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Dear Client:

The following is an overview of key payroll tax and subcontractor reporting changes affecting businesses in 2011:

**IRS Announces New Voluntary Worker Classification Settlement Program; Past Payroll Tax Relief Provided to Employers Who Reclassify Their Workers.**

The Internal Revenue Service launched a new program that will enable many employers to resolve past worker classification issues and achieve certainty under the tax law at a low cost by voluntarily reclassifying their workers.

To be eligible, an applicant must:

- Consistently have treated the workers in the past as nonemployees,
- Have filed all required Forms 1099 for the workers for the previous three years
- Not currently be under audit by the IRS
- Not currently be under audit by the Department of Labor or a state agency concerning the classification of these workers

Interested employers can apply for the program by filing Form 8952, Application for Voluntary Classification Settlement Program, at least 60 days before they want to begin treating the workers as employees. The Minnesota Department of Revenue's worker classification voluntary compliance initiative will be available through December 16, 2011.

**Increased penalty for failure to timely file information returns.**

For information returns required to be filed after Dec. 31, 2010, the 2010 Small Business Act increases the penalties for failure to timely file information returns to IRS. The first-tier penalty increases from \$15 to \$30, and the calendar year maximum increases from \$75,000 to \$250,000. The second-tier penalty increases from \$30 to \$60, and the calendar year maximum increases from \$150,000 to \$500,000. The third-tier penalty increases from \$50 to \$100, and the calendar year maximum increases from \$250,000 to \$1,500,000. For small business filers, the calendar year maximum increases from \$25,000 to \$75,000 for the first-tier penalty, from \$50,000 to \$200,000 for the second-tier penalty, and from \$100,000 to \$500,000 for the third-tier penalty. The minimum penalty for each failure due to intentional disregard increases from \$100 to \$250.

**Increased penalty for failure to furnish a payee statement.**

The penalty for failure to furnish a payee statement is revised to provide tiers and caps similar to those applicable to the penalty for failure to file the information return. A first-tier penalty will be \$30, subject to a maximum of \$250,000; the second-tier penalty will be \$60 per statement, up to \$500,000, and the third-tier penalty will be \$100, up to a maximum of \$1,500,000. Limitations will apply on penalties for small businesses and increased penalties for intentional disregard that parallel the penalty for failure to furnish information returns.

**Form 1099-MISC Reporting.**

The expanded Form 1099-MISC Reporting in the Patient Protection and Affordable Care Act of 2010 was repealed. The following three provisions were repealed: the requirement for rental property owners to issue Form 1099-MISC, the requirement for any business to issue Form 1099-MISC for payments of goods or property and the requirement for any business to issue Form 1099-MISC for payments made to corporations.

**FUTA Surcharge Has Expired.**

The Federal Unemployment Tax Act (FUTA) surcharge of 0.2% expired on June 30, 2011. This means that the FUTA rate for employers decreased from 6.2% to 6.0% starting on July 1, 2011. The IRS is currently working to revise Form 940, Employer's Annual Federal Unemployment Tax Return, to accommodate the two different rates and the form will be available before the January 31, 2012, due date.

**Increase to Earnings Subject to Social Security Tax**

Beginning January 2012, the maximum amount of earnings subject to the Social Security tax (taxable maximum) will increase to \$110,100 from \$106,800.

**Expiring 2% Employee Social Security Reduction**

For tax year 2011 only, The American Jobs Act of 2011 included a provision to reduce employee Social Security tax from 6.2% to 4.2%. This reduction is set to expire at December 31, 2011. President Obama has presented Congress with several proposals affecting both employer and employee payroll taxes. Stay tuned as these proposals may be enacted before the end of the year or early in 2012.

**Merchant Card and Third Party Network Payments**

A payment settlement entity (PSE) must file Form 1099-K, Merchant Card and Third Party Network Payments, for payments made in settlement of reportable payment transactions for each calendar year. A PSE is a domestic or foreign entity that is a merchant acquiring entity, that is, a bank or other organization that has the contractual obligation to make payment to participating payees in settlement of payment card transactions; or a third party settlement organization, that is, the central organization that has the contractual obligation to make payments to participating payees of third party network transactions.

**Tax credits to certain small employers that provide health insurance.**

The new law provides small employers with a tax credit (i.e., a dollar-for-dollar reduction in tax) for nonelective contributions to purchase health insurance for their employees. The credit can offset an employer's regular tax or its alternative minimum tax (AMT) liability.

*Small business employers eligible for the credit.* To qualify, a business must offer health insurance to its employees as part of their compensation and contribute at least half the total premium cost. The business must have no more than 25 full-time equivalent employees ("FTEs"), and the employees must have annual full-time equivalent wages that average no more than \$50,000. However, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of less than \$25,000.

*Years the credit is available.* The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is health insurance coverage purchased from an insurance company licensed under state law. For tax years beginning after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through a state exchange and is only available for two years. The maximum two-year coverage period does not take into account any tax years beginning in years before 2014. Thus, an eligible small employer could potentially qualify for this credit for six tax years; four years under the first phase and two years under the second phase.

*Calculating the amount of the credit.* For tax years beginning in 2010, 2011, 2012, or 2013, the credit is generally 35% (50% for tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums. The credit phases out as firm-size and average wages increase.

*Special rules.* The employer is entitled to an ordinary and necessary business expense deduction equal to the amount of the employer contribution minus the dollar amount of the credit. For example, if an eligible small employer pays 100% of the cost of its employees' health insurance coverage and the amount of the tax credit is 50% of that cost (i.e., in tax years beginning after 2013), the employer can claim a deduction for the other 50% of the premium cost.

Self-employed individuals, including partners and sole proprietors, two percent shareholders of an S corporation, and five percent owners of the employer are not treated as employees for purposes of this credit. There is also a special rule to prevent sole proprietorships from receiving the credit for the owner and their family members. Thus, no credit is available for any contribution to the purchase of health insurance for these individuals and the individual is not taken into account in determining the number of full-time equivalent employees or average full-time equivalent wages.

We have an Excel worksheet, which can be used to determine if you are eligible for the tax credit. Please contact us for a copy.

### **Minnesota Revenue New e-Services System**

In October 2011, the Minnesota Department of Revenue began to transition all businesses from the current e-File Minnesota system to a new e-Services online filing and paying system. It is expected that all businesses will be transitioned to the new system by the end of the year.

Once your business has been selected for transition, after entering your Minnesota ID in e-File, you will be redirected to a new screen with the heading, "Welcome to Minnesota e-Services!" The first time you are redirected, you will need to create a web profile. As part of creating your web profile, you will be prompted to re-enter your Minnesota ID and the password you have set up in e-File. If your organization has multiple users, you will be asked for the administrator's password. Once you have created your profile, you will get an e-mail that contains a link to begin using e-Services.

Most businesses are also required to pay all Minnesota tax types electronically, so we suggest checking your online account to verify your payment requirements.

### **Minnesota New Hire Reporting**

You must report the hiring or rehiring of any employee to the Minnesota Department of Human Services within 20 days of hiring the individual. Employers can report new hires online at <http://newhire-reporting.com>.

If you don't have access to the Internet, you may mail or fax a copy of the employee's W-4 form to the Minnesota New Hire Reporting Center. (Be sure that boxes 8 and 10 are completed with the employer's information.) Fax the W-4 to 1-800-692-4473, or mail a copy to the Minnesota New Hire Reporting Center, P. O. Box 64212, St. Paul, MN 55164-0212.

We hope this information is helpful. If you would like more information or to discuss the details of these tax changes, please do not hesitate to call.

Very truly yours,