PAYROLL BASICS

How to pay employees correctly and on time, and why most small businesses use a payroll service.

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AT A GLANCE

- **Payroll** means paying employees, withholding the right taxes, paying employer taxes, and filing reports on time.
- Mistakes bring penalties, and unpaid payroll taxes can make owners **personally responsible**.
- A **payroll service** usually costs far less than the time and risk of doing it yourself.

WATCH OUT

Payroll rules differ by state and city. This is general US information. Confirm details with a payroll provider or accountant.

Why it matters

Paying people correctly and on time builds trust. Getting taxes wrong can cost you penalties and interest, and the IRS treats unpaid withheld taxes very seriously.

What payroll includes

Step	What it means
Track hours	Time worked for hourly employees, including overtime
Calculate gross pay	Hours × rate, or salary
Withhold taxes	Federal and state income tax, Social Security and Medicare from each paycheck
Other deductions	Benefits, retirement contributions, garnishments if required
Pay employees	Direct deposit or check, on a regular schedule
Pay employer taxes	Employer Social Security and Medicare, federal and state unemployment
Deposit taxes	On the schedule the IRS and your state assign
File reports	Quarterly and yearly payroll filings; W-2 forms each January

Payroll service or do it yourself?

	Payroll service	Do it yourself
Cost	Monthly fee, often per employee	Your time
Tax calculations	Done for you	You calculate
Filings and deposits	Usually handled for you	You file and deposit
Errors	Many services guarantee their tax filings	Your responsibility

For most small businesses, a payroll service is the better choice. Many bookkeeping tools offer payroll add-ons. See **M-02 Choosing Bookkeeping Software**.

Step by step

1. **Register** for state payroll tax and unemployment accounts.
2. **Choose a payroll service** and connect your business bank account.
3. **Set a pay schedule**: weekly, every two weeks, twice a month or monthly, following state rules.
4. **Collect new-hire forms**: W-4, I-9 and state forms.
5. **Track time accurately** for hourly workers.
6. **Review each payroll** before it runs.
7. **Keep records** of hours, pay and filings.

> EXAMPLE
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> **Joseph** ran payroll by hand for two mechanics and missed a quarterly deposit, leading to a penalty. He switched to a payroll service connected to his bookkeeping software. It now calculates taxes, pays employees by direct deposit, makes deposits and files reports automatically. He spends 10 minutes reviewing each payroll.

Common mistakes

- **Paying employees as contractors** to skip payroll. See **O-02 Employees vs. Contractors**.
- **Missing deposit deadlines.**
- **Not paying overtime** where required.
- **Using withheld taxes for business bills.**

Your checklist

- ☐ Register for state payroll and unemployment accounts
- ☐ Choose a payroll service
- ☐ Set a pay schedule
- ☐ Collect W-4 and I-9 forms from every employee
- ☐ Review every payroll before it runs

Key words, explained

Word	What it means
Gross pay	Pay before deductions.
Net pay	Take-home pay after deductions.
Withholding	Taxes taken out of a paycheck.
Form W-2	A yearly summary of an employee's pay and taxes.
Overtime	Extra pay for hours over a set limit, often 40 a week.

Where to go next

- **M-13 Sales Tax, Payroll Tax and Staying Current**
- **O-01 Your First Hire: When and How**
- **O-13 Compliance Calendar**

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