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**PAYROLL, PAYROLL TAX AND INFORMATION RETURN UPDATE LETTER**

**December 2003**

**E-Mail Newsletter**

We encourage all clients to subscribe to the Boles, Grove and Metzger, P. C. e-mail newsletter. The newsletter is available at no cost to you, and is full of valuable information on managing your business. Also featured are helpful tips you can use to improve your tax knowledge, and the latest business headlines. If you are interested in receiving our newsletter in your inbox, please contact Deanna Boles at 717-238-0446, or by e-mail at [dboles@bgmcpa.com](mailto:dboles@bgmcpa.com).

**INFORMATION RETURN UPDATE**

**Introduction**

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



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## **Frequently Used Forms**

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

### **Form 1099-MISC**

Form 1099-MISC, Miscellaneous Income, is used for several types of payments. However, the most frequent use for small businesses and non-profit organizations is to report payments of at least \$600 in rents, services (including parts and materials) and directors fees. The instructions discuss the fact that the payment must be in connection with your trade or businesses. Non-profit organizations are considered to be engaged in a trade or business for the purpose of reporting such payments they make.

### **Payments to Attorneys**

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

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

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

### **Form 1099-INT**

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

### **Form 1099-DIV**

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

## **Penalties**

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

## **General Information**

We have enclosed a Guide to Information Returns for your reference. This chart explains which forms to use for the various types of payments that must be reported. Generally, a copy of the information return that is filed with the Internal Revenue Service is sent to the payee as the required annual statement.

We have also enclosed, for your convenience, a copy of the Internal Revenue Service's instructions for where to file your information returns. Please note that the address for filing paper returns is different than for magnetic reporting.

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

The recipient's copy of Form 1099 must be issued to the recipient by January 31, 2004. The Form 1096 and the Internal Revenue Service copy of Form 1099 must be filed by March 1, 2004, unless filed electronically in which case it is due by March 31, 2004. Information returns other than the 1099 series may have different due dates. Please refer to the enclosed Guide.

If you are required to file 250 or more information returns, you must file using magnetic media. The 250-or-more requirement applies separately to each type of form. For example, if you must file 500 Forms 1099-MISC and 10 Forms 1099-DIV, you are required to file the 1099-MISC Forms on magnetic media.

If you are required to file information returns on magnetic media, but cannot comply, you may request a hardship waiver on Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media.

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

## **Summary**

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

## **PAYROLL AND PAYROLL TAX UPDATE**

### **Introduction**

This is our annual update about payroll matters including certain changes to wage bases, rates, and limitations.

### **Mileage Rates for 2004**

Internal Revenue Service's standard mileage rates for 2004 are:

- 1) 37.5 cents per mile for business use;
- 2) 14 cents a mile for charitable purposes;
- 3) 14 cents a mile for medical and moving purposes.

### **Mandatory Postings for Pennsylvania Employers**

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

The Pennsylvania Department of Labor and Industry has an excellent listing included in its web site. The web site is [www.li.state.pa.us](http://www.li.state.pa.us). It can also be reached from the Commonwealth of Pennsylvania's home page.

### **Hiring New Employees**

You must verify that each new employee is legally eligible to work in the United States. This will include completing the Immigration and Naturalization Service (INS) **Form I-9**, Employment Eligibility Verification. You can get the form from INS offices or by calling 1-800-870-3676. Contact the INS at 1-800-375-5283, or visit the INS Web Site at [www.ins.gov](http://www.ins.gov) for further information.

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

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

To verify up to 50 names/SSNs, submit a paper listing containing the data listed above to your local Social Security office. Some offices accept faxed listings. You may reach the Harrisburg office at the following address: 555 Walnut Street, Harrisburg, PA 17101. Their phone numbers are (717) 782-3400 and 1-800-772-1213.

### **Form W-4, Employee's Withholding Allowance Certificate**

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

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

### **New-Hire Reporting**

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

### **FICA and Federal Income Tax**

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

The wage base for 2004 is \$87,900 for social security (old age, survivors, and disability insurance) and all wages (no limit) for Medicare (hospital insurance). For social security, the tax rate is 6.2% each for employers and employees. For Medicare, the rate is 1.45% each for employers and employees.

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

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

### **Tax Deposits**

Withheld FICA and federal income tax plus the employer's share of FICA is paid to the federal government by depositing the taxes with an authorized depository such as a bank.

The timing and frequency of deposits are determined annually based on the employer's deposit history during the lookback period which covers the 12 month period ending the previous June 30<sup>th</sup>. For 2004, the lookback period is July 1, 2002-June 30, 2003.

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

Although IRS should notify you if they identify you as having a change in your deposit schedule from 2003, you should review your tax liability for the lookback period to ensure compliance with the rules.

### **Federal Unemployment**

The 2003 Form 940 is due February 2, 2004.

The Federal Unemployment (FUTA) rate for 2004 remains at .8% (.008) of the first \$7,000 of wages per employee. Payments must be made quarterly to your bank, with a Form 8109 coupon, marked 940 and the appropriate quarter, or by EFTPS, if required.

### **Pennsylvania Income Tax**

**The rate of withholding for Pennsylvania Income Tax for 2004 has been increased to 3.07% of gross wages.**

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

## **Changes to definitions of compensation for local earned income tax**

PA Act 166 changed the definition of earned income and net profits for local income taxes. The reason for this change is so that the definitions for local taxes become uniform throughout the state. The definitions are now essentially the same for PA and for local income taxes. **The changes to these definitions took effect on February 7, 2003.**

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

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

## **Pennsylvania Unemployment Compensation**

The 2004 taxable wage base for employers' contributions remains \$8,000 per employee.

**Beginning January 1, 2004, employees will pay a .09 percent (nine-one hundredths of one percent) tax on their total wages, equal to 90 cents per \$1,000 earned—up from .02 percent in 2003.**

## **Occupational Privilege Tax**

Depending upon the municipality in which the business is located, an occupational privilege tax of \$10 must be withheld from every employee during the first quarter that they were employed each year.

## **Earned Income Tax**

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

## **Non-Payroll Income Tax Withholding**

Non-payroll withholding on payments is to be reported on Form 945, Annual Return of Withheld Federal Income Tax. The Form 945 is due by February 2, 2004. Non-payroll items include backup withholding and withholding for pensions, annuities, IRA's and gambling winnings. Separate deposits will be required for non-payroll withholding. All Form 945 deposits should be deposited to your bank with a Form 8109 coupon marked 945 and the appropriate quarter. If you do not have the revised 8109 coupon you must mark the Schedule A checkbox.

## **Summary**

There are a number of compliance items to consider in managing your payroll and payroll taxes.

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

Very truly yours,

**Boles, Grove and Metzger, P.C.**