

CHAPTER 4

PAYROLL TAXES

Irrespective of the form of business in which you operate, if you are going to have employees (including yourself if business is incorporated) then you will have to contend with payroll taxes. The brief summary which follows will give you some guidance in the rules and regulations of the various taxing authorities.

Available Publications

Circular E, Publication 15, Employer's Tax Guide, covers the payroll tax reporting and deposit requirements and can be obtained through the local office of the Internal Revenue Service and online at: <http://www.irs.gov/app/picklist/list/publicationsNoticesPdf.html>

Tax Deposit Requirements

Federal withheld income and FICA taxes (employer and employee portion) must be paid or deposited periodically based upon the following rules.

Monthly Depositor. New employers and employers that reported employment taxes of \$50,000 or less during the lookback period generally must make monthly deposits. The deposit for a month must be made on or before the 15th day of the following month.

Semi-Weekly Wednesday/Friday Depositor. An employer that reported employment taxes of more than \$50,000 during the lookback period is a semi-weekly depositor for the entire year. Such employers must make deposits on or before Wednesdays or Fridays depending on the timing of their payrolls. Specifically, employment taxes from payments to employees made on Wednesdays, Thursdays or Fridays must be deposited on or before the following Wednesday. Taxes from Saturday, Sunday, Monday or Tuesday payments to employees must be deposited by the following Friday. Many semiweekly depositors have to make these deposits electronically using the Electronic Federal Tax Payment System (EFTPS). The determination of who has to use EFTPS is based upon the taxpayer's aggregate tax liability (employment and other taxes) for the second preceding calendar year. For 2010, taxpayers have to use EFTPS if their aggregate 2008 tax liability was greater than \$200,000 or they were required to use EFTPS in 2009 or any prior year.

Nonbanking Days. Semi-weekly depositors will always have at least three banking days to make a deposit. If any of the three weekdays following the close of a semi-weekly period is a bank holiday, the employer will have an additional banking day to make the deposit. For example, if Monday is a bank holiday, deposits from the prior year Wednesday through Friday period can be made by following Thursday, rather than by the regular Wednesday deposit day.

One Day Depositor. If a monthly or semi-weekly depositor accumulates employment taxes of \$100,000 or more during a deposit period (monthly or semi-weekly), then the taxes must be deposited by the next banking day. This rule overrides the normal rules for determining deposit dates discussed above. A monthly depositor that must make a one day deposit under this rule immediately becomes a semi-weekly depositor for the rest of the calendar year and the following year.

Virginia withheld income must be deposited based upon the following rules.

Quarterly Filers. Employers that withheld \$100 or less per month, will usually be assigned a quarterly filing status. The payment and return are due on the last day of the month following the end of the calendar quarter. Form VA-5 in the Virginia Coupon Book is used to report the liability or use iFile for Businesses at the Department of Taxation at: <https://www.business.tax.virginia.gov/VTOL/Login.seam>.

Monthly Filers. Employers that withhold taxes of more than \$100, but less than \$1,000 per month will be assigned a monthly filing status. Monthly returns and payments are due by the 25th of the following month, (e.g., payment of withholding for the month of January is due by February 25th). Form VA-5 in the Virginia Coupon Book is used to report the liability or use iFile for Businesses at the Department of Taxation at: <https://www.business.tax.virginia.gov/VTOL/Login.seam>.

Semi-Weekly Filers. Employers that withhold taxes of more than \$1,000 per month must make payments at the same time as Federal payments required under the Federal semi-weekly rules. Form VA-15 in the Virginia Coupon Book is used to make the semi-weekly payments or use iFile for Businesses at the Department of Taxation at: <https://www.business.tax.virginia.gov/VTOL/Login.seam>. Form VA-16 is due by the end of the month following the end of the calendar quarter to report the income taxes withheld during the quarter and to reconcile to the payments for the quarter.

Federal Unemployment Taxes (FUTA)

To determine your quarterly liability for FUTA, multiply the first \$7,000 of each employee's annual wages that you paid during the quarter by .008. If your liability for any calendar quarter (plus any undeposited taxes for an earlier quarter) is more than \$500, you are required to pay the taxes with a Federal tax deposit coupon, at an authorized financial institution or Federal reserve bank by the end of the following month (or pay electronically using EFTPS). However, if the liability for all employees for the quarter is \$500 or less, there is no requirement to deposit it currently, you merely add it to your liability for the following quarter.

Employers that are required to make electronic deposits of withheld income taxes also have to make electronic deposits of federal unemployment taxes. You must use "EFTPS", if you are required to do so for other taxes, such as Federal withholding and FICA taxes. See <https://www.eftps.gov/eftps/>.

If the tax reported on your annual Form 940 Federal Unemployment Tax Return less payments for the year is:

More than \$500, then you must pay all of the tax by January 31st, or,

Less than \$500, then you may pay the taxes when you file Form 940.

State Unemployment Taxes

Depending on your state of residence, additional unemployment taxes may be due to a state taxing authority. In Virginia your quarterly liability for state unemployment tax is determined by multiplying the first \$8,000 of each employee's annual wages that you paid during the quarter by the assigned tax rate. Employee wages and the tax are reported quarterly and are due by the last day of the month following the end of the calendar quarter. For additional information, access the Virginia Employment Commission web site at: <http://www.vec.virginia.gov/vecportal/index.cfm>.

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Supplemental Wages

In general, if supplemental wages (such as bonuses, commissions, overtime pay) are included in the same payment with regular wages, then the tax withheld is determined as if the total of the supplemental and regular wages were a single payment for the regular payroll period.

If supplemental wages are not paid with the same payment as the regular wages, the employer may:

For Federal income tax, withhold at a flat rate of 25% or withhold based on the total of the supplemental wages and regular wages for the most recent payroll period (the rate is 35% for supplemental wages of more than \$1,000,000. For Virginia income tax, withhold at a flat rate of 5.75%.

Combine the supplemental wage with the last regular wage, determine the tax on the total wage, and subtract the amounts already withheld on the regular wage payment.

Fringe Benefits

Gross income does not include fringe benefits that qualify for exclusion, as described in the categories listed below. Fringe benefits that qualify for the exclusion are exempt from income tax and Social Security tax withholding (FICA and payment of Federal Unemployment Tax (FUTA)). Conversely, benefits which do **not** qualify are subject to these taxes. An example of a common non-qualifying benefit subject to tax is the automobile allowance. For additional information see IRS Publication 15-B at <http://www.irs.gov/app/picklist/list/publicationsNoticesPdf.html>.

No-additional-cost service. This is a service provided to an employee that is excludable if the service is offered for sale to the public in the ordinary course of the line of business of the employer in which the employee is working and the employer does not incur substantial additional cost. For example, employers who furnish airline travel or hotel rooms to employees working in these lines of businesses in such a way that the nonemployee customers are not displaced and they incur no substantial additional cost in providing those services to the employees, the cost is excludable from the employee's gross income.

Qualified employee discount. Any employee discount is an excludable qualified employee discount if: (1) in the case of property, it does not exceed the gross-profit percentage of the price at which the property is being offered to customers; (2) in the case of service, it does not exceed 20% of the price at which the service is being offered.

Working condition fringe. Any employer-provided property or services are excludable benefits to the extent that they are deductible as ordinary and necessary business expense had the employee paid for them. Under certain conditions, the fair market value of a qualified automobile demonstration used by a full time auto salesperson is an excludable working condition fringe.

De minimis fringe. Property or services not otherwise tax-free are excludable if their value is so small as to make accounting unreasonable or administratively impractical. An operation of any eating facility for employees is an excludable de minimis fringe if it is located on or near the employer's business premises and the revenue derived normally equals or exceeds the direct operating costs of the facility.

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Qualified Moving Expenses Reimbursement. An employee may exclude from gross income an amount received from an employer for payment of qualified moving expenses.

Transportation Fringe Benefits. Beginning in 1995, an employee may exclude from gross income certain maximum amounts received from an employer as reimbursements for transit passes, vanpooling expenses, and qualified parking expenses.

New Hire Reporting

Effective July 1, 1998 Virginia law requires the reporting of all newly hired employees within twenty (20) days of hire. The report is filed with the Virginia New Hire Reporting Center and may be filed online at <http://newhire-reporting.com/VA-Newhire/default.aspx>. Copies of the reporting form and instructions are included in the Exhibits at the back of this kit.

Other Tax Requirements

Whenever a wage payment is made, the employer must provide the employee with a statement of the gross wages and specific deductions (if any). Use the Form W-4 submitted by the employee and the tax tables provided in the employer's tax guides to determine the correct income tax to withhold. If the employee fails to submit a Form W-4, the employer must withhold at the rate applicable to a single person who has no withholding exemptions. The IRS may also request review of Forms W-4 from time to time.

An employer must obtain a completed Form I-9, Employment Eligibility Verification, from every employee at the time they start work and obtain the necessary citizenship or other employment eligibility status verification within three days of their beginning work. Detailed instructions to complete Form I-9 are contained in the Handbook for Employers, M-274 located on the web site for the U.S. Citizenship and Immigration Services under the link "For Employers" at: <http://www.uscis.gov/portal/site/uscis>. Copies of the reporting form, instructions and handbook are included in the Exhibits at the back of this kit.

An employer must report all new Virginia employees to the Virginia Employment Commission within thirty five days of the date of hire.

When making a reimbursement or payment of moving expenses to or for an employee, the employer must complete and furnish the employee with a Form 4782 for each move.

The employer must also furnish a Form W-2 to each employee showing remuneration and withheld taxes for each calendar year. Flat rate expense account allowance, disability insurance paid by the employer, and moving expense reimbursements are among the items to be included as other compensation on a Form W-2. Upon request, a Form W-2 must be furnished to a terminated employee within 30 days after the request or the final wage payment whichever is later. All other Forms W-2 should be given to the employees by January 31st of the following year.

The payroll tax requirements and the work related to compliance are quite cumbersome and complicated. Once a business employs more than a few people, we recommend that a qualified payroll service be used because it has generally been our experience that the cost of the service far outweighs the personnel and management time required to operate the payroll system in house.

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Tax Rates

The following charts contain tax rates and the taxable wage basis for employers and employees. The limits and maximum contributions for 2010 given are per employee.

Social Security Taxes and Unemployment Taxes	<u>Medicare</u>	<u>Social Security</u>	<u>Total</u>
Social Security Taxes (FICA)			
Tax rate for employer	1.45%	6.2%	7.65%
Tax rate for employee	1.45%	6.2%	7.65%
On wages not to exceed	No Limit	\$ 106,800.00	
Maximum employer contribution	No Limit	\$ 6,621.60	
Maximum employee contribution	No Limit	\$ 6,621.60	
Federal Unemployment Taxes (FUTA)			
Federal Unemployment Tax (employer only): Gross Federal tax rate			6.20%
Less credit for Virginia Unemployment tax (If timely payment is made)			5.40%
Net Federal tax rate			0.80%
On Wages not to exceed			\$7,000.00
Maximum employer contribution (per employee)			\$ 56.00
Virginia Unemployment Taxes (SUTA)			
Virginia tax rate			Varies
On Wages not to exceed			\$8,000.00
Maximum employer contribution (per employee)			Varies