

Third Party Sick Pay and Federal Employment Taxes

Most employers provide some degree of wage protection for employees who miss work due to personal illness or injury. Sick pay paid directly by an employer generally is treated as ordinary wages, subject to withholding for federal employment taxes. FICA taxes, however, apply to such payments only for the first six months.

If sick pay is provided through a third party, such as an insurance company, income tax withholding does not apply unless requested by the employee. For purposes of FICA, the third-party payer of sick pay is considered the employer and is responsible for withholding, paying, depositing and reporting taxes on sick payments unless this responsibility is transferred to the actual employer.

Any portion of sick pay paid by a third party that is attributable to the employee's own premium contribution is not wages and is not subject to withholding. However, when premium contributions are made with pre-tax dollars under the employer's cafeteria plan and deferred from taxation, then any sick pay paid by a third party to the employee is subject to FICA and FIT withholding.

Sick or Disability Payments Made by a Third Party

Income Taxes:

Where sick pay benefits are paid by an insurance company or other third party, withholding for income taxes is not automatically required. Federal income taxes must be withheld by the payer only if requested by the employee receiving sick pay.

An employee elects to have federal income tax withheld by submitting Form W-4S to the third party. Once requested, the third-party payer must begin withholding from payments made eight days after receipt of the Form W-4S. A withholding request remains effective until canceled or changed.

Withholding from third-party sick pay is not based on the regular withholding tables. Employees must specify on Form W-4S a whole dollar amount to be withheld. The minimum amount of withholding that employees may request is \$20 per week.

FICA:

Sick pay is generally subject to employee and employer FICA withholding, if the employee is covered by social security for service performed in their job. The governmental employer should communicate to the third party payer the employee's social security and medicare coverage status.

If the employee is covered for social security and medicare, FICA taxes apply to sick-pay payments only through the first six full calendar months following the month in which the

This fact sheet was designed to provide awareness of social security coverage and reporting responsibilities for Kentucky state and local government employers. This fact sheet should not be cited or used as authority with respect to federal employment taxes. The Internal Revenue Code and the Social Security Act, along with the associated regulations, rulings and case law, are the only valid citations of authority. Additional instructions are available in IRS Publication 15-A, Employer's Supplemental Tax Guide.

employee's leave of absence began. Payments made after the six-month period are exempt from FICA, even though they remain subject to income taxes. If the employee returns to work for any period of time, even just one day, and then goes on disability again, the six-month period must start over.

A third-party payer of sick pay is considered the employer for purposes of FICA taxation of these payments. Consequently, the third-party payer not only must withhold employee FICA taxes, but also is responsible for paying the employer's share of FICA, depositing taxes timely and reporting those taxes to the employee, SSA and the IRS.

The third-party can, however, transfer liability for the employer portion of FICA to the actual employer by withholding and depositing the employee FICA tax and notifying the employer on or before the date that the taxable sick pay is required to be deposited by the third party. For example—a third-party depositor classified by the IRS as a monthly depositor would have to notify the employer by the 15th day of the month following the month in which the sick pay is made.

Prompt notification to the employer is considered to be the mailing of the notice on or before the required date of deposit for the employee share of the tax by the third-party payer. For purposes of the employer's liability for depositing the employer portion of FICA tax, payment to the employee will be deemed to have been made on the date the employer receives notification from the third-party payer.

Reporting Sick Pay Payments Made by Third-Parties

These instructions apply when the third-party transfers liability for reporting to the employer and the employee is covered for social security and medicare.

What the Employer Must Report?

Deposits

The third party must make deposits of withheld employee social security, medicare and federal income tax using its own name and EIN. The employer must make deposits of the employer portion of the social security and medicare taxes using its name and EIN. In applying the deposit rules, the employer liability for these taxes begins when the third party's notice of sick pay payments is received.

Form 941

- On Line 2-include the total amount of sick pay the third party paid your employee(s).
- On Line 6a-include the total amount of sick pay the third party paid your employee(s) subject to social security.
- On Line 7-include the total amount of sick pay the third party paid your employee(s) subject to medicare. After you make the calculations for lines 6a, 6b, and 7, enter the total on line 8.

- On Line 9, enter the employee portion of the social security and/or medicare tax that the third party withheld and deposited. Also enter this amount in the “Sick Pay” adjustment entry space. Subtract line 9 from line 8.

Form W-2

The third-party, which has transferred the liability to the employer, must furnish the employer with a sick pay statement by January 15 of the year following the year in which sick pay was paid. The statement must reflect the following data about each employee who was paid sick pay:

- a) the employee’s name,
- b) the employee’s social security number,
- c) the amount of sick pay disbursed,
- d) any federal income tax withheld,
- e) any social security tax withheld and
- f) any Medicare tax withheld.

The employer must prepare a Form W-2 for the sick pay. Sick pay may be combined with other wages and reported on a single Form W-2, or a separate Form W-2 may be used to report the sick pay only.

Employers who file more than 250 Forms W-2 are required to transmit those via magnetic media. An employer may, however, transmit any third-party sick pay Form W-2 on paper, if there are less than 250 sick pay Forms W-2.

On either the regular or the separate W-2 enter the following in:

- Box 1-the amount the employee must include as income
- Box 2-the amount of income tax the third party withheld (if any)
- Box 3-the amount of sick pay that is subject to employee social security tax
- Box 4-the amount of social security tax the third party withheld
- Box 5-the amount of sick pay that is subject to employee Medicare tax
- Box 6-the amount of Medicare tax the third party withheld
- Box 12-Use Code “J” for any amount not included in income because the employee contributed to the plan.

Note: You must transmit any W-2 that is reporting an employee for “medicare only” separately from a W-2 that is given an employee who is covered for “Full FICA”.

For questions on social security coverage for a
Kentucky governmental employer contact the
Division of Social Security
403 Wapping Street, Suite 340
Frankfort KY 40601-2638
Phone: 502/564-3952
Fax: 502/564-2124

For questions on social security benefits or
social security cards contact the
Federal Social Security Administration
Social Security Administration
1-800/772-1213