

EMPLOYMENT TAXES

**Powerful Ideas: Using a
Common Paymaster
to Reduce Taxes**



Using a Common Paymaster to Reduce Taxes

Each employer is generally responsible for the collection and remittance of Federal Insurance Contributions Act (FICA) taxes, which include Social Security and Medicare taxes for all of its employees. This includes businesses that have common ownership. In addition, each individual is responsible for paying FICA taxes on the wages he or she receives. The Social Security portion of FICA applies only to wages up to \$137,700 (in 2020) with the Medicare tax rates being applied to all wages. When an individual is employed by more than one corporation, it is possible to pay Social Security taxes on wages in excess of this annual cap. Though an employee who pays FICA taxes in excess of the cap receives a credit to offset the taxes paid (reported on Line 71 of Form 1040), the employers do not receive a corresponding credit for the excess amounts paid.

How Can Owners of Multiple Businesses Avoid Overpaying FICA Taxes?

If a business owner operates more than one C and/or S corporation (or LLC taxed as such), he/she may be able to avoid overpaying FICA taxes by utilizing a Common Paymaster. When an employee is concurrently employed by two or more related employers and compensated through a Common Paymaster, the aggregate dollar amount for FICA taxes is no more than the taxes imposed upon a single employer. This means that rather than each employer paying FICA taxes for their shared employees, the Common Paymaster calculates and remits the taxes just once, as if the two employers were a single employer.

For a corporation (or an entity taxed as such) to be a Common Paymaster (1) the employers must be considered related under the tests supplied in Treas. Reg. §31.3121(s)-1 (see below), (2) the Common Paymaster must be a member of the related group, and (3) there is concurrent employment by one or more of the related employers. Corporations are considered related under Treas. Reg. §31.3121(s)-1 if they meet any one of the following:

- The corporations are members of a controlled group (with a 50%, rather than 80%, minimum ownership test);
- The corporations have common holders of at least 50% voting power;
- At least 50% of the corporation's officers are also officers of the other corporation(s); or
- At least 30% of one corporation's employees are concurrently employed by the other corporation(s).

If any one of these tests is met, an employer can elect to have one of the related companies act as the Common Paymaster. That company (the Common Paymaster) would then be responsible for filing information and tax returns and issuing Form W-2 with respect to the wages it pays on behalf of itself and any related companies (and any additional companies to which the rules would apply). Each company must pay its own part of the employment taxes and may deduct only its own part of the wages. The deductions won't be allowed unless the corporation reimburses the Common Paymaster for the wage and tax payments.

If the Common Paymaster fails to remit these taxes, it will remain liable for the full amount of the unpaid portion of these taxes. In addition, each of the other related corporations using the Common Paymaster is jointly and severally liable for its allocable share of these taxes.

Electing a Common Paymaster

In order to utilize a Common Paymaster, the corporations must be related as described above, the corporations must authorize one of the corporations to be the Common Paymaster, and the employees must work concurrently for the corporations. The authorization is in the form of an agreement between the corporations stating the duties of all parties. However, no form is required to be filed with the IRS regarding the Common Paymaster.

How Does the Common Paymaster Work?

Assume that Mike is the 100% owner of two S corporations (Brady Architects and Brady Construction), and he and his sons, Peter and Greg, are employed by and perform services for both businesses. The businesses are very successful and Mike, Greg and Peter each receive a \$200,000 salary from both companies. Neither company is a Common Paymaster, therefore they are both responsible for collecting and remitting FICA taxes on behalf of their employees as well as withholding FICA taxes from Mike's, Greg's and Peter's wages.

As a result, each company paid \$11,437 for FICA taxes ($\$137,700 \times 6.2\% + \$200,000 \times 1.45\%$) for Mike, Greg and Peter and withheld and remitted \$11,437 from Mike, Greg and Peter for their share of Social Security taxes. This results in total combined taxes paid by the companies of \$34,311 and \$34,311 withheld for Mike's, Greg's and Peter's shares.

Mike, Greg and Peter will each receive a credit for \$11,437 for the overpayment of their FICA taxes on their individual tax returns, however, the companies will not receive a corresponding credit. Because the companies do not receive a credit, Mike's income has been reduced by \$34,311 because his companies have overpaid Mike's, Greg's and Peter's combined Social Security taxes.

However, if Mike elects to have one of the companies operate as a Common Paymaster, the Common Paymaster would be responsible for filing information and tax returns and issuing Form W-2 for wages for both companies. This will result in tax savings to Mike of \$34,311.

This tax-related discussion reflects an understanding of generally applicable rules and was prepared to assist in the promotion or marketing of the transactions or matters addressed. It is not intended (and cannot be used by any taxpayer) for the purpose of avoiding any IRS penalties that may be imposed upon the taxpayer. Unless otherwise noted in the material, tax specific information, such as rates, credits, exclusions, exemptions and deductions are specific to 2020. New York Life Insurance Company, its agents and employees may not give legal, tax or accounting advice. Individuals should consult their own professional advisors before implementing any planning strategies. The Nautilus Group® is a service of New York Life Insurance Company. SMRU 1766707 Exp. 1.30.2022