FRAMEWORK

CRASH COURSE

Avoiding common payroll mistakes

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Step right up!

Sometimes all you want to do is pack your bags, hitch a ride, and join the circus. But when you're juggling a ton of responsibilities at work, your business can feel like the exact same thing. Whether your company is actually a circus, or a corner cafe, there are a lot of prickly rules involved when you're running the show. And the last thing you want to worry about is making a tiny payroll or accounting mistake that will send everything crashing down. But don't get bummed — in this guide, we'll show you everything you need to look out for.

We've identified the six most common accounting and payroll slip-ups small businesses make, along with the answers you need to cut them out of your life forever. At the end, you'll have a more concrete understanding of how it all works so you can continue to put on an encore-worthy performance.

How do I maximize my tax deduction and minimize my tax exposure?

Crumpled receipts: a common sighting in the life of every business owner. It's no surprise that most folks aren't expense-tracking gurus, particularly when it comes to receipts. How often do you find yourself saying:

Whatever, I'll just wade through this pile of paper when I work on my taxes.

If so, join the club. Thinking that a receipt is not a huge feat is a mistake made by newbies and pros alike. Receipts can become faded, smudged, or even disappear altogether. Around tax time, the impact of these forgotten receipts can be particularly palpable. If you don't organize them properly, you may forget to add expenses on your tax return, which means fewer deductions. There's also a chance you could miscategorize an expense, which could trigger an audit. When it comes down to it, less-than-stellar expense management means you have less-than-stellar insight into your company's spending.

But whisk your fears aside — you can do this. Rather than waiting until Tax Day to round up your expenses, track them in as close to real time as possible. Using FreshBooks, Xero, or QuickBooks software can help you monitor your expenses as soon as they happen.

PICTURE THIS...

Your big top is now kind of a big deal. As you travel to interview new talent, you end up taking a lot of taxis. Rather than wait until tax time to see the impact of all your travel expenses, record them right when they occur. By syncing expenses to reporting software, you'll be able to see the activity unfold in real time.

How often should I pay and file taxes to avoid penalties?

It's easy to procrastinate on taxes and think:

It's cool, I'll just reconcile my tax payments at the end of the year.

Not so fast. When it comes to payroll taxes, you have to face the music all year long. Your federal and state governments are in charge of how often you pay your taxes, and the schedule fluctuates depending on where you do business. The frequency of your payments also depends on how often you pay your team. Because of all these factors mixed together, it's really important to pay attention to every last tax notice that winds up in your mailbox. **40 percent of small businesses ignore this part, and end up getting fined around $850 a year for improperly paying their payroll taxes.**

Now take a seat, and flick through the next few pages. You'll find an exhaustive list of state regulatory offices that are in charge of payroll compliance. See? It's not so scary when you know where to go.

PICTURE THIS...

Back at the circus, you run weekly payroll for your hourly workers and semimonthly for your salaried folks. Since you have two schedules, you decide to pay your payroll taxes using the semimonthly period. That's where things go sour. Because you're not matching your taxes to each person's actual pay period, you may be at risk for extra fees. To prevent this from happening, team up with a payroll provider that will handle taxes for you.

State breakdown:

1. **ALABAMA**
   - Department of Labor
   - Department of Revenue

2. **ALASKA**
   - Department of Labor and Workforce Development
   - Department of Revenue

3. **ARIZONA**
   - Department of Economic Security
   - Department of Revenue

4. ARKANSAS

- Department of Finance and Administration
- Department of Workforce Services

5. CALIFORNIA

- Department of Industrial Relations
- Employment Development Department
- Franchise Tax Board

6. COLORADO

- Department of Labor and Employment
- Department of Revenue

7. CONNECTICUT

- Department of Labor
- Department of Revenue Services

8. DELAWARE

- Division of Revenue
- Department of Labor

9. DISTRICT OF COLUMBIA

- Department of Employment Services
- Office of Tax and Revenue

10. FLORIDA

- Department of Economic Opportunity
- Department of Revenue

11. GEORGIA

- Department of Labor
- Department of Revenue

12. HAWAII

- Department of Labor and Industrial Relations
- Department of Taxation

13. IDAHO

- Department of Labor
- State Tax Commission

14. ILLINOIS

- Department of Employment Security
- Department of Revenue

15. IOWA

- Department of Revenue
- Workforce Development

16. KANSAS

- Department of Revenue
- Department of Labor

17. KENTUCKY

- Career Center
- Department of Revenue

18. LOUISIANA

- Department of Revenue
- Workforce Commission

19. MAINE

- Department of Labor
- Revenue Services

20. MARYLAND

- Department of Labor
- Revenue Services

21. MASSACHUSETTS

- Department of Revenue
- Labor and Workforce Development

22. MICHIGAN

- Department of Licensing and Regulatory Affairs
- Department of Treasury

23. MINNESOTA

- Unemployment Insurance
- Department of Revenue

24. MISSISSIPPI

- Department of Employment Security
- Department of Revenue

25. MISSOURI

- Department of Revenue
- Department of Labor

26. MONTANA

- Department of Revenue
- Department of Labor and Industry

27. NEBRASKA

- Department of Revenue
- Department of Labor

28. NEVADA

- Department of Taxation
- Department of Employment, Training and Rehabilitation

29. NEW HAMPSHIRE

- Department of Labor

30. NEW JERSEY

- Department of the Treasury
- Department of Labor and Workforce Development

31. NEW MEXICO

- DTaxation and Revenue Department
- Department of Workforce Solutions

32. NEW YORK

- Department of Taxation and Finance
- Department of Labor

33. NORTH CAROLINA

- Department of Revenue
- Department of Labor

34. NORTH DAKOTA

- Department of Labor and Human Rights
- Office of State Tax Commissioner

35. OHIO

- Department of Taxation
- Department of Job and Family Services

36. OKLAHOMA

- Employment Security Commission
- Oklahoma Tax Commission

37. OREGON

- Department of Revenue
- Employment Department

38. PENNSYLVANIA

- Department of Labor and Industry
- Department of Revenue

39. RHODE ISLAND

- Department of Labor and Training
- Division of Taxation

40. SOUTH CAROLINA

- Department of Employment and Workforce
- Department of Revenue

41. SOUTH DAKOTA

- Department of Labor and Regulation

42. TENNESSEE

- Department of Revenue

43. TEXAS

- Workforce Commission

44. UTAH

- State Tax Commission
- Department of Workforce Services

45. VERMONT

- Department of Labor
- Department of Taxes

46. VIRGINIA

- Department of Taxation
- Department of Labor and Industry

47. WASHINGTON

- Department of Labor and Industries

48. WEST VIRGINIA

- State Tax Department
- Workforce West Virginia

49. WISCONSIN

- Department of Workforce Development
- Department of Revenue

50. WYOMING

- Department of Revenue

How do I get more cash back into my business?

Not every business has a ticket stand up front. You may be so busy working that you actually forget to collect the hard-earned money you deserve. Do you ever say to yourself:

Money, shmoney. If I just focus on getting customers and delivering great service, my business will be a breakout success.

But when you don't get paid quickly enough, you can run into cash shortfalls. Pair that with the fact that payments can float in at unpredictable rates, and you have a potential working capital problem on your hands. Thankfully, there are many ways you can keep your invoicing habits in check.

How to get paid on time:

- Invoice as soon as the project is finished
- Offer discounts for people who pay on time (or early!)
- Track the work throughout the entire project by tying billing increments to milestones
- Automate follow-ups, especially if payments are late. Consider using a service like Boomerang to help you schedule reminder emails.
- Accept online payments
- Create an online paper trail for both your customers and regulators

PICTURE THIS...

You decide to rent out your cotton candy machines during the off-season. A customer rents five machines for a party, and you send them their bill soon after. But then circus season revs back up, and you forget to follow up. Since you didn't have any systems in place to remind you of the outstanding payment, things don't end up outstanding on the money front.

Accrual or cash accounting: Which one should I go with?

Accounting may make you feel like you're wobbling on a tightrope. One misstep can bring you down, and you need a steady footing to keep you looking ahead. To find that balance, you need to find the right accounting method.

Sounds good, but my business is too small for this to matter. I'll just flip a coin.

In reality, the accounting style you choose can have a massive impact on how you understand and plan for your business. A good method will help you dodge errors, while also providing a clear glimpse into your company's financial health.

But first, let's wrap our head around the two methodologies:

Cash accounting:
This type of accounting recognizes revenue when cash is received and expenses when cash is paid out. Under this style, there is no such thing as accounts receivable or payable.

Accrual accounting:
On the flip side, this type recognizes revenue and expenses exactly when they are earned, regardless of when cash is paid in or out.

PICTURE THIS...

Business is booming. So you decide to hire someone to help you make sense of your finances. You're hoping to project how much profit you're making, but the two of you quickly realize that your cash accounting method won't do the trick. Therefore, you decide to switch over to the accrual (and super nice!) approach.

Check out the pros and cons of these two different methods below:

H: High   L: Low

		CASH BASED		ACCRUAL BASED
Cash flow visibility	H	Ledgers (also known as your accounting records) match up directly with the cash you have on hand.	L	Ledgers account for expenses or revenue that are not yet paid.
Insight into long-term trends	L	Balances for a specific period can be biased by an influx of payments, regardless of when the money was actually made.	H	Business owners can use trends to predict future costs and revenue.
Accounting complexity	L	Income and expenses are recorded in tandem with cash that comes in or out.	H	Recorded income and expenses do not always reflect the amount of cash you have on hand.

While **most companies start out with cash accounting, they tend to go with accrual as they grow** because it provides a better snapshot of their long-term financial health.

Still teetering between the two? Here are a few snags to avoid with whichever one you choose:

- With accrual accounting, if your business reports revenue before receiving payment, there's a chance you can become short on cash.
- With cash accounting, you might not have the best view into your company's growth because you typically only report revenue when cash comes in. This could lead to you underinvesting in areas where you shouldn't.

MATCHMAKER, MATCHMAKER

The accrual method also follows the accounting matching principle. This states that expenses and revenue should be recorded together in the period they occur.

How do I avoid misclassifying employees and contractors?

Hiring a contractor is a quick way to give your business an extra hand. But how do you know if your contractor is the real deal? You may catch yourself thinking:

Well, I only hire freelancers here and there so no need to worry about all the details.

Repeat after us: Correct categorization is key. If your contractor is actually an employee in disguise, you may be underpaying your payroll taxes, which can come back to haunt you. **In fact, nearly 30 percent of employees are misclassified as contractors**. And since employees can cost 25 to 30 percent more than contractors, there's a good chance you could be paying the wrong amount.

If you are still unsure about your worker's status, let the IRS help you crack the riddle by filling out Form SS-8. It could take up to six months for them to send you the results, but you'll be able to rest easy once you know the truth.

PICTURE THIS...

Your trapeze artist is on vacation, so you hire a contractor as a short-term replacement. They pick up a few hours on the weekend, but once you see how much the crowds love her, they begin working regular hours. Everything's just dandy, right? Right, but now your contractor might actually be an employee. To prevent your business (and your new employee!) from tumbling down, be sure to update their classification pronto.

EMPLOYEE	VS	CONTRACTOR
Qualifies for company-sponsored benefits like health insurance, retirement planning, vacation days, fitness stipends, training, and more.	**Company benefits**	Needs to make their own arrangements for health insurance and retirement planning. Contractors aren't allowed to participate in any company-sponsored benefits programs.
Eligible for unemployment benefits and state workers' comp insurance.	**Government benefits**	Generally does not receive unemployment benefits or state workers' comp insurance.
Has local, state, and federal taxes withheld from their paychecks, along with Social Security and Medicare deductions.	**Taxes**	No deductions are withheld from their paychecks. Therefore, they need to withhold taxes on their own in order to avoid end-of-year penalties.
Could be entitled to overtime pay depending on the role or number of hours worked.	**Overtime pay**	Ineligible for overtime pay.

What payroll and accounting reports do I need to keep on file?

Once you've turned in your taxes, it can be tempting to think you're solid for the rest of the year.

I filed the right forms, so I can finally relax. Isn't that right?

File this away in your memory: Your reporting doesn't end once you've filed your government forms. Like prizes and kettle corn, good reporting is best enjoyed year-round. It keeps your business in shape, helps you avoid pesky legal fines, and allows you to have better insight into what's going on behind the scenes.

No vanishing acts allowed
These are the payroll documents you need to hold onto throughout the year:

Form I-9: Everyone needs to fill out Form I-9 to verify that they're eligible to work in the US. You don't need to submit the form anywhere, but you must keep it on file (a digital copy works just fine!) for the whole time your worker is employed with you. This is either a minimum of three years from the hire date or one year from the termination date — whichever winds up longer. Don't want to deal with all the paper? You can also authenticate your employee's work status online using E-Verify.

Form W-4: Your worker will also need to fill out Form W-4 to determine their tax withholding. Even though you heart your team, this is something they need to do on their own. The W-4 does not need to be mailed anywhere, but each company needs to keep their team's forms on file for a minimum of four years.

REPORTING IN THE GOLDEN STATE

In California, companies use form DE-34 to report their new hires to the Employment Development Department in Sacramento. They have 20 days from the time their worker starts to be as good as gold.

New hire reporting for states: After you celebrate your new employee's arrival, be sure to share the good news with your state. Luckily, each state has a department that is completely dedicated to this part. While reporting, you'll typically send them your employee's name, address, and Social Security number. Depending on the state, you have anywhere between a few days to a few months to submit this information.

Form 941: Every time you run payroll, you have to dock federal income tax, Medicare, and Social Security from your employees' pay. In parallel, each quarter you also have to file Form 941 to report how much you withheld. You may also see this written as the Employer's Quarterly Federal Tax Return, but don't worry, it's the exact same thing.

State-specific withholding forms: Remember the form you just learned about above? Well, this is the state equivalent. Because most states also instruct employers to withhold income tax, this document is used to report the grand total on the state side.

Form 940: This form is used to figure out how much Federal Unemployment Tax Act (FUTA) tax you owe. The money you pay is earmarked for unemployment funds that help people who are looking for their next gig.

Form W-2: Two reasons not to forget to file your team's W-2s: 1) they need them to finish filing their taxes, and 2) you need them to stay compliant. Check out more filing instructions here.

PICTURE THIS...

Things at work are hectic. So hectic in fact, that you forget to report your new performer to your state's new hire agency. Around 21 days after their start date, you realize something is not right. You track down your state's specific agency, give them the information they need, and all is right with the world again.

Thanks for swinging by!

Nice going — your knowledge of payroll and accounting is off the charts. Now that you're up to speed on the most common blunders to avoid, it's time to prevent them from happening in the first place. Here are two places to check out:

Framework
Visit our resource center to learn new skills and soak up the latest and greatest in small business.

Gusto blog
Drop by the Gusto blog to discover stories exploring the future of work, company culture, and what it takes to build a truly amazing business.

Need more payroll advice?

LEARN HOW WE CAN HELP →