Are You Leap Ready?

Employers who pay employees on a biweekly basis may have noticed a unique wrinkle in 2020 payroll: due to the addition of leap day, February 29, and the year starting on a Wednesday, for many employers, the year contains 27 pay periods instead of the usual 26. This can have a big impact on pay for exempt and salaried nonexempt employees – employers who do nothing will end up paying their salaried employees one additional paycheck – in effect, giving each of their employees a raise.

Most employers choose this option, allowing employees to draw an "extra" paycheck in the leap year. If you do choose to take this option:

1. Inform employees so that you can take credit for the increase.
2. Also, be sure to inform the employees that their pay the following year (the year after the "27-pay-period year") will be reduced because they will be back to being paid over 26 pay periods.

Employers also have the option of dividing each employee's total salary among the 27 pay periods for that year, rather than 26. This option will result in smaller amounts in each paycheck. However, employers who choose this option must act immediately. The Fair Labor Standard Act's salary basis rules may be violated by an employer who changes pay strategies for exempt employees midyear.

Finally, employees can opt to change to weekly or semi-monthly pay structures – these payment methods do not change year-to-year.

One option that is **not** available to employers, however, is simply skipping or significantly reducing employee pay for the last pay period of the year. Such an action would violate the FLSA and state wage-and-hour rules.

Unintended Consequences

No matter which option an employer chooses, an additional pay period has a number of ancillary effects employers need to take into account when structuring payroll for the year.

Payroll Taxes

The amount of pay will affect the total Social Security and Medicare you and your employees pay. Some employees may reach the maximum Social Security contribution earlier and may reach the threshold for the additional Medicare tax if you make an additional payment.

Employee Benefits

Paying additional salary may also result in paying additional benefits. For example, an employer might inadvertently over-fund 401(k) or other benefit plans. Conversely, employers might over-deduct for benefits like health care. All deductions and contributions should be examined and, if necessary, adjusted to reflect an additional pay period. Where applicable, employees should be informed of the change and given the opportunity to adjust withholding amounts for retirement, Health Savings Accounts, and Flexible Spending Accounts.

Tax Reporting

Having a pay period extend over the end of a year can raise the issue of which year's taxes the payment is in. The general rule is that the tax should be on the W-2 for the year when the paycheck is issued, and the employee has use of it.

2020 is sure to be a challenging year for employers. The employee benefits team at Innovative can help ensure your benefit plans remain compliant with a changing landscape and keep you up to date on legal development and workplace trends.