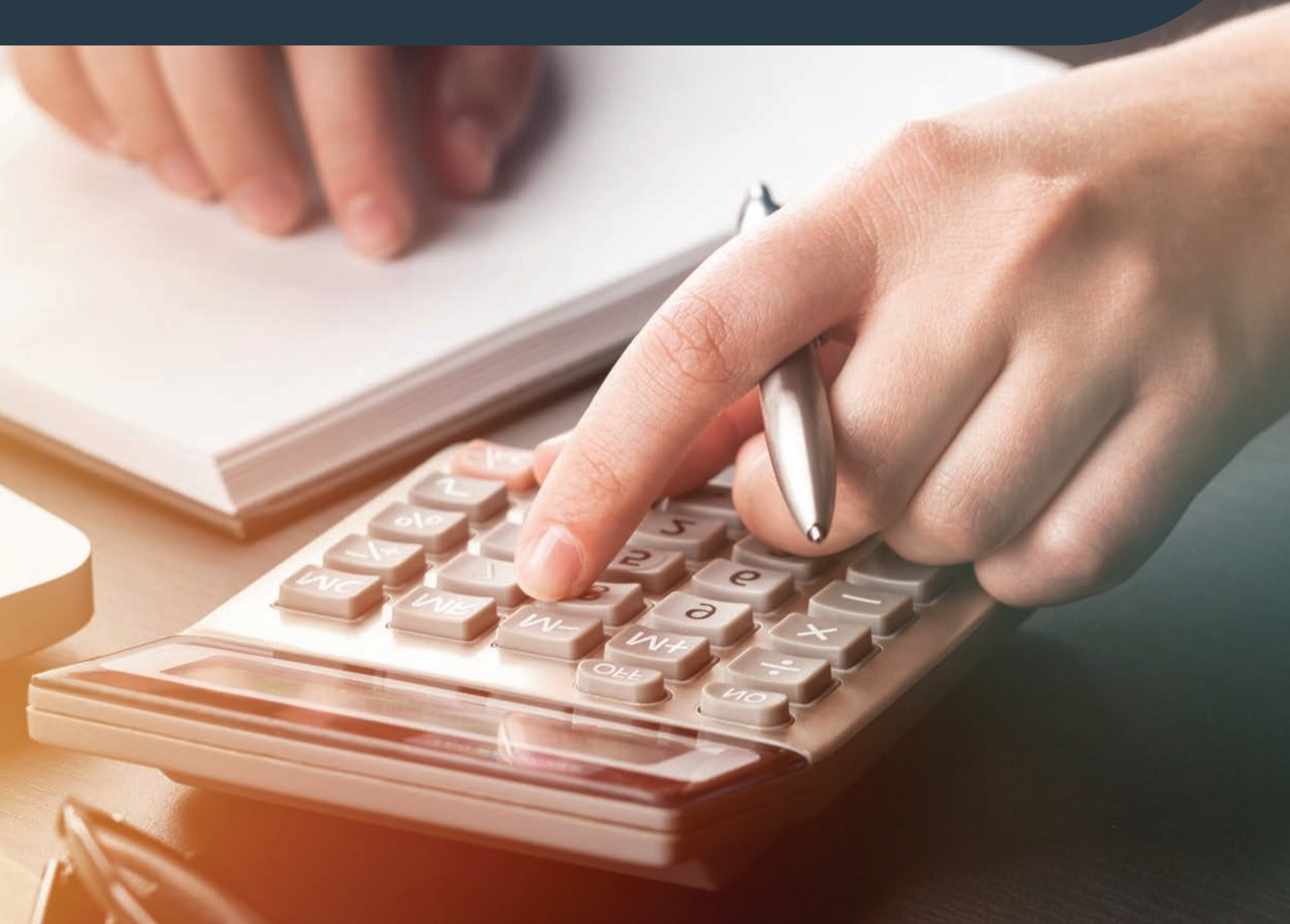
Fit Small Business

How to Do Payroll for Your Small Business



Introduction

Welcome to the Fit Small Business payroll ebook! We are so glad that you're here. We understand that payroll can feel like an overwhelming task for many business owners, but our goal with this ebook was to break down every step of the way to make it less scary. As we dive in, we're going to take a closer look at the payroll process overall and give you all of our best tips to ensure that your payroll process is as simple and effective as it can be.

We encourage you to start from the beginning, but feel free to jump ahead if you're looking for something specific. We'll talk about payroll calculations, laws, taxes, and best practices. You'll even get access to free payroll templates and calculators that you can start using today.

If you're interested in learning more about payroll providers that could be a good fit for your business, go ahead and check out our guide for the best providers for small businesses.

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CHAPTER 1

Payroll Basics

25 Payroll Terms Every Employer Should Know

When you're new to payroll, the lingo can sometimes leave you confused. It's important to invest some time into learning the most commonly used payroll terminology so you don't make any potentially costly mistakes.

The top 25 payroll terms you should know before running payroll are:

1. Accrue

This means to build up or accumulate over time. In payroll processing, accruals can happen a few different ways. Payroll accruals are funds owed to workers for hours they previously worked but haven't yet been compensated for.

Accruals also often happen as part of an employee benefits package. Many employers offer paid vacation, sick, and personal time, which is often earned on an accrual basis. This means that a certain amount of time off is earned per pay period.

2. ACH

ACH is an acronym for automated clearing house. An ACH is a computer-based electronic network for processing transactions. These transfers often include payroll direct deposits.

3. Deductions

Deductions are funds taken from an employee's paycheck. They are voluntary amounts that the employee elects to have taken from their pay (health insurance premiums, retirement plan contributions, etc.) These items can be considered pre-tax or post-tax, depending on the nature of the deduction.

4. Disposable Income

Disposable income refers to the wages left after all taxes and deductions have been taken from an employee's paycheck. This amount is used to determine the level of pay subject to garnishment or child support withholding.

5. Employee

Employee sounds straightforward, but we do need to clarify. Employees are workers formally hired to fulfill a specific position within a company. They should not be confused with independent contractors, which we will cover below.

Employers pay employees a reasonable wage and may offer benefits, especially if employees work at least 40 hours weekly; you must also pay and withhold taxes on employee earnings. In exchange, these employees must abide by company rules such as when and how to work.

6. Employer Identification Number (EIN)

The EIN is a unique nine-digit number assigned to all employers that submit an IRS EIN application; it helps identify businesses as they file taxes, apply for business loans, and open business bank accounts. In summary, it's like a Social Security number for businesses and required for any business processing payroll.

7. Exempt Employees

Exempt is a classification employers typically assign to employees paid a salary vs on an hourly basis (although in some circumstances, hourly workers can be exempt). Exempt employees are generally paid overtime for any excess hours they work over 40 in a week.

8. Fair Labor Standards Act

Also referred to as FLSA, you'll hear this thrown around quite a bit. This federal act consists of numerous laws meant to assure that employees are treated well and paid fairly. The federal minimum wage and overtime rules fall under this act as well as recordkeeping rules and child labor laws.

9. FICA Taxes

FICA taxes are Social Security and Medicare taxes that the federal government charges on each employee's earnings. Employers must reduce employee paychecks by 7.65% (6.2% for Social Security + 1.45% for Medicare) and pay that money to the IRS; they also have to pay that same amount from their business funds.

Additionally, employers must withhold an additional 0.9% for Medicare for any employee earnings that exceed $200,000 in the year ($250,000 for couples married and filing jointly). For Social Security, the maximum amount that can be taxed is $142,800 per year.

10. Fringe Benefits

Fringe benefits are additions to compensation that can be offered to employees. Some employers choose to offer these benefits universally to all employees, while others award them to high-level employees as an additional incentive. Some fringe benefits are taxable, and others aren't.

Fringe benefits include:

- Subsidized health insurance plans
- Gym memberships
- Tuition assistance programs
- Commuting benefits

11. Garnishment

Garnishments are court orders directing employers to withhold a certain amount from an employee's paycheck to pay an outstanding debt.

Employers are responsible for withholding and sending the money as directed on the garnishment notice; in addition, the notice will sometimes have an ending date that business owners can reference before stopping the collection process. It's imperative to act quickly after receiving a notice because employers can be held liable.

12. General Ledger

A general ledger (GL) is a record of accounts, identifiable by unique numbers and names used to track business transaction activities.

This is actually more payroll accounting than payroll terminology, but it's important to know because each time you run payroll the balances in select GL accounts change. For instance, when payday arrives and cash is transferred out of your bank account, the cash general ledger account should reflect the decrease.

13. Gross Pay

Gross pay is the amount of an employee's paycheck before payroll deductions are withheld. For hourly employees, this is their hourly rate multiplied by the number of hours they're being paid for across the period—plus any overtime, bonuses, and additional pay.

For salaried employees, gross pay is usually the same each payday; it's their annual salary divided by the number of pay periods in the year.

14. Independent Contractor

Independent contractors are workers hired to perform a specific job or project. They're not employees, so they aren't protected by federal labor laws or the federal government's minimum wage requirement. In turn, employers don't pay payroll taxes on their earnings; instead, they complete a 1099-NEC form for all contractors paid over $600.

It's important not to confuse contractors and employees. Unlike with employees, employers aren't allowed to dictate how or when contractors complete their work.

15. Minimum Wage

Minimum wage is the lowest hourly pay rate you're legally allowed to pay an employee. Per the Department of Labor (DOL), the federal minimum wage rate is currently $7.25 an hour, but state rates vary. There are exceptions, such as for minors and interns. Tipped employees are another group for which the law makes exceptions. Federal tipped minimum wage is $2.13 an hour, but employers must ensure that tips make up for the differential.

16. Net Pay

Net pay is the final amount you pay your employees for their work, after all deductions have been made.

17. New Hire Reporting

New hire reporting is a process employers undergo to report new hires to their state. Federal law requires that all new hires be reported within 20 days of their hire date, but some states are stricter (Alabama, for example, requires seven days).

All information is stored in the National Directory of New Hires and helps child support agencies locate parents who owe money. Before you can begin reporting, you must register under your state's New Hire Reporting Program.

18. Overtime Pay

Overtime pay is the additional hourly money you pay an employee in excess of their regular pay rate, usually for time worked over 40 hours in a seven-day period. Per federal law, these hours are paid at 1.5 times the employee's regular hourly pay rate. California law, however, requires double-time pay for all hours worked over 12 in a day and all hours worked over eight on an employee's seventh consecutive day of work.

19. Paid Time Off

Paid time off, or PTO, is time your employees don't spend working but still earn a paycheck (at their regular pay rate). It consists of any paid leave, i.e., vacation or sick time and even jury duty and holidays. Federal law doesn't have strict guidelines or requirements regarding PTO; you choose whether you want to offer paid vacation time or not.

State laws, however, differ; for instance, California requires employers provide at least 24 hours (three days) of paid sick leave each year.

20. Pay Period

A pay period is the time frame of work for which you're paying an employee. If you pay every other Friday, the pay period could be from the prior two weeks, with the last day being on the Friday that's also payday. Some employers prefer to push the pay period back a week, meaning the current week is always paid on the next paycheck; this gives them time to process payroll without having to predict work hours.

21. Payroll

Payroll is the process of paying employees for work they performed for your business. Federal, state, and sometimes local laws govern how you do payroll (and to an extent, how much you pay and how often), meaning you can't make up all the rules as you go.

The process also consists of withholding money for taxes and other employee expenses, not to mention paying your business employment taxes.

22. Shift Differential

A shift differential is a premium amount that you can pay employees who work outside of normal business hours. For some companies, this is the overnight shift and weekends. The additional pay is usually calculated as a percentage of the employee's pay rate, like 30% extra, or a flat dollar amount, like an extra $3 per hour.

23. Tipped Employees

Tipped employees are employees who regularly receive more than $30 monthly in tips for their work. Federal law allows employers to factor tips into their hourly pay rate.

As long as employee earnings at least equal the federal and state (and local, if applicable) minimum wage rate, employers can pay a federal tipped minimum wage of $2.13 an hour.

24. Unemployment Taxes

Unemployment taxes are taxes employers pay out of their own money to fund their state and federal unemployment programs. The federal unemployment tax (FUTA) rate is 6% on the first $7,000 each employee earns, and the state unemployment tax (SUTA) rate varies depending on the state. Rates depend on the length of time a business has been registered with the unemployment program—new employers have higher rates—and the number of claims that have been filed against the company. Fewer claims warrant a lower rate.

25. W-2 Form

The W-2 Form is a tax document that reports all employee earnings in addition to taxes and deductions withheld. Employers must send this document to all employees by January 31 following the year that's being reported.

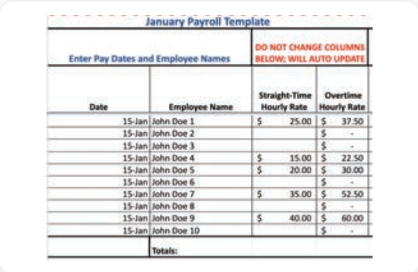
A copy should also be sent to the IRS and state tax agency, if applicable. The information provided helps employees complete their tax returns with accurate information.

Bottom Line

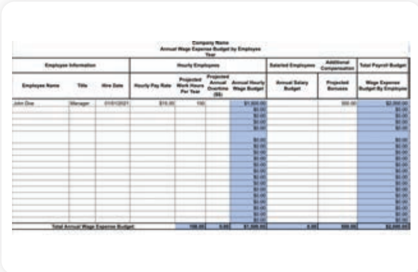
Understanding basic payroll terminology is essential to processing payroll successfully. You don't have to be an expert to know that both you and your employees pay FICA taxes or that all W-2s should be mailed by January 31. By implementing payroll terms into your vocabulary, you make it easier to digest related laws and concepts.

Payroll Templates: Free Downloads & How to Use Them

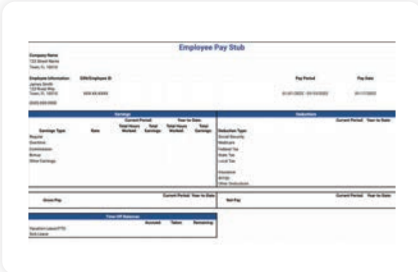
Payroll templates are predesigned spreadsheets and forms that help organize, calculate, and track payroll data. They're best for business owners preparing to hire their first employees and wanting to better manage payroll. You can use these templates instead of, or in conjunction with, payroll software to eliminate extra costs for add-ons like time tracking.



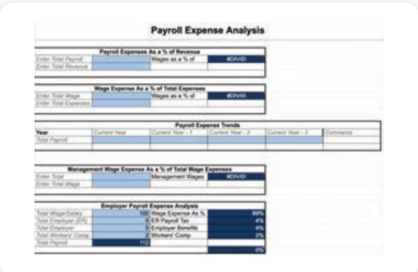
Annual Payroll Processing



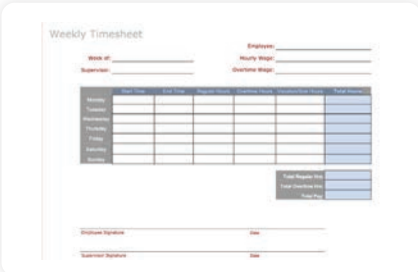
Payroll Budget



Employee Pay Stub



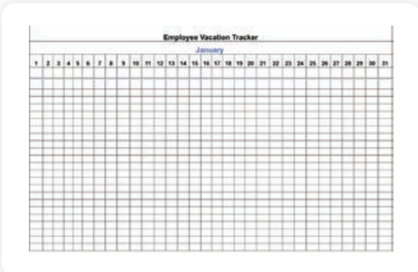
Payroll Expense Analysis



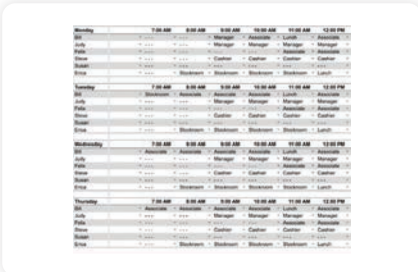
Employee Timesheet

Employee Information

Chart of Accounts



Vacation Tracker



Employee Scheduling

Need help with payroll? Check out our guide on how to do payroll for step-by-step instructions.

How Payroll Templates Work

Payroll templates are preformatted, so all you need to do is fill them in with the applicable information. If you need to personalize the templates, make sure you have an editable copy so you can add or change rows, columns, and cells.

Free payroll templates created through spreadsheet programs (like Microsoft Excel and Google Sheets) can help you save time, especially if the templates use formulas to automate calculations. These formulas work as a calculator and automatically figure solutions once you enter the required numerical information.
There are also simpler templates, such as employee information sheets and vacation trackers, that may be printed and filled in by hand. However, some documents (like pay stub templates) require data to be typed versus handwritten as it appears more professional.

Note that if you opt to use an online payroll template instead of creating one from scratch, be prepared to download and save it to your computer. If you start using a template before saving it, you could risk losing valuable data in the event of a system or website crash.

Below, you can check out the template you're interested in for more specific information on what it offers and how it can help you with your small business's payroll.

12-Month (Annual) Payroll Processing Template

Our 12-month template is pretty extensive and can calculate gross and net pay for each month. It computes taxes for each employee if you enter the required tax rates. You can even see payroll expenses broken down by month and totaled as annual expenses. Benefit contributions, payroll taxes, and reimbursements are a few other components managed in the spreadsheet.

Another useful feature is the PTO summary tracker within the "Set Up" tab of this template. As long as you enter the annual number of PTO hours that each employee is entitled to, along with the credits used each pay period (in the monthly tabs), the spreadsheet will keep a running total of available PTO per employee.

There's also a separate tab for employer payroll taxes and workers' compensation expenses. It automatically calculates how much you owe each month—provided you enter the rates you're required to pay. Note that FICA tax rates are already built in, so you won't need to re-enter them.

Payroll Budget Template

Creating a payroll budget is essential, especially for those preparing to either become an employer or continue business operations for a new year or month. You need a way to plan for the expenses ahead, so you can avoid cash shortages and issues with the IRS.

With a payroll budget template, you can plan and track expenses for staff wages, benefits, and Social Security taxes. This form has five tabs, with the first one containing instructions. It provides you the option of budgeting for a month, a year, or both. Regardless of which time frame you choose to budget, you should always start with the corresponding "Wage Budget by Employee" tab. It feeds into the "Payroll Expense Budget" tabs and automatically calculates FICA taxes.

In addition, this template enables you to budget for both salaried and hourly employees. There's even a special place to add in projected bonus payments. Plus, you can use it to plan for overtime expenses.

Company Name
Annual Payroll Budget
For the Year Ending ----

Payroll Expenses	Budget	Actual	Variance	Comments
Salaries/Wages	2,000.00		(2,000.00)	
Health Insurance			-	
Dental Insurance			-	
Vision Insurance			-	
Life Insurance			-	
Disability Insurance			-	
Retirement Benefits			-	
Workers' Compensation			-	
Employer's Federal			-	
Employer's State			-	
Employer's Federal			-	
Medicare Taxes (1.45%)	29.00		(29.00)	
Social Security Taxes	124.00		(124.00)	
Total Payroll Expenses	**$ 2,153.00**	**$ -**	**$ (2,153.00)**	

Enter applicable information in white cells only.

One item that doesn't fit in the template is tips. If you have tipped employees, note that while you will need to pay taxes on employee tips received, the tips won't be a payroll expense to your business.

In terms of budgeting tip payments, if you are paying tipped employees below minimum wage (meaning you are eligible for the tip credit), you should budget at or above the minimum wage amount. This is a conservative practice that will ensure you have enough money to pay employees should they not receive enough tips to boost their hourly wage to the required minimum wage amount. It also ensures your tax budget is sufficient.

Download the free payroll budget template if you need to plan for wage expenses by employee, including monthly and annual payroll expenses for the company.

Employee Pay Stub Template

Depending on your state laws, you may be required to provide your employees with pay stubs that list how much you paid in wages, the period for which you paid them, and other pay-related details.
In addition to the general pay stub that we've provided, we also have a few specific pay stub templates that you can use if they fit your business.


Employee Pay Stub

Household Employer Pay Stub


Employee Pay Stub

Restaurant Payroll Pay Stub

FREE Employee Pay Stub Template Download FREE Template

Payroll Expense Analysis Template

A payroll expense analysis template is good for any company that's undergone at least a month of payroll expenses. It provides key metrics to help you identify any red flags you should monitor going forward. With our template, you have five calculations that you can choose to use. You can enter annual payroll expense totals to see if there are any noticeable trends. The other analyses perform various calculations for you, while the payroll trend analysis is more of an observation than a calculation.

If you need help creating an employee expense report policy, check out our article that walks you through the steps and even has a free downloadable expense policy template.

There's even an option to evaluate management wage expenses as a percentage of total expenses. If you want to make comparisons, you can substitute management costs with labor costs for other staff types (like dishwashers, hosts, and chefs). Having access to this data can help you review how you schedule certain employees to drive down costs or identify whether you're overpaying in some areas.

For example, if you own a restaurant, you can use the template to calculate how much of your revenue is used to cover payroll expenses. Restaurateurs typically aim to keep labor costs between 20% and 30% of sales, according to Upserve. Imagine finding out your business is spending 50% on labor costs after entering the required data into the payroll template. This allows you to perform further analysis to figure out what's driving the excessive costs.

Payroll Expense Analysis

Payroll Expenses As a % of Revenue			
Enter Total Payroll		Wages as a % of	#DIV/0!
Enter Total Revenue			

Wage Expense As a % of Total Expenses			
Enter Total Wage		Wages as a % of	#DIV/0!
Enter Total Expenses			

Payroll Expense Trends					
Year	Current Year	Current Year - 1	Current Year - 2	Current Year - 3	Comments
Total Payroll					

Management Wage Expense As a % of Total Wage Expenses			
Enter Total		Management Wages	#DIV/0!
Enter Total Wage			

Employer Payroll Expense Analysis			
Total Wage/Salary	100	Wage Expense As %	89%
Total Employer (ER)	5	ER Payroll Tax	4%
Total Employer	5	Employer Benefits	4%
Total Workers' Comp	2	Workers' Comp	2%

You can utilize up to five calculations to help analyze your payroll costs.

Free Payroll Expense Analysis Template

Download FREE Template

Payroll Timesheets Templates

If you don't have time tracking software like Homebase, you need a timesheet to track employee work hours for payroll processing. This is critical for businesses that hire hourly employees like restaurant servers.

We have six different free payroll timesheet templates available for you to use. There's a timesheet for employers that pay daily, weekly, biweekly, semimonthly, monthly, and by project.

Download the one that fits your pay schedule and business requirements:

- Daily Timesheet Template
- Weekly Timesheet Template
- Biweekly Timesheet Template
- Semimonthly Timesheet Template
- Monthly Timesheet Template
- Project Timesheet Template

Payroll Chart of Accounts

Before you can start recording payroll transactions in your company's financial ledger, you must have a chart of accounts that include payroll accounts. Our payroll chart of accounts template can be used and printed as is without adding any information to it. However, if you need to personalize the template—whether by renaming an account or updating a description—you can copy the data and paste it into a Word file.

Free Payroll Chart Of Accounts Template

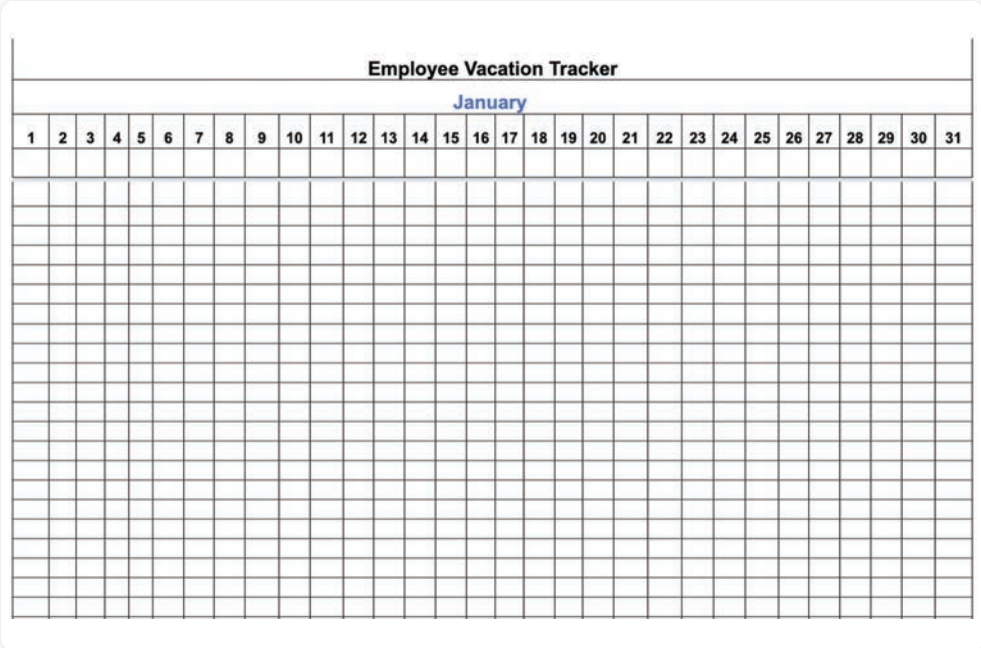
Download FREE Template

Vacation Tracker Template

If you offer your employees paid time off (PTO), you'll need a way to track the PTO hours used. Our free vacation tracker can be used either as an electronic spreadsheet or in printed form. It tracks vacation hours by day and month and has 12 tabs labeled by month.

If you opt to use the template electronically, note that the total hours will automatically populate as you enter data. This makes it easy to monitor how much PTO each employee has earned.

You can also print the tracker and post it in your office for easy access. However, be sure to delete all the data in Column AG (titled the "Total Hours" column) before printing. Currently, it has a formula that sums all of the cells to the left of it, which explains why it reflects zero. Once you delete the formulas, the cells will become blank, leaving space for you to manually enter a total at month-end.



Employee Vacation Tracker

January

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31

You can track employee vacation hours using the spreadsheet, or you can print it for easy access.

Free Vacation Tracker Template Download FREE Template

Employee Scheduling Template

Having an employee scheduling template is useful, especially if your company operates outside of normal business hours (8 a.m. to 5 p.m.). We have two templates available for you—one allows your employees to request changes within the spreadsheet, while the other doesn't. Both forms help you create weekly schedules as far into the future as you're willing to plan.

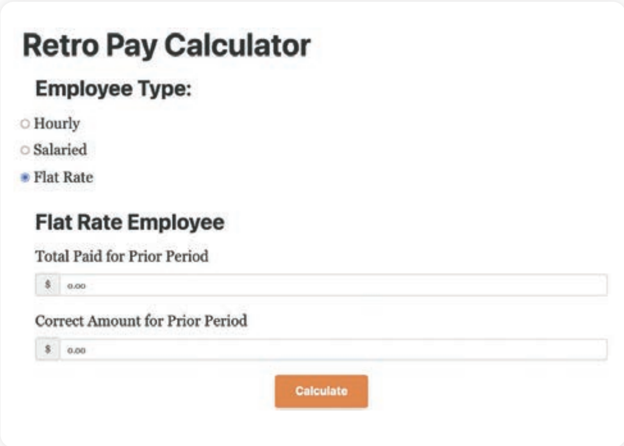
Free Employee Scheduling Template Download FREE Template

Bottom Line

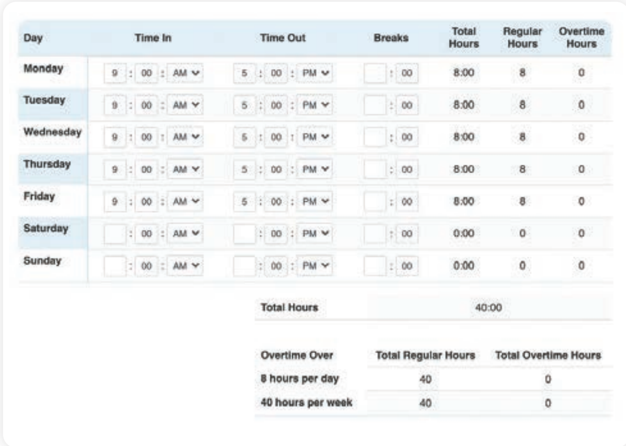
When doing payroll yourself, free payroll templates are a great tool to utilize. Aside from being free, they're also customizable. When deciding which templates are right for you, consider your business needs. While templates are great for organizing, tracking, and calculating, some of these forms aren't the best at handling unique employee- and payroll-related situations.

Payroll Calculators

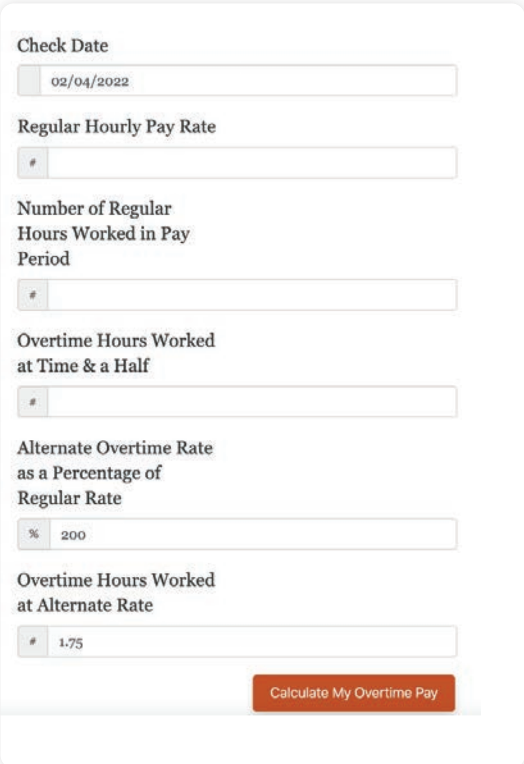
Below, you can check out our catalog of free calculators that will help you throughout the process.



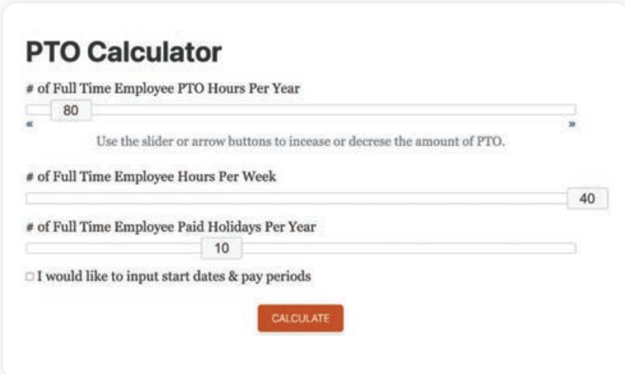
[Retro Pay Calculator](#)



[Time Card Calculator](#)



[Overtime Calculator](#)



[PTO Calculator](#)

15 Tips For Managing Payroll Effectively

Payroll management is a system for processing employee paychecks (salaries, bonuses, deductions), complying with labor laws, and maintaining adequate documentation.

It's important that businesses learn tips for managing payroll effectively because it directly affects their financial health. In 2020, the IRS assessed nearly $31.4 billion in civil penalties from noncompliance with employment tax requirements.

Here are 15 tips to help you learn how to manage payroll:

1. Create a Payroll Calendar

Payroll calendars help employees understand when they will be paid and when timecards are due. It also helps your payroll staff with planning and executing payroll tasks. Most payroll software will automatically create a payroll calendar for you once you've set up your pay schedule, but you can also use a spreadsheet to set up one for yourself.

Here are some guidelines to follow when creating your own payroll calendar:

- Use a regular calendar as your guide to help analyze certain dates that might require a lag to allow enough time for payroll processing.
- Use colored fonts to emphasize specific information, such as early time card deadlines due to a holiday.
- Give managers and supervisors a copy of the calendar so they can distribute it to their employees.

An effective payroll calendar should show all pay periods for the year. This simplifies payment processing and reduces employee confusion about when they will be paid and the time frames their paychecks will cover. Once you create a template for the calendar, save it on your hard drive so you can update it when needed.

2. Allow HR Staff to Attend Payroll Training

While processing payroll is part of a human resource (HR) professional's training, their expertise is more focused on recruitment and employee records management.

To improve your business' payroll management process, however, consider organizing payroll training sessions for your HR staff. Although the HR and payroll departments have distinct roles in an organization, they share functions crucial for a business' success.

Some benefits to providing payroll training for your HR staff are:

- Improves collaboration: Many payroll issues are related to HR, so working together would help the payroll and human resources departments use their shared knowledge to come up with more innovative solutions.
- Reduces manual/double work: You can reduce the amount of paperwork your staff prepares by consolidating some reports; it can also simplify processes.
- Creates a more cohesive team: If your HR staff has a broader understanding of your payroll team's procedures, they will be more sensitive to the time devoted to payroll processing.
- Prevents conflict: Payroll training will help prevent misunderstandings between your HR and payroll workers and give all employees more clarity on payroll policies.
- Your HR team's deeper understanding of payroll policies will help diffuse some of the payroll staff's pressure when communicating with employees. This eventually improves working relationships and boosts the overall mood inside of the office.

Check out our top ways to get payroll training to give yourself a head start.

Learn More

3. Stay Updated on State/Federal Tax Procedures

Employers need to stay on top of their tax obligations and any changes in state and federal reporting requirements. Changes can occur for various reasons, including business relocation, employee relocation, and hiring remote employees. When this happens, it's the employer's responsibility to gather and update the information it needs to compute payroll and taxes accurately.

Businesses should have employees submit a W-2 Form and file it with the Social Security Administration by mid-April of each year. Doing this helps the payroll department keep up with the changes that affect federal and state deadlines and calculate and correct hours, wages, tax holdings, and benefits. Failure to pay employer- and employee-withheld taxes accurately can result in penalties.

4. Standardize Turnover Processes

A big reason payroll staff turnover is painful is that all companies have their own unique payroll processing intricacies; these small details can take significant time for new hires to learn. To minimize the negative effects of losing team members to other companies, moving them to different roles, and temporarily filling positions when employees go on leave, you should consider ways to standardize your turnover process.

Some of the ideas you can implement to make your internal and external turnover process go smoother are:

- **Promote internally:** Consider promoting internally first to help minimize the learning curve of new hires.
- **Implement a buddy system:** Use a buddy system where each payroll team member trains another on their task.
- **Maintain standard process/role documentation:** Include a process flow chart and schedule in your payroll system documentation to help make managing roles easier when promoting payroll staff in the company
- **Update payroll templates:** Always update your payroll templates and save them in a drive accessible to everyone on your payroll team.

Creating a standard payroll process will improve your payroll team's productivity. It can also lower your risk of making payroll mistakes, making your payroll department more reliable.

5. Automate Your Payroll Process

Processing payroll takes a lot of time and money, and when done manually, is easily susceptible to mistakes that can result in severe penalties. This is especially true for a growing business that has a steadily increasing number of employees.

With limited HR and payroll staff, payroll processing can become a challenge. Automating your payroll process is the easiest way to keep up with time-consuming tasks.

6. Avoid Borrowing From Payroll Tax Funds

It might be tempting to dip into your payroll tax funds if your business is short on cash. However, borrowing from your tax fund would be a serious mistake that you should avoid at all costs.

In running a business, poor decisions like this can easily be overlooked until it's time to process your payroll tax payment. You could end up not having enough money to replace the borrowed funds and risk not being able to pay the IRS.

Consider opening a separate payroll bank account for your collected and contributed taxes. This will help ensure you don't use your payroll taxes to pay for other business expenses. You can also create a cash reserve for your business. If you become short on cash, you can access your emergency funds rather than payroll tax funds.

7. Distribute Payroll Duties Among Your HR Staff

If one or two payroll processors are having problems processing payroll in a timely manner, consider reallocating their payroll duties. You should document this change of duties and create or update your written payroll policies so the new process is communicated clearly.

It's also a good idea to review the new processes and policies regularly. Separating payroll tasks will not only relieve some stress from your individual payroll staff but should help with meeting deadlines, handling volume, increasing accuracy, and preventing fraud.

Payroll responsibilities that should be performed by multiple people versus one include verifying and processing changes to payroll and personnel data, approving payroll journal entries and changes, reviewing and approving monthly payroll reports, and distributing paychecks.

8. Observe Transparency in Your Payroll Process

Problems often arise because of employee misunderstandings of the payroll system. This happens most often in organizations where pay policies are either not accessible or inadequately presented to employees. Many payroll issues such as underpaid taxes or employee misclassifications (contractor vs employee) can be corrected by instituting a wholly transparent payroll policy.

A transparent payroll policy should include information on:

- How the payroll process works
- How employees are classified
- How salaries are determined
- Employee reporting responsibilities
- Company procedures for handling payroll mistakes
- Levels of vacationable earnings (earnings on which vacation pay is calculated)
- How wages and promotions are calculated

Put the policy in writing, display it prominently throughout the workplace, and ensure each employee has a copy. You should also update your employee manual accordingly.

9. Document Your Payroll Process

Documenting your payroll process is an important step in managing payroll. This strategy helps when analyzing and auditing your payroll system as it highlights each step and makes it easier to identify weak points in the process. Once you develop a payroll process that works best for your business, document these procedures and share them with the payroll team to help ensure each payroll staff member understands their role.

Maintain a standard payroll processing manual for the payroll department. This should include all the payroll processing steps as well as the reporting and check-handling processes. It will also be useful to have instructions on how to process payroll manually in case of emergencies.

Document the steps for printing and filing payroll registers and tax reports, along with the names of the individuals to whom you will be handing the paychecks and pay stubs.

10. Use Employee Scheduling & Time Tracking Software

Accuracy is important when processing payroll, and it all starts with properly monitoring employee attendance. Even the simplest error can create problems that result in significant civil penalties and poor feedback for the business.

Using scheduling and time tracking software will help save time, increase efficiency, and improve your payroll staff's productivity, which ultimately ensures the accuracy of your payroll reports.

11. Audit Your Payroll Process

It's not unusual to hear of occasional complaints about payroll computations. However, frequent incidence is a clear indication of the need to conduct regular audits of the entire payroll process. This is especially true for companies that still use a manual timecard system as they are exposed to high risk for discrepancies.

Automated systems can also be affected by data entry errors like incorrectly recording a new employee's tax status (married vs single) or entering old pay rates.

Steps you should follow to ensure an effective audit include:

- Verify and reconcile the accounting, payroll, and cash documentations to make sure the dollar values match across all records.
- Test plugins or add-ons to ensure that payroll software is properly integrated with your time and attendance system.
- Install a check-in system and/or biometric sign-in hardware to automatically note the times an employee logs in for work.

If employees raise concern about or have difficulties complying with payroll policies, then it's time to review your policies (and documentation) for accuracy and clarity. Employees must understand their role in the payroll process to complete tasks like timesheet submission or timecard use properly and on time.

12. Hire Qualified Payroll Staff

Payroll staff must be able to handle the demands of their job, or they risk making errors, incurring costly compliance penalties, and ultimately, experiencing job dissatisfaction.

It is therefore crucial for businesses to build a payroll team with the skills required to handle the level of payroll tasks your company needs. Keep in mind this refers to candidates with glowing credentials and also someone who can learn quickly and adapt to your work culture.

There are no essential "industry standard" qualifications for personnel entering payroll positions, but you can always look for relevant payroll accreditations that prove their math skills. Meanwhile, experience, adaptability, and integrity are also important qualities. Hiring the right payroll staff ensures all your business' payroll responsibilities will be taken care of, so being able to identify candidates with the right skills can make all the difference.

13. Complete Onboarding Paperwork on Time

Make sure you and new hires complete all of the employment forms you're legally required to submit. These forms will provide you with new hire data so that you properly classify and compensate employees. Legislation may differ based on your state or county, so make sure you check your state and county (and federal) websites for all paperwork and deadlines.

The most common types of employment forms employers are expected to complete are:

- W-4 Form (or W-9 for contractors)
- I-9 Employment Eligibility Verification Form
- Direct Deposit Form

Additionally, if you offer employee benefits, you will need to give each new hire paperwork that describes the terms and conditions of those benefits and, in some cases, request that they sign.

Onboarding documents are important to complete when new employees start working for you, and they're crucial to ensuring you manage payroll correctly. It's best to create an onboarding schedule that will help you complete these forms on time so you avoid errors in the future.

14. Solicit Feedback About Payroll Procedures From Employees

Never assume that employees fully understand your company's payroll procedures. Make it a point to ask and encourage employees to ask questions as well.

Communication will help identify areas of misunderstanding, such as improper timesheet submission or issues in the use of time cards. Inviting suggestions on improvement will encourage support from your staff after changes are implemented.

Start by holding an all-staff meeting dedicated to payroll issues. Employees will likely want to participate since everyone is directly affected by the process. At this meeting, ask employees what payroll processes work for them and what areas need improvement. You may be surprised by the creative suggestions you receive. You should also consider issuing a companywide survey to determine the level of employee satisfaction with current procedures.

15. Outsource Your Payroll Tasks

It's important that businesses are able to pay employees accurately and on time to avoid problems related to staffing. This can become overwhelming for a growing company for which tasks like payroll continue to take more time and effort.

Rather than managing payroll in-house, you can utilize one of the many payroll outsourcing options. Payroll software allows you to still be involved in the process without having to calculate paychecks and taxes on your own. If you use payroll software, you'll be responsible for managing the system and processing each payroll; however, it will automatically do the calculations and file and remit taxes on your behalf so you don't have to worry about it.

For a more hands-off approach, you can consider using a professional employer organization (PEO). A PEO acts as the employer of record for payroll and tax purposes. Depending on which provider you choose, you may still be the one pushing through the payrolls, but overall, PEOs will take most of the HR and payroll functions of your business off of your plate.

Bottom Line

Being able to accurately deliver employee paychecks is an immediate representation of your brand and signifies your ability to maintain high employee retention.

Make sure that learning how to manage payroll is at the top of your list for things to do well. By developing a payroll strategy that supports your culture, you're guaranteed to stay on top of payroll tasks all the time.

12 Payroll Forms Employers Need

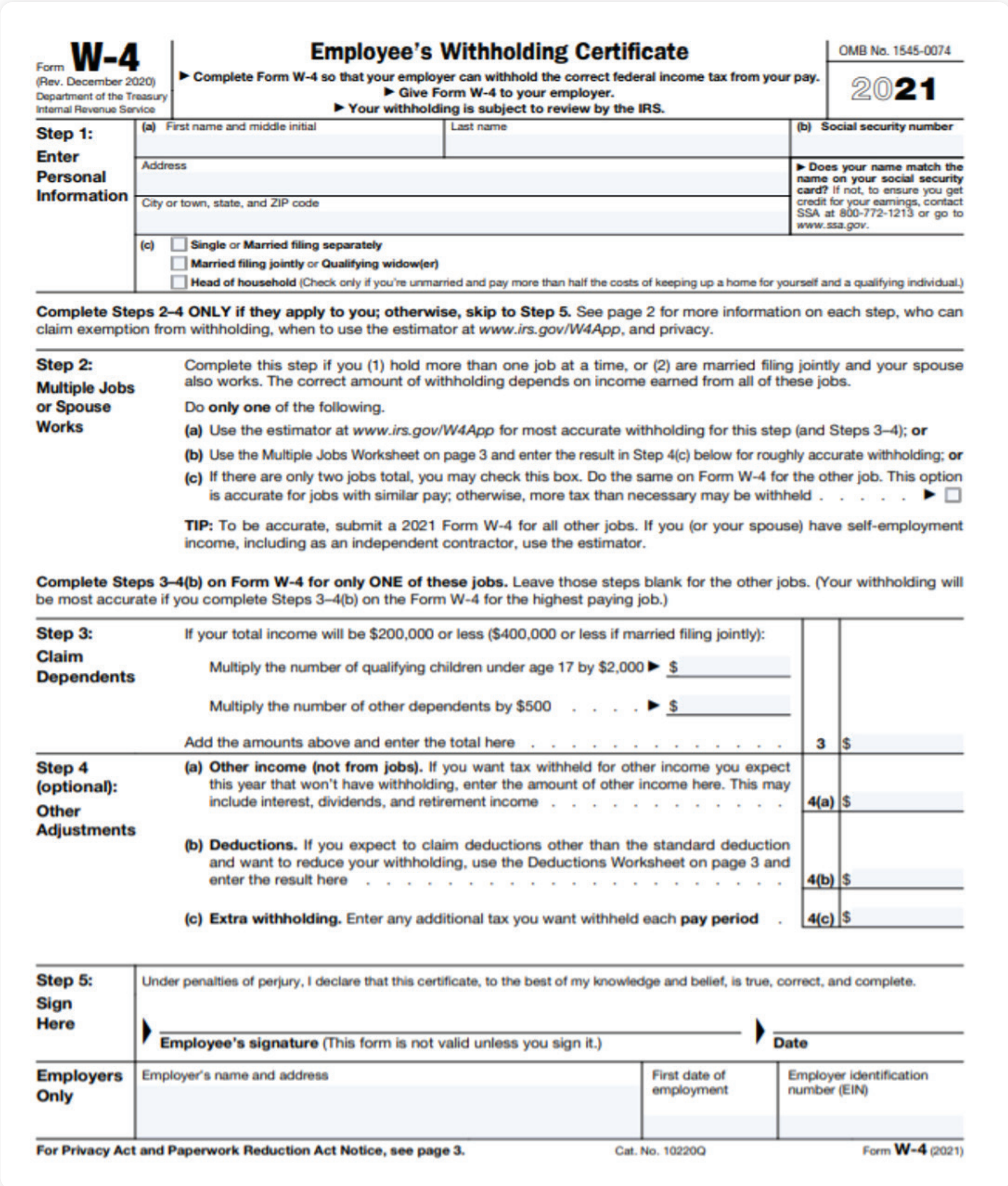
It is mandatory for employers to have up-to-date payroll forms regardless of how many employees they have. To maintain good standing with the IRS, you need the regulated payroll tax forms like W-4 for new hires and W-2 for wage and tax statements. Other less structured forms can also be useful in helping you organize your company's processes—for instance, direct deposit authorizations.

Payroll Tax Forms for Employers

Payroll Tax Forms	What is This Form Used For?
W-4 Form: Withholding Allowance Certificate	To help employers calculate federal income taxes to withhold from employee paychecks
W-2 Form: Wage and Tax Statement	Reporting total annual wages earned (one per employee)
W-3 Form: Transmittal of Wage and Tax Statements	Reports total wages and taxes for all employees
Form 940: Federal Unemployment Tax Reporting	Reports and calculate unemployment taxes due to the IRS
Form 941: Quarterly Federal Tax Return	Filing quarterly income and FICA taxes withheld from paychecks
Form 944: Annual Federal Tax Return	Reporting annual income and FICA taxes withheld from paychecks
Form 8027: Annual Information Return of Tip Income	To report tips received and determining allocated tips
Schedule H (Form 1040): Household Employment Taxes	Reporting employment taxes on cash wages paid to household employees (nannies, caregivers)
Form WH-347: Certified Payroll Form	Filing payroll information regarding employees who work on federal projects
W-9, 1099-NEC, and 1099-MISC: Contractor Forms	Providing non-employee pay information that helps the IRS collect taxes on contract work

Here's a more in-depth read and look at the payroll forms you may need to operate your business:

W-4 Form: Withholding Allowance Certificate



Form **W-4** (Rev. December 2020) Department of the Treasury Internal Revenue Service

Employee's Withholding Certificate

▶ Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.
▶ Give Form W-4 to your employer.
▶ Your withholding is subject to review by the IRS.

OMB No. 1545-0074 **2021**

Step 1: Enter Personal Information

(a) First name and middle initial | Last name | (b) Social security number

Address

City or town, state, and ZIP code

▶ **Does your name match the name on your social security card?** If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to *www.ssa.gov*.

(c) ☐ **Single** or **Married filing separately**
☐ **Married filing jointly** or **Qualifying widow(er)**
☐ **Head of household** (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

Complete Steps 2–4 ONLY if they apply to you; otherwise, skip to Step 5. See page 2 for more information on each step, who can claim exemption from withholding, when to use the estimator at *www.irs.gov/W4App*, and privacy.

Step 2: Multiple Jobs or Spouse Works

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs.

Do **only one** of the following.

(a) Use the estimator at *www.irs.gov/W4App* for most accurate withholding for this step (and Steps 3–4); **or**

(b) Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; **or**

(c) If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld . . . . . ▶ ☐

TIP: To be accurate, submit a 2021 Form W-4 for all other jobs. If you (or your spouse) have self-employment income, including as an independent contractor, use the estimator.

Complete Steps 3–4(b) on Form W-4 for only ONE of these jobs. Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3–4(b) on the Form W-4 for the highest paying job.)

Step 3: Claim Dependents

If your total income will be $200,000 or less ($400,000 or less if married filing jointly):

Multiply the number of qualifying children under age 17 by $2,000 ▶ $

Multiply the number of other dependents by $500 . . . . ▶ $

Add the amounts above and enter the total here . . . . **3** $

Step 4 (optional): Other Adjustments

(a) Other income (not from jobs). If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income . . . . **4(a)** $

(b) Deductions. If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here . . . . **4(b)** $

(c) Extra withholding. Enter any additional tax you want withheld each **pay period** . **4(c)** $

Step 5: Sign Here

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

▶ **Employee's signature** (This form is not valid unless you sign it.) ▶ **Date**

Employers Only

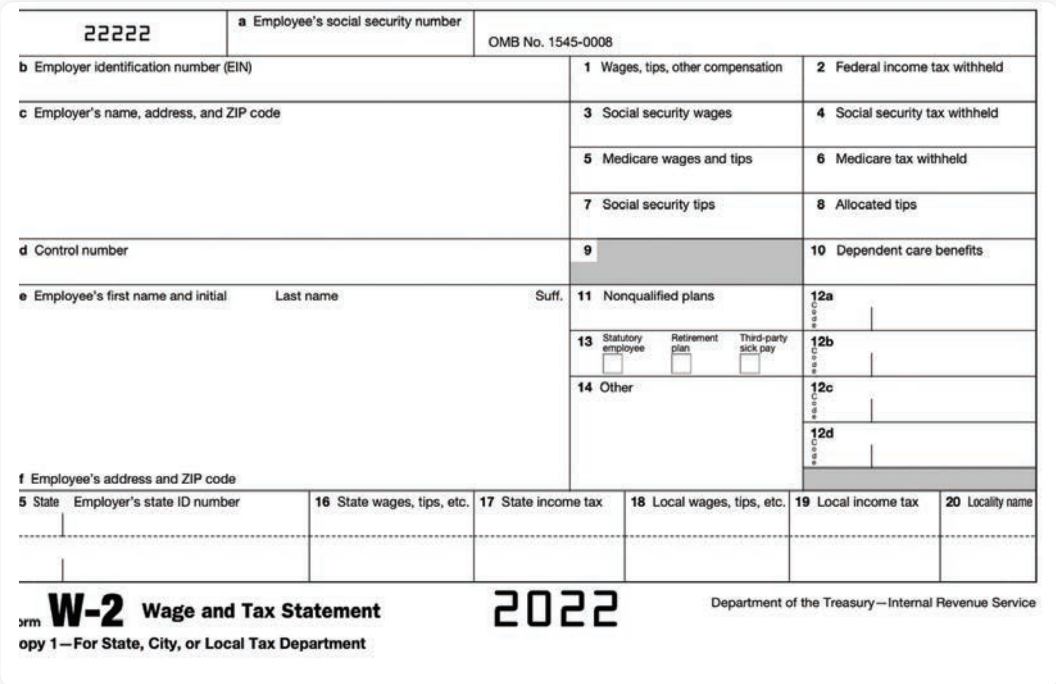
Employer's name and address | First date of employment | Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 3. Cat. No. 10220Q Form **W-4** (2021)

The W-4 Form will show you how much federal income tax you should withhold from employee paychecks.

All employers need updated copies of Form W-4 to distribute to new hires; employees should prioritize completing the form before or on their first day of work. You'll need the information to determine how much to withhold for taxes from employee paychecks each pay period. The document provides space for employees to enter their personal information, like name, address, marital status, and several dependents. Maintaining records of each completed W-4 Form simplifies W-2 Form preparation.

W-2 Form: Wage and Tax Statement


22222
a Employee's social security number
OMB No. 1545-0008
b Employer identification number (EIN)
1 Wages, tips, other compensation
2 Federal income tax withheld
c Employer's name, address, and ZIP code
3 Social security wages
4 Social security tax withheld
5 Medicare wages and tips
6 Medicare tax withheld
7 Social security tips
8 Allocated tips
d Control number
9
10 Dependent care benefits
e Employee's first name and initial Last name Suff.
11 Nonqualified plans
12a
13 Statutory employee Retirement plan Third-party sick pay
12b
14 Other
12c
12d
f Employee's address and ZIP code
15 State Employer's state ID number
16 State wages, tips, etc.
17 State income tax
18 Local wages, tips, etc.
19 Local income tax
20 Locality name
orm W-2 Wage and Tax Statement 2022
Department of the Treasury—Internal Revenue Service
opy 1—For State, City, or Local Tax Department

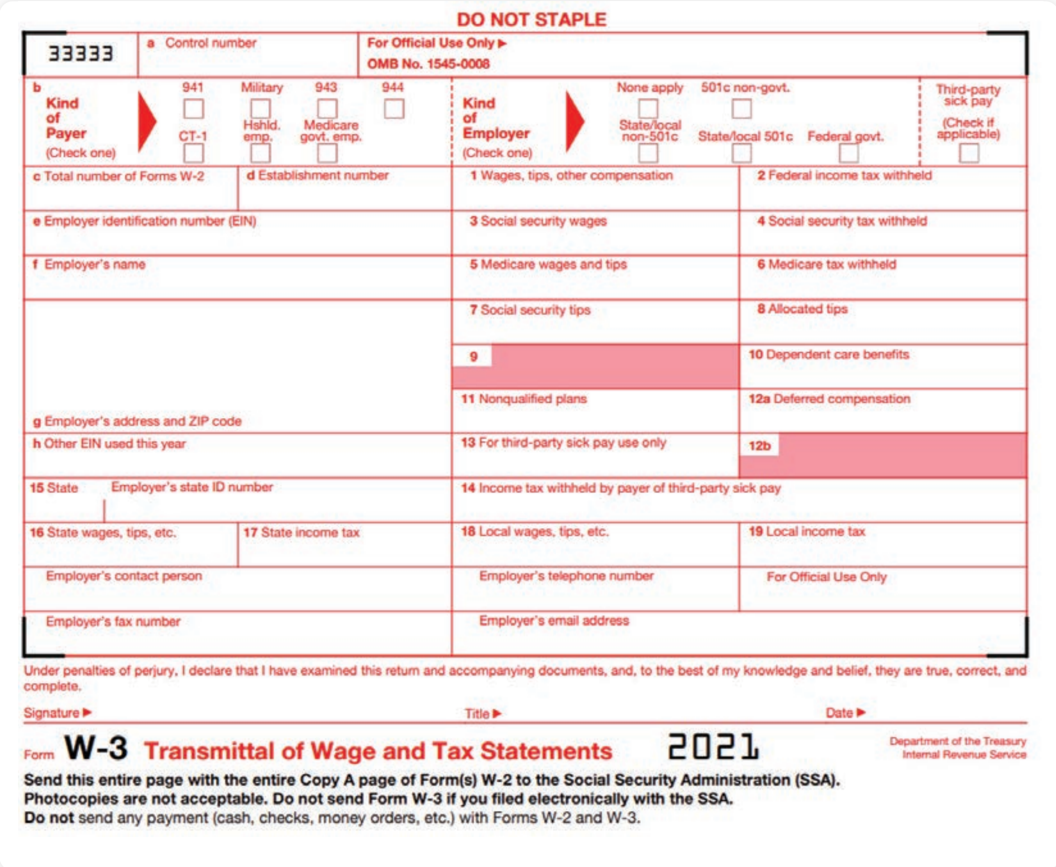
The W-2 Form shows how much an employee earns for the calendar year, in addition to taxes withheld, certain retirement benefits, and other withholding information that may impact taxes.

The W-2 Form is essential for all employers; you'll use it to report the total wages paid to employees throughout the year. Also, you'll include the total payroll taxes withheld (Social Security, Medicare, and income taxes) and other benefits. You'll give each employee a copy of their own form no later than January 31 after the year for which you're reporting. You'll also be responsible for sending copies of the forms to the Social Security Administration (SSA) and your state, city, or local tax department.

Be sure to check that you have six versions of each W-2 Form you distribute (one for each of the following: your records, the employee's records, for the employee to submit with their federal tax return, for the employee to file with their city, state, and/or local tax return, for you to submit to the SSA, and for you to submit to the city, local, and/or state tax department.

For directions on filling out the W-2 form, check out our step-by-step guide on how to fill out Form W-2.

W-3 Form: Transmittal of Wage & Tax Statements


DO NOT STAPLE

33333 | a Control number | For Official Use Only ▶ OMB No. 1545-0008

b Kind of Payer (Check one): 941, Military, 943, 944, CT-1, Hshld. emp., Medicare govt. emp.

Kind of Employer (Check one): None apply, 501c non-govt., State/local non-501c, State/local 501c, Federal govt.

Third-party sick pay (Check if applicable)

c Total number of Forms W-2 | d Establishment number | 1 Wages, tips, other compensation | 2 Federal income tax withheld

e Employer identification number (EIN) | 3 Social security wages | 4 Social security tax withheld

f Employer's name | 5 Medicare wages and tips | 6 Medicare tax withheld

7 Social security tips | 8 Allocated tips

9 | 10 Dependent care benefits

11 Nonqualified plans | 12a Deferred compensation

g Employer's address and ZIP code

h Other EIN used this year | 13 For third-party sick pay use only | 12b

15 State | Employer's state ID number | 14 Income tax withheld by payer of third-party sick pay

16 State wages, tips, etc. | 17 State income tax | 18 Local wages, tips, etc. | 19 Local income tax

Employer's contact person | Employer's telephone number | For Official Use Only

Employer's fax number | Employer's email address

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

Signature ▶ Title ▶ Date ▶

Form **W-3** Transmittal of Wage and Tax Statements 2021 Department of the Treasury Internal Revenue Service

Send this entire page with the entire Copy A page of Form(s) W-2 to the Social Security Administration (SSA). Photocopies are not acceptable. Do not send Form W-3 if you filed electronically with the SSA.

Do not send any payment (cash, checks, money orders, etc.) with Forms W-2 and W-3.

The W-3 Form is a summary of all W-2 Forms on one document; you'll submit it to the IRS with copies of each W-2 Form.

If you issue W-2 Forms, you will need to complete a W-3 Form and submit it to the SSA with applicable W-2 copies. It's essentially a summary of all the individual W-2 Forms you are distributing for the year. You'll report the total salary and wage payments you made to all employees in addition to the total taxes and other benefit information.

To check that all of the numbers you report on the W-3 flow, compare the totals to the information reflected on the other payroll forms. For example, add all individual salary and wage totals reported on the W-2 Forms, and the sum should equal the total wage amount reflecting on your W-3 Form.

Form 940: Federal Unemployment Tax Reporting

Form **940 for 2020: Employer's Annual Federal Unemployment (FUTA) Tax Return** 850113
Department of the Treasury — Internal Revenue Service
OMB No. 1545-0028

Employer identification number (EIN) ☐☐ – ☐☐☐☐☐☐☐
Name (not your trade name)
Trade name (if any)
Address
Number Street Suite or room number
City State ZIP code
Foreign country name Foreign province/county Foreign postal code

Type of Return
(Check all that apply.)
☐ a. Amended
☐ b. Successor employer
☐ c. No payments to employees in 2020
☐ d. Final: Business closed or stopped paying wages
Go to www.irs.gov/Form940 for instructions and the latest information.

Read the separate instructions before you complete this form. Please type or print within the boxes.

Part 1: Tell us about your return. If any line does NOT apply, leave it blank. See instructions before completing Part 1.

1a If you had to pay state unemployment tax in one state only, enter the state abbreviation . 1a
1b If you had to pay state unemployment tax in more than one state, you are a multi-state employer . . . 1b ☐ Check here. Complete Schedule A (Form 940).
2 If you paid wages in a state that is subject to CREDIT REDUCTION . . . 2 ☐ Check here. Complete Schedule A (Form 940).

Part 2: Determine your FUTA tax before adjustments. If any line does NOT apply, leave it blank.

3 Total payments to all employees . . . 3
4 Payments exempt from FUTA tax . . . 4
Check all that apply: 4a ☐ Fringe benefits 4c ☐ Retirement/Pension 4e ☐ Other
4b ☐ Group-term life insurance 4d ☐ Dependent care
5 Total of payments made to each employee in excess of $7,000 . . . 5
6 Subtotal (line 4 + line 5 = line 6) . . . 6
7 Total taxable FUTA wages (line 3 – line 6 = line 7). See instructions . . . 7
8 FUTA tax before adjustments (line 7 x 0.006 = line 8) . . . 8

Part 3: Determine your adjustments. If any line does NOT apply, leave it blank.

9 If ALL of the taxable FUTA wages you paid were excluded from state unemployment tax, multiply line 7 by 0.054 (line 7 × 0.054 = line 9). Go to line 12 . . . 9
10 If SOME of the taxable FUTA wages you paid were excluded from state unemployment tax, OR you paid ANY state unemployment tax late (after the due date for filing Form 940), complete the worksheet in the instructions. Enter the amount from line 7 of the worksheet . . 10
11 If credit reduction applies, enter the total from Schedule A (Form 940) . . . 11

Part 4: Determine your FUTA tax and balance due or overpayment. If any line does NOT apply, leave it blank.

12 Total FUTA tax after adjustments (lines 8 + 9 + 10 + 11 = line 12) . . . 12
13 FUTA tax deposited for the year, including any overpayment applied from a prior year . 13
14 Balance due. If line 12 is more than line 13, enter the excess on line 14.
- If line 14 is more than $500, you must deposit your tax.
- If line 14 is $500 or less, you may pay with this return. See instructions . . . 14

15 Overpayment. If line 13 is more than line 12, enter the excess on line 15 and check a box below 15

► You MUST complete both pages of this form and SIGN it. Check one: ☐ Apply to next return. ☐ Send a refund.

Next ►

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 11234O Form 940 (2020)

850212

Name *(not your trade name)* | Employer identification number (EIN)

Part 5: Report your FUTA tax liability by quarter only if line 12 is more than $500. If not, go to Part 6.

16 Report the amount of your FUTA tax liability for each quarter; do NOT enter the amount you deposited. If you had no liability for a quarter, leave the line blank.

16a 1st quarter (January 1 – March 31)	**16a**	.
16b 2nd quarter (April 1 – June 30)	**16b**	.
16c 3rd quarter (July 1 – September 30)	**16c**	.
16d 4th quarter (October 1 – December 31)	**16d**	.
17 Total tax liability for the year (lines 16a + 16b + 16c + 16d = line 17)	**17**	. **Total must equal line 12.**

Part 6: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details.

☐ **Yes.** Designee's name and phone number

Select a 5-digit personal identification number (PIN) to use when talking to the IRS.

☐ **No.**

Part 7: Sign here. You MUST complete both pages of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete, and that no payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments made to employees. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

X Sign your name here

Print your name here

Print your title here

Date / /

Best daytime phone

Paid Preparer Use Only

Check if you are self-employed ☐

Preparer's name		PTIN	
Preparer's signature		Date	/ /
Firm's name (or yours if self-employed)		EIN	
Address		Phone	
City	State	ZIP code	

Page **2** Form **940** (2020)

You should submit Form 940 when you pay your federal unemployment tax bill throughout the year.

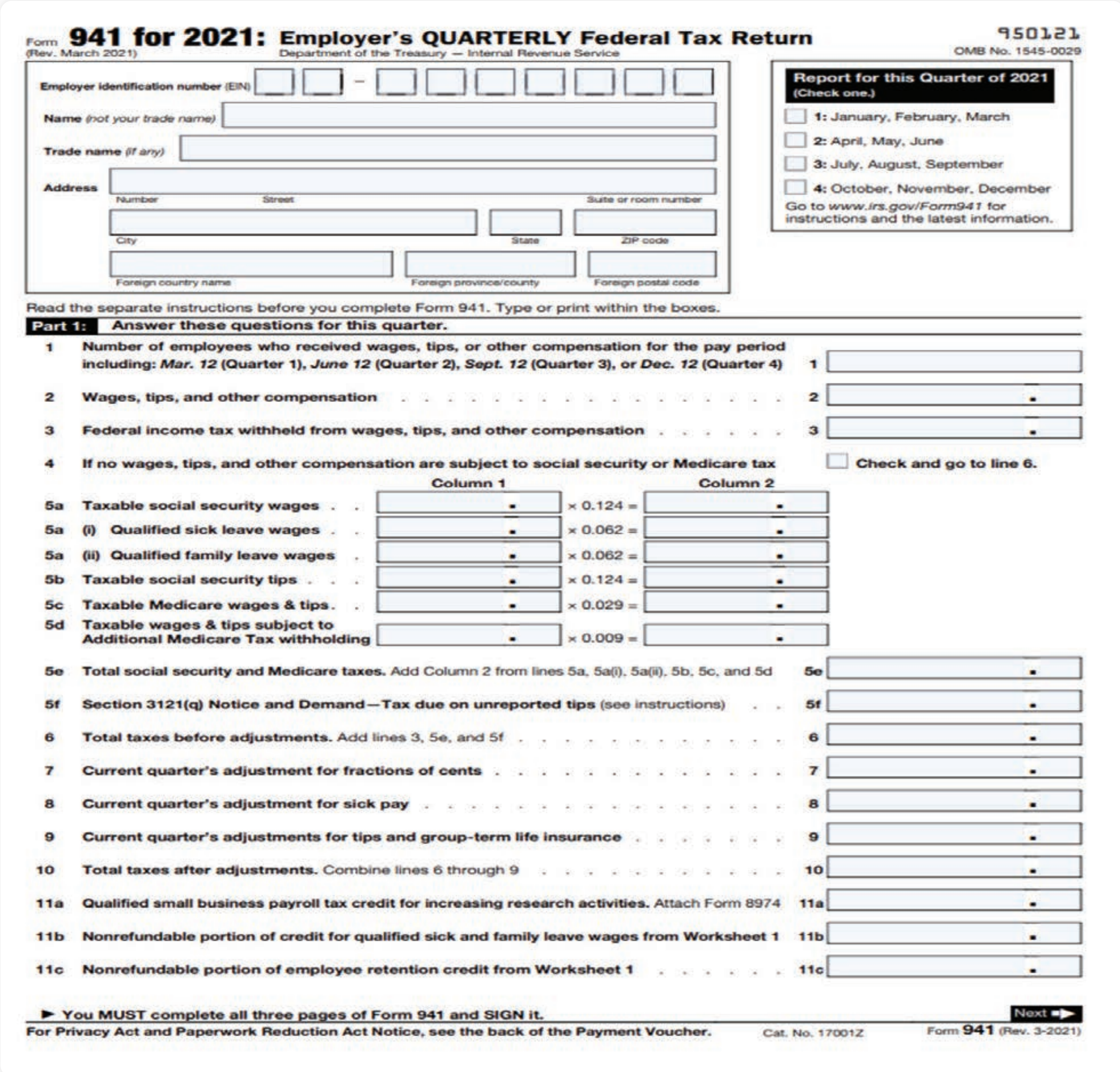
If you paid federal unemployment taxes (FUTA) during the year (most employers are required to), you'll need to submit Form 940 by January 31 of the following year. It helps you calculate and report the total FUTA taxes for which you're liable, net any payments made during the year. The IRS requires you to report and pay the tax quarterly if you'll owe more than $500 for the year; if you pay your FUTA taxes each quarter and are up-to-date by year-end, you can wait until February 10 of the following year (at the latest) to file.

Generally, you're subject to the tax if your business:

- Paid or will pay over $1,500 to its employees in a calendar quarter
- Employed one or more employees for at least 20 weeks of the year

Be mindful that you will likely also owe a state unemployment tax and subsequently need to report the total due on a specific payroll form for your state. Check your state tax agency's website to be sure.

Form 941: Quarterly Federal Tax Return



Form **941 for 2021: Employer's QUARTERLY Federal Tax Return** 950121
(Rev. March 2021) Department of the Treasury — Internal Revenue Service OMB No. 1545-0029

Employer identification number (EIN) ___ ___ - ___ ___ ___ ___ ___ ___ ___

Name (not your trade name)

Trade name (if any)

Address
Number Street Suite or room number
City State ZIP code
Foreign country name Foreign province/county Foreign postal code

Report for this Quarter of 2021
(Check one.)
☐ 1: January, February, March
☐ 2: April, May, June
☐ 3: July, August, September
☐ 4: October, November, December
Go to www.irs.gov/Form941 for instructions and the latest information.

Read the separate instructions before you complete Form 941. Type or print within the boxes.

Part 1: Answer these questions for this quarter.

1	Number of employees who received wages, tips, or other compensation for the pay period including: *Mar. 12* (Quarter 1), *June 12* (Quarter 2), *Sept. 12* (Quarter 3), or *Dec. 12* (Quarter 4)			1	
2	Wages, tips, and other compensation			2	.
3	Federal income tax withheld from wages, tips, and other compensation			3	.
4	If no wages, tips, and other compensation are subject to social security or Medicare tax				☐ Check and go to line 6.
		Column 1		Column 2	
5a	Taxable social security wages	.	× 0.124 =	.	
5a	(i) Qualified sick leave wages	.	× 0.062 =	.	
5a	(ii) Qualified family leave wages	.	× 0.062 =	.	
5b	Taxable social security tips	.	× 0.124 =	.	
5c	Taxable Medicare wages & tips	.	× 0.029 =	.	
5d	Taxable wages & tips subject to Additional Medicare Tax withholding	.	× 0.009 =	.	
5e	Total social security and Medicare taxes. Add Column 2 from lines 5a, 5a(i), 5a(ii), 5b, 5c, and 5d			5e	.
5f	Section 3121(q) Notice and Demand—Tax due on unreported tips (see instructions)			5f	.
6	Total taxes before adjustments. Add lines 3, 5e, and 5f			6	.
7	Current quarter's adjustment for fractions of cents			7	.
8	Current quarter's adjustment for sick pay			8	.
9	Current quarter's adjustments for tips and group-term life insurance			9	.
10	Total taxes after adjustments. Combine lines 6 through 9			10	.
11a	Qualified small business payroll tax credit for increasing research activities. Attach Form 8974			11a	.
11b	Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 1			11b	.
11c	Nonrefundable portion of employee retention credit from Worksheet 1			11c	.

► You MUST complete all three pages of Form 941 and SIGN it. Next ►

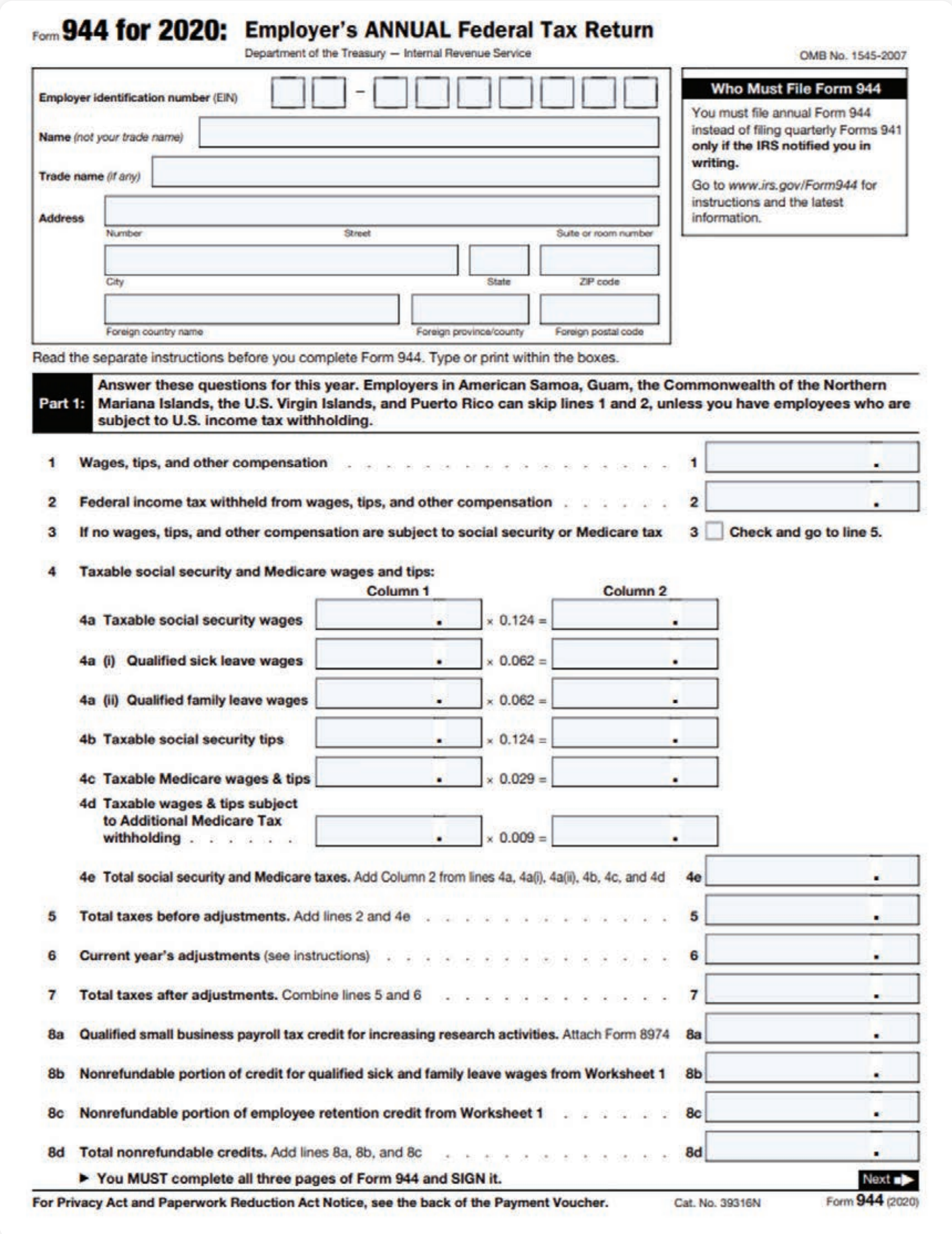
For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 17001Z Form **941** (Rev. 3-2021)

Submit this [Form 941] with your quarterly federal income tax payments.

If you withhold income tax, Social Security, and Medicare (FICA) payments from your employees' paychecks, you should submit Form 941 (or Form 944 if the payments are small). You'll report the total amounts withheld. It will also help you verify and pay the amount of FICA taxes for which your business is responsible (the total matches what you should withhold from employee checks, ultimately around 15.3% of wages paid).

The deadlines are at the end of the following months: April (for January through March), July (for April through June), October (for July through September), and January (for October through December).

Form 944: Employer's Annual Federal Tax Return



Form **944 for 2020: Employer's ANNUAL Federal Tax Return**
Department of the Treasury — Internal Revenue Service
OMB No. 1545-2007

Employer identification number (EIN) ☐☐ - ☐☐☐☐☐☐☐

Name *(not your trade name)*

Trade name *(if any)*

Address
Number Street Suite or room number
City State ZIP code
Foreign country name Foreign province/county Foreign postal code

Who Must File Form 944
You must file annual Form 944 instead of filing quarterly Forms 941 **only if the IRS notified you in writing.**
Go to *www.irs.gov/Form944* for instructions and the latest information.

Read the separate instructions before you complete Form 944. Type or print within the boxes.

Part 1: Answer these questions for this year. Employers in American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the U.S. Virgin Islands, and Puerto Rico can skip lines 1 and 2, unless you have employees who are subject to U.S. income tax withholding.

1 **Wages, tips, and other compensation** . . . 1
2 **Federal income tax withheld from wages, tips, and other compensation** . . . 2
3 **If no wages, tips, and other compensation are subject to social security or Medicare tax** 3 ☐ **Check and go to line 5.**
4 **Taxable social security and Medicare wages and tips:**

	Column 1		Column 2
4a Taxable social security wages	.	× 0.124 =	.
4a (i) Qualified sick leave wages	.	× 0.062 =	.
4a (ii) Qualified family leave wages	.	× 0.062 =	.
4b Taxable social security tips	.	× 0.124 =	.
4c Taxable Medicare wages & tips	.	× 0.029 =	.
4d Taxable wages & tips subject to Additional Medicare Tax withholding	.	× 0.009 =	.

4e **Total social security and Medicare taxes.** Add Column 2 from lines 4a, 4a(i), 4a(ii), 4b, 4c, and 4d 4e
5 **Total taxes before adjustments.** Add lines 2 and 4e . . . 5
6 **Current year's adjustments** (see instructions) . . . 6
7 **Total taxes after adjustments.** Combine lines 5 and 6 . . . 7
8a **Qualified small business payroll tax credit for increasing research activities.** Attach Form 8974 8a
8b **Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 1** 8b
8c **Nonrefundable portion of employee retention credit from Worksheet 1** . . . 8c
8d **Total nonrefundable credits.** Add lines 8a, 8b, and 8c . . . 8d

▶ **You MUST complete all three pages of Form 944 and SIGN it.** Next ▶

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 39316N Form **944** (2020)

Submit this Form 944 with your annual federal income tax payments; this is usually for really small companies.

Tax Form 944 fulfills the same purpose as Form 941 but is used less frequently. Only small businesses with an annual tax liability of less than $1,000 are eligible to file this form; it's a report of the total income and FICA taxes withheld and payable (employees' and employer's share) throughout the year and is for employers who are eligible to make one payment annually (versus four quarterly payments).

Form 8027: Annual Information Return of Tip Income

Form **944 for 2020: Employer's ANNUAL Federal Tax Return**

Department of the Treasury — Internal Revenue Service

OMB No. 1545-2007

Employer identification number (EIN)

Name (not your trade name)

Trade name (if any)

Address

Number Street Suite or room number

City State ZIP code

Foreign country name Foreign province/county Foreign postal code

Who Must File Form 944

You must file annual Form 944 instead of filing quarterly Forms 941 **only if the IRS notified you in writing.**

Go to *www.irs.gov/Form944* for instructions and the latest information.

Read the separate instructions before you complete Form 944. Type or print within the boxes.

Part 1: **Answer these questions for this year. Employers in American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the U.S. Virgin Islands, and Puerto Rico can skip lines 1 and 2, unless you have employees who are subject to U.S. income tax withholding.**

1 **Wages, tips, and other compensation** 1

2 **Federal income tax withheld from wages, tips, and other compensation** 2

3 **If no wages, tips, and other compensation are subject to social security or Medicare tax** 3 ☐ **Check and go to line 5.**

4 **Taxable social security and Medicare wages and tips:**

	Column 1		Column 2
4a Taxable social security wages	.	× 0.124 =	.
4a (i) Qualified sick leave wages	.	× 0.062 =	.
4a (ii) Qualified family leave wages	.	× 0.062 =	.
4b Taxable social security tips	.	× 0.124 =	.
4c Taxable Medicare wages & tips	.	× 0.029 =	.
4d Taxable wages & tips subject to Additional Medicare Tax withholding	.	× 0.009 =	.

4e **Total social security and Medicare taxes.** Add Column 2 from lines 4a, 4a(i), 4a(ii), 4b, 4c, and 4d 4e

5 **Total taxes before adjustments.** Add lines 2 and 4e 5

6 **Current year's adjustments** (see instructions) 6

7 **Total taxes after adjustments.** Combine lines 5 and 6 7

8a **Qualified small business payroll tax credit for increasing research activities.** Attach Form 8974 8a

8b **Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 1** 8b

8c **Nonrefundable portion of employee retention credit from Worksheet 1** 8c

8d **Total nonrefundable credits.** Add lines 8a, 8b, and 8c 8d

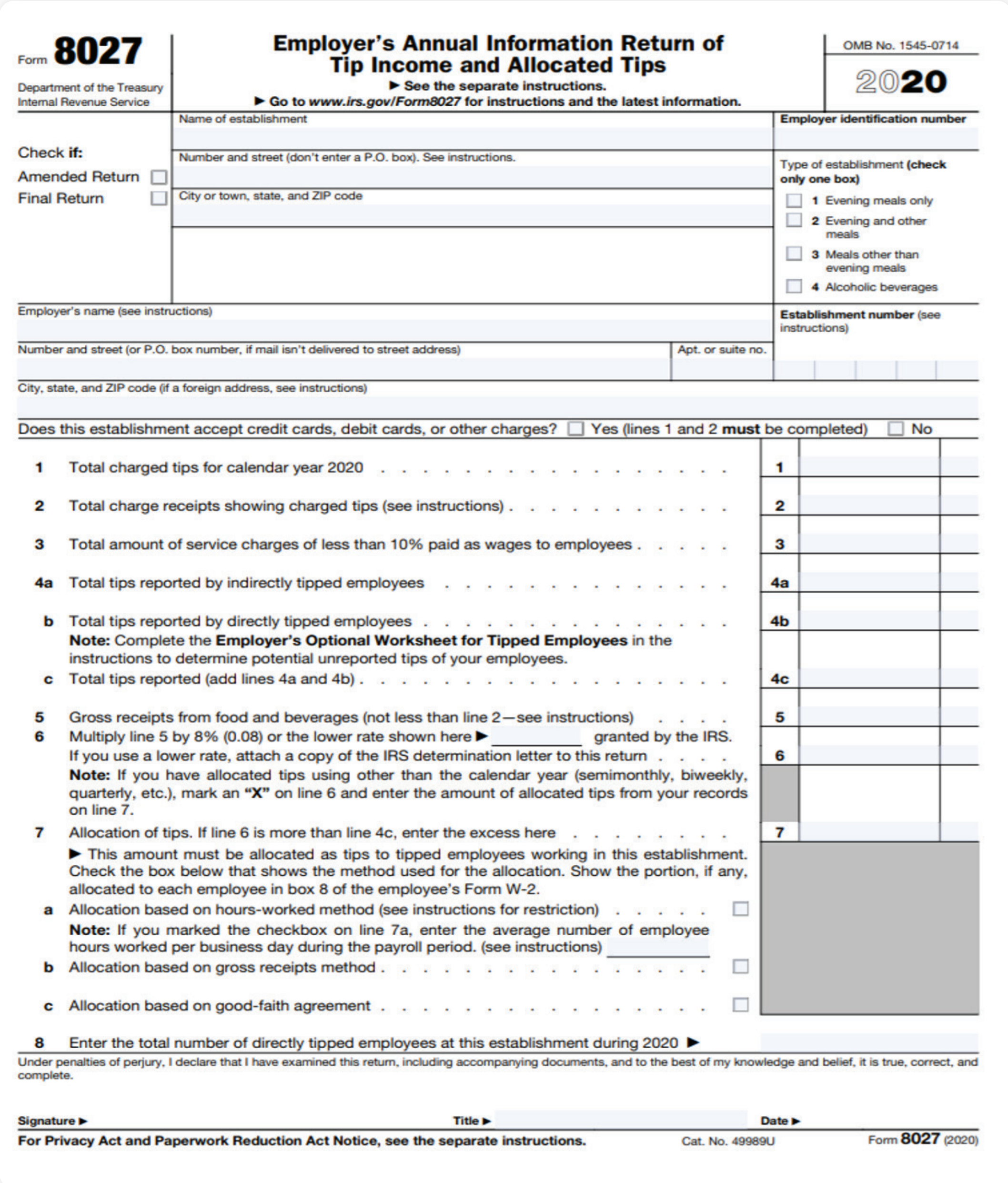
▶ **You MUST complete all three pages of Form 944 and SIGN it.** Next ▶

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 39316N Form **944** (2020)

Submit this Form 944 with your annual federal income tax payments; this is usually for really small companies.

Tax Form 944 fulfills the same purpose as Form 941 but is used less frequently. Only small businesses with an annual tax liability of less than $1,000 are eligible to file this form; it's a report of the total income and FICA taxes withheld and payable (employees' and employer's share) throughout the year and is for employers who are eligible to make one payment annually (versus four quarterly payments).

Form 8027: Annual Information Return of Tip Income



Form **8027**

Department of the Treasury
Internal Revenue Service

Employer's Annual Information Return of Tip Income and Allocated Tips

► See the separate instructions.

► Go to *www.irs.gov/Form8027* for instructions and the latest information.

OMB No. 1545-0714

2020

Check if:
Amended Return ☐
Final Return ☐

Name of establishment

Number and street (don't enter a P.O. box). See instructions.

City or town, state, and ZIP code

Employer identification number

Type of establishment **(check only one box)**
☐ 1 Evening meals only
☐ 2 Evening and other meals
☐ 3 Meals other than evening meals
☐ 4 Alcoholic beverages

Employer's name (see instructions)

Number and street (or P.O. box number, if mail isn't delivered to street address)

Apt. or suite no.

City, state, and ZIP code (if a foreign address, see instructions)

Establishment number (see instructions)

Does this establishment accept credit cards, debit cards, or other charges? ☐ Yes (lines 1 and 2 **must** be completed) ☐ No

1	Total charged tips for calendar year 2020	1	
2	Total charge receipts showing charged tips (see instructions)	2	
3	Total amount of service charges of less than 10% paid as wages to employees	3	
4a	Total tips reported by indirectly tipped employees	4a	
b	Total tips reported by directly tipped employees **Note:** Complete the **Employer's Optional Worksheet for Tipped Employees** in the instructions to determine potential unreported tips of your employees.	4b	
c	Total tips reported (add lines 4a and 4b)	4c	
5	Gross receipts from food and beverages (not less than line 2—see instructions)	5	
6	Multiply line 5 by 8% (0.08) or the lower rate shown here ► ______ granted by the IRS. If you use a lower rate, attach a copy of the IRS determination letter to this return **Note:** If you have allocated tips using other than the calendar year (semimonthly, biweekly, quarterly, etc.), mark an **"X"** on line 6 and enter the amount of allocated tips from your records on line 7.	6	
7	Allocation of tips. If line 6 is more than line 4c, enter the excess here ► This amount must be allocated as tips to tipped employees working in this establishment. Check the box below that shows the method used for the allocation. Show the portion, if any, allocated to each employee in box 8 of the employee's Form W-2.	7	
a	Allocation based on hours-worked method (see instructions for restriction) ☐ **Note:** If you marked the checkbox on line 7a, enter the average number of employee hours worked per business day during the payroll period. (see instructions) ______		
b	Allocation based on gross receipts method ☐		
c	Allocation based on good-faith agreement ☐		
8	Enter the total number of directly tipped employees at this establishment during 2020 ►		

Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature ► **Title ►** **Date ►**

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 49989U Form **8027** (2020)

Form 8027 shows how reasonable your employees' reported tip amounts are; you may be responsible for distributing more money if the total doesn't meet IRS guidelines.

Not all employers will use Form 8027—only large companies with workers who routinely receive tips (restaurants, bars, and companies in the hospitality industry). For purposes of this form, the IRS defines "large companies" as companies that have more than 10 employees working on a typical business day. The main purpose of this form is to report the total tip income received within the establishment and calculate allocated tip amounts (a component of some restaurant payroll processes) that employers are responsible for paying tipped employees.

Allocated tips are additional amounts some employers are required to pay out if their total reported tips appear to be too low according to the size of the business. Form 8027 helps to calculate any additional amounts due. The deadline to file a paper copy of the form is March 2nd and March 31st if you file electronically.

Schedule H (Form 1040)

SCHEDULE H (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Household Employment Taxes
(For Social Security, Medicare, Withheld Income, and Federal Unemployment (FUTA) Taxes)
▶ **Attach to Form 1040, 1040-SR, 1040-NR, 1040-SS, or 1041.**
▶ **Go to *www.irs.gov/ScheduleH* for instructions and the latest information.**

OMB No. 1545-0074
2020
Attachment Sequence No. **44**

Name of employer: Susan Green
Social security number: 001-11-1111
Employer identification number: 0 0 1 2 3 4 5 6 7

Calendar year taxpayers having no household employees in 2020 don't have to complete this form for 2020.

A Did you pay **any one** household employee cash wages of $2,200 or more in 2020? (If any household employee was your spouse, your child under age 21, your parent, or anyone under age 18, see the line A instructions before you answer this question.)

☑ **Yes.** Skip lines B and C and go to line 1a.
☐ **No.** Go to line B.

Part I Social Security, Medicare, and Federal Income Taxes

1a	Total cash wages subject to social security tax	1a	2,300		
b	Qualified sick and family wages included on line 1a	1b			
2a	Social security tax. Multiply line 1a by 12.4% (0.124)			2a	285
b	Employer share of social security tax on qualified sick and family leave wages. Multiply line 1b by 6.2% (0.062)			2b	
c	Total social security tax. Subtract line 2b from line 2a			2c	285
3	Total cash wages subject to Medicare tax	3	2,300		
4	Medicare tax. Multiply line 3 by 2.9% (0.029)			4	67
5	Total cash wages subject to Additional Medicare Tax withholding	5			
6	Additional Medicare Tax withholding. Multiply line 5 by 0.9% (0.009)			6	
7	Federal income tax withheld, if any			7	
8a	Total social security, Medicare, and federal income taxes. Add lines 2c, 4, 6, and 7			8a	352
b	Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 3			8b	
c	Total social security, Medicare, and federal income taxes after nonrefundable credit. Subtract line 8b from line 8a			8c	
d	Maximum amount of the employer share of social security tax that can be deferred (see instructions)			8d	
e	Refundable portion of credit for qualified sick and family leave wages from Worksheet 3			8e	
f	Qualified sick leave wages			8f	
g	Qualified health plan expenses allocable to qualified sick leave wages			8g	
h	Qualified family leave wages			8h	
i	Qualified health plan expenses allocable to qualified family leave wages			8i	

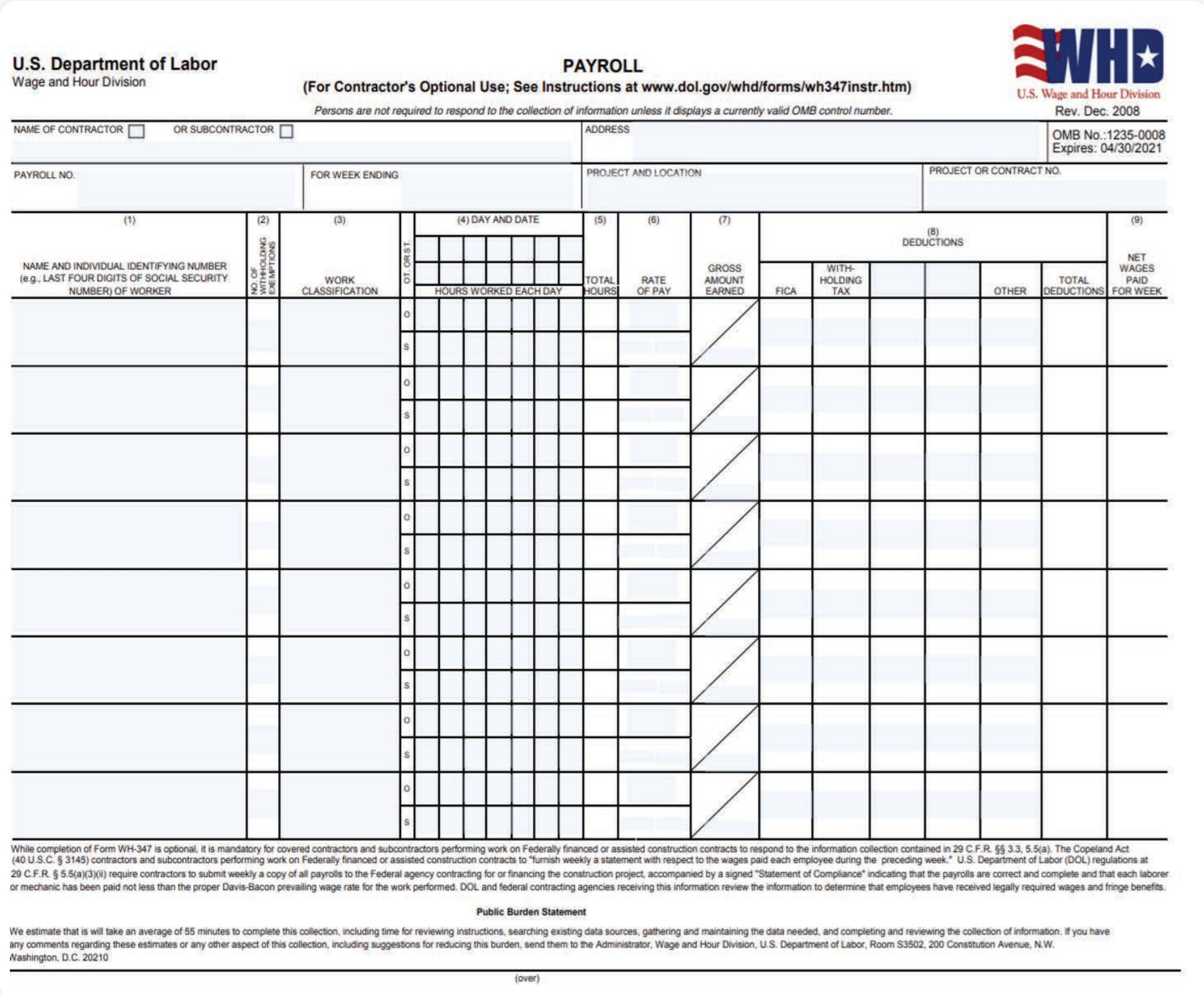
9 Did you pay **total** cash wages of $1,000 or more in **any** calendar **quarter** of 2019 or 2020 to **all** household employees? (**Don't** count cash wages paid in 2019 or 2020 to your spouse, your child under age 21, or your parent.)

☑ **No. Stop.** Include the amount from line 8c above on Schedule 2 (Form 1040), line 7a. Include the amount, if any, from line 8e on Schedule 3 (Form 1040), line 12b. If you're not required to file Form 1040, see the line 9 instructions.
☐ **Yes.** Go to line 10.

Schedule H helps ensure your household employees pay the appropriate amount of payroll taxes.

You use Schedule H if you are paying cash wages to household employees such as nannies, caregivers, or babysitters. You'll need to report the total wages paid along with taxes due (the form has clear directions to help you calculate the amounts owed, so you don't have to research it on your own).

Form WH-347: Certified Payroll


U.S. Department of Labor
Wage and Hour Division

PAYROLL
(For Contractor's Optional Use; See Instructions at www.dol.gov/whd/forms/wh347instr.htm)

Persons are not required to respond to the collection of information unless it displays a currently valid OMB control number.

U.S. Wage and Hour Division
Rev. Dec. 2008

NAME OF CONTRACTOR ☐ OR SUBCONTRACTOR ☐ | ADDRESS | OMB No.:1235-0008 Expires: 04/30/2021

PAYROLL NO. | FOR WEEK ENDING | PROJECT AND LOCATION | PROJECT OR CONTRACT NO.

(1) NAME AND INDIVIDUAL IDENTIFYING NUMBER (e.g., LAST FOUR DIGITS OF SOCIAL SECURITY NUMBER) OF WORKER	(2) NO. OF WITHHOLDING EXEMPTIONS	(3) WORK CLASSIFICATION	OT. OR ST.	(4) DAY AND DATE / HOURS WORKED EACH DAY	(5) TOTAL HOURS	(6) RATE OF PAY	(7) GROSS AMOUNT EARNED	(8) DEDUCTIONS: FICA	WITH-HOLDING TAX			OTHER	TOTAL DEDUCTIONS	(9) NET WAGES PAID FOR WEEK
			O											
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While completion of Form WH-347 is optional, it is mandatory for covered contractors and subcontractors performing work on Federally financed or assisted construction contracts to respond to the information collection contained in 29 C.F.R. §§ 3.3, 5.5(a). The Copeland Act (40 U.S.C. § 3145) contractors and subcontractors performing work on Federally financed or assisted construction contracts to "furnish weekly a statement with respect to the wages paid each employee during the preceding week." U.S. Department of Labor (DOL) regulations at 29 C.F.R. § 5.5(a)(3)(ii) require contractors to submit weekly a copy of all payrolls to the Federal agency contracting for or financing the construction project, accompanied by a signed "Statement of Compliance" indicating that the payrolls are correct and complete and that each laborer or mechanic has been paid not less than the proper Davis-Bacon prevailing wage rate for the work performed. DOL and federal contracting agencies receiving this information review the information to determine that employees have received legally required wages and fringe benefits.

Public Burden Statement

We estimate that is will take an average of 55 minutes to complete this collection, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. If you have any comments regarding these estimates or any other aspect of this collection, including suggestions for reducing this burden, send them to the Administrator, Wage and Hour Division, U.S. Department of Labor, Room S3502, 200 Constitution Avenue, N.W. Washington, D.C. 20210

(over)

This is a federal Form WH-347 - contractors can use to meet their certified payroll reporting requirements; however, some states are stricter and have their own forms. Be sure to check yours.

The Certified Payroll Form is a document for employers that work on federal projects. To ensure the agency funding the project continues to pay, you have to fill it out with details about every worker involved in the project, like name, hours worked, project name, wages earned, benefits paid, and so on. It's important to submit an updated copy to the agency weekly.

Other Payroll-Related Forms for Employers

Employer and employee tax forms are the most pressing payroll documents for many companies. However, there are others (some specifically payroll and some not) of which employers should be aware. For instance, HR and payroll go hand-in-hand, meaning you can't or shouldn't process payroll without filing some key HR forms. Also, completing the proper contractor forms can save your company time and money.

Employer Contractor Forms

There's a significant difference between employees and contractors in the sense that contractors have much more autonomy because employers cannot legally control how they perform their work. There's also a difference in how you should report the money you pay them. W-2, W-3, and W-4 Forms are not applicable to contractors. W-9 and 1099 Forms are more appropriate.

Here's a list of forms you need when paying contractors:

- W-9 Form: The W-9 is the W-4 for contractors. You should distribute a copy to each contractor you hire before they begin working. It will collect information like the employee's name and social security number). You'll use it to report to the IRS how much you paid out during the year (on Form 1099).
- 1099 Form: Similar to a W-2 (except it's only for contractors that were paid at least $600 and doesn't list any taxes paid), this form should report the total income paid to contractors. You should submit one to each contractor and send a copy to the IRS.
- 1096 Form: It is a summary of all 1099 Forms you distribute. It should reflect the grand total paid to all contractors and tie directly to each 1099 you're distributing.

Non-tax Payroll Forms

There are numerous non-tax-related payroll forms you can use to help manage your internal processes better. Since these are not regulated, you can create them on your own or download a free online payroll template.

Here are three of the most common non-tax payroll forms you should consider using:

- Direct deposit authorization form: Issued to employees wanting to receive their paychecks electronically vs by paper check; the form shows you have permission to pay them via direct deposit and usually includes space for a routing and account number.
- Timesheet: A document employees can use to record the hours they work each period; you can use it to verify work time before issuing paychecks.
- Pay stub: A document you can issue with each paycheck that shows a breakdown of total earnings, deductions, etc. Some states require you to issue them (and dictate what information to include), and others don't.

In addition to payroll forms, many employers require HR forms for new employees, including Form I-9 (used to verify work eligibility), Employer Identification Number (EIN) Form (used to request a state-issued number for reporting and paying taxes), and so on. These aren't payroll forms per se (although often confused as such) but are required before processing any paychecks.

Why Payroll Forms Are Important

Payroll forms are important because they help employers record, summarize, and report paycheck and payroll tax information. It's best to integrate them into your company processes, so they're completed at the right time. You can face penalties for not submitting the proper documents to the appropriate agencies by their deadlines. One of the first steps to learning how to do payroll successfully is to gather (and in some cases, create) the payroll forms that apply to your business. Payroll software services can also provide some guidance and resources.

Key Takeaways to Remember About Payroll Forms

Many forms are tax-related, subject to IRS regulations, and only reflect employee (not contractor) information; other forms are more flexible, and you can produce them in-house (direct deposit, timesheets, and so on). Forms like 1099s help organize payments made to contractors, although they're usually considered vendor payments rather than payroll.

All IRS forms have their deadline(s). Most employer payroll tax reports are filed quarterly while others are submitted annually. For your in-house forms, you can set your deadlines according to how you need to use the information (you can have employees submit timesheets weekly, biweekly, etc., depending on your pay cycle).

Bottom Line

Payroll forms are a necessity for your business. As a small business owner, it is best to start downloading the IRS forms applicable to your business. There are other, less-urgent forms you can customize for internal use, but you can integrate those into your processes later.

CHAPTER 2

Setting Up Payroll

Salary vs Hourly vs Commission Employees: Which Is Better for Your Business?

A salaried employee is paid a regular fixed rate regardless of the number of hours worked for each pay period. An hourly employee is paid a rate for each hour they worked for the period and is entitled to overtime pay if they work more than 40 hours in a week. An employee earning a commission, particularly those in sales and marketing, typically earns a percentage of their sales; some receive a commission as an addition to their base (guaranteed) salary.

Before choosing how to pay your employees, it's important that you've completed your payroll setup for your company up until this point. For guidance here, check out our section that covers registering your business from the very start.

Note: Although hourly workers are the primary ones who receive overtime pay, some salaried workers can as well (though not common) if they're classified as nonexempt. You'll notice the terms "exempt" and "nonexempt" used throughout this section. For a more in-depth read, check out our guide on exempt vs nonexempt employees.

Employee Types at a Glance

Aside from a steady paycheck, salaried employees usually have greater access to paid vacation leaves, bonuses, and benefits than hourly employees. Hourly employees, however, are usually entitled to state and/or federal-approved minimum wage and receive additional pay if they work overtime.

Commission-based employees' pay can fluctuate as it depends on the rate at which they're able to sell a product or service.

	Salary	Hourly	Commission
Minimum Salary	Minimum salary of $684 weekly or $35,568 to avoid paying overtime	Federal minimum wage ($7.25) or state minimum **wage - whichever is higher**	Federal minimum wage ($7.25) or state minimum **wage - whichever is higher**
Wage Rate	Fixed-rate predetermined by employer annually	Paid by the hour for work rendered using a specified hourly rate	Base salary rate + percentage of revenue brought in
Work Hours	Salaried exempt workers are typically paid for 40 hours a week	Varies	Varies
Overtime Eligibility	Not eligible for overtime pay regardless of hours put in and kind of work done except if status is salaried, nonexempt	Entitled to time and one-half their "regular rate" of pay under the FLSA for each hour they work exceeding 40 hours (some state rules vary)	Entitled to time and one-half their "regular rate" of pay under the FLSA for each hour they work exceeding 40 hours (some state rules vary)
Benefits Entitlement	Most jobs include benefit offers like health and retirement plan options	Availability of benefits varies	Benefits are commonly offered

For help with payroll calculations, including calculating time for salaried and hourly workers, check out our guide on how to calculate payroll.

How to Choose Between Salary, Hourly & Commission

The kind of workers you should employ depends on your business and how you plan to schedule your employees; flexibility is a big consideration. Service industries—such as retail and food—usually have hourly workers as the work schedule is rarely consistent.

On the other hand, firms with eight-hour workday schedules often hire salaried employees. For instance, many professional and consulting service employees don't have standard hours at all and receive a salary regardless of the work hours put in. And commission-based jobs, such as in insurance or certain types of retail sales, may or may not have set hours.

Salaried Employees

Aside from one-off deductions or pay adjustments, a salaried employee's pay typically remains the same for each pay period. That is why, regardless of the quality and amount of time spent on work, employers cannot reduce the employee's salary due to poor job performance, holidays, or a business closure for inclement weather days.

There are a few exceptions under the Fair Labor Standards Act (FLSA) where it is permissible to deduct money from an exempt employee's salary.

- Absences of one or more full days due to illness or disability, including work-related accidents (deductions for partial days are not allowed)
- To offset amounts employees receive as jury or witness fees, or for military pay
- Penalties imposed in good faith for infractions of safety rules of major significance (both full and partial days)
- Unpaid disciplinary suspensions of one or more full days imposed in good faith for violations of workplace conduct rules such as harassment and violence (deductions for partial days are not allowed)
- Absences under the Family and Medical Leave Act, or the FMLA (both full and partial days)
- During the initial or final week of employment, if the employee works less than a full week (both full and partial days)

Since most companies do not have to offer overtime pay for their salaried workers, they may provide a range of benefits as an alternative. Most full-time salaried employees are offered paid vacations, health, dental, vision, 401(k), or even retirement plans. However, there are salaried, nonexempt workers who must be compensated by their employer for overtime work—if they exceed their 40 hours—as mandated by the FLSA.

Pros	Cons
• You can budget your payroll for the year in advance • Keeps your payroll expenses consistent • Makes processing vacation and sick leaves easier (you don't need to worry about calculating or paying overtime) • Employees can rely on a steady paycheck per period.	• Possibly paying for work not completed (guaranteed salary instead of paying per hour) • Tracking is still necessary for all nonexempt employees (hours worked, overtime, breaks, etc.)

With salaried employees, it's important to consider the compa (or compensation) ratio, allowing you to know whether you are paying them competitive salaries. For more information and help calculating it, check out our guide to compa ratios.

Hourly Employees

In a nutshell, hourly employees must be paid at least the federal minimum wage for each hour worked. They must receive overtime pay of not less than one-and-a-half times their hourly rate for any hours worked beyond 40 each week. They usually use timecards or an automated tracking system to verify time worked. Human resources employees who work less than 40 hours a week are classified as part-timers.

They are also referred to as nonexempt employees under the supervision of the FLSA and its provisions. Most of these workers receive less than the minimum weekly salary of $684. Generally, employees are entitled to a minimum wage of no less than $7.25 per hour, although it depends on the hourly rate based on the state minimum wage legislation; some are higher. Aside from that, they are not usually given the same benefits like paid vacation, retirement plans, or even bonuses. Also, the government has guidelines for pay rates and break times that you often have to track.

Pros	Cons
• Beneficial for employers in hospitality, food, retail, and home care due to the flexibility in hours • Allows you to match your payroll expenses to the busy seasons when you'll generate more income • Employers pay for actual work performed and can save money by not providing a salary	• Much more tracking involved—hours worked, paid breaks, unpaid breaks/ lunch, overtime hours • You have to verify the hours reported on time cards and manage all the calculations

If you have hourly employees that require you to verify timesheets, it's a good idea to invest in a reliable time clock or time-keeping system like Homebase to make it easier.

Commission-based Employees

Commission-based workers are compensated based on the revenue they generate for your business rather than a straight salary. Usually, commission-based employees work in sales, retail, real estate, insurance, and the stock market. Their work structure can be based on individual or team performance.

There are different types of commissions that you can include in your pay structure.

- Straight commission: The employee only receives a commission as pay. It includes no base salary or hourly pay rate because both the employer and employee set an agreed-upon percentage of sales. This is common practice in the real estate and automotive industry.
- Salary plus commission: In addition to a fixed but smaller salary, an employee also receives a commission for their sales or performance. It is the most stable commission-based structure and most common in the retail industry.
- Bonus commission: It is more of a reward for an employee's or a team's stellar sales performance. It is usually earned based on an individual's or a team's success in meeting pre-established earning quotas. It is a common practice among startup companies as it motivates employees.
- Variable commission: To break into expanding markets, some companies reward employees with commissions to jump-start sales in a specific market. The longer the contract or the bigger the sales, the higher the commission.

- Graduated commission: A company can set up commission levels according to the number of sales that the employees will try to achieve. The rate at which an employee earns depends on what commission level they have achieved.
- Residual commission: An employee can only start receiving a commission once a client purchases a product. They will continuously receive it on a sale as long as it is generating revenue. It is usually practiced in consulting firms and insurance agencies.
- Draw against commission: A "draw" is the money that a company provides initially to an employee. If the employee sells more than the initial amount, it will be considered their income, and anything additional is the commission. However, if the employee's sales fell short of the "draw" then they must return the initial amount to the company.

Employers are also required to withhold payroll and federal income taxes on commissions.

Pros	Cons
• Employees earn income based on their work completed • Incentivizes employees to work hard to earn the most they can—the more sales, the higher their pay • Employees who earn commission have more flexibility—can be a big perk for those looking for a work/life balance	• These positions tend to have a high turnover rate (ex., sales people) • Since most commission-based employees are highly competitive, there can be issues in the workplace

For help doing your payroll in-house, check out our guide on how to do payroll.

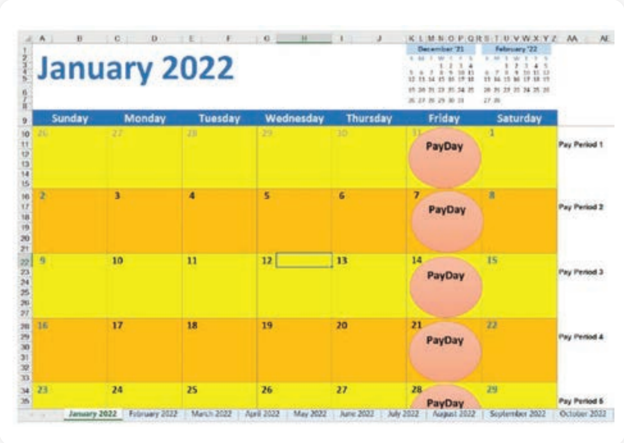
Bottom Line

Whether you should pay your employees hourly vs salary vs a commission depends on the flow and structure of your business. They all have pros and cons, and matching them with the right positions is essential so that you're not paying money you don't have to. Salaries are more suitable for established positions with a high level of schedule and work predictability, whereas hourly is great for fluctuating work demand. Meanwhile, commission is ideal for positions that directly impact sales.

Pay Periods: What Are They & Why They're Important for Your Business

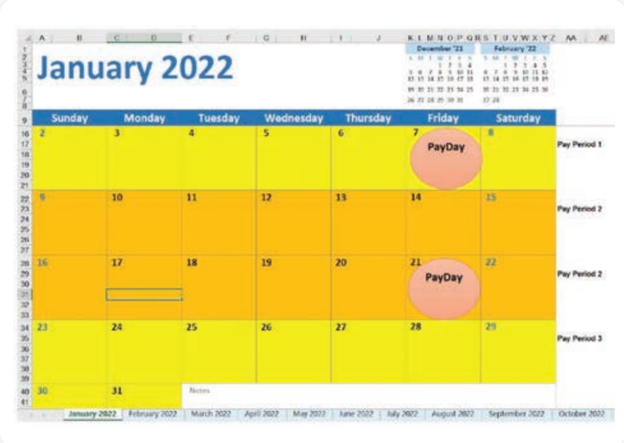
A pay period is the time over which employees work and are paid. Pay periods are fixed and most often occur on a biweekly or semimonthly basis (some state laws require a certain frequency). There are several pay periods from which to choose—and our payroll calendars make them easier to track.

Download the pay period calendar and corresponding chart that fits your payroll schedule.



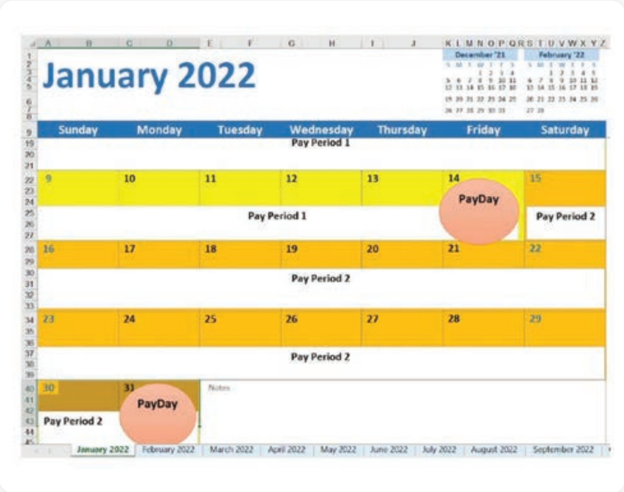
2022 Weekly Calendar

2022 Weekly Pay Period Chart



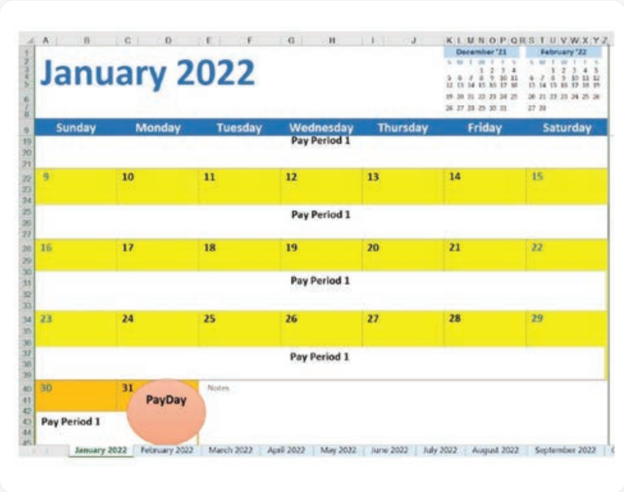
2022 Biweekly Calendar

2022 Biweekly Pay Period Chart



2022 Semimonthly Calendar

2022 Semimonthly Pay Period Chart



2022 Monthly Calendar

2022 Monthly Pay Period Chart

Using Our Pay Period Calendars & Charts

Using a pay period calendar and/or chart can help you avoid missing a payday. Bookkeepers find them useful when they need to record and forecast payroll expenses, and employees might want a copy to reference if they get confused (especially if payroll is paid in arrears).

Track Employee Hours Using the Pay Period Chart

After printing your payroll chart, you can use it when calculating your employees' work hours for the pay period. The chart lists the beginning and end dates you need to consider for each payroll, so you can easily ensure you're only paying for time worked in the appropriate period. It's a good idea to require your hourly employees to submit timesheets based on your set pay schedule.

Pay Employees on Designated Pay Date

The pay period calendar makes it easy to see each pay date because they're circled. You can post the calendar on your desk or wall for easy reference. You can also write additional information or reminders to help you keep track of other important dates. Just follow along each day, and you'll always know when payday is approaching. This really comes in handy if you process payroll manually.

How Pay Periods Work

Employers set a regular pay period to ensure their employees receive consistent paychecks. While most companies base their pay schedule on the needs of the business, there are labor laws in place that govern the minimum consistency with which these schedules must comply.

Employers consider the minimum frequency at which they can legally process payroll—usually monthly—to set a regular pay schedule. Remember, every pay schedule includes start and end dates for time worked and a payday on which employees receive their paychecks. The payday varies depending on the employer; some designate the payday to be the last date of every pay period, while others may opt to pay a week after the pay period ends.

If you're using a professional employer organization (PEO), your payday options may be limited (for instance, some larger payroll services only allow you to pay employees on Fridays).

Types of Pay Periods & How to Choose

A year can be divided into 52 weeks, 365 days, or 12 months, which means there are numerous schedules you can use for your payroll. Some businesses are more concerned with weekly payouts and opt to pay once a week or every other week. Others divide each month in half and choose to pay in the middle and at the end. Additionally, although not as frequent, a monthly pay schedule works better for some companies. Here are some factors you should consider when determining your pay schedule.

- **Average wages:** Restaurant employees who earn tipped minimum wage may be better suited for weekly paychecks. Forcing employees who receive low wages to wait two to three weeks for payday could damage morale.
- **Company cash flow:** Paying weekly means you must have enough cash available to pay more often. Some businesses have cash flow cycles that require more time before bank accounts are replenished—like stores that sell merchandise on credit.
- **Profitability:** Processing payroll more often usually costs more money ($50 to $100 per pay run for 10 employees), and some businesses, especially startups, have to manage their expenses more carefully. We recommend using providers that allow employers to run unlimited monthly payrolls at no extra cost.

Here are some of the most common pay schedules from which you can choose. Keep in mind that certain industries have norms, and you may need to follow your industry's tradition to remain a competitive employer.

Weekly

Employees are paid once a week; their paychecks include hours worked (or salary) for a workweek—for instance, Sunday through Saturday. Many companies choose Friday as their payday since it's the last weekday, but it can be any day of the week. Many businesses in the construction, manufacturing, restaurant, and mining industries pay on this cycle.

Biweekly

Biweekly means payroll is run once every two weeks or every other week, wherein employees are paid for two workweeks. For most months, this equates to two paydays, but three months in the year (that vary from year to year) have three biweekly paydays.

One thing to note is that biweekly is the most common pay schedule overall, with more than a third of US private businesses historically paying their employees every two weeks. Many businesses in education, healthcare, leisure and hospitality, and information technology industries follow it.

Semimonthly

Semimonthly, which is sometimes confused with biweekly, means twice a month. Many companies opt to pay on the 15th and last day of every month. If either of those days falls on a weekend, payroll is processed on the closest weekday before it. The pay period can include 14 to 16 days, depending on the number of days in the month. Typically, businesses in the financial, information technology, professional, and business service industries pay semimonthly—it's the second least frequently used pay schedule.

Monthly

With a monthly pay schedule, payroll is processed once a month. It's not as common as the others and results in only 12 pay dates in the year. Some companies pay employees on the last Friday of each month, while others opt to pay on the last day of the month. If that happens to be on the weekend, they may pay on the last weekday before it. Monthly is used the least frequently of the pay schedules but is sometimes used by businesses that offer professional or business services.

Paying in Arrears vs Current

When you pay on a current schedule, you pay employees as soon as or before their pay cycle ends. Paying in arrears means there's a delay between the time employees work and when they receive pay for that work. This delay could be a week or more, depending on state laws.

Here's an example of paying employees in arrears. Jeff sets his pay period as Sunday through Saturday but opts to pay Friday of the following week (six days after the last workday). While this is sometimes a nuisance to new employees who may have to work a week "in the hole," meaning they're not paid at the end of their first week, it can be beneficial for some employers.

If you pay your employees for time that has not yet passed, there could be unexpected changes in their schedule for which you'll need to make adjustments on the next pay period. This can become cumbersome as you'll have to keep track of pay cycles for which you've already processed payroll; you must comply with federal overtime laws—paying time and a half (1.5 times regular hourly pay) for hours worked over 40 in a workweek.

Determining Whether to Pay in Arrears or Current

There is no hard rule guiding whether you should pay in arrears or current. You should consider the needs of your business and your employees. Paying in arrears gives you time to gather all timesheets, tip reports, and other information to ensure you process payroll correctly; there's no need to forecast employee schedules.

Paying current is less confusing for some employees and works well in certain instances. Let's assume a company has a Sunday through Saturday pay cycle, with Friday being the payday. If the employees only work weekdays, Monday through Friday, there would be less guesswork. Although Saturday is a part of the pay cycle, the employees don't work on Saturdays. It also works for salaried employees who are paid the same amount every pay period, regardless of hours worked.

For a list of other payroll terms small business owners need to know, check out our guide on payroll terminology. It's also helpful to get a good grasp as to what payroll is and isn't.

Bottom Line

Choosing the pay period that best suits your business is essential, and following it consistently is even more important. Our payroll calendars and charts make it easy to track the beginning and end dates of your pay cycle along with your pay dates, so you never miss payday or run payroll for the wrong period.

How to Set Up Direct Deposit for Employees

The most common way to pay employees, direct deposit allows an employee's pay to be deposited directly into their bank account, usually within days of processing. Setting up direct deposit is simple—you just need your employees' bank account information, signed approval, and a service to help facilitate. We've outlined the steps you'll need to take below.

1. Choose a Direct Deposit Provider

The two most common ways to set up direct deposit are through your bank and with your payroll software. Many payroll software applications have this function and are able to automatically process payrolls as direct deposit. In addition, some HR services or software with payroll capabilities can also provide direct deposit services. If you are paying for payroll services, it makes sense to let them handle the direct deposit work.

No matter which option you choose, your bank is the one that transfers the funds. Thus, if you don't work with your bank directly, you will need to share your bank account information with the software or service provider to have direct deposits setup.

Direct Deposit Costs

Banks usually charge a setup fee of up to $150. Some will charge monthly or transaction fees, which typically can run from $1.50 to $1.90 per individual transaction.

If you work with a payroll service, it will handle direct deposits at no additional charge to you. It can verify your bank account automatically through its setup process and have you paying employees and payroll taxes in just a few days.

2. Set Up Direct Deposit Service

Once you've decided on your direct deposit service, it should tell you the steps you need to take to set up your direct deposit. Remember that it can take a few days to even a week or so to have everything in place. It's important to set realistic expectations with your team so your employees don't expect direct deposit with their next paycheck if it's not possible.

Below, we cover how to set up direct deposit through your bank or with a payroll service provider.

Through Your Bank

To arrange a direct deposit with your bank, you can call and talk to a representative to lead you through the process, or use your online portal to do it electronically. Each bank is different, so reaching out to your local branch to find out their process is a good place to start.

You'll sign the automated clearing house (ACH) terms of agreement, and may need to provide financial statements to prove you currently have and are likely to continue to have the cash available to finance the regular payrolls. At this time, you will also want to discuss how often you plan to run payroll.

With a Payroll Service Provider

If you are using a payroll service, it will set up the direct deposit for you. You need to provide your bank account information (routing number and account number).

There may be a verification process for you to go through that could include a test withdrawal. This means that a small amount (usually under $1.00) will be deposited into your account and then withdrawn (or vice versa) to make sure the service is able to access your funds.

3. Get Employee Authorization and Bank Information

Although direct deposit is the most common way to pay your employees, your workers still must choose to be paid via direct deposit. Many states have their own regulations about how employees can be paid and whether or not you can mandate electronic payments for your team.

Pro Tip: We recommend you download a direct deposit authorization form template you can distribute to all employees.

You'll also need to collect a bit of information from your employees, in addition to consent, to have direct deposits set up properly. You likely will need the following information:

- Bank routing number
- Bank account number
- Bank account type (checking/savings)
- Bank name
- Social Security number
- Employee name and address on the account
  (for verification to avoid mix-ups in delivery)

Pro Tip: If you have an HR or payroll software with an employee portal, you can have your employees fill out the information through the portal. However, make sure that as the employer you have full access to this information, as some services will store sensitive information such as bank account numbers and social security numbers masked (ex. **** *** **038).

4. Determine Pay Cycle

While having your direct deposits set up, it's important to determine a regular pay period that works best for your company and employees to make sure doing payroll runs smoothly. To help make that decision, consider the following:

- **Determine required lead time:** How much lead time does your bank or payroll service need to finish the deposit after you process payroll? Also, decide whether it needs a longer lead time for holidays or weekends.

  In general, you need to log payroll two to four days before the day your employees get their checks. Some businesses will move that back when payday falls on a weekend or holiday to get deposits out the business day before.

- **Determine your own financial schedule:** Funds must be available to transfer into your business account before paychecks can be distributed, so be sure your schedule works with anticipated cash flow.

- **Determine payday frequency:** The most common pay cycles are monthly, semimonthly (15th and 31st) or biweekly. Biweekly employees usually get 26 paychecks a year at a slightly smaller amount; semimonthly get 24 paychecks at a slightly higher amount.

- **Set deadlines with employees for submitting hours or time cards:** Give yourself enough time to review the data and submit the processed payroll for direct deposit.

- **Inform employees of the paydays:** Generally, funds are available by 9 a.m. local time at the receiving depository institution, but it's not set in stone; employees should expect funds by midnight of payday.

Your first pay run can take longer than usual, so allow extra time for set up to complete. It's a good idea to run a test pay run of only a penny or other token amount.

Ask employees to be on the lookout for this and to let you know if they have not received it by a specific date so you can track down any errors.

Understanding Direct Deposit Errors

One of the prime benefits of direct deposit is that it is generally timely and error-free, as long as you enter the correct payroll information. However, errors can occur. Here are some of the most common (though rare) problems people experience with direct deposit and how to handle them.

Wrong Employee Account Number

Prevention is the best way to stop these errors. First, ask for a copy of a canceled check, so you can verify the account and bank routing numbers manually. Next, do a single test deposit of a penny to ensure the payment goes through correctly. Banks often catch errors and will either put the money into the correct account (sometimes with a delay) or refund it back to you.

If, despite all this, the employee claims they are not getting their paycheck, start by verifying you are sending to the account they're checking (for example, if the employee gave you their savings account information instead of checking).

If somehow, the money does go to a legitimate but wrong account, you have five days to request a reversal. The payee must be notified, as outlined in the form instructions, but this is only a heads-up vs request for permission to transfer. You may first need to put a trace on the money to find where it has gone. In the meantime, you can cut your employee a paper check, put in an out-of-cycle payment to cover the paycheck, or have the employee work with their bank to credit them the money pending the actual deposit.

Payroll Didn't Deposit on Time

If you completed payroll on time, but your employees are saying they did not get their paychecks, you should first check that you actually did meet the correct deadline and allowed enough time for processing. Direct deposit can take two to four days to process—longer, if payday falls on a weekend or holiday.

If you have your dates correct, check that your account has sufficient funds to cover payroll. If that is not the problem, then call your bank or payroll service.

The Wrong Paycheck Amount Was Deposited

If your employee receives the wrong paycheck amount, check your payroll records. Were hours correctly calculated? Were all withholdings accounted for? Are the decimals in the right place?

Also, check that the employee did not ask for a split payment and if part of the balance was deposited to another account or is going to someone else for child support or other withholdings. You can correct errors by processing an additional transfer or check payment.

If you overpaid, you may be able to dock future paychecks, but be careful. Some state laws have strict rules about how you can retrieve overpayments (for instance, California); you still have to ensure the employee is receiving minimum wage.

Deposits Are Delayed Due to Holidays

Some banks don't record deposits on holidays. Your best bet is to be prepared and run payroll early. The best employers plan so that deposits are made on Fridays if a payday falls on a weekend or bank holiday. That way, employees have their paychecks for the weekend.

Direct Deposit Payment Made Twice

This is usually due to human error in the payroll. Be sure to check that an employee is not listed twice and their payroll information is correct.
You have five days for recalling the erroneous paycheck by putting in a Request for Reversal order. The reversal must be for the full amount, and the employee must be notified about the transaction.

National Automated Clearing House Association (NACHA) rules stipulate the entire amount must be refunded at once. Thus, if an employee's account does not have enough funds to bankroll the reversal, then you will need to work with them on some other way to pay back the error.

Bottom Line

With a little work upfront, direct deposit can save your business time, money, and headache. Direct deposit is generally error-free, but like anything else, errors are possible. By sending paychecks directly to your employees' accounts, you don't have to deal with paper checks and employees have access to their money right away.

Work with your bank or payroll solution to get the direct deposit set up accurately, then test it out to ensure everything is working. After that, be sure to get payroll done in a timely manner, and direct deposit will handle the rest.

CHAPTER 3

How To Do Payroll

How to Do Payroll Yourself in 8 Steps

When people think of payroll, they immediately jump to number crunching. Although calculations are part of it, you'll need to understand the overall process to learn how to do payroll yourself. Doing payroll includes everything from setting up your business as an employer to paying your employees, tax agencies, and other applicable entities.

While using a provider can be easier and at times more practical, it's still a very possible and plausible option to process your small business's payroll yourself. **Watch our video guide and follow along with the eight steps below:**

Watch Our Video Guide

Step 1. Set Up Your Business as an Employer

Assuming you've already established your business and applied for any required licenses, the first step in doing payroll is ensuring your business has met all of the legal requirements to operate as an employer. Consider any industry-specific payroll rules you may have to follow as well.

- Apply for a Federal Employer ID Number (EIN).
- Verify your state tax identification number is the same as your federal one; if not, determine whether you need to apply for one or if it's automatically assigned.
- Sign up for an account with the Electronic Federal Tax Payment System.
- Start a bank account solely for payroll transactions (separate from your main business account).
- Sign up for any applicable state electronic tax payment accounts.
- Purchase workers' comp insurance; most states require it.

Step 2. Establish Your Payroll Process

Now, you will need to make some decisions that will impact how you run payroll each period. You'll need to determine what will work for your business so that you can ensure your team is trained on the process properly. Explore the "why" behind each area. Be sure to consider the needs of both your employees and your business, in addition to any legal requirements.

- **Types of employees (not contractors):** Full-time vs part-time? Exempt vs nonexempt?
- **Tracking work time:** Will you need to track work hours? If so, how will you do it, and when will they need to be reported to you?
- **Benefits:** Will you be offering benefits? Who will pay for them? If employees are paying for them partially or in full, how will you manage the payroll deductions?
- **Taxes:** How often will you need to pay taxes, and which ones are you subject to? Will you need to pay state taxes? Local? Find out the rates in advance so you know how much to withhold.
- **Payroll processing and calculations:** Will you calculate and process payroll using Excel, by hand, with a calculator, or with a payroll service?
- **Paychecks:** Will you be cutting checks or paying via direct deposit? Pay cards? Cash?

You should also consider whether you want to use a payroll solution to help make the process easier; the right provider can be the difference between investing three days to run payroll vs an hour. To learn how easy it is to do payroll with some of our recommended software, check out provider-specific payroll guides below:

- How to do payroll with Gusto
- How to do payroll with Patriot
- How to do payroll with OnPay
- How to do payroll with QuickBooks

Step 3. Collect Your Employees' Payroll Forms When Hired

Once your employee is ready to start work, you need to collect some important payroll documents. These include tax and work authorization forms, which the employees need to sign.

You'll use the data on the forms described below to add the employee to your HR or payroll system if you have one. It's a good idea to store this information as a paper document or an electronic personnel file.

Federal W-4

A W-4 is the federal tax withholding document that tells you what tax rate to use for the employee. Collect a signed Federal W-4 form for tax withholding. You don't need to submit this to the IRS, but you should store it in a paper personnel file or electronically.

State W-4 (or equivalent)

The state tax withholding document is similar to the federal and may be called by a different name in your state. Collect a signed State W-4 form for tax withholding and store it in a paper personnel file or electronically.

I-9 Form

Collect a signed I-9 Form for work eligibility verification (within three days of the employee's start date). You'll want to make sure the employee can verify their identity and eligibility to work in the United States with a passport or two forms of identification.

Other Payroll Forms

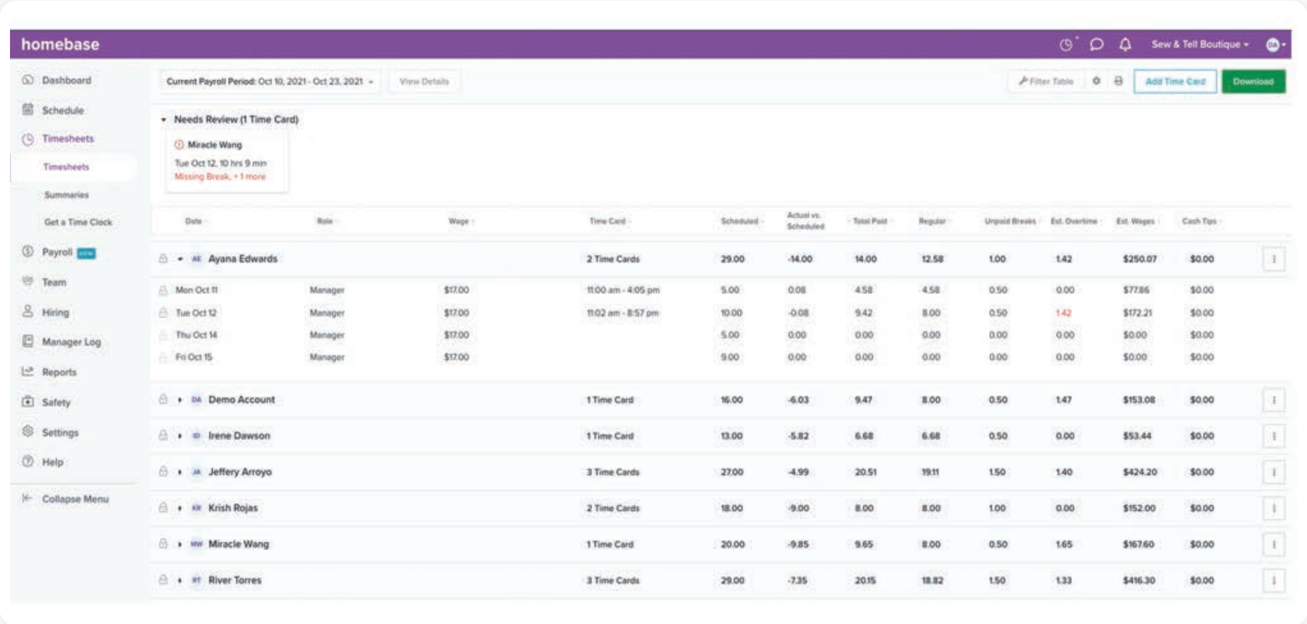
Get direct deposit information from employees via a voided check (if applicable).

Also, you'll need to register your employee in your state's New Hire Reporting Program (generally within 20 days). Make sure that you report all new or rehired employees to your state. Payroll software often files these reports automatically. The next three steps will be a part of your regular payroll process, unlike the prior three that you only need to do once.

Step 4. Collect Time Sheets, Review & Approve

Now you're ready to start collecting data on your employees' work time to help determine how much you need to pay them. You'll need to find the total hours worked for the period if you're paying hourly employees. Salaried employees typically receive the same pay each period, but you can still track their work hours for visibility if needed. Calculating hours worked is as simple as having the employee write down their start and end times each day and counting up the hours. Lunch breaks are not counted in the total.

Most businesses start out with a simple time sheet. As they grow, they often move up to a time and attendance system or time clock to manage employee schedules, break time, and hours worked. Here's an example of an electronic timesheet from our recommended free timekeeping vendor, Homebase.



Date	Role	Wage	Time Card	Scheduled	Actual vs. Scheduled	Total Paid	Regular	Unpaid Breaks	Est. Overtime	Est. Wages	Cash Tips
Ayana Edwards			2 Time Cards	29.00	-14.00	14.00	12.58	1.00	1.42	$250.07	$0.00
Mon Oct 11	Manager	$17.00	11:00 am - 4:05 pm	5.00	0.08	4.58	4.58	0.50	0.00	$77.86	$0.00
Tue Oct 12	Manager	$17.00	11:02 am - 8:57 pm	10.00	-0.08	9.42	8.00	0.50	1.42	$172.21	$0.00
Thu Oct 14	Manager	$17.00		5.00	0.00	0.00	0.00	0.00	0.00	$0.00	$0.00
Fri Oct 15	Manager	$17.00		9.00	0.00	0.00	0.00	0.00	0.00	$0.00	$0.00
Demo Account			1 Time Card	16.00	-6.03	9.47	8.00	0.50	1.47	$153.08	$0.00
Irene Dawson			1 Time Card	13.00	-5.82	6.68	6.68	0.50	0.00	$53.44	$0.00
Jeffery Arroyo			3 Time Cards	27.00	-4.99	20.51	19.11	1.50	1.40	$424.20	$0.00
Krish Rojas			2 Time Cards	18.00	-9.00	8.00	8.00	1.00	0.00	$152.00	$0.00
Miracle Wang			1 Time Card	20.00	-9.85	9.65	8.00	0.50	1.65	$167.60	$0.00
River Torres			3 Time Cards	29.00	-7.35	20.15	18.82	1.50	1.33	$416.30	$0.00

Homebase Digital Timecard

Step 5. Do Payroll Calculations

Once you know how much an employee has worked for the pay period, you can start figuring out the important payroll calculations. That includes gross pay, taxes due, deductions for insurance premiums and other benefits, and final net pay.

Gross Pay

[Calculating gross pay](#) is as simple as adding up the straight time hours (up to 40 hours within a week) and multiplying by the employee's hourly rate. Then, add up the overtime hours worked in the pay period and apply the employees' overtime pay rate to those hours. Straight time is paid at the employee's regular pay rate, while overtime is calculated at 1.5 times the regular rate of pay.

Payroll Deductions & Taxes

Doing payroll requires you to know in advance what payroll deductions you're going to make. Deductions include federal and state payroll taxes, benefits you might offer, and things like unemployment insurance or Social Security.

Here's a list of potential deductions with links to more information such as determining what to deduct for each employee. If you use payroll software, deductions are processed automatically.

Examples are:

- Social Security and Medicare (FICA)
- Federal unemployment tax (FUTA)
- Deductions based on:
    - Benefits you offer employees, like health insurance
    - Tax deductions based on employee tips
    - Miscellaneous deductions such as a uniform expense

To process those deductions, add up all the deductions for each employee to get a total, then subtract that total from the employee's gross pay. Alternatively, you can list each deduction as a line item and subtract them one by one from the employee's gross pay until you come up with a net pay amount.

If you're primarily struggling with the numbers side of payroll, our article on payroll calculations may be a better fit. Just be sure you also have a good grasp of the general steps you should take to run payroll.

Get Help With Payroll Calculations

Step 6. Pay Employees, Tax Agencies & Benefits Providers

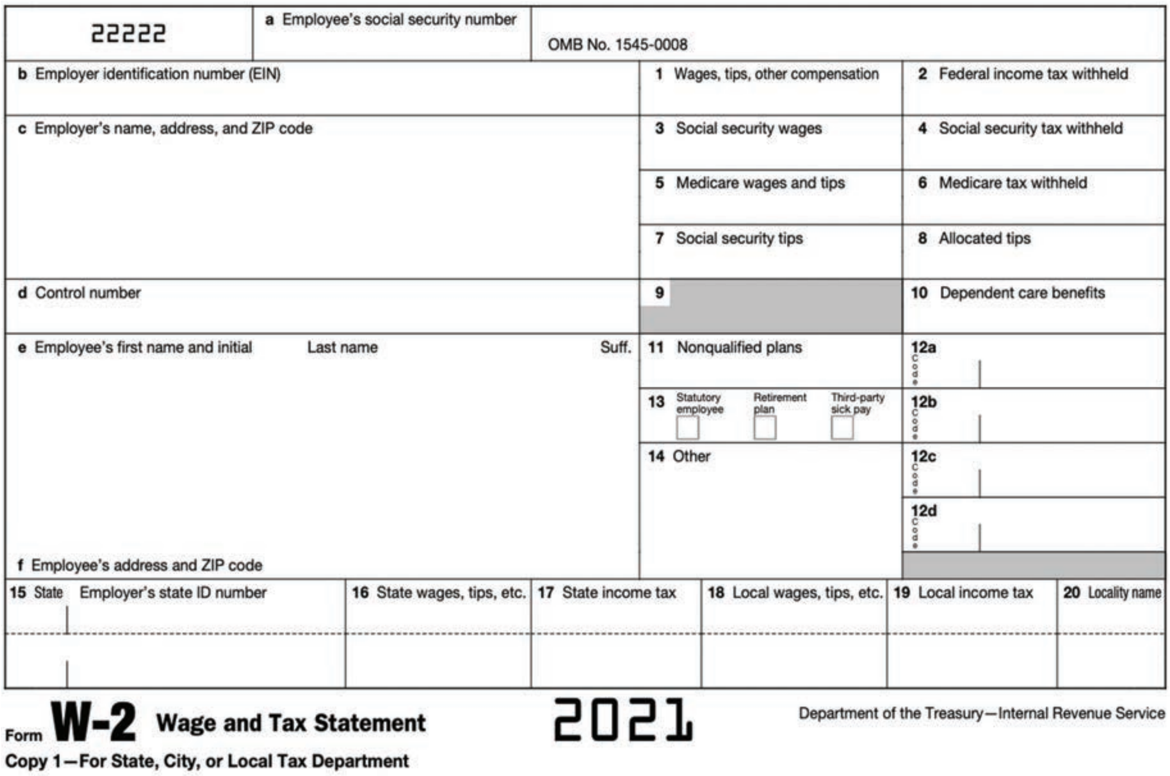
Once you subtract deductions from gross pay, you'll know the net amount you need to pay each employee, including totals for employment taxes and benefits you need to pay out. Be sure to follow the pay schedule you initially set so that employees always know what to expect (if you committed to paying wages every Friday, give yourself enough time in advance to process).

Taxes and benefit providers have their own due dates. Many employers are required to pay these expenses on a monthly basis, but it can vary. You'll need to pay out the amounts you withheld from your employees' paychecks in addition to any employer payroll tax and premium amounts your business owes.

Always check before making any payments to determine whether you have enough funds in your payroll bank account. Spending more money than you have can result in unnecessary fees and litigation.

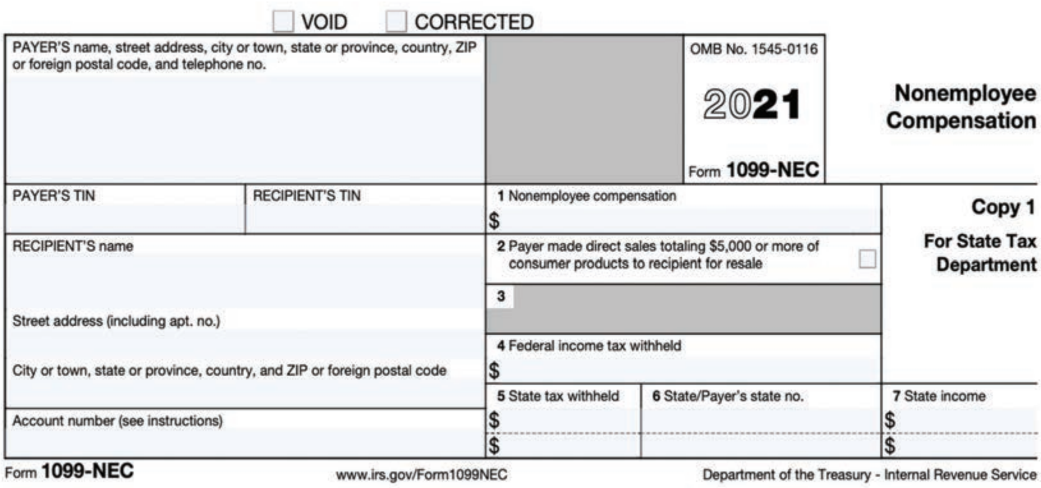
Step 7. Do Year-end Payroll Tax Reports

As the end of the year draws near, you'll need to prepare to distribute year-end payroll tax reports. Employees must receive their W-2 forms by January 31 of the following year, and the forms must show their total earnings and taxes paid. If you're paying independent contractors, you'll need to prepare 1099 NEC forms instead; this will show earnings but no taxes.



22222
a Employee's social security number
OMB No. 1545-0008
b Employer identification number (EIN)
1 Wages, tips, other compensation
2 Federal income tax withheld
c Employer's name, address, and ZIP code
3 Social security wages
4 Social security tax withheld
5 Medicare wages and tips
6 Medicare tax withheld
7 Social security tips
8 Allocated tips
d Control number
9
10 Dependent care benefits
e Employee's first name and initial Last name Suff.
11 Nonqualified plans
12a
13 Statutory employee Retirement plan Third-party sick pay
12b
14 Other
12c
12d
f Employee's address and ZIP code
15 State Employer's state ID number
16 State wages, tips, etc.
17 State income tax
18 Local wages, tips, etc.
19 Local income tax
20 Locality name
Form **W-2** **Wage and Tax Statement** 2021
Department of the Treasury—Internal Revenue Service
Copy 1—For State, City, or Local Tax Department

Form W-2: Wage and Tax Statement



VOID CORRECTED
PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
OMB No. 1545-0116
2021
Form 1099-NEC
Nonemployee Compensation
PAYER'S TIN
RECIPIENT'S TIN
1 Nonemployee compensation
$
Copy 1
For State Tax Department
RECIPIENT'S name
2 Payer made direct sales totaling $5,000 or more of consumer products to recipient for resale
3
Street address (including apt. no.)
4 Federal income tax withheld
City or town, state or province, country, and ZIP or foreign postal code
$
5 State tax withheld
6 State/Payer's state no.
7 State income
Account number (see instructions)
$
$
$
$
Form **1099-NEC** www.irs.gov/Form1099NEC Department of the Treasury - Internal Revenue Service

Form 1099-NEC: Nonemployee Compensation

Step 8. Document & Store Your Payroll Records

To remain compliant with federal labor laws, you'll need to document specific data for each pay period. Retain payroll documents—like timecards, pay stubs, and any information regarding pay increases. We discuss payroll documents and how retention works in a coming chapter of our e-book.

If you're using software, the documents are already online or can be uploaded and attached to the employee record. If you're maintaining documents manually, you'll want to ensure they're stored securely.

Free Small Business Payroll Checklist

Here's a checklist you can download to make sure you don't miss any steps. This checklist will also be helpful if you use payroll software to do payroll.

How to Do Payroll Checklist

Step	What To Do	Details
1	Collect Employee Data Link to more information on New Hire Checklist	**Gather:** __ employee name, __ address, __ zip code, __ tax withholdings (W-4), __ employment verification (I-9), __ pay rate, and __ employee's employment status
2	Gather Hours Worked Link to more information on Timekeeping and Break time laws	**Determine:** __ hours worked per pay period, __ paid and unpaid breaks, __ overtime
3	Calculate Gross Pay Link to more information on Overtime Rules	**Multiply:** __ pay rate __ by hours worked *Overtime is paid at 1.5x hourly pay rate*
4	Process Deductions Link to more information on Payroll Taxes or Employee Benefits	**Subtract:** __ employee deductions __ from gross pay
5	Provide Net Pay Link to more information on Pay Stubs or Business Checking Accounts	**Pay employees with:** __ paper check or pay stub, __ direct deposit, or __ pay card, and __ make sure to fund your payroll account!
6	Document Results Link to more information on Payroll Record Retention	**Keep:** __ timecards, __ pay stubs and __ any pay change information (raises or bonuses)

Download Checklist

If you're still unsure about what payroll is, check out our guide to payroll for more information.

Bottom Line

Learning how to do payroll can be a pain. You have to make sure your business registers with all the right agencies. You will need to fill out forms for each employee and purchase workers' compensation coverage—all on a tight deadline (less than 20 days for most states by law). Even seasoned business owners can get overwhelmed with the complexities of payroll compliance. That is why simple software solutions are the easiest and most time-saving options for business owners overall.

How to Do Payroll in Excel in 7 Steps

Doing payroll in Excel is best for businesses needing to pay 10 or fewer employees and operating in states without complex labor and tax laws. Since it is a completely manual approach to payroll, it does take time compared to other methods but can definitely be cost-effective for growing businesses.

Using a template can help with time and efficiency because it contains pre filled information like tax rates and overtime formulas. After inputting your employee information, you just need to enter the actual hours worked, and then the template will automatically populate the applicable payroll data.

Download Our Free Excel Template

Follow the steps below to run payroll using our free Excel payroll template. If you want to see the process in action, you can also watch our video tutorial on how to do payroll in Excel.

How To Do Payroll In Excel Video

1. Review Payroll Excel Template & Edit For Your Business

Figuring out how to do payroll using an Excel template can take some time. First, you need to take a look at the template and evaluate your business needs. A standardized template should have tabs for each month, with links to formulas that calculate employee taxes, deductions, and pay. You also need a "Set Up" tab from which your payroll calculations can pull standard information, such as pay rate and benefits enrolled.

Keep the "Set Up" tab up-to-date so you can easily link to it each month you run payroll. This helps with automation and prevents double work.

Here are some questions that can help you identify the information needed to finalize the template.

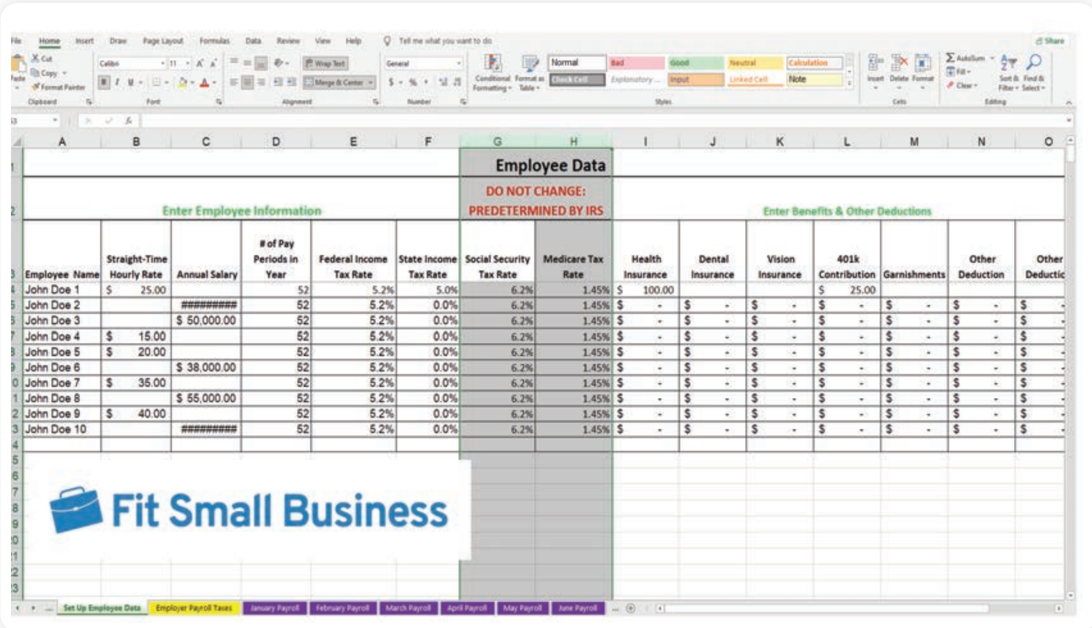
- How many employees do you have?
- What benefits payments and deductions do you need to withhold from their paychecks?
- Is there anything missing from the template that you need to add?

To add a column, choose the column letter (e.g., G, H, or I) you want your new column to come before. Right-click your mouse and then select "Insert." Enter a header (in row 3) for your new column (for example, "Local NYC Tax") and input the rates for applicable employees. Go to all the month tabs (from "January Payroll" to "December Payroll"), including the "Year-to-Date Payroll" tab, and enter a new column between columns N and Q (the tax columns). Label this "Local NYC Tax."

When adding new columns to the month tabs, you must be consistent. If you add a "Local NYC Tax" column in column O on the "January Payroll" tab, you must add it in the same place on other month tabs. For the "Year-to-Date Payroll" tab, which contains the summary of the 12 months, you also need to add any new columns so that it correctly reflects details from the monthly payroll tabs.

To delete columns, highlight the column you want to remove, right-click your mouse, and then select "Delete." The rules are the same if you delete a column from the "Set Up Employee Data" tab. If you delete a column from one of the payroll tabs, including the "Year-to-Date Payroll" and the "Set Up" tabs, then you must delete it from the others.

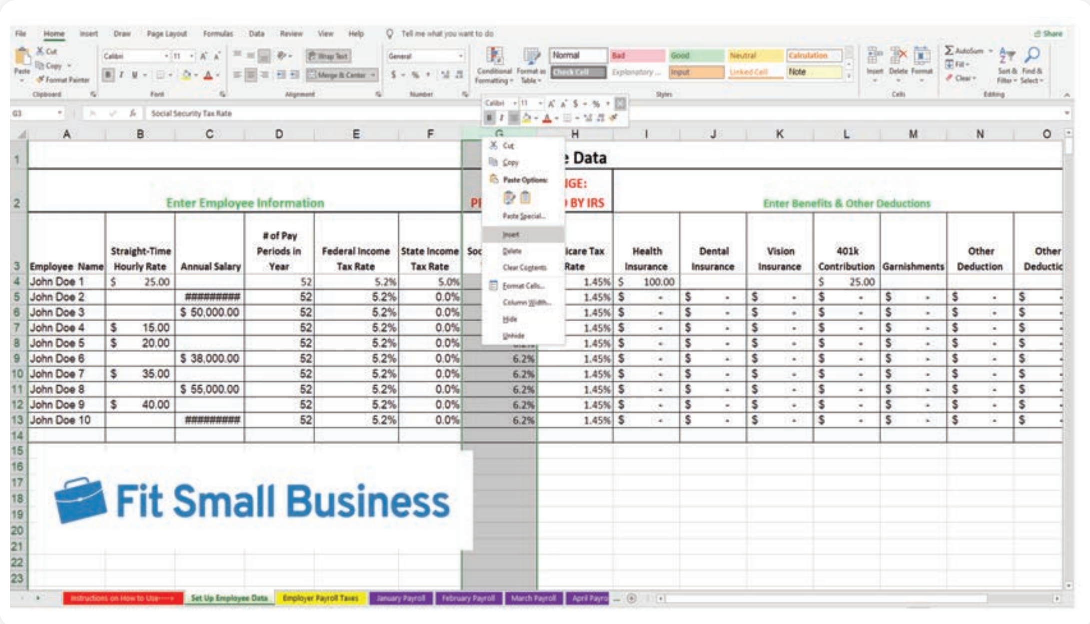
For example, if you delete the "Social Security Tax Rate" in column G of the "Set Up Employee Data" tab, you need to remove the "Social Security Tax" column (column N) in all the 13 payroll tabs. If not, you'll receive error messages—and your formulas won't work.


Employee Data

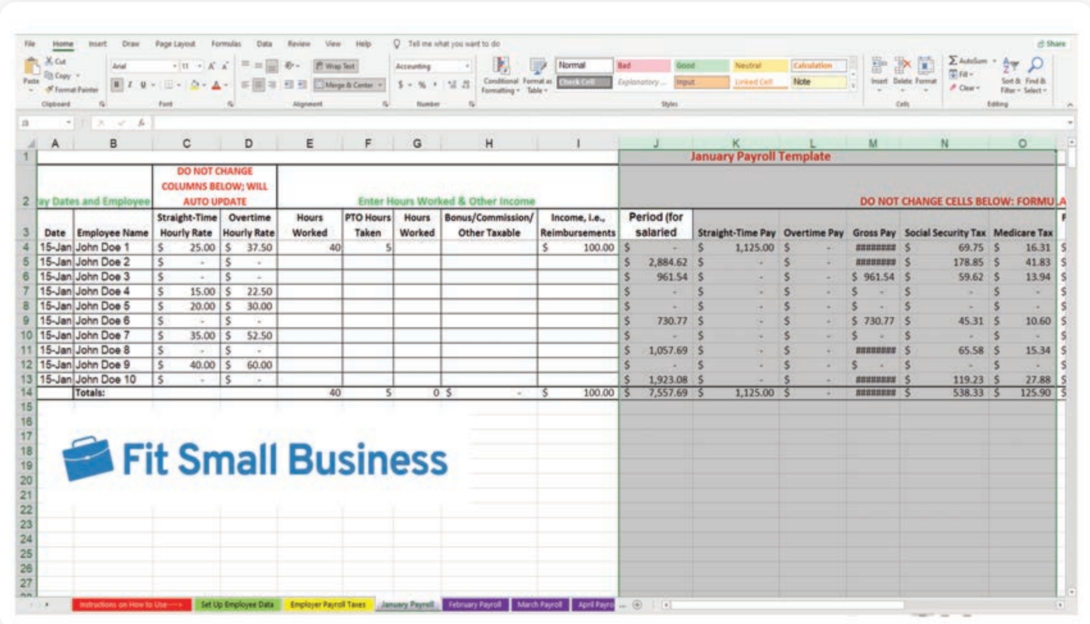
Enter Employee Information | DO NOT CHANGE: PREDETERMINED BY IRS | Enter Benefits & Other Deductions

Employee Name	Straight-Time Hourly Rate	Annual Salary	# of Pay Periods in Year	Federal Income Tax Rate	State Income Tax Rate	Social Security Tax Rate	Medicare Tax Rate	Health Insurance	Dental Insurance	Vision Insurance	401k Contribution	Garnishments	Other Deduction	Other Deductic
John Doe 1	$ 25.00		52	5.2%	5.0%	6.2%	1.45%	$ 100.00			$ 25.00			
John Doe 2		#########	52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 3		$ 50,000.00	52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 4	$ 15.00		52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 5	$ 20.00		52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 6		$ 38,000.00	52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 7	$ 35.00		52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 8		$ 55,000.00	52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 9	$ 40.00		52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -
John Doe 10		#########	52	5.2%	0.0%	6.2%	1.45%	$ -	$ -	$ -	$ -	$ -	$ -	$ -

This is the "Set Up Employee Data" tab. Don't change the Social Security and Medicare tax rates in columns G and H, respectively, because they are fixed.



When adding a column, simply highlight the column you want a new one to be in front of and right-click and select Insert.



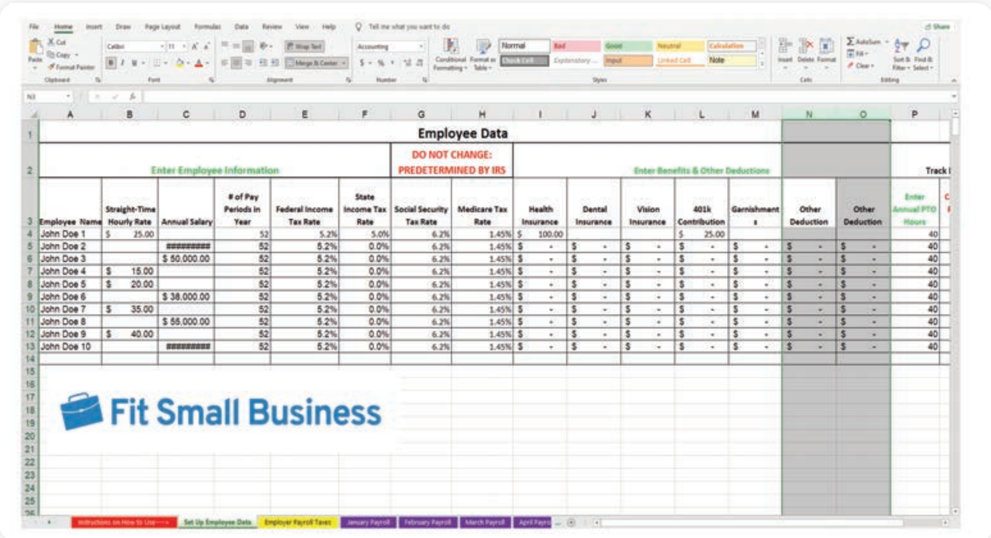
Check how the cells with formulas automatically calculate totals in the monthly payroll tabs once you enter data in columns A through I.

Change Column Names

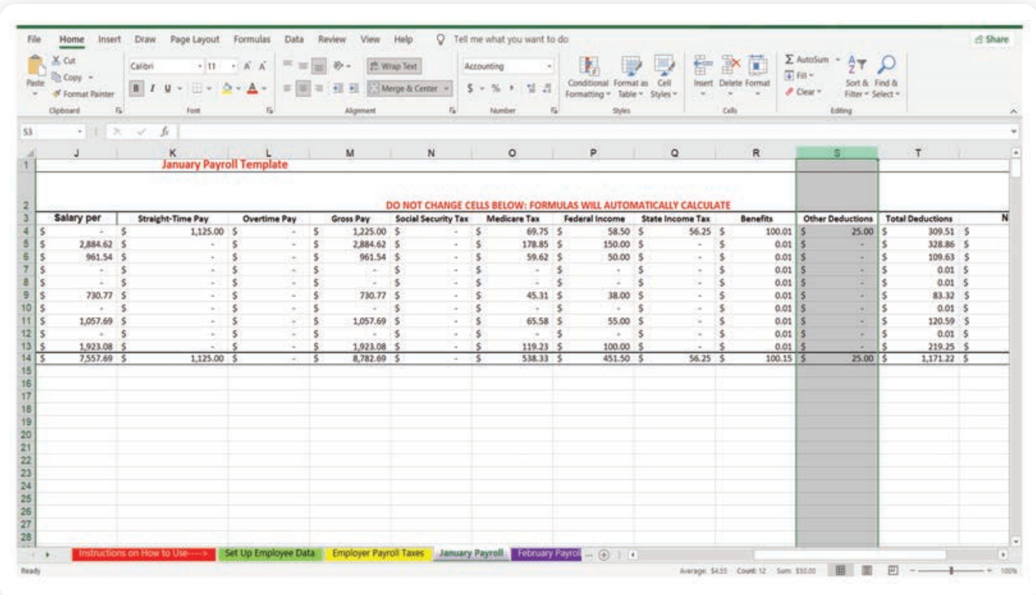
When adding and deleting columns, consider whether or not you can simply change some of the existing column labels in the payroll Excel template. Aside from cutting down on errors, this will save you time from having to change multiple tabs.

To help, we added two columns (columns N and O) in the "Set Up Employee" tab and labeled them "Other Deduction." Just double-click on the description and overwrite it with a label that more appropriately reflects your needs.

Note that we created the "Other Deduction" columns to be easily personalized, so you don't have to change any other tabs to match. There's only one "Other Deductions" column in the 13 payroll tabs, and the data that reflects here is the sum of columns N and O in the "Set Up Employee Data" tab. If you need to add more columns for deductions in the "Set Up" tab, follow the directions above for adding columns.



You can use the "Other Deduction" columns in the "Set Up" tab to input miscellaneous deductions specific to your company.



Check how the cells with formulas automatically calculate totals in the monthly payroll tabs once you enter data in columns A through I.

2. Set Up Payroll Information for Each Employee

Once you're satisfied with the template layout, you can begin setting up your employee data. To complete the "Set Up" tab, you need the following information.

Employee Name

Enter your employees' full names under column A in the "Set Up Employee" tab. Note that you need to re-enter their names on the monthly payroll tabs. When you do, ensure that it matches the name you entered in the "Set Up" tab. If there are differences in spelling and formatting, the monthly and annual payroll tabs will not be able to make automatic calculations.

When you have new hires, enter their details in the "Set Up" tab after the existing employees; information will be auto transferred to other tabs when you input their names.

**For employees who have resigned or been terminated, simply stop adding payroll data for them in the monthly payroll tabs. Don't remove them from the "Set Up Employee" tab or any prior months reflected in their payroll will update to $0 and your year-to-date payroll expense amounts will change. You can remove all inactive employees from the "Set Up" tab when you recreate the payroll Excel template for the next calendar year.

Straight-time Hourly Rate

In column B of the "Set Up Employee Data" tab, enter each hourly employee's straight-time hourly rate (excluding overtime). Leave this cell blank for salaried employees.

Annual Salary

In column C of the same tab, input each salaried employees' annual salary. For example, if your staff earns $50,000 a year, enter "$50,000."

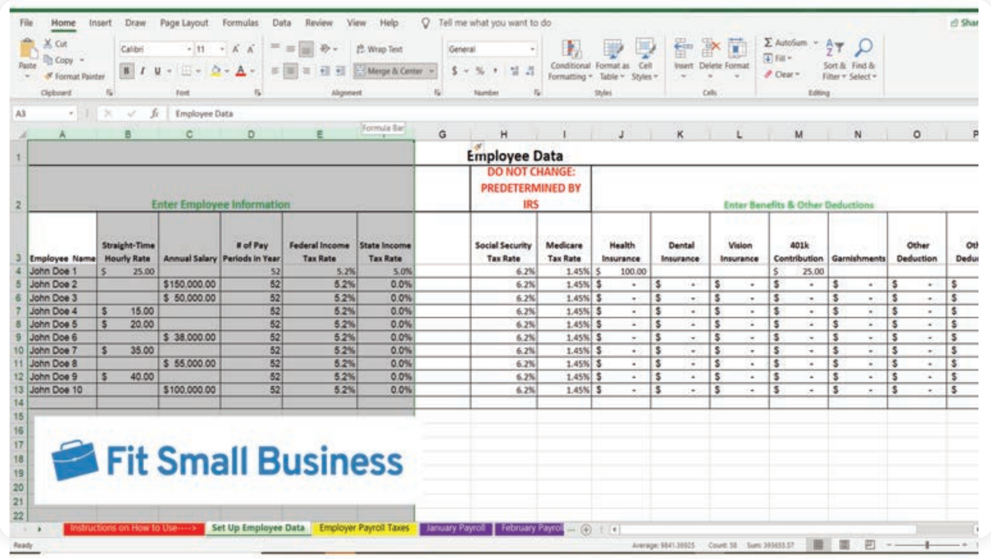
Number of Pay Periods in a Year

In column D, labeled "# of Pay Periods in Year," enter the applicable payroll period based on how often you pay employees.

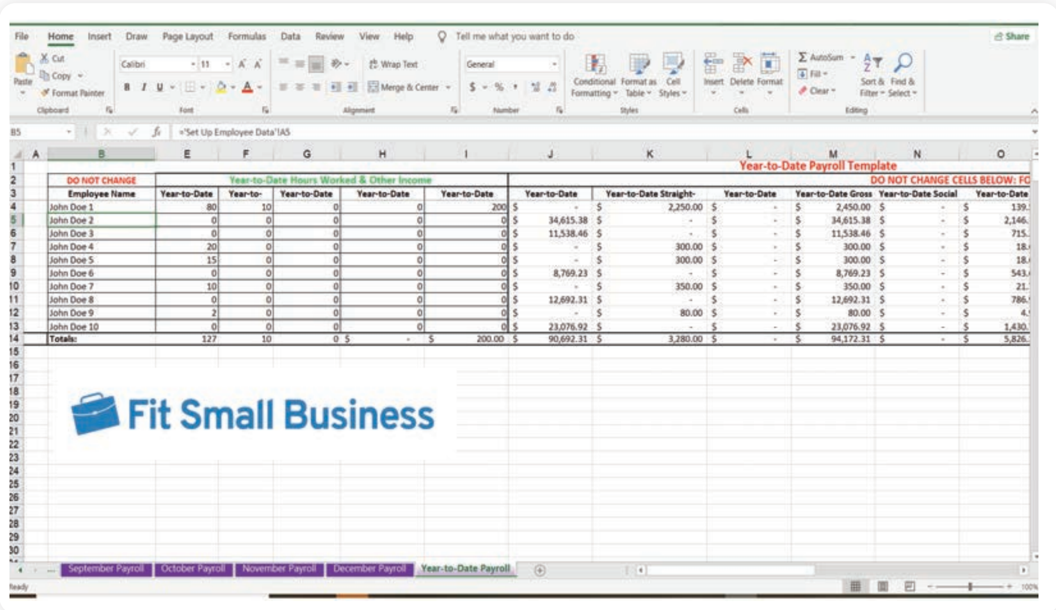
- If biweekly, input "26" (52 weeks/two weeks per pay period = 26)
- If weekly, input "52" (52 weeks in a year)
- If semimonthly, input "24" (12 months/two pay period per month = 24)
- If monthly, input "12" (12 months in a year)

Federal & State Income Tax Rates

Enter each employee's federal and state income tax rates in columns E and F, respectively. To find the applicable rates, use the W-4 forms collected from employees when they joined your company. The tax rates depend on the number of allowances your employees entered (usually based on the number of dependents) and their filing status—like married, single, or head of household. Generally, the more allowances employees claim, the lower their tax rates.



Columns A through F in the "Set Up Employee Data" tab don't have any formulas in the cells. Use your payroll records to ensure you enter accurate information.



This is the "Year-to-date Payroll" tab. All data automatically populates within this tab, so you shouldn't have to change any information in the cells.

Social Security & Medicare Tax Rates

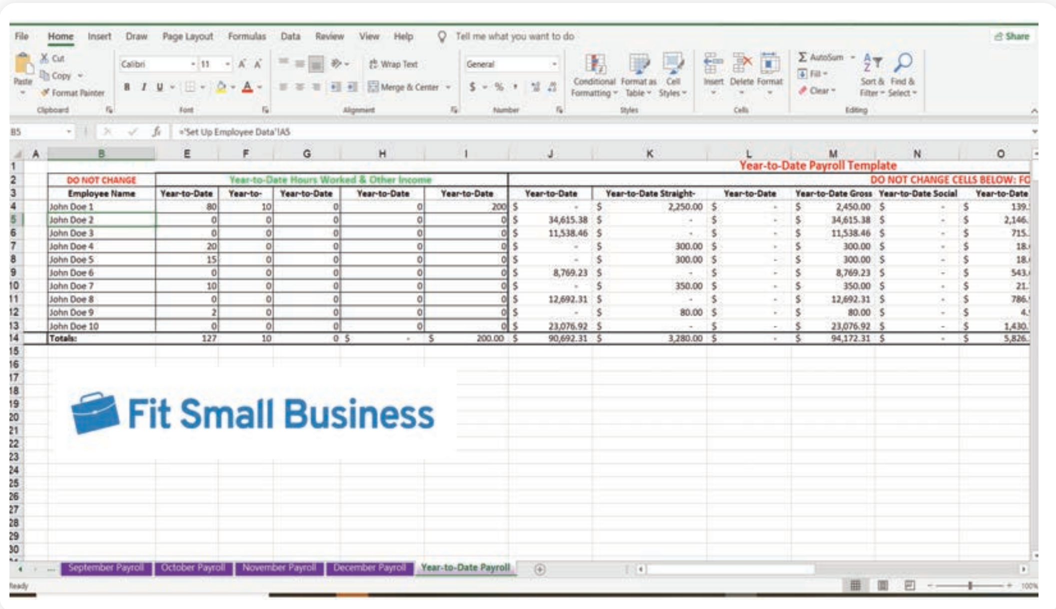
Don't change the Social Security and Medicare tax rates in columns G and H, respectively. These Federal Insurance Contributions Act (FICA) rates are predetermined by the IRS. Keep in mind that Social Security maxes out if an employee earns $142,800 in wages before the end of the year. If you have employees earning more than that, you need to stop withholding the 6.2% tax once their YTD earnings exceed that amount.

For example, if your employee meets the $142,800 earnings threshold for Social Security in April, delete all the formulas under "Social Security Tax" (column N) in payroll tabs May through December for the employee. Note that because the Social Security tax rate is 6.2% of wages, the maximum amount any employee will pay annually is $8,853.60 ($142,800 maximum x 6.2%).

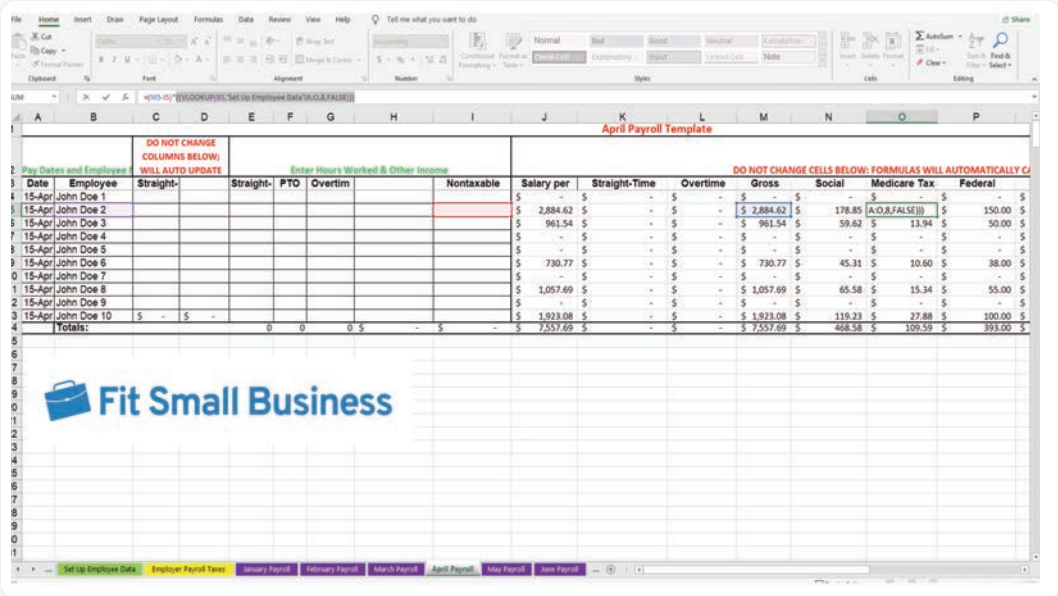
To help check your employees' total earnings, look at column M (labeled "Year-to-Date Gross Pay") in the "Year-to-Date Payroll" tab. This column shows the employees' YTD gross wages. Simply deduct all YTD nontaxable income (column I) from this amount to find the taxable gross income.

For Medicare, the tax rate is 1.45% on an employee's first $200,000 in wages and an additional 0.9% if the earned wages exceed $200,000 in a calendar year. This increases the total Medicare tax to 2.35% for those individuals. If you have employees who reach this threshold, you need to change the formulas in the "Medicare Tax" column (column O) on all monthly payroll tabs following the month the employee reached $200,000 in gross pay.

To further clarify, look at the screenshot below, specifically the formula field. Delete the (gray) highlighted part of the formula and replace it with "2.35%." Doing so will overwrite the link to the employee's Medicare tax rate (which is 1.45%) on the "Set Up Employee Data" tab.



This is the "Year-to-date Payroll" tab. All data automatically populates within this tab, so you shouldn't have to change any information in the cells.



If your employee reaches the $200,000 wage threshold for Medicare, check and revise the formula in the "Medicare Tax" column on applicable monthly payroll tabs.

Note that the threshold for Social Security has increased for the past eight years, while the Medicare tax rate has been the same for the past six years. To ensure that you remain compliant, check for any tax rate changes at the beginning of each year and update the payroll Excel template accordingly.

Benefits & Other Deductions

The template contains several columns for benefits you may offer employees, such as health, dental, vision, and 401(k) plans. For each benefit applicable to your business, enter the employees' premium per pay period in columns I through L of the "Set Up Employee Data" tab.

You can also use columns M, N, and O for garnishments and other employee deductions. After entering the benefits and deduction details on the "Set Up" tab, the template will automatically populate the appropriate fields when you input the employees' names in column B of the monthly payroll tabs.

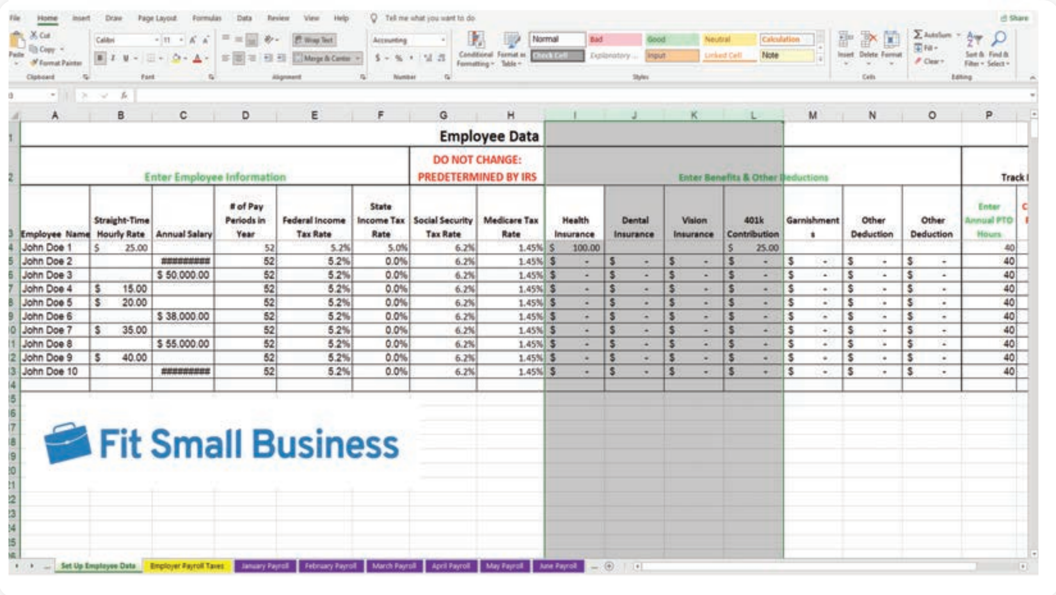
Paid Time Off (PTO) Calculations

Relying on your employees to keep track of their PTO is not a good strategy. To help you monitor this, we included a PTO calculation tool that's optional to use.

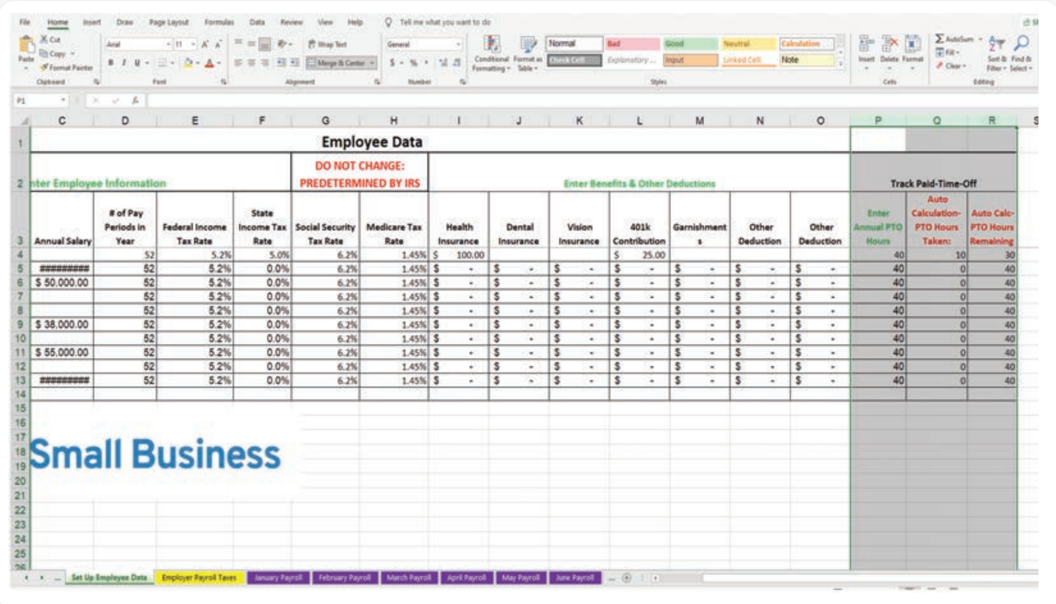
If you decide to use the PTO calculation tool, check the last three columns in the "Set Up" tab that pertain to PTO. In column P ("Enter Annual PTO Hours"), input the total PTO hours employees are entitled to in a year.

You don't need to fill column Q ("Auto Calculation-PTO Hours Taken") since the template will automatically pull the total PTO hours each employee has used from the "Year-to-Date Payroll" tab. The same goes for column R ("Auto Calc-PTO Hours Remaining") because it contains a formula that deducts the actual PTO taken from the employee's annual entitlement.

Note that you have to separately track the actual PTO hours that each employee has taken for the applicable payroll period of every pay run. Input the data in column F ("PTO Hours Taken") of the monthly payroll tabs and the "Year-to-Date Payroll" tab will sum up all PTO hours per employee.



There are columns for you to withhold premium deductions for common insurance benefits.



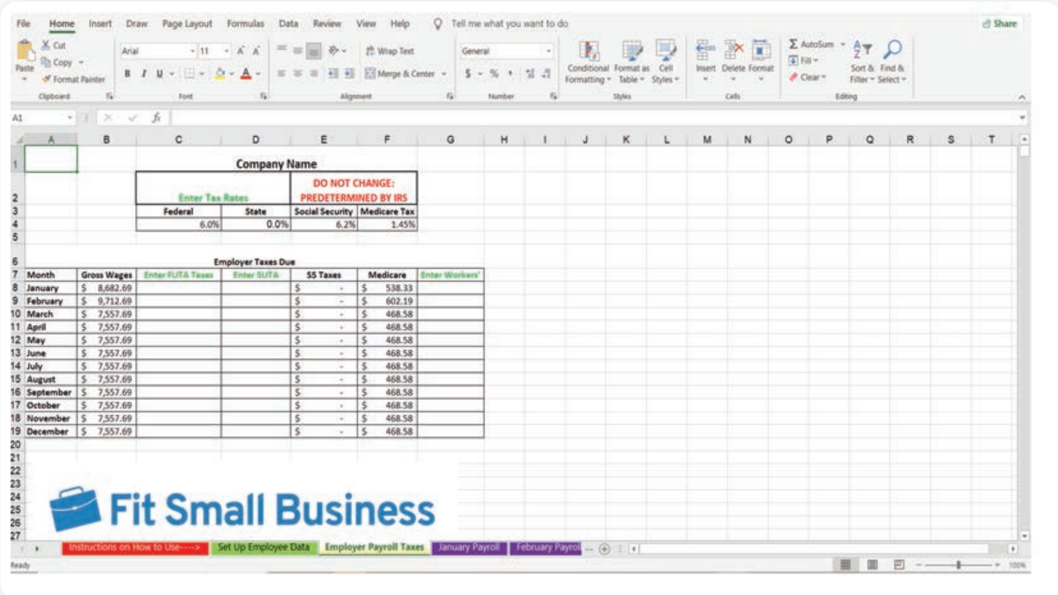
There's a section for PTO tracking. It will update as you enter paycheck details each period.

Need assistance on how to use the PTO calculation tool? This video tutorial on [calculating PTO hours using Excel] can help.

3. Set Up Employer Payroll Tax Information

In addition to tracking withholdings from employee paychecks, you're responsible for paying your share of payroll taxes. The "Employer Payroll Taxes" tab has cells you can use to enter your federal and state unemployment tax rates. Note that the 6% federal unemployment tax is only charged on the first $7,000 each employee earns (most state unemployment taxes follow the same logic). Be sure to review the information in the payroll tabs each month to help you calculate the tax amount due for each employee and the company.

You will also likely be responsible for workers' compensation insurance payments. The rates and amounts can vary, depending on the employees' work, your claim history, and other factors. However, you should receive a monthly premium amount due from the insurance fund that creates your policy. Simply enter the monthly premium amounts in column G ("Enter Workers' Comp Payable").



Use the "Employer Payroll Taxes" tab to help keep track of the taxes your business owes.

Download our Free Excel Payroll Template

4. Enter Hours Worked & Other Income Details

After entering all of your employee and employer data into the payroll Excel template, you're ready to calculate employee payments. Go to the appropriate monthly payroll tab—so if it's January, go to the "January Payroll" tab. Enter the pay date in column A and the full name of each employee you are paying for the period in column B. Then, input the actual regular hours worked, overtime hours, PTO hours taken, and other income details in the applicable columns.

Remember, the name must be the same as you entered in column A of the "Set Up Employee Data" tab. If it doesn't match, the pay rates, tax rates, and deductions will not populate in the monthly payroll tabs. If you're concerned you're not entering them correctly, copy and paste the names in.

Straight-time & Overtime Hours

For accurate employee paychecks, enter the correct number of straight-time hours in column E and overtime hours in column G of the monthly payroll tabs. For straight-time hours, this is usually 40 hours or fewer—unless your business is located in California. For overtime, the template calculates pay at a rate of 1.5 times your regular pay rate using the number of hours you specify. However, this can change depending on the labor laws of the state where your business operates.

We encourage you to review your state laws on overtime rates. Federal law generally requires you to pay employees overtime for any hours worked over 40 in a consecutive seven-day period. However, California considers any hours worked over eight in a day to be overtime—regardless of whether you work over 40 hours in a workweek.

Straight-time vs Overtime Hourly Rate

The straight-time and overtime hourly rates listed in columns C ("Straight-Time Hourly Rate") and D ("Overtime Hourly Rate") of the monthly payroll tabs are automated using a formula. There's also a note above both hourly rate columns that states not to change the contents of the cells because they will update automatically. So, whenever you enter your employees' names under column B of the monthly payroll tabs, the straight-time hourly rates automatically carry over from the "Set Up Employee Data" tab.

Meanwhile, the overtime hourly rates in column D are calculated at 1.5 times the straight-time hourly rates in column C.

If your business operates in California, you may need to make adjustments because of its rule that employees who work over 12 hours in one workday are entitled to double-time pay. So, any time worked between eight and 12 hours must be paid at a rate of 1.5 times and any hours over 12 must be paid at twice the straight-time rate. In this case, you have to change the formula in column D to reflect what you actually owe.

For example, if you need to pay double time for an employee who worked 16 hours in a day, you can overwrite the existing calculation with this formula. Note that the formula is broken into two parts: four hours to be paid at a rate of time and a half while the other four hours are considered double-time:

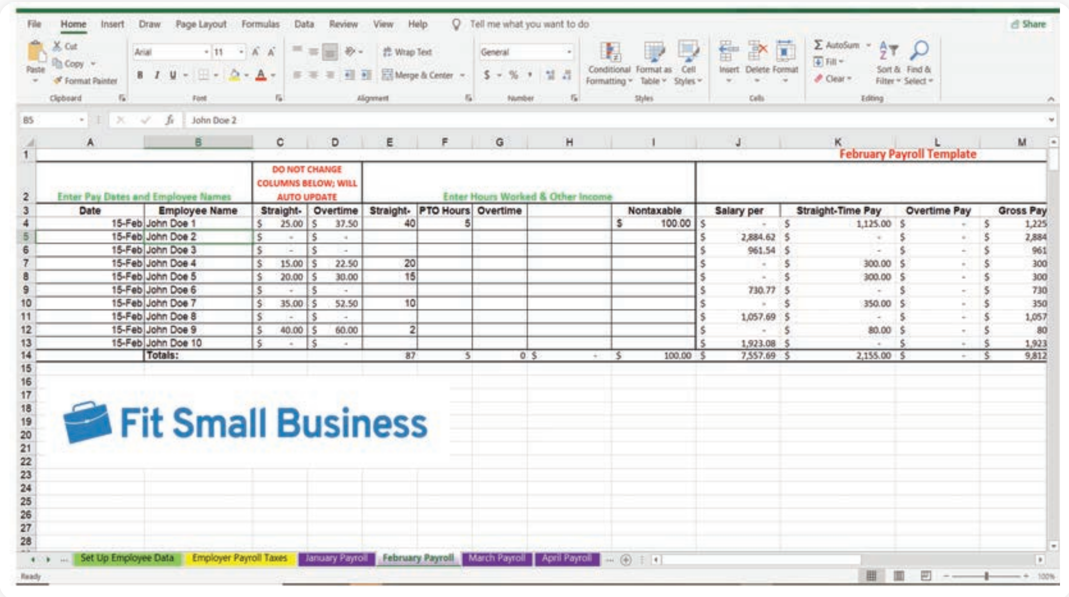
= (4*(C4*1.5))+(4*(C4*2))

Taxable & Nontaxable Income

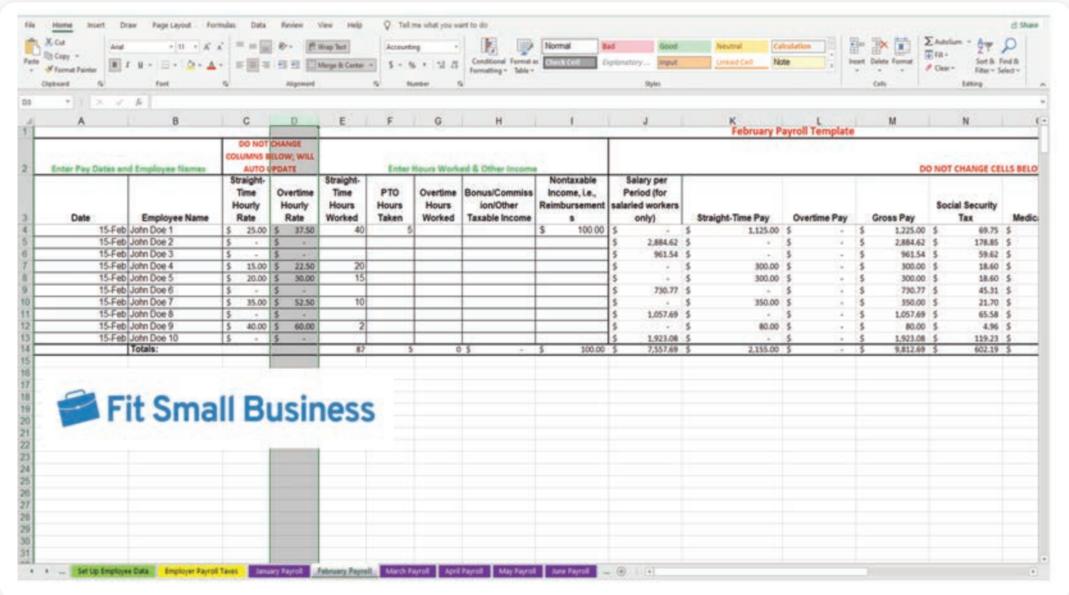
If you decide to pay an employee bonus, you must withhold payroll taxes similar to the way you do with regular wages. In this payroll Excel template, just enter the bonus amount in column H, and it will be included in the taxable gross income.

For reimbursements of expenses that employees incurred during business travel, note that these transactions are generally not taxable. This is because you are simply reimbursing the money employees used to pay for business expenses; therefore, the employee didn't actually receive any new income.

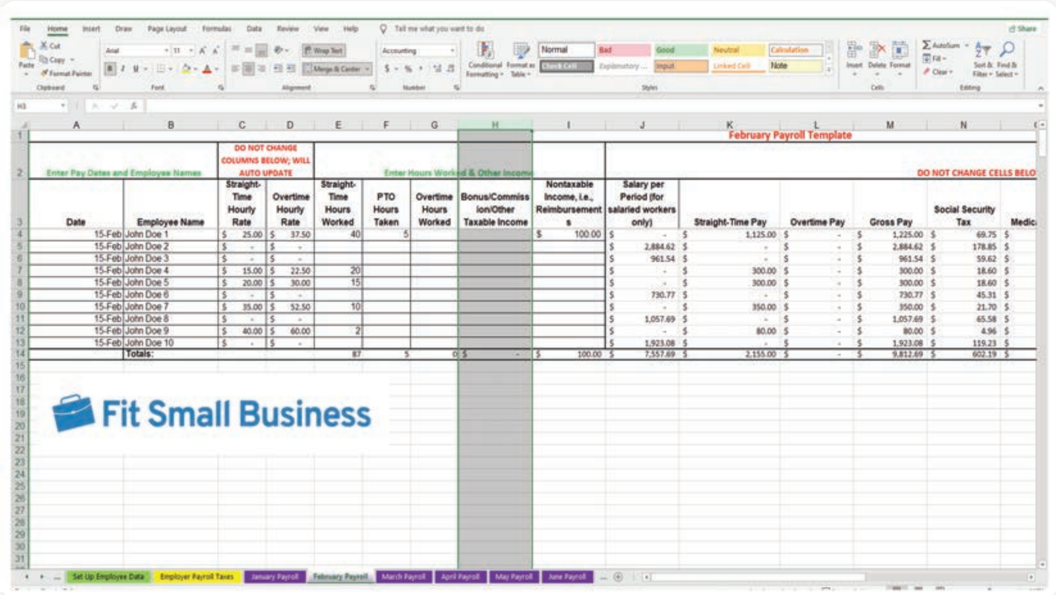
In this case, you don't need to withhold payroll taxes. Instead, enter the amount you need to reimburse to the employee in column I of the applicable monthly payroll tab. We have formulas in place that will disregard this amount when calculating taxes to withhold and pay.



The monthly payroll tabs have specific columns to enter your employees' names and actual hours worked.



The overtime rate in column D is based on the straight-time hourly rate you enter in column C with a formula that simply multiplies it by 1.5 (time and a half).



Bonuses and other taxable income should be entered in column H.

If learning how to do payroll in Excel seems too complex. You can pay your employees automatically and approve their hours worked online without having to update spreadsheets.

5. Review Automatic Payroll Calculations

After completing your initial setup and entering employee work hours, all payroll calculations should be visible. It's a good idea to review them before paying employees so you don't have to void and reissue payments later. The accuracy of your payroll tax calculations also depends on how accurate your employee payroll information is. If you're not careful, you can subject yourself to penalties. Here are the items you should review, including how the payroll Excel template computes each.

Salary Per Period

Salaries in column J of the monthly payroll tabs are automatically pulled from the "Set Up Employee Data" tab. Once the template has the employee's annual salary and your total number of pay periods in the year, the column will automatically reflect the employee's salary for the period. In calculating the per-period salary amount, note that the cells in column J have formulas that simply divide the annual salary by the number of annual pay periods you entered on the "Set Up Employee Data" tab.

Straight-time Pay

Similar to column J, the "Straight-Time Pay" column (K) of the monthly payroll tabs also contains automated formulas. It has two parts: the number of straight-time hours worked multiplied by the straight-time hourly rate and the number of PTO hours taken multiplied by the straight-time hourly rate. This helps ensure that you're paying employees all of the money they're due, especially PTO hours.

Overtime Pay

Overtime pay is simple in that it's calculated using the number of overtime hours you entered in column G and the hourly overtime rate in column D of the monthly payroll tabs. If you have overtime hours listed in column G, there should be a corresponding dollar amount in column L.

Gross Pay

Gross pay (column M) is the total income an employee is due before deductions and taxes. In this payroll Excel template, it's calculated by adding columns J through L, plus columns H and I, of the monthly payroll tabs. These columns contain the employees' per period salary, straight-time pay, overtime pay, bonuses and commissions, nontaxable income, and reimbursements.

FICA Taxes

FICA taxes are labeled as "Social Security Tax" (column N) and "Medicare Tax" (column O) of the monthly payroll tabs. These columns are linked to the "Set Up Employee Data" tab, automatically pulling the applicable tax rates from there. The cells then multiply the rates by the employee's gross pay minus any nontaxable income (such as reimbursements).

Income Tax Withholdings

As an employer, you are responsible for withholding federal income taxes from your employees' paychecks. You might also have to withhold additional amounts—depending on the state. In the monthly payroll tabs, columns P and Q (labeled "Federal Income Tax" and "State Income Tax," respectively) calculate taxes based on the tax rate information you provided in the "Set Up" tab.

Benefits & Other Deductions

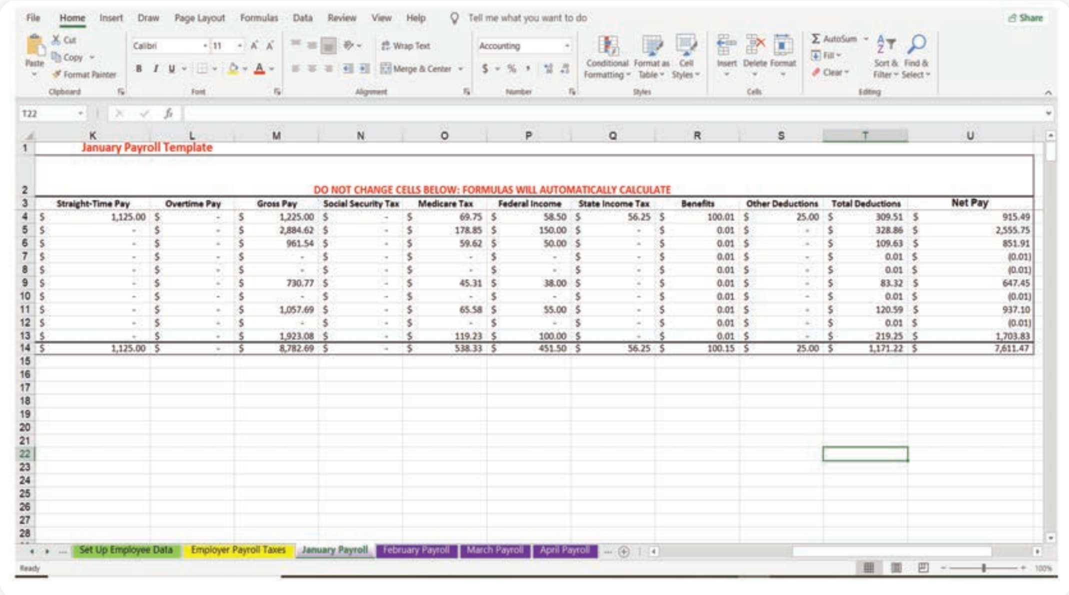
Benefits are reflected in column R on each monthly payroll tab, which sums all premiums showing in columns I through L on the "Set Up Employee Data" tab. The amounts should be fixed from one pay period to the next, but you can update the amounts in the "Set Up" tab if they ever change. If you do happen to change the benefit deductions for a particular employee, you need to overwrite the benefit deduction formulas for the prior months first and then overwrite it with the actual dollar amounts.

For example, if you need to change an employee's health insurance deduction from $100 to $200 starting in June, go to each prior month's payroll tab (January through May) and delete the formula in the health insurance column for that particular worker. Overwrite with $100 and then go to the "Set Up" tab to update the employee's health insurance deduction to $200.

Other deductions should be handled the same way as benefits. Note that the "Other Deductions" column (column S) in the monthly payroll tabs consists of garnishments and other deductions detailed in the "Set Up" tab. On the other hand, the "Total Deductions" (column (column T) is the sum of all taxes withheld, premiums collected for benefits, and other deductions.

Net Pay

The "Net Pay" column (column U) contains the amount you need to pay employees through check, direct deposit, or pay card. This amount is calculated automatically by subtracting the employee's total deductions (column T) from their gross pay (column M).

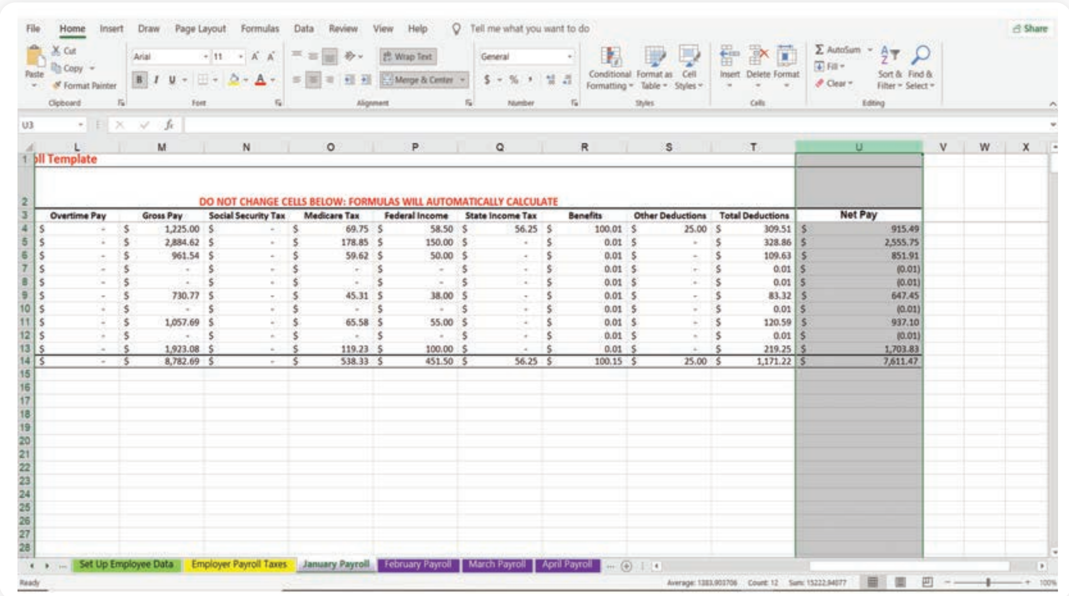


January Payroll Template

DO NOT CHANGE CELLS BELOW: FORMULAS WILL AUTOMATICALLY CALCULATE

Straight-Time Pay	Overtime Pay	Gross Pay	Social Security Tax	Medicare Tax	Federal Income	State Income Tax	Benefits	Other Deductions	Total Deductions	Net Pay
$ 1,125.00	$ -	$ 1,225.00	$ -	$ 69.75	$ 58.50	$ 56.25	$ 100.01	$ 25.00	$ 309.51	$ 915.49
$ -	$ -	$ 2,884.62	$ -	$ 178.85	$ 150.00	$ -	$ 0.01	$ -	$ 328.86	$ 2,555.75
$ -	$ -	$ 961.54	$ -	$ 59.62	$ 50.00	$ -	$ 0.01	$ -	$ 109.63	$ 851.91
$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ -	$ 730.77	$ -	$ 45.31	$ 38.00	$ -	$ 0.01	$ -	$ 83.32	$ 647.45
$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ -	$ 1,057.69	$ -	$ 65.58	$ 55.00	$ -	$ 0.01	$ -	$ 120.59	$ 937.10
$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ -	$ 1,923.08	$ -	$ 119.23	$ 100.00	$ -	$ 0.01	$ -	$ 219.25	$ 1,703.83
$ 1,125.00	$ -	$ 8,782.69	$ -	$ 538.33	$ 451.50	$ 56.25	$ 100.15	$ 25.00	$ 1,171.22	$ 7,611.47

Cells with "-" in them will continue to reflect that until sufficient employee and/or paycheck details are entered for it to complete the calculation.



ll Template

DO NOT CHANGE CELLS BELOW: FORMULAS WILL AUTOMATICALLY CALCULATE

Overtime Pay	Gross Pay	Social Security Tax	Medicare Tax	Federal Income	State Income Tax	Benefits	Other Deductions	Total Deductions	Net Pay
$ -	$ 1,225.00	$ -	$ 69.75	$ 58.50	$ 56.25	$ 100.01	$ 25.00	$ 309.51	$ 915.49
$ -	$ 2,884.62	$ -	$ 178.85	$ 150.00	$ -	$ 0.01	$ -	$ 328.86	$ 2,555.75
$ -	$ 961.54	$ -	$ 59.62	$ 50.00	$ -	$ 0.01	$ -	$ 109.63	$ 851.91
$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ 730.77	$ -	$ 45.31	$ 38.00	$ -	$ 0.01	$ -	$ 83.32	$ 647.45
$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ 1,057.69	$ -	$ 65.58	$ 55.00	$ -	$ 0.01	$ -	$ 120.59	$ 937.10
$ -	$ -	$ -	$ -	$ -	$ -	$ 0.01	$ -	$ 0.01	$ (0.01)
$ -	$ 1,923.08	$ -	$ 119.23	$ 100.00	$ -	$ 0.01	$ -	$ 219.25	$ 1,703.83
$ -	$ 8,782.69	$ -	$ 538.33	$ 451.50	$ 56.25	$ 100.15	$ 25.00	$ 1,171.22	$ 7,611.47

Column U shows the net pay amounts of employees.

Want to know more about how this payroll Excel template computes salaries and deductions? Watch this video tutorial we've put together on [calculating employee pay.]

6. Pay Your Employees

After you have reviewed your payroll taxes, deductions, and wage calculations for the pay period, you're ready to pay your employees. To do this, you can choose to either print checks online, deposit money to employee pay cards, or work with your bank to process direct deposits.

7. Review Year-to-Date Payroll Information

The last tab, titled "Year-to-Date Payroll," in our payroll Excel template lists all your employee payroll details for the year. It's linked to the monthly payroll tabs, so all employee payroll expenses should be reflected. If you decide to provide pay stubs—some states require you to do so—this tab will give you the YTD information you need to fill them in.

To help you organize and track payroll-related data, check out some of our other free payroll templates to get started.

Bottom Line

If you have 10 or fewer employees and live in a state that doesn't heavily regulate labor and payroll law, learning how to do payroll in Excel could be good for your business. Aside from paying employees, you can keep track of the payroll taxes you owe and maintain payroll records electronically.

Calculating Payroll for Employees: Everything Employers Need to Know

Before hiring employees, it's important to take the time to learn how to calculate payroll for your business. It'll save you time from having to correct errors and possibly thousands in fines, and you might even experience lower turnover by eliminating paycheck frustrations. You can perform calculations manually (hours worked X pay rate), use an online calculator, or rely on software.

To calculate payroll for your team, here are the five steps you'll need to follow:

Step 1: Determine Total Time Worked for the Period

To start doing payroll, you'll need to figure out how much time each employee has worked for the period. For hourly employees, this will be total work hours (and minutes if you want to pay exact amounts). For salaried staff, it'll be a set number of hours agreed upon at the time of hire (like a standard 40 hours, regardless of actual hours worked). You'll also need to have selected a pay schedule at this point. This schedule means you should know if you're paying employees weekly, biweekly, monthly, etc.

If you need help choosing a pay schedule, check out our article that walks you through everything small business owners need to know.

Total Work Time for Salaried Employees

You should pay your salaried employees the same amount per pay period (unless you have a non-exempt salaried position and are legally required to pay out overtime worked).

Upon hiring a new employee, you'll determine a set annual salary and a guaranteed number of hours for which they will be paid. When an exempt employee is hired at an annual salaried rate, they are expected to work a minimum of 40 hours each week. They can work more, but should know that they will not be compensated extra for it. Since their work time is typically fixed, most employers don't require their exempt employees to track their time.

Tip: If you're looking to use payroll software, check if there is an autopilot feature that automatically calculates payroll each period (without you having to do anything). Paychecks for salaried employees are the easiest to automate because their hours worked and pay rate stay the same.

Non-exempt Salaried Employees

The exception to that rule, however, is non-exempt salaried employees. Although not as common, some employers will pay their nonexempt employees a salary, meaning a guaranteed amount each week, along with any overtime they work.

The non-exempt part of the position means these employees fall under federal labor law protection. The employer expects employees to work the set minimum number of hours each week, but if they exceed those hours, they must be paid at an overtime rate for them. This requires time tracking to manage successfully.

Total Work Time for Hourly Employees

Calculating total work time for hourly employees is a little more involved than it is for salaried workers but not too complicated. Essentially, you'll add all of the hours and minutes an employee worked for the pay period.

For example, let's assume that an hourly employee has worked various hours throughout the week from Monday through Saturday and none Sunday. Let's calculate those hours and minutes to get the total hours worked for the period.

This employee's total work time for the week:
8.67 + 8.17 +8.75 + 8.75 + 7.08 + 2= **43.42 hours**

Some employers are stricter about the time their employees clock in and out (4:00 p.m. vs 4:05 p.m.), so calculations are easier. Nevertheless, if you find yourself needing to convert minutes for payroll, there are plenty of online resources to help.

If you'd rather skip the manual calculations and minutes to decimals calculations, check out our time card calculator. You can enter hours worked and breaks taken each day and it will calculate the total hours worked for you automatically.

Step 2: Calculate Gross Pay (Before Deductions & Taxes)

Once you know how many hours you'll be paying per employee, you can calculate gross pay. Gross pay is the total pay an employee earns before taxes and other deductions are subtracted, or more simply put, their pay rate multiplied by time worked.

For example, we will calculate Jenny's earnings for the week. She's an hourly employee who is paid $15 per hour, and she worked 35 hours this week. Her gross pay is $525.

$15 X 35 hours = $525

Step 3: Determine Your Payroll Deductions

Legally, you have to subtract payroll deductions from an employee's gross pay before determining their final payout. We suggest compiling a full list of the deductions each employee has and whether those deductions are pre-tax or post-tax. One thing to keep in mind is that in this section, we are separating taxes from payroll deductions.

Non-tax payroll deductions can include numerous items, such as:

- **Insurance premiums:** Health, dental, vision, life insurance
- **Retirement contributions:** 401(k), 403(b), IRA accounts
- **Child support payments:** Legal draft of your employees' check that's usually initiated by the state in which their child lives
- **Wage garnishments:** Court-ordered garnishments of an employee's paycheck when they don't pay their debts; third-party debtors can sue to hold them liable
- **Union dues:** Membership fees for being part of the union

We just listed a few, but there are plenty more that may be unique to your employees or company. For instance, some companies provide benefits like low cell phone rates for employees joining their company phone plans. This might require you to include employee phone charges on your business' phone bill; if you wanted to recoup some of the money, you could charge them a low monthly cost (with their approval, of course) and deduct it from their paychecks.

You'll need to add all payroll deductions together to get a grand total. Most deductions, like insurance, have premiums that are the same amount each month, though you may encounter some that are based on the employee's pay for the period (retirement contributions).

For example, in pay-based cases, just multiply the percentage the employee wants withheld (say, 4%) by the gross pay amount (say, $850) to find the total you should withhold.

$850 x 4% (0.04) = $34

Step 4: Find the Sum of Payroll Taxes

You'll need to find the total taxes your employees owe. This can be tricky without using a payroll calculator. Your employees should have completed a W-4 form upon hire; you can use this to help you figure out the percentage of their income that you need to withhold for federal, state, and local taxes. The IRS is also a good resource.

Here's a list of payroll taxes you may have to track, withhold, and send to the appropriate agencies:

- **Federal income taxes:** Most employees are subject to this, unless they are minors or exempt because they earn too little.
- **State income taxes:** States like Florida and Texas don't have a state tax, but many others do. Some are a flat percentage, and others charge tax based on the employees' income level (if they earn more, you withhold a higher percentage).
- **Local income taxes:** Local taxes aren't as common as state taxes. States like New York and California have several different ones, so be sure to withhold money for all that apply.
- **Social Security:** This is a 6.2% tax that goes toward each employees' government retirement fund. Once an employee earns $147,000 in a year, it no longer applies. You are also responsible for paying 6.2% (in addition to what the employee pays).
- **Medicare:** This is a 1.45% tax that goes toward the government medical fund for seniors. There is no income cap on this one, and you must also pay a matching amount out of your business funds.

Federal, State & Local Income Tax Rates

Deciding how much you should withhold in taxes is probably one of the most confusing parts of processing payroll. Income tax rates can vary depending on your worker's W-4 information like marital status and the number of allowances they claim. Use the IRS withholding calculator to determine how much to withhold for federal income taxes.

As your business grows, calculating tax amounts manually can become a tall task. If you're not ready for an all-in-one payroll software, you may want to consider a free payroll software as an option.

When it comes to state income tax rates, you should expect to withhold around 10% or lower; however, if you are in a state like California or Hawaii, which traditionally have the highest state income tax rates, your employees could be responsible for paying from 11% to 13% of their income. There are a number of city and county taxes that may apply as well; for instance, if you operate in New York City or your employees live in Yonkers.

Subtract Nontaxable Income Before Calculating Tax Amounts

Nontaxable income is important to consider when figuring employee taxes to withhold because you will need to exclude it from your calculations. This can include work-related amounts that the employee paid using their own money that you now need to reimburse. Be sure to deduct these amounts before calculating any taxes so you do not end up withholding too much.

For example, Fern's gross pay for the week is $3,500. Of that, $350 is for a reimbursement she is receiving for a hotel stay that she paid on behalf of the company. Her state tax rate is 9%. She owes $283.50 in state taxes.

$3,500 gross pay – $350 in hotel reimbursement= $3,150 taxable income
$3,150 taxable income X 0.09 = $283.50

Employer Payroll Taxes & Other Payroll Expenses

In addition to the taxes you need to withhold (and remit) for employees, you are also responsible for payroll taxes. It's not the most exciting part about being an employer but is necessary to avoid paying additional money in penalties and fees.

Here's a list of taxes and other payroll-related expenses you are responsible for paying out of your business' bank account:

- **FICA taxes:** These are the Social Security and Medicare taxes that employees pay. You'll pay 6.2% of their income for Social Security and 1.45% for Medicare.
- **Workers' comp:** Most states require employers to purchase workers' comp insurance to protect employees in the event of an injury in the workplace. Rates vary, depending on factors like previous claims, length of time in business, industry, and so on.
- **Unemployment taxes (or insurance):** You may be liable for both state and federal unemployment insurance. This goes toward government funds from which money is distributed when employees aren't working. The federal unemployment tax rate is 6%, but state rates vary.
- **Family Leave Act premiums:** Some states (like California and New York), require you pay money toward family leave insurance. This funds the accounts that pay employees when they take leave for big events (childbirth). Premiums can be less than $1 a month per employee.
- **Disability insurance:** Some states also require you pay into their disability fund. Rules and rates vary by state, but usually depend on factors like your total payroll amount.

Step 5: Subtract Deductions & Taxes From Gross Pay

To reach the employee's final paycheck amount, you should start with the gross amount you calculated in step two. You'll also need the total non-tax deductions and taxes calculated in steps three and four. At this point, you'll simply deduct all withholding amounts from gross pay

For example, let's look at Jill's gross pay. It's $2,600 for a two-week period. Total non-tax deductions equal $343, and total tax deductions equal $440. Her net pay amount would be $1,817, so you would process a check or direct deposit in this amount.

Gross Pay - (Non-Tax Deductions + Tax Deductions) = Net Pay

$2,600 - ($343 + $440) = $1,817

If you follow these steps to calculating payroll, you should be able to avoid lawsuits from employees, IRS penalties from inaccurate and/or untimely tax payments, and all of the back-end work that goes into correcting payroll errors.

Even with all the tools needed, everyone makes mistakes from time to time. If you do happen to find that you underpaid an employee, you can use a retroactive pay calculator to quickly compute the amount you need to pay the employee so the situation is resolved.

Keep in mind that you'll also need to determine the tax impact to remain in compliance. Using payroll software makes it easy, because all of the calculations (paycheck and taxes) are done for you.

Bottom Line

Calculating payroll becomes more complex as you hire additional employees. Keep in mind, though, that the steps are essentially the same. The ultimate goal is to pay employees and all applicable tax agencies the correct amount and on time. While some employers choose to calculate everything manually, others use online tools like payroll calculators and software. Whatever you use to help you calculate payroll, be sure to familiarize yourself with IRS tax rules and federal payroll laws so you avoid penalties.

How to Pay Independent Contractors

For employers, paying independent contractors is simpler and often cheaper than paying employees because they don't have to withhold or pay taxes.

An independent contractor is a person, business, or corporation that provides goods or services under a written contract or a verbal agreement. Unlike employees, independent contractors do not work regularly for an employer but work as required.

Although year-end reports are required to show amounts paid, labor laws that cover employees—like minimum wage—don't apply. Let's walk through the steps for paying independent contractors.

Step 1: Determine How to Pay Contractors

Paying independent contractors isn't difficult, but it is different from paying employees. Determining how to pay independent contractors (using payroll software in-house vs outsourcing to a payroll service) and how much to pay are some of the first decisions you'll make to ensure the process goes smoothly.

Unlike with employees, you don't typically pay contractors a salary. Instead, you should consider whether an hourly or per-project price would be more appropriate, their pay rates, and any payroll taxes to consider.

Contractor Pay Rates

Before starting any work, you and your contractor should reach an agreement regarding pay. If you've hired contractors for similar work before, you may already have an idea as to the going rate; if not, you can call around and request an anonymous quote from your competitors. Contractors usually have their own rates, so you'll need to ensure you're on the same page.

Also, consider the type of work your contractor performs; if it's work for which it's difficult to estimate the required time to complete, a per-project rate sounds ideal. Being unable to estimate costs is bad for your business and could create conflict between you and the contractor if you're charged more than expected.

Contractor Pay Frequency

As you determine how you're paying, be sure to reflect on the length and size of the project.

- Is it a month-long project? Or will the contractor finish it in a week?
- How much time will your contractor need to devote to the project daily?
- Are you expecting a big project to have a quick turnaround?

Depending on your answers and the contractor's terms, you may need to pay a deposit or make payments at predetermined intervals. If you're working with a contractor for the first time, be flexible; some contractors have had bad experiences with clients using their services without ever issuing payment.

Contractor Taxes

Another point to keep in mind when negotiating a project or hourly rate is that independent contractors pay taxes on the money you pay them. You're not required to withhold the taxes, but it is important to realize that the contractor won't be able to pocket all of the money you pay.

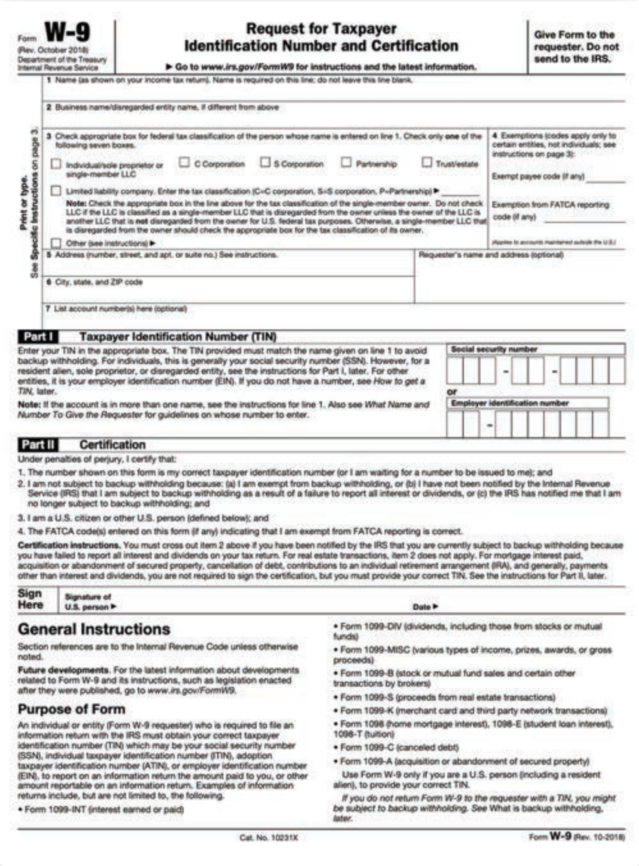
They'll pay federal and state income taxes in addition to local taxes—if they're in an area like New York City that requires it. They'll also pay self-employment tax of 15.3% (12.4% for Social Security and 2.9% for Medicare). In 2022, only the first $147,000 of earnings is subject to the Social Security portion.

These withholdings can quickly add up to 30% or more, which explains the need to pay contractors more than you would an employee. Employees pay half of the self-employment tax, although it's termed Federal Insurance Contributions Act (FICA), and employers pay the other half.

Once you and your contractor agree on payment terms—including project due dates, required deposit, rates, and so forth—you're ready to complete an official independent contractor agreement. This solidifies the deal and binds you both to deliver accordingly.

Step 2: Collect W-9 Forms

Once you decide how much and often to pay your contractors, you'll have them complete a W-9 Form, which includes personal information, like name and Social Security number. It's important to have all contractors complete this form before beginning work because you'll use it to report their annual earnings on Form 1099 at year-end.



Form **W-9** (Rev. October 2018) Department of the Treasury Internal Revenue Service

Request for Taxpayer Identification Number and Certification

▶ Go to *www.irs.gov/FormW9* for instructions and the latest information.

Give Form to the requester. Do not send to the IRS.

Print or type. See Specific Instructions on page 3.

1 Name (as shown on your income tax return). Name is required on this line; do not leave this line blank.

2 Business name/disregarded entity name, if different from above

3 Check appropriate box for federal tax classification of the person whose name is entered on line 1. Check only **one** of the following seven boxes.

☐ Individual/sole proprietor or single-member LLC ☐ C Corporation ☐ S Corporation ☐ Partnership ☐ Trust/estate

☐ Limited liability company. Enter the tax classification (C=C corporation, S=S corporation, P=Partnership) ▶

Note: Check the appropriate box in the line above for the tax classification of the single-member owner. Do not check LLC if the LLC is classified as a single-member LLC that is disregarded from the owner unless the owner of the LLC is another LLC that is **not** disregarded from the owner for U.S. federal tax purposes. Otherwise, a single-member LLC that is disregarded from the owner should check the appropriate box for the tax classification of its owner.

☐ Other (see instructions) ▶

4 Exemptions (codes apply only to certain entities, not individuals; see instructions on page 3):

Exempt payee code (if any)

Exemption from FATCA reporting code (if any)

(Applies to accounts maintained outside the U.S.)

5 Address (number, street, and apt. or suite no.) See instructions.

Requester's name and address (optional)

6 City, state, and ZIP code

7 List account number(s) here (optional)

Part I **Taxpayer Identification Number (TIN)**

Enter your TIN in the appropriate box. The TIN provided must match the name given on line 1 to avoid backup withholding. For individuals, this is generally your social security number (SSN). However, for a resident alien, sole proprietor, or disregarded entity, see the instructions for Part I, later. For other entities, it is your employer identification number (EIN). If you do not have a number, see *How to get a TIN*, later.

Note: If the account is in more than one name, see the instructions for line 1. Also see *What Name and Number To Give the Requester* for guidelines on whose number to enter.

Social security number

or

Employer identification number

Part II **Certification**

Under penalties of perjury, I certify that:

1. The number shown on this form is my correct taxpayer identification number (or I am waiting for a number to be issued to me); and
2. I am not subject to backup withholding because: (a) I am exempt from backup withholding, or (b) I have not been notified by the Internal Revenue Service (IRS) that I am subject to backup withholding as a result of a failure to report all interest or dividends, or (c) the IRS has notified me that I am no longer subject to backup withholding; and
3. I am a U.S. citizen or other U.S. person (defined below); and
4. The FATCA code(s) entered on this form (if any) indicating that I am exempt from FATCA reporting is correct.

Certification instructions. You must cross out item 2 above if you have been notified by the IRS that you are currently subject to backup withholding because you have failed to report all interest and dividends on your tax return. For real estate transactions, item 2 does not apply. For mortgage interest paid, acquisition or abandonment of secured property, cancellation of debt, contributions to an individual retirement arrangement (IRA), and generally, payments other than interest and dividends, you are not required to sign the certification, but you must provide your correct TIN. See the instructions for Part II, later.

Sign Here Signature of U.S. person ▶ Date ▶

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Future developments. For the latest information about developments related to Form W-9 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/FormW9*.

Purpose of Form

An individual or entity (Form W-9 requester) who is required to file an information return with the IRS must obtain your correct taxpayer identification number (TIN) which may be your social security number (SSN), individual taxpayer identification number (ITIN), adoption taxpayer identification number (ATIN), or employer identification number (EIN), to report on an information return the amount paid to you, or other amount reportable on an information return. Examples of information returns include, but are not limited to, the following.

- Form 1099-INT (interest earned or paid)
- Form 1099-DIV (dividends, including those from stocks or mutual funds)
- Form 1099-MISC (various types of income, prizes, awards, or gross proceeds)
- Form 1099-B (stock or mutual fund sales and certain other transactions by brokers)
- Form 1099-S (proceeds from real estate transactions)
- Form 1099-K (merchant card and third party network transactions)
- Form 1098 (home mortgage interest), 1098-E (student loan interest), 1098-T (tuition)
- Form 1099-C (canceled debt)
- Form 1099-A (acquisition or abandonment of secured property)

Use Form W-9 only if you are a U.S. person (including a resident alien), to provide your correct TIN.

If you do not return Form W-9 to the requester with a TIN, you might be subject to backup withholding. See What is backup withholding, *later.*

Cat. No. 10231X Form **W-9** (Rev. 10-2018)

Download W-9 Form

Pro Tip: Require each independent contractor you work with to complete the W-9 Form before beginning any work.

There have been rare cases when independent contractors refused to provide their Social Security number or entered an incorrect Social Security number on their W-9; when that happens, the IRS will notify you to immediately begin withholding 24% of the contractor's pay for backup withholding (taxes). In this case, you'd withhold, regardless of the contractor's dismay, and remit to the tax agency as instructed.

If you opt to use payroll software or a service, collecting the W-9 is simple. Once you add contractors to your account, it will email them a link they can use to start their online accounts. It'll also prompt them to provide all of the W-9 information before storing it within the application, saving you time and money. Sign up for its free 30-day trial.

Step 3: Set Up Contractors in Your Payroll System

Once you've collected the W-9 Form, you're ready to set up contractors in your payroll system, which may consist of a notebook, Microsoft Excel, or payroll software. However you choose to do payroll, you need to start by ensuring you've recorded all of your contractors' information; this will help prevent any hiccups on payday.

Step 4: Process Payments to Independent Contractors

After setup, you won't have much to do until it's time to make the first payment. If the agreement requires a deposit prior to beginning work, you'll need to process it immediately after setup.

Select the Payment Method

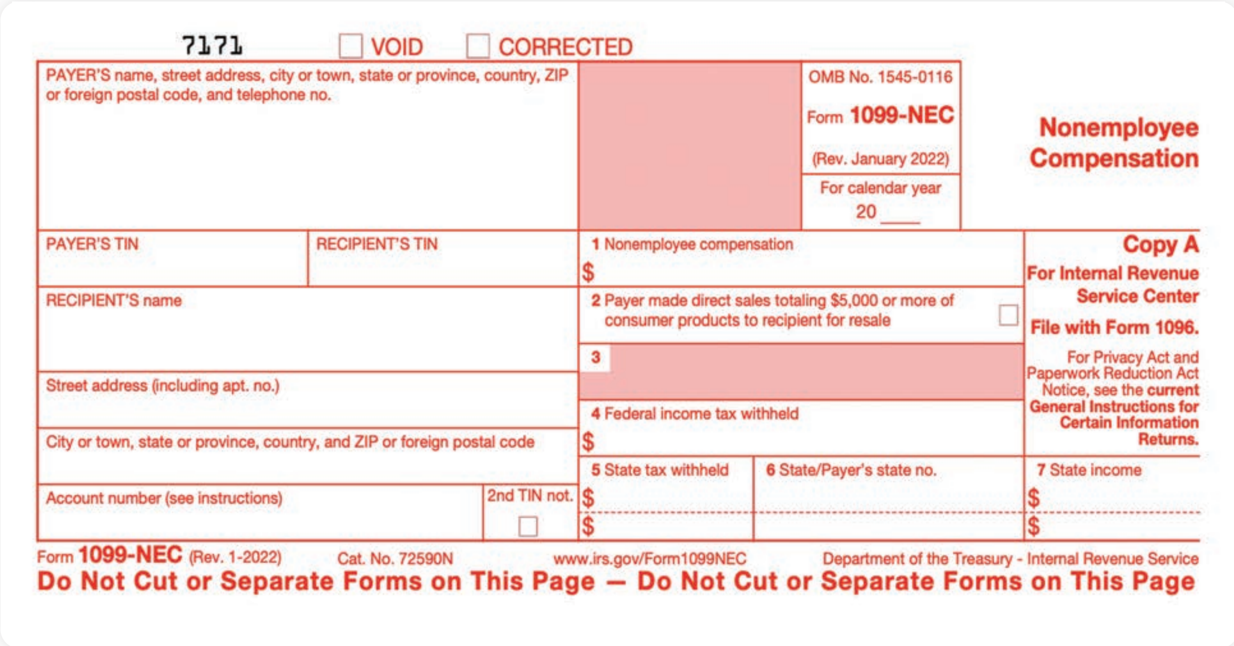
There are many different ways to pay your team for their work. You can pay using cash (not recommended due to lack of paper trail), check, direct deposit, and even pay cards, which are reloadable prepaid debit cards employers use to deposit wages. Be mindful of processing times; direct deposit, for example, requires up to four days to process.

Direct deposits usually cost additional money if you're not using a payroll service and go through your bank instead; however, if you only need to process a few payments, you can print checks online for free. Most of the best payroll software offers direct deposit at no additional charge, and some will guide you through printing your own checks using the system.

Pay cards are typically offered by the larger payroll providers, so while the pay card program is free, the payroll services you're required to purchase before being approved for the program are usually more expensive.

Step 5: Send 1099-NEC Forms

As the end of the year approaches, you should be ready to prepare 1099-NEC Forms for each contractor to whom you've paid more than $600 within the year. You'll have to distribute a copy of the 1099 to each contractor along with the IRS and state tax agency (if there are state income taxes), and it must include the total amount you paid during the year.



7171 VOID CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

OMB No. 1545-0116

Form **1099-NEC**

(Rev. January 2022)

For calendar year 20 ____

Nonemployee Compensation

PAYER'S TIN

RECIPIENT'S TIN

1 Nonemployee compensation $

Copy A For Internal Revenue Service Center

File with Form 1096.

RECIPIENT'S name

2 Payer made direct sales totaling $5,000 or more of consumer products to recipient for resale

3

For Privacy Act and Paperwork Reduction Act Notice, see the **current General Instructions for Certain Information Returns.**

Street address (including apt. no.)

4 Federal income tax withheld $

City or town, state or province, country, and ZIP or foreign postal code

5 State tax withheld $ $

6 State/Payer's state no.

7 State income $ $

Account number (see instructions)

2nd TIN not.

Form **1099-NEC** (Rev. 1-2022) Cat. No. 72590N www.irs.gov/Form1099NEC Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

Download 1099-NEC Form

Don't forget to keep a copy for your records, and be mindful of the January 31 deadline to report any payments made during the previous calendar year. You'll use the W-9 forms you collected from contractors prior to them beginning work; transfer information (such as name, address, and Social Security number) to the 1099-NEC to ensure the year-end reports you submit to the IRS are accurate.

The 1099-NEC Form helps independent contractors calculate how much they owe in taxes. It also helps the IRS track contractors from whom they should receive tax payments.

It's important to note that this process will look very different if you're processing payments for international contractors. You'll often be dealing with international banks and exchange rates and handling different forms. International contracting companies are required to submit a W-8BEN-E to your business—or a W-8BEN if the contractor is operating as an individual—before getting paid.

Processing payments for international contractors can be confusing, but there are many payroll services that can help take the burden off of you. If you're interested in a payroll service that can help you, check out our guide to the best international payroll services.

Laws for Paying Independent Contractors

Learning how to pay independent contractors involves understanding the legalities surrounding it. One major error some companies make is confusing employees with independent contractors. Federal law is pretty strict in differentiating between the two; thus, misclassifying can result in thousands of dollars in fines and taxes owed.

Keep in mind that contractors control how they deliver the finished project and how often they work. The only factor you determine is how the final product should look.

Federal

Per federal laws, your responsibilities when paying independent contractors are:

- Sending 1099-NEC forms: Send 1099-NEC forms before January 31 so contractors can report their income and file taxes. Also, submit a copy to the federal and state tax agency, if applicable. It's also a good idea to keep a copy on hand.
- Starting backup withholding if there's no Social Security number: If the contractor fails to provide a Social Security number or tax identification number (TIN) or provides an incorrect one, employers must begin withholding 24% from each payment processed immediately.
- Disregarding labor laws: This includes the minimum wage, overtime, unemployment compensation requirement, workers' compensation, and so forth. These only apply to employees, so contractors are not covered.
- Not withholding payroll taxes: Independent contractors don't pay FICA taxes and instead pay self-employment taxes. Income taxes are also due, but contractors pay these when they submit their tax forms for the prior year.

State

Many states regulate the classification of independent contractors, so in addition to receiving fines for misclassifying on the federal level, you can also receive penalties from your state. It's a good idea to visit your state Department of Labor (DOL) site because some states have more restrictive classification rules for independent contractors.

For example, California revised its regulations in 2018 to the ABC test that requires three factors to be met before classifying a worker as a contractor.

- **A:** The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- **B:** The worker performs work that is outside the usual course of the hiring entity's business.
- **C:** The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

There are numerous factors to consider when classifying independent contractors. The DOL has an opinion, as does the IRS and many states. Although there are no hard and fast rules, If you're ever confused, complete and submit Form SS-8 to the IRS; the IRS will review and make an official classification determination, but it could take up to six months.

> We've researched payroll providers that will help you pay contractors easily. If you're interested in payroll software but need help deciding which is best for your business, check out our guide to choosing contractor payroll services.

Bottom Line

Determining how to pay independent contractors isn't too complex if you set up an effective system to help you track contractor and payment information. You can use a notebook, Excel, or payroll software to help, and costs range from $0 to $6 a month for one contractor.

CHAPTER 4

Payroll Taxes

Federal & State Payroll Tax Rates for Employers

Both employers and employees are responsible for payroll taxes.

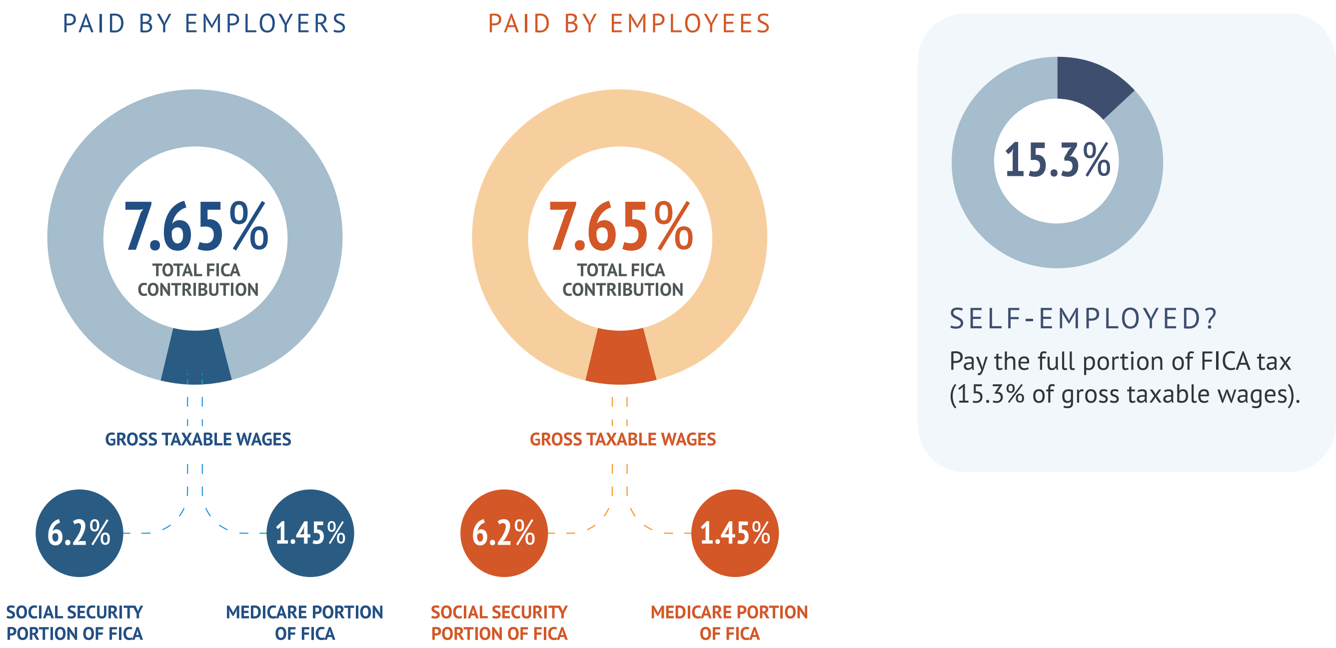
Federal tax rates, like income tax, Social Security (6.2% each for both employer and employee), and Medicare (1.45% each, plus an additional 0.9% withheld from the wages of an individual paid more than $200,000), are set by the IRS. However, each state specifies its own tax rates, which we will cover in more detail below.

Federal Payroll Tax Rates

There are two categories of employment taxes at the federal level in addition to income tax: FUTA and FICA. We'll cover each briefly as you'll process these as tax deductions on employees' paychecks. You must also pay these taxes on your employees' behalf, regardless of the state in which you operate.

- **Income Tax:** The tax rate is based on withholdings chosen on the employee's W-4 form.
- **FUTA:** This 6% federal tax on the first $7,000 of each employee's earnings is to cover unemployment; in most cases, you'll be credited back 5.4% of this amount for paying your state unemployment taxes on time, resulting in a net tax of 0.6%.
- **FICA:** This 15.3% federal tax is made up of two parts: 12.4% to cover Social Security and 2.9% to cover Medicare. Social Security has a wage base limit, which for 2022 is $147,000. For employees earning more than $200,000, the Medicare tax rate goes up by an additional 0.9%; therefore, FICA can range between 15.3% and 16.2%.

Payroll Taxes Broken Down



To learn more about federal Social Security, Medicare, and unemployment taxes, take a look at our guides on FICA and unemployment taxes.

State Payroll Tax Rates

Some states have an income tax; others (like Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) don't. The two states that tax investment income but do not assess personal income taxes are Tennessee and New Hampshire. However, all states have state unemployment taxes.

The percentage of State Unemployment Tax (SUTA) varies by state. Each state determines the wage base or minimum earnings required for SUTA to be deducted. Others may refer to it as unemployment insurance (UI).

Also, the SUTA rates are affected by an employer's specific unemployment history and industry. Besides, some states assign a generic new employer rate that may be higher or lower than what the employer will pay once it has been in business for a period of time, and each state determines the time frame. For example, if one employer has higher unemployment claims than another, that employer will pay a higher unemployment rate.
Below, are the most common state taxes that employers need to be aware of:

State Income Taxes

Most states have an income tax. They tax a portion of an employee's income based on withholding tables. Each state sets its own withholding tax rates, such as Arizona, which withholds between 0.08% and 5.1%, depending on the number of deductions an employee is eligible for.

Local Income Taxes

In states with large urban areas, you'll often find local taxes added to your employment tax requirements. For example, San Francisco, Denver, and Newark require employees to pay local income taxes. Other states, like Kentucky, Ohio, and Pennsylvania, collect local income taxes in many cities.

Supplemental Taxes

Some states tax supplemental wages like bonuses, commissions, overtime, and severance pay as examples. Less than half of US states have no supplemental tax while the rest range from 1.84% to 11%—except Vermont, which charges 30%. For instance, in California, employees are taxed 6.6% for most supplemental pay but are taxed at 10.23% if the supplemental pay is received from a bonus or stock option.

Workers' Compensation

Workers' compensation is purchased as private insurance by business owners in most states. However, states like New Mexico, Oregon, and Washington require it to be paid as a tax. As an example, Oregon employees pay 1.1 cents per hour while their employers match that rate for 2.2 cents an hour paid to Oregon to cover state-managed workers' compensation.

For more information on workers' compensation and where to purchase it, check out our guide on workers' comp.

Disability

Disability insurance differs from workers' compensation—which covers on-the-job injuries only—by covering all injuries and health issues that affect a worker's ability to work. Some states like California, Hawaii, and New York ensure that workers in their state have disability insurance coverage. Therefore, that additional insurance is included as a tax in those states. It ranges from 0.26% in New Jersey to 1.30% in Rhode Island.

Paid Leave

Some states have begun to mandate employer-provided sick leave or paid sick time off, which means it operates like a tax. New York, for example, deducts 0.27% of the employee's wages each pay period to cover paid leave for employees in that state.

How to Pay Federal & State Payroll Taxes

It's best to set aside money for employment taxes each pay period, even if you're only required to send payment monthly. You definitely need to withhold money from your employees' paychecks each period.

You will either need to deposit payroll taxes on a monthly or semiweekly basis. If you owed $50,000 or less in taxes for the prior year, you can pay monthly; anything more than that puts you on a semiweekly pay schedule. If you're a new employer, you're automatically placed on a monthly deposit schedule. For employers with very little payroll tax obligation (less than $2,500 a quarter), deposits can be made quarterly with the 941 tax return.

Federal Employment Tax Due Dates

If you determine your business needs to be on a monthly deposit schedule, you'll need to deposit your employment payroll taxes (FICA and federal income taxes) by the 15th of the following month for which they're due. Semiweekly schedules require that taxes for wages paid Wednesday, Thursday, or Friday be made by the following Wednesday. For wages paid on other days of the week, tax payments should be made by the following Friday.

Semiweekly Deposit Schedule

When payday falls on a:	Deposit taxes by the following:
Wednesday, Thursday, and/or Friday	Wednesday
Saturday, Sunday, Monday, and/or Tuesday	Friday

One important thing to note is that if you accumulate $100,000 or more in taxes, regardless of your deposit schedule, you must deposit the taxes by the next business day.

State Tax Due Dates

Not all states have a state income tax. However, in states that do, the employee must be asked what amount to withhold from the paycheck. That amount is to be withheld by the employer and paid to the state. The income tax rate varies by state and person based on factors such as their marital status and the number of exemptions they claim.

Employees provide this information on the equivalent of a federal W-4 form, which may be called by a different name in each state. For example, South Dakota has no state income taxes, while North Dakota does and uses the Federal W-4 to track withholdings. New Jersey also has state tax withholdings and tracks them on a Form NJ-W4.

Quarterly Tax Payment Due Dates

Quarterly FUTA taxes are due if you owe more than $500 in taxes each quarter.

The due dates are:

- Quarter One: April 30
- Quarter Two: July 31
- Quarter Three: October 31
- Quarter Four: January 31

However, SUTA tax due dates vary by state. For example, in Michigan, the taxes are due on the 25th of the month instead of the end of the month: April 25, July 25, Oct. 25, and Jan. 25.

Failing to meet the deadline may result in a penalty or late tax payment interest assessment. Therefore, you not only have to know what taxes to withhold and pay but also when and how to pay it—by state.

Filing Tax Forms

To file employment taxes with the IRS and other agencies, you'll need to use specific payroll tax forms so it's clear what and how much you are paying; the forms have formulas that will help you calculate how much you owe, and the typical filing requirement is quarterly or annually.

You'll need the following payroll forms (which we discussed in detail in Chapter 1) when you file your employment taxes:

- IRS Form 941 or Form 944 for federal income and FICA taxes
- Form 940 for federal unemployment taxes
- State income and/or disability tax forms, if applicable to your location
- Municipal or local tax forms, if applicable to your location

You must deposit the taxes by the respective due date to avoid interest and penalties and maintain compliance with payroll laws. We cover payroll compliance, including the importance of paying on time, in detail in Chapter 5. If you pay independent contractors, you won't need to pay or file taxes for them, but you will need to send in a 1099 form to the IRS (and the contractor) to show the total earnings you paid them throughout the year.

To see a bigger picture of how you should be processing payroll even beyond managing payroll taxes, check out our step-by-step guide on how to do payroll.

Penalties for Missing or Late on Employment Tax Payments

If employers fail to remit payroll tax payments or send them in late, it could have the following impact:

- Employers may face criminal and civil sanctions
- Employees may lose access to future Social Security or Medicare benefits
- Employees may lose access to future unemployment benefits

If you're late making deposits for FICA or federal taxes, you'll be charged penalties as follows:

Penalty	Reason Charged
2%	1 to 5 days
5%	6 to 15 days
10%	16 or more days but before 10 days from the date of the first IRS notice
10%	Amounts that should have been deposited, but instead were paid directly to the IRS or paid with your tax return
15%	Amounts still unpaid more than 10 days after the date of the first IRS notice or the day you receive notice and demand for immediate payment

Bottom Line

Paying your payroll taxes correctly and on time is an important part to becoming a successful employer, but it can become challenging as you grow. Tax rates change from year to year, especially state payroll tax rates, and you must keep track of them to accurately calculate your business and your employees' tax obligations.

State Payroll Guides

Our state payroll guides walk employers through everything they need to know—including minimum wage and overtime requirements—to run payroll within the respective state. Use the chart below to check out our state guides for all states relevant to your business.

Alabama	Alaska	Arizona	Arkansas	California
Colorado	Connecticut	Delaware	Florida	Georgia
Hawai	Idaho	Illinois	Indiana	Iowa
Kansas	Kentucky	Louisiana	Maine	Maryland
Massachusetts	Michigan	Minnesota	Mississippi	Missouri
Montana	Nebraska	Nevada	New Hampshire	New Jersey
New Mexico	New York	North Carolina	North Dakota	Ohio
Oklahoma	Oregon	Pennsylvania	Rhode Island	South Carolina
South Dakota	Tennessee	Texas	Utah	Vermont
Virginia	Washington	West Virginia	Wisconsin	Wyoming

Plus, Washington, D.C. too!

CHAPTER 5

Payroll Compliance

Payroll Compliance: Important Payroll Laws to Know

As an employer, you must follow all payroll laws to avoid financial penalties, interest fees, and lawsuits or even being forced to close your business. Payroll laws specifically govern how you pay your employees and taxes and how you report this information.

You must follow both federal and state laws to maintain payroll compliance; state laws, which vary based on your location, seem to trip some employers up more.

Here are the laws and regulations we think it's important to pay close attention to:

1. Payroll Taxes Must Be Calculated Correctly & Paid On Time

When doing payroll, you must withhold the correct amounts of payroll taxes from employee paychecks and pay them as required (monthly, quarterly, or annually). There are federal and state payroll taxes, and you'll need to determine the appropriate tax rates to ensure your calculations are correct.

Specifically, you need to withhold the following federal taxes from employees' paychecks (state taxes vary, depending on the state): income tax, Social Security, and Medicare.

There are also employer payroll taxes you must pay out of your own bank account. You'll pay the same amount in Social Security and Medicare taxes (often referred to as FICA) as you withhold from employee paychecks. In addition to FICA, employers are responsible for paying FUTA (federal unemployment tax).

2. Workers' Compensation Insurance Is a Required Purchase in Most States

Another important law that affects your payroll compliance is the workers' compensation insurance requirement. Most states require you to purchase workers' comp to cover potential expenses from on-the-job injuries by employees. It's usually funded through private entities and is regulated and overseen by the state.

There are very few exceptions to the workers' comp requirement, and Texas is the only state in which employers can opt out of purchasing the insurance. So, if you are a new business that doesn't operate out of Texas, do not skip this step. Many payroll services give you the option to purchase workers' comp through one of its partners or its own in-house products.

3. Employers Are Responsible for Managing Court-ordered Garnishments

There may be times when you receive a court order to withhold funds from an employee's paycheck to cover a debt. This is serious, and you must act quickly, or you could be responsible for paying the funds later.

You'll typically receive an income withholding order if an employee is behind on child support. You can also receive an earnings withholdings order for other debts that other parties have been awarded in a lawsuit.

4. Tax Forms Must Be Filed by Their Deadlines

Employers must report the taxes they withheld and paid to the IRS and other tax agencies for verification. Some reports must also show total income paid out, in particular the year-end W-2 forms that are required to be mailed out by January 31.

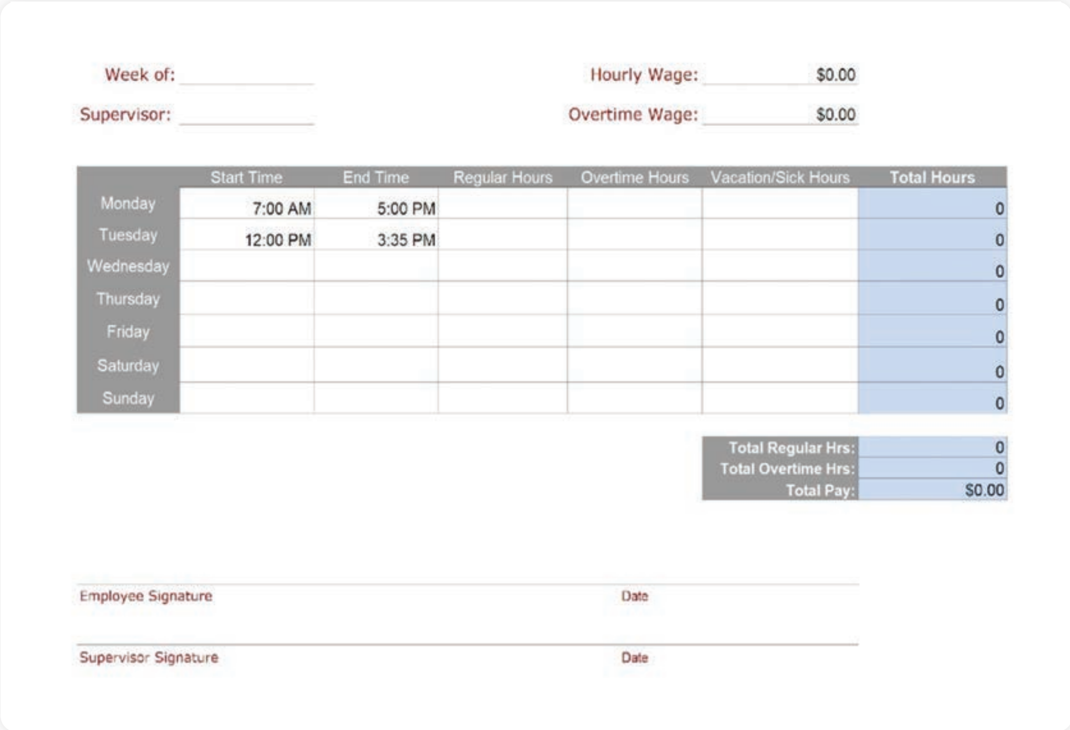
If you're using contractors, you'll need to send 1099 forms. It's important to make sure that your team is classified properly. To do so, make sure you know the differences between W-2 employees and 1099 contractors. There are many other payroll forms employers may need—some at the beginning of an employment relationship and others more regularly, like quarterly.

Pro Tip: It's important to remember that tax forms differ based on the type of entity you operate. Agricultural employers are subject to different taxes and filings than household employment, such as a nanny or housekeeper. These also differ from self-employed businesses, government contracts that require certified payroll, nonprofit organizations, and even international businesses. Make sure that you're familiar with your specific entity type to remain compliant.

5. Payroll Records Must Be Kept on File for 3–4 Years

You are responsible for several recordkeeping requirements for payroll, which may not seem intuitive when thinking about payroll. One best practice many employers follow is to keep all payroll records, like paycheck stubs, year-end tax forms, new hire tax forms, time sheets, etc., for at least four years. The law allows you to keep some of them for a minimum of three years.

Employers may use any timekeeping method they want to, but records must be complete and accurate and untampered with by the employer, aside from a supervisor sign-off. Employers may not alter timecards. The following is a sample time card format employers can use. Be sure to include total hours worked, meal and rest times, and the employee's signature.



Week of: ____________ Hourly Wage: $0.00

Supervisor: ____________ Overtime Wage: $0.00

	Start Time	End Time	Regular Hours	Overtime Hours	Vacation/Sick Hours	Total Hours
Monday	7:00 AM	5:00 PM				0
Tuesday	12:00 PM	3:35 PM				0
Wednesday						0
Thursday						0
Friday						0
Saturday						0
Sunday						0

Total Regular Hrs:	0
Total Overtime Hrs:	0
Total Pay:	$0.00

Employee Signature Date

Supervisor Signature Date

Although there are no DOL rules relating to how time sheets should look, it's important that you include enough information so that the employee, supervisor, payroll/accounting, and any outside auditors can make sense of the record when necessary.

6. Some Employees Must Be Paid Overtime & Minimum Wage Is Required

Federal law requires you pay employees extra if they work overtime. In addition, there are minimum wage amounts you must pay to each employee depending on which state you're operating in. There are overtime and minimum wage exemptions, but you'll need to familiarize yourself with them to ensure the employee situation you're considering is eligible.

Overtime Pay Rules

You'll need to separate your exempt employees and non-exempt ones. Non-exempt employees must be paid overtime when they work over 40 hours during a week (usually hourly workers but can be salaried, too); exempt employees are not entitled to overtime pay.

Overtime pay is paid at the time and a half rate (1.5 times their regular hourly rate). If you neglect to acknowledge overtime when required, you will be in violation of the Federal Labor Standards Act and have to repay the money plus late fees and penalties, eventually—not to mention you'll have to pay additional taxes on the wages too.

Did You Know? Beginning January 1, 2020, any employee earning less than the new salary threshold, $35,568 per year for a full-time worker, is eligible for overtime pay. The other way to calculate this is by assessing the standard weekly salary level, which was raised from $455 to $684.

Minimum Wage Rules

You can't just pay employees what you think they're worth; the federal government and many states have established a minimum wage amount you must pay to maintain payroll compliance. Federal minimum wage is $7.25 an hour, but many states have even higher rates—some up to $15.00 an hour.

7. Employees Must Be Paid on Time

When you start paying employees, it is important to set a pay schedule on which they're regularly paid. Weekly, biweekly, and semimonthly are the most common pay periods, but some businesses pay out monthly. Each state has its own minimum pay frequency requirements, so be sure to check yours.

There is no requirement that companies must pay their employees via direct deposit. Most employers offer that as it is easier to process payroll and allows employees to get their money faster. Approximately 93% of employees receive their pay via direct deposit.

Many states also have regulations regarding final paychecks when an employee voluntarily leaves or is terminated. States like New York and Washington give employers until the next scheduled payday to square up any owed monies, while California requires that all pay due is paid to employees at the time of termination.

8. Multiple Payroll Options Are Sometimes Legally Required

Usually, employers have autonomy in determining their preferences on how to pay employees, whether that be by paper check or direct deposit. However, since the use of pay cards is starting to increase, some states have passed laws requiring employers to offer an additional pay option beyond just that.

Also, contrary to what some believe, employers can pay employee paychecks in cash. The important thing is to learn how to pay employees cash legally. Proper documentation is one of the most important factors that will help you avoid fines and penalties.

9. Specific Rules on Paying Tipped Employees Must Be Followed

If you operate within the restaurant industry and if some of your employees receive tips or are part of a tip pool, then you need to be aware of tip reporting laws. This is incredibly useful if tipping pools are a part of your business.

One common challenge that many foodservice employers encounter is how minimum wage can be governed within jobs that also are eligible for tips. If you are new to this arena, it is a huge deal. For example, many states can pay their tipped employees a tipped minimum wage, which is a rate that is below the state's required minimum wage, with the concept being that these employees get paid from the restaurant plus their tip "wages."

Some states do not allow this practice; these states are known as "equal treatment states" and include Alaska, California, Hawaii, Minnesota, Montana, Nevada, Oregon, and Washington. Other tip wage laws differ significantly from state to state, so research your state laws carefully.

How to Remain Current With Payroll Compliance Laws

According to the National Small Business Association (NSBA), the top two burdens on small businesses are income and payroll taxes. These administrative and financial-related burdens can be so time-consuming and complex due to their evolving nature. Because of this, small business owners often find themselves spending an excessive amount of time completing them.

If you have chosen not to employ a payroll service to assist you with these regulatory responsibilities, then you'll need to learn how to do payroll yourself. Plus, you'll have to stay on top of payroll laws that change frequently.

We recommend that you take the following actions on an annual basis:

- Hire an auditor to review your payroll records, processes, and procedures. You can also conduct your own payroll audit.
- Sign up for the e-newsletter from the Small Business Administration (SBA).
- Visit the Department of Labor (DOL) website, which offers useful, easy-to-find payroll regulatory information on the FLSA and other payroll-related laws.
- Although you will need to maintain an annual membership, check the Society of Human Resource Management (SHRM), which retains a wealth of knowledge regarding payroll compliance laws, including details of the FLSA. An annual SHRM membership costs $229.
- See the American Payroll Association (APA), which provides solid resources listed that no small business owner should be without. For example, we like the Compliance Calendar, which outlines critical payroll filing dates that are challenging to find anywhere else. It is a great tool that can help your team stay on top of the many evolving tax filing rules and their dates throughout the year.

Agencies That Regulate Payroll Laws: IRS & DOL

The institutions that govern payroll law nationwide, the Internal Revenue Service (IRS) and Department Of Labor (DOL), are what we look to as payroll laws evolve. The IRS is responsible, in large part, for the taxation portion of payroll compliance. Meanwhile, the DOL manages aspects that differ from state to state, but more specifically, how the Fair Labor Standards Act (FLSA) impacts payroll processing.

IRS Payroll Regulations

If you have tax-related questions regarding payroll, then visit the IRS website, which outlines what you need to know as it relates to what taxable income is for employees, how to maintain tax records properly, how payroll taxes are affected by company mergers, how to report payroll tax of a deceased employee, and more.

DOL Payroll Regulations

If you have questions about the ever-expanding FLSA, then visit the DOL website, which helps you navigate the payroll regulations that can vary significantly from state to state.

For example, in the states of Alabama, Arkansas, Florida, and Mississippi, employers are not required to offer pay stubs to employees, while approximately 41 other states do require that employers provide pay stubs to employees.

The Department Of Labor's website lays out how the FLSA impacts payroll law compliance for the average employer. These payroll categories range from the minimum required (paid) rest periods and minimum wages from state to state to agricultural employment-related payroll regulations. The DOL's minimum wage guide easily helps employers determine what their wage responsibilities are to their employees.

Bottom Line

Payroll processing and its related compliance requirements can be complicated to manage in the long run due to a multitude of payroll laws that are complex and ever-evolving. Helpful resources and payroll partners can help.

Although the IRS and DOL offer copious amounts of resources, they each are somewhat unforgiving regarding oversights and poor practices; you can face expensive penalties for even unintentional lapses, so it's important to stay abreast of changes.

Payroll Records: What to Keep & How Long to Keep Them

Payroll records are documents with any information about a company's payroll, including data about employees, paychecks, and taxes. Per federal law, you should retain payroll records for three years and payroll tax records, such as unemployment taxes, for four years. States such as New York and laws such as the Employee Retirement Income Security Act (ERISA, governing private retirement and health plans), require you to keep some records for six years.

Best Practices for Retaining Different Types of Payroll Records

Though you may only be required to hold on to most documents for three to four years, we've gathered what we believe to be best practices for payroll records retention, keeping in mind not only federal regulations but also state guidelines.

2 Years	3 Years	4 Years	6 Years
Merit Increases and Pay Grade	Hiring Documents	Pay Stubs	Retirement Income and 401(k) Plan Details
	I-9 Documents	Employment Tax Documents like W-4s	
	Time Cards	Any Documents Relating to a Payment or Employment Dispute	
	Employee Handbook		
	FMLA Leave Details		
	Termination Information		

**Last Updated August 2021*

Job applications and interview records only need to be kept for one year, but once you've hired a candidate, their payroll documents need to be kept for three years. A few exceptions to this are employment tax documents such as W-4s that need to be kept for four years and retirement income documents that need to be kept for six.

A best practice for employers is to keep copies of all hiring documents that include the employee's full name, address, and Social Security number as well as time cards, pay stubs, and pay registers that are used while doing payroll.

Tip: Any time you have a termination dispute with an employee, it's a best practice to hold on to payroll documents until you resolve the dispute.

State-specific Laws About Retaining Payroll Records

Most states abide by the payroll document retention guidelines provided by the US Department of Labor (DOL) and other federal agencies. However, a few states—California, New York, Illinois, and Washington—have enacted legislation that affects what payroll records to keep and how long to keep them. Here are those state's specific requirements, with links to more information.

- **New York.** The Wage Theft Prevention Act increases the requirement to retain payroll records from the three years required by DOL to six years.
- **California.** Employers must retain payroll records for four years—eight years if the employees are exempt
- **Illinois.** Employers are required to retain payroll records for five years.
- **Washington.** The Department of Labor and Industries matches the DOL in terms of requiring payroll records to be maintained for three years; however, the requirements for what to retain are more specific. They include penalties of $250 for each non-compliance offense.

Important Information on Each Type of Payroll Record

Many agencies have specific payroll compliance requirements on what types of data each payroll record should show, and there is overlap among the agencies. Keep this in mind when choosing a payroll template to use for your employees. It saves time when records have sufficient information to meet multiple agencies' requirements—for instance, pay stubs that contain important hours, earnings, and tax data that satisfies both the DOL and the IRS.

- **Hiring documents:** New hire documents, such as an offer letter, include DOL-required data about the employee, their residential address, job title, and pay rate. You can also create an employee data sheet that includes required information such as the employee's gender.
- **I-9 documents:** Include information about the employee's eligibility to work in the US on the I-9 and include DOL required information such as the employee's full name and Social Security number.
- **Pay stubs:** Show information such as pay period, pay rate, and deductions and typically display hours worked each workweek, the basis for which wages are paid, as well as regular hourly or salary pay rates, overtime, and deductions. If you need a pay stub, download our free pay stub template to give you a head start.

- **Time cards:** Display hours worked, including unpaid lunch breaks and overtime hours. They can be paper or electronic, as long as the required data is retained for three years. If you still need a timesheet, download one of our free timesheet templates to get started and use our free time card calculator to calculate total work hours.
- **Termination documents:** Show last date worked and any final payments such as unused paid time off or severance.
- **Job evaluations and salary reviews:** Include rationale for pay increases and merit increases as required by the Equal Employment Opportunity Commission (EEOC).
- **Leave documentation:** Show leave dates and any leave amounts paid as an FMLA requirement.
- **Retirement income statements:** Include payment amounts and plan documents as required by ERISA, with 401(k) savings plan enrollment and statements that show employee contributions.
- **Employee handbooks:** They describe everything from pay dates and holidays to termination and severance pay. It's a best practice to hold on to your employee handbook for at least three years.

Personnel files often contain much of the documentation listed above. Therefore, a simple way to remain compliant is to box personnel files after an employee leaves the company and save those files for three years. However, if you store employee tax documentation in the employee personnel file instead of separate payroll and tax files, then you'll want to retain them for four years.

How to Store Payroll Records

In most cases, you have three storage options for payroll records that you need to keep. You can keep the files yourself, box and store the paper files off-site, or maintain the documents and data electronically. Here are some considerations for paper versus electronic payroll file storage.

Store Required Payroll Information on Paper Documents Off-Site

There are storage companies that will maintain your paper documents securely if you don't have room to keep them on-site. The benefit of a secure off-site storage facility is that you don't have to worry about storage space or keeping confidential health information, such as leave request forms, from being accessible to staff in violation of HIPAA law.

Store Required Payroll Information Electronically

There are companies like DocuSign that store electronic data for you. However, you'd need to verify the online data storage account is secure because payroll data contains sensitive information like birth dates, bank accounts, and Social Security numbers.

Most HR and Payroll software have document storage capabilities, allowing you to upload scanned copies of employee documents like the W-4 and I-9 forms. You can typically also input employee data directly into the system.

Who Determines What Payroll Information to Keep

Federal agencies like the DOL and IRS determine what payroll records to keep and how long to keep them. Other agencies, like the EEOC, are more specific and govern record retention for documents it uses exclusively to serve its mission.

DOL

The DOL's Fair Labor Standards Act requires you to keep payroll information for three years. It doesn't specify any particular document you need to keep, but does require specific information such as employee name, address, Social Security number, and pay rate. Most of this information can be found on hiring docs, pay stubs, and time cards, including:

- Full employee name, gender, and Social Security number
- Full residence address with ZIP code
- Job role (job title or function)
- Pay type (hourly, salaried, commission)
- Hours worked and pay rate
- Earnings by type (regular, overtime, additional)
- Total net earnings
- Date of payment and work period (pay period)

In addition, the ERISA requires that you retain retirement plan documents like premium payments and 401(k) plans for six years. However, it also states that you should keep payment records for as long as it's possible for the retirement plan to be audited. These records include enrollment documents, payment documents, and payroll deductions taken.

IRS

The IRS requires that you retain employee/employer tax documents for four years, including W-4s, payroll tax payments, and any W-2s that were returned undelivered.

Since you need to keep payroll tax deductions for four years, you may want to hold on to paper pay stubs for four years (rather than three) unless you have the data stored electronically.

EEOC

The EEOC requires employers to keep payroll information from one to three years and includes information such as pay scales, merit increases, and rationale for pay rate changes to prevent discrimination.

For example, job evaluations you need to keep for two years, which is the length of time a current or former employee has to review their personnel folder and dispute a salary increase, according to the Fair Pay Act.

How to Destroy Payroll Documents

Some business owners wonder if there's a risk to keeping documents longer than required. The answer is yes. Financial or personal information related to payroll, such as bank account information, credit reports, or photocopies of a Social Security card, should be destroyed after the retention timeframe to prevent confidential data from being misused.

The most important thing to remember when destroying files after their retention date, is that you should destroy all files securely. You can shred files in your office, or if the volume is large, you may want to use a company that picks up and shreds business documents at your location or off-site.

Keep a Log of What You've Destroyed

You'll also want to keep a log of what documents were shredded and when. It can be as simple as a spreadsheet that lists the kind of documents destroyed, how they were destroyed—shredded, incinerated—and when they were destroyed. It's also best to add a signature or initial and date so that if you have questions about destroyed documents, you can contact the person who destroyed them.

Bottom Line

You'll need to follow the DOL's rules as well as state and other federal agency requirements when retaining documents. Keep payroll documents as long as needed but no longer than reasonable to prevent confidential information from being released. Once the "destroy after" date has passed, be sure to shred or incinerate all documents to prevent unwanted access to confidential information.

How to Conduct a Payroll Audit

(Plus Free Checklist)

Conducting a payroll audit helps ensure your payroll process complies with labor, accounting, and tax laws. Further, regular payroll audits reduce occurrences of fraud, embezzlement, and wage theft. To help strengthen your financial controls and address potential issues, you can use our free customizable payroll audit checklist that covers how to conduct a payroll audit step-by-step.

Download Free Payroll Audit Checklist

1. Determine the Timeframe & Process for your Payroll Audit

Set yourself up for success when planning your payroll audit by considering the who, what, and when. We recommend conducting a payroll audit annually, but if this is your first audit and you want to make sure your payroll and data controls are working, you should consider doing mini audits more frequently (such as quarterly or even monthly).

You can use our Payroll Audit Checklist to come up with a plan for what you will be testing, when it should happen, and in what order. You may also want to note the names of individuals who can assist in the audit activity. This will help ensure the right team members are present when you need them, so the audit isn't delayed or completed out of order.

Payroll Audit Checklist

				Issue Identified?
Audit Period				
	Start Date			☐
	End Date			☐
Contributors			Notes:	
	HR			☐
	Benefits			☐
	Time & Attendance			☐
	Payroll			☐
	Other			☐
Run Reports				
	Employee Data Report	☐		☐
	Employee Hours Worked	☐		☐
	Employee Pay Rates	☐		☐
	Employee Overtime	☐		☐
		☐		☐
		☐		☐
		☐		☐
Verify Employee Data			Notes:	
	Employee list correct?			☐
	Employee pay rates valid?			☐
	Employee classifications correct?			☐
	1099 vs W2 employees noted?			☐
Verify Payroll Data			Notes:	
	Pay periods correct?			☐
	Payroll run on time?			☐
	Paychecks delivered on time?			☐

This online form contains comments to help you fill-out and customize the Payroll Audit Checklist.

2. Develop a Spot Checking Strategy

Instead of verifying data for all employees, look at the payroll data for 5%–10% of your total workforce. You should also determine how you will randomly select employees, payroll periods, and payroll transactions.

3. Run Reports for Employee & Payroll Data

If your business is using either a payroll software or service, note that these providers typically offer reports that help make payroll auditing easier. If you're handling payroll yourself, then you need to create and manage your own reports. To help you review employee and payroll data, here's a list of what you should verify for payroll audits.

Verify Active Employees

Some of the important items that you should look at include staff names, jobs, and start dates. You should also check if terminated employees are still on the payroll or if there are employee names that you've never heard of. The presence of either one indicates that there might be a problem.

If you are a small business owner, you can check the staff list yourself as you'll likely know the names of all your workers. However, if your company is a midsized business or large firm, you can ask help from your managers to ensure all their employees are listed correctly.

For businesses using various employee-related systems (like HR, timekeeping, and payroll solutions), you may want to verify whether the staff data matches between these software programs. Also, double-check contract worker information as their payment details may be stored in your accounting software instead of in your payroll system.

Verify Employee Pay Rates

Match the pay rates showing in the employee file to the amounts on your payroll reports. If you're using either an HR software or a payroll system, or both, these solutions typically have reports that list your employees' names, start dates, and pay rates. You ultimately want to see that no one is getting paid more or less than they should.

Verify Pay Periods Worked

If you have both a timekeeping and payroll system, you can compare data for a specific time frame (like a random pay period). You'll need to check that the pay periods line up and that data (such as actual hours worked) from one system matches what the employees got paid in that timeframe.

You also want to make sure that employees are receiving their pay on the designated day. If funds are being transferred too early, you may experience cash flow shortages that could impact inventory or supply purchases. If they're being remitted too late, you could face a labor law violation. Certain states have minimum pay frequency laws governing how your pay periods should flow.

Payroll rules vary by state. Some states let you mandate direct deposits, while others don't. Several states don't allow monthly pay. Others require you to give employees their final paycheck the same day you terminate them. As you're auditing your payroll, you should confirm that your company's payroll process aligns with the requirements for your location and industry.

4. Compare Hours Worked Against Time Card Data

Once you've taken a look at the big picture data—such as employees, pay rates, pay periods—it's good to do a deeper dive. You can check timekeeping records to ensure employees are being paid correctly for hours worked, including overtime for nonexempt employees. Here are some of the essential data points you should check.

Make Sure Employee Hours Worked Match Amounts Paid

Whether you're using paper timesheets, punch cards, or an employee time clock app, you can look at historical time card details and compare these to payroll data of the same time frame. If an employee's timesheet shows they worked 35 hours from September 2 through September 9, the payroll data (i.e., on the pay stub) should reflect the same information. Be sure you're comparing data that covers the same pay periods, and then list any differences or discrepancies between the two data sources.

Most payroll software will enable you to override electronic time cards or payroll data manually, such as when a worker forgets to clock in/out and when a worker is paid a bonus. You should always note those changes and verify the manual time adjustments if any.

Ensure Overtime Hours Are Calculated & Paid Correctly

A common payroll issue many employers experience is not paying workers overtime correctly. Most states require overtime to be calculated at time and a half, meaning that for every hour an employee works past 40 hours in a pay period, they get paid 1.5 times their regular rate. Note, however, that state overtime laws vary (i.e., California requires any employee working over 12 hours per day to be paid double their regular hourly rate).

Check to make sure you've calculated and paid overtime correctly per your state requirements. To verify that you've paid out the right amount to employees, you may need to recompute some payroll transactions. If there are differences, you need to backtrack and figure out what the problem is. Incorrectly paying overtime could subject you to fines and penalties, plus you may end up owing more money in taxes.

How to Manually Recalculate a Payroll Transaction for Payroll Audit

To start, find a list of your pay runs and choose a few transactions that include overtime pay. Multiply the 40 regular work hours by the regular pay rate—for example, 40 x $20 regular pay rate = $600. Then, find your overtime pay rate by multiplying it by 1.5 or time and a half. For example, $20 regular pay rate x 1.5 = $30 overtime pay rate.

Finally, you can multiply the hours worked over 40 in the pay period, which could differ depending on your state, by the overtime pay rate. For example, 10 overtime hours x $30 overtime pay rate = $300 overtime pay. In this instance, the employee's paycheck should reflect gross earnings of $900 ($600 regular pay + $300 overtime pay).

Verify Tips, Bonuses & Commissions

If your business is in the restaurant, services, and sales industries, you need to verify that additional payments are being tracked and managed correctly. These include bonuses, commissions, and tips to staff. You should track these amounts as they're earned and paid, and ensure the resulting employee pay matches on pay stubs.

If you're using HR or payroll software, check to see if it can create tip reports; they enable you to view employee tip data, amounts, and dates paid. Bonus payouts should be classified as what they are instead of tagging them as regular pay. You should also have documentation in your files to support the payout. Plus, it should be clear what the bonus is for (such as performance and holiday bonus) and who approved for it to be paid.

As for verifying commission payments, dig a little deeper to find paperwork that shows how the commission payment was calculated. You should know how many sales the employees made and which products they sold to earn money.

5. Run a General Ledger Report

Your general ledger (GL) shows every transaction that occurred within your company, making it an essential data source for conducting effective payroll audits. For payroll, you typically have expense and payable accounts. The expense accounts show what expenses your business incurred (like wage expense), while the payable accounts show the amounts that your business owes others (such as Social Security, Medicare, and FICA taxes).

You'll need to verify whether the amounts in your payroll records match what's on the books—the accountant's term for GL. If there are any amounts in your payroll records that you cannot trace back to the GL, you need to do some research.

Note that these records won't reflect work hours paid but rather amounts paid. You need to trace the payroll transactions you choose to analyze for the audit throughout the entire process—from timekeeping system and payroll records to GL. You can start by choosing random transactions in the general ledger and work back to check that they align with your other records.

Verify Federal & State Tax Payments & Deductions

It's important to review the taxes you've paid on behalf of your business in addition to the taxes you've withheld from your employees' paychecks to remit to the IRS.

As you start reviewing your payroll tax general ledger accounts, spot-check a few W-4 forms to ensure you're withholding the correct tax amounts for those employees and paying the right amount of taxes. Note also that regardless of whether you remit your payroll taxes quarterly or annually, there will be a delay from the time the expense and liability show up on your books until they are paid. You have to trace some of these transactions to ensure they are being handled correctly.

For example, when you pay quarterly taxes, the monies held from January to March shouldn't still be sitting in the taxes payable account in September. The amounts will enter your taxes payable accounts as credits on each payday and then clear as debits when you pay the IRS. If the amounts in your tax payable accounts are steadily increasing throughout the year, even at the end of the quarters after payments should have been made, then there's a problem.

If your payroll tax accounts don't seem to be clearing properly, and you're sure you've been paying the IRS, check the cash GL account. The best way to search is by dates. Find all transactions that are posted on and around the date you believe you paid the taxes—pull a receipt or some other tax documentation to help you pinpoint.

Look for the amount of the payment in the GL account, and once you find it, you should be able to see the other side of the transaction. If the other part of the transaction doesn't show your tax payable account, that would explain why your accounts aren't clearing. You'll need to see where the charges are going and make some corrections to your books. This is essentially payroll accounting, so you may need to solicit help from your bookkeeper or certified public accountant (CPA).

Verify Non-Tax Deductions Are in the Correct Accounts

Most employers deduct monies from an employee's paycheck for benefits, uniforms, or court-ordered judgments (like child support). You should verify if your payroll deductions are being booked properly by following a similar process to how we suggested you trace your payroll tax transactions—from beginning to end. This will confirm your end-to-end payroll deductions are functioning properly and whether you need to conduct further investigation into potential data discrepancies.

Look at the funds withheld on a payday and follow through to ensure those funds were credited to the correct account for holding and then immediately debited in the proper time frame. For example, 401(k) contributions and health insurance premiums can be sent to the provider every payday or at month's end.

You should also look at a few paystubs to check that benefits premiums that your employees are responsible for paying are coming out of their paychecks. Here are some of the employee deductions you should verify.

- **Health insurance:** Aside from checking whether health insurance deductions have been deducted from the correct employees' payroll, you should verify that these are being placed in the right insurance payable account and timely payments are being made to the insurance carrier.
- **Garnishments:** What you're looking for is whether garnishments are being tracked and that deductions are being made against the employees' paycheck. You should also check if the withheld amounts are paid to the requesting agency on time and from a garnishments payable account.
- **Retirement:** Verify that the 401(k) employee and employer contributions are being sent to the bank at the end of each pay period and if the employer contribution amounts or percentages are correct.

You may want to consider having separate payables accounts for each vendor and deduction type. For example, businesses in states that require employers to provide commuter benefits can set up a separate account for the said item. This makes payroll accounting and payroll auditing easier for you.

Verify That Payroll Account Data Matches Bank Account Data

By looking at bank account statements and comparing them to your payroll cash GL account, you can see whether there are amounts being paid out of the cash account that doesn't belong. You can also find if some employees haven't cashed their final checks or a payroll amount was paid twice to the same worker. These are issues you'll want to address.

If you have terminated employees whose unclaimed final paychecks have gone stale, then you have to void and reissue the checks. To avoid this situation, we recommend reaching out to these employees a reasonable number of times. If you're unable to reach them, you need to send their checks to the state as unclaimed funds.

6. Look For & Document Any Atypical Transactions

This is where you're doing a gut check and looking for anything that's out of the norm. If you see an employee is paid $2,600 every pay period for three months and, all of a sudden, they receive a $5,000 paycheck, you should research it. If you notice a garnishment payment that seemingly starts all of a sudden, and you have no knowledge of it, dig deeper.

Here are some atypical transactions to look for and monitor.

- **Retro Pay:** This is typically a line item that's added to an employee's paycheck when you're paying them after a payroll mistake has been made in a prior pay period. Maybe they got a raise, but it wasn't processed on time, or perhaps they forgot to tell you they worked six hours on a Saturday. The applicable retro pay amounts are then added to their current paycheck. However, these transactions should be infrequent.

- **Back Pay:** Back pay is due when you're ordered by a government agency to pay a person for prior pay periods items—such as miscalculated overtime pay, having paid a worker below minimum wage, and docking an employee's pay illegally. In cases of wrongful termination, back pay may be ordered by the court as part of the judgment. If you find yourself being ordered to pay back pay often, then it indicates that you have an HR or payroll compliance problem in your business that you have to fix going forward.

- **Garnishments:** Garnishments (like child-support) are managed differently in different states, plus the IRS may also garnish a person's wages for back taxes. You should ensure that the correct amounts are being deducted and paid, and that garnishment documentation is on file for payroll record-keeping purposes.

- **Freelancer Pay:** Review 1099 Form and W-9 Form copies. In addition, you should ensure that your business is not expensing payroll taxes on the amounts paid to freelancers and that your freelancers are classified correctly to avoid tax penalties.

7. Reconcile Payroll Accounts with Bank Account

Aside from reviewing what's in your GL, you should take a look at the specific bank accounts you have set up to manage payroll (like employee paychecks and direct deposit transactions) and payroll tax payments. Here are data items that you should verify.

Make Sure the Numbers Match

There are times when banks make mistakes, such as issuing paper checks when you have all your employees signed up on direct deposit and fees or reversals on your bank statement that don't look right. Compare what's in your GL accounts versus the balances and transactions in your bank accounts used for payroll processing—make sure that the data they reflect line up.

Look for Any Uncashed Checks

Checks that have gone uncashed for a year or more need to be managed according to your state's escheat laws, commonly known as unclaimed property laws. The check amount belongs to the employee, but how you handle it varies by state. Check your state's regulations on how to turn over unclaimed funds to a state agency.

Confirm Tax Payments are Made Correctly & On Time

Compare your bank statement to the tax agency due dates so you can determine whether or not tax payments are being made on time. Even if you're working with a third-party payroll software or service that manages your tax payments, you should still check these transactions since mistakes can happen. Note that in those cases, you—not the payroll processor—are typically liable for late tax payment penalties.

Why You Need a Payroll Audit

Payroll audits can help you check the accuracy of your company's payroll processes. It works as a risk-avoidance tactic to prevent you from making mistakes that may end up being costly to your company and business reputation. For payroll audits, you typically examine and verify data across various software systems and tools that manage your staff data, such as pay rate, overtime rules, pay type (like salary vs hourly), and employee job classification (exempt vs non-exempt).

Auditing also helps you uncover payroll-related fraudulent activity and innocent mistakes. For example, a staff member may have switched to part-time but is still being paid a full-time salary. On the more nefarious side, a staffer with access to payroll and bank accounts can deduct money from one account to pay herself extra. Your payroll audit will likely catch that.

One of the best practices to avoid potential fraudulent payroll activities is to have separate individuals managing employees, timekeeping, and payroll data. If HR can add a new hire, they shouldn't be allowed to also make payroll changes. Instead, you need segregation of duties to eliminate any temptation for staffers to steal from you. Payroll audits then verify that your processes are being followed.

Bottom Line

You don't have to wait until year-end to do a payroll audit. Listen to your gut. If something looks or feels off in your accounting system or payroll bank account, it's time to investigate. After all, it's your money at risk and your business reputation at stake if payroll violations that you aren't aware of crop up. By doing regular payroll audits, you can avoid getting fined for late taxes or sued for unfair pay practices.