

Eleven Mistakes to Avoid with Payroll Legal Obligations

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Payroll legal obligations can put companies and managers at great risk in many ways. If you have anything to do with employee payroll and related matters, be aware of the following 11 mistakes and corresponding penalties.

If an employer mishandles payroll-related responsibilities and fails to forward the correct amounts of withheld taxes and matching contributions, the IRS will seek recovery and penalties.

And the IRS doesn't care where the money comes from. If the business owner or the corporate entity doesn't have the money, the IRS will do its best to get it from the individual or individuals who were responsible for the payroll-related duties.

How can workplace leaders have a *personal* risk in payroll obligations? Isn't it the responsibility of the business? It's because specific laws and court decisions interpreting laws have put obligations on *employers* and then extend the obligations to *agents* of the employers. When executives, managers, supervisors, and other employees make decisions and take actions involving employees... they can be considered *agents*.

The Internal Revenue Code gets even more specific. Section 6672 reads: "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

To make matters worse, the IRS can go after and collect unpaid payroll taxes from as many people as it finds liable. In other words, even if one person has already paid the debt, the tax agency can collect it again from one or more other responsible individuals.



Mistake #1: Failing to deposit withheld income taxes, Social Security and Medicare contributions, and employer matching amounts on time. The government wants its money by strict deadlines. Penalties accrue quickly if your business or organization misses deposit deadlines.

The penalty for not making deposits on time is:



- 1 to 5 days late, 2 percent of amounts due.
- 6 to 15 days late, 5 percent.
- 16 or more days, 10 percent.
- 15 percent if notice from the IRS is ignored, plus interest on the amount not deposited, plus 100 percent of the uncollected amounts if the failure to deposit is willful.

Note this grave, personal danger: These penalties can be levied personally against all responsible *individuals* in a business or organization. The corporate veil is no shield in these situations. Any *individual* with a responsibility for getting the money to the government on time faces possible exposure to penalties and fines.

Mistake #2: Under-withholding and failing to match required amounts.

The employer's obligation is to withhold income tax, Social Security, and Medicare contributions from employees' pay, as well as match the Social Security and Medicare contributions. Failure to do so subjects the employer to late deposit penalties of up to 15 percent of the under-withheld and under-deposited amounts. If the IRS deems the under-reporting or under-depositing willful, the penalties can be up to 100 percent of the uncollected amounts.

As is true with failing to make deposits in a timely manner, under-withholding and failing to match amounts creates a *personal* risk to *individuals* with a responsibility for getting the correct sums of money to the government on time.

Mistake #3: Failing to pay -- or under-paying -- state and federal unemployment taxes. The greatest portion of unemployment insurance (UI) taxes is levied by the state. And state-levied penalties vary. Since state UI funds are being exhausted in this period of high unemployment, states are aggressive in collection efforts.



Mistake #4: Failing to process wage garnishments correctly. Federal and state laws obligate employers to accurately withhold from employee pay, and remit, court-ordered garnishments, levies, and child support.

Violating these laws can result in penalties, depending on state laws. Also, federal law limits the amount of earnings that can be garnished, and protects employees from being terminated from their jobs because of a first-time garnishment. A violation can mean reinstatement of a discharged employee, payment of back wages, and restoration of improperly garnished amounts. Employers who willfully violate the discharge provisions of the law can be prosecuted criminally and fined up to \$1,000, imprisoned for not more than one year -- or both.

Mistake #5: Making unauthorized deductions from an employee's pay. Employers can legally deduct from an employee's pay *only* amounts authorized or required by law (such as tax withholding), by court order (such as garnishments), and amounts authorized by the employee (such as the employee's share of health insurance).

What are unauthorized deductions? State laws vary and it can be tricky. In addition, federal wage and hour law requires payment of agreed upon and earned wages (with the allowed deductions listed above.)

Do you ever feel compelled to dock an employee's pay if he or she breaks or damages company products or equipment? Check first with your attorney to see if this is permitted by your state law -- even with the employee's permission

Mistake #6: Treating some workers as *independent contractors* when they're not. Misclassifying employees as independent contractors exposes employers to substantial legal costs and penalties.



In an effort to increase collections, the IRS and state agencies have ramped up investigations of misclassified employees. When a misclassification is discovered, the employer becomes obligated for unreported and undeposited withholding taxes, Social Security and Medicare contributions, penalties, and possible liability for employee benefits. When the IRS deems the misclassification to be negligent, the penalties can be up to 100 percent of the uncollected taxes.

And the payment of unreported taxes and contributions isn't just for the past year. When the IRS and state agencies discover the misclassification of just one or two employees, this can trigger audits of the employer's employment for prior years.

Mistake #7: Failing to include the value of awards, bonuses, and fringe benefits (when required) in employees' taxable incomes. This action then results in the failure to withhold sufficient amounts from the total reportable income and not reporting the total reportable income to the IRS. *The risk:* The employer is subject to under-reporting penalties of up to 15 percent of the under-withheld and under-deposited taxes. If the failure is willful, the penalties can be up to 100 percent. And the employer could also be subject to information return penalties for incorrect W-2 forms (up to \$50 penalty for each incorrect W-2).

Mistake #8: Using bogus or incorrect Social Security numbers for employees on their W-2 Forms and failing to accurately complete I-9 Forms. The risk: The employer can be subject to information return penalties for incorrect W-2 Forms, of up to \$50 for each incorrect W-2. This mistake or failure by the employer also creates issues for the employees involved because they aren't receiving proper earnings credits through the Social Security Administration.



Mistake #9: Failing to pay at least the higher of the federal or state minimum wage to non-exempt employees... as well as overtime in any seven-day workweek in which they work more than 40 hours. *The risk:* If this error is discovered, the employer is required to compensate the employee for back pay, plus fines and penalties. In addition to the fines and penalties imposed by the Department of Labor, the employer likely will be subject to federal and state wage and hour audits and owe additional amounts

Mistake #10: Not preparing and filing W-2 forms, and failing to send them to employees. The risk: The employer can be subject to information return penalties for incorrect W-2 forms, penalties of up to \$100 for each incorrect or unreported W-2. For intentional failure, the penalties can go up to \$200 for each incorrect statement.

Mistake #11: Failing to abide by state laws. It's not just the federal wage and hour rules that employers must comply with. Employers need to be aware of, and comply with, the laws in the states

When Using Independent Contractors . . .

Here are a few quick tips to help protect your business:

- **Have written contracts** with independent contractors that spell out the details of the relationships.
- **Once contracts are in place, resist the urge to supervise** independent contractors in the same way as employees.
- **Maintain good records.** You obviously need to keep information required by the IRS, such as taxpayer information numbers. But also keep items that can help prove a person is self employed, such as business cards, newspaper and yellow page advertisements, invoices and letterheads.

Contact us today for assistance in classifying workers and dealing with the IRS on independent contractor issues.

