

10 steps to maintain end-of-year payroll compliance

The end of the year is a hectic time for payroll staff and business owners. While the year is winding down, the payroll department is ramping up to prepare for the end of the year and ensure that all reporting deadlines are met.

Some payroll tax compliance items are completed quarterly, or more frequently throughout the year. For example, employers must deposit payroll taxes — including [FICA taxes](#) (social security and medicare taxes that are partially withheld from employees through payroll and partially paid by the employer), FUTA taxes (federal unemployment taxes), and income taxes to the internal revenue service throughout the year. However, there are a large number of payroll compliance items that need to be completed at the end of the year or the start of the new year.

Here are the steps you need to take to close out the year in proper payroll compliance:

1. Review employee's personal information

The end of the year is a great time to double-check your staff data. Do you have current mailing addresses for all staff members? You will need those to send out W-2s in January.

If you've had new hires, including year-end seasonal hires, double-check that you have W-4s and all required paperwork from them. You can also verify employees' legal names and social security numbers on the Social Security Administration (SSA) website in batches as you hire. You need the correct name and SSN to submit the year-end W-2 records to the SSA.

Also, double-check that you have W-9 forms from all contractors. While you need to have the W-4 form with the withholding selections from employees in order to pay them properly, W-9s are mostly used for year-end reporting, as taxes are not taken out from their checks. You should absolutely be asking for W-9 forms while onboarding new contractors, but these tend to be the forms that get overlooked or missed most often. Take time to verify that you have a W-9 for all contractors that will need a 1099 and chase down any that you don't have filled out yet.

Finally, double-check that any changes in employee withholdings have been applied properly. Employees can update their W-4 forms and withholdings and exemptions at any point throughout the year. Your payroll provider may allow them to do this online with the changes applied in their system automatically for the next payroll processing date.



2. Verify wages, taxes, and

benefits

Take some time to carefully review your payroll records for the year. You won't be able to close out payroll for the year until the last pay date of the year, but you can start reviewing your records before then.

Verify the employee wages paid, tax withholdings, and benefits. Work to correct any payroll compliance mistakes and resolve any open payroll concerns raised by employees. Verify that any special cases, such as employees with wage garnishments, were handled correctly. If any handwritten paper checks were sent to employees, ensure that these were properly recorded. Hand-written checks are sometimes issued to employees on their last day in order to meet legal requirements for paying out employees upon termination if the employer is unable to process a special paycheck request in their payroll system outside of the regular payroll schedule.

Also, take a look at overtime wages paid and ensure that applicable Department of Labor (DOL) compliance requirements for overtime pay have been followed, including properly classifying exempt and nonexempt workers to pay out overtime to the correct staff members.

3. Pay out bonuses

The end of the year is a popular time to pay out bonuses to employees. Some businesses provide a holiday bonus as a show of appreciation to employees. This year is an especially important year to show your appreciation to employees, as many businesses are struggling with employee retention right now. These bonuses are often fairly standard across the board, making them easy to calculate and pay out.

On the other hand, some companies or job roles include bonuses and bonus criteria in their compensation plans. These may be paid out annually or quarterly. At the end of the year or beginning of the next year, human resources will need to evaluate the set success metrics and bonus criteria and calculate what bonuses need to be paid out. These are generally tied to some performance metrics of the employee, their team, or the company.

4. Handle unused PTO and benefits

There are many PTO administration policies and methodologies. Many employers base paid time off limits, rollovers, and accrual timelines on the employee's hire date rather than the calendar year. However, if your

company does use the calendar year rather than the employee's anniversary date for annual PTO limits, let employees know what will happen to unused PTO balances. How much can be rolled over to the next year? Will they lose their accrued balance or simply stop accruing PTO hours until they use some of their balance if they have reached the cap. Give employees a heads up so that they may use their balance if it will not roll over. It's best to communicate this before the end of the year, rather than fielding complaints at the start of a new year. Do keep in mind that state laws on PTO payouts vary.

If your organization offers FSA benefits, it's also a good idea to remind employees to use their FSA balances. FSAs (flexible spending accounts) are typically a use-it-or-lose-it benefit. Pre-tax dollars are deducted through payroll and placed into a flexible spending account to cover eligible medical or dependent care expenses. If employees haven't spent the funds or submitted for reimbursement of eligible expenses put onto their personal cards, the funds may be lost or forfeited. These plans typically follow the standard calendar year, and many employees make an effort to spend their remaining balances in December, so sending out a reminder could be helpful.

5. Brush up on legal changes

Carve out some time to research new payroll and labor laws going into effect in the new year. This can be a time-intensive process if you operate in multiple regions, as you'll need to research new or updated local and state laws for each region in addition to any updates from the federal government.

Pay special attention to laws on employee and contractor classification, as many states have been passing updated regulations in this area and misclassification can carry significant fines for businesses. Also, check for minimum wage increases in any states in which you employ people.

Check your workplace labor law posters and order new ones as needed. Some of the regulations of the Fair Labor Standards Act (FLSA) require posters to be put up in the workplace. Visit the [FLSA website](#) to see what posters you need to have up and check if there are updated posters for the new year.

Finally, make note of any new tax rates for the next year that may impact withholding requirements or increase your employer contributions.

6. Distribute the new year's payroll schedule



Take a look at your payroll schedule for the next year. Make note of which pay dates fall on holidays or weekends, and include the adjusted date that employees will be paid on for that period. Also look for any period ending dates and payroll processing dates that occur on holidays, long weekends, or other dates that could cause delays or difficulties for the HR or payroll department.

Complete any necessary planning and adjustments to the payroll schedule, then distribute the payroll schedule to employees. This is often posted online within your online payroll portal or an electronic employee resource folder.

7. File state reconciliation forms

State requirements will vary, but most states do require businesses to file some form of reconciliation form at the end of the year to account for state payroll taxes withheld from employees' paychecks, wages earned, and other relevant information.

Start preparing for this now by researching or speaking with your accountant about the filing deadlines and requirements for every state in which you employ people. It's also helpful to verify that you have been compliant with all state-required hire reporting, payroll laws, and tax filing requirements for the year. Many employers have shifted to remote work over the past year or two, and if employees have moved out of state or you've started opening up remote positions to out-of-state applicants, you may find that you have significantly more states to report to this year. For a small business, keeping track of all of these newly applicable compliance requirements can be challenging, but it is important to do your research to avoid missed reporting deadlines.

8. Send out W2s

Form W-2 is the Wage and Tax Statement that employees need in order to file their income tax returns in the new year. These forms must be sent out by January 31st each year to employees (including any previous employees that earned wages and had taxes withheld during the tax year). A W-2 form must be sent to any employee for which Income, Social Security, or Medicare taxes were withheld, or would have been withheld if the employee had claimed no more than one withholding allowance or had not claimed exemption from withholding on a Form W-4.

Independent contractors that were paid \$600 or more throughout the year by your company will also need to be sent a 1099 form. Both the W-2 and 1099s may be mailed or delivered electronically.

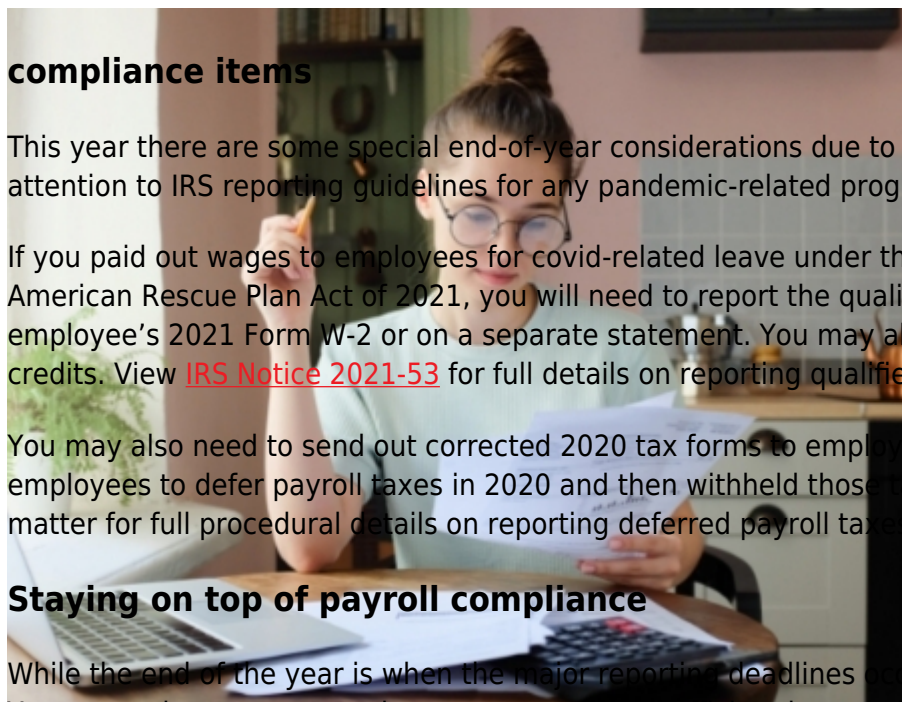
The Social Security Administration also needs a copy of each employee's W-2 forms from the employer. Employers must submit these to the SSA by January 31st as well.

9. File IRS forms and deposit taxes

Your tax form filing requirements and deadlines will vary based on the type of business and size of your company. The majority of businesses need to follow quarterly tax deadlines.

Your fiscal year may also not follow the calendar year, which may impact when you need to submit the required IRS forms. However, W-2s need to be reported by January 31st regardless of the schedule you follow, as employees need to be able to submit their income taxes by Tax Day on April 15th.

You will also need to make your final payroll tax deposits for FICA and FUTA taxes and meet quarterly deadlines for IRS Form 940 and 941, the forms that report FICA and FUTA taxes deposited for the quarter.



10. Pandemic specific end-of-year

compliance items

This year there are some special end-of-year considerations due to the coronavirus pandemic. Pay special attention to IRS reporting guidelines for any pandemic-related programs your company participated in.

If you paid out wages to employees for covid-related leave under the Families First Coronavirus Response Act or American Rescue Plan Act of 2021, you will need to report the qualified leave wages either on Box 14 of the employee's 2021 Form W-2 or on a separate statement. You may also be eligible to claim refundable tax credits. View [IRS Notice 2021-53](#) for full details on reporting qualified covid-related sick and family leave wages.

You may also need to send out corrected 2020 tax forms to employees in the form of a W-2c if you allowed employees to defer payroll taxes in 2020 and then withheld those taxes in 2021. [Read the IRS guidance](#) on this matter for full procedural details on reporting deferred payroll taxes.

Staying on top of payroll compliance

While the end of the year is when the major reporting deadlines occur, payroll compliance is a year-round effort. You can make your year-end process smooth and efficient by practicing effective recordkeeping throughout the year and using effective payroll software or payroll services.

The end of the year processes can also help you identify what is working and what can be improved. If you notice errors in paperwork processing, recordkeeping, the payroll services used, or instances of non-compliance, take steps to remedy this and find solutions to prevent issues in next year's payroll processes.