
Withholding Taxes from Employees

Quick Notes...

Employers paying cash wages must generally withhold Income, Social Security and Medicare taxes.

Spouses and children under age 18 are not subject to Social Security and Medicare taxes.

Withholdings and the employer's share of Social Security and Medicare taxes are generally due by the 15th of the month following the month of payment.

Employers are required to withhold income taxes and social security taxes from employees subject to social security and Medicare taxes. 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.

Necessary Information

Employers required to report withheld income tax or social security and Medicare taxes must have an "employer identification number" (EIN). This nine digit number can be obtained by using Form SS-4, "Application For Employer Identification Number."

Form W-4, "Employee's Withholding Allowance Certificate" is completed by each employee and maintained in the records of the employer. This form lists the employee's social security number and provides the employer with the information necessary to withhold income taxes from the employee's wages.

Form W-8109, "Federal Tax Deposit Coupon" is used by employers to deposit withheld income, social security, and Medicare taxes and the employer's share of social security and Medicare taxes. The deposits are to be made monthly or semiweekly to an authorized financial institution or Federal Reserve bank. The IRS notifies employers each November as to the schedule they must follow for making deposits.

Form I-9, "Employment Eligibility Verification Form" must be completed by the employee and kept on file by the employer. This form verifies that the employee is legally eligible to work in the United States.

Form W-2, "Wage and Tax Statement" must be furnished to every employee to whom compensation was paid for services. The form must be sent to the employee by January 31 of the following year. A copy of the form must be provided to the Social Security

Administration by February 28 of the following year.

Form 941, "Employer's Quarterly Federal Tax Return," Form 943, "Employer's Annual Tax Return For Agricultural Employees," and Form 945, "Annual Return of Withheld Federal Income Tax," are used to quarterly and annually, respectively, to summarize withholdings from employee wages.

Social Security And Medicare Tax Withholdings

Social security tax, Medicare tax, and income tax withholding apply to all cash wages paid during the year to an employee if either of the two following tests is met:

1. Cash wages to an employee were \$150 or more in a year. This test applies separately to each worker employed; or
2. Cash wages paid to all employees were \$2,500 or more in a year. If this test is met, it still may not be necessary to withhold taxes from an employee's wages if the employee received less than \$150 in annual cash wages and other conditions are met.

Social security and Medicare do not cover the services of children under the age of 18 working for his/her parent nor an individual hired by his/her spouse in a farm or ranch business. Hence, social security and Medicare taxes do not have to be paid by neither the employer nor employee. Income taxes must be paid on the wages according to the individual's tax situation.

For wages paid in 1994, the social security tax rate is 6.2% and the Medicare tax rate is 1.45% for both the employer and the employee. A farm/ranch employer may pay the employee's share of the social security and Medicare tax without deducting it from the employee's wages. However, the tax must

still be paid. Also, the employee's share of the tax paid by the employer is considered income to the employee.

Income Tax Withholding

There are several ways to figure income tax withholding with the two primary methods being: (1) percentage method and (2) wage bracket tables method. Both methods require the use of information found in various tables, so it is necessary to consult IRS Publication 51, "Circular A, Agricultural Employer's Tax Guide", IRS Publication 15, "Circular E, Employer's Tax Guide", and/or a tax professional. It is necessary for the employer to have a completed Form W-2 for each employee in order to calculate the income tax withholdings for the employee.

If employees do not furnish a correct taxpayer identification number to the employer, the employer must withhold federal income tax at 31% (backup withholding) on commissions and other payments for services made in the course of business. The backup withholding rules do not apply to wages, pensions or annuities. IRS Publication 505 should be seen for more information.

Employers who are required to withhold federal income tax are also required to withhold state income tax (in those states with an income tax). Employers should consult with their state's Department of Revenue and/or tax professional to obtain the appropriate forms and information to withhold state income taxes.

Federal Unemployment Tax

Farm/ranch employers who 1) paid cash wages of \$20,000 or more to workers in any calendar quarter during the current or preceding calendar year or 2) employed 10 or more workers for some part of at least one day during each of 20 different calendar weeks during the current or preceding calendar year are required to pay federal and state unemployment tax (FUTA). These rules do

not apply to children under age 21, parents, and spouses.

Circular A and Circular E should be referred to for details concerning who must pay FUTA, what forms are required, and when deposits must be made.

Supplemental Compensation

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, severance pay, awards, backpay, and payments for non-deductible moving expenses. Tips are generally subject to withholding but with specific rules. See Circular E for more information regarding tips.

If supplemental wages are paid with regular wages but the amounts of each are not specified, income tax withholdings should be figured as if the total were a single payment for a regular payroll period.

If supplemental wages are paid separately or with regular wages and the amounts of each specified, the income tax withholding method depends partly on whether or not income taxes are withheld from the employee's regular wages. If income taxes are withheld from the employee's regular wages, the employer may 1) withhold a flat 28% or 2) add the supplemental and regular wages for the most recent payroll period and then figure the income tax withholding as if the total were a single payment.

If income taxes are not withheld from the employee's regular wages, add the supplemental and regular wages and figure the income tax withholding as if the total were a single payment.

Earned Income Credit

An eligible employee who has a qualifying child may receive earned income credit (EIC) payments with his/her pay during the year. Employers are required to make advanced EIC payments to employees who properly complete Form W-5, "Earned Income Credit Advance Payment Certificate," and are not agricultural workers paid on a daily basis. Refer to Circulars A and E for more details.

Necessary Records

Every employer subject to employment taxes must keep all related records available for inspection for at least four years after the due date of the return period to which the records relate. The records should include:

1. the employee's name, address, and taxpayer identification number (social security number);
2. dates of the employee's employment;
3. dates and amounts of all cash wages, noncash payments, and other payments;
4. amounts of income, social security, and Medicare taxes withheld;
5. dates and amounts of tax deposits;
6. copies of the employee's Form W-4 and Form W-2; and
7. information regarding Earned Income Credit.

Important Dates

Following is a listing of dates important to Employers. The listing is not all inclusive and refers to when federal returns are due. State returns are usually--but not always--due at the same time.

15th of All Months.	Deposit any due income, social security, and Medicare taxes.
Last Day of All Months.	Deposit any due federal unemployment taxes.
January 31.	Deadline for filing Form 943, Form 945, and Form 940 if all taxes were not paid in full and on time. Must furnish each employee a completed Form W-2.
February 10.	Deadline for filing Form 943 and Form 940 if all taxes were deposited on time.
February 15.	Request a new Form W-4 from each employee who claimed exemption from withholding in the prior year.
February 28.	Deadline for filing Form W-3 and Copy A of all Forms W-2 issued for the prior year.
April 30, July 31, October 31, and January 31.	Deposit federal unemployment tax due and any undeposited income, social security, and Medicare taxes.

Sources: 1) IRS Publication 51, Circular A, Agricultural Employer's Tax Guide; (2) IRS Publication 15, Circular E, Employer's Tax Guide; and (3) IRS Publication 225, Farmer's Tax Guide.

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