

Ask SCORE

TWO CRITICAL STEPS BEFORE SETTING UP PAYROLL FOR YOUR SMALL BUSINESS

When you start off as a team of one, handling every job to keep your business moving on your own is tough. Most owners dream of the day they can afford to bring on another set of arms and legs.

Hiring an employee is also a big step towards scaling your business and planning for growth. But, when you make the shift from a solopreneur to an employer, the game changes. Suddenly, owners find themselves delegating the day-to-day tasks of running their business in exchange for the internal tasks of managing the business. In the case of hiring, one of those tasks is payroll.

Hiring your first employee changes your business' relationship with the IRS.

Setting up payroll can bring about headaches for businesses that fail to take the right steps before they hire.

That's because the IRS is involved in the relationship between you and your worker and has set employer guidelines that businesses must follow. Save yourself time down the road and make sure you take these two critical steps before you bring on your first employee.

Step 1: Register for an Employer Identification Number (EIN)

The IRS requires that every business register for and receive an EIN prior to hiring an employee. It's the first of two critical steps before you bring your first team member on board. You'll use the identification number when you report employee information to state agencies.

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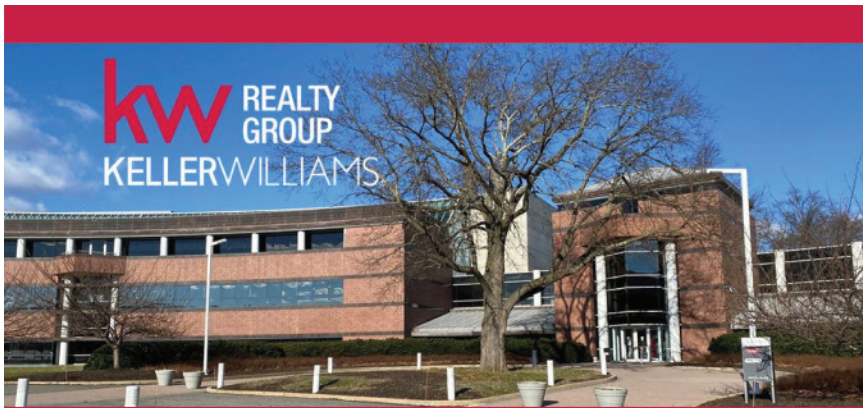
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Even without employees, many businesses have an EIN that they use when reporting taxes and other documents to the IRS. To register, apply for an EIN on IRS.gov.

Step 2: Determine if Your New Hire Will Be an Employee or Independent Contractor

The distinction between an employee and an independent contractor has been a hot topic in the world of HR over the last couple of years. The IRS has tightened the reigns on businesses, narrowing the parameters of what constitutes an independent contractor. The tightened measures are there to protect workers and ensure they're not denied benefits or taxed incorrectly if, in fact, they're performing the work of an employee.

The IRS uses three categories of criteria to determine whether a worker is an employee or an independent contractor. Those categories are broken down as *Behavioral*, *Financial*, and *Type of Relationship*.

Behavioral: If you have what the IRS calls 'behavioral control' over a worker, that worker is considered an employee. Behavioral control refers to control over

how your worker performs their job with parameters that include giving employees instruction, evaluation, and training. Businesses have the right to direct and control an employee, but not an independent contractor.

Financial: Financial control refers to whether or not your business has the right to control the economic aspects of the worker's job. When the IRS looks at financial control, they're specifically looking at whether a business can control a worker's reimbursement expenses, methods of payment, opportunity for profit or loss, and more.

Type of Relationship: The way a business and a worker perceive their relationship to one another is a big factor in whether that worker is designated as an employee or a contractor. The written contract between both parties stipulates how the two will do business with determinations about the behavioral and financial factors mentioned above.

Other factors that determine the type of relationship between a business and a worker are employee benefits, the permanency of the relationship, and services provided as key activities of the business.

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There is a lot that goes into determining whether the worker you hire should be designated as an employee or an independent contractor. Start by reviewing additional details as to how the IRS views these on the IRS' website, <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>. Talk to your accountant as well. They can help you determine the proper designation and make sure your business is abiding by the IRS' guidelines.

After you've completed these two critical steps and are ready to set up payroll, take a look at the SCORE article, "Essential Steps for Hiring Your First Employee: Paperwork & Payroll", <https://www.score.org/resource/essential-steps-hiring-your-first-employee-paperwork-payroll>, for a thorough resource on what next steps to take.

Seek guidance as you begin hiring and managing payroll.

Managing payroll and the admin tasks that come along with employing a staff aren't necessarily the same skills you've needed and used to run your business up to this point. Seek guidance from others who manage hiring or payroll to learn

how to best run this new facet of your business.

A SCORE mentor experienced in running a business is an excellent source of wisdom as you get started. Your mentor can help you find the best payroll system, connect you with an accountant and be by your side as you take the two critical steps ahead of hiring your first employee. Get started and Contact a SCORE mentor today.

Since 1964, SCORE "Mentors to America's Small Business" has helped more than 10 million aspiring entrepreneurs and small business owners through mentoring and business workshops. More than 11,000 volunteer business mentors in over 320 chapters serve their communities through entrepreneur education dedicated to the formation, growth and success of small businesses. For more information about starting or operating a small business, contact SCORE TriCounty, <https://tricity.score.org/content/find-mentor-183>.

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