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The Clock Is Ticking and Year-End Is Coming

Tips for Year-End Success

By Wendy Seyfert, Vice President of Agency Relations at ADP

Albert Einstein once said, "The hardest thing in the world to understand is the income tax." Add the specialized field of employment tax and the year-end 2014 environment into the mix and know that it's okay to be confused.

Employment tax is complicated, and navigating the obstacles of it—especially at year-end—can be overwhelming. For 2014, there are 10 key tips to ensure year-end is as successful as possible. In addition, it's important to understand the new state requirements to avoid penalties and be familiar with important federal changes. This includes changes to W-2s, the new third-party sick pay form, new truncated taxpayer identification number requirements, annual contribution limits, the benefit cost ratio add-on, and year-end filing forms related to the Affordable Care Act.

10 Tips for a Successful Year-End

1. Check Social Security number accuracy – All employees must have a valid Social Security Number (SSN) and name format when employers file tax forms. Invalid information may result in rejected filings and the possibility of associated penalties. One way to avoid this problem is to use the Social Security Administration's (SSA) Social Security Number Verification System with every new hire to ensure the SSN matches the name of each employee.

2. Compare unemployment insurance wages to Federal Unemployment Tax Act (FUTA) wages – With all the moving parts in FUTA, it's even more important to ensure employers don't lose any tentative credit because of taxable wage problems between unemployment insurance and FUTA wages.

3. Double-check key filing criteria – It is imperative that an employer's basic profile information is correct regarding the Jurisdiction Identification Number (JIN) and the Federal Identification Number (FEIN). Don't forget to use the right experience rate and pay at the correct payment frequency and with the right disbursement type. For e-filing, any inaccuracies could mean an automatic notice or penalty status.

4. Keep notices from escalating – Even the most diligent employers can get notices. Employers must always request a hold on the account if a notice is received. Don't wait for the issue to escalate to a collection, lien, or levy situation. For notices from the SSA, check with Business Services Online to get a glimpse of what might be wrong and request an Employer Report Query (ERQY) to help identify the issue. For Form 941 notices, self-identify issues through the Payer/Agent list, submit requested information on company letterhead and fax it to 877-477-0572. The Internal Revenue Service (IRS) will be in contact if further information is needed.

5. Help employees with their notices – Provide all copies of corrected Forms W-2 or 1099 to your employees with a detailed statement of what corrective actions were taken and when. In addition, advise employees to have a hold placed on their account while they determine the cause of discrepancies.

6. Review the figures within returns – Watch for negatives in data fields that shouldn't have them and make sure tax fields are not higher than wages. Common causes for discrepancies within Form 941 include negative figures for Federal Income Tax (FIT), Federal Insurance Contributions Act Tax (FICA), Medicare, or Third Party Sick Pay (3PSP), positive Earned Income Credit (EIC), or if Medicare wages are less than Social Security wages.

7. Balance quarterly to annual figures – Whether it's Form 941 and Form W-2s, or any other quarter and annual return, ensure that totals for the year add up to what was reported each quarter.

8. Use valid account numbers – Agencies don't have as much tolerance for "applied for" compared to previous years due to more efficient automated systems. A valid identification number on filings aids agencies with posting and helps eliminate rejects, notices, and penalties.

9. File amendments immediately – Amendments for prior quarter-periods of the filing year should be completed, before reconciling the annual payroll tax year, to ensure the annual return is in balance and to prevent the possibility of discrep-

ancy notices and penalties.

10. Resolve discrepancy or billing notices immediately – Timely resolution of agency notices for prior periods within the payroll tax year may help prevent discrepancies with the annual tax.

Federal Form Changes: W-2 and W-3

For W-2 and W-3 forms, there aren't any significant changes this year, just some box title changes (see below box). Barcodes continue to be optional and the IRS is still considering separate reporting of additional Medicare tax and varying due dates still apply. There is a federal budget proposal that includes accelerating filing due dates to prevent refund fraud. That hasn't passed yet, but has been proposed for several years in a row and is gaining momentum.

Forms W-3 and W-3c box title changes	
2013	**2014 & 2015**
Contact name	Employer's contact person
Telephone #	Employer's telephone #
E-mail address	Employer's e-mail address
Fax number	Employer's fax number

The e-mail address requirement will not be enforced for electronic filings in 2014 because implementation of the requirement is delayed and it may be permanently optional due to the difficulty to enforce employers to provide the information. The reason for the employer address inclusion requirement is that it would allow the SSA to notify employers that there was a failure with the employer copy of the W-2 filing.

In regard to the SSA acceptance of W-2s, the SSA will "return" W-2 forms if:

» Medicare wages and tips are less than the sum of Social Security wages and tips.

» Social Security tax is greater than zero and Social Security wages and tips equal zero.

» Medicare tax is greater than zero and Medicare wages and tips equal zero.

» Social Security wages and Social Security tips are less than the yearly minimum for household employers, which is $1,900.

» Medicare wages and tips are less than the yearly minimum for household employers, which is $1,900.

Those forms that are returned must be resubmitted by the employer with corrected errors. SSA is monitoring the wage report more closely for invalid conditions as part of its overall system redesign. Find details on what is incorrect through Accuwage, which is available through the SSA's Business Services Online.

For 2014 and beyond, the SSA has updated the algorithms it uses to determine whether a submission is a duplicate of a previous submission. A more detailed analysis will be used, including hash totals for dollar item entries, which will ultimately result in fewer submissions being wrongly rejected. Currently, the false duplicate rate is too high, and the SSA would prefer to accept more data because of its long-term impact on benefit payments. The downside with accepting more is that this could create more out of balance conditions that are actually duplicates, which means more notices.

Federal Form Changes: Third-Party Sick Pay (3PSP)

There is a new form this year-end for 3PSP—Form 8922. This form replaces the recap W-2 that was previously used and will go directly to the IRS. Either the insurance company or the employer needs to file this—whichever one needs to reconcile withholding against their Forms 941.

The items to report for Form 8922 include sick pay subject to federal income tax and tax withheld, sick pay subject to Social Security tax and tax withheld, and sick pay subject to Medicare tax wages and tax withheld. The draft of Form 8922 can be found here.

Federal Form Changes: Truncated Taxpayer Identification Numbers (TTIN)

The IRS released final regulations regarding TINs in July 2014. What started as a pilot program for Form 1099 payee statement in 2009 is now allowed on recipient statements. Remember not to truncate on the agency copy.

These new truncation rules apply to Social Security Numbers (SSNs), Taxpayer Identification Numbers (TINs), Adoption Taxpayer Identification Numbers (ATINs), and Employer Identification Numbers (EINs).

When truncating a TIN, only display the last 4 digits, for example: [XXX-XX-1234 or ***-**-1234].

The TTIN is allowed only on the payee's copies of an electronic or paper form. A payer may not truncate his or her own TTIN. Lastly, truncation is not allowed on the employee or employer copies of the W-2 or W-3.

Due dates for 2014 forms are as follows:

» Payee Copies B, C, and 2 are due on Feb. 2, 2015

- Copy A filed on paper is due on March 2, 2015
- Copy A filed electronically is due on March 31, 2015

Find 2014 forms below:

- Form 1096
- Form 1099-MISC
- Form 1099-R

The Next ACA Implementation Phase

Employers need to have a strategy in place by the time open enrollment begins for the 2015 plan year. Starting Jan. 1, 2015, if an employer has 50 or more full-time employees—employees that work 30 or more hours per week—and full-time equivalent employees, employers must offer affordable, minimum essential coverage of minimum value, or employers will potentially be subject to tax penalties.

Tax penalties will only be issued to employers by the IRS if an employee goes to an exchange and is found eligible for a premium tax credit. Penalties will not be imposed in 2015 on employers with 50-99 full-time employees and full-time equivalent employees as long as those employers do not restructure their workforce or change their health coverage in 2014-2015, or for non-calendar year plans.

For employers with 100 or more full-time employees and full-time equivalent employees, transition relief applies for 2015 (and months in 2016 in the 2015 plan year) under which the employer will not be assessed the penalty if it offers coverage to at least 70 percent of its full-time employees. In 2016 that number will increase to 95 percent and will eventually apply to those employers with 50-99 employees.

There are some optional forms to begin filing this year to start testing an employer's system in preparation for 2015. Note that these forms are not mandated until tax year 2015 is due in 2016. Draft Forms 1094-C and 1095-C can be found along with other important ACA information here.

2015 Annual Contribution Limits

The 2015 contribution limits will be posted soon for qualified pension plan contributions, federal withholding allowance amounts, adoption assistance limits, qualified transportation limits, and standard mileage rates. Use the following resources to monitor limit information as they are released later this year:

- e-News for payroll professionals – federal payroll tax returns
- Retirement news for employers – retirement plan information
- e-News for small business – IRS products and programs for small businesses or self-employed
- e-File News for large businesses – IRS products and programs for large & mid-size corporations
- Primary site for IRS subscriptions – locate all subscriptions

See below chart for Health Savings Account (HAS) limit changes:

	Coverage	**2014**	**2015**
Contributions	Self only Family	$3,300 $6,550	**$3,350** **$6,650**
High Deductible:	Self only	$1,250	**$1,300**
Annual Deductible	Family	$2,500	**$2,600**
High Deductible: Out-of Pocket	Self only Family	$6,350 $12,700	**$6,450** **$12,900**

Federal Unemployment Tax Act (FUTA) Credit Reduction

It is important to understand the status of FUTA credit reduction in your state. A FUTA credit reduction may occur when a state takes federal loans to help fund unemployment payments to claimants and the loan was not repaid within two years. This is a reduction of the allowable 5.4 percent tentative credit that employers can take on the tax due, and is a result of a state taking a federal loan to meet its unemployment obligations.

States have two years to repay the loan, and if they are unable to repay the loan or meet credit reduction avoidance criteria by Nov. 10 of the year the loan is due, the state may become a credit reduction state.

The Department of Labor mandates credit reduction states in a joint effort with the Department of the Treasury and IRS after the Nov. 10 deadline. For 2014, the standard FUTA calculation is the 6 percent FUTA rate minus the allowable 5.4 percent tentative credit which equals the 0.6 percent final FUTA rate.

However, for those states with outstanding loans beyond the two years, the credit reduction "chips away" at that allowable 5.4 percent credit, with a little more being reduced each year.

You can find the most up-to-date information and the status of each state here.

Federal Unemployment Tax Act (FUTA) Tentative Credit

The tentative credit is different than the FUTA credit reduction, but could affect an employer's FUTA tax rate every year. The Department of Labor ideally would issue a tentative 5.4 percent credit for timely unemployment insurance tax payments to the states throughout the year, giving employers an adjusted FUTA rate of 0.6 percent. Every year, this is reported on Form 940 and the allowance of the credit is subject to review by the IRS.

Not every employer is eligible to receive this 5.4 percent credit. If an employer is late with a quarterly payment to its unemployment insurance tax agency, if the payment goes completely missing, or if the employer is located in a state where certain wages may not be subject to state taxation but are subject to federal taxation, then those wages in those scenarios make an employer ineligible for the 5.4 percent credit.

Benefit Cost Ratio (BCR)

States with outstanding federal loans are at risk for their employers to have a BCR add-on tax. To avoid the BCR add-on, states must have paid-off loans or requested a waiver from the Department of Labor before July 1, 2014. States also had to meet the requirement that there not be a "net decrease in solvency" in the state unemployment insurance trust fund between Oct. 1, 2013, and Sept. 30, 2014.

There are five states that have not submitted waivers and are unlikely to pay off their loans by the due date. Those states are Arkansas, Connecticut, Delaware, Georgia, and New Jersey. None of this will be solidified until as after Nov. 10, watch closely and be prepared.

Monthly Wage Reporting

It's important to be aware of legislation pending in New Jersey. Last year, Illinois mandated new monthly wage reporting in order to help the state with Medicare fraud. New Jersey has similar legislation introduced that would require monthly wage reporting. If it passes, New Jersey would be the second state to enact monthly wage reporting and more states could follow. ■

About ADP

With more than $12 billion in revenues and 65 years of experience, ADP® (Nasdaq: ADP) serves approximately 637,000 clients in more than 125 countries. As one of the world's largest providers of business outsourcing and Human Capital Management solutions, ADP offers a wide range of human resource, payroll, talent management, tax and benefits administration solutions from a single source, and helps clients comply with regulatory and legislative changes, such as the Affordable Care Act (ACA). ADP's easy-to-use solutions for employers provide superior value to companies of all types and sizes. ADP is also a leading provider of integrated computing solutions to auto, truck, motorcycle, marine, recreational vehicle, and heavy equipment dealers throughout the world. For more information about ADP, visit the company's Web site at www.ADP.com.

About Wendy Seyfert

A 23-year veteran at Automatic Data Processing, (ADP), Wendy Seyfert has worked to strengthen the ties between the organization and various government agencies. As the vice president of agency relations in ADP Added Value Services (AVS), Seyfert leads a team of 35 associates who service more than 500,000 employers who use ADP's tax filing and depositing service in thousands of jurisdictions.

Seyfert has spent most of her career at ADP, with 20 years in agency relations ensuring compliance for tax jurisdictions, child support, and garnishment payment processing, new hire reporting, and benefits claim processing products. When she first started at ADP, Seyfert was a supervisor who assisted in all profile set-ups for 30,000 new clients per year and 500,000 corresponding changes. She then moved on to become an agency relations manager who successfully led a Y2K project implementation for all federal, state, and local agency processes. Before taking on her current position, Seyfert was an agency relations director and oversaw negotiations of $2.1 million in penalty removal from tax agencies.

Now, as the vice president of agency relations, she leads multiple departments that negotiate and interact with thousands of state and local government agencies to determine ADP compliances.

Seyfert is currently an active member and Certified Payroll Professional (CPP) with the American Payroll Association (APA

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Preparing for 2015 Employment Tax Compliance

While payroll tax law changes will be minimal in the coming year, some companies may see substantial hikes in their tax rates

By Jaclyn Jaeger

As companies begin planning for tax compliance in the coming year, they are finding 2015 to be a mixed bag. The good news is that payroll and other tax law changes are minimal; the bad news is that some companies may see hikes in their tax rates.

"Thankfully, this year is a relatively quiet one in terms of tax law changes," says Adam Lambert, managing director and national leader for Grant Thornton's employment tax services practice. That means now is an ideal time for payroll and tax departments to go back and take a look at any improvements they may want to make—such as ensuring new benefits they provide to employees are captured appropriately, or that all employees' taxpayer ID numbers are up-to-date—so that they can feel more confident about their employment tax filing process going into 2015, he says.

For tax law changes that are on the horizon, however, companies will need to be properly prepared. Some are in for a rude awakening.

Employers in certain states, for example, may soon be assessed more than five times the amount of federal unemployment tax than normally would apply if those states did not have a Federal Unemployment Tax Act (FUTA) credit reduction. FUTA is an employment tax imposed on employers used to fund the federal unemployment trust fund reserve.

For employers in credit reduction states, 2014 marks the first year for which a new FUTA cost—the Benefit Cost Rate (BCR) add on—will be imposed. States potentially losing credit include California, Connecticut, Delaware, Indiana, Kentucky, Ohio, North Carolina, New York, and the Virgin Islands.

BCR add-on potentially applies to employers in those states that have had an outstanding loan balance from the federal unemployment trust fund reserve of at least five consecutive years (as of Jan. 1, 2015), that still have a balance as of Nov. 10, 2014, and that did not successfully apply with the Department of Labor for relief from a BCR add-on prior to July 1, 2014.

"Several states submitted waivers, and some states are still trying to pay off their loan amount entirely by Nov. 10," Wendy Seyfert, vice president of agency relations at payroll solutions provider ADP, explained during a recent Compliance Week Webcast.

"From a practical standpoint, this means that employers in certain states will see higher effective FUTA tax rates and associated taxes for 2014, as states continue to struggle with low state unemployment reserves and their loan repayments," Scott Schapiro, principal at KPMG, says.

"As of this point, it is anticipated that no more than 10 states will have a 2014 FUTA credit reduction, though that number may change," Schapiro says.

The specific states requiring employers to reduce their credit and the amount of credit reduction will not be known for certain, however, until the Labor Department makes a final determination after the loan payoff deadline of Nov. 10. Employers will be required to note those states and the appropriate credit reduction using Schedule A (Form 940) for 2014.

> "A well-trained and connected employment tax department can effectively facilitate compliance and reduce overall corporate risk and maintain employee confidence."
>
> Scott Schapiro, Principal, KPMG

The only exception is Connecticut, which is the only state that has had a loan balance for at least five years and opted not to submit a waiver request. Instead, it will impose on all employers a .5 percent FUTA tax increase for 2014.

Form W-2 Changes

Some companies may also have some work to do on cleansing up data on employee records. Beginning with electronic W-2 and W-2C forms filed for tax year 2014, the Social Security Administration (SSA) will no longer accept forms with invalid employer identification codes. Traditionally, the SSA would make some attempt to correct invalid employer identification codes—but that's all about to change. "If you have an overall invalid record format, the entire file will be rejected and will need to be resubmitted once the errors are corrected," Seyfert said.

Employers will want to make sure that they use the SSA's Accuwage software, which is a free tool that allows employers to submit test files to check for any invalid employer identification codes before submitting final returns to the SSA. "If you aren't using Accuwage already to check the format of your file, you may want to start," Seyfert advised.

For companies that are outsourcing employment tax reporting, they "need to ensure they're not becoming too complacent," Debby Salam, director of payroll information management services for Ernst & Young, says. They need to make sure that their vendors are using Accuwage, and then further check the test results before filing a final return.

Proactive Measures

Overall, employers should periodically review and refresh their employment tax knowledge base and internal processes and procedures, Schapiro advises. "Even in the

event of a partial or total outsourcing of payroll tax processing, the company retains the overall responsibility for understanding, implementing, and maintaining federal, state, and local employment tax laws and regulations," he says.

Keeping on top of any changes that may occur is vital. Employment tax professionals should have access to reliable news sources, and monitor them regularly, Salam advises.

"The best advice I can offer employers is to get ahead of things as much as possible as they approach year-end, so that they're not in a position where they need to do a lot of adjustments to their Form W-2s or Form 941s come January," Lambert says. Don't make the mistake of getting year-end changes to the payroll department until the last minute, leaving people scrambling, he says.

Schapiro recommends that employers review such items as the company's geographic footprint; the taxability of fringe benefits and deferred compensation treatment; information flow between internal departments; and even the depth of the employer's relationship with its outside vendors. This enables employers to get a full picture of its employment tax responsibilities and help resolve identified issues before they turn into year-end concerns, he says.

"The best advice I can offer employers is to get ahead of things as much as possible as they approach year-end, so that they're not in a position where they need to do a lot of adjustments."

Adam Lambert, National Leader, Employment Tax Services Practice, Grant Thornton

"The ultimate responsibility for employment tax compliance always falls on the employer's shoulders," Schapiro adds. "A well-trained and connected employment tax department can effectively facilitate compliance and reduce overall corporate risk and maintain employee confidence."

Concludes Schapiro: Providing employees with effective tools to remain compliant—generally some mix of formal training, legislative update materials, and professional guidance on the combined tax, benefit, and legislative issues—can help improve and maintain compliance. ■

FUTA CREDIT REDUCTION

Below is an explanation of a credit reduction state and how it affects employment tax.

A state is a credit reduction state if it has taken loans from the federal government to meet its state unemployment benefits liabilities and has not repaid the loans within the allowable time frame. A reduction in the usual credit against the full FUTA tax rate means that employers paying wages subject to UI tax in those states will owe a greater amount of tax.

The FUTA tax levies a federal tax on employers covered by a state's UI program. The standard FUTA tax rate is 6.0% on the first $7,000 of wages subject to FUTA. The funds from the FUTA tax create the Federal Unemployment Trust Fund, administered by the United States Department of Labor (DoL).

Generally, employers may receive a credit of 5.4% when they file their Form 940 (PDF), Employer's Annual Federal Unemployment (FUTA) Tax Return, to result in a net FUTA tax rate of 0.6% (6.0% - 5.4% = 0.6%).

Some states take Federal Unemployment Trust Fund loans from the federal government if they lack the funds to pay UI benefits for residents of their states.

If a state has outstanding loan balances on January 1 for two consecutive years, and does not repay the full amount of its loans by November 10 of the second year, the FUTA credit rate for employers in that state will be reduced until the loan is repaid.

The reduction schedule is 0.3% for the first year the state is a credit reduction state, another 0.3% for the second year, and an additional 0.3% for each year thereafter that the state has not repaid its loan in full. Additional offset credit reductions may apply to a state beginning with the third and fifth taxable years if a loan balance is still outstanding and certain criteria are not met.

DoL runs the loan program and announces any credit reduction states after the November 10 deadline each year. DoL has information about the credit reduction states and loan balances on the UI Statistics page of its Department of Labor Website.

How does the credit reduction affect employment taxes?

The result of being an employer in a credit reduction state is a higher tax due on the Form 940.

For example, an employer in a state with a credit reduction of 0.3% would compute its FUTA tax by reducing the 6.0% FUTA tax rate by a FUTA credit of only 5.1% (the standard 5.4% credit minus the 0.3% credit reduction) for an effective FUTA tax rate of 0.9% for the year.

Any increased FUTA tax liability due to a credit reduction is considered incurred in the fourth quarter and is due by Jan. 31 of the following year.

Employers who think they may be in a credit reduction state should plan accordingly for the lower credit. The IRS includes the credit reduction states, the applicable credit reduction rates, and an example in the Schedule A (Form 940) (PDF), Multi-State Employer and Credit Reduction Information. The Instructions for Form 940 (PDF) also has information about the credit reduction and deposit rules.

Source: IRS.

Regulators Going After Worker Misclassification

Enactment of the Consolidated Appropriations Act gives Labor Dept. right to award $10.2 million in grant funding to states to improve enforcement of misclassification

By Jaclyn Jaeger

State and federal agencies are issuing a renewed warning to companies that regularly use independent contractors: classify them correctly, or face big penalties.

The push by regulators to enhance employee misclassification detection and enforcement began in 2011, when the Department of Labor and the Internal Revenue Service signed a "memorandum of understanding" in which they agreed to share information to reduce incidents of worker misclassification. The initiative picked up steam this year, however, with enactment of the Consolidated Appropriations Act, which authorized the Labor Department to award $10.2 million in grant funding to states to improve enforcement of misclassification.

The grants "will enhance states' ability to detect incidents of worker misclassification and protect the integrity of state unemployment insurance trust funds," U.S. Secretary of Labor Thomas Perez said in October in a prepared statement. The 19 states chosen to receive these grants will use the funds for a variety of initiatives, including enhancing employer audit programs and conducting employer education programs, the Labor Department said.

Perez

The federal government is also rewarding states that excel in detecting misclassification. Under the agency's "high-performance bonus" program, four states—Maryland, New Jersey, Texas, and Utah—will receive a combined $2 million in additional grants due to their high performance, or most improved performance, in detecting incidents of worker misclassification.

The increase in funds earmarked for detection likely means more audits are on the way. "I would expect to see increased enforcement at the state level, particularly with the state unemployment offices," Maggie Hanrahan, a shareholder with law firm Ogletree Deakins, says. "Those are the agencies that are really going to start to target this area."

Interagency Cooperation

In November, Alabama became the latest state to enter into a formal agreement with the Labor Department to share information regarding independent contractor misclassification. Other states have entered into similar agreements, including: California, Colorado, Connecticut, Illinois, Louisiana, Maryland, Massachusetts, New York, Washington, and others.

Another catalyst for increased scrutiny of worker classification is rules in the Affordable Care Act that require larger companies to provide health coverage to full-time workers. Under the ACA, beginning in 2015, companies with at least 100 full-time employees must provide suitable healthcare coverage to them. After 2015, employers with at least 50 full-time employees must provide such coverage.

> "The reality is if you have 100 independent contractors paid on average $100,000 annually, the financial risk could exceed $4.5 million."
>
> Dana Shaw, Chief Operating Officer, ICon Professional Services

Thus, if an employer fails to provide adequate healthcare coverage by misclassifying a full-time employee as an independent contractor, the employer could be subject to substantial penalties under the ACA.

The risk of a misclassification audit or any related penalties is especially high for industries that typically use more independent contractors—oil and gas, construction, transportation, and information technology companies, for example.

Employee misclassification litigation is also on the rise. Over the last couple of months, several federal and state courts have ruled against employers for improperly classifying large classes of workers as independent contractors rather than employees. The broader implication of those cases could cause a significant increase in similar employee misclassification class-action lawsuits, Hanrahan warns.

Vulnerabilities Persist

Despite the focus on worker classification that such cases have sparked, significant vulnerabilities among companies still persist. A recent survey conducted by ICon Professional Services, a provider of contingent workforce management solutions, finds a significant gap between the actual risk posed by companies that misclassify their independent contractor workforce and how companies perceive that risk.

According to the survey, 68 percent of senior-level executives say they're confident they would pass a worker misclassification audit. Of those audited, only 55 percent actually reported passing such an audit.

The survey further found that 57 percent of respondents said they have "great confidence" in accurately estimating the number of independent contractors engaged at any time. Another 24 percent expressed "some confidence." These findings indicate an increase in the likelihood of an audit uncovering working misclassification, the report stated.

Many also underestimate the cost of non-compliance. According to the survey, 77 percent of respondents believe their total financial risk exposure of failing a worker misclassification audit is below $100,000. "The reality is if you have

100 independent contractors paid on average $100,000 annually, the financial risk could exceed $4.5 million," says Dana Shaw, chief operating officer of ICon Professional Services.

Another problem is that the human resources department and senior executives are often kept in the dark about the company's true use of independent contractors. In the ICon survey, for example, only 57 percent of respondents reported that they have "great confidence" in knowing the exact number of independent contractors they are currently using.

The risk of an employee misclassification audit or enforcement action is only going to increase as independent contractors play an increasingly important role in the labor market. Eighty-four percent of respondents said they plan to maintain or increase their investment in independent contractors in 2015.

Avoiding an employee misclassification enforcement action requires that companies know how to properly assess and classify their independent contractors from the start. Although the IRS and the Department of Labor each use their own test to determine when a service provider qualifies as an employee or an independent contractor, a primary factor in their analysis comes down to the amount of control exercised over the service provider by the company.

> "In light of the current enforcement environment, companies are working to enhance the classification of their independent contractors, or deciding whether to reclassify contractors as employees."
>
> Maggie Hanrahan, Shareholder, Ogletree Deakins

An independent contractor, for example, typically controls the work schedule, as well as the manner, method, and means of how the work is done, Hanrahan explains. Additionally, they're typically high-skilled workers who do not require training or supervision. In comparison, employees work under a set schedule, receive direction on how to perform job duties, and require supervision and training, she says.

From a financial control standpoint, independent contractors are responsible for their own business-related expenses, and they are able to hire helpers or others to do the work in their place, Hanrahan says.

Proactive Measures

In light of the current enforcement environment, companies are working to enhance the classification of their independent contractors, or deciding whether to reclassify contractors as employees, Hanrahan says. They should also make sure that the services being performed are consistent with an independent contractor relationship, she says.

Many companies have a lot of independent contractors working side-by-side with their employees with no material differences other than the method of payment, Hanrahan adds. "When that's the case, reclassification might be the best option, and it's a good idea to consider a reclassification strategy now, and come up with an effective plan, before you get hit with an audit," she says.

Another way to reduce the risk of misclassification is to train managers, especially new hires, about the use of independent contractors and the best ways to classify them, advises Shaw.

Between the inevitable rise in employee misclassification audits from state agencies, the potential increase in class-action lawsuits, and the risk of related penalties under the ACA, companies cannot afford to ignore the importance of properly classifying their workforce if they want to avoid any potential legal and compliance risks. "Having your head in the sand is no longer an option," says Shaw. ■

2014 MISCLASSIFICATION GRANTS

The following states recently received misclassification grants from the Department of Labor.

State	Regular
California	$499,792
Delaware	$27,672
Florida	$31,792
Hawaii	$500,000
Idaho	$500,000
Indiana	$500,000
Maryland	$494,600
Massachusetts	$499,800
New Hampshire	$330,468
New Jersey	$342,222
New Mexico	$499,970
New York	$500,000
Oregon	$500,000
South Dakota	$500,000
Tennessee	$499,260
Texas	$500,000
Utah	$500,000
Vermont	$500,000
Wisconsin	$499,607
Totals	**$8,225,183**

Source: Department of Labor.

Centralized Payroll: From Myth to Reality

Advances in technology are helping companies streamline their payroll processing operations. They are looking to achieve better control and greater visability across markets

By Jaclyn Jaeger

Payroll processing is one of the most essential functions of a company, and yet if you ask any multinational how closely it is aligned with its payroll providers—across each and every jurisdiction where the company operates—you'll probably be met with the sound of crickets.

Traditionally, many companies have relied on an in-house delivery model to service their payroll operations; but as multinational companies continue to expand the size and scope of their operations, many today are using numerous payroll service providers, sourced and managed locally in various parts of the world, each with their own separate systems. Absent any sort of centralized payroll process, most companies have no real sense of whether the payroll systems or vendors they use are as compliant as they need to be.

Human resource and finance departments at corporate headquarters have "no real visibility into how payroll is being processed in any given market," Mary St. Cyr, a senior consultant with Towers Watson, says. This can also create a lot of costly tax and regulatory implications for the company, she says.

As multinational companies continue to expand into new and emerging markets, those risks increase exponentially, due to the lack of vendor governance, compliance, process standardization, and tax reporting obligations. "With individual local systems, the ability to manage the various relationships as well as bring all that data together into a single view is even more difficult," says Jon Ziglar, managing director of international solutions at human resource services provider Ceridian.

One of the main drivers for outsourcing payroll is to bring on a vendor, whose core focus is to stay abreast of the various tax reporting and compliance changes globally, taking that compliance obligation off the company itself. Payroll service providers, however, are only as compliant as the company for which it serves. The individuals who are feeding payroll materials to these vendors also need to understand tax reporting laws "to make sure anything they're doing is not creating a reporting requirement," says Carolyn Gould, a principal at PwC.

For example, if HR gives an employee a gift card—or some other type of so-called "benefit-in-kind"—payroll can't report what they don't know about. "In a lot of countries, that's a taxable event that needs to get reported in payroll as income that was provided to the employee," Gould says. "That's where we're finding most of the compliance issues."

Many companies are starting to address this problem by creating a cross-functional compliance group, with responsibility for keeping a master list of all potential benefits-in-kind that employees receive, what the tax reporting rules are, and making sure people know. "It needs to be a responsibility that's shared across the functions, not any one individual," Gould says. "This helps ensure that everyone understands the total scope of what is being provided to employees."

> "Visibility is often times the key benefit realized by moving to a global solution from a local or in-house solution."
>
> Jon Ziglar, Managing Director of International Solutions, Ceridian

Global Payroll Model

Advances in technology are also helping companies streamline their payroll operations. That's where a global payroll model comes into play—a centralized tool delivered by a payroll vendor that consolidates disparate payroll operations for multiple countries by using a standardized system of record. Such a model helps companies deliver

payroll services in a timely manner and in compliance with local rules and regulations.

The widespread adoption of a global payroll model is "still in its nascent stages," St. Cyr says. "Very few employers are using it to its full potential."

Over the last two years, however, that's quickly started to change. "The globalization of human capital management solutions overall is an area that is growing leaps and bounds," Ziglar says. Large companies looking to expand their global footprint, in particular, increasingly are looking to adopt a global solution over that of formerly localized solutions, he says.

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>
> Carolyn Gould, Principal, PwC

The main driver for moving toward a global payroll model is to achieve the same level of functionality and controls across all their markets. "Visibility is often times the key benefit realized by moving to a global solution from a local or in-house solution," Ziglar adds.

New payroll vendors and services are cropping up every day, so it's important for the company to first determine its own needs before choosing what type of payroll service to implement. Some smaller companies, for example, may prefer to keep a lot of their payroll in-house, and only use a vendor to help make their HR department more efficient, while a large company with a high employee count in multiple countries will require a vendor with a "very deep and sophisticated technology platform," Ziglar says, one that can provide enhanced reporting and analytics, automated processes, and a standardized delivery model.

The company also should have a firm grasp on where it can, or needs to, standardize its payroll processes. "There is often a large change management component to any global project, often larger than a client anticipates," Ziglar says.

A centralized payroll processing system could also help companies on a coming difficult compliance requirement: the pay-ratio rule. The Securities and Exchange Commission is currently working on a requirement that all public companies would have to report the ratio of the compensation of their CEOs to the median compensation of their employees. A global payroll processing system would give companies a leg up on the calculation, which some have argued will be extremely difficult to put together from many systems.

It's also advisable that the company goes out and speaks with a lot of potential vendors, advises Ziglar. Explain to them your current payroll model operations and challenges, "and then see how they'll partner with you to solve those problems," he says.

Also consider how much flexibility and scalability the vendor has to grow with the company over time to support evolving HR needs. Whatever system a company uses, "it needs to be able to manage 100 percent of data required for payroll," Ziglar says. "Many vendors claim to enable global payroll, but their platforms are built for higher level HR functions like talent, not the more complex transactional aspects of HR such as payroll and time, which incorporate complex market specific labor rules, taxing authorities and entitlements to name a few. Without supporting 100% of the data required for pay, manual processes, and therefore opportunity for errors and poor reporting, persist."

Another consideration is the company's technology strategy, Ziglar says. "Do you have a global deployment of an ERP system that's so engrained in what you've got going already that you know you need to keep that and build on that? That will many times inform the ultimate decision."

Once a vendor has been selected, and the company is reading to make the leap to a global payroll model, be prepared to suffer some battle wounds. An effort of this magnitude requires buy-in both from senior executives and the in-country managers responsible for payroll. Some managers won't want to move off the existing payroll system, because it's working just fine, or they don't want the head office to have the level of visibility a global solution provides."

The resistance that comes from the regional level "often can stall or kill a [global payroll] initiative," Ziglar says. So getting the entire company on board will go a long way toward smoothing the process for implementing a seamless global payroll model. ■

WHERE DO I START?

Jon Ziglar, managing director of international solutions for Ceridian, offers some helpful tips on how companies can start the process when moving toward a global payroll system:

- **Gain executive approval.** Global change needs top-down support; bottom-up can paralyze a global project.
- **Establish the baseline.** Understand what unique solutions exist in each country.
- **Understand your processes.** Do you have unique processes and rules in each market? Where are the similarities? Where can you standardize?
- **Determine technology strategy.** Understand what technology exists, and how/if it should be leveraged.
- **Select a partner.** Select a partner that can deliver the right solution and can evolve with your organization over time.

Source: Ceridian.

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