office equipment rental
- Find suitable temporary housing for employees
- Keep backup files off premises
- Keep employee safety uppermost in any plans
- Communicate the plan
- Consider electronic vaulting for a quicker recovery

Automated Time and Attendance

Labor costs are usually one of the largest expenses an organization faces. Time and attendance automation can help control these costs.

Time and attendance benefits

- Less time spent on _____
- Fewer _____ introduced during processing
- Decreased _____

FLSA, FMLA and SOX Compliance

In today's environment, compliance with legislative and regulatory requirements is essential. Penalties are steep if an employer improperly tracks time or fails to comply with time and labor regulations. Some of the requirements an employer may be subject to are:

- FMLA eligibility and tracking
- FLSA compliance for overtime, including average rate calculations
- Sarbanes-Oxley Act
- State overtime laws
- For global installations, the regulations in other regions or countries

Time and Attendance Attributes

- _____
- _____
- _____
- _____
- _____

Self-Service, the Internet, and Mobile Applications**Employee and Manager Self-Service**

In an effort to reduce costs that result from performing manual tasks and paperwork, many companies are using self-service applications which give employees access to their personnel data and allow them to review, print out, and/or update certain portions of that data. There are several ways that these applications can be delivered including:

- Kiosks
- Interactive Voice Response
- Internet and Intranets

Manager self-service

Under the same data ownership principles that drive employee self-service, organizations are increasingly implementing manager self-service applications to enhance their productivity and value to their employer.

Managers may be notified of upcoming employee performance appraisals, have access to comprehensive compensation information, and may also be able to initiate promotions, salary increases, and transfers.

Implementing Internet Technology

Before companies can begin offering employee self-service over the internet or a corporate intranet, they have to go through many of the same processes that are used in selecting a new payroll/HRMS system. The steps that should be taken are to:

- Build a _____
- Select _____
- Encourage use of _____
- Address _____ concerns
- Develop _____

Web-Enabled Applications

With all the movement toward the Internet, the term that describes the methods of gaining access to company information and initiating the processing of changes to that information is “Web-enabled applications”

Web-enablement defined

A Web-enable application is one that uses the Internet as another means of accessing an organization’s data and the HRMS application logic itself.

How it works

The two most important elements of Web-enabled applications are accessing the data and accessing the application logic behind the data, which allows data changes to be validated and processed.

Elements Needed

In order to develop Web-enabled applications, the following elements are required:

- Internet infrastructure to allow large numbers of users to gain secure access
- Web-enabling tools
- Core technology expertise
- HRMS application expertise
- Design and media skills
- Workflow strategy

System Terminology

In addition to the topics covered in the Payroll Source, be prepared to know about general system terminology. An additional job aid will be made available during our session called “System Terminology.” You may also want to consider doing some internet searches for sites such as www.webopedia.com which contain additional system terminology.

In particular, there is a section of this site dealing with data formats that you might find helpful: http://webopedia.com/Data/Data_Formats

Click on the terms to view their definitions.

Section 13 – Managing a Payroll Department

Objectives

- Define several management theories
- Review Necessary Management Skills
- Identify several specific management issues
- Identify Research Needs

Basic Management Theory

The skills needed to manage a payroll department are vastly different from those needed to work in the payroll department. There are many management theories, but below are some of the most commonly recognized theories.

Situational Leadership (Hersey, Blanchard, Johnson)

Emphasizes that successful managers use not just the management style that comes naturally to them, but whatever style fits the demands of the particular job or function and the employee or group of employees seeking to accomplish it. In particular, this theory indicates that the way managers handle their staff depends on two factors: tasks and relationships.

- Task behavior (guidance) -> high task managers emphasize control over EEs
- Relational behavior (support) -> high relational managers place few restrictions on communications with staff

_____ task / _____ relationship (_____)

Little control sought by manager. Leaders pass everyday decisions to their subordinates. Manager facilitates and takes part in decisions, but leaves the subordinates some of the control.

_____ task / _____ relationship (_____)

Manager controls jobs and procedures. Managers define roles and tasks, but seek input and suggestions from their subordinates. Decisions are still a prerogative. Communication is more two-way.

_____ task _____ relationship (_____)

Most jobs delegated to staff. Managers are still involved in decisions and problem solving, but control is left with their subordinates. These decide how and when the manager will be involved.

_____ task _____ relationship (_____)

Manager seeks to control staff and direct performance. Managers define the roles and tasks and closely supervise subordinates. Manager makes and announces decisions. Communication is largely one-way.

Supporting	Coaching
Delegating	Directing

Principle-Centered Leadership (Covey)

Deals with four fundamental dimensions that grow out of leadership centered on principles such as integrity, justice, and the Golden Rule. This is summed up in a single statement: “Treat people the way you want to be treated.” The four dimensions are:

- _____ – Collective sense of strength and self-esteem
- _____ – Direction on which we base our decisions and actions
- _____ – Ability to maintain balance and perspective among diverse internal/external forces
- _____ – Energy to decide, to act, and to change

Empowerment

The purpose is to give employees the tools to accomplish an objective and allow them the space to develop the methods of attaining those objectives.

The empowerment process involves five steps:

- Step 1: Establish the desired results
- Step 2: Provide guidelines
- Step 3: Identify resources available to accomplish the task
- Step 4: Hold people accountable
- Step 5: Identify consequences

Not just one right way

Each of these management theories has its proponents and detractors, but the key is that managers need to tailor their management style to fit different situations, jobs, and employees. On the next few pages are some additional theories that are not mentioned in the Payroll Source, but which have come up in PayTrain and may be on the exam.

Management vs. Leadership (Kotter) (Not in Payroll Source)

According to John P. Kotter, management is important because managers produce order and consistency, keeping things running day-to-day. Leaders, on the other hand, produce change and movement, allowing a company to grow. **Note:** This theory is not mentioned in the Payroll Source, but may be on the exam.

Management Produces order and consistency	In Action	Leadership Produces change and movement	In Action
Planning/ Budgeting	<ul style="list-style-type: none"> • Setting targets and goals • Allocating financial and people resources 	Vision Building/ Strategizing	<ul style="list-style-type: none"> • Setting directions for departments or company • Creating change strategies
Organizing/ Staffing	<ul style="list-style-type: none"> • Designing jobs • Hiring Staff • Monitoring and tracking performance 	Aligning People/ Communicating	<ul style="list-style-type: none"> • Communicating new direction to staff • Keeping message/actions of leader credible and desirable to staff • Empowering employees
Controlling/ Problem Solving	<ul style="list-style-type: none"> • Establishing quality targets • Monitoring results • Creating fail-safe, risk-free work processes 	Motivating/ Inspiring	<ul style="list-style-type: none"> • Communicating the vision, keeping the audiences' values in mind • Satisfying basic human needs for achievement (recognition, self esteem, being a part of something important) • Tapping staffs' energy to overcome obstacles

Total Quality Management (Not in Payroll Source)

Based on concepts developed by statistician and management theorist W. Edwards Deming, Total Quality Management (TQM) includes techniques for achieving efficiency, solving problems, imposing standardization and statistical control, and regulating design, housekeeping, and other aspects of business or production processes

This is a management strategy aimed at embedding awareness of quality in all organizational processes. TQM has been widely used in manufacturing, education, government, and service industries, as well as NASA space and science programs. TQM functions on the premise that the quality of the products and processes is the responsibility of everyone who is involved with the creation or consumption of the products or services offered by the organization. In other words, TQM capitalizes on the involvement of management, workforce, suppliers, and even customers, in order to meet or exceed customer expectations. Considering the practices of TQM as discussed in six empirical studies, Cua, McKone, and Schroeder (2001) identified the nine common TQM practices as cross-functional product design, process management, supplier quality management, customer involvement, information and feedback, committed leadership, strategic planning, cross-functional training, and employee involvement

Basic Management Theory (Not in Payroll Source)

Here are brief statements of some of the most commonly recognized management theories, as they have been described in recent years.

Theory X

Douglas McGregor, professor of management at the Massachusetts Institute of Technology, defined two types of managers. The first type, managers who take a negative view of human nature and perceive all employees as lazy, are Theory X managers. They assume that, without threats of punishment and cajoling, employees will seek and find ways to avoid work and have little to offer the organization in the way of ideas. Theory X managers believe in tight control of processes and procedures and feel that more money is the only incentive that works to improve performance.

Theory Y

The second type he called Theory Y managers. McGregor observed that Theory Y managers operate from a very different set of assumptions. They believe that most employees are willing to work and accept responsibility and, if given the chance, can serve as a source of ideas and solutions to departmental problems. Theory Y managers open up the decision making process to rank-and-file employees for their input.

Theory Z

While Theory Y gained increasing acceptance over the years, in the 1980s it was taken a step further with the development of participatory management, or Theory Z. Under this theory, managers share decision making responsibility with groups of employees and try to reach a consensus as to the action that will be taken. Theoretically, by giving each employee a voice in the decision making process, better management decisions will be made and decisions will receive more support from employees. This management theory was seen as one of the major reasons for the Japanese economic successes of the 1980s.

The Role of the Manager

Managers manage. They plan, organize, staff, direct, control, report, coach, counsel, give feedback, instruct, train, set standards, delegate, evaluate, and do a host of other essential tasks except perhaps one: the work. Most of the actual work in any department is performed by the staff. In this sense, managers do not get paid for what they do. They get paid for what their employees do.

The Three "P's"

Most payroll managers have three essential functions, called the three "P's" of payroll management.

Process - First, you must manage the process of payroll. You plan and direct the procedures that result in the department's tasks being accomplished in a productive and efficient manner.

People - Second, you're a people manager. You hire, train, coach, counsel, delegate, discipline, and reward the people who report to you.

Proficiency - And finally, payroll managers must remain technically proficient, especially in the areas of both compliance and technical issues. Even if you no longer "do payroll", both staff members and managers from other departments expect you to be the ultimate source of technical knowledge about the field.

Few managers naturally excel in all three functions. You have undoubtedly known (and perhaps worked for) managers who managed the process efficiently but lacked good people skills. Or maybe you fondly remember a former manager who was terrific with people but ran a chaotic department or was no longer abreast of the field. Truly great managers are rare precisely because they can simultaneously master all three functions—managing the process efficiently and the people effectively while remaining technically proficient

Management Skills

There are certain fundamental skills that must be mastered and that make up the duties and responsibilities of most managerial positions. The skills that we'll be exploring in more detail are:

- Strategic Planning & Organizing
- Staffing
- Directing Employees
- Controlling Performance
- Reporting

Strategic Planning & Organizing

- Defining goals & objectives
- Defining the time frame
- Defining the subtasks
- Analyzing available resources
- Evaluating costs

Staffing

Hiring the right employees

As with any important task, hiring consists of more than one activity:

- _____ – decision to fill an open position or create a new one, and an analysis of the tasks which the job is to accomplish
- _____ – should include educational requirements, necessary knowledge/skills, training opportunities that can be provided to the new employee, the level of supervision required in the job, and how much communication and interaction with the other employees will be necessary
- _____
- _____

Delegating tasks and responsibilities

- Assigning _____ – who will do what?
- Assigning _____ – what level of authority will they have to perform their responsibilities?
- Hold on to the _____ – cannot delegate accountability – it's yours – take the responsibility
- Strike a _____ – don't delegate too much or too little

Training

- Can improve skills and knowledge, not attitude
- Link training to payroll's mission
- Types of training opportunities
 - _____
 - _____
 - _____
 - _____
 - _____

Directing Employees

Providing feedback

While information and reinforcement are essential for providing effective feedback, there are several other guidelines that managers need to be aware of.

- _____
- _____
- _____
- _____
- _____
- _____

Example 1: Assume that Sonia in HR has been given the responsibility of maintaining new-hire files to ensure state and local compliance. Sonia has done an excellent job and a recent audit proved her efficiency. As she is walking past the manager in the hallway, he pats her on the back and says: "Sonia, good job".

Is this effective feedback? Why or why not?

Listening

Some of the common barriers to listening are:

- _____
- _____
- _____
- _____
- _____
- _____

Coaching

This deals with performance improvements that can be gained by increasing technical knowledge and performance skills. Some of the work situations that may require coaching are:

- _____ and _____ of new employees
- Teaching new _____
- Explaining departmental policies
- Explaining the corporate culture of your organization
- Follow-up after a training session
- Performance appraisals
- When the manager is _____
- When an employee wants to improve performance
- When an employee is given _____

Counseling

Counseling is used to help an employee resolve a personal or attitude problem that is adversely affecting job performance. Occasions when you might need to counsel EEs include:

- Reorganizations, mergers, acquisitions
- Layoffs
- Demotions due to organizational changes
- Salary freezes
- When promotion and growth opportunities are limited
- When an employee is _____ with others in the department
- When an employee is unhappy about a work assignment
- When an employee feels _____ about skills or ability to do the job
- When an employee's personal problems are interfering with work
- When an employee is _____ at work assignments
- When an employee is feeling _____ and _____

Leadership

While coaching and counseling are one-on-one, leadership must be provided to groups or an entire department. Qualities include:

- Having a _____
- Building _____
- Seeking _____
- Accepting _____
- Making _____ and _____
- Leading by _____

Controlling Performance

Steps to controlling performance:

- Setting standards
- Monitoring actual progress
- Comparing progress with standards
- Corrective actions

Controlling to improve employees' performance

If progress is not on pace to meet the objective, the payroll manager must exercise control over the employees performing the work to bring things back on track. Managers must realize employees respond differently to different motivators. It is up to the payroll manager to be aware of what motivators might be best spur each employee to a better performance. These motivators can include:

- _____
- _____ - for employees who are driven by a personal need to succeed and be the best. Some ways to motivate them are:
 - Delegate authority
 - Public or private recognition
 - Giving them new and challenging assignments
 - Letting them work with less supervision
- _____ – for employees who place importance on leading others, influencing the group, giving direction, and having control. Some ways to motivate them effectively are:
 - Publicly recognizing their leadership talents
 - Promoting them to supervisory positions
 - Making them leaders of project teams
 - Taking them into your confidence and seeking their input

- _____ – for employees who place a good deal of emphasis on the social aspects of the workplace – being liked by other employees and accepted into the group. Some ways to motivate them effectively are:
 - Being friendly with them and including them in lunchtime or after-work activities
 - Assigning them to project teams
 - Providing them with networking opportunities
 - Encouraging them to join and participate in professional organizations
- _____ – for employees who are motivated by receiving recognition of their efforts as evidence of their importance and prestige in the department. Some ways to motivate them effectively are:
 - Giving them public credit for their accomplishments
 - Giving them an important-sounding title
 - Giving them awards or plaques recognizing their efforts
 - Initiating departmental contests and competitions that give them a chance to win.

Reporting

A manager must be able to communicate to his or her immediate supervisor, other department heads, and other management in written reports detailing payroll developments that will affect the organization. Reports required might include:

- New legislative and/or regulatory developments
- Monthly labor costs
- Annual wages, taxes, and benefits
- Variance between compensation paid and budgeted
- Reports required from all department heads

Several important points to keep in mind are:

- Report must include only _____
- Report must be provided _____
- Write clearly and be _____ whenever possible
- Leave out the _____

Specific Management Issues

Up till now, this section has concentrated on the basic management skills a payroll manager must master to achieve success. Following are some more specific skills.

Conducting and Attending Meetings

Here are some guidelines for conducting meetings:

- Plan according to the type of meeting
- Will the meeting be informational only?
- Is the meeting being held so the manager can get opinions or information from employees?
- Will those attending make a decision at the meeting?
- Is the meeting being held to exchange new ideas?
- Meeting preparation – put together an agenda and prioritize the items
- Keep the meeting on track – start on time, review the agenda, move the meeting along, end on time with a summary
- Promote participation – ask open-ended questions, don't wait until the end of the meeting to ask for questions or opinions
- Keep a written record – keep notes or have another attendee do so

Keep Written Policies and Procedures

Items that should be documented include:

- Company policies on overtime, benefits, vacations, sick leave, termination, recordkeeping
- Procedures for handling payroll, tax deposits, quarterly returns, liabilities, direct deposit, account reconciliations, etc.
- All aspects of and tasks involved in the payroll process
- Disaster recovery plans
- Payroll computer system user manuals
- Payroll department job descriptions
- File descriptions

Crisis Management

The ability to prevent and control a crisis so that damage to the department and the company is minimal can sometimes make or break a manager's career. The steps for crisis management are:

a crisis – be proactive

- Tools are available to do the job
- Plan for 'worst case scenario'
- Make sure there is a 'back-up' for all systems
- Open communication network to air potential problems before they happen
- Cross train individuals
- Conduct regular review of department policies, procedures, documents
- Deal promptly with 'grape vine' rumors
- Comprehensive review of all department output
- Remain flexible

or a crisis

- Keep calm
- Identify the crisis
- Focus on solving the problem, not the cause
- Rank the solutions
- Keep staff informed
- Initiate action plan
- Document all crisis related activities
- Document and monitor the progress of the plan
- At the end, express appreciation to staff for their team efforts

the crisis – lessons to be learned

- Identify problems which are preventable
- Initiate plan to prevent identified problems
- List successful results of crisis operation
- List issues not resolved
- Express your appreciation to the staff

_____ **from the crisis**

- Meet w/boss to review crisis and outcome
- Share your experiences w/other payroll professionals (network)
- Assess staff's performance under stress, note outstanding skills
- Assess your own performance under stress
- Follow thru with implementation of any new procedures
- Use this to build / enhance team spirit in department

Time Management

Prioritizing is up to the manager

Four combinations of time categories tell the manager what their priorities should be

- _____
- _____
- _____
- _____

Scheduling and delegating are keys to time management

There are ways to help become proactive rather than reactive and to find time where there did not seem to be any.

- Schedule your activities
- Delegate tasks
- Encourage ownership of the task or project

Controlling your email

A couple ways to avoid the potential waste of time with email are:

- Let others know that you will check email only at certain times of the day
- Do not check email when you first get to work

Team Building

Characteristics of a successful team

Four stages of team development

- Stage 1 _____
- Stage 2 _____
- Stage 3 _____
- Stage 4 _____

Managing different employee styles – different styles are:

- _____
- _____
- _____
- _____

Performance Evaluations

These are a formal way of giving feedback. The purpose is to improve the employee's performance in relation to the goals that have been set. Other reasons are:

- Weed out good performers from the bad
- Provide documentation for salary increase decisions
- Determine which employees are promotable
- Support a decision whether a poor performer needs more training or must be disciplined
- Encourage employees' personal growth and development
- Provide documentation for employment decisions that may later be legally challenged by the employee

Effective performance evaluations

Several elements are generally found in a successful system:

- Objective job-related goals and performance criteria
- Managers conducting the evaluations are trained in delivering feedback
- There are written guidelines for administering the evaluation system
- Employees who disagree with the evaluation are allowed to challenge it
- The evaluation system does not place unreasonable technical and time constraints on managers

Ineffective performance evaluations

Three common mistakes:

- Guilt over _____ evaluations
- No _____ for the manager
- Improper _____ of standards

Promoting Quality Customer Service in Payroll

What is customer service in payroll? There are several basic principles:

- _____
- _____
- _____
- _____
- _____

How to instill quality customer service values in your department

- _____
- _____

Providing Customer Service in a Shared Services Environment

In payroll, shared services most often means the melding of employee service functions and integration of the processes they use so that employees have to make only one phone call or complete one e-mail to finish a transaction or get a problem solved.

Research Needs

One of the most important aspects of payroll manager's responsibilities is keeping on top of current developments in the payroll field.

Tracking Tax Laws and Regulations

Payroll managers need to understand the basic federal payroll tax laws.

Employment Laws and Regulations

Payroll managers also need to be aware of wage-hour, garnishment, child support, immigration, anti-discrimination, family leave, and escheat laws and regulations.

Payroll Related Web Sites

It is critical for payroll professionals to be familiar with the most important and useful sites.

Company Policies and Procedures

Once procedures have been documented, it is important for the payroll manager to make any changes necessitated by amendments to overall company policies and procedures or those used by other departments interfacing with payroll.

Union Contracts

Payroll managers in organizations that have employees working under a union contract have certain obligations to fulfill regarding those contracts

Section 14 – Payroll For U.S. Employees Abroad and Aliens in the U.S.

Objectives

- Review Federal Income Tax Withholding Rules for U.S. Citizens and Resident Aliens Working Abroad
- Review Social Security and Medicare Tax Rules for U.S. Citizens and Resident Aliens Working Abroad
- Define the Foreign Earned Income and Housing Cost Exclusions
- Define U.S. Income Tax Treaties
- Determine the Status of a Resident/Nonresident Alien
- Review Federal Income Tax Withholding Rules for Resident Aliens
- Review Social Security and Medicare Tax Rules for Nonresident Aliens
- Identify various types of Visas

U.S. Citizens and Resident Aliens Working Abroad

In general, wages earned by U.S. citizens and resident aliens working in a foreign country are subject to federal income tax withholding. The exceptions would be for wages excluded under the foreign earned income exclusion or foreign housing exclusion. Wages may also be reduced for employees who are eligible for a tax credit for foreign tax payments. Wages may also be exempt from withholding if the employer is required to withhold foreign taxes under the law of that country.

Federal Income Tax Withholding

U.S. employers must withhold federal income tax unless the wages fit one of the exemptions below:

- _____
- _____
- _____
- _____

Social Security and Medicare Taxes

In general wages paid to U.S. citizens and resident aliens working abroad for a U.S. employer are subject to social security and Medicare tax withholding, which the employer must match.

Totalization agreements

To alleviate the burden of double _____ taxation and to integrate coverage of employees, the U.S. government has entered into binational social security agreements. Under a totalization agreement, expatriate employees working temporarily in the foreign country are subject to U.S. social security and Medicare taxes only, to the same extent their compensation would be subject to those taxes had they remained in the U.S. Wages earned by employees working permanently in the foreign country are subject only to the foreign country's social security taxes.

Foreign affiliate coverage elections

A foreign affiliate of a U.S. employer can elect social security coverage for U.S. citizens and resident aliens working there. Otherwise they are not covered.

Federal Unemployment Tax

In general, employment by U.S. citizens working abroad for a U.S. employer is covered by the Federal Unemployment Tax Act (FUTA) if the work performed would be covered in the U.S. FUTA does not apply to resident aliens working abroad or to American employees of foreign affiliates.

Foreign Earned Income and Housing Cost Exclusions

U.S. citizens and resident alien employees working outside the U.S. who qualify for the foreign earned income exclusion can choose to exclude the first \$_____ of foreign earned income. They may also exclude certain housing cost amounts from their gross income.

To qualify, the employee must have foreign earned income, the employee's tax home must be in a foreign country, and the employee must meet either a bona fide residence or physical presence test that proves the employee is not living in the U.S. during the year in question.

Foreign tax home

The employee's tax home must be in a foreign country for the entire period of residence or physical presence in that country during the year. In general, an employee's tax home is the location of his or her regular or principal place of business or employment.

One factor determining whether an employee's tax home is in the U.S. or a foreign country is whether the employee is on a temporary or indefinite assignment.

Bona fide residence test

Employees wishing to qualify for these exclusions can do so by proving they have been bona fide residents of a foreign country for an uninterrupted period that includes at least one full taxable year. Whether an employee is a bona fide resident of a foreign country depends on several factors:

- Whether the employee brings their _____ and they intend to make the foreign country their home for the duration of the assignment
- Purchase of a _____ or signing a long-term lease in the foreign country
- Involvement in the _____ and _____ of the foreign country
- The terms of the employment agreement regarding the foreign assignment
- The type of _____ or residence permit secured by the employee

Physical presence test

Another way that expatriate employees can qualify for the foreign earned income exclusion is by meeting the physical presence test. This test is met if the expatriate employee is physically present in a foreign country for _____ full days during any consecutive 12-month period. The qualifying days do not have to be consecutive, and all periods spent in foreign countries during the 12-month period are totaled to determine whether the test has been met.

Foreign earned income exclusion

Up to \$_____ of foreign earned income may be excluded from a qualifying employee's gross income in 2017. There are several definitions and restrictions that must be applied in determining the amount of the exclusion

- **Foreign earned income** – this is income earned by an employee from sources within a foreign country while the employee has a foreign tax home and qualifies for the exclusion under the bona fide residence or physical presence test. Earned income includes all compensation, such as wages, salaries, commissions, tips, bonuses, tax reimbursements, cost of living allowances, educational reimbursements, professional fees, etc., paid for personal services rendered, including noncash payments.
- **Determining the source of earned income** – this is determined by where the employee performed the services that produced the income.

If an employee cannot determine how much earned income is for work done in the U.S., the determination can be made on a time basis with the following formula:

$$\frac{\text{Number of days worked in the U.S.}}{\text{Total number of days worked}} \times \text{Total income} = \text{U.S. Source Income}$$

Example:

Brian is a U.S. citizen who is a bona fide resident of Ireland earning \$84,000 a year in salary in 2016. He also received a \$7,000 cost of living allowance. Brian's total income is \$91,000, he works a 5-day week and has worked a total of 250 days after subtracting vacation time and 40 of those days he worked in the U.S. His U.S. source income is determined as follows:

$$\frac{40 \text{ days worked in the U.S.}}{250 \text{ total days worked}} \times \$91,000 = \$\underline{\hspace{2cm}}$$

Foreign housing cost exclusion

In addition to the foreign earned income exclusion, employees who have a foreign tax home and qualify under the bona fide residence or physical presence test can take an exclusion for reasonable foreign housing expenses exceeding a base housing amount.

Housing expenses eligible for the exclusion include the reasonable expenses paid during the time that the employee qualified for the exclusion. Reasonable expenses **do not** include:

- _____
- _____
- _____
- _____
- _____

Base housing amount – this is 16% of the maximum foreign earned income exclusion, figured on a daily basis, multiplied by the number of days during the year the employee met the bona fide residence or physical presence test. For 2017, this would be \$_____

Housing cost exclusion limitation- the reasonable housing expenses that are used to calculate the housing cost exclusion are limited to 30% of the maximum foreign earned income exclusion, figured on a daily basis, multiplied by the number of days during the year the employee met the bona fide residence or physical presence test. For 2017 this maximum would be \$_____.

The formula for calculating the foreign housing cost exclusion is:

Foreign housing cost exclusion = reasonable housing expenses – base housing amount

Example:

Employee Jennifer qualifies for the foreign housing cost exclusion under the physical presence test for all of 2017, spending \$25,700 on reasonable housing expenses. Her foreign housing cost exclusion would be calculated as follows:

\$25,700 - \$_____ = \$_____

Base Housing Amount – Calculating on a Daily Basis

If employee is not in the foreign country for the entire year, then the base housing amount must be calculated on a daily basis.

Base Housing Amount (\$16,336) ÷ 365 (2017) = Daily Base Housing Amount (\$44.76 per day)

Total Base Housing Amount = Daily Base Housing Amount (\$44.76) x Number of Days in Foreign Country

U.S. Income Tax Treaties

The U.S. has entered into more than 55 income tax treaties with foreign countries. These are designed to clarify each country's taxing jurisdiction and to avoid double taxation of income.

Possible Treaty Benefits

Generally, reductions in taxes are not possible. However, the nondiscrimination clauses in most treaties allow them to qualify for the foreign earned income and housing cost exclusions under the bona fide resident and physical presence tests.

Other possible benefits are:

- _____
- _____
- _____
- _____
- _____

To claim a treaty benefit, the employee will have to produce proof of U.S. residency in the form of a letter from the IRS – Form 6166, *Certification of U.S. Residency*.

Employer Tax Reimbursement Policies

Income and social security taxes are often higher in foreign countries than in the U.S. In general, most compensation and tax reimbursement policies are designed to ensure the employee will not have to pay combined taxes on income in the two countries exceeding the taxes that would have been paid if the employee had remained in the U.S.

Tax protection plans

The idea behind this is that the employee will be reimbursed by the employer to the extent the employee's combined income and social security taxes in the U.S. and the foreign country exceed the amount the employee would have paid if living and working in the U.S. If the employee's combined actual taxes lower because the foreign taxes are low or nonexistent or the employee qualifies for exclusions from U.S. tax, the employee gets a tax benefit he or she can retain.

Tax equalization plans

The trend among U.S. companies has been away from tax protection and toward tax equalization. Tax equalization plans are designed to make taxes a neutral factor when determining an expatriate employee's compensation package.

Hypothetical taxes

Whether an employer uses tax protection or tax equalization to reimburse an employee for higher foreign taxes, the employer must determine the tax that the employee would have paid if _____. This is known as the hypothetical or stay-at-home tax.

Resident and Nonresident Aliens Working in the U.S.

The taxation and reporting of income earned by foreign citizens (aliens) working in the U.S. depend on whether the employee is a resident or nonresident alien. In general, resident aliens are taxed on their worldwide income and their employers treat them the same way they treat U.S. citizens. Nonresident aliens, however, are taxed only on their income from U.S. sources, with some exceptions.

Determining Resident/Nonresident Alien Status

Generally, foreign citizens working in the U.S. are considered nonresident aliens unless they qualify as residents by meeting either one of two tests:

- _____ - Based on the alien's legal right to be in the U.S., not on their physical presence.
- _____ - An alien is considered a U.S. resident for income tax purposes if:
 - They are present in the U.S. for at least 31 days during the current calendar year
 - The total number of days in the U.S. during the current calendar year, plus one-third of the U.S. days during the first preceding calendar year, plus one-sixth of the U.S. days during the second preceding calendar year is at least 183 days.

Federal Income Tax Withholding and Employment Taxes for Resident Aliens

In general, wages paid to U.S. resident aliens are subject to federal and state income withholding and employment taxes to the same extent that wages paid to U.S. citizens are.

Federal Income Tax Withholding for Nonresident Aliens

Nonresident aliens are subject to the same federal income tax withholding requirements as other employees for all of their income that is from _____.

Special withholding calculation rules

For wages paid on or after January 1, 2015, employers must take the following steps when withholding federal income tax from the wages of nonresident alien employees.

Step 1. Add to the wages paid to the nonresident alien employee for the payroll period the amount shown in the chart below for the applicable payroll period.

<u>Payroll Period</u>	<u>Add Additional</u>
Weekly	\$ 43.30
Biweekly	86.50
Semimonthly	93.80
Monthly	187.50
Quarterly	562.50
Semiannually	1,125.00
Annually	2,250.00
Daily or Miscellaneous (each day of the payroll period)	8.70

Step 2. Use the amount calculated in Step 1 to figure income tax withholding using the tables that are used to figure income tax withholding for all other employees.

U.S. source income

Nonresident aliens in the U.S. are subject to federal income tax withholding on their U.S. source income. The important factor is where the employee performs services. In most situations, compensation paid to an employee for work performed in the U.S. is U.S. source income subject to federal income tax withholding. It makes no difference where the employer is located, where the employment agreement was signed, or where or when the wages are paid. Compensation paid to a nonresident alien for services performed outside the U.S. is not U.S. source income and is not subject to federal income tax withholding.

Tax treaty exemptions

The U.S. has income tax treaties with more than 55 countries that exempt or reduce the amount of withholding from wages earned by nonresident aliens in the U.S. if certain conditions are met.

Foreign students receiving scholarships or fellowships

Scholarships and fellowships granted to nonresident alien students to cover tuition and related expenses are exempt from federal income tax withholding and reporting if the students are degree candidates and are temporarily in the U.S. as nonimmigrants under “____”, “____”, “____”, or “____” visas. Payments that do not qualify for the exemption because they are unrelated to tuition are subject to withholding at a rate of ____%.

Social Security and Medicare Taxes for Nonresident Aliens

With several exceptions, social security and Medicare taxes generally apply to all wages paid for work performed in the U.S. The exceptions are:

- _____
- _____
- _____
- _____
- _____
- _____

Federal Unemployment Tax for Nonresident Aliens

Generally, FUTA tax applies to all wages paid for work performed in the U.S. The exemptions from FUTA are generally the same as those under social security and Medicare taxes.

Wages earned by nonresident agricultural workers temporarily admitted to the U.S. under “___” visas are exempt from FUTA.

Depositing and Reporting Obligations

Businesses paying nonresident aliens face different depositing and reporting obligations depending on whether the compensation is paid to an employee or a nonemployee and what type of compensation is paid.

Wages paid to employees - All taxes must be deposited according to the general rules and must be reported on Form 941. Each employee must be sent a Form W-2.

Other compensation - Compensation paid to independent contractors for services, plus other nonwage income may also be subject to withholding, but the depositing and reporting rules are not the same.

Types of Visas

There are two types of visas for foreign nationals seeking admission to the U.S. – immigrant visas and nonimmigrant visas.

Immigrant visas

Also called “green cards,” these are issued to foreign nationals who seek to be lawful permanent residents of the U.S.

Nonimmigrant visas

Nonimmigrant or temporary visas are issued to foreign nationals who wish to enter the U.S. for a specific purpose and will not be in the country indefinitely.

Visa	Type
B-1	
D-1	
E-1	
E-2	
E-3	
F-1	
H-1B	
J-1	
L-1	
M-1	
O-1 and O-2	
P-1	
Q	
R-1	
TN	