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PAYROLL, PAYROLL TAX AND INFORMATION RETURN UPDATE LETTER

January 2012

We strive to provide the highest quality service at all times, to all our clients. As part of our commitment to you, we endeavor to provide you with valuable information to assist you in management of your business. Included for your review and reference is our annual Payroll and Payroll Tax Update, Information Return Update and our 2011-2012 Tax Planning Guide. We anticipate that this information will be an invaluable resource to you for the coming year and as always, we are available to answer any questions you may have concerning any of the information presented.

Key Points to Consider

The Social Security Wage base rises to $110,100 in 2012. **The social security tax rate paid by employees will remain at 4.2%, at least through Feb. 29, 2012.** Congress hopes to enact legislation in the coming weeks that will keep this rate in effect through December 31, 2012. The employer rate will remain at 6.2%.

The 0.2% **federal unemployment tax** surtax expired on June 30, 2011. The FUTA tax rate, before consideration of state unemployment tax credits of up to 5.4%, is 6.2% from January 1, 2011 to June 30, 2011, and 6.0% after June 30, 2011. Employers in 20 states will see their state unemployment tax credits reduced on their 2011 FUTA return because their state failed to repay its federal unemployment insurance loans before the required deadline. Pennsylvania is a credit reduction state which means employers in Pennsylvania must reduce their .054 credit on their Form 940 by .003 to .051.

The **minimum wage** in Pennsylvania remains at $7.25 per hour. All employees are covered unless specifically exempt. Please call us with questions concerning exemption.

Act 32 Local Earned Income Tax Withholding Reform becomes effective statewide January 1, 2012. This law will bring major changes to Pennsylvania's income tax collection system. Local income tax collections will be consolidated from the 560 current tax collectors to 66 county-wide collectors. In addition, employers are required to obtain and maintain residency certifications from employees. Please see our Act 32 Local Earned Income Tax Changes Guide available in the Resources section of our website for a complete guide on this new legislation.

PAYROLL AND PAYROLL TAX UPDATE

Mileage Rates for 2012

Internal Revenue Service's standard mileage rates for 2012 are:

1) 55.5 cents per mile for business use;
2) 14 cents per mile driven in service of charitable organizations;
3) 23 cents a mile for medical and moving purposes.

Mandatory Postings for Pennsylvania Employers

There are a significant number of employee notices that either the state or federal government requires employers to post in a conspicuous place. These include such things as minimum wage and equal pay law information which are required to be posted by all employers. In addition, there are other required notices if you employ more than a minimum number of employees.

The Pennsylvania Department of Labor and Industry has an excellent listing included on its web site. The web site is www.dli.state.pa.us. It can also be reached from the Commonwealth of Pennsylvania's home page.

Hiring New Employees

You must verify that each new employee is legally eligible to work in the United States. This will include completing the U. S. Citizenship and Immigration Services (USCIS) **Form I-9**, Employment Eligibility Verification. You can get the form from USCIS offices or by calling **1-800-375-5283**, or visit the USCIS Web Site at www.uscis.gov for further information.

You can verify up to five names/SSNs by calling the Social Security Administration's toll-free number for employers – 1-800-772-6270 – weekdays from 7:00 a.m. to 7:00 p.m. EST. You will be asked for your company name and EIN. Then you will be asked to provide the following information for each name/SSN you want to verify.

1. SSN
2. Last name
3. First name
4. Middle initial (if applicable)
5. Date of birth, and
6. Gender

To verify up to 10 names/SSNs, you may go to Social Security's website at http://www.socialsecurity.gov/employer/ssnv.htm Full information is available on the website. To verify up to 50 SSNs, submit a paper listing containing the data listed above to your local Social Security office. Some offices accept faxed listings. You may reach the Harrisburg office at the following address: 555 Walnut Street, Harrisburg, PA 17101. Their phone numbers are (717) 782-3400 and 1-800-772-1213.

Form W-4, Employee's Withholding Allowance Certificate

Employers must request each new employee to complete and sign a Form W-4, indicating the number of withholding allowances the employee intends to claim. If a new employee does not provide a completed Form W-4, tax is withheld as if the employee is single and has no withholding allowances until a proper Form W-4 is submitted.

Under certain circumstances (change in marital status or birth of a child for example) an existing employee may need to file an updated W-4 with you. Withholding in accordance with the new Form W-4 must begin no later than the start of the first payroll ending on or after the 30th day from the date you receive the new Form W-4.

New-Hire Reporting

All employers must complete a New Hire Report with the required information and submit it to the Commonwealth of Pennsylvania (or other appropriate state government) within 20 days of hiring a new employee. The required information about the new employee is the name, address, social security number, date of birth and date of hire. For more information, the New Hire Reporting Program in Pennsylvania can be reached at 1-888-724-4737 or visit their website at www.cwds.state.pa.us

FICA and Federal Income Tax

Federal income tax is withheld based on the withholding allowances claimed by each employee on Form W-4. FICA (both the social security portion and the Medicare portion) is withheld based on the taxable wage base and tax rate currently in effect.

The wage base for 2012 is $110,100 for social security (old age, survivors, and disability insurance) and all wages (no limit) for Medicare (hospital insurance). For social security, the tax rate is 6.2% for employers and 4.2% for employees (at least through February 29, 2012), then it may go back up to the 6.2% for the remainder of 2012 or stay at the 4.2% for 2012, depending on legislation. The maximum that can be withheld for employees will depend on which way the legislation goes. For Medicare, the rate is 1.45% each for employers and employees on all wages.

All cash tips must be reported for the employee and employer's share of FICA.

Wages of a husband or wife employed by the other spouse's proprietorship and of a child age 18 or older employed by a parent's proprietorship or partnership are subject to FICA. FICA must be withheld from the employee and be matched by the employer at the same rates as other employees.

Tax Deposits

Withheld FICA and federal income tax plus the employer's share of FICA are paid to the federal government by depositing the taxes by electronic funds transfer or by telephone

The timing and frequency of deposits are determined annually based on the employer's deposit history during the look back period which covers the 12 month period ending the previous June 30th. For 2012, the look back period is July 1, 2010-June 30, 2011.

An employer is a monthly depositor for the entire calendar year if the aggregate amount of employment taxes reported for the look back period is $50,000 or less. Conversely, an employer is a semi-weekly depositor for the entire calendar year if the aggregate amount of employment taxes reported for the look back period exceeds $50,000.

Although IRS should notify you if they identify you as having a change in your deposit schedule from 2011, you should review your tax liability for the look back period to ensure compliance with the rules.

Federal Unemployment

The 2011 Form 940 is due January 31, 2012 and will also require you to file Schedule A if you are a multi-state employer or a credit reduction state.

The Federal Unemployment (FUTA) rate for 2012 remains at .6% (.006) on the first $7,000 of wages per employee. The credit reduction will also be in effect for 2012. Payments must be made quarterly by EFTPS if required, or they can be sent in with the annual Form 940 if they are under $500.00 for the year.

Pennsylvania Income Tax

The PA Department of Revenue replaced the paper coupon booklets for filing and paying Employer Withholding Taxes with two electronic filing systems: via the internet and over the telephone. Visit their website at www.etides.state.pa.us for additional information.

The rate of withholding for Pennsylvania Income Tax for 2012 is continuing at 3.07% of gross wages.

Employers are required to file a reconciliation return for each quarter, whether you pay the tax monthly or quarterly. These returns must be received on or before the last day of April, July, October and January for the quarters ending on the last day of March, June, September and December respectively.

Changes to definitions of compensation for local earned income tax

PA Act 166 uniformly defines earned income and net profits for local income taxes. The definitions of earned income are now essentially the same for PA and for local income taxes.

Following is a summary of the changes that impact employer reporting:

Cafeteria Plans – Employer-provided flex dollars that an employee must use to pay for Pennsylvania-exempt benefits, such as health insurance or life insurance, are excludable from earned income tax. Employee contributions to a qualified IRC Section 125 plan for coverage for hospitalization, sickness, disability or death, supplemental unemployment benefits, or strike benefits, like employer contributions, are exempt from earned income tax, but only to the extent they are exempt for federal income tax purposes. If an employer has an employee benefit plan that is not a qualified IRC Section 125 plan, employee contributions, even for the same kinds of coverage, are not excludable from Pennsylvania or local taxable compensation. Employee payments and contributions for other benefits, including dependent care and contributions to an IRS 401 plan, are not excludable from Pennsylvania and local taxable compensation. (Cafeteria plan local taxability prior to Act 166: Any benefit was taxable to the extent it could have been, not necessarily that it was, taken in cash.)

Pennsylvania Unemployment Compensation

The 2012 taxable wage base for employers' contributions remains $8,000 per employee.

The rate for employee withholding in 2012 will remain at .08 percent (eight-one hundreds of one percent) tax on their **total wages**, equal to 80 cents per $1,000 earned.

Paper forms are no longer being sent to employers who file electronically. The mandatory electronic filing requirements have still not taken effect due to the Unemployment Compensation Management System (UCMS) not yet being available. So the Department of Labor & Industry is still accepting paper UC-2/2A forms for wage information.

Local Services Tax

The Local Services Tax (LST) is different depending upon the municipality in which the business is located. The rate varies from $10 to $52, which must be withheld from every employee. For employees working in a municipality that levies a $10 LST, the amount will be withheld in a lump sum at the beginning of the year. If the municipality levies a tax in excess of $10, the tax will be withheld in equal installments based upon the number of pay periods in a year. For example, a $52 tax will be collected at $1 per pay for weekly pay period; $2 per pay for bi-weekly pay periods; or $4.33 per pay for monthly pay periods. Municipalities that levy an LST in excess of $10 must exempt Taxpayers whose total earned income and net profits from that municipality are less than $12,000. The employee must complete and provide and exemption form to the employer. Further information, and exemption and refund forms are available at www.newpa.com. Search for Local Services Tax.

Local Earned Income Tax

Many school districts have passed tax reforms that have changed the earned income tax rate. It is vital that you know the municipality where each employee lives so that your earned income tax withholding is accurate.

Act 32 Local Earned Income Tax Withholding Reform becomes effective statewide January 1, 2012. This law will bring major changes to Pennsylvania's income tax collection system. Local income tax collections will be consolidated from the 560 current tax collectors to 66 county-wide collectors. Under Act 32 employers are required to withhold the higher of the employee's resident earned income tax amount (rate of total resident EIT where they reside) vs. the employee's municipal non-resident earned income tax amount (rate of non-resident EIT where they are employed).

Employers are required to obtain information in the Residency Certification Form for every new employee and employee who has a change of address. Information of the Act 32 Local Earned Income Tax Changes can be found in the Resources section of our website: www.bmbecpa.com and additional information on Act 32 can be found at www.newpa.com

Non-Payroll Income Tax Withholding

Non-payroll withholding on payments is to be reported on Form 945, Annual Return of Withheld Federal Income Tax. The Form 945 is due by January 31, 2012. Non-payroll items include backup withholding and withholding for pensions, annuities, IRA's and gambling winnings. Separate deposits will be required for non-payroll withholding. All Form 945 deposits will be required to be deposited by EFTPS in 2011.

INFORMATION RETURN UPDATE

Introduction

We would like to remind you of some important filing and reporting requirements. In order to track unreported income, the Internal Revenue Service has developed a program for cross-referencing information by identification number. Therefore, there has been increasingly stringent enforcement of the regulations requiring the filing of annual information returns and statements to recipients of certain types of payments. These are primarily the 1099 series of forms. Please be sure to file the required forms as further described below.

Frequently Used Forms

In our experience, the three most frequently used 1099 forms by small businesses and non-profits are the 1099-MISC, 1099-INT and 1099-DIV.

Form 1099-MISC

Form 1099-MISC, Miscellaneous Income, is used for several types of payments. However, the most frequent use for small businesses and non-profit organizations is to report payments of at least $600 in rents, services (including parts and materials used to perform the services) and director's fees; please note that it is not necessary to issue a 1099 for the purchase of products only. The instructions discuss the fact that the payment must be in connection with your trade or business. Non-profit organizations are considered to be engaged in a trade or business for the purpose of reporting such payments they make.

Payments to Attorneys

Attorney's fees of $600 or more paid by your business continue to be reportable in box 7 of Form 1099-MISC. Two important compliance rules are:

1. The exemption from reporting payments made to corporations does not apply to payments for legal services. **Therefore, you must report attorney's fees (or gross proceeds) to corporations that provide legal services.**
2. If you make a payment to an attorney in connection with legal services and the attorney's fee is not separately identified, the total amount paid to the attorney (gross proceeds) must be reported in box 14. For example, a company pays an attorney $50,000 to settle a claim. The company would report $50,000 in box 14 of Form 1099-MISC. If the company knew that the attorney's fee is $10,000, then the company would report $10,000 in box 7 and nothing in box 14.

You must obtain the attorney's tax identification number (social security or employer identification) on Form W-9, Request for Taxpayer Identification Number and Certification. This, of course, is no different than with the provider of any other services to your trade or business.

Form 1099-INT

Form 1099-INT, Interest Income, is used to report, among other things, interest of at least $10 you paid in connection with your trade or business. A typical use would be for interest <u>paid to</u> a person on a <u>loan to the business</u> made by that person.

Form 1099-DIV

Form 1099-DIV, Dividends and Distributions, is used to report, among other things, dividend payments of $10 or more or payments of $600 or more as part of liquidation.

Penalties

There are substantial penalties for failure to file these returns. There may be a penalty for non-filing or late filing of information returns of up to $50 per return up to a maximum of $100,000 for small businesses, or $250,000 for business with average gross receipts in excess of $5,000,000 for the most recent 3 tax years ending before the calendar year in which the information returns were due. The $50 per return penalty also applies in various situations for failure to furnish the recipient's identification number, for reporting incorrect identification numbers for recipients and for failure to timely furnish a statement to a payee.

Additional Information

Available in the Resources Section of our website www.bmbecpa.com is a *Guide to Information Returns* for your reference. This chart explains which forms to use for the various types of payments that must be reported. Generally, a copy of the information return that is filed with the Internal Revenue Service is sent to the payee as the required annual statement.

Also available on our website is a copy of the Internal Revenue Service's instructions for where to file your information returns. Please note that the address for filing paper returns is different than for magnetic reporting.

Generally, a Form 1096 (Annual Summary and Transmittal of U.S. Information Returns) must be used to summarize and transmit the required Forms 1099 to the Internal Revenue Service. A separate Form 1096 must be used for each type of Form 1099. For example, if you must file both Forms 1099-INT and 1099-DIV, you must prepare a separate Form 1096 for each group.

The recipient's copy of Form 1099 must be issued to the recipient by January 31, 2012. The Form 1096 and the Internal Revenue Service copy of Form 1099 must be filed by February 29, 2012, unless filed electronically in which case it is due by March 31, 2012. Information returns other than the 1099 series may have different due dates. Please refer to the above reference Guide.

If you are required to file 250 or more information returns, you must file electronically using the FIRE (Filing Information Returns Electronically) System at http://fire.irs.gov. The 250-or-more requirement applies separately to each type of form. For example, if you must file 500 Forms 1099-MISC and 10 Forms 1099-DIV, you are required to file the 1099-MISC Forms electronically.

If you are required to file information returns electronically, but cannot comply, you may request a hardship waiver on Form 8508, Request for Waiver from Filing Information Returns Electronically.

The information that you need in order to prepare a Form 1099 can be obtained from the payee on Form W-9, Request for Taxpayer Identification Number and Certification. We recommend that any independent contractors, and others for whom you might have to file an information return, complete a Form W-9 as soon as you begin doing business with them. Available in the resources section of our website is a Form W-9 and the W-9 instructions for your reference.

Summary

In summary, the rules are being enforced more stringently and there are essentially no exceptions. You must comply with the requirements or you will be penalized.

E-Mail Newsletter

We encourage all clients to subscribe to the weekly Boles Metzger Brosius & Emrick PC e-mail newsletter. The newsletter is available at no cost to you, and is full of valuable information on managing your business. Also featured are helpful tips you can use to improve your tax knowledge, and the latest business headlines. If you are interested in receiving our newsletter in your inbox, please contact Deanna Boles at 717-238-0446, or by e-mail at dboles@bmbecpa.com.

If you have questions about any of these things, please contact our office. We will be pleased to help you in any way we can.

Very truly yours,

Boles Metzger Brosius & Emrick PC