Payroll Simplified: Third Party Sick Pay

What do you need to know about third party sick pay as an employer? Learn the difference between sick pay and third party sick pay, as well as what's entailed for each, in the next blog in our Payroll Simplified series!

Published September 18, 2018

First things first - what is sick pay?

Sick pay is money paid to your employees if they are temporarily absent from work because of an injury, illness, or disability. Often, that absence is due to either short-term or long-term disability.

How is sick pay different from workers' compensation?

Big difference here! Workers' compensation specifically refers to a *work-related* injury or illness, which means the injury happened on the job or the illness was somehow caused by working conditions. Sick pay, on the other hand, is a payment to an employee as part of a plan when the employee misses work for a medical cause unrelated to work.

Okay, so what is third party sick pay?

As an employer, you have a choice for how to execute sick pay for employees – either you can pay them directly, or you can use a third party, like an insurance company. Third party sick pay is basically what it sounds like – an external party pays your employees' sick pay.

What payments don't count as sick pay?

Don't get these payments confused with sick pay – they're separate payments and they're not taxed the same way!

- Disability retirement payments are a separate issue and don't follow the same rules – they fall under the category of pensions and annuities.
- Medical expense payments don't apply if they're paid under a specific plan or system (think insurance) for medical and hospitalization expenses.
- Payments that aren't related to an absence from work don't count either.

How does sick pay get taxed? Who pays the taxes?

When paid by a third party, sick pay is subject to social security, Medicare, and FUTA taxes. Usually the third party will withhold and deposit the employee social security and Medicare, and you, the employer, will be responsible for the employer social security, Medicare, and FUTA. However, if you pay the sick pay directly to your employee without the middle man, you must handle employee FICA as well, and also withhold federal income tax.

Which kinds of payments are not taxable?

Whether you or your third party pays, payments that are *not* subject to social security, Medicare, or FUTA include:

- Anything paid after an employee's death or disability retirement
- Anything paid to an employee entitled to social security disability insurance benefits (FUTA still applies though)
- Anything paid after an employee has been absent from work more than 6 months
- Anything paid that can be attributed to employee contributions

How is third party sick pay reported by the employer on the form W-2?

Assuming the third party has given you the job of taking care of the employer FICA and FUTA – which is what usually happens-- here's what you need to do:

- Include the taxable third party sick pay payments in Boxes 1, 3 and 5 on Form W-2.
- Any taxes withheld should be included in Boxes 2, 4 and 6.
- If any third party sick pay is nontaxable because the employee made contributions, report this amount in Box 12, Code J.
- Check off Box 13 "Third-party sick pay" as well.

The information in this article comes from the IRS. For more information on third party sick pay, visit the IRS website . For more Payroll Simplified blogs from our CPA, Malka Trump, click here.

This information is for educational purposes only, and not to provide specific legal advice. This may not reflect the most recent developments in the law and may not be applicable to a particular situation or jurisdiction.