

Payroll 101: An Introduction to Payroll and Taxes

As an employer, you probably have questions about what it means to "do payroll." This document will provide you with an introduction to payroll processing and some background about your obligations as an employer.

BMA Payroll is designed to help you with payroll every step of the way

There are three main things you need to do related to payroll:

1. Pay your employees: calculate gross pay and taxes withheld each pay period
2. Pay taxes: pay taxes withheld from employees' paychecks as well as tax liabilities you incur as an employer to the appropriate government agencies, such as the IRS or your state's department of revenue
3. File tax forms: these must be dealt with every quarter. Even if you've paid everything you owe, you still have to file tax forms that report your liabilities.

This introduction is designed to get you comfortable with the service BMA Payroll provides and to familiarize you with some common payroll jargon. For more detail, see IRS Publication 15 (Circular E) <http://www.irs.gov/formspubs/index.html>

Part I: What Are Payroll Taxes?

Payroll taxes are those taxes withheld from your employees' paychecks, as well as those taxes you pay as an employer based on the wages you pay your employees. These include:

- Social Security and Medicare
- Federal and state unemployment
- Personal income tax (federal and state)
- Miscellaneous other state taxes

Most payroll taxes, such as income tax, apply to all earnings. However, some taxes have what is called a *wage cap*—the maximum annual earnings per employee that is subject to that tax. These caps may be adjusted by the governing agency (typically annually).

Summary of the most common payroll taxes:			
	Tax Rate	Who Pays	2012 Wage Cap
Social Security (SS)	4.2% (employee) 6.2% (employer)	Employee and Employer	\$110,100
Medicare	1.45%	Employee and Employer	unlimited
Personal Income Tax (PIT)	Varies based on projected annual income	Employee	unlimited
Federal Unemployment (FUTA)	0.6%	Employer	\$7,000
State Unemployment Insurance (SUI)	Varies based on employer's <i>experience</i> rate	Employer in all states; some states have employee contribution	Varies by state

Social Security and Medicare

Social Security and Medicare taxes are paid by both employers and employees. As an employer, you withhold the employee's part of the taxes and also pay a matching amount.

The employee tax rate (amount withheld) for Social Security is 4.2%. The employer tax rate for Social Security is 6.2% (10.4% total). This is a tax with a wage cap, which means that the tax is calculated only up to a maximum dollar amount of wages per employee each year. For 2012, the wage cap for Social Security is \$110,100.

The employee tax rate (amount withheld) for Medicare is 1.45%. The employer tax rate for Medicare tax is also 1.45% (2.9% total). There is no wage cap for Medicare tax, which means the tax is paid on all of the wages that the employee earns. (The exception is exempt wages—see "Special Tax Exemptions" below.)

Personal Income Tax

The amount of federal income tax withheld from employees' paychecks depends on their marital status, the number of withholding allowances (exemptions) they claim on Form W-4, and their projected annual income.

In addition, all but nine states have a personal income tax (exceptions are Alaska (AK), Florida (FL), Nevada (NV), New Hampshire (NH), Tennessee (TN), Texas (TX), South Dakota (SD), Washington (WA), and Wyoming (WY)). It may be a flat tax rate (as in Illinois (IL)), regardless of projected income, or a graduated tax rate based on annual income, like the federal income tax.

In some states, employees also pay local tax (to cities, school districts, or counties) through their paycheck.

Form W-4. An employee reports several items on Form W-4:

- *Filing Status.* This is the marital status that dictates which tax table will be used to calculate income tax withholding. For federal income taxes, there are four filing status options: single, married filing jointly, head of household, and married filing separately.
- *Withholding Allowances.* Also called *exemptions*, withholding allowances reduce taxable income by a designated amount per allowance. The IRS updates allowance amounts periodically. Factors such as number of dependents influence how many allowances an employee will claim.
- *Additional Amount to be Withheld.* This amount is added to the income tax calculated for each paycheck. It is on top of the amount of income tax withholding based on the employee's filing status and withholding allowances. An employee working multiple jobs might choose to have an additional amount withheld to compensate for understatement of annualized wages (and therefore understatement of his real tax rate) by each employer.

The W-4 includes several worksheets intended to help the employee arrive at the most accurate projection of tax liability possible. Some states have similar forms for state tax liability.

You'll find Form W-4, state equivalents, and other useful forms for new employees in the Taxes & Forms section of your payroll account, under Employee Setup. Once your employee's W-4, and state information in their setup, BMA Payroll automatically calculates withholding for you.

Federal Unemployment (FUTA)

The Federal Unemployment Tax Act (FUTA), along with the state unemployment systems, provides for payments of unemployment compensation to workers who have lost their jobs. For 2012, the effective FUTA tax rate is 0.6%. The tax applies to the first \$7,000 employers pay to each employee as wages during the year, so your maximum FUTA liability per employee is \$42.00 per year.

However, if any of your employees are exempt from State Unemployment Insurance (for example, they are Directors or Officers), your FUTA tax may be higher. Also, if your state has borrowed funds from the federal government to cover shortfalls in its unemployment insurance program, all employers in your state may be subject to additional tax liability at the end of the year to repay those loans.

State Unemployment Insurance (SUI)

All states maintain a reserve for unemployment that is funded through an unemployment insurance tax. In most cases, SUI is paid only by the employer. Employees in some states, such as New Jersey and Pennsylvania, also contribute to SUI through their paychecks.

Most states have established a starting SUI rate for new employers. (Wherever possible, BMA Payroll provides this rate to you.) After a designated period of time, employers are assigned an experience rate, which may be higher or lower than the new employer rate depending on the employer's reserve account balance. You will receive a notice from the state if your rate changes.

Other Payroll Taxes

Some states administer disability insurance (SDI) or workers' compensation as a tax collected through payroll. Many states also have a tax paid jointly with SUI that is used to fund job training programs. Where applicable, BMA Payroll calculates these taxes for you.

BMA Payroll tracks all tax rates and wage caps for you. Whenever there is a change coming, we automatically update our calculations. We 100% guarantee our paycheck calculations so you don't have to worry. If there are tax rates based on employer experience (like SUI), we'll prompt you to enter the rates that apply to you and provide you with assistance in finding your rate if you don't know it.

Special Tax Exemptions

Some types of employees are exempt from one or more payroll taxes, which means that they do not pay those taxes. For example, a minor working for a parent who is a sole proprietor does not have to pay social security, Medicare, or FUTA.

In addition, certain portions of regular employees' wages may be exempt from one or more payroll taxes. For example, *tax-sheltered* or *pretax* insurance plans save both the employer and the employee money by exempting premium amounts from all federal taxes and some state taxes. Some fringe benefits, like S-Corporation owners' health insurance, are also taxed differently from regular wages.

If your company is a not-for-profit 501(c)3 corporation, you do not pay FUTA at all—regardless of who your employees are.

BMA Payroll automatically handles the special taxability of certain wage types. If you have employees who are eligible for special tax exemptions, you can indicate this when setting up the employee. Your accountant can help you determine whether you have employees who fall in this category; however, most employees pay all payroll taxes.

Part II: Paying Taxes

As an employer, you remit taxes to the IRS and to your state agencies either by paying electronically or by using a form provided by the tax agency. Before we cover the timing of tax deposit due dates or deposit frequency, we'll acquaint you with some common payroll terms.

Constructive Receipt

You become liable for payroll taxes on the date you pay your employees, regardless of when they did the work associated with that paycheck. This rule is known as *constructive receipt*. If you only pay employees on Fridays, you only report a tax liability on Fridays, even if employees earn wages every day of the week.

A common point of confusion is when work is performed in one tax period, but employees are paid in a different tax period. The IRS only tracks when employees are paid, not the span of time when the money is earned.

Example:

Tom's Market pays employees every two weeks. Employees receive a paycheck on January 6, 2012, which covers work performed during the pay period December 16–December 31st 2011. In which month does the tax liability for this payroll fall?

Answer: Tom's payroll is considered part of his January 2012 tax liability, even though the pay period fell completely in December 2011.

Lookback Period

This is a reference period used by the IRS to determine your federal tax payment due dates. The IRS evaluates your tax liability during this twelve-month period and determines whether you are a monthly or a semi-weekly depositor (see below) for the coming year.

Most new employers are monthly depositors.

Deposit Period

Refers to the span of time during which tax liabilities accumulate for each deposit due date.

Payment Coupon

The form with which a payroll deposit is submitted. When you pay electronically, you don't need a payment coupon.

Note: Effective for tax payments after January 1, 2011, the IRS has eliminated and will no longer accept the Form 8109 and 8109-B tax payment coupons. All tax payments must be made through the Electronic Federal Tax Payment System (EFTPS).

Federal Tax Deposit Schedules

The following deposit schedules apply to all federal taxes other than FUTA.

Monthly depositors: You are a federal monthly depositor in 2012 if your company's federal tax liability during the lookback period (7/1/10–6/30/11) was less than \$50,000. This is why all new employers are monthly depositors. Monthly depositors pay taxes for a given month by the 15th of the next month. For example, June taxes are due by July 15th. (However, if the 15th falls on a weekend or bank holiday, the taxes are due the next banking day.)

Semi-weekly depositors: If your lookback liability is greater than \$50,000, you are a semi-weekly depositor. You pay taxes three banking days after the end of any semi-weekly period in which you accrued a liability. The IRS divides the week into two periods: (1) Wednesday, Thursday, and Friday, and (2) Saturday, Sunday, Monday and Tuesday. Taxes accrued during the Wednesday–Friday period are due on the following Wednesday, and taxes accrued during the Saturday–Tuesday period are due on the following Friday.

In some cases, when a bank holiday (such as July 4th or Christmas) occurs during the week, semi-weekly depositors have an extra day to make their tax payment.

You'll never have to keep track of tax due dates with BMA Payroll. Whenever you have taxes due, BMA Payroll schedules all payments for you based on your deposit schedule. However, if the government notifies you of a deposit schedule change, you will need to update this information with BMA Payroll.

Exceptions to the Deposit Schedule Rules

There are three main exceptions to the monthly and semi-weekly tax deposit requirements, as follows.

Next-Day Deposit Rule: If you accrue \$100,000 or more in federal tax liability at any point during a deposit period, you must remit taxes on the next banking day. This could result from a single payroll, or it could result from multiple payrolls within a single deposit period (month or semi-week). For example, if you are a monthly depositor and pay a one-time bonus to employees that results in more than \$100,000 in liability on a single day, you must pay the amount due immediately. You also become a semi-weekly depositor until your lookback liability falls below the \$50,000 threshold again.

BMA Payroll automatically updates your deposit frequency requirements whenever you hit the next-day threshold.

Quarterly exemption: If you owe less than \$2,500 in federal taxes for a quarter, you can choose to pay when you file your taxes at the end of the quarter (instead of making deposits during the quarter). If you're not sure how much your business will grow, you should make more frequent deposits: the IRS will assess penalties if you owe more than \$2500 at the end of a quarter and have not made tax deposits.

If you choose to make quarterly tax deposits but have \$2500 or more due in a quarter, we automatically update your deposit schedule to be monthly.

Annual exemption: If the IRS has notified you in writing that you are a 944 filer, and your total annual federal tax liability is less than \$2500, you can make your federal tax deposits annually. The 944 filing status is for very small employers who typically pay \$4000 or less in annual wages.

Paying FUTA and SUI

Unlike other federal taxes, FUTA (federal unemployment tax) is paid on the last day of the month following the end of each quarter:

- April 30 (for Q1)
- July 31 (for Q2)
- October 31 (for Q3)
- January 31 (for Q4)

If you accrue less than \$500 of FUTA liability in a quarter, you do not need to make a deposit until the following quarter.

Like FUTA, SUI is also paid once per quarter to your state.

BMA Payroll keeps track of your total FUTA liability and schedules to pay FUTA whenever you hit the \$500 threshold. BMA Payroll also schedules SUI payments when due.

State Withholding Schedules

Like the IRS, states have established deposit schedules for paying income tax you've withheld from your employees' paychecks. When you register with the state revenue agency they notify you of your state deposit schedule.

Once you specify the deposit schedule with BMA Payroll, you don't have to worry about the complexity of these schedules. BMA Payroll tracks when and how much to deposit. BMA Payroll will provide payment coupons, which may be required to accompany a deposit if necessary.

State Unemployment Insurance

Like FUTA, state unemployment insurance (SUI) taxes are remitted once a quarter, regardless of the employer's size. In addition, other taxes administered by the state's unemployment commission, such as Arizona's Job Training Tax or New York's Re-employment tax, tend to be paid jointly with the SUI tax on a quarterly schedule. In states such as Florida and Nevada, where there are no state taxes withheld from employees' wages, SUI is the only payroll tax employers pay, so all employers pay taxes quarterly.

Part III: Payroll Tax Reporting and Forms

Now that you've given all your employees accurate paychecks and paid all the payroll taxes you owe, you've got one more responsibility: filing tax forms. This section provides an overview of the types of form filings required of all employers.

BMA Payroll tracks whenever you have a tax form filing due. Tax forms must be filed each quarter, and at year-end, even if you have already paid all the taxes you owe!

Federal Forms

Form 941. Most employers file this tax form every quarter with the IRS. It compares federal payroll taxes owed with taxes paid during the quarter to determine whether your payments were timely and whether you have a balance due.

Form 944. Employers who have received written notice from the IRS may file Form 944 annually instead of Form 941 each quarter. Like Form 941, it reports wages and calculates federal payroll tax liability. Most 944 filers also pay taxes once a year.

Form 940. All employers who pay FUTA file this tax form at year end with the IRS. Like Form 941, it compares FUTA tax liability with FUTA tax payments to determine whether your deposits were timely and whether you have a balance due.

Form W-2. All employers provide Form W-2 to each employee at year end as an earnings record for income tax filing purposes. You are also responsible for filing Form W-2 with the Social Security Administration.

BMA Payroll prepares all your federal tax forms for you. BMA Payroll files Form 941 (or Form 944), Form 940, and Form W-2 electronically.

State Forms

Wage Reports report wages paid to each employee for a given quarter. They are sometimes combined with a quarterly *contribution* report that calculates SUI tax owed and is typically accompanied by the SUI payment at quarter end. Most states require both a wage report and a contribution report each quarter, either as separate forms or as a combined form. Many states also require a quarterly reconciliation for state income tax.

Annual Reconciliations. Some states require filing an annual reconciliation for income tax at the end of the year. This may or may not be accompanied by copies of employees' W-2's.

BMA Payroll files all state forms electronically in all states that support electronic filing. For states where this is not available BMA Payroll will file paper forms manually.

Cities, counties, or school districts that assess tax may also require quarterly or annual forms and may require copies of W-2's. Check with each agency to which you pay tax.

Frequently Asked Questions

Here are the most common questions we receive from new employers. If you have additional questions, please contact BMA Payroll.

Q Do I need to register as an employer?

A You must register with both the federal government and your state when you hire your first employee. When you register, you are assigned a federal employer identification number (FEIN) and usually, a state employer identification number (EIN). In some states, you register with both the state revenue agency and the unemployment insurance agency.

- Link to register with the IRS - <http://www.irs.gov/businesses/small/article/0,,id=98350,00.html>
- To register with your state go to your states department of revenue web site or call the state for more information

You won't need identification numbers until it's time to pay and file taxes, so you can run payroll before you receive your numbers. The fastest way to register and receive an FEIN is online.

Q How do I know how much to withhold?

A Have each employee fill out a Form W-4 to tell you their status and allowances. After each employee is set up, BMA Payroll can now calculate withholding taxes. You may also withhold voluntary deductions, such as health insurance or retirement plans. BMA Payroll also supports involuntary deductions such as garnishments for which you receive a court order that explains the amount to withhold.

Q Is my contractor really an employee?

A The amount of control the employer has over the worker determines whether or not the worker is an employee or an independent contractor. If the employer controls what must be done and how the work gets done, and supplies the tools to complete the work, then the worker is an employee. If the worker controls how the work is to be done, the worker is self-employed. Self-employed workers usually provide their own tools and have independent businesses serving multiple clients. See IRS Publication 15, Circular E: Employer's Tax Guide for more information regarding whether a worker is an employee or a contractor.

Q As the owner of a business, am I considered to be an employee?

A The owner, sole proprietor, or partner in a small business does not earn wages and is not considered an employee (some LLC members and S Corp owners are also not employees). To confirm a worker's employment status, talk to your accountant or see IRS Publication 15, Circular E: Employer's Tax Guide

Q What forms must I file?

A BMA Payroll provides the necessary tax forms, and completes them for you when due. In some localities, employers must file local tax forms (with school districts, health agencies, cities, or counties). BMA Payroll does not supply local tax forms, however if we are provided the forms or access to local tax jurisdiction on-line accounts, we will file them for you.

Q When do I pay and file taxes?

A BMA Payroll processes tax payments whenever a tax must be deposited or a tax report filed. Each tax agency establishes deposit schedules for employers based upon the size of the employer's liability.

Q What is workers' compensation insurance and do I need it?

A Workers' compensation is a state-administered program to pay for injuries that occur in the course of employment. Workers' compensation insurance is required for nearly all employers in all states. If you are a small business employer, consult your insurance broker or contact our office to get help establishing a policy for your business.

It is very important that you have adequate workers' compensation insurance. Otherwise, if your employee is injured on the job, you may be personally liable—not only for the cost of medical treatment, but also for disability payments during the period in which the employee is unable to work. You can find what is required in your state by visiting the Office of Workers' Compensation programs website. <http://www.dol.gov/owcp/>

Glossary

Term	Definition
EIN (Employer Identification Number) or FEIN or EAN	A 9-digit number issued by the federal government that uniquely identifies an employer. An EIN is required on all forms that you (as the employer) file for an employee. Also known as FEIN (Federal Employer Identification Number) or an EAN (Employer Account Number). To apply for an EIN, go http://www.irs.gov/businesses/small/article/0,,id=98350,00.html or call the IRS 1-800-829-4933
deposit schedule	Tax agencies define when employers must deposit payroll taxes. New employers typically are assigned to a less frequent schedule. The IRS, for example, assigns new employers to a monthly schedule. State and local agencies define their own schedules and set their own thresholds.
Federal Insurance Contributions Act (FICA)	The federal Social Security and Medicare tax law. These taxes are paid by both employee and employer and are all remitted to the federal government at the same time.

Federal Unemployment Tax (FUTA)	The federal unemployment tax (generally, 0.6% of gross wages if paid on time) paid by employers only; employees do not pay this tax.
filing name	The name under which you file your state and federal tax returns. The filing name of a small business is whatever you specified when you applied for your Federal Employer Identification Number (FEIN). The government sent you a letter containing both your filing name and your FEIN. (Your filing name also appears in the booklet of tax payment coupons you receive from the government.) Household employers: Your filing name is not necessarily your legal name. For example, if you and your spouse file jointly, your filing name might be Martha and George Washington.
I-9	Federal form I-9 is used to verify the eligibility of individuals for employment. Employers must complete and keep on file an I-9 for each employee. (You can print Form I-9 at the Taxes & Forms section.) Your employee should provide the documents needed to verify eligibility. You are required to keep your employee's completed I-9 form for your records.
Medicare tax	Federal taxes for medical insurance. Currently, both employee and employer pay 1.45% (2.9% total) on all wages the employee earns.
Non-profit (501c3) corporations	Non-profit corporations that qualify under the federal 501c3 provision of the tax code are exempt from FUTA and can be exempt from income taxes. Non-profit organizations may be able to choose a reimbursable status for SUI. See IRS Publication 557 Tax Exempt Status for Your Organization. You can specify with BMA Payroll that your employees are exempt from taxes.
Personal Income Tax (PIT) wages	All wages paid during the specified period that are subject to federal, state, or local personal income tax (PIT) even if no PIT was withheld (states may have other names or abbreviations for personal income tax).
Personal Income Tax (PIT) withholding	A payroll tax for a federal, state, county, or city. Local agencies may or may not require an employer to withhold PIT from a household employee's wages.
Social Security tax	Federal taxes for old age, survivors, and disability insurance. Currently, the employee pays 4.2% and the employer pays 6.2% for a total of 10.4% on wages up to \$110,100 (in 2012).

<p>State Disability Insurance Tax (SDI)</p>	<p>A state payroll tax withheld from your employees' wages to provide benefit payments in case they are not able to work as a result of a non-occupational illness or injury. States set SDI rates.</p>
<p>SUI (State Unemployment Insurance) Tax</p>	<p>A payroll tax used to pay benefits to workers who are unemployed and qualify for unemployment insurance benefits. Typically, a state has one rate for new employers and lower or higher rates for employers who have a track record for paying taxes and for claims. For example, the SUI tax rate for new employers in California is 3.4% for the first three years. In following years, the tax rate will change depending on: (1) the average payroll for the previous three years, (2) how much you paid in SUI taxes, and (3) how much money has been paid and charged to your SUI reserve account for unemployment insurance benefits for people who no longer work for you.</p> <p>Your rate may change based on the <i>experience rate</i>, which includes business climate factors as well as your own record and that of other employers. In some states, the SUI rate can change midyear.</p>
<p>wage cap</p>	<p>Some taxes are paid only up to a specific amount of yearly wages. For example, in 2012, employees (and employers) pay Social Security tax only on their first \$110,100 of wages. FUTA taxes are paid only on the first \$7,000 earned annually by each employee. Not all taxes are wage-capped, and wage caps vary from tax to tax. BMA Payroll accounts for all wage caps when calculating taxes. Agencies re-evaluate wage caps annually and send you a notice when the cap changes.</p>
<p>W-2</p>	<p>Form W-2 is a federal form completed by employers to show an employee's total income and withholding for the year. BMA Payroll creates the W-2 form for you and files it with various tax agencies. You must give W-2's to all employees, including terminated employees. BMA Payroll mails W-2's to employees by January 31st as required by law.</p>
<p>W-4</p>	<p>Form W-4 is a federal form completed by employees so the employer can withhold the correct federal income tax from the employee's paycheck.</p> <p>BMA Payroll has W-4 forms available for you in the Taxes & Forms section of your account.</p> <p>Some states require the use of their own W-4 equivalent. These state forms are also available in the Taxes & Forms section.</p>