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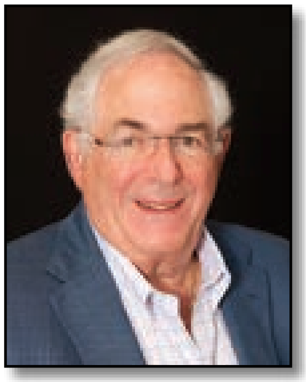

Avoiding Payroll Tax Surprises

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Business owners in the construction industry need to adjust their workforce continually, which can lead to complicated payrolls. The IRS and the state of Texas have a vested interest in you getting payroll right, though, because employment taxes are a huge source of revenue for them.

The Texas Workforce Commission (TWC) is tasked with auditing Texas businesses over state payroll tax issues. According to TWC, businesses are usually flagged for one of four reasons:

- A former worker files an unemployment claim. If no wages were reported for that claimant, an investigation may be initiated.
- A competitor or someone else reports that an employer may be misclassifying its workers.
- A random audit of the employer is performed as part of TWC's goal of auditing 2% of Texas businesses every year.
- TWC decides to target a specific industry or geographical area (the construction industry has been targeted in past years).

As you can see, misclassifying workers as independent contractors is a significant trigger. Misclassifying a worker as a contractor when they really operate as an employee means they're on the hook to pay their own employment taxes, which doesn't happen as often as it should. In 2014, the Fort Worth Star-Telegraph reported that nearly 40% of Texas construction workers were misclassified. The problem contributed to a $1.2 billion-a-year loss in tax income for Uncle Sam. So, of course, they'd like to prevent that from happening.

There could also be payroll deduction problems that cause your business to be flagged. Many of these can happen by accident. Examples include child-support garnishments ordered by the court that bring a worker's wages below the minimum wage and employee loan deductions that aren't approved in writing per Texas Payday Law.

So how does the IRS get involved? If TWC finds an employer failed to report wages and pay taxes correctly, back taxes and interest are assessed. At that point, TWC will likely inform the IRS that the business isn't entitled to a federal tax credit for the wages in question, which, in turn, can lead to an IRS audit.

Payroll issues can become a huge legal issue particularly when employment taxes are collected from paychecks but not paid to the state or IRS. With the complexity of bookkeeping on construction projects, it's a law that often trips up contractors. And when that happens, each business owner and manager in charge of payroll can be held personally responsible for the overdue bill.

The IRS assesses about 6 million civil penalties amounting to over $6 billion dollars for employer payroll tax issues each year. Some of these violations are due to what the IRS considers a "willful" failure to pay or even a "reckless disregard" for not acknowledging when bookkeeping is being mismanaged. Either way, business owners and every other person responsible for running the business or distributing payroll can be held personally accountable. In those cases, the IRS can dole out individual trust fund recovery penalties and, sometimes, even criminal charges. More than 100,000 individuals face these penalties at any given time with an average price tag of more than $90,000 a person.

The best way to avoid these surprises—big and small—is to maintain excellent payroll records and timely payments. "Many audits result in no finding of anything wrong and are finished within a few hours, depending upon how well the employer has been keeping records of workers and payments to workers," TWC states. Those records can include canceled checks, time cards, cash vouchers, petty cash, filed tax forms, TWC tax reports, chart of accounts, profit and loss statements, and more. Chances are, the tax examiner will not require most of these records, but it's better to be safe (have them ready) than sorry.

Working with a CPA from the start can help ensure regulations are followed. They can also represent you before tax auditors if that dreaded payroll audit letter does arrive. You may find that reputable payroll help on a regular basis is necessary, too. Payrolls often become unmanageable to the point where mistakes start mounting:

1. During rapid business growth. When a business grows quickly, the owner sometimes has no choice but to trust newly designated employees to stay on top of the books for them—often with little to no oversight.
2. While taking on projects outside your local jurisdiction. Are you taking on multistate or out-of-state projects? Employees are generally subject to the income tax withholding **of the state in which they work** (not the state in which the employer is located).
3. When adding to your temporary labor force. As stated before, the IRS has a keen eye on labor classification—especially for those in the construction industry—since employment violations in this area are common.
4. When upgrading to the latest payroll systems. Moving to a paperless payroll system can save you and your employees time and effort, but it can also lead to data security issues and other oversights. "I thought it was happening automatically" isn't a great excuse when facing IRS scrutiny.
5. As paperwork requirements become overwhelming. Construction businesses are often required to submit additional forms many other businesses don't need to worry about.

Look for these indicators and take actions to correct payroll issues before it's too late. Remember that you (the employer) are ultimately responsible for payroll taxes no matter who in your organization misses the boat.

Steven Bankler has more than 44 years of experience in the accounting industry. Steven's expertise lies in consulting, planning, tax, and asset protection as well as exit strategy services for closely held businesses. He also provides litigation support (both as a testifying expert witness and a consulting expert), business negotiations and estate planning. Visit www.bankler.com for additional tax strategy tips and to learn more about Steven Bankler, CPA, Ltd.