

How To Tie Out Total Payroll Expenses on Profit and Loss to W-2s/W-3:

Please follow these steps:

1. Obtain Form W-3 from payroll company - this is the summary of all the W-2s filed in a year
2. Obtain Year End Payroll Summary preferably by employee that shows the gross wages, deductions, and taxes for each person and in total for the salon
3. Use the Year End Payroll Summary to tie to the Form W-3. This is how each wages box on the W-3 is calculated:

- Box 1 Wages, tips, and other compensation
 - Gross wages (including tips)
 - Less any pretax retirement plan contributions (401k, SIMPLE IRA)
 - Less any pretax benefits like health insurance premiums, dental insurance premiums, and vision insurance premiums
- Box 3 Social Security wages
 - Gross wages (including tips)
 - Less any pretax benefits like health insurance premiums, dental insurance premiums, and vision insurance premiums
 - Less reported tips
- Box 5 Medicare wages and tips
 - Gross wages (including tips)
 - Less any pretax benefits like health insurance premiums, dental insurance premiums, and vision insurance premiums
- Box 7 Social security tips
 - Equals total tips on the Year End Payroll Summary

Now that you know how the W-3 ties to the Year End Payroll Summary you can then tie the Year End Payroll Summary to the Profit and Loss to verify the wage expense.

4. The total of the wage expense accounts on the P&L (commission salaries, retail commission, owner salary, salon manager salary, bonus & profit sharing expense, vacation pay, sick pay, front desk salaries, etc) should tie to the Gross wages less tips or Box 3 of the Form W-3.
 - The salon should not show tips as an expense because the tips come from the clients that is not income to the salon. The employees are taxed on tips (Box 1 and 5) but wages paid by the salon should be close to Box 3 of the Form W-3 (Gross wages less tips).
5. If the total of the wage expense accounts on the P&L are within \$5,000-\$10,000 of Box 3 (Gross wages less tips), that is reasonable (depending on overall gross payroll and gross sales)
6. You also want to ensure that payroll tax expense for the employer is reasonable. That means that the employer's share of Social Security and Medicare along with federal and state unemployment expenses are about 8-12% of total wage expense.
7. If you follow these steps and within a reasonable range, you can rest easy knowing the wages are reasonable to what the tax filings show.

Here is an example to further illustrate:

1. In the example screenshots below you can tie to the W-3 by using this payroll summary and start with Gross Pay (\$1,337,590.13) and subtract the pretax items (dental, health and vision insurance (total of \$36,187.77)) to tie to Box 1 wages of \$1,301,402.36. The total tips on the W-3 and the payroll summary match so then in this example, the total wage expense on the P&L should be close to Box 3 (\$1,040,779.61) but plus the pretax items (36,187.77) or \$1,076,967.38.

2. On the P&L screen shots below, you can see the total of the wage expense accounts total to \$1,072,571.77 which is close to what they should be of \$1,076,967.38.

- You may need to take into account the payroll accrual entries that occurred on 1/1 and 12/31 of the current year. They could throw off your totals if the payroll accrual liabilities are materially different in the current year compared to the prior year.

3. The payroll tax expense is also reasonable by taking the total payroll taxes expense of 100,844.30 divided by the gross wages of \$1,076,967.38 = 9.36%. This is within the 8-12% acceptable range.

Year End Payroll Summary

	TOTAL	
	Hours	Rate Jan - Dec ...
Employee Wages, Taxes and Adjustm...		
Gross Pay		
Salary-Management	52.00	144,289.34
Vacation Pay	9.00	2,852.71
Vacation Pay.	133.00	19,290.52
Wages-Front Desk	2,411.65	39,177.35
Wages		782,514.62
Inventory Wage		5,200.00
Marketing Wage		8,645.00
Performance Bonus		9,885.48
Retail Bonus		56,037.36
Training Wage		9,075.00
Reported Paycheck Tips		260,622.75
Total Gross Pay	2,605.65	1337590.13
Deductions from Gross Pay		
Dental Insurance (pre-tax)		-3,092.40
Education Fund		-37,250.00
Employee Loan Repay		-1,609.30
Employee Payroll Deduction		-977.70
Health Insurance (pre-tax)		-32,967.59
Phone Deduction - Anita		-76.92
Vision Insurance (pre-tax)		-127.78
Total Deductions from Gross Pay		-76,101.69
Adjusted Gross Pay	2,605.65	1261488.44

Form W-3

1	Wages, tips, other compensation	
		1301402.36
3	Social security wages	
		1040779.61
5	Medicare wages and tips	
		1301402.36
7	Social security tips	
		260622.75
9		

Profit & Loss

Payroll Expense		
Payroll Expense (Management)		126,538.40
Payroll Expense (Vacation)		22,143.23
Performance Bonus		11,885.48
Retail Bonus		57,561.75
Salaries - Associates		0.00
Salaries - Front Desk		56,928.29
Salaries - Producers		797,514.62
Svc Charge Waived/4% Comm Bonus		0.00
Total Payroll Expense		1,072,571.77

Payroll Taxes		
FICA & MED		99,557.30
FUTA		969.50
SUTA		618.70
Payroll Taxes - Other		-301.20
Total Payroll Taxes		100,844.30



Chris Wittich

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Chris, head of Boyum Barenscheer's Tax Department, specializes in the salon industry, which was particularly impacted by COVID-19. He expertly guided clients through complex tax legislation, implementing crucial relief programs like PPP loans and the Employee Retention Credit (ERC). Chris is dedicated to developing customized strategies and resources that empower salon owners to better understand their financial landscape, driving stability and growth in their businesses.

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Tracy Stevens

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Tracy Stevens is a leader in business advisory services, specializing in tax, consulting, and outsourced solutions with a focus on the salon industry. Having grown up in a family business, she deeply understands the unique challenges faced by small business owners. Tracy is passionate about helping clients navigate their accounting and tax needs while learning the intricate details of their businesses and how they've evolved over time. She finds fulfillment in building strong relationships and contributing to the success of her clients.



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