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FIGURE 13.10 Jason Johnson's 2013 Form W-2

22222		Void <input type="checkbox"/>	a Employee's social security number 444-55-6666		For Official Use Only ▶ OMB No. 1545-0008		
b Employer identification number (EIN) 64-1234567			1 Wages, tips, other compensation 10000.00		2 Federal income tax withheld 1500.00		
c Employer's name, address, and ZIP code  Parts Company 345 Main St Madison MS 39110			3 Social security wages 13000.00		4 Social security tax withheld 806.00		
			5 Medicare wages and tips 13000.00		6 Medicare tax withheld 188.50		
			7 Social security tips		8 Allocated tips		
d Control number			9		10 Dependent care benefits		
e Employee's first name and initial Jason J		Last name Johnson		Suff.	11 Nonqualified plans		
f Employee's address and ZIP code  456 Elm St Madison MS 39110			13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12a See instructions for box 12		
			14 Other		12b		
					12c		
					12d		
15 State MS	Employer's state ID number 641-234-567	16 State wages, tips, etc. 10000.00	17 State income tax 200.00	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

Form **W-2** Wage and Tax Statement **2013**  
 Copy A For Social Security Administration — Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable.

Department of the Treasury—Internal Revenue Service  
 For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions.  
 Cat. No. 10134D

## Members of the Clergy

The salary a church pays to a licensed, commissioned, or ordained member of the clergy for performing his or her religious duties is not subject to social security or Medicare tax withholding even if the individual is a church employee for income tax purposes [I.R.C. § 3121(b)(8)]. The determination of employee status is based on three factors: behavioral control, financial control, and the relationship between the church and the clergy member.

If the individual is self-employed under the common law rules, the church issues Form 1099-MISC. If the individual is an employee, the church issues a Form W-2 that identifies the amount of wages paid, any optional income tax withholding, and certain fringe benefits. Boxes 3 through 9 should be left blank. A housing allowance may be reported in box 14.



### Practitioner Note Self-Employment Tax

A member of the clergy is treated as self-employed for purposes of the social security and Medicare taxes [I.R.C. §§ 1401 and 1402(e)], even if the employee receives a Form W-2 reporting his or her compensation from the church. An accepted Form 4361, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, provides an SE tax exemption for the clergy member.



### Cross-Reference Payments to Clergy

See Issue 6 of the "Individual Taxpayer Issues" chapter of this book for a brief discussion of the clergy housing allowance. Also see pages 32–39 in the 2011 National Income Tax Workbook for a discussion of reporting payments to ministers and examples of completed Forms W-2.

## Tipped Employees

I.R.C. § 6053(a) requires all tipped employees (not just food service workers) to report to their employers the tips they received each month. The employer is required to withhold income, social security, and Medicare taxes on both the reported tips and the hourly wages the employer pays the employee. If the wage the employer pays is less than the required withholding on the employee's total compensation, the employee can give additional funds to the employer or the employer can show uncollected social security and Medicare tax on tips with codes A and B in box 12 of the employee's Form W-2. The employer includes the tip amounts the employee reported to the employer in the amounts reported in boxes 1, 5, and 7 of the employee's Form W-2.



### **Practitioner Note** Form W-2 Boxes 3, 5, and 7

The amount in box 5 (Medicare wages and tips) of Form W-2 should equal or exceed the total of the amounts in box 3 (social security wages) and box 7 (social security tips).

I.R.C. § 6053(c) generally requires large food and beverage establishments (restaurants, cocktail lounges, and similar businesses) to allocate tips if servers report a total tip amount that is less than 8% of their food and drink sales. A tip allocation is made only to those employees with a reporting shortfall. No income, social security, or Medicare tax is withheld on allocated tips, and the amount should **not** be included in boxes 1, 3, 5, or 7 of Form W-2. It is reportable only in box 8.



### **Cross-Reference** Allocated Tips

Allocated tips are not included in the employee's income if the employee has tip records that substantiate the amount of tips the employee actually received. The employer (or a majority of the employees) may ask the IRS to approve a lower rate than 8% for tip allocation if its clientele normally tips less than 8% of the charges for food and beverages eaten on the establishment's premises.

See pages 199–202 in the *2012 National Income Tax Workbook* for a further discussion of tip income.

## Employee Taxes Paid by Employer

A business employer that pays an employee's share of social security and Medicare taxes (rather than deducting the amount from the employee's wages) must treat the tax payments as additional wages that are then subject to income tax, social security tax, and Medicare tax. A circular computation results if the employer then pays the additional social security and Medicare taxes for the employee, which is resolved by an algebraic formula. The employer determines the additional amount to include as wages by dividing the wages actually paid to the employee by 0.9235 [ $1 - 0.0765$  (the 2013 combined social security and Medicare tax rate)].



### **Practitioner Note** Household and Farm Employees

This wage gross-up rule does not apply to household and agricultural employees. An employer that pays a household or agricultural employee's social security and Medicare taxes simply multiplies the employee's wages by the employee social security and Medicare rates and includes these payments in the employee's wages reported in box 1 of Form W-2. The wage increase due to the tax payment is not subject to social security or Medicare taxes and is not included in boxes 3 or 5 of Form W-2.

### **Example 13.17 Employee's Taxes Paid by Business Employer**

Gordon Garrison hired Olivia Olson to work in his office for 2 weeks during 2013. He agreed to pay her \$1,000 without any withholding. (Olivia gave him a Form W-4 claiming that she was exempt from federal income tax withholding because she had no tax liability for 2012 and expected to have none for 2013.)

Gordon must gross up Olivia's wages and report \$1,082.84 ( $\$1,000 \div 0.9235$ ) in boxes 1, 3, and 5 of her Form W-2. He enters \$67.14 ( $\$1,082.84 \times 6.2\%$ ) as social security tax withheld in box 4 and \$15.70 ( $\$1,082.84 \times 1.45\%$ ) as Medicare tax withheld in box 6 of her Form W-2, even though he did not actually withhold the amounts from Olivia.

## Example 13.18 Employee's Taxes Paid by Household Employer

Abby Arnold pays Norma Nelson \$100 a week to clean her home on 2 days each week. She agreed to pay Norma 2 weeks' vacation pay and not to withhold any taxes. Income tax withholding is not required for a household employer, but if wages paid to a household worker in 2013 total \$1,800 or more, they are subject to social security and Medicare taxes.

Norma's stated wages were \$5,200 ( $\$100 \times 52$  weeks), so her share of the social security tax is \$322.40 ( $\$5,200 \times 6.2\%$ ) and her share of the Medicare tax is \$75.40 ( $\$5,200 \times 1.45\%$ ). Abby reports \$5,597.80 ( $\$5,200 + \$322.40 + \$75.40$ ) in box 1 of Norma's Form W-2. She enters \$5,200 in boxes 3 and 5, \$322.40 in box 4, and \$75.40 in box 6.



### Cross-Reference

#### Household Workers

See Issue 4 of the "Individual Taxpayer Issues" chapter of this book for a discussion of whether a household worker is an employee or an independent contractor.

## Business Expense Reimbursements

If an employer's accountable plan includes a per diem or mileage allowance that exceeds the IRS per diem rates or business standard mileage allowance, the excess allowance is treated as wages reportable on Form W-2 and subject to income tax withholding and social security and Medicare taxes [Treas. Reg. § 1.62-2(h)(2)]. The nontaxable portion (the amount deemed to be substantiated) is reported in box 12 using code L.

All payments made under a nonaccountable plan are reported as wages on Form W-2 and are subject to federal income tax withholding and social security and Medicare taxes.

## Example 13.19 Taxable Expense Reimbursement

In 2013 Dawn Dalton drove 10,000 miles for business. Her employer, TRV Company, has an accountable plan that reimbursed employees 60¢ a mile in 2013 for substantiated mileage, which

exceeded the IRS's 56.5¢ standard business mileage rate by 3.5¢ a mile.

TRV's \$6,000 ( $10,000 \times 60\%$ ) reimbursement to Dawn exceeds the \$5,650 ( $10,000 \times 56.5\%$ ) amount deemed substantiated by \$350 ( $\$6,000 - \$5,650$ ). TRV must treat the excess \$350 as wages in boxes 1, 3, and 5 of her Form W-2 and report the \$5,650 in box 12 with code L. TRV withheld income tax and the employee share of social security and Medicare taxes on the excess reimbursement each pay period from Dawn's other wages.

## Moving Expenses

Qualified moving expenses that an employer pays to a third party on behalf of the employee (for example, to a moving company) and services that an employer furnished in kind to an employee are not reported on Form W-2.

- Qualified moving expense reimbursements that the employer pays directly to an employee are reported only in box 12 of Form W-2, with code P.
- Nonqualified moving expense reimbursements are reported in boxes 1, 3, and 5 (14 if RRTA taxes apply) of Form W-2. These amounts are subject to federal income tax, social security tax, and Medicare tax (or RRTA tax) withholding.

Qualified expenses are the reasonable costs of moving the employee's household goods and personal effects (including in-transit storage expenses) and traveling (including lodging but not meals) to the employee's new location, if time and distance tests are met.

## Fringe Benefits

An employer generally must include the value of all taxable fringe benefits (cash and noncash) in boxes 1, 3, and 5 of Form W-2. The taxable amount is generally the excess of the benefit's FMV over the sum of any excludable amount and any amount the employee pays for the benefit. The most common taxable noncash fringe benefit is personal use of a business vehicle.

An employer who provides taxable fringe benefits may include the total value of all the taxable benefits in box 14 of Form W-2 or provide a separate statement to the employee. If an

employer includes 100% of a motor vehicle's annual lease value in the employee's income, the employer must report that amount separately in box 14 or in a separate statement so that the employee can compute the value of any business use of the vehicle.



**Cross-Reference**

**Fringe Benefits**

See pages 432–450 in the *2012 National Income Tax Workbook* for a discussion and examples of both taxable and nontaxable fringe benefits.

## Noncash Wages for Farm Labor

Farm employees, as well as nonfarm employees, often receive part of their compensation in the form of noncash fringe benefits including health insurance and retirement plan contributions. A farm employer may provide employees with housing, meals, use of vehicles, and continuing education courses. A study by Iowa State University found that almost one-third of farm employers gave employees paid recreational opportunities, such as tickets to entertainment events, but only about 4% of farm workers were paid in farm commodities [[www.extension.iastate.edu/AgDM/wholefarm/html/c1-60.html](http://www.extension.iastate.edu/AgDM/wholefarm/html/c1-60.html)].

The income tax rules for determining whether noncash benefits are included in gross income are generally the same for both farm and nonfarm employees. However, noncash farm wages, including commodity wages, are not subject to social security or Medicare taxes even if they are included in gross income.

If wages are paid in commodities that the employee can market, the FMV of the commodity at the time the employer distributes it to the employee is reported in box 1 of Form W-2. If the employee lacks control of the commodity, the arrangement is treated as a cash payment of wages.

### Example 13.20 Agricultural Employee's Form W-2

Wendy Way is an employee of the Triple W Farm. Triple paid her \$12,000 of cash wages and 100 bushels of wheat. The wheat's FMV was \$5,000 (\$50 per bushel × 100 bushels) on the date she received it. Triple reports \$17,000 (\$12,000

+ \$5,000) in box 1 of her Form W-2. Only the \$12,000 of cash wages is subject to social security and Medicare tax withholding and reported in boxes 3 and 5.

## H-2A Workers

The H-2A visa program allows U.S. employers or agents to bring foreign nationals to the United States to fill temporary agricultural jobs. The wages are not subject to social security or Medicare tax withholding [I.R.C. § 3121(b)(1)], but they are reportable in box 1 of Form W-2 if the employer pays the worker at least \$600 during the year and the worker has a valid SSN.

Because wages (including cash wages) paid to H-2A workers are agricultural wages that are exempt from social security and Medicare taxes, they are also exempt from regular income tax withholding [I.R.C. § 3401(a)(2)] unless the worker asks for income tax withholding and the employer agrees to it. In that case the worker must give the employer a completed Form W-4 with a valid SSN. The employer includes the withholding in box 2 of the worker's Form W-2.

If the worker does not provide a valid SSN and the employer pays the worker at least \$600 during the year, 28% flat rate backup withholding is required and the payments are reported on Form 1099-MISC.



**Cross-Reference**

**Commodity Wages and H-2A Workers**

See the "Agricultural Issues" chapter in this book for a discussion of commodity wages (Issue 1) and H-2A workers (Issue 4).

## Filing Form W-2

Employers who are required to file 250 or more Forms W-2 generally are required to e-file the forms. The SSA encourages all employers to e-file because of increased accuracy, but employers filing fewer than 250 wage statements may choose to send the SSA paper copies of Form W-2 with a Form W-3 transmittal.

Form W-3 simply reflects the totals from boxes 1–11 of all of the employer's Forms W-2,

plus the total amount of deferred compensation from box 12 (the amounts reported with codes D through H, S, Y, AA, BB, and EE). Boxes 13 and 14 are completed if any of the Forms W-2 include third-party sick pay. Boxes 15–20 report the total state and local wage and tax information. (If the employer reports information for more than one state, all amounts are totaled on a single Form W-3.)

A paper Form W-3 requires the employer's signature, but a payroll service provider may sign the form for the employer if the provider is authorized to sign for the employer by an agency agreement (oral, written, or implied) that is valid under state law. The agent must write "For (name of payer)" next to his or her signature.

The totals for income tax withholding, social security and Medicare wages, and social security and Medicare tax withheld on Form W-3 should match the total numbers on the employment tax returns filed with the IRS. A reconciliation worksheet that identifies discrepancies up front so that the employer can correct them and prevent a future Combined Annual Wage Reporting (CAWR) notice from the IRS, as explained later in this issue.

## Checking for Errors

The following prefiling checks of Forms W-2 can help reduce discrepancies on the forms themselves and prevent a CAWR notice:

1. Ensure that social security and Medicare wages and taxes are reported separately.
2. Ensure that social security taxes withheld are reported in box 4, not in box 3.
3. Ensure that Medicare taxes withheld are reported in box 6, not in box 5.
4. Do not report a nonzero amount in box 4 of if boxes 3 and 7 are both zero.
5. Do not report a nonzero amount in box 6 if box 5 is zero.
6. Do not report an amount in box 5 that is less than the sum of boxes 3 and 7.
7. Ensure that the social security wage and tip amount for each employee (the sum of boxes 3 and 7) does not exceed the social security wage base limit (\$113,700 for 2013).
8. Ensure that noncash wages that are not subject to social security or Medicare taxes are

not reported as social security or Medicare wages.

## Due Dates

Employers must furnish copies B, C, and 2 of an employee's Form W-2 to the employee by January 31 of the year following the year the wages were paid. Employers who file paper Forms W-2 and W-3 must file the paper forms with the SSA by February 28. The SSA extends the due date to March 31 for e-filed forms. Copy 1 is filed with the appropriate state under state regulations.

Employers may request an automatic 30-day extension of time to file Forms W-2 with the SSA by filing Form 8809, Application for Extension of Time To File Information Returns, with the IRS. Treas. Reg. § 31.6051-1(d)(2) allows the IRS to grant an employer an extension of time to furnish Forms W-2 to its employees, but this extension is not granted automatically.



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### **Practitioner Note** Month's Difference in Due Dates

Some employers file copy A with the SSA at the same time they issue Forms W-2 to their employees. However, waiting to file the SSA forms can be advantageous because the employer has an opportunity to correct an erroneous Form W-2 before it is filed with the SSA.

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Employers should retain copies (paper or electronic) of the Forms W-2 they issued for 4 years after the return due date.

## Undeliverable Form W-2

Employers should retain any undeliverable employee copies of Forms W-2 for 4 years. This requirement is waived if the employer can reproduce the Forms W-2 electronically through April 15 of the fourth year after the filing year. Employers should not send undeliverable employee copies of Forms W-2 to the SSA. (Copy A of the form is still filed with the SSA.)

## Reissued Form W-2

If an employee loses a Form W-2 and the employer provides a duplicate paper copy, the employer should write "REISSUED STATEMENT" on the new form that is given to the

employee. (Copy A of a reissued form is not sent to the SSA.) If an electronic copy is provided to the employee, the “REISSUED STATEMENT” notation is not required. The Internal Revenue Code does not prohibit employers from charging a fee for preparing and issuing a duplicate Form W-2.

## Successor or Predecessor Employer

Rev. Proc. 2004-53, 2004-2 C.B. 320, provides Form W-2 and employment tax return filing procedures for employers that buy or sell a business during the year. Under the standard procedure a predecessor employer performs all reporting duties for the wages and other compensation it paid, including furnishing and filing Forms W-2 for its former employees. The alternate procedure allows the predecessor and successor to agree that the successor employer will issue to each acquired employee a single Form W-2 that includes all wages paid during the year by both the predecessor and successor employers.

## Business Termination

Employers that terminate a business must provide their employees with Forms W-2 by the due date of the final employment tax return (such as Forms 941) and file the Forms W-2 with the SSA by the last day of the month that follows the employment tax return due date.

## Information Return Penalties

Failure to file correct and complete Forms W-2 by the due date can result in the following I.R.C. § 6721 penalties:

- \$30 per Form W-2, up to \$250,000 per year, if the employer corrects any errors within 30 days of the due date (\$75,000 maximum for small businesses with average annual gross receipts up to \$5,000,000 for the 3 most recent tax years)
- \$60 per Form W-2, up to \$500,000 per year, if the employer corrects any errors more than 30 days after the due date but no later than August 1 (\$200,000 maximum for small businesses)
- \$100 per Form W-2, up to \$1,500,000, if the employer does not correct errors until after August 1 or does not file at all (\$500,000 maximum for small businesses)

- \$250 per Form W-2 if the employer’s failure to file is due to intentional disregard of the filing requirements (no maximum penalty)

The same per-Form W-2 penalty tiers may apply if the employer does not furnish a correct Form W-2 to an employee by the due date [I.R.C. § 6722].



### Practitioner Note Reasonable Cause

The penalty will not apply if the employer can show the failure was due to reasonable cause and not to willful neglect [I.R.C. § 6724(a)]. Reasonable cause is generally an event that is beyond the employer’s control or that resulted from significant mitigating factors. The employer must show that it acted in a responsible manner and took steps to avoid the failure [Treas. Reg. § 301.6724-1].

The penalty is not assessed for an inconsequential error or omission (generally defined as one that does not prevent the SSA from processing the Form W-2 or the IRS from correlating the Form W-2 information with the payee’s tax return). This could include misspelling an address or first name, but misspelling a surname or using an incorrect SSN is never considered inconsequential.

A de minimis rule avoids the penalty for the greater of 10 information returns or 0.5% of the total number of information returns that the employer is required to file for the calendar year if the employer timely filed the original forms (albeit with errors) and then filed corrected returns by August 1 [Treas. Reg. § 301.6721-1(d)].

## Combined Annual Wage Reporting

The SSA and the IRS exchange employment tax data to ensure that the taxes an employer pays match the amounts the employees claim. The SSA shares Form W-2 data with the IRS, and the IRS shares information from the following employment tax returns with the SSA:

- Form 941, Employer’s QUARTERLY Federal Tax Return
- Form 943, Employer’s Annual Federal Tax Return for Agricultural Employees

- Form 944, Employer's ANNUAL Federal Tax Return
- Form 945, Annual Return of Withheld Federal Income Tax
- Schedule H (Form 1040), Household Employment Taxes



## **Practitioner Note** Use of Form 94X

The IRS uses the term *Forms 94X* to refer collectively to Forms 941, 943, 944, and 945, and this discussion adheres to that practice.

The CAWR program compares the federal income tax (FIT) withheld, social security wages and tips, and Medicare wages reported to the IRS on Forms 94X and Schedule H (Form 1040) with the amounts reported to the SSA on Forms W-2. Advance earned income credit (EIC) amounts were also matched for prior years.

## **CAWR Inquiries**

If the wage amounts reported to the SSA are less than the amounts reported to the IRS (so that one or more Forms W-2 appear to be missing or incorrect), the SSA first requests information from the employer to resolve the discrepancy. If the employer does not respond after the SSA has sent two notices, or if the employer's response does not resolve the imbalance, the SSA refers the case (called an SSA-CAWR case) to the IRS.

If the amounts reported on Forms 94X or Schedule H (Form 1040) are less than the amounts reported on Forms W-2, the IRS makes the initial contact with the employer. IRS tax examiners attempt to reconcile a discrepancy in an IRS-CAWR case before contacting the employer, checking to see if corrected Forms W-2 were filed in the interim; if voided Forms W-2 were processed incorrectly; if duplicate Forms W-2 were filed; or if the discrepancy resulted from an acquisition, statutory merger, or business consolidation.



## **Practitioner Note** Timing of Reviews

IRS tax examiners begin reviewing SSA-CAWR issues each April by looking at data for the third preceding tax year. This means that during 2013 the IRS was analyzing tax year 2010 SSA-CAWR cases. IRS tax examiners begin reviewing IRS-CAWR issues each April by looking at data for the second preceding tax year. This means that during 2013 the IRS was analyzing tax year 2011 IRS-CAWR cases.

If a discrepancy remains after the IRS's initial case analysis, the tax examiner issues a letter to the employer explaining the discrepancy and requiring a response within 45 days.

## **Preparing a Response**

An employer who receives a CAWR notice should take the following actions:

- It should review the business's employment tax records and compare them to the CAWR issue.
- If some required Forms W-2 were not filed, it should submit the forms (using the correct year's forms) to the IRS, attaching them behind the response page included with the IRS's letter. The information return penalties explained earlier in this issue apply to these late-filed forms unless the employer establishes reasonable cause.
- If the employer disagrees with the issue, it should include an explanation in a signed statement sent with the response page. (If the Forms W-2 were previously filed with the SSA, the employer must provide proof of timely submission.)
- If a Form W-2c or an amended employment tax return will resolve the discrepancy, the employer should include the amended form or forms in the reply, being sure that any adjustments do not create an out-of-balance account.
- Finally, it should mail or fax the reply by the due date shown on the letter.

## Failure to Respond Timely

If the IRS does not receive a response to a CAWR letter within the 45-day response period, it will close the case and take the following actions:

- In an SSA-CAWR case, the IRS assesses an I.R.C. § 6721(e)(2)(A) penalty for intentional disregard of the requirement to file correct information returns. Because the actual number of missing or incorrect Forms W-2 is not known, the penalty is 10% of the aggregate difference between the Medicare wages (or the total social security wages and tips, if greater) shown on the employment tax returns filed with the IRS and the Forms W-2 filed with the SSA.
- In an IRS-CAWR case, the IRS assesses the additional employment taxes that were proposed in the CAWR letter and sends a bill for the tax, interest, and penalties.

## Correcting Form W-2 Errors

Form W-2 errors can cause a domino effect on the employer's employment tax reporting and on the employee's tax return. Errors made in preparing or filing a Form W-2 could include entering incorrect names, addresses, SSNs, EINs, or wage or withholding amounts; filing duplicate returns in error; using the wrong year's form; and incorrectly reporting employee repayments of prior-year wages.

Form W-2c, Corrected Wage and Tax Statement, is used to correct most errors on Forms W-2. Its boxes correspond to the boxes on Form W-2 but include separate columns for previously reported amounts and correct information. No entry is made in boxes for items that were correct on the originally filed Form W-2.

An employer should file Form W-2c (with Form W-3c, Transmittal of Corrected Wage and Tax Statements) with the SSA as soon as the reporting error is discovered and provide a copy of the Form W-2c to the employee.

## Special Situations

The following discussion addresses special situations for correcting Form W-2 errors.

## Employee Wage Repayments

If an employer overpays an employee, and the employee repays the surplus amount in the same calendar year, the employer should report the correct net pay on the employee's Form W-2 and make any necessary adjustments on the employer's Form 94X.

If an employee repays the surplus in a later year, box 1 of the employee's Form W-2 for the year of the overpayment should include the overpayment, and no adjustment is made to taxable wages in the repayment year. (The employee may deduct the overpayment as an itemized deduction.)

If the overpayment error is not discovered until after the employer filed Forms W-2 for the overpayment year, the employee's Form W-2 and the employer's Form 94X must be amended to show the correct amount of social security and Medicare wages and taxes.

## Error Discovered before Filing

If an error is discovered on a Form W-2 after it is issued to the employee but before the employer files the Form W-2 with the SSA, Form W-2c is not completed. The employer should take the following steps:

1. Check the "Void" box at the top of copy A of the incorrect Form W-2
2. Prepare a new Form W-2 with the correct information
3. Write "CORRECTED" on the copies B, C, and 2 of Form W-2 and give them to the employee
4. Do not write "CORRECTED" on copy A of Form W-2, which will be the original return sent to the SSA
5. If the voided Form W-2 is on a page with a correct Form W-2, send the entire page to the SSA because it will not process the voided form

## Correcting Employee Name or SSN

If the only correction on the Form W-2 is the employee's name or SSN, follow these steps:

1. Complete only boxes d through i (the employer and employee identification section) of Form W-2c, leaving boxes 1-20 (the money amounts) blank



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2. Send the Form W-2c with a Form W-3c to the SSA
3. Advise the employee to correct the SSN and name on his or her original Form W-2



## **Practitioner Note** SSA's Change of Name or SSN

If the SSA issues a new card to an employee after a name change or with a different SSN, the employer should file a Form W-2c to correct the name or SSN reported on the most recently filed Form W-2.

### **Correcting EIN or Tax Year**

The IRS's e-file system will reject individual income tax returns if the employer's EIN is entered incorrectly on the employee's Form W-2. If an EIN is incorrect on the originally filed forms (or if the employer mistakenly used an incorrect year's Form W-2), the following steps should be taken:

1. Complete a Form W-2c for each affected employee as follows:
  - a. Enter the originally reported tax year and EIN in boxes b and e
  - b. Enter in the "Previously reported" boxes the dollar amounts reported on the original Form W-2
  - c. Enter zeros in the "Correct information" boxes
2. Prepare a second Form W-2c for each affected employee as follows:
  - a. Enter the correct tax year and correct EIN in boxes b and e
  - b. Enter zeros in the "Previously reported" boxes
  - c. Enter the correct amounts in the "Correct information" boxes

Each set of Forms W-2c must be sent to the SSA with its own Form W-3c.

### **Correcting Duplicate Form W-2**

To prepare a correction for an employee for whom more than one Form W-2 was filed under the same EIN for the tax year, do either of the following:

- Consider all the Forms W-2 when determining the amounts to enter on Form W-2c
- File a single Form W-2c to correct only the incorrect Form W-2

### **Example 13.21 Two Forms W-2 Filed for Same EIN—Only One Required**

LAMZ Company filed two Forms W-2 for Hannah Hardworker using the same EIN and tax year. One Form W-2 correctly reported social security wages of \$20,000, but the other Form W-2 incorrectly reported \$30,000 of social security wages. LAMZ has two options to correct Hannah's multiple Forms W-2: one option corrects her total reported social security wages, and the other option focuses only on her incorrect Form W-2. LAMZ can either

- file one Form W-2c, entering 50000.00 in box 3 under "Previously reported," and 20000.00 in box 3 under "Correct information"; or
- file one Form W-2c, entering 30000.00 in box 3 under "Previously reported," and 0.00 in box 3 under "Correct information."

A Form W-3c must be sent with either Form W-2c to the SSA.

### **HIRE Act Wages**

The Hiring Incentives to Restore Employment (HIRE) Act, Pub. L. No. 111-147, gave employers who hired certain previously unemployed workers in 2010 an exemption from the employer's 6.2% share of social security tax on qualifying wages paid from March 19, 2010, through December 31, 2010. The qualified wages and tips were reported in box 12 of the employee's 2010 Form W-2 with code CC.

If an employer needs to correct those wages and tips, the employer reports the correction in box 12 of Form W-2c using the same code CC.



## **Cross-Reference** HIRE Act

See pages 302–307 in the *2010 National Income Tax Workbook* for a discussion of the HIRE Act employment tax deduction and income tax credit.

**Example 13.22 HIRE Act Wages Correction**

In Rev. Rul. 2013-17, 2013-38 I.R.B. 201, the IRS announced that legal same-sex marriages will be recognized for federal tax purposes, and that these spouses may choose to be treated as married for federal tax purposes for any prior tax year that is still open under the I.R.C. § 6511 statute of limitations for credits or refunds.

Milo Mighty and his husband, Gray Skies, asked their tax practitioner to review their prior-year tax returns for any tax refund opportunities. Milo had paid for Gray’s health insurance through an employer-sponsored group health plan, and Milo’s employer, Rainbow Enterprises, had reported the cost of Gray’s coverage as a taxable fringe benefit for Milo. Because this amount is not a taxable fringe under Rev. Rul. 2013-17, Milo asked his employer to correct his 2010, 2011, and 2012 Forms W-2 (the open years).

Milo was a qualified HIRE Act employee in 2010. Rainbow reports the reduction to Milo’s taxable wages in boxes 1, 3, and 5 of a separate Form W-2c for each year, and reports the social security and Medicare tax reductions in boxes 4 and 6. Rainbow also reports the HIRE Act wage correction in box 12 of Milo’s 2010 Form W-2c with code CC.

Milo can use the Forms W-2c to file amended income tax returns as a married person. Rainbow must amend its Form 94X reporting for the 3 years to claim refunds or credits of both the employer and employee shares of social security and Medicare taxes, and it must repay the employee shares to Milo.

**Back Pay**


Form W-2c is **not** used to report payments made in the current year for compensation earned in a prior year (back pay). For income tax purposes the IRS treats all back pay as wages in the year paid. If a back pay award is not made under a statute, the SSA also credits back pay as wages in the year paid.

However, federal law requires the SSA to credit back pay awarded under a statute to an individual’s earnings record in the period the wages should have been paid. Wages not credited to the proper year may result in lower social security benefits or a failure to meet the requirements for benefits. The employer must notify the

SSA in a separate, special report when back pay is paid under a statute.

**Completing Form W-2c**

An employer must complete boxes a through d (which identify the employer) and boxes h and i (the employee’s name and address) on **all** Forms W-2c. The employer completes boxes e, f, and g if the employer is correcting the employee’s name or SSN.

 **Practitioner Note** Definition of Back Pay Awarded under Statute

*Back pay awarded under a statute* is a payment by an employer following an award, determination, or agreement approved or sanctioned by a court or government agency responsible for enforcing a federal or state statute that protects an employee’s right to employment or wages.

Delayed wage payments and retroactive pay increases resulting from a union negotiation or payments under local ordinances or regulations are not payments made under a statute.

See IRS Publication 957, *Reporting Back Pay and Special Wage Payments to the Social Security Administration*, and Form SSA-131, Employer Report of Special Wage Payments.

 **Practitioner Note** SSN and Name Originally Blank

If the employee name and SSN boxes were blank on the original Form W-2, the employer should not file a Form W-2c. Instead, the employer should contact the SSA at 800.772.6270.

An employer should enter amounts in boxes 1–20 only if the information is different from the information reported on the original Form W-2. If the employer wants to make an entry in box 14, the SSA requests that the entry be made only on copies B, C, 1, and 2 of Form W-2c but not on copy A, if that is possible.



## Practitioner Note Income Tax Amount

The amount reported in box 2 of Form W-2 as income tax withheld cannot be changed on a Form W-2c even if the reported wage amount in box 1 changes, unless the employer made an administrative error on the original Form W-2 (defined as entering an amount of tax that was not the amount actually withheld). The employee reports the actual tax withheld when filing his or her federal income tax return.

If the only changes to the original Form W-2 are to state or local data in boxes 15–20, the employer does not send copy A of Form W-2c to the SSA but instead files the Form W-2c with the state or local agency and furnishes copies to the employee.

## Example 13.23 Correcting Form W-2

Cray Company has one employee, Karen Kane. Her 2013 Form W-2 payroll information is shown in Figure 13.11. After Cray filed its Forms W-2 and W-3 with the SSA but before Karen filed her 2013 tax returns, Cray discovered that it had erroneously allowed Karen to elect a \$3,000 salary reduction medical flexible spending arrangement (health FSA) that exceeded the \$2,500 maximum for 2013. Cray repaid Karen the excess amount (net of the required withholding for social security and Medicare taxes) and prepared and filed Forms W-2c and W-3c to reflect this correction. Figure 13.11 shows Karen's 2013 payroll information that Cray Company used to complete the Form W-2c shown in Figure 13.12. Cray also corrected its payroll tax returns for 2013 and collected the employee share of the additional social security and Medicare taxes from Karen in 2014.

**FIGURE 13.11 Karen Kane's 2013 Payroll Information**

	Form W-2	Form W-2c
Gross wages	\$65,000.00	\$65,000.00
Health FSA contribution	(3,000.00)	(2,500.00)
Social security and Medicare wages (boxes 3 and 5)	\$62,000.00	\$62,500.00
401(k) plan contribution	(6,500.00)	(6,500.00)
Wages (boxes 1 and 16)	\$55,500.00	\$56,000.00
Federal income tax withheld (box 2)	(7,215.00)	(7,215.00)
State income tax withheld (box 17)	(2,220.00)	(2,220.00)
Social security tax withheld (box 4) (box 3 wages × 6.2%)	(3,844.00)	(3,875.00)
Medicare tax withheld (box 6) (box 5 wages × 1.45%)	(899.00)	(906.25)
Net pay	\$41,322.00	\$41,783.75
Employer-paid health insurance (box 12, code DD)	\$ 3,600.00	\$ 3,600.00

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FIGURE 13.12 Karen Kane's Form W-2c

13

44444		For Official Use Only ▶ OMB No. 1545-0008																																									
a Employer's name, address, and ZIP code  Cray Company 789 First St Chareleston SC 29401		c Tax year/Form corrected  2013 / W-2	d Employee's correct SSN  123-45-6789																																								
b Employer's Federal EIN 63-6363636		e Corrected SSN and/or name (Check this box and complete boxes f and/or g if incorrect on form previously filed.) <input type="checkbox"/>																																									
<p><b>Note:</b> Only complete money fields that are being corrected (exception: for corrections involving MQGE, see the Instructions for Forms W-2c and W-3c, boxes 5 and 6).</p> <table border="1"> <thead> <tr> <th>Previously reported</th> <th>Correct information</th> <th>Previously reported</th> <th>Correct information</th> </tr> </thead> <tbody> <tr> <td>1 Wages, tips, other compensation 55500.00</td> <td>1 Wages, tips, other compensation 56000.00</td> <td>2 Federal income tax withheld</td> <td>2 Federal income tax withheld</td> </tr> <tr> <td>3 Social security wages 62000.00</td> <td>3 Social security wages 62500.00</td> <td>4 Social security tax withheld 3844.00</td> <td>4 Social security tax withheld 3875.00</td> </tr> <tr> <td>5 Medicare wages and tips 62000.00</td> <td>5 Medicare wages and tips 62500.00</td> <td>6 Medicare tax withheld 899.00</td> <td>6 Medicare tax withheld 906.25</td> </tr> <tr> <td>7 Social security tips</td> <td>7 Social security tips</td> <td>8 Allocated tips</td> <td>8 Allocated tips</td> </tr> <tr> <td>9 Advance EIC payment</td> <td>9 Advance EIC payment</td> <td>10 Dependent care benefits</td> <td>10 Dependent care benefits</td> </tr> <tr> <td>11 Nonqualified plans</td> <td>11 Nonqualified plans</td> <td>12a See instructions for box 12</td> <td>12a See instructions for box 12</td> </tr> <tr> <td>13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/></td> <td>13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/></td> <td>12b</td> <td>12b</td> </tr> <tr> <td>14 Other (see instructions)</td> <td>14 Other (see instructions)</td> <td>12c</td> <td>12c</td> </tr> <tr> <td></td> <td></td> <td>12d</td> <td>12d</td> </tr> </tbody> </table>		Previously reported	Correct information	Previously reported	Correct information	1 Wages, tips, other compensation 55500.00	1 Wages, tips, other compensation 56000.00	2 Federal income tax withheld	2 Federal income tax withheld	3 Social security wages 62000.00	3 Social security wages 62500.00	4 Social security tax withheld 3844.00	4 Social security tax withheld 3875.00	5 Medicare wages and tips 62000.00	5 Medicare wages and tips 62500.00	6 Medicare tax withheld 899.00	6 Medicare tax withheld 906.25	7 Social security tips	7 Social security tips	8 Allocated tips	8 Allocated tips	9 Advance EIC payment	9 Advance EIC payment	10 Dependent care benefits	10 Dependent care benefits	11 Nonqualified plans	11 Nonqualified plans	12a See instructions for box 12	12a See instructions for box 12	13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>	13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>	12b	12b	14 Other (see instructions)	14 Other (see instructions)	12c	12c			12d	12d	f Employee's <b>previously reported</b> SSN	
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		i Employee's address and ZIP code 456 Third St Charleston SC 29401																																									
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For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Copy A—For Social Security Administration

Form **W-2c** (Rev. 2-2009)

**Corrected Wage and Tax Statement**

Cat. No. 61437D

Department of the Treasury  
Internal Revenue Service

**ISSUE 5: VOLUNTARY CLASSIFICATION SETTLEMENT PROGRAM**

Businesses that may have misclassified workers may voluntarily reclassify their workers as employees for future tax periods in return for limited employment tax liability for their past treatment of the workers as nonemployees.

The IRS launched a Voluntary Classification Settlement Program (VCSP) in September 2011 that allows businesses to reclassify one or more groups of workers for federal employment tax purposes for future tax periods [Announcement 2011-64, 2011-41 I.R.B. 503]. The settlement provides partial relief from the federal employment taxes that would be owed for prior periods if the IRS reclassified the workers.

Facts and circumstances determine whether a worker performing services is considered an employee or an independent contractor. A major factor is whether the service recipient has the right to direct and control the worker's performance of the services. In some situations the proper classification of a worker may not be clear or may not have been addressed.

**Eligibility Criteria**

To participate in the VCSP, a business must meet the following requirements:

- It has consistently treated the workers as nonemployees.
- It has filed all required Forms 1099-MISC, Miscellaneous Income, for the workers for the previous 3 years.
- It is not currently undergoing an IRS employment tax audit.
- Its treatment of the workers as nonemployees is not currently being audited by the Department of Labor or by a state government agency.

A taxpayer who was previously audited by the IRS or the Department of Labor concerning the classification of the workers is eligible to participate in the VCSP only if the taxpayer has complied with the results of that audit and is not currently contesting the classification in court.

After considering comments and suggestions from taxpayers and taxpayer representatives in

response to Announcement 2011-64, the IRS modified or clarified the VCSP rules in four ways [Announcement 2012-45, 2012-51 I.R.B. 724]:

1. The original audit restriction is eased, so that taxpayers undergoing an IRS audit that is not an employment tax audit may participate in the VCSP.
2. Participants are not required to agree to an extension of the normal 3-year statute of limitations for assessment of payroll taxes as part of the VCSP closing agreement.
3. Members of an affiliated group under I.R.C. § 1504(a) are not eligible to participate in the VCSP if any member of the group is undergoing an employment tax audit.
4. Taxpayers that are contesting in court the classification of workers from a previous IRS or Department of Labor (DOL) audit are not eligible to participate in the VCSP.

**Practitioner Note** CSP Offered by IRS Examiners

The Classification Settlement Program (CSP) that has been in existence since 1996 allows businesses and tax examiners to resolve worker classification cases at the beginning of the audit process. The taxpayer relief provisions under section 530 of the Revenue Act of 1978 are considered first. If the taxpayer is not eligible for full section 530 relief, and the IRS examiner then determines that the workers should be treated as employees, the examiner offers the taxpayer a closing agreement that reclassifies the workers as employees for future years and requires payment of a reduced amount of federal employment tax liabilities for past nonemployee treatment [Notice 98-21, 1998-1 C.B. 849, and Rev. Proc. 99-28, 1999-2 C.B. 109].

See the "Construction Contractors" chapter of this book for an explanation of the requirements for section 530 relief.

## Reduced Tax Liability

A VCSP closing agreement requires the business to treat the class or classes of workers as employees for future tax periods, and it requires the business to pay a small percentage of its potential liability for employment taxes.

- The business must pay 10% of its potential I.R.C. § 3509 liability for withholding taxes for the most recent tax year and 10% of the employer's share of FICA taxes on the employees' wages.
- No interest or penalty is charged.
- The business is sheltered from an employment tax audit with respect to the workers' classification in prior years.

## Application Process

A business applies for the VCSP by filing Form 8952, Application for Voluntary Classification Settlement Program (VCSP), at least 60 days before it plans to begin treating the workers as employees to allow the IRS time to process the application. IRS acceptance of the application is discretionary.

Part II of the form requires the name of a contact person. A valid Form 2848, Power of Attorney and Declaration of Representative, must be attached if the contact person is not the taxpayer.

The taxpayer (not the taxpayer's representative) must sign Form 8952. For a corporation or an LLC taxed as a corporation, the signature may be that of any officer authorized to sign; for a partnership, a general partner must sign. For an LLC classified as a partnership, the form must be signed by a member or manager who is authorized to sign the LLC's Form 1065, U.S. Return of Partnership Income.

The IRS will communicate with the contact person after it has reviewed the application and verified the taxpayer's eligibility. If the application is accepted, a closing agreement finalizes the VCSP terms, and the taxpayer pays the full amount due under the closing agreement at that time.

## Payment Calculation

When the IRS reclassifies a worker as an employee, I.R.C. § 3509 imposes a special liability in lieu of the full amount of income and FICA taxes that the employer should have withheld from the reclassified employees' wages for the most recently closed tax year.

The tax liability for income tax that was not withheld is 1.5% of the worker's wages. The reduced liability for the employee's share of FICA taxes is 20% of the amount that should have been withheld. Both assessments are doubled if the business did not file information returns.

These payments are considered a penalty for noncompliance because the employee does not receive credit for the amounts paid by the employer, the employer does not receive credit for any tax payments previously made by the employee, and the employer is not permitted to recover the I.R.C. § 3509 payment from the employee.

The I.R.C. § 3509 reduced rate calculations apply only to the withholding liability; the employer still owes its full matching share of FICA taxes. The VCSP provides an incentive for compliance by requiring businesses to pay only 10% of the I.R.C. § 3509 reduced amount and only 10% of the employer share of FICA taxes.



### Practitioner Note

Voluntary Payment Is Lower Than CSP

By contrast, a CSP closing agreement requires payment of at least 25% and sometimes 100% of the I.R.C. § 3509 amount.

The I.R.C. § 3509(a) rate is determined at the time the taxpayer files the VCSP application. The combined rate for tax withholding (income tax and the employee's share of FICA taxes) and the employer's share of FICA taxes is generally 10.68%. However, for 2011 and 2012 the combined rate is 10.28% for compensation up to the social security wage base and 3.24% for compensation above the social security wage base. Figure 13.13 shows the calculation of these rates.

The 10.28% and 3.24% rates apply to 2013 VCSP applications because the most recently closed tax year is 2012.

## FIGURE 13.13 VCSP Rates for Compensation Paid

	Compensation Subject to the Social Security Tax Wage Base		Additional Compensation
	2011 and 2012	2010 and 2013	All Years
Federal income tax withholding	1.50%	1.50%	1.50%
Employee social security tax <sup>1</sup>	0.84%	1.24%	0.00%
Employer social security tax	6.20%	6.20%	0.00%
Employee Medicare tax <sup>2</sup>	0.29%	0.29%	0.29%
Employer Medicare tax	1.45%	1.45%	1.45%
<b>Total</b>	<u><u>10.28%</u></u>	<u><u>10.68%</u></u>	<u><u>3.24%</u></u>

<sup>1</sup> 2011 and 2012:  $4.2\% \times 20\% = 0.84\%$ ; 2010 and 2013:  $6.2\% \times 20\% = 1.24\%$

<sup>2</sup>  $1.45\% \times 20\% = 0.29\%$

Form 8952 first applies the 3.24% rate to all compensation (line 19) and then subtracts compensation that exceeds the social security wage base. A 7.04% rate (10.28% – 3.24%) is then applied to the compensation included in the social security wage base (line 22). The two amounts are totaled to arrive at the I.R.C. § 3509 amount on line 23 before the 10% calculation is made on line 24.

### Example 13.24 Determining a VCSP Payment

In 2012 Bob’s Builders paid \$150,000 to four drywallers and reported the payments on Forms 1099-MISC. Its owner, Robert Robertson, now wants to reclassify those workers as employees. None of the workers earned more than the social security wage base. Robert wants to begin treating this class of workers as employees on January 1, 2014, so he submitted his VCSP application by October 1, 2013.

Part IV of Form 8952, “Payment Calculation Using Section 3509(a) Rates,” begins with the \$150,000 amount Robert paid the workers in 2012 because 2012 was the most recently completed tax year at the time Robert filed his application.

Robert’s reduced I.R.C. § 3509(a) liability for income tax and FICA tax withholding combined with the employer’s share of FICA tax is \$15,420 ( $10.28\% \times \$150,000$ ). If his application is approved, the VCSP payment due at the time of the closing agreement will be \$1,542 ( $10\% \times \$15,420$ ). Figure 13.14 shows Bob’s Builders’s completed Form 8952.

FIGURE 13.14 Bob's Builders' Form 8952 (page 1 of 2)

Form **8952**

(Rev. November 2013)

Department of the Treasury  
Internal Revenue Service

**Application for Voluntary  
Classification Settlement Program (VCSP)**

▶ Do not send payment with Form 8952.

▶ Information about Form 8952 and its separate instructions is at [www.irs.gov/form8952](http://www.irs.gov/form8952).

OMB No. 1545-2215

**Caution.** Taxpayer must make certain representations in order to be eligible to participate in the VCSP. These representations can be found in Part V on page 2.

**Part I Taxpayer Information**

<b>1</b> Taxpayer's name Robert Robertson, dba Bob's Builders	<b>2</b> Employer identification number (EIN) 99-0008952
<b>3</b> Number and street (or P.O. box number if mail is not delivered to a street address) 123 Main Street	Room/Suite
<b>4</b> City, town or post office, state, and ZIP code Anytown, USA 99999	
<b>5</b> Telephone number 888.888.8888	<b>6</b> Website address (optional)
<b>7</b> Fax number (optional)	<b>8</b> Email address (optional)
<b>9</b> Type of entity. Check the applicable box: <input checked="" type="checkbox"/> Sole proprietorship <input type="checkbox"/> Cooperative organization described in section 1381 of the Internal Revenue Code <input type="checkbox"/> Joint venture <input type="checkbox"/> Tax-exempt organization <input type="checkbox"/> Partnership <input type="checkbox"/> State or local government (for worker class or position not covered under a section 218 agreement) <input type="checkbox"/> C corporation <input type="checkbox"/> Other (specify here) _____ <input type="checkbox"/> S corporation	
<b>10</b> Are you a member of an affiliated group? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If "Yes," complete the common parent information on lines 11-14. If "No," skip to Part II.	
<b>11</b> Name of common parent of the affiliated group	<b>12</b> EIN of common parent
<b>13</b> Number and street (or P.O. box number if mail is not delivered to a street address) of common parent	
<b>14</b> City, town or post office, state, and ZIP code of common parent	

**Part II Contact Person**

Attach a properly completed Form 2848, Power of Attorney and Declaration of Representative, if applicable.

- Name and title of contact person Robert Roberson
- Contact person's number and street (or P.O. box number if mail is not delivered to a street address) 123 Main Street
- Contact person's city, town or post office, state, and ZIP code Anytown, USA 99999
- Contact person's telephone number 888.888.8888
- Contact person's fax number (optional) \_\_\_\_\_
- Contact person's email address (optional) \_\_\_\_\_

**Part III General Information About Workers To Be Reclassified**

<b>15</b> Enter the total number of workers from all classes to be reclassified. A class of workers includes all workers who perform the same or similar services.  4	<b>16</b> Enter a description of the class or classes of workers to be reclassified. If more space is needed, attach separate sheets (see instructions).  Drywall installers
<b>17</b> Enter the beginning date of the employment tax period (calendar year or quarter) for which you want to begin treating the class or classes of workers as employees. This date should be at least 60 days after the date you file Form 8952 (see instructions).  01 / 01 / 2014	



## FIGURE 13.14 Bob's Builders' Form 8952 (page 2 of 2)

Taxpayer's name <b>Robert Robertson</b>		Employer identification number (EIN) <b>99-0008952</b>	
<b>Part IV Payment Calculation Using Section 3509(a) Rates</b> (see instructions)			
18 Enter total compensation paid in the most recently completed calendar year to all workers to be reclassified (see instructions)	<b>18</b>	150,000	
19 Multiply line 18 by 3.24% (.0324)	<b>19</b>		4,860
20 Enter any compensation included on line 18 that exceeded the social security wage base for any worker or workers for the most recently completed calendar year (see instructions)	<b>20</b>	0	
21 Subtract line 20 from line 18	<b>21</b>	150,000	
22 Multiply line 21 by 7.44% (.0744) [7.04% (.0704) for compensation paid prior to 2013]	<b>22</b>		10,560
23 Add lines 19 and 22	<b>23</b>		15,420
24 Multiply line 23 by 10% (.10). This is the VCSP payment you will pay when you submit your signed closing agreement (see instructions)	<b>24</b>		1,542

### Eligibility Expansion Was Temporary

Announcement 2012-46, 2012-51 I.R.B. 725, opened a 6-month window for VCSP participation to taxpayers that during the prior 3 years had not filed all of their required Forms 1099-MISC for the reclassified workers. This eligibility expansion expired on June 30, 2013.

Participants were required to file all of the delinquent Forms 1099, and the required payment determined under the expansion provision was 25% (instead of 10%) of the I.R.C. § 3509(a) amount for the workers' compensation paid in

the most recently closed tax year, plus a penalty based on the total number of unfiled Forms 1099 for the prior 3 years. The payment was calculated on a worksheet attached to Announcement 2012-46.



#### **Cross-Reference**

VCSP Q&As

Answers to frequently asked questions about the VCSP can be found on page 132 in the *2012 National Income Tax Workbook* and online at [www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Voluntary-Classification-Settlement-Program-\(VCSP\)-Frequently-Asked-Questions](http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Voluntary-Classification-Settlement-Program-(VCSP)-Frequently-Asked-Questions).

### ISSUE 6: VOLUNTEERS AND UNPAID INTERNS Unpaid internships have been headline news this year, and benefits provided to volunteer workers can be problematic.

The Fair Labor Standards Act (FLSA) sets minimum wage and overtime pay requirements for covered workers and nonexempt employees, but there are two major exceptions to those rules: interns and volunteers. The Internal Revenue Code addresses the topic only in terms of fringe benefits and charitable contributions, but employers need to be aware of their Department of Labor (DOL) responsibilities as well because a DOL employment audit can result in liability to pay back wages and the associated employment taxes.

Individuals who volunteer or donate their services, usually on a part-time basis, for civic, charitable, or humanitarian reasons, without expectation of pay, are not considered employees of the nonprofit organizations that receive their services [29 C.F.R. § 553.101].

Employees cannot volunteer services to for-profit private sector employers. Most individuals can volunteer services to public sector employers such as community agencies, but public sector employers may not allow their employees to volunteer, without compensation, additional time to do the same work for which they are employed.

Unpaid internships in the public sector and for nonprofit charitable organizations, where the intern volunteers without any expectation of compensation, are generally permissible. Unpaid internships in for-profit businesses are allowed only when the individual is receiving training for his or her own educational benefit and only when the training meets DOL criteria. If the employer provides job shadowing opportunities that allow an intern to learn certain functions under the close and constant supervision of regular employees, but the intern performs no or minimal work, the activity is more likely to be viewed as a bona fide education experience.

## Definitions

Defining who is a *volunteer* and who is an *unpaid intern* is the first step in evaluating the proper tax treatment of cash and noncash benefits offered to these individuals.

### Volunteers

Treas. Reg. § 1.132-5(r)(3)(i), which provides guidance for working condition fringe benefits, states that an individual is a bona fide volunteer if the individual does not have a profit motive for purposes of I.R.C. § 162. A volunteer is considered to lack a profit motive if the total value of the benefits the individual receives for his or her services to a tax-exempt organization or government agency is substantially less than the total value of the volunteer services the individual provides to the organization.

The term *volunteer* is defined in 42 U.S.C. § 14505(6) as an individual who performs services for a nonprofit organization or a governmental entity and does not receive more than \$500 in compensation (other than a reasonable reimbursement or allowance for expenses actually incurred), or anything else of value in lieu of compensation. A volunteer for this purpose may serve as a director, officer, trustee, or direct service volunteer for the organization.

DOL Opinion Letter FLSA2001-18 (July 31, 2001), which is accessible online at [www.dol.gov/whd/opinion/FLSA/2001/2001\\_07\\_31\\_18\\_FLSA.htm](http://www.dol.gov/whd/opinion/FLSA/2001/2001_07_31_18_FLSA.htm), responded to a nonprofit hospital's request for an opinion as to whether participation in community service activities by its nurses on their

days off or during other nonwork hours was compensable under the FLSA.

The opinion letter identifies six factors that the DOL considers in determining whether an employee's involvement in a community activity is "ordinary volunteerism."

1. The nature of the entity receiving the services
2. The receipt (or expectation of receipt) by the worker of any benefits from the entity that receives the services
3. Whether the activity is less than a full-time occupation
4. Whether regular employees are displaced
5. Whether services are offered freely, without pressure or coercion
6. Whether the services are of the kind typically associated with volunteer work

The DOL said that when the community service activities were employer sponsored, the nurses could not be treated as volunteers, but if the activities were under the control of other entities, the nurses' participation would be "ordinary volunteerism" if the criteria are satisfied.

Examples of ordinary volunteerism include a city police officer who volunteers as a part-time referee in a basketball league sponsored by the city, an employee of the city parks department who serves as a volunteer city firefighter, and an office employee of a city hospital who volunteers to spend time with a disabled or elderly person in the same institution during off-duty hours as an act of charity [29 C.F.R. § 553.103].

### Unpaid Interns



#### Observation Medical and Other Paid Interns

This issue does not address the employment classification of individuals who have recently graduated from school and must complete a period of practical training. Although they are called interns, they are employees and are not interns under the DOL definition.

The determination of whether an internship or training program is providing training for the intern's educational benefit depends on all the facts and circumstances, the DOL explains in its Wage and Hour Division's "Fact Sheet

#71,” dated April 2010 and accessible online at [www.dol.gov/whd/regs/compliance/whdfs71.htm](http://www.dol.gov/whd/regs/compliance/whdfs71.htm).

In general, the more an internship program is structured around a classroom or academic experience as opposed to the employer’s actual operations, the more likely the internship will be viewed as an extension of the individual’s educational experience (this often occurs where a college or university exercises oversight over the internship program and provides educational credit). The more the internship provides the individual with skills that can be used in multiple employment settings, as opposed to skills particular to one employer’s operation, the more likely the intern would be viewed as receiving training. Under these circumstances the intern does not perform the routine work of the business on a regular and recurring basis, and the business is not dependent upon the work of the intern. On the other hand, if the interns are engaged in the operations of the employer or are performing productive work (for example, filing, performing other clerical work, or assisting customers), then the fact that they may be receiving some benefits in the form of a new skill or improved work habits will not exclude them from the FLSA’s minimum wage and overtime requirements because the employer benefits from the interns’ work.

The fact sheet lists six factors that the DOL applies in determining whether an intern is actually an employee. There is no employment relationship if all six standards are met.

1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training which would be given in an educational environment.
2. The internship experience is for the benefit of the intern.
3. The intern does not displace regular employees, but works under close supervision of existing staff.
4. The employer that provides the training derives no immediate advantage from the activities of the intern; and on occasion its operations may actually be impeded.

5. The intern is not necessarily entitled to a job at the conclusion of the internship.
6. The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

## Payments and Benefits

*Unpaid* does not necessarily mean that the volunteer or intern receives no financial assistance. Organizations may provide volunteers or interns with items needed to perform their services, reimburse them for out-of-pocket costs, provide reasonable fringe benefits, and sometimes pay a nominal stipend.

## Expenses

Treas. Reg. § 1.132-5(r)(1) provides that for purposes of I.R.C. § 132(d) and Treas. Reg. § 1.132-5(a)(1), a bona fide volunteer (including a director or officer) who performs services for a tax-exempt organization or a government employer is deemed to have a profit motive under I.R.C. § 162.

I.R.C. § 132(d) and Treas. Reg. § 1.132-5(a)(1) state that gross income does not include the value of a *working condition fringe*, defined as any property or service provided by an employer to an employee if the employee could deduct the expense under I.R.C. § 162 (ordinary and necessary business expenses) or 167 (depreciation) if the employee paid for the property or service.

Thus an organization might provide unpaid personnel (for example, school crossing guards) with uniforms or uniform allowances and an allowance for maintaining a required uniform, meals or a meal allowance while on duty, and reimbursements for transportation expenses (including parking).

## Benefits

Individuals do not lose their volunteer status if the organization provides reasonable benefits, such as liability insurance coverage, for the volunteer’s services [Treas. Reg. § 1.132-5(r)(3)(ii)]. The organization may also provide benefits such as reasonable length of service awards; free or discounted admission to the organization’s events; and free training, including books and supplies.