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**BEAT THE TAX
PENALTIES: WHY
OUTSOURCED
PAYROLL IS THE
KEY**



Beat the Tax Penalties: Why Outsourced Payroll is the Key

In a recent study by ADP Research Institute, 30% of companies surveyed have had to deal with unexpected expenses in the form of penalties, fines, and even lawsuits this past year--all because of unintentional non-compliance with government payroll tax and workforce regulations.

This is despite the fact that 83% of the business owners surveyed had been confident about their compliance with payroll tax laws and regulations. And 80% expressed similar confidence regarding workforce regulations involving workers' compensation, 401(k) management and the like. The study also revealed that close to a third of the firms that had been hit with fines and penalties received more than just one; an average of six, in fact, was reported, with a total average cost of more than \$90,000.

Notably, businesses in the study that processed payroll in-house received almost twice as many fines as those using an outsourced payroll service.

New legislation, such as the Affordable Care Act (ACA), has complicated matters even further; while 70% of business owners felt confident that they were in compliance with the ACA, fewer than half believed their organization fully understood the new regulations.

Regulatory compliance challenges have greatly increased for businesses of all sizes. The above findings apply to mid-sized firms, but smaller businesses are by no means exempt from the threat of unexpected fines and penalties. The IRS reports that 40 percent of small businesses pay an average penalty of \$845 a year in tax related penalties.

Here are the top six penalties to look out for if you own or manage a small business:

- 1. Failure to file or filing late**—If you owe taxes but fail to file by the due date, you could be penalized at a rate of 5% per month, up to a maximum of 25%. Be sure to file your taxes, even if you cannot pay at the time, because the penalty for not filing is steep.
- 2. Failure to pay or paying late** —The penalty for failure to pay your taxes is .5% per month on the outstanding tax balance. This penalty can be reduced to .25% a month if you accept an instalment agreement to pay back the taxes you owe. However, it can increase to 1% per month if the IRS has issued a notice of intent to levy. This penalty has a maximum of 25%.

3. **Estimated tax underpayment** –The IRS will assess a penalty if you do not pay at least 90% of your estimated taxes for the current year. This amount should be paid in equal instalments; you may be hit with a penalty for paying less in earlier months and more later in the year. The best way to avoid these fines is to be sure to pay at least 100% of the amount of your prior year's tax bill in equal quarterly instalments. Make that 110% if your business earns over \$150,000.
4. **Inaccuracy**–Tax return errors due to negligence, or significantly understating the amount of taxes you owe, can result in a 20% penalty. For example, if you are audited by the IRS and are unable to provide satisfactory proof for the deductions you have entered, you will face this penalty.
5. **Tax fraud**– This one is huge; if the IRS finds that you have filed your taxes with the intent to commit fraud, intentionally under-reporting your income, you will be charged a 75% tax fraud penalty on the amount that you under-paid. File your taxes accurately and with scrupulous honesty, and you won't have to worry about this penalty.
6. **Trust Fund Recovery Penalty (TFRP)** – If you have employees, you are required to withhold and pay trust fund taxes. These are simply your payroll taxes, which you essentially hold in trust for your employees until tax time. This includes income tax, federal unemployment tax, Social Security and Medicare. You should be sending these to the IRS each month. The penalty for not doing so is equal to the unpaid balance of the trust fund tax. However, if your total payroll taxes amount to less than \$2500 a month, you can file the withholdings quarterly.
7. **Failure to e-file**– If your total amount of payroll taxes exceeds \$200,000 in a year you are required to file using the Electronic Federal Tax Payment System (EFTPS). Failure to do so will result in a 10% penalty.

How Outsourcing Payroll Can Reduce Your Risk

Outsourcing payroll can offer your business a number of advantages, not the least of which is accurate and timely filing of taxes. Most payroll services provide a tax guarantee so you can be assured that your business will incur no tax related fees or penalties. Such providers will take full responsibility in the event that any penalties occur. This cost savings alone can easily justify the price of using an outsourced payroll provider.



Many in-house payroll departments are finding it challenging to keep up with the electronic filing requirement. An outsourced payroll provider can also spare you the pain of dealing with the complexities of the EFTPS, which can vary from state to state.

In addition to saving yourself the anxiety of possible penalties due to inaccurate taxes or missed deadlines, an outsourced vendor will keep your company's payroll accounting organized and up-to-date. Your provider can also relieve your human resources department of some of its more time-consuming processes, such as the administration of retirement plans and other benefits, saving your company additional labour dollars.

Here are a few additional benefits you can take advantage of when you outsource your payroll:

- **Pay check processing for multiple company locations** can be easily handled by your payroll supplier. Some vendors have a branch in every major city. Smaller suppliers will distribute pay checks to multiple locations via an overnight delivery service.
- **Direct deposit** is a feature that most employees appreciate and that smaller businesses are unable to offer through an in-house system. Funds deposited directly into employees' bank accounts are often available a day earlier than a paper check would be.
- **Check stuffing** for those employees who prefer a paper check. Your payroll service will handle the time-consuming chore of printing checks and placing them in envelopes.
- **Special reports.** Ask your payroll vendor for a list of their report-writing packages. This service can be of real value if your company needs any type of specialized report. Again, many in-house payroll systems do not have this capability.
- **Data backup.** You won't need to be concerned about losing payroll information because most payroll providers back up their data regularly.
- **New employee reports.** The law in most states requires businesses to file a report for each new hire. Your payroll service can compile the data of all your new employees and submit this information to the government electronically.
- **Advanced technology.** Payroll processing firms continually adopt the latest advances in payroll applications. This give your company the advantage of robust payroll systems that would not be practical to install and operate in-house.



- **Less risk to your company.** Outsourcing payroll can greatly reduce the likelihood of being assessed fees and penalties due to late or incorrect tax
- **Expertise.** You will have a team of payroll processing experts at your service. Your payroll provider will usually be able to answer your questions over the phone and some will even come to your location for a consultation.

Payroll vendors may offer packages or bundles that include basic payroll services along with some or all of the following value added services:

- Computing salaries and wages, including bonuses and commissions
- Administering employer-paid benefits (insurance, profit-sharing, etc.)
- Benefits, such as health care, life insurance, and vacation time
- Electronic tax filing and payments
- Year-end balances and checklists
- Withholding payroll taxes
- Pay check distribution
- Social security taxes
- Year-end payments
- Bonus withholding
- Record keeping
- Tip reports

Consider the following questions before hiring a payroll vendor:

1. Does the vendor offer a free trial so you can experience first-hand whether their solution is easy to set up and use?
2. In the U.S., is the vendor a member of the American Payroll Association (APA)? Do they have a proven ability to meet tax deadlines?
3. Can they pass a background check, including a check through the Better Business Bureau?
4. Do they use accountants and individuals that are financially savvy and comfortable with financial calculators?
5. A good payroll accounting firm will use due diligence to find out answers to questions, such as the amount of vacation that employees had, overtime hours and more.



6. Does the firm file taxes electronically as well as by mail? It may be important that your company has options when it comes to filing.
7. Is the vendor able to electronically file state employment taxes in a particular state?
8. The company should have access to all tax and reporting forms.
9. Does the vendor have the ability to pay 1099 workers such as contractors?
10. The company should provide a detailed end-of-year report of the business's payroll situation on an annual basis. Some companies also provide detailed monthly reports.
11. Is customer service widely available anytime you have a question?
12. What is the cost of payroll processing? It's wise to weigh this factor along with quality of service and features, rather than basing your choice on savings alone.
13. Will the company provide options for your business growth if you take on more employees and payroll expenses?
14. Is the vendor able to export payroll data to various accounting software packages?
15. Is online help and technical support available?

In Conclusion

Could your business use an easy way to pay employees, help with benefits management, detailed reports and organized payroll processing, and accurate tax reporting to avoid penalties? Quality payroll vendors can do all of this and more so you can spend your time growing your business.

Let InsideUp match your business needs with the best payroll providers at budget-friendly rates. It only takes a few minutes to compare rates and save on top quality payroll services. Plus, you'll receive our complimentary guide to choosing payroll services.



PAYROLL SERVICE PROVIDERS

For **49%** OF SMALL BUSINESSES WHO USE AN OUTSIDE PAYROLL SERVICE, **SAVING MONEY** WAS THE PRIMARY MOTIVATION

Reasons to Consider



THE TOP REASONS FOR USING PAYROLL SERVICES ARE COMPREHENSIVENESS (45%), EFFECTIVENESS (17%) BETTER WORKFLOW (14%) and GREATER ACCURACY (11%)



SOURCES: ADP, Bureau of National Affairs, Inc. The Hackett Group, National Federation of Independent Businesses, Intuit

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Glossary

125(k) Plan: a Flex or Cafeteria Plan in which employees have money deducted from their wages to fund certain benefit plans. Premium payments are usually taken on a pre-tax basis, reducing the employee's federal, Social Security, Medicare and state taxes.



401(k) Plan: a cash-deferred plan that allows employees to authorize their employer to invest their pre-tax earnings in a retirement plan. The employee's contributions and any earnings on them are not subject to federal income tax until they are withdrawn.

403(k) Annuity: a mutual fund that provides retirement income for public school employees and some tax exempt organizations.

Advance Earned Income Credit (AEIC): is the payment of earned income credit during the year to employees who expect to be eligible for the credit; employers make the payments out of federal income, Social Security and Medicare taxes withheld from the employees' wages.

Annual Wage Reporting (AWR): is the Social Security Administration's system of recording wages reported annually by employers.

Automated Clearing House (ACH): when a private financial institution or a Federal Reserve Bank acts as a clearinghouse for direct deposit transactions. Entries are transmitted by the Automated Clearing House under the rules of the association.

Child support withholding: amount deducted from an employee's wages to satisfy a court order for child support. The employer is responsible for withholding the amounts and paying them over to the party named in the withholding order.

Fair Labour Standards Act (FLSA): regulates minimum wage, overtime pay, and child labour laws for employers and employees covered by the law.

Federal Employer Identification Number (FEIN): is a number assigned to taxpayers and businesses by the federal government. This number is used for all tax transactions.

Internal Revenue Code (IRC): Federal tax laws.

Liabilities: outstanding business debts.

Medicare: a federal insurance plan for persons 65 or older, and some disabled individuals. Funded through the FICA; employee and employer pay matching amounts with no annual wage limit.

Social Security: insurance withholding for retirement, disability and survivor benefits.

Taxpayer Identification Number (TIN): a Social Security number or employer identification number (EIN) that serves as the taxpayer's account number with the Internal Revenue Service (IRS) and Social Security Administration, (SSA).

Withholding: deducting a portion of an employee's wages for taxes, garnishments or other deductions, such as health insurance and union dues; these amounts are then paid to the government agency or other party to whom they are owed.