# **ACCT 1130**

# **CHAPTER 3 – SOCIAL SECURITY TAXES**

Reminders before starting: sole proprietors and partners are not employees. They are owners who pay Self Employment taxes.

FICA (Federal Insurance Contributions Act) imposes two taxes on employees and two taxes on employers. OASDI (old age, survivors, and disability insurance program) and HI, Medicare program.

Employees are not exempt from the FICA tax on the basis of income level or age. No distinction between young and old workers, nor top level management versus workers. Part-time employees and seasonal employees are taxed in the same way as full-time employees.

Children employed by a father or mother whose business is a sole proprietorship or a partnership are exempt from FICA.

Employers do NOT pay or withhold payroll taxes on payments made to independent contractors; they are NOT employees. The individual contractors are liable for social security taxes (Refer to Figure 3.2 for a test for independent contractor status) on the net earnings of their businesses.

Taxable wages include actual money received by employees (wages/salaries), cash value of meals and lodging provided for the convenience of the employees, bonuses and commissions as well as other listed items in Figure 3.3.

FICA considers cash tips of $20 or more in a calendar year to be taxable wages. Employers must collect the employees’ FICA tax on the tips that each employee reports. The employer deducts the employee’s FICA tax from the **wages** due the employee. (Remember the employer MUST pay at least $2.13 in wages—and more if $2.13 plus the tips are not enough to cover $7.25/hr)

The first six months of sick pay an employee receives is considered wages and is subject to FICA tax.

Employee pre-tax contributions under a qualified cash or deferred compensation arrangement (retirement plan) are subject to FICA tax. However, the employers’ matching contributions are tax-free.

Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) program limits the amount of earnings subject to taxation for a given year. This limit must change each year with changes in the national [average wage index](http://www.ssa.gov/OACT/COLA/AWI.html), also known as the Consumer Price Index. Accordingly social security benefits are increased. We call this annual limit the contribution and base or ceiling. **For earnings in 2021, this base was not yet determined at book publication date, so the 2020 base will be used on all text examples & problems. 2020 base was $137,700.**

**For Your Information: The actual 2021 ceiling (established after the printing of the text) was $142,800.**

The employer must consider the *taxable wage base* ($137,700) when computing the OASDI portion of the FICA tax.

Once the OASDI taxable wage base has been reached, all payments to the employee during the *remainder* of the year are *not taxable*.

The wage base applies to *amounts paid* employees in a calendar year & not to the time when the services were performed by the employees.

The HI portion of the FICA tax does not have a ceiling; so employers compute this tax on the total wages & salaries paid during the year.

 Rate Wage Base

Employee & Employers OASDI 6.2% $137,700

Employee & Employer HI 1.45% None

Employee HI Additional 0.9% on wages over $200,000

Sometimes an employee has paid FICA OASDI taxes on wages in excess of the taxable base because of having worked for more than one employer. If so, the employee is entitled to a refund of the overpayment.

The employers must also pay OASDI & HI taxes with one small difference. The employer’s taxes are not computed on the wages paid each employee, but on the *total taxable wages* paid all employees. The employers’ OASDI rate is also 6.2%.

Wages paid by the prior employer can be counted towards the annual OASDI wage base by a successor employer if all the following criteria are met: The successor has acquired all the property used in the prior employer’s business; the affected employees were employed immediately before and continued working right after the transfer of the business; wages were paid by the prior employer during the calendar year of acquisition.

## Self Employed Individuals

Self Employed Contributions Act (SECA) uses an individual’s self-employment income as the basis for levying taxes & for determining the amount of income to credit toward OASDI insurance benefits or HI coverage.

Earnings of < $400 from self-employment are ignored.

If the individual is also an employee for another company, the wages received can reduce the amount of self-employment income that is taxed for OASDI if wages + self-employment income > $137,700.

SECA requires self-employed persons to include SECA taxes in their quarterly payment of estimated income taxes. Self-employed individuals must be pay both employer and employee portion of OASDI and HI. Accordingly, the OASDI rate is 12.4% (6.2% employee + 6.2% employer) and the HI rate is 2.9% (1.45% employee + 1.45% employer). Self-employment income is also subject to .9% additional HI tax on earned income in excess of $200,000.

Every employer must file an application for an identification number which uniquely identifies each business; accordingly each employee and self-employed person made have a social security number.

## Deposit requirements

The requirements (nonagricultural workers) for depositing FICA taxes and income taxes withheld from employees’ wages vary according to the amount of such taxes reported during a *lookback period*. A lookback period consists of four quarters beginning July 1 of the second preceding year and ending June 30 of the prior year. Each November, the IRS notifies employers whether they will be a monthly or semiweekly depositor for the next calendar year.

A *monthly* depositor is required to deposit their taxes by the *15th day of the following month*.

A *semiweekly* depositor is required to deposit their taxes *from payment days* Wednesday, Thursday, and/or Friday on the following Wednesday; from payment days Saturday, Sunday, Monday, and/or Tuesday on the following Friday.

If on any day during a deposit period, an employer has accumulated $100,000 or more in undeposited employment taxes, the taxes must be deposited by the close of the next business day.

A new employer becomes a monthly depositor until a lookback period that can be used to determine deposit frequency is established. However, if an unsatisfied deposit of $100,000or more triggers the one day rule at any time during the year, the new employer becomes a semiweekly depositor for the remainder of the current calendar year and the subsequent calendar year.

Most employers must now make their deposits via the Electronic Federal Tax Payment System (EFTPS). The major exception will be for business with $2,500 or less in quarterly tax liabilities that pay when they file the quarterly 941 return. A deposit using this system must be initiated at least one business day before it is due in order to be considered timely.

Once enrolled in the EFTPS program, an employer can switch between the computer software and online methods anytime. The linkage on all the methods is provided by the company’s EIN.

Employer’s Quarterly Federal Tax Return (Form 941) is used to make a *quarterly* return of FICA taxes & withheld taxes for the three months of each calendar quarter. Note this reports OASDI withheld and matched, HIP withheld and matched, and federal income taxes withheld.

Form 941 is generally due on or before the *last* *day* of the *month following the close of the calendar quarter* for which the return applies. However, if an employer makes timely tax deposits for the quarter, the employer may file Form 941 on or before the *10th day* of the *second* month following the close of the calendar quarter. For example 941 for the quarter ended March 31 would be due April 30, May 10th if timely deposits have been made.

If the last day for filing a quarterly return falls on Saturday, Sunday or a legal holiday, the employer may file the return on the *next* business day.

Refer to 3-7a, 3-7b, 3-7c, 3-7d, 3-7e, and 3-7f for penalty and interest assessments for failure to comply with filing and paying rules for 941 taxes.