



## **BASIC EMPLOYER PAYROLL ISSUES**

It's important to have a basic understanding of your tax obligations as an employer since Federal and State laws have numerous requirements that must be met from both a legal and a tax standpoint.

Keep in mind that most of these laws also apply to the business owner if the owner is set up as an employee of a corporation. If the business is a sole proprietorship or partnership, legal owners do not register as employees. However, for purposes of the following discourse, an owner is the same as an employee.

### **A Quick Overview Of Some Labor Law Guidelines**

As of the present year, 2000, federal labor laws revolve around 15 main Congressional Acts; the most prevalent one is the Federal Fair Labor Standards Act (FLSA). Not all employers must meet all the provisions of these Acts, and not all employees of covered employers must necessarily be included. However, employees may also be covered under numerous state labor laws which tend to mirror many of the federal laws. Therefore, a working knowledge of the main requirements from a tax standpoint are in order.

**Exempt vs Non-exempt employees:** The Federal and State labor laws tend to vary in some areas between these two classes of employees. Exempt employees are those who do not have to be covered under different provisions such as overtime pay. An exempt employee falls under the "laws of exception" so it is always important to get a ruling if there is any doubt about the exemption status. Generally, exempt employees are as follows:

Managerial types such as executives, professionals, outside sales people, other highly compensated individuals.

Certain employees in retail, seasonal, farming, domestic help, and transportation fields.

These exemptions can vary between the Federal and State levels and are based on criteria such as the type of business, nature of work, and customs of the particular industry. The difference between an exempt and non-exempt employee can be very difficult to determine, so unless you are 100% sure the employee is exempt, assume the opposite.

Therefore, the following guidelines (unless otherwise noted) will deal with non-exempt employee situations.

**Minimum Wage Laws:** The federal government and most states have minimum hourly wage amounts you must pay. For 1997, the Federal minimum wage was \$5.15/hour.



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**Overtime Pay:** All non-exempt employees must be paid one and one-half times the regular hourly rate for any hours worked in excess of 40 in a week. The employer cannot average the weeks, so even if the employee worked only 20 hours the week before, overtime must be paid if the work hours exceed 40 the next week. Also, the hours are calculated based on the full week, not per day. Thus, in this case the hours are averaged for the week. If an employee works 10 hours one day it doesn't mean overtime is required so long as the total hours for the week do not exceed 40.

**Vacation Pay, Other Fringes:** Normally there are no set requirements forcing you to pay for items such as vacation time, sick pay, premium pay, meal money, or other fringe benefits such as medical insurance, life insurance, etc. You may elect to do so as part of the employer package, but it isn't covered under Federal laws. However, if you are providing any of these to any employees, there may be various "non-discriminatory" testing rules to meet if you aren't covering ALL of your employees. This is a very complicated part of the compensation regulations.

**Travel Pay:** Unless it is part of an employee's job to travel between required job sites or meetings, you normally do not have to pay for travel time.

**Workers' Rights Notices:** The employer is required to post various notices listing workers' rights and grievance procedures. The particular notices to be posted vary with the type of employment and employees. If your employee files for unemployment benefits, the State will notify you and request information regarding the nature of the separation from employment. These notices should not be ignored if you are challenging the unemployment claim. Incidentally, your state unemployment rate you can rise with incidents of employee unemployment claims, so don't ignore any situation you feel is unwarranted.

**Worker's Compensation Requirements:** With very few exceptions, an employer should obtain Worker's Compensation coverage for all required employees. The rate that will be charged for the coverage varies with the type of work involved, and employees covered. Without this coverage, however, the employer is extremely vulnerable for damages should an employee receive job-related injuries. This coverage is obtained on the State/local level rather than the Federal level.

## **Employee Tax Registration Forms Needed**

Employees must record certain information for income and payroll tax validation purposes. These forms are: W-4 Form, I-9 Form, and related State Withholding Allowance Certificates.

**W-4 Form:** This form records the employee's name, address, social security number, and number of "withholding allowances" to be claimed. These allowances help to determine how much income tax should be withheld from one's pay. The employee signs this form. The employer keeps this W-4 on file.

**State Withholding Allowance Certificate:** Similar to the W-4 Form, this helps to determine how much State income tax should be withheld from an employee's pay (in States where an income tax exists).

**I-9 Form:** This is now a required form for nearly every employee. There are few exceptions, and since the potential penalty for failing to have one of these on file can be upwards of \$20,000 per violation, you should make this mandatory for all employees. The purpose of this form is to verify an employee's eligibility for employment according to Immigration laws.



The "citizen vs alien" status is recorded, and a section containing identity and employment eligibility verification is checked off. Both employer and employee sign this I-9 Form, and it is kept on file with the W-4. In effect, the purpose of this form is to ascertain that the person is not an "illegal alien" for job purposes.

## **Types Of Payroll Taxes That Must Be Paid**

As an employer, you must take on the task of being a type of collecting agent for the government. You are required to properly withhold and/or pay various Federal and State payroll taxes. Failure on your part to properly do this can result in heavy penalties.

Some of these taxes are paid by the employee, and therefore withheld from pay. Others are paid by you, the employer. The main taxes paid by the employee are Federal Income Tax, Federal Social Security Tax, Federal Medicare Tax, and State Income Tax. The main taxes paid by the employer are the employer's share of Federal Social Security Tax, Federal Medicare Tax, Federal Unemployment Tax, State Unemployment Tax and State Worker's Compensation.

These employer/employee taxes are collected by you, the employer, and sent to the government or a designated agent on a periodic, timely basis. Failure on the employer's part to do this can result in very heavy penalties and interest. For the Federal government, the normal procedure is to make these deposits using a set of pre-printed Tax Deposit Coupons(Form 8109) which are obtained by applying on Form SS-4.

On a timely basis you fill out one of these coupons designating the type and amount of the tax payment; usually it is brought to an authorized depository bank(most commercial banks are authorized). States have similar types of coupons to use for State withholding purposes; however most businesses are allowed to send these coupons directly to the State instead of going through the bank.

**Payroll Deposit Rules:** The size of the calculated payroll tax liability usually determines the frequency with which you must make these deposits. It can get quite complicated as the payroll liability grows. The government offices want the money as soon as possible! On the State level the payment usually is based on a monthly or quarterly schedule except for very large businesses. However, the Federal requirements are either monthly or semi-weekly deposits for the average business.

The two main exceptions to this are: If the total of payroll tax liability(FUTA excluded) for a 3 month period is less than \$1,000 then this amount can be paid when the quarterly payroll tax return is filed. If the tax liability reaches \$100,000 the deposit generally must be made the next banking day after this threshold is reached. FUTA tax must be deposited once the liability reaches \$100.

The State Unemployment Tax is generally calculated on a quarterly basis and paid subsequently. Since this is a State employer-paid tax it doesn't come under the previously-mentioned deposit due dates.



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**Special Note On Payroll Tax Liability:** The government views the employer as a collecting agent with fiduciary responsibilities to forward these payroll taxes. It is important to keep current with them since you can be held personally liable for any deficiencies. If your company becomes unable to pay these taxes, the IRS can impose this obligation on any responsible party. Also, bankruptcy does not usually absolve you of these particular tax obligations.

## **Tax Returns That Must Be Filed**

Above and beyond collecting the required payroll taxes, an employer is required to file periodic Federal and State payroll tax returns. These are filed on a quarterly basis. The returns are actually due by the end of the following month of the quarter in question. In addition, yearly W-2 Forms must be filed to summarize the payroll numbers. A brief description of the tax returns and forms is as follows:

**Federal Form 941:** A quarterly tax return which summarizes the Federal income tax withholding, Social Security tax, Medicare tax, and tax deposits made.

**Federal Form 940:** A yearly tax return which summarizes the Federal Unemployment Tax owed and paid on behalf of all appropriate employees.

**Federal and State W-2 Forms:** Yearly forms to be given to employees and copies to be sent to the governments detailing the wages and taxes per employee.

**Federal and state W-3 Transmittal Form:** A yearly form which summarizes the totals of the individual W-2 Forms for federal and state income tax, and Social Security Administration purposes.

**State Unemployment and/or withholding Tax Return:** Usually a quarterly tax return which calculates the unemployment tax and/or withholding tax the employer must pay on behalf of each qualifying employee.

**Worker's Compensation Reporting:** This employer-paid expense is not truly a payroll "tax" but it is a direct result of having employees, so it is listed here. This is payable on the State level, usually to an authorized State agency/ carrier. The report is usually in the form of a yearly review by the appointed agent. Since Worker's Compensation rates are based on the type of employee and nature of the work, this report categorizes the payroll and size to determine if any additional liability is due.

## **Required Recordkeeping**

Having employees means keeping good records for a number of reasons. First, it's the law. Second, in the event an employee challenges you regarding pay or overtime or worker's compensation issues, the burden is oftentimes on you to prove your case instead of the employee's claims.

With the exception of the previously mentioned Federal and State Withholding Allowance forms, records may be kept in many ways.



However, the minimum requirements are:

Personal information:	name, address, birth date, social security number.
Workweek information:	hour and day week begins, hours required to be worked for the week.
Pay Calculations:	hours worked per day and week, hourly pay rate, straight-time and overtime rate calculations, deductions from wages, pay period date, and payment date.

Most employers do this with a form of a payroll register. While time cards are not legally required, most employers also have employees fill out some type of record of hours worked.

Payments to the employee should detail how the gross and net pay has been calculated, and a form of a "pay stub" should be given for each pay period. Obviously employees should be paid by check whenever possible. In situations where this is not possible, a signed receipt from the employee should be obtained.

Payroll records should be kept for a minimum of three years beyond the year of occurrence. However, due to possible State or Social Security Administration inquiries, a more widely used time frame is 7 years.

## **Put Your Payroll Policies In Writing**

Even if you may have no legal requirement to have written personnel policies, it is a good idea to at least have pay policies in writing. It can avoid serious misunderstandings with employees, and it can bolster your case against any challenges by authorities.

If you are going to offer any extra benefits like vacation pay, sick pay, holiday pay, insurance, retirement funding, etc., you should put your policy in writing—especially if these benefits will not be available to all employees. Disclosing in advance how you will handle severance pay can save you from a disgruntled employee's challenge down the road. Legally clarifying Exempt vs Non-exempt employees is practically mandatory.

Here are some tips on a written pay policy:

Be as specific as you can be for each issue. If you are paying for holidays, which holidays? How many vacation days? What type of insurance coverage?

Get a receipt from the employee acknowledging a copy of the pay policy was received.

If certain employee categories are excluded from certain benefits detail these variances clearly.

Have a qualified legal adviser go over it before you give it to anybody.



## **Conclusion**

Payroll issues for a business can get complicated—and expensive. You take on fiduciary responsibilities, and legal responsibilities. The forms, reports, and returns that must be timely and properly filed can be quite a challenge. There is added expense above and beyond the actual cost of paying the employee wages. First, there is the extra cost of the employer's share of various payroll-related taxes. Then there is the cost of filing the required Federal and State tax returns, W-2's, and so forth.

Unfortunately, this complexity is a "necessary evil" if you want the business to operate on a legitimate level. The positive aspects are that you can deduct the qualified business expenses associated with payroll, so you are sharing some of the expense with the government. In addition, if you do this properly instead of cutting corners you can have peace of mind and protection for yourself, your business, and your employees.