

Payroll Trends

3rd Quarter 2006

New York FUTA Credit

For 2006 New York will no longer be a Federal Unemployment Tax Act credit reduction state. This means New York employers that pay their full state unemployment taxes on time will have a federal unemployment tax rate of .08% for 2006.

Taxable Benefits

The tax code has long established that anything given to an employee is taxable unless it is specifically excluded. Yet IRS audits continue to find this is one of the areas of abuse by many employers. If unable to find a specific exclusion, many try to invoke the "de minimis" exception, that the value is so little and the cost to track the personal usage is so great, that any attempt to tax the benefit is unreasonable.

The complexity and varied thoughts of taxing these type benefits was recently highlighted at an American Bar Association taxation meeting discussion on company provided cell phones. Purpose, usage, flat rate costing and other criteria were all brought out in discussing whether the phones should be taxed or not. With no agreement, IRS cell phone taxation clarification may be sought.

Campaign to Fight ID Theft

The Federal Trade Commission is launching a media campaign to combat identity theft. The three key points of the campaign are deter, detect and defend. Although the campaign is aimed at the general public, the information is adaptable for employer use. More information may be secured at the FTC web site www.ftc.gov/idtheft.

Katrina Deadlines

The extended individual and business deadline for filing returns and paying taxes for those in the Katrina disaster area is set to expire August 28, 2006. Returns and payments with a due date, or extended due date, on or after August 29, 2005, were granted the extended deadline. Failure to deposit penalties will be waived if taxpayers can show they were unable to make deposits during this time.

FLSA Overtime Update

New Fair Labor Standards Act overtime regulations were issued two years ago with the promise of simplification and reduced litigation in the overtime area. Due to the subjective nature of the tests to determine whether a person is exempt or non-exempt from overtime, there is naturally going to be disagreement on the result. Therefore, there

continues to be a similar number of lawsuits as under the old regulations, indicating the process and not the specific rules may be the weak link in having a less litigious system.

SUTA Dumping Update

The SUTA Dumping Prevention Act of 2004 required all states to have conforming legislation by January 1, 2006. By masking high levels of unemployment claims, unscrupulous employers were passing their tax liabilities to all other employers in the various state systems. Seventeen states made the deadline and have automated systems to detect suspicious activity in this area. Twenty-five states and DC are in the development phase, with nine states not having started the process. The final four states have passed their legislation in 2006. **FMLA**

The Department of Labor has reiterated that employers must continue contributions to health and cafeteria plans for employees on leave under the Family and Medical Leave Act. This is true even if a person taking a non-FMLA unpaid leave would be treated differently.

Deferred Compensation

The IRS has still made no determination on W-2 reporting of deferred compensation. At this time they anticipate having viable reporting requirements for reporting on 2006 Form W-2s. Thus, employers will need to make sure information relating to any deferred plans is available and can be easily extracted for whatever reporting requirements are finally required.

Supplemental Wage Withholding

Final regulations have not been issued following the January, 2005, proposed regulations that created a stir over supplemental payments exceeding \$1 million. However, for supplemental payments of lesser amounts, the key is to remember the proposed regs clearly show the intention is to retain the 25% withholding rate.

Docking Pay

The Department of Labor has ruled exempt employees cannot have their pay docked for not working a required number of hours or for payment of damaged equipment. This type of pay docking would result in reclassification as a non-exempt employee for overtime requirements. Neither of these situations meet the allowed docking for disciplinary reasons.

Employers maintain a literal gold mine of information for anyone inclined to consider identity theft. The news is full of spectacular examples of lost computer hard drives, back-up disks, etc., containing thousands, or even millions of records, but most theft is on a much smaller scale. Yet the impact on the individual that has their identity stolen is just as traumatic regardless of who committed the crime.

Employers usually have in one location a person's full name, address, date of birth, and social security number. In conjunction with payroll records, bank account information is often available, and with benefit records there is information on dependents and health situations. This is obviously more than a thief needs to assume someone's identity.

Studies show that up to 75% of identity theft is carried out by fellow employees and employers need to take clear precautions to prevent theft of their employee's data.

The beginning point is obviously the hiring process and making thorough background checks to prevent problems, whether for full- time or part-time employment.

Employers need to look at their security procedures for data and access to data. Categorize data as to level of sensitivity, use encryption and password security, and have clear policies in these areas. Make sure physical security is adequate and access is controlled at all times, even when the business is closed.

Other key processes include shredding and destroying paper records timely and properly. Also make sure laptops and desktop computers are not improperly carried home, and if they are used away from the office, they do not contain unnecessary sensitive data and are responsibly handled.

One of the best precautions remains common sense, so instill in employees to be cautious, alert, have a questioning attitude, and to avoid complacency when dealing with sensitive data. Security and prevention of theft is truly a responsibility for every employer and employee in today's environment.

As Congress moves toward immigration reform, employers should remember that employment of illegal immigrants is one of the areas being addressed and changes will probably be mandated. The Department of Homeland Security could also mandate further restrictions, even if Congress does not act, as many believe the migration of illegal immigrants is a threat to national security.

Both the House and Senate versions of pending legislation contain requirements for expansion or creation of a system similar to the Basic Pilot Employment Verification Program. The Basic Pilot program is currently used by approximately 4,800 employers to verify social security numbers and work authorization through the internet.

With over eight million employers, large and small, any verification system must accommodate requests from one to hundreds of verifications in a single submission. The current Basic Pilot program would not accommodate such a large influx of requests, but could serve as a model for what the ultimate service levels and processing should accomplish.

As with most new government regulations, a large part of the burden will likely fall on individual employers in the private sector. Much like other payroll compliance, employers will have to train and provide the workforce to comply with the verification

requirements, maintain systems to interface with the data base, etc. It will also fall on employers to assure they are in compliance to avoid whatever enforcement penalties are created.

The current Basic Pilot requires the applicant and employer to follow-up and resolve any "tentative" non-confirmations within eight days if they feel the person is actually eligible for employment. This requires contacting either the Social Security Administration or Department of Homeland Security, and this could be another area where employers are required to use their resources.

By tightening up the employment process, many think illegal immigration will decline as there will be no need to apply for work if you know you will be declined.

In a recent address to the American Payroll Association, Homeland Security officials outlined other steps they would like to implement to curtail illegal immigration. Among the other steps would be 1) biometric identification cards for legal immigrants, 2) elimination of easily counterfeited local identification cards, 3) interface to multiple data bases to allow real-time status checks and reduce errors, 4) link verification and sponsorship and 5) use verification patterns to audit for identity fraud and employer abuses.

Homeland Security feels to meet the above steps, Congress would have to also act on limiting the documents accepted for employment, increase penalties on employers for non-compliance, involve other agencies such as Social Security, and generally support the audit and enforcement work necessary to curb fraud.

It appears with immigration such a hot topic, some legislation will pass and employers will be brought into the solution mix. However, the process might be a gradual one as all the processes are developed and procedures defined.

Over the last few months, President Bush has signed several new laws that have an impact in the payroll/benefit area. We could also still see further legislation impacting these areas as the budget process continues for the new fiscal year beginning October 1, 2006.

Deficit Reduction Act

Signed into law on February 8, 2006, the Deficit Reduction Act's largest impact relates to the increased limit on garnishment amounts for student loan repayments. The limit for any pay period garnishment to repay a federal student loan has been increased from 10% to 15% of disposable pay. These new limits are effective July 1, 2006.

The Act also requires all states to look to either parent, or both parents, to provide health insurance for their child under child support orders issued or amended after February 8, 2006, and impacts approximately half the states not currently following the new rules.

Effective October 1, 2007, the Act requires states to adjust child support orders for families on welfare at least every three years, either by full review, cost-of-living adjustment, or automated adjustments.

Tax Increase Prevention & Reconciliation Act

Signed into law on May 17, 2006, the Tax Increase Prevention and Reconciliation Act contained many provisions that were reported in the media, such as continuation of reduced capital gain and dividend tax rates, and indexed alternative minimum tax exemption amounts.

Earlier versions of this legislation contained several provisions to extend expired or expiring items most observers thought would be extended. The Work Opportunity Tax Credit and the Welfare to Work Tax Credit for employers was not extended beyond December 31, 2005. Likewise, Archer Medical Savings Account contributions were not extended beyond December 31, 2005, and the Saver's Tax Credit is still set to expire December 31, 2006.

Of importance to payroll and benefit professionals is the elimination of income limitations on conversion from a traditional IRA to a Roth IRA. Effective January 1, 2010, taxpayers may convert their traditional IRA accounts to a Roth IRA account regardless of the adjusted gross income level.

For payroll processors with employees in foreign countries, effective January 1, 2006, the foreign earned income exclusion will be adjusted for inflation. For 2006, the exclusion is \$82,400. There are also changes in the base housing and foreign housing exclusion calculations for U.S. citizens working and living abroad.

Heroes Earned Retirement Opportunities Act

On May 29 the President signed the Heroes Act impacting members of the Armed Forces serving in a combat zone. Under the new provisions, qualified military personnel can contribute to an IRA even if their compensation base is excluded from gross income. Effective retroactively to January 1, 2004, impacted persons have until May 29, 2009, to make contributions for prior years.

For more information on any of these new provisions, go to the IRS website, www.irs.gov.

This year National Payroll Week will be observed September 4-8, 2006, with the continuing theme "America Works Because We're Working for America."

Of special emphasis this year will be the new "Money Matters" National Education Day on September 8, 2006. Business and payroll professionals have set aside this day to teach teenagers about payroll checks. Plans are to take the message to schools and youth groups across America in easy to present one-hour sessions.

Other activities during the week will recognize the tremendous contribution of payroll professionals to the core of our life-style. Through payroll, most taxes are collected, insurance premiums paid, retirement plans funded, and money for our everyday existence distributed to the individuals that spend and drive our economy. This is all accomplished with constantly changing federal and state laws, company procedures, plan changes, etc., while maintaining a phenomenal accuracy rate.

If you or your company would like to volunteer to help take the message to the youth on Education Day, or sponsor or host other activities, go to nationalpayrollweek.com for more information on supporting this important initiative.

The Trustees of the Social Security Trust Fund have issued their annual report on the financial condition of the Social Security program. Based on current law, the projections are both long and short-term estimates of the trends and are not actual amounts that will be calculated each year.

Projecting the next ten years, it is estimated the wage base for 2007 will be \$98,400, \$116,100 in 2011, and increase to \$136,500 in 2015.

The Trust Fund encompasses both the Old Age and Survivors Fund and the Disability Insurance Fund. It is projected that financing will be adequate for the next ten years, but it is anticipated tax revenues will fall below benefit cost in 2017, the same as estimated last year. Full benefits will still be payable through 2040 when considering tax revenues, interest earnings and asset liquidations, one year earlier than last years projection.

After 2040, current tax rates will generate only enough revenue to pay 74% of scheduled benefits, reducing to 70% by 2080.

For 2005, Trust Fund income was \$702 billion, up \$44 billion over the prior year, paid by 159 million people with covered earnings. Expenses to administer the program were only 1% of total expenditures, very low for any program and contrary to what many would expect from a government program.

The complete report is available on the web site www.socialsecurity.com