

Payroll Trends

2st Quarter 2007

National Payroll Week

National Payroll Week (NPW) will be observed September 3-7, 2007, with the permanent theme "America Works Because We're Working For America."

Celebrated since 1996, this week recognizes the unique role payroll professionals play for America's workers, employers and government entities. Payroll withholding alone accounts for over 60% of all federal revenue, plus significant portions of state and local revenues.

These same professionals are accountable for collecting and remitting insurance premiums, retirement plan contributions and disbursing the funds to each person that cumulatively drive the economy. These amazing statistics are accomplished in a constantly changing environment of state, federal and local laws, company rules, plan modifications, etc. Yet we all expect our payroll checks to be correct and take for granted the knowledge and effort required to achieve that goal.

As part of the NPW week activities, this will be the second year for the "Money Matters" National Education Day. Volunteer instructors will use prepared materials to teach students at local high schools or youth groups about their payroll checks and the withholding system. This basic financial literacy lesson will help instill the value of money in our future work force.

If you or your company would like to volunteer to teach on Education Day, sponsor or host other activities, or need more information to decide how to help, go to the web site at nationalpayrollweek.com. As with all endeavors, a little time or effort by many adds up to the success known as National Payroll Week.

Tax Bills

On May 25, 2007, President Bush signed into law legislation containing a series of unrelated tax bills. Attached to the supplemental appropriations bill for funding the Iraq war, the Fair Minimum Wage Act of 2007 and the Work Opportunity Tax Act of 2007 both impact employers and their payroll related processing.

This continues the trend, over the last two decades, of annual changes requiring business and other taxpayers to implement new tax laws on a continuing basis. Impacting over 60 code sections, the changes are comprehensive, with only a few of the payroll-related items listed below.

Minimum Wage

The Fair Minimum Wage Act of 2007 is the first change in the minimum wage since 1997 and is effective for work done after the effective dates shown.

The new law increases the federal hourly minimum wage to \$5.85 an hour on July 24, 2007, \$6.55 an hour on July 24, 2008, and \$7.25 an hour on July 24, 2009.

The new law immediately increases the minimum wage in states that follow the federal law or have minimums less than the federal law. Employers in states with minimums greater than any of the steps in the increase must use the higher state wages for their employees.

Work Opportunity Tax Act

To help defray the cost of the increased minimum wage, this portion of the new legislation provides nearly \$5 billion in tax incentives primarily to "small" businesses. Only the key payroll-related items are covered below.

The FICA tip credit for the food and beverage industry (Sec. 45B credit) will continue to be based on the old minimum wage of \$5.15 an hour. The effect of this provision is to keep the credit at the current level and not reduce the credit due to the minimum wage increase. This provision applies to tips received for services after December 31, 2006.

The new legislation broadens and extends the expiring Work Opportunity Tax Credit through August 31, 2011, allowing employers to plan the use of the credit over a period of years. The expanded provisions are effective May 26, 2007.

The credit is a percentage of the wages paid during the first two years of employment for qualified, targeted individuals. In the past this consisted of high-risk youth, ex-felons, veterans, those on public assistance, and other groups in need.

The new legislation includes veterans with service-connected disabilities unemployed for at least six months during the annual period ending on the date hired by the employer. Also, the veteran must be hired within one year of discharge or release from active duty. The qualified wage is doubled from \$6,000 to \$12,000 for those eligible under the expanded veterans definition.

The high-risk youth definition has been renamed and expanded to include those from rural areas that have seen population decreases. The age range for those eligible in this "designated community residents" group is now 18-40 years old.

You may go to irs.gov and dol.gov for more information on these and other changes, and how they impact your circumstances.

Minimum Pay & Garnishments

Employers are reminded that most federal and state garnishment laws are based on disposable earnings and/or a multiple of minimum wage rates. Thus, the increase in minimum wages will impact the amount of wages that can be garnished by creditors for employees and may require recalculation of amounts currently being withheld.

New Gaming Tip Compliance Agreement

The IRS has issued Revenue Procedure 2007-32 with an updated model tip agreement for the gaming industry. The new agreement updates administrative procedures and promotes the use of current financial technology in the reporting process. Employers wishing to change to the new agreement or begin participation in the program should review the notice at irs.gov for complete information.

2008 HSA Limits

In Revenue Procedure 2007-36 the IRS has announced the cost-of-living adjusted maximum Health Savings Account contributions for 2008. For calendar year 2008, the contribution for an individual with self-only coverage will be \$2,900, and for an individual with family coverage, \$5,800. In each case, the person must have a high deductible health plan as required by HSA rules.

Free Overtime Help

The Department of Labor now has an overtime calculator on its web site to help employers understand how to make FLSA required pay calculations. The calculator is an education tool that provides links to more detailed information for the various steps in the calculation process. As with the IRS and Social Security web sites, this is a free resource that enhances an employer's knowledge base. You may utilize this free resource at dol.gov/elaws/overtime.htm.

SS Number Verification Updates

Effective August 25, 2007 the Social Security Administration (SSA) will make several changes to the system used to verify SS number and name matches. After the effective date, all names and numbers will be returned, not just mismatches. If there is a match, only the last four digits of the SS number will be shown. A new code 6 will also be implemented for those submissions not verified for reasons not included in the other five categories. There will also now be a sixteen digit confirmation number for each submission, replacing the tracking number. You may go to socialsecurity.gov for more information.

Lodging Expense Change

The IRS has announced in Notice 2007-47 that lodging expenses incurred when an employee is not traveling away from home may be deductible if they otherwise qualify as valid business or moving expenses. The lodging must be temporary, necessary and deductible if paid by the employee. Go to irs.gov for the full notice.

Per Diem Abuse IRS Target

The IRS says it will reclassify per diem travel expense arrangements that show a pattern of abuse as non-accountable plans, making all expense reimbursements for those companies taxable income to the recipients. This also reclassifies not just per diems, but all expense reimbursements, for payroll tax treatment of both the employee and employer. This is a follow-up action to Revenue Ruling 2006-56 that can be found in full on irs.gov.

Tax Gap

Congress continues to look for ways to close the tax gap, or the difference between what is paid in taxes and what should be paid if all income were properly reported. One of the key areas continuing to be looked at is the use of independent contractors. There is some sentiment to require tax withholding on payments to independent contractors, and others want to tighten the definition of independent contractors and remove the "safe harbor" from the 1978 tax act. As federal deficits increase and tax gap projections increase, look for some legislation impacting this area of workers.

Pre-Retirement Qualified Plan Distributions

The IRS has issued final regulations for pre-retirement plan distributions as authorized under the Pension Protection Act of 2006. Distributions may now be made to an employee who has attained age 62 and not separated from employment. With a safe harbor age of 62, a lower age could be used if it can be proved it is representative of the typical retirement age for the industry. Likewise, the distribution cannot start later than age 65, or five years after participation began in the plan. The new rules are generally effective May 22, 2007 for private sector employers. The full regulations can be reviewed at irs.gov or you may contact your plan administrator for more information.

The Social Security Board of Trustees have released their annual financial report for 2007. Although only "assumptions" based on various criteria, these annual reports provide us with an "educated guess" of the trends and health of the system upon which many depend for retirement or disability benefits.

Of immediate interest to employers are the projections for wage base changes over the next ten years. Based on SSA projections, the wage base for 2008 will be \$102,300 (the actual will be released in October). In future years, the wage base is projected to reach \$121,500 in 2012 and by 2016, reach \$141,900.

Social Security Report

The report indicates we can expect tax revenues to fall below program cost in 2017, the same as last year's projection. Based on current benefits, Social Security Trust Funds are expected to be completely depleted by 2041, one year later than last year's study.

The actuarial projection is a deficit of 1.95% of taxable payroll in 75 years, a .06% decrease from last year's study. Over the next 75 years, without changes, an additional \$4.7 trillion will be required above the amount of taxes collected, a \$100 billion increase over last year.

In 2006, 162 million workers had earnings covered by Social Security, with 49 million beneficiaries receiving benefits as of the end of the year.

In addition to some of the projections being better than last year, it is encouraging to know that administrative expenses for the Social Security program are only 1.0% of the total expenditures of the program. This expense factor is very impressive, even when compared to the private sector.

Likewise, the Trust Fund was able to earn interest in 2006 at an annual effective rate of 5.3%.

Roth

Final IRS regulations have been issued for distributions from a Designated Roth account under a 401(k) or 403(b) plan.

Qualified distributions are not included in an employee's gross income. Qualified distributions are those made after five taxable years of participation to an employee age 59½ or older, after the employee's death or due to the employee's disability.

The plan administrator is required to keep up with the five taxable years for each employee and passing the information on for direct rollovers. Roth contributions are not excluded from income and are included in wages on the W-2 and distributions must be reported on Form 1099-R. The final regulations are effective January 1, 2007.

Youth Regulations

In May, 2007, the U.S. Department of Labor (DOL) issued proposed regulations updating and revising the child labor regulations under the Fair Labor Standards Act (FLSA) for employment of minors age 14 to 18 years old. Highlights of the proposed changes are shown here, with more information available at dol.gov.

14-15 Year Olds

The proposed regulations for youth ages 14-15 would expand the list of permitted or prohibited jobs and remove the limitation on authorized work only in retail, food service and gasoline service occupations. The proposal also combines all rules related to power-driven machinery and expands the list of "examples" of prohibited equipment to include trimmers, weed-eaters, edgers, golf carts, food processors and food mixers.

In addition, the proposal would expressly permit the following for age 14-15 employees:

- perform jobs such as computer programmer, computer applications demonstrator, print and runway modeling, and musical director at a church or school.
- to ride in the enclosed passenger compartment of vehicles unless the reason for being a passenger is for work involving the transporting of other persons or property.
- to load or unload from vehicles light non-powered hand tools used in their employment, such as rakes, hand-held clippers, shovels, brooms, etc. as long as they are not power-driven maintenance equipment. They may also load or unload personal items such as protective equipment, back-packs, lunch boxes and coats. The proposed regulation would also clarify the following for age 14-15 year old employees:
 - they may perform car washing, cleaning and polishing by hand, but not with power equipment.
 - non-agricultural employment limitations of no more than three hours of employment on a day when school is in session applies to Fridays.
 - the term "week" means a standard calendar week.
 - school is not considered to be in session for any 14-15 year old who has graduated from high school or is excused from compulsory attendance beyond the eighth grade.

The proposal also would allow schools to apply to operate work-study programs that would permit, under specific circumstances, the 14-15 age group to work during school hours for up to eight hours in a day.

16-17 Year Olds

As proposed the following would be expressly prohibited for 16-17 year old employees:

- forest fire fighting or prevention occupations.
- tending, riding, working from, servicing, repairing or disassembling power-driven hoisting apparatus, such as cherry-pickers and bucket trucks.
- meat product manufacturing, such as processing sausage or prepared meat products, including poultry, buffalo and deer slaughter and processing, as well as equipment cleaning.
- operating, loading or unloading balers and compactors for any materials.
- operating, repairing, oiling, cleaning or adjusting chain saws, wood chippers or reciprocating saws.

Other proposed changes related to employment of 16-17 year olds would allow them to operate power pizza dough rollers as long as all safety features are operational. The definition of "high-lift truck" would also be revised to include skid, skid steer and bobcat loaders.