

2014

# U.S. MASTER™ *Payroll Guide*



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**Wolters Kluwer**  
Law & Business

# ***2014 Master Payroll Guide***



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- Employers and Their Obligations
- Processing New Employees
- FLSA: Employee Classifications
- FLSA: Wages and Hours
- FLSA: Recordkeeping and Enforcement
- What are Wages?
- Payment of Wages
- Tax Treatment of Fringe Benefits
- Tax Treatment of Deferred Compensation and Retirement Plans
- Tax Treatment of Health Benefits
- Tax Treatment of Other Specific Payments

- Basics of Payroll Withholding
- FICA Taxation
- FUTA Taxation
- State Unemployment Insurance
- Garnishments and Other Deductions from Pay
- Tax Deposits and Returns
- Statements to Employees/Information Returns
- Penalties
- Payroll Management and Administration Issues
- Topical Index

### **Revisions and Your Input**

This book is published annually. Therefore, it is important for users to let us know regularly how we may improve the book. Whether it is with the book's format or design or topics that should be included or expanded upon, please continue to interact with us.

**February 2014**

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# Employers and Their Obligations

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## ¶ 5

### Who is an Employer?

For purposes of withholding federal income tax, an *employer* is the person for whom one or more individuals perform services, of whatever nature, as an employee.<sup>1</sup>

The number of employees, the irregularity of their work periods, the frequency of wage payments, and the fact that wage payments may be small have nothing to do with whether you are an employer.<sup>2</sup> All these factors may be very significant in determining how much, if any, tax must be withheld, but this is an altogether different problem from the one of employer status.

#### **CCH Pointer: *FAST FACTS on employers***

*Employers are responsible for collecting and paying federal employment taxes, which include income tax and taxes under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA).*

*An employer may be one of several entities, including:*<sup>3</sup>

- ☐ *Individuals.*
- ☐ *Corporations.*
- ☐ *Partnerships.*
- ☐ *Joint-stock companies.*
- ☐ *Associations.*
- ☐ *Syndicates.*
- ☐ *Groups.*
- ☐ *Pools.*
- ☐ *Joint ventures.*
- ☐ *Other forms of unincorporated organizations.*

## Performance of services

To be an employer, you must have individuals who perform services as employees. If an individual is subject to the will and control of the person for whom the services are performed, both as to what is to be done and the manner in which it is to be accomplished, that individual is an employee.

**CCH Pointer:** It makes no difference whether the individual is given considerable discretion and freedom of action, so long as the one for whom the services are performed has the legal *right* to control both the method and the result of those services. For a detailed discussion on determining who is an “employee” for federal income tax withholding purposes, see ¶ 110—¶ 125.

## Control of wages

Ordinarily, the one for whom an employee performs services will be the one who pays his or her wages. If, however, that party does not have control over the payment of wages, the *employer* is the one having that control. <sup>4</sup> Where wages, such as certain types of pensions or retirement pay, are paid by a trust, and the person for whom the services were performed has no legal control over the payment of the wages, the trust becomes the “employer” for withholding purposes. <sup>5</sup>

**Example:** Abel Corporation engaged a construction company to construct a building according to specifications drawn up by Gene Huey and Associates, a firm of architects. The architects had to check the construction periodically to see that the job was being done properly. Several people were hired by the Abel Corporation to handle this supervision work. They were responsible to the Abel Corporation for the performance of their services and were subject to dismissal at any time by Abel Corporation. Their wages, however, were paid by Gene Huey and Associates. The firm was subsequently reimbursed by Abel Corporation. In such a situation, Gene Huey and Associates is required to withhold federal income tax. <sup>6</sup>

**CCH Pointer:** In these areas, “control” means the legal power to control the payment of wages. The questions generally to be answered are:

- ☐ Who makes up the payroll?
- ☐ Who determines the employees to be included on the payroll?
- ☐ Who determines the actual amount to be paid? <sup>7</sup>

**Example:** Johnson, Ltd. is a prime contractor on a residential development project. Johnson had a contract with the Trim Shop, a subcontractor, to install all cabinets and required trim. When the Trim Shop defaulted on the contract, Johnson assumed control over the subcontractor’s employees as if they were its own. For withholding purposes, Johnson would be the “employer.”

**Example:** Widge Corporation is the parent company of Acey Corporation. The employees of Acey Corporation are hired by Acey and perform services exclusively for Acey. However, the employees are paid by Widge. In this situation, Widge has control over the payment of wages; therefore, Widge is the employer for federal income tax withholding purposes. However, Acey would be the employer for FICA and FUTA purposes.

## Specialized payments

The term “employer” can mean any person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation not engaged in trade or business within the United States or Puerto Rico.<sup>8</sup>

The term “employer” also means a person making a payment of a supplemental unemployment compensation benefit that is treated as wages. For example, if supplemental unemployment compensation benefits are paid from a trust created under a collective bargaining agreement, the trust will generally be deemed to be the employer. However, if the person making the payment is acting solely as an agent for another person, the “employer” is the other person and not the person making the actual payment.

## Employer for purposes of FICA taxes

The Federal Insurance Contributions Act does not define the term “employer.” FICA taxes are measured by the amount of *wages* paid to *employees* in *covered employment*.<sup>9</sup> Therefore, an employer is one who pays wages to one or more employees in covered employment. As with federal income tax withholding, an employer subject to FICA is the government’s collection agent for those taxes.

An employer may be an individual, partnership, corporation, joint stock company, association, syndicate, group, joint venture, pool or other unincorporated entity.

### *Control of employee*

An employee is an individual performing services for another person subject to the direction and control of that person as to both the results to be accomplished and the details of when, where, and how the services are to be performed. It is the *right* to direct and control, not the exercise of that right, that is important. Neither the number of employees nor the period during which any of them are employed is material for determining whether the person for whom the services are performed is an employer.<sup>10</sup>

**Caution:** *Once liability has been incurred for the payment of FICA tax, an entity’s status as an employer is not affected by the discharge or resignation of an employee. Also, the discharge or resignation does not, of itself, create any right to a refund of taxes already withheld or paid by either the employer or the employee.*<sup>11</sup>

### *Control of wages irrelevant*

Where it is unclear just who the employer is for FICA purposes, a careful study of the facts is required. Unlike federal income tax withholding, the question of who furnishes the funds with which employees are paid ordinarily is of no significance. The employer will be the person or entity that has the final authority to control the worker in the performance of his services or the one who reserves the right to do so.

**Example:** Chicken Feed Financial (CFF) is a subsidiary of High Interest Loan (HIL) Corporation. Although CFF's employees are completely subject to its direction and control as to the services they perform and the result those services are to achieve, HIL pays their salaries. In some instances, CFF reimburses HIL for the salaries it pays. In others, there is no reimbursement. For federal income tax withholding purposes, HIL—the parent—is the employer because it controls the payment of wages. For FICA and FUTA purposes, however, control over the wage payments is immaterial. Hence, CFF—the subsidiary—is the employer responsible for reporting and paying FICA and FUTA taxes.<sup>12</sup>

### **Employer for purposes of FUTA taxes**

You must meet one of two conditions to be considered an employer for purposes of the FUTA tax—the “one-in-20” test or the payroll test.<sup>13</sup>

**CCH Pointer:** If you qualify as an employer under one of these tests, it makes no difference that you do not meet the requirements of the other test. An employer may be an individual, corporation, partnership, company, association, trust, or estate. The nature of the business organization is generally immaterial in determining who is an employer.

#### *Applying the “1-in-20” test*

Under the 1-in-20 test, you will be covered by FUTA if you have had at least one employee for some portion of the day on each of 20 days (each in a different calendar week) during the preceding or current calendar year. The one employee does not have to be the same individual each day—different employees could be employed on each day so long as at least one employee worked during a 24-hour period. Also, the 20 weeks do not have to be consecutive.

To determine whether you have had at least one employee in your employ during a 20-week period, several questions must be answered to decide which employees should be counted toward the test.

- ☐ **How long is a week?** A “calendar week” is a period of seven successive days beginning with Sunday and ending at the close of the following Saturday. The beginning and ending of your weekly payroll period are immaterial. If the first week of a calendar year begins before Sunday, or if the last week ends before Saturday, these “short weeks” are counted as calendar weeks for FUTA purposes.<sup>14</sup>
- ☐ **What about employees whose sole remuneration is not taxable?** The fact that payments to an employee are not taxable wages is not controlling in evaluating whether the employee must be counted in determining coverage.<sup>15</sup>
- ☐ **Must employees who are not paid at all be counted?** Neither the law nor the regulations make it necessary for wages or any other type of remuneration to be paid to an individual rendering services for another in determining the employer under FUTA.<sup>16</sup>



Therefore, the fact that an employee is not paid **at all** is of no consequence in establishing your liability for the tax. All employees must be counted.

- **What about regular employees who are absent?** So long as an employer-employee relationship exists, whether the employee actually performs any services is immaterial in determining employer coverage. Thus, an employee who is on vacation or sick leave must still be counted in determining whether you meet the “1-in-20” test.<sup>17</sup>

**CCH Pointer:** An employee who resigns and has vacation time for which the employee receives regular compensation is considered to be in your employ during the vacation period, and must be counted as an employee. Furthermore, the employee who replaces the person on vacation should also be counted as an employee. In both cases, there is a continuing employer-employee relationship in existence during the vacation period.<sup>18</sup>

### *Applying the payroll test*

To be considered an employer under the payroll test, you must have paid wages of \$1,500 or more during any calendar quarter in the current or preceding calendar year. This test is intended to ensure coverage of employees of persons who may employ many workers periodically but never for 20 weeks in any one calendar year.

### *Right to control employee activities*

If it is difficult to determine which of two possible entities is actually the employer for FUTA purposes, the “employer” will be the one who has the ultimate right (whether exercised or not) to direct and control the activities of the employees.

The IRS has no objection to an agreement where payment of the FUTA tax is assumed by a person other than the real employer. However, the liability for the tax still rests with the real employer, who must continue to file returns and bear the responsibility for paying the tax to the government if the other party fails to pay the taxes.<sup>19</sup>

### *Special categories of employer under FUTA*

- **Agricultural labor.**—In the case of agricultural labor, an employer is a person who pays wages of \$20,000 or more for such labor during any quarter of the current or preceding calendar year or employs 10 or more individuals in agricultural labor for some portion of the day on each of 20 days during the current or preceding calendar year.<sup>20</sup>
- **Domestic services.**—A person is an employer if the person pays wages of \$1,200 or more in any quarter of the current or preceding calendar year for domestic services performed in a private home, college club, or local chapter of a college fraternity