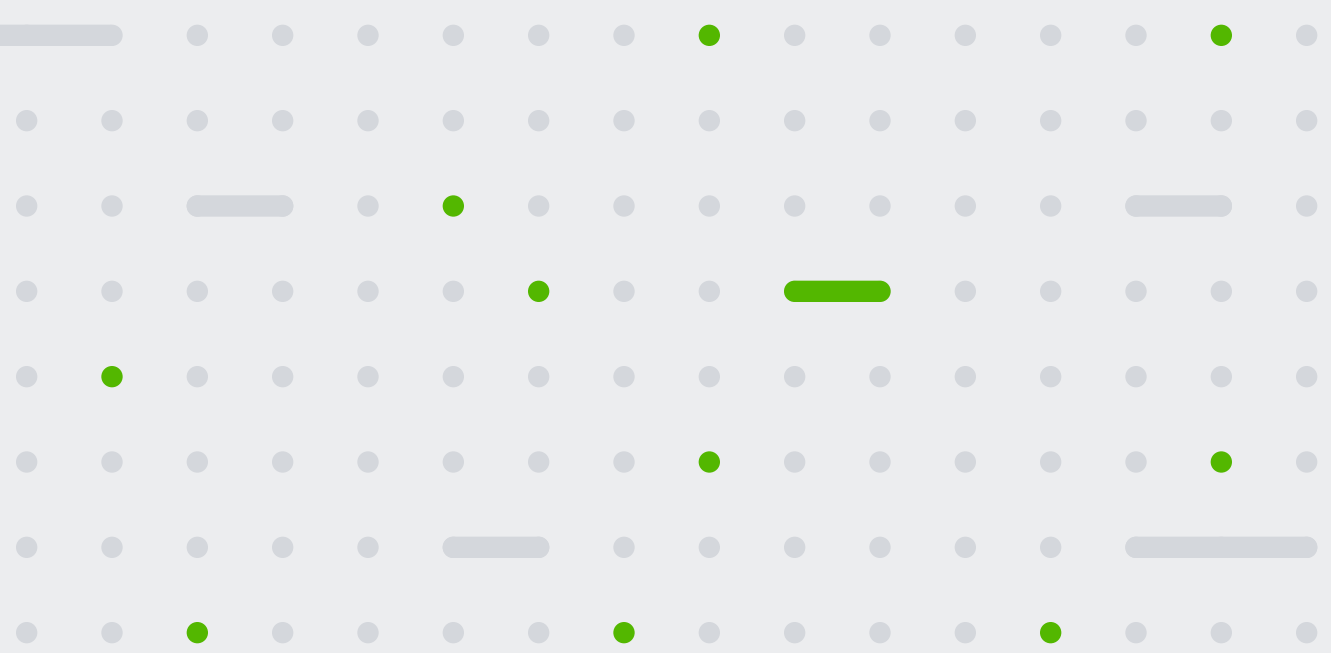


You Just Hired your First Employee – Now What?



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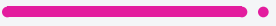
Your first employee just signed your offer letter and you're preparing for their first day.

While you'll want to concentrate on training and onboarding, you need to take care of legal compliance and operational tasks before your new employee begins.

If you address these four areas before your employee's first day, you can focus fully on setting them up for success:

- Reporting and Notice Requirements
- HR Policies and Procedures
- Workers' Rights
- Accounting





Reporting and Notice Requirements

It should go without saying the government wants to know once you've hired an employee.

Government reporting requirements include three key areas:

- Taxes
- Immigration
- Insurance

Taxes

Before you pay your employee, you'll need to obtain an Employer Identification Number (EIN) from the Internal Revenue Service.

The IRS uses your EIN to identify your tax account as an employer. When it was just you running your business, you may have used your personal social security number for tax purposes. Now that you have an employee working for you, this is no longer an option.

Applying for an EIN is free and simple. First, visit the [EIN application website](#). To complete your EIN application, you need some basic information about your business:

- Your business' legal structure (e.g. LLC, sole proprietor, etc.)
- Basic ownership information (e.g. members, shareholders, etc.)
- Location of your business
- Desired tax treatment (e.g. disregarded entity, corporation, partnership, etc.)



- Reason for EIN application (e.g. new business, hiring employees, opening bank account, etc.)
- The name and social security number of the responsible party (or EIN if the responsible party is an existing business)
- Responsible party contact information
- Your business' principal business activity

Once you submit your application, you will immediately receive your EIN number. A few days later, you will receive paper confirmation of your EIN.

Alternatively, you can apply for an EIN via mail or fax by completing [Form SS-4](#), but this is a slower process. International businesses can apply over the phone.

The W-4 is another tax form required for each employee. The W-4 helps identify the appropriate federal taxes to withhold from your employee's paycheck.

Your employee must complete their own W-4 and will need to provide some basic personal and tax information such as:

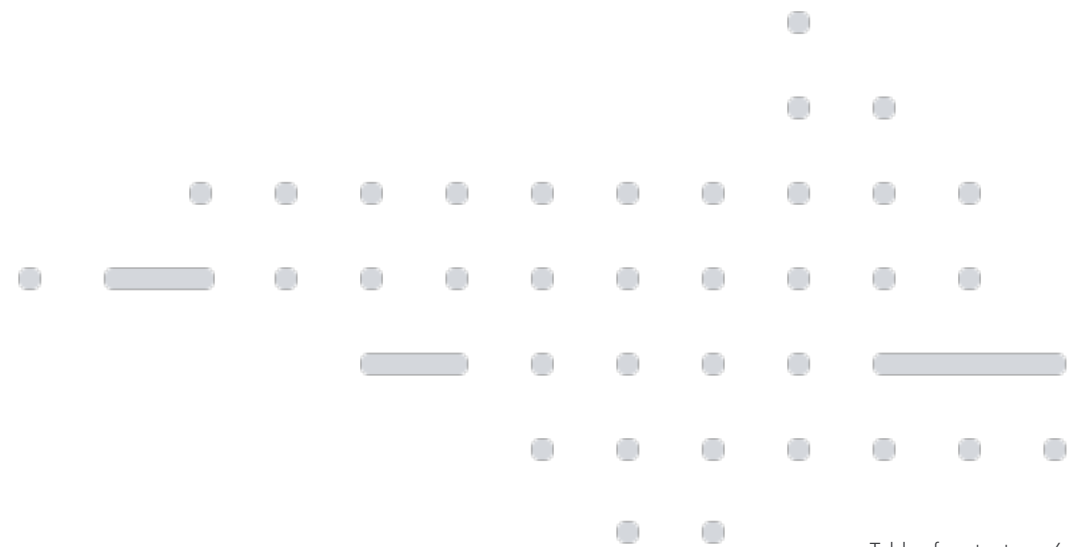
- Full name
- Social Security Number
- Address
- Marital status
- Total allowances (the W-4 includes a [worksheet](#) that walks the employee through calculating allowances based on information such as the number of dependents and tax credits)
- Additional withholdings (additional amounts an employee desires to be withheld from each paycheck)
- Tax exemptions
- Employer name & EIN

- First date of employment

In addition to the W-4, you will use the [IRS withholding tables](#) to determine how much to withhold from your employee's paycheck. The withholding tables guide you, as the employer, on how much to withhold from each paycheck based on your employee's wage, marital status, and the number of allowances claimed.

Keep in mind, the EIN and W-4 are federal tax requirements. State and local governments typically require similar reporting and withholding obligations.

To ensure you comply with state and local requirements, check with an attorney or accountant in your area.



Immigration

Your first employee should have confirmed the following on his or her job application:

"I represent that I am legally eligible to work in the United States and can provide sufficient documentation necessary to establish my identity and eligibility to work the United States."

The above representation is important because the Immigration Reform and Control Act of 1986 (IRCA) prohibits employers from:

- Hiring workers not legally authorized to work in the US

BUT ALSO,

- Prevents employers from discriminating based on national origin or citizenship

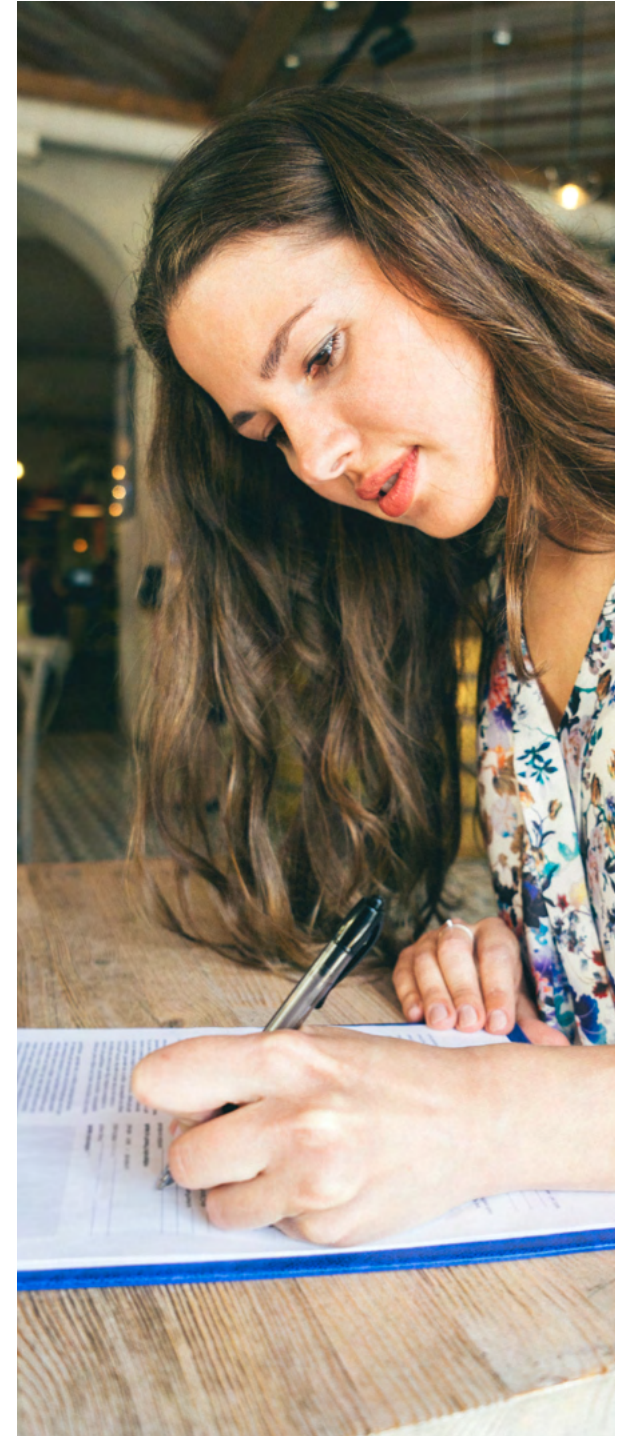
If your employee is required to make this confirmation before you hire them, you don't risk accidentally discriminating against them based on national origin or citizenship after offering employment.

Why?

If a candidate is not legally authorized when he or she applies, you may be in the position to sponsor them through the immigration process. However, if you are hiring your first employee, you likely don't have the budget or the expertise to navigate the complicated immigration system.

At this point, it's best to require candidates be legally authorized to work in the US before you consider them for employment.

With eligibility taken care of, you have additional IRCA requirements when your first employee arrives.



Your Employee must complete section 1 of [Form I-9](#). The I-9 is often referred to as an Employment Eligibility Verification form, and it is meant to verify an employee's identity and eligibility to work in the US.

Both US citizens and noncitizens must complete an I-9.

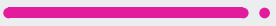
To complete section 1 his or her I-9, your employee will need some personal information:

- Complete legal name
- Citizenship or immigration status (e.g. US citizen, lawful permanent resident, foreign national, etc.)
- Registration number for lawful resident or foreign national
- Date authorized to work through if lawful resident or foreign national
- Maiden name, if applicable
- Address
- Date of birth
- Social security number
- Telephone number or email address (not mandatory)
- [Authorized documents](#) (e.g. US passport, US passport card, green card, employment authorization document (EAD), driver's license, social security card, etc.)

For an updated list of acceptable authorized documents, and combinations of documents, review the [US Citizenship and Immigration Service \(USCIS\) Handbook for Employers](#).

After the employee completes section 1 of the I-9, you as the employer have until the employee's third day of work to:

- Review the employee's completion of section 1 for accuracy



**Both US citizens
and noncitizens
must complete
an I-9.**

- Verify the documents provided are genuine
- Complete section 2

The employee must be physically present when you review the documents.

To complete section 2, you need:

- Employee's full name
- Employee's citizen or immigration status (from section 1)
- Authorization documents used
- Employee's first day of employment
- Employer's authorized representative name and title (most likely you)
- Business name and address


Keep I-9s and copies of the authorization documents for each employee during his or her employment, and for either; one year after the employee's termination or three years from the employee's hire date, whichever comes first.

I-9s are not difficult to complete if you and your employee have access to all of the information. Make sure your employee knows what's needed so the I-9 completion doesn't take too much time during your employee's first few days.

The USCIS keeps a [Table of Changes](#) so you can stay up to date with any changes to I-9 requirements.

Unless you are a government contractor, you are not required to use the US government's E-Verify system to verify the documents your employees provide to prove their eligibility to work in the US. However, many employers use E-Verify as a best practice.

For your first hire, E-Verify might be overkill, but you can learn more and enroll at [Homeland Security's E-Verify website](#).



**The employee
must be physically
present when
you review the
documents.**

Insurance

Employer Insurance

In most states, employers must pay into state-managed insurance funds that protect workers. The most common include:

Worker's compensation insurance

- Unemployment insurance
- State disability insurance

Worker's Compensation Insurance

Worker's compensation insurance covers employees who are injured during the course of their employment.

Worker's compensation insurance is the most common and the majority of states require employers with one or more employees carry workers' compensation insurance. A minority of states don't require workers' compensation until a certain number of employees are hired. For example, South Carolina requirements don't apply until an employer reaches 4 employees.

While worker's compensation will be a new cost to your business when you start hiring employees, one benefit to the coverage is that in many instances worker's compensation can prevent employees from suing you in civil court for on-the-job injuries.

To learn more about your state's requirements, visit the worker's compensation commission, or comparable state agency website for your state.



Unemployment Insurance

Unemployment insurance provides temporary income for workers who lose employment, generally when the employee is not at fault.

You pay unemployment taxes through a joint program between the federal government and the states. Employers are the primary funder of this program.

The individual states administer the funds provided by employers. If an employee is eligible for unemployment, the state will pay unemployment under the prescribed guidelines.

Your unemployment tax burden will change based on the number of your former employees who file and receive unemployment benefits.

The best way to minimize your unemployment insurance exposure is to pay unemployment taxes compliantly for each employee on your payroll and avoid employee turnover as much as possible.


The formulas used to calculate employee benefits, and employer insurance amounts vary by state. [Consult an expert](#) in your state for specifics.

State Disability Insurance

State disability insurance is typically managed in one of two ways:

- Employer provides disability benefits to employees directly
- Employer pays into a state-managed fund that provides disability benefits to employees

Your responsibility for disability insurance will depend on your state's elected disability program. It's best to check with an expert to understand your responsibilities for disability insurance.

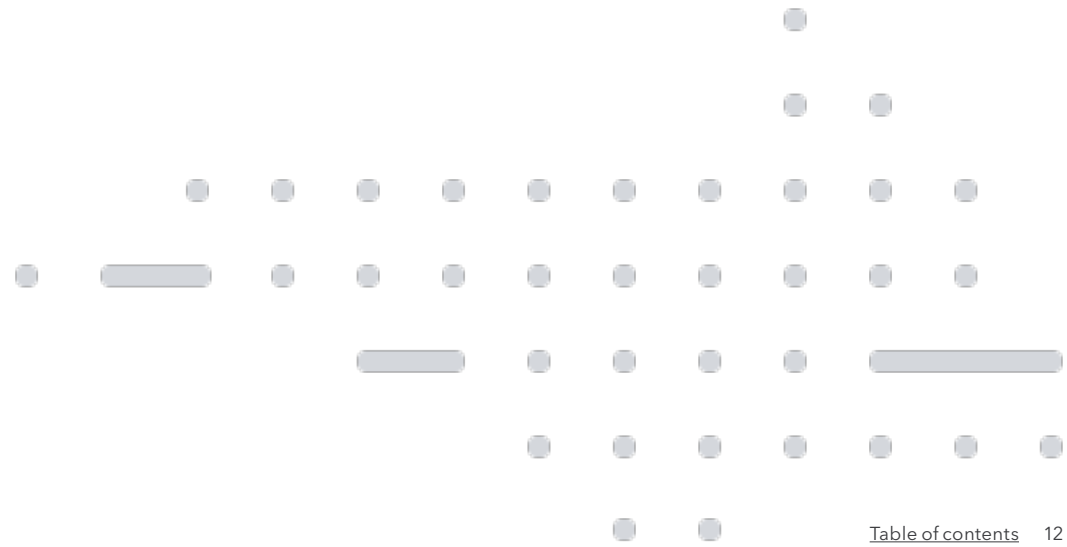


In most states, employers must pay into state-managed insurance funds that protect workers.

Workers' compensation, unemployment, and disability insurance are the most commonly required policies you need to be aware of before your first employee arrives. However, additional insurance may be required or recommended depending on the nature of your business.

For instance, if you run a professionally licensed services company (e.g. legal practice, medical practice, accounting firm, etc.) you may be required to carry some form of malpractice insurance. If you fall into this type of category, start by checking with your state licensing agency. Such agencies are typically well-versed in insurance requirements and options.

Other common insurance coverages that are recommended for business include commercial general liability insurance, directors and officers' insurance, employer practices liability, property and casualty insurance, and umbrella insurance policies.





HR Policies and Procedures

Although workplace policies and procedures are not legally required, most employers create and maintain [policies and procedures](#) for multiple reasons:

- Set expectations between employee and employer
- Prevent unlawful conduct by both employee and employer in the workplace
- Resolve workplace conflicts before such conflicts escalate into legal claims
- Promote a healthy company culture and communicate company values

Employee Handbooks

An employee handbook provides a central location to keep company policies. The handbook gives you the ability to accomplish the four goals listed above and easily update the policies as needed.

Frequent changes in law and your goal to constantly improve your company culture creates the need to edit your policies consistently. It's easier to update a single handbook than to manage dozens of different documents and manuals.

In the unfortunate event that you face a lawsuit or a government inquiry into your employment practices, your handbook is a solid piece of evidence showing your compliance with the law.

The potential list of policies and procedures is limitless. As your company grows, maintaining a compliant handbook will likely become a future employee's full-time job.



There's no single recipe for drafting an employee handbook. But, there are some best practices:

- Use language that balances professionalism and your company culture
- Avoid legalese. Use plain language.
- Avoid language that suggests your handbook creates a contract between you as the employer and the employee
- Avoid absolutes. Leave discretion for the employer to make decisions based on the situation. For example, a set list of "fireable" offenses suggests that employees can be fired only if they violate the list.
- Translate the handbook into the languages your employees, or potential employees, speak (and update as your workforce and geography expands)
- List company contacts who can answer questions related to a specific policy
- Comply with the current law, and update as laws change
- Ensure company policies don't contradict each other
- Create a table of contents and organize subjects and policies by subject matter
- Create a tracking system for changes (including dates of changes), so employees can easily see what changes have been made and review changes of interest
- Always date the first page with the most recent date of any change
- If all employees have intranet access, post the handbook on your internal intranet. If intranet access is not available to all employees, make the handbook available in some method for all employees to have access
- Proactively inform employees when changes have been made
- Include appropriate disclaimers
 - The handbook is not a contract. Employment is at-will
 - The employer has the right to modify policies at anything with or without notice
 - Policies and procedures are guidelines only, and the employer has the discretion to act outside of procedures and guidelines
- Create a process for employees to acknowledge receipt, review, and understanding of handbook



Here's a list of common policies that you can find in a modern employee handbook:

- At-will employment policy
- Equal employment policy
- Anti-discrimination policy
- Anti-retaliation policy
- Disability accommodations policy
- Religious accommodations policy
- Social media policy
- Payroll practices
- Compensation policy
- Workweek and business hours
- Timekeeping
- Pay period and Payday
- Bonus program
- Retirement benefits
- Sick leave
- Vacation policy
- Lactation breaks
- Meal breaks
- Business travel and expense policy
- Tuition reimbursement policy
- Employee referral policy
- Nepotism policy
- Attendance policy
- Code of conduct
- Performance review procedure and policy
- Dress code
- IT resources policy
- Communications policy
- Social media policy
- Privacy policy
- Bring your own device to work policy
- Outside employment policy
- Non-compete policy
- Intellectual property rights policy
- Confidentiality obligations
- Employee non-solicitation policy
- Telecommuting and remote work policy
- Flexible work schedule policy
- Company car policy
- Health and safety in the workplace policy
- Substance abuse policy
- Drug testing policy
- Workplace violence
- Employee benefits
- Pregnancy and parental leave policy
- Bereavement policy
- Military service leave policy
- Jury Duty leave policy

As long as this list seems, the number of procedures and policies continues to grow in modern workplaces.

You don't need all of these policies in place before your first employee arrives.

You need a basic handbook with some critical policies in place before you hire your first employee.

Some of the policies you should consider for your employee handbook before you first employee comes to work are listed below.

At-Will Employment Policy


Unless you have a compelling reason to hire employees on a contract basis, you will most likely hire your first employee on an at-will basis.

At-will employment means that the employee or the employer may voluntarily terminate employment at any time, with or without notice, with or without cause.

Your offer letters should include the mention of at-will employment. However, to reaffirm the at-will status of your employees, it's best to maintain an independent at-will employment policy that employees can review.

Many employers go the extra step and add an at-will employment disclaimer to any published company policy. A typical policy disclaimer states that the applicable policy doesn't create a contract between employee and employer, and reiterates at-will employment:

"Nothing in this policy is intended in any way to create a contract of employment. Each employee is employed at-will and both employee and employer have the right to terminate the employment relationship at any time with or without notice or cause."



You need a basic handbook with some critical policies in place before you hire your first employee.

Equal Employment and Anti-Discrimination Policies

Although at-will employment seems to allow you to terminate an employee for any reason, anti-discrimination and workers' rights laws disallow you to terminate or take any action against an employee, or a potential employee, for protected reasons.

Protected reasons include protected characteristics and protected activities.

The list of protected characteristics and protected activities consistently change. Federal, state, and local governments investigate and enforce laws related to protected characteristics and activities.

Unfortunately, there is no single source to ensure your equal employment and anti-discrimination policies are up to date.

Here is a list of government resources to assist you:

- [Equal Employment Opportunity Commission \(EEOC\)](#)
- [National Labor Relations Board \(NLRB\)](#)
- [US Department of Labor \(DOL\)](#)
- [US Department of Justice, Civil Rights Division \(DOJ, CRD\)](#)

Anti-Retaliation Policy

Similar to equal employment and anti-discrimination policies, you cannot retaliate against an employee for protected reasons. It's a best practice to create a separate anti-retaliation policy. Even employers with the best intentions can unwittingly retaliate against employees.

A strong anti-retaliation policy clearly states that your company will not tolerate unlawful retaliation in any form such as discipline, intimidation, change of working conditions, or any other form.

Protected reasons include protected characteristics and protected activities.

Examples of protected characteristics include:

- Age
- Citizenship
- Color
- Genetic information
- National origin or ancestry
- Physical or mental disability
- Race
- Religion or creed
- Sex, including pregnancy
- Veteran status

Examples of protected activities include:

- Making good faith complaints
- Filing lawsuits
- Concerted activity (e.g. join a representative organization (union), collective bargaining)
- Discuss working conditions
- Strike
- Request access to personal employee file

Your anti-retaliation policy should clearly show a procedure for how complaints and protected activity is responded to by your company. The company should follow this policy when responding to any such complaint.

Review an example of how a well-intentioned employer accidentally retaliates:

Retaliation is a common claim from the modern workforce. Implement your anti-retaliation policy as soon as possible, and use clear examples like the one above, to train yourself and your employees.

Time-Off Policy

Did you discuss vacation time with your first employee during the interview process? If you did, did you discuss how to request time off, whether sick days and vacation days are treated the same, and what is considered a company holiday and what isn't?

Not only is time off expected from employees, but more and more states are also implementing laws that mandate minimum levels of time off.

A clear time off policy ensures legal compliance and sets proper expectations for your employees.

Your time off policy should address all aspects of requesting and taking time off:

- Paid time off (vacation, sick days)
- Unpaid time off (FMLA, leave of absence, etc.)
- Company holidays
- Request and approval procedure
- Work coverage
- Voting
- Religious rights

Review an example of how a well-intentioned employer accidentally retaliates:

- Employee 1 submits a sexual harassment report against Employee 2.
- Employee 1 and Employee 2 sit in the same area.
- After the report, Employee 1 no longer feels comfortable sitting closely to Employee 2.
- Because you want Employee 1 to feel comfortable, you offer to move Employee 1 to a new location or let Employee 1 work from home until the matter is investigated and resolved.
- Unfortunately, your changing Employee 1's location could be seen as retaliation. The more appropriate action is to send Employee 2 home until the matter is resolved.

- Time off accrual methodology
- Bereavement
- Maternity/Paternity Leave

As with most policies, clarity is key. Use plain language to describe each element of your time off policies. Any employee or candidate should be able to read your time off policy and understand the circumstances under which he or she can request and take time off.

Employee Code of Conduct

A code of conduct, sometimes referred to as a business code of ethics, allows you to communicate your business values and expected behavior to your employees.

Through a code of conduct, you inform your employees of what's expected from them in interactions between each other and with customers, suppliers, and other third parties.

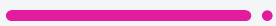
Your code of conduct is more than a mere list of "Dont's".

Use the code as an opportunity to state your value system. If you have a mission or value statement, restate it in your code of conduct. Use the code to list behavior that builds towards achieving your mission statement.

Balance expected, positive behavior with strictly prohibited behavior.

Common prohibited behavior includes:

- Fraud
- Theft
- Violence
- Bribery



**Your code of
conduct is more
than a mere list of
"Dont's".**

- Sleeping at work
- Habitual absenteeism
- Neglecting job duties

Once you have drafted a code of conduct, it's best to have an attorney review it. Some business' codes of conduct have been found to violate protected activity.

For instance, a recent court found that a prohibition on defaming the company disallowed workers from discussing their working conditions (a protected activity). Another court decided that a prohibition against profanity in the workplace chilled workers' first amendment rights (another protected activity).

But, the courts have found that an employer can prohibit employees from defaming customers or using profanity in front of customers.

These small differences are created, and updated, in the courts. Attorneys can help you stay up to date with where the law stands at any given time.

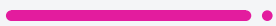
Additional Workplace Policies

You likely need additional policies in your employee handbook before you hire your first employee. The exact policies will depend on the nature of your business and the role of your first hire.

If your first employee will travel extensively, a travel and expense reimbursement policy is important.

If your employee will actively use social media in his or her role, a social media policy and bring your own device policy are important to have immediately.

Keep in mind, none of these policies are required by law, but implementing such policies is a strong attempt to keep you and your employees from violating the law.



**Balance expected,
positive behavior
with strictly
prohibited
behavior.**



Worker's Rights

No single definition of workers' rights exists. There is no one law or government agency that dictates workers' rights.

But, your workers, including your first hire, have plenty of rights. And It is your responsibility to protect their rights.

Focus on two categories to ensure workers' rights compliance before your first employee arrives:

- Wages
- Working conditions

Wages

The Fair Labor Standards Act (FLSA) is the primary federal law governing wages for both full time and part-time employees. The FLSA sets standards for minimum wage, overtime, timekeeping, and more.

To ensure you are paying your first employee in compliance with federal law, you must first ensure that you have classified your employee correctly.

Your first employee will be classified as either exempt or nonexempt under the FLSA.

Employees are presumed nonexempt unless a series of tests qualify the employee for exempt status. You, as the employer, must meet minimum requirements to protect your nonexempt employees' FLSA rights:

- Track time
- Pay at least the [federal minimum wage](#)
- Pay [minimum overtime rate](#) for all hours worked over 40 in a workweek.



You have the burden of protecting your nonexempt employees' FLSA rights.

You can include your employees in the compliance process through policies and procedures (e.g. require employees to report all hours worked, disallow overtime beyond certain time limits, etc.); however, the employer ultimately maintains responsibility for wage compliance.

It's critical to implement compliant time tracking and wage compliance policies before your first hire starts. If you are like many entrepreneurs, you work around the clock and time tracking is the last thing on your mind.

Unless your first employee qualifies as an exempt employee under the FLSA, they can't be expected to have the same disregard for personal time as you do. If your first employee is exempt, you are not required to track time, pay minimum wage, or pay overtime.

To classify an employee as exempt, the employee must pass three tests for exemption:

- Salary basis test
- Salary level test
- Job duties test

An employee meets the salary basis test if you pay the employee:

- On a frequent basis (e.g. weekly, bi-monthly, monthly)
- A predetermined amount that includes all or part of the employee's compensation
- An amount that is not subject to reduction based on the quality or quantity of the work performed

Certain deductions are permissible under the salary basis test; however, many deductions are not. Rulings on permissible deductions are frequently challenged in court. Visit the [DOL's Wage and Hour division Fact Sheets](#) for updates.

The salary level test varies depending on the job duties test category (discussed below). For Executive, Administrative, and Professional exemptions, you must pay an exempt employee at least \$455 per week to meet the salary level test.

For the Computer Professional exemption, you must pay an exempt employee at least \$455 per week, or an hourly rate of at least \$27.63.

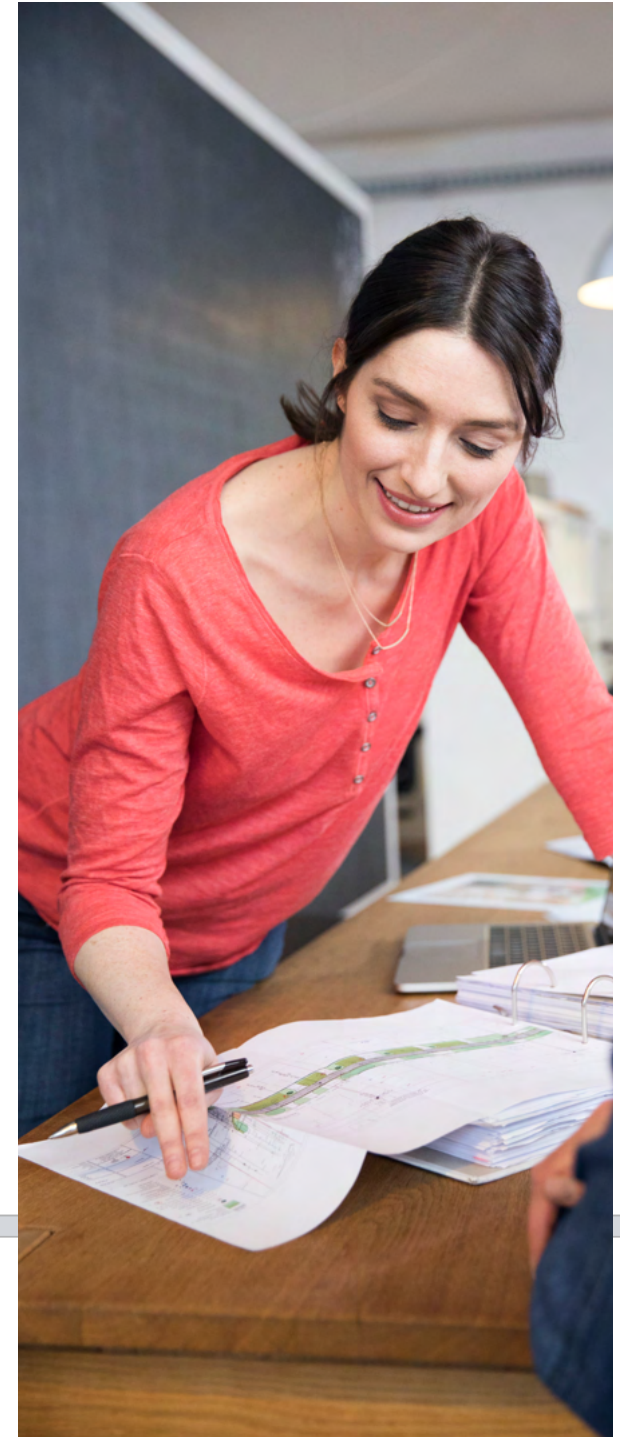
For the Highly Compensated Employee exemption, you must pay an exempt employee at least \$455 per week on a salary basis, and at least \$100,000 per year in total. No salary level test applies to the Outside Sales exemption.

The salary level test became a major source of political tension during the past few administrations. Certain changes approved by the Obama Administration were challenged by the states, and the changes were mostly invalidated under the Trump Administration. To stay current on salary levels, review the [DOL's Wage and Hour division Fact Sheets](#).

An employee meets the job duties test if his or her role falls under one of six categories:

- [Executive exemption](#)
- [Administrative exemption](#)
- [Professional exemption](#)
- [Computer professional exemption](#)
- [Outside sales exemption](#)
- [Highly Compensated Employee exemption](#)

When conducting the job duties test, you should analyze the duties that your employee actually performs in the course of his or her performance. The job description alone will not qualify for one of the exemptions.



Don't assume that a particular role meets one of the categories because of the job title. Each of the categories includes specific requirements that must be met in order to qualify for an exemption.

For all details on the job duties categories, visit the hyperlinks in the list above.

The job duties categories are broad in title, but specific in practice. Visit the [DOL's Wage and Hour division Fact Sheets](#) and consult an expert if you think your first employee might be exempt under the FLSA.

Working Conditions

Working conditions is a broad category that includes the many areas outside of wages where you must respect your workers' rights. You should focus on compliance in two areas of working conditions when readying your business for its first employees:

- Workers' rights to associate and discuss working conditions
- Workers' safety

Workers' rights to associate and discuss working conditions is not likely a concern for your first employee. These topics deal mainly with employees' rights to negotiate better working conditions, form and join unions, strike, and participate in other activities common to large workforces.

While these issues won't affect you as you prepare for your first hire, you do have some compliance responsibilities regarding these protected activities. Your main responsibilities in this area are to ensure your employees know their rights through posting required signage at your office.

[QuickBooks Labor Law Poster Service](#) helps automate your signage obligations.

Below is a brief description of each exemption category.

The Executive exemption applies to business owners who:

- Own at least a 20% equity interest in your company, AND
- Take an active management role your company

The Administrative exemption applies to employees who:

- Perform non-manual work in the management or operation of your company or your customers, AND
- Use independent judgment in matters of significance (i.e. a decision maker)

The Professional exemption applies to employees who are:

- Learned professionals (advanced knowledge and instruction in a field of science or learning), OR
 - Examples include lawyers, accountants, engineers, architects, teachers, scientists, pharmacists
- Creative professionals (requires invention, imagination, originality, or talent)
 - Examples include actors, musicians, conductors, illustrators

The Computer professional exemption applies to:

The QuickBooks service creates initial signage and any updates needed when laws are amended.

The service addresses notice requirements for both federal and state law.

The Occupational Safety and Health Administration (OSHA) is the primary government agency protecting worker safety.

As a small business employer, you may have heard that OSHA jurisdiction doesn't apply to you until you have 10 employees. This is not always the case.

There are some narrow exceptions in certain industries and certain reporting requirements for businesses under 10 employees. However, OSHA generally has jurisdiction over all businesses.

Your OSHA responsibilities will vary depending on the nature of your business. A financial services firm working out of a traditional white collar office space will have drastically different safety requirements than a manufacturing facility.

If your business activity exposes employees to any type of safety hazard, it's best to seek expert guidance.

Regardless of industry, use two guiding principles from the [OSHA duties clause](#) when considering safety in your workplace:

- Provide your employees with a work environment that is free from recognized hazards that are likely to cause death or serious physical harm; and
- Comply with [occupational safety and health standards](#)

- Computer systems analysts, OR
- Computer programmers, OR
- Software engineers, OR
- Other roles with duties similar to the above-listed

The Outside sales exemption applies to employees who:

- Make sales, AND
- Take orders or make contracts for orders, AND
- Regularly work outside of your business office, AND
- Do not make sales only by mail, telephone, or internet

The Highly Compensated Employee (HCE) exemption applies to employees who:

- Meet the HCE salary level test mentioned above, AND
- Perform non-manual work, office work, AND
- Regularly engage in administrative, executive, or professional tasks



Accounting

Once you address the legal and regulatory issues of hiring that first employee, you must consider the accounting process required to pay employees. This section starts with some rules of the road for payroll recordkeeping, then provides a step-by-step process for calculating and paying workers.

If you add employees to support company growth, the accounting process becomes more complicated. As your firm grows, you may add worker benefits, such as health insurance and retirement plans. This discussion wraps up with a look at benefits, and how you can use a procedures manual and outsourcing to manage payroll complexity.

As you read through this section, consider how you'll manage these processes in your own business.

Recordkeeping Basics

In order to generate accurate accounting data, you need to create some basic systems. Every owner should keep business records separate from personal transactions, and you should have a separate bank account for your business activity.

One effective tactic for growing your business is to automate as many routine tasks as possible, including your payroll process. Finally, you need to understand the key components of payroll processing.

Business vs. Personal Activity

It's critically important to [separate business from personal transactions](#) and to take this step from the moment you start your company. Here are some reasons why:

- **Legal liability:** Some business structures, such as a C corporation, allow you to set up a business entity

that is separate from you as an individual. This distinction is important, because you may be able to protect your personal assets from a lawsuit involving your business. If your personal and business records are not carefully separated, this legal separation may not apply. Consult with an attorney on this issue.

- **Management, taxes:** Business owners use accounting data to make informed decisions, such as how to set a price for a product, or how much cash a company needs to operate. If a personal activity is mixed in your business records, you don't have accurate data to make decisions. You also need an accurate set of company financial statements to prepare your business taxes.
- **Investors, purchasers:** If you decide to bring in another investor, or you want to sell your business down the road, you'll need to provide financial statements that exclude all personal transactions.

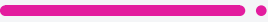
Start your business on the right foot by excluding personal transactions. Using accounting software makes this process easier as all of the accounts in your software will be business-related. As a result, you're less likely to post a personal transaction to a business account.

Finally, keep your business records in order by using a separate business bank account.

Why Automate?

Business growth is exciting.

Getting a new client or signing a contract with a new customer is satisfying, and it validates your business approach. However, business growth makes operating your business more complex. As you add customers, you'll generate more invoices, spend more money, and post more accounting transactions.



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It's tempting to use the same processes to operate your company as you grow, but those same systems may not be effective over time. This is a big issue for business owners that hire employees and must deal with payroll. As you'll read below, accounting for payroll is complex, and the tax laws change frequently.

If you use Excel to post your [accounting records](#), you'll quickly find that spreadsheets are not sufficient for handling payroll. Using Excel is time-consuming, and you're far more likely to make a posting error. There's also the risk of losing your files or using the wrong version of a particular file.

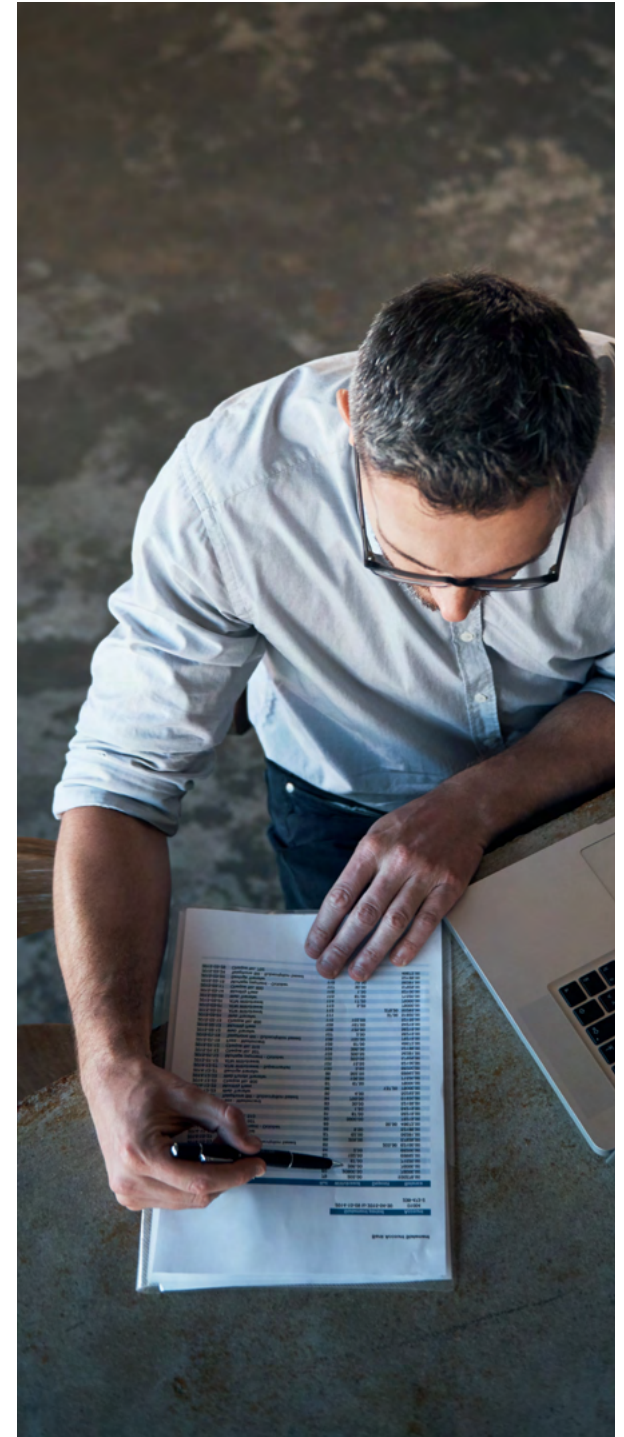
When you hire that first employee, you should strongly consider using accounting software to [process payroll](#). To grow your business successfully, you need to automate as many routine tasks as possible, including payroll.

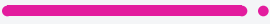
How Payroll Works

Processing payroll boils down to four steps:

- **Data collection:** You must collect information from your new employee, including tax information. Collecting data is the first step.
- **Withholding amounts:** Employers are required to calculate and withhold federal and state taxes, and other amounts from payroll.
- **Pay employees:** After withholdings are calculated, you pay employees.
- **Reporting and forwarding payments:** The last step in payroll is to forward taxes and other amounts withheld to the correct entity, and to report the amounts to each entity. If \$200 in federal taxes are withheld from a worker's pay, that \$200 must be sent to the IRS, and properly reported.

Now that you understand the basics of the process, consider a specific example of payroll processing.





How to Do Payroll: Step-by-Step

Assume, for this example, that Julie, the owner of Hillside Landscaping, hires Joe to be her office manager. Joe's job is to take on many of the tasks that are not directly related to Julie's landscaping work. Joe answers calls from customers and prospects, handles the mail, and buys supplies with Julie's approval, among other tasks. Hiring Joe allows Julie to maximize her time providing landscaping work for customers.

Joe's salary is \$52,000 a year, and Julie decides to pay Joe every other week, or 26 times a year. As a result, Joe is paid \$2,000 in gross wages each pay period.

Employee Decisions

Joe completes the W-4 form and makes decisions regarding federal tax withholdings, and he completes a similar document for state tax withholdings. Julie uses [tax tables](#) to calculate Joe's withholding for federal taxes, and she consults her state department of revenue's tax tables to compute Joe's state tax withholdings.

Calculating Withholdings

To keep the math simple, assume that Julie computes a 20% withholding for federal taxes and 5% for state taxes.

Employers must also withhold the worker's share of FICA taxes from payroll. FICA taxes are withheld to fund Social Security and Medicare, and the current tax rate is 7.65% for both the worker and the employer. Julie, the business owner, will also pay 7.65% for FICA, and the employer contribution as a business expense.



The formula to compute Joe’s net pay for the first payroll period is (\$2,000 gross pay - \$400 federal tax withholdings less \$100 state tax withholdings less \$153 FICA tax= \$1,347 net pay).

Processing Payroll

The details of the payroll calculation are posted as an accounting [journal entry](#). A journal entry collects all of the important information for a particular transaction, and the data from each journal entry is used to create the financial statements.

Here is Julie’s journal entry to calculate Joe’s net pay on the first pay date:

You’ll note that the journal entry uses [debits and credits](#), and that the journal entry includes the date and an explanation of the entry (to pay payroll). Note the following:

- **Wage expense:** The \$2,000 in gross wages is a company expense, and expenses are increased with a debit.
- **Withholdings:** Hillside Landscaping withholds taxes, and each amount withheld must be submitted to a taxing authority. Until the payments are sent, these amounts are a company liability, and liabilities are increased with a credit entry.
- **Net pay:** The difference between gross pay and the withholdings is net pay, and cash is reduced (credited) to pay the worker.

March 1st, 2018	Debit	Credit
Wage expense	2,000	
Federal tax withholding		400
State tax withholding		100
FICA tax withholding		153
Cash (net pay)		1,347
(To pay payroll on 3/1/18)		

This type of journal entry is posted on each payment date.

Reporting and Paying Taxes

The amounts a business withholds from gross pay must be sent to each taxing authority, along with a report that states the amounts and employees who are paid during the period. These payments can be challenging, because the different entities may require payments on different dates. You may have to report and submit payments annually, quarterly, monthly, or even weekly, depending on the type of withholding, and the dollar amount. To determine the correct payment schedule, you need to consult the IRS (federal tax and FICA tax) and state department of revenue (state tax) websites.

To keep things simple for this example, assume that the three amounts withheld are paid on March 15th. Here is the journal entry for paying the amounts withheld:

March 15, 2018	Debit	Credit
Federal tax withholding	400	
State tax withholding	100	
FICA tax withholding	153	
Cash		653

(To pay amounts withheld from gross pay)

The liability accounts are reduced with debit entries, and cash is reduced by posting a credit entry.

It's important that every withholding amount is paid on time, because your business may incur late fees and penalties for late payments.



Year-end Reporting

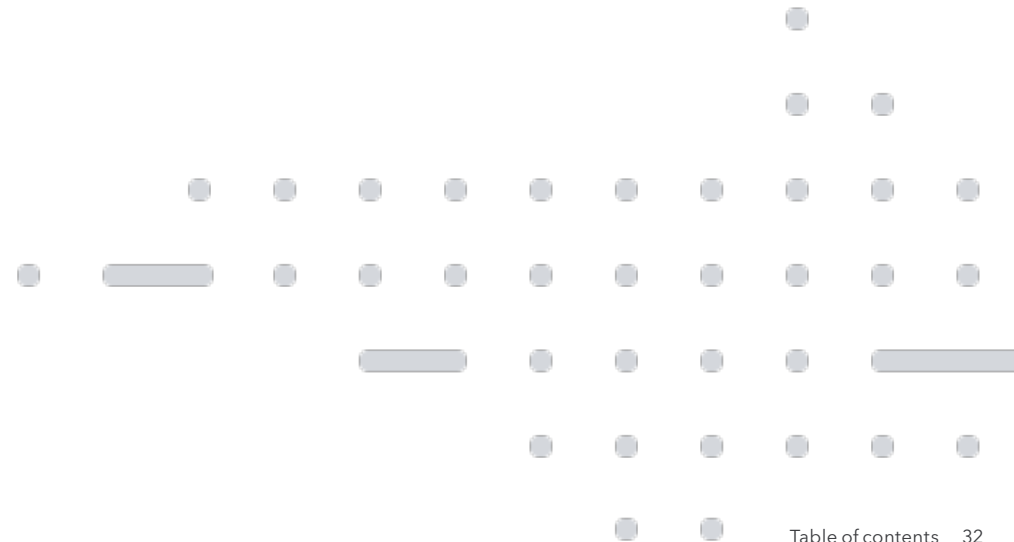
Each taxing authority (federal, state, FICA) requires an employer to report the total amounts submitted for the year. Hillside Landscaping will issue Joe a W-2, which lists the total dollar amounts withheld for payroll during the year.

Keep in mind that reporting and paying the correct amounts has a direct impact on your employee's personal tax return. Joe, for example, will use the total federal taxes withheld by Hillside Landscaping when he prepares his tax return. If the total federal taxes withheld on the W-2 do not match the dollar amount Hillside submitted to the IRS, Joe's tax return will be incorrect.

Make sure that you carefully handle payment reporting, because generating a tax problem for a worker may damage your relationship with your valued employee.

Easy, accurate, done. That's payroll, perfected.

Handle withholdings, employee classifications, benefit deductions and more with [QuickBooks Payroll](#).





Managing Complexity

As you grow your business, you'll have to face several issues that make processing payroll more complicated. First, realize that payroll will become more complex simply by hiring more people. If Julie staffs up to five employees, for example, she must collect data, calculate withholdings, pay, and report taxes on five people 26 times a year. Hillside must generate five W-2s at year end, and submit tax payments for each worker.

How complicated would Julie's payroll and accounting be for 50 workers?

As Julie adds to her staff, she may want to start offering benefits as an incentive to retain valuable workers. Two common types of benefits are health insurance and retirement plans.

Finally, to manage the growing complexity of payroll, a business owner needs to leverage technology and hire experts.

Adding Employee Benefits

Most employer-provided health insurance plans require that the employer and the worker each pay a portion of the insurance premiums. Just as with FICA taxes, the employer-paid portion of the insurance coverage is a business expense.

Premiums paid by workers must be part of the net pay calculation and withheld from the payroll. The employer must submit the premium payments to the insurance company, along with a report of the worker names and amounts paid.

In a similar way, retirement plan funding may include company contributions and dollars contributed by the worker. Offering a retirement plan adds another step to the net pay calculation, and to a company's accounting and payroll reporting process.

Preparing for Growth

To avoid a huge investment of time in the payroll process, smart business owners must prepare for growth, using these resources:

- **Procedures manual:** Your business should have a written procedure manual for every routine task that you must complete every month, and that includes payroll processing. Your manual should include each step of the process, who performs each step, and access to the records needed to complete the work.
- **Accounting software:** Find [accounting software that is user-friendly](#), and a system that is designed to handle your business needs as you grow over time.
- **Payroll company:** Many companies, even businesses with just a few employees, use a third-party [payroll service](#) for a portion of their payroll processing. For example, you may use an outside firm to submit direct deposit payments to each of your employees. A payroll company can also provide updates for changes in federal and state payroll tax laws.

Set yourself up for growth by writing a formal procedures manual, purchasing accounting software, and by considering the services of a payroll company.

Conclusion

Just about every business owner must hire employees to grow a company over time, and hiring your first worker can be exciting.

Before you take the plunge and hire staff, think carefully about the topics covered here. You need to plan for hiring so that you properly address the related legal and accounting issues. Follow these steps to hire that first worker and to increase your sales and profits.