

# Stay on track with this payroll compliance checklist

Payroll compliance is no small task. Everyone knows that executing payroll accurately and on time is important, after all everyone wants to get paid for their work. However, there is also a lot more that goes into proper payroll processing including a large number of compliance functions and concerns. Keeping track of all of the compliance responsibilities can be cumbersome and a mistake may be costly. To help, we've created this payroll compliance checklist to help guide you through the steps that you need to complete at each stage of the payroll management process.

## Payroll compliance checklist for onboarding new hires

While onboarding isn't exclusively a payroll function, there are several steps and checks that need to be performed before you enter a new hire into your payroll system. Here are the compliance considerations to keep in mind before you start actually paying a new employee.

### Properly classify employment status

One of the most common payroll mistakes is misclassifying employees. Often this error begins with a new hire's offer letter. However, it's still a good idea to verify the validity of each new employee's classification when you enter them into the payroll systems as misclassification can result in payroll non-compliance.

There are a couple of common mistakes that can occur at this stage, including:

- **Paying someone as an independent contractor when they do not meet the legal criteria for this classification.** This is an evolving area of employment law and payroll compliance as many states have passed legislation to restrict who may be classified and paid as an independent contractor. Be sure to check your state laws before hiring independent contractors to ensure that you are paying them appropriately and that they do not need to be considered employees.
- **Misclassifying an employee as exempt.** The Fair Labor Standards Act (FLSA) provides clear guidelines on which employees may be classified as exempt vs. non-exempt. Nonexempt employees are compensated on an hourly basis and eligible for overtime pay. Employers must follow FLSA regulations as well as any state overtime rules in order to properly compensate non-exempt employees for the time worked. Exempt workers aren't entitled to overtime pay. You pay them based on the job they do, not the number of hours worked. These are typically salaried employees, but employers must verify that each job role passes specific tests before the employee filling it may be classified as hourly.

Making classification errors can result in employers owing backpay or fines. If you are unsure of how to classify someone for payment, refer to the Department of Labor's [guidelines on qualifying exemptions](#).

## **Provide FLSA and EPA compliant compensation**

In addition to regulating employee classification, the Fair Labor Standards Act (FLSA) sets minimum wage, overtime pay, and record-keeping requirements. Hourly employees covered under FLSA must be paid the federal minimum wage. Non-exempt employees are also entitled to overtime pay that is at least one and a half times the employee's normal pay.

The Equal Pay Act (EPA) requires that men and women receive equal pay for equal work within a company. Under the Equal Pay Act, the jobs being compared must require substantially equal skill, effort, and responsibility and be performed under similar working conditions within the same establishment. The Department of Labor considers each paycheck with unequal pay to be a new violation, so payroll departments should consider the EPA when reviewing compensation and speak to leadership if they notice a possible instance of EPA non-compliance.

## **Collect the required forms**

Many employers have their own onboarding forms that must be completed, but there are also a handful of government forms that employers must collect from new hires. The main two are the I-9 form and IRS Form W-4.

Form W-4 is the federal tax form that you'll need in order to determine how much money to withhold from each employee's paychecks for federal taxes. It asks for information such as the employee's filing tax status, extra withholding preferences, and more.

An I-9 form is a very important piece of compliance documentation. The purpose of this form is to verify a hire's eligibility to work and their identifying documents. A member of your staff or an authorized representative must review these identifying documents, typically a Driver's License, Passport, birth certificate, and/or social security card, and sign off that they have reviewed them. The I9 must be signed and completed within three business days of the employee starting work.

## **Verify employment eligibility**

It's also a good idea to verify new hire's information and employment eligibility. You can conduct a social security number (SSN) trace to ensure that you have the employee's real and correct social security number. The SSN is important as it is used to track payroll taxes and must be included on the end-of-year tax forms such as their W-2. This can be done on the Social Security Administration's website.

Some employers also participate in [E-Verify](#). E-Verify allows employers to verify the identity and employment eligibility of newly hired employees by electronically matching information provided by employees on their I-9 against records available to the Social Security Administration (SSA) and the Department of Homeland Security (DHS). This process is voluntary for most employers, but is required if your business has federal contracts or operates in a state that requires E-Verify.

It can be good to get into the habit of performing these checks as you enter new hires into your payroll provider's system. Many employers end up waiting until the end of the year to verify SSN numbers before sending out W-2s, but you'll have better compliance outcomes and an easier year-end process if you verify them as you go throughout the year.

## **Report new hires to the state**

Employers must report new hires or newly rehired employees to their state within 20 calendar days. Though some states have earlier deadlines. The following information must be provided.

1. Employee's name
2. Employee's address
3. Social Security number (SSN)
4. Date of hire (the date the employee first performs services for pay)
5. Employer's name
6. Employer's address
7. Federal Employer Identification number (FEIN)

This information is used by state and federal agencies to locate parents who owe child support payments and are subject to income withholding.

## **Payroll tax compliance checklist**

### **FUTA taxes**

The Federal Unemployment Tax Act (FUTA) provides unemployment insurance for those that have lost their jobs involuntarily. Unlike many other forms of payroll tax, FUTA is not taken out of employees' paychecks. However, employers are still responsible for tracking their FUTA obligations and making regular payments. Often employers must pay both a FUTA as well as state unemployment tax.

### **FICA taxes**

Federal Insurance Contributions Act (FICA) is a federal payroll tax that is used to contribute to social security. Social security taxes are deducted from each paycheck and recorded using an employee's Social Security number. The employee then earns credits for Social Security benefits as they work and pay FICA taxes throughout their life. They can then receive social security when they retire or become disabled.

### **Federal Income Tax**

Of course, the IRS always needs its share of each employee's earnings. FIT, or Federal Income Tax, is the money that employers need to withhold from employees' paychecks for taxes. The amount that must be withheld from each person will depend on the information provided on their W4 form. You'll also need to properly report the taxes withheld to both the employee and the government at the end of the year, typically on IRS Form W-2.

### **State Income Tax**

You'll also need to follow all state requirements for state tax withholding. While there are a few states that do not, the majority of them do and you will be required to withhold and submit state taxes from your employees' paychecks. The withholding amount for each employee will vary based on their selections on their state tax forms.

## **The states that do not charge income tax are:**

- Alaska
- Florida
- Nevada
- New Hampshire
- South Dakota
- Tennessee
- Texas
- Washington
- Wyoming

If you have employees in these states you may not need to worry about state income tax but will still need to stay compliant with federal income tax withholdings for your staff.

## **Reporting fringe benefits**

Payroll employees also need to be aware that some fringe benefits are taxable. Fringe benefits like personal use of a company car, gym membership reimbursements, and wellness stipends are becoming increasingly popular as employers work to attract competitive talent. Many of these fringe benefits are actually subject to federal tax withholding, Social Security, and Medicare taxes and must be reported on employees' W-2 forms.

## **Other payroll compliance considerations**

### **Record keeping**

Proper record-keeping is important for compliance in all departments, however, it is especially important in payroll. There are a number of important documents related to payroll including new hire paperwork, benefits selections, documentation on bonuses or special payments, payroll records from past paydays, and tax forms. If federal or state tax agencies ask to see these forms, you may have a problem if you've lost or misplaced them. Misplacing them could also result in payroll errors.

You should maintain your payroll records for all of your current employees and anyone who has left the company within the last three years. While three years is the standard, some states do have longer retention requirements so check the regulations for each state that you employ people in.

One simplified option is to maintain electronic records in a payroll system. This reduces the risk of a document

or file getting lost or damaged. Using a payroll software system also makes running payroll more efficient and typically reduces the likelihood of errors.

## **Final paychecks**

Meeting regular payroll and deposit deadlines is highly important. Most companies and payroll team members do a good job of making sure that employees receive their checks or direct deposits on the scheduled paydays. However, many companies do make mistakes when it comes to final paychecks.

While federal law gives employers a bit more flexibility in final payouts, compliance regarding an employee's final check will vary based on state and local laws. Many states have tight deadlines for providing employees with their final payouts. In some states, like California and Illinois, there can even be fines, interest charges, and other expenses for late final payments. Many employers assume that they can provide final checks along the company's normal payroll schedule, but it's important to double-check your state laws before you make a costly mistake.

In addition to providing payment for the hours worked during an employee's final shifts, the last check also often includes a payout for unused PTO. Just as the required timeline varies by state, so do the requirements for paying out unused PTO. In some states like California, vacation pay is considered part of an employee's compensation and any unused but accrued vacation must be paid out upon separation. This is particularly important to keep in mind for employers that have moved to remote work policies. Your company policy may be that PTO is not paid out at termination, but if you have remote employees working from a state that legally requires PTO payouts, you'll still typically need to comply.

## **Focus on compliance throughout the year**

While payroll compliance is a big end-of-year topic, it's important to stay diligent throughout the year. Having a compliant payroll onboarding process can help set you up for success when you reach the end-of-year reporting and W-2 period. Missing paperwork or tax deadlines can create a huge compliance headache for employers, so don't overlook any of the above requirements or steps.