

Payroll Trends

4th Quarter 2006

Year-End Planning

Once again, it is time to begin preparing for payroll year-end activities. Bring affected parties together, both within and outside the organization and reach agreement on schedules, deadlines, etc. Have employees review social security numbers and names to make sure they match exactly to their social security cards. Balance bank accounts, reissue outstanding payroll checks, and enter adjustments early. In other words, do not wait until the last minute and make your year-end as smooth as possible.

As a professional resource in this area, contact us for information on the services, or additional services, we can provide to regularly help with your needs.

Lock-In Letters

In lieu of having employers provide copies of questionable W-4s, the IRS uses other means to identify underwithholding situations and request W-4s from employers only for those cases. The IRS may then notify the employer to withhold tax based on the effective date and exemption allowances stated in the "lock-in" letter. It is very important that employers comply with the letters and instructions furnished in the letters to avoid penalties.

Disaster Leave Sharing

The IRS has issued Notice 2006-59 (go to www.irs.gov) clarifying plans that allow employees to deposit leave in employer sponsored leave banks for use by other employees impacted by major disasters. A leave donor does not recognize income on the leave as long as the written plan treats the recipient of the leave as having received wages.

Separation Payments

The U.S. Court of Federal Claims has now reversed itself on a 2002 case and considers separation payments when a choice is offered are compensation subject to employment taxes. Where the employee was given the choice of separating, transferring or remaining in an employment capacity, the payments do not qualify as supplemental unemployment benefits (SUB) according to the Court, and are thus taxable. Payments made to employees that are clearly discharged involuntarily would probably qualify as SUB payments per the Court.

Tip Offsets

The Department of Labor (DOL) has clarified that restaurants may not deduct uniform and cleaning expenses from the tips and wages of tipped employees, even if a signed agreement exists authorizing it. In Wage and Hour Opinion Letter FLSA 2006-21, DOL stressed this was a cost of doing business for the employer and could not be passed on to the employee, when doing so brings pay below minimum wage.

Supplemental Wages

The IRS has issued final regulations effective January 1, 2007, on supplemental wages. The final regulations provide that supplemental wages are wages not classified as "regular wages", i.e., those paid at a regular hourly rate or predetermined fixed amount. Thus, commissions, tips and bonuses are supplemental wages. The final regs, however, allow for tips and overtime pay to be treated as regular wages, and such treatment does not have to be uniform for all employees. Go to www.dol.gov for more information.

Immigration

Mid-term election year rhetoric, security, and other concerns have kept immigration at the forefront of issues being debated throughout the country. As with most issues, employers tend to often be the gate keepers as solutions are proposed and action is taken.

Some of the more recent items of interest to employers in this area are highlighted here. Look for much more debate and possible action required by employers.

Partnership Proposed

The Immigration and Customs Enforcement (ICE) division of the Department of Homeland Security (DHS) has announced an initiative call the ICE Mutual Agreement between Government and Employers (IMAGE) program. The program, designed for targeted industries, is intended to strengthen employer practices and reduce unlawful hiring of illegal aliens through training and due diligence of employers.

Increased criminal prosecution of employers has led to a mutual need to avoid illegal employment by both sides of the issue. Employers would be required to submit to Form I-9 audits and institute the following:

- Utilize the Basic Pilot program verification for all new hires.
- Establish internal training programs to assure document compliance.
- Limit work in the I-9 area only to those trained in compliance.
- Submit to I-9 audits by neutral third parties.

- Self-report deficiencies to ICE.
- Establish procedures to handle no-match letters from Social Security.
- Create a tip-line for employees to report violations.
- Avoid unlawful discrimination.
- Assure sub-contractors and contractors also adhere.
- Provide annual reports to ICE.

In exchange for meeting these requirements, ICE would agree to the following:

- Provide compliance training.
- Keep employers notified of the latest ways legal hiring is being circumvented.
- Review partner practices and work with them to correct issues.

It is anticipated this proposal will not only improve hiring practices, but also reduce identity theft.

No-Match Letters

DHS has proposed a rule requiring employers to follow specific steps in responding to no-match letters from Social Security Administration (SSA) when names or Social Security numbers do not agree with the SSA database. The original intent of the letters was to allow Social Security wages to be properly posted to employee records.

The DHS proposal provides safe harbors employers would be required to follow to avoid violating immigration laws. Clerical errors would have to be corrected within 14 days of receipt of the letter, with notice provided to DHS and SSA that the record now matches, etc.

If there is no clerical error, the employee would have to be notified, within the same 14 days, to verify the records and notify the employer for correction, or the employee would have to contact the appropriate agencies to resolve the problem if the information matches their records.

If the problem is not resolved within 60 days, a new I-9 would have to be completed as if the employee was a new hire, but could not use any documents with the "incorrect" information. If the new I-9 cannot be completed, the employer must choose to terminate the employee or risk legal action from DHS.

Employer groups, labor groups and immigration advocates have all strongly opposed the new proposal. With confusion over the spelling of foreign names and the short time to resolve issues, one fear is these procedures could lead to discrimination in hiring of these mostly low-wage workers, itself a violation of other federal laws. Additional information on these and other ICE procedures may be found at www.dhs.gov.

Minimum Wages

In 2006, ten states have enacted laws with minimum wages in excess of the federal minimum wage. This makes 23 states and the District of Columbia that now have a higher minimum wage than the federal amount.

On November 7, six additional states have measures on their ballots to increase the minimum wage above the federal and provide automatic inflation adjustments in the future.

If half of the six ballot initiatives are passed in November, for the first time in history a majority of states will have a minimum wage higher than the federal government.

To put this in perspective, at the federal minimum of \$5.15 per hour, the annual wage is \$10,712, while at the \$6.85 minimum contained in many of the state laws, the annual wage is \$14,248.

Advocates for raising the minimum point to the eroding of the wage due to inflation since the last federal increase, while opponents contend that jobs will be lost and business will be hurt from increased labor cost.

Whether you are pro or con on the issue, this is one area where federal lawmakers have conceded the issue to state lawmakers or voters, with the result being a multitude of different laws for multi-state employers.

Pensions

The President signed into law the Pension Protection Act (PPA) on August 17, 2006. The new law covers many pension areas of overall interest, such as defined benefit plan funding, solvency of the Pension Benefit Guaranty Corporation (PBGC), new cash benefit plans and benefit accrual.

The new law was in response to the much publicized termination of large corporate plans, underfunding of plans and the impact of these plan problems on the PBGC. Even though spurred by negative employer actions, the new law has some favorable provisions for employers and employees.

Automatic 401(k) Enrollment

Effective with January 1, 2008, plan years, automatic enrollment and contribution provisions must be included in 401(k) plans to help increase plan participation.

Automatic elective contributions of at least 3% of compensation will be required for the first year of employee participation, 4% for the second year, 5% in the third year and 6% for subsequent years. Qualified plans can voluntarily increase these percentages up to 10%.

Employers must make matching contributions of 100% of the the first 1% of automatic contributions, plus 50% of automatic contributions up to 6% of compensation.

Automatically enrolled employees will have up to 90 days to withdraw from the plan, being refunded their contributions and earnings without penalty. The PPA preempts state laws that may govern automatic 401(k) plan arrangements.

Permanent Provisions

Increases in employee deferral amounts, catch-up contributions for employees age 50 and over, and Roth IRA provisions that were set to expire at the end of 2010 have been made permanent by the PPA. In addition, the new law indexes for inflation income limits for deductible contributions to employer-sponsored plans and income limits for Roth IRA contributions.

Other Provisions

Other provisions of the PPA that also impact employers and their employees include the following:

- Beginning January 1, 2007, individual income tax refunds can be directed for deposit to an IRA account of the taxpayer .
- Plan administrators must provide quarterly benefit statements to participants and beneficiaries who direct their investment accounts, and annual statements to those that do not have the right to direct investments.
- Qualified plans must allow employees to invest in securities other than the employer's for after-tax contributions, and for employer contributions after three years participation by the employee.
- Beginning in 2008, qualified plan rollovers can be made to Roth IRAs. In 2007, non-spouse beneficiaries will have the same right as a spouse to roll distributions.
- The "savers credit" of up to \$2,000 against income taxes is made permanent for low-income persons participating in retirement plans.

- There will be significant penalties for employers that fund deferred-compensation plans for their top five officers while their employee plan is underfunded, during bankruptcy or near the time of plan termination.

Tips

The Internal Revenue Service has issued a new tip reporting procedure for the food and beverage industry effective January 1, 2007. The Attributed Tip Income Program (ATIP) offers benefits to both employers and employees similar to those under previous tip reporting arrangements first introduced in 1993.

The ATIP is an additional voluntary option for qualified employers to reduce record keeping requirements and promote better reporting of tips received in the industry. The program is an initial three-year pilot that may be elected on a year-to-year basis.

Although participation in ATIP must be made for each establishment of an employer, election does not require meeting with the IRS to sign an agreement. Election is made by checking a box on Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips.

Employers who participate in ATIP report tip income of employees based on a formula that uses a percentage of gross receipts determined from charged tips and allocated to employees based on practices of the restaurant.

Employer benefits include:

- 1) The IRS will not initiate an "employer-only" tip audit during the period the employer participates in ATIP.
- 2) Tip reporting is simplified and in many cases employers will not have to receive and process tip records from participating employees.
- 3) Enrollment is simple, does not require meetings with the IRS or signing of any agreements, merely requiring a check the box declaration.

Benefits to employees participating in ATIP include:

- 1) No daily tip logs or other tip records required to be maintained.
- 2) The IRS will not initiate a tip examination for the period the employer and employee participate in ATIP.
- 3) The new reporting procedures should make documenting wages for loans and other purposes simpler.

If the employer is participating, employees can participate by signing an agreement with the employer to have tip income calculated under ATIP and reported as wages for tax reporting purposes.

General requirements for employer participation require annual election on Form 8027. For smaller employers not required to file Form 8027, even simpler filing is provided. Each eligible establishment must have at least 20% of gross receipts as charged receipts with tips in order to establish the basis to allocate tips under the program, which will be the charged tip rate minus 2% to allow for lower cash tip amounts.

At least 75% of tipped employees for each establishment must also agree to participate in the program and this participation rate must be reasonably met throughout the year. Form 8027 or other filing requirements must reflect information that substantiates each establishment is qualified for the program.

Additional information can be secured from Revenue Procedure 2006-30 at www.irs.gov.