

Publication 15-A

Employer's Supplemental Tax Guide (Supplement to Pub. 15, Employer's Tax Guide)

For use in preparing
2024 Returns)

Volume 1 of 2



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Future Developments

For the latest information about developments related to Pub. 15-A, such as legislation enacted after it was published, go to [IRS.gov/Pub15A](https://www.irs.gov/pub15a).

What's New

Social security and Medicare tax for 2024. The social security tax rate is 6.2% each for the employee and employer. The social security wage base limit is \$168,600.

The Medicare tax rate is 1.45% each for the employee and employer, unchanged from 2023. There is no wage base limit for Medicare tax.

Social security and Medicare taxes apply to the wages of household workers you pay \$2,700 or more in cash wages in 2024. Social security and Medicare taxes apply to election workers who are paid \$2,300 or more in cash or an equivalent form of compensation in 2024.

Reminders

Form W-4P and Form W-4R. Form W-4P, Withholding Certificate for Periodic Pension or Annuity Payments, (previously titled Withholding Certificate for Pension or Annuity Payments) was redesigned for 2022. Form W-4P is now used only to make withholding elections for periodic pension or annuity payments. Previously, Form W-4P was also used to make withholding elections for

nonperiodic payments and eligible rollover distributions. Withholding elections for nonperiodic payments and eligible rollover distributions are now made on Form W-4R, Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions. Although the redesigned Form W-4P and new Form W-4R were available for use in 2022, the IRS postponed the requirement to begin using the new forms until January 1, 2023. Payers should have updated their system programming for these forms in 2022. See section 8 for more information about withholding on retirement payments and annuities. See Pub. 15-T to figure withholding on periodic pension and annuity payments.

2024 withholding tables. The discussion on the alternative methods for figuring federal income tax withholding and the Tables for Withholding on Distributions of Indian Gaming Profits to Tribal Members are no longer included in Pub.15-A. This information is now

included in Pub. 15-T with the Percentage Method and Wage Bracket Method withholding tables. However, the IRS is no longer providing the Formula Tables for Percentage Method Withholding (for Automated Payroll Systems); Wage Bracket Percentage Method Tables (for Automated Payroll Systems); or the Combined Federal Income Tax, Employee Social Security Tax, and Employee Medicare Tax Withholding Tables.

Form 1099-NEC. Use Form 1099-NEC, Nonemployee Compensation, to report nonemployee compensation paid in 2023.

Disaster tax relief. Disaster tax relief is available for those impacted by disasters. For more information about disaster relief, go to [IRS.gov/DisasterTaxRelief](https://www.irs.gov/DisasterTaxRelief).

Moving expense reimbursements. Section 11048 of P.L. 115-97, Tax Cuts and Jobs Act, suspends the exclusion for qualified moving expense reimbursements from your

employee's income for tax years beginning after 2017 and before 2026. However, the exclusion is still available in the case of a member of the U.S. Armed Forces on active duty who moves because of a permanent change of station due to a military order. The exclusion applies only to reimbursement of moving expenses that the member could deduct if they had paid or incurred them without reimbursement. See *Moving Expenses* in Pub. 3, *Armed Forces' Tax Guide*, for the definition of what constitutes a permanent change of station and to learn which moving expenses are deductible.

No federal income tax withholding on disability payments for injuries incurred as a direct result of a terrorist attack directed against the United States.

Disability payments (including Social Security Disability Insurance (SSDI) payments) for injuries incurred as a direct result of a terrorist attack directed against the United

States (or its allies) aren't included in income. Because federal income tax withholding is only required when a payment is includible in income, no federal income tax should be withheld from these payments. See Pub. 907, Tax Highlights for Persons With Disabilities, and Pub. 3920, Tax Relief for Victims of Terrorist Attacks.

Federal tax deposits must be made by electronic funds transfer (EFT). You must use EFT to make all federal tax deposits. Generally, an EFT is made using the Electronic Federal Tax Payment System (EFTPS). If you don't want to use EFTPS, you can arrange for your tax professional, financial institution, payroll service, or other trusted third party to make electronic deposits on your behalf. Also, you may arrange for your financial institution to initiate a same-day wire payment on your behalf. EFTPS is a free service provided by the Department of the Treasury. Services

provided by your tax professional, financial institution, payroll service, or other third party may have a fee.

For more information on making federal tax deposits, see *How To Deposit* in Pub. 15. To get more information about EFTPS or to enroll in EFTPS, go to [EFTPS.gov](https://eftps.gov) or call 800-555-4477. To contact EFTPS using Telecommunications Relay Services (TRS) for people who are deaf, hard of hearing, or have a speech disability, dial 711 and then provide the TRS assistant the 800-555-4477 number above or 800-733-4829. Additional information about EFTPS is also available in Pub. 966.

Electronic filing and payment. Businesses can enjoy the benefits of filing and paying their federal taxes electronically. Whether you rely on a tax professional or handle your own taxes, the IRS offers you convenient and secure programs to make filing and payment easier.

Spend less time worrying about taxes and more time running your business. Use *e-file* and EFTPS to your benefit.

- For *e-file*, go to [IRS.gov/EmploymentEfile](https://www.irs.gov/employmentefile) for additional information. A fee may be charged to file electronically.
- For EFTPS, go to [EFTPS.gov](https://www.eftps.gov) or call 800-555-4477. To contact EFTPS using TRS for people who are deaf, hard of hearing, or have a speech disability, dial 711 and then provide the TRS assistant the 800-555-4477 number above or 800-733-4829.
- For electronic filing of Forms W-2, Wage and Tax Statement, go to [SSA.gov/employer](https://www.ssa.gov/employer). You may be required to file Forms W-2 electronically. For details, see the General Instructions for Forms W-2 and W-3.

Electronic submission of Forms W-4 and W-4P. You may also set up a system to electronically receive Forms W-4 and W-4P

from an employee or payee. See Pub. 15-T for electronic submission requirements for Forms W-4 and W-4P.

Electronic submission of Forms W-4R, W-4S, and

W-4V. You may also set up a system to electronically receive any or all of the following forms (and their Spanish versions, if available) from an employee or payee.

- Form W-4R, Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions.
- Form W-4S, Request for Federal Income Tax Withholding From Sick Pay.
- Form W-4V, Voluntary Withholding Request.

For each form that you establish an electronic submission system for, you must meet each of the following five requirements.

1. The electronic system must ensure that the information received by you is the information sent by the employee or payee. The system must document all occasions of user access that result in a submission.

In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and submitting the form is the person identified on the form.

2. The electronic system must provide exactly the same information as the paper form.
3. The electronic submission must be signed with an electronic signature by the employee or payee whose name is on the form. The electronic signature must be the final entry in the submission.

4. Upon request, you must furnish a hard copy of any completed electronic form to the IRS and a statement that, to the best of your knowledge, the electronic form was submitted by the named employee or payee. The hard copy of the electronic form must provide exactly the same information as, but need not be a facsimile of, the paper form.
5. You must also meet all recordkeeping requirements that apply to the paper forms.

See *Substitute Submissions of Form W-4R* in section 8 for the specific requirements for Form W-4R.

More information on electronic submissions. For more information on electronic submissions for Forms W-4S and W-4V, see Announcement 99-6. You can find Announcement 99-6 on page 24 of Internal

Revenue Bulletin 1999-4 at [IRS.gov/pub/irs-irbs/irb99-04.pdf](https://www.irs.gov/pub/irs-irbs/irb99-04.pdf).

Additional employment tax information.

Go to [IRS.gov/EmploymentTaxes](https://www.irs.gov/EmploymentTaxes) for additional employment tax information.

Telephone help. You can call the IRS Business and Specialty Tax Line with your employment tax questions at 800-829-4933.

Help for people with disabilities. You may call 800-829-4059 (TDD/TTY for persons who are deaf, hard of hearing, or have a speech disability) with any employment tax questions. You may also use this number for assistance with unresolved tax problems.

Furnishing Form W-2 to employees electronically. You may set up a system to furnish Form W-2 electronically to employees. Each employee participating must consent (either electronically or by paper document) to receive their Form W-2 electronically, and you must notify the employee of all hardware

and software requirements to receive the form. You may not send a Form W-2 electronically to any employee who doesn't consent or who has revoked consent previously provided.

To furnish Forms W-2 electronically, you must meet the following disclosure requirements and provide a clear and conspicuous statement of each requirement to your employees.

- The employee must be informed that they will receive a paper Form W-2 if consent isn't given to receive it electronically.
- The employee must be informed of the scope and duration of the consent.
- The employee must be informed of any procedure for obtaining a paper copy of their Form W-2 and whether or not the request for a paper statement is treated as a withdrawal of their consent to receiving their Form W-2 electronically.

- The employee must be notified about how to withdraw a consent and the effective date and manner by which the employer will confirm the withdrawn consent. The employee must also be notified that the withdrawn consent doesn't apply to the previously issued Forms W-2.
- The employee must be informed about any conditions under which electronic Forms W-2 will no longer be furnished (for example, termination of employment).
- The employee must be informed of any procedures for updating their contact information that enables the employer to provide electronic Forms W-2.
- The employer must notify the employee of any changes to the employer's contact information.

You must furnish electronic Forms W-2 by the same due date as the paper Forms W-2. For more information on furnishing Form W-2 to

employees electronically, see Regulations section 31.6051-1(j).

Pub. 5146 explains employment tax examinations and appeal rights.

Pub. 5146 provides employers with information on how the IRS selects employment tax returns to be examined, what happens during an exam, and what options an employer has in responding to the results of an exam, including how to appeal the results. Pub. 5146 also includes information on worker classification issues and tip exams.

Photographs of missing children. The IRS is a proud partner with the [National Center for Missing & Exploited Children® \(NCMEC\)](#). Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication supplements Pub.15. It contains specialized and detailed employment tax information supplementing the basic information provided in Pub.15. Pub. 15-B contains information about the employment tax treatment of various types of noncash compensation. Pub. 15-T contains the Percentage Method and Wage Bracket Method withholding tables, including information on how to withhold on periodic pension or annuity payments; Tables for Withholding on Distributions of Indian Gaming Profits to Tribal Members; and a discussion on the alternative methods for figuring federal income tax withholding.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can send us comments through [IRS.gov/FormComments](https://www.irs.gov/FormComments).

Or, you can write to:

Internal Revenue Service
Tax Forms and Publications
1111 Constitution Ave. NW, IR-6526
Washington, DC 20224

Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments as we revise our tax forms, instructions, and publications. **Don't** send tax questions, tax returns, or payments to the above address.

Getting answers to your tax questions. If you have a tax question not answered by this publication, check IRS.gov and *How To Get Tax Help* at the end of this publication.

Getting tax forms, instructions, and publications. Go to [IRS.gov/Forms](https://www.irs.gov/forms) to download current and prior-year forms, instructions, and publications.

Ordering tax forms, instructions, and publications. Go to [IRS.gov/OrderForms](https://www.irs.gov/OrderForms) to order current forms, instructions, and publications; call 800-829-3676 to order prior-year forms and instructions. The IRS will process your order for forms and publications as soon as possible. **Don't** resubmit requests you've already sent us. You can get forms and publications faster online.

Useful Items

You may want to see:

Publication

- ☐ **15-B** Employer's Tax Guide to Fringe Benefits
- ☐ **15-T** Federal Income Tax Withholding Methods
- ☐ **505** Tax Withholding and Estimated Tax
- ☐ **515** Withholding of Tax on Nonresident Aliens and Foreign Entities

- **583** Starting a Business and Keeping Records
- **1635** Employer Identification Number: Understanding Your EIN

1. Who Are Employees?

Before you can know how to treat payments that you make to workers for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be:

- An independent contractor,
- A common-law employee,
- A statutory employee, or
- A statutory nonemployee.

This discussion explains these four categories. A later discussion, *Employee or Independent Contractor* in section 2, points out the differences between an independent

contractor and an employee and gives examples from various types of occupations.

If an individual who works for you isn't an employee under the common-law rules (see section 2), you generally don't have to withhold federal income tax from that individual's pay. However, in some cases you may be required to withhold under the backup withholding requirements on these payments. See Pub. 15 for information on backup withholding.

Independent Contractors

People such as doctors, veterinarians, and auctioneers who work in an independent trade, business, or profession in which they offer their services to the public are generally not employees. However, whether such people are employees or independent contractors depends on the facts in each case. 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.

Common-Law Employees

Under common-law rules, anyone who performs services for you is generally your employee if you have the right to control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed. For a discussion of facts that indicate whether an individual providing services is an independent contractor or employee, see section 2.

If you have an employer-employee relationship, it makes no difference how it is labeled. The substance of the relationship, not the label, governs the worker's status. It

doesn't matter whether the individual is employed full time or part time.

For employment tax purposes, no distinction is made between classes of employees. Superintendents, managers, and other supervisory personnel are all employees. An officer of a corporation is generally an employee; however, an officer who performs no services or only minor services, and neither receives nor is entitled to receive any pay, isn't considered an employee. A director of a corporation isn't an employee with respect to services performed as a director.

You generally have to withhold and pay income, social security, and Medicare taxes on wages that you pay to common-law employees. However, the wages of certain employees may be exempt from one or more of these taxes. See *Employees of Exempt Organizations* (section 3) and *Religious Exemptions and Special Rules for Ministers* (section 4).

Additional information. For more information about the treatment of special types of employment, the treatment of special types of payments, and similar subjects, see Pub. 15.

Statutory Employees

If workers are independent contractors under the common-law rules, such workers may nevertheless be treated as employees by statute (also known as statutory employees) for certain employment tax purposes. This would happen if they fall within any one of the following four categories and meet the three conditions described next under *Social security and Medicare taxes*.

1. A driver who distributes beverages (other than milk) or meat, vegetables, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.

2. A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
3. An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
4. A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers; retailers; contractors; or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for you must be the salesperson's principal business activity. See Salesperson in section 2.

Social security and Medicare taxes. You must withhold social security and Medicare taxes from the wages of statutory employees if all three of the following conditions apply.

- The service contract states or implies that substantially all the services are to be performed personally by them.
- They don't have a substantial investment in the equipment and property used to perform the services (other than an investment in facilities for transportation, such as a car or truck).
- The services are performed on a continuing basis for the same payer.

Federal unemployment (FUTA) tax. For FUTA tax (the unemployment tax paid under the Federal Unemployment Tax Act), the term “employee” means the same as it does for social security and Medicare taxes, except that it doesn't include statutory employees defined in categories 2 and 3 above. Any

individual who is a statutory employee described under category 1 or 4 above is also an employee for FUTA tax purposes and subject to FUTA tax.

Income tax. Don't withhold federal income tax from the wages of statutory employees.

Reporting payments to statutory employees. Furnish Form W-2 to a statutory employee, and check "Statutory employee" in box 13. Show your payments to the employee as "other compensation" in box 1. Also, show social security wages in box 3, social security tax withheld in box 4, Medicare wages in box 5, and Medicare tax withheld in box 6. The statutory employee can deduct their trade or business expenses from the payments shown on Form W-2. The statutory employee reports earnings on line 1 of Schedule C (Form 1040), Profit or Loss From Business, and also deducts business expenses on Schedule C (Form 1040).

H-2A agricultural workers. On Form W-2, don't check box 13 (Statutory employee), as H-2A workers aren't statutory employees.

Statutory Nonemployees

There are three categories of statutory nonemployees: direct sellers, licensed real estate agents, and certain companion sitters. Direct sellers and licensed real estate agents are treated as self-employed for all federal tax purposes, including income and employment taxes, if:

- Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked; and
- Their services are performed under a written contract providing that they won't be treated as employees for federal tax purposes.

Direct sellers. Direct sellers include persons falling within any of the following three groups.

1. Persons engaged in selling (or soliciting the sale of) consumer products in the home or place of business other than in a permanent retail establishment.
2. Persons engaged in selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis prescribed by regulations, for resale in the home or at a place of business other than in a permanent retail establishment.
3. Persons engaged in the trade or business of delivering or distributing newspapers or shopping news (including any services directly related to such delivery or distribution).

Direct selling includes activities of individuals who attempt to increase direct sales activities of their direct sellers and who earn income based on the productivity of their direct sellers. Such activities include providing motivation and encouragement; imparting skills, knowledge, or experience; and recruiting.

Licensed real estate agents. This category includes individuals engaged in appraisal activities for real estate sales if they earn income based on sales or other output.

Companion sitters. Companion sitters are individuals who furnish personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled. A person engaged in the trade or business of putting the sitters in touch with individuals who wish to employ them (that is, a companion sitting placement service) won't be treated as the employer of the sitters if that person doesn't receive or pay the salary

or wages of the sitters and is compensated by the sitters or the persons who employ them on a fee basis. Companion sitters who aren't employees of a companion sitting placement service are generally treated as self-employed for all federal tax purposes. However, the companion sitter may be an employee of the individual for whom the sitting services are performed; see Pub. 926.

Misclassification of Employees

Consequences of treating an employee as an independent contractor. If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you're liable for employment taxes for that worker, and the relief provision, discussed next, won't apply. See section 2 of Pub. 15 for more information.

Relief provision. If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having

to pay employment taxes for that worker. To get this relief, you must file all required federal information returns on a basis consistent with your treatment of the worker. You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977.

Technical service specialists. This relief provision doesn't apply for a technical services specialist you provide to another business under an arrangement between you and the other business. A technical service specialist is an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

This limit on the application of the rule doesn't affect the determination of whether such workers are employees under the common-law rules. The common-law rules control whether the specialist is treated as an

employee or an independent contractor. However, if you directly contract with a technical service specialist to provide services for your business and not for another business, you may still be entitled to the relief provision.

Test proctors and room supervisors. The consistent treatment requirement doesn't apply to services performed after December 31, 2006, by an individual as a test proctor or room supervisor assisting in the administration of college entrance or placement examinations if the individual:

- Is performing the services for a section 501(c) organization exempt from tax under section 501(a) of the Code, and
- Isn't otherwise treated as an employee of the organization for employment taxes.

Voluntary Classification Settlement Program (VCSP). Employers who are currently treating their workers (or a class or

group of workers) as independent contractors or other nonemployees and want to voluntarily reclassify their workers as employees for future tax periods may be eligible to participate in the VCSP if certain requirements are met. File Form 8952 to apply for the VCSP. For more information, go to [IRS.gov/VCSP](https://www.irs.gov/VCSP).

2. Employee or Independent Contractor?

An employer must generally withhold federal income taxes, withhold and pay over social security and Medicare taxes, and pay unemployment tax on wages paid to an employee. An employer doesn't generally have to withhold or pay over any federal taxes on payments to independent contractors.

Common-Law Rules

To determine whether an individual is an employee or an independent contractor under

the common-law rules, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. These facts are discussed next.

Behavioral control. Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of the following.

Instructions that the business gives to the worker. An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Training that the business gives to the worker. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

Financial control. Facts that show whether the business has a right to control the business aspects of the worker's job include the following.

The extent to which the worker has unreimbursed business expenses.

Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their employer.

The extent of the worker's investment.

An independent contractor often has a significant investment in the facilities or tools they use in performing services for someone else. However, a significant investment isn't necessary for independent contractor status.

The extent to which the worker makes their services available to the relevant market.

An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

How the business pays the worker. An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is often paid a flat fee or on a time and materials basis for the

job. However, it is common in some professions, such as law, to pay independent contractors hourly.

The extent to which the worker can realize a profit or loss. An independent contractor can make a profit or loss.

Type of relationship. Facts that show the parties' type of relationship include the following.

- Written contracts describing the relationship the parties intended to create.
- Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.
- ***The permanency of the relationship.*** If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that your intent was

to create an employer-employee relationship.

- ***The extent to which services performed by the worker are a key aspect of the regular business of the company.*** If a worker provides services that are a key aspect of your regular business activity, it is more likely that you'll have the right to direct and control their activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

IRS help. If you want the IRS to determine whether or not a worker is an employee, file Form SS-8 with the IRS.

Industry Examples

The following examples may help you properly classify your workers.

Building and Construction Industry

Example 1. Jerry Jones has an agreement with Wilma White to supervise the remodeling of a house. Wilma didn't advance funds to help Jerry carry on the work. Wilma makes direct payments to the suppliers for all necessary materials. Wilma carries liability and workers' compensation insurance covering Jerry and others that Jerry engaged to assist on the remodel. Wilma pays them an hourly rate and exercises almost constant supervision over the work. Jerry isn't free to transfer the assistants to other jobs. Jerry may not work on other jobs while working for Wilma. Jerry assumes no responsibility to complete the work and will incur no contractual liability if the work isn't completed. Jerry and the assistants perform personal services for hourly wages. Jerry Jones and the assistants are employees of Wilma White.

Example 2. Milton Manning, an experienced tile setter, orally agreed with a corporation to perform full-time services at construction sites. Milton uses personally owned tools and performs services in the order designated by the corporation and according to its specifications. The corporation supplies all materials, makes frequent inspections of Milton's work, pays Milton on a piecework basis, and carries workers' compensation insurance on Milton. Milton doesn't have a place of business or seek to perform similar services for others. Either party can end the services at any time. Milton Manning is an employee of the corporation.

Example 3. Wallace Black agreed with Sawdust Co. to supply the construction labor for a group of houses. The company agreed to pay all construction costs. However, Wallace supplies all the tools and equipment. Wallace performs personal services as a carpenter and mechanic for an hourly wage.

Wallace also acts as superintendent and foreman and engages other individuals to assist with construction. The company has the right to select, approve, or discharge any helper. A company representative makes frequent inspections of the construction site. When a house is finished, Wallace is paid a certain percentage of its costs. Wallace isn't responsible for faults, defects of construction, or wasteful operation. At the end of each week, Wallace presents the company with a statement of the amount that was spent, including the payroll. The company gives Wallace a check for that amount from which Wallace pays the assistants, although Wallace isn't personally liable for their wages. Wallace Black and the assistants are employees of Sawdust Co.

Example 4. Bill Plum contracted with Elm Corporation to complete the roofing on a housing complex. A signed contract established a flat amount for the services

rendered by Bill Plum. Bill is a licensed roofer and carries workers' compensation and liability insurance under the business name, Plum Roofing. Bill hires roofers for Plum Roofing who are treated as employees for federal employment tax purposes. If there is a problem with the roofing work, Plum Roofing is responsible for paying for any repairs. Bill Plum, doing business as Plum Roofing, is an independent contractor.

Example 5. Vera Elm, an electrician, submitted a job estimate to a housing complex for electrical work at \$16 per hour for 400 hours. Vera is to receive \$1,280 every 2 weeks for the next 10 weeks. This isn't considered payment by the hour. Even if Vera works more or less than 400 hours to complete the work, Vera will receive \$6,400. Vera also performs additional electrical installations under contracts with other companies that are obtained through

advertisements. Vera is an independent contractor.

Trucking Industry

Example. Rose Trucking contracts to deliver material for Forest, Inc., at \$140 per ton. Rose Trucking isn't paid for any articles that aren't delivered. At times, Jan Rose, who operates as Rose Trucking, may also lease another truck and engage a driver to complete the contract. All operating expenses, including insurance coverage, are paid by Jan Rose. All equipment is owned or rented by Jan and Jan is responsible for all maintenance. None of the drivers are provided by Forest, Inc. Jan Rose, operating as Rose Trucking, is an independent contractor.

Computer Industry

Example. Steve Smith, a computer programmer, is laid off when Megabyte, Inc., downsizes. Megabyte agrees to pay Steve a

flat amount to complete a one-time project to create a certain product. It isn't clear how long it will take to complete the project, and Steve isn't guaranteed any minimum payment for the hours spent on the program. Megabyte provides Steve with no instructions beyond the specifications for the product itself. Steve and Megabyte have a written contract, which provides that Steve is considered to be an independent contractor, is required to pay federal and state taxes, and receives no benefits from Megabyte. Megabyte will file Form 1099-NEC to report the amount paid to Steve. Steve works at home and isn't expected or allowed to attend meetings of the software development group. Steve is an independent contractor.

Automobile Industry

Example 1. Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. Donna works 6 days a week and is on duty in Bob's showroom on certain

assigned days and times. Donna appraises trade-ins, but the appraisals are subject to the sales manager's approval. Lists of prospective customers belong to the dealer. Donna is required to develop leads and report results to the sales manager. Due to experience, Donna requires only minimal assistance in closing and financing sales and in other phases of work. Donna is paid a commission and is eligible for prizes and bonuses offered by Bob. Bob also pays the cost of health insurance and group-term life insurance for Donna. Donna is an employee of Bob Blue.

Example 2. Sam Sparks performs auto repair services in the repair department of an auto sales company. Sam works regular hours and is paid on a percentage basis. Sam has no investment in the repair department. The sales company supplies all facilities, repair parts, and supplies; issues instructions on the amounts to be charged, parts to be used, and

the time for completion of each job; and checks all estimates and repair orders. Sam is an employee of the sales company.

Example 3. An auto sales agency furnishes space for Helen Bach to perform auto repair services. Helen provides personally owned tools, equipment, and supplies. Helen seeks out business from insurance adjusters and other individuals and does all of the body and paint work that comes to the agency. Helen hires and discharges helpers; determines working hours; quotes prices for repair work; makes all necessary adjustments; assumes all losses from uncollectible accounts; and receives, as compensation for services, a large percentage of the gross collections from the auto repair shop. Helen is an independent contractor and the helpers are Helen's employees.

Attorney

Example. Donna Yuma is a sole practitioner who rents office space and pays for the following items: telephone, computer, online legal research linkup, fax machine, and photocopier. Donna buys office supplies and pays bar dues and membership dues for three other professional organizations. Donna has a part-time receptionist who also does the bookkeeping. Donna pays the receptionist, withholds and pays federal and state employment taxes, and files a Form W-2 each year. For the past 2 years, Donna has had only three clients, corporations with which there have been long-standing relationships. Donna charges the corporations an hourly rate for services, sending monthly bills detailing the work performed for the prior month. The bills include charges for long-distance calls, online research time, fax charges, photocopies, postage, and travel, costs for which the corporations have agreed

to reimburse Donna. Donna is an independent contractor. **Taxicab Driver**

Example. Tom Spruce rents a cab from Taft Cab Co. for \$150 per day. Tom pays the costs of maintaining and operating the cab. Tom keeps all fares received from customers. Although Tom receives the benefit of Taft's two-way radio communication equipment, dispatcher, and advertising, these items benefit both Taft and Tom Spruce. Tom is an independent contractor.

Salesperson

To determine whether salespersons are employees under the usual common-law rules, you must evaluate each individual case. If a salesperson who works for you doesn't meet the tests for a common-law employee, discussed earlier in this section, you don't have to withhold federal income tax from their pay (see Statutory Employees in section 1). However, even if a salesperson isn't an

employee under the usual common-law rules for income tax withholding, their pay may still be subject to social security, Medicare, and FUTA taxes as a statutory employee.

To determine whether a salesperson is an employee for social security, Medicare, and FUTA tax purposes, the salesperson must meet all eight elements of the statutory employee test. A salesperson is a statutory employee for social security, Medicare, and FUTA tax purposes if they:

1. Work full time for one person or company except, possibly, for sideline sales activities on behalf of some other person;
2. Sell on behalf of, and turn their orders over to, the person or company for which they work;
3. Sell to wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments;

4. Sell merchandise for resale, or supplies for use in the customer's business;
5. Agree to do substantially all of this work personally;
6. Have no substantial investment in the facilities used to do the work, other than in facilities for transportation;
7. Maintain a continuing relationship with the person or company for which they work; and
8. Aren't an employee under common-law rules.

3. Employees of Exempt Organizations

Many nonprofit organizations are exempt from federal income tax. Although they don't have to pay federal income tax themselves, they must still withhold federal income tax from the pay of their employees. However,

there are special social security, Medicare, and FUTA tax rules that apply to the wages that they pay their employees.

Section 501(c)(3) organizations.

Nonprofit organizations that are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code include any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, or literary or educational purposes; fostering national or international amateur sports competition; or the prevention of cruelty to children or animals. These organizations are usually corporations and are exempt from federal income tax under section 501(a).

Social security and Medicare taxes.

Wages paid to employees of section 501(c)(3) organizations are subject to social security and Medicare taxes unless one of the following situations applies.

- The organization pays an employee less than \$100 in a calendar year.
- The organization is a church or church-controlled organization opposed for religious reasons to the payment of social security and Medicare taxes and has filed Form 8274 to elect exemption from social security and Medicare taxes. The organization must have filed for exemption before the first date on which a quarterly employment tax return (Form 941) or annual employment tax return (Form 944) would otherwise be due.

An employee of a church or church-controlled organization that is exempt from social security and Medicare taxes must pay self-employment tax if the employee is paid \$108.28 or more in a year. However, an employee who is a member of a qualified religious sect can apply for an exemption from the self-employment tax by filing Form

4029. See Members of recognized religious sects opposed to insurance in section 4.

FUTA tax. An organization that is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code is also exempt from FUTA tax. This exemption can't be waived. However, a section 501(c)(3) organization is subject to FUTA tax when paying wages to employees on behalf of a non-section 501(c)(3) organization (for example, a section 501(c)(3) organization paying wages to employees of a related non-section 501(c)(3) organization, a section 501(c)(3) organization that is a section 3504 agent paying wages on behalf of a non-section 501(c)(3) organization, a section 501(c)(3) organization that is a common paymaster paying wages on behalf of a non-section 501(c)(3) organization, etc.).



An organization wholly owned by a state or its political subdivision should contact the appropriate state official for information about reporting and getting social security and Medicare coverage for its employees.

Other than section 501(c)(3)

organizations. Nonprofit organizations that aren't section 501(c)(3) organizations may also be exempt from federal income tax under section 501(a) or section 521. However, these organizations aren't exempt from withholding federal income, social security, or Medicare tax from their employees' pay, or from paying FUTA tax. Two special rules for social security, Medicare, and FUTA taxes apply.

1. If an employee is paid less than \$100 during a calendar year, their wages aren't subject to social security and Medicare taxes.

2. If an employee is paid less than \$50 in a calendar quarter, their wages aren't subject to FUTA tax for the quarter.

The above rules don't apply to employees who work for pension plans and other similar organizations described in section 401(a).

Excise tax on excess executive compensation. Certain tax-exempt organizations may be subject to an excise tax on excess executive compensation. For more information, see the Instructions for Form 4720.

4. Religious Exemptions and Special Rules for Ministers

Special rules apply to the treatment of ministers for social security and Medicare tax purposes. An exemption from social security and Medicare taxes is available for ministers and certain other religious workers and members of certain recognized religious

sects. For more information on getting an exemption, see Pub. 517.

Ministers. Ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacerdotal functions, and administer ordinances and sacraments according to the prescribed tenets and practices of that religious organization.

Ministers are employees if they perform services in the exercise of ministry and are subject to your will and control. The common-law rules discussed in section 1 and section 2 should be applied to determine whether a minister is your employee or is self-employed. Whether the minister is an employee or self-employed, the earnings of a minister aren't subject to federal income, social security, and Medicare tax withholding. However, even if the minister is a common-law employee, the earnings as reported on the minister's Form

1040 or 1040-SR are subject to self-employment tax and federal income tax. You don't withhold these taxes from wages earned by a minister, but if the minister is your employee, you may agree with the minister to voluntarily withhold tax to cover the minister's liability for self-employment tax and federal income tax. For more information, see Pub. 517.

Form W-2. If your minister is an employee, report all taxable compensation as wages in box 1 of Form W-2. Include in this amount expense allowances or reimbursements paid under a nonaccountable plan, discussed in section 5 of Pub. 15. Don't include a parsonage allowance (excludable housing allowance) in this amount. You may report a designated parsonage or rental allowance (housing allowance) and a utilities allowance, or the rental value of housing provided in a separate statement or in box 14 of Form W-2. Don't show on Form W-2, Form 941, or Form

944 any amount as social security or Medicare wages, or any withholding for social security or Medicare tax. If you withheld federal income tax from the minister under a voluntary agreement, this amount should be shown in box 2 of Form W-2 as federal income tax withheld. For more information on ministers, see Pub. 517.

Exemptions for ministers and others.

Certain ordained ministers, Christian Science practitioners, and members of religious orders who haven't taken a vow of poverty may apply to exempt their earnings from self-employment tax on religious grounds. The application must be based on conscientious opposition because of personal considerations to public insurance that makes payments in the event of death, disability, old age, or retirement, or that makes payments toward the cost of, or provides services for, medical care, including social security and Medicare benefits. The exemption applies only to

qualified services performed for the religious organization. See Revenue Procedure 91-20, 1991-1 C.B. 524, for guidelines to determine whether an organization is a religious order or whether an individual is a member of a religious order.

To apply for the exemption, the employee should file Form 4361. See Pub. 517 for more information about claiming an exemption from self-employment tax using Form 4361.

Members of recognized religious sects opposed to insurance. If you belong to a recognized religious sect or to a division of such sect that is opposed to insurance, you may qualify for an exemption from the self-employment tax. To qualify, you must be conscientiously opposed to accepting the benefits of any public or private insurance that makes payments because of death, disability, old age, or retirement, or makes payments toward the cost of, or provides services for, medical care (including social

security and Medicare benefits). If you buy a retirement annuity from an insurance company, you won't be eligible for this exemption. Religious opposition based on the teachings of the sect is the only legal basis for the exemption. In addition, your religious sect (or division) must have existed since December 31, 1950.

Self-employed. If you're self-employed and a member of a recognized religious sect opposed to insurance, you can apply for exemption by filing Form 4029 to waive all social security and Medicare benefits.

Employees. The social security and Medicare tax exemption available to the self-employed who are members of a recognized religious sect opposed to insurance is also available to their employees who are members of such a sect. This applies to partnerships only if each partner is a member of the sect. This exemption for employees applies only if both the employee and the employer are members

of such a sect, and the employer has an exemption. To get the exemption, the employee must file Form 4029.

An employee of a church or church-controlled organization that is exempt from social security and Medicare taxes can also apply for an exemption on Form 4029.

5. Wages and Other Compensation

Pub. 15 provides a general discussion of taxable wages. Pub. 15-B discusses fringe benefits. The following topics supplement those discussions.

Relocating for Temporary Work Assignments

If an employee is given a temporary work assignment away from their regular place of work, certain travel expenses reimbursed or paid directly by the employer in accordance with an accountable plan (see section 5 of Pub. 15) may be excludable from the

employee's wages. Generally, a temporary work assignment in a single location is one that is realistically expected to last (and does in fact last) for 1 year or less. If the employee's new work assignment is indefinite, any living expenses reimbursed or paid by the employer (other than qualified moving expenses paid to a member of the U.S. Armed Forces on active duty who moves because of a permanent change of station due to a military order) must be included in the employee's wages as compensation. For the travel expenses to be excludable:

- The new work location must be outside of the city or general area of the employee's regular workplace or post of duty,
- The travel expenses must otherwise be allowed as a deduction by the employee, and
- The expenses must be for the period during which the employee is at the temporary work location.

If you reimburse or pay any personal expenses of an employee during their temporary work assignment, such as expenses for home leave for family members or for vacations, these amounts must be included in the employee's wages. See chapter 1 of Pub. 463, Travel, Gift, and Car Expenses, and section 5 of Pub. 15 for more information. These rules generally apply to temporary work assignments both inside and outside the United States.

Employee Achievement Awards

Don't withhold federal income, social security, or Medicare tax on the fair market value of an employee achievement award if it is excludable from your employee's gross income. To be excludable from your employee's gross income, the award must be tangible personal property given to an employee for length of service or safety achievement, awarded as part of a meaningful presentation, and awarded under

circumstances that don't indicate that the payment is disguised compensation. Excludable employee achievement awards also aren't subject to FUTA tax.

The exclusion doesn't apply to awards of cash, cash equivalents, gift cards, gift coupons, or gift certificates (other than arrangements granting only the right to select and receive tangible personal property from a limited assortment of items preselected or preapproved by you). The exclusion also doesn't apply to vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.

Limits. The most that you can exclude for the cost of all employee achievement awards to the same employee for the year is \$400. A higher limit of \$1,600 applies to qualified plan awards. Qualified plan awards are employee achievement awards under a written plan that doesn't discriminate in favor of highly

compensated employees. An award can't be treated as a qualified plan award if the average cost per recipient of all awards under all of your qualified plans is more than \$400.

If during the year an employee receives awards not made under a qualified plan and also receives awards under a qualified plan, the exclusion for the total cost of all awards to that employee can't be more than \$1,600. The \$400 and \$1,600 limits can't be added together to exclude more than \$1,600 for the cost of awards to any one employee during the year.

Scholarship and Fellowship Payments

Only amounts that you pay as a qualified scholarship to a candidate for a degree may be excluded from the recipient's gross income. A qualified scholarship is any amount granted as a scholarship or fellowship that is used for:

- Tuition and fees required to enroll in, or to attend, an educational institution; or
- Fees, books, supplies, and equipment that are required for courses at the educational institution.

The exclusion from income doesn't apply to the portion of any amount received that represents payment for teaching, research, or other services required as a condition of receiving the scholarship or tuition reduction. These amounts are reportable on Form W-2. However, the exclusion will still apply for any amount, despite any service condition attached to the amount, received under the National Health Service Corps Scholarship Program; the Armed Forces Health Professions Scholarship and Financial Assistance Program; and a comprehensive student work-learning-service program operated by a work college, as defined in section 448(e) of the Higher Education Act of 1965.

Any amounts that you pay for room and board aren't excludable from the recipient's gross income. A qualified scholarship isn't subject to social security, Medicare, and FUTA taxes, or federal income tax withholding. For more information, see Pub. 970, Tax Benefits for Education.

Outplacement Services

If you provide outplacement services to your employees to help them find new employment (such as career counseling, resume assistance, or skills assessment), the value of these benefits may be income to them and subject to all withholding taxes. However, the value of these services won't be subject to any employment taxes if:

- You derive a substantial business benefit from providing the services (such as improved employee morale or business image) separate from the benefit that you

would receive from the mere payment of additional compensation, and

- The employee would be able to deduct the cost of the services as employee business expenses if they had paid for them.

However, if you receive no additional benefit from providing the services, or if the services aren't provided on the basis of employee need, then the value of the services is treated as wages and is subject to federal income tax withholding and social security and Medicare taxes. Similarly, if an employee receives the outplacement services in exchange for reduced severance pay (or other taxable compensation), then the amount the severance pay is reduced is treated as wages for employment tax purposes.

Withholding for Idle Time

Payments made under a voluntary guarantee to employees for idle time (any time during which an employee performs no services) are

wages for the purposes of social security, Medicare, and FUTA taxes, and federal income tax withholding.

Back Pay

Treat back pay as wages in the year paid and withhold and pay employment taxes as required. If back pay was awarded by a court or government agency to enforce a federal or state statute protecting an employee's right to employment or wages, special rules apply for reporting those wages to the Social Security Administration. These rules also apply to litigation actions and settlement agreements or agency directives that are resolved out of court and not under a court decree or order. Examples of pertinent statutes include, but aren't limited to, the National Labor Relations Act, Fair Labor Standards Act, Equal Pay Act, and Age Discrimination in Employment Act. See Pub. 957, Reporting Back Pay and Special Wage Payments to the Social Security

Administration, and Form SSA-131, Employer Report of Special Wage Payments, for details.

Supplemental Unemployment Compensation Benefits

If you pay, under a plan, supplemental unemployment compensation benefits to a former employee, all or part of the payments may be taxable and subject to federal income tax withholding, depending on how the plan is funded. Amounts that represent a return to the employee of amounts previously subject to tax aren't taxable and aren't subject to withholding. You should withhold federal income tax on the taxable part of the payments made, under a plan, to an employee who is involuntarily separated because of a reduction in force, discontinuance of a plant or operation, or other similar condition. It doesn't matter whether the separation is temporary or permanent.

There are special rules that apply in determining whether supplemental unemployment compensation benefits are excluded from wages for social security, Medicare, and FUTA tax purposes. To be excluded from wages for such purposes, the benefits must meet the following requirements.

- Benefits are paid only to unemployed former employees who are laid off by the employer.
- Eligibility for benefits depends on meeting prescribed conditions after termination.
- The amount of weekly benefits payable is based upon state unemployment benefits, other compensation allowable under state law, and the amount of regular weekly pay.
- The right to benefits doesn't accrue until a prescribed period after termination.

- Benefits aren't attributable to the performance of particular services.
- No employee has any right to the benefits until qualified and eligible to receive benefits.
- Benefits may not be paid in a lump sum.

Withholding on taxable supplemental unemployment compensation benefits must be based on the withholding certificate (Form W-4) that the employee gave to you.

For more information, see Revenue Ruling 90-72, 1990-36 I.R.B. 13.

Golden Parachute Payments

A golden parachute payment, in general, is a payment made under a contract entered into by a corporation and key personnel. Under the agreement, the corporation agrees to pay certain amounts to its key personnel in the event of a change in ownership or control of the corporation. Payments to employees

under golden parachute contracts are subject to social security, Medicare, and FUTA taxes, and federal income tax withholding. See Regulations section 1.280G-1 for more information.

No deduction is allowed to the corporation for any excess parachute payment. To determine the amount of the excess parachute payment, you must first determine if there is a parachute payment for purposes of section 280G. A parachute payment for purposes of section 280G is any payment that meets all of the following.

1. The payment is in the nature of compensation.
2. The payment is to, or for the benefit of, a disqualified individual. A disqualified individual is anyone who at any time during the 12-month period prior to, and ending on, the date of the change in ownership or control of the corporation (the disqualified individual

determination period) was an employee or independent contractor and was, in regard to that corporation, a shareholder, an officer, or a highly compensated individual.

3. The payment is contingent on a change in ownership of the corporation, the effective control of the corporation, or the ownership of a substantial portion of the assets of the corporation.
4. The payment has an aggregate present value of at least three times the individual's base amount. The base amount is the average annual compensation for service includible in the individual's gross income over the most recent 5 tax years.

An excess parachute payment amount is the excess of any parachute payment over the base amount. For more information, see Regulations section 1.280G-1. The recipient

of an excess parachute payment is subject to a 20% nondeductible excise tax. If the recipient is an employee, the 20% excise tax is to be withheld by the corporation.

Example. An officer of a corporation receives a golden parachute payment of \$400,000. This is more than three times greater than their average compensation of \$100,000 over the previous 5-year period. The excess parachute payment is \$300,000 (\$400,000 minus \$100,000). The corporation can't deduct the \$300,000 and must withhold the excise tax of \$60,000 (20% of \$300,000).

Reporting golden parachute payments.

Golden parachute payments to employees must be reported on Form W-2. See the General Instructions for Forms W-2 and W-3 for details. For nonemployee reporting of these payments, see the Instructions for Forms 1099-MISC and 1099-NEC.

Exempt payments. Payments by most small business corporations and payments under certain qualified plans are exempt from the golden parachute rules. See sections 280G(b)(5) and (6) for more information.

Interest-Free and Below-Market-Interest-Rate Loans

In general, if an employer lends an employee more than \$10,000 at an interest rate less than the current applicable federal rate (AFR), the difference between the interest paid and the interest that would be paid under the AFR is considered additional compensation to the employee. This rule applies to a loan of \$10,000 or less if one of its principal purposes is the avoidance of federal tax.

This additional compensation to the employee is subject to social security, Medicare, and FUTA taxes, but not to federal income tax withholding. Include it in compensation on Form W-2 (or Form 1099-NEC for an

independent contractor). The AFR is established monthly and published by the IRS each month in the Internal Revenue Bulletin. You can get these rates by going to [IRS.gov](https://www.irs.gov) and entering “AFR” in the search box. For more information, see section 7872 and its related regulations.

Leave-Sharing Plans

If you establish a leave-sharing plan for your employees that allows them to transfer leave to other employees for medical emergencies, the amounts paid to the recipients of the leave are considered wages. These amounts are includible in the gross income of the recipients and are subject to social security, Medicare, and FUTA taxes, and federal income tax withholding. Don't include these amounts in the wages of the transferors. These rules apply only to leave-sharing plans that permit employees to transfer leave to other employees for medical emergencies.

In addition, you may establish a leave-sharing plan that allows your employees to deposit leave in an employer-sponsored leave bank for use by other employees who have been adversely affected by a major disaster. Under such programs, the IRS won't assert that a leave donor who deposits leave in the employer-sponsored leave bank under a major disaster leave-sharing program has income, wages, compensation, or rail wages for the deposited leave if the plan treats the employer's payments to the leave recipient as wages or compensation for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), the Railroad Unemployment Repayment Tax (RURT), and federal income tax withholding, unless excluded by another provision of law. See Notice 2006-59, 2006-28 I.R.B. 60, available at [IRS.gov/irb/ 2006-28 IRB#NOT-2006-59](https://www.irs.gov/irb/2006-28_IRB#NOT-2006-59), for what constitutes a major disaster and other rules.

Nonqualified Deferred Compensation Plans

Income Tax and Reporting

Section 409A provides that all amounts deferred under a nonqualified deferred compensation (NQDC) plan for all tax years are currently includible in gross income (to the extent the amounts deferred are not subject to a substantial risk of forfeiture and not previously included in gross income) and subject to additional taxes, unless certain requirements are met pertaining to, among other things, elections to defer compensation and distributions under an NQDC plan.

Section 409A also includes rules that apply to certain trusts or similar arrangements associated with NQDC plans if the trusts or arrangements are located outside the United States, are restricted to the provision of benefits in connection with a decline in the financial health of the plan sponsor, or contributions are made to the trust during

certain periods such as when a qualified plan of the service recipient is underfunded.

Employers must withhold federal income tax (but not the additional section 409A taxes) on any amount includible in gross income under section 409A. Income included under section 409A from an NQDC plan must be reported on Form W-2 or on Form 1099-MISC or on Form 1099-NEC, whichever applies. Amounts deferred during the year under an NQDC plan subject to section 409A may also be reported on the Form W-2 or Form 1099-MISC, but this isn't required. For more information, see the General Instructions for Forms W-2 and W-3 and the Instructions for Forms 1099-MISC and 1099-NEC. These reporting rules don't affect the application or reporting of social security, Medicare, or FUTA tax.

The provisions don't prevent the inclusion of amounts in income or wages under other provisions of the Internal Revenue Code or common-law principles, such as when

amounts are actually or constructively received or irrevocably contributed to a separate fund. For more information about NQDC plans, see Regulations sections 1.409A-1 through 1.409A-6. Notice 2008-113 provides guidance on the correction of certain operation failures of an NQDC plan. Notice 2008-113, 2008-51 I.R.B. 1305, is available at IRS.gov/irb/2008-51_IRB#NOT-2008-113. Also, see Notice 2010-6, 2010-3 I.R.B. 275, available at IRS.gov/irb/2010-03_IRB#NOT-2010-6; and Notice 2010-80, 2010-51 I.R.B. 853, available at IRS.gov/irb/2010-51_IRB#NOT-2010-80.

Social security, Medicare, and FUTA taxes. Employer contributions to NQDC plans, as defined in the applicable regulations, are treated as wages subject to social security, Medicare, and FUTA taxes when the services are performed or the employee no longer has a substantial risk of

forfeiting the right to the deferred compensation, whichever is later.

Amounts deferred are subject to social security, Medicare, and FUTA taxes at that time unless the amount that is deferred can't be reasonably ascertained, for example, if benefits are based on final pay. If the value of the future benefit is based on any factors that aren't yet reasonably ascertainable, you may choose to estimate the value of the future benefit and withhold and pay social security, Medicare, and FUTA taxes on that amount. You'll have to determine later, when the amount is reasonably ascertainable, whether any additional taxes are required. If taxes aren't paid before the amounts become reasonably ascertainable, when the amounts become reasonably ascertainable they are subject to social security, Medicare, and FUTA taxes on the amounts deferred plus the income attributable to those amounts deferred. For more information, see

Regulations sections 31.3121(v)(2)-1 and 31.3306(r)(2)-1.

Section 83(i) election to defer income on equity grants (qualified stock).

An arrangement under which an employee may receive qualified stock (as defined in section 83(i)(2)) isn't treated as an NQDC plan with respect to such employee solely because of such employee's election, or ability to make an election, to defer recognition of income under section 83(i).

Tax-Sheltered Annuities

Employer payments made by a public educational institution or a tax-exempt organization to purchase a tax-sheltered annuity for an employee (annual deferrals) are included in the employee's social security and Medicare wages if the payments are made because of a salary reduction agreement. However, they aren't included in box 1 of Form W-2 in the year the deferrals

are made and aren't subject to federal income tax withholding. See Regulations section 31.3121(a)(5)-2 for the definition of a salary reduction agreement.

Contributions to a Simplified Employee Pension (SEP)

An employer's SEP contributions to an employee's individual retirement arrangement (IRA) are excluded from the employee's gross income. These excluded amounts aren't subject to social security, Medicare, or FUTA tax, or federal income tax withholding.

However, any SEP contributions paid under a salary reduction agreement (SARSEP) are included in wages for purposes of social security, Medicare, and FUTA taxes. See Pub. 560 for more information about SEPs.

Salary reduction simplified employee pensions (SARSEPs) repealed. You may not establish a SARSEP after 1996. However,

SARSEPs established before January 1, 1997, may continue to receive contributions.

SIMPLE Retirement Plans

Employer and employee contributions to a savings incentive match plan for employees (SIMPLE) retirement account (subject to limitations) are excludable from the employee's income and are exempt from federal income tax withholding. An employer's nonelective (2%) or matching contributions are exempt from social security, Medicare, and FUTA taxes. However, an employee's salary reduction contributions to a SIMPLE retirement plan are subject to social security, Medicare, and FUTA taxes. For more information about SIMPLE retirement plans, see Pub. 560. Sick pay may also be subject to either mandatory or voluntary federal income tax withholding, depending on who pays it.

6. Sick Pay Reporting

Special rules apply to the reporting of sick pay payments to employees. How these payments are reported depends on whether the payments are made by the employer or a third party, such as an insurance company.

Sick pay is usually subject to social security, Medicare, and FUTA taxes. For exceptions, see *Social Security, Medicare, and FUTA Taxes on Sick Pay*, later in this section. Sick pay may also be subject to either mandatory or voluntary federal income tax withholding, depending on who pays it.