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Shareholder Payroll Kickstart Kit

Thank you for trusting WCG to process your required shareholder payroll. As you might know, WCG processes payroll through ADP and Paychex. You should have received login information so you can pull reports, print paystubs, download W-2s, etc. directly. Anytime you need help, however, we can always upload documents into your client portal. Just let us know!

ADP can be accessed here-

https://runpayroll.adp.com/enrollment.aspx

or

wcginc.com/adp

Paychex can be accessed here-

https://myapps.paychex.com/landing_remote/login.do

or

wcginc.com/paychex

We are transitioning away from Gusto which appears to be more geared towards small business owners than tax and accounting firms.

Frequency

We typically process shareholder payroll on or about the 10th of each month. This avoids some of the problems with January 1, July 4 and Labor Day, including those odd federal holidays that only bankers seem to remember.

Should you have employees, then we modify shareholder payroll to align with the cadence of the employee payroll (usually bi-weekly, paid on Friday).

Direct Deposit

We require all shareholders to provide direct deposit information so that payroll truly feels like payroll, and you receive a deposit into your personal checking account. This also makes the cash needs number for payroll processing that we provide more realistic since it assumes direct deposit and it also assumes 401k deductions (more on cash needs and 401k stuff in a bit).

To complete the direct deposit form, please visit-

wcginc.com/dd

Cash Needs to Process Payroll

We will provide a cash needs number to process payroll, and **this amount must be in your business checking account 3 days prior to the check date.** As mentioned, this includes all taxes and your net check amount. However, the 401k employee deferral is not included in your cash needs number and will not be drafted from your business checking account. You will need to initiate the 401k payment directly.

Let's look at a quick example assuming a monthly salary of **$6,000-**

	401k	**No 401k**
Salary	6,000	6,000
Employee Taxes	3,200	3,200
Employee 401k Deferral	1,200	0
Net Check	1,600	2,800
Employer Taxes (your biz)	500	500
ADP / Paychex Bank Draft	**5,300**	**6,500**
Total Cash Needs including 401k	**6,500**	**6,500**

Notes-

- The employee taxes are Social Security, Medicare and income taxes withheld based on a tax plan. There might be other taxes such as State Disability Insurance.
- In both examples, the total cash needs for payroll processing are $6,500 ($5,300 as a payroll bank draft and another $1,200 payment to the 401k plan).

  Or said differently, the monthly salary of $6,000 plus the employer taxes of $500 for Social Security, Medicare and Unemployment.
- In the 401k example (tan column), the ADP or Paychex bank draft is $5,300. This is $1,200 less than the No 401k example (blue column). This is the same as the 401k deferral and the difference in net check.
- In the 401k example, and as mentioned earlier, you would need to transfer the $1,200 401k deferral from the business checking account into your 401k plan.

Where Did the Cash Go?

Good question! So, when ADP or Paychex drafts a zillion dollars from your business checking account, where does it all go? Attached at the end is a PDF titled Payroll Details from ADP (we do not have a Paychex example, but it is similar).

Please find these numbers- **$562.50, $2,437.50 and $352.50.**

For this shareholder, a $3,000 salary was processed on March 10 and $2,790 was drafted by ADP. Here we go-

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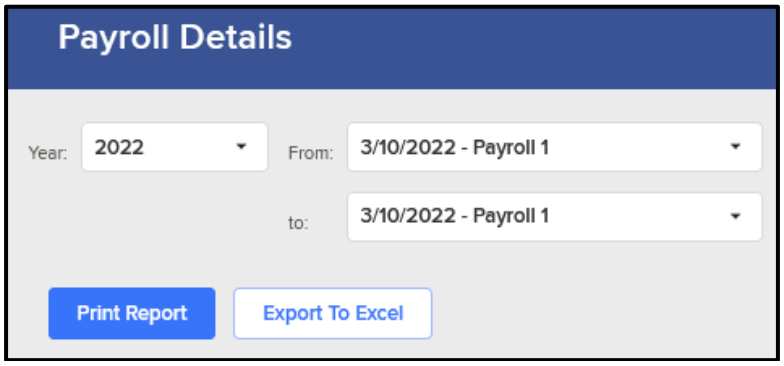
- $562.50 is the net check amount.
- $2,437.50 was the total of all tax deductions for the shareholder and includes Social Security, Medicare, income taxes and California's State Disability Insurance (SDI).
- $352.50 was the total of all employer taxes and includes Social Security, Medicare and Unemployment.
- Adding $2,437.50 and $352.50 equals $2,790.00 which is the amount drafted by ADP from the business checking account. In this example, the shareholder was not using direct deposit (tsk tsk), and he can either transfer the $562.50 to his personal checking account or we can reclassify shareholder distributions to reconcile this during tax preparation.

  Yes, the most elegant way is to setup direct deposit (**wcginc.com/dd**)

You can download this report from ADP by going to Reports, selecting Payroll Details and entering the periods you are needing. We are adding a screenshot of Paychex at a later date.



Taxes Are High

Keep in mind that we are calculating and withholding taxes based on a tax plan which incorporates all your income sources. Said in another way, let's say your business earns $150,000 after expenses and a shareholder salary of $60,000 is being paid out of the $150,000.

We would withhold taxes as if you were paying yourself a $150,000 salary since that is the total income derived from the business (what we call the net economic benefit). Therefore, when you compare the amount of taxes being withheld to the actual salary being paid ($60,000 in this example), the taxes appear ridiculously high.

Yes, this is normal. It is also very elegant since by increasing income tax withholdings you can usually **avoid having to pay quarterly estimated income taxes separately.**

Payroll Compression

When payroll is started late in the year, there is a payroll compression since we always think in terms of annualized salaries. For example, $60,000 is a reasonable salary and must be reported on your W-2 as such. If we start payroll processing in January, this is $5,000 per month.

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If we start in July, for example, we usually do one big payroll of $35,000 ($5,000 x 7 months) for July to catch up for the year, then resume a normal amount of $5,000 in August and for remaining months. This allows you to get into a rhythm from a cash flow perspective.

Advance Deductions

To reduce the amount of cash that is needed to process payroll, at times we create an advance deduction which reduces net check amounts (and cash needs to process payroll). This advance accounts for all the cash you have already pulled out of the business as shareholder distributions and is usually a result of starting payroll late in the year.

For example, let's say you have a $60,000 annual salary, but payroll processing isn't started until July resulting in a $35,000 catch up salary (using our situation above). This would take approximately $37,700 in cash to process payroll resulting in a net paycheck (for example) of $15,000.

So, why have $37,700 in your business checking account just to get a net paycheck of $15,000? Rather, we would show an advance deduction of $14,000. This would reduce your cash needs by $14,000 from $37,700 to $23,700. The net paycheck would also reduce from $15,000 to $1,000.

Quick recap-

- Advance deduction can be viewed as shareholder distributions already taken from the business that should have been partly classified as salary / wages.
- This allows for less cash in your busines checking account while still simulating a $60,000 salary.
- Very common on catchup or large payroll amounts (bonus).

Minimum Payrolls

At times you might need to process minimum payrolls. This is common for seasonal businesses such as realtors, or other businesses where income is lumpy or bumpy. We cannot skip payroll since some states will close your payroll accounts which creates a large mess. As such, the minimum salary is $500 per month which requires about $100 in cash needs (we do some magic with advance deduyctions to "zero out" the net check to reduce cash needs).

At some point, however, we need to re-evaluate payroll needs and make adjustments in Q4.

Also, the beauty of payroll processing and leveraging it to pay income taxes similar to estimated tax payments is that the IRS and the state assume salary and income taxes were paid evenly throughout the year regardless of when payroll was actually processed and the amounts. Yay! Having said that, we prefer to have routine and even salary amounts each month if possible.

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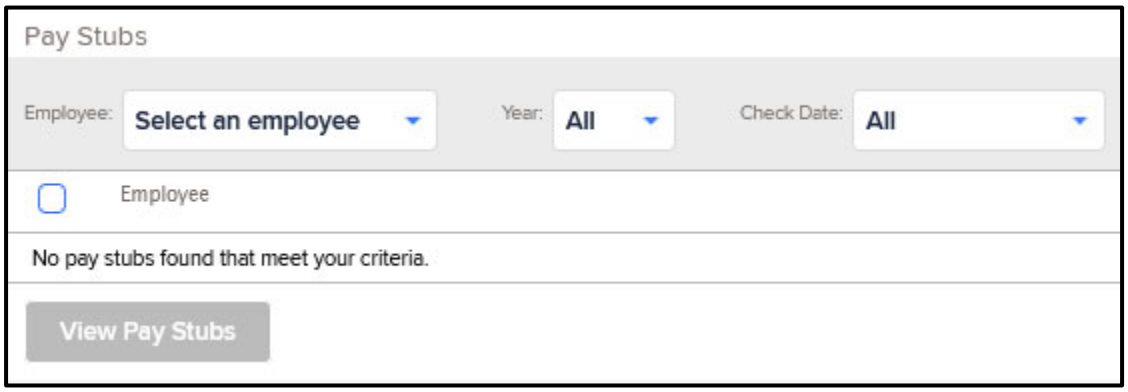
Paystubs

For your first payroll, we have printed the Payroll Details and the Paystub, and uploaded them to your client portal for review. The payroll team will provide a direct link so you can access them quickly.

Similar to Payroll Details, you can view and print paystubs by logging into ADP and going to Reports and selecting Paystubs. Next select the employee (you), year and check date.



We will add Paychex examples later.

Run and Done (aka, "autopilot")

For shareholder payroll processing, we will establish a cash needs number with you and that amount must be available in your business checking account 3 days prior each month. **We will not alert you to upcoming payroll processing and ADF / Paychex bank drafts,** hence "Run and Done." Or perhaps better said, "Autopilot."

Should you need to temporarily reduce salary, please communicate with us by the 1st of the month!

Paying for 401k, Health Insurance, Disability, Etc.

Payments for 401k, health insurance, health savings accounts (HSA), health reimbursement arrangements (HRA), long-term care and disability must be paid with business funds.

401k payments seem to be the most confusing. If you worked for Google and asked them to deduct $1,000 per paycheck for your 401k employee deferral, they would withhold the money and then later remit to the 401k plan on your behalf. They are acting as a fiduciary by withholding your money and then sending it off.

This is the same situation when you are self-employed and processing payroll. Instead of thinking that you work for yourself, perhaps think that you work for a business that you own. A little pay on words, sure, but keep in mind as an owner of an S Corporation, for example, you wear two hats- employee and investor.

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When the payment is made for the employee 401k deferral, this is not an expense. The expense is already captured in wages. When payroll is processed with a 401k deduction, a payroll liability is created for the 401k amount. When the 401k payment for the employee deferral is made, the liability account goes to zero.

Here is the quickie journal entry when payroll is processed. Note that there is not an entry for 401k "expense."

	debit	**credit**
Wages Expense	100,000	
Employer Payroll Tax Expense	8,000	
401k Payable		**22,500**
Cash		85,500

Next, when the 401k payment is made, this is the subsequent journal entry to zero it out.

	debit	**credit**
401k Payable	**22,500**	
Cash		22,500

Again, the employee 401k deferral is captured in Wages Expense, and never appears on your profit and loss statement as an expense. The company is simply setting aside some of the wages on behalf of the employee for remittance to the 401k plan.

When a 401k discretionary company contribution is made, then this becomes an expense like so.

	debit	**credit**
401k Company Contribution	25,000	
Cash		25,000

The $25,000 represents 25% of $100,000 in wages, and is merely an example.

Disability insurance is also confusing. Yes, you should have your disability insurance paid by the business. No, it is not an income tax deduction; otherwise the benefits paid would be taxable income. But! It adds to the reasonable salary test and therefore reduces the amount of salary subjected to Social Security and Medicare taxes. Said in another way, you are saving 15.3% in taxes with disability insurance being paid by the business.

Mechanically on the business entity tax return (S Corp, for example), we do a "book to tax" reconciliation that removes disability insurance as a tax deduction. So, you have book expenses… and you have tax expenses. Hence, the book to tax reconciliation. The same thing is done with meals which might be 100% book expense but only 50% tax expense.

Paying "Quarterlies"

There are two types of "quarterlies-" payroll taxes and income taxes. With the processing of payroll with ADP or Paychex, all payroll taxes such as Social Security, Medicare and Unemployment, are being paid in real time.

Additionally, and as mentioned elsewhere, we increase your income tax withholdings on your paychecks to account for all your business income (and landing you on tax neutrality in April).

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Therefore, **you do not need to worry about making "quarterlies"** whether it is payroll tax deposits or quarterly estimated income tax withholdings, or both.

Having said that, at times we need you to make separate quarterly estimated income tax payments. The primary cause for this is a relatively small salary with a large 401k deduction. For example, if your salary is $60,000 and you deduct $30,000 for 401k deferrals (assuming $22,500 + $7,500 for the 2023 tax year) there might not be enough "room" on your paychecks for the necessary increased income tax withholdings. In these situations, we communicate and develop a schedule for estimated income tax payments. Yay!

Adding Spouse or Children to Payroll

The two biggest reason to add your spouse to payroll are to double the 401k employee deferral and to increase tax deductions for business meals and travel. The biggest reason to add children to payroll is to fund a Roth IRA which can in part help fund education expenses.

More discussion is required.

End of Year Verification **(critical!)**

We must verify certain amounts in November so your W-2 is correctly presented to the IRS. Here is the list-

- Self-Employed Health Insurance (SEHI). If this amount is not detailed on your W-2, you will likely lose the tax deduction. This can be huge!

  A $10,000 annual premium can save you 15.3% for Social Security and Medicare taxes + your marginal tax rate in income taxes. For example, if you are in the 24% marginal tax bracket, your $10,000 premium costs you $6,100 in cash. Not bad.

- Health Savings Account (HSA). Same as SEHI above.

- Health Reimbursement Arrangement (HRA), Long-Term Care (LTC) and Disability Insurance. These amounts are not as critical, but if they are being used to buttress the reasonable shareholder salary, then we must detail these on your W-2 as well.

  LTC might be deductible, but it is limited based on age and income.

  Disability Insurance is not deductible (and therefore the benefits are not taxable), but you do save 15.3% of the premiums as a reduction in Social Security and Medicare taxes.

- 401k Deferrals. We can add Roth 401k Contributions without much grief. However, if you contact us in January and say that you made a $20,500 contribution to your pre-tax 401k, we must amend your payroll filings and W-2. This gets really expensive. See 401k Issues below.

  401k Contributions by the employer (your business) do not appear on the W-2, and are discretionary. This means we can discuss this during tax preparation without creating a mess. They are generally limited to 25% of your W-2 wages.

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Keep these end of year (EOY) verifications in mind as we solicit this data in November for the accurate processing of your final paycheck and W-2 preparation.

401k Issues **(critical!)**

As alluded to earlier, deferrals into your Roth 401k plan is more of an end of year housekeeping activity since it does not alter your taxable wages. However, deferrals into your pre-tax 401k plan can create a mess.

Let's say your annual salary is $60,000 or $5,000 per month. If you tell us you want to defer $20,500 into your pre-tax 401k, we would do this evenly throughout the year or about $1,708 per month.

But if you tell us November that you would like the defer $20,500 on your December check into your pre-tax 401k plan, we have problems since your December check is only $5,000. We can certainly increase your December check to $30,000 to account for this big fat 401k deferral, but you just added about $3,700 in additional (and unnecessary) Social Security and Medicare taxes by increasing your December salary.

The lesson here is to plan for pre-tax 401k deferrals early.

A quick sidebar- employee (you) deferrals into a 401k can be either pre-tax or Roth or some combination. The employer (your business) discretionary contribution must go into the pre-tax account since it is a tax deduction to the business.

Payroll Tax Notices

It is common to receive a flurry of letters and whatnot from the state and other taxing agencies in the early stages of payroll setup and processing. Please upload all correspondence (ensuring all pages, front and back) to your client portal-

wcginc.com/portal

There are three scenarios-

1. Payroll Prior to Switching to WCG
Not to worry, we can assist. However, at times the prior payroll processor might be better suited.

2. ADP / Paychex Handling
If the payroll notice is for a period that ADP or Paychex was handling, then we coordinate the resolution with them directly (you do not need to do anything). This usually means we supply the notice and then request updates from them during our weekly meeting (held on Thursdays). After those meetings, we will update you directly as to the progress.

3. WCG Handling
Certain payroll matters, especially payroll setups or manual payroll processing, are usually WCG's responsibility. We will write a response letter and compile supporting documentation on your behalf.

Some of these notices sound threatening. Some of these are just informational. Please have the same agnostic emotion (think of Spock from Star Trek), enjoy dinner and send these to us. **We will get to the bottom of it, but it takes time.** You will probably receive more notices with an escalating tone- do not be alarmed. At the same

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time, please send these to us right away to ensure it is not a new issue or something we need to address separately.

A couple of housekeeping duties-

- We might need a Power of Attorney (POA) to speak on your behalf to the IRS or taxing agency. If we need a POA, we will prepare the document, send it for electronic signature and notify you via email and text message.

- Please understand that taxing agencies are government bodies full of humans who are prone to mistakes like any human. Just because a payroll notice is generated does not automatically mean we, you or ADP / Paychex did anything incorrect.

Also, starting in December and through February-ish, states will update their unemployment rates. We need this information as well.

In Closing

Payroll can be confusing. Payroll can also create really big messes if we do not plan and communicate correctly. Please connect with us if you have any questions or concerns.

Thank you!

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Payroll Details

Hours and Earnings				Taxes		Deductions			Employer	
Description	Hours	Rate	Amount	Tax	Amount	Deduction	Amount	Net Pay	Liability	Amount
Pay Frequency: Monthly										
Employee: Smith, Jason				**SSN: xxx-xx-9999**						
Regular	0.00		3,000.00	FED FIT	1,740.00			562.50	FED SOCSEC-ER	186.00
	0.00		3,000.00	FED SOCSEC	186.00				FED MEDCARE-ER	43.50
				FED	43.50				FED FUTA	18.00
				MEDCARE					CA SUI-ER	105.00
				CA SIT	435.00					352.50
				CA SDI	33.00					
					2,437.50					
Check Date: 03/10/2022 / Check / Check No: 10000 $562.50										
Pay Frequency Totals: Monthly										
Regular	0.00		$3,000.00	FED FIT	$1,740.00			$562.50	FED SOCSEC-ER	$186.00
	0.00		$3,000.00	FED SOCSEC	$186.00				FED MEDCARE-ER	$43.50
				FED	$43.50				FED FUTA	$18.00
				MEDCARE					CA SUI-ER	$105.00
				CA SIT	$435.00					$352.50
				CA SDI	$33.00					
					$2,437.50					
Total Employees - Monthly: 1										
Company Totals:										
Regular	0.00		$3,000.00	FED FIT	$1,740.00			$562.50	FED SOCSEC-ER	$186.00
	0.00		$3,000.00	FED SOCSEC	$186.00				FED MEDCARE-ER	$43.50
				FED	$43.50				FED FUTA	$18.00
				MEDCARE					CA SUI-ER	$105.00
				CA SIT	$435.00					$352.50
				CA SDI	$33.00					
					$2,437.50					
Total Employees - Company: 1										