



Santa Clara County Office of Education

Charles Weis, Ph.D.  
County Superintendent of Schools

# Informational Bulletin

## District Business & Advisory Services

Nimrat Johal: Director- DBAS: 408-453-6599

Cathy McKim, Manager-DBAS: 408-453-6588

Bulletin: 11-010

Date: March 16, 2011

To: District Fiscal Directors

From: Cathy McKim

Re: Payroll Process Changes for Third Party Sick Leave and Retirement Processing

I have attached the process changes for *Third Party Sick Leave and Retirement Error processing* pursuant to the discussion and subsequent agreement during the Fiscal Directors Roundtable on January 20<sup>th</sup>.

*Please distribute this memo within your District as deemed appropriate..*

Approved:

Nimrat Johal- Director, District Business & Advisory Services



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### Third Party Sick Leave Processing

#### **Background:**

Third party sick leave is used when an employee receives reimbursement if they are unable to work. Historically districts have processed their *Third Party Sick Leave* with the vendor issuing payments directly to the employee. These payments included deductions for the employee portion of FICA and Medicare, but did not include the employer portion of these burdens. The employer burdens were later processed by manual cash transfers to move the totals from the district's general ledger to the Santa Clara County Office of Education's (SCCOE) general ledger and a manual adjustment was made to the employee's W2 totals at year end. This process created a variance between payroll history contained in the payroll system (QSS) and the W2 totals.

#### **Relevance**

Section 931.5 of the California Unemployment Insurance Code (CUIC) provides that third-party sick payments are "wages" for the purpose of reporting Unemployment Insurance (UI) and Employment Training Tax (ETT). These payments are also reportable as Personal Income Tax (PIT) wages, which are wages subject to California personal income tax. Even though PIT withholding on these wages is not mandatory, the wages are considered taxable income to the recipient and must be reported on the recipient's California income tax return. Without exception, payments for third-party sick pay are not subject to State Disability Insurance\* (SDI).

#### **What Is Third-Party Sick Pay?**

Third-party payers, such as insurance companies or trusts, pay sick pay in place of wages. These payments are made to employees under a plan established for a participating employer during any period when an employee is absent from work due to illness or injury. These payments are sometimes known as short-term disability payments.

#### **What is NOT considered Third Party Sick Leave?**

- Payments made by a third party when the employee has paid the premiums are not third-party sick pay.
- Sick pay which is made after the first six calendar months following the last calendar month in which the employee performed services for the employer...
- Payments received under a workers' compensation law and SDI payments.
- A third party who makes sick payments to an employee as an agent of the employer is not considered a third-party payer. The determining factor as to whether a third party is an agent of the employer is whether the third party bears any insurance risk. If the third party bears no insurance risk and is reimbursed on a cost-plus-fee basis, the third party is an agent of the employer. Sick payments made by an agent of an employer are defined as "wages" paid by the employer.



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Per the Publication 15-A of the Internal Revenue Service, there are two scenarios for the payment of Third-Party Sick Pay.

***Employer's Agent:*** The third party that makes payments of sick pay as your agent is not considered the employer and generally has no responsibility for employment taxes. This responsibility remains with the employer. These payments should be paid directly to the employer and the employee should be paid through the employer's payroll system. Liability for payment of employee and employer taxes is the responsibility of the employer.

***Third Party Not Employer's Agent:*** A third party that makes payments of sick pay other than as an agent of the employer is liable for federal income tax withholding (if requested by the employee) and the employee part of the social security and Medicare taxes. The third party is also liable for the employer part of Social Security, Medicare, FUTA and 1099 reporting.

### **SCCOE Policy**

- Districts must ensure that third party vendors that are making payments directly to the employees are responsible for the tax remittance and reporting.
- All third party sick leave requiring district burden tax payments need to be processed through the payroll system.
- Manual processing of third party sick leave totals will no longer be processed. By eliminating the need for manual adjustments during calendar year end processing, payroll history records will retain data integrity and employees should receive their W2 forms earlier in January.



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### Retirement Error Processing

#### **Background:**

Historically, retirement errors have been identified after payroll had been processed and then corrected in the QSS Retirement system before the file transmission is sent to the reporting agencies. DBAS provided the information to the districts to refund or collect monies from the employees who had incorrect payroll information and created cash transfers to correct the money on the district's books. Additionally, manual W2 adjustments were made during year end processing to correct the employees wages. This process created a variance between payroll history contained in the payroll system (QSS), the retirement system and the W2 totals.

#### **Relevance:**

STRS continues to tighten the type of errors that the system will allow during the file import process. It is the goal of the STRS agency to realize a zero error tolerance rate. This restriction will force districts to verify the accuracy of the payroll data prior to submission to STRS. To meet the strict requirements and save districts interest and penalties for submitting incorrect data, Technology Services and DBAS are collaborating to identify several new automated processes to identify errors prior to payroll closing. This will enable Districts to identify and correct the data prior to data submission; ensuring that only accurate data is transferred. We believe that PERS will be doing the same thing in the near future and are making adjustments to facilitate their changes as well. These changes will insure the integrity of the data in the payroll system, the retirement system and the W2 is intact.

#### **SCCOE Policy**

- The Districts must maintain responsibility for employee retirement setup.
- The District will be instructed to identify and correct all errors in their payroll system prior to submission of data.
- Training and support will be provided to ensure that there is clear understanding of new rules, regulations and processes in place to identify and resolve errors .
- New methods for identifying errors as they are implemented will be communicated.
- Manual retirement and W2 adjustments will no longer be processed. By eliminating the need for manual adjustments during the year, payroll history records will retain data integrity and employees should receive their W2 forms earlier in January.