

SUMMARY

Federal and state wage and hour laws regulate the method of payment of wages, the payment of wages upon termination of employment, allowable deductions from employee paychecks, the withholding and payment of employment taxes, wage garnishments, recordkeeping, and the maintenance of payroll records. Employers must withhold from employee paychecks certain tax payments including federal and state income taxes and FICA. To determine the proper withholding for federal and state income taxes, employees must complete a Form W-4 and provide the employer with their Social Security number. At the end of each year, employers are required to report on a Form W-2 each employee's earnings and the taxes withheld. Employers must also have an employer identification number (EIN) for reporting and paying federal and state unemployment and payroll taxes. In addition, employers are required to report new hire information to a state directory as part of federal legislation on welfare reform.

FAIR LABOR STANDARDS ACT (FLSA) AND PAYROLL

FLSA, also known as the Wage and Hour Law, regulates minimum wage, overtime, equal pay, recordkeeping, and child labor for employees of enterprises engaged in interstate or foreign commerce and employees of state and local governments. It has implications to payroll, such as paychecks, withholding allowances, taxes, payment practices, and recordkeeping. This section is intended to give a general description of these issues. Employers should seek professional advice on complicated matters.

PAYCHECKS

There is no federal law that sets out how often or in what form employers must pay wages to employees. However, most states address these issues.

Timing of paydays. Virtually all states regulate how frequently employers must pay employees their wages. State laws also specify the length of time that may elapse between the end of the pay period and payday. Employers in some states are required to notify their employees in advance of regularly scheduled paydays.

In addition, some state laws specify when to pay employees who are absent on payday and when the regular payday falls on a holiday.

Payment upon termination. Most states also specify when employers must pay employees who leave the company. The statutes often distinguish between voluntary and involuntary termination. Under the most common provision, employees who are fired or laid off must be paid just after termination; employees who resign must wait until the next regular payday. However, some state laws provide that employees who give their employers sufficient advance notice of their intention to resign are entitled to receive their pay on their final day of work.

Some states require that, in addition to wages, employers pay terminating employees for accrued vacation time. For additional information, see the state *PAYCHECKS* section.

WITHHOLDING ALLOWANCES

Form W-4. The amount of federal income tax withheld is based on withholding tables published by the Internal Revenue Service (IRS) and the information provided on each employee's Form W-4, Employee's Withholding Allowance Certificate. Each new employee should fill out a W-4 when hired. If a new employee does not provide a completed W-4, tax is withheld as if he or she is single, with no withholding allowances. A W-4 remains in effect until the employee provides a new one. Revised withholding must begin no later than the first payroll period ending on or after the 30th day after the date the revised W-4 was received. Employers may establish systems that let employees change their W-4 information electronically.

CROSS-REFERENCE

Fair Labor Standards Act (FLSA)	V-77	Overtime	V-181
Garnishment	V-81	Paychecks	V-187
Minimum Wage	V-171	Withholding	V-269

Employers are no longer required to routinely submit an employee's W-4 to the IRS when the employee claims more than 10 withholding allowances or claims an exemption from withholding and would normally earn wages of more than \$200 per week. However, in certain circumstances, the IRS may direct an employer to submit a W-4 for certain employees in order to ensure that the employees have adequate withholding. Employers are now required to submit the W-4s to the IRS only if directed to do so in a written notice or pursuant to specified criteria to be set forth in future published guidance.

If the IRS determines that an employee does not have enough withholding, it will notify the employer to increase the amount of withholding tax by issuing a "lock-in" letter that specifies the maximum number of withholding allowances permitted for the employee.

The employer will also receive a copy for the employee that identifies the maximum number of withholding allowances permitted and how the employee can provide additional information to the IRS for determining the appropriate number of allowances. If the employee still works for the employer, the employer must furnish the employee copy to the employee. If the employee no longer works for the employer, the employer must send a written response to the IRS office designated in the lock-in letter indicating that the employee is no longer employed. The employee will be given time before the lock-in rate takes effect to submit a new W-4 and a statement supporting the allowance claims made to the IRS office designated in the lock-in letter. Unless otherwise notified by the IRS, employers are required to begin withholding based on the allowances specified in the lock-in letter no sooner than 45 calendar days after the date of the lock-in letter. Once a lock-in rate is effective, an employer cannot decrease withholding without IRS approval.

After the receipt of a lock-in letter, employers must also disregard any W-4 that decreases the amount of withholding. The employee must submit any new W-4 and a statement supporting the claims made that would decrease federal income tax withholding directly to the IRS address in the lock-in letter. The IRS will notify the employer to withhold at a specific rate if the employee's request is approved. If, at any time, the employee furnishes a W-4 that claims a number of withholding allowances less than the maximum number specified in the lock-in letter, the employer must increase withholding by withholding tax based on that W-4.

Warning: Employers that do not follow the IRS lock-in instructions will be liable for paying the additional amount of tax that should have been withheld.

Invalid W-4. If an employee files a W-4 and has indicated that the number of exemptions shown on the W-4 is false, the W-4 is invalid. In this circumstance, an employer may request a new W-4 with valid information. If one is not provided, the employer should continue to use the previous W-4. If there is no previous W-4, withholding should be at the rate for a single person with no exemptions.

W-4 revisions. There is no limit to the number of times an employee may change the number of withholding exemptions that employees claim by filing a new W-4. Employers are not permitted to charge a fee for processing revised W-4s. A revised exemption does not have to take effect until the first payroll period ending on or after the 30th day after the new form is filed, and employees may have to wait 3 to 4 weeks after they file a change for it to take effect.

A revised W-4 should be filed when an employee needs to change the number of exemptions claimed. This generally implies a change in circumstances such as a marriage, divorce, new dependent, the loss of a dependent, a change in income with no withholding requiring more or less withholding, or a change in itemized deductions requiring more or less withholding. It is unlikely that an employee who is making frequent changes in his or her withholding allowances is actually experiencing changes in circumstances to justify the requests. An employer may inquire about what the change in circumstance is. If the number of allowances claimed is not based on fact, the revised W-4 is invalid and need not be accepted.

GARNISHMENTS

What is a wage garnishment? A wage garnishment is an order from a judicial or governmental agency requiring an employer to withhold a certain sum from the wages of an employee for payment of a debt. Such an order may come from the IRS, a federal or state agency or court, or from an individual creditor. An employer's response to a garnishment demand will depend upon its nature and in what order the employer receives it. Wage garnishments are enforceable in all 50 states, Puerto Rico, the District of Columbia, and all U.S. territories and possessions.

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Wage garnishments are very complex. Federal law is not straightforward, and state laws also interact with garnishment obligations. An employer who receives a wage garnishment order may want to consult a legal advisor before deciding how much to withhold and, in the case of multiple garnishments, where priorities lie.

Never ignore a garnishment order. Failure to answer and comply may result in a contempt of court judgment, and in some cases the employer may wind up with liability for the amount owed. In the case of a consumer order, if an employer is unable to honor it because of its priority or the exemption amount, the employer must communicate with the court or agency and explain the circumstances.

Note: Employers should take care not to be misled by official-looking documents mailed by collection agencies requesting deductions from an employee's paycheck.

Processing fee. Employers may withhold a processing fee from the employee's wages, which is generally set by the orders themselves or by state law. For additional information, see the state **GARNISHMENT** section for details on garnishments in your state.

NEW-HIRE REPORTING

As part of the comprehensive welfare reform legislation known as the **Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996**, every state must operate a child support enforcement program. Under the PRWORA provision (42 USC 653a), employers must report each newly hired worker to a state "directory of new hires" within 20 days of hiring by submitting the employee's W-4 form or equivalent document containing the worker's name, address, and Social Security number. The state agency in turn must report this information to a "national directory of new hires" at the U.S. Department of Health and Human Services. Multistate employers can designate one state registry for filing all new-hire reports. See the state **HIRING** section for details on reporting requirements in your state.

TAXES: FICA AND FUTA

The **Federal Insurance Contributions Act (FICA)** and the **Federal Unemployment Tax Act (FUTA)** are tax areas that payroll practitioners need to be aware of.

FICA. FICA provides for a federal system of old age, survivors, disability, and hospital insurance. Old age, survivors, and disability insurance is financed by the Social Security tax. Hospital insurance is financed by Medicare tax. Social Security and Medicare taxes are levied on both the employer and the employee, and each is reported separately. The employer must withhold and deposit the employee's part of the taxes and pay a matching amount. Generally, employee wages are subject to Social Security and Medicare taxes regardless of the employee's age or whether he or she is receiving these benefits.

FICA tax rates. Except for 2011, the Social Security tax is 6.2 percent for both employer and employee (12.4 percent total). In 2011 only, the employer's share is 6.2 percent, but the employee's share is 4.2 percent. In 2011 the Social Security wage base limit is \$106,800. The Medicare tax is 1.45 percent for both employer and employee (2.9 percent total) and does not have a wage base limit.

The amount of withholding for Social Security and Medicare taxes is determined by multiplying each payment by the employee tax rate. There are no withholding allowances for either tax.

FUTA. FUTA, with state unemployment systems, provides for payments of unemployment compensation to workers who have lost their jobs. Most employers pay both a federal and a state unemployment tax. In contrast to FICA, only the employer pays FUTA tax, and it is not deducted from the employee's wages.

There are three tests to determine whether an employee is subject to FUTA: a general test, a head of household test, and a test for farm workers. Each test applies to a different category of employee and is independent of the others. If a test describes the employer's situation, it is subject to FUTA tax on the wages paid to employees in that category during the current calendar year.

Exemptions from FUTA. These types of employment are most commonly exempt from FUTA:

- Certain agricultural labor
- Certain domestic service (household)
- Casual labor
- Employing family members
- Railroad workers

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- Certain nonprofit organizations
- Religious teachers
- Students employed by schools or colleges
- Student nurses
- Newspaper carriers

General test. An employer is subject to FUTA tax on the wages paid to its employees (not farm workers or household workers) if this test is met using the preceding calendar year's data:

1. Wages of \$1,500 or more were paid in any calendar quarter.
2. One or more employees were employed for at least some part of a day in any 20 or more different calendar weeks.

Domestic employers test. Employers of domestic employees must pay state and federal unemployment taxes if they pay cash wages to household workers totaling \$1,000 or more in any calendar quarter of the current or preceding year. A household worker is an employee who performs domestic services in a private home, such as babysitters, caretakers, cleaning people, drivers, nannies, health aides, yard workers, and private nurses. (See IRS Publication 15 for more information.)

Agricultural employers test. Employers must pay federal unemployment taxes if (1) they pay cash wages to employees of \$20,000 or more in any calendar quarter, or (2) in each of 20 different calendar weeks in the current or preceding calendar year there was at least 1 day in which they had 10 or more employees performing service in agricultural labor. The 20 weeks neither have to be consecutive weeks, nor must they be the same 10 employees, nor must all employees be working at the same time of the day. Generally, agricultural employers are also subject to state unemployment taxes.

Computing FUTA tax. The FUTA tax rate is 6.2 percent. The tax applies to the first \$7,000 employers pay to each employee as wages during the year. This is the federal wage base. The state wage base may be different. Generally, employers can take a credit against their FUTA tax for amounts paid into state unemployment funds. This credit cannot be more than 5.4 percent of taxable wages. If employers are entitled to the maximum 5.4 percent credit, the FUTA tax rate after the credit is 0.8 percent (6.2 percent minus 5.4 percent). This would equate to a maximum of \$56 per employee, per year (.008 times \$7,000 equals \$56) in federal tax.

Depositing FUTA tax. For deposit purposes, employers should figure FUTA tax quarterly. Employers can determine FUTA tax liability by multiplying the amount of taxable wages paid during the quarter by .008 (0.8 percent). Employers should stop depositing FUTA tax on an employee's wages when the employee reaches \$7,000 in taxable wages for the calendar year. If any part of the wages subject to FUTA is exempt from state unemployment tax, the employer may have to deposit more than the tax using the 0.8 percent rate. For example, in certain states, wages paid to corporate officers, certain payments of sick pay by unions, and certain fringe benefits are exempt from state unemployment tax.

If an employer's FUTA tax liability for a quarter is \$500 or less, the employer does not have to deposit the tax. Instead, the employer may carry it forward and add it to the liability figured in the next quarter to see if the employer must make a deposit. If the FUTA tax liability for any calendar quarter is over \$500 (including any FUTA tax carried forward from an earlier quarter), the employer must deposit the tax by electronic funds transfer (EFTPS) or in an authorized financial institution using Form 8109, Federal Tax Deposit Coupon.

Employers must deposit the FUTA tax by the last day of the first month that follows the end of the quarter. If the due date for making the deposit falls on a Saturday, Sunday, or legal holiday, employers may make the deposit on the next business day. If an employer's liability for the fourth quarter (plus any undeposited amount from any earlier quarter) is over \$500, employers should deposit the entire amount by the due date of Form 940 (January 31). If it is \$500 or less, employers can make a deposit, pay the tax with a major credit card, or pay the tax with their Form 940 by January 31.

EMPLOYER IDENTIFICATION NUMBERS

Employers that are required to report employment taxes or give tax statements to employees need to have employer identification numbers (EINs).

EINs are nine-digit numbers issued by the Internal Revenue Service (IRS). The digits are arranged as follows: 00-000000. The numbers are used to identify the tax accounts of employers and certain others that have no employees. Employers should use EINs on all items sent to the IRS and Social Security Administration (SSA).

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Employers can call the IRS Center at 866-816-2065, Monday to Friday, from 7:30 a.m. to 5:30 p.m., EST. Employers located outside the United States should call the Philadelphia Service Center at 215-516-6999.

Employers also can mail Form SS-4 to get an EIN. The instructions on the form provide the correct mailing address, which may be different from the location an employer used in the past.

Employers that took over another employer's business should not use that employer's EIN. Instead, employers should write "Applied for" and the date in the space shown for the number on the form. For additional information, see IRS Pub. 1635, *Understanding Your EIN*.

EMPLOYEE'S SOCIAL SECURITY NUMBER (SSN)

Employers are required to obtain each employee's name and SSN and enter them on Form W-2, the Wage and Tax Statement. (This requirement also applies to resident and nonresident alien employees.) Employers should ask employees to show his or her Social Security card. The employee is required to show the card if it is available.

Copying the card. Employers may, but are not required to, copy the Social Security card if the employee provides it. If the employee does not provide an SSN, he or she must complete Form SS-5 (Application of a Social Security Card), available by calling the SSA offices at 800-772-1213 or by visiting their website at <http://www.ssa.gov>. In the meantime, employers should write "Applied for" on the W-2. Once received, Form W-2c (the corrected Wage and Tax statement) should be completed and a copy given to the employee.

INCOME TAXES

Federal. There are many federal tax forms that employers should be aware of. The most commonly used forms are the W-2 and 1099 (Wage and Tax Statements), Forms 940 and 940 EZ (FUTA tax return), and Form 941 (Quarterly Tax Returns), and they are some of the most important forms. These and other forms can be downloaded from the Internal Revenue Service's website at <http://www.irs.gov>.

State. Most states have an income tax. Employers should check their state law to see if they are subject to income tax.

Every employer's tax situation will be different. Therefore, it is best to seek professional advice from a certified accounting professional.

PAYMENT PRACTICES

Direct deposit. Many states allow employers to use direct deposit or debit cards to pay wages and salaries. Employers that pay their employees by depositing funds directly into the employees' bank accounts or with a debit card should keep the employees' written authorizations on file. For more details, see the state **PAYCHECKS** section.

Giving paycheck to another individual. Employees who are absent on payday will sometimes ask a friend or relative to pick up their paychecks for them. Although there is no specific legal prohibition against this practice, the law requires the employer to pay the *employee*. If the relative or friend steals the check, the employer must still pay the employee. Employers that engage in this practice should be sure to get identification and a signed receipt.

Check cashing. Some state laws suggest that employers must provide employees with a check-cashing service, or that paychecks must be drawn on a bank that is convenient to employees.

Although they are under no statutory obligation to do so, some employers grant employees paid time off so that they may cash their paychecks. This practice was developed before the advent of automatic teller machines and electronic funds transfers when it was difficult for employees to cash their checks. For additional information, refer to the state **PAYCHECKS** section.

RECORDKEEPING

Payroll recordkeeping is regulated by both federal and state law. Many states require employers to notify employees of all earnings and deductions for each pay period. The federal Fair Labor Standards Act requires that employers keep certain information on file for each person on the payroll.

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Exempt and nonexempt. The following information must be kept for both exempt and nonexempt personnel:

- Employee's full name, number, or identifying symbol
- Home address
- Date of birth, if the employee is under the age of 19
- Sex and occupation in which employed
- Time and day of week on which workweek begins
- Total wages paid each pay period
- Date of payment and the pay period covered by the payment
- Retroactive wage payment under government supervision

Nonexempt only. The following information must be kept for nonexempt personnel only:

- For any week in which overtime pay is due, regular hourly rate of pay, the basis on which wages are paid, and regular rate exclusions
- For any week in which overtime pay is due, regular hourly rate of pay, the basis on which wages are paid, and regular rate exclusions
- Hours worked each workday and each workweek
- Total daily or weekly straight time earnings or wages
- Total premium pay for overtime hours
- Total additions to or deductions from wages paid in each pay period
- Factors other than gender that are the basis for payment of any wage differential to employees of differing sex

PLACE FOR KEEPING RECORDS AND THEIR AVAILABILITY FOR INSPECTION

Place of records. Employers must keep records safe and accessible at the place or places of employment, or at one or more of the established central recordkeeping offices where the records are customarily maintained. When the records are maintained at a central recordkeeping office, other than in the place or places of employment, the records must be made available within 72 hours following notice from an administrator (of the Department of Labor) or a duly authorized and designated representative.

Inspection of records. All records must be available for inspection and transcription by an administrator (of the Department of Labor) or a duly authorized and designated representative (29 CFR 516.7).

IMPORTANT DATES FOR 2011

The following is a list of important tax dates for employers in 2011.

By JANUARY 31

Furnish Forms 1099 and W-2. Furnish each employee with a completed Form W-2, Wage and Tax Statement. Furnish each independent contractor with a completed Form 1099.

File Form 940 or 940-EZ. File Form 940 or Form 940-EZ, Employer's Annual Federal Unemployment (FUTA) Tax Return. However, if all of the FUTA tax was deposited when due, there are 10 additional days to file.

File Form 941 or Form 944. File Form 941, Employer's Quarterly Federal Tax Return, for the fourth quarter of 2009 and deposit any undeposited income, Social Security, and Medicare taxes. Employers may pay these taxes with Form 941 if the total tax liability for the quarter is less than \$2,500. An employer should file Form 944, Employer's Annual Federal Tax Return, for the previous calendar year instead of Form 941 if the IRS has notified the employer in writing to file Form 944, and pay any undeposited income, Social Security, and Medicare taxes. Employers may pay these taxes with Form 944 if their total tax liability for the year is less than \$2,500.

File Form 945. File Form 945, Annual Return of Withheld Federal Income Tax, to report any nonpayroll income tax withheld in 2008.

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Request a new Form W-4 from withholding-exempt employees. Ask for a new Form W-4, Employee's Withholding Allowance Certificate, from each employee who claimed exemption from income tax withholding last year.

BY FEBRUARY 16

Expired W-4s. Any Form W-4 previously provided claiming exemption from withholding has expired. Begin withholding for any employee who previously claimed exemption from withholding, but has not given a new Form W-4 for the current year. If the employee does not give a new Form W-4, withhold tax as if he or she is single, with zero withholding allowances. However, if there is an earlier Form W-4 for this employee that is valid, withhold based on the earlier Form W-4.

BY FEBRUARY 28

File Forms 1099 and 1096. File Copy A of all Forms 1099 with Form 1096, Annual Summary and Transmittal of U.S. Information Returns, with the Internal Revenue Service (IRS) (For electronically filed returns, the date is March 31.)

File Forms W-2 and W-3. File Copy A of all Forms W-2 with Form W-3, Transmittal of Wage and Tax Statements, with the Social Security Administration (SSA) (For electronically filed returns, the date is March 31.)

File Form 8027. File Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, with the IRS (For electronically filed returns, the date is March 31.)

BY MARCH 31

File electronic (not magnetic media) Forms 1099, W-2, and 8027. File electronic (not magnetic media) Forms 1099 and 8027 with the IRS. File electronic (not magnetic media) Forms W-2 with the SSA.

BY APRIL 30, JULY 31, OCTOBER 31, AND JANUARY 31

Deposit FUTA taxes. Deposit federal unemployment tax due if it is more than \$500.

File Form 941. File Form 941, Employer's Quarterly Federal Tax Return, and deposit any undeposited income, Social Security, and Medicare taxes. Employers may pay these taxes with Form 941 if the total tax liability for the quarter is less than \$2,500 and the taxes are paid in full with a timely filed return. If all taxes were deposited when due, there are 10 additional days to file the return.

BEFORE DECEMBER 1

New Form W-4. Remind employees to submit a new Form W-4 if their withholding allowances have changed or will change for the next year.

ADDITIONAL INFORMATION

For additional information, see IRS Publication 15, Circular E, the *Employer's Supplemental Tax Guide*, on the Internal Revenue Service's website at <http://www.irs.gov/formspubs/index.html?portlet=3>.

