



MOST SMALL EMPLOYERS FACE LOW COSTS TO IMPLEMENT AUTOMATIC IRAS

A Report Prepared for AARP
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SUMMARY

One of the concerns about an Automatic IRA program for all employees who do not have access to an employer-provided retirement plan is the potential costs to employers. We find that most employers would likely face low costs to implement a system of Automatic IRAs. Automatic IRAs can be designed to integrate into existing business payroll systems in a way that will minimize an employer's responsibilities. Most small employers will have only small incremental costs to modify their payroll processing systems in order to facilitate enrollment in Automatic IRAs and withholding of Automatic IRA contributions. The widespread adoption of automated payroll systems, including within the small business sector, and the ability of those system providers to build the Automatic IRA into their services, will make this new employee benefit relatively simple to implement.

The points below summarize the findings contained in this report:

- **The more automated the employer's payroll processing, the easier Automatic IRAs will be to implement.** The enrollment of employees in an Automatic IRA program and the withholding of money for Automatic IRA contributions will be part of the employer's payroll processing system. The key will be for payroll software companies, payroll service providers, and Professional Employer Organizations (PEOs) to integrate the Automatic IRA into *their* systems.
- **According to market research, 97 percent of employers with 10 or more employees use automated systems and do not process payroll manually. These employers would have far fewer responsibilities with respect to Automatic IRAs.** Payroll software developers and payroll service companies would incorporate Automatic IRA processes into their payroll processing systems. Employers using one of these payroll processing methods might have to provide election forms to employees, but these elections could be provided as part of the Form W-4 withholding certificate that are already provided to new employees. The employer might have to select an Automatic IRA service provider or that selection might be done through the payroll service the employer uses. And employers using payroll software might have to withhold and transmit the Automatic IRA payments from employee paychecks if that service is not offered as part of the payroll software.
- **Following enactment of Automatic IRAs, payroll software companies, payroll service providers, and PEOs would have strong market incentives to incorporate the Automatic IRA requirements in their services to small employers.** Indeed, Automatic IRA service providers might actively seek to partner with payroll service providers and payroll software companies to try to get the payroll processors to help link the Automatic IRA service providers directly to employers. Simple solutions such as these would simplify the process significantly.
- **A tiny fraction of employers with more than 10 employees (as low as 3 percent according to research by ADP) use manual payroll processing.** A small employer that prepares their payroll manually will also implement their Automatic IRA program manually. This employer will have to learn about the law, provide employees with elections to participate or not participate in Automatic IRAs, select an Automatic IRA service provider (employer selected, employee selected, or default), calculate the withholding amounts from employee paychecks for Automatic IRA contributions, and transmit to IRA service providers the employee contributions. The use of manual payroll processing tends to be directly correlated to the size of the employer, so the larger the employer, the less likely the employer will use manual payroll processing. As a result, the smallest employers – those

most likely to process their payroll manually – would not be required to offer Automatic IRAs, because the Automatic IRA proposal would not apply to employers with less than 10 employees.

- **The incremental costs to most small businesses related to the implementation of Automatic IRAs are likely to be quite low.** Further, the Automatic IRA proposal offers a tax credit (\$250 per year for two years) to small employers to help them offset the costs of implementation.

These findings also serve to clarify related research on the Automatic IRA and employer costs. A 2007 report prepared by Optimal Benefit Strategies, LLC for AARP discussed the feasibility and administrability of an Automatic IRA proposal.¹ The 2007 report raised specific issues with respect to Automatic IRAs, including the potential costs for employers and employees. The 2007 report looked at the potential overall costs of Automatic IRAs and did not specifically differentiate between costs that would be borne by employers and costs that would be borne by Automatic IRA participants. Refinements to the Automatic IRA proposal since 2007 and discussions with payroll processing companies make clear that the employer costs under an Automatic IRA proposal generally would be the incremental costs associated with changes in payroll processing that would be coincident with the implementation of Automatic IRAs—and that these costs may be low in many cases.

SMALL BUSINESS DEMOGRAPHICS

The most prevalent form of business in the United States is the sole proprietorship, which is considered the traditional “mom and pop” business. In 2006, 22.07 million nonfarm sole proprietorships filed returns with the IRS comprising 72 percent of all nonfarm business returns, compared to 1.97 million C corporations, 3.87 million S corporations, and 2.95 million partnerships.² While sole proprietorships are the most common business form in the United States, most of these businesses have 10 or fewer employees.³ Thus, large employers who already provide a qualified retirement plan for their employees and many of the 22 million sole proprietorships will generally not be required to offer Automatic IRAs.

Table 1 uses Census survey data for 2006 to provide data on the breakdown of businesses by number of employees. This data includes business locations (establishments) with at least one paid employee.

¹ Schmitt, Mary M. and Xanthopoulos, Judy. *Automatic IRAs: Are They Administratively Feasible, What Are the Costs to Employers and The Federal Government, and Will They Increase Retirement Savings?* Optimal Benefit Strategies, LLC, March 2007. [http://www.aarp.org/research/financial/ira/auto\)ira.html](http://www.aarp.org/research/financial/ira/auto)ira.html).

² Refer to Internal Revenue Service, Statistics of Income, Business Tax Statistics, various tables available at <http://www.irs.gov/taxstats/index.html?portlet=5>.

³ According to 2006 nonemployer statistics reported by the U.S. Census Bureau, over 18 million sole proprietorships had no employees. http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=NS0600A1

Table 1 – Employment Size of Establishments, 2006

Employment Size of Establishment	Number of Establishments	Number of Employees	Establishments as Percentage of Total	Cumulative Percentage of Establishments
1 to 4 employees*	4,137,018	6,932,206	54.4%	54.4%
5 to 9 employees*	1,432,352	9,502,160	18.8%	73.3%
10 to 19 employees	964,024	12,994,803	12.7%	85.9%
20 to 49 employees	658,710	19,872,543	8.7%	94.6%
50 to 99 employees	227,125	15,631,618	3.0%	97.6%
100 to 249 employees	130,048	19,444,384	1.7%	99.3%
250 to 499 employees	32,704	11,171,950	0.4%	99.8%
500 to 999 employees	12,121	8,247,601	0.2%	99.9%
1,000 employees or more	7,058	16,119,900	0.1%	100.00%
All establishments	7,601,160	119,917,165	100.00%	100.00%

Source: 2006 County Business Patterns, U.S. Census. An establishment is a single physical location of a business. A single firm may have one or more establishments. The data include all operating establishments with one or more paid employees. Self-employed individuals, employees of private households, railroad employees, agricultural production employees, and most government employees are excluded.

* To the extent that these establishments represent a single firm they would be exempt from Automatic IRA requirements, as would firms with 10 employees. Any firm with 10 or fewer employees, however, could opt to use an Automatic IRA if they desired.

Of the approximately 7.6 million establishments with employees in the United States in 2006, 73 percent had less than 10 employees, 86 percent had less than 20 employees and 99.3 percent had less than 250 employees. Of the approximately 120 million private sector employees in the United States in 2006, 70 percent worked for an establishment with less than 250 employees. These employees of small businesses are much less likely to have access to a retirement savings plan through their employer than employees of large businesses. The 73 percent of businesses with less than 10 employees, which employ approximately 13 percent of all employees, would be exempt from the Automatic IRA proposal.

TYPES OF PAYROLL PROCESSING SYSTEMS

Any small business with at least one employee must have a system in place to process payroll. Federal and state income tax withholding, unemployment taxes, fringe benefits like health insurance, and other items can make processing payroll a difficult process for a small business. For this reason, payroll processing was one of the first business applications to be automated.

There are two elements to payroll processing – the method by which payroll calculations are done and the way in which employees are paid. Small businesses might use one of four methods to calculate payroll – in-house manual preparation, in-house processing using specially designed payroll software, a third party payroll service company, and a PEO to outsource all payroll and human resource activities. To pay employees, employers use either paper checks, pay cards (similar to debit cards) or electronic transmission of pay to an employee’s bank account through direct deposit. According to a 2006 survey of payroll practices by the National Federation of Independent Businesses (NFIB), the use of direct deposit increases as employer size increases.⁴

⁴ See, *NFIB National Small Business Poll, Payroll*, Volume 6, Issue 1, 2006. The NFIB 2006 survey of small business payroll practices classified small employers into three categories, 1 to 9, 10 to 19, and 20 to 249 employees. Since the Automatic IRA proposal would apply only to those employers with more than 10 workers, the following discussion will focus on the two larger categories. With respect to direct deposit, the NFIB survey found that 41.5 percent of

Precise figures are not available to determine the distribution of employers by processing methods. In 2007, a survey by ADP researched employer payroll method by number of employees; the ADP survey broke down employers into two categories – 10-24 employees and 25-49 employees. The 2006 NFIB survey broke employers into three categories: 1-9 employees, 10-19 employees, and 20-249 employees. Some differences in the statistics between the two surveys may result because of the differences in the classification of employers and from the way in which survey questions were either asked or answered or in the way the surveys were conducted.

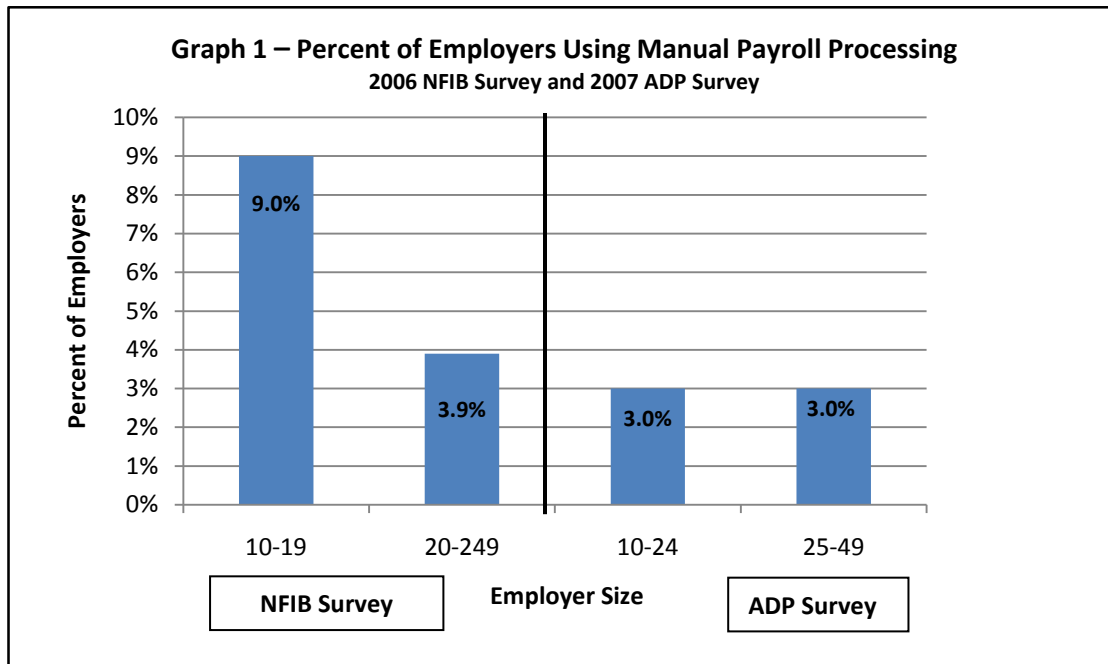
The NFIB survey indicates that as the size of the employer increases, the likelihood of using a third party payroll processor also increases. Smaller employers indicate a growing trend toward electronic filing, either through a third party processor or through specially designed software. As the size of the employer decreases, it is more likely that the employer uses one of the two in-house methods – payroll software or manual payroll preparation.

In-house manual payroll processing – purely manual payroll processing is done in-house by the small business owner (or an employee). The business might use a spreadsheet program, but does not use any specialized payroll processing software. When manual payroll is used, employees will more likely be paid by paper checks.

Graph 1, shows that manual payroll processing is most likely to be done by very small businesses. ADP's 2007 survey found that only 3 percent of small businesses with either 10-24 employees or 25-49 employees used manual payroll processing. The NFIB survey found a higher percentage of small businesses that appear to be using manual payroll processing. However, the NFIB survey did not directly ask how many employers used manual payroll processing and what kind of systems those employers used, an important omission that makes the data less useful for understanding the impact of the Automatic IRA.⁵

employers with 10-19 employees and 54.5 percent of employers with 20-249 employees made direct deposit available to their employees.

⁵ The percentages from the NFIB survey shown in Graph 1 were obtained as follows: employers that responded that they did their payroll in-house were asked whether they used an electronic spreadsheet. If they answered no to that question, they were assumed to be doing payroll manually.



The NFIB survey suggests that the use of manual payroll is inversely related to employer size – the smallest employers were the most likely to be using manual payroll processing. In the NFIB survey, 72.5 percent of employers with 10-19 employees indicated that their payroll processing took 3 hours or less per pay period. Approximately 80 percent of employers with 20-249 employees reported that payroll processing took less than 10 hours per pay period.⁶ Bureau of Labor Statistics data from the National Compensation Survey can provide some idea of what processing payroll costs for these small businesses. In 2007, the average hourly wage for a payroll and timekeeping clerk was \$17.50.⁷ Three hours of work at \$17.50 equals \$52.50, whereas 10 hours of work equals \$175.00.

Payroll processing software – small employers can use specialized payroll processing software, which are either standalone systems or are integrated into the business’s accounting application. In this type of payroll processing, the responsibility for payroll is still maintained “in-house,” but the calculations are automated. Checks and pay statements are printed in-house or direct deposit or pay cards may be utilized. Payroll processing software will provide periodic updates for changes in the law or tax tables, making it easier for small businesses to remain in compliance with Federal and state laws.

The ADP survey found that approximately 53 percent of small employers with 10-24 employees and 52 percent of small employers with 25-49 employees used payroll processing software. The NFIB Payroll survey found slightly lower percentages with 41 percent of employers with 10 to 19 employees and 45.5 percent of employers with 20 to 249 employees indicating that they use some kind of electronic spreadsheet for payroll.

Table 2 displays alphabetically the most commonly used electronic accounting and payroll systems.

⁶ These percentages represent an average for all employers, not just those who do their payroll manually. It is likely that manual payroll processing would average more hours per pay period, but the NFIB survey does not offer this information.

⁷ National Compensation Survey: Occupational Earnings in the United States, 2007. Bureau of Labor Statistics, Bulletin 2704, August 2008.

ACCPAC	Microsoft Great Plains (includes Dynamics, CompuLaw, and Enterprise)	Quickbooks (includes PRO, Premier, Mac, Windows, Basic, Enterprise Solutions, Contractor, Nonprofit, and Simple Start)
Business Works	MAS (includes 90 and 200 series)	Real World
Check Mark	Microsoft Money	Small Business Acc
Creative Solutions	M.Y.O.B.	Solomon
CYMA	One Write Plus	Tabs3
DacEasy	Open Systems	Timberline
DelteK	Peachtree	Yardi
Intuit Quicken	PCS	

Payroll software is a relatively inexpensive way for small employers to process payroll. For example, Quickbooks Basic Payroll is available for \$99 per year for up to 3 employees and \$199 per year for unlimited employees. Direct deposit is available through Quickbooks Basic Payroll for approximately \$1.00 per check. Quickbooks Enhanced Payroll is available for \$249 per year for up to 3 employees and for \$349 per year for an unlimited number of employees. Peachtree Payroll software is available for \$250 per year for basic service and \$350 per year for enhanced service that includes e-file of payroll tax returns. Peachtree direct deposit generally is \$1.60 per deposit. Some payroll processing software is available as an on-line system; similarly, some payroll service companies also offer an online system of payroll processing. As a result, the differences between payroll software and payroll service companies are becoming more subtle as more online payroll services are offered. Quickbooks offers online payroll processing for a fee of \$19.95 per month.

Payroll service companies – small employers can use an outside business, such as a bookkeeper, accountant, or payroll processing firm, such as Paychex or ADP, to handle the businesses payroll processing needs. These outside payroll processors will receive information from small businesses such as employee hours and will handle all payroll related functions. Checks will be printed and delivered to the small business or the payroll processing firm will offer electronic funds transfer to make direct deposits of pay to employee bank accounts. Many payroll service companies (and payroll software companies) offer a web-based payroll service, which operates much like payroll software.

The NFIB asked employers about their use of bookkeepers, accountants, and payroll service companies to process payroll. Almost 50 percent of small business firms use an outside business to handle all their payroll processing. Table 3 shows the percentages of small businesses using either a bookkeeper/accountant or a payroll service company.

Table 3 – Use of Bookkeeper/Accountant or Payroll Service Company by Small Businesses

	Business Size	
	10-19 Employees	20-249 Employees
Bookkeeper/Accountant	15.9%	9.1%
Payroll Service Company	31.7%	37.7%

Source: 2006 NFIB Payroll Survey.

The ADP survey found that approximately 12 percent of small businesses with either 10-24 employees or 25-49 employees used accountants for payroll processing and approximately 33 percent used a service bureau or PEO (see the discussion below). These numbers are consistent with the NFIB survey results.

The NFIB survey asked about the costs associated with bookkeeper/accountants and payroll service companies.⁸ Overall, approximately 30 percent of small businesses reported that their outside bookkeeper or accountant charged less than \$100 per pay period for payroll processing and approximately 20 percent reported costs of \$100 or more. In the case of a payroll service company, about 23 percent of small businesses reported that costs were less than \$100 per pay period and 34 percent reported costs of \$100 or more.

An informal internet survey of payroll service companies showed prices per pay period for payroll services ranging from \$50 to \$250 for employers with 10-150 employees depending upon the frequency of payroll and the number of employees.⁹ Typically, there is also an additional fee for each check written that can be as much as \$2. Intuit offers a payroll service in conjunction with Quickbooks that begins at \$60 per month base fee plus \$1 per employee per pay period, a \$49 one-time set up fee, and \$.99 per paycheck for direct deposit.

The Internal Revenue Service (IRS) subjects Payroll Service Providers to either the Assurance Testing System or the Business Acceptance Testing System. These testing systems evaluate the software, the reporting agents and the transmitters of electronic business returns to the IRS to determine their suitability for business use.¹⁰ Currently, the IRS identifies 23 service providers that have satisfactorily passed the testing system, listed below in Table 4 (in alphabetical order).

⁸ These numbers may be less reliable because significant percentages of survey respondents did not answer questions related to their costs.

⁹ See Buyer Zone at <http://www.buyerzone.com/personnel/payroll/bps-payroll-prices-large.html>

¹⁰ See www.irs.gov/efile/lists/0,,id=101120,00.html.

AccountantsWorld, LLC	Fidelity HR Services	PayCycle, Inc.
Advantage Payroll Service, Inc.	Greatland Corporation	Paylocity Corporation
Automatic Data Processing Inc. (ADP)	Greenshades Software	Payroll People, Inc. Business Services
CERIDIAN	Intuit Inc.	Perquest, Inc
CheckPoint HR	MasterTax, LLC	SurePayroll
CompuPay, Inc.	Netchex	Time+Plus Payroll Services
Corporate Payroll Services	Padgett Payroll Services/PayTrak Payroll Services	www.eSmartPayroll.com www.Simplepayroll.com www.eSmartTax.com
Federal Liaison Services. (FLS)	Paychex, Inc.	

Professional employer organization – a professional employer organization (PEO) provides another way in which small businesses handle payroll processing.¹¹ Some businesses contract with a PEO to outsource the management of their human resource, payroll, employee benefits, and workers’ compensation obligations. Contractually, PEOs function as a co-employer with the business client, adopting a shared employment relationship. Businesses that use a PEO generally have no direct responsibility for the withholding and payment of payroll taxes.

There are approximately 700 PEOs operating in the United States, providing services relating to two to three million employees.¹² The average business that uses a PEO has 19 employees. It is estimated that 95 percent of the employees in a PEO arrangement have access to a work-place based retirement plan, such as a 401(k) plan.¹³ Thus, most small businesses using a PEO would probably not be subject to the Automatic IRA requirements because they would already maintain a qualified retirement plan for their employees.

PEO services typically require a one-time start-up fee and then an ongoing percentage of payroll, which can fluctuate from less than 5 percent to more than 15 percent of payroll, depending on the services and the average worker salary.

IMPACT OF PAYROLL PROCESSING METHODS ON THE IMPLEMENTATION OF AUTOMATIC IRAS

Based on the available survey data, a small percentage of small employers (as low as three percent in the ADP survey) use manual payroll processing.¹⁴ A small employer’s costs and responsibilities will vary depending on the way in which they handle payroll processing. An employer that currently processes payroll manually, and does not opt to use payroll software, a payroll servicing company, or a PEO, would have to implement Automatic IRAs on their own. The employer would have to learn about the law, provide

¹¹ The ADP survey included data on use of PEOs for payroll processing in the statistics for payroll service companies. The NFIB survey did not specifically ask any questions concerning use of PEOs.

¹² *PEO Industry Facts*. <http://www.NAPEO.org/peoindustry/industryfacts.cfm>.

¹³ Id.

¹⁴ While the NFIB survey suggests that this percentage may be as high as 9 percent, it’s important to remember that the NFIB survey did not ask a direct question about manual payroll processing. Thus, employers may have interpreted the NFIB question differently than employers who were part of the ADP survey.

employees with the election to participate or not participate in Automatic IRAs, decide what Automatic IRA service provider to use (employer selected, employee selected, or default), calculate the amount to be withheld from employee paychecks for Automatic IRA contributions, and transmit the contributions to the Automatic IRA service provider.

However, the vast majority of small employers do not process payroll manually and these employers would have far fewer responsibilities with respect to Automatic IRAs. These employers might have to provide election forms to employees, but these elections could be provided as part of the Form W-4 withholding certificates that are already provided to new employees. The employer might have to select an Automatic IRA service provider or that selection might be done through the payroll service the employer uses. And employers using payroll software might have to withhold and transmit the Automatic IRA payments from employee paychecks if that is not offered as part of the payroll software.

Table 5, below, summarizes the responsibilities that small employers might have for Automatic IRAs under each payroll processing method.

Table 5 – Automatic IRAs Under Various Payroll Processing Systems				
Auto IRA Processing	Type of Payroll Processing System			
	Manual	Payroll Software	Payroll Servicing Company	PEO
Learn about the law and changes needed to existing payroll processing procedures	Yes	No	No	No
Provide employee with election to participate in Automatic IRA	Yes, but election can be included on Form W-4, which employer is already giving employee	Yes, but election can be included on Form W-4, which employer is already giving employee	Yes, but election can be included on Form W-4, which employer is already giving employee	No
Calculate amount to be withheld from employee pay for Automatic IRA	Yes	No	No	No
Select Automatic IRA service provider or provide employees with the right to select Automatic IRA service provider	Yes, but employer could use default system to keep costs low	Perhaps, or payroll software might be linked to an Automatic IRA service provider	Perhaps, or payroll service company might negotiate with an Automatic IRA service provider	No
Withhold and transmit employee Automatic IRA contributions	Yes	Depends on software used	No	No

Following enactment of the Automatic IRA, payroll software companies, payroll service providers, and PEOs would have strong market incentives to incorporate the Automatic IRA requirements in their services to small employers. Indeed, Automatic IRA service providers might actively seek to partner with payroll service providers and payroll software companies to try to get the payroll processors to help link the Automatic IRA service providers directly to employers. Further, because of the economies of scale that can be achieved by these payroll processing businesses, the incremental costs to most small businesses related to the implementation of Automatic IRAs are likely to be quite low. Finally, the Automatic IRA proposal includes a proposed temporary tax credit to help small employers offset these costs.