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# 1995

## Publication 1407-A 1995 Publication 15 (Circular E) Advance Proof Copy

This advance proof is subject to change.

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Attached is an advance proof copy of the 1995 **Publication 15 (Circular E)**, Employer's Tax Guide. The 1995 withholding tables are not included.

We have started a 2-year project to provide separate employment tax publications covering general and specialized employment tax situations. Our goal is to develop a "core" Circular E and a "supplemental" employment tax publication. The core Circular E, designed to meet the needs of the small business employer, will provide basic employment tax information needed by all employers, including the withholding tables. The supplemental employment tax publication will include detailed information that applies to larger employers, including information currently found in other separate publications.

For 1995, we removed material from Circular E that most employers don't need. The amount of detail on some topics was reduced, while other topics were eliminated entirely. For example, the discussion on fringe benefits was reduced to the basic material needed by most employers, while the information on golden parachute/excessive termination payments was eliminated. For 1995 only, the material eliminated from Circular E will appear in other publications, primarily **Publication 937**, Employment Taxes. For 1996, we plan to combine appropriate portions of the material removed from the "core" Circular E with Publication 937 and related information from other publications to produce the supplemental publication for larger employers.

By removing the information, we were able to change the format, expand the table of contents, and increase the size of the print in Circular E to make it easier to read and use. We also were able to add sections to provide clarifying information, such as—

- A section with a comprehensive example on how to withhold, deposit, and report employment taxes, including the completion of Forms 941 and 940.
- A section on how to report current and prior period adjustments on Form 941, including examples.

The following list summarizes the material removed from the 1995 Circular E. The major changes or additions are circled in the attached proof copy.

### Material Removed

- Part of the **Who Are Employees?** section concerning the employee vs. contractor issue. Detailed discussion in Pub. 937.
- The Golden Parachute discussion in the **Taxable Wages** section. Detailed discussion in Pub. 937.
- The Social Security Totalization Agreements discussion in the **Taxable Wages** section. Detailed discussion in Pub. 937.



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- **Chapter II**, Nonpayroll Income Tax Withholding (pages 21-22 of 1994 Circular E). Detailed information given in the **Instructions for Forms 1099, 1098, 5498, and W-2G**, and the instructions for **Form 945**, Annual Return of Withheld Federal Income Tax.

- **Chapter III**, Information Returns (pages 22-24 of 1994 Circular E). Detailed information given in the instructions for Forms 1099 and W-2.

- **Social Security and Medicare Tax Tables** (pages 51-53 of 1994 Circular E).

- **Federal Tax Deposit (FTD) Checklist** (pages 60-61 of 1994 Circular E).

If you have comments about our effort to provide general and specialized employment tax publications or our changes to the 1995 Circular E, please let us know by September 15, 1994. Write to: Tax Forms Committee, Early Release, Internal Revenue Service, Room 5577, 1111 Constitution Ave., NW, Washington DC 20224. Although we may be unable to give detailed responses to your comments, we will carefully consider each suggestion.

If you need additional copies of this package, please write to: Internal Revenue Service, P.O. Box 25866, Richmond, VA 23289-5866.

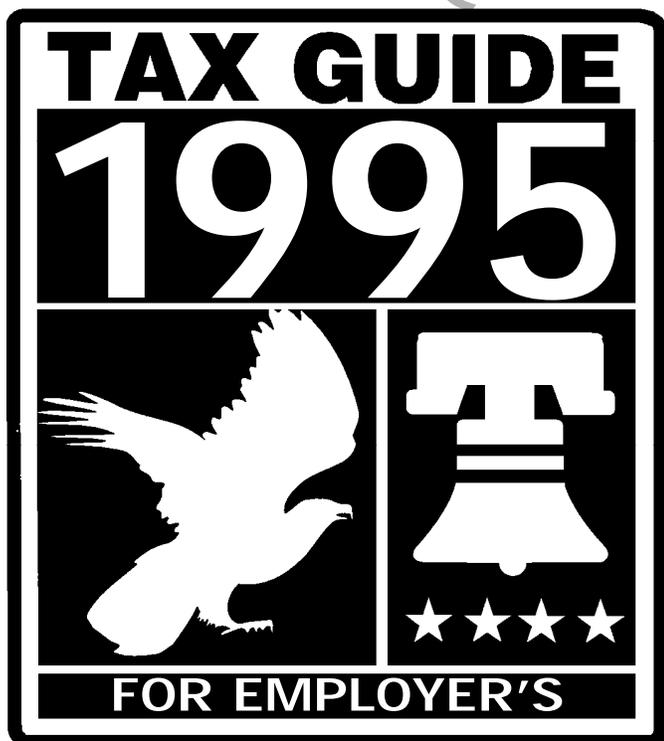


**Publication 15**

Cat. No. 10000W

**Circular E  
Employer's  
Tax Guide**

(Rev January 1995)



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**Important Changes for 1995**

**Employment Tax Rates and Wage Base for 1995**

- Social Security Tax - 6.2% each for employers and employees
- Medicare Tax - 1.45% each for employers and employees
- Federal Unemployment (FUTA) Tax - 6.2% (employers only)
- 1995 Wage Base for Social Security Tax - xx,xxx

**Calendar**

The following is a list of important dates. Also see **Pub. 509**, Tax Calendars for 1995.

**Note:** For any due date, you will meet the "file" or "furnish" requirement if the form is properly addressed, mailed, and post-marked on or before the due date. If any date shown falls on a Saturday, Sunday, or legal holiday, use the next business day.

**By January 31**

Furnish each employee a completed **Form W-2**, Wage and Tax Statement. Furnish each recipient a completed Form 1099 (e.g., **Form 1099-R**, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., and **Form 1099-MISC**, Miscellaneous Income). You may furnish Form W-2 or 1099 by mail as explained in the **Note** above.

**Federal Unemployment (FUTA) Tax.**—File **Form 940** or **Form 940-EZ**, Employer's Annual Federal Unemployment (FUTA) Tax Return. However, if you deposited all the FUTA tax when due, you may file **Form 940** or **940-EZ** by February 10.

**Annual Return of Withheld Federal Income Tax.**—File the new **Form 945**, Annual Return of Withheld Federal Income Tax, to report any nonpayroll income tax withheld during 1994. See the **Nonpayroll Income Tax Withholding** section on this page for more information.

**By February 15**

Ask for a new **Form W-4**, Employee's Withholding Allowance Certificate, from each employee who claimed exemption from withholding last year.

**On February 16**

Begin withholding for each employee who previously claimed exemption from withholding but has not given you a new Form W-4 for the current year. If the employee does not give you a new Form W-4, withhold tax as if he or she is single, with zero withholding allowances. The Form W-4 previously given you claiming exemption is now expired. (See section 9.)

**By February 28**

File Copy A of all Forms 1099 with **Form 1096**, Annual Summary and Transmittal of U.S. Information Returns, with the Internal Revenue Service Center for your locality.

**By the Last Day of February**

File Copy A of all Forms W-2 with **Form W-3**, Transmittal of Wage and Tax Statements, with the Social Security Administration (SSA).

**Allocated Tip Reporting.**—File **Form 8027**, Employer's Annual Information Return of Tip Income and Allocated Tips, with the Internal Revenue Service. (See section 6.)

**By April 30, July 31, October 31, and January 31**

Deposit Federal unemployment tax due if it is more than \$100. File **Form 941**, Employer's Quarterly Federal Tax Return, and pay any undeposited income, social security, and Medicare taxes. If you deposited all taxes when due, you have 10 additional days from the due dates above to file the return.

File **Form 942**, Employer's Quarterly Tax Return for Household Employees, and pay the tax due. (See section 13.)

**Before December 1**

**Income Tax Withholding.**—Ask for a new Form W-4 from each employee whose withholding allowances have changed or will change for the next year.

**On December 31**

**Form W-5**, Earned Income Credit Advance Payment Certificate, expires. Eligible employees who want to receive advance payments of the earned income credit next year must give you a new Form W-5.

## Reminders

### When Hiring New Employees

**Eligibility for Employment.**—You must verify that each new employee is legally eligible to work in the United States. This will include completing the Immigration and Naturalization Service (INS) **Form I-9**, Employment Eligibility Verification Form. The form can be obtained from INS offices. Contact the INS for further information concerning your responsibilities.

**Income Tax Withholding.**—Ask each new employee to complete the 1995 Form W-4.

**Name and Social Security Number.**—Record each new employee's name and number from his or her social security card. Any employee without a social security card should apply for one. (See section 4.)

### When Paying Wages or Annuities

**Income Tax Withholding.**—Withhold tax from each wage payment or supplemental unemployment compensation plan benefit payment according to the employee's Form W-4 and the correct withholding rate. (Employers who have nonresident alien employees, see section 9.) Withhold from periodic pension and annuity payments as if the recipient is married claiming three withholding allowances, unless he or she has filed Form W-4P either electing no withholding or giving a different number of allowances, marital status, or additional amount to be withheld. Do not withhold on direct rollovers from qualified plans. (See sections 5, 9, and 10, and **Pub. 505**, Tax Withholding and Estimated Tax, for more information.)

### Information Returns

You may have to file information returns to report certain types of payments made during the year. For example, you must file **Form 1099-MISC**, Miscellaneous Income, to report payments of \$600 or more to persons not treated as employees (e.g., independent contractors) for services performed for your trade or business. For details about filing Forms 1099 and for information about required magnetic media filing, see the Instructions for Forms 1099, 1098, 5498, and W-2G. Do not use Forms 1099 to report wages and other compensation you paid to employees; report these on Form W-2. See the separate **Instructions for Form W-2** for details. "Other compensation" to be reported on Form W-2 is described in section 5 and the Instructions for Form W-2.

**Social Security and Medicare Taxes.**—Withhold 6.2% from each wage payment in 1995 for social security. Stop when you reach \$xx,xxx in taxable wages. Withhold 1.45% from each wage payment in 1995 for Medicare. (If the employee reported tips, see section 6.)

### Nonpayroll Income Tax Withholding

For payments made after December 31, 1993, income tax withheld on nonpayroll items can no longer be reported on Form 941. Nonpayroll items include the following:

- Pensions, Annuities, and IRAs
- Military Retirement
- Gambling Winnings
- Backup Withholding

This nonpayroll withholding must be reported on the new **Form 945**, Annual Return of Withheld Federal Income Tax. Form 945 is an annual tax return and the return for 1994 will be due January 31, 1995. Separate deposits are required for payroll and nonpayroll (Form 945) withholding beginning January 1, 1994.

All income tax withholding reported on Forms 1099 or W-2G must be reported on Form 945. All income tax withholding reported on Form W-2 must be reported on Form 941. For details on depositing and reporting nonpayroll income tax withholding, see **Instructions for Form 945**.

**Backup Withholding.**—Payers must generally withhold 31% of taxable interest, dividends, and certain other payments if payees fail to furnish payers with their correct taxpayer identification numbers. There are other circumstances when the payer is also required to withhold. This withholding is referred to as backup withholding. Please see **Form W-9**, Request for Taxpayer Identification Number and Certification, and the Instructions for Forms 1099, 1098, 5498, and W-2G for details. Backup withholding does not apply to wages, pensions, or annuities.

### Recordkeeping

Keep all records of employment taxes for at least 4 years. These should be available for IRS review. Records should include:

- Your employer identification number.
- Amounts and dates of all wage, annuity, and pension payments.
- Amounts of tips reported.
- The fair market value of in-kind wages paid.
- Names, addresses, social security numbers, and occupations of employees and recipients.
- Any employee copies of Form W-2 that were returned to you as undeliverable.
- Dates of employment.
- Periods for which employees and recipients were paid while absent due to sickness or injury, and the amount and weekly rate of payments you or third-party payers made to them.
- Copies of employees' and recipients' income tax withholding allowance certificates (Forms W-4, W-4P, and W-4S).
- Dates and amounts of tax deposits you made.
- Copies of returns filed.
- Records of allocated tips.
- Records of fringe benefits provided, including substantiation.

### Change of Address

To notify the IRS that you changed your business mailing address or business location, send **Form 8822**, Change of Address, to the IRS.

### Unresolved Problems

If you have a tax problem you have been unable to resolve with the IRS, write to your local IRS district director or call your local IRS office and ask for Problem Resolution assistance. This office will take responsibility for your problem and ensure that it receives proper attention. Although this office cannot change the tax law or technical decisions, it can frequently clear up problems that resulted from previous contacts.

Hearing-impaired taxpayers with access to TDD equipment may call 1-800-829-4059 for Problem Resolution assistance.

### Additional Forms or Publications

If you need to order forms or publications, including additional copies of this booklet, you may use **Form 7018-A**, Employer's Order Blank for 1995 Forms, at the end of this booklet or you may call 1-800-TAX-FORM (1-800-829-3676).

## General Information

This guide explains your tax responsibilities as an employer. It explains the requirements for withholding, depositing, reporting, and paying taxes. It explains the forms you must give your employees, those your employees must give you, and those you must send to the IRS and SSA. (Detailed filing requirements and instructions for completing the forms are contained in the instructions for each form.) This booklet also has tax tables you need to figure the taxes to withhold for each employee for 1995.

Most employers must withhold (except FUTA), deposit, report, and pay the following employment taxes—

- Income tax.

- Social security and Medicare taxes.
- Federal unemployment tax (FUTA).

There are exceptions to these requirements. See pages xx through xx. Railroad retirement taxes are explained in the **Instructions for Form CT-1**.

See **Instructions for Form 945** for information on depositing and reporting Federal income tax withheld from nonpayroll items. These items include backup withholding and withholding from pensions, annuities, IRAs, and gambling winnings. Effective January 1, 1994, nonpayroll income tax withholding must be reported on the new Form 945 and has separate deposit requirements.

## 1. Are You an Employer?

Generally, an employer is a person or organization for whom a worker performs a service as an employee. The employer usually gives the worker the tools and place to work and has the right to fire the worker. A person or organization paying wages to a former employee after the work ends is also considered an employer.

Specific definitions of employers apply for income and FUTA tax purposes.

**Income Tax Withholding.**—For income tax withholding purposes, the term “employer” includes organizations that are exempt from income, social security, Medicare, and FUTA taxes.

**FUTA Tax.**—For FUTA tax purposes, an employer is:

- Any person or organization (other than an agricultural or household employer) that during this year or last year either:
  1. Paid wages of \$1,500 or more in any calendar quarter, or
  2. Had one or more employees at any time in each of any 20 different calendar weeks.
- Any agricultural employer who during this year or last year either:
  1. Paid cash wages of \$20,000 or more to farmworkers in any calendar quarter, or
  2. Employed 10 or more farmworkers during some part of a day for at least 1 day during any 20 different weeks.
- Any household employer who during this year or last year paid cash wages of \$1,000 or more during any calendar quarter for household service in a private home, local college club, or local chapter of a college fraternity or sorority.

**Federal Government Employers.**—If you are a Federal agency, the information in this guide applies, except deposit Federal taxes only at Federal Reserve banks or through the FedTax option of the Government On-Line Accounting Link Systems (GOALS). See the **Treasury Financial Manual (1 TFM 3-4000)** for more information.

**State and Local Government Employers.**—Wages of your employees are generally subject to Federal income tax withholding. In addition, wages of your employees, with certain exceptions, are subject to social security and Medicare taxes. See page XX for more information on the exceptions.

You can get information on reporting and social security coverage from your local IRS office. If you have any questions about coverage under a section 218 (Social Security Act) agreement, contact the appropriate state official.

## 2. Employer Identification Number (EIN)

If you are required to report employment taxes or give tax statements to employees or annuitants, you need an EIN.

The EIN is a nine-digit number the IRS issues. The digits are arranged as follows: 00-0000000. It is used to identify the tax accounts of employers and certain others that have no employees. For more information, get **Pub. 1635**, Understanding Your EIN.

If you have not asked for a number, request one on **Form SS-4**, Application for Employer Identification Number. You can get this form at IRS or SSA offices.

You should have only one number. If you have more than one and are not sure which one to use, please check with the Internal Revenue Service Center where you file your return. Give the numbers you have, the name and address to which each was assigned, and the address of your main place of business. The IRS will tell you which number to use. **Use your EIN on all the items you send to the IRS and SSA.**

If you took over another employer’s business, do not use that employer’s number. If you don’t have your own number by the time a return is due, write “Applied for” and the date you applied in the space shown for the number. Please see **Pub. 583**, Taxpayers Starting a Business, for more information on how to file returns, etc., if due before you have received your number.

See **Depositing Without an EIN** on page X if you must make a deposit and you have not received your EIN.

## 3. Who Are Employees?

Generally, employees can be defined either under common law or under special statutes for special purposes.

**Employment Status Under Common Law.**— Anyone who performs services is an employee if you, as an employer, can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the legal right to control the method and result of the services. Get **Pub. 937**, Employment Taxes, for detailed information on how to determine whether an individual providing services is an employee or an independent contractor.

Generally, people in business for themselves are not employees. For example, doctors, lawyers, veterinarians, construction contractors, and others in an independent trade in which they offer their services to the public are usually not employees.

If an employer-employee relationship exists, it does not matter what it is called. The employee may be called a partner, agent, or independent contractor. It also does not matter how payments are measured or paid, what they are called, or whether the employee works full or part time.

**Statutory Employees.**—Individuals providing certain specified services are defined as employees by statute. Although an individual is not an employee under the common law rules explained above, they may be an employee by statute. Get **Pub. 937** for details on statutory employees.

**Statutory Nonemployees.**—Direct sellers and qualified real estate agents are by law considered nonemployees. They are instead treated as self-employed for income tax and employment tax purposes. See **Pub. 937** for details.

**Treating Employees as Nonemployees.**—You will be liable for income tax and employee social security and Medicare taxes if you don’t deduct and withhold these taxes because you treat an employee as a nonemployee. See Internal Revenue Code section 3509 for details.

If you want the IRS to determine whether a worker is an employee, file **Form SS-8**, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding.

## 4. Employee's Social Security Number (SSN)

You must obtain each employee's name and SSN because you must enter them on Form W-2. If you do not provide the correct name and SSN, you may owe a penalty. Any employee without a social security card can get one by completing **Form SS-5**, Application for a Social Security Card. You can get this form at SSA offices or by calling 1-800-772-1213. If your employee has applied for an SSN but does not have one when you must file Form W-2, enter "Applied For" on the form. When the employee receives the SSN, file **Form W-2c**, Statement of Corrected Income and Tax Amounts, to show the employee's SSN.

Record the name and number of each employee exactly as they are shown on the employee's social security card. If the employee's name is not correct as shown on the card, including if the employee's name has changed due to marriage or divorce, the employee should request a new card from the SSA.

If your employee was given a new social security card to show his or her correct name and number after an adjustment to his or her alien residence status, correct your records and show the new information on Form W-2. If you filed Form W-2 for the same employee in prior years under the old name and SSN, file Form W-2c to correct the name and number. Advise the employee to contact the local SSA office about 6 months after the Form W-2c is filed to ensure that his or her records have been updated.

## 5. Taxable Wages

Wages subject to Federal employment taxes include all pay you give an employee for services performed. The pay may be in cash or in other forms. It includes salaries, vacation allowances, bonuses, commissions, and fringe benefits. It does not matter how you measure or make the payments.

See pages xx through xx for exceptions to the general rules for wages. See section 6 for a discussion of tips. See the Instructions for Form W-2 for reporting other compensation not subject to withholding. Get Pub. 937 for information on excessive termination payments (golden parachutes).

Value noncash pay (such as goods, lodging, and meals) by its fair market value. This kind of pay may be subject to tax and withholding. See pages xx and xx.

**Partially Exempt Employment.**—If an employee spends half or more of his or her time in a pay period performing services subject to employment taxes, all the employee's pay in that pay period is taxable. If the employee spends less than half the time performing services subject to taxes, no pay in that pay period is subject to employment taxes.

**Supplemental Unemployment Compensation Benefits.**—Treat these benefits as wages for income tax withholding to the extent they are includible in your employee's gross income. This applies if you pay benefits to your employee because of his or her involuntary separation from the job under a plan to which you are a party. Involuntary separation includes a reduction in force or closing a plant or operation. It does not include separation because of disciplinary problems or because of age. Also see Rev. Rul. 90-72, 1990-2 C.B. 211.

**Deferred Compensation Plans.**—Employer contributions to deferred compensation or nonqualified pension plans are treated as social security and Medicare wages when the services are performed or when the employee no longer has any substantial risk of forfeiting the right to the deferred compensation, whichever is later. Distributions from such plans must be treated as wages for purposes of withholding and reporting. The withheld income tax must be reported on Forms W-2 and 941. Get the Instructions for Form W-2 for more information.

**Employee Stock Options.**—There are two classes of stock options, statutory (covered by a specific Code provision) and nonstatutory. Generally, statutory stock options are not taxable to the employee either when the option is granted, or when it is exercised (unless the stock is disposed of in a disqualifying disposition). However, nonstatutory stock options normally are taxable to the employee as wages when the option is exercised (see Regulation section 1.83-7). These wages are subject to social security and Medicare taxes and income tax withholding.

**Travel and Business Expenses.**—Payments to your employee for travel and other necessary expenses of your business generally are taxable if (1) your employee is not required to or does not substantiate timely those expenses to you with receipts or other documentation, or (2) you advance an amount to your employee for business expenses and your employee is not required to or does not return timely any amount he or she does not use for business expenses.

**Moving Expenses.**—Reimbursed and employer-paid qualified moving expenses (those that would otherwise be deductible by the employee) are not includible in employee's income unless the employer has knowledge that the employee deducted the expenses in a prior year. Reimbursed and employer-paid nonqualified moving expenses are includible in income and are subject to employment taxes and income tax withholding. For more information on moving expenses for 1995, get **Pub. 521**, Moving Expenses.

**Payments to Nonresident Aliens.**—In general, if you pay wages to nonresident aliens, you must withhold income tax (unless excepted by regulations), social security, and Medicare taxes as you would for a U.S. citizen. You must also give a Form W-2 to the nonresident alien and file it with the SSA. The wages are subject to FUTA tax as well. However, see the chart on page xx for exceptions to these general rules.

In some cases, a Code section or a U.S. treaty provision will exempt payments to a nonresident alien from wages. These payments are not subject to regular income tax withholding. Form W-2 is not required in these cases. The payments, unless exempt from tax because of a Code or U.S. tax treaty provision, are subject to withholding at a flat 30% or lower treaty rate. You must report the payments and any withheld tax on **Form 1042-S**, Foreign Person's U.S. Source Income Subject to Withholding. Form 1042-S is sent to the IRS with **Form 1042**, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons. You may have to make deposits of the withheld income tax, using **Form 8109**, Federal Tax Deposit Coupon. See **Pub. 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations, for more information. For information on the requirement to file Forms 1042-S on magnetic media, see **Pub. 1187**.

The United States has social security agreements with many countries to eliminate dual taxation and coverage under two social security systems (see Pub. 937 for a list of current treaty countries).

**Employee's Portion of Taxes Paid by Employer.**—If you are not a household or agricultural employer and you pay your employee's social security and Medicare taxes without deducting them from the employee's pay, you must include the amount of the payments in the employee's wages for social security, Medicare, and FUTA taxes, and for income tax withholding. To properly calculate the wages and taxes in this situation, you must use the formula in Rev. Rul. 86-14, 1986-1 C.B. 304. Generally, in applying the formula, use the rates in effect in the year the wages are paid. See Pub. 937 for more information.

However, if you are a household employer in a private home or an agricultural employer, any employee social security and Medicare taxes you pay for an employee is additional income to the employee for income tax purposes. But it is not considered wages for social security, Medicare, and FUTA taxes.

**Fringe Benefits.**—Unless the law says otherwise, you must include fringe benefits in an employee's gross income. The benefits are subject to income and employment taxes. Fringe benefits include cars you provide, flights on aircraft you provide, free or discounted commercial flights, vacations, discounts on property or services, memberships in country clubs or other social clubs, and tickets to entertainment or sporting events. In general, the amount you must include is the amount by which the fair market value of the benefits is more than the sum of what the employee paid for it plus any amount the law excludes. There are other special rules you and your employees may use to value certain fringe benefits. **Get Pub. 937 for more information on fringe benefits.**

**Sick Pay.**—In general, sick pay is any amount you pay, under a plan you take part in, to an employee because of sickness or injury. These amounts are sometimes paid by a third party, such as an insurance company or employees' trust. In either case, these payments are subject to social security, Medicare, or railroad retirement (RRTA) taxes, and Federal unemployment (FUTA) taxes. The payments are also subject to income tax.

If you make the payments, withhold on the basis of the employee's Form W-4. Include payments subject to social security and Medicare taxes on lines 6a and 7 of Form 941. Report payments subject to RRTA taxes on **Form CT-1**, Employer's Annual Railroad Retirement Tax Return. Pay FUTA tax as you normally would for any other type of taxable wages. Include the amount of sick pay payments on line 1, Part I, of Form 940 or 940-EZ.

If a third party makes the payments, the employee may request income tax withholding by giving the third-party payer a **Form W-4S**, Request for Federal Income Tax Withholding From Sick Pay. Even though the third party makes the payments, you may be responsible for paying social security and Medicare taxes and reporting on Form W-2. See **Pub. 952**, Sick Pay Reporting, for details.

The following payments are not subject to social security, Medicare, RRTA, or FUTA taxes:

1. Payments received under a worker's compensation law.
2. Payments, or portions of payments, attributable to the employee's contributions to a sick pay plan.
3. Payments received under the Railroad Retirement Act.
4. Payments of benefits under the Railroad Unemployment Insurance Act for an on-the-job injury.
5. Payments made more than 6 months after the last calendar month in which the employee worked.

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## 6. Taxable Tips

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Tips your employee receives are generally subject to withholding. Your employee must report cash tips to you by the 10th of the month after the month the tips are received. The report should include tips you paid over to the employee for charge customers and tips the employee received directly from customers. No report is required for months when tips are less than \$20. Your employee reports the tips on **Form 4070**, Employee's Report of Tips to Employer, or on a similar statement. The statement must be signed by the employee and must show the following:

- The employee's name, address, and social security number.
- Your name and address.
- The month or period the report covers.
- The total tips.

Both Forms 4070 and **4070-A**, Employee's Daily Record of Tips, are included in **Pub. 1244**, Employee's Daily Record of Tips and Report to Employer.

**You must collect** income tax, employee social security tax, and employee Medicare tax on the employee's tips. You can collect these taxes from the employee's wages or from other

funds he or she makes available. (See **Tips Treated as Supplemental Wages** in section 7 for further information.) Stop collecting the employee social security tax when his or her wages and tips for the year reach \$XX,XXX; collect the employee Medicare tax for the whole year on all wages and tips.

You are responsible for the employer social security tax on wages and tips until the wages (including tips) reach the limit. You must withhold income tax for the whole year on wages and tips.

File Form 941 to report withholding on tips. If, by the 10th of the month after the month you received an employee's report on tips, you don't have enough employee funds available to deduct the employee tax, you no longer have to collect it. Show any uncollected social security and Medicare taxes on Form W-2, on lines 6b and 7 of Form 941, and as an adjustment on line 9, Form 941. (See the instructions for Forms W-2 and 941.)

If an employee reports to you in writing \$20 or more of tips in a month, they are subject to FUTA tax.

**Allocated Tips.**—If you operate a large food or beverage establishment, you must report allocated tips under certain circumstances. A large food or beverage establishment is one that provides food or beverages for consumption on the premises, where tipping is customary, and where there are normally more than 10 employees on a typical business day during the preceding year.

You must allocate tips among employees who receive them if the total tips reported to you during any payroll period are less than 8% (or an approved lower rate) of the establishment's gross receipts for that period. Use Form 8027 to report allocated tips.

Generally, you must allocate to tipped employees an amount equal to the difference between the total tips reported by the employees and 8% (or an approved lower rate) of gross receipts (less carryout sales and sales with at least a 10% service charge added). You or a majority of your employees may request a lower percentage rate, but not below 2%. See Rev. Proc. 86-21, 1986-1 C.B. 560, for details.

The tip allocation may be made using one of three methods—hours worked, gross receipts, or good faith agreement. For information about these allocation methods and further information, including the requirement to file Forms 8027 on magnetic media if 250 or more forms are filed, see the separate **Instructions for Form 8027**.

Do not withhold income, social security, or Medicare taxes on allocated tips.

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## 7. Supplemental Wages

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Supplemental wages are compensation paid to an employee in addition to the employee's regular wages. They include, but are not limited to, bonuses, commissions, overtime pay, accumulated sick leave, severance pay, awards, prizes, back pay and retroactive pay increases for current employees, and payments for nondeductible moving expenses. Other payments subject to the supplemental wage rules include taxable fringe benefits and expense allowances paid under a nonaccountable plan.

If you pay supplemental wages with regular wages but do not specify the amount of each, withhold income tax as if the total were a single payment for a regular payroll period.

If you pay supplemental wages separately (or combine them in a single payment and specify the amount of each), the income tax withholding method depends partly on whether you withhold income tax from your employee's regular wages:

- If you withhold income tax from an employee's regular wages, you can use one of the following methods for the supplemental wages:

- a. Withhold a flat 28%.

b. Add the supplemental and regular wages for the most recent payroll period this year. Then figure the income tax withholding as if the total were a single payment. Subtract the tax already withheld from the regular wages. Withhold the remaining tax from the supplemental wages.

• If you did not withhold income tax from the employee's regular wages, use method **b**. (This would occur, for example, when the value of the employee's withholding allowances claimed on Form W-4 is more than the wages.)

Regardless of the method you use to withhold income tax on supplemental wages, including bonuses, supplemental wages are subject to social security and Medicare taxes.

**Tips Treated as Supplemental Wages.**— Withhold the income tax on tips from wages or from other funds the employee makes available. If an employee receives regular wages and reports tips, figure income tax as if the tips were supplemental wages. If you have not withheld income tax from the regular wages, add the tips to the regular wages. Then withhold income tax on the total. If you withheld income tax from the regular wages, you can withhold on the tips by method **a** or **b** above.

**Vacation Pay.**—Vacation pay is subject to withholding as if it were a regular wage payment. When vacation pay is in addition to regular wages for the vacation period, treat it as a supplemental wage payment. If the vacation pay is for a time longer than your usual payroll period, spread it over the pay periods for which you pay it.

**Back Pay Under a Statute.**—Treat back pay as wages and withhold and pay employment taxes as appropriate. If back pay was awarded by a court or government agency to enforce a Federal or State statute protecting an employee's right to employment or wages, special rules apply for reporting those wages to the SSA. These rules also apply to litigation actions, and settlement agreements or agency directives that are resolved out of court and not under a court decree or order. Examples of pertinent statutes include, but are not limited to, the National Labor Relations Act, Fair Labor Standards Act, Equal Pay Act, Civil Rights Act, and Age Discrimination in Employment Act. Get **Pub. XXX** for details.

## 8. Payroll Period

The payroll period is that period of service for which you usually pay wages. When you have a regular payroll period, withhold income tax for that time period even if your employee does not work the full period.

When you don't have a payroll period, withhold the tax as if you paid wages on a daily or miscellaneous payroll period. Figure the number of days (including Sundays and holidays) in the period covered by the wage payment. If the wages are unrelated to a specific length of time (e.g., commissions paid on completion of a sale), count back the number of days from the payment period to the latest of:

- The last wage payment made during the same calendar year,
- The date employment began, if during the same calendar year, or
- January 1 of the same year.

When you pay an employee for a period of less than 1 week, and the employee signs a statement under penalties of perjury that he or she is not working for any other employer during the same calendar week for wages subject to withholding, figure withholding based on a weekly payroll period. If the employee later begins to work for another employer for wages subject to withholding, the employee must notify you within 10 days. You should then figure withholding based on the daily or miscellaneous period.

## 9. Withholding From Employees

**Form W-4.**—To know how much income tax to withhold from employees' wages, you should have a **Form W-4**, Employee's Withholding Allowance Certificate, on file for each employee. Ask all new employees to give you a signed Form W-4 when they start work. Make the form effective with the first wage payment. If a new employee does not give you a completed Form W-4, withhold tax as if he or she is single, with no withholding allowances. A Form W-4 remains in effect until the employee gives you a new one. If an employee gives you a Form W-4 that replaces an existing Form W-4, begin withholding no later than the start of the first payroll period ending on or after the 30th day from the date you received the replacement Form W-4. For exceptions, see this page for exemption from income tax withholding and forms that must be sent to the IRS, and page X for invalid Forms W-4.

The amount of income tax withholding must be based on filing status and withholding allowances. Your employees may not base their withholding amounts on a fixed dollar amount or percentage. However, the employee may specify a dollar amount to be withheld **in addition** to the amount of withholding based on filing status and withholding allowances claimed on Form W-4.

Employees may claim **fewer** withholding allowances than they are entitled to claim. They may wish to claim fewer allowances to generate a larger tax refund or to offset other sources of taxable income that are not subject to adequate withholding.

**Note:** A Form W-4 that makes a change for the next calendar year will not take effect in the current calendar year.

**Pub. 505**, Tax Withholding and Estimated Tax, contains detailed instructions for completing Form W-4. Along with Form W-4, you may wish to order Pub. 505 and **Pub. 919**, Is My Withholding Correct for 1995?

When you receive a new Form W-4, do not adjust withholding for pay periods prior to the effective date of the new form; that is, do not adjust withholding retroactively. Also, do not accept any withholding or estimated tax payments from your employees in addition to withholding based on their Form W-4. If they require additional withholding, they should submit a new Form W-4 and, if necessary, pay estimated tax by filing Form **1040-ES**, Estimated Tax for Individuals.

**Exemption From Income Tax Withholding For Eligible Persons.**—An employee may claim exemption from income tax withholding because he or she had no income tax liability last year and expects none this year. However, the wages may still be subject to social security and Medicare taxes.

An employee must file a Form W-4 each year by February 15 to claim exemption from withholding. If the employee does not give you a new Form W-4, withhold tax as if the employee is single with zero withholding allowances.

**Withholding on Nonresident Aliens.**—Employers should remind nonresident aliens when completing Form W-4 that to avoid underwithholding of income taxes they should (1) not claim exemption from income tax withholding; (2) request withholding as if they are single, regardless of their actual marital status; and (3) claim only one allowance. However, if the nonresident alien is a resident of Canada, Mexico, Japan, or Korea, he or she may claim more than one allowance. For more information, see Pub. 515.

**Sending Certain Forms W-4 to the IRS.**—You must send to the IRS copies of certain Forms W-4 received during the quarter from employees still employed by you at the end of the quarter. Send copies when the employee (1) claims more than 10 withholding allowances or (2) claims exemption from withholding and his or her wages would normally be \$200 or more per week. You are not required to send any other Forms W-4 unless the IRS notifies you in writing to do so.

Send in Forms W-4 that meet either of the above conditions each quarter with Form 941. (However, if your Form 941 is filed on magnetic media, you must send your paper Forms W-4 to the appropriate service center with a cover letter.) Complete boxes 8 and 10 on any Forms W-4 you send in. You may use box 9 to identify the office responsible for processing the employee's payroll information. Also send copies of any written statements from employees in support of the claims made on Forms W-4. Send these statements even if the Forms W-4 are not in effect at the end of the quarter. You can send them to your Internal Revenue Service Center more often if you like. If you do so, include a cover letter giving your name, address, employer identification number, and the number of forms included. In certain cases, the IRS may notify you in writing that you must submit specified Forms W-4 more frequently to your district director separate from your Form 941.

Base withholding on the Forms W-4 that you send in unless the IRS notifies you in writing that you should do otherwise. If the IRS notifies you about a particular employee, base withholding on the number of withholding allowances shown in the IRS notice. You will get a copy of the notice to give to the employee. Also, the employee will get a similar notice directly from the IRS. If the employee later gives you a new Form W-4, follow it only if (1) exempt status is not claimed or (2) the number of withholding allowances is equal to or fewer than the number in the IRS notice. Otherwise, disregard it and do not submit it to the IRS. Continue to follow the IRS notice.

If the employee prepares a new Form W-4 explaining any difference with the IRS notice, he or she may either submit it to the IRS or to you. If submitted to you, send the Form W-4 and explanation to the IRS office shown in the notice. Continue to withhold based on the notice until the IRS tells you to follow the new Form W-4.

**Filing Form W-4 on Magnetic Media.**—Form W-4 information may be filed with the IRS on magnetic media. If you wish to file on magnetic media, you must submit **Form 4419**, Application for Filing Information Returns Magnetically/ Electronically, to request authorization. See **Pub. 1245**, Specifications for Filing Form W-4, Employee's Withholding Allowance Certificate, on Magnetic Tape, and 5¼- and 3½-Inch Magnetic Diskettes. To obtain additional information about magnetic media filing, call the IRS Martinsburg Computing Center at (304) 263-8700.

**Note:** Any Forms W-4 with employee supporting statements that you must submit to the IRS must be submitted on paper. They cannot be submitted on magnetic media.

**Invalid Forms W-4.**—Any unauthorized change or addition to Form W-4 makes it invalid. This includes taking out any language by which the employee certifies that the form is correct. A Form W-4 is also invalid if, by the date an employee gives it to you, he or she indicates in any way that it is false.

When you get an invalid Form W-4, do not use it to figure withholding. Tell the employee it is invalid and ask for another one. If the employee does not give you a valid one, withhold taxes as if the employee were single and claiming no withholding allowances. However, if you have an earlier Form W-4 for this worker that is valid, withhold as you did before.

**Amounts Exempt From Levy on Wages, Salary, and Other Income.**—If you receive a Notice of Levy on Wages, Salary, and Other Income (Forms 668W or 668W(c)), you must withhold amounts as described in the instructions for these forms. **Pub. 1494**, Table for Figuring Amount Exempt From Levy on Wages, Salary, and Other Income (Forms 668W and 668W(c)), shows the exempt amount.

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## 10. Figuring Withholding

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There are several ways to figure income tax withholding:

- Percentage method (see pages xx–xx).

- Wage bracket tables (see pages xx–xx).

Also see page xx for directions on how to use the tables for employees claiming more than 10 allowances.

- Alternative formula tables for percentage withholding (see **Pub. 493**, Alternative Tax Withholding Methods and Tables).
- Wage bracket percentage method withholding tables (see **Pub. 493**).
- Combined income, employee social security, and employee Medicare tax table (see **Pub. 493**).
- Annualized wages method (see **Pub. 493**).
- Average estimated wages method (see **Pub. 493**).
- Cumulative wages and part-year employment methods (see **Pub. 493**). These may be used if your employee requests that you use them, and you agree to this.
- Other alternative methods (see page xx).

If an employee wants additional tax withheld, have the employee show the extra amount on Form W-4, line 6.

**Social Security and Medicare Taxes, Employer's and Employee's Share.**—For wages paid in 1995, the social security tax rate is 6.2% and the Medicare tax rate is 1.45% for both the employer and the employee. Multiply each wage payment by these percentages.

Employee wages are subject to social security and Medicare taxes regardless of the employee's age, or whether he or she is receiving social security benefits.

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## 11. Depositing Taxes

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In general, you must deposit income tax withheld and both the employer and employee social security and Medicare taxes (minus any advance EIC payments) by mailing or delivering a check, money order, or cash to an authorized financial institution or Federal Reserve bank.

**Payments With Returns.**—You may make payments with your return instead of depositing if:

- Your net tax liability for the return period (line 13 on Form 941) is less than \$500, or
- You are making a payment in accordance with the **Accuracy of Deposits (98% Rule)** provision in the deposit rules discussed on page XX. This amount may exceed \$500. **Caution:** Only monthly schedule depositors are allowed to make this underpayment with the return.

**Separate Deposit Requirements for Nonpayroll (Form 945) Tax Liabilities.**—Separate deposits are required for nonpayroll income tax withholding on payments made after 1993. **DO NOT** combine deposits for Form 941 and Form 945 tax liabilities. Generally, the deposit rules for nonpayroll liabilities are the same as discussed below. See Instructions for Form 945 for details.

**Federal Tax Deposit (FTD) Coupon.**—Use **Form 8109**, Federal Tax Deposit Coupon, to make the deposits. **Do not** use the deposit coupons to pay delinquent taxes assessed by the IRS. Send those payments directly to your Internal Revenue Service Center with a copy of any related notice the IRS sent you.

For new employers, the IRS will send you an FTD coupon book 5 to 6 weeks after you receive an employer identification number (EIN). (Apply for an EIN on Form SS-4.) The IRS will keep track of the number of FTD coupons you use and **automatically** will send you additional coupons when you need them. If you do not receive your resupply of FTD coupons, contact your local IRS office. You can have the FTD coupon books sent to a branch office, tax preparer, or service bureau that is making your deposits by showing that address on **Form 8109C**, FTD Address Change, which is in the FTD coupon book. (Filing Form 8109C will not change your address of record; it will change only the address where the FTD coupons are

mailed.) The FTD coupons will be preprinted with your name, address, and EIN. They have entry boxes for indicating the type of tax and the tax period for which the deposit is made.

It is very important to clearly mark the correct type of tax and tax period on each FTD coupon. This information is used by the IRS to credit your account.

If you have branch offices depositing taxes, give them FTD coupons and complete instructions so they can deposit the taxes when due.

Please use only your FTD coupons. If you use anyone else's FTD coupon, you may be subject to the failure to deposit penalty. This is because your account will be underpaid by the amount of the deposit credited to the other person's account. See **Penalties** on page X for details.

**How To Make Deposits.**—Mail or deliver each FTD coupon and a single payment covering the taxes to be deposited to a qualified depository for Federal taxes or to the Federal Reserve bank or branch (FRB) serving your area. Follow the instructions in the FTD coupon book. Make the check or money order payable to the depository or FRB where you make your deposit. To help ensure proper crediting of your account, include your EIN, the type of tax (e.g., Form 941), and tax period to which the payment applies on your check or money order.

**Reporting agents.**—Reporting agents who make deposits for their clients should see Rev. Proc. 89-48, 1989-2 C.B. 599.

**Deposits at Depositories.**—Authorized depositories must accept cash, a postal money order drawn to the order of the depository, or a check or draft drawn on and to the order of the depository. You can deposit taxes with a check drawn on another financial institution only if the depository is willing to accept that form of payment.

**Note:** *Be sure that the financial institution where you make deposits is an authorized depository. Deposits made at an unauthorized institution may be subject to the failure to deposit penalty.*

**Deposits at FRBs.**—If you want to make a deposit at an FRB, make the deposit with the FRB serving your area. Deposits may be subject to the failure to deposit penalty if the payment is not considered an immediate credit item on the day it is received by the FRB. A personal check, including one drawn on a business account, is not an immediate credit item. To avoid a penalty, deposits made by personal checks drawn on other financial institutions must be made in advance of the deposit due date to allow time for check clearance. To be considered timely, the funds must be available to the FRB on the deposit due date before the FRB's daily cutoff deadline. Contact your local FRB to obtain information concerning check clearance and cutoff schedules.

**Depositing on Time.**—The IRS determines if deposits are on time by the date they are received by an authorized depository or FRB. However, a deposit received by the authorized depository or FRB after the due date will be considered timely if the taxpayer establishes that it was mailed in the United States at least 2 days before the due date. **Note:** *If you are required to deposit any taxes more than once a month, any deposit of \$20,000 or more must be made by its due date to be timely.*

**Depositing Without an EIN.**—If you have applied for an EIN but **have not** received it, and you must make a deposit, make the deposit with your Internal Revenue Service Center. **Do not** make the deposit at an authorized depository or FRB. Make it payable to the Internal Revenue Service and show on it your name (as shown on Form SS-4), address, kind of tax, period covered, and date you applied for an EIN. Attach an explanation to the deposit. **Do not** use Form 8109-B in this situation.

**Depositing Without Form 8109.**—If you do not have the preprinted Form 8109, you may use **Form 8109-B** to make deposits. Form 8109-B is an over-the-counter FTD coupon that is not preprinted with your identifying information. It is available only at your local IRS office. Be sure to have your EIN ready

when you contact the office. If the phone number of your local IRS office is not listed in your telephone directory, you may call 1-800-829-1040 to get the number. You will not be able to obtain this form by calling the general 1-800-TAX-FORM number.

Use Form 8109-B to make deposits only if:

- You are a new entity and you have been assigned an EIN, but you have not received your initial supply of Forms 8109.
- You have not received your resupply of preprinted Forms 8109.

**Deposit Record.**—For your records, a stub is provided with each FTD coupon in the coupon book. The FTD coupon itself will not be returned. It is used to credit your account. Your check, bank receipt, or money order is your receipt.

**How To Claim Credit for Overpayments.**—If you deposited more than the right amount of taxes for a quarter, you can request on Form 941 for that quarter to have the overpayment refunded or applied as a credit to your next return. Do not ask the depository or FRB to request a refund from the IRS for you.

**Penalties.**—Penalties may apply if you do not make required deposits on time, you make deposits at an unauthorized financial institution, you pay directly to the IRS, or you pay with your return (see **Payments With Returns** on page X for exceptions). The penalties do not apply if any failure to make a proper and timely deposit was due to reasonable cause and not to willful neglect. For amounts not properly or timely deposited, the penalty rates are:

- 2% - Deposits made 1 to 5 days late.
- 5% - Deposits made 6 to 15 days late.
- 10% - Deposits made 16 or more days late. Also applies to amounts paid to the IRS within 10 days of the date of the first notice the IRS sent you asking for the tax due.
- 10% - Deposits made at unauthorized financial institutions or directly to the IRS (but see **Depositing Without an EIN** earlier).
- 15% - Amounts still unpaid more than 10 days after the date of the first notice the IRS sent you asking for the tax due or the day on which you receive notice and demand for immediate payment, whichever is earlier.

**Order in Which Deposits Are Applied.**—Tax deposits are applied first to satisfy any past due underdeposits for the quarter, with the oldest underdeposit satisfied first.

**Example:** Employer A is required to make a deposit of \$1,000 on February 15 and \$1,500 on March 15. A does not make the deposit on February 15. On March 15, A deposits \$1,700 assuming that he has paid his March deposit in full and applied \$200 to the late February deposit. However, because deposits are applied first to past due underdeposits in due date order, \$1,000 of the March 15 deposit is applied to the late February deposit. The remaining \$700 is applied to the March 15 deposit. Therefore, in addition to an underdeposit of \$1,000 for February 15, A has an underdeposit for March 15 of \$800. Penalties will be applied to both underdeposits as explained above.

**Separate Accounting When Deposits Are Not Made or Withheld Taxes Are Not Paid.**—Separate accounting may be required if you do not pay over withheld employee social security, Medicare, or income taxes; deposit required taxes; make required payments; or file tax returns. In this case, you would receive written notice from the district director requiring you to deposit taxes in a special trust account for the U.S. Government. You would also have to file monthly tax returns on **Form 941-M**, Employer's Monthly Federal Tax Return.

### When To Deposit

There are two deposit schedules—monthly or semiweekly—for determining when you deposit Federal employment and withholding taxes (other than FUTA taxes). The IRS will notify you each November whether you are a monthly or semiweekly depositor for the coming calendar year. The rules apply to social

security and Medicare tax and Federal income tax withheld on wages, tips, and sick pay. Similar rules apply for Federal income tax withholding for nonpayroll items such as backup withholding and withholding on pensions, annuities, and gambling winnings. These rules do not apply to tax required to be reported on Forms 940 or 942.

Your deposit schedule for a calendar year is determined from the total taxes reported on your Form 941 in a four-quarter lookback period—July 1 through June 30—as shown in the chart below. If you reported \$50,000 or less of employment taxes for the lookback period, you are a monthly depositor; if you reported more than \$50,000, you are a semiweekly depositor. There are two exception rules—the \$500 rule and the \$100,000 rule. The deposit rules and exceptions are discussed in the following sections.

Lookback Period For Calendar Year 1995			
Calendar Year 1995			
Jan.–Mar.	Apr.–June	July–Sept.	Oct.–Dec.
Lookback Period			
1993		1994	
July–Sept.	Oct.–Dec.	Jan.–Mar.	Apr.–June

### Monthly Deposit Schedule Rule

Under the **monthly rule**, employment and other taxes withheld on payments made during a calendar month must be deposited by the 15th day of the following month. An employer is a monthly depositor for a calendar year if the total employment taxes for the four quarters in the lookback period were \$50,000 or less.

Monthly depositors should **not** file Form 941 on a monthly basis. Do not file **Form 941-M**, Employer's Monthly Federal Tax Return, unless you are instructed to do so by an IRS representative.

**New Employers.**—During the first calendar year of your business, your tax liability for each quarter in the lookback period is considered to be zero. Therefore, you are a monthly depositor for the first year of your business (but see the **\$100,000 One-Day Rule** exception below).

### Semiweekly Deposit Schedule Rule

An employer is a semiweekly depositor for a calendar year if the total employment taxes during its lookback period were more than \$50,000. Under the **semiweekly rule**, employment and other taxes withheld on payments made on Wednesday, Thursday, and/or Friday must be deposited by the following Wednesday. Amounts accumulated on payments made on Saturday, Sunday, Monday, and/or Tuesday must be deposited by the following Friday.

Payment Days/Deposit Periods	Deposit By
Wednesday, Thursday, and/or Friday	Following Wednesday
Saturday, Sunday, Monday, and/or Tuesday	Following Friday

If a quarterly return period ends on a day other than Tuesday or Friday, employment taxes accumulated on the days covered by the return period just ending are subject to one deposit obligation, and employment taxes accumulated on the days covered by the new return period are subject to a separate deposit obligation. For example, if one quarterly return period ends on Thursday and a new quarter begins on Friday, employment taxes accumulated on Wednesday and Thursday are subject to one deposit obligation and taxes accumulated on

Friday are subject to a separate obligation. Separate **Forms 8109**, Federal Tax Deposit Coupons, are required for each deposit because two different quarters are affected. Be sure to mark the quarter for which the deposit is made on each Form 8109.

### Example of Monthly and Semiweekly Rules

Employer A reported employment tax liability on Form 941 as follows:

1995 Lookback Period		
3rd Quarter 1993	-	\$12,000
4th Quarter 1993	-	\$12,000
1st Quarter 1994	-	\$12,000
2nd Quarter 1994	-	\$12,000
		\$48,000

1996 Lookback Period		
3rd Quarter 1994	-	\$12,000
4th Quarter 1994	-	\$12,000
1st Quarter 1995	-	\$12,000
2nd Quarter 1995	-	\$15,000
		\$51,000

Employer A is a monthly depositor for 1995 because its tax liability for the four quarters in its lookback period (3rd quarter 1993 through 2nd quarter 1994) was not more than \$50,000. However, for 1996, Employer A must follow the semiweekly rule described above because A's liability exceeded \$50,000 for the four quarters in its lookback period (3rd quarter 1994 through 2nd quarter 1995).

### Application of Monthly and Semiweekly Rules

The terms "monthly depositor" and "semiweekly depositor" do not refer to how often your business pays its employees, or even how often you are required to make deposits. The terms identify which set of rules you must follow when a tax liability arises (e.g., when you have a payday). The deposit rules are based on the dates wages are paid; **not** on when payroll liabilities are accrued.

**Monthly Rule Example:** Employer A is a seasonal employer who has a monthly deposit schedule. It paid wages each of the four Fridays during January but did not pay any wages during February. Under the monthly rule, Employer A must deposit the combined tax liabilities for the four January paydays by February 15. Employer A does not have a deposit requirement for February (due by March 15) because no wages were paid and, therefore, it did not have a tax liability for the month.

**Semiweekly Rule Example:** Employer B, who has a semiweekly deposit schedule, pays wages once each month on the last day of the month. Although Employer B has a semiweekly deposit schedule, it will deposit just once a month because it pays wages only once a month. The deposit, however, will be made under the semiweekly deposit rule as follows: Employer B's tax liability for the January 31, 1995 (Tuesday) payday must be deposited by February 3, 1995 (Friday). Under the semiweekly deposit rule, liabilities arising on Saturday through Tuesday must be deposited by the following Friday.

### Deposits on Banking Days Only

If a deposit is required to be made on a day that is not a banking day, the deposit is considered timely if it is made by the close of the next banking day. In addition to Federal and State bank holidays, Saturdays and Sundays are treated as nonbanking days. For example, if a deposit is required to be made on a Friday and Friday is not a banking day, the deposit will be considered timely if it is made by the following Monday.

A special rule is provided for **semiweekly depositors** that allows these depositors at least 3 banking days to make a deposit. That is, if any of the 3 weekdays after the end of a semiweekly period is a banking holiday, they will have one additional banking day to deposit. For example, if a semiweekly

depositor accumulated taxes for payments made on Friday and the following Monday is not a banking day, the deposit normally due on Wednesday may be made on Thursday (allowing 3 banking days to make the deposit).

### \$500 Rule

If an employer accumulates less than a \$500 tax liability during a return period (e.g., during a quarter for Form 941), no deposits are required and this liability may be paid with the tax return for the period. However, if you are unsure that you will accumulate less than \$500, deposit under the appropriate rules so that you will not be subject to failure to deposit penalties.

### \$100,000 One-Day Rule

If the total accumulated tax reaches \$100,000 or more on any day during a deposit period, it must be deposited by the next banking day, whether an employer is a monthly or semiweekly depositor. For monthly depositors, the deposit period is a calendar month. The deposit periods for a semiweekly depositor are Wednesday through Friday and Saturday through Tuesday.

For purposes of the \$100,000 rule, do not continue accumulating employment tax liability after the end of a deposit period. For example, if a semiweekly depositor has accumulated a liability of \$95,000 on a Tuesday (of a Saturday-through-Tuesday deposit period) and accumulated a \$10,000 liability on Wednesday, the \$100,000 one-day rule does not apply. Thus, \$95,000 must be deposited by Friday and \$10,000 must be deposited by the following Wednesday.

In addition, once you accumulate at least \$100,000 in a deposit period, stop accumulating at the end of that day and begin to accumulate anew on the next day. For example, Employer C is a semiweekly depositor. On Monday, C accumulates taxes of \$110,000 and must deposit this amount on Tuesday, the next banking day. On Tuesday, C accumulates additional taxes of \$30,000. Because the \$30,000 is not added to the previous \$110,000 and is less than \$100,000, C must deposit the \$30,000 by Friday following the semiweekly deposit rule.

If a monthly depositor accumulates a \$100,000 employment tax liability on any day, it becomes a semiweekly depositor on that day and remains so for at least the remainder of the calendar year and for the following calendar year.

**Example of \$100,000 One-Day Rule.**—Employer B started its business on February 1, 1995. On February 9, it paid wages for the first time and accumulated a tax liability of \$60,000. On February 10, Employer B paid wages and accumulated a liability of \$40,000, bringing its accumulated employment tax liability to \$100,000. Because this was the first year of its business, the tax liability for its lookback period is considered to be zero, and it would be a monthly depositor based on the lookback rules. However, since Employer B accumulated \$100,000 on February 10, it became a semiweekly depositor on February 10. It will be a semiweekly depositor for the remainder of 1995 and for 1996. Employer B is required to deposit the \$100,000 by February 11, the next banking day.

### Adjustments and the Lookback Rule

Determine your tax liability for the quarters in the lookback period based on the tax liability as **originally** reported. If you made adjustments to correct errors on previously filed employment tax returns, these adjustments do not affect the amount of tax liability for purposes of the lookback rule. If you report adjustments on your current employment tax return to correct errors on prior period returns, include these adjustments as part of your tax liability for the current quarter. If you filed Form 843 to claim a refund for a prior period overpayment, your tax liability does not change for either the prior period or the current period quarter for purposes of the lookback rule.

**Example:** An employer originally reported a tax liability of \$45,000 for the four quarters in the lookback period ending June 30, 1994. The employer discovered during January 1995 that the tax during one of the lookback period quarters was

understated by \$10,000 and corrected this error with an adjustment on the 1995 first quarter return. This employer would be a monthly depositor for 1995 since the lookback period tax liabilities are based on the amounts originally reported and they were less than \$50,000. The \$10,000 adjustment would be treated as part of the 1995 first quarter tax liability.

### Accuracy of Deposits (98% Rule)

You will be considered to have satisfied the deposit requirements if you deposit timely at least 98% of your tax liability or if any deposit shortfall does not exceed \$100. No deposit penalties will be applied if the shortfall is deposited by the shortfall makeup date as follows:

- **Monthly Depositor**—Deposit or pay the shortfall with your return by the due date of the Form 941 for the period in which the shortfall occurred. You may pay the shortfall with Form 941 even if the amount exceeds \$500.

- **Semiweekly Depositor**—Deposit by the first Wednesday or Friday, whichever is earlier, falling on or after the 15th day of the month following the month in which the shortfall occurred. For example, if a semiweekly depositor has a shortfall during January 1995, the shortfall makeup date is February 15, 1995 (Wednesday).

However, if the due date of the return (e.g., Form 941) falls before the shortfall makeup date, the shortfall must be deposited by the return due date. For example, if a semiweekly depositor has an employment tax liability from a March 31, 1995, pay date and deposits that liability on April 5 (Wednesday, the required date), any shortfall must be deposited by the due date of the first quarter return (April 30) rather than the May 17 shortfall makeup date (the first Wednesday or Friday on or after May 15).

### Depositing Federal Unemployment (FUTA) Taxes

**FUTA Amount To Deposit.**—For deposit purposes, figure FUTA tax quarterly. Determine your FUTA tax by multiplying by .008 that part of the first \$7,000 paid to each employee during the year. The \$7,000 amount is the Federal wage base. Your state wage base may be different. If any part of the amount paid is exempt from state unemployment taxes, you may deposit an amount more than the .008 rate. For example, in certain states, wages paid to corporate officers, certain payments of sick pay by unions, and certain fringe benefits, are exempt from state unemployment tax. Refer to section 14 for more information.

**Employers Not Required To Deposit.**—If your total FUTA tax for the year is \$100 or less, you do not have to deposit the tax. Pay your FUTA tax with your Form 940 or Form 940-EZ.

**Employers Required To Deposit.**—If your liability for any of the calendar year quarters of 1995 is over \$100 (including any undeposited amount from any earlier quarter), you must make deposits in an authorized depository using **Form 8109**, Federal Tax Deposit Coupon (see page x for details).

If the undeposited amount is \$100 or less, you may carry it to the next quarter. If your liability for the 4th quarter (plus any undeposited amount from any earlier quarter) is over \$100, deposit the entire amount by the due date of Form 940 or Form 940-EZ (January 31). If it is \$100 or less, you can either make a deposit or pay it with your Form 940 or Form 940-EZ by its due date.

**When To Deposit.**—Deposit the FUTA tax by the last day of the first month after the quarter ends.

Quarter	Ending	Due Date
Jan.-Feb.-Mar.	Mar. 31	Apr. 30
Apr.-May-June	June 30	July 31
July-Aug.-Sept.	Sept. 30	Oct. 31
Oct.-Nov.-Dec.	Dec. 31	Jan. 31

**Note:** Enter the total amount of all deposits for the four quarters in Part II, line 7 of Form 940 or Part I, line 7 of Form 940-EZ.

## 12. Filing the Employer's Quarterly Federal Tax Return (Form 941)

Each quarter, all employers who are subject to income tax withholding (including withholding on sick pay and supplemental unemployment benefits) or social security and Medicare taxes must file **Form 941**, Employer's Quarterly Federal Tax Return. However, the following exceptions apply:

**1. Seasonal employers who no longer file for quarters when they regularly have no tax liability because they have paid no wages.**—To alert the IRS that you will not have to file a return for one or more quarters during the year, mark the Seasonal employer box above line 1 on Form 941. The IRS will mail two Forms 941 to the seasonal filer once a year after March 1. The preprinted label will not include the date the quarter ended. You must enter the date the quarter ended when you file the return. The IRS will generally not inquire about unfiled returns if at least one taxable return is filed each year. However, you must mark the Seasonal employer box on every quarterly return you file. Otherwise, the IRS will expect a return to be filed for each quarter.

**2. Household employers reporting social security and Medicare taxes and/or withheld income tax.**—Report these on **Form 942**, Employer's Quarterly Tax Return for Household Employees.

**3. Employers reporting wages for employees in American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, or the Virgin Islands.**—If the employees are not subject to U.S. income tax withholding, use Form 941-SS. Employers in Puerto Rico use Form 941-PR.

**4. Agricultural employers reporting social security and Medicare taxes and withheld income tax.**—Report these on **Form 943**, Employer's Annual Tax Return for Agricultural Employees.

**When To File.**—Due dates for returns are:

Quarter	Ending	Due Date
Jan.-Feb.-Mar.	Mar. 31	Apr. 30
Apr.-May-June	June 30	July 31
July-Aug.-Sept.	Sept. 30	Oct. 31
Oct.-Nov.-Dec.	Dec. 31	Jan. 31

If you deposited all taxes when due for the quarter, you may file the return by the 10th day of the month following the due date.

**Where To File.**—The addresses are listed in the Form 941 instructions. Please note that there may be different addresses for filing returns, depending on whether you file with or without a payment.

**Magnetic Tape Filing of Form 941.**—Reporting agents filing Forms 941 for groups of taxpayers can file them on magnetic tape. For more information, see **Pub. 1264**, Magnetic Tape Reporting of Form 941, Employer's Quarterly Federal Tax Return.

**Penalties.**—For each whole or part month a return is not filed when required (disregarding any extensions of the filing deadline), there is a penalty of 5% of the unpaid tax due with that return. The maximum penalty is 25%. Also, for each whole or part month the tax is paid late (disregarding any extensions of the payment deadline), a penalty of 0.5% of the amount of tax generally applies. The maximum for this penalty is also 25%.

The penalties will not be charged if there is an acceptable reason for failing to file or pay.

**Trust Fund Recovery Penalty.**—If income, social security, and Medicare taxes that must be withheld are not withheld or are not paid to the IRS, the trust fund recovery penalty may apply. The penalty is the full amount of the unpaid trust fund tax. This penalty may apply to you if these unpaid taxes cannot be immediately collected from the employer or business.

The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to be **responsible** for collecting, accounting for, and paying over these taxes, and who acted **willfully** in not doing so.

A **responsible person** can be an officer or employee of a corporation, a partner or employee of a partnership, an accountant, a volunteer director/trustee, or an employee of a sole proprietorship. A responsible person also may include one who signs checks for the business or otherwise has authority to cause the spending of business funds.

**Willfully** means voluntarily, consciously, and intentionally. A responsible person acts willfully if the person knows the required actions are not taking place.

**Hints on Filing.**—Do not report more than one calendar quarter on a return.

Use the preaddressed form mailed to you. If you don't have the form, get one from any IRS office in time to file the return when due. If you use a form that is not preaddressed, please show your name and EIN on it. Be sure they are exactly as they appeared on earlier returns. See the instructions for Form 941 for suggestions for preparing the form.

**Final Return.**—If you go out of business, you should file a final return for the last quarter in which wages are paid. If you continue to pay wages or other compensation for quarters following termination of your business, you are required to file returns for those quarters. See the Form 941 instructions for details on how to file a final return.

**Successor Employer.**—If you received all or most of the property used in the trade or business of another employer, or a unit of that employer's trade or business, you may include the wages the other employer paid to your employees when you figure the annual wage limit for social security. See Regulations section 31.3121(a)(1)-1 for more information. Also see Rev. Proc. 84-77, 1984-2 C.B. 753, for the procedures used in filing returns in a predecessor-successor situation.

**Common Paymaster.**—For information on concurrent employment by related corporations with a common paymaster, see Regulations section 31.3121(s)-1.

**Modifying Forms 941 and 942 for Prior Years.**—If you are filing an original return for a quarter in a prior year and you are using the current year form, you will have to modify Forms 941 and 942.

**Caution:** *The instructions on the form may be inappropriate for the year for which you are reporting taxes because of changes in the law, regulations, or procedures. Contact the IRS if you have any questions. The revision date (found under the form number at the top of the form) will tell you the year for which the form was developed.*

**Note:** *A form for a particular year can generally be used without modification for any quarter within that year. For example, a form with any 1995 revision date (e.g., January or October 1995) can generally be used without modification for any quarter of 1995.*

In all cases, however, be sure to correctly fill out the "Date quarter ended" section at the top of the form. If you are modifying a form with a label, change the date on the label (the date is shown with the month and year the quarter ends; for example, JUN95 would be for the quarter ending June 30, 1995). Cross out any inapplicable tax rate(s) shown on the form and write in the rate from the chart below. You can get tax

rates and wage bases for years not shown in the table from the IRS.

#### Social Security and Medicare Tax Rates (for 3 prior years)

Calendar Year	Wage Base (each employee)	Tax Rate on Taxable Wages and Tips
1994-Social Security	\$60,600	12.4%
1994-Medicare	All Wages	2.9
1993-Social Security	57,600	12.4
1993-Medicare	135,000	2.9
1992-Social Security	55,500	12.4
1992-Medicare	130,200	2.9

**Reconciling Forms W-2, W-3, and 941.**—When there are discrepancies between Forms 941 filed with the IRS and Forms W-2 and W-3 filed with the SSA, we must contact you to resolve the discrepancies. This costs time and money, both for the Government and for you the employer.

To help reduce errors that can cause discrepancies—

1. Report bonuses as wages and as social security and Medicare wages on Forms W-2 and 941.

2. Report both social security and Medicare wages and taxes separately on Forms W-2, W-3, and 941.

3. Report social security taxes on Form W-2 in the box for social security tax withheld, not as social security wages.

4. Report Medicare taxes on Form W-2 in the box for Medicare tax withheld, not as Medicare wages.

5. Make sure social security wage amounts for each employee do not exceed the annual social security wage base.

6. Do not report noncash wages that are not subject to social security or Medicare taxes as social security or Medicare wages.

7. If you used an EIN on any of the four quarterly Forms 941 for the year that is different from the EIN reported on Form W-3, enter the other EIN on Form W-3 in the box for "Other EIN used this year."

To reduce the discrepancies between amounts reported on Forms W-2, W-3, and 941—

1. Be sure the amounts on Form W-3 are the total amounts from Forms W-2.

2. Reconcile Form W-3 with your four quarterly Forms 941 by comparing amounts reported for—

- Social security wages, social security tips, and Medicare wages and tips. Form W-3 should include Form 941 adjustments only for the current year (i.e., if the Form 941 adjustments include amounts for a prior year, do not report those prior year adjustments on the current-year Forms W-2 and W-3).

- Social security and Medicare taxes. The amounts shown on the four quarterly Forms 941 including current-year adjustments should be approximately twice the amounts shown on Form W-3. This is because Form 941 includes both the employer and employee shares of social security and Medicare taxes.

- Advance earned income credit.

For payments made after December 31, 1993, **do not** report on Form 941 nonpayroll items such as backup withholding and withholding on pensions, annuities, and gambling winnings. These nonpayroll items must be reported on the new Form 945 (see Instructions for Form 945 for details). Income tax withholding required to be reported on Forms 1099 or W-2G must be reported on Form 945. Only taxes and withholding properly reported on Form W-2 should be reported on Form 941.

Amounts reported on Forms W-2, W-3, and 941 may not match for valid reasons. If they do not match, you should determine that the reasons are valid. Keep your reconciliation so you will have a record of why amounts did not match in case there are inquiries from the IRS or the SSA.

## 13. Adjustments

There are two types of adjustments: current period adjustments and adjustments to correct errors on prior period returns. See the instructions for Forms 941 and 941c for more information on how to report these adjustments.

### Current Period Adjustments

Generally, current period adjustments are to subtract amounts reported as social security and Medicare taxes on lines 6a, 6b, and 7 of Form 941 for which the employer is not liable. These amounts, for which the employer is not liable, are reported on lines 6a, 6b, and 7 because they must be reported to the employee on Form W-2 and the amounts reported as social security and Medicare wages and taxes on Form 941 must equal the corresponding amounts reported on Forms W-2 (see the **Reconciling Forms W-2, W-3, and 941** discussion in section 12). Current period adjustments are reported on line 9 of Form 941 and include the following:

**Adjustment of tax on tips.**—If, by the 10th of the month after the month you received an employee's report on tips, you do not have enough employee funds available to withhold the employee's share of social security and Medicare taxes, you no longer have to collect it. Report the entire amount of these tips on lines 6b (social security tips) and 7 (Medicare wages and tips). Include as an adjustment on line 9 the total uncollected employee share of the social security and Medicare taxes.

**Adjustment of group-term life insurance premiums paid for former employees.**—The employee share of social security and Medicare taxes on group-term life insurance over \$50,000 for a former employee is paid by the former employee with his or her tax return, and is not collected by the employer. However, include all social security and Medicare taxes for such coverage on lines 6a and 7 (social security and Medicare taxes), and back out the amount of the employee share of these taxes as an adjustment on line 9.

**Note:** Also enter the amount of the above adjustments in the "other" adjustment entry space and provide a brief statement explaining the nature and amount of the adjustments (see the example below).

**Adjustment of tax on third-party sick pay.**—Deduct on line 9 the social security and Medicare taxes on third-party sick pay for which you are not responsible, and enter the amount of the sick pay adjustment on line 9. Also enter the sick pay adjustment in the "sick pay" adjustment entry space. No additional statement for this adjustment is required. See **Pub. 952**, Sick Pay Reporting, for more information.

**Fractions of cents adjustment.**—If there is a difference between the total tax on line 8 and the total deducted from your employees' wages or tips plus the employer's contribution, and this difference is caused by adding or dropping fractions of cents in collecting the tax, report the difference on line 9. Also enter the amount of this adjustment in the entry space for "fractions of cents." No additional statement for this adjustment is required.

**Example of Reporting Current Period Adjustments:** Cedar Company was entitled to the following current period adjustments:

- Third-party sick pay: It included \$2,000 for sick pay on lines 6a and 7 for social security and Medicare taxes. However, the third-party payer of the sick pay withheld and paid to the IRS the employee share (\$1,000) of these taxes. Cedar Company is entitled to a \$1,000 sick pay adjustment (negative).

- Fractions of cents: Cedar Company determined that the amounts calculated and deposited for social security and Medicare taxes during the quarter were a net \$50 less than the amount figured on lines 6a and 7 (social security and Medicare taxes). This difference was caused by adding or dropping frac-

tions of cents when figuring employment taxes for each wage payment. It must report a \$50 fractions of cents adjustment (positive).

• **Life insurance premiums:** Cedar Company paid group-term life insurance premiums for policies in excess of \$50,000 for former employees. The former employees must pay the employee share of the social security and Medicare taxes (\$200) on the policies. However, the Cedar Company must include the employee share of these taxes with the social security and Medicare taxes reported on lines 6a and 7 of Form 941 (because this amount must also be reported on Form W-2 for the former employees and the amounts reported on Forms 941 and W-2 must reconcile for these taxes). It is entitled to \$200 adjustment (negative). Cedar Company reported these adjustments as shown in the **Current Period Adjustment Example** below.

**Prior Period Adjustments**

Generally, you can correct errors on prior period Forms 941 by making an adjustment on the Form 941 for the quarter during which the error was discovered. For example, if you made an error in reporting social security tax on your 2nd quarter, 1994, Form 941 and discovered the error during January 1995, correct the error by making an adjustment on the 1st quarter, 1995, Form 941.

The adjustment increases or decreases your tax liability for the quarter in which it is reported (the quarter the error is discovered) and is interest-free. The net adjustments reported on Form 941 may include any number of corrections for one or more previous quarters, including both overpayments and underpayments.

You are required to provide background information and certifications supporting prior period adjustments. File with Form 941 a **Form 941c**, Supporting Statement To Correct Information, or an equivalent statement providing the same required information. **Do not file Form 941c separately.** The IRS will not be able to process your adjustments without this supporting information. See the instructions for Form 941c for more information.

**Income tax withholding adjustments.**—Correct prior period income tax withholding errors by making an adjustment on line 4 of Form 941 for the quarter during which the error was discovered. **Note:** You may make an income tax withholding adjustment only for previous quarters during the **same calendar year.** This is because the employee uses the amount shown on Form W-2 as a credit when filing the income tax return (Form 1040, etc.).

You cannot adjust amounts reported as income tax withheld in a prior calendar year unless it is to correct an **administrative error.** An administrative error would be any error that does not change the amount of income tax that was actually withheld or deducted from an employee. For example, if the total income tax actually withheld was incorrectly reported due to a mathematical or transposition error, this would be an administrative error. The administrative error adjustment corrects only the amount reported on Form 941, not the actual amount withheld or deducted from the employee in a prior calendar year.

**Social security and Medicare tax adjustments.**—Correct prior period social security and Medicare tax errors by making an adjustment on line 9 of form 941 for the quarter during which the error was discovered. You may make adjustments to correct errors reported on Form 941 for previous quarters in the current and prior years. If you are also reporting current period adjustments (discussed above), also include the net prior period social security and Medicare adjustment in the “other” adjustment entry space.

**Reporting prior period adjustments on the record of Federal tax liability.**—Adjustments to correct errors in prior periods must be taken into account on either line 17 of Form 941, Monthly Summary of Federal Tax Liability, or on **Schedule B (Form 941)**, Employer’s Record of Federal Tax Liability. If the adjustment was to correct an **underreported liability** in a prior quarter, report the adjustment on the entry space corresponding to the date the error was discovered.

If the adjustment corrects an **overreported liability**, use the adjustment amount as a credit to offset subsequent liabilities until it is used up. For example, Elm Company, a monthly

**Current Period Adjustment Example**

7	Taxable Medicare wages and tips . . . . .	\$		×	2.9% (.029) =	7		
8	Total social security and Medicare taxes (add lines 6a, 6b, and 7). Check here if wages are not subject to social security and/or Medicare tax . . . . .					8		
9	Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ (1000.00) ± Fractions of Cents \$ 50.00 ± Other \$ (200.00) =					9	(1150	00)
10	Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9—see instructions).					10		
11	<b>Total taxes</b> (add lines 5 and 10)					11		

**Prior Period Adjustment Example**

- **All filers:** If line 13 is less than \$500, you need not complete line 17 or Schedule B.
- **Semiweekly depositors:** Complete Schedule B and check here . . . . .
- **Monthly depositors:** Complete line 17, columns (a) through (d) and check here . . . . .

<b>17 Monthly Summary of Federal Tax Liability.</b>			
(a) First month liability	(b) Second month liability	(c) Third month liability	(d) Total liability for quarter
- 0 -	4000.00	4500.00	8500.00

**Sign Here** Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature ▶ Print Your Name and Title ▶ Date ▶

schedule depositor, discovered on January 10, 1995, that it overreported social security tax on a prior quarter return by \$5,000. Its total tax liabilities for the 1st quarter of 1995 were: January—\$4,500, February—\$4,500, and March—\$4,500. Elm Company completed line 17 of Form 941 as shown in the **Prior Period Adjustment Example** on page 14.

The adjustment for the \$5,000 overreported liability was used to offset the January liability, so the \$4,500 liability was not deposited and a -0- liability was reported on line 17, column (a). The remaining \$500 of the \$5,000 adjustment credit was used to partially offset the liabilities for February, so only \$4,000 of the \$4,500 liability was deposited and reported on line 17, column (b).

**Note:** Do not make any changes to the record of Federal tax liability for current period adjustments. The adjusted liabilities are already reflected there.

**Filing a claim for overreported prior period liabilities.**—Alternatively, if you discover an error on a prior quarter return resulting in a tax overpayment, you may file **Form 843**, Claim for Refund and Request for Abatement, for a refund of the amount overpaid. This form also can be used to request an abatement of an overassessment of employment taxes, interest, and/or penalties. You must file Form 941c, or an equivalent statement, with Form 843. See the separate **Instructions for Form 843**.

**Collecting underwithheld taxes from employees.**—If you withheld no income, social security, or Medicare taxes or less than the right amount from an employee's wages, you can make it up from later pay to that employee. But you are the one who owes the underpayment to the IRS. Reimbursement is up to you and the employee. Underwithheld income tax must be recovered from the employee **on or before the last day of the calendar year**. (There are special rules for tax on tips. See section 6.)

**Refunding amounts incorrectly withheld from employees.**—If you withheld more than the right amount of income, social security, or Medicare taxes from wages paid, give the employee the excess. Any excess income tax withholding must be reimbursed to the employee prior to the end of the calendar year. Keep in your records the employee's written receipt showing the date and amount of the repayment. If you don't have a receipt, you must report and pay each excess amount when you file the return for the quarter in which you withheld too much tax.

**Filing corrected Form W-2 and W-3 statements.**—When adjustments are made to correct social security and Medicare taxes because of a change in the wage totals reported for a previous year, you also may need to file **Form W-2c**, Statement of Corrected Income and Tax Amounts, and **Form W-3c**, Transmittal of Corrected Income and Tax Statements.

## 14. Filing the Employer's Quarterly Tax Return for Household Employees (Form 942)

**Household Employees.**—File **Form 942**, Employer's Quarterly Tax Return for Household Employees, for services performed in or about a private home. Generally, household work includes services performed in or about your private home by cooks, butlers, housekeepers, governesses, maids, cleaning people, babysitters, janitors, caretakers, handy persons, gardeners, and drivers of cars for family use.

Do not file Form 942 for the following: (1) If you are a sole proprietor and file Form 941 for business employees, you may include taxes for household employees on your Form 941. (2) For household employees in a private home on a farm operated for profit, file Form 943. They are considered farmworkers. (3) For domestic service in a college club, fraternity, or sorority,

file Form 941. These services are not considered to have been performed in a private home.

You can withhold income tax from wages of your household employees if you and your employees agree to this arrangement.

You are liable for social security and Medicare taxes if you pay a household employee cash wages of \$50 or more in a calendar quarter. It doesn't matter when the wages were earned. The \$50 test applies to each household employee. Checks, money orders, etc., are the same as cash. The value of food, lodging, clothing, bus or subway tokens, and other noncash items you give to the employee is not subject to social security and Medicare taxes.

You do not have to pay social security and Medicare taxes on cash wages for any household service done in your home by your mother or father unless both **1** and **2** below apply.

**1.** You have in your home a son or daughter, or stepson or stepdaughter, who is under 18, or who has a physical or mental condition requiring the personal care of an adult for at least 4 continuous weeks in the quarter.

**2.** You are a widow or widower, or are divorced, or have a spouse in your home who, because of a physical or mental condition, is unable to care for your son or daughter, or stepson or stepdaughter, for at least 4 continuous weeks in the quarter.

The due dates for filing Form 942 are the same as for filing Form 941. See **When To File** on page XX.

For social security and Medicare taxes on household employees only, you may round each wage payment to the nearest whole dollar to figure taxes and report wages on your returns. If you do this, you must round off every wage payment made to every household employee during the same quarter. Get **Pub. 926**, Employment Taxes for Household Employers, for more information.

## 15. Filing the Federal Unemployment (FUTA) Tax Return (Form 940 or 940-EZ)

The Federal Unemployment Tax Act (FUTA), together with state unemployment systems, provides for payments of unemployment compensation to workers who have lost their jobs. Most employers pay both a Federal and state unemployment tax. Only the employer pays this tax; it is not deducted from the employee's wages. Use **Form 940** or **940-EZ**, Employer's Annual Federal Unemployment (FUTA) Tax Return, to report Federal unemployment tax.

The IRS will mail a preaddressed Form 940 or 940-EZ to employers who filed returns the year before. If you do not receive Form 940 or 940-EZ, you can get one from the IRS.

By January 31, file Form 940 or 940-EZ and deposit or pay the balance of tax. If you deposit all FUTA tax when due, you may file Form 940 or 940-EZ by February 10.

You may be able to use Form 940-EZ if (1) you paid unemployment taxes ("contributions") to only one state, (2) you paid these taxes by the due date of Form 940 or 940-EZ, (3) you paid wages that are not subject to the state unemployment laws of a credit reduction state, and (4) all wages that were taxable for FUTA tax purposes were also taxable for your state's unemployment tax. Otherwise, use Form 940. For example, if you paid wages to corporate officers (these wages are subject to FUTA tax) in a state that exempts these wages from its unemployment taxes, you cannot use Form 940-EZ.

For 1994 and 1995, the FUTA tax is 6.2% of wages paid during the year. The tax applies to the first \$7,000 you pay each employee as wages during the calendar year. The \$7,000 amount is the Federal wage base. Your state wage base may be different. Generally, you can take a credit against your FUTA tax for amounts you paid into state unemployment funds. This

credit cannot be more than 5.4% of taxable wages. The FUTA tax rate after the credit is .8%. (See Instructions for Form 940 for details.)

**Successor Employer.**—If you acquired a business from someone who was an employer liable for FUTA tax, you may count the wages that employer paid to the employees who continue to work for you when you figure the wage limit. If the prior owner was not subject to FUTA tax, you may be eligible for a credit based on the state unemployment contributions paid by that owner, under Code section 3302(e) and Regulations section 31.3302(e)-(1). See Instructions for Form 940.

**Magnetic Tape Filing of Form 940.**—Reporting agents filing Forms 940 for groups of taxpayers may file them on magnetic tape. See **Pub. 1314**, Magnetic Tape Reporting of Form 940, Employer's Federal Unemployment Tax Return.

## 16. Advance Payment of the Earned Income Credit

An eligible employee (defined later) who has a qualifying child is entitled to receive earned income credit (EIC) payments with his or her pay during the year. To get these payments, the employee must give you a properly completed **Form W-5**, Earned Income Credit Advance Payment Certificate. You are required to make advance EIC payments to employees who give you a completed and signed Form W-5.

Certain employees who do not have a qualifying child may be able to claim the EIC on their tax return. However, they **cannot** get advance EIC payments.

Payment of the advance EIC is limited to 60% of the EIC an eligible employee would receive if he or she has only one qualifying child. For 1995, the advance payment can be as much as \$x,xxx. The tables that begin on page xx reflect that limit.

**Eligible Employee.**—Only eligible employees can get advance EIC payments. The eligibility requirements for advance EIC are shown on Form W-5 and are summarized below:

1. The employee must have a qualifying child as defined on Form W-5.
2. The employee's expected 1995 earned income and adjusted gross income (including the spouse's income if the employee files a joint return) must each be less than \$xx,xxx.
3. The employee expects to be eligible to claim the EIC for 1995. If they expect to file **Form 2555**, Foreign Earned Income, or **Form 2555-EZ**, Foreign Earned Income Exclusion, for 1995, they **cannot** claim the EIC.

**Form W-5.**—On Form W-5, an employee states that he or she expects to be eligible for the EIC and shows whether he or she has a certificate in effect with any other current employer. The employee also shows the following:

- Whether he or she has a qualifying child.
- Whether he or she is married.
- If the employee is married, whether his or her spouse has a certificate in effect with any employer.

An employee may have only one certificate in effect with a current employer at one time. If an employee is married and his or her spouse also works, each spouse should file a separate Form W-5.

**Length of effective period.**—Form W-5 remains in effect until the end of the calendar year unless the employee revokes the certificate or files another one. Eligible employees must file a new certificate each year.

**Change of status.**—If an employee gives you a signed Form W-5 and later becomes ineligible for advance EIC payments, he or she must revoke the certificate within 10 days after learning about the change of circumstances. The employee must give you a new Form W-5 stating that he or she is no longer eligible for or no longer wants advance EIC payments.

If the employee's situation changes because his or her spouse files a Form W-5, the employee must file a new Form W-5 showing that his or her spouse has a certificate in effect with an employer. This will reduce the maximum amount of advance payments you can make to that employee.

If the employee's spouse has filed a Form W-5 that is no longer in effect, the employee may file a new Form W-5 with you, but is not required to do so. A new form will certify that the spouse does not have a certificate in effect and will increase the maximum amount of advance payments you can make to that employee.

**Invalid certificate.**—The Form W-5 is invalid if it is incomplete, unsigned, or has an alteration or unauthorized addition. The form has been altered if any of the language has been deleted. Any writing added to the form other than the requested entries is an unauthorized addition.

You should consider a certificate invalid if an employee has made an oral or written statement that clearly shows the Form W-5 to be false. If you receive an invalid certificate from an employee, tell the employee that the certificate is invalid as of the date the employee made the oral or written statement. For advance EIC payment purposes, the invalid certificate is considered void.

The employer is not required to determine if a completed and signed Form W-5 is correct. However, you should contact the IRS district director if you have reason to believe the certificate has any incorrect statement.

**How To Figure the Advance EIC Payment.**—You must include advance EIC payments with wages you pay to eligible employees who give you a signed and completed Form W-5. Make the initial certificate effective for the first payroll period ending (or the first wage payment made without regard to a payroll period) on or after the date the employee gives you the form.

For purposes of the advance EIC payment, wages means amounts subject to income tax withholding. For employees who claim exemption from income tax withholding on Form W-4, wages means amounts that would have been subject to income tax withholding. For household employees, wages means amounts subject to social security and Medicare taxes.

To figure the amount of the advance EIC payment to include with the employee's pay, you must consider:

1. Wages, including reported tips, for the pay period.
2. Whether the employee is married or single.
3. Whether a married employee's spouse has a Form W-5 in effect with an employer.

**Note:** *If during the year you have paid an employee total wages of at least \$xx,xxx, you must stop making advance EIC payments to that employee for the rest of the year.*

Figure the amount of advance EIC to include in the employee's pay by using the tables that begin on page XX. There are separate tables for employees whose spouses have a certificate in effect. If an employee shows on Form W-5 that his or her spouse has a Form W-5 in effect with an employer, use either the wage bracket or percentage method tables titled "MARRIED With Both Spouses Filing Certificate." Otherwise, use either the wage bracket or percentage method tables titled "SINGLE or MARRIED Without Spouse Filing Certificate." Be sure to use the correct table for your pay period (i.e., weekly, biweekly, monthly, daily, etc.). The amount of advance EIC paid to an employee during 1995 cannot exceed \$x,xxx.

**Example 1:** You pay Wanda Carter \$140 a week. She has given you a Form W-5 that shows she is married and her husband has given his employer a Form W-5. You have decided to use the wage bracket method to figure your advance EIC payments. You turn to the wage bracket tables for a weekly payroll period, and look at the table "MARRIED With Both Spouses Filing Certificate." According to this table, you will include an \$x

advance EIC payment with Wanda Carter's net pay for the week.

**Paying the Advance EIC to Employees.**—An advance EIC payment is not wages and is not subject to withholding of income, social security, or Medicare taxes. An advance EIC payment does not change the amount of income, social security, or Medicare taxes you withhold from the employee's wages. You add the EIC payment to the employee's net pay for the pay period. At the end of the year, you show the total advance EIC payments in the box for "Advance EIC payment" on the Form W-2. Do not include this amount in the "Wages..." box.

**Employer's returns.**—Show the total payments you made to employees on the advance EIC lines of your Form 941, 942, or 943, whichever applies. Subtract this amount from your total taxes (see the specific instructions for each form).

Generally, employers will make the advance EIC payment from withheld income tax and employee and employer social security and Medicare taxes. These taxes are normally required to be paid over to the IRS either through Federal tax deposits or with employment tax returns. For purposes of deposit due dates, advance EIC payments are considered deposited on the day you pay wages (including the advance EIC payment) to your employees. The advance EIC payment reduces, in this order, the amount of income tax withholding, withheld employee social security and Medicare taxes, and the employer's share of social security and Medicare taxes.

**Example 2:** You have 10 employees, each entitled to an advance EIC payment of \$10. The total advance payments you make for the payroll period is \$100. The total income tax withholding for the payroll period is \$90. The total employee and employer social security and Medicare taxes for the payroll period is \$122.60 (\$61.30 each).

You are considered to have made a deposit of \$100 advance EIC payment on the day you paid wages, and you subtract this amount from your employment taxes for the payroll period. The \$100 is treated as if you paid the IRS the \$90 total income tax withholding and \$10 of the employee social security and Medicare taxes. You remain liable only for \$112.60 of the social security and Medicare taxes (\$51.30 + \$61.30 = \$112.60).

**Advance EIC Payments More Than Taxes Due.**—If for any payroll period the total advance EIC payments are more than the total payroll taxes (withheld income tax and both employee and employer shares of social security and Medicare taxes), you may choose either of the following options:

**Option 1.**—Reduce each employee's advance payment by an amount figured by multiplying the employee's advance payment by a fraction. The numerator is the excess advance amount, and the denominator is the total advance EIC payments for the pay period. See **Example 3** below.

**Option 2.**—Elect to make full payment of the advance EIC and treat the excess as an advance payment of employment taxes. The excess payment is applied first to income tax withholding, next to employee social security and Medicare taxes, and then to employer social security and Medicare taxes due for the reporting period in which the excess amount was paid.

**Example 3:** You have 10 employees who are each entitled to an advance EIC payment of \$10. They are all student nurses whose wages are exempt from social security and Medicare taxes. The total amount of advance EIC payments for the payroll period is \$100; the total income tax withholding is \$90. The advance EIC amount is \$10 more than the total income tax withholding.

Under Option 1, reduce the advance payment to each employee by \$1.00, or  $\frac{1}{10}$  of the excess payment, figured as follows:

$$\frac{\$10 \text{ (excess advance amount)}}{\$100 \text{ (total advance payments)}} = \frac{1}{10} \times \$10 = \$1.00$$

Under Option 2, you choose to pay each employee the full advance EIC amount (\$100 total) and treat the excess advance payments (\$10) as an advance payment of employment taxes. Show the full \$100 as advance EIC on your employment tax return for the reporting period in which you made the payment.

If you elect to make full payment, you must include with your employment tax return a statement of the amount of the excess advance EIC payments and the payroll period to which the excess applies. You may make separate elections for separate pay periods. If the amount of employment taxes you owe on the return remains less than the amount of excess payment, you may claim a refund of the difference or have the credit applied to your next return.

**Penalty.**—You must make advance EIC payments to employees who correctly fill out Form W-5. If you do not, you may be subject to a penalty equal to the amount of the advance EIC payments not made.

If you are in American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, or the Virgin Islands, consult your local tax office for information on the EIC. You cannot take advance EIC payments into account on Form 941-SS.

### Required Notice to Employees

You must notify employees who have no income tax withheld that they may be able to claim a tax refund because of the EIC. Although you do not have to notify employees who claim exemption from withholding on **Form W-4**, Employee's Withholding Allowance Certificate, about the EIC, you are encouraged to notify any employees whose wages for 1994 were less than \$xx,xxx that they may be eligible to claim the credit for 1994. This is because eligible employees may get a refund of the amount of EIC that is more than the tax they owe. For example, an employee who had no tax withheld in 1994 and owes no tax, but is eligible for a \$xxx EIC, can file a 1994 tax return to get a \$xxx refund.

You can notify your employees by giving them one of the following:

1. The IRS Form W-2, which has the required statement about the EIC on the back of Copy C.
2. A substitute Form W-2, with the same statement on the back of the employee copy that is on Copy C of the IRS Form W-2.
3. **Notice 797**, Possible Federal Tax Refund Due to the Earned Income Credit (EIC).
4. Your written statement with the exact wording as Notice 797.

If you are required to give Form W-2 and do so on time, no further notice is necessary if the Form W-2 has the required statement about the EIC on the back of the employee's copy. If a substitute Form W-2 is given on time but doesn't have the required statement, you must notify the employee within 1 week of the date the substitute Form W-2 was given. If Form W-2 is required but isn't given on time, you must give the employee Notice 797 or your written statement by the date Form W-2 was required to be given. If Form W-2 is not required, you must notify the employee by February 7, 1995.

For more information about notification requirements, see

**Notice 1015** (formerly Pub. 1325), Employers—Have You Told Your Employees About the Earned Income Credit (EIC)?

**Note:** For 1995, you are encouraged to notify the following employees that they may be able to claim the EIC on their 1995 returns:

- Employees with one qualifying child and wages less than \$xx,xxx.
- Employees with two or more qualifying children and wages less than \$xx,xxx.
- Employees without children and wages less than \$x,xxx.

## 17. Example of How To Figure Employment Taxes

Peter Cone owns a small furniture business which he runs with three full-time employees. In 1994, he paid one employee \$600 a week, one employee \$500 a week, and one employee \$400 a week. He did not hire anyone else during the year, and the employees stayed with him the entire year.

It is Peter's practice to pay his employees on Monday. If Monday is a holiday, payday is Tuesday.

The sections that follow discuss how Peter figured his employment taxes for the year. They show how he figured his deposits and how he filled out Forms 940-EZ and 941. Only the 4th quarter Form 941 is illustrated.

Peter files Form 941 quarterly. On it, he reports:

- Income tax he withholds from his employees' wages; and
- Social security and Medicare taxes, both the part he withholds from his employees' wages and the part he pays as an employer.

Before filing Form 941 for the 4th quarter, Peter must deposit the taxes at various times during the quarter because his net tax liability each quarter regularly exceeds \$500.

Each of Peter's employees has already filled out a Form W-4. Form W-4 tells him:

- How many withholding allowances the employee claims; and
- Whether to withhold at the "married" or at the "single" rate.

Using this information, Peter finds the correct amount to withhold in Circular E. He uses the wage bracket tables in the January 1994 Circular E to find the correct amount to withhold during the 4th quarter. The tables are for wages paid after December 1993.

In the 4th quarter of 1994, the first payday for Peter's employees is Monday, October 3. His income tax withholding for this payday is shown in the chart below:

Employee	Wages for the week	Withholding rate and allowances	Amount to be withheld
R. Apple	\$ 600	married-3	\$ 51.00
J. Jones	500	married-2	43.00
F. Plum	400	single-1	46.00
Total	\$1,500		\$140.00

Peter's liability for withheld income tax on this payday totals \$140.00. If any of his employees had asked him (on Form W-4) to withhold an extra amount, he would have included it with the total.

Peter also withholds 6.2% of each employee's wages as social security tax and pays a 6.2% share himself, for a total of 12.4% in 1994. In addition, he withholds 1.45% of each employee's wages as Medicare tax and pays a 1.45% share himself, for a total of 2.9%. The total social security tax for this payday is \$186.00 (\$1,500 total wages times 12.4%), and the total Medicare tax is \$43.50 (\$1,500 total wages times 2.9%).

Social security tax applies to only the first \$60,600 paid to each employee in 1994. The Medicare tax applies all wages in 1994. If any of Peter's employees had already earned \$60,600, or reached this limit on the October 4 payday, he would have included only the Medicare tax when figuring the tax. However, none of his employees will earn more than \$60,600 in 1994.

None of the employees is eligible for advance earned income credit payments (discussed later).

On this payday, Peter's total liability for social security tax, Medicare tax, and withheld income tax is \$369.50 (\$186.00 plus \$43.50 plus \$140.00). The following chart shows his tax liability for the paydays in the 4th quarter:

Payday	Total wages paid	Income Tax withheld	Social Security (12.4%)	Medicare (2.9%)
Oct. 3	\$1,500.00	\$140.00	\$186.00	\$43.50
Oct. 11	1,500.00	140.00	186.00	43.50
Oct. 19	1,500.00	140.00	186.00	43.50
Oct. 24	1,500.00	140.00	186.00	43.50
Oct. 31	1,500.00	140.00	186.00	43.50
Nov. 7	1,500.00	140.00	186.00	43.50
Nov. 14	1,500.00	140.00	186.00	43.50
Nov. 21	1,500.00	140.00	186.00	43.50
Nov. 28	1,500.00	140.00	186.00	43.50
Dec. 5	1,500.00	140.00	186.00	43.50
Dec. 12	1,500.00	140.00	186.00	43.50
Dec. 19	1,500.00	140.00	186.00	43.50
Dec. 27	1,500.00	140.00	186.00	43.50
Total	\$19,500.00	\$1,820.00	\$2,418.00	\$565.50

### Making Deposits

Peter's schedule for making deposits depends on whether he is a semiweekly or a monthly schedule depositor. The total employment taxes for his lookback period (July 1, 1992, to June 30, 1993) is less than \$50,000. Therefore, he is a monthly depositor for all of 1994. The taxes accumulated for October must be deposited by November 15.

During November, Peter's payroll remains the same. The following chart shows how the social security tax, Medicare tax, and withheld income tax he owes add up during November:

Payday	Total wages paid on the payday	Taxes owed for the payday	Taxes owed since last deposit requirement
Nov. 1	\$1,500	\$369.50	\$369.50
Nov. 8	1,500	369.50	739.00
Nov. 15	1,500	369.50	1,108.50
Nov. 22	1,500	369.50	1,478.00
Nov. 29	1,500	369.50	1,847.50

Because Peter is a monthly depositor for all of 1994, he must make a deposit of the taxes accumulated for November (\$1,847.50) by December 15.

During December, Peter's payroll remains the same. The following chart shows how the social security tax, Medicare tax, and withheld income tax he owes add up during December.

Payday	Total wages paid on the payday	Taxes owed for the payday	Taxes owed since last deposit requirement
Dec. 6	\$1,500	\$369.50	\$369.50
Dec. 13	1,500	369.50	739.00
Dec. 20	1,500	369.50	1,108.50
Dec. 27	1,500	369.50	1,478.00

A \$1,478.00 deposit by January 17, 1995, is required. (January 15 falls on Sunday and January 16 is a holiday).

### Filling Out Form 941

Peter begins filling out Form 941 by using the preaddressed form with his name, address, and employer identification number. The form identifies the quarter the return is for as ending on December 31, 1994. Since it is a 4th quarter return, he does not have to fill in line 1. If he had gone out of business in 1994, he would fill in the final return entries above line 1 on the Form 941. Because he made all his deposits in the state

shown in his address, he does not have to make an entry in the state code box.

**Line 2.** Peter enters the total wages he paid in the quarter, \$19,500.

**Line 3.** Peter enters the total income tax he withheld from his employees' wages during the quarter, \$1,820.

**Line 5.** Peter does not have to make any adjustments for errors in the withholding he reported for the first 3 quarters of the year (line 4). He enters the amount from line 3 on line 5.

**Line 6a.** None of Peter's employees earned more than the \$60,600 limit for 1994. The amount they were paid during the quarter, \$19,500, is counted as "taxable social security wages." He enters 12.4% of this amount, or \$2,418, as his social security tax on this line. This includes both his share and the amount he withheld from his employees' wages.

**Line 6b.** Peter's employees did not earn any taxable tips.

**Line 7.** Peter again enters the wages he paid. He enters 2.9% of this amount, or \$565.50, as his Medicare tax on this line. This includes both his share and the amount he withheld from his employees' wages.

**Lines 8 and 10.** Peter does not have to make any adjustments for errors in social security or Medicare taxes he reported previously (line 9). He enters the total amount of social security and Medicare taxes on lines 8 and 10.

**Line 11.** Peter adds the withheld income, social security, and Medicare taxes. He enters the total, \$4,803.50.

**Line 13.** None of Peter's employees received advance payments of the earned income credit (line 12). He enters the amount from line 11 on line 13.

**Lines 14 and 15.** Peter shows that the amount of tax he owed for the quarter and the amount he deposited are the same. He does not have to make a payment with his return (line 15). Nor is he owed a refund (line 16).

**Line 17.** Peter completes the Monthly Summary of Federal Tax Liability section by filling in the monthly liability totals in line 17, columns (a), (b), (c), and the quarterly total in column (d). He confirms that the amount in column (d) equals the amount reported on line 13.

**Signature and date.** Peter signs the return, prints his name and title, and enters the date. Because Peter deposited the tax on time and in full, he has an extra 10 days to file his return.

### Form 940 or Form 940-EZ

Peter must pay state as well as federal unemployment tax. His state gave him an experience rate of 3.0% for 1994. Since his state bases its tax on the first \$7,000 of wages paid to each employee, and since he paid each of his employees more than that amount in 1994, he must pay the state tax on \$21,000 (\$7,000 times 3 employees). He paid \$630 (3.0% of \$21,000) in state unemployment tax during 1994.

For federal unemployment tax, Peter must fill out Form 940, or Form 940-EZ if he qualifies, for the year and make any deposits required. A deposit is required if an employer has more than \$100 of tax outstanding at the end of a calendar quarter.

### Making Deposits

The federal unemployment tax rate is 6.2% of the first \$7,000 in wages paid to each employee in 1994. Peter figures his deposits under the assumption that he will receive full credit for the state unemployment tax he paid. The maximum credit allowed is 5.4%. He figures his deposits using an effective tax rate of 0.8% (6.2% minus 5.4%). Although he has a state experience rate of less than 5.4%, he is still able to take the 5.4% credit.

Peter will not know until the end of the year whether the 5.4% credit will be reduced for employers in his state. If it is reduced, he must take the reduction into account when figuring the deposit for the 4th quarter.

**First quarter.** There were 13 paydays for Peter's employees in the 1st quarter of 1994. Each employee's wages remained the same on all 13 paydays. The following table shows how much of each employee's total wages for the 1st quarter is subject to federal unemployment (FUTA) tax:

Employee	Wages paid in 1st quarter	Wages subject to FUTA in 1st quarter
R. Apple	\$7,800	\$7,000
J. Jones	6,500	6,500
F. Plum	5,200	5,200
Total	\$19,500	\$18,700
Tax rate		×.008

Tax liability for 1st quarter \$149.60

Peter figures his tax for the quarter as 0.8% of \$18,700, or \$149.60. Because this is more than \$100, he must deposit it by the end of April.

**Second quarter.** There were 13 paydays for Peter's employees in the 2nd quarter of 1994. Each employee's weekly wages remained the same. The following table shows how much of each employee's total wages for the 2nd quarter is subject to federal unemployment (FUTA) tax:

Employee	Wages for the week	Withholding rate and allowances	Amount to be withheld
R. Apple	\$7,800	\$7,000	\$ -0-
J. Jones	6,500	6,500	500
F. Plum	5,200	5,200	1,800
Total	\$19,500		\$2,300
Tax rate			×.008

Tax liability for 2nd quarter \$18.40

The wages he paid to all his employees reached the yearly \$7,000 limit during the quarter. For example, all the wages paid to J. Jones in the 1st quarter, \$6,500, were subject to the tax. Therefore, only \$500 (\$7,000 minus \$6,500) of Jones's 2nd quarter wages are subject to the tax.

Peter's federal unemployment tax liability for the 2nd quarter is \$18.40. This is figured by multiplying the total wages subject to the tax in the quarter (\$2,300) by the tax rate (0.8%). He does not have to make a deposit for the 2nd quarter because the amount he owes is not more than \$100.

**Third quarter.** Peter carried over his 2nd quarter tax liability of \$18.40 to the 3rd quarter. However, since he already reached the \$7,000 limit for all his employees in the 2nd quarter, none of the wages paid in the 3rd quarter are subject to FUTA tax.

**Fourth Quarter.** Peter carried his tax liability of \$18.40 to the 4th quarter. Since Peter did not pay wages that are subject to the unemployment compensation laws of a credit reduction state, he does not have to figure a credit reduction for the 4th quarter. He can either deposit the \$18.40 or pay it with his Form 940 or Form 940-EZ by January 31, 1995.

Peter can file Form 940-EZ, a simplified version of Form 940, because: (1) he paid state unemployment taxes to only one state; (2) he paid all the state unemployment taxes by the due date of Form 940 or Form 940-EZ; (3) all his wages taxable for FUTA tax were also taxable for state unemployment tax; and (4) he paid no wages in 1993 subject to the unemployment compensation laws of a credit reduction state. If Peter did not meet these 4 conditions, he would have to file Form 940.

## Filling Out Form 940-EZ

Peter begins filling in Form 940-EZ by using the preaddressed form with his name, address, and employer identification number. If he uses a trade name, he also adds it if it is not already on the form.

**Items A and B.** Peter enters the amount he paid to the state unemployment fund, \$630.00. He then enters the name of his state and his state reporting number.

Peter is now ready to fill out the rest of the form.

### Part I

**Line 1.** Peter enters the total amount he paid to his employees during 1994. His payroll was \$78,000 for 1994.

**Line 2.** None of the wages he paid in 1994 was exempt from federal unemployment tax. Peter does not enter anything on this line. (Wages paid to a family member are an example of exempt wages.)

**Line 3.** Peter enters \$57,000, the amount of wages he paid that was over the \$7,000 limit for each employee. Any amount included on line 2 should not be included on this line.

**Line 4.** Peter enters \$57,000, the sum of lines 2 and 3.

**Line 5.** Peter subtracts his total exempt payments on line 4 from his total payments on line 1. He enters the difference,

\$21,000, on line 5. This is the amount of his 1994 wage payments subject to federal unemployment tax.

**Line 6.** Peter enters \$168, 0.8% of the \$21,000 in taxable wages listed on line 5.

**Line 7.** Peter enters \$149.60, the amount of his federal unemployment tax deposit for the 1st quarter. He made no other deposits during the year.

**Line 8.** Because his deposits do not equal his tax liability for the year, Peter writes a check for the additional amount.

**Line 9.** Because he did not overpay the tax, Peter leaves this line blank.

### Part II (Tax Liability Record)

Peter enters his tax for the 1st quarter, \$149.60, in the first column.

Peter enters his tax for the 2nd quarter, \$18.40, in the second column. He makes no entries in the 3rd and 4th quarter columns because he has no tax liability for those quarters.

Peter enters his total tax liability, \$168, in the last column.

**Signature and date.** Peter signs the return, enters his title as "owner," and enters the date.



## Employer's Annual Federal Unemployment (FUTA) Tax Return

**If incorrect,  
 make any  
 necessary  
 changes.** ▶

Name (as distinguished from trade name) Peter Cone	Calendar year 1994
Trade name, if any	
Address and ZIP code 362 Main Street Pinetown, VA 23000	Employer identification number 10:1234567

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Follow the chart under **Who May Use Form 940-EZ** on page 2. If you cannot use Form 940-EZ, you must use Form 940 instead.

**A** Enter the amount of contributions paid to your state unemployment fund. (See instructions for line A on page 4.) ▶ \$ 630 | 00

**B** (1) Enter the name of the state where you have to pay contributions . . . . . ▶ Virginia

(2) Enter your state reporting number as shown on state unemployment tax return. ▶

If you will not have to file returns in the future, check here (see **Who Must File**, on page 2) complete, and sign the return . . . . . ▶

If this is an Amended Return check here . . . . . ▶

**Part I Taxable Wages and FUTA Tax**

<b>1</b>	Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees	<b>1</b>	78000	00
<b>2</b>	Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ▶			
<b>3</b>	Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. Do not use your state wage limitation. The \$7,000 amount is the Federal wage base. Your state wage base may be different . . . . .	<b>3</b>	57000	00
<b>4</b>	Total exempt payments (add lines 2 and 3) . . . . .	<b>4</b>	57000	00
<b>5</b>	Total taxable wages (subtract line 4 from line 1) . . . . . ▶	<b>5</b>	21000	00
<b>6</b>	FUTA tax. Multiply the wages on line 5 by .008 and enter here. (If the result is over \$100, also complete Part II.) . . . . .	<b>6</b>	168	00
<b>7</b>	Total FUTA tax deposited for the year, including any overpayment applied from a prior year (from your records)	<b>7</b>	149	60
<b>8</b>	Amount you owe (subtract line 7 from line 6). This should be \$100 or less. Pay to "Internal Revenue Service". ▶	<b>8</b>	18	40
<b>9</b>	Overpayment (subtract line 6 from line 7). Check if it is to be: <input type="checkbox"/> Applied to next return, or <input type="checkbox"/> Refunded ▶	<b>9</b>		

**Part II Record of Quarterly Federal Unemployment Tax Liability** (Do not include state liability.) Complete only if line 6 is over \$100.

Quarter	First (Jan. 1 – Mar. 31)	Second (Apr. 1 – June 30)	Third (July 1 – Sept. 30)	Fourth (Oct. 1 – Dec. 31)	Total for year
Liability for quarter	149.60	18.40	-0-	-0-	168.00

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and, to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments to employees.

Signature ▶ Peter Cone Title (Owner, etc.) ▶ Owner Date ▶ 1/25/95

## 18. Special Rules for Various Types of Services and Products

(Section references are to the Internal Revenue Code unless otherwise noted.)

Special classes of employment and special types of payments	Treatment under employment taxes		
	Income tax withholding	Social security and Medicare	Federal unemployment
Accident and health insurance premiums under a plan or system for employees and their dependents generally or for a class or classes of employees and their dependents.	Exempt (except 2% shareholder-employees of S corporations)	Exempt	Exempt
<b>Agricultural labor</b>	See <b>Circular A</b>	See <b>Circular A</b>	See <b>Circular A</b>
<b>Aliens:</b> (Aliens not qualifying as resident aliens under the statutory definition contained in section 7701(b) are defined as nonresident aliens. See <b>Pub. 515</b> , <i>Withholding of Tax on Nonresident Aliens and Foreign Corporations</i> , and <b>Pub. 519</b> , <i>U.S. Tax Guide for Aliens</i> , for more information.)			
a. Resident			
1. Service performed in U.S.	Same as U.S. citizen	Same as U.S. citizen; service as crew member of foreign vessel or aircraft exempt if any part is performed outside U.S.	Same as U.S. citizen
2. Service performed outside U.S.	Same as U.S. citizen	Taxable if (1) working for an American employer, or (2) an American employer by agreement covers U.S. citizens and residents employed by its foreign affiliates	Exempt unless on or in connection with an American vessel or aircraft and either performed under contract made in U.S., or alien is employed on such vessel or aircraft when it touches U.S. port
b. Nonresident working in U.S.			
1. Canadians and Mexicans entering U.S. frequently in transportation service across boundary, or in construction or operation of waterway, bridge, etc., at boundary.	Exempt under the conditions stated in the regulations	Exempt if railroad service	Exempt if railroad service
2. Other Canadians and Mexicans entering U.S. frequently to work.	Same as U.S. citizen	Same as U.S. citizen	Same as U.S. citizen
3. Workers from any foreign country or its possession lawfully admitted on a temporary basis to perform agricultural labor (H-2(A) visas only).	Exempt	Exempt	Exempt until 1995, but counted to see if either test in section 17 of Circular A is met
4. Student, scholar, trainee, teacher, etc., as nonimmigrant alien under section 101(a)(15)(F), (J), or (M) of Immigration and Nationality Act (i.e., aliens holding F-1, J-1, or M-1 visas).	Withhold unless excepted by regulations	Exempt if service is performed for purpose specified in section 101(a)(15) (F), (J), or (M) of Immigration and Nationality Act	
5. All other nonresidents working in U.S.	Withhold unless excepted by regulations	Same as U.S. citizen; service as crew member of foreign vessel or aircraft exempt if any part performed outside U.S. and employer is not "American employer"	Same as U.S. citizen
c. Nonresident working on American vessel or aircraft outside U.S.	Exempt	Taxable if under contract made in U.S., or worker is employed on vessel or aircraft when it touches U.S. port	
Cafeteria plans under section 125.	If the employee chooses cash, subject to all employment taxes. If the employee chooses another benefit, the treatment is the same as if the benefit were provided outside the plan.		
Deceased worker's wages paid to beneficiary or estate in same calendar year of worker's death.	Exempt	Taxable	Taxable
Deceased worker's wages paid to beneficiary or estate after the year of worker's death. See page xx for details.	Exempt	Exempt	Exempt
Dependent care assistance programs (limited to \$5,000; \$2,500 if married filing separately).	Exempt to the extent it is reasonable to believe that amounts will be excludable from gross income under section 129		
Disabled worker's wages paid after year in which worker became entitled to disability insurance benefits under the Social Security Act.	Withhold	Exempt, if worker did not perform any service for employer during period for which payment is made	Taxable

Special classes of employment and special types of payments	Treatment under employment taxes		
	Income tax withholding	Social security and Medicare	Federal unemployment
Dismissal or severance pay.	Withhold	Taxable	Taxable
Domestic service in college clubs, fraternities, and sororities.	Exempt (Withhold if both employer and employee voluntarily agree)	Exempt if paid to regular student; also if employee is paid less than \$100 in a year by an income-tax-exempt employer	Taxable if employer paid cash wages of \$1,000 or more in any calendar quarter in the current or preceding year
Educational assistance programs.	Exempt to the extent it is reasonable to believe the amounts will be excludable from gross income under section 127.		
Employee achievement awards.	Exempt to the extent it is reasonable to believe the amounts will be excludable from gross income under section 74(c)		
<b>Employee Business Expense Reimbursement:</b>			
a. Accountable plan.			
1. Amounts not exceeding specified government rate for per diem or standard mileage.	Exempt	Exempt	Exempt
2. Amounts in excess of specified government rate for per diem or standard mileage. (See pages x & xx for details.)	Withhold	Taxable	Taxable
b. Nonaccountable plan.	Withhold	Taxable	Taxable
<b>Family employees:</b>			
a. Son or daughter employed by parent (or by partnership consisting only of parents).	Withhold	Exempt until age 18	Exempt until age 21
b. Son or daughter employed by parent-owned S corporation.	Withhold	Taxable	Taxable
c. Son or daughter employed by parent for domestic work.	Exempt (Withhold if both employer and employee voluntarily agree)	Exempt until age 21	Exempt until age 21
d. Parent employed by a son or daughter.	Withhold	Taxable if in course of the son's or daughter's business. For household work in private home of son or daughter, see section 13, page xx.	Exempt
e. Spouse employed by spouse.	Withhold	Taxable if in course of spouse's business	Exempt
<b>Federal employees:</b>			
a. Members of uniformed services; Young Adult Conservation Corps, Job Corps, or National Volunteer Antipoverty Program; Peace Corps volunteers.	Withhold	Taxable	Exempt
b. All others.	Withhold	Taxable if employee is covered by FERS or has a break in service of more than 1 year (unless the break in service was for employment with an international organization or for temporary military or reserve duty). Others generally subject to Medicare tax	Exempt unless worker is a seaman performing services on or in connection with American vessel owned by or chartered to the United States and operated by general agent of Secretary of Commerce
<b>Fishing and related activities, employment in connection with:</b>			
a. Salmon or halibut.	Withhold unless c. applies	Taxable unless c. applies	Taxable unless c. applies
b. Other fish, sponges, etc.	Withhold unless c. applies	Taxable unless c. applies	Exempt unless on vessel of more than 10 net tons (and c. does not apply)
c. An arrangement with the owner or operator of a boat by which the individual is not paid cash remuneration but receives a share of the boat's catch (or proceeds from the sale of the catch), the share depending on the boat's catch, and the operating crew of the boat is normally fewer than 10 individuals.*	Exempt	Exempt	Exempt
Foreign governments and international organizations.	Exempt	Exempt	Exempt

\*Income derived by Native Americans exercising fishing rights is generally exempt from employment taxes.

Special classes of employment and special types of payments	Treatment under employment taxes		
	Income tax withholding	Social security and Medicare	Federal unemployment
<b>Foreign service by U.S. citizens:</b> a. As U.S. Government employee.  b. For foreign affiliates of American employers and other private employers.	Withhold  Exempt if at time of payment (1) it is reasonable to believe employee is entitled to exclusion from income under section 911, or (2) the employer is required by law of the foreign country to withhold income tax on such payment	Same as within U.S.  Exempt unless (1) an American employer by agreement covers U.S. citizens employed by its foreign affiliates, or (2) U.S. citizen works for American employer	Exempt (See also <b>Federal employees</b> on page xx.) Exempt unless (1) on American vessel or aircraft and work is performed under contract made in U.S., or worker is employed on vessel when it touches U.S. port, or (2) U.S. citizen works for American employer (except in a contiguous country with which the U.S. has an agreement for unemployment compensation) or in the Virgin Islands
Fringe benefits. (See page x.)	Subject to withholding and employment taxes on excess of fair market value of the benefit over the sum of any amount paid for it by the employee and any amount excludable by law. However, optional special valuation rules may apply.*		
Group-term life insurance costs.	Exempt	Generally, only the cost of group-term life insurance that is includible in gross income is taxable (Special rules apply for former employees.)	Exempt
<b>Homeworkers (industrial, cottage industry):</b> a. Common law employees. b. Statutory employees. (See page x.)	Withhold Exempt	Taxable Taxable if paid \$100 or more in cash in a year.	Taxable Exempt
Household workers (domestic service in private homes; farmers, see Circular A). (Also see <b>Domestic service in college clubs</b> above.)	Exempt (Withhold if both employer and employee voluntarily agree)	Taxable if paid \$50 or more in cash in quarter	Taxable if employer paid cash wages of \$1,000 or more in any calendar quarter in the current or preceding year
<b>Insurance agents or solicitors:</b> a. Full-time life insurance salesperson.  b. Other salesperson of life, casualty, etc., insurance.	Withhold only if employee under common law  Withhold only if employee under common law	Generally taxable, regardless of common law  Taxable only if employee under common law	Exempt if not common law employee or if paid solely by commissions  Exempt if not common law employee or if paid solely by commissions
Interns working in hospitals.	Withhold	Taxable	Exempt
<b>Leave-sharing plans:</b> Amounts paid to an employee pursuant to a leave-sharing plan. (See Rev. Rul. 90-29, 1990-1 C.B. 11.)	Withhold	Taxable	Taxable
Loans with below-market interest rates (for foregone interest and deemed original issue discount). (See section 7872 and related regulations for details.)	Exempt (but deemed payments of compensation-related loans must be shown on Form W-2)	Exempt, unless loans are compensation-related	Exempt, unless loans are compensation-related
Meals and lodging including those furnished at a bargain charge to the employee. (For household employees, agricultural labor, and service not in the course of the employer's trade or business, see <b>Noncash payments</b> on page xx.)	(a) Meals—subject to withholding and taxable unless furnished for employer's convenience and on the employer's premises. For information on the de minimis fringe exclusion, see section 132(e)(2) (b) Lodging—subject to withholding and taxable unless furnished on employer's premises, for the employer's convenience, and as condition of employment		
Ministers of churches performing duties as such. ( <b>Note:</b> Ministers are subject to self-employment tax unless Form 4361 has been filed and approved. See Pub. 517.)	Exempt (Withhold if both employer and employee voluntarily agree)	Exempt	Exempt
Members of religious orders who have taken a vow of poverty and who are instructed by the order to perform services: a. For the order, agency of the supervising church, or associated institution.	Exempt	Exempt, unless the religious order or autonomous subdivision thereof irrevocably elects coverage for entire active membership	Exempt

\* **Note:** Benefits provided under cafeteria plans may qualify for exclusion from wages for social security, Medicare, and Federal unemployment taxes. Employer-provided outplacement services may also qualify for exclusion. See Rev. Rul. 92-69, 1992-2 C.B. 51.

Special classes of employment and special types of payments	Treatment under employment taxes		
	Income tax withholding	Social security and Medicare	Federal unemployment
Members of religious orders who have taken a vow of poverty, etc. (continued) b. For any organization other than those described in a. above. (See Rev. Rul. 76-323, 1976-2 C.B. 18, as clarified by Rev. Rul. 77-290, 1977-2 C.B. 26, and amplified by Rev. Rul. 80-332, 1980-2 C.B. 35.)	Withhold	Taxable	Taxable
Members of religious orders who have <b>not</b> taken a vow of poverty and who are instructed by the order to perform services: a. For the order, agency of the supervising church, or associated institution. b. For any organization other than those described in a. above. (See Rev. Ruls. 76-323, 77-290, and 80-332.)	Exempt  Withhold	Exempt  Taxable	Exempt  Taxable
<b>Moving Expense Reimbursement:</b> a. Expenses incurred before 1994. (See page xx.) b. Expenses incurred after 1993. 1. Qualified expenses. 2. Nonqualified expenses.	Exempt, if you reasonably believe expenses are deductible by the employee; otherwise subject to withholding and employment taxes.  Exempt, unless you have knowledge that the employee deducted the expenses in a prior year. Withhold	Taxable  Taxable	Taxable
Newspaper carrier under age 18.	Exempt (Withhold if both employer and employee voluntarily agree)	Exempt	Exempt
Newspaper and magazine vendors buying at fixed prices and retaining excess from sales to customers.	Exempt (Withhold if both employer and employee voluntarily agree)	Exempt	Exempt
<b>Noncash payments:</b> a. For household work, agricultural labor, and service not in the course of the employer's trade or business. b. To certain retail commission salespersons ordinarily paid solely on a cash commission basis.	Exempt (Withhold if both employer and employee voluntarily agree)  Optional with employer	Exempt  Taxable	Exempt  Taxable
<b>Nonprofit organizations:</b> a. Religious, educational, charitable, etc., organizations described in section 501(c)(3) exempt from income tax under section 501(a).  b. Corporations organized under Act of Congress described in section 501(c)(1).  c. Other organizations exempt under section 501(a) (other than a pension, profit-sharing, or stock bonus plan described in section 401(a) or under section 521.	Withhold  Withhold  Withhold	Taxable if paid \$100 or more in a year. (See <b>Form 8274</b> , Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption From Employer Social Security and Medicare Taxes, to elect exemption for certain churches and church-controlled organizations)  Taxable if employee is paid \$100 or more in a year unless services excepted by section 3121(b)(5) or (6)  Taxable if employee is paid \$100 or more in a year	Exempt  Taxable if employee earns \$50 or more in a quarter unless services excepted by section 3306(c)(6)  Taxable if employee earns \$50 or more in a quarter
Patients employed by hospitals.	Withhold	Taxable (Exempt for state or local government hospitals)	Exempt
Railroads, etc.—Payments subject to Railroad Retirement Tax Act.	Withhold	Exempt	Exempt
<b>Retirement and pension plans:</b> a. Employer contributions to a qualified plan. b. Elective contributions and deferrals to a plan containing a qualified cash or deferred compensation arrangement (e.g., 401(k)).	Exempt  Generally exempt, but see section 402(g) for limitation	Exempt  Taxable	Exempt  Taxable

Special classes of employment and special types of payments	Treatment under employment taxes		
	Income tax withholding	Social security and Medicare	Federal unemployment
<b>Students: (continued)</b>			
c. Student working for public school, college, or university, if enrolled and regularly attending classes, and student nurse working for public hospital.	Withhold	Taxable only if covered by a section 218 (Social Security Act) agreement. Otherwise, the wages are not taxable.	Exempt
d. Spouse of student, if that spouse is advised at the time service begins that (1) the employment is provided under a program to provide financial assistance to the student by the school, college, or university, and (2) the employment will not be covered by any program of unemployment insurance.	Withhold	See <b>Nonprofit organizations and State governments and political subdivisions, employees of</b> , above.	Exempt
e. Student enrolled in a full-time program at a nonprofit or public educational institution. Institution must normally maintain a regular faculty and curriculum and normally have a regularly organized body of students where its educational activities are carried on. Student's service must be taken for credit at the institution. It must combine academic instruction with work experience. It must be an integral part of the program, and the institution must have so certified to the employer.	Withhold	Taxable	Exempt unless program was established for or on behalf of an employer or group of employers
f. Student nurse performing services for hospital as incidental part of student nurse's training, where employment is substantially less than full-time, and total earnings are nominal.	Withhold	Exempt	Exempt
g. Students employed by organized camps.	Withhold	Taxable	Exempt (section 3306(c)(20))
Supplemental unemployment compensation plan benefits.	Withhold	Exempt	Exempt
Tips, if \$20 or more in a month.	Withhold	Taxable	Taxable, for all tips reported in writing to employer
Tips, if less than \$20 in a month.	Exempt	Exempt	Exempt
<b>Wage limit:</b>			
a. Maximum of taxable wages paid each employee by same employer in same calendar year.	Unlimited	Maximum social security wage base is \$60,600 for 1994 and \$xx,xxx for 1995. All 1994 and 1995 wages are subject to Medicare tax. (Limit for new owner of business is reduced by predecessor's wage payments in certain cases.)	\$7,000
b. Individuals concurrently employed by two or more related corporations and paid through a common paymaster that is one of the corporations. See Regulations sections 31.3121(s)-1 and 31.3306(p)-1 for details.	Withhold	The related corporations are considered to be a single employer for purposes of paying wages subject to social security, Medicare, and FUTA taxes. (Limit for new owner of business is reduced by predecessor's wage payments in certain cases.)	
Workmen's compensation.	Exempt	Exempt	Exempt

# 19. Income Tax Withholding and Advance Earned Income Credit (EIC) Payment Methods

## Percentage Method

If you do not want to use the wage bracket tables on pages xx-xx to figure how much income tax to withhold, you can use a percentage computation based on the table below and the appropriate rate table. This method works for any number of withholding allowances the employee claims.

Use these steps to figure the income tax to withhold under the percentage method:

1. Multiply one withholding allowance (see table below) by the number of allowances the employee claims.
2. Subtract that amount from the employee's wages.
3. Determine amount to withhold from appropriate table on pages xx and xx.

### Percentage Method—Amount for One Withholding Allowance

Payroll Period	One withholding allowance
Weekly . . . . .	\$xx.xx
Biweekly . . . . .	xx.xx
Semimonthly . . . . .	xxx.xx
Monthly . . . . .	xxx.xx
Quarterly . . . . .	xxx.xx
Semiannually . . . . .	x,xxx.xx
Annually . . . . .	x,xxx.xx
Daily or miscellaneous (each day of the payroll period) . . . . .	x.xx

**Example:** An unmarried employee is paid \$450 weekly. This employee has in effect a Form W-4 claiming two withholding allowances. Using the percentage method, figure the income tax as follows:

1. Total wage payment . . . . .	\$450.00
2. One allowance . . . . .	\$xx.xx
3. Allowances claimed on Form W-4 . . . . .	<u>2</u>
4. Multiply line 2 by line 3 . . . . .	<u>\$xx.xx</u>
5. Amount subject to withholding (subtract line 4 from line 1). . . . .	\$xxx.xx
6. Tax to be withheld on \$xxx.xx from Table 1—single person, page xx . . . . .	<u>\$ xx.xx</u>

To figure the income tax to withhold, you may reduce the last digit of the wages to zero, or figure the wages to the nearest dollar.

**Annual Income Tax Withholding.**—Figure the income tax to withhold on annual wages under the Percentage Method of Withholding for an annual payroll period. Then prorate the tax back to the payroll period.

**Example:** A married person claims four withholding allowances. She is paid \$1,000 a week. Multiply the weekly wages by 52 weeks to figure the annual wage of \$52,000. Subtract \$x,xxx (the value of four withholding allowances) for a balance of \$xx,xxx. Using the table for the annual payroll period, \$x,xxx.xx is withheld. Divide the annual tax by 52. The weekly tax is \$xxx.xx.

## Wage Bracket Method

Under the wage bracket method, find the proper table (on pages xx through xx) for your payroll period and the employee's marital status as shown on his or her Form W-4. Then, based on the number of withholding allowances claimed on the Form W-4 and the amount of wages, find the amount of tax to withhold. If your employee is claiming more than 10 withholding allowances, see below.

**Note:** If you cannot use the wage bracket tables because wages exceed the amount shown in the last bracket of the table, use the percentage method of withholding described above. Be sure to reduce wages by the amount of total withholding allowances before using the percentage method tables on pages xx and xx.

### Adjusting Wage Bracket Withholding for Employees Claiming More Than 10 Withholding Allowances

**Note:** The percentage method of figuring withholding adapts to any number of allowances.

The wage bracket tables can be used if an employee claims up to 10 allowances. More than 10 allowances may be claimed because of the special withholding allowance, additional allowances for deductions and credits, and the system itself.

To adapt the tables to employees with more than 10 allowances:

1. Multiply the number of withholding allowances over 10 by the allowance value for the payroll period. (The allowance values are in the **Percentage Method—Amount for One Withholding Allowance** above.)
2. Subtract the result from the employee's wages.
3. On this amount, find and withhold the tax in the column for 10 allowances.

This is a voluntary method. If you use the wage bracket tables, you may continue to withhold the amount in the "10" column when your employee has more than 10 allowances, using the method above. You can also use any other methods described below.

### Alternative Methods of Income Tax Withholding

Rather than the Percentage or Wage Bracket Methods described above, you can use an alternative method to withhold income tax. **Pub. 493**, Alternative Tax Withholding Methods and Tables, describes these alternative methods and contains:

1. Formula tables for percentage method withholding (for automated payroll systems).
2. Wage bracket percentage method tables (for automated payroll systems).
3. Combined income, social security, and Medicare tax withholding tables.

Some alternative methods explained in Pub. 493 are annualized wages, average estimated wages, cumulative wages, and part-year employment. For more information on alternative methods, see Regulations sections 31.3402(h)(1)-1-(h)(4)-1.

### Advance Payment Methods for the Earned Income Credit

To figure the advance EIC payment, you may use either the Percentage Method or the Wage Bracket Method explained below. You may use other methods for figuring advance EIC payments if the amount of the payment is about the same as it would be using tables in this booklet. See the tolerances allowed in the chart under Other Methods in Pub. 493. See page xx in this booklet for an explanation of the advance payment of EIC.

### Percentage Method

If you do not want to use the wage bracket tables to figure how much to include in an employee's wages for the advance EIC payment, you can use the percentage computation based on the appropriate rate table.

Find the employee's gross wages before any deductions in the appropriate table on pages xx and xx. There are different tables for (a) single or married employees without spouse filing a certificate and (b) married employees with both spouses filing certificates. Determine the amount of the advance EIC payment shown in the appropriate table for the amount of wages paid.

#### **Wage Bracket Method**

If you use the wage bracket tables on pages xx through xx, figure the advance EIC payment as follows.

Find the employee's gross wages before any deductions using the appropriate table. There are different tables for (a) single or married employees without spouse filing a certificate and (b) married employees with both spouses filing certificates. Determine the amount of the advance EIC payment shown in the appropriate table for the amount of wages paid.

With either method, the number of withholding allowances an employee claims on Form W-4 is not used in figuring the advance EIC payment. Nor does it matter that the employee has claimed exemption from income tax withholding on Form W-4.

#### **Whole-Dollar Withholding and Paying Advance EIC**

The income tax withholding amounts in the wage bracket tables (pages xx through xx) have been rounded to whole dollar amounts.

When employers use the percentage method (pages xx and xx) or an alternative method of income tax withholding, the tax for the pay period may be rounded to the nearest dollar.

The wage bracket tables for advance EIC payments (pages xx through xx) have also been rounded to whole dollar amounts. If you use the percentage method for advance EIC payments (pages xx and xx), the payments may be rounded to the nearest dollar.

If rounding is used, it must be used consistently. Withheld tax amounts should be rounded to the nearest whole dollar by (1) dropping amounts under 50 cents and (2) increasing amounts from 50 to 99 cents to the next higher dollar. For example, \$2.30 becomes \$2, and \$2.80 becomes \$3.