

# **Payroll Trends**

## **2<sup>nd</sup> Quarter 2008**

### **Minimum Wage Increase**

On July 24, 2008, the minimum wage increases to \$6.55 under legislation passed in 2007. Employers in states with minimums greater than the federal amount must use the higher state minimum wage. If the state minimum wage is less than the federal, the higher federal rate will prevail. The federal minimum wage is also set to increase to \$7.25 on July 24, 2009.

### **SSA Website**

The Social Security website is one of the most informative technical sites on the web and will undergo updates this summer. The Business Services portal will have the password protection features updated and a new retirement estimator will be added to the Benefits Calculator features. This is an excellent site to refer your employees when they have questions, or a site for employers to brush up on the fundamentals. To see what is available, go to [www.ssa.gov](http://www.ssa.gov).

### **Worker Classification**

With the Tax Gap continuing to be a hot topic with Congress and the media, the IRS intends to focus a third of its audit resources on the classification of workers in the coming fiscal year. There is still no clear definition or new legislation in the area, with existing rules, including the filing of Form 1099s, being the basis for audits. Employers need to be prepared to justify their use of independent contractor status should the IRS reclassify a person to employee status.

There is also an effort by the IRS and certain members of Congress to revoke the 1978 Section 530 safe harbor rules for worker classification. A new safe harbor would be available only if all applicable tax returns required to be filed were consistent with independent contractor status and there was no reasonable basis for treating the person as an employee.

### **Cafeteria Plans**

The Treasury Department plans to have the final Section 125 rules issued in 2008. The proposed regulation comments are being addressed and Treasury anticipates no problems with implementation for those plans currently in compliance under existing rules.

### **HSA 2009 Limits**

The IRS has issued inflation adjusted limits for 2009 health savings plans. Self-only deduction limits will be \$3,000, with family coverage limits being \$5,950. A high-deductible health plan for HSA qualification has an annual deductible of not less than \$1,150 for self-only coverage, or \$2,300 for family coverage. For 2009, out-of-pocket expenses cannot exceed \$5,800 for self-only coverage and \$11,600 for family coverage.

## **DOL Website**

The Department of Labor has created a new feature to allow employers to more easily stay in compliance with labor laws. The "First Step" tool allows an employer to answer certain questions and then guides the employer to basic information on the federal laws applicable to that employer. A summary of the paperwork required for that employer is also available, as well as the ability to download and print necessary posters and notices required of that employer. To make sure your company is in compliance, go to [www.dol.gov](http://www.dol.gov).

## **Exempt Salary**

The Fair Labor Standards Act (FLSA) exempts from minimum wage and overtime those employees meeting certain requirements. One of the criteria is a minimum weekly salary of \$455. In a recent opinion letter, the Department of Labor states the \$455 amount cannot be prorated for employees working less than full-time, even if the duties test are still met. A salary of \$455 must be paid each week, regardless of the number of days or hours worked, to qualify for the exemption per the opinion.

## **Stimulus Payments**

Employers are reminded that their employees may have questions regarding the 2008 Economic Stimulus payments. Answers to most questions can be found at [www.irs.gov](http://www.irs.gov), by either the employee or employer. There is a payment tracker feature on the site. It is also important to note the payments are not taxable income for federal income tax purposes, so the payment will cause no shortfall in withholding or have any other payroll related tax implications.

## **Compliance Issues**

As the National Payroll Week article on the next page quantifies, payroll is not only a very important part of every business, but is becoming more complicated to administer with every new tax bill or reporting requirement that is enacted. Therefore, as a professional resource in this area, we would like the opportunity to discuss ways to partner, or expand our partnership, with you to assure your compliance requirements are being met effectively and efficiently for 2008 and beyond.

## **Child Labor**

The Fair Labor Standards Act (FLSA) was amended to increase the civil penalties for child labor and other violations, effective May 21, 2008. The new law provisions include the following:

- Increase from \$10,000 to \$11,000 the maximum penalty for each employee subject to a child labor law violation.
- Creates a \$50,000 civil penalty for each violation that causes death or serious injury of an employee under age 18, with double penalties for repeated or willful violations.
- Increases from \$1,000 to \$1,100 the penalty for repeated or willful violation of wage or hours rules.

## **The Department of Homeland Security**

The Department of Homeland Security (DHS) continues to push the use of its E-Verify system to screen for problems with I-9 information provided to employers. The system compares the employer data with the Social Security Administration database and the DHS database, including naturalized citizens.

By using the E-Verify system, employers can make sure an applicant is legally eligible to work.

The President signed an Executive Order in June, 2008, requiring government contractors to assure they are not employing illegal immigrants and to utilize available verification tools to verify all of their employees can legally work in the U.S.

DHS also offers the ICE Mutual Agreement between Government and Employers (IMAGE) program to help employers minimize practices that can lead to employing illegal immigrants. The IMAGE program promotes screening, procedures and education in a coordinated effort to aid employers.

DHS also is targeting unscrupulous employers by prosecuting employers for money laundering when paying illegal workers through various schemes. These schemes can be very sophisticated, involving transfers among financial institutions to hide the payments to illegal workers.

Not only does the employment of illegals give unscrupulous employers an advantage in lower employment cost and deprive the government of appropriate taxes, the illegal employee is also deprived of access to protected working conditions and is often treated inhumanely.

Since employers who operate legally are being penalized with lost business and increased taxes, this is a problem all employers need to be vigilant in reporting.

For more information on using E-Verify and IMAGE, or any other DHS initiatives, go to [www.dhs.gov](http://www.dhs.gov).

## **New Law**

The Heroes Earnings Assistance and Relief Tax (HEART) Act is aimed at active duty and reserve military families and also contains a clarification of the tax treatment of benefits for volunteer emergency personnel. The following is an overview of some key provisions of interest to employers.

The new legislation opens up economic stimulus payments to all military families, even if the spouse does not have a valid social security number, permanently adds tax-free combat pay to the earned income credit calculation, makes permanent penalty-free retirement plan and flexible spending account withdrawals, and makes retiree disability pay non-taxable.

Under the new law, employer qualified plans must be amended to entitle survivors of former employees called to active duty, to any additional benefits under the plan, as if the former employee had returned to work and then died. This would apply to benefits provided to beneficiaries upon termination of employment due to death.

The new law also provides that beneficiaries receiving military death benefits may put the full amount into a Roth IRA or Coverdell Education Savings Account, disregarding the annual contribution limits.

Employer voluntary differential wage payments to employee's called to active duty will now be considered wages subject to withholding and retirement plan purposes. The withholding provision is effective for payments made after 2008, while other provisions are effective for 2008.

Small employers (less than 50 employees) will be eligible for a tax credit of 20% of differential wage payments up to \$20,000 of credit. The credit provision ceases at the end of 2009, and amounts taken as credits are not deductible compensation for tax purposes.

State veteran bonuses paid to those in the military for combat service are excludable from income under the new law.

The HEART legislation also provides a tax relief provision for volunteer fire fighters and emergency medical responders. Amounts paid by states or local governments to recruit and retain qualified professional volunteers (expense allowances, service awards, tax or license incentives, etc.) are now excluded not only from income taxes, but also FICA and FUTA calculations, retroactively to the enactment of the Mortgage Debt Forgiveness Act of 2007.

To pay for these liberalized tax positions, certain penalties or exclusions are being changed. The failure-to-file a timely tax return penalty will increase from \$100 to \$135, or the amount of tax on the return if less.

The ability of U.S. government contractors to use off-shore shell companies to avoid Social Security, medicare and unemployment taxes will be eliminated. Now, all foreign subsidiaries performing work for the government will be treated as U.S. employers for purposes of payroll taxes.

The penalties for group health plans not providing mental health parity is extended through 2008, and wealthy persons giving up their citizenship or residency will pay tax on the value of their property as if it had been sold.

For more complete information on the new law, go to [www.irs.gov](http://www.irs.gov).

### **No Match Letters**

As you may recall, the Department of Homeland Security (DHS) proposed last year to require employers to begin using the Social Security no-match letters as tools to find illegal immigrants. Since the name and social security numbers did not match the Social Security Administration records, there was a DHS presumption of possible illegal usage. A federal judge halted the proposal for 2006 no-match letters and that injunction is still in effect.

Therefore, no letters will go to employers notifying them of mismatches on W-2s submitted for tax year 2007. However, employers should be aware that no-match letters will be mailed to the employee for 2007. Employees may go to their employer for help in resolving the mismatched

information for 2007 and to update their payroll-related records with corrected information to prevent future problems.

No-match letters have been sent to employees and employers each year since 1979. Unless the information can be corrected, a person's Social Security records cannot be updated and their Social Security benefits could be adversely impacted.

Employees receiving the 2007 letters should notify the Social Security Administration and their employer of the correct information. Notification instructions are included with the letter each employee will receive.

### **National Payroll Week**

In 1996, the American Payroll Association sponsored the first National Payroll Week (NPW) celebration to honor the professionalism of those who work with payroll throughout the country.

The slogan for NPW is the same each year, "America Works Because We're Working for America." Although very simple, it highlights the role of payroll in the everyday life of the American worker and all levels of government.

Take a moment to quantify the impact of payroll. In addition to providing the income that flows throughout the economy, over 66% of federal revenue comes through payroll. Many states rely on payroll for the majority of their revenue and the Social Security system is primarily funded through payroll. Most retirement programs are funded by payroll, unemployment security is a payroll function, national health care protection is funded through payroll, and the list goes on and on.

In other words, the very foundation of the "American Experience" that we all have come to expect flows through payroll to a great extent. Yet, the payroll professional is expected to know all the rules for all of these many separate initiatives, apply them correctly on each paycheck, and report them to all of the government agencies, insurance and retirement companies, etc. This is the reason it takes a dedicated professional to handle this myriad task.

National Payroll Week has now grown to include education of the future American workforce. Payroll professionals volunteer on Money Matters National Education Day to teach teens about working, completing payroll forms, payroll deductions, minimum and overtime wages, and the tax systems payroll supports.

National Payroll Week will be September 1-5, 2008, with Money Matters National Education Day on September 4, 2008. If you would like to provide volunteers, sponsor some local activities, or just recognize those in your organization working with payroll related activities, you may find more information at [www.nationalpayrollweek.com](http://www.nationalpayrollweek.com).

## **Severance**

A recent U.S. Court of Appeals ruling has clarified the tax treatment of payments made to employees being terminated in workforce reduction situations. With the economy slowing, this situation could be more common than in the last few years.

Whether the action is workforce reduction, downsizing or any other action where the employer makes payments to the departing employee, the result will be the same. This includes situations where the employee elects to leave for the payment or where the employee is involuntarily let go by the employer.

In any of these situations, the payments made to a terminating employee are not only taxable for income tax withholding, but also for FICA purposes.

The court case came about as the result of some 1980s workforce reductions that are still winding their way through the court system. In the lower court, the ruling was that if the termination was involuntary, the payments qualified as supplemental unemployment benefits and were therefore not subject to FICA taxes.

The result of the appeals court ruling is to bring all severance pay under the same payroll tax procedures, i.e. severance pay of any type is treated as taxable wages for income and FICA purposes.