

The Easy Tax Season Glossary



Managing business taxes involves a lot more paperwork than filing your personal tax returns—and with that extra paperwork comes extra jargon. To lighten your mental load this tax season and help you with **payroll compliance**, we've taken some of the most commonly used tax terms and compiled a glossary of quick, simple definitions.

Are You Making These 5 Common Payroll Mistakes?

When payroll mistakes crop up, the impact can ripple across your entire company. Fortunately, the most common payroll errors are avoidable. Learn how to identify—and prevent—the most common errors.

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401 A

A **401(a) plan** is a defined-contribution retirement plan for public employees. Typically provided by government agencies, this employer-sponsored benefit plan allows participants to save for retirement on a tax-advantaged basis and may be offered alongside other savings plans as part of an employee's benefit package.

401 K

A **401(k)** is an employer-sponsored, defined-contribution retirement savings and investment plan often offered by private-sector employers. The plan is optional and has eligibility requirements, such as participant age and employment timeframe.

Employers may match employee contributions, but aren't legally required to do so. In a **traditional 401(k)**, money is deducted from an employee's pre-tax pay each pay period and deposited into the designated investment account. In a Roth 401(k), contributions are deducted after tax.

403(b)

A **403(b) plan**, or a tax-sheltered annuity (TSA), is an employer-sponsored retirement plan for public schools and other nonprofit organizations. Under this annuity contract, employees defer a portion of their paychecks to the designated investment account through automatic payroll deductions.

Employers may match these contributions, but they aren't required to. Contributions to a traditional 403(b) plan are made before tax, while contributions to a Roth 403(b) plan are made after tax.

Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) Tests

ADP and ACP tests determine whether a 401(k) plan disproportionately benefits your highly-compensated employees compared to your non-highly compensated employees. The ADP test compares the average employee contributions between the two employee groups, while the ACP test compares employer matching contributions. Your company's 401(k) plan must pass both these tests to meet IRS qualifications.

After-Tax Deduction

An after-tax deduction, also known as a post-tax deduction, is money subtracted from a taxpayer's earnings after taxes are withheld.

After-tax deductions can vary by state, but may include:

- Roth 401(k) contributions
- 529 college savings plans
- Union dues
- Disability and certain life insurance policies
- Charitable contributions

Before-tax Deduction

A before-tax deduction, or a pre-tax deduction, is subtracted from a taxpayer's earnings before taxes are withheld.

Examples of pre-tax deductions include:

- Traditional 401(k) contributions
- Medical insurance
- Dental insurance
- Health savings account (HSA) contributions

Circular E

Circular E is the Employer's Tax Guide published by the IRS. The publication provides guidance and instructions to employers about their federal tax responsibilities. It includes the basic IRS rules for withholding, reporting, and depositing taxes, correcting employment taxes, and other insights. Additionally, Circular E includes links to other helpful IRS publications employers may need.

CP-575 Letter

A **CP-575 letter** is issued by the IRS to confirm the Employer Identification Number (EIN) issued to your business. The EIN provided in a CP-575 letter is required to file your company's taxes, open a business bank account, and apply for a business credit card, loan, or payroll processing.

The CP-575 letter also provides information about tax forms the business will be required to file. Often, all you need to provide is the EIN itself—but the CP-575 proves the number is yours.

Deferred Compensation

Deferred compensation is a plan that allows employees to delay receiving a portion of their compensation earned in one tax year to a future tax year. Deferred compensation is not considered taxable income for employees until they receive the deferred payment in a future tax year.

Deferred compensation plans are not required for all employees. Employers that choose to implement a deferred compensation plan usually do so for key employees or high-earning employees in their organization. Employers should detail the conditions under which employees can access their deferred funds, and follow specific rules for deferred compensation to avoid penalties with the IRS.

Dependent Care Benefits

Dependent care benefits allow employees to withhold pre-tax money from each paycheck to help them pay for costs related to caring for a child, spouse, or other dependent adult living in their household. Dependent care benefits can be issued via a dependent care flexible spending account (DCFSA) offered by the employer, or through a childcare tax credit on the individual employee's tax return.

Earned Income Tax Credit

The **Earned Income Tax Credit (EITC)** helps individuals and families whose income is below certain federal thresholds receive additional tax benefits. Workers can receive a refundable tax credit if they earn income up to a specific threshold during the taxable year. The amount of earned income credit received and the income threshold varies based on each person's filing status, number of children, and income for the year.

Electronic Federal Tax Payer System

The **Electronic Federal Tax Payment System (EFTPS)** is an online tool that allows anyone—including business entities and the public—to pay their tax bill at no cost to them. The system also provides the opportunity to pay through voice response. The EFTPS system is provided by the US Department of Treasury free of charge and is available for processing payments 24/7/365.

The EFTPS system should not be confused with Direct Pay, which is an official direct-to-IRS system individuals can use to pay their tax bills. Unlike EFTPS, **Direct Pay** does not accept payments from business owners who file a tax return separate from their personal tax returns, and it caps each payment at \$10 million.

Employer Identification Number

An **Employer Identification Number (EIN)** is a nine-digit ID assigned by the Internal Revenue Service (IRS). One of five types of Tax ID Numbers (TINs), it's used to identify business entities and administer tax laws. The two-digit EIN prefix indicates the IRS location where the number was assigned and the subsequent seven digits identify the entity itself (e.g., XX-XXXXXXX).

Using this unique number reduces the likelihood of your business being misidentified. Much like a fingerprint, a business's EIN is entirely unique—it never expires or gets recycled for another company.

Free Download: Payroll Checklist

Nothing squashes employee morale like a botched payday. That's why we've wrangled all the important payroll to-dos you need to ensure accurate, on-time payroll runs for your company.

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Employer Payroll Tax

Employer payroll taxes are the taxes withheld from an employee's paycheck that companies are responsible for paying to the government. **Payroll taxes** are used to fund different programs, such as Social Security, Medicare, federal unemployment, and state unemployment benefits.

Federal Income Tax

Federal income tax is levied by the federal government on the annual earnings of individuals, businesses, trusts, and other legal entities. Not all earnings are subject to federal income tax, only those that fall under the category of taxable income (both earned and unearned).

Here are some examples of earnings subject to federal income tax:

- Wages and salaries (including those from self-employment)
- Bonuses and cash gifts from employers
- Tips and commissions
- Unemployment benefits
- Canceled debts
- Business income
- Gambling income
- Capital gains

Federal Tax Deposit

As an employer, one of your biggest responsibilities is to **withhold taxes from your employees' wages**. Taxes withheld on your payroll must be deposited to the IRS according to their requirements. When you make a deposit of those taxes, you're making a federal tax deposit. Employers must make federal tax deposits on a monthly or semi-monthly schedule.

Federal Unemployment Tax Act (FUTA)

The **Federal Unemployment Tax Act (FUTA)** is a federal law requiring employers to **pay unemployment tax**. Employers must file a FUTA tax form every year (Form 940), and FUTA tax payments are due the last day of the month at the end of every quarter.

FICA

FICA, or the Federal Insurance Contributions Act, is a US payroll tax deducted from employees' paychecks to **fund Social Security and Medicare**—two federal programs that provide benefits to retirees, people with disabilities, and children of deceased workers. Both employees and employers pay these taxes equally, but employers submit FICA tax payments on behalf of their workers.

Flexible Spending Account (FSA)

A **flexible spending account (FSA)** is an employer-sponsored benefit employees use to pay for approved health and dependent care costs. **Organizations can offer FSAs** along with an insurance plan, enabling employees to set aside money for qualifying expenses outside the scope of their policy. FSA contributions are pre-tax deductions.

Types of FSAs include:

- **Healthcare FSA:** This FSA is for any IRS-approved medical expense.
- **Dependent Care FSA (DCFSA):** This dependent care benefit is only for costs related to your employees' qualifying dependents (child or adult).
- **Limited-Purpose FSA (LPFSA):** An LPFSA is exclusively for dental and vision expenses not covered by an insurance plan.

Form 940

IRS Form 940, the Employer's Annual Federal Unemployment (FUTA) Tax Return, is a document employers must file to pay and report on their federal unemployment taxes. The amount of unemployment tax due is calculated and compared against the employer's liability and the tax already paid. It factors in payments to all company employees minus any tax-exempt deductions, such as group term life insurance, dependent care benefits, and some fringe benefits.

Multi-state businesses may also have to fill out Schedule A for Form 940 to calculate their credit reduction rate.

Form 941

IRS Form 941, the Employer's Quarterly Tax Form, is an essential tax form for businesses. Unlike individuals who file taxes on a yearly basis, most US employers are required to file quarterly federal tax returns. Businesses who have employees must file Form 941 to report federal withholdings from employees.

Required information includes:

- Number of employees
- Total wages paid
- Any adjustments made for tips, group life insurance, and sick days
- Federal income tax withheld from each employee
- All Social Security withholdings
- All Medicare withholdings

When filing Form 941, companies are also expected to pay the employer portion of FICA. The IRS deadlines for the quarterly forms are April 30, July 31, October 31, and January 31 of each year. Failure to file a Form 941 in time may result in penalties.

Form 1040-ES

Form 1040-ES is a tax form that taxpayers can file for estimated tax—income taxes on income that isn't subject to withholding. This includes earnings from self-employment, interest, dividends, rents, and alimony.

Form 1042-S

IRS Form 1042-S, Foreign Person's US Source Income Subject to Withholding, is used to report amounts paid to non-US citizens and non-residents by a withholding agent (US-based institution or business). This applies to non-resident aliens, foreign partnerships, foreign corporations, foreign estates, and foreign trusts subject to income tax withholding.

Form 1094-C/1095-C

Form 1094-C and **Form 1095-C** are forms used to report required information about healthcare to the IRS. Following the **Affordable Care Act (ACA)**, all applicable large employers (ALEs) need to report whether they've offered health coverage to each employee and whether those employees are enrolled in health coverage.

Form 1094-C is the summary of this information for all employees. Employers must file a Form 1095-C for all employees who were full-time employees during any month of the calendar year. They also need to send a copy of Form 1095-C to these employees.

Form 1099-NEC

Form 1099-NEC is part of a series of tax documents used to report payments made to **non-employees** (i.e., independent contractors, freelancers, or sole proprietors) who were **paid \$600 or more** within the tax year. A copy must be provided to the IRS and the payee, who must then report that income when they do their own taxes. This way, the IRS knows if there's a discrepancy between the reported income on a tax return and the total income a person actually received.

Form 1099-SA

A **1099-SA form** reports debits made from a **health savings account (HSA)**, Archer medical savings account (Archer MSA), or Medicare Advantage medical savings account (MA MSA). Its purpose is to show you (and the IRS) how much money you spent from your account.

For example, if you were to fall and break your wrist, you might use money from your HSA to pay for your medical bills. When it comes time to file your end-of-year income tax return, your HSA provider will send you a 1099-SA listing the amount you spent, so you can include that information with your tax return.

Form 1120

IRS Form 1120 is the federal tax return form for corporations. Form 1120 is used for reporting your corporation's income, gains, losses, deductions, and credits, as well as for calculating your tax liability.

Form 1120-S

Form 1120-S is the required IRS tax return document businesses registered as **S corporations (S corp)** use to report any profits, losses, and deductions for the fiscal year.

Because S corporations are pass-through tax entities—which means income “passes through” to the owners (referred to as “shareholders”)—business income is reported on the shareholders’ personal income tax returns. In other words, S corps don’t pay corporate taxes. Instead, the income is taxed at the shareholders’ personal income tax rate.

Form 1120-S generates a Schedule K-1 for each of your shareholders, specifying what income, deductions, credits, and other items each shareholder owns. Individual shareholders can then file their Schedule K-1 when filing their personal tax returns.

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Form 2553

Form 2553 is a tax form that a corporation can file to elect taxation as an **S corporation**. Form 2553 provides the IRS with information to continue the process of transforming a corporation to an S corporation. The form also provides documentation of the effective date of the S corporation election, removing the need to file other tax classification forms (such as **Form 8832**).

Form 8233

Form 8233 is a document issued by the IRS for nonresident alien (NRA) employees. This form helps NRA employees claim exemption from **federal income tax withholding (FITW)** based on international agreements between the US and their country of residence.

Generally, **Internal Revenue Code (IRC) section 1441** requires a 30% NRA tax withholding on any income for independent personal services. The exception to this rule includes individuals who are exempt based on tax treaties. Form 8233 applies the tax treaty benefit by claiming a reduced withholding rate or total exemption on US-sourced income.

Form 8832

Every business structure has a default tax status under IRS rules. **Form 8832**, Entity Classification Election, is an IRS document used to change a business entity’s default classification for federal income tax purposes.

Only qualifying entities can use this form, such as:

- Limited liability companies (LLCs)
- Partnerships
- Certain foreign entities

With Form 8832, businesses can elect to be classified (or re-classified) as a corporation, a partnership, or a disregarded entity (part of the owner’s personal income tax return).

Form I-9

Form I-9, or Employment Eligibility Verification, confirms an individual’s eligibility to work in the US. This form is a product of the **Immigration Reform and Control Act of 1986 (IRCA)**, which requires employers to confirm that employees are eligible for employment before paying them for work or services.

Form W-2

Also known as the Wage and Tax Statement, a **W-2 form** is a document an employer is required to send to each of **their employees and the IRS**. It reports an employee’s wage or salary and tax withholding information for the previous year. The W-2 is an important form for preparing federal and state tax returns.

W-2 forms are only given to employees. Independent contractors or those who are self-employed will receive an earnings statement on a **Form 1099** rather than a W-2. W-2s are also given out by third-parties who provided sick pay to any employee in the tax year.

Form W-3

Form W-3 is a tax form used by employers to report combined employee income to the IRS and the Social Security Administration. Employers who send out more than one Form W-2 to employees must complete and submit this form to summarize their total salary payment and withholding amounts.

Employers who send out a single Form W-2 don’t need a separate form to tally the total amounts, as they’re displayed on their single employee’s Form W-2.

Form W-4

The **IRS Form W-4**, Employee’s Withholding Certificate, is a form that lets employers know how much federal income tax to withhold from an employee’s paycheck. Employees can also use this form to claim certain tax credits and withhold additional amounts from their pay. The employer submits this form to the IRS on their behalf.

Form W-9

Form W-9, or Request for Taxpayer Identification Number and Certification, is completed when a person or company pays another person or company (e.g., independent contractors and freelancers). Note that the person completing the W-9 form isn't employed by the company but earns some form of income or payment from the company.

A W-9 isn't sent to the IRS but is considered a simple information-gathering form to help companies and banks prepare their taxes and report their finances. Form W-9 collects five pieces of information:

- Name
- Business name (if applicable)
- Address
- Taxpayer identification number or social security number
- Type of business, such as a sole proprietor, S-Corp, C-Corp, or other (if applicable)

Health Savings Account

A **health savings account (HSA)** is a tax-advantaged account employees can use to save money to pay for qualified medical expenses. It's tied to a high-deductible health plan (HDHP), and contributions are automatically deducted pre-tax from their paychecks each pay period. Employers may make matching contributions. Unlike an FSA, the money in an HSA rolls over into the next year and can be invested.

Imputed Income

Imputed income describes benefits employees receive that aren't part of their salary or wages (**company perks** like a car or a gym membership) but is taxed as part of their income. The employee may not have to pay for those benefits, but they are responsible for paying the tax on the value of them.

In the example of the company car, employees would have to pay taxes on the amount it'd cost to lease that same car. Some benefits employees receive are excluded and tax-exempt, such as health insurance or meals.

Self-Employment Tax

Freelancers, independent contractors, and other self-employed professionals are responsible for **paying several taxes** on their earnings—one of which is the **self-employment tax (SE tax)**. Used to fund Social Security and Medicare, the SE tax equals the total amount due for those two programs.

SE tax is higher than the Social Security and Medicare taxes you pay when you work for someone else because employers are required to split these taxes with their employees. When self-employed, **you're responsible for paying the full amount** yourself.

Social Security Number

A **Social Security number (SSN)** is a unique ID assigned by the Social Security Administration (SSA) to US citizens and other residents. Linked to a person's SSA account, an SSN is used to help accurately identify and record **Social Security wages** (employee and/or self-employment earnings) and determine benefits eligibility. If individuals don't have an SSN, they can get a **Tax Identification Number (TIN)**.

State Disability Insurance Tax (SDI Tax)

A **State Disability Insurance (SDI) tax** is a payroll tax required by some states. The money from an SDI tax is put into a state disability insurance program that provides financial assistance to workers who lose the ability to work due to a physical or mental disability not directly related to their profession.

An SDI tax is paid through employee payroll as opposed to workers' compensation insurance, which is paid for by employers.

State Unemployment Insurance

State unemployment insurance (SUI) is a tax-funded program to give short-term benefits to workers who have lost their job through no fault of their own, as determined by state law. The law varies in each state, but typically an employer will need to fund state unemployment insurance through a payroll tax.

Taxable Wage Base

The **taxable wage base** is the amount of an employee's income from which the IRS calculates an individual's tax liability for Social Security. In other words, the taxable wage base is the income an employee earns on which Social Security taxes must be paid.

An employer uses the **taxable wage base** to calculate the correct amount of Social Security taxes to withhold from a paycheck. It can also be used in other cases, such as to determine some state unemployment taxes, other state-specific taxes, or an employer's federal unemployment tax withholdings.

Tax Credit

A **tax credit** is an amount of money a business can subtract from its tax liability. For example, suppose that a company's tax liability is \$1,000,000, and the company claims tax credits totaling \$250,000. In that case, the company would now owe the IRS only \$750,000 in taxes.

The federal government offers tax credits to incentivize behaviors viewed as societally beneficial, like **fair chance hiring**. Tax credits often have strict qualification parameters and cap the amount of credit the business can claim.

Tax Identification Number (TIN)

A **Tax Identification Number (TIN)** is a general term that describes any identification number the Internal IRS uses to administer tax laws. A TIN is required when filing tax returns, withholding certificates for treaty benefits, and other tax-related documents.

Taxpayer identification numbers used by the IRS include:

- **Social Security Number (SSN):** This unique ID is assigned to US citizens and other residents.
- **Employer Identification Number (EIN):** An EIN is used for business entities, estates, trusts, and more.
- **Individual Taxpayer Identification Number (ITIN):** This ID is for individuals ineligible for an SSN.
- **Adoption Taxpayer Identification Number (ATIN):** This temporary ID number is issued by the IRS to individuals who are in the process of legal adoption.
- **Preparer Taxpayer Identification Number (PTIN):** A paid tax preparer must use a valid PTIN on all prepared returns.

Tax Levy

A **tax levy** is a collection process used by the IRS to legally seize a taxpayer's assets to satisfy unpaid taxes. Assets that may be seized through the tax levy process include:

- Bank Accounts
- Investment Accounts
- Account Receivables
- Wages
- Social Security
- Pensions
- Insurance Policies
- Physical Assets

Withholding

Withholding is the portion of an employee's wages that is left out of their take-home paycheck. Withholding is paid to federal, state, and local tax authorities. For example, the money deducted from a paycheck to pay federal taxes is called federal income tax withholding.

Withholding minimizes the amount of taxes employees have to pay when they submit their annual tax returns. An employee's earned wages along with the amounts withheld are shown on the Form W-2 they receive at the end of the year. 🌱

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