

Outsourced but not forgotten...

Employers using a payroll service are still on the hook if problems come up.

Employers can streamline their business operations and easily meet filing deadlines and deposit requirements by outsourcing payroll and related tax duties to payroll service providers. However, employers that outsource some or all of their payroll responsibilities still remain liable for all taxes, penalties and interest due. We are strong advocates of using a payroll service as it frees up your time to manage and grow your business, and can also be a good tool to ensure compliance with all filing and deposit requirements. The IRS recently issued a warning, though, that any problems that arise with your payroll taxes remain your responsibility even if they are the fault of the payroll service.

Cases such as *Pediatric Affiliates P.A.*, (DC NJ, 2/23/06) illustrate that employers, and not their payroll service providers, are ultimately responsible for the payment of income tax withheld and both the employer and employee portions of Social Security and Medicare taxes. An employer can use a payroll service to remove much of the aggravation and paperwork associated with paying employment taxes. But out of sight shouldn't mean out of mind. Employers remain responsible for all taxes, penalties and interest. That's true even if the failure to pay is entirely due to the payroll service provider's negligence or fraud. What's more, an employer may be held personally liable for certain unpaid federal taxes.

Our office strongly suggests that the address of record with IRS not be changed to that of the payroll service provider. If there are any issues with an account, the IRS will send notices to their address on file. So changing the address may significantly limit your ability to be timely informed of tax matters involving its business. You should ask the payroll service provider if they have a fiduciary bond. This could protect you in the event of default.

You should also ask the service provider to enroll in and use the Electronic Federal Tax Payment System (EFTPS). EFTPS maintains a business's payment history for 16 months and can be viewed on-line. So an employer can immediately confirm payments electronically through the internet or by phone. We recommend that you verify EFTPS payments as part of your bank account reconciliation process. In addition, EFTPS allows employers to make additional tax payments that their payroll service provider isn't making on their behalf (e.g., estimated tax payments).

There have been instances of individuals and companies acting under the guise of service providers, who have stolen funds intended for payment of employment taxes. There are other hazards in outsourcing payroll arrangements, as a recent case illustrates. DT Floormasters, Inc., a California company, contracted with Innovative Personnel Solutions, Inc. (IPS), an Indiana payroll service company, for standard payroll services. IPS leased employees to Floormasters. IPS paid the employees' wages, all employer taxes, federal, state, and local employee withholding taxes, worker's compensation insurance, medical insurance, vacation pay, and benefits. The problem was that IPS owed the IRS for unpaid taxes from transactions having nothing to do with Floormasters. The IRS levied the company's checking account, seizing funds that Floormasters had transferred to IPS. After IPS failed to make the payroll, Floormasters lost those funds and had to pay the employees itself. The district court held that once Floormasters transferred the funds to IPS's bank account, those funds were subject to the tax levy based on IPS' obligations.

Marty Bank manages Integrity Payroll Solutions, LLC and has been in the payroll industry for more than ten years. He agrees that business owners should be diligent about keeping an eye on their payroll tax responsibilities. He noted that several systems are in place to ensure payroll companies comply with the law and remain accountable to their customers. “In my ten years experience, I have only heard rumors of companies making off with customer funds. At most, this is exceptionally rare and should be fairly straightforward to trace and recover in a system that so heavily depends upon electronic funds transfers.” Marty described the paper trail surrounding funds transfers as “bold” and highly traceable.

Marty agrees that contact information should remain with the employer, as noted above. He added that it is extremely important that any notices received be forwarded to the payroll service immediately. “In my business, if we are responsible for any error, we will cover the penalties associated with it. I would expect that any reputable payroll service would do the same, but this is something that should be verified when interviewing payroll services.” He also cautioned against using any payroll service that is not making use of the electronic funds system for tax payments, known as the EFTPS. “EFTPS is a sure method for timely payments.”

When it comes to hiring a payroll service, Marty recommends talking to several companies first. “Like anything else, you should not hesitate to ask for references and testimonials, and call on those references.” When deciding whether to use a service at all, Marty says you need to track your own time in handling payroll for a couple of months. Then look at the fees involved, sometimes as low as \$30 per pay period, and decide whether it makes sense to outsource that function based on the amount of time it takes out of your schedule to do it yourself.

To summarize, using a payroll service is an excellent way to reduce your own aggravation, ensure compliance with filing and deposit requirements, and focus on your business. But in doing so, you still need to keep a careful eye on the process because ultimately you are still responsible to the IRS and state tax and regulatory agencies.



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