

Internal Revenue Service  
Tax Exempt and Government Entities  
**Indian Tribal Governments**

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# Employment Tax Desk Guide



**Indian** Tribal  
Governments

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# CHAPTER 1

## Introduction to Employment Tax Desk Guide for Indian Tribal Governments

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The office of Indian Tribal Governments (ITG) at the Internal Revenue Service was established to help Indian tribes address their federal tax matters. During the planning and creation of this office, we received valuable input from Indian tribal governments and tribal associations so we would be better able to understand and meet your specialized needs.

The overall goal of this office is to use partnership opportunities with Indian tribal governments, tribal associations, and other federal agencies, to respectfully and cooperatively meet the needs of both the Indian tribal governments and the federal government, and to simplify the tax administration process.

This *Employment Tax Desk Guide* is intended to assist you in meeting federal employment tax responsibilities. It will provide you with key information and helpful tips for maintaining good records, preparing payroll, and filing and depositing employment taxes. **It is provided for general information only and should not be cited as any type of legal authority.** Your ITG Specialist is available to answer any specific questions you may have. If you do not know who your specialist is, contact the ITG manager in your area per the **Area Contacts** chart shown later in this chapter.

The links to various publications throughout this document were current at the printing of this guide. To be sure you are referencing the most current document, form or publication, go to [Forms and Publications](#). Contact your area specialist, or visit us at [www.irs.gov/tribes](http://www.irs.gov/tribes) for further information on any of the topics covered.

### **Are Federally Recognized Tribal Governments Subject to Employment Taxes?**

Generally, Indian tribes in their role as employers are subject to federal employment tax laws and procedures. It is a well-established principle of tax law that in the ordinary affairs of life, Indians are U. S. citizens and are subject to the payment of federal income taxes.

Where a business enterprise or political subdivision of an Indian tribe is organized and operated by the tribe itself, such enterprise is considered a private tribal activity. When workers perform services in the employ of a private tribal activity, these services also constitute employment.

The federal statutes, regulations, case law, revenue rulings, and other sources of tax authority establish the role of Indian tribal governments as employers. As such, tribal governments are required to follow substantially the same procedures

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## Introduction to Employment Tax Desk Guide for Indian Tribal Governments

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as other employers. There are some special provisions that apply to tribal governments and they are addressed in later chapters. If you have questions about anything contained in, or omitted from this guide, please telephone your local IRS Indian Tribal Governments office.

### **Employment Tax Requirements**

Employers are required to withhold and pay employment taxes. Employment taxes represent the income tax and social security and Medicare taxes (also known as FICA, Federal Insurance Contributions Act taxes) withheld from the wages of an employee, plus the employer's share of social security taxes and federal unemployment (FUTA) taxes, when applicable. The withheld (employee's) portion of employment taxes is referred to as "trust fund" taxes. FUTA will be addressed later in Chapter 15.

In addition to your responsibilities for withholding, depositing and reporting federal taxes, your state taxing authority or tribal governmental taxing agency may also have tax reporting requirements. This guide is designed to assist you in complying with **federal tax** requirements. You should contact your state and, in some cases, tribal taxing agencies for information concerning state and tribal tax requirements.

### **Who is an Employee?**

Employees are defined in the Treasury Regulations as every individual who performs services subject to the will and control of an employer, both as to what is to be done and how it is to be done. The right to discharge or to fire an employee, is an important indicator that the person having the right to discharge is an employer. The employee may have considerable discretion and freedom of action as long as the employer has the legal right to control both the method and the result of the employee's work.

An employee may be called a partner, an agent, or an independent contractor and still meet the criteria of an employee. The description is immaterial if the legal relationship of employer and employee exists. Managers and other supervisory personnel are employees. A corporate officer is an employee.

Tribal council members are not employees for purposes of employment taxes. Tribal council members and other situations unique to Indian tribes are discussed in Chapter 3.

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## Introduction to Employment Tax Desk Guide for Indian Tribal Governments

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### Who is an Employer?

The Treasury Regulations define an employer as any person for whom an individual performs or performed any service. An employer may be an individual, a corporation, a partnership, a trust, an estate, an Indian tribe, educational institutions, organizations, federal/state/local governmental entities, and other entities.

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## Introduction to Employment Tax Desk Guide for Indian Tribal Governments

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*We offer a number of products and services to assist you...*

### ***Publications***

[Publication 3908](#), *Gaming Tax Law for Indian Tribal Governments*

[Publication 3747](#), *Introduction to Indian Tribal Governments*

### ***Workshops available for presentation at your location:***

Employment Tax  
Gaming Tax Law  
Tip Reporting  
Anti-money Laundering

# CHAPTER 1

## Introduction to Employment Tax Desk Guide for Indian Tribal Governments

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### AREA CONTACTS

Group Name	Manager	Contact
<b>National Headquarters</b> <i>District of Columbia</i>	Christie Jacobs <i>Washington, DC</i>	(202) 283-9800
<b><u>Eastern U.S. &amp; Southern Plains</u></b> <i>Alabama, Arkansas, Connecticut, Delaware, Florida, Georgia, Indiana, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia, West Virginia</i>	Gary Hahn <i>Buffalo, NY</i>	(716) 686-4862
<b><u>North Central</u></b> <i>Illinois, Iowa, Kansas, Michigan, Minnesota, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wisconsin, Wyoming</i>	John Walters <i>Fargo, ND</i>	(701) 239-5400 Ext. 253
<b><u>Pacific Northwest</u></b> <i>Alaska, Idaho, Oregon, Washington</i>	Debra Thompson <i>Las Vegas, NV</i>	(702) 455-1379
<b><u>Southwest</u></b> <i>Arizona, Colorado, New Mexico, Utah</i>	Steve Bowers <i>Santa Ana, CA</i>	(714) 347-9430
<b><u>Western</u></b> <i>California, Hawaii, Nevada</i>	John Saltmarsh <i>San Bernardino, CA</i>	(909) 388-8162
<b>Customer Account Services toll-free</b>		<b>(877) 829-5500</b>

**Visit our web site:**  
[www.irs.gov/tribes](http://www.irs.gov/tribes)

**Call for assistance:**  
Customer Account Services  
**(877) 829-5500**

**Write to the following address:**  
Internal Revenue Service  
Indian Tribal Governments SE:T:GE:ITG  
1111 Constitution Avenue, NW  
Washington, DC 20224

## CHAPTER 2

### Employee or Independent Contractor

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Publication 51](#), *Circular A, Agricultural Employer's Tax Guide*
- [Publication 1779](#), *Independent Contractor or Employee*
- [Form SS-8](#), *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*.

#### Employees

A person who works for you may be classified as a common law employee, a statutory employee or an independent contractor. The classification of the worker determines which forms you must file and which taxes you must pay. An employer must generally withhold income taxes, withhold and pay social security and Medicare taxes, and pay unemployment tax on wages paid to an employee. An employer does not generally have to withhold or pay any taxes on payments to independent contractors.

I.R.C. §3121(d)(2) defines "employee" as "any individual who, under the usual **common law rules** applicable in determining the employer/employee relationship, has the status of an employee." The "usual common law rules" referred to in the statute and in the regulations, are those factors to which the courts have looked over the years in order to decide whether or not a person is an employee.

Generally, an employer/employee relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer.

In determining whether a worker is an employee or an independent contractor under the common law rules, three main categories must be considered: 1) behavioral control, 2) financial control, and 3) relationship of the parties.

1. Behavioral control—A worker is an employee when the business has the right to direct and control the worker. Facts to consider include:

## CHAPTER 2

### Employee or Independent Contractor

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- Instruction the business gives to the worker, such as:
    - How, when, or where to do the work
    - What tools or equipment to use
    - What assistants to hire to help with the work
    - Where to purchase supplies and services
    - What work must be performed by a specified individual
    - What order or sequence to follow
  - Training the business gives the worker
2. Financial control—Facts that show whether there is a right to direct or control the business part of the work include:
- Significant investment—the extent of the worker’s investment
  - Expenses—the extent to which the worker has unreimbursed business expenses
  - Opportunity for profit or loss—the extent to which the worker can realize a profit or loss
  - The extent to which the worker makes services available to others
  - How the business pays the worker
3. Relationship of the parties—Facts that illustrate how the business and worker perceive their relationship include:
- Employee benefits—whether the business provides the worker with employee-type benefits
  - Written contracts describing the relationship
  - The permanency of the relationship
  - The extent to which services performed by the worker are a key aspect of the business

Even after evaluating the above factors, there will be times when it is difficult to make the determination as to whether an individual is a **common law employee** or self-employed and should be treated as an independent contractor. Many individuals who have personal service contracts with tribal governments may be employees rather than independent contractors. The mere existence of a contract does not mean the individual is not an employee.

It is important to the worker that the employment status be determined as quickly as possible so that the earnings can be properly reported. To request a determination from the IRS as to whether or not a worker is an employee, file a Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*. Further information is provided in Chapter 3.

## CHAPTER 2

### Employee or Independent Contractor

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Some workers may be considered **statutory employees** (even though independent contractors under the common law rules) if they fall into any one of four categories and they meet three additional conditions. The law defines certain workers as employees by statute. These categories include: 1) drivers who distribute certain food products or deliver laundry or dry cleaning, 2) full-time life insurance sales agents, 3) individuals who work at home on materials and goods you supply and must be returned to you, and 4) full-time traveling or city salespersons who turn in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. Refer to Publication 15-A, Section 1, *Who are Employees?* for further information.

The general rule is that an individual is an **independent contractor** if you, the person for whom the services are performed, have the right to control or direct only the result of the work and not the means and methods of accomplishing the result. Workers who offer their services to the public are generally not employees. A Form 1099-MISC, *Miscellaneous Income*, should be furnished to independent contractors and filed with IRS.

#### **Misclassification of Employees**

If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker (IRS §3509). In some instances, you may have reasonable basis for not treating a worker as an employee and may be entitled to relief under Section 530 of the Revenue Act of 1978.

#### **Examples of Employees**

1) The tribal business pays Mr. Tom, an individual, \$500 per week to clean the tribal office complex. Mr. Tom only works for the tribe. He does not have the right to hire or fire any assistants, and he is required to personally do the work. The tribe provides the supplies and tools. Based on these facts, Mr. Tom is considered an employee and the tribe should withhold income taxes and employment taxes. Mr. Tom will be issued a Form W-2.

2) Mr. Bills works as a deputy for the tribal police department. When Mr. Bills is off-duty, he has been repairing the roof of the tribal hospital. The tribe has determined when the work is to be done, has provided the supplies needed, and has determined how Mr. Bills will be paid. Based on these facts, Mr. Bills is considered an employee for the tribe for both jobs and should be issued a Form W-2 showing the withheld income taxes and employment taxes.

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### Employee or Independent Contractor

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3) Ms. Fran is a tribal member but **not** a council member. Ms. Fran is on the Beautification Committee. She is required to attend the Ms. Indian Pageant Committee meeting and is paid \$50. Ms. Fran is considered an employee and is subject to withholding of federal income taxes, FICA, and Medicare tax. Ms. Fran will also be issued a Form W-2.

#### Example of an Independent Contractor

The tribe pays Mr. Paul \$1000 per week to clean the bingo halls. Mr. Paul operates his own janitorial service that performs work for numerous entities. He has the right to hire and fire his own employees, and provides his own supplies. The tribe does not have the right to control Mr. Paul. Therefore, Mr. Paul is not an employee of the tribe and would be issued a Form 1099-MISC.

If you have a question about the treatment of any of your workers, please contact your ITG Specialist.

#### **Agricultural Labor (Farm work)**

There are special rules for social security and Medicare withholding on agricultural workers. Refer to Publication 51, Section 4, *Social Security and Medicare Taxes*, and also Section 13, *Income Tax Withholding Methods*.

#### **Crew Leaders**

A crew leader is a person who furnishes and pays workers to do farm work for the farm operator. If there is no written agreement between you and the farm operator stating that you are his (or her) employee and if you pay the workers (either for yourself or for the farm operator), then you are a crew leader. This person is an independent contractor and will receive a Form 1099-MISC for all of the work performed.

Employment taxes for farm workers must be filed on Form 943 and must be separate from other workers' employment taxes filed on Form 941. Further information on agricultural workers is addressed in Chapter 14.

## CHAPTER 3

### Treatment of Certain Payments

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#### References:

- Internal Revenue Code §7873
- Revenue Ruling 59-354 (Attachment A at the end of this guide)
- [Publication 15](#), *Circular E, Employer's Tax Guide*

In this chapter, we will discuss how certain payments are treated. Some of these payments are specific to Indian tribes, while others are not. For example, payments made from fishing rights-related activities and payments made to tribal council members are tribal specific issues. Payments made to elected and appointed officials and those payments made as bonuses are general in nature. The proper treatment of these payments for withholding and reporting purposes is sometimes confusing.

In the next four sections of this chapter, payments to tribal council members, fishing rights-related activities, bonuses, and payments to elected and public officials will be discussed. If you have questions about any of these payments, or how they are to be treated, you should contact your local Indian Tribal Governments office<sup>1</sup> for assistance.

#### **Fishing Rights-Related Activities**

Income derived by a member of an Indian tribe directly or through a qualified Indian entity, or by a qualified Indian entity, from a fishing rights-related activity is exempt from income, self-employment, and employment taxes.

The term “fishing rights-related activity” means any activity directly related to harvesting, processing, or transporting fish harvested in the exercise of a recognized fishing right of the tribe or to selling fish, but only if substantially all of the harvesting was performed by members of the tribe.

“Qualified Indian entity” means, with respect to an Indian tribe, any entity if:

- The entity is engaged in a fishing rights-related activity of the tribe,
- All of the equity interest is owned by qualified Indian tribes, members of the tribes, or their spouses,
- Except, as provided for, an entity that engages to any extent in any substantial processing or transporting of fish, 90 percent or more of the annual gross receipts of the entity is derived from fishing rights-related

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<sup>1</sup> Contact information for your local IRS Indian Tribal Governments office is listed in Chapter 1 of this guide.

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- activities of one or more qualified Indian tribes each of which owns at least 10 percent of the equity interest in the entity, and
- Substantially all of the management functions of the entity are performed by members of qualified Indian tribes.

Only tribes that have entered into fishing treaties, secured fishing rights as of March 17, 1988, or received an Executive order or an Act of Congress are eligible for this tax treatment.

For questions regarding this tax treatment, please contact your local Indian Tribal Governments office.<sup>1</sup>

#### **Tribal Council Members**

Salaries paid to tribal council members for services performed by them as council members are treated differently. These amounts should be included in the council member's gross income. However, they do not constitute wages for purposes of the Federal Insurance Contributions Act (FICA) or federal withholding taxes.

Council members' salaries will be shown in Box 1, Wages, Tips, Other Compensation, of the Form W-2. Additionally, in Box 14, Other, you should indicate Revenue Ruling 59-354. This will show why there are no amounts listed in the boxes for Federal Income tax withheld (Box 2) or FICA (Boxes 3,4, and 7).

Exhibit 3-1 (at the end of this chapter) is a sample of a W-2 for a tribal council member. Tribal council members can receive two Form W-2s. One for tribal council member wages and one for services performed in another capacity. See Form W-2 instructions for further information.

A copy of Revenue Ruling 59-354 is included as Attachment A at the end of this guide. Part of your responsibility as employer is to provide the council member with either a copy of the Revenue Ruling or a statement advising them that their W-2 is treated differently – salaries do not constitute wages for purposes of FICA or federal withholding taxes per Revenue Ruling 59-354. The council member should then attach a copy of the Revenue Ruling or statement to their individual tax return.

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<sup>1</sup> Contact information for your local IRS Indian Tribal Governments office is listed in Chapter 1 of this guide.

## CHAPTER 3 Treatment of Certain Payments

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### **Bonuses**

Bonuses that the tribe pays an employee are includable in the employee's income and are shown as wages on the Form W-2. If the bonuses are paid to the employee in the form of goods or services, the fair market value of the goods or services will be added to the employee's income.

Bonuses are considered supplemental wages paid in addition to the employee's regular wages. How you withhold on bonuses depends on whether the bonus is identified as a separate payment from regular wages.

### **Bonus Combined with Regular Wages**

If you pay bonuses 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.

### **Bonus Identified Separately from Regular Wages**

If you pay bonuses 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 **withheld** income tax from an employee's regular wages, you can use one of the following methods for the bonus:

- a) Withhold a flat 25% (no other percentage allowed).
- b) Add the bonus and regular wages for the most recent payroll period this year.
- c) 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 bonus.

If you **did not withhold** income tax from the employee's regular wages, use method **b** above. (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 bonuses, they are subject to social security, Medicare, and FUTA (if applicable) taxes.

## CHAPTER 3 Treatment of Certain Payments

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### EXAMPLE 3.1

You pay Sharon a base salary on the first of each month. She is single and claims one allowance. Her July 1, 2003, pay is \$2,000. Using the wage bracket tables, you withhold \$202. On July 15, 2003, you pay Sharon a bonus of \$2,000. Electing to use supplemental payment method **b**, you:

- 1) Add the bonus amount to the amount of wages from the most recent pay date ( $\$2,000 + \$2,000 = \$4,000$ ).
- 2) Determine the amount of withholding on the combined \$4,000 (\$621 using the wage bracket tables).
- 3) Subtract the amount withheld from wages on the most recent pay date from the combined withholding amount ( $\$621 - \$202 = \$419$ ).
- 4) Withhold \$419 from the bonus payment.

### EXAMPLE 3.2

The facts are the same as in the above example, except that you elect to use the flat rate method of withholding on the bonus. You withhold 25% of \$2,000, or \$500, from Sharon's bonus payment.

### **Elected and Public Officials**

Generally, public officials are employees for Federal Insurance Contributions Act (FICA) purposes. Treasury Regulation § 31.3401(c)-1(a) defines employee to include every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. **If there is any question whether a person is a public official, obtain a copy of, or a reference to, the pertinent statute or ordinance relating to the establishment of the position.**

The following are normally public officials:

1. Tax collectors and assessors,
2. Justices of the peace, and
3. Members of boards/commissions.

Jurors are generally not public officials, nor are they employees under the common law. Additionally, notaries public are not public officials.

The old age, survivors, and disability insurance (OASDI) and the Medicare components of FICA apply to Indian tribal government employees.

## CHAPTER 3

### Treatment of Certain Payments

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#### **Election Workers**

If an election worker's compensation is subject to withholding of FICA tax, reporting is required for all compensation, regardless of the amount. If an election worker's compensation is not subject to withholding of FICA tax, information reporting is required for payments that aggregate \$600 or more in a calendar year. See Revenue Ruling 2000-6 (Attachment B at the end of this guide) to determine when an election worker's compensation is subject to withholding of FICA tax.

In the following examples, all the wages paid in 2003 have been for services as an election worker only.

1. If wages paid during the year are less than \$600, no W-2 is required. The wages are not subject to FICA or federal income tax withholding. The election worker must report the earnings as wages.
2. If wages paid during the year are between \$600 and \$1,199, a Form W-2 should be issued. FICA and federal income tax withholding are not required to be withheld. The election worker must report the earnings as wages.
3. If wages are equal or greater than \$1,200 (this amount is indexed for inflation), a W-2 should be issued. The wages are subject to FICA, but not federal income tax withholding. The election worker must report the earnings as wages.

#### **Form SS-8**

Occasionally, an Indian tribal government will be unable to determine whether a worker is an employee or whether the worker is self-employed and should be treated as an independent contractor. Many individuals who have personal service contracts with Indian tribal governments may be employees rather than independent contractors. The existence of a contract does not mean that the individual performing the service is not an employee. It is important to the worker that the employment status be determined as soon as possible so that the earnings can be properly reported.

If no clear resolution is possible, consider filing a Form SS-8, *Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, with the IRS for a determination. A Form SS-8 is used to gather information to determine whether a worker is an employee for federal employment taxes.

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### Treatment of Certain Payments

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All pertinent facts relating to the individual's work arrangement should be obtained and submitted to the IRS on a Form SS-8. A Form SS-8 may be submitted by the tribal government or by the worker. If a contract has been executed between the worker and the entity, a copy of the contract should be furnished with the Form SS-8. When a Form SS-8 is submitted to the IRS, all the facts are analyzed and the determination of a worker's status is presented to the employer in the form of a determination or letter ruling.

Several problems arise for a worker when incorrectly treated as an independent contractor. To begin with, the worker would probably pay more taxes (i.e., Self-Employment Contributions Act (SECA) taxes) than if the worker was being correctly treated as an employee. As an employee, only the employee's portion of the social security and Medicare taxes are withheld and paid from the employee's wages. As an independent contractor, the worker is not eligible for any unemployment benefits or other benefit plans that the worker would have as an employee. Also, as an independent contractor, the worker may have to pay estimated tax payments each quarter.

# CHAPTER 3

## Treatment of Certain Payments

### EXHIBIT 3.1

#### Sample Form W-2 for tribal council member

<b>a</b> Control number		22222	Void <input type="checkbox"/>		For Official Use Only ▶ OMB No. 1545-0008	
<b>b</b> Employer identification number			00-0000000		<b>1</b> Wages, tips, other compensation	<b>2</b> Federal income tax withheld
					\$ 5,000.00	\$ -0-
<b>c</b> Employer's name, address, and ZIP code  Tribe XYZ 123 Main Street Anytown, USA 76543			<b>3</b> Social security wages		<b>4</b> Social security tax withheld	
			\$ -0-		\$ -0-	
			<b>5</b> Medicare wages and tips		<b>6</b> Medicare tax withheld	
			\$ -0-		\$ -0-	
<b>d</b> Employee's social security number			123-45-6789		<b>7</b> Social security tips	<b>8</b> Allocated tips
					\$ -0-	\$
<b>e</b> Employee's first name and initial		Last name		<b>9</b> Advance EIC payment		<b>10</b> Dependent care benefits
Sarah A.		Lee		\$		\$
333 Elm Street Anytown, USA 76543			<b>11</b> Nonqualified plans		<b>12a</b> See instructions for box 12	
			\$		\$	
			<b>13</b> Statutory employee Retirement plan Third-party sick pay		<b>12b</b>	
			<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		\$	
<b>f</b> Employee's address and ZIP code			<b>14</b> Other		<b>12c</b>	
			See Revenue Ruling 59-354		\$	
					\$	
<b>15</b> State	Employer's state ID number	<b>16</b> State wages, tips, etc.	<b>17</b> State income tax	<b>18</b> Local wages, tips, etc.	<b>19</b> Local income tax	<b>20</b> Locality name
		\$	\$	\$	\$	

Form **W-2** Wage and Tax Statement (99)

2003

Department of the Treasury—Internal Revenue Service  
For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Copy A For Social Security Administration—Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable.

Cat. No. 10134D

## CHAPTER 4

### Tipped Employees

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 531](#), *Reporting Tip Income*
- Instructions for Form W-2, Box 1 and Box 8
- [Publication 1872](#), *Tips on Tips, A Guide to Tip Income Reporting for Employees in the Food and Beverage Industry*
- [Publication 1875](#), *Tips on Tips, A guide to Tip Income Reporting for Employers in the Food and Beverage Industry*
- [Publication 3148](#), *Tips on Tips, A Guide to Tip Income Reporting for Employees Who Receive Tip Income*
- [Publication 3144](#), *Tips on Tips, A guide to Tip Income Reporting for Employers in Businesses Where Tip Income is Customary*
- [Instructions for Form 941](#), Line 6c, Taxable Social Security Tips
- [Publication 2011](#), *How the Restaurant & Employees Compute the Tip Rate*
- [Form 8027](#) and [instructions](#), *Employer's Annual Information Return of Tip Income and Allocated Tips*
- [Publication 1239](#), *Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically*

#### References for your employees:

- [Publication 1244](#), *Employee's Daily Record of Tips and Report to Employer* (This publication includes Form 4070, *Employee's Report of Tips to Employer*, and Form 4070A, *Employee's Daily Record of Tips*.)
- [Form 4137](#), *Social Security and Medicare Tax on Unreported Tip Income*

#### Tips are Wages

Tips are defined as wages under IRC §3121(a) and §3401(a). Tips that are received by an employee in the course of employment should be reported to the employer whether received directly from customers or indirectly in the form of shared tips or tip-outs from fellow employees. For purposes of FICA, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash (unless specifically excepted). For purposes of federal income tax withholding, the term "wages" is similar to the one for FICA.

All tips received by an employee are taxable income subject to federal income tax. Tips paid in cash (or checks or other cash equivalent), including charged tips, of \$20 or more that an employee receives in a calendar month while working for any one employer, are wages subject to FICA and income tax withholding.

## **CHAPTER 4**

### **Tipped Employees**

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Tips of less than \$20 received by an employee during a calendar month while working for a particular employer are not wages for FICA or federal income tax withholding purposes, even though such tips are taxable income. Once the amount of tips received in a calendar month reaches \$20 from any one employer, the entire amount of tips received must be reported to the employer and included in wages (not just the amount over \$20).

An employee who receives \$20 or more in tips must report those tips in writing to his (or her) employer by the tenth day following the month in which the tips are received (or more often if required by the employer).

#### **Service Charges**

Services charges added to the customer's bill by the establishment as a gratuity are receipts to the establishment. Although commonly thought of as tips, they constitute wages when distributed and paid to the tipped employee. These service charges are treated as wages and are includible on Form W-2.

#### **Large Food and Beverage Establishments**

There are special tip reporting requirements for large food and beverage establishments. A "large food and beverage establishment" is defined as a business operation with the following characteristics: food and beverages are provided for consumption on the premises, tipping is a customary practice, and there are more than 10 employees who work more than 80 hours on a typical business day.

For the Form 8027 filing requirement:

- Casino buffets are included if tipping is customary.
- Ten or more employees include the total of all employees at the establishment, not just the tipped employees.
- If an employer owns more than one establishment, a separate Form 8027 must be filed for each establishment.
- If there is more than one business operating within a single building, and if the receipts for the businesses are recorded separately, then each location should file a separate Form 8027.

File Form 8027, *Employer's Annual Information of Tip Income and Allocated Tips*, for large food and beverage establishments by the last day of February for the preceding calendar year. Extensions may be requested on Form 8809, *Request for Extension of Time to File Information Returns*, if the request is filed

## **CHAPTER 4**

### **Tipped Employees**

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before the due date of the return. Refer to Publication 1239, *Specifications for Filing Form 8027 Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically*, to file magnetically or electronically. The due date if filed electronically (but not by magnetic media) is April 1 for the preceding calendar year.

#### **Allocated Tips**

IRC §6053(c)(2) and (3) requires large food and beverage establishments to allocate tips to those employees who report tips of less than 8% of gross receipts to them. The total allocated is the difference between the 8% and the amount reported by the employees. The establishment must report these allocations in Box 8 of the Form W-2. See Exhibit 4-1 for an example.

#### **Tip Rate Reduction Requests**

A request may be made for a reduced allocation rate by submitting a petition that clearly demonstrates that a rate less than 8% should apply. Refer to Instructions for Form 8027 on how to apply.

#### **IRC §3121(q)**

The Omnibus Budget Reconciliation Act of 1987 (OBRA) amended IRC §3121(q) to provide that tips are deemed to have been paid by the employer for purposes of FICA tax and to require that employers withhold both the employer and employee shares of FICA. IRC §3121(q) also provides that unreported tips are subject to employer FICA tax. IRC §3121(q) allows the Service to assess the employer's share of FICA taxes with respect to reported tips (i.e., where no statement reporting such tips was furnished by an employee or to the extent the statement is inaccurate or incomplete). The vehicle to assess this additional tax is in Section 3121(q) Notice and Demand. When determining the employer's additional FICA tax liability, the tips are deemed paid on the date the Notice and Demand is made to the employer by the Service.

#### **Employer's General Responsibilities**

IRC §3102(a) provides that the employer is responsible for deducting and depositing the employee's FICA tax on tips included in the written report furnished by the employee to the extent that collections can be made from the

## CHAPTER 4 Tipped Employees

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employee's wages (under the employer's control, excluding tips) on or after the time the written statement is furnished.

### **Additional FICA Tax Payable**

IRC §6053(b) states that the employer must furnish to the employee a written statement showing the amount of employee FICA on tips, which exceeds the tax the employer can collect from the wages under the control of the employer. The regulations provide that the statement is provided on the employee's Form W-2. The employee is required to report and pay over to the Service the portion of employee tax, which the employer was unable to withhold due to the lack of employee wages available to cover the liability.

An employee's regular pay may not be enough for the employer to withhold all of the taxes an employee owes on the regular pay and reported tips. If this happens an employee may give the employer more money to cover the taxes.

If the employee's pay, under the employer's control, is not enough to cover all of the taxes, the Treasury Regulations at §31.3102-3(a)(1) clarify the sequence the employer must follow when paying over the withheld taxes as follows:

1. All taxes (FICA, federal withholding, and state and local) on regular pay, exclusive of tips
2. Social security and Medicare taxes on reported tips
3. Federal, state, and local taxes on reported tips

### **EXAMPLE 4.1 Employee taxes on wages and tips exceed regular wages**

Grady Cimarron is a blackjack dealer for a tribal casino in Oklahoma. He routinely receives tips as a part of his compensation as a dealer. The casino pays him a salary of \$200 per week (\$400 every two weeks). He receives tips in cash each day that he works.

Grady keeps a daily tip record and reports tips to his employer every other Friday. He has a Form W-4, *Employee's Withholding Allowance Certificate*, on file with his employer (the casino). It reflects that he is single with one exemption. For the two-week period ending April 12, 2002, Grady reported \$1,200 in cash tips to his employer. His regular wages for the same two-week period are \$400. The casino tip policy allows Grady to keep his cash tips at the time he receives them.

## CHAPTER 4 Tipped Employees

The following computation illustrates that Grady's total withholding for wages and tips exceeds his regular wages, causing him to owe taxes to his employer on payday.

Gross Regular Pay				\$400.00
Less:				
	Tax on Wages of \$400.00	Tax on Tips of \$1,200.00	Total Tax to be Withheld	
FICA	\$ 30.60	\$ 91.80	\$122.40	
Federal Withholding	\$100.00*	\$200.00*	\$300.00*	
State Withholding	\$ 30.00	\$ 20.00	\$ 50.00	
Total	\$160.60	\$311.80	\$472.40	-472.40
Net Paycheck				Zero **

**\* These withholding amounts are for this example only to show the intended result. The withholding tables were not consulted for either federal or state withholding taxes.**

**\*\*The employee owes the amount of tax (\$72.40) that exceeds his regular paycheck.**

Because all tips are taxable wages to the employee, this situation creates a withholding shortfall for Grady. The withholding on his wages plus his tips exceeds his biweekly paycheck from his regular salary.

If Grady does not make arrangements with his employer to pay all his FICA and withholding, his taxes will be applied in the following order:

1. Withholding on regular wages (FICA, federal income, state income)  
\$160.60
2. FICA withholding tax on tips (\$91.80)
3. Federal income tax withholding (\$147.60 of the \$200 due)

Net paycheck = 0 (\$400 less \$160.60, \$91.80 and \$147.60)

After his net paycheck is zero, Grady still owes \$52.40 in federal income tax withholding and \$20 in state withholding.

## CHAPTER 4 Tipped Employees

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Because Grady's regular pay is not enough for his employer to withhold all the taxes he owes on his regular pay plus his reported tips, he may give his employer money for taxes. He may give his employer money until the close of the calendar year to pay the rest of the taxes.

His employer may also collect any taxes that remain unpaid from his next paycheck. If withholding taxes remain uncollected at the end of the year, Grady may be subject to a penalty for underpayment of estimated tax.

In the example, Grady's regular paycheck paid all his FICA (social security and Medicare taxes). This is not always the case; sometimes an employee may owe social security and Medicare taxes uncollected at the end of the year. These uncollected taxes will be shown in Box 12 of Form W-2, *Wage and Tax Statement*, and must be reported on the employee's Form 1040, *U.S. Individual Income Tax Return*.

### **Your Tip Employment Tax Responsibilities**

- Include tips as wages, withholding FICA and federal income tax, and include on Form 941 and Form W-2
- Allocate tips when required
- File the information report, Form 8027, if required

### **You and Your Employees' Record keeping Responsibilities (This is specific to large food and beverage establishments.)**

Treasury Regulation §31.6053-1(b) states that the written statement furnished by the employee to the employer in respect to tips received by the employee shall be signed by the employee and should disclose:

- The name, address, and SSN of the employee.
- The name and address of the employer.
- The period for which, and the date on which, the statement is furnished. If the statement is for a calendar month, the month and year should be specified. If the statement is for a period of less than one calendar month, the beginning and ending dates of the period should be shown (i.e., January 1 through January 8, 2004).
- The total amount of tips received by the employee during the period covered by the statement, which are required to be reported to the employer.

## **CHAPTER 4**

### **Tipped Employees**

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Treasury Regulation §31.6053-1(b)(2)(i) indicates that no particular form is prescribed; however, Form 4070 (included in Publication 1244) may be used unless the employer provides some other form.

If the employer chooses to use another form, the form must meet the requirements of Treasury Regulation §31.6053-1(b)(2)(ii) as follows:

- The form is to be used solely for the purpose of reporting tips,
- It meets the requirements of subparagraph (1) (of the regulations as listed above), and
- A blank copy must be made available to the employee for completion and retention by such employee.

In lieu of a special form for tip reporting, Treasury Regulation §31.6053-1(b)(2)(ii) provides that an employer may provide regularly used forms (such as time cards) for use by the employees in reporting tips. Any such regularly used form must include both the period for which and the date on which the statement is furnished, as well as the total amount of tips received by such employee. The form must also contain identifying information, which will ensure identification of the employee by the employer.

#### **Tip Agreements**

The IRS began its Tip Rate Determination/Education Program (TRD/EP) in October 1993 for businesses where tip income is customary. The objective of the program has been to improve and ensure compliance by employers and employees with statutory provisions relating to tip income.

Only employers in the food and beverage industry can choose either a Tip Rate Alternative Commitment (TRAC) or Tip Rate Determination Agreement (TRDA). Businesses in the gaming industry may enter into a Gaming TRDA or a new program Gaming Industry Tip Compliance Agreement (GITCA) written specifically for them issued as Revenue Procedure 2003-35. The program is entirely voluntary.

The employer may enter into a tip agreement depending on the specific business. The IRS will assist applicants in understanding and meeting the requirements for participation. Please contact your ITG specialist for any questions about entering into a tip agreement or to review your current agreement.

# CHAPTER 4 Tipped Employees

## EXHIBIT 4.1, Form W-2, Wage and Tax Statement showing allocated tips

<b>a</b> Control number		22222		Void <input type="checkbox"/>		<b>For Official Use Only ▶</b> OMB No. 1545-0008	
<b>b</b> Employer identification number				00-0000000		<b>1</b> Wages, tips, other compensation	
						<b>2</b> Federal income tax withheld	
				\$ 5,000.00		\$ 515.00	
<b>c</b> Employer's name, address, and ZIP code				Tribe XYZ 123 Main Street Anytown, USA 76543		<b>3</b> Social security wages	
				\$ 5,000.00		<b>4</b> Social security tax withheld	
						<b>5</b> Medicare wages and tips	
				\$ 5,000.00		<b>6</b> Medicare tax withheld	
						<b>7</b> Social security tips	
				\$ -0-		<b>8</b> Allocated tips	
						\$ 425.00	
<b>d</b> Employee's social security number				123-45-6789		<b>9</b> Advance EIC payment	
						<b>10</b> Dependent care benefits	
						\$	
<b>e</b> Employee's first name and initial		Sarah A.		Last name		Lee	
						<b>11</b> Nonqualified plans	
						\$	
<b>f</b> Employee's address and ZIP code				<b>13</b> Statutory employee		<input type="checkbox"/>	
				Retirement plan		<input type="checkbox"/>	
				Third-party sick pay		<input type="checkbox"/>	
				<b>14</b> Other			
						<b>12a</b> See instructions for box 12	
						\$	
						\$	
						\$	
						\$	
<b>15</b> State		Employer's state ID number		<b>16</b> State wages, tips, etc.		<b>17</b> State income tax	
				\$		\$	
				\$		\$	
				\$		\$	
						<b>18</b> Local wages, tips, etc.	
						\$	
						\$	
						\$	
						<b>19</b> Local income tax	
						\$	
						\$	
						<b>20</b> Locality name	

Form **W-2** Wage and Tax Statement (99)

2003

Department of the Treasury—Internal Revenue Service

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

**Copy A For Social Security Administration**—Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable.

Cat. No. 10134D

## CHAPTER 5

### Employee Business Expense Reimbursements

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 17](#), *Your Federal Income Tax*
- [Instructions](#) for Form W-2 and W-3
- [Publication 1542](#), *Per Diem Rates*

Employees are often required to use their personal vehicles for business purposes or to incur business-related expenses in connection with their job. Often employers will reimburse employees for these “out-of-pocket” expenses. The reimbursement policy of the employer will determine the proper tax treatment of these reimbursed employee business expenses. This chapter addresses the two basic types of reimbursement arrangements that can exist between an employer and an employee and how these reimbursements are handled for income tax purposes.

There are two general types of expense reimbursement plans that an employer may use to reimburse employees for out-of-pocket business expenses. They are (1) an accountable plan, and (2) a non-accountable plan. Each of these plans will be discussed in detail below, but the principal difference is whether employees are required to substantiate expenses (accountable plan) to their employer for the amounts they incur for job related expenses, or not (non-accountable plan).

#### **Non-accountable Plan**

Under a non-accountable reimbursement plan, the employee is generally not required to substantiate any expenses to the employer. Reimbursements received by the employee under such a plan are included in the employee's Form W-2 as taxable wages subject to income tax withholding, social security, Medicare, and FUTA taxes. The employee may deduct the actual expenses incurred as a miscellaneous itemized deduction on his or her personal tax return.

#### **Accountable Plan**

To qualify as an accountable plan, the plan must contain the following features:

- The employee's expenses must be incurred in connection with his services as an employee with no personal expenses.

## CHAPTER 5

### Employee Business Expense Reimbursements

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- The employee must substantiate expenses to the employer within a reasonable period of time from when the expenses were incurred.
- The employer must require that any excess advance or reimbursement over the actual substantiated expense be returned within a reasonable period of time.

Amounts paid under an accountable plan are not wages and are not subject to income tax withholding and payment of social security, Medicare, and FUTA taxes.

If the expenses covered by this arrangement are not substantiated, or amounts in excess of expenses are not returned within a reasonable period of time, the amount is treated as paid under a non-accountable plan. A reasonable period of time depends on the facts and circumstances. It is considered reasonable if your employees receive the advance within 30 days of the time they incur the expense, adequately account for the expenses within 60 days after the expenses were paid or incurred, and they return any amounts in excess of expenses within 120 days after the expense was paid or incurred. Also, it is considered reasonable if you give your employees a periodic statement (at least quarterly) that asks them to either return or adequately account for outstanding amounts and they do so within 120 days.

#### **Per Diem and Car Allowances**

A per diem allowance is a fixed amount of daily reimbursement an employer gives an employee for lodging, meals, and incidental expenses when the employee is away from home on business. You may reimburse your employees by travel days, or miles, or some other fixed allowance. In these cases, your employee is considered to have accounted to you if the payments do not exceed rates established by the federal government. The standard mileage rate for auto expenses is 36 cents per mile for 2003 and 37.5 for 2004. The federal per diem rates for meals and lodging in the continental U.S. are listed in Publication 1542, *Per Diem Rates*.

Per diem allowances may be used only if the time, place, and business purpose of the travel are substantiated by adequate records or other evidence. An employee can satisfy the substantiation requirements for business vehicle expenses in two general ways. First, an employee can submit periodically to the employer a log of business miles driven. The expense is deemed substantiated to the extent of the standard mileage rate (36 cents per business mile for 2003 and 37.5 for 2004). Second, an employee can submit documentation of actual vehicle expenses (gas, maintenance, insurance, etc.) with support for the

## **CHAPTER 5**

### **Employee Business Expense Reimbursements**

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percentage of business use of the vehicle (e.g., a log showing both business and personal mileage).

If the per diem or allowance exceeds the federal rate, and you do not require your employees to return the difference between the two rates, you must report the excess amount as wages. This excess amount is subject to income tax withholding, and payment of social security, Medicare, and FUTA taxes. Report the nontaxable (substantiated) portion of the per diem or mileage allowance in Box 12 of Form W-2 using code L.

The following is an example of how you would report per diem payments to employees that are in excess of the allowable federal per diem rate:

#### **EXAMPLE 5.1**

The tribe sent an employee on a 5-day business trip to Phoenix and gave the employee a \$225 (\$45 per day) advance to cover meals and incidental expenses. The federal per diem for meals and incidental expenses for Phoenix is \$42 per day. The tribe does not require the employee to return the difference between the advance and the federal rate for Phoenix. The \$15 (\$3 x 5) will be included in Box 1 on Form W-2. Box 12 on Form W-2 will show \$210 using code L.

## CHAPTER 5 Employee Business Expense Reimbursements

### EXHIBIT 5.1 - Reporting Reimbursements Table

#### Reporting Reimbursements

If the type of reimbursement (or other expense allowance) arrangement is under	Then the employer reports on Form W-2:
<b>An ACCOUNTABLE PLAN with:</b>	
<i>Actual expense reimbursement</i> Adequate accounting made and excess returned	No amount
<i>Actual expense reimbursement</i> Adequate accounting and return of excess both required but excess not returned	The excess amount as wages in Box 1.
<i>Per diem or mileage allowance up to the federal rate</i> Adequate accounting and excess returned	No amount
<i>Per diem or mileage allowance up to the federal rate</i> Adequate accounting and return of excess both required but excess not returned	The excess amount as wages in Box 1. The amount up to the federal rate is reported only in Box 13 – it is not reported in Box 1.
<i>Per diem or mileage allowance exceeds the federal rates</i> Adequate accounting up to the federal rate only and excess not returned	The excess amount as wages in Box 1. The amount up to the federal rate is reported only in Box 13 – it is not reported in Box 1.
<b>A NON-ACCOUNTABLE PLAN with:</b>	
Either adequate accounting or return of excess, or both, not required by plan.	The entire amount as wages in Box 1.
No reimbursement plan	The entire amount as wages in Box 1.

## CHAPTER 6

### Fringe Benefits

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Publication 15-B](#), *Employer's Tax Guide to Fringe Benefits*
- [Publication 463](#), *Travel, Entertainment, Gift, and Car Expenses*
- [Publication 508](#), *Tax Benefits for Work-Related Education*
- [Publication 520](#), *Scholarships and Fellowships*
- [Publication 521](#), *Moving Expenses*
- [Publication 525](#), *Taxable and Nontaxable Income*
- [Publication 1542](#), *Per Diem Rates*
- Instructions for Form W-2, Special Reporting Situations for Form W-2

IRS Publication 15-B, *Employer's Tax Guide to Fringe Benefits*, addresses the question, "Are Fringe Benefits Taxable?" If the recipient of a taxable fringe benefit is your employee, the benefit is subject to employment taxes and must be reported on Form W-2, *Wage and Tax Statement*. However, you can use special rules to withhold, deposit, and report the employment taxes. Refer to Section 4 of Publication 15-B, *Rules for Withholding, Depositing and Reporting*.

#### **What is a Fringe Benefit?**

Treasury Regulation §1.61-21 states that gross income includes compensation for services, including fees, commissions, fringe benefits or similar items. A fringe benefit is any property, service, cash or cash equivalent in addition to regular pay provided to an employee by an employer in connection with the performance of services. Whether a particular fringe benefit is taxable depends on whether there is a specific statutory exclusion that applies to the benefit. Employers should treat taxable fringe benefits as wages for employment tax purposes.

Because the tax treatment of fringe benefits can vary depending on the facts and circumstances under which they are provided, it may be helpful to follow a three-step analysis:

- Identify the particular fringe benefit and start with the assumption that its value will be taxable as compensation to the employee.
- Check to see if there are any statutory provisions that exclude the fringe benefit from the employee's gross income.
- Value any portion of the benefit that is not excludable for inclusion in the employee's gross income.

## CHAPTER 6

### Fringe Benefits

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The following are examples of fringe benefits:

- Accident/health benefits
- Allowances not accounted for (i.e., clothing)
- Automobile allowances
- Awards and prizes
- Back pay awards
- Bonuses
- Cafeteria plans
- Club memberships
- Dependent care assistance program
- Educational reimbursements
- Employee discounts
- Frequent flier credits
- Group term life insurance
- Law enforcement housing assistance
- Legal counseling
- Local transportation for commuting
- Lodging on the employer's premises
- Meal money
- Moving expense reimbursements
- Parking
- Professional licenses or dues for professional organizations
- Severance pay
- Scholarships and fellowships
- Sick pay
- Stipends
- Travel reimbursement
- Use of vacation homes
- Vacations

The fringe benefits listed above may or may not be taxable to the employee who receives the benefit. Refer to Publication 15-B to determine if fringe benefits are taxable and how to value them.

#### **Employer-provided Vehicles**

Employer-provided vehicles are sometimes available for employees to use during off-duty hours. The personal use of a tribally owned vehicle is a taxable fringe benefit. Personal use includes the value of commuting to and from work in the vehicle, even if the vehicle is taken home for the convenience of the employer.

## CHAPTER 6 Fringe Benefits

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The value of the fringe benefit must be included in income as wages and is subject to income and employment taxes. There are three methods that can be used to determine the value of the vehicle provided to the employee:

- The commuting value rule,
- The cents-per-mile rule, or
- The automobile lease rule

There are certain employees designated as “control employees” who must use the automobile lease rule. A “control employee” is a government employee whose compensation is equal to or exceeds Federal Government Executive Level V. (See the Office of Personnel Management web site at [www.opm.gov/oca/payrates/index.asp](http://www.opm.gov/oca/payrates/index.asp) for compensation information.) See Chapter 3 of Publication 15-B for further information on control employees.

### **Qualified Non-personal Use Vehicle**

A qualified non-personal use vehicle is any vehicle the employee is not likely to use more than minimally for personal purposes because of its design. Qualified non-personal use vehicles are:

- Clearly marked police and fire vehicles
- Unmarked vehicles use by law enforcement officers - The officer must be authorized to carry a firearm, execute search warrants and make arrests.
- An ambulance or hearse used for its specific purpose
- Any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds
- Delivery trucks with seating for the driver only or driver plus a folding jump seat
- A passenger bus with a capacity of at least 20 passengers used for a specific purpose
- School buses
- Tractors and other special purpose farm vehicles

If an employee drives one of these vehicles home, the personal use of the vehicle is not a taxable fringe benefit.

## CHAPTER 6 Fringe Benefits

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### **All Other Employer-Provided Vehicles**

If you have an employer-provided vehicle that does not qualify as a non-personal use vehicle, and the employer uses the vehicle for personal use (which includes commuting), the personal use of the vehicle is a non-cash taxable fringe benefit. It is the employer's responsibility to determine the actual value of this fringe benefit and to include the taxable portion in the employee's income.

#### **EXAMPLE 6.1**

A tribally owned pickup truck that is not a police vehicle has the name of the tribe marked on the vehicle. Usually the employee is allowed to take the vehicle home because he is "on call". The vehicle is not a qualified non-personal use vehicle, thus, the commuting is a non-cash taxable fringe benefit. The value of the personal use of this vehicle must be included as wages to the employee, and it is subject to income and employment taxes.

### **Lodging on Your Business Premises**

You can exclude the value of lodging furnished to an employee from the employee's wages if it meets the following tests:

- It is furnished on your business premises,
- It is furnished for your convenience, and
- The employee accepts it as a condition of employment.

This exclusion does not apply if you allow your employee to choose to receive additional pay instead of lodging.

#### **EXAMPLE 6.2**

A hospital gives Joan, an employee of the hospital, the choice of living at the hospital free of charge or living elsewhere and receiving a cash allowance in addition to her regular salary. If Joan chooses to live at the hospital, the hospital cannot exclude the value of the lodging from her wages because she is not required to live at the hospital to properly perform the duties of her employment.

## CHAPTER 6 Fringe Benefits

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### EXAMPLE 6.3

A police officer of an Indian tribal government is required to live in housing furnished by the tribe, as a condition of employment. The tribe requires this as a matter of security for the residents in the neighborhood and as a convenience for the tribe to protect the housing facilities. The value of the lodging is not included in the police officer's salary since the housing is a condition of employment, it is on the business premises, and it is a convenience to the tribe.

### **Employee Business Expenses – Accountable and Non-accountable Plans**

IRS Publication 15, *Circular E, Employer's Tax Guide*, defines employee business expense reimbursements. A reimbursement or allowance arrangement is a system by which you substantiate and pay the advances, reimbursements, and charges for your employees' business expenses. How you report a reimbursement or allowance amount depends on whether you have an accountable or a non-accountable plan. If a single payment includes both wages and an expense reimbursement, you must specify the amount of the reimbursement.

These rules apply to all ordinary and necessary employee business expenses that would otherwise qualify for a deduction by the employee.

### **Accountable Plan**

Amounts paid under an accountable plan are not wages and are not subject to income tax withholding and payment of social security, Medicare and SUTA and/or Federal unemployment (FUTA) taxes.

To be an accountable plan, your reimbursement or allowance arrangement must require your employees to meet all three of the following rules:

- They must have paid or incurred deductible expenses while performing services as your employees;
- They must adequately account to you for these expenses within a reasonable period of time; and
- They must return any amounts in excess of expenses within a reasonable period of time.

If the expenses covered by this arrangement are not substantiated or amounts in excess of expenses are not returned within a reasonable period of time, the amount is treated as paid under a non-accountable plan. This amount is subject

## **CHAPTER 6**

### **Fringe Benefits**

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to income tax withholding and payment of social security, Medicare, and SUTA and/or FUTA taxes for the first payroll period following the end of the reasonable period.

A reasonable period of time depends on the facts and circumstances. Generally, it is considered reasonable if your employees receive the advance within 30 days of the time they incur the expense, adequately account for the expenses within 60 days after the expenses were paid or incurred, and they return any amounts in excess of expenses within 120 days after the expense was paid or incurred. Also, it is considered reasonable if you give your employees a periodic statement (at least quarterly) that asks them to either return or adequately account for outstanding amounts and they do so within 120 days.

#### **Non-accountable Plan**

Payments to your employee for travel and other necessary expenses of your business under a non-accountable plan are wages and are treated as supplemental wages subject to income tax withholding and payment of social security, Medicare, and SUTA and/or FUTA taxes. Your payments are treated as paid under a non-accountable plan if:

- Your employee is not required to or does not substantiate timely those expenses to you with receipts or other documentation, or
- 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.

See Section 7 of Publication 15 for more information on supplemental wages.

#### **Per Diem or other Fixed Allowance**

You may reimburse your employees by travel days, or miles, or some other fixed allowance. In these cases, your employee is considered to have accounted to you if the payments do not exceed rates established by the federal government. The 2003 standard mileage rate for auto expenses is 36 cents per mile. The government per diem rates for meals and lodging in the continental United States are listed in Publication 1542, *Per Diem Rates*. Other than the amount of these expenses, your employees' business expenses must be substantiated (for example, the business purpose of the travel or the number of business miles driven).

## CHAPTER 6 Fringe Benefits

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If the per diem or allowance paid exceeds the amounts specified, you must report the excess amount as wages. This excess amount is subject to income tax withholding and payment of social security and Medicare taxes. Show the amount equal to the specified amount (i.e., the nontaxable portion) in Box 12 of the Form W-2, using code L.

## CHAPTER 7

### Pension Plans

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Publication 505](#), *Tax Withholding and Estimated Tax*
- [Publication 560](#), *Retirement Plans for Small Business*
- [Publication 571](#), *Tax-Sheltered Annuity Plans*
- [Instructions](#) for Form W-2 and W-3
- Announcement 2001-93, Reporting Elective Deferral Catch-up Contributions on the 2002 Form W-2
- [Form 5500](#), *Annual Return/Return of Employee Benefit Plan*,

The purpose of this chapter is to provide information regarding the various pension plans that Indian tribal governments may have as well as annual reporting requirements applicable to these plans. Since the area of pension law can be quite complex, this chapter is not intended to be all-inclusive. It is intended to provide basic information. The pension plan administrator should address more detailed questions.

#### **Types of pension plans that may be maintained by Indian tribal governments:**

- (1) **Simplified Employee Pension Plan (SEP)** – SEPs provide a simplified method for employers to make contributions to a retirement plan for their employees. Instead of setting up a qualified plan with a separate trust, the employer makes contributions to an IRA, (commonly referred to as a SEP-IRA) that meets the requirements of IRC section 408(k).
- (2) **SIMPLE Plan** – Savings Incentive Match Plan for Employees. A SIMPLE Plan, also referred to as a SIMPLE-IRA to distinguish it from a SIMPLE-401 (k) plan, is described under IRC section 408(p). In a SIMPLE Plan, employees are allowed to elect to defer compensation up to a prescribed amount. The employer must either match the employee contributions or make a non-elective contribution on behalf of the employees. A SIMPLE plan can be established only if the employer had 100 or fewer employees who earned \$5,000 or more in compensation during the preceding year. An employer cannot sponsor a SIMPLE if they currently sponsor another plan.
- (3) **Section 401(k) Plan** – A Section 401(k) plan, also referred to as a cash or deferred arrangement (CODA), is an arrangement in which participants may make elective deferrals (pre-tax contributions) to a plan that is qualified under IRC section 401(a). The CODA must be part of a profit sharing plan, stock bonus plan, or a pre-ERISA money purchase plan. Indian tribal

## CHAPTER 7 Pension Plans

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governments are allowed to maintain 401(k) plans, effective January 1, 1997. (Treas. Reg. section 1.410(b)-9 defines a Section 401(k) plan.)

- (4) **Section 403(b) Plan**- A vehicle by which contributions may be deferred from tax and invested in annuity contracts and/or mutual funds for retirement planning purposes. Indian tribal governments are eligible to maintain this type of plan only in limited circumstances. Generally, the organization associated with the tribal government must be an educational institution, a 501(c)(3) organization, or a grandfathered Indian tribe (see definitions).
- (5) **Qualified Plan** – A qualified plan, also referred to as a 401(a) plan, is a plan that satisfies the requirements of IRC section 401(a). Examples of qualified plans are as follows: profit sharing plan, money purchase plan, 401(k) plan, target benefit plan or a defined benefit plan.

All of the plans listed above, with the exception of certain qualified plans, are deferred compensation plans that allow employees to save for retirement on a pre-tax basis. The 401(k) and 403(b) plans are each named after the respective sections of the Internal Revenue Code that authorize them.

### Definitions

**Deferred Compensation** – With regard to pensions, deferred compensation is an amount the employer deducts from the employee's current compensation and pays to a retirement plan. Employees do not pay tax on qualified deferred compensation until distributions are received. Participation in a deferred compensation plan allows employees to "defer" or delay, receiving a portion of their wages until a later date, generally when they retire or reach a distributable event.

**Rollover** – The contribution or direct transfer of a qualified plan distribution to another plan within 60 days. The plan receiving the rollover may be any of the following:

- another qualified plan
- an IRA
- a SEP-IRA
- for distributions made after December 31, 2001, a section 403(b) plan

**501(c)(3) Organization** - Defined generally as one organized and operated exclusively for the following purposes:

- religious
- charitable
- scientific

## CHAPTER 7 Pension Plans

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- public safety testing
- literary or education
- to encourage national or international amateur sports competition
- for the prevention of cruelty to children or animals

These organizations include:

- charities
- social welfare agencies
- private hospitals
- health care organizations
- private schools
- religious institutions
- research facilities

**Grandfathered Indian Tribe** - An Indian tribal government, a subdivision, agency or instrumentality of an Indian tribal government, or a corporation chartered under federal, state, or tribal law which is owned in part by any of the foregoing is treated as an employer described in 501(c)(3) with respect to any annuity contract purchased in a plan year beginning before January 1, 1995.

**Catch-up Contributions** – Elective deferrals that are made pursuant to IRC section 414(v) in excess of the limits under IRC sections 402(g), 403(b), 408(p), and 415 to the following type plans: 401(k) plans, 403(b) plans, SARSEPs (SEPs that include a salary reduction arrangement), SIMPLE-IRA plans or SIMPLE-401 (k) plans. Catch-up contributions may be made only by participants who are at least age 50 by the end of the year in which the catch-up contributions are being made.

**Qualified Plan** – A qualified plan is a plan that meets the requirements of IRC section 401(a). These requirements are generally designed to ensure that the plan is established and operated for the benefit of a broad class of employees. Meeting the requirements entitles the plan sponsor, the trust or other funding vehicle, and participants to certain income tax advantages.

**Nonqualified Plan** – A nonqualified plan is a plan that does not meet the requirements of IRC section 401(a). As a result, the plan sponsor, participants and trust, or other plan funding vehicle, are generally not entitled to income tax benefits, unless the plan is intended to be, and meets the requirements of, for example, section 402(b) plans, SEPs, SIMPLE plans and certain IRAs.

**Salary-reduction Arrangement** – An agreement where the employee chooses to have part of his pay contributed to a retirement plan rather than receive it in cash.

## CHAPTER 7 Pension Plans

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**Elective-Deferral** - Contributions made by the employer at the election of the employee to a retirement plan via a salary reduction agreement. The elective deferrals are excluded from the employee's gross income (compensation) and include deferrals under a section 401(k) arrangement, a section 403(b) plan, a SIMPLE-IRA plan and a SARSEP.

**Non-elective Contributions** – Employer contributions made to any type of plan, excluding those employer contributions made under a salary reduction agreement. Employer contributions also do not include matching contributions.

### **Income tax withholding**

Generally, the participant's pre-tax contributions (deferred compensation) plus any earnings on these contributions will not be included in gross income until that amount is paid or made available to the participant or beneficiary.

Therefore, this amount will not be subject to income tax withholding at the time the contribution is made. However, the total amount contributed during the tax year will be reflected on the participant's Form W-2.

### **Social security, Medicare, and FUTA taxes**

**Qualified plans, Tax-sheltered Annuities, SEPS, and SIMPLE Retirement Plans** – Generally, elective deferrals made by an employee are excluded from the employee's gross income. However, they are included in wages for purposes of social security, Medicare, and FUTA taxes.

Employer contributions to these plans are not included in the definition of wages and are not subject to social security, Medicare, or FUTA taxes unless the payment is made for services rendered.

**Nonqualified Deferred Compensation Plans** – Annual deferrals under a nonqualified plan are treated as wages subject to social security, Medicare, and FUTA (if applicable) taxes in the tax year in which the later of the following occurs: (a) when the services are performed, or (b) when there is no substantial risk of forfeiture of the employee's right to the deferred amount. A substantial risk of forfeiture exists where rights in property that are transferred are conditioned upon the future performance of services or the occurrence of a condition related to the purpose of the transfer. Annual deferrals mean the amount of compensation deferred under the plan whether by salary reduction or non-elective employer contribution during a taxable year.

## CHAPTER 7 Pension Plans

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### EXAMPLE 7.1

The tribe's nonqualified plan provides for elective deferrals from current salary, as well as a one percent of salary non-elective contribution for each employee who participates in the plan and who is employed with the tribe during the plan year. All deferrals and contributions, including the tribe's contributions, are fully and immediately vested.

Because these contributions are not subject to a substantial risk of forfeiture (and the services to which they relate have already been performed), the elective deferrals are required to be taken into account as wages for purposes of the social security, Medicare, and FUTA (if applicable) tax at the time of the deferral. The Tribe's non-elective contribution is required to be taken into account as wages at the time of the contribution for purposes of the social security, Medicare, and FUTA tax.

### EXAMPLE 7.2

Assume the same facts as in Example 1, except that the plan has three-year vesting for the tribe's non-elective contribution. Therefore, an employee's rights to the non-elective contributions (and the associated earnings) are subject to a substantial risk of forfeiture until the employee has been employed by the tribe for three years.

The tribe's non-elective contributions (and earnings thereon) are not wages for purposes of the social security, Medicare, and FUTA taxes until the employee has completed three years of service. At that time, the aggregate amount of the tribe's non-elective contributions, plus earnings thereon, is required to be taken into account as wages for purposes of the social security, Medicare, and FUTA tax. Once an individual has met the vesting requirements, future non-elective contributions by the tribe are required to be taken into account as wages for these purposes when the contribution is made.

The following are examples of how you would prepare a Form W-2 to reflect deferred compensation depending on whether the plan is a qualified plan or a nonqualifying plan.

### EXAMPLE 7.3 Qualified Plan

Sarah Lee earned \$30,000 during the year of which she elected to contribute 10% (\$3,000) to her employer's qualified 401(k) pension plan. The employer also contributed 5% (\$1,500) to the pension plan on Sarah's behalf.

## CHAPTER 7 Pension Plans

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Sarah had federal withholding of \$3,000, social security withholding of \$1,860, and Medicare withholding of \$435.

Sarah's W-2 will reflect the following amounts:

- Box 1 - \$27,000.00 (\$30,000 gross wages less \$3,000 elective deferral)
- Box 3 - \$30,000.00 – Although Sarah's elective deferrals are not included in gross wages for the purpose of federal income tax; they are includable wages for the social security tax.
- Box 5 - \$30,000.00 – Sarah's elective deferrals are includable wages for Medicare tax purposes.
- Box 12 - D \$3,000.00 – Code D is the code for elective deferrals to a section 401(k) cash or deferral arrangement. (See W-2 instructions for other retirement plan codes)
- Box 13 - Check the Retirement Plan Box
- Box 14 - \$1,500.00 – This is the Non-elective employer contribution made on behalf of an employee. This is not a mandatory entry

If your state has a state income tax, then Box 16 on Form W-2 will normally be the same amount as the amount shown in Box 1 providing the employee was a resident of the state for the entire year.

# CHAPTER 7 Pension Plans

## EXHIBIT 7-3 Form W-2

<b>a</b> Control number		22222	Void <input type="checkbox"/>	<b>For Official Use Only ▶</b> OMB No. 1545-0008		
<b>b</b> Employer identification number			00-0000000			
<b>c</b> Employer's name, address, and ZIP code  Tribe XYZ 123 Main Street Anytown, USA 76543			<b>1</b> Wages, tips, other compensation \$ 27,000.00		<b>2</b> Federal income tax withheld \$ 3,000.00	
			<b>3</b> Social security wages \$ 30,000.00		<b>4</b> Social security tax withheld \$ 1,860.00	
			<b>5</b> Medicare wages and tips \$ 30,000.00		<b>6</b> Medicare tax withheld \$ 435.00	
			<b>7</b> Social security tips \$ -0-		<b>8</b> Allocated tips \$	
<b>d</b> Employee's social security number			123-45-6789			
<b>e</b> Employee's first name and initial		Sarah A.		<b>Last name</b> Lee		
333 Elm Street Anytown, USA 76543			<b>11</b> Nonqualified plans \$		<b>12a</b> See instructions for box 12 D \$ 3,000.00	
			<b>13</b> Statutory employee <input type="checkbox"/> Retirement plan <input checked="" type="checkbox"/> Third-party sick pay <input type="checkbox"/>		<b>12b</b> \$	
			<b>14</b> Other \$1,500.00		<b>12c</b> \$	
					<b>12d</b> \$	
<b>f</b> Employee's address and ZIP code						
<b>15</b> State	Employer's state ID number	<b>16</b> State wages, tips, etc.	<b>17</b> State income tax	<b>18</b> Local wages, tips, etc.	<b>19</b> Local income tax	<b>20</b> Locality name
		\$	\$	\$	\$	
		\$	\$	\$	\$	

Form **W-2** Wage and Tax Statement (99)

2003

Department of the Treasury—Internal Revenue Service

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

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# CHAPTER 7 Pension Plans

## EXAMPLE 7-4 Nonqualified Plan

Assume the same facts as above except that instead of a 401(k) plan, the plan is a nonqualified plan, and there is no substantial risk of forfeiture of the deferred amount.

Box 1 - \$27,000.00

Box 3 - \$31,500.00 – Note that both Sarah’s contributions (elective deferrals) and the employer’s contributions (non-elective deferrals) are includable wages for the social security tax.

Box 5 - \$31,500.00 – Same as above with regard to the Medicare tax.

Box 12 – D \$3,000.00

Box 13 – Check the Retirement Plan Box

Box 14 - \$1,500.00 – Not Mandatory

### EXHIBIT 7.4 Form W-2

<b>a</b> Control number		22222	Void <input type="checkbox"/>	<b>For Official Use Only ▶</b> OMB No. 1545-0008			
<b>b</b> Employer identification number			00-0000000		<b>1</b> Wages, tips, other compensation	<b>2</b> Federal income tax withheld	
<b>c</b> Employer's name, address, and ZIP code Tribe XYZ 123 Main Street Anytown, USA 76543					\$ 27,000.00	\$ 3,000.00	
					<b>3</b> Social security wages	<b>4</b> Social security tax withheld	
					\$ 31,500.00	\$ 1,953.00	
					<b>5</b> Medicare wages and tips	<b>6</b> Medicare tax withheld	
					\$ 31,500.00	\$ 457.00	
					<b>7</b> Social security tips	<b>8</b> Allocated tips	
					\$ -0-	\$	
					<b>9</b> Advance EIC payment	<b>10</b> Dependent care benefits	
<b>d</b> Employee's social security number 123-45-6789					\$	\$	
					<b>11</b> Nonqualified plans	<b>12a</b> See instructions for box 12	
<b>e</b> Employee's first name and initial		Last name					
Sarah A.		Lee				D \$ 3,000.00	
333 Elm Street Anytown, USA 76543			<b>13</b> Statutory employees		<input type="checkbox"/>	<b>12b</b>	\$
			Retirement plan		<input checked="" type="checkbox"/>	12c	\$
			Third-party sick pay		<input type="checkbox"/>		12d
			<b>14</b> Other				\$1,500.00
<b>f</b> Employee's address and ZIP code							
<b>15</b> State	Employer's state ID number	<b>16</b> State wages, tips, etc.	<b>17</b> State income tax	<b>18</b> Local wages, tips, etc.	<b>19</b> Local income tax	<b>20</b> Locality name	
		\$	\$	\$	\$		
		\$	\$	\$	\$		

**Form W-2 Wage and Tax Statement (99) 2003** Department of the Treasury—Internal Revenue Service  
**Copy A For Social Security Administration**—Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable. **For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.**  
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## CHAPTER 7 Pension Plans

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### CATCH-UP CONTRIBUTIONS

Participants over age 50 may contribute additional elective deferrals “catch-up contributions” to 401(k), 403(b), SIMPLE IRA, or SEP plans. The catch-up contribution limits are shown on the chart on page XXX.

Catch-up contributions are combined with regular contributions for W-2 reporting.

### EXAMPLE 7.5

Jerry Q. Public, age 52, earned \$25,000 during the year. He contributed 10% (\$2,500) of his salary to his employer’s qualified 401(k) plan. In addition, Jerry contributed \$500 in catch-up contributions during the year. His employer contributed \$1,250 to the pension plan on Jerry’s behalf. Jerry had federal withholding of \$2,800, social security withholding of \$1,550, and Medicare withholding of \$363.

Jerry’s W-2 will reflect the following amounts:

Box 1 - \$22,000 (\$25,000 gross wages less \$3,000, which is the \$2,500 annual deferral plus \$500 catch-up contribution).

Box 3 - \$25,000 – The annual deferral and catch-up contributions are includable wages subject to social security tax.

Box 5 - \$25,000 – Same as above with regard to the Medicare tax

Box 12 – D \$3,000 – Annual deferral and catch-up contributions are combined in this box using the proper retirement code (see W-2 instructions).

Box 13 – Check the Retirement Plan Box

Box 14 - \$1,250 – Not mandatory



## CHAPTER 7 Pension Plans

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### CONTRIBUTION LIMITS

Effective Year	Elective deferral limits for 403(b) and 401(k) plans
2002	\$11,000
2003	\$12,000
2004	\$13,000
2005	\$14,000
2006	\$15,000
2007 and thereafter	\$15,000 (indexed in \$500 increments)
Effective Year	Elective deferral limits for SIMPLE-IRA and SIMPLE 401(k) plans
2002	\$7,000
2003	\$8,000
2004	\$9,000
2005	\$10,000
2006 and thereafter	\$10,000 (indexed in \$500 increments)

### CATCH-UP PROVISIONS

Effective Year	Catch-up contributions for deductible 403(b) and 401(k) (non-simple only) for individuals over age 50
2002	\$1,000
2003	\$2,000
2004	\$3,000
2005	\$4,000
2006	\$5,000
2007 and thereafter	\$5,000 (indexed in \$500 increments)
Effective Year	Catch-up contributions for SIMPLE-IRA and SIMPLE 401(k) plans
2002	\$500
2003	\$1,000
2004	\$1,500
2005	\$2,000
2006	\$2,500
2007 and thereafter	\$2,500 (indexed in \$500 increments)

## CHAPTER 8 Cafeteria Plans

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### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Publication 15-B](#), *Employer's Guide to Fringe Benefits*
- [Form 5500](#), *Annual Return/Return of Employee Benefit Plan*
- [Publication 502](#), *Medical and Dental Expenses*
- [Publication 503](#), *Child and Dependent Care Expenses*
- [Publication 968](#), *Tax Benefits for Adoption*
- [Form 8839](#), *Qualified Adoption Expenses* (attachment to Form 1040)

Section 125 of the Internal Revenue Code makes it possible for employers to offer their employees a choice between cash and a variety of nontaxable benefits.

A cafeteria plan is a written benefit plan maintained by an employer for the benefit of its employees. The plan must allow employees to choose between two or more benefits consisting of cash (or a taxable benefit which is treated as cash) and certain "qualified benefits."

The written plan must include the following provisions:

- a specific description of each benefit available under the plan and the period of coverage
- the rules governing which employees are eligible to participate in the plan
- the procedures for making elections under the plan, including when elections may be made, the rules governing irrevocability of elections and the periods for which elections are effective
- the manner in which employer contributions may be made, such as by salary reduction agreement between the employer and employee, by non-elective employer contributions, or by both
- the maximum amount of employer contributions available to any participant
- the plan year

Examples of qualified benefits of a cafeteria plan are:

- accident and health benefits
- adoption assistance
- dependent care assistance
- group-term life insurance coverage

## CHAPTER 8 Cafeteria Plans

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### **Filing Requirements**

Contributions to a cafeteria plan are usually made pursuant to salary reduction agreements between the employer and the employee in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. Salary reduction contributions are not actually or constructively received by the participant. Therefore, those contributions are not considered wages for federal income tax purposes. In addition, those sums generally are not subject to FICA and FUTA. Employers are required to report employees' nontaxable cafeteria plan benefits on the Form W-2, in Box 12.

If you maintain a cafeteria plan, you must report information about the plan each year by the last day of the 7<sup>th</sup> month after the plan year ends. Use Form 5500, *Annual Return/Report of Employee Benefit Plan*.

For more detail, refer to Publication 15, Circular E, Employer's Tax Guide, Publication 15-A, Employer's Supplemental Tax Guide and Publication 15-B, Employer's Tax Guide to Fringe Benefits.

## CHAPTER 9

### Scholarships & Educational Assistance

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide* (Section 15, Special Rules for Various Types of Services and Payments, for students)
- [Publication 15-A](#), *Employer's Supplemental Tax Guide* (Section 5, Wages and Other Compensation, Scholarship and Fellowship Payments)
- [Publication 508](#), *Tax Benefits for Work-Related Education*
- [Publication 520](#), *Scholarships and Fellowships*
- Instructions for Form W-2

#### **Educational Assistance**

Section 127 of the Internal Revenue Code (IRC) addresses educational assistance programs and whether income to the recipient should be included in income.

Gross income of an employee does not include amounts paid or expenses incurred by the employer for educational assistance to the employee. The income exclusion from employee gross income is limited to \$5,250 per employee (for tax year 2002) in educational assistance during a calendar year. The excludable amount is not subject to income tax withholding or other employment taxes. The education need not be job-related.

Job-related educational expenses are excluded from an employee's income as a "working condition" fringe benefit. This is a tax-free benefit of property or service provided by an employer to an employee that, if the employee had paid for it, the employee could have deducted as an unreimbursed employee business expense on Form 1040. The exclusion is, generally, available for any form of educational instruction or training that improves or develops the job-related capabilities of an employee.

For purposes of IRC §127, the term "educational assistance" means:

- The payment, by an employer, of expenses incurred by or on behalf of an employee for education of the employee (including, but not limited to tuition, fees, and similar payments, books, supplies, and equipment); and
- The provision, by an employer, of courses of instruction for such employee (including books, supplies, and equipment), but does not include payment for or the provision of, tools or supplies which may be retained by the employee after completion of a course of instruction, or meals, lodging, or transportation. The term "educational assistance" also does not include any payment for, or the provision of, any benefits with respect to any course or other education involving sports, games, or hobbies, and such term also does

## CHAPTER 9

### Scholarships & Educational Assistance

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not include any payment for, or the provision of, any benefits with respect to any graduate level course of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree.

#### **Scholarships**

Section 117 of the Internal Revenue Code provides an exclusion from income for certain scholarships made to an individual who is candidate for a degree. Per IRC § 170, an educational institution is defined as an educational organization, which maintains a regular faculty, a curriculum, and has a regularly enrolled body of students on site.

#### **Nontaxable Benefits**

A scholarship is generally an amount paid for the benefit of a student at an educational institution to aid in the pursuit of studies. Only amounts you pay as a qualified scholarship may be excluded from the recipient's gross income. The student may be either an undergraduate or graduate.

A qualified scholarship is any amount of grant that is used for 1) tuition and fees paid to enroll in, or to attend, and educational institution, and 2) fees, books, supplies and equipment that are required for the courses at the educational institution and if required of all students in the courses.

A scholarship is tax free only if: 1) the student is a candidate for a degree at an educational institution, and 2) the grant is a qualified scholarship.

#### **Taxable Benefits**

Any amounts paid for room and board, teaching, research or other services required as a condition of receiving the scholarship are includable in the recipient's gross income, reported on Form W-2. Such amounts are subject to income tax withholding. Taxability for social security and Medicare taxes depends on the nature of the employment and status of the organization.

## CHAPTER 10

### Earned Income Credit (EITC)

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Form W-5](#), *Earned Income Credit Advance Payment Certificate*
- [Notice 797](#), *Possible Federal Refund Due to the Earned Income Tax Credit (EIC)*

The EITC is a refundable tax credit for certain workers whose earned income is below a certain level. Because it is a “credit”, the EITC is subtracted from the amount of tax owed, if any. As a refundable credit, any excess over the total tax is refunded to the individual. Even workers who have not filed a tax return in the previous year, because their wages were below minimum income-level requirements to file, may be able to get the credit – but only if they file a tax return. Therefore, you must notify each employee who worked for you at any time during the year, and from whom you did not withhold any income tax, about EITC. You will meet the notification requirements by giving the employee either Notice 797, *Possible Federal Refund Due to the Earned Income Tax Credit (EITC)*; your own written statement as long as it has the exact wording of Notice 797; or the official IRS Form W-2, *Wage and Tax Statement*, which contains a statement on the back of Copy B. You do not need to notify employees who claimed exemption from withholding on Form W-4, *Employee's Withholding Allowance Certificate*.

An eligible employee can receive advance payments of up to 60% of the maximum credit for one qualifying child. To claim the advance EITC, eligible employees should fill out a Form W-5, *Earned Income Credit Advance Payment Certificate*, and return it to you. Employees must file a new W-5 each year they claim the advanced earned income credit. Use the advance EITC tables in Publication 15 each payroll period to figure the correct amount of advance payment to include in the employee's pay. The advance payment first reduces the withheld income tax and then the employee and employer social security and Medicare taxes, thereby reducing your total tax liability.

**Note: An employee's advance EITC payments are limited (See Publication 15 for current year's limitation), although the credit may be more. They will have to claim any additional amount of EITC on their tax return.**

# CHAPTER 11

## Employment Taxes

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### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Publication 505](#), *Tax Withholding and Estimated Tax*
- [Publication 509](#), *Tax Calendars for 2004*
- [Publication 515](#), *Withholding of Tax on Nonresident Aliens and Foreign Entities*
- [Publication 519](#), *U.S. Tax Guide for Aliens*
- [Publication 919](#), *How Do I Adjust My Tax Withholding?*
- [Form W-4](#), *Employee's Withholding Allowance Certificate, Instructions*
- [Publication 966](#), *Electronic Choices for Paying All your Federal Taxes*
- [Form I-9](#), *Employment Eligibility Verification*
- [Publication 1635](#), *Understanding Your Employer Identification Number*
- [Form SS-4](#), *Application for Employer Identification Number*
- [Form 8109-B](#), *Federal Tax Deposit Coupon*

### **Form SS-4**

When you have employees, you will need to apply for an EIN (Employer's Identification Number) to identify the tax returns of your tribe's business. If you don't already have an EIN, you need to get one if you:

- pay wages to employees
- are required to withhold taxes for non-wage payments
- operate your entity as a corporation, partnership, or
- file any of these tax returns:
  - employment
  - excise
  - fiduciary or
  - alcohol, tobacco and firearms

If you have not applied for an EIN and you are required to have one, you should obtain Form SS-4, *Application for Employer Identification Number*, from the IRS. The address to mail your completed Form SS-4 can be found on the back of the form.

Form SS-4, Line 8A, Type of Entity, has a box that indicates Indian Tribal Governments/Enterprises. By designating this box, you will let the Internal Revenue Service know of your status as a Federally Recognized Indian Tribal Government. This will reduce errors and facilitate processing of your returns by routing them to specially trained employees. It allows us to code the returns so

## CHAPTER 11

### Employment Taxes

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any questions will be directed to the Indian Tribal Governments Division of IRS. Because it takes several weeks to receive an EIN after the Form SS-4 has been filed, apply for your EIN well before your tax returns are due. You may be able to obtain an EIN sooner by telephone or fax.

To obtain an EIN by telephone, you can call toll-free (866) 816-2065, Monday through Friday from 7:30 a.m. until 5:30 p.m. local time. You can also fax an EIN request 24 hours a day/ 7 days a week. Instructions on the Form SS-4 indicate which location will accept your faxed request. Fax locations are:

- Brookhaven, NY (631) 447-8960
- Cincinnati, OH (859) 669-5760
- Philadelphia, PA (215) 516-3990

You may obtain additional information by using the following website:

[http://communications.no.irs.gov/internal/new2002/EIN\\_fact\\_sheet1.doc](http://communications.no.irs.gov/internal/new2002/EIN_fact_sheet1.doc)

**Note: Use your EIN on all items you send to the IRS or Social Security Administration (SSA).**

This section introduces federal employment taxes. It briefly explains your responsibilities as an employer to withhold and pay these taxes, and it gives other related information. Employment taxes represent the income tax and social security and Medicare (FICA) taxes withheld from the wages of an employee plus the employer's share of social security taxes and federal unemployment (FUTA) taxes, when applicable. The withheld (employee's) portion of employment taxes is referred to as "trust fund" taxes. FUTA will be addressed later in this guide.

If the tribe is required to withhold income or social security and Medicare taxes, a return reporting the amounts withheld must be filed. Form 941, *Employer's Quarterly Federal Tax Return*, is used for this purpose. However, other forms are used under certain circumstances.

- Farms operated for a profit require Form 943, *Employer's Annual Tax Return for Agricultural Employees*.
- Form 945, *Annual Return of Withheld Federal Income Tax*, is used to report income tax withheld from non-payroll payments, such as pensions, IRAs, gambling winnings, per capita payments, and backup withholdings.

You can use the following publications for additional information:

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### Employment Taxes

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- Publication 15, *Employer's Tax Guide (Circular E)*, explains the rules and methods of withholding, paying, depositing and reporting federal income tax, social security and Medicare taxes and federal unemployment (FUTA) tax on wages, tips and fringe benefits. It also explains who is an employee, what are taxable wages and what are taxable tips.
- Publication 15-A, *Employer's Supplemental Tax Guide*, provide specialized information supplementing the basic employment tax information provided in Circular E, such as a more detailed discussion of fringe benefits and information on how to report third-party sick pay.
- Publication 15-T, *New Withholding Tables (For Wages Paid Through December 2004)* reflects changes due to the recent tax cut bill.

#### **Form W-4, Employee's Withholding Allowance Certificate**

To know how much federal income tax to withhold from an employee's wages, you should have a Form W-4, *Employee's Withholding Allowance Certificate*, on file for each employee. The amount to be withheld is determined by the employee's gross wages and the information submitted by the employee on Form W-4.

This information includes:

- employee's marital status
- number of withholding allowances claimed
- employee's request to have additional tax withheld or
- employee's claim to exemption from withholding

Ask each new employee to give you a signed Form W-4 by his or her first day of work. This certificate is effective with the first wage payment and will last until the employee files a new certificate.

If an employee does not give you a signed Form W-4, withhold tax as if the employee were a single person who has claimed no withholding allowances. If not enough tax is withheld and your employee has not provided a Form W-4 or has claimed an exemption from withholding, he or she may be subject to penalties. An employee who claims exemption from withholding must renew his or her status by filing a new Form W-4 with you by February 15 of each year.

**Note: Student status does not automatically exempt the employee from income tax withholding.**

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Generally, Forms W-4 are for your records. They need not be sent to IRS unless:

- the employee claims more than 10 withholding allowances or
- the employee normally earns more than \$200 per week and claims exemption from withholding on Line 7.

If you receive Forms W-4 that meet either of these two conditions, send them to the IRS at Ogden, UT 84201-0046, along with Form 941. Also send copies of any written statements from employees in support of the claims made on Forms W-2. You can send questionable Forms W-4 to the IRS more often if you like. If you do so, include a cover letter giving your name, address, EIN, and the number of forms included.

For more information on withholding, see Publication 505, *Tax Withholding and Estimated Tax*. You can help your employees determine whether they are having the right amount of income tax withheld by ordering Publication 919, *How Do I Adjust My Tax Withholding?*

#### **Form I-9, Employment Eligibility Verification**

As an employer, you must verify that each new employee is legally eligible to work in the United States. Both you and the employee must complete the Immigration and Naturalization (INS) Form I-9, *Employment Eligibility Verification*. For questions or more information on employer responsibilities, call the INS at 1-800-375-5283 or visit the INS web site at <http://www.bcis.gov>.

#### **Federal Income Tax**

The wages you pay your employees generally are subject to income tax withholding if their wages for any payroll period are more than the dollar amount of their withholding allowances for that period. The amount to be included is figured separately for each payroll period. Wages 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 not excluded by law. It does not matter how payments are measured or paid. Wages paid in any form other than money (such as goods, lodging and meals) are measured by the fair market value. See Publication 15, *Employer's Tax Guide (Circular E)* for more information about income tax withholding.

The income tax to be withheld is figured on **gross** wages before any deductions are made for social security and Medicare taxes. You may figure the withholding by different methods, the most common of which are the percentage method and

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the wage bracket tables method. Publication 15 contains the applicable tables and instructions for using both of these withholding methods, and it gives more information on reporting and withholding requirements on wages and tip income.

#### **Social Security and Medicare Taxes**

Under the Federal Insurance Contributions Act (FICA), you must withhold social security and Medicare taxes from wages that you pay your employees each payroll period.

Generally, meals, lodging, clothing, services and other payments in kind are subject to social security and Medicare taxes, as are wages paid in cash. However, meals are not taxable wages if furnished for the employer's convenience and on the employer's premises. Lodging is not taxable if furnished for the employer's convenience, on the employer's premises and as a condition of employment.

You, as an employer, must withhold and deposit the employee's part of the taxes and pay a matching amount. The social security tax is withheld from the employee's gross wages until the employee's cumulative wages for the year reach the wage base limit. Any wages above the wage base limit are not subject to social security withholding. However, there is no wage base limit for Medicare tax; **all covered wages are subject to Medicare tax.**

The United States has social security agreements with many countries that eliminate dual taxation and coverage. Compensation subject to social security and Medicare taxes may be exempt under one of these agreements. You can get more information and a list of agreement countries from the Social Security Administration (SSA) at [www.ssa.gov/international](http://www.ssa.gov/international).

#### **Federal Unemployment Tax (FUTA)**

FUTA will be discussed in depth later in this guide.

#### **How and When To Deposit**

In general, you must deposit income tax withheld and both the employer and employee social security and Medicare taxes (minus any advance EITC payments). But first, you must determine which deposit schedule to use.

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There are two deposit schedules – **monthly or semiweekly** – for determining when you deposit social security, Medicare and withheld income taxes. These schedules tell you when a deposit is due after a tax liability arises (e.g., when you have a payday).

#### **IMPORTANT NOTE:**

**Remember: Form 941 is a quarterly return, but deposits may be required on a monthly or semiweekly schedule. Publication 509, *Tax Calendars for 2004*, is a useful publication for employers to monitor due dates of deposits. Whether you are a monthly or semiweekly depositor, Publication 509 has deposit due date schedules for both types of depositors. The calendars in this publication also include due dates for filing returns, providing information returns to employers, and other important dates employers need to know.**

#### **Lookback Period**

Your deposit schedule for a calendar year is determined from the total taxes (not reduced by any advance EITC payments) reported on your Form 941 (line 11) in a four-quarter lookback period. The lookback period for Form 941 filers begins July 1 and ends June 30. See Publication 15 for the table that explains the Lookback Period for the current Calendar Year. If you reported \$50,000 or less of taxes for the lookback period, you are a monthly schedule depositor; if you reported more than \$50,000 you are a semiweekly schedule depositor.

#### **Monthly Deposit Schedule**

Under the monthly deposit schedule, deposit Form 941 taxes on payments made during a month by the 15<sup>th</sup> day of the following month.

**Note: If this is a new tribal entity, during the first calendar year, your tax liability for each quarter, in the lookback period, is considered to be zero. Therefore, you are a monthly schedule depositor for the first calendar year of the business unless the \$100,000 Next-Day Deposit rule (discussed later) applies.**

#### **Semiweekly Deposit Schedule**

You are a semiweekly schedule depositor for a calendar year if the total taxes on Form 941 (line 11) during your lookback period were more than \$50,000. If the payday falls on Wednesday, Thursday, and or Friday, you must deposit the Form

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941 taxes no later than the following Wednesday. (See Exhibit 11.1 below). If the payday falls on Saturday, Sunday, Monday and/or Tuesday, deposit by Friday.

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### EXHIBIT 11.1 Semiweekly Deposit Schedule

<b>Semiweekly Deposit Schedule</b>	
<b>If the payday falls on a...</b>	<b>Then deposit taxes by the following...</b>
Wednesday, Thursday and/or Friday	Wednesday
Saturday, Sunday, Monday and/or Tuesday	Friday

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### **\$100,000 Next-Day Deposit Rule**

If you accumulate a tax liability (reduced by any advance EITC payments) of \$100,000 or more on any day during a deposit period, you must deposit the tax by the next banking day, regardless of whether you are a monthly or semiweekly schedule depositor. The term deposit period refers to the period during which tax liabilities are accumulated for each required deposit due date. For monthly schedule depositors, the deposit period is a calendar month. If you are a monthly depositor and become subject to the rule, you become a semiweekly depositor for the remainder of the year and all of the following year.

### **How to Deposit**

The two methods of depositing employment taxes are by Electronic Federal Payment System (EFTPS) and by using Federal Tax Deposit (FTD) coupons, Form 8109-B.

You are required to make electronic deposits using EFTPS of all your tax liabilities in 2003 if your total deposits of all federal depository taxes were more than \$200,000 in 2001 or you were required to use EFTPS in 2002. For more details see Publication 15.

**Note: Even if you are not required to make electronic tax deposits, you may voluntarily participate in EFTPS. To enroll, call 1-800-945-8400 or 1-800-555-4477. You can obtain additional information on EFTPS requirements by accessing Publication 966, Electronic Federal Tax Payment System, at: <http://publish.no.irs.gov/PUBS/PDF/22397E03.PDF>. You can register on-line and receive more information by using the EFTPS website at: <http://www.eftps.gov>**

If you are not required to use EFTPS, you can use FTD coupons to make your required deposits at a financial institution or Federal Reserve Bank (FRB) that is an authorized depository<sup>2</sup> for federal taxes. The IRS will issue you a book of coupons 5 to 6 weeks after you receive your EIN. After the initial mail out, FTD coupons will be automatically mailed by the IRS depending upon the number of FTD coupons you use.

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<sup>2</sup> An authorized depository is a financial institution (e.g., a commercial bank) that is authorized to accept federal tax deposits.

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If you prefer, you may mail your coupon and payment to:  
Financial Agent, Federal Tax Deposit Processing  
P.O. Box 970030  
St. Louis, MO 63197

Make sure your check or money order is made payable to **Financial Agent**.

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

#### **Deposit Penalties**

Penalties may apply if you do not make required deposits on time, make deposits for less than the required amount, or if you do not use EFTPS when required. Always ensure your deposits are timely. Check with your local depository or FRB for information concerning their cutoff time (exact hour they start dating deposits as received on their next banking day).

**Note: If you use EFTPS to make deposits, you must make your deposit one calendar day prior to your tax due date. Otherwise, the payment will post late and penalties may be assessed.**

Deposits not made in a proper or timely manner may be subject to penalties. 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.
- 10% - Deposits made at an unauthorized financial institution, paid directly to the IRS or paid with your tax return. See Publication 15 for more exceptions.
- 10% - Amounts that are subject to electronic deposit requirements but not deposited using EFTPS.
- 15% - Amounts still unpaid more than 10 days after the date of the first notice the IRS sent asking for the tax due or the day on which you receive the notice and demand for immediate payment, whichever is earlier.

The following example illustrates how a tribe would figure their deposit requirements and due dates.

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### EXAMPLE 11.1

Tribal Enterprises  
EIN: 11-1111111  
1512 Poplar St.  
Inn, MI 48200

Period Ending	Number of Employees	Gross Wages	*FICA Withheld	*Employer's FICA	Income Tax Withheld	Total Taxes
1/31	4	\$ 4,800.00	\$ 367.20	\$ 367.20	\$ 400.00	\$1,134.40
2/28	4	\$ 4,750.00	\$ 363.38	\$ 363.38	\$ 406.00	\$1,132.76
3/31	3	\$ 4,200.00	\$ 321.30	\$ 321.30	\$ 340.00	\$ 982.60
Quarterly Totals		\$13,750.00	\$1,051.88	\$1,051.88	\$1,146.00	\$3,249.76
*Social Security and Medicare taxes are referred to as FICA						

Tribal Enterprises, Inc., as a monthly depositor, must deposit each month's taxes by the 15<sup>th</sup> of the following month (\$1,134.40 by February 15<sup>th</sup>; \$1,132.76 by March 15<sup>th</sup> and \$982.60 by April 16<sup>th</sup> (April 15<sup>th</sup> is a Sunday). If the **total** taxes for all three months of the quarter had been less than \$2,500, then they could have been deposited or paid with the Form 941 to be filed by April 30.

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### Preparation of Payroll Checks

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Publication 51](#), *Circular A, Agricultural Employer's Tax Guide*
- [Publication 463](#), *Travel, Entertainment, Gift, and Car Expenses*
- [Publication 966](#), *Electronic Choices to Pay all Your Federal Taxes*

#### Payroll Files

In Chapter 11, Form W-4, *Employee's Withholding Allowance Certificate*, Form W-5, *Earned Income Credit Advance Payment Certificate*, and Form I-9, *Employment Eligibility Verification* are discussed. These are forms that your employees may have on file with your payroll department. It is important to maintain separate files for each employee with his or her completed, signed payroll forms.

#### Payroll Records

Other records of employment taxes maintained in your payroll records are discussed in Publication 15, *Circular E, Employer's Tax Guide*. Payroll records should be retained for 4 years. Those records include:

- notification of assignment of employer identification number, or other record of your employer identification number
- amounts and dates of all wage, annuity, and pension payments
- amounts of tips reported
- records of allocated tips
- 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
- dates and amounts of tax deposits you made and acknowledgment numbers for deposits made using the Electronic Federal Tax Payment System (EFTPS)

## CHAPTER 12

### Preparation of Payroll Checks

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- copies of returns filed, including 941 TeleFile Tax Records and confirmation numbers
- records of fringe benefits provided, including substantiation
- Notice 797, *Possible Federal Refund Due to Earned Income Tax Credit*, or other proof of notification of Earned Income Tax Credit (EITC) eligibility
- Form I-9, *Employment Eligibility Verification*
- travel reimbursement plan for non-accountable plans

Records to support each payroll item should be maintained for a minimum of 4 years.

#### **Payroll Period**

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

Each tribe or entity determines the dates on which it will pay its employees. Some entities have weekly paydays, some on the first and fifteenth of the month (semimonthly); some pay every other week (biweekly), some on a monthly basis, and some at irregular intervals. Some entities have different classes of workers (for instance, factory and office) who are paid at different times. It is important to know the payroll period covered for each individual for each paycheck you are about to issue. Knowing the proper payroll period is one element to ensure you are withholding the proper amount of federal income tax from your employee's wages. Circular E has a detailed discussion of this topic.

#### **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. Publication 15-A, *Employer's Supplemental Tax Guide*, provides additional information on wages and other compensation, including:

- adoption assistance
- awards
- back pay
- below-market loans
- cafeteria plans
- deferred compensation

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- educational assistance
- group-term life insurance
- outplacement services
- retirement plans
- supplemental unemployment benefits, and other

A common item that must be included as wages is employee business expense reimbursement that is under a **non-accountable** plan. Accountable and non-accountable plans are discussed in Publication 463, *Travel, Entertainment, Gift, and Car Expenses*, and in Chapter 5 of this guide

Unusual situations may be encountered in determining gross wages paid to an employee. The general rule is all payments in cash, cash equivalents, goods, and services are wages for purposes of withholding. Publication 15-A is a good reference for the purpose of determining what constitutes wages.

#### **Timekeeping**

A manual or computerized timekeeping system is generally used to record the hours employees worked during any given pay period. Some type of record will be given to the payroll department as a voucher from which a paycheck will be generated. The timesheet or other voucher should be signed by the appropriate party, or parties, and retained for record keeping purposes.

Once the payroll department is assured of proper reporting of time, it should be determined if any miscellaneous items (as discussed above) should be included in the gross wage computation. Gross wages are the dollar value of the total wages for the pay period. Gross wages are the starting point for computing withholdings and net payroll.

#### **Part-Time Workers**

For income tax withholding and social security, Medicare, and federal unemployment tax (FUTA) purposes, there are no differences among full-time employees, part-time employees, and employees hired for short periods. It does not matter whether the worker has another job or has the maximum amount of social security tax withheld by another employer. Income tax withholding may be figured the same way as for full-time workers, or it may be figured by the part-year employment method explained in Publication 15-A.

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#### **Review Payroll Records**

After gross wages are computed for each employee, the employee's file should be inspected to determine federal income tax withholding allowances; state income tax withholding allowances (if applicable); and whether the employee has on file a Form W-5, *Earned Income Credit Advance Payment Certificate*. The employer may be required to withhold other items such as child support payments, wage garnishments by court order, federal income tax wage levies, health insurance, charitable payroll deductions, and other items.

The payroll department should retain copies of all items that support a deduction to an employee's wages for a period of 4 years.

#### **Federal Income Tax Withholding**

To know how much federal income tax to withhold from employees' wages, you should refer to Form W-4, *Employee's Withholding Allowance Certificate*, on file for each employee. 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.

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 30<sup>th</sup> day from the date you received the replacement Form W-4.

The amount of income tax withholding must be based on marital 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 ensure that they have enough withholding or to offset other sources of taxable income that are not subject to adequate withholding.

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. See the Form W-4 instructions for more information. The wages are still subject to social security and Medicare taxes.

In general, if you pay wages to nonresident aliens, you must withhold income tax (unless exempted by regulations), social security, and Medicare taxes just as you would for a U. S. citizen. The general rules for nonresident aliens are found in

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### Preparation of Payroll Checks

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Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*, and Publication 519, *U. S. Tax Guide for Aliens*.

#### **Social Security and Medicare Taxes**

The Federal Insurance Contributions Act (FICA) provides for a federal system of old age, survivors, disability, and hospital insurance. The old age, survivors, and disability insurance part is financed by the social security tax. The hospital insurance part is financed by the Medicare tax. Each of these taxes is reported separately.

Social security and Medicare taxes are levied on both the employer and employees. The employer must withhold and deposit the employee's part of the taxes, and must pay a matching amount. Generally, 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.

#### **Advance Earned Income Tax Credit (EITC) Payment**

An employee who is eligible for the earned income tax credit (EITC) and has a qualifying child is entitled to receive EITC payments with his or her pay during the year. To get those payments, the employee must provide to you a properly completed Form W-5, *Earned Income Credit Advance Payment Certificate*, using either the paper form or using an approved electronic format. You are required to make advance EIC payments to employees who give you a completed and signed Form W-5. Publication 15, *Circular E, Employer's Tax Guide*, has a more detailed section on advance earned income credit payments.

#### **Other Payroll Deductions**

Before arriving at the employee's net paycheck, you must also review the individual's payroll folder to determine if you are required to withhold other amounts. Many states require the employer to withhold state income taxes. You should contact your state tax authority for information and instructions on their requirements.

Miscellaneous payroll deductions may include insurance, charitable items, union dues, and others. In each case, you should have an authorization signed by the employee to allow you to make deductions from their wages and remit to the various organizations. Each signed authorization should have instructions on

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### Preparation of Payroll Checks

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when and where to remit payments. It is important as an employer to be able to account for each deduction from an employee's paycheck.

There may be involuntary deductions from an employee's paycheck such as a court ordered judgment, a federal or state tax levy, or court enforced child support payments. In these cases, the employer is required to make the deductions and remit them to the appropriate agency, even if the employee disagrees with the process. The employer is required by federal or state law to honor the levy or court order. Again, the employer is required to keep all payroll records for at least 4 years.

#### **Net Paycheck**

Once you ensure you have computed the payroll correctly, you are ready to issue payroll checks. You may want to use a computerized or manual payroll system to monitor the process. Often, someone other than the payroll clerk is required to sign payroll checks as a matter of internal control.

Many computerized payroll systems automatically print a check stub with fields to list the gross wages and each of the items deducted, with columns for the current pay period and year-to-date totals for each category. If your system does not automatically track these items, you may want to design a spreadsheet to do so. Employees need to be able to reconcile these items from time to time during the year to ensure they are withholding the proper amounts.

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### Preparation of Payroll Checks

#### EXAMPLE 12.1

#### Sample Payroll Ledger Sheet for an Hourly Employee Paid Weekly For the Quarter Ending March 31

Name	SSN	Address	W-4	W-5
John Doe	123-45-6789	111 Elm St. Anytown, USA	Married, 3 exemptions	None

Date	Hrs.	Hourly Rate	Gross Pay	Social Security	Medicare	Federal WH	State WH	Insurance	Other	Net Pay
January										
Week 1	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
Week 2	38	\$10.00	\$380.00	\$23.56	\$5.51	\$14.00	\$4.00	\$25.00	\$0.00	\$307.93
Week 3	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
Week 4	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
February										
Week 5	38	\$10.00	\$380.00	\$23.56	\$5.51	\$14.00	\$4.00	\$25.00	\$0.00	\$307.93
Week 6	38	\$10.00	\$380.00	\$23.56	\$5.51	\$14.00	\$4.00	\$25.00	\$0.00	\$307.93
Week 7	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
Week 8	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
March										
Week 9	32	\$10.00	\$320.00	\$19.84	\$4.64	\$5.00	\$2.00	\$25.00	\$0.00	\$263.52
Week 10	31	\$10.00	\$310.00	\$19.22	\$4.50	\$2.00	\$0.00	\$25.00	\$0.00	\$259.28
Week 11	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
Vacation	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
Week 13	40	\$10.00	\$400.00	\$24.80	\$5.80	\$17.00	\$4.00	\$25.00	\$0.00	\$323.40
Total			\$4,970.00	\$308.14	\$72.07	\$185.00	\$46.00	\$325.00	\$0.00	\$4,033.79

#### EXAMPLE 12.2

#### Sample Payroll Ledger Sheet for a Salaried Employee Paid Semi-Monthly

Name	SSN	Address	W-4	W-5
Jim Doe	000-65-4321	116 Elm St. Anytown, USA	Married, 2 exemptions	None

Date	Semi-Monthly Salary	Gross Pay	Social Security	Medicare	Federal WH	State WH	Insurance	Other	Net Pay
Jan 15	\$ 900.00	\$ 900.00	\$ 55.80	\$13.05	\$60.00	\$10.00	\$35.00	\$0.00	\$726.15
Jan 31	900.00	900.00	55.80	13.05	60.00	10.00	35.00	\$0.00	726.15
Feb 15	900.00	900.00	55.80	13.05	60.00	10.00	35.00	\$0.00	726.15
Feb 28	900.00	900.00	55.80	13.05	60.00	10.00	35.00	\$0.00	726.15
Mar 15	900.00	900.00	55.80	13.05	60.00	10.00	35.00	\$0.00	726.15
Mar 31	900.00	900.00	55.80	13.05	60.00	10.00	35.00	\$0.00	726.15
		\$5,400.00	\$334.80	\$78.30	\$360.00	\$60.00	\$210.00	\$0.00	\$4,356.90

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### Preparation of Payroll Checks

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#### **Payroll Taxes**

After you have computed payroll, you must calculate your payroll tax liability. Federal income tax, social security tax, and Medicare taxes are withheld from your employees. Taxes withheld from your employees make up what is known as “trust fund” taxes. They are called trust fund taxes because you are entrusted to deposit the taxes withheld from your employees’ wages with a federal depository. Please refer to Chapter 19 for more specific information on trust fund penalties.

#### **Other Payroll Deductions**

There are other payroll deductions from the wages of the employees in the examples in this chapter. There may be state income taxes withheld, hospitalization insurance withheld, and other miscellaneous items. Because these items are withheld from your employees’ wages, you as the employer are entrusted with remitting them to the proper payee.

## CHAPTER 13

### Form 941, Employer's Quarterly Federal Tax Return

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Form 941](#), *Employer's Quarterly Federal Tax Return*, and [Instructions](#)
- [Schedule B](#) (Form 941), *Employer's Record of Federal Tax Liability*
- [Form 941c](#), *Supporting Statement to Correct Information*, and instructions

#### **Due Dates for Filing Form 941**

Form 941 is due by the last day of the month after each quarter ends. The return filing dates are listed below:

QUARTER	ENDS	DUE DATE
January, February, March	March 31	April 30*
April, May, June	June 30	July 31*
July, August, September	September 30	October 31*
October, November, December	December 31	January 31*

\*If the due date for a return falls on a Saturday, Sunday or legal holiday, **the due date is the next business day.**

If you paid the quarterly tax payments in full, you are allowed an additional 10 days to file the return. For example, your return for the quarter that ends on June 30 would be due on August 10 instead of July 31.

Semiweekly schedule depositors, and monthly schedule depositors who accumulate \$100,000 or more on any day, must complete a Schedule B (*Employer's Records of Federal Tax Liability*) and attach it to Form 941. You do not need to complete a Schedule B if you accumulate less than \$2,500 in tax liability (reduced by any advance earned income credit payment) during the quarter, and you pay in full with a timely filed return.

The IRS uses Schedule B to determine if you have timely deposited your employment and withholding tax liabilities. Unless Schedule B is properly completed and filed with your Form 941, the IRS may not be able to process your return correctly, and deposit penalties could be applied.

Do not file more than one Form 941 per quarter and do not report more than one calendar quarter on a return.

Seasonal employers are not required to 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, check the

## CHAPTER 13

### Form 941, Employer's Quarterly Federal Tax Return

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seasonal employer box above line 1 on Form 941 each time you file. The IRS will mail two Forms 941 to you once a year after March 1. The preprinted name and address information will not include the date the quarter ended. You must enter that date when you file the return.

If you are not a seasonal employer, but you receive a preaddressed Form 941 for a quarter in which you have no employees or may have temporarily stopped paying salaries, file a return anyway. This ensures that you will continue to receive Form 941. If the tribe has an entity that ceases to do business or pay wages, a final return needs to be filed. The instructions on Form 941 give information on how to file the final return.

Always use the preaddressed form mailed to you. If you do not receive a preaddressed form, print or type the tribe's name and address **exactly** as shown on the previous return.

The date your quarter ends and your **EIN** must also be shown. If you have not received notification of your EIN, write "Applied for" and the date you applied in the space provided for the EIN.

#### **Where to mail Forms 941 without a payment:**

**Internal Revenue Service  
Ogden, UT 84201-0046**

**Regardless of where the tribal government is located, all Forms 941 that are not accompanied by a payment should be mailed to the Ogden address.**

#### **Payment With Return**

You may make a payment with Form 941 instead of depositing it if your net tax liability (reduced by any advance earned income credit) during the quarter (line 13 of Form 941) is less than \$2,500 and you pay in full with a timely filed return. Form 941-V Payment Voucher would be used. See Publication 15 for additional information and exceptions.

#### **Where to mail Forms 941 together with a payment and Form 941-V, Payment Voucher:**

**Internal Revenue Service  
P. O. Box 660264  
Dallas, TX 75266-0264**

## CHAPTER 13

### Form 941, Employer's Quarterly Federal Tax Return

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Regardless of where the tribal government is located, all Forms 941 that are accompanied by a payment should be mailed to the Dallas address.

**Note:** Do not use the Form 941-V payment voucher to make federal tax deposits.

#### **Correcting Form 941**

Errors made in figuring taxes in an earlier quarter can be corrected on a current Form 941 by making an adjustment to the current quarter's taxes. For example, an error in reporting income tax withholding on your first quarter 2003 Form 941 and discovered in April 2003 can be corrected on the second quarter 2003 Form 941.

File a Form 941c, *Supporting Statement to Correct Information*, along with the Form 941 on which you make the adjustment. **Do not file Form 941c separately.** An example of a corrected Form 941 and the related Form 941c are located at the end of this chapter. Section 13 of Circular E describes in detail how to correct errors to income tax withholding, social security and Medicare taxes.

#### **Filing By Other Methods**

You may be able to file Form 941 by telephone if you meet certain criteria. A 941 TeleFile package is automatically mailed to eligible employers each quarter. You may also use your personal computer to transmit tax return information through an approved third-party transmitter. Visit the IRS Web Site at [www.irs.gov/efile](http://www.irs.gov/efile) for a list of approved business providers.

# CHAPTER 13

## Form 941, Employer's Quarterly Federal Tax Return

### EXHIBIT 13-1 - Sample Form 941, Employer's Quarterly Federal Tax Return and related Form 941c

<b>Form 941</b> (Rev. January 2003) Department of the Treasury Internal Revenue Service (IRS)	<b>Employer's Quarterly Federal Tax Return</b> See separate instructions revised January 2003 for information on completing this return. Please type or print.	OMB No. 1545-0029 T FF FD FP I T																																																																				
Enter state code for state in which deposits were made <b>only</b> if different from state in address to the right (see page 2 of separate instructions).	Name (as distinguished from trade name) <b>ACD Tribe</b> Trade name, if any  Address (number and street) <b>PO Box 8000</b>	Date quarter ended <b>04/30/2003</b> Employer identification number <b>00-0000000</b> City, state, and ZIP code <b>Anywhere, SD 50000</b>																																																																				
If address is different from prior returns, check here <input type="checkbox"/>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%;">1</td><td style="width: 10%;">2</td><td style="width: 10%;">3</td><td style="width: 10%;">3</td><td style="width: 10%;">3</td><td style="width: 10%;">3</td><td style="width: 10%;">3</td><td style="width: 10%;">4</td><td style="width: 10%;">4</td><td style="width: 10%;">4</td><td style="width: 10%;">5</td><td style="width: 10%;">5</td><td style="width: 10%;">5</td> </tr> <tr> <td>0</td><td>7</td><td>8</td><td>8</td><td>8</td><td>8</td><td>8</td><td>8</td><td>9</td><td>9</td><td>9</td><td>9</td><td>9</td><td>10</td><td>10</td><td>10</td><td>10</td><td>10</td><td>10</td> </tr> </table>		1	1	1	1	1	1	1	2	3	3	3	3	3	4	4	4	5	5	5	0	7	8	8	8	8	8	8	9	9	9	9	9	10	10	10	10	10	10																														
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A If you do not have to file returns in the future, check here <input type="checkbox"/> and enter date final wages paid <input type="checkbox"/> B If you are a seasonal employer, see <b>Seasonal employers</b> on page 1 of the instructions and check here <input type="checkbox"/>																																																																						
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">1 Number of employees in the pay period that includes March 1st.</td> <td style="width: 10%; text-align: center;">1</td> <td style="width: 10%; text-align: center;">300</td> <td style="width: 20%;"></td> </tr> <tr> <td>2 Total wages and tips, plus other compensation</td> <td style="text-align: center;">2</td> <td style="text-align: right;">\$1,269,293.19</td> <td></td> </tr> <tr> <td>3 Total income tax withheld from wages, tips, and sick pay</td> <td style="text-align: center;">3</td> <td style="text-align: right;">175,991.26</td> <td></td> </tr> <tr> <td>4 Adjustment of withheld income tax for preceding quarters of this calendar year</td> <td style="text-align: center;">4</td> <td style="text-align: right;">0</td> <td></td> </tr> <tr> <td>5 Adjusted total of income tax withheld (line 3 as adjusted by line 4)</td> <td style="text-align: center;">5</td> <td style="text-align: right;">175,991.26</td> <td></td> </tr> <tr> <td>6 Taxable social security wages</td> <td style="text-align: center;">6a</td> <td style="text-align: right;">1,269,293.19</td> <td style="text-align: right;">x 12.4% (.124) =</td> </tr> <tr> <td>Taxable social security tips</td> <td style="text-align: center;">6c</td> <td style="text-align: right;">0</td> <td style="text-align: right;">x 12.4% (.124) =</td> </tr> <tr> <td>7 Taxable Medicare wages and tips</td> <td style="text-align: center;">7a</td> <td style="text-align: right;">1,269,293.19</td> <td style="text-align: right;">x 2.9% (.029) =</td> </tr> <tr> <td>8 Total social security and Medicare taxes (add lines 6a, 6c, and 7a). Check here if wages are not subject to social security and/or Medicare tax <input type="checkbox"/></td> <td style="text-align: center;">8</td> <td style="text-align: right;">194,201.66</td> <td></td> </tr> <tr> <td>9 Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ _____ ± Fractions of Cents \$ _____ ± Other \$ _____</td> <td style="text-align: center;">9</td> <td></td> <td></td> </tr> <tr> <td>10 Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9)</td> <td style="text-align: center;">10</td> <td style="text-align: right;">0</td> <td></td> </tr> <tr> <td>11 Total taxes (add lines 8 and 10)</td> <td style="text-align: center;">11</td> <td style="text-align: right;">369,993.12</td> <td></td> </tr> <tr> <td>12 Advance earned income credit (EIC) payments made to employees (see instructions)</td> <td style="text-align: center;">12</td> <td style="text-align: right;">16,997.00</td> <td></td> </tr> <tr> <td>13 Net taxes (subtract line 12 from line 11). If \$2,500 or more, this must equal line 17, column (d) below (or line D of Schedule B (Form 941))</td> <td style="text-align: center;">13</td> <td style="text-align: right;">352,996.18</td> <td></td> </tr> <tr> <td>14 Total deposits for quarter, including overpayment applied from a prior quarter</td> <td style="text-align: center;">14</td> <td style="text-align: right;">352,996.18</td> <td></td> </tr> <tr> <td>15 Balance due (subtract line 14 from line 13). See instructions</td> <td style="text-align: center;">15</td> <td style="text-align: right;">0</td> <td></td> </tr> <tr> <td>16 Overpayment. If line 14 is more than line 13, enter excess here \$ _____ and check if to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded.</td> <td style="text-align: center;">16</td> <td></td> <td></td> </tr> </table>			1 Number of employees in the pay period that includes March 1st.	1	300		2 Total wages and tips, plus other compensation	2	\$1,269,293.19		3 Total income tax withheld from wages, tips, and sick pay	3	175,991.26		4 Adjustment of withheld income tax for preceding quarters of this calendar year	4	0		5 Adjusted total of income tax withheld (line 3 as adjusted by line 4)	5	175,991.26		6 Taxable social security wages	6a	1,269,293.19	x 12.4% (.124) =	Taxable social security tips	6c	0	x 12.4% (.124) =	7 Taxable Medicare wages and tips	7a	1,269,293.19	x 2.9% (.029) =	8 Total social security and Medicare taxes (add lines 6a, 6c, and 7a). Check here if wages are not subject to social security and/or Medicare tax <input type="checkbox"/>	8	194,201.66		9 Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ _____ ± Fractions of Cents \$ _____ ± Other \$ _____	9			10 Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9)	10	0		11 Total taxes (add lines 8 and 10)	11	369,993.12		12 Advance earned income credit (EIC) payments made to employees (see instructions)	12	16,997.00		13 Net taxes (subtract line 12 from line 11). If \$2,500 or more, this must equal line 17, column (d) below (or line D of Schedule B (Form 941))	13	352,996.18		14 Total deposits for quarter, including overpayment applied from a prior quarter	14	352,996.18		15 Balance due (subtract line 14 from line 13). See instructions	15	0		16 Overpayment. 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• All filers: If line 13 is less than \$2,500, do not complete line 17 or Schedule B (Form 941). • Semiweekly schedule depositors: Complete Schedule B (Form 941) and check here <input checked="" type="checkbox"/> • Monthly schedule depositors: Complete line 17, columns (a) through (d), and check here <input type="checkbox"/>																																																																						
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="4">17 Monthly Summary of Federal Tax Liability. (Complete Schedule B (Form 941) instead, if you were a semiweekly schedule depositor.)</td> </tr> <tr> <td style="width: 25%;">(a) First month liability</td> <td style="width: 25%;">(b) Second month liability</td> <td style="width: 25%;">(c) Third month liability</td> <td style="width: 25%;">(d) Total liability for quarter</td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> </tr> </table>			17 Monthly Summary of Federal Tax Liability. (Complete Schedule B (Form 941) instead, if you were a semiweekly schedule depositor.)				(a) First month liability	(b) Second month liability	(c) Third month liability	(d) Total liability for quarter																																																												
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Do you want to allow another person to discuss this return with the IRS (see separate instructions)? <input checked="" type="checkbox"/> Yes. Complete the following. <input type="checkbox"/> No																																																																						
Third Party Designee  Sign Here	Designer's name <b>J. Smith, CPA</b> Phone no. <b>(685) 555-5555</b> Person's identification number (PIN) <b>54399</b> 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 _____																																																																					

# CHAPTER 13

## Form 941, Employer's Quarterly Federal Tax Return

<b>SCHEDULE B (FORM 941)</b> <small>(Rev. January 2002)</small> Department of the Treasury Internal Revenue Service	<b>Employer's Record of Federal Tax Liability</b> ▶ See Circular E for more information about employment tax returns. 5551 ▶ Attach to Form 941 or 941-SS.	OMB No. 1545-0049
Name as shown on Form 941 (or Form 941-SS)	Employer identification number	Date quarter ended
ACD Tribe	XX-xxxxxxx	06/30/2003

You must complete this schedule if you are required to deposit on a semiweekly schedule, or if your tax liability on any day is \$100,000 or more. Show tax liability here, **not** deposits. (The IRS gets deposit data from FTD coupons or EFTPS.)

A. Daily Tax Liability—First Month of Quarter

1	8	15	22	29	
2	9	16	23	30	
3	10	17	24	31	115,532.03
4	11	18	25		
5	12	19	26		
6	13	20	27		
7	14	21	28		
A Total tax liability for first month of quarter ▶					115,532.03

B. Daily Tax Liability—Second Month of Quarter

1	8	15	22	29	
2	9	16	23	30	
3	10	17	24	31	
4	11	18	25		
5	12	19	26		
6	13	20	27		
7	14	21	28		
B Total tax liability for second month of quarter ▶					117,532.03

C. Daily Tax Liability—Third Month of Quarter

1	8	15	22	29	
2	9	16	23	30	
3	10	17	24	31	119,532.12
4	11	18	25		
5	12	19	26		
6	13	20	27		
7	14	21	28		
C Total tax liability for third month of quarter ▶					119,532.12

D Total for quarter (add lines A, B, and C). This should equal line 13 of Form 941 (or line 10 of Form 941-SS) ▶

352,596.18

For Paperwork Reduction Act Notice, see page 2. Cat. No. 11991D Schedule B (Form 941) (Rev. 1-2002)

# CHAPTER 13

## Form 941, Employer's Quarterly Federal Tax Return

<b>Form 941c</b> (Rev. October 1994) Department of the Treasury Internal Revenue Service	<b>Supporting Statement To Correct Information</b> <b>Do Not File Separately</b> File with Form 941, 941-M, 941-SS, 943, 945, or 943.	OMB No. 1545-0046  Page No.
Name <b>ACD Tribe</b>		Employer identification number <b>XX-XXXXXXX</b>
Telephone number (optional) <b>605-989-8555</b>	A. This form supports adjustments to: <b>Check one box.</b> <input checked="" type="checkbox"/> Form 941 <input type="checkbox"/> Form 941-SS <input type="checkbox"/> Form 945 <input type="checkbox"/> Form 941-M <input type="checkbox"/> Form 943	
B. This form is filed with the return for the period ending (month, year) <b>12/2003</b>	C. Enter the dollar amount of each error reported on this form. If you are making more than one correction and the errors were not discovered at the same time, please explain in Part IV. <b>42000</b>	

**Part I Signature and Certification** (You **MUST** complete this part for the IRS to process your adjustments for repayments.) Skip Part I if all your adjustments are underpayments. (See the instructions for Part I.)

I certify that Forms W-2s, Corrected Wage and Tax Statement, have been filed (as necessary) with the Social Security Administration, and that (check appropriate boxes):

- All overcollected income taxes for the current calendar year and all social security and Medicare taxes for the current and prior calendar years have been repaid to employees. For claims of overcollected employee social security and Medicare taxes in earlier years, a written statement has been obtained from each employee stating that the employee has not claimed and will not claim refund or credit of the amount of the overcollection.
- All affected employees have given their written consent to the allowance of this credit or refund. For claims of overcollected employee social security and Medicare taxes in earlier years, a written statement has been obtained from each employee stating that the employee has not claimed and will not claim refund or credit of the amount of the overcollection.
- The social security tax and Medicare tax adjustments represent the employer's share only. An attempt was made to locate the employee(s) affected, but the affected employee(s) could not be located or will not comply with the certification requirements.
- None of this refund or credit was withheld from employee wages.

**Sign Here**

Signature _____	Title _____	Date _____
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**Part II Income Tax Withholding (Including Backup Withholding) Adjustment**

	(a) Period Corrected (For quarterly returns, enter date quarter ended. For annual returns, enter year.)	(b) Withheld Income Tax Previously Reported for Period	(c) Correct Withheld Income Tax for Period	(d) Withheld Income Tax Adjustment
1	12/31/2003	99,421.93	97,399.93	2,022.00
2				
3				
4				
5	Net withheld income tax adjustment. If more than one page, enter total of ALL columns (d) on first page only. Enter here and on the appropriate line of the return with which you file this form.			2,022.00

**Part III Social Security Tax Adjustment** (Use the tax rate in effect during the period(s) corrected. You must also complete Part IV.)

	(a) Period Corrected (For quarterly returns, enter date quarter ended. For annual returns, enter year.)	(b) Wages Previously Reported for Period	(c) Correct Wages for Period	(d) Tips Previously Reported for Period	(e) Correct Tips for Period	(f) Social Security Tax Adjustment
1						
2						
3						
4						
5	Totals. If more than one page, enter totals on first page only.					
6	Net social security tax adjustment. If more than one page, enter total of ALL columns (f) on first page only. Enter here and on the appropriate line of the return with which you file this form.					
7	Net wage adjustment. If more than one page, enter total of ALL lines 7 on first page only. If line 5(c) is smaller than line 5(b), enter difference in parentheses.					(2,022.00)
8	Net tip adjustment. If more than one page, enter total of ALL lines 8 on first page only. If line 5(e) is smaller than line 5(d), enter difference in parentheses.					

# CHAPTER 13

## Form 941, Employer's Quarterly Federal Tax Return

Form 941 (Rev. 10-03)

Page **2**

**Part IV Medicare Tax Adjustment**

	(a) Period Covered (For quarterly returns, enter date quarter ended. For annual returns, enter year.)	(b) Wages and Tips Previously Reported for Period	(c) Correct Wages and Tips for Period	(d) Medicare Tax Adjustment
1				
2				
3				
4				
5	Totals. If more than one page, enter totals on first page only . . . . .			
6	Net Medicare tax adjustment. If more than one page, enter total of ALL columns (d) on first page only. Enter here and on the appropriate line of the return with which you file this form . . . . .			6
7	Net wage and tip adjustment. If more than one page, enter total of ALL lines 7 on first page only. If line 5(c) is smaller than line 5(b), enter difference in parentheses . . . . .			7

**Part V Explanation of Adjustments**

16 new employees did not turn in the Form W-4 for a 2 month period so federal income tax withholding was done at the highest rate.

12 existing employees made changes to their Form W-4's and returned them timely to the payroll department but they were not processed timely by the payroll department. These forms were turned in to their supervisors on March 1st, 2003.

## CHAPTER 14

### Form 943, Agricultural Employees

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#### References:

- [Publication 51](#), *Circular A, Agriculture Employer's Tax Guide*
- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Form 943](#), *Employer's Annual Tax Return for Agricultural Employees*

#### In General

Agricultural workers are subject to FICA tax if certain wage tests are met. Amounts paid to seasonal farm workers are excluded from FICA tax if specific provisions are met.

You are an employer of farm workers if your employees:

- Raise or harvest agricultural or horticultural products on a farm.
- Work in connection with the operation, management, conservation, improvement, or maintenance of your farm and its tools and equipment.
- Handle, process, or package an agricultural or horticultural commodity if you produced over half of the commodity (for a group of more than 20 operators, all of the commodity).
- Do work related to cotton ginning, turpentine, or gum resin products.

The term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, as well as plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising or harvesting of agricultural or horticultural commodities and orchards.

Farm work does not include reselling activities that do not involve any substantial activity of raising agricultural commodities, such as a retail store or a greenhouse used primarily for display or storage. Refer to Publication 51 for information to distinguish between farm and non-farm activities.

#### Taxable Wages

Cash wages you pay to employees for farm work are subject to social security and Medicare taxes, if the wages meet the wage test (discussed below). They are also subject to income tax withholding. Additionally, they may also be liable for federal unemployment (FUTA) tax.

## CHAPTER 14

### Form 943, Agricultural Employees

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Cash wages include checks, money orders, etc. Do not count the value of food, lodging, and other non-cash items. For more information on what payments are considered taxable wages, see Publication 15, *Employer's Tax Guide (Circular E)*.

#### **Wage Test**

All cash wages you pay to an employee during the year for farm work are subject to social security and Medicare taxes and income tax withholding if **either** of the two tests below is met:

- You pay cash wages to an employee of \$150 or more in a year for farm work (count all cash wages paid on a time, piecework, or other basis).
- The total you pay for farm work (cash and non-cash) to all your employees is \$2,500 or more during the year.

#### **EXAMPLE 14-1**

A tribe is the owner of a local mushroom farm. The tribe paid their employees to plant mushrooms. John was paid \$95, Tom was paid \$175, and Kirk \$900. The tribe had no other employees on the farm. Wages paid to Tom and Kirk were subject to FICA tax because they met the \$150 or more requirement. John's wages were not subject to FICA because he did not meet the wage requirement.

**Exceptions:** The \$150 and \$2,500 test do not apply to the following situations:

- 1) Wages you pay to a farm worker who receives less than \$150 in annual cash wages are not subject to social security and Medicare taxes, or income tax withholding, even if you pay \$2,500 or more in that year to all your farm workers, if the farm worker:
  - a) Is employed in agriculture as a hand-harvest laborer,
  - b) Is paid piece rates in an operation that is usually paid on a piece-rate basis in the region of employment,
  - c) Commutes daily from his or her home to the farm, and
  - d) Had been employed in agriculture less than 13 weeks in the preceding calendar year.

Amounts you pay to these seasonal farm workers, however, count toward the \$2,500-or-more test to determine whether wages you pay to other farm workers are subject to social security and Medicare taxes.

## CHAPTER 14

### Form 943, Agricultural Employees

---

#### EXAMPLE 14-2

A tribe, a local avocado grower, hired Marion, a high school student, to harvest a new crop of avocados. Marion, who had never harvested avocados before, was paid by the pound as is customary in the industry. Marion was transported by a bus, provided by the tribe, from her home to the farm. She was given instructions by the tribe on where and how to harvest the avocados. The tribe inspected and approved the avocados that Marion harvested. Marion earned \$125.

The amount earned by Marion is not subject to FICA tax based on the provision of IRC 3121(a)(8)(B). This exception to FICA tax applies regardless of the fact that the worker had the status of common law employee.

#### **Due Date of Form 943**

Form 943, *Employer's Annual Tax Return for Agricultural Employees*, should be filed with the Internal Revenue Service by January 31. However, if you deposited all Form 943 taxes when due, you may file Form 943 by February 12.

#### **Making Payment with Form 943**

Make a payment with your Form 943 only if:

1. Your net taxes for the year (line 11 on Form 943) are less than \$2,500 **or**
2. You are a monthly schedule depositor making a payment in accordance with the Accuracy of Deposit Rule. (See section 7 of Publication 51 for more details.) This amount may be \$2,500 or more.

Otherwise, you must deposit the amount at an authorized financial institution or by electronic funds transfer. Do not use the Form 943-V payment voucher to make federal tax deposits.

**Caution: If you pay an amount with Form 943 that should have been deposited, you may be subject to a penalty.**

For information about depositing social security and Medicare taxes and income tax withheld, see Publication 51. This publication also contains information about penalties that may apply if deposits are not made on time and/or if the Form 943 is not filed timely.

## CHAPTER 14

### Form 943, Agricultural Employees

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#### Where to file

Government entities, including Indian tribal governments, use the following addresses to file Form 943, regardless of the location of the tribal government:

**Return without payment:**

**Internal Revenue Service  
Ogden, UT 84201-0008**

**Return with payment:**

**Internal Revenue Service  
P. O. Box 660587  
Dallas, TX 75266-0587**

There are special rules for social security and Medicare withholding on agricultural workers. Refer to Section 4, Social Security and Medicare taxes, in Pub 51. Also refer to Section 13, Income Tax Withholding Methods, for withholding methods.

#### **Crew Leaders**

A crew leader is a person who furnishes and pays workers to do farm work for a farm operator. A crew leader must pay the workers on his/her behalf, or on behalf of the farm operator and the crew leader must not have a written agreement with the farm operator stating that he or she is an employee. A crew leader is an independent contractor and will receive a Form 1099-MISC for (all of) the work performed.

Employment taxes for farm workers must be filed on Form 943 and must be separate from other workers filed on Form 941.

Refer to Publication 51, *Circular A, Agricultural Employer's Tax Guide*, for more complete information on agricultural workers.

## CHAPTER 15

### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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#### References:

- [Publication 15](#), *Employer's Tax Guide (Circular E)*
- [Publication 15-A](#), *Employer's Supplemental Tax Guide*
- [Form 940](#), *Employer's Annual Federal Unemployment (FUTA) Tax Return and Instructions*
- Consolidated Appropriations Act 2000

As of December 21, 2000, Indian tribes are now treated similarly to state and local governments when they participate in the Federal-State Unemployment Compensation (UC) program. This is due to the Consolidated Appropriations Act 2000 (CAA) that was signed in to law on December 21, 2000 (Public Law No. 106-554.)

As a condition of participation in the UC program, services performed in the employ of tribes generally are no longer subject to the Federal Unemployment Tax Act (FUTA), if they participate in SUTA.

Prior to CAA amendments, coverage was at the option of the state.

Under CAA, Tribes must be offered the reimbursement option. Prior to the CAA amendments, states were prohibited from offering the reimbursement option to Indian tribes.

If an Indian tribe fails to make required payments to the state's unemployment fund or payments of penalty or interest, then the tribe will become liable for the FUTA tax and the state may remove tribal services from state UC coverage.

In the event a tribe does not meet the requirements of the UC program, the IRS will be notified. Once the IRS is notified, the tribe will become liable for filing Form 940 with the IRS.

Form 940 is an annual return. It is due on January 31 of the subsequent year. However, if you deposited all FUTA tax when due, you have ten additional days to file. If the due date falls on a Saturday, Sunday, or legal holiday, the due date will be the next business day.

For 2003, the FUTA tax rate is 6.2%. Only the employer pays the FUTA tax. Do not collect or deduct it from your employees' wages. The tax applies to the first \$7,000 of wages you pay each employee during the year.

Although Form 940 covers a calendar year, you may have to make deposits of the tax before filing the return. Deposit FUTA tax quarterly if the FUTA tax

## CHAPTER 15

### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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exceeds \$100. For more information on FUTA taxes, the tribe should refer to Publication 15, *Employer's Tax Guide (Circular E)* and Publication 15-A, *Employer's Supplemental Tax Guide*, for assistance with filing Form 940.

**Note: When a tribe is required to file Form 940, due to the failure to meet UC program requirements, there will not be any benefits received by the tribe's employees with regard to unemployment compensation benefits, even though the tax per the Form 940 is paid. Therefore, the tribe's employees will not receive unemployment compensation benefits when they otherwise would be eligible.**

#### **Who are Employers?**

In general, you are an employer for UC tax purposes and must file UC tax when you would qualify as an employer if you were subject to FUTA. Under FUTA, you are an employer generally if you:

- Paid wages of \$1,500 or more in any calendar quarter to employees (other than farm workers or household workers) **or**
- Have one or more employees (other than farm workers or household workers) at any time in each of any 20 or more weeks (calendar).

The 20 weeks do not have to be consecutive. Count all regular, temporary and part-time employees, and count employees on vacation or sick leave.

**Note: The definition of an employer may change from state to state.**

The tribe should refer to Publication 15 and Publication 15-A for assistance with the definition of an employer for FUTA purposes.

#### **Who are Employees?**

The rules used for purposes of social security and Medicare tax also apply in determining who are common-law employees for purposes of paying UC tax.

For UC tax, as for social security and Medicare taxes, there are statutory employees and non-employees in addition to common-law employees.

**Note: The definition of an employee may change from state to state.**

## CHAPTER 15

### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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The tribe should refer to Publication 15, *Employer's Tax Guide (Circular E)* and Publication 15-A, *Employer's Supplemental Tax Guide* for assistance with the definition of employees for FUTA purposes.

#### **What are UC Wages?**

Wages subject to UC will vary from state to state because each state has a different method for computing UC.

States may base the UC on a wage base and an experience rate.

A state experience rate is the rate at which the state taxes your payroll for UC. This rate may be adjusted from time to time based on the number and length of claims for unemployment compensation that your former employees make against the fund. If you do not know your rate, contact your state employment security agency.

Each state may have a different wage base upon which the UC is computed. This rate can vary from year to year. It may also vary, depending on the duties performed.

For example, a state's 2001 wage base subject to UC is \$10,100. The UC program has assigned the tribe an experience rate of 1%, based upon the employment history of the tribe. The tribe would pay a maximum of \$10,100 X 1% or \$101 per year for each employee subject to UC.

#### **What if wages are not paid in cash?**

If you pay your employees in some medium that is neither cash nor a readily negotiable instrument (such as a check), you are said to pay them "in kind." Payments in kind may be in the form of goods, lodging, food, clothing, or services. Generally, wages paid in kind are treated the same way as wages paid in money. The value of a wage payment in kind is its fair market price on the day the payment is made.

#### **Frequently Asked Questions:**

1. Are services performed as a member of an Indian tribal council required to be covered?

## CHAPTER 15

### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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No. IRS Revenue Ruling 59-354 states "amounts paid to members of Indian tribal councils for services performed by them as council members do not constitute "wages" for the purposes of FUTA." As a result, the required coverage provisions of the FUTA do not apply to these services.

2. Are any services excepted from the required coverage of tribal services?

Yes. The same services, which may be excluded from coverage for state and local governments, may be excluded when performed for a tribe. For exceptions, refer to Publication 15 or Publication 15-A. These services are in paragraphs (1) through (6) and (8) through (20) of IRC Section 3306(c) and IRC Section 3309(b) of the FUTA. The CAA amended three of the FUTA exceptions to specifically address their application to services performed for tribes. These exceptions now provide that states are not required to cover services performed –

- "as a member of a legislative body, or a member of the judiciary, of a state or political subdivision thereof, or of an Indian tribe." (Section 3309(b)(3)(B)).
- "in a position, which under or pursuant to the state or tribal law, is designated as (i) a major non-tenured policymaking or advisory position, or (ii) a policymaking or advisory position the performance of the duties of which ordinarily does not require more than 8 hours per week" (Section 3309(b)(3)(E)).
- "as part of an unemployment work-relief or work-training program assisted or financed in whole or in part by any Federal agency or an agency of a state or political subdivision thereof or of an Indian tribe, by an individual receiving such work relief or work training (Section 3309(b)(5)).

**Note: States are not required to except any services performed for a tribe from coverage. This decision is entirely a state option.**

3. What is the definition of Indian tribe? The CAA added a new provision to the FUTA defining Indian tribe. For FUTA purposes:

The term "Indian tribe" has the meaning given to such term by section 4(e) of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 450b(e)), and includes any subdivision, subsidiary, or business enterprise wholly owned by such an Indian tribe. [Section 3306(u), FUTA.]

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### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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Section 4(e) of the Indian Self-Determination and Education Assistance Act provides-

"Indian tribe" means any Indian tribe, band, nation, or other organized group or community, including any Alaska Native village or regional or village corporation as defined in or established pursuant to the Alaska Native Claims Settlement Act (85 Stat. 688) (43 U.S.C. 1601 et seq.), which is recognized as eligible for the special programs and service provided by the United States to Indians because of their status as Indians.

The amendments made by the CAA apply only to these Indian tribes. States are not required to cover services for Indian tribal entities not meeting this definition. States are prohibited from offering the reimbursement option to Indian tribal entities not meeting this definition.

4. How does the CAA give tribes the reimbursement option? How does the CAA allow states to terminate coverage and the reimbursement option?

Since, as discussed in the preceding item, services performed in the employ of Indian tribes now fall under Section 3309(a)(1), the reimbursement option must be offered to Indian tribes. Therefore, the states are required to offer the option of "payments in lieu of contributions" (or reimbursement) option to Indian tribes.

The reimbursement option is described in Section 3309(a)(2):

...the state law shall provide that a governmental entity, **including an Indian tribe**, or any other organization (or group of governmental entities or other organizations) which, but for the requirements of this paragraph, would be liable for contributions with respect to service to which paragraph (1) applies may elect, for such minimum period and at such time as may be provided by state law, to pay (in lieu of such contributions) into the state unemployment fund amounts equal to the amounts of compensation attributable under the state law to such service. The state law may provide safeguards to ensure that governmental entities or other organizations so electing will make the payments required under such elections. [Amendment in bold.]

In addition to making the reimbursement requirements of section 3309(a)(2) applicable to the tribes, the CAA added a new section 3309(d)

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### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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to FUTA concerning elections of reimbursement status by an Indian tribe. It provides that-

The state law shall provide that an Indian tribe may make contributions for employment as if the employment is within the meaning of section 3306 or make payments in lieu of contributions under this section, and shall provide that an Indian tribe may make separate elections for itself and each subdivision, subsidiary, or business enterprise wholly owned by such Indian tribe. State law may require a tribe to post a payment bond or take other reasonable measures to assure the making of payments in lieu of contributions under this section. Notwithstanding the requirements of section 3306(a)(6) [*sic* - should be 3304(a)(6)], if, within 90 days of having received a notice of delinquency, a tribe fails to make contributions, payments in lieu of contributions, or payment of penalties or interest (at amounts or rates comparable to those applied to all other employers covered under the state law) assessed with respect to such failure, or if the tribe fails to post a required payment bond, then service for the tribe shall not be excepted from employment under section 3306(c)(7) until any such failure is corrected. This subsection shall apply to an Indian tribe within the meaning of section 4(e) of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 450b(e)).

#### 5. What is the effect of these amendments on the reimbursement option?

The amendments to FUTA establish the following rules for offering tribes the reimbursement option-

- States must offer the reimbursement option to tribes.
- A tribe must be given the option of making separate reimbursement elections for itself, each subdivision, subsidiary, or business enterprise wholly owned by the tribe.
- Tribes must be allowed to combine into group reimbursement accounts if they so choose.
- States may require a payment bond or take other reasonable measures to assure reimbursements are made.
- States may establish minimum periods for which an election (or the declining of the election) is applicable and the times at which elections may be made.

#### 6. What happens if a tribe fails to make payments required under state law?

Concerning any failure of a tribe to make payments required under state law-

## CHAPTER 15

### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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- The failure applies to any contributions, reimbursements, penalties, interest, and bonds required by state law.
- The amount of the penalty or rate of interest must be "comparable" to those applied to all other employers covered under state law. For ease of administration, states are encouraged to apply identical amounts or rates. States should not vary the amount or rate from that which would be charged other employers by more than 10 percent.
- If, within 90 days of receiving a delinquency notice, the tribe fails to make a required payment, then the services performed will no longer "be excepted from unemployment under section 3306(c)(7) until any such failure is corrected." This means that--
  - I. Services performed for the Indian tribe become subject to the FUTA tax.
  - II. States are, at their option, no longer required to cover services performed for the tribe.
  - III. States are prohibited from allowing the tribe to reimburse the state's unemployment fund. If the state chooses to continue coverage of tribal services, the tribe must be converted to contributing status.

Whether a tribe fails to make the required payment within 90 days of receiving a delinquency notice is a determination made under state law. Since the effects of unpaid liabilities for Indian tribes differs from the effects on other employers, states should advise the tribes at the time of mailing of the delinquency notice that non-payment will result in the tribe becoming subject to the FUTA tax, the exclusion of tribal services from coverage (if the state decides to exercise this option), and loss of reimbursement status.

Under Section 3309(d), FUTA, if "a tribe fails to make" a payment or "fails to post a required payment bond," then "service for the tribe" shall not be excepted from the FUTA definition of employment. When any subdivision, subsidiary, or business enterprise wholly owned by the tribe ("tribal units") fails to make a payment or post a required bond, *all* services performed for the tribe become subject to the FUTA and states are no longer required to cover the services. If, however, the services continue to be covered, the tribe must be converted to contributing status. In cases where tribal units have separately elected the reimbursement option, states may wish to consider making the entire tribe and its tribal units jointly and severally liable so that the risk of the Indian tribe losing its privileges is minimized.

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### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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States are not required to terminate coverage due to nonpayment. If a state elects to do so, the state should terminate coverage due to nonpayment only as a last resort because terminating coverage punishes workers who have no control over whether their employers satisfy their UC liabilities.

States have some flexibility to determine when the termination of reimbursement status becomes final. For example, the termination could become effective either immediately or the following tax year. Also, if the state has reason to believe the tribe will pay the amounts due, termination may be delayed. For example, states may enter into payment schedules, which, if adhered to by the tribe, would be a basis for delaying termination. Similarly, once the tribe satisfies its liabilities, the state has the option of immediately converting the tribe back to a reimbursing employer, waiting until the following tax year, or requiring a new election. States may also choose to treat certain delinquencies differently depending on the nature of the delinquency. For example, if a tribe is delinquent in posting the initial required payment bond for purposes of becoming a reimbursing employer, the state may grant reimbursing status immediately upon the bond being paid. Alternatively, if the delinquency is for unpaid reimbursements, the state may wait until the following tax year to again grant reimbursing status.

7. Do the amendments to the FUTA apply to all enterprises wholly owned by an Indian tribe, including those that might compete with similar private businesses?

Yes. The amendments to Section 3306(a)(7), FUTA, apply to service performed "in the employ of an Indian tribe." Section 3306(u) defines "Indian tribe" to include "any subdivision, subsidiary, or business enterprise wholly owned by such an Indian tribe." As a result, the amendments apply to all wholly owned tribal enterprises, regardless of whether they compete with private businesses. This parallels the treatment of governmental entities performing business activities, such as the operation of resorts or the sale of beer, wine and liquor.

The amendments also apply when the service is performed in the employ of an entity that is wholly owned by two or more tribes. The amendments do not apply when the service is performed in the employ of an enterprise jointly owned by an Indian tribe and another entity that is not tribally owned. In this case, the services are not "performed in the employ of" the tribe itself, but for the jointly owned entity or partnership. In addition, the

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### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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amendments do not apply when the service is performed in the employ of a contractor who may operate a tribally owned business because the services are not "performed in the employ of" the tribe itself, but for the contractor.

8. Section 7873 of the Internal Revenue Code provides that no employment tax (including FUTA) will be imposed on services performed "in a fishing rights-related activity of an Indian tribe by a member of such tribe for another member of such tribe or for a qualified Indian entity" as defined in Section 7873(b). Are states required to cover these services?

No. Section 2079 of the Revised Statutes (25 U.S.C. 71) provides that states may not impose taxes on the activities described in Section 7873 of the Internal Revenue Code. Section 7873 and 2079 exempt fishing rights income from federal and state tax, "including income, social security, and unemployment compensation insurance taxes."...Therefore a state may no longer tax remuneration paid for services to which Section 7873 pertains for state unemployment compensation purposes.

States are not required to cover services that they are prohibited from taxing. However, nothing prevents tribes from voluntarily entering into coverage for such services.

9. A tribe has employees in other state(s). How are they treated for FUTA purposes?

The tribe's employees are included in the UC program of the state where the employee works. As a result, there may be cases when states without an Indian tribe located in the state will need to amend their laws to conform with the FUTA requirements related to Indian tribes.

10. My state has a separate experience rating system for state and local governments. Do the amendments to the FUTA require that Indian tribes be made part of this system when they do not elect the reimbursement option?

No. When Indian tribes are experience rated, they must be assigned rates under your state's general experience rating provision.

The experience rating requirements of Section 3303(a)(1), FUTA, apply to "persons." "Person" is defined in Section 7701(a)(1) of the Internal Revenue Code to "mean and include an individual, a trust, estate,

## CHAPTER 15

### Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

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partnership, association, company or corporation.” Tribes have been considered persons for the purpose of experience rating. The amendments to the FUTA did not change the definition of “person” and therefore did not change the fact that the experience rating provisions are applicable to tribes that do not reimburse the state’s unemployment fund. Rather, the amendments simply required STATES to offer Indian tribes the option of electing reimbursement in lieu of contributions under an approved experience-rating plan.

#### **Contact Information:**

For additional information, contact the IRS Tax Exempt/ Government Entity Toll Free Assistance at 1-877-829-5500. You may also contact your local IRS Indian Tribal Government Office at the telephone number listed in the introduction chapter of this publication (this is not a toll-free number) or go to our website at [www.irs.gov/tribes](http://www.irs.gov/tribes).

For state specific information on unemployment benefits, employment assistance, or employer information, visit the website of the Office of Workforce Security at <http://www.workforcesecurity.doleta.gov/>.

## CHAPTER 16

### Wage Reports

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Form W-2](#), *Wage and Tax Statement*
- [Form W-3](#), *Transmittal of Wage and Tax Statements*
- [Instructions](#) for Forms W-2 and W-3

#### **Form W-2, Wage and Tax Statement**

Generally, by January 31, you must furnish a copy of Form W-2, *Wage and Tax Statement*, to each employee to whom you paid wages during the year.

Form W-2 must show total wages and other compensation paid (even if not subject to withholding); total wages subject to social security and Medicare taxes; allocated tips (if any); amounts deducted for income, social security and Medicare taxes; and the total advance earned income credit payment. In all cases, you must give each of your employees the statement by January 31 following the end of the calendar year covered. If not computer-generated, every effort should be made to ensure that Forms W-2 provided to employees are legible.

If employment ends before the close of the year, the employee may request the form earlier. You must give the employee a Form W-2 within 30 days of the employee's request or final payment, whichever is later. You should keep any undeliverable employee copies of Form W-2 (Copies B and C) as part of your records for 4 years.

If you file more than 250 Forms W-2 for the year, you are required to file them by magnetic media or electronically. See Chapter 17 for magnetic media filing requirements and mailing addresses. The instructions for Forms W-2 and W-3 also give detailed instructions.

#### **Form W-3, Transmittal of Wage and Tax Statements**

Each year, you must file Form W-3 in order to transmit Copy A of Forms W-2 to the Social Security Administration (SSA) by the last day of February after the calendar year for which the Forms W-2 are prepared. The SSA will process these forms and provide the IRS with the income tax data that it needs from those forms.

## CHAPTER 16

### Wage Reports

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File Copy A of Form W-2 with the entire page of Form W-3, *Transmittal of Wage and Tax Statements*, by February 28<sup>th</sup>. Paper Forms W-2 and W-3 should be mailed to:

Social Security Administration  
Data Operations Center  
Wilkes-Barre, PA 18769-0001

**Note: The totals on the Form W-3 you file should equal the totals from all Forms 941 filed for the same year.**

#### **Correcting Forms W-2 and W-3**

If there is an error made on Forms W-2 or W-3, make the correction by filing Form W-2c, *Corrected Wage and Tax Statement*, and Form W-3c, *Transmittal of Corrected Wage and Tax Statements*.

#### **Reconciling Forms W-2, W-3, 941, and 943**

Certain amounts reported on the four quarterly Forms 941 should agree with the Forms W-2 totals reported on Form W-3 that are filed with the SSA. The amounts that should agree are income tax withholding, social security wages, social security tips, Medicare wages and tips, and the advance earned income tax credit. A reconciliation should be conducted at the end of each year, before the Forms W-2 and W-3 are mailed to the SSA. If the totals do not agree, the discrepancy should be investigated.

The Combined Annual Wage Reporting (CAWR) is the system that permits employers to file a single statement to report the employees' earnings. Both the IRS and SSA use the information reported by employers to ensure the proper amount of taxes have been paid and reported. CAWR cases are identified by the SSA when it appears that the amounts, as noted above, do not agree with the Forms 941, 943, W-2, and W-3, or for not filing any or all of the required Forms W-2.

Upon receipt of the notification of a CAWR discrepancy, you should review your copies of the Forms 941s, W-2, and W-3 that were filed and do a complete review to find the error. A complete explanation of the error and what you did to make the necessary corrections (including any corrected forms) should be sent to the address noted on the CAWR discrepancy notice. If you still have questions, please contact your local ITG Manager.

## CHAPTER 16

### Wage Reports

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To reduce the discrepancies between amounts reported on Forms W-2, W-3 and Forms 941/943:

- Be sure the amounts of Form W-3 are the total amounts from Forms W-2.
- Reconcile Form W-3 with your four quarterly Forms 941 (or annual Form 943) by comparing amounts reported for income tax withholding, social security wages, Medicare wage and tips, and social security tips.
- The amounts for social security and Medicare taxes on the four quarterly Forms 941 (or annual Form 943) should be approximately twice the amounts shown on Form W-3.

**Remember: Amounts reported on Forms W-2, W-3, and 941/943 may not match for valid reasons. If they do not match, you should determine that the reasons are valid. Keep your reconciliation in case you receive a CAWR discrepancy notice.**

## CHAPTER 17

### Magnetic Media Filing Requirements for Form W-2, Wage and Tax Statements

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#### References:

- [Instructions](#) for Forms W-2 and W-3
- Social Security Employer Services Online User Handbook (1-888-772-2970)
- Social Security Employee Verification Service (1-800-772-6270)  
EVS information line for technical questions (1-410-965-7140)  
Internet website: [www.ssa.gov/employer\\_info](http://www.ssa.gov/employer_info)
- Social Security Magnetic Media Reporting and Electronic Filing (MMREF) for Tax Year 2003 (MMREF-1 updated annually)
- Social Security Business Services Online at [www.ssa.gov/bsowelcome.htm](http://www.ssa.gov/bsowelcome.htm)
- [Form 8508](#), *Request for Waiver from Filing Information Returns Magnetically*

#### **Forms W-2, Wage and Tax Statements**

Forms W-2 are filed with the Social Security Administration. Employers are required to file Forms W-2, Wage and Tax Statements, to report wages, tips, social security withholdings, Medicare tax withholdings, federal income tax withholdings, and other items with regard to an employee's annual wages. The Social Security Administration provides W-2 information to the Internal Revenue Service.

Social Security BSO, Business Services Online, is a suite of business services for companies to conduct business with the Social Security Administration. It consists of Registration Services, Employer Services to submit a wage file, W-2 online, view status, view notices, and view errors, and Social Security Number Verification Service (SSNVS). You must be a registered BSO user to use these services. Other services will be added in the future. You can register online.

When employers file **250 or more Forms W-2** for a given year, they are required to file them with the Social Security Administration by either magnetic media, or electronically. The employer must provide a paper copy of Form W-2 to employees, and may retain a copy of the paper document for their own records. They should also retain copies of magnetic media, or electronic files transmitted.

**Electronic submission of Forms W-2 and W-3 is considered the best practice and is recommended by the Social Security Administration.**

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### Magnetic Media Filing Requirements for Form W-2, Wage and Tax Statements

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#### **Information from the Social Security Employer Services Online User Handbook for Tax Year 2003:**

Before year-end, you should register with the Social Security Administration either by accessing the Internet site at <http://www.ssa.gov/employer>, or telephoning 1-800-772-6270 Monday through Friday from 7 a.m. to 7 p.m. It is preferable to register in December for new registrations and submitting test files. Register early so you'll be ready when the filing season begins.

The Social Security Administration has Employer Services Liaison Officers (ESLO) in regional offices across the country that can help you with information and expertise. A list of specialists can be found at [www.ssa.gov/employer/wage\\_reporting\\_specialists.htm](http://www.ssa.gov/employer/wage_reporting_specialists.htm)

The Social Security Administration must confirm your identity before issuing a **PIN** and **password**. They also have to know how to contact you if the need arises. You will be asked to provide your name as it appears on your Social Security Card, Social Security Number (SSN), date of birth, mailing address, work telephone number, fax number (optional), e-mail address (optional), company name, Employer Identification Number (EIN), and company telephone number. Your SSN, date of birth, and EIN will be verified against Social Security Administration records. The SSA will match your name, date of birth and SSN against their records and verify that you work for the company that will submit the file.

Once the information is verified, a **PIN** will be issued immediately. A **password** will be mailed and you should receive it within 10-14 days.

The first time you log on to the system, you will be asked to change your **password**. You can change your **password** at any time, and you are required to change it at least once every 365 days for security purposes.

The SSA will notify the tribe of the magnetic media registration.

#### **Commercial Software Packages**

Most commercial software packages for payroll programs have detailed instructions for year-end closing and procedures for transmitting data either by magnetic media or electronically. You will also need to consult with your software developers to determine if they have compatible state W-2 magnetic media products if you are required to file W-2s with your state. You will also want to verify with your state if they support the MMREF (Magnetic

## CHAPTER 17

### Magnetic Media Filing Requirements for Form W-2, Wage and Tax Statements

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Media Return Electronic Filing) format used by the Social Security Administration.

#### **Requests for Waiver of Requirement**

Under the Treasury Regulations at section 301.6011-2(c)(4), the Commissioner of Internal Revenue may waive the magnetic media requirements upon a written showing of hardship by the filer. In determining whether hardship has been shown, the principal factor to be taken into account is the amount, if any, by which the cost of filing returns using magnetic media exceeds the cost of filing returns on paper forms.

A request for waiver must be filed at least 90 days before the filing of the first return for which a waiver is requested. The filer must send the request to the IRS using Form 8508, *Request for Waiver from Filing Information Returns on Magnetic Media*.

#### **Accuracy**

Accurate reporting of employee's W-2 information directly affects the eligibility for, and amount of any Social Security and Medicare benefits payable to employees and their families. That is why we continually emphasize the importance of recording the right employee name, SSN and wages for each employee. Accurate reporting can also prevent penalty assessments for inaccurate or late filing.

#### **Frequently Asked Questions**

##### **1. Who should I call if I have problems with registration?**

Call 1-800-772-6270 Monday through Friday between 7:00 AM and 7:00 PM Eastern time.

##### **2. What if I have 250 or more W-2s and I submit paper forms to the SSA?**

The IRS may penalize you.

##### **3. What is meant by the term Magnetic Media?**

Using the MMREF-1 format, the following may be used to submit W-2 information:

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### Magnetic Media Filing Requirements for Form W-2, Wage and Tax Statements

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- BSO (Social Security Business Services Online)
- ½ inch magnetic tape
- 3480/3480E cartridges
- 3490/3490E cartridges

**Note: Electronic Data Transfer (EDT) is not available for use by Indian Tribal Governments**

#### 4. What is magnetic tape/cartridge filing?

The media requirements for tapes and cartridges are ½ inch magnetic tape, 3480/3480E cartridges, or 3490/3490E cartridges. These media are submitted to the SSA via the U. S. Post Office or by other delivery services. There is a section in the SSA Publication *Magnetic Media Reporting and Electronic Filing*.

#### 5. Could an Indian tribal government file using magnetic tape or cartridges?

Yes. Generally, an Indian Tribal Government will submit W-2 information by use of the OWRS (On Line Wage Reporting System), or by magnetic tape or cartridge. If you use a physical medium to copy and transmit your information, you will need to send it to the Social Security Administration by mail or other carrier.

If you are sending W-2 information on a **magnetic tape or cartridge**, you should send it to:

Social Security Administration  
AWR Magnetic Media Processing  
5-F-17, NB, Metro West  
P. O. Box 33009  
Baltimore, MD 21290-3009

If you are sending W-2 information on a **diskette**, you should send it to:

Social Security Administration  
AWR Magnetic Media Processing  
5-F-17, NB, Metro West  
P. O. Box 33014  
Baltimore, MD 21290-3014

#### 6. How will I know if my file complies with the MMREF-1 format?

## CHAPTER 17

### Magnetic Media Filing Requirements for Form W-2, Wage and Tax Statements

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You can download AccuWage from the Internet. AccuWage is a self-extracting compressed file to verify that your file complies with the MMREF-1 format for a given tax year.

#### **7. Where can I find AccuWage?**

By accessing <http://www.ssa.gov/employer>, select Wage Reporting Software, and select AccuWage Information and Software

#### **8. When is my filing deadline to the Social Security Administration?**

Paper Forms W-2 must be provided to the employee by January 31 of each year.

W-2 information must be transmitted to the SSA no later than February 28 for magnetic media. For files transmitted via BSO, the deadline is April 1.

#### **9. Can I correct W-2 information that has already been processed?**

You can submit corrections to the W-2 processed information using magnetic media, electronically, or using a paper W-3c and W-2c. If there are more than 250 corrections, you must transmit the correction by magnetic media or electronically.

## CHAPTER 18

### Records Retention

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#### **What if Records are Lost or Destroyed?**

Fires, natural disasters, equipment failure, and human error may cause records to be lost or destroyed. The extent to which payroll records can be reconstructed depends primarily on back ups, storage, and cataloging of archived records.

Reconstructed records are no substitute for maintenance of original records, as they are never as accurate or complete as the originals. An extensive effort to reconstruct records is sometimes required. However, a reconstruction may lack the authenticity and credibility of original records to regulators, state agencies, federal agencies, or the courts. Reconstructed records, simply put, are better than nothing.

In this chapter, we will briefly discuss record retention, as well as duplicate information that may be available from banks, regulators and government agencies.

#### **Back up of Records**

Instructions on how to back up your accounting and payroll records can be found in accounting and bookkeeping textbooks, from the manufacturer of your payroll system, and many other sources. The form of back up will depend on the system you use to maintain your records. For instance, a manual peg-board payroll system creates carbon copies of payroll entries. A computerized system will be stored on your computer's hard-drive.

However you decide to back up your payroll records, it is important to follow instructions, and to test a back up copy from time to time to ensure you are copying the intended files. Back ups of either manual or computerized systems should be made routinely, checked for accuracy, and should be stored in a safe place.

#### **Storage**

The site you select for storage of records should be carefully chosen. You will want your back up copies to be reasonably secure from physical damage including fire, flood, theft, insects, rodents, temperature and humidity. While paper documents may seem more sensitive to these hazards, you will want to provide the same safeguards for your computerized records.

## **CHAPTER 18**

### **Records Retention**

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You also want to ensure privacy of your records by restricting access to those persons with a “need to know.” Payroll records contain a great deal of personal information, and employees depend on their employers to keep this information confidential. Employee names, addresses, and social security numbers, in addition to items like notices of employee levies, garnishments, and child support payments should always be kept secure.

#### **Record Retention**

As previously stated in this guide, there are pre-determined periods of time for which records should be maintained. The general rule is 4 years.

Original records should be well labeled and well organized. Because payroll records “close out” at year-end, a new file should be started for each employee for each year. Some payroll records such as Form W-4, garnishments, court ordered deductions for child support, and others, may span more than one calendar year. A copy of the original document should be made for the prior year file. Keep the original in the new file folder for the employee.

All payroll reconciliation workpapers generated in your payroll office should be retained. Some entities reconcile payroll every payday, or every week, or every month. Often payroll reconciliations coincide with the payroll deposits you make with the bank, or over the telephone using the Electronic Federal Tax Payment System (EFTPS). You will want to keep all the workpapers, receipts, recordation of telephone deposits, photocopies of checks written for payroll deposits, copies of the front and back of canceled checks written for payroll deposits, and any IRS correspondence. These records will be useful when you prepare your quarterly payroll reports, and they should be retained for at least 4 years.

#### **Copies for Easy Access**

Sometimes, the Internal Revenue Service will send out correspondence with regard to payroll tax deposits, or payroll tax reports. This correspondence may have a short response time. It is recommended you keep accessible copies of payroll deposits and payroll reports for the past two years. (This should be an **extra copy** in addition to the ones you are going to take to storage).

#### **Preparing Hard Copy Files for Storage**

After you file year-end payroll reports, Forms W-2, and W-3, you will prepare files for storage. It is well worth the time to organize, label, and place the files

## CHAPTER 18

### Records Retention

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(whether they are electronic or hard copy) in some sort of storage container. If you store large quantities of records, it is helpful to label the box with a list of contents and the calendar year. For instance, you may have a storage box labeled Payroll Records – 2002. You should also attach a packing list to inventory the contents of each box.

#### **Preparing Computerized Copies for Storage**

After you follow established procedures for backing up your computerized payroll records, test the media on which they are stored. You want to ensure you copied the correct information and there are no glitches or errors to prevent you from reloading it if the need arises.

A secure, off-site location is generally recommended for storage of back ups to your computerized records. They should be well labeled and write-protected so no one can accidentally write over your valuable back up.

#### **Reconstruction**

After taking steps to prepare complete and accurate records and store them according to established procedures, something unexpected may happen to cause your records to be lost or destroyed.

Every effort should be made to find lost records, or partial records that may have “survived” a disaster. If partial records are recovered, they are the best place to begin a reconstruction.

A reconstruction of records is best approached in reverse order. In other words, begin with the end of the year and work backward. The following steps may be helpful in the reconstruction process:

1. Determine exactly what has been lost.
2. Determine if you lost the only copy of an item.
3. For those items where you lost the only copy, rank the relative importance of the lost items, starting with those of highest importance.
4. Make a list of the items you determine warrant the time and expense of reconstruction.
5. Determine if there is a state, federal, or other agency from which you can request a copy of a lost report. For instance, from the Internal Revenue Service, you can request either a transcript of a filed return, or a

## CHAPTER 18 Records Retention

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photocopy of a filed return. Either can be certified as an actual copy and can take the place of your copy of a lost return. Transcripts are available at no cost.

6. For items of public record, contact your local courthouse for a copy.
7. For bank records, contact your bank. It could be expensive to get copies of canceled checks, but they are available.

You will want to evaluate the need for the records in relation to the cost of reconstruction. For assistance with IRS records, you should contact your Indian Tribal Government office<sup>3</sup>.

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<sup>3</sup> Contact information for your local IRS Indian Tribal Governments office is listed in Chapter 1 of this guide.

## CHAPTER 19

### Penalties

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#### References:

- [Publication 15](#), *Circular E, Employer's Tax Guide*
- [Notice 746](#), *Information About Your Notice, Penalty, and Interest*

The ultimate goal of each payroll/accounting department is timely compliance with the different filing, paying, and depositing requirements. There may be times when this doesn't happen.

The following is a list of some of the penalties that may be assessed for not complying with certain filing and payment requirements:

**Failure to File** – a penalty of 5% (of the tax required to be shown on a return) may be imposed for each month or part of a month that a return is not filed (not to exceed 25%)

**Failure to Pay** – a penalty of .05% will be imposed on any tax not timely paid (not to exceed 25%)

**Dishonored Check** – 2% of the amount of the bad check. If the check is less than \$750, the penalty is 2% of the check or \$15 whichever is lesser.

**Failure to Timely File an Information Return** - You may be required to file information returns to report certain types of payments made during the year (i.e., Forms 1099-MISC, 1099-R, W-2, etc.). This penalty applies if you fail to timely file, you fail to include all information required to be shown, or you include incorrect information on a return. The penalty is:

\$15/return if correctly filed within 30 days of due date (maximum penalty of \$75,000 per year or \$25,000 for small businesses, defined below),

\$30/return if correctly filed more than 30 days after the due date (\$150,000 maximum or \$50,000 for small businesses), or

\$50/return if not filed or correctly filed after August 1 (\$250,000 maximum or \$100,000 for small businesses)

(You are a small business if your average annual gross receipts for the 3 most recent tax years ending before the calendar year in which the information returns were due, are \$5 million or less.)

**Failure to Timely Furnish a Copy of any Information Return to the Payee** – a penalty of \$50/return is imposed for failure to provide an information return to the

## CHAPTER 19

### Penalties

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payee by January 31. You may also be subject to the penalty for failure to include all information required to be shown or if you include incorrect information on the statement. (Penalty not to exceed \$1,000,000.)

#### **Failure to Make Federal Tax Deposits On Time in an Authorized Government Depository**

- Penalties may apply if you do not make required deposits on time, make deposits for less than the required amount, or if you do not use EFTPS (Electronic Federal Tax Payment System) when required. 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 within 10 days of the date of the first notice the IRS sent asking for the tax due.)
- 10% - Deposits made at an unauthorized financial institution, paid directly to the IRS, or paid with your tax return (unless otherwise excepted)
- 10% - Amounts subject to electronic deposit
- 15% - Amounts still unpaid more than 10 days after the date of the first notice the IRS sent asking for the tax due or the day on which you receive notice and demand for immediate payment, whichever is earlier.

**Failure to Collect and Pay Over Trust Fund Taxes** – If income, social security and Medicare taxes that are to be withheld are not withheld or are not deposited or paid to the United States Treasury, the trust fund recovery penalty may apply. This penalty is the full amount of the unpaid trust fund tax. It may be imposed on all persons who are determined by the IRS to be responsible for collecting, accounting for, and paying over these taxes. Refer to Chapter 20 for further information on the trust fund recovery penalty.

If a penalty is assessed and you don't feel that the assessment is correct or you still have questions, the law allows the IRS to remove or reduce the penalties if you can show you acted reasonably and in good faith, or relied on the incorrect advice of an IRS employee.

Upon receipt of your assessment notice, you may send us a signed statement explaining why you believe the penalty should be removed or reduced. Please be sure to explain in detail what caused the problem. Your statement will be reviewed and you will be notified if your explanation is accepted.

Please refer to Notice 746, *Information About Your Notice, Penalty, and Interest*, for detailed information on why penalties are assessed and in what amounts, and the removal of penalties. Contact your local Indian Tribal Governments office for further assistance.

## CHAPTER 19

### Penalties

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#### **How are Penalties Paid**

If you receive a notice of penalty, it will include instructions to send payment with the voucher at the bottom of the notice. Do not pay penalties via EFTPS. If you have questions regarding the payment of penalties, please call you ITG Specialist.

## CHAPTER 20

### The Collection Process

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#### **The Collection Process: What To Do When You Owe Taxes**

It is highly recommended that you have one designated office for each entity to receive and review all IRS notices. It is important to pay attention to the time frame as stated in the notice and then to respond to the notice promptly. This internal control will alleviate notices being lost or misdirected.

When employment tax returns are filed, we check to see if the math is accurate and if the correct amount of tax has been paid or timely deposited. If you have not paid all you owe, we send a bill called a Notice of Tax Due and Demand for Payment. The bill includes the taxes, plus penalties and interest. We encourage you to pay your bill by check or money order as quickly as possible. If you have received a bill for unpaid taxes, you should pay the entire amount, or tell us right away why you cannot. If you have received a tax notice or if you would like to know if there are any outstanding tax debts, call the IRS Indian Tribal Governments office<sup>4</sup> in your area for assistance.

If you do not pay the taxes you owe and if you make no effort to pay them, we can ask you to take action to pay your taxes, such as selling or mortgaging assets or getting a loan. If you still make no effort to pay your bill or to work out a payment plan, we may also take more serious action, such as seizing bank accounts or other assets.

#### **If you Cannot Pay in Full, There's Still Something You Can Do...**

If you cannot pay all your taxes now, pay as much as you can. Paying now reduces the amount of interest and penalty owed on the account. Then, immediately call or write the IRS Indian Tribal Governments office, or visit the nearest IRS office to explain your situation. They will assist you with resolving the account.

#### **What if You Believe Your Bill is Wrong?**

If you believe your bill is wrong, let us know as soon as possible. Call the number on your bill or contact the IRS Indian Tribal Governments office in your area for assistance.

To help us correct the problem, gather a copy of the bill along with copies of any records, tax returns, and canceled checks, etc., that will help us understand why you believe your bill is wrong. If we find you are correct, we will adjust your account.

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<sup>4</sup>Contact information for your local IRS Indian Tribal Governments office is listed in Chapter 1 of this guide.

## CHAPTER 20

### The Collection Process

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Before any action that is explained in this section is taken, you have the opportunity to voluntarily pay what is owed. But if you do not pay your taxes in full and do not contact us to let us know why you cannot pay or why you disagree with our decision to take enforcement action, the law requires us to take action. We may:

- **File a lien** against property (make a legal claim to property as security or payment for a tax debt)
- **Serve a levy** on property (legally seize property to satisfy a tax debt)
- **Assess a trust fund recovery penalty** for employment taxes

These *enforced collection actions* are the means by which the *Notice and Demand for Tax Payment* is enforced. Publication 1660, *Collection Appeal Rights*, and Publication 5, *Your Appeal Rights and How to Prepare a Protest if You Don't Agree*, give detailed information regarding the appeals process.

#### Liens

Liens give a legal claim to property as security or payment for a tax debt. A *Notice of Federal Tax Lien* may be filed only after:

- We assess the liability,
- We send you a *Notice and Demand for Payment* (a bill that tells how much is owed in taxes); and
- You neglect or refuse to pay the debt within 10 days after we notify you about it.

Once these requirements are met, a lien is created for the amount of the tax debt. Filing this notice publicly notifies other possible creditors that the federal government has a claim against the debtor's property, including property acquired after the lien is filed.

Liens can be attached to all property or rights to property, including an employer's accounts receivable.

#### Levies

A levy is a legal seizure of property to satisfy a tax debt. Levies are different from liens. A lien is a claim used as security for the tax debt, while a levy actually takes the property to satisfy the tax debt.

## CHAPTER 20

### The Collection Process

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If the taxes are not paid, or arrangements are not made to settle the debt, the IRS may seize and sell any type of real or personal property.

Generally, these three requirements must be met before a levy action is taken:

- Tax is assessed and a *Notice and Demand for Payment* is issued,
- Someone neglects or refuses to pay the tax, and
- A *Final Notice of Intent to Levy* and *Notice of Your Right to a Hearing* (levy notice) was issued at least 30 days before the levy.

#### **Trust Fund Recovery Penalty**

To encourage prompt payment of withheld income and employment taxes, including social security taxes, railroad retirement taxes, or collected excise taxes, Congress passed a law that provides for the trust fund recovery penalty. (These taxes are called *trust fund taxes* because you actually hold the employee's money in trust until you make a federal tax deposit in that amount.)

If we plan to assess the trust fund recovery penalty, we will send you a letter stating that you are the *responsible* person. You have 60 days after you receive our letter to appeal our proposal. If you do not respond to our letter, we will assess the penalty against you as a responsible person and send you a *Notice and Demand for Payment*. Also, we can apply this penalty whether or not you are out of business.

A responsible person is a person or group of people who has the duty to perform and the power to direct the collecting, accounting, and paying of trust fund taxes. This person may be:

- an officer or an employee of a corporation,
- a tribal council member,
- a member or employee of a partnership,
- a corporate director or shareholder,
- a member of a board of trustees of a nonprofit organization, or
- another person with authority and control over funds to direct their disbursement.

#### **Assessing the Trust Fund Recovery Penalty**

We may assess the penalty against anyone:

## CHAPTER 20

### The Collection Process

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- **Who is responsible** for collecting or paying withheld income and employment taxes, or for paying collected excise taxes, and
- **Who willfully** fails or neglects to collect or pay them.

For willfulness to exist, the responsible person must:

- Have known about the unpaid taxes, and
- Have used the funds to keep the business going or allowed available funds to be paid to other creditors.

#### **Employment Taxes Are:**

- The amount you should withhold from your employees for both income and social security tax, plus
- The amount of social security tax you pay on behalf of each employee.

***If you ignore the federal tax deposit and filing requirements, the amount you owe can increase dramatically.***

If you do not pay your employment taxes on time, or if you were required to and did not include your payment with your return, we will charge you interest and penalties on any unpaid balance. We may charge you penalties of up to 15% of the amount not deposited, depending on how many days the deposit is late.

If you do not pay withheld trust fund taxes, we may take additional collection action. We may require you to:

- File and pay your taxes monthly rather than quarterly, or
- Open a special bank account for the withheld amounts, under penalty of prosecution. See Form 8109, *Federal Tax Deposit Coupon*, and Publication 15, *Circular E, Employer's Tax Guide*.

There is a special program to help you with tax problems that cannot be resolved through normal IRS channels.

The **Taxpayer Advocate Service** is an IRS program that provides an independent system to assure that tax problems, which have not been resolved through normal channels, are promptly and fairly handled. Each state and Internal Revenue Service campus has at least one local Taxpayer Advocate, who is independent of the local IRS office and reports directly to the National Taxpayer Advocate. The Taxpayer Advocate can help if:

- You are suffering, or are about to suffer, a significant hardship

## CHAPTER 20

### The Collection Process

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- You are facing an immediate threat of adverse action
- You will incur significant cost (including fees for professional representation)
- You will suffer irreparable injury or long-term adverse impact
- You have experienced a delay of more than 30 days to resolve the issue
- You have not received a response or resolution by the date promised; or
- All established systems or procedures have failed to operate as intended to resolve the problem or dispute.

#### **You May Apply for Taxpayer Advocate Service Assistance by:**

- Completing Form 911, *Application For Taxpayer Assistance Order* (ATAO),
- Completing a written request for assistance (if Form 911 is not available),
- Requesting an IRS employee complete a Form 911 on your behalf (in person or over the telephone), or
- Sending (or FAX) Form 911 to your local Taxpayer Advocate. Refer to Publication 1546, *The Taxpayer Advocate Service of the IRS*, for your local Taxpayer Advocate address, telephone and FAX numbers. Call the Taxpayer Advocate Service toll-free number on 1-877-777-4778. TDD 800-829-4059.

## GLOSSARY OF TERMS

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Application for Taxpayer Assistance Order	ATAO
Consolidated Appropriations Act	CAA
Combined Annual Wage Reporting	CAWR
Cash or Deferred Arrangement	CODA
Electronic Data Transfer	EDT
Electronic Filing	E-FILE
Electronic Federal Tax Payment System	EFTPS
Employer Identification Number	EIN
Earned Income Tax Credit	EITC
Employee Retirement Income Security Act	ERISA
Frequently Asked Questions	FAQs
Federal Insurance Contributions Act	FICA
Federal Reserve Bank	FRB
Flexible Spending Account	FSA
Federal Tax Coupon	FTD
Federal Unemployment Tax Act	FUTA
Immigration and Naturalization Service	INS
Individual Retirement Account	IRA
Internal Revenue Code	IRC
Internal Revenue Service	IRS
Magnetic Media Reporting & Electronic Filing	MMREF
Old-Age, Survivors, and Disability Insurance	OASDI
Online Wage Reporting Service	OWRS

## GLOSSORY OF TERMS

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Personal Identification Number	PIN
Railroad Retirement Tax Act	RRTA
Salary Reduction Simplified Employee Pension	SARSEP
Self-Employment Contributions Act	SECA
Simplified Employee Pension Plan	SEP
Savings Incentive Match Plan	SIMPLE
Social Security Administration	SSA
Social Security Number	SSN
Trust Fund Recovery Penalty	TFRP
Unemployment Compensation	UC
Publication 15 Circular E, Employer's Tax Guide	Pub 15, or Circular E
Publication 15-A, Employer's Supplemental Tax Guide	Pub 15-A
Publication 15-B, Employer's Tax Guide to Fringe Benefits	Pub 15-B
Publication 51, Agriculture Employer's Tax Guide	Pub 51, or Circular A

**ATTACHMENT A**  
**Revenue Ruling 59-354**

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**Revenue Ruling 59-354**

**SECTION 61 – Gross Income Defined**  
1959-2 Cumulative Bulletin 24; July 1959

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items (Also Sections 3121, 3306, 3401; 31.3121(a)-1, 31.3306(b)-1, 31.3401(a)-1.)

Although includible in gross income under section 61 of the Internal Revenue Code of 1954, amounts paid to members of Indian tribal councils for services performed by them as council members do not constitute "wages" for the purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act and the collection of income tax at source on wages.

Amounts paid to other salaried employees of such Indian councils and to employees of private tribal business enterprises constitute "wages" subject to the Federal employment taxes, including the withholding of income tax under section 3402 of the Internal Revenue Code of 1954.

Advice has been requested whether the salaries of members of Indian tribal councils are subject to Federal income tax and Federal employment taxes and whether the tribal councils are liable for the withholding and payment of such taxes.

The constitution and bylaws of the various Indian tribes provide that the members of the council are elected from among the full tribal membership; that their duties include representing the tribe in business dealings with the United States Government and the public generally; that the council is a policy determining [\*2] group; and that the members also have some duties to perform in legislative and executive capacities for the tribe. Their duties appear to be similar to the duties of a city council.

Section 61(a) of the Internal Revenue of 1954 defines the term "gross income" to include "income derived from any source whatever."

Exemption from the payment of Federal income tax may not be implied and, if exemption of Indians from the payment of such tax exists, it must derive plainly from the Federal tax statutes or from treaties or agreements with the Indian tribes concerned or some Act of Congress dealing with their affairs. See Revenue Ruling 54-456, C.B. 1954-2, 49. Accordingly, Indians are required to include in gross income all income they receive which has not been specifically exempted in some manner from Federal income tax.

**ATTACHMENT A**  
**Revenue Ruling 59-354**

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There is no provision in the Federal income tax laws, which would exempt Indians, as such, from income taxation. Accordingly, unless income of an Indian derived from a particular source is otherwise exempt; such income will be subject to tax in his hands the same as it would be in the hands of any other taxpayer. Similarly, all remuneration received by an Indian [\*3] for services performed as an employee for his employer which constitutes "wages," as that term is defined in the Federal employment tax statutes, is subject to the taxes imposed by such statutes.

Where a business enterprise of an Indian tribe is organized and operated by the tribe itself, such enterprise is considered a private tribal activity and services performed in its employ constitute employment. In this connection, see Revenue Ruling 56-110, Cumulative Bulletin 1956-1, 488.

A review of many court decisions and legislative enactments pertaining to Indian tribes indicates that the powers vested in any tribe or tribal council by existing law, within the meaning of section 16 of the Wheeler-Howard Act, 25 U.S.C. 476, precludes a conclusion that services performed by members of such councils in their capacities as council members constitute employment for Federal employment tax purposes. Accordingly, it is held that the amounts paid to members of tribal councils for services performed by them as council members do not constitute "wages" for purposes of the Federal Insurance Contributions Act, Federal Unemployment Tax Act and the collection of income tax at source on wages (chapters 21, 23 [\*4] and 24, respectively, Subtitle C, Internal Revenue Code of 1954).

It is held further that services performed by other salaried employees of tribal councils and by employees of tribal business enterprises constitute employment and their wages are subject to the Federal employment taxes, including the withholding of income tax under section 3402 of the Code. The tribal councils are responsible for the withholding of taxes where applicable and for the payment of any taxes owing with respect to the wages paid to such employees.

**ATTACHMENT B**  
**Revenue Ruling 2000-6**

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**Revenue Ruling 2000-6**

**SECTION 6041 – Information at Source**  
2001-1 Cumulative Bulletin 512; February 7, 2000

26 CFR 1.6041-2: Return of information as to payments to employees. (Also Sections 3121, 3401, 6051); (Also Section 1.6041-1.)

ISSUE

How do the information reporting requirements of §§ 6041(a) and 6051(a) of the Internal Revenue Code apply to election workers?

FACTS

Election workers are individuals who are generally employed to perform services for state and local governments (governments) at election booths in connection with national, state, or local elections. Governments typically pay election workers a set fee for each day of work. Election workers' wages are includible in gross income as compensation for services. Section 61(a)(1). An individual employed as an election worker may also perform services for the government in another capacity.

A state and the Social Security Administration may agree to extend social security coverage to services of employees of the state or its political subdivisions under § 218 of the Social Security Act (§ 218 agreement). A § 218 agreement may cover the services of election workers. If so, the § 218 agreement may specify the level of fees the election workers must receive to be entitled to coverage. Information about a state's § 218 agreement can be obtained from the State Social Security Administrator.

Situation 1: Government A pays V \$ 200 in a calendar [\*2] year for services as an election worker. A does not employ V in any other capacity. The services of A's election workers are not covered by a § 218 agreement. V is not covered by a retirement plan maintained by A.

Situation 2: Government B pays W \$ 200 in a calendar year for services as an election worker. B does not employ W in any other capacity. The services of B's election workers are covered by a § 218 agreement if their remuneration is \$ 100 or more in a calendar year. W is not covered by a retirement plan maintained by B.

**ATTACHMENT B**  
**Revenue Ruling 2000-6**

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Situation 3: Government C pays X \$ 1,100 in calendar year 2000 for services as an election worker. C does not employ X in any other capacity. The services of C's election workers are not covered by a § 218 agreement. X is not covered by a retirement plan maintained by C.

Situation 4: Government D pays Y \$ 200 in a calendar year for services as an election worker. D also employed Y in another capacity, in which Y earned wages of \$ 300 that are subject to income tax withholding. The services of D's election workers are not covered by a § 218 agreement. Y is [\*3] not covered by a retirement plan maintained by D.

Situation 5: Government E pays Z \$ 200 in a calendar year for services as an election worker. E also employed Z in another capacity, in which Z earned wages of \$ 500 that are subject to income tax withholding. The services of E's election workers are not covered by a § 218 agreement. Z is not covered by a retirement plan maintained by E.

**LAW**

Taxes under the Federal Insurance Contribution Act (FICA) apply to "wages" as defined in § 3121(a). That section provides that the term wages includes only remuneration for "employment." Section 3121(b)(7)(F)(iv) provides that the services of an election worker are not employment for FICA purposes if the worker's remuneration is less than \$ 1,000. For calendar years beginning on or after January 1, 2000, the amount is indexed for inflation. The applicable amount for the year 2000 is \$ 1,100. Because service performed by an election worker for calendar year 2000 for an amount less than \$ 1,100 is excluded from employment for FICA purposes, that amount is not wages for FICA purposes unless covered under a § 218 agreement.

Similarly, section 3121(u)(2)(B)(ii)(V) [\*4] provides that the services of an election worker are not employment for purposes of the Medicare tax portion of the FICA if the worker's remuneration is less than \$ 1,000 in a calendar year. For calendar years beginning on or after January 1, 2000, the amount is indexed for inflation. The applicable amount for the year 2000 is \$ 1,100. For services performed before January 1, 1995, the § 3121(u)(2)(B)(ii)(V) exclusion was for remuneration of less than \$ 100. Rev. Rul. 88-36, 1988-1 C.B. 343, A2, provides that an election worker is subject to Medicare tax unless the remuneration paid to the worker in a calendar year is less than \$ 100.

Section 3401(a) provides that, for purposes of income tax withholding, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for an employer. Section 31.3401(a)-2(b)(2) of the Employment Tax Regulations states that amounts

**ATTACHMENT B**  
**Revenue Ruling 2000-6**

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paid to precinct workers for services performed at election booths are "in the nature of fees paid to public officials" and not subject to income tax withholding.

Sections 6041(a) and 6051(a) both impose a duty to file information [\*5] reports of compensation paid to workers.

Section 6041(a) provides:

All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income ... of \$ 600 or more in any taxable year ... shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Under § 1.6041-1(b)(1) of the Income Tax Regulations, the term "all persons engaged in a trade or business," as used in § 6041(a), includes organizations the activities of which are not for the purpose of gain or profit.

The general rule stated in § 1.6041-1(a)(2) is that the required return is made on Forms 1096 and 1099, except that § 1.6041-1(a)(2)(ii) provides that compensation paid to an employee by an employer shall be reported on Forms W-3 and W-2 under the provisions of § 1.6041-2 (relating to return of information [\*6] as to payments to employees).

Under § 1.6041-2(a)(1), payments of wages not subject to income tax withholding must be reported on Form W-2 if the total of those payments and the amount of the employee's wages subject to income tax withholding, if any, is \$ 600 or more in a calendar year. For example, if a payment of \$ 700 was made to an employee and \$ 400 thereof represents wages subject to withholding under section 3402 and the remaining \$ 300 represents compensation not subject to withholding, such wages and compensation must both be reported on Form W-2. If the employee has no wages subject to income tax withholding, the employer is required to file Form W-2 for that employee if payments to that employee equal \$ 600 or more in a calendar year.

Section 1.6041-2(a)(1) provides that, at the election of the employer, components of amounts required to be reported on Form W-2 pursuant to this subparagraph may be reported on more than one Form W-2. Thus the

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amounts paid to an individual for services as an election worker may be reported on a separate W-2 from amounts paid to the individual for service in another capacity, even though the amounts are aggregated to determine whether reporting [\*7] applies.

Section 6051(a) imposes a reporting requirement on the following two categories of payors of remuneration:

Every person required to deduct and withhold from an employee a tax under section 3101 [employee FICA tax] or 3402 [income tax withholding], ... or every employer engaged in a trade or business who pays remuneration for services performed by an employee ... .

Section 6051(a) does not require reporting of compensation that is not subject to withholding of FICA tax or income tax.

Section 6051(c) provides that the Secretary may prescribe by regulations the reporting of additional items. No regulations requiring employers to furnish additional information have been published.

#### ANALYSIS

Compensation of an election worker is not subject to income tax withholding. Sections 3401(a) and 31.3401(a)-2(b)(2). If an election worker's compensation is less than \$ 1,100 for calendar year 2000, it is generally not subject to FICA tax. Sections 3121(b)(7)(F)(iv) and 3121(u)(2)(B)(ii)(V). However, under a state's § 218 agreement, an election worker's compensation may be subject to both the old-age, survivors and disability insurance (OASDI) and the Medicare portions of the FICA [\*8] tax at a level below \$ 1,100 for calendar year 2000.

Section 6041(a) applies to payments of compensation that are not subject to withholding of FICA or income tax. If an election worker's compensation is not subject to withholding of FICA tax, the § 6041(a) reporting requirement applies to payments that aggregate \$ 600 or more in any taxable year. Under § 1.6041-2(a)(1), compensation subject to income tax withholding is taken into account in determining whether the \$ 600 reporting requirement applies.

Section 6051(a) requires reporting of compensation subject to either FICA tax or income tax withholding. No reporting is required by §§ 6051(a) and 31.6051-1(a) and (b) for items of income that are not subject to withholding of FICA tax or income tax. If an election worker's compensation is subject to withholding of FICA tax, reporting is required by § 6051(a), regardless of the amount of compensation.

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**HOLDINGS**

The reporting requirements applicable to governments that employ election workers are as follows:

Situation 1: Neither FICA tax nor income tax withholding applies to the \$ 200 paid to V. The reporting requirements of § 6041(a) apply. Because V earns fees that are less **[\*9]** than \$ 600, Government A is not required to issue Form W-2 to V.

Situation 2: FICA tax, but not income tax withholding, applies to the \$ 200 paid to W because the fees exceed the \$ 100 threshold in the § 218 agreement. Government B must follow the reporting requirements of § 6051(a), reporting on Form W-2 the fees of \$ 200 and the FICA tax withheld.

Situation 3: FICA tax, but not income tax withholding, applies to the \$ 1,100 paid to X for calendar year 2000. Government C must follow the reporting requirements of § 6051(a), reporting on Form W-2 the fees of \$ 1,100 and the FICA tax withheld.

Situation 4: Neither FICA tax nor income tax withholding applies to the \$ 200 paid to Y for services as an election worker, but the \$ 300 payment is subject to income tax withholding. Government D must follow the reporting requirements of § 6051(a), reporting on Form W-2 the \$ 300 payment and the income tax withheld. Section 6041(a) does not require reporting of the \$ 200 payment because the total of the two payments is less than \$ 600 for the calendar year.

Situation 5: Neither FICA tax nor income tax withholding applies to the \$ 200 paid to Z for services **[\*10]** as an election worker, but the \$ 500 payment is subject to income tax withholding. Government E must follow the reporting requirements of §§ 6041(a) and 6051(a), reporting on Form W-2 both the \$ 200 and the \$ 500 payments and the amount of income tax withheld.

**EFFECT ON OTHER REVENUE RULING(S)**

This ruling modifies Rev. Rul. 88-36, A2, to reflect the increase in the amount of remuneration applicable for purposes of the Medicare tax exclusion under § 3121(u)(2)(B)(ii)(V), currently \$ 1,100 for calendar year 2000.



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