

# FREE Payroll Book

## A Quick Guide To Payroll Basics

Prepared by

**Real Business Solutions**

Makers of

Payroll Mate, W2 Mate, and Sales Tax Mate

[www.PayrollMate.com](http://www.PayrollMate.com)

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# Preface



- It is quite clear that there is no a shortage in books and manuals when it comes to payroll as it is an important subject for almost any business. However most of those manuals and books are written by accountants for accountants.
- This FREE payroll E-Book guide is an attempt intended to help introduce small business owners and small business managers to payroll concepts and methods to help them better track their payroll as well as make the right decisions to choose the appropriate methods and practices, and also shed some light on major [payroll questions](#). This guide is not intended for tax professionals or professional payroll managers, who mostly refer to more detailed manuals.
- This quick guide also offers a basic payroll preparation model using common payroll preparation practices and not intended to offer any legal or tax advice as there are several laws and regulations the employer or the employee could be subject to depending on the subject matter and the circumstances.
- We strongly recommend that the user seeks tax and legal advice as well as contact the proper Federal, State and local agencies to determine what are his or her legal and financial obligations.



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# Part 1

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# About Real Business Solutions



- Real Business Solutions is an industry leader in providing solutions for businesses and tax professionals, and prides itself on providing some of the best technical support in the industry.
- Real Business has three published products:
  - Payroll Mate: Comprehensive [payroll software](#) that fits the needs of accountants, small and medium size businesses. Payroll Mate automatically calculates net pay, federal withholding tax, Social Security tax, Medicare, state and local payroll taxes. Payroll Mate also supports different types of payroll pay periods, prints checks, prepares payroll forms 941, 944, 940, W2 and W3. Payroll Mate software also supports user-defined income, tax, and deduction categories, making it very flexible and powerful with the ability to add on options like direct deposit capability, generate W2 forms on blank paper, and MICR checks. Payroll Mate can also generate forms California DE-6, California DE-7, Texas C-3, Texas C-4, New York NYS-45, Illinois IL-941 and Illinois UI-3/40. Payroll Mate exports payroll data to QuickBooks, Quicken and other accounting software like Microsoft Office Accounting.
  - W2 Mate Software: Simple yet sophisticated [W2 1099 software](#), used to prepare, import, e-file and print W2 and 1099 forms. W2 Mate offers the ability to print on preprinted tax forms and on blank paper. W2 Mate supports 1099-MISC, 1099-INT, 1099-DIV, 1099-R, 1096, W-2, W-3. W2 Mate can import data from QuickBooks, Microsoft Dynamics GP, MAS 90 and MAS 200 and other accounting software.
  - Sales Tax Mate: Powerful, yet user friendly software, used to prepare Illinois sales tax returns and generate sales tax forms on blank paper ready to be filed with Illinois Department of Revenue.

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# Introduction and History of Payroll Taxes

- Payroll has evolved over time from its humble beginnings of just tracking hours worked by employees, paying employees and maintaining the proper records into a profession that employs thousands of professionals and handles a wide range of duties that naturally includes tracking employees (hours worked, vacation time, sick time), withholding taxes, reporting wages and submitting different reports to various government and non-government agencies utilizing the advancements in technology, including computer software, time tracking equipment and remotely hosted applications.
- In modern time the true start of payroll tax occurred with the passage of the Revenue Act in 1861 which introduced a 3% withholding on all incomes of \$800.00 per year. Another landmark was the introduction of the Social Security Act in 1935, which comprised of a two percent tax: One percent paid by the employer and one percent deducted from the employee's paycheck. Over time payroll taxes were amended and changed repeatedly.
- Currently the following payroll taxes are applicable:
  - Federal Withholding Payroll tax which includes Social Security and Medicare taxes.
  - Federal Unemployment tax.
  - State Withholding Payroll tax (not applicable in all states).
  - State Unemployment tax or something similar depending on individual states.
  - Local taxes. (City or County taxes for example).



# Terminology



- **Payroll:** Payroll is all the financial records and data related to salaries, wages, overtime, bonuses, deductions, withholdings, garnishments related to the entities, employees, owners or partners paid for services provided during a specific period of time.
- **Employee:** In this guide the term employee strictly means a W2 recipient regardless of how he or she is defined under various statuses.
- **W-2 Form:** An official Internal Revenue Service tax form used by the employers (regardless of whether they are tax exempt or not) to report wages paid by employers to their employees and taxes withheld in accordance with the applicable tax code for the particular tax year. It may also include other deductions such as health insurance, 401K and other related items. Employers are required under the law to file the W2 forms with Social Security Administration before the deadline in place every year.
- **W-3 Form:** An official Internal Revenue Service tax form used by the employers (regardless of whether they are tax exempt or not) that summarizes most of the data reported on individual W2 forms. Currently each employer files one W3 (regardless of the number of W2 forms filed) along with the W2 forms filed with the Social Security before the deadline every year.
- **W-4 Form:** An official Internal Revenue Service tax form used by the employers, prepared and signed by the employees to collect vital tax data from employees like their filing status and number of allowances, to help the employer withhold the accurate amount of Federal taxes from employees earnings as required by the applicable tax laws. Employers should keep a signed copy on file for each employee, and are encouraged to update the form annually, or when changes in the number of allowances occur.
- **941 Form:** An official Internal Revenue Service tax form used by the employers (regardless of whether they are tax exempt or not). The form summarizes wages paid, [Federal payroll taxes](#) withheld, Social Security taxes, Medicare taxes, and other related payments and withholdings to the Internal Revenue Service at the end of every quarter.
- **940 Form:** An official Internal Revenue Service tax form used by the employers that summarizes wages paid and Federal Unemployment Taxes accrued on wages subject to Federal Unemployment Tax (FUTA) for the entire tax year. The form is filed annually before the official deadline.
- **944 Form:** An official Internal Revenue Service tax form used by the employers (regardless of whether they are tax exempt or not) that summarizes wages paid, Federal payroll taxes withheld, Social Security taxes, Medicare taxes, and other related payments and withholdings to the Internal Revenue Service at the end of every year (mostly used by smaller employers).

# Terminology (cont'd)



- **What is Payroll :** Payroll is all the financial records and data related to salaries, wages, overtime, bonuses, deductions, withholdings, garnishments related to the entities, employees, owners or partners paid for services provided during a specific period of time.
- **Employee:** There are various definitions for who is an employee. One of the definitions for an employee is the common law definition (an employee is a person who performs services for an employer who has the right to control and direct the results of the work and the way in which it is done). In this guide the term employee strictly means a W2 recipient regardless of how he or she is defined under various statutes.
- **W-2 Form:** An official Internal Revenue Service tax form used by the employers (regardless of whether they are tax exempt or not) to report wages paid by employers to their employees and taxes withheld in accordance with the applicable tax code for that particular tax year. It may also include other deductions such as health insurance, 401K and other related items. Employers are required under the law to file the W2 forms with Social Security Administration before the deadline in place every year.
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- **W-4 Form:** An official Internal Revenue Service tax form used by the employers yet prepared and signed by the employees to collect vital tax data from employees like (their filing status and number of allowances) to help the employer withhold the accurate amount of Federal taxes from employees earnings as required by the applicable tax laws. Employers should keep a signed copy on file for each employee and are encouraged to update the form annually or when changes in the number of allowances occur.
- **941 Form:** An official Internal Revenue Service tax form used by the employers (regardless of whether they are tax exempt or not) that summarizes wages paid, Federal payroll taxes withheld, Social Security taxes, Medicare taxes, and other related payments and withholdings to the Internal Revenue Service at the end of every quarter.
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# Methods of Payroll Preparation



- Following are the most popular methods for payroll preparation:
  - **Full outsourcing:** (use full payroll preparation provider)  
Using an online system or actually calling and speaking with a live customer service representative.  
Typically in this method the employer reports the hours worked, any overtime, any new hire, status changes garnishments or any special payroll requirement. The payroll preparation company then creates the [payroll checks](#) and delivers them to the employer whether signed or not depending on how the payroll service was setup with the company. The payroll company will also remit the related tax liabilities to the proper parties. This method entails little work on the employer's side as he will mainly handle the office related paperwork, like tracking the workers hours, files and vacation time.  
This method costs several times the cost of in-house payroll preparation and is popular with small employers with little payroll background knowledge.
  - **Assisted in house preparation:** Contact a tax professional, typically your accountant, and decide with him or her on a method to handle payroll which in most cases means he or she will handle the reporting part and have you (the employer) make the payroll tax payments, and prepare the payroll checks in house, with the tax professional guidance either using some [payroll preparation software](#) or processing payroll entirely manually.  
This method is also popular with small businesses with some accounting or payroll background experience and generally costs less than outsourcing the entire payroll process.
  - **Manual:** Prepare the payroll manually and handle the payroll tax payments and reporting requirements in house. This will entail issuing the payroll checks in house and handling the reporting requirements manually. Businesses use this method if they have a limited number of employees and the owner or manager has a strong payroll background. Of course this method will cost little to setup as there is very little upfront spending. However, this method will cost a lot of time and possibly money as a result calculation errors.
  - **Assisted Online Method:** Subscribe to online payroll preparation software where the software and data are both remotely hosted by the software company so there is nothing to install locally on your machine (the user pays a monthly subscription fee typically based on the number of employees covered and the frequency of payroll checks.) Payroll data is typically remotely hosted at the service provider's servers and that requires live internet access any time payroll is prepared, or to access reports or forms. This method typically costs more than buying software and preparing payroll in house, but costs less than full outsourcing.
  - **In house payroll software:** Buying payroll preparation software and using it to prepare payroll.  
In this method the employer is responsible for data input, printing checks, remitting taxes withheld to the proper agencies, filling tax forms and other related reports. This method is efficient and economical as it typically cost way less than all methods except for the full manual method, and as technology improves it is becoming a popular way. It eliminates calculation errors as the software automatically calculates tax withholdings, and tracks all defined garnishments and deductions. It also means keeping good track of payroll data. It is definitely much faster than the manual method, and it gives the user great control over payroll data and ability to prepare payroll instantly when compared with using a payroll preparation company where the turnaround time between reporting the payroll, or inputting the data online and receiving the checks could be 24 hours or more.

# Payroll Processing Steps



Hours and Earnings		Year-to-Date
Hours	This Period	
	384.00	
	276.90	
	384.00	

1. Tracking employees hours worked especially for hourly employees to make sure they work the right number of hours as planned and track any overtime hours worked to properly compensate the employees in accordance with the applicable laws and the company's policies.

***Normally this is accomplished by using some form of time cards: electronic or manual.***

2. The actual preparation of payroll checks including the calculation of all related withholdings, garnishments, printing checks and handing them out to employees.
3. Remitting the related tax liabilities , related paperwork and forms to the proper parties: government or non-government related agencies.

# Why buy software and prepare payroll in house?



- As mentioned earlier there are at least four common methods to prepare payroll, and each of these methods has its pros and cons
- Typically using either method depends on the specific circumstances for each entity including the availability of skilled staff, company size, number of employees, payroll frequency, level of control the entity desires to have on its payroll data.
- Here are some of the advantages of using in house software method over the rest of the payroll preparation methods:
  1. It is the least expensive method next to the full manual preparation method.
  2. It gives the employer great control over the payroll data as the data is stored locally its more secure and can be accessed any time without the need to go online.
  3. It gives the user the ability to prepare payroll any time compared to outsourcing where the turnaround time is about twenty four hours or more.
  4. It eliminates the calculation errors compared to using the manual method.
  5. It is effective for almost any size of business.

# How to choose the right in house payroll preparation software?



- Once you have decided to use the [in-house payroll preparation](#) method the first and most important step would be to find the right software that best fits your needs within your budget.
- Obviously, if you have an open budget to spend on buying payroll preparation software, you can buy the most expensive package in the market with all the added features that can come with it assuming that this package will cover all your needs to prepare your payroll. The reality is that even Fortune 500 companies have a set budget on how much to spend on buying software, let alone the fact that not every company needs all the features that could be added to software packages. ***The trick here is to buy the software that costs the least and best serves your needs.***

# Basic features of a good payroll preparation software:

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A good payroll preparation software should be:

- Easy to install on your machine.
- Easy to use and navigate around.
- Easy to setup your company and employees data and make future changes.
- Ability to handle the number of employees you expect to process payroll for, while having room for future growth and expansion.
- Easy to update through internet access.
- Easy to back up and restore your data.
- Capable of generating Federal quarterly and year-end forms, and preferably state forms too.
- Providing decent technical support.
- Able to be customized to better fit your needs.
- Able to print either on preprinted check stock or on blank check stock.
- Able to generate reports or data to export, or book into your general ledger software.
- Able to generate direct deposit files (ACH).
- Able to generate a wide range of reports that can serve your needs like amount required to make a payroll tax deposit.
- Supporting updates, changes in tax tables and forms that are covered during the tax year.
- Offering annual updates at a reasonable price.



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# Part 2

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# If you are responsible for running payroll for your entity what do you need to do?

- Contact the INTERNAL REVENUE SERVICE , the local and state tax authorities to inquire about the registration requirements, reporting requirements, record keeping requirements, tax withholding requirements, payroll tax payment requirements and any other compliance requirements.
- ***Educate yourself about payroll tax and payroll preparation methods.***
- ***Refer to Publication 15, better known as (Circular E). It has a wealth of information. You can access the publication free from the official IRS website at [www.irs.gov](http://www.irs.gov)***
- ***Decide on what method to use to prepare payroll based on your needs, skills and the size of your payroll.***



# You have a new employee what now?

- Once you have a new hire and you have both agreed on the pay scale, job description and other related issues, you should create a new file for that employee and that file typically contains at least the following items:

1. Job application.
2. Employee resume.
3. Copies of proper identification cards.
4. Signed W-4 and the equivalent of a state W-4.
5. Information related to wage garnishments and deductions.
6. All leaves or vacation requests.
7. All employee reviews, thank you letters, or any formal communications with the employee.
8. Resignation letter or anything similar after the employee leaves.





# Minimum Wage Requirements

- The U.S Department of Labor mandates that employers pay their employees covered under the law the minimum wage published by the department or higher. Also some states mandate minimum wage requirements. In cases where the employee is subject to both federal and state minimum wage requirements, the employee is entitled to receive the higher of the two minimum wages.
- ***You can contact your State Department of Labor or U.S Department of Labor for more information about this topic.***



# Employees Time Tracking



- In general there should be a method for tracking: when every employee punches in and out of work, and track lunch breaks and the time off taken during the working day.
- As for hourly paid employees, maintaining time cards is part of the payroll preparation process to account for hours worked and any overtime if applicable.
- The two most popular methods for time tracking are:
  1. Manual punch cards. The employee punches the card as he/she starts his/her work and punches out when he/she leaves.
  2. Electronic time tracking could be as simple as swiping a magnetic card in a machine or as sophisticated as a thumb identification sign in, sign out method.
- Regardless of the method used, it is important to remember that the primary purpose of tracking employees time is to prepare payroll and cut pay checks.

# Time to prepare payroll using your in house payroll preparation software



- Now that you have hired employees ,started a file for each one of them, implemented a system to track their time at work, purchased [payroll software](#) and installed it on your computer, you are ready to prepare your first payroll.
- Generally this comprises of three steps:
- **Step one**
  - Setup your company data and employees data inside the software
- **Step two**
  - Process actual live payroll
- **Step three**
  - Remit taxes and file forms and reports

# Prepare Your First Payroll

## Step One



### Setup your company data and employees data inside the software

1. Make sure you setup your company information inside the in-house payroll software you have purchased and installed on your computer.
2. Setup all the employees inside the [payroll software](#), make sure you pay attention to all the details and never overlook any step, box or check mark.
3. Setup the employees basic info such as name, address, social security number and contact information.
  - Pay special attention to employees pay frequency as this in most cases tells the software how to calculate the tax withholding amounts.
  - Pay special attention to the tax withholding setup in regards to filling status, number of exemptions, any additional withholdings the employee asked for.  
***All data should be taken from the W-4 signed earlier by the employee.***
  - Pay special attention to deductions and garnishments setup as to whether they are pre-tax or after tax deductions.
  - Pay special attention to the regular hourly pay setup and overtime pay setup.
4. Run a sample payroll for every employee and make sure the software tracks and calculates data as intended. Run some reports and perhaps the 941 form and review all the details. You could contact your tax professional and ask him/her to review the output to make sure you have setup your employees correctly, and make any changes if necessary. (Make sure you delete all the dummy checks you have created inside your payroll software).

# Prepare Your First Payroll

## Step Two



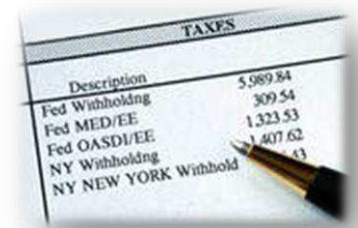
## Process actual live payroll

Now that you have finished your employees and company setup properly you can start your first payroll.

1. To run a real payroll, start by collecting your employees time cards and calculating hours worked by each one.
2. ***Pay attention to overtime or any special requests.***
3. Prepare paychecks for your salaried employees, first then print the checks and review them.
4. Prepare paychecks for hourly employees, then print the checks and review them.
5. Remove the one check stub from each paycheck you have prepared and attach them to time sheets for this particular pay period. (Typically each paycheck sheet contains two pay stubs).
6. Run a detailed report for this pay period and keep it for your records.
7. Make sure you back up your data into a portable device like a flash drive or something similar and keep it in a safe and handy place.

# Prepare Your First Payroll

## Step Three



Description	Amount
Fed Withholding	5,989.84
Fed MED/EE	309.54
Fed OASDI/EE	1,323.53
NY Withholding	1,407.62
NY NEW YORK Withhold	43

## Remit taxes and file forms and reports

1. Remit taxes withheld to the appropriate tax authorities and that typically includes federal, state and maybe local taxes. Normally the frequency of tax remittance depends on the amount withheld, and the tax authorities instructions. Therefore it is important to know ahead of time where and when to remit taxes withheld.
2. Remit any deductions such as 401k or similar deductions to the proper party.
3. Remit any garnishments such as child support to the proper authorities.
4. File the required reports or tax forms with the appropriate authority, that includes quarterly 941 form or similar state or local form, or other authorities.

# Direct Deposit



- Direct deposit generally refers to the process of depositing the employees net pay check directly into their bank account known otherwise as ACH (Automated Clearing House) method.
- Benefits of using this method include:
  1. Confidentiality, as the number of people who handle a paycheck is about three times the number of people who handle the direct deposit.
  2. Reduction of fraud, for example forged signature and stolen checks.
  3. Saving paper and envelopes (go green).
  4. Ensuring (in most cases) timely deposit of funds into employees bank accounts.
  5. Saving the employees the leg work of going to the bank to deposit or cash the checks (go green).
  6. Ensuring the employee gets paid timely if he/she was off or on vacation at pay day, without having go to work just to pick up the check or have the check mailed (go green).

# Direct Deposit (cont'd)



- It is important to remember, however, that the employer has to give the employees the choice between the direct deposit method and the actual paper check as some employees don't have bank accounts. If you decide to offer your employees the direct deposit method, make sure you have your employees fill out and sign the direct deposit authorization form which typically contains:
  1. Employee's first and last name
  2. Employee's address.
  3. Employee's financial institution name.
  4. Employee's financial institution account number.
  5. Employee's financial institution routing number.
  6. Account type whether it is savings or checking account.
  7. Account ownership, is it self or joint or other.
  8. Date direct deposit becomes effective.
  9. A paragraph authorizing the employer to deposit funds in the account and reverse the deposit or a portion if there were deposit errors.
  10. Employee's signature and date the form was completed.
  11. In most cases your financial institution can help or direct you as to where you can obtain direct deposit authorization forms.



# Year end Payroll requirements

- Following are some of the requirements employers need to comply with:
  1. File the year end 940 Federal Unemployment tax form (some tax exempt organizations are not required to file this form) check with your tax advisor or the Internal Revenue Service to learn more about this subject.
  2. Prepare W2 forms and furnish them to the employees before the deadline (currently the deadline is January 31st of the year following the subject year.)
  3. File W2 forms with the Social Security Administration, the two most popular methods used are: E-filing and filing the actual forms.



# Payroll preparation good habits for in house software users

1. Try to make payroll frequency as least as possible to eliminate errors.
2. Be consistent and try to follow the same steps every time you prepare payroll to eliminate errors. For example if you start by preparing payroll for salaried employees, always start by preparing payroll for salaried employees.
3. If you have to prepare payroll for a big number of employees, divide them into batches print them and review them before you proceed to the second batch.
4. Have a check list for preparing payroll and mark off the steps you completed as you progress.
5. Prepare payroll ahead of time and don't wait until the last minute.
6. Always update employees data as you get it and don't wait till you prepare payroll.
7. Always review employees hours and compare them to their schedule. Look for overtime or out of the ordinary hours.
8. Avoid making exceptions for employees as they might ask for favors such as receiving payroll checks one or two days ahead of time, or an advance on the next payroll check.
9. Back up your data every time you prepare payroll to an external drive ( flash or something similar).
10. Keep hard copies for check stubs for all checks prepared.
11. Maintain a separate file for each tax year and keep hard copies of all forms and reports filed and notices received.
12. Setup a password on your payroll software and share it with only one trusted person.
13. Limit the number of people who access the computer where you store your payroll and business data.

# Helpful Websites

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- Official IRS website [www.irs.gov](http://www.irs.gov)
- Official Social Security website [www.ssa.gov](http://www.ssa.gov)
- Official U.S Department of Labor website [www.dol.gov](http://www.dol.gov)
- Official U.S Small Business Administration website [www.sba.gov](http://www.sba.gov)
- Payroll Software for Small Business & Tax Professionals [www.PayrollMate.com](http://www.PayrollMate.com)
- Payroll Taxes for Major US Cities [www.Payroll-Tax.Realtaxtools.com](http://www.Payroll-Tax.Realtaxtools.com)
- American Payroll Association [www.AmericanPayroll.org](http://www.AmericanPayroll.org)
- Payroll Forms, Payroll Checks and Tax Supplies [www.FormsMall.com](http://www.FormsMall.com)

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