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Reshape your Payroll and HR:

Top 10 most common payroll and tax mistakes that will prevent your business from growing

Deluxe Payroll

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Introduction

Congratulations on achieving the American Dream!

Owning a small business means that you're part of something really big – the backbone of the American economy: Small businesses account for 99.7% of U.S. companies and employ nearly half of the private sector workforce.[1]

Of course, owning a small business also means that you've got to successfully manage countless tasks. And, when you're pulled in so many different directions, it's easy to make a mistake—especially when it comes to something as complicated as payroll and employment taxes.

This eBook will help you learn to recognize payroll and tax errors before a single paycheck is issued so that you can:

- Avoid potentially pricey penalties
- Keep your employees happy
- Continue to be a positive force in your local community
- Reap the benefits of your american dream come true!

[1] https://www.uschamberfoundation.org/smallbizregs/, accessed 12/6/2021

#1- Misclassifying the people who work for you

Defining who is an employee is not as simple as it sounds and involves laws, court cases and numerous state and federal agencies.

To grossly paraphrase playwright William Shakespeare, an employee by any other name is, well, not necessarily an employee by legal definition. The distinctions between employees and contractors, and exempt employees versus non-exempt employees, are critical for small business operators to understand when it comes to payday.

Employee versus contractor

Misclassifying the people who work for you can result in millions of dollars in government fines and jury awards. The reason legislators and regulators make such a big deal over classification is that it is the basis of significant revenue for the government. To put it another way, you're required to withhold and pay income, Social Security and Medicare taxes as well as unemployment taxes to help fund those important economic safety nets. And, these taxes must be taken from the wages you pay to your employees, but, generally, are not withheld from pay to independent contractors.

Defining who is an employee is not as simple as it sounds and involves laws, court cases and numerous state and federal agencies. Using the simplest standard as your guide: If an employer controls their work, the worker is an employee, not an independent contractor.[1]

However, the jurisdictions (that is, state, county and city) in which you operate your business may require other factors to be considered when defining who is your employee and who is a contractor, such as the amount of direction exercised over how the work is done, the results of that work and whether the worker has the right to provide similar services to other organizations.

[1] https://www.irs.gov/businesses/small-businesses-self-employed/employee-common-law-employee, accessed 12/6/2021

For example, the IRS defines an independent contractor as a worker for whom "the payer has the right to control or direct only the result of the work and not what will be done and how it will be done.[2]" California, for example, requires the application of an "ABC test"[3] to determine if someone is an independent contractor, and under the test, anyone who performs a service for someone else is assumed to be an employee. Be sure to check with your state to ensure you are classifying correctly.

Confused? You're not alone.

Exempt versus non-exempt

The main consideration between exempt and non-exempt employees is determining who is entitled to overtime pay. In a nutshell, non-exempt employees are usually hourly-based workers who are due overtime pay when they work more than 40 hours a week.

Exempt workers are salaried or on a consistent hourly schedule with a relatively unchanging paycheck. Exempt workers also usually hold managerial, administrative or degreed positions.[4]

Small business operators need to understand the distinction between exempt and non-exempt classifications, because not paying overtime to non-exempt employees is a violation of the federal Fair Labor Standards Act, and can result in lawsuits and fines.

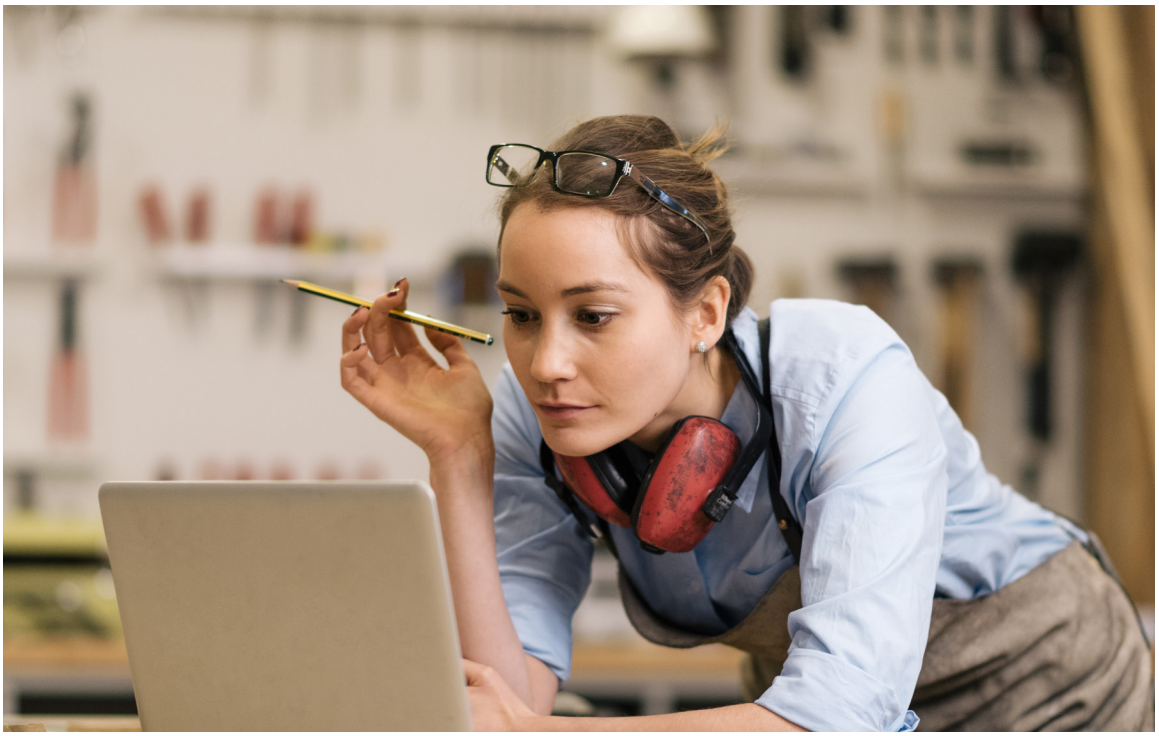
[2] https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-defined, accessed 12/6/2021
[3] https://www.natlawreview.com/article/it-s-official-newsom-expands-definition-employee-under-california-law, accessed 12/6/2021
[4] https://www.nfib.com/content/partner-program/money/are-you-guilty-of-committing-these-5-payroll-mistakes/, accessed 12/6/2021

#2- Not paying payroll taxes or missing tax deadlines

Unlike personal income taxes that most people pay once a year, staying on top of payroll taxes is a regular responsibility for employers – one that small business owners may unintentionally neglect.

The IRS and the states regulate your payroll tax payment schedule. Generally, the frequency of your tax payments depends on how often you pay your employees.[1] There are a number of rules about when to deposit your payroll taxes[2]; the key thing to remember is to make your tax deposit in a timely manner – either the same day as you pay employees or shortly thereafter.

Another common mistake is not matching tax payments with pay periods. In other words, if you pay your taxes monthly, but your employees receive paychecks every two weeks, you could be risking tax penalties.



[1] https://www.score.org/blog/most-common-payroll-mistakes-your-business-can-make, accessed 12/6/2021
[2] https://www.irsvideos.gov/Business/SBTW/Lesson7, accessed 12/6/2021

#3- Generating W-2s with errors

Most of us who've held a job are familiar with the IRS' W-2 forms – the annual statement showing how much we've earned and how much has been withheld for taxes and other, voluntary withholdings.

The W-2 is a relatively simple form, but it's easy for managers and business owners to make mistakes on them – such as placing a decimal point in the wrong place or adding dollar signs to the amount boxes. Other common errors include:

- Misspellings or other errors in an employee's name
- Mistakes in the employee's Social Security Number (SSN) or the Employer Identification Number (EIN)
- Inaccuracies or miscalculations in dollar amounts regarding retirement contributions, employer-sponsored health coverage, wages or tax withholdings

Fortunately, it's easy to correct these errors, because failure to do so can result in IRS fines totaling up to $200,000 for small businesses.[1]

[1] https://www.irs.gov/pub/irs-pdf/iw2w3.pdf, accessed 12/6/2021

#4- Miscalculating or not paying overtime

When the work in your company needs to get done, overtime can be inevitable. But when you're extra busy, it can be challenging to keep track of who worked how many extra hours. It can be even more burdensome to calculate those extra hours and to figure out what pay rate your employees are entitled to for their extra work.

One of the most common mistakes employers make regarding overtime is misclassifying which employees are exempt and which are non-exempt (see Mistake #1); non-exempt employees are entitled to overtime pay while exempt workers, generally, are not. Other mistakes employers make when it comes to overtime include:

- Miscalculating the hourly rate. Overtime must be paid at 150% of an employee's hourly rate – but that hourly rate has to also include commissions, bonuses and shift differentials.
- Requiring employees to work through unpaid breaks or meals
- Not counting time employees spend putting on or taking off protective gear and clothing at the worksite
- Not counting time employees spend traveling for work (For example, if employees are required to report to a particular location, then are transported or drive from there to a worksite.)
- Not counting time spent on required training and other mandatory activities

If you're at risk of underpaying your employees when it comes to overtime, you need to know that the federal Department of Labor (DOL) is very clear: Employees have two years to recover any wages lost through underpayment. That's two years from the date when the underpayment took place. The DOL makes an exception for deliberate underpayment of overtime. In that case, the statute of limitations stretches to three years.[1]

[1] https://smallbusiness.chron.com/statute-limitations-discovery-payroll-error-77707.html, accessed 12/6/2021

#5- Failing to properly maintain payroll records

Did you know that employers are required to keep certain employee payroll records for up to four years after they leave the organization?

The federal government, for example, requires employers to keep Form I-9 (the form every employee fills out to verify that they're legally eligible to work in the United States) on file throughout the employee's tenure with you, and then for a minimum of three years from the hire date or one year from the termination date, whichever is longer.[1] Form W-4, which determines tax withholdings for each employee, must be kept for a minimum of four years.[2]

The Fair Labor Standards Act[3] also mandates that employers keep the following information on file for each non-exempt worker:

- Employee's full name and social security number
- Address, including zip code
- Birth date, if younger than 19
- Sex and occupation
- Time and day of week when employee's workweek begins
- Hours worked each day
- Total hours worked each workweek
- Basis on which employee's wages are paid (e.g., "$9/hour, $440/week, piecework")
- Regular hourly pay rate
- Total daily or weekly straight-time earnings
- Total overtime earnings for the workweek
- All additions to or deductions from the employee's wages
- Total wages paid each pay period
- Date of payment and the pay period covered by the payment

[1] https://www.ice.gov/factsheets/i9-inspection, accessed 12/6/2021
[2] https://www.irs.gov/taxtopics/tc753, accessed 12/6/2021
[3] https://www.dol.gov/agencies/whd/fact-sheets/21-flsa-recordkeeping, accessed 12/6/2021

#6- Not staying compliant with employment tax laws

Employment tax laws such as federal income tax withholdings, Social Security and Medicare taxes and federal unemployment taxes apply to all employers, including small businesses. Staying on top of the ever-changing rules and regulations around these laws can be daunting even for the most experienced Human Resources practitioner, especially when you consider that the U.S. tax code alone has grown tremendously over the years. For Tax Year 2021, the tax code contains nearly 10,000 sections. Over the past 10 years, it is estimated that the tax code has been amended or revised over 4,000 times.[1]

As if that weren't enough, states also make regular changes to their labor laws covering issues as diverse as paid family and sick leave, equal pay, unemployment and exempt salary thresholds.[2]

Given the magnitude of existing laws and never-ending changes, it can be tempting to keep your focus on what you do best – run your operation – and hope that your business will fly under the radar when it comes to labor law compliance.

Doing so can result in fines up to $10,000 and even jail time.[3]

[1] https://www.efile.com/tax-history-and-the-tax-code/, accessed 12/6/2021
[2] https://www.natlawreview.com/article/roadmap-to-compliance-major-employment-laws-effective-january-2021-and-beyond
[3] https://www.dol.gov/general/topic/youthlabor/enforcement, accessed 12/6/2021

#7- Ignoring or not properly processing wage garnishments

An employee's personal credit card debt, alimony, child support, federal and state income taxes, and even student loans and medical bills can become an employer's responsibility if that employee fails to make their payments. Under state and federal wage garnishment laws, creditors have the right to turn to the individual's employer to seek recompense; and even though ignoring a garnishment order can result in extreme penalties, some businesses still choose to ignore the summons.

In most states, an offending garnishee (the employer) is liable for up to the full amount of the debtor's (whether this person turns out to be an employee or not) outstanding debt. Courts are holding employers liable for large sums of money for simply missing answer deadlines or for filing defective answers.[1]

To make matters worse for the employer, court-ordered garnishments can be confusing. That can lead to mistakes in responding properly within mandated timeframes and in accurately calculating the amount that needs to be withheld from the employee's paycheck. Mistakes like this can cause your business to be liable for the entire debt.[2]

[1] https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/wage-garnishment-orders.aspx, accessed 12/6/2021
[2] https://www.hg.org/legal-articles/employer-s-failure-to-garnish-employee-wages-47605, accessed 12/6/2021

#8- Not automating the payroll process

Payroll has traditionally been one of the most expensive operating costs and one of the most demanding administrative burdens for small businesses.

Consider everything that goes into calculating your company's payroll:

- Determining hours, deductions, and paid time off
- Processing direct deposit payments
- Prepping payroll taxes
- Submitting governmental tax remittances according to the most current rules and regulations
- Generating reports

It's no wonder that processing payroll takes a lot of time and money for every employer. But, for small businesses, payroll has traditionally been one of the most expensive operating costs and one of the most demanding administrative burdens. About one-third of small businesses surveyed spend more than six hours each month handling payroll internally, while one-third of businesses with five or more employees spend more than six hours per month handling payroll taxes internally.[1]

Processing payroll with only spreadsheets and calculators comes with another burden: mistakes are a lot easier to make, and those mistakes can result in stiff IRS penalties and unhappy employees.

If you've not considered payroll outsourcing before, it's important to understand that it's safe, secure and reliable.

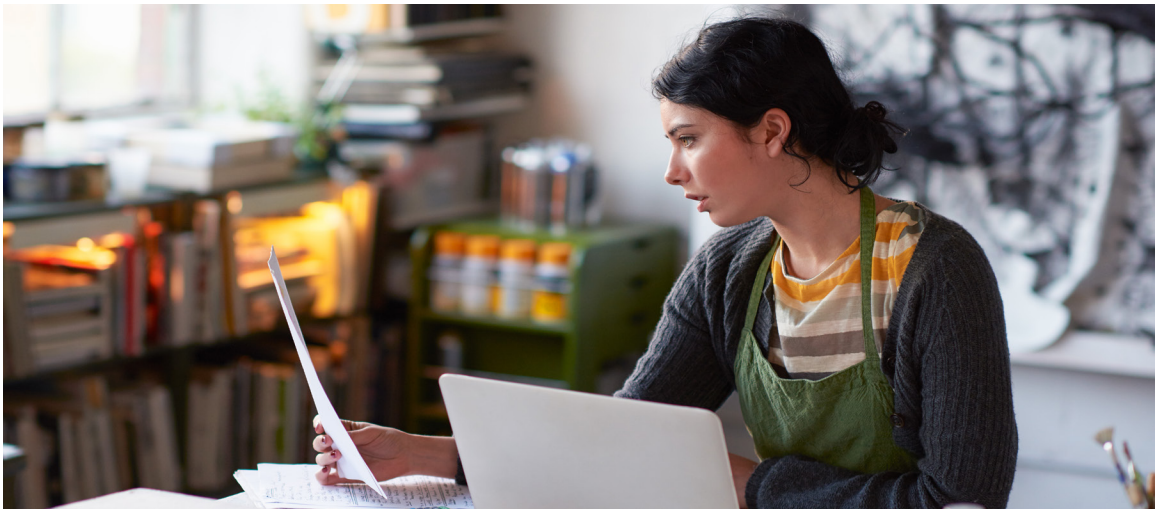
[1] https://nsba.biz/wp-content/uploads/2018/04/Tax-Survey-2018.pdf, accessed 12/6/2021

#9- Failing to deposit employment taxes correctly or on time

According to the IRS, not depositing employment taxes, or failing to do so by specified deadlines, is a common mistake made by small businesses.[1]

Every business owner who has employees is required to deposit the taxes they withhold from employees' checks, plus the employer's share of those taxes, through electronic fund transfers. If those taxes are not deposited correctly or on time, the IRS could fine the business owner. Penalties are figured by multiplying the amount of the tax not paid by a percentage rate:[2]

- 1-5 days late = 2%
- 6-15 days late = 5%
- 16+ days late = 10%



[1] https://www.irs.gov/newsroom/four-common-tax-errors-that-can-be-costly-for-small-businesses, accessed 12/6/2021
[2] https://www.irs.gov/pub/irs-pdf/p3151a.pdf, accessed 12/6/2021

#10- Not training new HR employees[1]

Employee turnover is a common challenge for payroll, but when turnover occurs within your payroll or HR department, the obstacles to stay on top of your tax obligations can be especially challenging. Every new payroll hire must be trained in the tax code and in your system, which takes time and resources away from other essential tasks. You might need to implement an in-house training program to make sure new employees are up to speed with your payroll tax payments and filings.

Even if you don't experience much turnover, in-house staff probably need to undergo training every time tax laws change. Again, this takes time and resources away from other business operations; plus, it can be costly if you send staff to tax seminars or hire outside help to teach in-house staff about new regulations.

[1] https://www.deluxe.com/blog/12-payroll-tax-filing-challenges/, accessed 12/6/2021

Conclusion

If you'd rather spend your time and energy tending to your business instead of dealing with payroll and employment taxes, now is a good time to consider partnering with an experienced payroll service that can help you meet your tax obligations, streamline operations and avoid penalties.

Deluxe Payroll and HR Solutions offers a full suite of payroll and tax filing services designed to help you maintain compliance and transform your time-starved days so you can grow your business.

10 things you can do with the time you'll Save by automating your payroll with deluxe

1. Watch these 10 movies that every entrepreneur should see.
2. Take long lunches with your significant other.
3. Take up kickboxing – not only will you get into great shape, it's a terrific stress buster.
4. Read these 9 books for small business owners.
5. Explore areas of your community that you're not familiar with.
6. Join, or even coach, a local sports league – from cornhole and dodgeball to cycling and volleyball.
7. Take a cooking class.
8. Rock out to your favorite jams.
9. Make time for a favorite hobby – or try a new one.
10. Take a vacation.

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