

# The 15 Biggest Payroll Mistakes

*And How You Can Avoid Them*

 **Intuit**® Payroll Services



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Payroll is an essential business practice — like sales and customer service — not just a twice-monthly bookkeeping annoyance. Since it is the primary way employees are rewarded and retained, late or incorrect paychecks can lead to a dissatisfied, unmotivated workforce — or worse. It can be hard to retain people when a company gets payroll wrong.

The employer / employee relationship is highly regulated, and many of the rules are reflected in payroll. There are literally hundreds of things to know, and an equal number of mistakes you can make. As a result, payroll is much more complicated than anyone who has never done it can possibly know.

Since you have done payroll and do know, it shouldn't surprise you that payroll is one of the oldest commercial computer applications in the world. In 1954, GE bought the first computer sold to a private company, a UNIVAC I, and promptly programmed it to run their payroll! Now the computer sitting on your desk today may have processing power thousands of times greater than that 50-year-old UNIVAC I, but the challenges of payroll are not just computational: They frequently depend on access to outside information and knowing constantly changing rules and regulations. So your desktop computer by itself gives you only the slightest leg up.

And the consequences of some mistakes can be much more serious than your checks simply being wrong. Many mistakes result in getting a very hard time, not from your employees or colleagues, but from people you don't already know and certainly don't want to know!

We don't want you to meet those federal and state government enforcement types either. So here are the 15 biggest (and often the most frequent) mistakes in payroll and how to start avoiding them today.

# #1

## Misclassifying Employees as Independent Contractors

There's one sure way to avoid doing payroll — not having any employees.

- 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 (see Mistake #6) will indeed eliminate certain taxes, but the mistake is serious and illegal.
- Answer these questions about each of your workers before deciding if they legally qualify as independents. If your answers are all “yes,” a worker is almost certainly an employee, not an independent contractor:
  - Do you control their work and hours?
  - Do you furnish their tools and equipment?
  - Do you forbid them from substituting someone else to do their work?
- For more information, contact the Internal Revenue Service at [www.irs.gov](http://www.irs.gov).

# #2

## Fouling Up 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 get a W-2 to every employee by January 31 that lists their total wages and deductions for the prior year. You also need to file this form with other government agencies by deadlines that depend upon your filing method (electronic or paper).
- Mismatching names and Social Security numbers is one of the most common W-2 filing errors, resulting in earnings not being properly credited to employees and problems with Social Security payments. Leaving out other taxable items (see Mistake #9) also happens frequently.
- 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.
- 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 popular mistake. Stick with 12-point Courier.

- Believe it or not, one IRS Section Chief suggests placing the numbers in the middle of the boxes as the top filing tip she recommends!
- For more information, contact the Social Security Administration at [www.ssa.gov](http://www.ssa.gov).

# #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.
- You are also required to use EFTPS (Electronic Federal Tax Payment System) for your payments if your yearly obligation to the federal government totals \$200,000 or more. Even a small company can reach this threshold faster than you'd imagine, since it includes all corporate taxes, payroll taxes (quarterly Form 940 and yearly Form 941) and pensions.
- For more information, visit [www.irs.gov](http://www.irs.gov).

# #4

## Misclassifying a Worker's Employee Type

The major question is whether your employees must be paid overtime or not.

- The Fair Labor Standards Act (FLSA), enforced by the U.S. Department of Labor, sets the rules here. Put much too simply: Salaried employees are “exempt” from the overtime rules; “non-exempt” employees, who are most frequently paid by the hour or the day, must be paid overtime. The rules are precise and must be applied properly.

- Many small employers don't know the rules. The principal test to decide which type is correct centers around managing others and the authority to hire, promote, or terminate the employment of others. But an "exempt" employee also can't work on non-exempt duties more than 20% of the time (twice that for retail and service businesses) and must be paid at least \$155 per week. A "non-exempt" employee can also be paid a per-day salary, but must still be paid overtime after working more than 40 hours in a week. There are other specific requirements for "administrative" and "professional" employees, and, as with all federal employment rules, there are exceptions for certain industries and jobs.
- Learn the rules, apply them correctly, and don't ever think your mistakes won't catch up with you. A disgruntled worker will see the overtime standards on your required Wage Poster (see Mistake #12) along with clear information about how to contact the Wage and Hours Board should they want to lodge a complaint against you.
- For more information, contact the U.S. Department of Labor at [www.dol.gov](http://www.dol.gov).

## #5 Improper Overtime Payments

Everyone knows hourly employees get time-and-a-half after 40 hours of work a week. Right? Not always.

- Employees must be paid according to all the other mandates of the Labor Department and the states. Are you calculating the overtime rate properly? A very common small business practice is granting compensatory overtime or "comp time" (time off) instead of paying overtime as legally required. This is illegal in most situations. Under the FLSA, only state or government agencies may legally offer comp time, and even then it's subject to a raft of exclusions. Some states do allow it, but it's tricky.
- Overtime is not always 1.5 times the employee's hourly rate. In fact, you must add in other payments, such as production bonuses or shift differentials, in calculating an employee's overtime rate. Go to California and the rules change. (If you already live in California, many of the rules did change on January 1, 2003.)
- You must follow any state's Wage and Hour regulations if they are more generous than the federal rules.
- For more information, contact the National Association of State Workforce Agencies at [www.icesa.org](http://www.icesa.org) and [www.dol.gov](http://www.dol.gov).

## #6 Messing Up Form 1099-MISC

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

- If your business provides services and is not incorporated, you may receive a Form 1099-MISC from your own clients totaling their payments to you for the tax year. Whatever the structure of your own business, however, you are required to send a Form 1099 to report all payments for services of \$600 or more to all of your own independent contractors. None is required for payments to a corporation or for goods.
- 1099 forms are due to your independent contractors every year by January 31 and to the IRS by February 28. And there are penalties for not sending them on time.
- The simplest way to get the information you need for them is to send your vendors a Form W-9 (before paying their invoice!) which requests name, address, and Tax ID Number (either Social Security or Employer ID Number). Be sure to transfer the information carefully. The IRS says mismatching names to taxpayer identification numbers is the most significant mistake occurring on Form 1099.
- For more information, visit [www.irs.gov](http://www.irs.gov).

## #7 Miscalculating State Unemployment Tax

The State Unemployment Tax is an employer-paid 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 — not to mention contesting the claim, if that's appropriate?
- You are also required to post state-supplied information about unemployment benefits or notify terminated employees that they could be eligible for them. An employer who fails to provide notice can be sued if an

eligible employee fails to file a timely claim.

- For more information, contact the Federation of Tax Administrators at [www.taxadmin.org](http://www.taxadmin.org) and [www.dol.gov](http://www.dol.gov).

## #8

### Mishandling Garnishments, Levies or Child Support

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

- Long ago, 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. Naturally, the states also get involved, typically requiring child support be paid first. But, if a federal tax levy arrives in your office first, it gets deducted first. Except for the exceptions, naturally.
- For more information, visit [www.irs.gov](http://www.irs.gov).

## #9

### Ignoring Other Taxable Items

You need to withhold taxes from more than wages.

- All gifts, prizes, bonuses, and awards employees receive are taxable, including any use of a company car.
- Unlike wages, there are several ways to withhold taxes from these items. Pay the amount on a regular pay-check, and it's taxed at the normal rate. Pay it separately, and you must withhold at the supplemental tax rate (27% in 2003). Or "gross it up," paying the tax due on the gift yourself, but that becomes income, too! Don't let the complexities stop you from giving those gifts and awards. You know how critical incentives are to a business, but remember to withhold taxes for them.
- For more information, visit [www.irs.gov](http://www.irs.gov).

## #10 Incorrect Forms I-9

The U.S. Immigration and Naturalization Service (INS) requires a form, too — for every employee.

- Originally designed to discover foreign nationals ineligible to work in the U.S., INS Form I-9 must be completed, up-to-date and ready for inspection at any time for every single employee in your company hired after November 8, 1986 — citizen or not. In 2003, the penalty is up to \$1,000 for each employee who has not completed one.
- But keep in mind, that penalty may be nothing compared to the bureaucratic briar patch you'll be tossed into for employing an unauthorized worker, whom you must still pay and properly report their earnings even though they do not have a valid Social Security number!
- For more information, contact the U.S. Immigration and Naturalization Service at [www.bcis.gov](http://www.bcis.gov).

## #11

### 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 because of mistakes or "buddy punches" on the time clock 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.
- How long do you have to keep payroll records? Which agencies decide? About 10 different agencies and laws have requirements (counting the states as only one!). Here are only the most common items and how long to keep them. Did someone mention the "paperless" office?!?
  - time sheets (three years),
  - cancelled and cashed checks (four years),



- payroll registers showing payment and deduction detail (requirements vary, but four years covers everybody), and
  - Forms W-4 (complicated, but five to six years). (Note: These time frames can differ from state to state and some states require an employer to be able to provide records within a certain period of time, or incur fines.)
- For more information, visit [www.irs.gov](http://www.irs.gov), [www.ssa.gov](http://www.ssa.gov), [www.dol.gov](http://www.dol.gov), [www.ins.bcis.gov](http://www.ins.bcis.gov), [www.icesa.org](http://www.icesa.org), [www.NucleusResearch.com](http://www.NucleusResearch.com).

## #12 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](http://www.dol.gov).

## #13 Breaches in Confidentiality

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

- There is at least one taboo left in public discourse: Your weekly salary. The best place to find out someone else's salary is in your company's payroll processing records.
- 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!

## #14 Check Fraud

Writing your payroll checks on your local bank's regular paper may be like handing a stranger a signed, blank check.

- There are dozens of ways to change the dollar amount on a regular business check, and more are being invented every day. And with sophisticated color scanners, copiers and printers easily available, reproducing checks to commit fraud is not rocket science.
- Perhaps no one working for you would ever commit check fraud, but they might endorse your check over to someone who would.
- Have you noticed how many different security features payroll companies have on their check paper? Since they write more checks than any other business in the country, they have already discovered the dangers. Consider upgrading your check security.

## #15 None of This Applies to Me

The most dangerous payroll mistake of all!

- Please don't think your business is too small, too local or too simple to have to comply with all these constantly changing federal and state rules and regulations. Don't fool yourself.
- At first glance the FLSA — with all its fundamental rules about minimum, overtime and equal pay — may not seem to apply to you. It seems to require that two or more of your employees be engaged in interstate commerce in order to apply. But accepting an out-of-state credit card puts you into interstate commerce!
- Some businesses are automatically required to comply, including dry cleaners and construction companies. And the FLSA has been amended often enough since 1938 that now virtually all businesses have to follow most of it.
- Assume you must comply until definitively told otherwise. And remember, however your payroll is done — by yourself, an accountant or an outside service — reporting and paying all payroll taxes correctly and on time are ultimately your responsibility. And what you don't know can definitely hurt you.

# The Best Way To Avoid Payroll Mistakes — And Stay Out Of Trouble

## Use Intuit Payroll Services!

At Intuit Payroll Services we take the hassles out of doing payroll. We offer you payroll services designed to meet your individual needs. From do-it-yourself solutions to full-service outsourcing, all our services are designed to help keep you in compliance with payroll regulations. And for whatever service you choose, we also offer tools that provide compliance guidance all in one place for payroll and employment laws that can help you avoid ever making these or other payroll mistakes.

## Intuit Payroll Services Solutions:

### QuickBooks Do-It-Yourself Payroll

Manage payroll yourself using QuickBooks — includes the tools and tax tables you need

- Tax table and form updates to help reduce the penalties and hassles from incorrect payroll withholdings
- Automatic earnings and deductions calculations in QuickBooks

### QuickBooks Assisted Payroll

Keep control over your payroll data using QuickBooks while we handle payroll hassles like tax filing and W-2 preparation for you

- Tax filing services that help you process payroll — all from within QuickBooks
- Maintain control of your payroll in QuickBooks — including your ability to print checks and payroll reports
- Our “No-Penalties” Guarantee\* assures the accuracy and timeliness of your payroll taxes

### Intuit Payroll Services Complete Payroll

The only full-service payroll solution that seamlessly downloads data into QuickBooks by the makers of QuickBooks.

- Full-service payroll to help streamline managing your business
- Give us your payroll data via Web Entry, PC Entry, fax or phone and we do the rest
- Better insight into your business with 40 comprehensive reports at no additional cost
- Our “No-Penalties” Guarantee\* assures the accuracy and timeliness of your payroll taxes
- Comprehensive human resources and benefits services

Over 800,000 companies manage their payroll with one of Intuit's payroll solutions. We offer a better way to do payroll by giving customers more value for about the same, or less, cost than they are paying today. Why would you ever trust your payroll to anyone else?

Call 1-800-365-9621 today.

**Don't work another day without the ease and convenience of Intuit Payroll Services. Help protect yourself from payroll tax violations.**

\*If the data you supply is accurate, on time and your account is sufficiently funded, your payroll tax deposits and filings will be on time and accurate or we'll pay the resulting tax penalty.

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