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In order to understand the role we play in handling and managing the payroll process for you, it is helpful to understand what's involved with payroll to begin with, from withholdings to remittances.

As a new 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.

There are three main tasks associated with payroll that you are responsible for as a household employer:

1. Pay your employees: calculate gross pay and withhold federal and state taxes 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 assistance our service provides and to familiarize you with some common payroll jargon.

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

Tax Type	Tax Rate	Who Pays	Cap
Social Security (FICA)	6.2%	Employee **&** Employer	$106,800
Medicare	1.45%	Employee **&** Employer	unlimited
Federal Unemployment (FUTA)	.8%	Employer	$7,000
State Unemployment Insurance (SUI)	Varies based on employer's experience rate	Employer in all states; some states have employee contribution	Varied by State

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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).

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 6.2%. The employer tax rate for Social Security is also 6.2% (12.4% 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 2010, the wage cap for Social Security is $106,800.

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 AK, FL, NV, NH, TN, TX, SD, WY, and WA). It may be a flat tax rate (as in Illinois), 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

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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.

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 2006, the effective FUTA tax rate is 0.8%. 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 $56.00 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, we provide 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, we calculate these taxes for you.

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.

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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.

Part II: Paying Taxes

As an employer, you remit taxes to the IRS and to your state agencies. 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 5th 2010, which covers work performed during the pay period December 15–December 31st 2009. In which month does the tax liability for this payroll fall?

Answer: Tom's payroll is considered part of his January 2010 tax liability, even though the pay period fell completely in December 2009.

How Do I Pay Federal Taxes

Do I make federal payroll tax payments during the year or pay with my personal tax return?

As a household employer, your federal payroll tax liability is considered part of your personal federal income tax liability. While household employers are not formally required to make employment tax deposits during the year, in general, you must make estimated federal tax payments during the year if (1) you expect to owe at least $1,000 in taxes for the year, after subtracting withholding and credits, and (2) you expect that your withholding and credits will amount to less than the smaller of (a) 90% of the tax you will owe at the end of the year, or (b) 100% of the tax shown on your return for the last year (110% if your adjusted gross income exceeded

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$150,000). You might fall into this category because of the employer taxes and employee withholdings that you accrue throughout the year.

If you are already making estimated payments using Form 1040-ES, you can add your federal payroll tax liability for each period onto those payments. The due date for the filing of Form 1040-ES is:

- April 15 (for Q1)
- June 15 (for Q2)
- September 15 (for Q3)
- January 15 (for Q4)

State Withholding Schedules

Like the IRS, states have established deposit schedules for paying income tax you've withheld from your employees' paychecks. For example, with New York State, once your state tax withholdings exceeds $700, it forces the requirement to remit the funds via a coupon payment to New York State within 5 business days of payroll. This is done with the filing of a NYS-1-MN form.

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.

Federal Forms

Schedule H. You must complete Schedule H whenever you employ someone, even if you don't file an individual income tax return. Be aware that, if you have to file Schedule H, you must also provide the household worker with a Form W-2 and send copies of Form W-2 and W-3 to the Social Security Administration.

Form W-2 and W-3. 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.

State Forms

Wage Reports report wages paid to each employee for a given quarter. In New York State, these filings are called the NYS-45. Most states require both a wage report and a contribution report each quarter, either as separate forms or as a combined form. (California is one exception; only a wage report is filed each quarter.) Many states also require a quarterly reconciliation for state income tax.