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## Employment Payroll Tax Basics

### Introduction

Hiring employees is a sign that your farm is growing. But rules governing payroll taxes can be complex. Payroll taxes are generally calculated as a percentage of the salary that employers pay their staff. Farms that employ workers must withhold money from their employees' paychecks, timely submit withheld amounts to the appropriate tax authorities, and file payroll tax returns with state and federal agencies. This guide outlines what payroll taxes are, and how and when to pay them.

This guide can help you get started with payroll tax basics, but this is a complicated topic. It is important to consult with a tax professional to be sure you're on the right track. Some farms may opt to use a payroll management service to help manage payroll taxes.

### What are Payroll Taxes?

Payroll taxes are the taxes that an employer withholds from the salary and other wages of his or her employees, together with those that the employer must directly pay. These include federal, state, and sometimes local income taxes, Social Security and Medicare taxes, federal and state unemployment taxes, and, in some states, disability insurance taxes.

### Who is Responsible for Payroll Taxes?

The farm is responsible for collecting and remitting payroll taxes from wages it pays to its employees and for paying the employer's share of payroll taxes on those wages. Individuals who are self-employed or operating as independent contractors are generally not considered employees for payroll tax purposes. A separate set of rules applies to such individuals.

### What Are Taxable Wages?

Payroll taxes are based on the taxable wages of the employee. Taxable wages include salary, bonuses and the value of in-kind compensation, such as room and board. Generally, reimbursements of business expenses incurred by the employee are not considered wages. Such expenses must be ordinary and necessary expenses related to the business, must have been incurred by the employee while performing services as an employee of the business, and must be substantiated by the employee to the employer within a reasonable period of time (generally by providing receipts).

Non-cash compensation, like room and board, provided to agricultural employees (discussed below) is generally not subject to Social Security taxes, Medicare taxes, or federal income tax withholding. However, the value of such non-cash compensation must be reported on the employee's Form W-2 and will be subject to federal income tax unless a specific exclusion applies.



## Types of Payroll Tax

### 1. *Federal Insurance Contributions Act (FICA)*

The Federal Insurance Contributions Act (FICA) taxes employers and employees to fund Social Security and Medicare. A portion of these taxes are paid by the employee (withheld from paycheck) and a portion by the employer. The Social Security tax rate for employees is 6.2% on wages paid up to the Social Security wage base. The employer matches this withholding with by paying an additional 6.2% Social Security tax on those wages, for a total of 12.4%. The Social Security wage base is adjusted each year and is \$132,900 for 2019. The Medicare tax rate for employees is 1.45% on all wages. This is similarly matched by employers for a total of 2.9%. There is no cap on Medicare taxes. Wages in excess of \$200,000 are subject to an additional 0.9% Medicare tax that must be withheld from the employee's paycheck (such that the employee pays a total Medicare tax of 2.35% on wages over \$200,000). There is no employer share of the additional 0.9% Medicare tax.

### 2. *Federal Unemployment Tax Act (FUTA)*

The Federal Unemployment Tax Act (FUTA) created a tax for employers that funds unemployment benefits. Generally, employers must pay this tax if:

- the employer pays wages totaling at least \$1,500 in any calendar quarter in a calendar year or the preceding calendar year, or
- the employer has at least one employee on any day in any 20 or more weeks in a calendar year or the preceding calendar year (regardless of if these weeks are consecutive).

The FUTA tax rate is 6% and applies to the first \$7,000 in wages paid to each employee annually. However, most employers qualify for a credit of up to 5.4% for amounts paid into *state* unemployment funds, making their total FUTA tax liability as low as 0.6%, or only \$42 a year per employee. Employees do not pay FUTA taxes.

Organizations with 501(c)(3) status are exempt from FUTA tax. A different set of FUTA rules applies to wages paid to farm workers (see below). You should check with an accountant or tax expert to determine if these rules apply to your workers.

### 3. *State Unemployment Tax Act (SUTA)*

State unemployment taxes vary by state and are usually paid by employers<sup>1</sup>. Each state sets its own tax rates and wage base for taxation. Even within a single state, there may be no single rate that all employers pay. Some states assign every employer an individual unemployment tax rate. This tax rate is referred to as an *assessment* and can be based on employer's experience, number of unemployment

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<sup>1</sup> New Jersey, Pennsylvania and Alaska require employees to pay state unemployment taxes.

claims made by previous employees or industry type. For example, industries with historically higher turnover rates may have a higher tax rate.

On a state-by-state basis, some agricultural employees are exempt from SUTA taxes or follow the federal exemption guidelines.

SUTA taxes are typically paid on a quarterly basis. Taxes are generally based on the state where the employee performs the service, not where the employee lives.

#### *4. Federal, State and Local Income Taxes*

Federal, state and local income tax on wages are paid by the employee only. Employees must complete and submit to the employer a Form W-4 showing their filing status as well as their number of exemptions. The employer withholds taxes from employees' paychecks based on the information provided in the Form W-4 and forwards the withheld amount to the appropriate agency.

IRS Publication 15 (Circular E), Section 17: Federal Income Tax Withholding Methods provides guidance on how to withhold Federal income tax from employee wages.

Most states have income tax on wages as well<sup>2</sup>. Check with state tax authorities to determine the tax rates for your state.

Occasionally, there are also local income taxes. Check with local tax authorities to determine the tax rates for your town or municipality.

### **Farm Specific Considerations**

#### *Definition of Agricultural Labor*

Federal laws exempt "agricultural labor" from some payroll tax requirements. Some states may also have agricultural labor exemptions. Agricultural labor generally includes activities related to the farming operations, for example, the **growing and harvesting** of agricultural or horticultural products. However, activities that do not take place on the farm or are tangential to the farm operation, for example, **selling or processing farm products**, typically are not considered agricultural labor. The table below identifies some tasks that are considered agricultural labor or non-agricultural labor.

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<sup>2</sup> Alaska, Florida, Nevada, South Dakota, Texas, Washington, New Hampshire, Tennessee and Wyoming do not impose income tax on wages.

AGRICULTURAL LABOR
Cleaning, sorting and packing of harvested crops, e.g., sorting, cleaning and packing grapes
Raising livestock or poultry
Repair and maintenance of farm property and equipment
NON-AGRICULTURAL LABOR
Processing produce, e.g., making jelly from grapes
Selling produce in a farm stand or farmers' market
Agritourism or educational events on the farm
Handling of agricultural or horticultural products where the farm produced less than 50% of the produce

### *Agricultural Labor Exemptions*

- *Federal Insurance Contributions Act (FICA)* - A farm must withhold Social Security and Medicare taxes (FICA) from an employee's cash wages and remit the withheld portion to the IRS when either of the following happens: when the farm pays the employee \$150 or more in cash wages per year OR the farm pays an aggregate of \$2,500 or more in cash or non-cash wages to all employees for farm work during the year. If the farm uses non-agricultural labor, FICA taxes must be withheld and remitted on those wages under the general rules described above.
- *Federal Unemployment Tax Act (FUTA)* - Farms must pay FUTA taxes if: (1) they pay wages to farm workers of \$20,000, or more, in any calendar quarter in the calendar year or the preceding calendar year; or (2) employed 10 or more farm workers during at least some part of a day during any 20 or more different weeks in the calendar year or the preceding calendar year. The 20 weeks do not have to be consecutive weeks, nor must they be the same 10 employees, nor must all employees be working at the same time. Once a farm passes this threshold, the regular FUTA rules apply.
- *State Unemployment Tax Act (SUTA)* - Generally, agricultural employers are also subject to state unemployment taxes. Some follow the Federal exemption guidelines. Farms should consult the appropriate state agencies for both state definition of 'agricultural labor' (which may differ from Federal definition) and state specific exemptions.
- *Federal, State and Local Income Taxes* - Farms must withhold Federal income tax from the wages of farm workers if the wages are subject to FICA taxes. Generally, non-cash wages paid to farm workers are not subject to Federal income tax withholding. However, the employee may request additional income tax withholding by submission of a W-4 form. The farm must also withhold income tax from an agricultural worker when he or she is doing non-agricultural work.

### *H-2A Visa Workers*

Many farmers employ H-2A workers for agricultural work. Separate duties apply to these workers. Employers should make sure that the employee has a verified H-2A visa before assessing payroll taxes. H-2A workers are not subject to the FUTA tax (although wages paid to H-2A workers count toward the FUTA threshold tests described above). They are also not subject to Social Security or Medicare (FICA) taxes. Farms are not required to withhold Federal income tax from wages of H-2A farm workers, however, they may do so if requested by the H-2A worker by submission of a Form W-4.

## **Employer Obligations**

### *Reports*

- Employers are required to provide quarterly and annual reports to the federal Internal Revenue Service (IRS) on their payroll withholding and payments.
- Employers must file Form 941, Employer's Quarterly Federal Tax Return each quarter. This form reports the federal income taxes you withheld and the FICA taxes you withheld and paid during a quarter. (Employers who qualify for annual reporting file Form 944.)
- FUTA taxes are reported annually and are filed through Form 940.
- Agricultural employers file Form 943, Employer's Annual Federal Tax Return for Agricultural Employees to report agricultural wages. If a farm employs both farm workers and non-farm workers, the employment taxes for each group of employees should be reported separately.
- At the end of the year, the employer must also complete Form W-2, Wage and Tax Statement for each employee to report wages, tips and other compensation paid to the employee. A copy is provided to the employee and the appropriate state tax collection agencies.
- The Forms W-2 of all employees are submitted with Form W-3, Transmittal of Wage and Tax Statements, to the Social Security Administration. Form 3 summarizes all the W-2 information from all the farm's employees. For more information on depositing and filing these forms, refer to Publication 15, Employer's Tax Guide or Publication 51, the Agricultural Employer's Tax Guide. It is important to maintain a copy of all these filings and proof of payment for at least four years for recordkeeping purposes.

### *Payments*

- Employers are required to timely pay (or withhold and remit, as applicable) all the taxes that have been discussed in this guide. Federal payroll taxes are paid to the Internal Revenue Service (IRS) through the Electronic Federal Tax Payment System (EFTPS). The IRS has two deposit schedules for Social Security, Medicare and income taxes: monthly and semi-weekly. Your deposit schedule is based on your total tax liability reported on Form 941 (or Form 943, as applicable), with larger payrolls required to pay on the more frequent, semi-weekly basis. It is important to deposit these taxes on time because late penalties of up to 15% and interest can apply.

- FUTA taxes are generally paid on a quarterly basis. Whenever FUTA tax liability exceeds \$500 during a quarter (including rolled-over amounts as described in the following sentence), you must deposit the tax. If your tax liability is \$500 or less during a quarter, you can roll it over to the next quarter. If tax liability is less than \$500 for the year, the final total can be paid at end of year.
- State agencies will generally have their own electronic or manual processes to submit state payroll taxes.

## Conclusion

Due to the complexity of payroll taxes, keeping clear and organized systems to track payroll and calculate taxes is important. IRS publications such as Publication 15: Employer's Tax Guide and Publication 51: Agricultural Employer's Tax Guide provide many helpful details and examples.

While it is important to know what is required of you as an employer, you may consider outsourcing your payroll tax duties to a payroll service. If you choose this route, know that you are still responsible if your payroll servicer fails to perform a necessary duty of yours. It is important to thoroughly research what this service will include and how convenient this method will be.

## Other Resources

- Your Payroll Responsibilities if you Outsource - <https://www.irs.gov/businesses/small-businesses-self-employed/outsourcing-payroll-duties>
- Publication 15 (2019), (Circular E), Employer's Tax Guide <https://www.irs.gov/publications/p15>
- Publication 51 (2019), (Circular A), Agricultural Employer's Tax Guide, <https://www.irs.gov/pub/irs-pdf/p51.pdf>
- A Farmer's Guide to Employment Laws in Rhode Island by Gina A. DiCenso and Erika Kyzmir-McKeon, <https://www.legalfoodhub.org/wp-content/uploads/2019/01/RI-Farmers-Employment-Guide.pdf>
- Employment Law for Massachusetts Farmers by Andrew Dennington, Mary O'Neal, and Henry Tran, <https://www.legalfoodhub.org/wp-content/uploads/2018/01/Employment-Law-Booklet.pdf>

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