Social Security Administration

Internal Revenue Service

SSA/IRS

Reporter

Winter 2016 **A Newsletter for Employers**

Inside this Issue...

Accepting late rollover contributions allowed

Retirement plan administrators, and IRA trustees, custodians and issuers ("IRA trustees") can now accept late rollover contributions from individuals who self-certify they qualify for a waiver of the 60-day rollover requirement (Revenue Procedure 2016-47) if

- individuals provide them with the Model Letter contained in Rev. Proc. 2016-47 (or a certification that is substantially similar in all material respects), and
- they don't have actual knowledge contradicting the certification.

Plans and IRA trustees can rely on the self-certification only for the purpose of accepting a rollover that doesn't meet the 60-day requirement and not as to whether the contribution satisfies other requirements for a valid rollover. Plans and IRA trustees may also provide the Model Letter to their clients seeking to self-certify a late rollover.

Background

There are many requirements to make a valid rollover contribution, including the 60-day requirement - individuals have 60 days from the date they receive a distribution from a retirement plan or IRA to roll it over to another plan or IRA. Otherwise, the distribution may be taxable (other than qualified Roth distributions and any amounts already taxed), including a 10% additional tax on early distributions unless an exception applies. The IRS may waive the 60-day rollover requirement in certain situations (see FAQs: Waivers of the 60-Day Rollover Requirement).

Financial institutions that serve as IRA trustees or custodians might not have accepted late rollovers unless provided with an IRS ruling waiving the 60-day rollover requirement, or the automatic waiver rule applied. They may now, however, rely on an individual's self-certification to accept late rollover contributions, unless they have actual knowledge contrary to the certification.

Additional resources

- New Procedure Helps People Making IRA and Retirement Plan Rollovers
- Treas. Regs. Section 1.401(a)(31)-1, Q&A 14
- Revenue Ruling 2014-9 IRS

Retirement plan correction procedures updates are available

Revenue Procedure 2016-51, released September 29, 2016:

- modifies the Employee Plans Compliance Resolution System (EPCRS),
- replaces Rev. Proc. 2013-12, and
- incorporates changes described in Rev. Proc. 2015-27 and Rev. Proc. 2015-28.

Some key changes

- Determination letter applications no longer permitted when applying the correction programs under EPCRS. The requirement for a plan sponsor to submit a determination letter application to the IRS when correcting qualification failures that include a plan amendment no longer applies.
- Fees. Fees associated with the Voluntary Correction Program (VCP) are now user fees and no longer set forth in the EPCRS revenue procedure. For VCP submissions made:
  - in 2016, refer to Rev. Proc. 2016-8 and Rev. Proc. 2013-12 to determine the applicable user fee.
  - after 2016, refer to the annual Employee Plans user fees revenue procedure to determine VCP user fees for that year.
- SCP. Availability of Self-Correction Program (SCP) for significant failures has been modified to provide that, for qualified individually designed plans, a determination letter need not be current to satisfy the Favorable Letter requirement.

Audit CAP changes

- Revised approach to determining Audit CAP sanctions.
- A reasonable sanction is no longer a negotiated percentage of the maximum payment amount (MPA). Instead, auditors will review facts and circumstances and the MPA amount is simply one factor to consider. In addition, there are revised, additional factors that IRS considers.
- Sanctions, generally, will not be less than the fees associated with VCP.
- New factors used in determining sanctions for late amender failures will apply.
- For late amender failures discovered by the IRS, while reviewing a determination letter application, a new approach to determining the applicable sanction will apply.

No partial refunds for certain Anonymous Submissions

The IRS will no longer refund half the paid user fee if there is disagreement over correction in Anonymous Submissions.

Miscellaneous

Several items in Rev. Proc. 2013-12 revised to update citations or cross-references.

Submit comments on recovery of overpayments

The IRS continues to solicit comments from the public on expanding EPCRS correction rules to provide additional guidance on the recovery or recoupment of overpayments. (See sections 2.05(2) and 17.)

Effective date

The revenue procedure is effective January 1, 2017. Plan sponsors may not elect to apply provisions before January 1, 2017. Rev. Proc. 2013-12, as modified by Rev. Proc. 2015-27 and Rev. Proc. 2015-28, are in effect for 2016.

EPCRS Revenue Procedures superseded

- Rev. Proc. 2013-12 no longer applies as of January 1, 2017.
- Provisions of Rev. Proc. 2015-27 and Rev. Proc. 2015-28 are part of the new EPCRS revenue procedure. As of January 1, 2017, the older revenue procedures no longer apply. HHS

Watch the IRS Tax Calendar Webinar

Individuals can now view the IRS Tax Calendar for Businesses and Self-Employed Webinar posted to the IRS Video Portal.

Business owners can watch the August 24, 2016 webinar recording to learn about:

- **tracking Federal tax due dates on your computer or mobile device,**
- **customizing the online tax calendar,**
- **accessing the Desktop Calendar Tool or (IRS CalendarConnector),**
- **using the Mobile Calendar Tool or (IRS CalendarConnector),**
- **using the Subscribe/Download feature, and**
- **obtaining calendar reminders or RSS feeds.**
- **Access the Tax Calendar for Businesses and Self-Employed Webinar. Business owners can also access the IRS Tax Calendar YouTube video in (English), (Spanish) or (American Sign Language).** IRS

A new employer –The Certified Professional Employer Organization

This summer, the IRS began a new voluntary certification program for professional employer organizations (PEOs), as required by the Stephen Beck, Jr., Achieving Better Life Experience (ABLE) Act of 2014. To become and remain a certified professional employer organization (CPEO), an applicant must meet certain tax status, background, experience, financial reporting, bonding, and other requirements described in sections 3511 and 7705 of the Internal Revenue Code of 1986, as amended (Code), their accompanying treasury regulations, and other IRS guidance. Once certified, a CPEO is treated as the employer for employment tax purposes of any individual who is performing services for a customer of the CPEO (typically the common law employer of the individual) and is covered by a contract described in the Code between the CPEO and the customer (CPEO contract), but only with respect to remuneration paid by the CPEO to that individual. The CPEO program provides a new option for employers who use third parties for reporting and paying employment taxes.

Before January 1, 2017, the existence of a three-party arrangement (typically an employer, employee, and PEO) would not relieve the common law employer from liability for employment tax obligations, except in very limited circumstances, regardless of the terms of the contract between the PEO and the common law employer. Congress changed the landscape with the enactment of sections 3511 and 7705 and the IRS' implementation of the CPEO program. Now, if a third party is certified as a CPEO by the IRS, the CPEO is solely liable for employment taxes on remuneration it pays to a certain category of workers called "work site employees." Additionally, for workers who are not work site employees, the CPEO is the employer and liable for taxes on remuneration it pays to such workers, but the common law employer customer is still also liable. This article describes the impact of the new CPEO program from an employer's perspective.

Three-Party Arrangements in General

The Federal Insurance Contributions Act (FICA), Federal Unemployment Act (FUTA), and the federal income tax withholding provisions of the Code impose taxes on wages paid to employees in respect of employment. Generally, the requirement to withhold and pay FICA and federal income tax and the requirement to pay FUTA (collectively, employment taxes) are obligations of the common law employer. However, many employers use third parties such as PEOs for reporting and paying these employment taxes. Under a typical PEO arrangement, the PEO pays the wages of the employees of its client (which is usually the common law employer), and reports and pays the federal employment taxes on those wages using its own federal employer identification number. In return, the employer pays the PEO an amount that is typically comprised of the total amount of wages and employment taxes being paid by the PEO, plus a service fee.

As noted above, in most cases, before the enactment of the CPEO provisions under sections 3511 and 7705 of the Code, the common law employer remained liable for the employment taxes and related reporting and payment obligations when it entrusted a third party, such as a PEO, with its deposit and payment obligations. This was true regardless of the terms of the contract between the third party and the common law employer. The common law employer could not contract away its employment tax obligations.

CPEOs and Employment Taxes

Sections 3511 and 7705 of the Code (the CPEO provisions) authorize a new type of entity – the CPEO. Organizations that are certified as CPEOs are considered employers, for federal employment tax purposes, of the employee workers performing services for their customers (usually the common law employers of the workers) under a CPEO contract. These employee workers who are covered by a CPEO contract are called "covered employees." With respect to a subset of covered employees, called "work site employees," section 3511 provides that, for federal employment tax purposes, the CPEO, and no other person, is treated as the employer with respect to remuneration the CPEO pays to the work site employees. This means that the CPEO is considered the employer of all covered employees it pays and the sole employer of all the work site employees it pays. Put another way, the CPEO is liable for the employment taxes on the remuneration it pays to covered employees, and solely liable for employment taxes on the remuneration it pays to work site employees. Consequently, an employer who, under a CPEO contract, entrusts a CPEO to pay its work site employees, and to withhold, pay, and report employment taxes on those payments, is completely absolved of any employment tax liability on such payments. This is distinct from all other three-party arrangements in which, as described above, except in very limited circumstances, the common law employer remains liable for the employment taxes paid on its behalf by the third party.

It is important to remember that with respect to covered employees who are ***not*** work site employees, even though the CPEO is treated as the employer for employment tax purposes, it is ***not*** the sole employer. For these workers, the common law employer (typically the customer of the CPEO) is also liable for the employment taxes on remuneration the CPEO pays to the common law employer's workers.

So who then is a work site employee? A "work site employee" is a covered employee who performs services for the CPEO customer at a work site (typically, the physical location at which an individual regularly performs services for a customer of a CPEO) where at least 85 percent of the individuals performing services for that customer are covered by a CPEO contract. Therefore, an employer who utilizes a CPEO and wants to be completely relieved of liability for the employment taxes paid by the CPEO on wages remitted by the CPEO to the employer's covered employees must ensure that the location where these covered employees work (their "work site") meets these requirements.

Although the CPEO provisions changed the previously existing rules regarding employment tax liability, they did not alter the rules for determining whether certain exemptions from tax might apply. The common law employer is still treated as the employer for purposes of applying exemptions or exclusions from tax, and for applying certain definitions or other rules. For example, if the services are performed for a common law employer that is a tax-exempt organization, and those services would be excluded from employment for FUTA purposes, they are still excluded from employment for FUTA purposes even if the tax-exempt organization contracts with a CPEO that is not tax-exempt. The CPEO is treated as the employer for purposes of reporting and paying employment taxes on the remuneration it pays the organization's covered employees, but not for purposes of determining whether an exception from FUTA applies.

There are numerous other special rules applicable to CPEOs and their customers, including special predecessor and successor rules related to wage base limitations and reporting requirements, but it is important to note that the provisions of section 3511 only apply in the context of federal employment taxes. Nothing in section 3511 or section 7705 creates any inference with respect to the determination of who is an employee or employer for other federal tax purposes, or for purposes of any other provision of law.

Conclusion

The CPEO provisions create a new three-party arrangement option that, in certain circumstances, relieves common law employers of any liability for the employment taxes reported and paid by the CPEO on remuneration the CPEO pays to the employer's common law employees. While the IRS began accepting applications for certification as a CPEO in July of 2016, no CPEOs will be certified with an effective date of certification earlier than January 1, 2017. Beginning in 2017, the IRS will publish a list of all currently certified CPEOs on irs.gov. For more information on the CPEO program, including links to the proposed and temporary regulations under sections 3511 and 7705 of the Code and links to other guidance related to CPEOs, visit https://www.irs.gov/for-tax-pros/basic-tools/certified-professional-employer-organization. APA

Understand your tax responsibilities as an employer

As a business owner, one of the most important decisions you have to make is whether the people who perform services for your business are employees or independent contractors. Either way, the IRS wants you to make the right decision.

To make the right decision, start by checking out the Independent Contractor (Self-Employed) or Employee? page on IRS.gov. There you'll find information on basic rules. If you're still not sure, you can file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding (PDF). The IRS will review the facts and circumstances and officially determine the status of your worker.

A reputable payroll service or local tax professional can also help. But keep in mind that at the end of the day you're responsible for your business' taxes. So it's important to know what your employment tax responsibilities are and how to meet them. That way you can make informed decisions and effectively monitor a payroll service if you use one.

Other resources to help you are:

- IRS Publication 15, Employer's Tax Guide
- The Employment Taxes page on IRS.gov
- Outsourcing Payroll and Third Party Payers
- Small Business Administration (sba.gov/starting-business) and its SBA Learning Center
- Local chambers of commerce

Enforcement of employment tax laws

Misclassifying your workers and failing to meet your payroll tax responsibilities affects you and your business. The IRS and the Justice Department will take civil and criminal enforcement actions against employers and individuals who violate employment tax laws. Criminal enforcement can include prosecution, fines, restitution and imprisonment. Civil enforcement actions can include holding you and responsible people who work for you personally liable for unpaid employment taxes. Under its Early Interaction Initiative, the IRS identifies employers who may be behind on their payroll taxes and contacts them even before their payroll tax returns are due. The goal of this early interaction is to help employers stay on track and avoid civil and criminal enforcement.

Civil enforcement may also include significant financial penalties for failure to meet your employment tax responsibilities. With penalties added to your tax bill and with interest on late payments, the bill can quickly become overwhelming.

Bottom line – be smart. And if you need help with properly classifying workers, use resources to help you make the right decision for your business. HHS

IRS alerts payroll professionals of the treatment of tips and service charges

IRS has discovered employers mischaracterized service charges, also known as auto-gratuities, as tip income. Due to the mischaracterization, IRS issued Rev. Rul. 2012-18, 2012-26 I.R.B.1032. The revenue ruling reviews when a payment should be characterized as a "tip" to help explain the difference between tips and service charges, and reviews both an employer's tip reporting responsibilities and employee's tip reporting responsibilities. In addition, this revenue ruling provides information on the Section 3121(q) Notice and Demand process.

What is a Service Charge?

A fixed amount added by the employer to a customer's bill. Some examples are:

- Fixed Gratuity
- Contract Gratuity
- Large Party
- Auto Gratuity
- Service Charges
- Bottle Fees
- Some Poker Tournament Fees
- Contracted Luggage Assistance Fees

Service charges distributed to employees are non-tip wages and should be included in Box 1 (Wages, tips, other compensation), Box 3 (Social security wages) and Box 5 (Medicare wages and tips) of the employee's Form W-2, *Wage and Tax Statement*. Service charges are NOT included in Box 7 (Social security tips) of Form W-2.

Note, employers may not claim the Internal Revenue Code Section 45B credit on service charges. An employer in the food and beverage industry may be entitled to a Section 45B credit for the employer share of the social security and Medicare taxes paid on employees' tip income.

Directly tipped employees (such as food servers) cannot "tip out" on service charges. The employer must distribute the monies to both directly and indirectly tipped employees.

What is a Tip?

Tips are optional or extra payments that employees receive from customers. Tips include:

- Cash tips received directly from customers.
- Tips employees receive from customers through electronic settlement or payment, including credit cards, debit cards, gift cards, or any other electronic payment method.
- The value of any noncash tips, such as tickets, or other items of value employees may get from customers, and
- Tip amounts received from other employees paid out through tip pools, tip-outs or tip splitting, or other formal or informal tip sharing arrangements.

The differences between service charges and tips are discussed in Rev. Rul. 2012-18. Q& A 1 of Rev. Rul. 2012-18 reaffirms the factors from Rev. Rul. 59-252, 1959-2 C.B. 215.

To be a "tip" all of the following factors must be met.

The payment must be made free from compulsion

- The customer must have the unrestricted right to determine the amount
- The payment should not be the subject of negotiation or dictated by employer policy
- Generally, the customer has the right to determine who receives the payment.

Employee's Responsibilities

An employee that receives tip income must do three things:

- Keep a daily tip record or tip diary
- Report tips to the employer, unless their tips are less than $20 in a given month.
- Report all tips on their individual income tax return.

IRS has Publication 1244, *Employee's Daily Record of Tips and Report of Tips,* which includes Form 4070A, *Employee's Daily Record of Tips*, and Form 4070, *Employee's Report of Tips to Employer*. However, many employers provide other means for their employees to report tips. Employees are required to report the tip income received to their employer by the 10th day of the month following receipt.

The daily tip record or tip diary should show:

Tips received directly from customers and other employees

- Credit, debit, and gift card tips received
- Tips paid out to other employees
- Names of the employees to whom tips were paid

Employer's Responsibilities

Retain employee tip reports

- Withhold income taxes and employee's share of social security and Medicare taxes from wages or other funds made available by the employee for this purpose.
- Pay the employer share of social security and Medicare taxes based on the non-tip wages paid to the employee and the tips reported to the employer
- Report the income tax and social security tax, and Medicare taxes on Form 941, Employer's QUARTERLY Federal Tax Return
- Deposit taxes in accordance with *federal tax deposit requirements.*

Section 3121(q) Notice and Demand

If the IRS identifies unreported tips, an employer will become liable for the employer share of social security and Medicare taxes on the unreported tips at the time the IRS sends a Section 3121(q) Notice and Demand for the tax due. The notice advises the employer in writing of the amount of tips employees failed to report to the employer. The IRS may learn about these unreported tips when the employee reports the tips on his or her income tax return. If the IRS determines that a particular employer is not reporting tips, the IRS may audit that employer. Once the employer receives the Section 3121Notice and Demand the amount should be reflected on the employer's Form 941, *Employer's QUARTERLY Federal Tax Return,* line 5f, Section 3121(q) Notice and Demand – Tax due on unreported tips for the quarter in which the notice was received. The Section 45B credit, with respect to the tips reported on the Section 3121(q) Notice and Demand, is available to the employer in the year the notice and demand is made.

For more information see https://www.irs.gov/irb/2012-26_IRB/ar07.html or send an email to Tip.Program@IRS.Gov. APA

Payroll professionals must know how to properly handle the taxation of bonuses and awards

Employers that sponsor one-participant plans should take necessary steps to prevent a qualified retirement plan from becoming an orphan plan - a plan that no longer has a plan sponsor.

When employers decide to offer awards or prizes to their employees, payroll professionals need to be ready to explain the financial impact that these awards may have for both the employer and the employee.

In most cases, the value of an award must be included in the employee's income and is subject to federal income tax withholding and social security, Medicare, and FUTA taxes. When all or part of the value of an award is taxable, the employer may choose to pay the taxes on behalf of the employee. In these situations, payroll must calculate the "grossed-up" amount to provide to the employee. Because the grossed-up amount may be significantly higher than the initial award, payroll should be prepared to explain the variance so an informed decision about whether to gross up the amount can be made.

Cash or cash equivalent is taxable

If an employer decides to give an annual or a holiday bonus to an employee, the amount given is treated as taxable wages. If the bonus is given in the form of a gift certificate or gift card, the amount is still taxable. These items do not qualify as de minimis fringe benefits because they are considered cash equivalents.

Grossing-up

When all or part of an award will be taxable income to the employee, an employer may decide to pay the taxes on the employee's behalf to ensure that the employee receives the intended amount of the award. This includes federal and state income taxes, social security taxes, and Medicare taxes. Of course, the amount to cover the taxes is also taxable income to the employee.

To help figure out the amount to add to the initial amount, the IRS has approved a procedure to calculate the total payment. The procedure, known as "grossing up," calculates the total amount of the payment by dividing the amount the employer wants to give to the employee by the difference between 100% and the applicable total tax percentage.

Say an employer wants to give an employee a $1,000 bonus. Let's assume the federal and state income tax supplemental withholding rates are 25% and 3.5%, respectively; social security tax is 6.2%; and Medicare tax is 1.45% (for an applicable total tax percentage of 36.15%). To determine the grossed-up rate, subtract 36.15% from 100%, resulting in 63.85%. Then divide the desired net amount ($1,000) by the grossed-up rate (63.85%) to find the grossed-up amount ($1,566.17).

Regular rate of pay

Discretionary bonuses and special occasion bonuses (e.g., a holiday bonus) do not need to be included in an employee's regular rate of pay (used in overtime calculations under the Fair Labor Standards Act).

Withholding

Generally, the employer may choose between two federal income tax withholding methods for bonus payments. The employer may withhold using the information provided on the employee's current Form W-4 or may use an optional flat rate (currently 25%). If the employee has claimed exempt from federal tax withholding on From W-4, then the employer should not withhold on the bonus. If the bonus and all other supplemental wage payments for the year equal more than $1 million, the employer must use a mandatory flat rate of 39.6%. Finally, when determining the applicable total tax percentage for a gross-up, don't forget the Additional Medicare Tax of 0.9% once an employee's wages exceed $200,000 for the year.

Prizes for retail salespeople

Special rules exist for noncash awards given to retail salespeople who are ordinarily paid on commission. If an award is given for exceeding a sales quota or outselling fellow employees, the employer may elect not to withhold federal income tax from the award but remains responsible for social security, Medicare, and FUTA taxes. The employer must also include the value of the award as income on the salesperson's Form W-2.

Length of service or safety achievement awards

In certain circumstances, the value of an award for length of service or safety achievement may be excluded from an employee's income.

Editor's Note: The American Payroll Association's strong partnership with the IRS and SSA allows it to prepare its classes and publications, such as The Payroll Source®, with the most accurate and up-to date information to educate employers. More APA information is available at www.americanpayroll.org. APA

Get replacement Social Security tax forms online with ease

Preparing for tax season can seem overwhelming. Some forms and paperwork might be difficult to track down. Social Security has made this much easier with annual Benefit Statements.

An SSA-1099 is a tax form Social Security mails each year in January to people who receive Social Security benefits. It shows the total amount of benefits received from Social Security in the previous year so people know how much Social Security income to report to IRS on their tax return.

For noncitizens who live outside of the United States and received or repaid Social Security benefits last year, we will send form SSA-1042S instead. The forms SSA-1099 and SSA-1042S are not available for people who receive Supplemental Security Income (SSI).

If your clients currently live in the United States and need a replacement form SSA-1099 or SSA-1042S, we have a way for them to get an instant replacement quickly and easily. Encourage your clients to go online and request an instant replacement form with a *my* Social Security account at http://www.socialsecurity.gov/myaccount. The online replacement form is available beginning February 1, 2017.

Every working person in the U.S. should create a my Social Security account. The secure and personalized features of my Social Security are invaluable in securing a comfortable retirement — for today and tomorrow. SSA

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