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# Form 941: Compliance Challenges and Intensified IRS Audits

Avoiding Errors That Trigger Costly Penalties and Documenting a Solid Case for Examiners

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TUESDAY, SEPTEMBER 27, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Patrick Haggerty, Owner, **Patrick A. Haggerty, EA**, Chapel Hill, N.C.

Elizabeth Dold, Principal, **Groom Law Group**, Washington, D.C.

Kurt Lawson, Partner, **Hogan Lovells**, Washington, D.C.

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# Form 941: Compliance Challenges and Intensified IRS Audits Seminar

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Sept. 27, 2011

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Kurt Lawson, Hogan Lovells  
[kurt.lawson@hoganlovells.com](mailto:kurt.lawson@hoganlovells.com)

Patrick Haggerty, Patrick A. Haggerty, EA  
[phaggerty@prodigy.net](mailto:phaggerty@prodigy.net)

Elizabeth Dold, Groom Law Group  
[edold@groom.com](mailto:edold@groom.com)

# Today's Program

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Fundamental Aspects Of Form 941  
*[Kurt Lawson and Patrick Haggerty]*

Slide 7 - Slide 37

Wage, Back-Up And Non-Resident Alien Withholding Rules  
*[Kurt Lawson]*

Slide 38 - Slide 51

Correcting Errors On Prior Returns  
*[Patrick Haggerty]*

Slide 52 - Slide 80

Potential Interest, Penalties For Non-Compliance, Late Filings  
*[Elizabeth Dold]*

Slide 81 - Slide 87

Preparing For IRS Employment Tax Audits  
*[Elizabeth Dold]*

Slide 88 - Slide 96

Kurt Lawson, Hogan Lovells

Patrick Haggerty, Patrick A. Haggerty, EA

# **FUNDAMENTAL ASPECTS OF FORM 941**

# WHAT IS AN “EMPLOYER” AND WHO ARE ITS “EMPLOYEES”?

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## A. “COMMON LAW” EMPLOYER.

1. **Right to direct and control results and means for achieving those results. See Treas. Reg. § 31.3121(d)-1(c)(2).**
2. **“20 Factor” Test. See Rev. Rul. 87-41, 1987-1 C.B. 296.**
3. **Independent Contractor or Employee?, IRS Training Manual 3320-102 (10/96).**
  - a) Nature and degree of financial control.
  - b) Nature and degree of behavioral control.
  - c) Relationship of the parties.
4. **Congressional “moratorium” on regulations regarding “independent contractor” determinations imposed by section 530 of the Revenue Act of 1978, Pub. L. No. 95-600, as amended by section 1706 of the Tax Reform Act of 1986, Pub. L. No. 99-514, and the Small Business Job Protection Act of 1996, Pub. L. No. 104-188 (“Section 530”).**
  - a) Section 1706 of the Tax Reform Act of 1986 created an exception for certain technical services workers (engineer, designer, drafter, computer programmer, systems analyst and similarly skilled workers).
  - b) RESULT: IRS can issue guidance on classification of such workers.



# WHAT IS AN “EMPLOYER” AND WHO ARE ITS “EMPLOYEES”?

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## **B. JOINT EMPLOYERS AND CO-EMPLOYERS.**

### **1. “Joint employment” and “co-employment” recognized under common law.**

- a) Restatement (Second) of Agency § 226 (joint employment).
- b) Restatement (Second) of Agency § 227 (borrowed servants).

### **2. IRS recognition mixed.**

- a) Rev. Rul. 66-162, 1966 1 C.B. 234 (because rule is based on common law, it applies for employment tax purposes).
- b) Proc. 2002-21, 2002-1 C.B. 911 (requiring plans maintained by PEOs for the benefit of worksite employees to be terminated or converted into multiple employer plans to avoid disqualification despite claim of co-employment)
- c) PLR 200017041 (March 3, 2000) (“The concept of a ‘co-employer’ is not recognized in Subtitle C [the employment tax provisions] of the Internal Revenue Code.”).
- d) CCA 200415008 (Jan 9, 2004) (“If a client company was the common law employer of workers it leased from [a PEO], [the PEO] could also be a common law employer under the theory of co-employment.”).

# WHAT IS AN “EMPLOYER” AND WHO ARE ITS “EMPLOYEES”?

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## C. “STATUTORY” EMPLOYER.

### 1. Who is the person in “control of the payment of wages”? See Code § 3401(d)(1).

- a) Relates to determination of “employer” for federal income tax withholding (“FITW”).
- b) Expanded to include FICA and FUTA responsibility. See, e.g., *Otte v. United States*, 419 U.S. 43 (1974); *In re Armadillo Corp.*, 410 F. Supp. 407 (D. Colo. 1976), aff’d, 561 F.2d 1382 (10th Cir. 1977).
- c) Issue appears in “employee leasing” context.

# WHAT IS AN “EMPLOYER” AND WHO ARE ITS “EMPLOYEES”?

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## C. “STATUTORY” EMPLOYER. (CONTINUED)

### 2. Exception from “common law” rule for determining income tax withholding liability.

- a) IRS position is that the “common law” test applies for purposes of determining what is “wages” and what is “employment” with respect to FITW, FICA, and FUTA (even if a “statutory employer” exists).
  - (1) “Statutory” (i.e., Code § 3401(d)(1)) employer is the “employer” for purposes of:
    - Withholding;
    - Reporting; and
    - Payment
  - (2) “Common law” employer also is the “employer” for purposes of whether there is a liability for employment taxes and how much, i.e., the “wage base.” See e.g., Blue Lake Rancheria v. United States, 2011 WL 3506092 (9th Cir. 2011) (FUTA exemption for services performed for Indian tribe does not apply not when tribe is merely a “statutory employer” that operates as common paymaster); Cencast Services, L.P. v. United States, 62 Fed. Cl. 159 (2004); Rev. Rul. 54 471, 1954 2 C.B. 348.
- b) IMPORTANT: The “common law” employer is not necessarily relieved from liability if the “statutory employer” fails to do its job.
  - (1) Issue appears in “employee leasing” context, and should be addressed in contract arrangements.

# WHAT IS AN “EMPLOYER” AND WHO ARE ITS “EMPLOYEES”?

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## D. RELIEF UNDER SECTION 530 OF THE REVENUE ACT OF 1978, AS AMENDED.

### 1. Requirements.

- a) Consistency.
  - (1) Company treats “similarly situated” workers as not being “employees.”
  - (2) Timely filing of tax returns consistent with treatment of the workers as “independent contractors” or “not employees” (i.e., Forms 1099).
- b) Reasonable Basis.
  - (1) Judicial precedent, published ruling, technical advice/letter ruling to the putative “employer”; or
  - (2) Past IRS employment tax audit that resulted in no assessment in relation to substantially similar positions; or
  - (3) Long-standing practice of a significant segment of this industry.

# WHAT IS AN “EMPLOYER” AND WHO ARE ITS “EMPLOYEES”?

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## D. RELIEF UNDER SECTION 530 OF THE REVENUE ACT OF 1978 (CONTINUED).

### 1. Limitations.

- a) Available only for federal employment taxes.
  - (1) But many states will follow if federal “Section 530” relief has been granted.
- b) Worker remains responsible for “employee” half of FICA.
  - (1) File Form 8919 (Uncollected Social Security and Medicare Tax on Wages).
  - (2) Form 8919 introduced in 2007; Form 4137 used in earlier years.

### 2. Section 1706 of the Tax Reform Act of 1986

- a) created an exception for certain technical services workers (engineer, designer, drafter, computer programmer, systems analyst and similarly skilled workers).
- b) RESULT: status of such workers must be determined under the common law test.

(EIN)   -

Employer identification number

Name (not your trade name)

Trade name (if any)

Address

Number Street Suite or room number

City State ZIP code

**Report for this Quarter of 2011**  
 (Check one.)

1: January, February, March

2: April, May, June

3: July, August, September

4: October, November, December

Prior-year forms are available at [www.irs.gov/form941](http://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: <i>Mar. 12</i> (Quarter 1), <i>June 12</i> (Quarter 2), <i>Sept. 12</i> (Quarter 3), or <i>Dec. 12</i> (Quarter 4)	1	<input type="text"/>
2	Wages, tips, and other compensation . . . . .	2	<input type="text"/>
3	Income tax withheld from wages, tips, and other compensation . . . . .	3	<input type="text"/>
4	If no wages, tips, and other compensation are subject to social security or Medicare tax	<input type="checkbox"/> Check and go to line 6e.	
		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	Add <i>Column 2</i> line 5a, <i>Column 2</i> line 5b, and <i>Column 2</i> line 5c . . . . .	5d	<input type="text"/>
5e	Section 3121(q) Notice and Demand—Tax due on unreported tips (see instructions) . . . . .	5e	<input type="text"/>
6a	Reserved for future use.		
6b	Reserved for future use.		

For 2011, the employee social security tax rate is 4.2% and the Medicare tax rate is 1.45%. The employer social security tax rate is 6.2% and the Medicare tax rate is 1.45%.

**Do Not Complete Lines 6a-6d**

# Income Tax Wages: Definition

## Form 941 Box 2: Wages

- Gross income 26 U.S.C. §61(a)(1)
  - Compensation for services including fees, commissions, fringe benefits and similar items
- Adjusted gross income (AGI)
  - Gross income minus certain items
  - For example, trade or business expenses
  - Unless trade or business consists of performing services as an employee 26 U.S.C. §62(a)(1)
  - Unless employee reimbursed under accountable plan 26 U.S.C. §62(a)(2) reference to 26 U.S.C. §161

# Income Tax Wages: Definition (Cont.)

## Form 941 Box 2: Wages - Exceptions

- Specifically excluded benefits
  - § 104 Compensation for injuries or sickness
  - § 105 Amounts received under accident and health plans
  - § 106 Contributions by employer to accident and health plans
  - § 107 Rental value of parsonages
  - § 112 Certain combat zone compensation of members of the Armed Forces
  - § 119 Meals or lodging furnished for the convenience of the employer



# Income Tax Wages: Definition (Cont.)

Form 941 Box 2: Wages – Exceptions (Cont.)

Specifically excluded benefits

- § 120 Amounts received under qualified group legal services plans
- § 125 Cafeteria plans
- § 127 Educational assistance programs
- § 129 Dependent care assistance programs
- § 132 Certain fringe benefits
- § 137 Adoption assistance programs
- § 139C COBRA premium assistance

# Income Tax Wages: Definition (Cont.)

Form 941 Box 2: Wages – Exceptions (Cont.)

§ 132 Certain fringe benefits

- No-additional-cost service
- Qualified employee discount
- Working condition fringe
- *De minimis* fringe
- Qualified transportation fringe
- Qualified moving expense reimbursement
- Qualified retirement planning services, or
- Qualified military base realignment and closure fringe

# Income Tax Wages: Definition (Cont.)

## Form 941 Box 2: Wages – Exceptions (Cont.)

- Qualified plan contributions 26 U.S.C §401 et seq
  - Employer
  - Employee elective deferrals
- Certain deferred compensation plans
- Certain stock options
- And more (e.g., tips less than \$20 per month)
- Some taxable wages are not included in box 2 wages.
  - E.g., wages of deceased worker paid after DOD

# Income Tax Wages: Definition (Cont.)

Form 941 Box 3: Withholding 26 U.S.C. 3401

- List is similar to income taxable wages.
- Taxable wages not subject to withholding
  - Paid to U.S. citizens or residents in U.S. by foreign government or international organization
  - Election workers
  - Household employees
  - Statutory employees
  - Newspaper carriers and vendors
  - Certain non-cash payments
  - Excess group term life insurance

# Requirement To Withhold

- Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary § 3402(a)(1).
- Withholding exemptions § 3402(a)(2)
  - Wages – (allowance amount X number of exemptions)

# Withholding Methods: Percentage Method

Table 5. Percentage Method—2011 Amount for One Withholding Allowance

Payroll Period	One Withholding Allowance
Weekly .....	\$ 71.15
Biweekly .....	142.31
Semimonthly .....	154.17
Monthly .....	308.33
Quarterly .....	925.00
Semiannually .....	1,850.00
Annually .....	3,700.00
Daily or miscellaneous (each day of the payroll period) .....	14.23

**Example.** An unmarried employee is paid \$600 weekly. This employee has in effect a Form W-4 claiming two withholding allowances. Using the percentage method, figure the income tax to withhold as follows:

Gross Pay			\$600.00
Allowances	2	\$71.15	<u>-142.30</u>
			\$457.70
Bracket Base			<u>-204.00</u>
			\$253.70
Tax Rate			<u>X15%</u>
			\$38.06
Prior Brkt Tax			<u>16.40</u>
Withholding			\$54.46

## Percentage Method Tables for (For Wages Paid)

TABLE 1—WEEKLY

(a) SINGLE person (including head of household)— If the amount of wages (after subtracting withholding allowances) is:		The amount of income tax to withhold is:	(b) If the amount of wages (after subtracting withholding allowances) is:
Not over \$40	.....	\$0	Not over \$40
Over—	But not over—	of excess over—	Over—
\$40	—\$204	\$0.00 plus 10%	\$40
\$204	—\$704	\$16.40 plus 15%	\$204
\$704	—\$1,648	\$91.40 plus 25%	\$704
\$1,648	—\$3,394	\$327.40 plus 28%	\$1,648
\$3,394	—\$7,332	\$816.28 plus 33%	\$3,394
\$7,332	.....	\$2,115.82 plus 35%	\$7,332

TABLE 2—BIWEEKLY

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# Withholding Methods: Wage Bracket Method

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—										
\$600	\$610	\$77	\$66	\$55	\$45	\$34	\$23	\$14	\$7	\$0	\$0	\$0
610	620	78	67	57	46	35	25	15	8	1	0	0
620	630	80	69	58	48	37	26	16	9	2	0	0
630	640	81	70	60	49	38	28	17	10	3	0	0
640	650	83	72	61	51	40	29	18	11	4	0	0
650	660	84	73	63	52	41	31	20	12	5	0	0
660	670	86	75	64	54	43	32	21	13	6	0	0
670	680	87	76	66	55	44	34	23	14	7	0	0
680	690	89	78	67	57	46	35	24	15	8	0	0
690	700	90	79	69	58	47	37	26	16	9	1	0
700	710	92	81	70	60	49	38	27	17	10	2	0
710	720	94	82	72	61	50	40	29	18	11	3	0
720	730	97	84	73	63	52	41	30	20	12	4	0
730	740	99	85	75	64	53	43	32	21	13	5	0
740	750	102	87	76	66	55	44	33	23	14	6	0
750	760	104	88	78	67	56	46	35	24	15	7	0
760	770	107	90	79	69	58	47	36	26	16	8	1
770	780	109	91	81	70	59	49	38	27	17	9	2
780	790	112	94	82	72	61	50	39	29	18	10	3
790	800	114	96	84	73	62	52	41	30	20	11	4
800	810	117	99	85	75	64	53	42	32	21	12	5
810	820	119	101	87	76	65	55	44	33	23	13	6
820	830	122	104	88	78	67	56	45	35	24	14	7
830	840	124	106	90	79	68	58	47	36	26	15	8
840	850	127	109	91	81	70	59	48	38	27	16	9
850	860	129	111	94	82	71	61	50	39	29	18	10
860	870	132	114	96	84	73	62	51	41	30	19	11

# Withholding Methods: Supplemental Wages

- Mandatory flat rate
  - 35% of gross to extent cumulative supplemental pay for calendar year exceeds \$1 million
  - If this applies, no other method is allowed.
- Aggregate method
  - Default method
  - Computes withholding on combined amount
  - Total WH – WH on regular pay = WH on supplemental
- Optional flat rate method
  - 25% of gross supplemental pay
  - Payment must meet certain criteria or else it is not allowed.

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# Withholding Methods: Alternative Methods

- Annualized wage
  - Annualizes pay for current period
  - Computes tax on annual amount
  - Divides by number of pay periods in year
- Cumulative wage
  - Employee must request this method be used in writing.
  - Divide YTD wages by YTD pay periods (including current)
  - Compute withholding
  - Multiply WH by YTD pay periods
  - Subtract YTD WH from total for current WH

# Withholding Methods

## Alternative Methods (Cont.)

- Quarterly average wage
  - Compute WH on total expected wages for quarter
  - Divide by number of pay periods in quarter
  - Withhold equal amount each pay period
  - Adjust if expected pay changes during quarter
- Part-year employment
  - Takes into account partial-year employment
  - We don't have time to explain this one in detail today.
- Other methods

# Withholding Methods Alternative Methods (Cont.)

- Other methods
  - Any method may be used that withholds within the maximum allowable deviations.
  - Must test full range of wage and allowance situations
  - May not be worth the trouble proving it works

If the tax required to be withheld under the annual percentage is—	The annual tax withheld under your method may not differ by more than—
Less than \$10.00	\$9.99
\$10 or more but under \$100	\$10 plus 10% of the excess over \$10
\$100 or more but under \$1,000	\$19 plus 3% of the excess over \$100
\$1,000 or more	\$46 plus 1% of the excess over \$1,000

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5b	Taxable social security tips . . . . .	<input type="text"/>	× .104 =	<input type="text"/>	For 2011, the employee social security tax rate is 4.2% and the Medicare tax rate is 1.45%. The employer social security tax rate is 6.2% and the Medicare tax rate is 1.45%.	
5c	Taxable Medicare wages & tips . . . . .	<input type="text"/>	× .029 =	<input type="text"/>		
5d	Add <i>Column 2</i> line 5a, <i>Column 2</i> line 5b, and <i>Column 2</i> line 5c . . . . .				5d	<input type="text"/>
5e	Section 3121(q) Notice and Demand—Tax due on unreported tips (see instructions) . . . . .				5e	<input type="text"/>
6a	Reserved for future use.					
6b	Reserved for future use.	<b>Do Not Complete Lines 6a-6d</b>				
6c	Reserved for future use.					
6d	Reserved for future use.					
6e	Total taxes before adjustments (add lines 3, 5d, and 5e) . . . . .				6e	<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 6e through 9 . . . . .				10	<input type="text"/>
11	Total deposits, including prior quarter overpayments . . . . .				11	<input type="text"/>
12a	COBRA premium assistance payments (see instructions) . . . . .				12a	<input type="text"/>
12b	Number of individuals provided COBRA premium assistance . . . . .	<input type="text"/>				
13	Add lines 11 and 12a . . . . .				13	<input type="text"/>
14	Balance due. If line 10 is more than line 13, enter the difference and see instructions . . . . .				14	<input type="text"/>
15	Overpayment. If line 13 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. **Next** ➔

# SPECIAL SITUATIONS.

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## A. WITHHOLDING ON PAYMENTS TO NONRESIDENT ALIENS (“NRAS”).

1. Most “U.S. source” income paid to an NRA is subject to a 30% withholding tax. See Code §§ 1441-1443.
2. But income for personal services performed in the U.S. is subject to regular wage withholding. See Code § 1441(c)(4); cf. CCA 201027046 (July 9, 2010) (services performed on structures or vessels on the outer continental shelf).
3. The rate of withholding may be lower – or zero – based on a tax treaty or specific Code provision. (Certain visa categories, for example, e.g., F-1, are exempt from FICA.)
  - a) To claim a treaty exemption, use Form 8233 for personal service income, Form W-8BEN for other income. See Rev. Proc. 2005-44, 2005-29 I.R.B. 110.
  - b) Central Withholding Agreement (CWA) under some circumstances for NRA athlete or entertainer to withhold at the anticipated amount of tax liability—applied for with Form 13930.
4. Some different wage withholding rules apply. For example:
  - a) An employee who is an NRA may claim only one personal allowance (for himself or herself) on Form W-4. An employee who is an alien but is a US resident may claim an additional personal allowance for his or her spouse on Form W-4, even if the spouse is a nonresident alien, but generally must check the box for single status on Form W-4 unless the couple expects to be able to file a joint tax return for the year (i.e., they plan to elect to treat the nonresident alien spouse as a US resident).
5. Payments subject to withholding under Code § 1441 are reported on Form 1042-S (in lieu of Form W-2) and Form 1042 (in lieu of Form 941 or other appropriate 94X series form).

# SPECIAL SITUATIONS.

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## **B. BACK-UP WITHHOLDING.**

### **1. Imposed by Code § 3406.**

### **2. Payers making certain types of payments (“reportable payments”) must withhold a specified percentage of the payments under certain conditions.**

- a) Applies to payments reported on Form 1099, such as interest, dividends, rents, commissions and other payments for services to independent contractors, gambling winnings.
- b) But not real estate transactions, cancelled debt, foreclosure, distributions from qualified plans and IRAs.

### **3. Backup Withholding Rate: 28% through December 31, 2010.**

### **4. When to do backup withholding.**

- a) No Taxpayer Identification Number (“TIN”) has been provided.
- b) Payee fails to certify, under penalties for perjury, on Form W-9 or an acceptable substitute, that the TIN is correct (for interest, dividend, broker and barter exchanges only).
  - (1) In the case of compensation for services, certification does not have to be under penalties of perjury, so using a substitute for Form W-9 makes more sense.
- c) Notification from IRS that Payee has provided an incorrect TIN or that TIN is missing.
  - (1) CP2100/CP2100A Notices.

# SPECIAL SITUATIONS.

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## **B. BACK-UP WITHHOLDING. (CONTINUED)**

### **5. How to avoid penalties for improper backup withholding.**

- a) Request a TIN when the relationship begins. See Treas. Reg. § 301.6724-1(e)(1)(i).
  - (1) Form W-9 or an acceptable substitute can be used for this purpose.
  - (2) Does not have to be signed if the service-provider does not have to certify his TIN under penalties of perjury. See Treas. Reg. § 31.3406(h)-3(b).
- b) Upon receipt of IRS notice:
  - (1) Compare listing on IRS notice to own records.
  - (2) If TIN is missing, begin backup withholding if not started already, and ask up to three times for the TIN (initial, first annual, and second annual solicitations).
  - (3) If TIN is incorrect, send First “B” Notice to payee (if records agree) or update records (if records do not agree) after receiving first IRS notice; send Second “B” Notice if second IRS notice received within three calendar year period.

### **6. Reported on Form 945 (not Form 941).**

# SOCIAL SECURITY AND MEDICARE WAGES.

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## A. GENERAL RULES.

1. **“All remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash,” unless subject to an exception. Code § 3121(a).**
2. **The determination of “wages” is vital for FITW and FUTA as well as FICA purposes.**
  - a) The definition of “wages” sounds similar under Code §§ 3401 (for FITW), 3121(a) (for FICA), and 3306(b) (for FUTA), and the United States Supreme Court, in Rowan Companies v. United States, 452 U.S. 247 (1981), held that Congress can be assumed to have intended that “wages” for FICA means the same thing as “wages” for FITW.
  - b) However, the IRS has argued that the term “wages” may be applied differently in each context. See, e.g., CSX Corp. v. United States, 518 F.3d 1328 (Fed. Cir. 2008).
  - c) In addition, Code § 3121 (the “anti-Rowan” amendment) expressly states that exclusions from wages provided under the FITW regulations do not necessarily apply with respect to FICA.



# SOCIAL SECURITY AND MEDICARE WAGES.

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## B. EXCEPTIONS TO THE GENERAL RULES.

### 1. Numerous specific differences between FICA, FUTA and FITW wages. For example:

- a) Certain supplemental unemployment benefits (“SUB” pay) are excluded from FICA and FUTA wages, but not FITW wages. See Code § 3401(o)(2)(A).
  - (1) According to IRS, FICA and FUTA exception applies only if employee (i) is involuntarily separated from service due to a plant closing, layoff, or reduction in force, and (ii) meets the requirements to receive state unemployment benefits. See Rev. Rul. 90-72, 1990-2 C.B. 211.
  - (2) CSX Corp. v. United States, 52 Fed. Cl. 208 (Fed. Cl. 2002), recognized a much broader exemption from wages, but the decision was reversed on appeal. See CSX Corp. v. United States, 518 F.3d 1328 (Fed. Cir. 2008).
- b) An employee of a sect that is religiously opposed to the receipt of insurance benefits can elect, along with the organization, for exemption from FICA. See Code § 3127.
  - (1) Employee must waive all social security benefits.
  - (2) Sect generally must have existed since 1950.
  - (3) Either employer or employee must file Form 4029, “Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits.”
  - (4) No excuse from FITW or requirement to provide an SSN. Cf. Section 12 of the EEOC Compliance Manual on “Religious Discrimination” (July 22, 2008) (“It will typically pose an undue hardship for an employer to accommodate an applicant or employee’s asserted religious belief against providing or using a social security number.”).

# SOCIAL SECURITY AND MEDICARE WAGES.

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## 1. Numerous specific differences between FICA, FUTA and FITW wages. (Continued)

- a) Service performed for a school, college or university by a student who is enrolled and regularly attending classes at the school, college, or university is exempt. See Code § 3121(b)(10).
  - (1) IR-2010-025 (March 2, 2010) announced that the IRS had “made an administrative determination to accept the position that medical residents are excepted from FICA taxes based on the student exception for tax periods ending before April 1, 2005, when new IRS regulations went into effect.”
  - (2) Mayo Found. for Medical Educ. and Research v. United States, (U.S. 2011), held that the Treasury Department acted reasonably in promulgating a rule that says medical residents do not qualify for the student exception in Code § 3121(b)(10).
- b) Military differential pay is subject to FITW, but is excluded from FICA and FUTA wages if the active military service will extend for more than 30 days. See Code § 3401(h); Rev. Rul. 2009-11, 2009-18 I.R.B. 896.

# SOCIAL SECURITY AND MEDICARE WAGES.

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## B. EXCEPTIONS TO THE GENERAL RULES. (CONTINUED)

2. **FICA and FITW taxes on tips are reported in the same general manner as non-tip wages. However:**
  - a) An employer is only required to report and withhold FICA and income taxes on tips that are reported to the employer. See Code §§ 3121(q) & 3402(k).
  - b) The employer is not liable for its portion of the FICA taxes on tips an employee failed to report to the employer until notice and demand for the taxes is made to the employer by the IRS. See Code §§3121(q).
  - c) Certain large food and beverage establishments generally must allocate – for information reporting purposes only – a portion of their gross receipts among tipped employees if the total tips reported by all employees is less than 8% of gross receipts from food and beverage sales. See Code § 6053(c)(3).
3. **For purposes of FICA/FUTA, “remuneration” that exceeds the applicable “wage base.”**
  - a) FICA/OASDI: \$106,800 for 2009-2011 (no limit for Medicare portion of FICA).
  - b) FUTA: \$7,000.
4. **Code § 3121(v)(2) subjects nonqualified deferred compensation to FICA and FUTA taxes on the later of:**
  - a) When the underlying services are performed; and
  - b) The date the “deferred compensation” is no longer subject to “substantial risk of forfeiture.”

**RESULT:** FICA tax may be due and owing on “deferred compensation” at a time when the employee is still working.

# Adjustments

## Sick pay – Employer

- Employee share of social security and Medicare Tax
  - Include in wages on lines 5a and 5c
  - Withheld and deposited by third-party payer
- Third-party payer
  - Amount of employer taxes to be paid by employer
- Tips
  - Uncollected employee share of OASDI & HI tips
- Group term life insurance
  - Uncollected employee share of OASDI & HI pm GTL premiums paid for former employees

## **OTHER FORMS IN THE 94X SERIES AND RELATED FORMS.**

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- A. FORM 940 – EMPLOYER’S ANNUAL FEDERAL EMPLOYMENT TAX (FUTA) RETURN.**
- B. FORM 943 – EMPLOYER’S ANNUAL FEDERAL TAX RETURN FOR AGRICULTURAL EMPLOYEES.**
- C. FORM 944 – ANNUAL FEDERAL TAX RETURN (FOR CERTAIN SMALL EMPLOYERS).**
- D. FORM 945 – RETURN OF WITHHELD FEDERAL INCOME TAX.**
- E. FORM 1042 – NON-WAGE AND EXEMPT WAGE PAYMENTS TO NONRESIDENT ALIENS.**
- F. FORM CT-1 – ANNUAL RAILROAD RETIREMENT TAX RETURN.**
- G. FORM 1040, SCHEDULE H – RETURN FOR HOUSEHOLD EMPLOYMENT TAXES.**

Kurt Lawson, Hogan Lovells

**WAGE, BACK-UP AND NON-  
RESIDENT ALIEN  
WITHHOLDING RULES**

# DEPOSIT REQUIREMENTS.

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- A. WHEN DEPOSITS ARE DUE.** See Treas. Reg. § 31.6302-1(b); IRS Publication 15.
- 1. Based on reported amount of employment taxes accumulated during a “lookback period.”**
    - a) 12-month period ending on the preceding June 30th.
    - b) For example, for 2011, lookback period will be July 1, 2009, to June 30, 2010.
  - 2. Semiweekly deposit rule.**
    - a) Applies if the amount of employment taxes accumulated during the “lookback” period is more than \$50,000.
    - b) Generally, employer must deposit by the Wednesday or Friday of the week following the week when wage payments are made—depending on the day of the week that wages are paid.
    - c) “Safe Harbor” from “failure to deposit” penalties if shortfall amount is not more than the greater of \$100 or 2% of the amount of employment taxes to be deposited AND shortfall is remitted by the earlier of:
      - (1) The first Wednesday or Friday (whichever is earlier) after the 15th day of the month following the month in which the deposit was required; OR
      - (2) The due date for the return during the period which the shortfall occurred. See Treas. Reg. § 31.6302-1(f)(3).

# DEPOSIT REQUIREMENTS.

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## A. WHEN DEPOSITS ARE DUE. (CONTINUED)

### 3. Monthly deposit rule.

- a) Applies if the amount of employment taxes accumulated during the “lookback” period is less than \$50,000.
  - (1) IRS will notify employer if and when deposit schedule changes, i.e., \$50,000 threshold has been exceeded.
- b) Generally, employment taxes deposited on or before the 15th day of the month following the month during which the associated wages were paid.
  - (1) For example, employment taxes accumulated on wages paid during May 2011 must be paid by June 15, 2011.
- c) Shortfall “safe harbor” also applies, except that the shortfall must be remitted by the due date for the quarterly return for the period in which the shortfall occurs.



# DEPOSIT REQUIREMENTS.

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## A. WHEN DEPOSITS ARE DUE. (CONTINUED)

### 4. “\$100,000 one-day” exception.

- a) If any employer accumulates \$100,000 of employment taxes on any day during a deposit period, taxes must be deposited by the close of the next banking day. See Treas. Reg. § 31.6302(c).
  - (1) Exception applies even if the employer had already deposited some of the employment taxes accumulated during the period, i.e., there’s no “lookback” rule.
- b) If the employer was a monthly depositor, invocation of the rule will convert it to a semiweekly depositor for the rest of the calendar year and for the next calendar year, too. See Treas. Reg. § 31.6302-1(b)(2)(ii).

### 5. De minimis exceptions.

- a) Less than \$2,500 in total employment taxes per quarter.
- b) Deposit tax by the end of the month following the end of the quarter, or send in the tax with a timely filed Form 941. See Treas. Reg. § 31.6302-1(f)(4).

# DEPOSIT REQUIREMENTS.

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## A. WHEN DEPOSITS ARE DUE. (CONTINUED)

### 6. Separate Deposit Regime for Nonpayroll withholding.

- a) Nonpayroll withholding from Form 1099 (e.g., payments to independent contractors and distributions from tax-qualified plans and IRAs) and W-2G (i.e., gambling winnings) are not aggregated with payroll tax payments for determining applicable deposit schedule.
- b) Lookback period is the second year preceding the calendar year, e.g., 2009 for 2011.

### 7. FUTA taxes.

- a) FUTA tax liability of more than \$500 at the end of a calendar quarter generally must be deposited by the last day of the month following the end of that calendar quarter; e.g., by April 30th for the calendar quarter ending on March 31st. See Treas. Reg. § 31.6302(c)-3(a)(2).
- b) FUTA taxes are deposited separately from other payroll taxes. See Treas. Reg. § 31.6302(c)-3(b)(1).

# DEPOSIT REQUIREMENTS.

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## B. HOW DEPOSITS ARE MADE.

### 1. Employers required to use EFTPS.

- a) All employers required to use Electronic Federal Tax Payment System (“EFTPS”) in 2011 and later years.
  - (1) See T.D. 9507, 75 Fed. Reg. 75897 (Dec. 7, 2010).
  - (2) Notice 2010-87, 2010-52 I.R.B. 908, states that the IRS will not assert deposit penalties for FTDs due in 2011 that are untimely solely because the depositor treated a statewide legal holiday as if it were a legal holiday in the District of Columbia.
    - (a) This is necessary because all FTDs must be deposited electronically beginning in 2011, and therefore the timeliness of deposits will be determined by reference to “business days” rather than “banking days.”
- b) Employer must enroll in the EFTPS.
  - (1) Online: at <https://www.eftps.gov/eftps/>.
  - (2) Mailing: Form 9779, “EFTPS Business Enrollment Form.”
- c) EFTPS Direct ACH Debit transaction.
  - (1) Payment deemed to be made when amount is debited/withdrawn from depositor’s account. See Treas. Reg. § 31.6302-1(h)(7)(i).

# DEPOSIT REQUIREMENTS.

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## B. HOW DEPOSITS ARE MADE. (CONTINUED)

### 1. Employers required to use EFTPS. (Continued)

- d) EFTPS Credit Transaction (through a financial institution and available only to business taxpayers).
  - (1) Payment deemed to be made when the funds are paid into the Treasury's account at the Federal Reserve Bank of New York or invested under Treasury's tax and loan program. See Treas. Reg. § 31.6302-1(h)(7)(ii).
- e) Electronic Tax Application—Same Day Payment (Fedwire).

# DEPOSIT REQUIREMENTS.

---

## B. HOW DEPOSITS ARE MADE. (CONTINUED)

### 2. Employers not required to use EFTPS.

- a) Relevant for 2010 and earlier years.
- b) Deposits of all employment taxes are separately made using Form 8109, “Federal Tax Deposit (FTD)” coupon.
  - (1) 24 coupons with stub receipts in a tax deposit coupon book.
  - (2) Form 941 (payroll tax) and Form 945 (nonpayroll tax) deposits each must include a separate Form 8109 coupon.
- c) Payroll taxes are deposited with a “designated depository” by bank draft or money order made out to that depository. See Code § 6302(c). “Designated depositories” are:
  - (1) Commercial banks
  - (2) Credit unions
  - (3) Trust companies

Federal Reserve Banks are not “designated depositories.”

Payments are deemed to have been made to the Treasury even if the government never receives them because the institution became bankrupt or insolvent. See Rev. Rul. 78-244, 1978-1 C.B. 433.

# RETURN REQUIREMENTS.

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**A. TYPES OF RETURNS.** See generally Circular E, Employer's Tax Guide, IRS Publication 15.

**1. Form 940 – Employer's Annual Federal Employment Tax (FUTA) Return.**

- a) Employer must file if paid wages of at least \$1,500 (\$20,00 if agricultural labor) in a calendar quarter or had one or more employees (20 if agricultural) for part of a day in 20 different weeks (even if not consecutive). See Code §§ 3306(a), (c)(1)(B).
  - (1) However, a tax exempt employer is not required to file Form 940.
- b) If merger or other change in ownership occurs during the year, both predecessor and successor employers must file a Form 940 (if they each meet the above criteria) but successor is permitted a credit.
- c) File by January 31st of the year following the calendar year to which the Form 940 relates (or February 10th if all deposits were timely made).
  - (1) 90-day extension to file (but pay timely) is available. See Treas. Reg. § 31.6081(a)-1(b).
- d) Employer may use Form 940-EZ if, among other things, all unemployment contributions were made to the same state.

# RETURN REQUIREMENTS.

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## **B. FORM 941 – EMPLOYER’S QUARTERLY FEDERAL TAX RETURN.**

- 1. Must be filed by all employers who withhold income tax from wages or who are liable for FICA.**
- 2. If merger or other change in ownership occurs during the year, both predecessor and successor employers must generally file a Form 941 but successor is permitted a credit against OASDI wage base (but not Medicare insurance). Note: New rules may provide relief.**
- 3. Must be filed by the last day of the first month after the end of the calendar quarter (e.g., the Form 941 for the quarter the ends June 30th is due by July 31st).**
  - a) Extension until the 10th day of the second month after the close of the calendar quarter if deposits are made of the taxes due. See Treas. Reg. § 31.6071(a)-1.**
- 4. Form 941 may be filed electronically using an approved third-party transmitter (or, by telephone, for “zero-wage” employers with no withholding, tax deposits, or taxes to report).**

# RETURN REQUIREMENTS.

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## C. FORM 943 – EMPLOYER’S ANNUAL FEDERAL TAX RETURN FOR AGRICULTURAL EMPLOYEES.

1. Used to report FICA (employer and employee share) and FITW for “agricultural” employees beginning for the first year that an employer pays \$2,500 for farm work in a year or \$150 to one farm worker. See Circular A, IRS Publication. 51, Agricultural Employer’s Tax Guide, for definition of “farm work”.
  - a) Also used to report wages of household workers in a private residence on a for-profit farm.
2. Must be filed by January 31st of the year following the year for which the return is made (or by February 10th if timely deposits made of taxes due for the year).

## D. FORM 944 – ANNUAL FEDERAL TAX RETURN (FOR CERTAIN SMALL EMPLOYERS).

1. If annual employment tax liability is less than \$1,000, a small employer must file annual Form 944 (rather than quarterly Form 941) once notified by the IRS. See T.D. 9440 (Dec. 29, 2008).
2. However, Rev. Proc. 2009-51, 2009-45 I.R.B. 625, contains procedures for employers that are eligible to file annual federal employment tax returns in 2010 and later years to request to file quarterly returns on Form 941 instead (i.e., opt out) for any reason, and for employers that previously made such an election to elect to file annual returns instead (i.e., opt in).



# RETURN REQUIREMENTS.

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## E. FORM 945 – RETURN OF WITHHELD FEDERAL INCOME TAX.

1. Used to report nonpayroll tax withholdings (e.g., distributions from IRAs and tax-qualified plans, military retirement pay, backup withholdings, gambling winnings), generally reported on Form 1099 or W2-G.
2. Must be filed by January 31st of the year after the year to which the Form 945 relates (or February 10th if timely deposits have been made).

IMPORTANT: Once a taxpayer has filed a Form 945 for one year, it must continue to do so in succeeding years (even if the amount reported is zero).

## F. FORM CT-1 – ANNUAL RAILROAD RETIREMENT TAX RETURN.

1. Railroad Retirement System established in 1937 (and amended by the Railroad Retirement Act of 1974) as separate from the Social Security System to provide monthly benefits to retired, disabled, and deceased railroad workers and to their dependents and beneficiaries under social insurance principles.
  - a) System is overseen by the United States Railroad Retirement Board (RRB).
2. Must be filed by each railroad system unit and local lodge with the IRS Service Center in Cincinnati, Ohio.
3. Form reports on the amount of Medicare tax paid. Deposits are made using Form 8109 or the EFTPS.
  - a) IRS and RRB act to coordinate their efforts.
4. See Code § 3231(e) for the RRTA definition of “compensation,” which generally tracks “wages” under Code § 3121(a). Cf. ILM 200919030 (Jan. 30, 2009) (value of stock and stock options are subject to tax under the RRTA).

# RETURN REQUIREMENTS.

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## **G. FORM 1040, SCHEDULE H – RETURN FOR HOUSEHOLD EMPLOYMENT TAXES.**

- 1. Must be filed for the employer and employee share of social security tax if the employer paid a household employee more than \$1,700 (in 2009) (amount is adjusted each year for inflation).**
  - a) Under Code § 3401(a)(3), remuneration for “domestic service” provided in a “private home, local college club, or local chapter of a college fraternity or sorority” is not “wages” subject to FITW.
  - b) However, a “domestic” employee may elect to have FITW.
- 2. Must be filed by April 15th of the year following the year to which the return relates as part of the employer’s own Form 1040.**
- 3. Payments are made with the Form 1040.**

# ELECTRONIC FILING.

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- A. IRS'S EMPLOYMENT TAX E-FILE SYSTEM ENABLES REGISTERED EMPLOYERS TO FILE ELECTRONICALLY FORMS 940, 941, AND 944 (AMONG OTHERS), IN A SINGLE TRANSMISSION FILE.**
- B. TO PARTICIPATE, EMPLOYER MUST COMPLETE AN IRS E-FILE APPLICATION AND REGISTER FOR E-SERVICES. See IRS Publication 3112.**
  - 1. Business filers are issued a 10-digit PIN with which to sign their returns.
  - 2. Applicants must comply with the Assurance Testing (December 2010 for this year) and Production Filing (January 2011 for this year) deadlines.
  - 3. See the IRS's e-file Resource Page at <http://www.irs.gov/efile/article/0,,id=105629,00.html>.

Patrick Haggerty, Patrick A. Haggerty, EA

# **CORRECTING ERRORS ON PRIOR RETURNS**

# Form 941-X

Used to correct previously filed Forms 941

- File a separate Form 941-X for each quarter being corrected
- File separately from Form 941
- If Form 941 was not filed for the quarter being corrected, then file Form 941 and not Form 941-X.
- Use Form 843 to file a claim for refund or abatement of penalty or interest; do not use Form 941-X.

# Form 941-X (Cont.)

- Multiple corrections for the same prior quarter can be made on the same Form 941-X.
- 
- Over- and under-reported amounts
    - May be reported on the same Form 941-X
    - An adjustment is required if under-reported amounts
    - Employer may file two forms for the same quarter.

# Form 941-X (Cont.)

- Over-reported amounts
  - May claim a refund of over-reported amounts
  - May not claim refund if under-reported amounts were reported on same Form 941-X
  - May file two separate forms – one claiming refund for over-reported amounts and one making an adjustment for under-reported amounts

Form **941-X: Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund**  
 (Rev. January 2011) Department of the Treasury — Internal Revenue Service

OMB No. 1545-0029

(EIN)  
 Employer identification number   -

Name (not your trade name)

Trade name (if any)

Address   
Number Street Suite or room number

City State ZIP code

Read the instructions before completing this form. Use this form to correct errors you made on Form 941 or 941-SS. Use a separate Form 941-X for each quarter that needs correction. Type or print within the boxes. You MUST complete all three pages. Do not attach this form to Form 941 or 941-SS.

**Part 1: Select ONLY one process.**

- 1. **Adjusted employment tax return.** Check this box if you underreported amounts. Also check this box if you overreported amounts and you would like to use the adjustment process to correct the errors. You must check this box if you are correcting both underreported and overreported amounts on this form. The amount shown on line 21, if less than zero, may only be applied as a credit to your Form 941, Form 941-SS, Form 944, or Form 944-SS for the tax period in which you are filing this form.
- 2. **Claim.** Check this box if you overreported amounts only and you would like to use the claim process to ask for a refund or abatement of the amount shown on line 21. Do not check this box if you are correcting ANY underreported amounts on this form.

**Part 2: Complete the certifications.**

- 3. I certify that I have filed or will file Forms W-2, Wage and Tax Statement, or Forms W-2c, Corrected Wage and Tax Statement, as required.

Note. If you are correcting underreported amounts only, go to Part 3 on page 2 and skip lines 4 and 5.

**Return You Are Correcting ...**

Check the type of return you are correcting:

- 941
- 941-SS

Check the ONE quarter you are correcting:

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

Enter the calendar year of the quarter you are correcting:

(YYYY)

**Enter the date you discovered errors:**

/  /   
 (MM / DD / YYYY)



**Part 2: Complete the certifications.**

3. I certify that I have filed or will file Forms W-2, Wage and Tax Statement, or Forms W-2c, Corrected Wage and Tax Statement, as required.


*Note.* If you are correcting underreported amounts only, go to Part 3 on page 2 and skip lines 4 and 5.

4. If you checked line 1 because you are adjusting overreported amounts, check all that apply. You must check at least one box. I certify that:

- a. I repaid or reimbursed each affected employee for the overcollected federal income tax for the current year and the overcollected social security and Medicare taxes for current and prior years. For adjustments of employee social security and Medicare taxes overcollected in prior years, I have a written statement from each employee stating that he or she has not claimed (or the claim was rejected) and will not claim a refund or credit for the overcollection.
- b. The adjustments of social security tax and Medicare tax are for the employer's share only. I could not find the affected employees or each employee did not give me a written statement that he or she has not claimed (or the claim was rejected) and will not claim a refund or credit for the overcollection.
- c. The adjustment is for federal income tax, social security tax, and Medicare tax that I did not withhold from employee wages.

5. If you checked line 2 because you are claiming a refund or abatement of overreported employment taxes, check all that apply. You must check at least one box. I certify that:

- a. I repaid or reimbursed each affected employee for the overcollected social security and Medicare tax. For claims of employee social security and Medicare tax overcollected in prior years, I have a written statement from each employee stating that he or she has not claimed (or the claim was rejected) and will not claim a refund or credit for the overcollection.
- b. I have a written consent from each affected employee stating that I may file this claim for the employee's share of social security and Medicare tax. For refunds of employee social security and Medicare tax overcollected in prior years, I also have a written statement from each employee stating that he or she has not claimed (or the claim was rejected) and will not claim a refund or credit for the overcollection.
- c. The claim for social security tax and Medicare taxes is for the employer's share only. I could not find the affected employees; or each employee did not give me a written consent to file a claim for the employee's share of social security and Medicare taxes; or each employee did not give me a written statement that he or she has not claimed (or the claim was rejected) and will not claim a refund or credit for the overcollection.
- d. The claim is for federal income tax, social security tax, and Medicare tax that I did not withhold from employee wages.

Next 

For Paperwork Reduction Act Notice, see the instructions.

Cat. No. 17025J

Form 941-X (Rev. 1-2011)

Name (not your trade name)	Employer identification number (EIN)	Correcting quarter (1, 2, 3, 4)
		Correcting calendar year (YYYY)

**Part 3: Enter the corrections for this quarter. If any line does not apply, leave it blank.**

	Column 1 Total corrected amount (for ALL employees)	Column 2 Amount originally reported or as previously corrected (for ALL employees)	Column 3 Difference (If this amount is a negative number, use a minus sign.)	Column 4 Tax correction
6. Wages, tips and other compensation (from line 2 of Form 941)	<input type="text"/>	<input type="text"/>	<input type="text"/>	Use the amount in Column 1 when you prepare your Forms W-2 or Forms W-2c.
7. Income tax withheld from wages, tips, and other compensation (from line 3 of Form 941)	<input type="text"/>	<input type="text"/>	<input type="text"/>	Copy Column 3 here ▶ <input type="text"/>
8. Taxable social security wages (from line 5a, Column 1 of Form 941 or Form 941-SS)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/> × .124* = <input type="text"/>
9. Taxable social security tips (from line 5b, Column 1 of Form 941 or Form 941-SS)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/> × .124* = <input type="text"/>
10. Taxable Medicare wages and tips (from line 5c, Column 1 of Form 941 or Form 941-SS)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/> × .029* = <input type="text"/>
11. Section 3121(q) Notice and Demand – Tax due on unreported tips (from line 5e of Form 941 or Form 941-SS)	<input type="text"/>	<input type="text"/>	<input type="text"/>	Copy Column 3 here ▶ <input type="text"/>
12a. Number of qualified employees first paid exempt wages/tips this quarter (from line 6a of Form 941 or Form 941-SS)*	<input type="text"/>	<input type="text"/>	<input type="text"/>	*Complete lines 12a, 12b, and 12c only for corrections to quarters ending after March 31, 2010, and before January 1, 2011.
12b. Number of qualified employees paid exempt wages/tips this quarter (from line 6b of Form 941 or Form 941-SS)*	<input type="text"/>	<input type="text"/>	<input type="text"/>	
12c. Exempt wages/tips paid to qualified employees this quarter (from line 6c of Form 941 or Form 941-SS)*	<input type="text"/>	<input type="text"/>	<input type="text"/>	
13. Tax adjustments (from lines 7–9 (lines 7a–7c for quarters ending before January 1, 2011) of Form 941 or Form 941-SS)	<input type="text"/>	<input type="text"/>	<input type="text"/>	Copy Column 3 here ▶ <input type="text"/>

(c) Patrick A. Haggerty, 2011

941 or Form 941-SS)*						Only for corrections to quarters ending after March 31, 2010, and before January 1, 2011.	
12b.	Number of qualified employees paid exempt wages/tips this quarter (from line 6b of Form 941 or Form 941-SS)*	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	
12c.	Exempt wages/tips paid to qualified employees this quarter (from line 0c of Form 941 or Form 941-SS)*	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	x .062 = <input type="text"/>
13.	Tax adjustments (from lines 7-9 (lines 7a-7c for quarters ending before January 1, 2011) of Form 941 or Form 941-SS)	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	Copy Column 3 here ▶ <input type="text"/>
14.	Special addition to wages for federal income tax	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	See instructions <input type="text"/>
15.	Special addition to wages for social security taxes	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	See instructions <input type="text"/>
16.	Special addition to wages for Medicare taxes	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	See instructions <input type="text"/>
17.	Combine the amounts on lines 7-16 of Column 4						<input type="text"/>
18.	Advance earned income credit (EIC) payments made to employees (from line 9 of Form 941; only for quarters ending before January 1, 2011)	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	See instructions <input type="text"/>
19a.	COBRA premium assistance payments (from line 12a of Form 941 or Form 941-SS)	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	See instructions <input type="text"/>
19b.	Number of individuals provided COBRA premium assistance (from line 12b of Form 941 or Form 941-SS)	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	
19c.	Number of qualified employees paid exempt wages/tips March 19-31, 2010 (from line 12c of Form 941 or Form 941-SS)*	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	*Complete lines 19c and 19d only for corrections to the second quarter of 2010.
19d.	Exempt wages/tips paid to qualified employees March 19-31, 2010 (from line 12d of Form 941 or Form 941-SS)*	<input type="text"/>	-	<input type="text"/>	=	<input type="text"/>	x .062 = <input type="text"/>
20.	Total. Combine the amounts on lines 17-19d of Column 4. Continue on next page						<input type="text"/>

Next ▶



**Part 5: Sign here. You must complete all three pages of this form and sign it.**

Under penalties of perjury, I declare that I have filed an original Form 941 or Form 941-SS and that I have examined this adjusted return or claim, including accompanying schedules and statements, and to the best of my knowledge and belief, they are 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

Print your name here

Print your title here

Date

Best daytime phone

**Paid Preparer Use Only**

Check if you are self-employed . . .

Preparer's name

PTIN

Preparer's signature

Date

Firm's name (or yours if self-employed)

EIN

Address

Phone

City

State

ZIP code

# Withholding Errors

## Over-withheld income tax

- Do not adjust prior year over-withholding
  - Included on employee's tax return
  - Only "administrative errors" may be adjusted.
    - Reported amount differed from actual amount
  - Do not refund prior-year income tax
- Correct over-reported income tax by later of:
  - Three years from date Form 941 filed (April 15)
  - Two years from date tax was paid

# Withholding Errors (Cont.)

## Under-withheld income tax

- Adjust on Form 941-X
  - By Form 941 due date for quarter error discovered
  - Interest-free adjustment
- Could withhold more from current pay, BUT
  - Does not cure underpayment for prior quarter
- Do not adjust prior year under-withholding
  - Included on employee's tax return
  - Employee may have a penalty due to employer error.

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# Withholding Errors (Cont.)

## Incorrect FICA

- Use Form 941-X
  - Either current or prior year
  - Amend Form 941 for quarter error occurred
  - SSA: Report wages in quarter earned
    - For benefits purposes
- Date error is considered discovered
  - Date employer has enough information to correct the error
- Obtain employee certifications for overpayment



# Withholding Errors (Cont.)

## Under-withheld income or FICA tax

- The employer is responsible for withholding, collecting and depositing the correct amount of tax.
- Failure to withhold the correct amount does not excuse the employer from the obligation to pay the correct amount.
- If the employer did not properly withhold, and the employee did not pay the tax, the IRS will look to the employer.
  - It is up to the employer to settle with the employee.

# Underpayments

- Employee is not paid on payday
  - New hire
  - Time card errors
  - Miscalculated overtime
  - Raises not communicated
- Timely payment
  - Under most state wage and hour laws, timely payment is an issue.

# Underpayments (Cont.)

- Reporting
  - Form 941, Schedule B
  - Show the tax liability on the day the employee was actually paid - not the next payday
- Aggregate with appropriate regular pay to avoid supplemental pay issues
  - Unless it is supplemental pay
- Payment is included in the W-2 for the year the wages are paid.

# Overpayments

- It is best if this is caught and recovered in the year the overpayment was made.
- 
- Repayments must be in “gross” pay.
    - Tax adjustments
    - Other items; e.g., 401(k) deduction
  - Within same calendar year
    - Adjust YTD wages and taxes for repayments
    - Use Form 941-X for repayment in a subsequent quarter of prior quarter overpayment

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# Overpayments (Cont.)

For subsequent year repayments:

- Do not adjust subsequent year wages and taxes
  - No effect on subsequent year W-2.
- Refund excess FICA to employee
  - File claim with IRS
    - Form W2-c and Form 941-X required
    - Installment repayment: Multiple Forms 941-X
- Employee takes a credit or a deduction on the current year form 1040 for repayment.
  - No adjustment to prior year income tax wages

# Overpayments (Cont.)

Partial repayment in year of overpayment

	Year 1			Where's the money?
	Over Payment	Repaid	Not Repaid	
Gross Pay	1200			
FIT W/H	148	118	30	Ee IRS Account
FICA W/H	92	74	18	Ee SSA Account
Net Pay	960	768	192	Refund to Ee
Repayment		960	240	

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# Overpayments (Cont.)

Full repayment in year of overpayment

	Year 1			Where's the money?
	Over Payment	Repaid	Not Repaid	
Gross Pay	1200			
FIT W/H	148	148	0	Ee IRS Account
FICA W/H	92	92	0	Ee SSA Account
Net Pay	960	960	240	Refund to Ee
Repayment		1200	240	

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# Overpayments (Cont.)

Partial repayment in subsequent year

	Year 1	Year 2		Where's the money?
	Over Payment	Repaid	Not Repaid	
Gross Pay	1200			
FIT W/H	148		148	Ee Form 1040
FICA W/H	92	74	18	Ee SSA Account
Net Pay	960	886	74	Refund to Ee
Repayment		960	240	

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# Overpayments (Cont.)

Full repayment in subsequent year

	Year 1	Year 2		Where's the money?
	Over Payment	Repaid	Not Repaid	
Gross Pay	1200			
FIT W/H	148		148	Ee Form 1040
FICA W/H	92	92	0	Ee SSA Account
Net Pay	960	1108	92	Refund to Ee
Repayment		1200	240	

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# Misclassified Employees

- Non-exempt salaried employee as exempt
  - Can result in back overtime pay
  - Some courts have allowed fluctuating work week method to compute damages.
  - Some courts do not allow it.
  - DOL Opinion Letter FLSA 2009-3
- Employee as non-employee
  - Generally a tax problem with safe harbors
  - Sect. 3509 rates may provide some relief.
    - Report on Form 941-X
  - If Sect. 3509 does not apply, then file Form 941 for each delinquent quarter.
    - Attach a Form 941-X showing dates and explanations

# Adjustments: Back Pay Awards

- IRS Publication 957
- May cover prior/multiple years
- For income tax
  - Include in W-2 in year paid
- For FICA – non-statutory back pay
  - Delayed wage payments
  - Retro pay increases
    - Union negotiation
  - Payments under local ordinances or regulations
  - Report on W-2 for year paid

# Adjustments: Back Pay Awards (Cont.)

- For FICA – statutory back pay
  - Award, determination or agreement approved or sanctioned by a court or government agency responsible for enforcing a federal or state statute that protects an employee’s right to employment or wages
- SSA credits back pay awarded under a statute to an individual’s earnings record in the period(s) the wages should or would have been paid.
- FICA wages and taxes reported in year paid on W-2
- May affect benefits

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# Adjustments: Back Pay Awards (Cont.)

- For FICA – statutory back pay
- Examples of statutes
  - Age Discrimination in Employment Act
  - Americans with Disabilities Act
  - Equal Pay Act
  - Fair Labor Standards Act
  - National Labor Relations Act
  - State minimum wage laws
  - State statutes that protect rights to employment and wages
- Excludes amounts designated as damages, penalties, etc.

# Adjustments: Special Wage Payments

- Wages paid in a year subsequent to the year earned
- Examples per SSA
  - Amounts paid after retirement
    - Prior-year accrued vacation or sick leave
  - Amounts paid on account of retirement
    - Deferred compensation
    - Severance pay
  - Bonuses paid per a prior agreement or contract

# Adjustments: Special Wage Payments (Cont.)

- See Publication 957
- Reported on Form SSA-131
- For W-2 – wages and taxes are reported in year paid
- Payment may otherwise affect current year benefits
  - Maximum earnings

# Adjustments: Deceased Employee

- Paid or constructively received prior to death
  - Report on W-2 for all tax and withholding purposes

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- Paid after date of death in same calendar year
  - Report FICA wages and taxes on W-2
  - Report income tax wages on Form 1099-MISC
    - Box 3 – Other Income
  - No income tax withholding
  - Use payee's (estate, beneficiary, personal rep) TIN



Elizabeth Dold, Groom Law Group

**POTENTIAL INTEREST,  
PENALTIES FOR NON-  
COMPLIANCE, LATE FILINGS**



## Employer Liable For Employment Taxes It Fails To Withhold

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- **FICA liability (Form 941)**: The employer is liable for both the employee share and employer share of FICA (7.65% for each share up to the taxable FICA wage base for the year; \$106,800 for 2009), or 1.45% each in excess of the FICA wage base (if not already reached for the year). Code §§3102, 3111.
- **Federal income tax withholding liability (Form 941)**: In general, the employer is liable for the federal income tax that should have been deducted and withheld. Code §3403. However, if the employee pays the tax, then the employer is not required to pay; see Form 4669. Code §3402(d).
- **FUTA liability (Form 940)**: The employer is liable for FUTA tax up to the maximum wages for the year. Code §3301.



# Interest On Underpayment Of Taxes

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- **Interest on the underpayment**: Interest is generally imposed on the underpayment of FICA, FUTA and income tax withholding. Code §§ 6601(a), 6205(b); Treas. Reg. §31.6205-1



# Penalties For Failure To Correctly Report Or Late Filing

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- **Failure to report and pay tax Form 940 and 941**
  - A penalty of 0.5% of the tax due per month (maximum 25%) is imposed for failure to pay tax.
  - A penalty of 5% of the tax due per month (maximum 25%) is imposed for failure to file a Form 941/940.
  - Reasonable cause exception may be available.
  - Special offset rules apply if both penalties apply. Code § 651
- **Failure to deposit taxes (employer share of FICA, FUTA)**: Generally 10% of the underpayment, subject to reasonable cause exception Code §6656



## Penalties For Failure To Correctly Report Or Late Filing (Cont.)

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- **Failure to file Form W-2**: \$100 per return (maximum \$1.5M per year), subject to reasonable cause exception; 10% of the aggregate amount of the items required to be reported correctly if intentional disregard of filing requirements, with no maximum. Code §6721
- **Failure to furnish Form W-2 to Employee**: \$100/per return (maximum \$1.5M per year), subject to reasonable cause exception; 10% of the aggregate amount of the items required to be reported correctly if intentional disregard of filing requirements, with no maximum. Code §6722



## Penalties For Failure To Correctly Report Or Late Filing (Cont.)

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- **Willful failure to withhold**: Willfully (i.e., voluntary, consciously and intentionally) fails to collect and pay over the tax; liable for 100% of the underpayment (income tax withholding, FICA, FUTA). Code §6672
- **Accuracy-related penalty**: Failure to properly report on Forms W-2, 940 or 941 the underpayment of tax due to negligence or disregard of rules or regulations results in a penalty of 20% of the tax underpaid. Code § 6662(b)(1) This penalty is not combined with the failure to file penalty. Code § 6662 Alternatively, if the understatement results in a substantial understatement (i.e., exceeds the lesser of: (a) 10% of correct tax (or, if greater, \$10,000) or (b) \$10 million), then the 20% penalty will apply (but not both the negligence penalty and this penalty). Code §6662(d)



## Penalties For Failure To Correctly Report Or Late Filing (Cont.)

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- **Civil and criminal fraud penalties**: The IRS may also impose civil and/or criminal fraud penalties. Code §§6663, 6674, 7201, 7202, 7203, 7204, 7207 For example, willful failure to collect any tax is a felony and, upon conviction, the person may be fined not more than \$100,000, or imprisoned not more than five years, or both, together with the costs of prosecution. Code §7202

Elizabeth Dold, Groom Law Group

# **PREPARING FOR IRS EMPLOYMENT TAX AUDITS**





# National Research Project

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- 6,000 audits over three-year period
- Examinations began in February 2010, based on random selection.
- Objective: To obtain trend information by category
  - Worker classification
  - Fringe benefits
  - Information reporting (1099 and W-2)
  - Officers' compensation



# Worker Classification

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- Form W-2 or 1099-MISC?
- Common law employee: 20-factor test set forth in Revenue Ruling 87-41 (and more recently described on Form SS-8); otherwise, independent contractor status on Form 1099-MISC
- If worker is reclassified to common law employee, there is potential exposure.
  - Liable for employment taxes, interest and penalties (see above)
  - Risk eligible for welfare and fringe benefits
  - Risk eligible for pension benefits
    - Improper exclusion of eligible employee; operational failure raises tax qualification issues – EPCRS (Revenue Procedure 2008-50)
    - Add “Microsoft” language to expressly exclude reclassified workers



## Worker Classification (Cont.)

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- **Possible relief for employment taxes**
  - **Sect. 530 relief**
    - Reporting consistency: Filed appropriate returns based on intended classification (e.g., 1099 MISC)
    - Substantive consistency: Consistently treated similarly situated workers as independent contractors
    - Reasonable basis: Have reasonable basis for not treating as employee (e.g., judicial precedent, published ruling, private ruling issued to taxpayer, results of past IRS audit or longstanding recognized industry practice)



## Worker Classification (Cont.)

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- **Sect. 3509 relief**
  - Reduces liability for failing with withhold employment and income taxes due to misclassification, *provided employer did not intentionally disregard*
  - If employer issued 1099, income tax withholding liability for income taxes is limited to 1.5% of wages, and liability for *employee's* share of FICA limited to 20% of amount otherwise due (1.45% for Medicare and 6.20% for Social Security, i.e., 1.53% of payment).
  - Above rates are doubled if no 1099 was issued.
  - 3509 provides no relief for employer's share of FICA.



## Worker Classification (Cont.)

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- **IRS classification settlement program (available on audit)**: Series of graduated settlement offers is available if full 530 relief is not available
  - If a taxpayer meets the reporting consistency requirement under Sect. 530, but clearly does not meet the substantive consistency requirement or reasonable basis requirements, then the offer will be a full employment tax assessment for the most recent taxable year under examination.
  - If a taxpayer meets the reporting consistency requirement, and has a colorable argument that it meets the substantive consistency and reasonable basis requirements, then the offer will be an assessment of 25% of the employment tax liability for the most recent year under examination.

I.R.M. 4.23.6.13.1 (04-21-1999)



## Worker Classification (Cont.)

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- **Voluntary worker classification settlement program** (Ann. 2011-64)
  - Form 8952 – Closing Agreement
  - Eligibility: (1) consistently treated workers as non-employees, (2) filed 1099-MISC for previous three years, (3) not under audit, and (4) agree to extend statute of limitation for three years
  - Payment: 10% employment tax liability for most recent year, using 3509 rates



# Employer-Provided Cell Phones

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- Recent guidance issued this month – Notice 2011-72 and field exam memorandum
  - No tracking or imputing income for personal use of employer-provided cell phones, provided that they are intended to be used primarily for business purposes
  - Imputed income limited to compensatory purposes only
  - Effective Dec. 31, 2009



# IRS Resources

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- [http://www.irs.gov/irm/part4/irm\\_04-023-002.html](http://www.irs.gov/irm/part4/irm_04-023-002.html)
- <http://www.irs.gov/businesses/small/article/0,,id=108149,00.html>
- <http://www.irs.gov/businesses/corporations/article/0,,id=135045,00.html>
- <http://www.irs.gov/businesses/corporations/article/0,,id=134943,00.html>