

To Our Clients Who Are Employers:

Re: **2003 PAYROLL TAXES**

With the New Year, we suggest you review your payroll procedures and policies and identify those areas that are affected by new federal and state regulatory requirements or changes in existing law.

Below is a summary of the most notable changes for 2003. At a minimum, please scan this pamphlet and review these items to see if they may affect your payroll requirements. A copy of this letter will be posted on our website for future reference www.metcalfhodges.com. All website references have hyperlinks to web pages for easy access.

- Due Dates – 1099s and W-2s should be given to recipients by **January 31**. Federal copies of 1099s, 1096 and Social Security Administration (SSA) forms are due on **February 28**; if filed electronically the due date is **March 31**. **Delay** mailing the SSA forms until late in February. This allows time to correct W-2s, if necessary, without filing the dreaded W-2c's – see page 3
- Social Security Tax Rates and Limits – Social Security wage base raised to **\$87,000** – see page 1
- Significant increases in L&I for 2003 – see page 2
- Electronic Filing – call 1.877.645.3353 for paperless excise taxes – see page 3
- How to minimize failure-to-deposit penalties see page 4
- 1099s – You must include a contact telephone number on the recipient's copy – see page 5
- Payroll – Washington State minimum wage is **\$7.01** per hour effective 1/1/2003 – see page 6
- Washington State Sales and Use Tax - Whatcom County increases to **8.2%** effective 01/01/2003 – see page 2
- Standard Mileage Rate – **Decreases to 36¢** effective 1/1/2003– see page 7
- Health insurance for more than 2% shareholders of an S corporation and their employee relatives must appear on the individual's W-2 – see page 7

If you have any questions, please call us.

Sincerely,

Metcalfe, Hodges & Co., P.S.

CHANGES WHICH AFFECT FEDERAL AND WASHINGTON STATE PAYROLL TAXES
FOR WAGES PAID IN 2003

SOCIAL SECURITY TAX RATES AND LIMITS- WWW.SSA.GOV

Forms 941 and W-2 for 2003 require employers to separately report the withholding for Social Security and Medicare. The maximum earnings subject to the OASDI employee and employer portion of FICA are **\$87,000**. The Medicare portion has no limit. The tax rates remain the same.

	Wages Subject To Tax	Tax Rate			Maximum Tax		Total
		Employee	Employer	Total	Employee	Employer	
FICA:	\$87,000	6.20%	6.20%	12.4%	\$5,394	\$5,394	\$10,788
Medicare:	All wages	1.45%	1.45%	2.9%	No limit	No limit	
Total		7.65%	7.65%	15.3%			

Self employed- Since you are both the employer and the employee your maximum tax for Social Security is \$10,788 at a rate of 12.4%. There is no limit to the Medicare portion and the tax rate is 2.9%.

The amount of wages a Social Security recipient may earn without a loss of Social Security benefits also increases. Those under 65 can earn \$11,520 annually or \$960 per month; for each \$2 earned above \$11,520, \$1 in benefits will be lost. If you turn 65 this year the limit is \$30,720 annually or \$2,560 per month, for each \$3 earned above these limits \$1 of benefits will be lost. This applies only to earnings for months prior to attaining full retirement age. Work as long and hard as you want beginning the month you reach age 65. It is no longer necessary to file an annual earnings report with the Social Security Administration (SSA).

To be eligible for disability benefits you must have earned half (20 quarters) of the minimum work credits (40) within 10 years of the disability. One quarter of social security coverage in 2003 is considered to be \$890.

Tip: Consider paying wages to a spouse for bonafide work in your business so that quarters are accumulated.

You can retire with full benefits at age 65 only if you were born before 1938. For every year younger add 2 months to the full benefit age. If you were born between 1943 -1954 you can retire at 66. If you were born in 1960 or later you'll have to wait until you're 67.

FEDERAL UNEMPLOYMENT TAX (FUTA) FORM 940, 940-EZ

For 2003, the FUTA rate and taxable earnings remain at 6.20% and \$7,000, respectively. If state unemployment is paid the maximum tax is \$56 based on a net rate of .8% with maximum wages subject to tax equal to \$7,000. If the state unemployment contribution is zero the FUTA tax rate is 6.2%. Use line 15 of your Washington Employment Security tax form to determine your state contributions that are entered on line 3 column i of your 940. The Employer Identification Number (EIN) on your Washington Employment Security form must match the EIN on your 940 or the IRS will not give you the state credit.

Do not use any Employment Administrative fund payments to calculate your FUTA tax.

DEPOSIT REQUIREMENTS (FUTA)

The requirements are unchanged. If at the end of any calendar quarter, the accrued undeposited amount totals \$100 or more, the tax must be deposited before the end of the following month. Interest and penalty charges are the same as for FICA. The annual return for 2002 (Form 940) is due by January 31, 2003.

FORM 941, EMPLOYERS QUARTERLY TAX REPORT

Form 941 is due quarterly. The IRS will continue to scrutinize 941s and compare them to W-2 data submitted to the SSA. Use your 941s as a double check for your W-2/W-3 reconciliation to avoid costly mistakes.

FORM 945, ANNUAL RETURN OF WITHHELD FEDERAL INCOME TAX

This form is due by January 31, 2003 for the year ended December 31, 2002. This form is used to report non-payroll tax liability, including backup withholding, income tax withheld from gambling winnings, pensions, annuities, and IRAs. You cannot combine deposits for Form 941 and Form 945.

Generally, the deposit rules that apply to Form 941 also apply to Form 945. However, because Form 945 is an annual return, the rules for determining your deposit schedule are different from those for Form 941. See section 11 of Circular E for a detailed discussion of the deposit rules.

WASHINGTON STATE SALES AND USE TAXES

Whatcom County's combined state and local tax is **.082** (rate change is effective January 1, 2003). Other counties have also had recent rate increases.

Please remember that sales and/or use tax must be paid when you are the end user of a product no matter where or how it was purchased. The Department of Revenue has been aggressively enforcing use tax during 2002. Use tax must be paid on all purchases by catalog, telephone or **internet** when you are not charged sales tax. You must remit use tax with your excise tax return. Please see the Department of Revenue website <http://www.dor.wa.gov/> for more information.

WASHINGTON STATE EMPLOYMENT SECURITY TAX (UNEMPLOYMENT) (SUTA)

Employment Security Tax is based on an experience rating system with a taxable wage base of **\$29,700** for 2003. New rate notices were not mailed in November. The State was holding all rate notices pending a legal opinion on the constitutionality of Referendum 53. On Friday, January 10, 2003 Referendum 53 was certified. New rates should be released soon.

This tax is paid quarterly on a form provided by the Employment Security Department. Hours reportable are all hours paid **including** holidays, sick leave and vacation. The maximum hours reportable for salaried employees are 520 hours per quarter. The tax, however, is computed on the dollar amount of the wage paid.

Corporate officers may elect coverage. Once voluntary coverage is approved it remains in effect for a minimum of two full calendar years (example: Start May 1, 2001 covered until December 31, 2003). There is potential FUTA tax savings for corporate officers with wages exceeding \$29,700 and state rates less than 1.46%. In this situation corporate officers may want to elect coverage. If you have questions regarding coverage of corporate officers, please check with our office.

If you don't have payroll during the quarter you can file your report by phone 1(888) 836-1900. Electronic filing of tax and wage reports can be done by ordering the free **UIFastTax** software product at 1(360) 902-9716 or e-mail uifreg@esd.wa.gov. You may also download a free copy at <http://www.wa.gov/esd/uifasttax/default.htm>

WORKER'S COMPENSATION PREMIUM (INDUSTRIAL INSURANCE)

You will receive a notice from the Department of Labor and Industries indicating your composite rate for 2003. This composite rate also includes amounts for Medical Aid and Supplemental Pension Assessment. The law allows

employers to withhold one-half of the Medical Aid and Supplemental Pension Assessment from the employee. **Recent legislation has resulted in a 29% increase in premiums for 2003.** Check your new rates and plan accordingly.

For hourly employees, report the hours actually worked. **Do not include** vacation, holidays, or sick leave. For salaried employees, use either 40 hours per week or 160 hours per month. Sole proprietors, partners and their spouses are exempt from Industrial Insurance, but these persons may elect to be covered. Please note corporate officers will not be covered under Industrial Insurance unless they file an election to be covered.

NOTE: Partners, sole proprietors, and corporate officers who are not covered by Industrial Insurance should check their group/individual medical insurance policy. Unless the policy has 24/7 coverage that includes "on the job" coverage for themselves they may be uninsured if injured at work.

DUE DATES FOR FORMS W-3 AND 1096

File paper copies of Form W-3 with copy A of the W-2 by **February 28**, or file electronically by **March 31 to the SSA**. Form 1096 with copy A of all forms 1099 must be mailed to the IRS by **February 28** or electronically filed by **March 31**. W-2s and 1099s should be mailed to recipients by **January 31**.

Special Tip: Wait to mail the Federal copies until close to the due date of February 28. If the employer discovers an error after the Form W-2 has been issued to the employee but before Copy A of Form W-2 and the accompanying Form W-3 are filed with the SSA, the employer should mark the "Void" box on the original Copy A. The employer should then prepare a new Form W-2 for the employee, write the word "Corrected" on the copies given the employee and send Copy A of the new form to the SSA. (This new Copy A should not be marked "Corrected"). If a W-2 is corrected before the SSA receives their copy, it will not be necessary to prepare Form W-2c.

FEDERAL W-2 AND 1099 MAGNETIC MEDIA FILING

Any employer with **250** or more W-2 forms or 1099 forms (in a given year) **must file** on magnetic media. Magnetic media filing is optional for employers with fewer than 250 forms. Exceptions must be requested 45 days before the due date of February 28, 2003(i.e. no later than Jan 15, 2003).

NOTE: The penalty for failure to file on magnetic media is \$50 per document

ELECTRONIC FILING

Washington State is offering many electronic filing options this year. The software can be downloaded from the Internet and transmitted online. Monthly and quarterly statements can be filed. Reports to Employment Security, Department of Revenue and Labor & Industries can all be transmitted electronically. The website <http://www.access.wa.gov/onlineservices/taxcenter.asp> has links to all State tax departments offering electronic filing.

The IRS has also added new electronic filing options. You may now electronically file 941s and 1099s, as well as partnership, estate, and Form 5500 returns. Please check www.irs.gov for more information.

For information on electronically filing your employer information with the Social Security Administration, please go to <http://www.ssa.gov/employer/>.

ELECTRONIC FEDERAL TAX PAYMENT SYSTEM (EFTPS)

Enrollment is easy (Form 9779) and convenient. The Electronic Federal Tax Payment System (EFTPS) allows taxpayers to initiate Federal tax payments electronically instead of using paper coupons. Tax payments are initiated from your office using your phone or computer. EFTPS applies to taxes for the following forms: 720, 940, 941, 943, 945, 990-C, 990-PF, 990-T, 1041, 1042, 1120, CT-1 and Section 4947(a)(1). Enrollment forms can be obtained by calling 1.800.945.8400 or 1.800.555.4477. If you are a **voluntary** EFTPS participant, you may still use Federal Tax Deposit coupons.

EFTPS enrollment packages have been mailed to business taxpayers who are **required** to begin making electronic payments in January 2003. These businesses include those who were required to use EFTPS in a previous year and those who paid more than \$200,000 in **aggregate** Federal tax deposits in calendar year 2001. These businesses should have sent in their enrollment forms by November 1 to allow time for processing. If you paid more than \$200,000 in deposits in 2002, you will be required to use EFTPS beginning January 2003. Affected businesses that are not yet using EFTPS will have received letters this fall reminding them to begin making electronic payments by the end of the year. Electronic deposits can be made by telephone or online. **Once an employer is required to use EFTPS, all tax deposits must be made electronically**, including estimated tax payments, FICA deposits, extension payments, and FUTA deposits.

DEPOSIT REQUIREMENTS

Federal Tax Deposit Coupon Book, Form 8109-B, contains the tax deposit forms for withheld income tax, FICA, and FUTA deposits as well as corporate Federal Income Tax. It is very important to clearly mark the correct type of tax and tax period on each deposit coupon. This information is used by the Internal Revenue Service to credit your account. Entries are processed by optical scanning equipment and must be made in pencil – use a soft lead (#2, for example) so that the equipment can read your entries more accurately. You **cannot** use photocopies of the coupons to make deposits. Do not staple, tape, or fold the coupons. Those deposits that are mailed **must arrive** at the depository **by the due date**. Your deposit schedule for a calendar year is determined from the total taxes reported on your Form 941 in a four- quarter look back period- July 1 through June 30. The IRS notifies you each November to let you know what your deposit status is for the coming calendar year.

Threshold for deposit requirement is \$2,500

As of January 1, 2002 if your net taxes for the quarter are less than \$2,500, you are not required to make deposits and may pay the taxes with Form 941. You may file Form 941 electronically. Form 943 payments may also be made with Form 943 if your net tax liability for the year is less than \$2,500. The rules are the same for Form 945.

\$100,000 NEXT-DAY DEPOSIT RULE

If you accumulate a tax liability of \$ 100,000 or more on any day during a deposit period, you must deposit the tax by the next banking day **no matter what type of schedule depositor you are**. If you are a monthly schedule depositor and accumulate a \$ 100,000 tax liability on any day during a month, you become a semiweekly schedule depositor on the next day and remain so for at least the rest of the calendar year and for the following calendar year. Please refer to Circular E for more details. A copy is available on the IRS website at www.irs.gov .

DEPOSIT PENALTIES

The penalties for failure to make deposits of taxes are based on applicable percentages of the amount of underpayment determined by the number of days the deposit is late. If the failure is:

1. Not more than 5 days late, the applicable percentage is 2% of the under-deposited taxes;
2. More than 5 days but less than 15 days late, the applicable percentage is 5% of the under-deposited taxes; or
3. If the failure is more than 15 days late, the penalty is 10% and
4. The penalty becomes 15% if you fail to make the deposit on or before the earlier of (1) 10 days after the first notice and demand to you for these amounts or (2) the day on which notice and demand for immediate payment is given to you under a jeopardy assessment.

There is a 10% penalty for deposits made at an unauthorized financial institution, paid directly to the IRS, subject to electronic deposit, or paid with the return unless the deposit shortfall rules apply.

Upon receiving a penalty notice showing multiple failure-to-deposit penalties, call the toll free number shown on the notice within 90 days and designate the deposit period within the return period to apply the deposit to. This may minimize the § 6656 failure-to-deposit penalty for deposits after January 18, 1999.

Deciding correctly which day is "payday" is important in determining the date when certain liabilities arise. Failure to correctly make this determination can be costly in penalties and interest. Employer liability normally arises at the time wages are paid to the employee, either actually or constructively. **The liability does not arise at the time the wages were earned.** For example:

A payroll is prepared for the pay period March 1-31. Payday is April 1.
The liability was incurred April 1; therefore, it is a second quarter liability.

FORM W-9

The IRS now has the ability to match the Employer Identification Number (EIN) to the business name by computer. If you get a notice of back-up withholding from someone you do business with, check your original EIN application (SS-4) and provide the identical information on the W-9. The IRS cross matches by computer the first four letters on the application to the number they assigned. If they do not match there is an automatic letter generated to the entity that submitted the 1099 requiring back up withholding of 31%. Your "doing business as" (d.b.a.) name cannot be used as the primary name. Schedule C filers should use their EIN and last name.

Individuals- the IRS uses the first 4 letters of the last name.

Trusts- the first 4 letters of the name of the person/entity in whose name the trust was established.

Partnerships- the first 4 letters of the trade or business name, if none, the first 4 letters of the last name of the first partner listed on the original SS-4.

All other organizations- the first 4 letters of the entity's name on the original SS-4.

Letter 147C

Some businesses have recently received requests from vendors for a Form 147C. The IRS has notified the vendors that they must use backup withholding unless a 147C is received. The 147C is actually a letter from the IRS verifying the EIN and name of your company. It is required when there is a matching problem between your W-9 and the IRS records. To get this letter you may call 1(800) 829-8815 and request it from the IRS. If you would like our help in resolving this issue, we can file a power of attorney with the IRS.

Form 1099

You are required to include the telephone number of a person to contact on your Form 1099's to recipients. The IRS has recently begun assessing \$50 fines to those who do not respond to their requests for a phone number. The number must provide direct access to an individual who can answer questions about the statement. Payers are permitted to include the telephone number in any conspicuous place on the statements. The number is not required on Copy A (IRS copy).

Form 1099-INT is filed for each person to whom payments of \$10 or more in interest were paid during the year.

Form 1099-DIV is filed for payments of gross dividends and other distributions of stock.

Form 1099-MISC is used to report aggregate payments of \$600 or more to persons not treated as employees for services performed for your trade or business (independent contractors). It is also used for rents and royalties. Form 1099-MISC should not be used to report employee payments or bonuses. Ordinarily, payments made to corporations are not reported on Form 1099-MISC, however, there are exceptions. Medical and health care payments, commercial fish purchases for cash, attorney's fees, and gross proceeds paid to an attorney are the most common exceptions.

Tip: When an independent contractor performs services, have them fill out a W-9 for you before you pay them. This ensures you have an address and identification number available when you prepare the 1099 the following

January. If someone refuses to provide you with their Taxpayer Identification Number (TIN), you are required by law to withhold 31% from payments made until you receive a TIN. To verify a social security number call 1(800) 772-6271 for up to five names.

PAYMENTS TO ATTORNEYS

All payments to attorneys are reported on Form 1099-MISC **whether or not** they add up to \$600 for the year. If you made a payment to an attorney in the course of your business in connection with legal services and the attorney's fee cannot be determined, you must report the total fees and cost reimbursements paid to the attorney in Box 13 with code A on Form 1099-MISC. If a check is delivered to an attorney who is not a payee, an information return must be filed with respect to the attorney if, under the circumstances, it is reasonable for the payer to believe that the attorney is receiving the check in connection with legal services. If a check has attorney and non-attorney payees and the check is delivered to a non-attorney, an information return (1099) must be filed with respect to the first listed attorney.

PAYROLL

The Washington State minimum wage rate, effective **January 1, 2003**, is **\$7.01** per hour. The new minimum wage applies to all workers in the State except workers under age 16 in nonagricultural work who may be paid \$5.96 (85% of minimum).

Tips cannot be included to calculate the minimum wage. Overtime (1.5 times an employee's regular rate) need only be paid for all hours actually worked in excess of 40 in a week. Paid non-work hours (paid vacation, holidays, sick days, jury duty, etc.) do not count for overtime purposes. Bonuses are wages in the year paid and are subject to all Federal and State taxes except Labor & Industries (workers compensation). When an employee is terminated or quits, the wages due may be paid at the end of the established pay period. This does not apply to union or other labor-management agreements that provide otherwise (RCW 49.48.010).

FAMILY EMPLOYEES

An important exemption from social security taxes applies to sons and daughters under 18 years of age employed by their parents in a trade or business. The trade or business must be a sole proprietorship or a partnership in which all partners are parents of the child. The child's wage must be reasonable and the hours and services carefully documented. Payments for the services of a child under age 18 who works for his or her parent in a trade or business are not subject to Social Security and Medicare taxes or FUTA. If these services are for work other than in a trade or business, such as domestic work in the parent's home, they are not subject to Social Security and Medicare taxes until the child reaches age 21. Payments for the services of a child under age 21 who works for his or her parent whether or not in a trade or business are not subject to FUTA tax. Although not subject to FUTA tax, a child may still be subject to income tax withholding.

Tip: Open a Roth-IRA in your child's name with the money saved on FICA (up to a maximum of \$3,000 or their earnings, whichever is less). Money put in before age 21 and saved until retirement could make him/her a millionaire without new taxes to pay. The difference between contributing to a Roth IRA at age 16 and age 21 is amazing. Check out the calculators at our web site's "Financial Strategies" section to see the difference.

OUTSTANDING CHECKS, UNUSED DEPOSITS, GIFT CERTIFICATES

Outstanding payroll and other checks which have not been claimed or cashed are required to be turned over to the Unclaimed Property Division of the Department of Revenue. Outstanding checks through June 30, 2002 must be reported by November 1, 2003. For more information visit <http://ucp.dor.wa.gov/>

ACCIDENT PREVENTION PROGRAM

Every employer in the State of Washington, regardless of the number of employees, is required to have a safety and health committee plan. Additionally, Washington Industrial Safety and Health Act (WISHA) rules require each employer to establish an accident prevention program outlined in a written format. You may contact our office if you need information on implementing this program or visit L&I's website www.lni.wa.gov/wishas/ for more information. The website has sample programs which can be downloaded.

COMPANY REIMBURSEMENTS

There are strict requirements for non-taxable treatment of cash payments to employees. Some examples would be substantiated employee reimbursements for meals and entertainment, travel expenses and other necessary business expenses.

Cash payments made by an employer to an employee do not qualify as a working condition fringe benefit (non-taxable to the employee) unless the employer maintains an "accountable plan" that requires the employee to:

1. Use the payment for expenses in connection with a specific activity for which a deduction is allowed as a business expense;
2. Substantiate the expenditures that the payment was for; **and**
3. Return to the employer any part of the payment not so used.

Failure by the employer or employee to meet these conditions will cause the cash payments to be taxable to the employee (and subject to withholding and employment taxes) and require the employee to deduct the "unreimbursed" business expenses as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limitation.

Thus, auto allowances are wages if the employee is not required to substantiate the business mileage and return the unused portion. The allowances are subject to FIT, FICA and FUTA and reported on the employee W-2 as well as the 941 and 940.

The per diem continental U.S. (CONUS) standard rate for 2003 is \$55 for lodging and \$30 for meals and incidental expenses.

TREATMENT OF MEDICAL INSURANCE PREMIUMS FOR S CORPORATION SHAREHOLDERS

Medical insurance premiums paid for greater than 2% shareholders of S corporations are deductible by the corporation and are included in income on the W-2's of a greater than 2% shareholder. Covered family members who are also employees of the S corporation must also have premiums included in gross wages. The premiums are not subject to withholding for Social Security or Medicare tax if the premiums are paid under a health plan covering employees. For 2003, **100%** of the premiums may be deductible on Form 1040 as self-employed health insurance deductions. In the case of an employee who is related to a more than 2% shareholder, a statement should be attached to the W-2 issued to the employee. The statement should explain the reason for the taxable income increase and notify the employee that he/she may be eligible for the self employed health insurance deduction for any month the family is not covered by another employer sponsored plan. This statement should be attached to the employee's tax return.

STANDARD MILEAGE RATES FOR 2003 AND 2002

As of January 1, 2003 the mileage rate will be **36¢ per mile**. The 2002 rate was 36.5¢ per mile.

CHILD SUPPORT GARNISHMENTS

Employers can now make payments on the Internet by using Washington State's Child Support Internet Payment Service www.childsupportpayment.dshs.wa.go

PENSION PLANS

Qualified retirement plan limits for 2003

Over Age 50

Pretax contributions for 401(k), SEP plans and 403(b) annuities	\$12,000	\$14,000
Combined employer/employee pay-in limits for all defined contribution plans	\$40,000	\$40,000
Annual defined benefit plan limitation	\$160,000	\$160,000
Maximum annual compensation limit for retirement plan computations	\$200,000	\$200,000
Minimum compensation limit for SEP participation	\$450	\$450
Highly compensated employee	\$90,000	\$90,000
SIMPLE pretax contribution limit	\$8,000	\$9,000

Employee pretax contributions (elective deferrals) to a qualified plan, such as a 401(k), SEP, or SIMPLE plan, are exempt from FIT but are subject to FICA and FUTA and are reported on the 941, lines 6 and 7(not on line 2). In other words, taxable wages will be less than gross wages by the amount of the contribution.

TRADITIONAL AND ROTH IRAS

IRA and Roth IRA contribution limits are still the lesser of \$3,000 or earned income. For those over 50 there is a "catchup provision" which allows the lesser of \$3,500 or earned income.

SAVINGS INCENTIVE MATCH PLANS FOR EMPLOYEES (SIMPLE)

SIMPLE plans became available to small employers (fewer than 100 employees) in 1997. The IRA form of this plan allows the employer to adopt and maintain a plan with relative ease and few administrative costs. The employer is required to either match employee elective contributions on a dollar-for-dollar basis up to 3% of the employee's compensation (up to \$170,000 of employee compensation) or, in lieu of making a matching contribution, make a 2% of compensation non-elective contribution for each eligible employee regardless of whether the employee puts any of his/her own money in the plan. Employer-matching and non-elective contributions to a SIMPLE account are not subject to employment taxes when made. This means that you can make matching contributions for your employees free from employment taxes such as FICA and FUTA. If you are self-employed and file a Schedule C, all matching and/or non-elective contributions that are made to your own personal SIMPLE plan account *are* subject to self-employment taxes. If you have a SIMPLE plan you are still eligible to contribute to a Roth or regular IRA provided you are within the income limits. Distributions from a SIMPLE plan generally are taxed under the rules applicable to traditional IRAs, and tax-free rollovers can be made from one SIMPLE account to another. A SIMPLE account can be rolled over to a traditional IRA on a tax-free basis after a two-year waiting period that starts the day the individual first became a participant in the SIMPLE plan. If an employee is no longer participating in a SIMPLE plan and two years have passed since the employee first participated in the SIMPLE plan, the employee's SIMPLE account is treated as a traditional IRA. It can be rolled over to a Roth under the traditional IRA rules at this stage. Withdrawals of any kind within the first two years of participation are subject to federal income tax (FIT) plus a 25% penalty. Early withdrawals from a SIMPLE account after the two years have passed generally are subject to the 10% early withdrawal penalty applicable to IRAs.

Employee deferrals and matching or non-elective contributions to SIMPLE plans are each limited to \$8,000 per year (\$9,000 for those over age 50). **If you are a participant in any other employer plans during 2003 and you have elective salary reductions or deferred compensation under those plans, the salary reduction contributions under the SIMPLE plan also are included in the annual limit of \$12,000 on exclusions for pretax contributions for 401(k) and SEP plans.**

ONE-PERSON 401(K) RETIREMENT PLAN FOR SELF-EMPLOYED

One-person 401(k) retirement plans are available to any business whose only full-time employees are its owners and their spouses. Congress modified the existing 401(k) to aid low/middle income business owners, aiming specifically at those with annual earnings of \$50,000-160,000. Corporations, partnerships, sole proprietorships, and not-for-profit organizations are all eligible. This plan allows the tax-deferral of a 401(k) with increased contribution limits. Business owners may now contribute the greater of 25% of compensation or 100% of compensation up to \$12,000 (\$14,000 if over 50). The annual contribution is limited to \$40,000. IRA, SEP, KEOGH, SIMPLE and 401(k) s are eligible for rollover into a one-person 401(k). However you may not contribute to a Simple IRA and establish a one-person 401(k) within the same year.

Any Simple IRA contributions in 2003 will disallow the establishment of a one-person 401(k) until 2004.

2003 ONE-PERSON 401(K) CONTRIBUTION LIMITS

W-2 Income/Sch C Net Profit	\$12,000	\$50,000	\$100,000	\$150,000
Contribution	\$12,000*	\$24,500*	\$37,000*	\$40,000*

*additional \$2000 catch-up contribution allowed for employees over 50.

NEW HIRES

All new employees are required to fill out a W-4 and an I-9 that must be verified and completed by the employer. The requirement applies to all employers including household employers and not-for-profit organizations regardless of the number of employees. It is important to physically check the documentation as the penalties for non-compliance include civil monetary fines as well as more serious criminal penalties.

HOW TO REPORT NEW HIRES

Federal law requires employers to submit to their state agency six data elements for each newly hired employee. The purpose of the law and the program is to help locate parents who are not paying child support. The law also allows other state agencies like the Department of Labor and Industries and the Employment Security Department (ESD) to use new hire information to detect claim fraud. Report all new hires and rehires to the Division of Child Support (DCS) within **20 days** after employment begins. Failure to report could result in a penalty.

Employers may submit reports in a variety of ways, including W-4 forms, diskettes, magnetic tapes, and computer printouts. If faxing or mailing W-4s, copy them and then fill in the employer information in boxes 8-10 and add the employee birth date to the bottom of the form.

Mail – ISSD Data Control
 New Hire Directory
 P.O. Box 9023
 Olympia, WA 98507-9023
 Fax – 1.800.782.0624
 Phone – 1.800.562.0479 (up to four new hires)
 Internet – www.wa.gov/DSHS/newhire (only one new hire at a time)

WHO IS AN EMPLOYEE?

The Washington State Employment Security Department has issued the following guidelines on the classification of workers hired as independent contractors or employees. It will not be considered employment if all six of the

following tests are met. **It is important to keep a record of the individual's verification of independence (i.e., UBI number).**

Independent Contractors Test

1. The individual is free from direction and control of the business; **and**
2. The individual is performing services outside the usual course of your business; **and**
3. The individual is independently established in his/her own business; **and**
4. The individual is responsible for filing a schedule of expenses with the IRS; **and**
5. The individual has established an account with the Department of Revenue and other appropriate state taxing agencies; **and**
6. The individual is maintaining a separate set of records for the business.

NOTE: *According to the IRS a worker's status under the common law test is determined by applying relevant facts that fall into three main categories. All facts must be considered. No single fact provides the answer.*

1. Behavioral controls: A worker is an employee when the business has the right to direct and control the worker even if they do not actually exercise that right.
2. Financial controls: A worker who has the opportunity for profit or loss; or unreimbursed expenses; or a significant investment in the work may be an independent contractor.
3. Relationship of the parties: A written contract may show the relationship between the worker and the business. Receiving benefits indicates the worker is an employee.

We have tried to make this payroll letter as complete and accurate as possible. Laws change, however, and we ask that you consult the government websites or publications for the most recent regulations. Please call us if we can be of assistance.