The Top 10 Payroll Mistakes

...And What to Look Out For

Intuit® Payroll

#1 Employee Misclassification

Employees or Contractors? This common misclassification can mean serious employment tax penalties

- Some small businesses avoid the extra costs of having employees (paying Social Security, Workers' Compensation and State Unemployment Insurance are three examples) by classifying their workers as independent contractors and paying them with Accounts Payable checks.
- Misclassifying employees as independent contractors will indeed eliminate certain taxes, but the mistake is serious. If you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker.
- The main factor in determining how to classify workers is the degree of control the business has over its worker. The more control the business has over a worker; the more likely it is that the worker is an employee rather than an independent contractor.
- Answer questions like these about each of your workers before deciding if they legally qualify as independent contractors. If your answers are all "yes," to these questions a worker is almost certainly an employee, not an independent contractor:
  - Do you control their work and hours?
  - Do you control how their work will be done?
  - Do you furnish their tools and equipment?
- For more information, visit www.irs.gov. Or consult with your accountant or tax professional.

#2 Errors in Filling Out Form W-2

This is the most common tax form employers file and naturally suffers the most frequent errors – both simple (which boxes to use?) and complex.

- You must furnish copies B, C, and 2 of Form W-2 to every employee by January 31 that lists their total wages and deductions for the prior year. To meet the 'furnish' requirement, the form must be properly addressed and mailed on or before the due date. You are also required to file Forms W-2 and W-3 with the SSA by February 28 or 29, or if filing electronically by March 31 of the following year. The filing deadlines for state and local government agencies vary, which may depend upon your filing method (electronic or paper).
- Mismatching is so common that the Social Security Administration runs a toll-free Employee Verification Service at 1-800-772-6270. You can verify up to five employee names and Social Security numbers on each call for no fee. You can also use their online verification system (SSNVS) to verify up to 10 names and SSNs (per screen) and receive immediate results or upload overnight files of up to 250,000 names and SSNs and usually receive results the next government business day. For more information on SSNVS, visit the SSA website at http://www.ssa.gov/employer/ssnv.htm.
- Other problems are easier to avoid. Don't write dollar signs in the boxes. Government optical scanners often read them as eights. Using a computer (or typewriter) font that is too large or too light is a common mistake. Stick with 12-point Courier and use only black ink.

- Believe it or not, Linda Stiff, Acting Commissioner of Internal Revenue, has this suggestion for filing: place the numbers in the middle of the boxes for maximum clarity.

- For more information, you can get the W-2 instructions from the IRS website at http://www.irs.gov/formspubs/lists/0,,id=97817,00.html.

#3 Missing Tax Deposit and Filing Deadlines

There are considerable penalties for missing the deadlines for depositing your payroll taxes and filing the required reports.

- Nearly every payroll professional in a large company has a calendar over his or her desk with all the deadlines for federal, state, county and municipal tax deposits (which really mean "payments") and tax filing deadlines for the entire year. You must also report the earnings and withholdings of each employee, payments to contract workers, total withholdings amounts and other information.

- You or your accountant have a lot of other things to worry about, but if you're not also focused on all those deadlines, one of them will bite you sooner or later. And in this case, a "bite" means a hefty penalty for late payment or reporting.

- Some business taxpayers are required to use EFTPS (Electronic Federal Tax Payment System) because they have met certain criteria. One criterion is if your total deposits of all federal depository taxes (such as employment tax, excise tax, and corporate income tax) during a calendar year exceed $200,000, you are required to use EFTPS beginning in the second succeeding calendar year. For example: if you had more than $200,000 in federal tax deposits in calendar year 2005, you are required to use EFTPS beginning January 2007.

- For more information, visit www.irs.gov. Or consult with your accountant or tax professional.

#4 Messing Up Form 1099-MISC

The IRS finds businesses make many mistakes in the forms required for independent contractors.

- So long as the independent contractor provides the employer with a valid Taxpayer Identification Number (TIN), the employer's only obligations are to give the contractor a Form 1099-MISC at the end of the year stating how much the contractor was paid for the services rendered (if the total was at least $600) and to send a copy of the form to the Internal Revenue Service.

- 1099-MISC forms are due to your independent contractors the following year by January 31. File Form 1099-MISC on paper or magnetic media by February 28 (March 31, if filing electronically). Also, file a Form 1096 with paper forms. The requirement will be met if the form is properly addressed and mailed on or before the due date. If the regular due date falls on a Saturday, Sunday or legal holiday file by the next business day.

- To report payments to an independent contractor on Form 1099-MISC, you must obtain the independent contractors TIN. You may use Form W-9, Request for Taxpayer Identification Number and Certification, to obtain the independent contractors TIN. An independent contractor is required to promptly supply its TIN. If the independent contractor fails to provide its TIN you must backup withhold on the reportable payments.

- For more information, visit www.irs.gov. Or consult with your accountant or tax professional.

#5 Miscalculating State Unemployment Tax

The State Unemployment Tax is an employer-paid (also employee-paid in some states) but state-run program, and all the states have different rules.

- The Social Security Act of 1935 required all states to set up unemployment compensation programs, and the Federal Unemployment Tax Act (FUTA) was passed to assist states in funding them. If you fail to pay your State Unemployment Tax on time, you can lose the federal unemployment credit at the end of the year.

- Are you paying at the correct rate for your company? Are you using the correct maximum amount of wages? And if a claim is filed, who will supply the required information — you, your accountant or payroll provider? These are important questions for an employer to consider on state unemployment taxes.

- Some states have employee paid tax in addition to the employer paid tax, such as Alaska, New Jersey, and Pennsylvania.

- For more information, contact the Federation of Tax Administrators at www.taxadmin.org and the U.S. Department of Labor at www.dol.gov.

#6 Mishandling Garnishments, Levies or Child Support

As part of your payroll, you may have to pay money your employee owes to a third party.

- The government decided that the best way to collect certain court-determined debts was to go to the source — the employer — and collect the money directly from the employee's salary.
- If someone wins a money judgment in court against your worker, they can garnish the wages. You have to withhold it, write a check, and send it to the third party. Similar rules apply to workers with court orders to pay child support through payroll deductions. Certain levies can also be applied against a salary.
- This is a quagmire for employers of every size. There are rules for withholding, for how much an employee must be allowed to retain, and for which one of multiple claims gets paid first. A child support income withholding must be paid before all other garnishments. Not only must child support be paid first, a higher percentage of the employee's disposable income can be withheld for child support. The only withholding that takes precedence over child support is a federal tax levy issued prior to when the child support order was established.
- For more information regarding multiple orders, visit the U.S. Department of Health & Human Services at http://www.acf.hhs.gov/programs/cse/newhire/employer/publication/basic_iwo_guidelines_private.htm. Or consult with your accountant or tax professional.

#7 Poor Record-Keeping and Data-Gathering

A study by Nucleus Research shows payroll errors average nearly 1.2 percent of total payroll costs.

- Payroll errors — overpayments due to errors in data entry, misapplying pay rules and similar clerical mistakes — average nearly 1.2 percent of total payroll costs, according to the Nucleus Research report issued on 12/23/02. The same report found that the inflation of payroll due to inaccurate calculation of hours worked could also be a significant cost — an average of .72 percent.
- Don't forget, you have to maintain payroll records as a chronological history of your employment practices. Certainly a bother, but the alternatives are the usual: fines, penalties, interest, or even jail.
- Keeping accurate records for each employee is very important in order to stay in compliance with various federal, state, and local laws affecting payroll. It is important for you to be aware of your state and local regulations because they may be different than federal regulations.
- For more information, visit www.irs.gov., www.ssa.gov, www.dol.gov, www.uscis.gov, www.icesa.org.

#8 Not Displaying Wage Posters

Wage Posters are not artifacts of the Industrial Age or required only in factories.

- The federal government takes its requirement very seriously that you prominently display the poster publicizing the federal minimum wage and overtime pay standards. Even in your small office, it must be placed where employees will see it as they come and go from work.
- If convicted, the penalty for any person willfully violating any provisions of the FLSA, including the posters, may be a fine of not more than $10,000 or imprisonment for not more than six months, or both. That certainly makes it worth the risk of clashing with your wallpaper or other office decor.
- For more information, visit www.dol.gov.

#9 Breaches in Confidentiality

No one talks about their salary in public. No one should find out someone else's salary in private.

- Large companies have full-time professionals using automated systems with high levels of security. But, if you do payroll, you may push your ledger sheets aside to the corner of your desk to take an important phone call. Your accountant may pass the task around to several bookkeepers in the office.
- Your payroll system must be designed with complete confidentiality in mind. Remember, it's how much money you make, too!

#10 Claiming Ignorance

The most dangerous payroll mistake of all!

- Whether you do your payroll by yourself or use an accountant or outside service, reporting or paying all payroll taxes correctly and on time are ultimately your responsibility. What you don't know can definitely hurt you.

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