

# **Payroll Trends**

## **2<sup>nd</sup> Quarter 2006**

### **Minimum Wages**

The federal minimum wage continues to remain at \$5.15 per hour. However, many states and localities are making increases of their own. During calendar year 2005, eleven states increased their minimum wage, with eight of those increases being effective January 1, 2006. There are currently 46 states with minimum wage laws, 19 of them with higher wages than the federal minimum wage. One state has a lower minimum wage, and 26 have the same level as the federal rate. In the first quarter of 2006, two states have already increased their minimum wage, with both being significantly higher than the federal rate. There are also many local minimum wage laws, especially for workers on local government contracts.

### **New Hire Reporting**

During March, the Office of Child Support Enforcement (OCSE) will mail 89,000 letters to multi-state employers. The letters will remind the employers of their new hire reporting requirements, including the need to designate a state to receive all of their new hire reports if they are electing single state reporting. Likewise, employers are reminded of the need to keep information updated for changes from mergers, acquisitions or other significant events.

### **Circular E**

For many years, Circular E (Publication 15) has been a great resource for basic payroll rules, updated withholding tables and reporting rules. Every employer receives a copy in the mail each year and now employers may access Circular E online to download withholding and earned income credit tables to their Excel spreadsheet programs. Go to [www.irs.gov](http://www.irs.gov), link to Publications, and open Publication 15. Double click the paperclip icon within the publication and save the tables separately to disk. The file can then be opened in your Excel program.

### **Contractor Withholding**

The independent Taxpayer Advocate Office of the IRS has again called for simplification of the tax code to increase compliance and ultimately increase tax collections. Under-reported and unreported income from the "cash" economy, including independent contractors, continues to be one of the largest problem areas. The Advocate Office recommends the IRS use existing back-up withholding rules, or new withholding rules, to create incentive for compliance from this sector.

### **Per Diem**

If your business reimburses employees for travel related expenses using the federal per diem rates, you should check frequently to see if rate levels or designations have changed. The latest information can be found at [www.gsa.gov](http://www.gsa.gov).

### **Deferred Compensation**

The IRS withdrew the requirement for deferred compensation to be reported on 2005 Form W-2s. However, the IRS indicated employers may be required to file a corrected Form W-2 in the future, based on further review by the IRS. So make sure the 2005 information is retained to file corrected forms if necessary.

### **Workers Compensation**

The IRS has issued regulations clarifying the treatment of disability payments for FICA purposes to state and local government employees. Code sections spoke to payments under a workers' compensation law, while some government employees are specifically excluded from such laws. The final regulations provide that payments made to government employees under a statute of the same nature as workers compensation are treated as having been made under a workers compensation law and are therefore excluded from wages for FICA purposes.

### **Non-Resident Aliens**

Effective January 1, 2006, the IRS announced new rules on the calculation of withholding from wages for non-resident aliens. An amount is added to wages for calculation purposes only to offset the assumed standard deduction built into the withholding tables. If you have non-resident alien employees, you may secure the necessary table of additions in the Circular E mailed to you or at [www.irs.gov](http://www.irs.gov).

### **Professional Help**

Successful employers understand they cannot be experts in every phase of their business. They are successful because they know the things they can and cannot do well. Another trait that makes them successful is securing the best help possible in the areas of their business where they do not excel. As a professional resource in an area where many employers are not comfortable, we provide specialized services to allow your resources to be utilized on the things you do well. As this newsletter shows with each issue, the broad realm of payroll related activities is constantly changing. We would like the opportunity to review with you the services, or additional services, we can offer to your business to allow us to partner with you on a professional basis.

### **Roth plans**

In January and February, 2006, the IRS issued final regulations for contributions to a designated Roth under an employer's 401(k) plan and proposed regulations on distributions from such plans.

Enacted in 2001 and effective January 1, 2006, an employee can make elective contributions to a designated Roth. The designated Roth is currently scheduled to expire on December 31, 2010. Unlike other contributions to a 401(k), contributions to a designated Roth are made with after tax dollars, instead of the pre-tax regular 401(k) contributions.

One of the perceived advantages of designated Roth contributions are no income caps on persons eligible to make contributions to a plan. Also, provided a person has been employed five years, they can start withdrawing money tax free at age 59 1/2. A disadvantage is that distributions must begin by age 70 1/2 under the qualified plan rules. Although these required distributions are non-taxable, funds are not continuing to grow tax free once distributions start. Funds in a designated Roth must also be maintained in separate accounts from the 401(k) accounts and employer contributions can only be made to the 401(k) accounts.

Issued as proposed regulations, the designated Roth distribution rules are effective January 1, 2007. However, the regulations contain language that allows them to be used immediately. Qualified distributions are not taxable and are those made after five taxable years of participation, are made on or after age 59 1/2, or are paid to a disabled employee.

The five-year rule begins with the first day of the year that a designated Roth contribution is made (the year a Roth 401(k) first appears in the employees earnings) and ends when five consecutive years have been completed.

Non-qualified designated Roth 401(k) distributions are taxed differently from non-qualified Roth IRAs. Under a regular Roth IRA, the first money paid out represents a return of contributions, until all contributions are recovered, making these first distributions tax free. That concept was rejected in the distribution regulations for the Roth 401(k). Thus, non-qualified distributions will be prorated as to the taxable amount of earnings and the non-taxable return of contributions.

Rollovers from a Roth IRA to a designated Roth 401(k) are prohibited. The regulations point out this violates the separate accounting rules for amounts in a Roth 401(k). Amounts in a Roth 401(k) can be rolled into another Roth 401(k) or to a regular Roth IRA. Rollovers from one qualified Roth 401(k) to another do not carry the years of participation over to the new plan for the five-year rule.

If you think you might want to add Roths to your plan, or need to learn more, contact your plan administrator.

The budget proposed by President Bush for the 2007 fiscal year (October 1, 2006 through September 30, 2007) continues the long history of constant change for payroll-related processing. Remember, these are only proposals, and they will receive much debate before being introduced as legislation and enacted on by Congress.

### **Permanent Tax Cuts**

In 2001, legislation was passed phasing in reduced individual tax rates, expanding the 10% tax bracket and increasing the standard deduction and 15% tax bracket for married persons to eliminate the "marriage penalty." The child tax credit was gradually increased and the employer-provided educational assistance was expanded to include graduate courses. In 2003 and 2004 most of these graduated items were accelerated, but all of these provisions are still set to expire on December 31, 2010. The budget as proposed would make all of these provisions permanent without reverting back to pre-2001 levels.

### **Employer Retirement Savings Accounts (ERSA)**

The budget, as proposed, would consolidate all pre-tax defined benefit plans (401(k), 403(b) and 457 plans) and simplify the rules that they operate under beginning January 1, 2007. ERSAs would be open to all employers and would generally follow current 401(k) rules, with simplified nondiscrimination and safe harbor rules.

### **Retirement Savings Accounts (RSA)**

The current traditional, Roth, and non-deductible IRAs would become RSAs under the budget proposal. They would be solely for retirement purposes and any early withdrawal would be subject to penalties and income taxes.

### **Lifetime Savings Accounts (LSA)**

The current two forms of non-retirement IRAs, Coverdell and 529 plans, would be consolidated into LSAs. Contributions of up to \$5,000 per year would not be subject to wage limits and would not be pre-tax or tax deductible. However, earnings within the account would be allowed to accumulate tax free.

### **Health Savings Accounts (HSA)**

The new budget proposes to allow a tax deduction for the premium amount and a refundable tax credit for individuals that purchase HSA-eligible non-group coverage. Contribution amounts to HSAs would be increased and a tax credit would be provided to individuals to offset the employment taxes. Lower income individuals would also have a tax credit for participating in an HSA.

### **Employee Leasing**

To clarify payroll tax responsibilities, the budget proposes that employee leasing companies are liable for payroll taxes when they meet specific requirements. In all other cases, both the leasing company and their client would be jointly and severally liable for the taxes.

### **Other Proposals**

Under other proposals, the IRS could access the National New Hire Directory, Individual Development Accounts for low income individuals would be created and the FUTA .2% surcharge would be extended through December 31, 2012.

### **Katrina relief**

Individuals and businesses in the more severely damaged areas of Louisiana and Mississippi automatically have through August 28, 2006 to file returns and make tax payments. Returns and payments with a due date or extended due date on or after August 29, 2005 and prior to August 28, 2006 qualify.

Failure to deposit penalties will be waived if the taxpayer was unable to make deposits during this time.

The Louisiana parishes of Cameron, Jefferson, Orleans, Plaquemines, St. Bernard, St. Charles and St. Tammany automatically receive the extended deadlines. In Mississippi, the counties of Hancock, Harrison and Jackson also automatically qualify. Taxpayers outside these areas that can prove severe damage, must write in red ink on the top of the appropriate return "Hurricane Katrina" to secure relief. This includes areas of Alabama in addition to Mississippi and Louisiana.

### **Summer work**

Employers are reminded that new rules were issued in February, 2005, regarding child labor laws. Even though it may be traditional in your location or industry to hire minors while they are on summer vacation from school, there are very strict laws on age, hours and type employment.

There are different rules for 14-15 year olds, 16-17 and 17 and older. Therefore, you must be aware of the differences based on age and not allow all summer workers to perform the same task. For example, minors under 17 cannot drive a vehicle for your business, 16-17 year olds cannot do roofing, 14-15 year olds have restrictions on cooking related task, with the list going on and on.

If you plan on hiring summer youth this year, go to [www.dol.gov/elaws/esa/flsa/cl](http://www.dol.gov/elaws/esa/flsa/cl). Knowing the rules can reduce injuries and fines for employers.

### **Veteran Regs**

Effective January 18, 2006, final regulations were issued by the Department of Labor implementing all provisions of the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA).

As we continue to have high demanded for National Guard, Military Reserve, and volunteers, every employer needs to at least know where to find a copy of the regulations in case they have qualified employees or applicants. The full regulations can be secured

at [www.dol.gov](http://www.dol.gov) and then by clicking the link to "USERRA Regulations" from the selection on the right of the page.

Generally, employees who leave their employment to serve in the armed services are entitled to reinstatement to their former job or a position of like seniority, status and pay, unless the job they are leaving was a temporary position. USERRA reemployment provides the same rights and benefits as when they left, plus increases in pay or benefits they would have been entitled to if they had remained continuously employed.

### **Notice**

The departing employee does not have to secure the employer's permission before leaving for active duty to be covered by USERRA. The employee may wait to decide if they want to return to their prior employer and position after they conclude their active service. The employer cannot require the use of any leave time to cover any part of the military service absence. However, the employee may request to use accrued vacation or similar type leave with pay during periods of service.

### **Health Coverage**

Those leaving for military service may request continuous health insurance while away from the job to serve in the military. Employers must consider that where military necessity prevents a request for continuing health coverage, then it must be restored retroactively upon return of the employee without any waiting period for the employee or any dependent.

### **Reemployment Time Frame**

Employers must rehire employees returning from military service within two weeks after application. There can be some delays for unusual circumstances, such as major changes in the make up of the business. Delays cannot be for the fact the employee's previous job has been filled or no comparable positions are available.

### **Seniority Adjustments**

A person returning from military service must be restored to the same level of seniority as when they left, plus any increased seniority they would have obtained if they had remained continuously employed. This applies to not only job benefits, but also the returning rate of pay, including any raises, increases (merit or step) or bonuses that would have reasonably been paid but for the absence.

### **Retirement Plans**

Employers must also make contributions to pension plans no later than 90 days of reemployment. The returning employee may also make up missed employee contributions, either partially or in full. Likewise, funds withdrawn from a defined benefit

plan during the time of military service can be repaid, plus interest for the time the money was not in the plan.

### **Posters**

Also, effective January 18, 2006, employers must display a poster showing the employee rights and obligations. The poster may also be secured on the internet at [www.dol.gov/elaws/userra.htm](http://www.dol.gov/elaws/userra.htm).