

BY THE BOOK

A Publication of Baker, Peterson & Franklin, CPA, LLP

Checklist for Year-End Payroll Processing

- Ask employees to verify their names, addresses and Social Security Numbers before preparing W-2s. Employee names should be reported in capital letters exactly as on their Social Security cards—do not use nicknames or titles such as Dr., Mr., etc.
- Finalize the last payroll of the year 2002. Wages earned in 2002 and paid with a check dated in 2003 will be reported in 2003.
- Check that no one exceeded the annual withholding limits of \$5,263.80 for Social Security or \$416.94 for State Disability Insurance. If someone has exceeded the limits, make adjustments or refunds before making the final payroll tax deposit for tax year 2002.
- Reconcile payroll data to the general ledger. Verify that all manual or voided payroll checks have been properly recorded.
- Record other employee taxable income such as personal use of company vehicles, relocation expense reimbursements, and company-paid education assistance.
- Print quarterly and year-end reports. Print W-2s. Verify that quarterly tax returns added together agree with the amounts reported on the W-2s. Make sure the Employer Identification Number is correct on all forms.
- Make a year-end backup. Close 4th quarter and year-end payroll. Load new tax tables for 2003.
- Ask employees to complete new W-4 forms to report changes for 2003. Employees who claimed exempt in 2002 must turn in a new W-4 form by February 15th (or employer must start withholding as Single-0).
- Employee W-2 copies should be in employee's possession, postmarked or available on a website by January 31, 2003.
- If you file 250 or more Forms W-2, you must report to the Social Security Administration on magnetic media.
- Form W-2, Copy A, and Form W-3 must be postmarked by February 28, 2003. Send via Certified Mail and keep the receipt.
- Mail to the Social Security Administration, Data Operations Center, Wilkes Barre, PA 18769-0001. If sending by Certified Mail, use zip code 18769-0002.

Verify that all manual or voided payroll checks have been properly recorded.

Checklist for 1099-MISC Reporting

If the following four conditions are met, businesses must generally report nonemployee compensation on Form 1099-MISC:

- You made the payment to someone who is not your employee
 - You made the payment for services in the course of your trade or business
 - You made the payment to an individual, partnership, estate, or attorney
 - You made payments to the payee of at least \$600 during the calendar year
- Provide the payee with Form W-9 "Request for Taxpayer Identification Number and Certification." Update your vendor files to include the vendor name, address, and tax identification number (TIN). When entering an address, do not use a number (#) sign (for example, enter "Apt B" rather than "Apt #B").
- If a Social Security Number is to be used as the TIN, use this person's name on the top line in the "recipient" box, with the business name underneath. Social Security Numbers are to be typed in a 000-00-0000 format.
- Amounts should be presented without dollar signs or commas. Add a decimal followed by the cents. Leave the box blank if the amount is zero.
- Report on preprinted forms, not photocopies. Be sure to order forms in advance or if you only need a few, they are available from most stationery stores. You **cannot** use forms printed from the IRS website. Do not use prior year forms to report current year information.
- Recipient copies (Copy B) are due or postmarked by January 31, 2003. Internal Revenue Service copies (Copy A) must be postmarked by February 28, 2003 (or filed by magnetic media by March 31, 2003).
- Mail to the Internal Revenue Service, Ogden, UT 84201.

For more information see "General Instructions for Forms 1099, 1098, 5498, and W-2G" available at www.irs.gov.

California Unclaimed Property

You may be one of the fortunate individuals who has unclaimed property at the State Controller's Office. The Controller's Office has an amnesty program for holders of unclaimed property which ends on December 31, 2002. There will be new additions to the website after the first of the year.

To find out if you have unclaimed property, go to the website at www.sco.ca.gov and click on "Unclaimed Property." We suggest you use a last name and first initial only. Look up other family names if you are a beneficiary. You can narrow the search by entering a city. You can also search by business name.

So You Have Household Employees...Here Are Some Helpful Tips

According to the IRS, household employees include housekeepers, private nurses, babysitters, gardeners, and others who work in or around your private residence as your employees. Household workers are your employees if you control not only the work they do, but how they do it.

Repairmen, plumbers, contractors, and other business people who work for you as independent contractors are not your employees.

Wages paid to your spouse, your child (20 years or younger), your parent (some exceptions apply), or an employee who is age 17 or younger and attends school are not included when reporting household employee wages.

Can the employee legally work in the United States?

When you hire a household employee to work for you on a regular basis, you and the employee must complete the Immigration and Naturalization Service (INS) Form I-9, "*Employment Eligibility Verification*." If he or she does not have a Social Security Number they must apply for one. An employee who has lost a card or whose name is not correctly shown on the card should apply for a new one.

Do I need to report and pay federal employment taxes?

Social Security and Medicare

If you pay a household employee cash wages of \$1,300 or more in the year, you generally must withhold Social Security (6.2%) and Medicare taxes (1.45%) from all cash wages you pay to that employee. Social Security and Medicare are calculated as 7.65% of the wages and the employer must match that amount for a total of 15.30%.

If you start withholding from an employee and that employee's wages do not exceed \$1,300 during a calendar year, you will need to repay the employee.

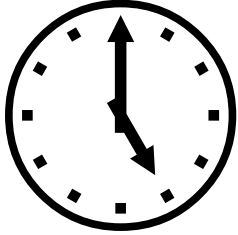
If you do not wish to withhold from the employee, you may pay both the employee and employer share out of your own funds. The Social Security and Medicare taxes you pay to cover your employee's share must be reported in the employee's wages for income tax purposes. However, they are not counted as Social Security and Medicare wages or as federal unemployment (FUTA) wages. Reimbursement for mileage is not counted as part of the cash wages.

Federal Income Tax

You are not required to withhold federal income tax from wages you pay a household employee, unless the employee makes this request and you agree. If so, you will need a completed W-4 "*Employee's Withholding Allowance Certificate*," and the tax withholding table. Also, the employee's wages and withholding will need to be reported on a W-2 form.

Household workers are your employees if you control not only the work they do, but how they do it.

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Federal Unemployment Tax

If you pay cash wages to household employees totaling \$1,000 or more in any calendar quarter, you generally must pay federal unemployment tax on the first \$7,000 earned by each employee.

If the cash wages you pay are less than \$1,000 in each calendar quarter of 2002, but you had household employees who earned more than \$1,000 during any quarter in 2001, the cash wages you pay in 2002 are still FUTA wages.

Do I need to report and pay state employment taxes?

State Disability Insurance

If you paid \$750 or more in one calendar quarter you are responsible for withholding SDI from your employees' wages up to the maximum limit.

State Unemployment Insurance and Employer Training Tax

If wages are \$1,000 or more in one calendar quarter you are responsible for paying UI and ETT taxes based on all taxable wages paid to your employees.

If the cash wages you pay are less than \$1,000 in each calendar quarter of 2002, but you had household employees who earned more than \$1,000 during any quarter in 2001, the cash wages you pay in 2002 are still SUI wages.

State Income Taxes

You are not required to withhold state income tax from wages you pay a household employee, unless the employee makes this request and you agree. If so, you will need a completed W-4 "Employee's Withholding Allowance Certificate," and the state payroll tax withholding table.

How do I report federal wages and employment taxes?

If you own a business as a sole proprietor or your home is on a farm operated for profit, and you pay household employment taxes with your business or farm employment taxes, you must report your household employment taxes with those other employment taxes.

If you do not file reports with your business or farm, and you file Form W-2 or pay federal unemployment tax, you will need to file a Schedule H, "Household Employment Taxes." This form is usually filed after the end of the year with your individual federal income tax return, and payroll taxes are paid with your income taxes. You may have to pay estimated taxes using Form 1040-ES.

How do I report state wages and employment taxes?

If you pay less than \$20,000 in a year, you may elect to pay EDD annually—otherwise you pay quarterly. If you elect to pay annually, the wages still need to be reported quarterly. If you pay more than \$20,000 in a year, the taxes are reported on Form DE6 and paid quarterly using a payroll tax deposit coupon.

What records should I keep?

- Keep a record of the employee's name and Social Security Number exactly as it appears on his or her Social Security card.

- Keep copies of all government forms and reports filed
- Every payday, record the date and amounts of all cash and non-cash wages paid
- Every payday record Social Security tax, Medicare tax, federal income tax, and state employment taxes you withhold or agree to pay for your employee

For more help and questions

The Baker Peterson & Franklin CPA, LLP, bookkeeping staff is available to help you determine what is needed to meet the reporting requirements for household employees based upon your individual situation. Available on the EDD website is a 72-page booklet, "Household Employer's Guide," DE 8829. See also IRS Publication 926, "Household Employer's Tax Guide."

The flow charts on pages 6 and 7 of this newsletter, "State Guide to Household Employee Payroll Taxes" and "Federal Guide to Household Employee Payroll Taxes," summarize the general guidelines.

Other considerations

It is advisable that you check references before hiring anyone who will have regular access to your home. When caring for the elderly or disabled, take special precautions against theft or embezzlement. You will need adequate insurance coverage in the event that the employee is injured on the job. This may be included in your homeowner's policy. California labor law requirements (overtime, minimum wage etc.) can be obtained from the Department of Industrial Relations, Labor Standards Enforcement Division.

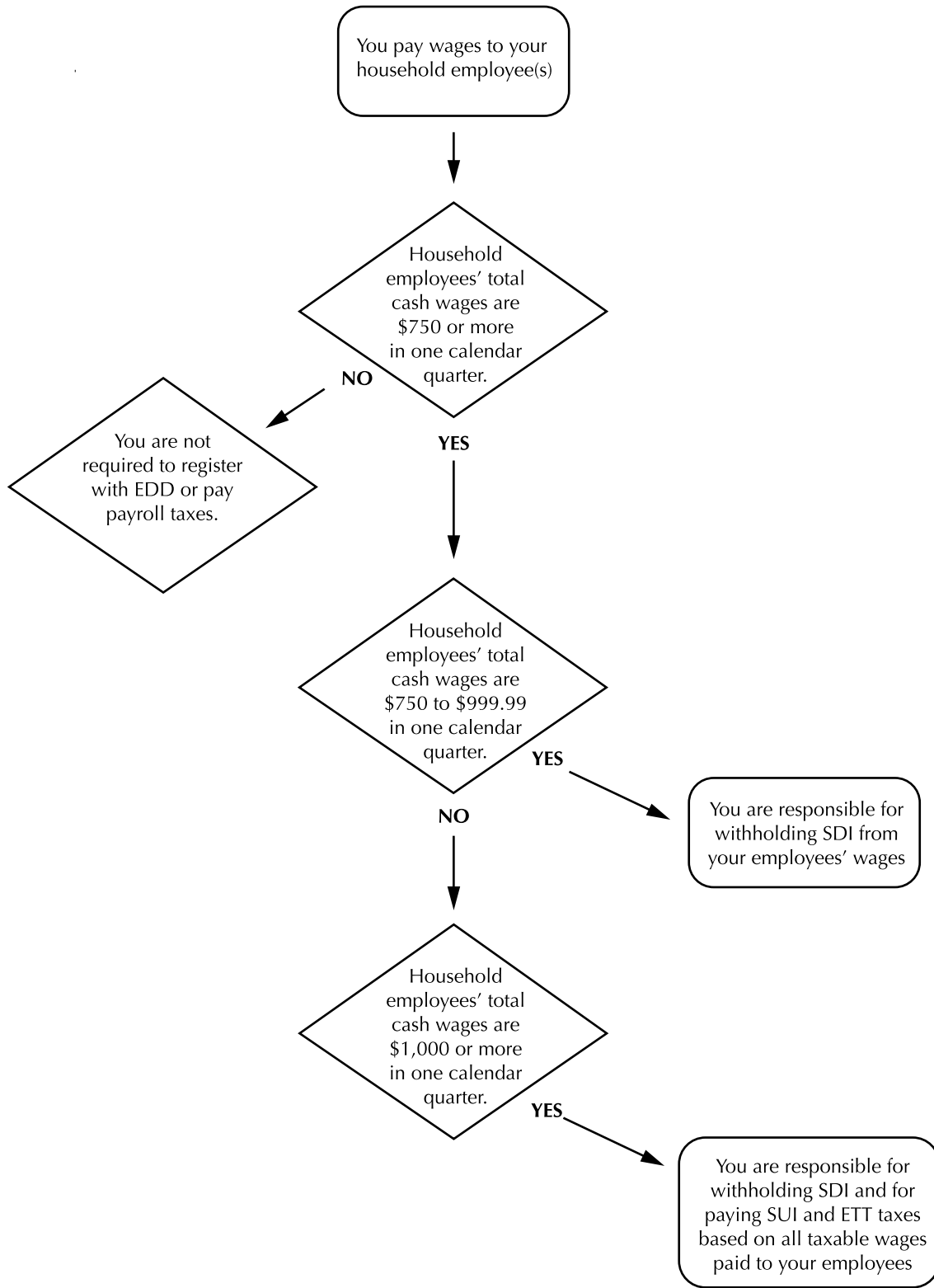
For more information go to www.edd.ca.gov and www.irs.gov



Check Out These .gov Websites

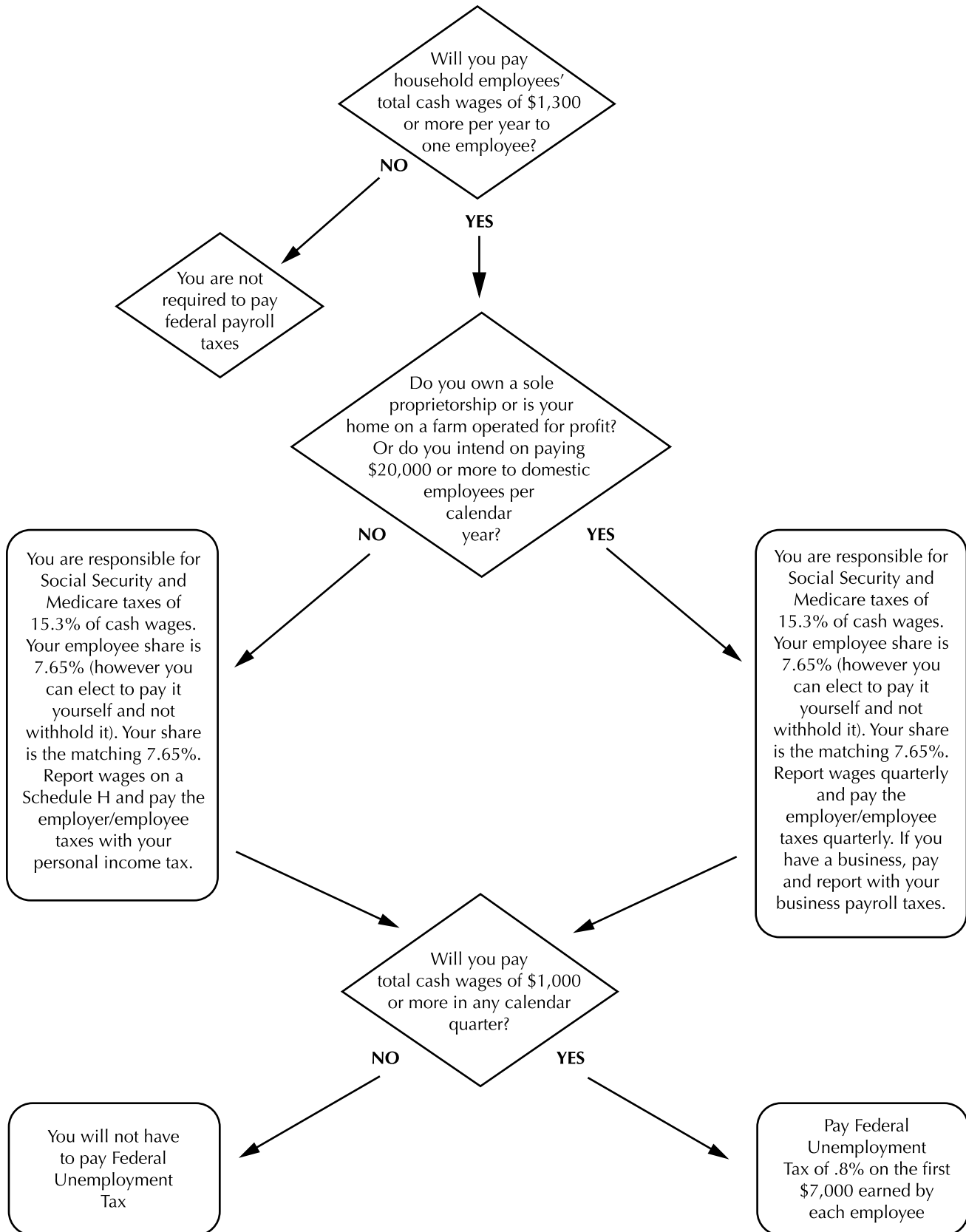
California Dept. of Industrial Relations (DIR), Labor Standards Enforcement Division	www.dir.ca.gov/dlse
California Dept. of Industrial Relations (DIR), Workers' Compensation Division	www.dir.ca.gov/dwc
California Employer Tax Forms	www.edd.ca.gov/taxform.htm
California Environmental Protection Agency	www.calgold.ca.gov
California Tax Information Center	www.taxes.ca.gov
California Legislative Information	www.leginfo.ca.gov
EDD's Labor Market Information Division	www.calmis.ca.gov
Employment Development Department	www.edd.ca.gov
Internal Revenue Service	www.irs.gov
SBA's Online Women's Business Center	www.wbc.gov
Small Business Administration	www.sba.gov
Social Security Administration	www.ssa.gov/employer
State Controller's Office	www.sco.ca.gov
U.S. Business Advisor	www.business.gov

State Guide to Household Employee Payroll Taxes



Source: EDD DE 8829

Federal Guide to Household Employee Payroll Taxes



Family Temporary Disability Insurance Program

The employer will have indirect costs associated with trying to cover job responsibilities for the absent employee.

Beginning January 1, **2004**, California employees who pay for State Disability Insurance (SDI) will have a new payroll tax deduction. The Family Temporary Disability Insurance Program (FTDI) will require employers to deduct .08% (.0008) of the taxable income up to the wage limit of \$68,829. The maximum annual contribution for each employee will be \$55.06. Employees will be eligible to file claims beginning July 1, 2004.

The purpose of the FTDI program is to enable employees to take time off work to care for a seriously ill child, spouse, parent or domestic partner, or to bond with a new child. The employee may claim up to six weeks during a 12-month period (after the initial seven-day waiting period). During this time he or she will be eligible for weekly payments at approximately 55% of their normal earnings up to the maximum weekly amount of \$728.

Employees are covered for FTDI benefits regardless of the size of their employer. The employer will have indirect costs associated with trying to cover job responsibilities for the absent employee.

For more information visit www.ca.gov.

Preventing Fraud in the Workplace

Do not sign blank checks or checks that are not filled out completely.

Let's be honest—as a small business owner you don't want to think it could happen to you, but every year businesses lose money due to internal fraud. Here are a few "Loss controls" to help limit your exposure to fraud:

- Screen personnel before hiring. Check references, educational institutions, professional licenses, credit reports, and possible criminal records.
- Divide responsibilities between several people. For instance, allow one employee to write checks and another employee to reconcile the bank statement. Change responsibilities between employees occasionally or for a short period of time.
- Do not sign checks without proper documentation such as original invoices.
- Do not sign blank checks or checks that are not filled out completely.
- Have bank statements mailed to your home instead of your business and periodically examine cancelled checks and the supporting documentation. Ask questions if something does not look right.
- Be aware of the warning signs of fraud: an employee who often works late, lives beyond his or her means, or is secretive about his or her work.
- Keep cash, checks, employee records, Social Security numbers, original software discs, and computer backups in a secured area.

Table of 2003 Tax Rates

It is time once again to highlight changes for the upcoming year. The maximum wage base and maximum annual deduction will change for FICA and SDI. The standard mileage rate will go down from 36.5 cents to 36 cents. Sales tax will remain the same. Included in the following table are some important rates for the coming year. Please call our office if you have any questions.

PAYROLL TAXES	Rate	Maximum Subject to Tax	Maximum Deduction
FEDERAL			
Employer:			
FICA	6.2 %	\$ 87,000.00	\$ 5,394.00
FICA Medicare	<u>1.45%</u>	All wages – no limit	Unlimited
Total FICA	<u>7.65%</u>		
FUTA	0.8 %	\$7,000.00	\$ 56.00
Employee:			
FICA	6.2 %	\$ 87,000.00	\$ 5,394.00
FICA MEDICARE	<u>1.45%</u>	All wages – no limit	Unlimited
TOTAL FICA	<u>7.65%</u>		
STATE			
Employer:			
SUI (State unemployment insurance)	0.7% to 5.4% Rates will vary	\$ 7,000.00	Amount will vary
ETT (Employment training tax)	0.1 % (Some employers are exempt)	\$ 7,000.00	\$ 7.00
Employee:			
SDI (State disability insurance)	0.9 %	\$ 56,916.00	\$ 512.24
SALES TAX			
Fresno County 7.875%	City of Clovis 8.175%	Madera County 7.75%	Merced County 7.25%
STANDARD MILEAGE RATE FOR 2003 = 36 cents per mile			

Stock Options and Bonuses

Of special note, the state withholding rate changes from 6 percent to 9.3 percent for stock options and bonus payments that constitute wages paid on or after January 1, 2003.

Preparing for an EDD Audit

Don't assume that the status of an independent contractor will be accepted without physical proof.

It may just be a matter of time before you are notified that your business has been selected for an EDD audit. The time to prepare for this is now.

Primarily, the EDD will look for service providers who were treated as independent contractors but should have been treated as employees. The documentation you collect now will be very important in the event of an audit.

What the auditor may request

The auditor may request documentation for up to three calendar years. Keep organized copies of all accounts payable invoices and payroll records for the past three years in addition to the current year.

Here are some of the records you may be asked for:

- Payroll reports DE6 and DE7
- Payroll check registers
- General check registers
- General Ledger detail
- Form 1099-Misc "Miscellaneous Income"
- Form W-9 "Request for Taxpayer Identification Number and Certification"
- Physical proof of independent contractor status such as a contract, business card, or invoice.
- Accounts payable invoices and cancelled checks.

Common pitfalls to avoid

Don't assume that the status of an independent contractor will be accepted without physical proof. You may be asked to provide the auditor with a contract, an invoice, a business card, or copies of advertisement indicating that the worker is in business. Also, does the worker have other clients, or are they primarily engaged in working for your company?

Without documentation, the auditor may determine that service providers who were treated as independent contractors should have been treated as employees. The State will invoice you for SUI, ETT, SDI and California withholding at 6%, plus penalties and interest.

Other common pitfalls are not reporting taxable benefits such as employee's personal use of a company vehicle, or not reporting cash bonuses. These items are subject to payroll tax.

Upcoming Due Dates

January 31, 2003

- W-2 Copies B, C and 2, Wage and Tax Statement, should be in employees' possession, postmarked or available on a Web site
- 941 Employer's Quarterly Federal Tax Return
- 943 Employer's Annual Tax Return for Agricultural Employees
- 940 or 940-EZ Annual Federal Unemployment Tax Return
- DE6 EDD Quarterly Wage and Withholding Report
- DE7 Annual Reconciliation Statement
- 1099s Mailed to payees

February 28, 2003

- W-2 Copy A, Wage and Tax Statement, due to the Social Security Administration
- W-3 Transmittal of Wage and Tax Statements
- 1099 Copy A due to the Internal Revenue Service
- 1096 Annual Summary and Transmittal of U.S. Information Returns

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What To Do If Your Wallet Is Stolen

Some very good advice concerning identity theft was recently passed along via e-mail to our office, and we are sharing it with you. We only hope this never happens to you.

Make a copy of the contents of your wallet—just in case. Copy both sides of each license, credit card, etc., so you will know what you had in your wallet and all of the account numbers and phone numbers to call to cancel the cards and obtain replacement cards. Keep the photocopy in a safe place.

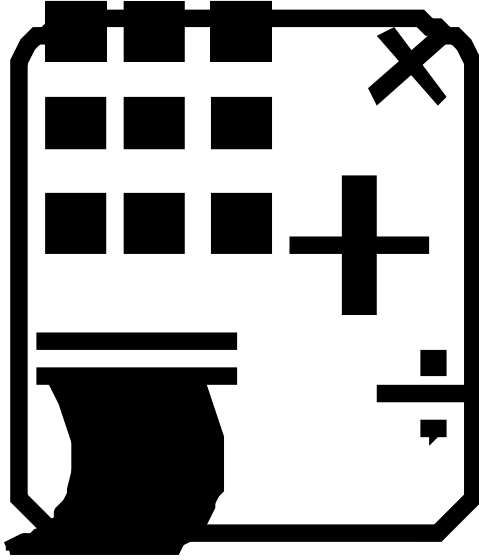
In the event a wallet or purse is stolen, you should do several things:

- Cancel your cards. Use the photocopy you kept to get the numbers.
- Call the three national credit reporting organizations immediately to place a fraud security alert on your name and Social Security Number. The alert means any company that checks your credit knows your information was stolen and they will have to contact you by phone to authorize new credit.
 - Equifax: (800) 525-6285
 - Experian: (888) 397-3742
 - Trans Union: (800) 680-7289
- File a police report in the jurisdiction where it was stolen. This proves to the credit card companies that you were diligent.
- Call the Social Security Administration fraud line at (800) 269-0271

In the event a wallet or purse is stolen, you should do several things.

“By The Book”

The next issue of “BY THE BOOK” will be mailed in Summer 2003 and will be posted on our website under “Resources.” If you would like to receive a copy of “BY THE BOOK” by e-mail, please send your request to: mail@bpfcpa.com. Your questions or comments are welcome.



YEAR-END PAYROLL PROCESSING • 1099-MISC REPORTING • UNCLAIMED PROPERTY •
HOUSEHOLD EMPLOYEES • GOVERNMENT WEBSITES • FAMILY TEMPORARY DISABILITY •
PREVENTING FRAUD • 2003 TAX RATES • PREPARING FOR AN EDD AUDIT • STOLEN WALLET

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