Navigating
**Income Tax**

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 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 $160,200 (in 2023) 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 on their individual income tax return for the excess taxes paid, the employers do not receive a corresponding credit for the excess taxes paid. A 0.9% additional Medicare tax also applies to Medicare wages that exceed $250,000 for married filing jointly taxpayers, $125,000 for married filing separately, and $200,000 for all other taxpayers. An employer is responsible for withholding the additional Medicare tax from wages it pays to an employee in excess of $200,000 in a calendar year, without regard to filing status. There is no employer match for additional Medicare tax.

## 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 is employed by and performs services for both businesses. The businesses are very successful, and Mike receives a salary of $200,000 from each business. Neither company is a Common Paymaster, so each business is responsible for collecting and remitting FICA taxes on behalf of their employees as well as withholding FICA taxes from their employees' wages.

As a result, each company paid $12,832 for FICA taxes ($160,200 times 6.2% plus $200,000 times 1.45%) for Mike and withheld and remitted $12,832 from Mike's paychecks for his share of Social Security and Medicare taxes. This results in total combined taxes paid by the companies of $25,665 in addition to $25,665 withheld for Mike's paychecks. Mike will receive a credit of $12,832 for the overpayment of his Social Security taxes on his individual tax returns and will pay an additional $1,800 in additional Medicare tax on his wages in excess of $200,000. The companies, however, will not receive a credit for the excess Social Security taxes paid, reducing Mike's share of income from his S corporations by $12,832.

If Mike were to elect 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 a single Form W-2 for wages for both companies. This would reduce the Social Security taxes paid by the companies and withheld from Mike's paycheck, and increase the Medicare taxes withheld from Mike's paycheck, resulting in a net taxable income increase of $19,865. Mike would no longer need to claim the credit for excess Social Security taxes paid nor separately pay the $1,800 in additional Medicare tax when he files his individual tax return.

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