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PAYROLL TAX GUIDELINES

The income tax system in the U.S., as well as most state income tax systems, requires employers to withhold payroll taxes from their employees' gross salaries and wages. The withholding of taxes and other deductions from employees' paychecks affects the employer in several ways: (1) it reduces the cash amount paid to employees, (2) it creates a current liability for the employer, and (3) it requires the employer to remit the withheld taxes to the federal and state government by specific deadlines. Failure to remit payroll taxes in a timely manner results in interest and penalties levied on the employer; flagrant violations trigger more severe consequences. Certain taxes are withheld from the employees' gross pay. These taxes are then remitted by the employer. Alternatively, other taxes are not withheld from the employees' gross pay, but are instead a payroll-related expense that is incurred by the employer.

Taxes and Benefits Paid by Employees

Payroll withholdings that are paid by employees should be withheld from the employees' gross pay and then remitted by the employer. These withholdings include:

1. Employee portion of Social Security tax – Social Security tax is withheld from an employee's salary or wages and the employer is also required to pay a Social Security tax. In 2017, the amount of Social Security tax that an employer must withhold from an employee is 6.2% of the first $127,500 of the employee's annual wages or salary. Any amount above that threshold is not subject to Social Security tax.
2. Employee portion of Medicare tax – Medicare tax is also withheld from an employee's salary or wages and the employer is also required to pay a Medicare tax. In 2017, the amount of Medicare tax that an employer must withhold from an employee is 1.45% of the employee's annual wages or salary. There is also a Medicare surtax of 0.9% that is withheld from the employee on wages and salaries in excess of certain amounts.
3. Federal income tax – an employer is required to withhold the federal income tax that an employee is expected to owe based on salaries or wages. The employee's year-end income tax return will determine the exact amount owed for the year, based on their specific circumstances during the year. The amount withheld is based on the employee's salary or wages, in addition to the information that was provided by the employee on Form W-4.
4. State income tax – most states will have state income tax which an employer is required to withhold based on salaries or wages. Again, the year-end income tax return will determine the exact amount owed for the year. The amount withheld is based on the employee's salary or wages, in addition to the information that was provided by the employee on the state version of Form W-4. Colorado does not have a separate Colorado form, so employers should follow the exemptions given on the federal Form W-4.
5. Other withholdings – may include court-ordered withholdings or voluntary items such as union dues, charitable contributions, insurance premiums, and 401(k) contributions.

Taxes and Benefits Paid by Employers

Payroll withholdings that are paid by employers should be treated as a payroll-related expense incurred and remitted by the employer. These withholdings include:

1. Employer portion of Social Security tax – in addition to the amount withheld from its employees for Social Security taxes, the employer must also contribute and remit an additional amount. This additional amount is an expense for the employer. In 2017, the employer's portion of Social Security tax is 6.2% of the first $127,500 of the employee's annual wages or salary. Any amount above that threshold is not subject to Social Security tax.
2. Employer portion of Medicare tax – in addition to the amount withheld from employees for Medicare tax, the employer must also contribute and remit an additional amount. This additional amount is an expense for the employer. In 2017, the amount of Medicare tax that an employer must withhold from an employee is 1.45% of the employee's annual wages or salary.
3. State unemployment tax – states determine their state unemployment tax rate for each employer. Typically, employers that have paid in and built up a reserve in the state's unemployment fund will have lower unemployment tax rates and employers with no reserve will have higher tax rates. The tax rate is then applied to a wage base (determined by each state), meaning that the tax rate will be multiplied by each employee's salary or wages (up to the wage base) and summed together to determine the entire tax due by the employer.
4. Federal unemployment tax – the federal government requires employers to pay a federal unemployment tax of 6.0% (less a credit if the employer has paid into a state unemployment fund). The resulting rate is then applied to each employee's first $7,000 of salary or wages.
5. Worker compensation insurance – this provides coverage for employees who sustain injuries while they are working on the job. State law often requires that employers carry this insurance. Rates are determined based on the type of business or industry that it operates in, the type of job that is being performed, and the employer's history of claims.
6. Employer portion of insurance – some companies require employees to pay a portion of their health insurance premium cost, which is often collected via payroll withholding. The employers' net expense is the total amount of premiums paid to the insurance company minus the cost funded by the employees.
7. Employer paid holidays, vacations, and sick days – the cost of paid absences (i.e. holidays, vacations, and sick days) must be recognized as an expense during the time the employee is present and working, or as the benefit is being earned.
8. Employer contributions toward 401(k), savings plans, & profit-sharing plans – if an employer is required to contribute to an employee savings program or profit-sharing plan, the contribution should be expensed in the period when the contribution was earned.
9. Employer contributions to pension plans – the cost of the benefits relating to a pension plan should be recognized during the years that the employees are working (not when the employee is retired and receiving payments from the plan.)
10. Post-retirement health insurance – this benefit is treated the same way that contributions to a pension plan are treated. The cost should be recognized during the years that the employees are working.

Federal Filing – Form 941

Form 941, "Employer's Quarterly Federal Tax Return", is used to report the wages paid by an employer during the quarter (and any tips reported by employees, if applicable), the federal income tax withheld by the employer, both the employer's and the employee's share of social security and Medicare taxes, additional Medicare tax withheld from employees (if applicable), and any necessary current quarter adjustments to social security and Medicare taxes. This form is also used to report information about an entity's deposit schedule and tax liability for the quarter.

After filing your first Form 941, you must file a return for each quarter, even for quarters that do not have taxes to report, unless you have filed a final return or meet one of the exceptions listed next. Seasonal employers don't have to file a Form 941 for any quarters in which they do not have a tax liability because they did not pay wages. Employers of household employees usually do not file Form 941. Finally, employers of farm employees usually do not file Form 941.

You are required to file your initial Form 941 for the quarter in which you first paid wages that are subject to social security and Medicare taxes or subject to federal income tax withholding. The taxes associated with Form 941 may be remitted with the form if the total tax liability for either the current quarter or the preceding quarter is less than $2,500 and you didn't incur a $100,000 next-day deposit obligation during the current quarter. If your total tax liability is more than $2,500, then you must pay the liability using the Electronic Federal Tax Payment System ("EFTPS") and you must determine which of the two deposit schedules you are required to use. The deposit schedule you must use is based on the total tax liability reported on Form 941 during a lookback period. The lookback period is the four-quarter period ending on June 30 of the prior year. For example, the lookback period for calendar year 2017 starts with July 1, 2015 and ends on June 30, 2016. If you reported $50,000 or less of taxes for the lookback period, then you are a monthly schedule depositor. Employers should deposit employee taxes on payments made during a month by the 15th day of the following month. If you reported more than $50,000 of taxes for the lookback period, then you are a semiweekly depositor. Employers should deposit employee taxes for payments made on a Wednesday, Thursday, and/or Friday by the following Wednesday. Employers should deposit employee taxes for payments made on a Saturday, Sunday, Monday, and/or Tuesday by the following Friday.

The IRS pre-enrolls new businesses in EFTPS when they request an Employer Identification Number ("EIN"). When you are assigned an EIN, the IRS should also send a letter with your four-digit EFTPS PIN. You will need to call and activate your enrollment to EFTPS to access the EFTPS system.

Small business may be able to file an annual payroll tax return (Form 944) instead of Form 941 and remit taxes with that return, but you must request permission from the IRS before filing an annual return. You can request to file an annual return with the IRS if you have an estimated annual employment tax liability of $1,000 or less for the entire calendar year, if you are not an agricultural employer who is required to file Form 943, and if you are not a household employer who is required to file Form 1040, Schedule H.

Federal Filing – Form 940

The Federal Unemployment Tax Act (or "FUTA"), along with state unemployment systems, provides payment of unemployment compensation to workers who have lost their jobs. Form 940, "Employer's Annual Federal Unemployment (FUTA) Tax Return" is used to report an entity's

FUTA tax. Most employers pay both a federal and a state unemployment tax. FUTA taxes are paid by the employer and should not be deducted from an employee's wages. The FUTA tax is currently 6.0% and applies to the first $7,000 you pay to each employee during a calendar year after subtracting any payments that are exempt from FUTA tax. If you paid wages of $1,500 or more to employees in any calendar quarter during the two previous years or if you had one or more employees for at least some part of a day in any 20 or more different weeks during either of the previous two years, then you must file Form 940. The due date for Form 940 for February 1st, but if you deposited all your FUTA tax when it was due, you may file Form 940 by February 10th. A credit is given for amounts paid to a state unemployment fund by the due date of your Form 940. If you pay your state unemployment taxes, unless you live in California, Connecticut, or Ohio, then you can reduce the FUTA tax paid to 0.6%.

Although Form 940 covers an annual period, generally, you must deposit your federal unemployment taxes on a quarterly basis. The taxes must be paid by the last day of the month following the end of a calendar year. If your FUTA liability is less than $500, then you can pay the amount at the end of the year instead of making quarterly payments. Payments should be made using the EFTPS.

<u>State Filing – Colorado Income Taxes – Form DR 1094</u>

Form DR 1094, "Colorado W-2 Wage Withholding Tax Return" is used by employers to report Colorado W-2 income taxes that have been withheld form employee pay. Form DR 1098 should be used to calculate the necessary Colorado income taxes that should be withheld.

An employer must withhold Colorado income tax from any compensation paid to any employee if the compensation is subject to federal withholding for income tax purposes and the employee is a Colorado resident or the employee is a nonresident of Colorado performing services in Colorado. If you are required to withhold Colorado tax, then you must register with the Department of Revenue as a withholding tax agent.

Withholding tax filing periods are generally based the estimated amount of tax that will be withheld. An employer will need to estimate the amount of Colorado withholding tax that the business will expect to pay for all employees over the course of one year. Employers who report less than $7,000 of withholding tax per year can file quarterly. Taxes are due for quarterly filers on the last day of the month following the quarter-end. Employers who report between $7,000 and $50,000 of withholding tax per year can file monthly. Taxes are due for monthly filers on or before the fifteenth day of the following month. Employers who report more than $50,000 of withholding tax per year should file weekly. Taxes for weekly filers must be paid via an Electronic Funds Transfer ("EFT") to the Department of Revenue on or before the third business day following the end of the week in which payroll was paid. For weekly filers, a withholding tax return must be filed for every filing period or at least once a month.

<u>State Filing – Colorado Unemployment Insurance – Form UITR-1</u>

Form UITR-1, "Unemployment Insurance Tax Report" is used to report quarterly wage information, in addition to reporting the number of covered workers who worked during or received pay for the payroll period that includes the 12th of the month. Alternatively, you can file the quarterly report using Colorado's MyUI Employer website. The Quarterly Reports section of this site allows employers to report and pay the required premiums for their unemployment insurance. An employer has the ability to file quarterly wage and/or premium reports for the current period or reports that are past due, in addition to being able to file a zero-wage report.

An employer is required to pay unemployment insurance premiums if it paid wages of at least $1,500 during the prior or current calendar year or if it employed at least one person for at least some part of a day in any 20 weeks during either the prior or current calendar year.

Denver Filing – Denver Occupational Privilege Tax

This tax consists of two distinct parts: the employee occupational privilege tax and the business occupational privilege tax. The tax is imposed on businesses that operate in Denver and on individuals who perform sufficient services within Denver to receive compensation from an employer of at least $500 for a calendar month. Each taxable employee is liable for the employee OPT, which is withheld by the employer. The employee OPT is currently $5.75 per month. An employer is also required to pay the business OPT, which is currently $4.00 per month for each taxable employee. This tax is used to generate funds for the planning or design for, and the replacement, expansion, acquisition, construction, installation, repair or improvement of city facilities.

Businesses with ten or more employees must file and remit these taxes monthly. Businesses with less employees may be allowed to file and remit quarterly or annually. Monthly payments are due on the last day of the month following the month in which the liability was incurred. Quarterly payments are due on the last day of the month following the three-month period in which the liability was incurred.

Failure to heed the advice set forth in these guidelines could result in interest or penalties. Please let us know if you have any questions.