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entertainment industry payroll companies must pay up to fica "cap" on behalf of each producer for whom an individual performs services

MSK Client Alert

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On September 10, 2013, in *Cencast L.P. v. United States*, 112 AFTR 2d 2013-xxxx (CA Fed. Cir. 2013), the United States Court of Appeals for the Federal Circuit ruled that Cencast Services, L.P., and a number of other entertainment industry payroll service companies (collectively "Cencast"), could not apply the "cap" applicable to collection of the employer's share of FICA payments because Cencast was not the common law employer of employees it paid. This ruling could have a dramatic effect on how payroll service companies do business in the future and leaves open the possibility that the Internal Revenue Service (the "IRS") could look to production companies to pay underpayments of the employer's share of FICA payments.

Employers and employees are each required to pay their share of FICA payments. FICA payments are the nonmedical portion of the Social Security taxes. Unlike the medical portion, which is paid on all wages paid to an employee during a year, the nonmedical portion is collected only on wages paid to an employee up to a certain "cap." For 2013, this cap is $113,700. Since the FICA payments for employer and employee is 6.2% of wages, up to $113,700 of wages, the employer and the employee are each required to make up to $7,049.40 in FICA payments for wages paid in 2013.

In the past, payroll service companies collected the full employer's share from each of the production companies that hired them. However, where an employee worked for several production companies within the same tax year, the payroll service company would utilize the cap and remit to the IRS the maximum payment on the "capped" amount of wages. For example, if an employee worked for three production companies in a calendar year and earned $100,000 from each production company, the payroll service company

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would collect $6,200 from each production company, but only remit to the IRS 6.2% of the wages up to the applicable cap, and the payroll service company would retain as profit the difference.

As a result of the *Cencast* decision, there is a deficiency in the employer's portion of the FICA liability for certain employees paid by the payroll service companies. Although the payroll service companies are the "statutory employers" for payroll tax purposes, the Court concluded that the production companies for whom services are performed are "common law" employers, requiring the FICA cap to be applied to the wages paid on behalf of each common law employer each year. This means that, for an employee who earned $100,000 from each of three production companies in a single year, FICA taxes in the amount of $6,200 per producer (totaling $18,600) would need to be remitted by the payroll services company.

While only the payroll services companies were parties to the *Cencast* litigation, it appears that the producers, as common law employers, remain jointly and severally liable for these taxes. However, the employer's portion of the FICA liability is not deemed to be a "trust fund tax." Because of this, owners, officers, and employees of the payroll service companies and the production companies should not have personal liability for these taxes.

ASK MSK

Q: Does the *Cencast* decision have other implications for entertainment industry employers?

A: This determination of who is the "common law" employer is likely to have implications in other areas of law as well. For example, the regulatory agencies have stated that it will be the common law employer that is liable under the Affordable Care Act for penalties that may apply starting in 2015 to "applicable large employers" who do not provide compliant health coverage to "full time employees" (as those terms are defined under the Act). Thus, it would be reasonable to expect that a production company would be treated as the common law employer of its production employees paid through a payroll company for purposes of these rules under the Affordable Care Act.

Q: Does the *Cencast* decision have implications outside of the entertainment industry?

A: Today, many employers utilize employee leasing companies and temporary agencies to engage all or part of their workforces. Where an individual is employed by one such entity (such as a temporary agency) but performs services for more than one of that entity's clients in a single tax year, depending on the facts, arguments could be made that each such "client" is a separate common law employer and that FICA taxes must be remitted up to the "cap" for each such client that utilized the services of the same individual.