Enter Taxable 3rd-Party Sick Pay (Disability)

Overview
You can enter taxable third party sick pay on a payroll check in QuickBooks.

Assumptions
You have an active payroll subscription and would like to add third-party sick pay to your employee’s payroll.

Expected Outcome
Third-party sick pay will report correctly on tax forms.

Details
To allow the taxes to be withheld from actual wages paid to the employee, taxable 3rd-party sick pay should be included with a regular paycheck whenever possible. If this is not possible (for example, if the employee has not yet returned to work or the sick pay crosses over to another calendar year), then an "employee advance" may be necessary to cover the taxes. If the employee portion of social security, Medicare and or federal withholding has been paid by a 3rd party, also follow the additional steps at the end of this article.

To track, report, and create paychecks for taxable 3rd-party sick pay:

A) Create an Expense account:
1. Click the Lists drop-down menu and select Chart of Accounts.
2. Click the Account button and select New.
3. Select Expense and click Continue.
4. Enter the name of the new Expense account (something like, Taxable Third Party Sick Pay) In the Account Name field. Note: We recommend that you create this Expense account as a subaccount of "Payroll Expenses" to make the new account easier to find and to associate it with payroll expenses. To do this, check the Subaccount of box and select Payroll Expenses from the drop-down list.
5. Click Save & Close.
B) Create an Addition payroll item.
1. Click the Lists drop-down menu and select Payroll Item List.
2. Click the Payroll Item button, select New.
3. Select Custom Setup.
4. Click Next.
5. Select Addition, and click Next.
6. Enter the name of the new payroll Addition item (e.g., "Add Taxable Third Party Sick") in the Enter name for addition field, and click Next.
7. Select the name of the Expense account from the Enter the account for tracking this expense dropdown list, created in step 1, and click Next.
8. Select Compensation from the drop-down list, and then click Next. (The paid amount will appear in box 1 of the W-2 form).
9. Select the Federal and State taxes that apply. If sick pay is provided through a third party, such as an insurance company, income tax withholding does not apply unless requested by the employee.
10. Click Next.
11. Select Neither, and click Next.
12. Clear both fields (they should be blank).
13. Click Finish.

C) Create the "employee advance" payroll item to cover extenuating circumstances and to prevent creating a negative paycheck.
I). Create an Other Current Asset account.
1. Click the Lists drop-down menu and select Chart of Accounts.
2. Click the Account button and select New.
3. Select other Current Asset from the Other Account Types drop-down list.
4. Click Continue.
5. Enter the name of the new Other Current Asset account (something like, "Employee Advance") in the Account Name field.
6. Click Save & Close.
II). Create a new Addition payroll item.
1. Click the Lists drop-down menu and select Payroll Item List.
2. Click the Payroll Item button and select New.
3. Select Custom Setup, and click Next.
4. Select Addition, and click Next.
5. Enter the name of the new payroll Addition item something like, "Add Employee Advance") in the Enter name for addition field.
6. Click Next.
7. Select the name of the Other Current Asset account from the Enter the account for tracking this expense drop-down list created in step 3.a, and click Next.
8. Select None from the drop-down list, and click Next.
9. Click the Default button, and click Next.
10. Select Neither, and click Next.
11. Select net pay, and click Next.
12. Clear both fields (they should be blank).
13. Click Finish.

D) Create a Deduction payroll item.
1. Click the Lists drop-down menu and select Payroll Item List.
2. Click the Payroll Item button and then select New.
3. Select Custom Setup, and click Next.
4. Select Deduction, and click Next.
5. Enter the name of the new payroll Deduction item (e.g., "Deduct Taxable Third Party Sick") in the Enter name for deduction field.
6. Click Next.
7. In the dropdown box for the Liability account, select the name of the Expense account created in step 1, and click Next.
8. Select None from the Tax Tracking Type drop-down list, and click Next.
9. Do not make any selections. Be sure that no taxes are selected, and click Next.
10. Select Neither, and click Next.
11. Select net pay, and click Next.
12. Clear both fields (they should be blank) and click Finish.
E) Create paychecks.

1. Zero out any earning in the Earnings box.
2. In the Other Payroll Items field zero out any default deductions, addition or company contributions
3. In the Other Payroll Items field, select the new Addition item created in step 2 from the drop-down list, enter the amount the employee was paid in the Rate column.
4. On the next line in the other Payroll Items field, select the new Deduction Item created in step 4 from the drop-down list, enter the amount the employee was paid in the Rate column (a minus sign will automatically appear in front of this amount).
5. If an "employee advance" is required, select that payroll item created in step 3 on the next line in the Other Payroll Items field, and then enter an amount equal to the negative amount of the check to create a net zero check.

This procedure allows taxes to be calculated on the sick pay which was added to the Gross amount. The sick pay and the taxes now show on the W-2 form. The Deduction item then backs out the additional sick pay, so that the Net pay will not increase the paycheck.

If the employee portion of social security, Medicare and or federal withholding has been paid by a third party, also follow-the additional steps at the end of this article.

According to IRS Publication 15 (Circular E): Adjustments of tax on third-party sick pay.

Report both the employer and employee shares of social security and Medicare taxes for sick pay on lines 5a and 5c of form 941. Show as a negative adjustment on line 8 the social security and Medicare taxes withheld on sick pay by a third party payer. See section 6 of Publication 15-a for more information. In order to show QuickBooks that you do not need to pay the social security and Medicare wages withheld, create a negative liability adjustment once the paycheck has been created.
Track social security and Medicare payments made by a 3rd party and adjust the liability balance.

1. Go to the Employees menu, choose Payroll Taxes and Liabilities, click Adjust Payroll Liabilities.
2. In the Date field, enter the date for which you are making the adjustment. Note: QuickBooks auto populates today's date, but you should enter the date that you want the adjustment to be effective. Otherwise, this item will not show up in the appropriate Payroll Summary Report.
3. In the Effective Date field, enter the date that you want this adjustment to affect your liability balance. QuickBooks uses this date to calculate amounts on your Forms 940 and 941 and on the payroll liability balances report.
4. In this case choose to associate this liability adjustment with the company. Note: Since you are associating the adjustment to the Company, it will reduce the amount that is showing up in the pay liabilities screen. However, since you are not associating the adjustment with a particular employee the number reporting on the 941 will not be reduced. 941 lines will be reduced manually.
5. In the “Name Item Field”, choose the payroll item. In this case choose social security employee (Ignore the warning message) and Medicare employee (ignore the warning message).
6. In the Amount field, enter the amount of the adjustment. This should be the amount paid by the third party. To decrease the amount owed, enter a negative number in the Amount field.
7. (Optitional) In the Memo field, enter a note to yourself about the adjustment. The note will appear on any detail payroll reports that include this transaction.
8. Click Accounts Affected to check or modify the setting.
9. Click OK.
10. When prompted for an account to associate this adjustment with, choose the asset account to which you earlier associated the employee advance. This will offset the money that was loaned to the employee in order to cover the social security, Medicare and federal withholding paid by the third party.
Completing the **941**: If all your payroll liabilities have been paid for the quarter, line #14 will show a balance owed, equal to the amount that the 3rd party paid. Manually enter this amount as a negative number in Line 8.

**Completing the W-2**: In the **W-2 interview process**, Step 1: **Forms W-2 and W-3 Interview - Special Employees Situations**, you will be asked if there was any third party sick pay. **DO NOT** check this box. Doing so will cause this money to be reported twice on the **W-2s**.