

Federal and California Payroll Tax Issues for 2012

Below, please find a summary of some of the Federal and California regulations that may affect you as a California employer. Please note that on December 23, 2011, the Congress passed and President Obama signed into law the “Temporary Payroll Tax Cut Continuation Act of 2011” (“TTCA”). The provisions of the TTCA consist of a two-month temporary extension of the payroll tax cuts that is currently in place for 2011. There is also a parallel extension of a lower Self-Employment Contribution Act (“SECA”) tax rate on self-employment income. A House-Senate Conference will convene soon to consider extending the temporary payroll tax cut for the remainder of 2012.

FEDERAL PAYROLL TAX RATES & AMOUNT FOR 2012

Social Security Tax (SS):

| | |
|---|--------|
| Employee (SS) Withholding Rate - (See period covered above) | 4.20% |
| Employer (SS) Withholding Rate | 6.20% |
| Combined Social Security Rate | 10.40% |
| Self-Employment (SS) Tax Rate - (See period covered above) | 10.40% |

| | | |
|----------------------------------|----|------------|
| Covered FICA/(SS) Earnings | \$ | 110,100.00 |
| Maximum Employee's FICA/(SS) Tax | | 4,624.20 |
| Maximum Employer's FICA/(SS) Tax | | 6,826.20 |
| Maximum Self-Employment (SS) Tax | \$ | 11,450.40 |

Medicare Hospital Insurance (HI):

| | |
|---------------------------------|-------|
| Employee (HI) Withholding Rate | 1.45% |
| Employer (HI) Contribution Rate | 1.45% |
| Combined (HI) Rate | 2.90% |
| Self-Employment (HI) Tax Rate | 2.90% |

| | |
|--|-----------|
| Covered Medicare Hospital Insurance Earnings | |
| Maximum Employee's (HI) Tax | Unlimited |
| Maximum Employer's (HI) Tax | Unlimited |
| Maximum Self-Employment (HI) Tax | Unlimited |

Federal Unemployment Tax Act (FUTA):

| | |
|----------------|-------------|
| FUTA Rate | 0.9% |
| FUTA Wage Base | \$ 7,000.00 |

CALIFORNIA PAYROLL TAX RATES & AMOUNTS FOR 2012

State Disability Insurance (SDI)

| | | |
|----------------------------|----|-----------|
| Covered SDI Earnings | \$ | 95,585.00 |
| Employee SDI Rate | | 1.0%* |
| Maximum Employee's SDI Tax | \$ | 955.85 |

*Includes Paid Family Leave

State Unemployment Insurance (UI)

Rate: The UI rate for new employers is 3.4% for up to 3 years. The UI rate for experienced employers varies based on each employer's experience and the balance of the UI fund and is issued by the Employment Development Department.

Base: \$7,000
Payable By: Employer

State Employment & Training Fund

Rate: 0.1%
Base: \$7,000
Payable By: Employer

OTHER PERTINENT PAYROLL TABLES OR INFORMATION

Withholding Tax Tables

There have been changes in both Federal and California income tax withholding tables for 2012. Therefore, **it is imperative to use the latest withholding tables issued.** See www.irs.gov or www.ftb.ca.gov for updated tables.

Form W-4 - Employer Withholding Allowance Certificates

A Form W-4 should be completed by all new employees and any continuing employee when that employee wishes to change exemptions and/or amount of income tax withheld.

Employees who will be exempt from income tax should also complete a Form W-4 stating their exemption. An employee may claim to be exempt from income tax withholding if he or she had no income tax liability last year and expects none this year. W-4 Forms for employees who claim total exemption from withholding no longer need to be filed with the IRS.

Agricultural Workers

Cash wages earned by agricultural workers are subject to Federal and California income tax, FICA, FUTA, SDI, and SUI.

Household Employees / “Nanny Tax”

Wages earned by household employees are subject to certain payroll taxes. Some examples of household employees are housekeeper, babysitter, health care provider, cook, maid, or chauffeur. Generally, those who provide services to a number of homeowners, using their own tools are not household employees, but are instead “independent contractors”. When there are household employees, the following filing requirements apply:

- Household employers must obtain a Federal Employer Identification Number. Employers must provide Employees with a Form W-2 reporting their wages (if over \$1,700 for the year) and related taxes by January 31 of the following year, and provide a copy to the IRS by the end of February.
- Federal household employment taxes are reported on Schedule H of the employer’s personal income tax return (Form 1040) and are paid annually. FICA taxes apply if wages of \$1,700 or more are paid to any one employee during the calendar year. Household workers under 18 (such as babysitters) are exempt from FICA taxes even if the wages exceed \$1,700. FUTA taxes apply if combined wages of \$1,000 or more are paid to all household employees in any calendar quarter in the current or prior year.
- California employment tax payments and forms vary depending on the total amount of wages paid during the year. Please call us for assistance.
- Employers are not required to withhold Federal or California income tax from household employees' wages but may do so at the request of the employee.

W-2 Reporting

Although not mandatory for 2011, employers are encouraged to report the total value of all health coverage, excluding medical FSAs, on employees’ Forms W-2, which should be issued in January 2012. To comply with the W-2 reporting changes, employers should report the aggregate value of the benefit they provide for all health insurance coverage, excluding coverage for stand-alone vision and dental plans. This provision is intended to be information only and does not change the taxability.

Federal Tax Deposits

For 2012 most employers are required to pay taxes electronically unless an exception is met. The primary exception is the \$2,500 rule discussed below. The threshold that determines whether an employer must use the Federal Electronic Federal Tax Payment System (EFTPS) to deposit taxes is \$200,000. All Federal tax deposits (such as deposits for employment tax, excise tax, and corporate income tax) made during the 2011 calendar year are combined to determine whether the \$200,000 threshold has been exceeded. If the total of the Federal tax deposits made in 2011 exceeded \$200,000 then EFTPS must be used. Those that meet the requirements must deposit all Federal taxes through the EFTPS.

Although a third party payroll processor and/or financial institution is used to pay taxes, enrollment is still required prior to EFTPS use. Please ensure that the payroll processor is aware of the EFTPS requirement.

EFTPS payments must be initiated on the day before the due date. “Debit” method payments are considered made on the date withdrawn and “Credit” method payments are considered made on the date received by the IRS.

For the purpose of making tax deposits, employers are classified as either Monthly Depositors or Semi-Weekly Depositors. However, if \$100,000 or more of taxes accumulates on any day during the year, the One-day Deposit rule applies.

Monthly Depositor Rule

Monthly depositors for the current year are determined if the total tax on Forms 941 (or 941E) for the “lookback period” (see below) is \$50,000 or less. Employment taxes and taxes withheld during a calendar month must be deposited by the 15th day of the following month.

Monthly depositors’ final deposit for the quarter may be paid with the filing of the quarterly return, if the payment is not more than \$2,500.

Semi-Weekly Depositor Rule

Semi-weekly depositors for the current year are determined if the total taxes reported on Forms 941 (or 941E) for the “lookback period” (see below) is more than \$50,000. These depositors must make tax deposits based on what day of the week the payroll payments are made, as shown below:

| <u>Payment Days</u> | <u>Deposit By</u> |
|--|---------------------|
| Wednesday, Thursday, and/or Friday | Following Wednesday |
| Saturday, Sunday, Monday, and/or Tuesday | Following Friday |

Federal Tax Deposits - (Continued)

One-day Deposit Rule

Whenever accumulated taxes total \$100,000 or more, these taxes must be deposited by the close of the next banking day, regardless of whether the employer is a monthly or a semi-weekly depositor.

\$2,500 Exception

If accumulated taxes are less than \$2,500 during a current quarter, no deposit is required and the taxes can be paid with the filing of the quarterly return.

Lookback Period

The lookback period consists of the four quarters beginning July 1 of the second preceding year and ending June 30 of the prior year. These four quarters are the lookback period even if there were no taxes reported for any of the quarters. For 2012 the lookback period is July 1, 2010 through June 30, 2011. For Agricultural employers, the lookback period is the second calendar year preceding the current calendar year (calendar 2010 for 2012).

California Employment Tax Deposits

California manual tax deposit (Form DE-88) and Electronic Fund tax deposit requirements are generally the same as the Federal requirements. Whichever deposit method is used to make Federal deposits will generally be the method used to make California deposits.

The following are California differences to the Federal methods:

- One-day Deposit Rule – You are required to make California Next Banking Day SDI and withholding deposits if you are required to make Federal Next Banking Day deposits AND you accumulate more than \$500 in California withholding during one or more payroll periods.
- Household employers are required to remit quarterly deposits. An election is available to pay taxes annually; the election is not available when wages exceed \$20,000 annually. The quarterly payroll tax return (Form DE6) is still required even if annual payment is elected.
- Semi-weekly deposits of SDI and withholding are required if you are required to make Federal semi-weekly deposits AND you accumulate more than \$500 in California income tax withholding during one or more payroll periods.
- You will be required to make monthly SDI and withholding deposits if you are required to make Federal Next Banking Day or semi-weekly deposits and you accumulate more than \$350-\$500 in California withholding during one or more months of a quarter.
- Employers are required to file a Quarterly Contribution Return and Report of Wages (DE9).

California Employment Tax Deposits - (Continued)

- Employers are required to indicate California income tax withholdings by employee on their quarterly wage reports (DE 9C).
- The California deposit coupon (DE88) includes all funds to be paid to the Employment Development Department: unemployment insurance (UI), employment training tax (ETT), disability insurance (DI), and personal income tax (PIT).
- If the average (per payment) deposit for SDI and PIT is \$20,000 or more for the prior state fiscal year (July 1, 2010 to June 30, 2011), then the requirement is to pay all SDI and PIT deposits by Electronic Funds Transfer (EFT). “ACH Debit” or “ACH Credit” methods may be used to make electronic transfers.
- Employers are required to report new employees to the EDD within 20 days on Form DE34.

Business Information Returns and Backup Withholding

Federal and California tax legislation enacted over the last few years has increased the number of information returns to be filed by every person engaged in a trade or business, as well as the penalties for failure to file the returns correctly and in a timely manner. We are taking this opportunity to remind you of the items that must be reported on various 1098 and 1099 Forms series. A guide on the filing requirements for information returns is attached.

The various forms in the 1098 and 1099 series require, in addition to the amounts, the recipient’s name, address and taxpayer identification number. These forms are to be mailed or delivered to the recipient by January 31st, with copies to the Internal Revenue Service (and, when applicable, the Franchise Tax Board) by February 28th. As noted below, the penalties (which vary with the type of return) for failure to file properly and in a timely manner can be high.

In general, most payments made to individuals or unincorporated businesses will require an information return if the total amounts paid for the year exceed the amounts per the enclosed guide. Payments made to corporations are generally exempted from the reporting requirements. This exemption does not apply to the reporting of dividend payments or liquidating dividend distributions to a corporation. Further, this exemption does not apply to providers of medical services (except tax exempt hospitals) or legal services. If you are not sure if an information return is required, we will be pleased to provide information about the filing requirements.

See IRS Form 1099/1098 guide at <http://www.irs.gov/pub/irs-pdf/i1099gi.pdf> for specific reporting requirements

Business Information Returns and Backup Withholding – (Continued)

Federal penalties for failure to file these forms accurately or timely could be as high as \$50 per form, to a maximum of \$250,000. For late filing, the amount of the penalty varies with the length of time from the due date.

All of the reportable payments are also subject to the Federal “backup withholding” rules. Under these rules, if an individual payee has not furnished a taxpayer identification number, or has furnished an incorrect number, the payor is required to withhold (and remit to the IRS) 28% of the payments. Form W-9 should be used to report and certify taxpayer identification numbers to the payor.

Also, any business or entity that is or will be required to file a Federal Form 1099-MISC is required to file a California Form DE542, Report of Independent Contractors, within 20 days of the earlier of entering into a contract for \$600 or more or when the aggregate payments to an Independent Contractor reach \$600 or more.

Magnetic Media Reporting

If you file 250 or more information returns (counting each type of return separately), you must use magnetic media to file with both the IRS and FTB. You may file the magnetic media directly with FTB or you can contact the IRS to request approval to file using the Federal Combined Filing Program. If you must file on magnetic media, and are uncertain as to how to fulfill this requirement, please contact us.

If you have any questions about any of the above mentioned areas or with regard to employment taxes in general, please do not hesitate to contact our office at any time.

Respectfully,

White Nelson Diehl Evans LLP

Certified Public Accountants and Consultants

GUIDE TO INFORMATION RETURNS

Guide to Information Returns (If any date shown falls on a Saturday, Sunday, or legal holiday, the due date is the next business day.)

| Form | Title | What To Report | Amounts To Report | Due Date | |
|----------|--|---|---|--------------|--|
| | | | | To IRS | To Recipient (unless indicated otherwise) |
| 1042-S | Foreign Person's U.S. Source Income Subject to Withholding | Income such as interest, dividends, royalties, pensions and annuities, etc., and amounts withheld under Chapter 3. Also, distributions of effectively connected income by publicly traded partnerships or nominees. | See form instructions | March 15 | March 15 |
| 1097-BTC | Bond Tax Credit | Tax credit bond credits to shareholders. | All amounts | February 28* | On or before the 15th day of the 2nd calendar month after the close of the calendar quarter (on or before May 15; August 15; November 15; February 15 of the following year) |
| 1098 | Mortgage Interest Statement | Mortgage interest (including points) and certain mortgage insurance premiums you received in the course of your trade or business from individuals and reimbursements of overpaid interest. | \$600 or more | February 28* | (To Payer/Borrower) January 31 |
| 1098-C | Contributions of Motor Vehicles, Boats, and Airplanes | Information regarding a donated motor vehicle, boat, or airplane. | Gross proceeds of more than \$500 | February 28* | (To Donor) 30 days from date of sale or contribution |
| 1098-E | Student Loan Interest Statement | Student loan interest received in the course of your trade or business. | \$600 or more | February 28* | January 31 |
| 1098-T | Tuition Statement | Qualified tuition and related expenses, reimbursements or refunds, and scholarships or grants (optional). | See instructions | February 28* | January 31 |
| 1099-A | Acquisition or Abandonment of Secured Property | Information about the acquisition or abandonment of property that is security for a debt for which you are the lender. | All amounts | February 28* | (To Borrower) January 31 |
| 1099-B | Proceeds From Broker and Barter Exchange Transactions | Sales or redemptions of securities, futures transactions, commodities, and barter exchange transactions. | All amounts | February 28* | February 15** |
| 1099-C | Cancellation of Debt | Cancellation of a debt owed to a financial institution, the Federal Government, a credit union, RTC, FDIC, NCUA, a military department, the U.S. Postal Service, the Postal Rate Commission, or any organization having a significant trade or business of lending money. | \$600 or more | February 28* | January 31 |
| 1099-CAP | Changes in Corporate Control and Capital Structure | Information about cash, stock, or other property from an acquisition of control or the substantial change in capital structure of a corporation. | Over \$1000 | February 28* | (To Shareholders) January 31 |
| 1099-DIV | Dividends and Distributions | Distributions, such as dividends, capital gain distributions, or nontaxable distributions, that were paid on stock and liquidation distributions. | \$10 or more, except \$600 or more for liquidations | February 28* | January 31** |
| 1099-G | Certain Government Payments | Unemployment compensation, state and local income tax refunds, agricultural payments, and taxable grants. | \$10 or more for refunds and unemployment | February 28* | January 31 |
| 1099-H | Health Coverage Tax Credit (HCTC) Advance Payments | Health insurance premiums paid on behalf of certain individuals. | All amounts | February 28* | January 31 |
| 1099-INT | Interest Income | Interest income. | \$10 or more (\$600 or more in some cases) | February 28* | January 31** |
| 1099-K | Merchant Card and Third-Party Network Payments | Merchant card | All amounts | February 28* | January 31 |
| | | Third-party network payments. | \$20,000 or more (and 200 or more transactions) | | |
| 1099-LTC | Long-Term Care and Accelerated Death Benefits | Payments under a long-term care insurance contract and accelerated death benefits paid under a life insurance contract or by a viatical settlement provider. | All amounts | February 28* | January 31 |

*The due date is March 31 if filed electronically.

**The due date is March 15 for reporting by trustees and middlemen of WHFITs.

Guide to Information Returns (Continued)

| Form | Title | What To Report | Amounts To Report | Due Date | |
|-----------|---|---|--|-----------------------|--|
| | | | | To IRS | To Recipient (unless indicated otherwise) |
| 1099-MISC | Miscellaneous Income (Also, use to report direct sales of \$5,000 or more of consumer goods for resale.) | Rent or royalty payments; prizes and awards that are not for services, such as winnings on TV or radio shows. | \$600 or more, except \$10 or more for royalties | February 28* | January 31** |
| | | Payments to crew members by owners or operators of fishing boats including payments of proceeds from sale of catch. | All amounts | | |
| | | Section 409A income from nonqualified deferred compensation plans (NQDCs). | All amounts | | |
| | | Payments to a physician, physicians' corporation, or other supplier of health and medical services. Issued mainly by medical assistance programs or health and accident insurance plans. | \$600 or more | | |
| | | Payments for services performed for a trade or business by people not treated as its employees. Examples: fees to subcontractors or directors and golden parachute payments. | \$600 or more | | |
| | | Fish purchases paid in cash for resale. | \$600 or more | | |
| | | Crop insurance proceeds. | \$600 or more | | |
| | | Substitute dividends and tax-exempt interest payments reportable by brokers. | \$10 or more | | February 15** |
| | Gross proceeds paid to attorneys. | \$600 or more | February 15** | | |
| 1099-OID | Original Issue Discount | Original issue discount. | \$10 or more | February 28* | January 31** |
| 1099-PATR | Taxable Distributions Received From Cooperatives | Distributions from cooperatives passed through to their patrons including any domestic production activities deduction and certain pass-through credits. | \$10 or more | February 28* | January 31 |
| 1099-Q | Payments From Qualified Education Programs (Under Sections 529 and 530) | Earnings from qualified tuition programs and Coverdell ESAs. | All amounts | February 28* | January 31 |
| 1099-R | Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. | Distributions from retirement or profit-sharing plans, any IRA, insurance contracts, and IRA recharacterizations. | \$10 or more | February 28* | January 31 |
| 1099-S | Proceeds From Real Estate Transactions | Gross proceeds from the sale or exchange of real estate and certain royalty payments. | Generally, \$600 or more | February 28* | February 15 |
| 1099-SA | Distributions From an HSA, Archer MSA, or Medicare Advantage MSA | Distributions from an HSA, Archer MSA, or Medicare Advantage MSA. | All amounts | February 28* | January 31 |
| 3921 | Exercise of an Incentive Stock Option Under Section 422(b) | Transfer of an employer's stock to an employee pursuant to the exercise of an incentive stock option under section 422(b). | All amounts | February 28* | January 31 |
| 3922 | Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c) | Transfer(s) of stock acquired through an employee stock purchase plan under section 423(c). | All amounts | February 28* | January 31 |
| 5498 | IRA Contribution Information | Contributions (including rollover contributions) to any individual retirement arrangement (IRA) including a SEP, SIMPLE, and Roth IRA; Roth conversions; IRA recharacterizations; and the fair market value (FMV) of the account. | All amounts | May 31 | (To Participant) For FMV/RMD Jan 31; For contributions, May 31 |
| 5498-ESA | Coverdell ESA Contribution Information | Contributions (including rollover contributions) to a Coverdell ESA. | All amounts | May 31 | April 30 |
| 5498-SA | HSA, Archer MSA, or Medicare Advantage MSA Information | Contributions to an HSA (including transfers and rollovers) or Archer MSA and the FMV of an HSA, Archer MSA, or Medicare Advantage MSA. | All amounts | May 31 | (To Participant) May 31 |
| W-2G | Certain Gambling Winnings | Gambling winnings from horse racing, dog racing, jai alai, lotteries, keno, bingo, slot machines, sweepstakes, wagering pools, poker tournaments, etc. | Generally, \$600 or more; \$1,200 or more from bingo or slot machines; \$1,500 or more from keno | February 28* | January 31 |
| W-2 | Wage and Tax Statement | Wages, tips, other compensation; social security, Medicare, and withheld income taxes. Include bonuses, vacation allowances, severance pay, certain moving expense payments, some kinds of travel allowances, and third-party payments of sick pay. | See separate instructions | To SSA | To Recipient |
| | | | | Last day of February* | January 31 |

*The due date is March 31 if filed electronically.

**The due date is March 15 for reporting by trustees and middlemen of WHFITs.