CHAPTER 9   Withholding, Estimated Payments & Payroll Taxes

- ➢ Compute income tax withholding from employee wages
- ➢ Determine taxpayers' quarterly estimated payments
- ➢ Understand FICA, federal deposit system and employer payroll reporting
- ➢ Calculate self-employment tax
- ➢ Compute FUTA tax
- ➢ Apply special tax and reporting requirements for household employees
- ➢ Calculate .9% Medicare surtax on earned income of high-income taxpayers

Withholding Methods

➢ Employer calculates income tax withholding from employees' paychecks based on their Form W-4
- Pay includes salaries, fees, bonuses, commissions, vacation and retirement pay
- W-4 completed by employee and tells employer
  - Number of allowances claimed by employee
  - Marital status - single, married, or married but withhold tax at higher single rate
  - Exempt status – employee can only claim exempt if he/she had no income tax liability last year and expects none this year

Note: If no W-4 filed, employer must withhold at "single with no exemptions"

Special Withholding Allowances

➢ Employee does not need to prove to employer that number of allowances is valid

➢ Single employee with one job may claim one special allowance

➢ Married employee may claim one special allowance in certain situations (see page 9-2)

➢ Married employee with more than one job or working spouse must complete W-4 Page 2 "*Two Earners/Multiple Jobs Worksheet*" to calculate number of allowances (see page 9-4)

Compute Withholding

➢To compute amount to withhold from pay using percentage method

- o Multiply number of allowances found on W-4 by allowance amounts (on page 9-5, based on frequency of pay)
- o Subtract that amount from employee's gross wages

➢Then, use IRS tables to calculate federal income tax based on wages after allowance amounts

- o Found in textbook in Appendix C
- o IRS also publishes "(Circular E) Employer's Tax Guide"

Withholding on Pensions

➢ Payors must withhold on IRA distributions, stock bonus plans, profit-sharing and pension distributions

➢ Withholding depends upon whether pension/deferred payment is a periodic or nonperiodic payment

  ○ Rates are based on treating periodic payment as if it were wages, withholding based on W-4P

  ○ Non-periodic withholding is flat 10% or 20%

Withholding on Tips

➢ If employee reports less than 8% of gross food/beverage sales in tips, then employer must allocate tips
  ◦ However, employer is not required to withhold taxes based on allocated tips

➢ Employer must report employees' tips to IRS and may allocate using one of three methods
  ◦ Gross receipts per employee
  ◦ Hours worked by each employee
  ◦ Good faith agreement on Employer's Annual Information Return of Tip Income & Allocated Tips (Form 8027)

Note: Beginning in 2014, compulsory and fixed charges (for example, 20% service charge for tables of 10 or more) is considered wages

Backup Withholding

➢ In some situations, individuals may be subject to flat 28% back-up withholding on interest and dividends*

➢ This backup withholding, applied to dividends and interest, is required when:

- Taxpayer does not provide an identification number (SSN) or provides incorrect number
- Taxpayer fails to certify that he/she is not subject to withholding
- IRS informs payor that taxpayer gave incorrect identification number
- IRS informs payor that withholding is mandatory because taxpayer hasn't complied in the past

This is to assure that tax is paid on this income

Estimated Payments

➤ Taxpayers must make quarterly estimated tax payments if
  ◦ After withholding, payment due for the year is ≥ $1000
  ◦ Quarterly payments due 4/15, 6/15, 9/15, and 1/15 of next year

➤ Total annual estimated payments is lesser of
  ◦ 90% of current year tax
                  or
  ◦ 100% of prior year tax
                  or
  ◦ 90% of current year taxable income (TI), alternative minimum TI & adjusted self employment income, annualized for each quarter

➤ Nondeductible penalty applied for underpayment

Exception: if AGI > $150,000 for prior year, annual required estimated payments = 110% of prior year's tax

FICA Tax

➢Federal Insurance Contributions Act (FICA) of 1935 was legislation intended to provide retirement and disability benefits for American workers and their families

➢FICA comprised of two taxes
  ◦ Social Security (OASDI) – employee pays 6.2% of first $117,000 of gross wages and the employer pays 6.2%

  and

  ◦ Medicare - 1.45% of total gross earnings, with no cap
    ◦ Additional .9% Medicare surtax is required for high-income taxpayers, starting in 2013

FICA Example

Example

Shannon is employed at Berkeley SolarTech LLC, where her 2014 annual salary = $125,000; what is her FICA tax for the current year? How much does her employer pay for FICA?

Solution

Example

Shannon is employed at Berkeley SolarTech LLC where her 2014 annual salary = $125,000; what is her FICA tax for the current year? How much does her employer pay?

Solution

$117,000 x 6.2% = Social Security tax $7,254.00

$125,000 x 1.45% = Medicare tax   1,812.50

      Total FICA $9,066.50

Employer's share is the same ($9,066.50)
6.2% OASDI and 1.45% Medicare

Federal Tax Deposit System

➢ Employer withholds both federal income tax and FICA from checks

➢ Must deposit these taxes either monthly or semiweekly (IRS notifies tax payer)
  ◦ Monthly depositors make deposit by 15th of following month (all new employers are automatically monthly)
  ◦ Semiweekly depositors make deposit either Wednesday and/or Friday (depending upon when payroll is run)
    ➢ Very small employers with federal payroll tax liabilities of $1,000 or less can file/pay annually by using a Form 944
    ➢ Large employers (who accumulate $100,000 or more of tax liability must comply with special one-day deposit rule)

Federal Tax Deposit System

➢ Deposits must be electronically deposited via Electronic Federal Tax Payment System (EFTPS) or by another electronic payment method

➢ Form 941 (Employer's Quarterly Federal Tax Return) must be accompanied by payroll taxes not yet deposited for quarter

Note that if liability is less than $2,500, employer may skip monthly deposits and pay with Form 941

Employer Reporting Requirements

➤ Annually, employers must send Wage and Tax Statement (Form W-2) to each employee by 1/31
  ◦ Also, send to Social Security Administration by 2/28 with a Form W-3 transmittal

➤ W-2 shows gross wages, income tax and FICA withholding and other items with tax ramifications
  ◦ Note that not all amounts on W-2 are subject to income tax withholding
  ◦ Special rules pertain to employer reimbursements for travel, if there is not an accountable plan in place

➤ Form W-2G
  ◦ Required for gambling winnings, transmittal is W-3G

Information Returns

➢ Annually, employers must complete and send out various Form 1099s for recipients of certain payments
  ◦ Must be mailed to recipients by 1/31
  ◦ Exception: Payors have until 2/15 to mail 1099-B, 1099-S and certain 1099-MISC statements
➢ Each kind of 1099 is transmitted by separate Form 1096
➢ See Table 9.1 on page 9-16 for the various types of 1099s

Self-Employment Tax

➢ Self-employment tax is the same as FICA, except self-employed taxpayer pays both shares

➢ Therefore, rates are:
  ◦ Social Security (OASDI) is 12.4% of first $117,000 of net self-employment income (for 2014)
  ◦ Medicare is 2.9% on total net self-employment income

➢ FICA is not required if net earnings < $400

➢ May take a *Deduction for AGI* on individual tax return for ½ of self-employment tax paid

If taxpayer has both W-2 wages and self-employment
income, the $117,000 limit applies to the combined earnings

FUTA Tax

➢ Federal Unemployment Tax Act (FUTA) requires employers to pay tax to administer state unemployment programs

➢ Net FUTA rate = .6%*

- Must deposit quarterly, but only if over $500
- Must file annual Form 940

➢ Employers pay largest portion of unemployment taxes (SUTA) to state governments; in order to get full credit against FUTA they must pay SUTA by due date

- Also, if state has borrowed funds from Federal government for SUTA and has outstanding loan balance for two consecutive years, employers in that state will see SUTA credit reduction

The Nanny Tax

- Provisions in place to simplify reporting process for employers of domestic household workers
  - Household worker is anyone working, full-time or part-time, in taxpayer's home, such as cook, housekeeper, etc., where hiring party has "will and control" of the taxpayer.
- Household employer must withhold and match FICA on any household worker who earns ≥ $1,900 in a calendar year
  - Must withhold and deposit income taxes for household employees if asked to do so by employee
    and
  - Must pay FUTA if employee annually earns more than $1,000

The Nanny Tax

➢ To report, household employer must
- o Complete Schedule H annually and attach to 1040

  or
- o If have non-household workers, may report household employees on Forms 941 and 940 with regular employees

➢ Must file W-2 for each household employee who earns $1,900 or more a year

.9% Medicare Surtax

➢ An additional Medicare amount of .9% is imposed by the Affordable Care Act (ACA) on the earned income of high-income taxpayers

➢ Thresholds are as follows
  - $250,000 for MFJ
  - $125,000 for MFS
  - $200,000 for single, HOH and qualifying widow(er)

➢ How it works
  - Any earner with wages over $200,000 will have the .9% surtax withheld from checks
  - However, two high-income earners that each (for example) earn $175,000 won't have any surtax withheld, but will owe the surtax on their 1040 at year end since MFJ and over $250,000
  - Employer is not required to match

.9% Medicare Surtax – Self-Employed Taxpayers

➢ Additional .9% surtax not included in computation for deduction for AGI of self-employment tax

➢ Losses from either spouse may offset gains from self-employment and will therefore decrease the .9% surtax owed; this is not true for the 2.9% Medicare on self-employment income, because this tax is computed separately for each spouse

➢ Losses from self-employment may not offset wages for purposes of the .9% Medicare surtax