



**CALCULATING PAY AND
PAYROLL TAXES:
THE BEGINNING OF THE
PAYROLL PROCESS**



Chapter 7

Learning Objectives

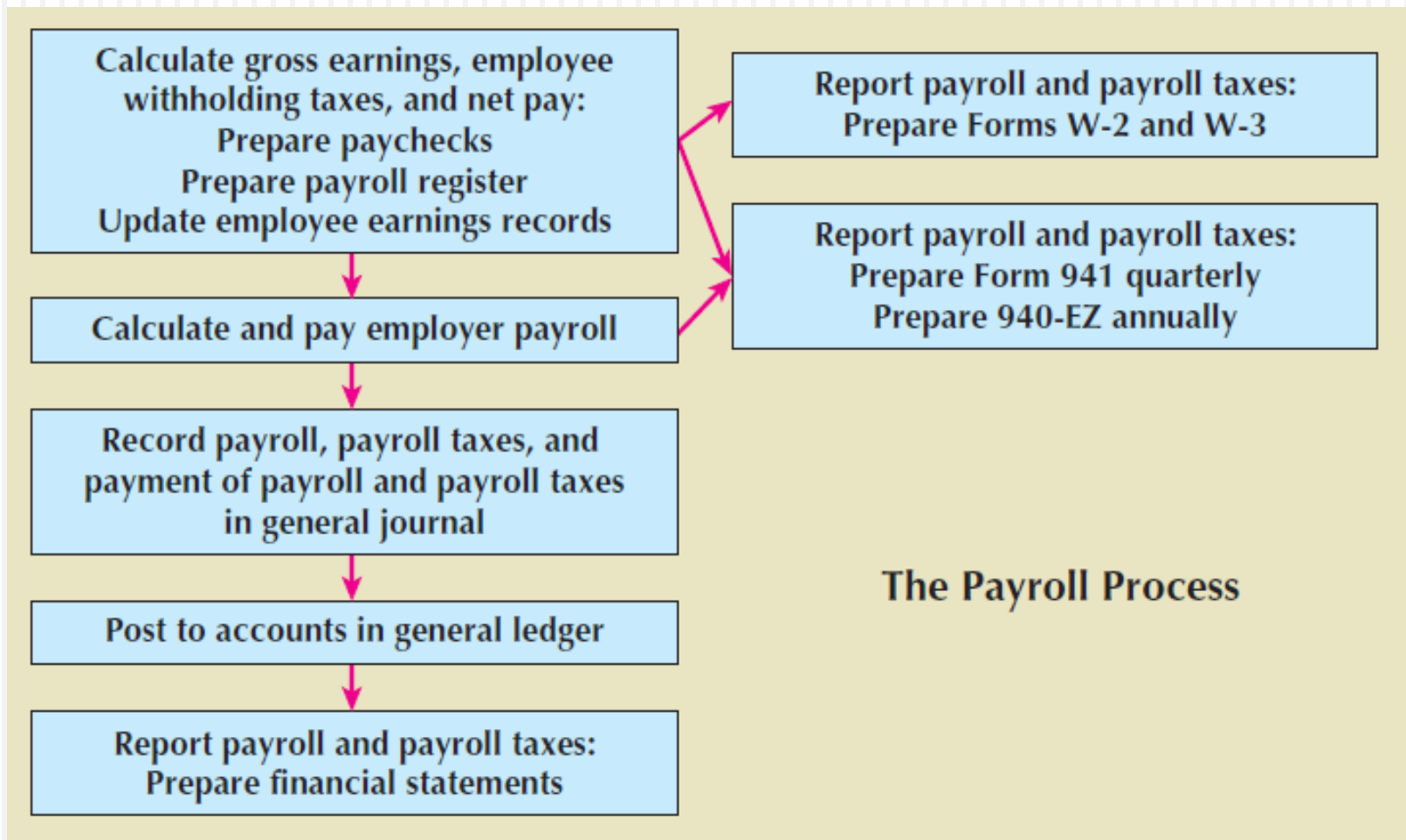
1. Calculating gross pay, employee payroll tax deductions for federal income tax withholding, state income tax withholding, FICA (OASDI, Medicare), and net pay
2. Calculating employer taxes for FICA, FUTA, SUTA, and workers' compensation insurance
3. Preparing a payroll register
4. Maintaining an employee earnings record

Payroll

- A typical business event
- Is the same whether a business is small or a major department store
- A business needs to know:
 - ▣ How to calculate, pay, and record
 - ▣ How to report payroll and payroll taxes
- Federal, state, and maybe even local laws regulate the payroll process

The Payroll Process

- Use this chart as a reference tool when reading this chapter



Learning Objective 1

Calculating gross pay, employee payroll tax deductions for federal income tax withholding, state income tax withholding, FICA – OASDI/Medicare, and net pay

The Payroll Process

- **Must be accurate**
 - Any mistake with the payroll affects both the employee and the company
- **Must be on time**
 - To ensure the employees get their paychecks and governments receive taxes
- **Must obey the law**
 - Federal, state, and local laws governing payroll
- **Must keep data confidential**

Payroll Terms

- Employees
 - Hourly – paid only for hours worked
 - Salaried – paid fixed dollar amount
- Pay Period
 - Can start on any day of the week and must end after the specified period of time
 - Daily, weekly, biweekly, semimonthly, monthly, quarterly, annually
 - Can use different pay periods for different groups (hourly or salaried)

Gross Earnings

- The regular earnings for an employee for the pay period
 - Overtime earnings must be computed according to the law (State and Federal)
- Fair Labor Standards Act
 - The federal law that governs overtime earnings
 - Applies to employers involved in interstate commerce (doing business in more than one state)
 - Pay at least one and a half times regular rate over 40 hours in one workweek
 - Workweek is a seven-day (or 168-hour) period that can start at any time

Calculating Gross Earnings

- Example for a biweekly pay period
 - ▣ Week one - 44 hours worked
 - ▣ Week two - 38 hours worked

Week No.	Week Ending	Regular Hours	Overtime Hours	Total Hours
1	October 22	40	4	44
2	October 29	<u>38</u>	<u>0</u>	<u>38</u>
Total		78	4	82

Calculating Gross Earnings

- The pay rate is \$11.40 for the 82 total hours with 4 overtime hours

\$11.40 regular rate × 1.5 = \$17.10 overtime rate

78 regular hours × \$11.40 regular rate =

\$889.20 regular earnings

4 overtime hours × \$17.10 overtime rate =

68.40 overtime earnings

\$889.20 regular earnings + \$68.40 overtime earnings = \$957.60 gross earnings

Or, Katherine could figure Stephanie's pay this way:

SAME

*\$11.40 regular rate × 0.5 = \$5.70 extra pay
for each overtime hour*

82 total hours × \$11.40 regular rate =

\$934.80 earnings at the regular rate

*4 overtime hours × \$5.70 extra pay for each
overtime hour =*

22.80 extra earnings

*\$934.80 earnings at the regular rate + \$22.80
extra earnings =*

\$957.60 gross earnings

Federal Income Tax Withholding

- Withholding
 - ▣ Several different taxes taken out of employees gross pay
- Form W-4, Employee's Withholding Allowance Certificate
 - ▣ Used to determine the amount of taxes to be withheld
 - ▣ It lists marital status and total number of allowances claimed

W-4, Employee's Withholding Allowance Certificate

Form **W-4**
Department of the Treasury
Internal Revenue Service

Employee's Withholding Allowance Certificate

OMB No. 1545-0074

2011

▶ Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.

1 Type or print your first name and middle initial.		Last name		2 Your social security number	
Home address (number and street or rural route)				3 <input type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. Note. If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.	
City or town, state, and ZIP code				4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. ▶ <input type="checkbox"/>	
5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)					5
6 Additional amount, if any, you want withheld from each paycheck					6 \$
7 I claim exemption from withholding for 2011, and I certify that I meet both of the following conditions for exemption. • Last year I had a right to a refund of all federal income tax withheld because I had no tax liability and • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability. If you meet both conditions, write "Exempt" here ▶					7

Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.

Employee's signature

(This form is not valid unless you sign it.) ▶

Date ▶

8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)		9 Office code (optional)	10 Employer identification number (EIN)
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Cat. No. 10220Q

Form **W-4** (2011)

Federal Income Tax Withholding

- Withholding amount is determined by
 - Marital status
 - Number of claimed allowances
 - Gross pay
 - Pay period length
- Wage bracket tables are found in the Circular E, Employer's Tax Guide

Federal Wage Bracket Tables

- Circular E has a similar table for married persons who are paid biweekly, as well as tables for single and married persons who are paid daily, weekly, monthly, semimonthly, quarterly, and annually (<http://www.irs.gov/pub/irs-pdf/p15a.pdf>)

SINGLE Persons—BIWEEKLY Payroll Period

(For Wages Paid through December 2011)

And the wages are—		And the number of withholding allowances claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10
The amount of income, social security, and Medicare taxes to be withheld is—												
\$ 0	\$105	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%

MARRIED Persons—BIWEEKLY Payroll Period

(For Wages Paid through December 2011)

And the wages are—		And the number of withholding allowances claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10
The amount of income, social security, and Medicare taxes to be withheld is—												
\$ 0	\$250	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%
250	260	\$14.41	\$14.41	\$14.41	\$14.41	\$14.41	\$14.41	\$14.41	\$14.41	\$14.41	\$14.41	\$14.41
260	270	14.97	14.97	14.97	14.97	14.97	14.97	14.97	14.97	14.97	14.97	14.97
270	280	15.54	15.54	15.54	15.54	15.54	15.54	15.54	15.54	15.54	15.54	15.54
280	290	16.10	16.10	16.10	16.10	16.10	16.10	16.10	16.10	16.10	16.10	16.10
290	300	16.67	16.67	16.67	16.67	16.67	16.67	16.67	16.67	16.67	16.67	16.67

State Income Tax Withholding

- States charge their residents an income tax on money they earn
- Some states have no income tax
 - In 2008, only Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not
 - New Hampshire and Tennessee only imposed taxes on interest and dividends
- States have similar tables as the federal

Other Income Tax Withholding

- Many cities and counties tax employee earnings
 - ▣ It may be a percentage of gross earnings much like federal income tax
 - ▣ It may be a fixed dollar amount
- They have their own rules regarding payroll tax deposits and tax reports

Employee Withholding for Social Security Taxes

- Social Security tax in addition to federal and state taxes
- 1935 federal law called the Federal Insurance Contribution Act (FICA)
- Became effective in 1937
- Employers are required to withhold amounts from employees' pay

Employee Withholding for Social Security Taxes

- Used to make the following payments
 - ▣ Monthly retirement benefits for persons over 62 years old
 - ▣ Medical benefits for persons over 65 years old
 - ▣ Benefits for persons who have become disabled
 - ▣ Benefits for families of deceased workers who were covered by this law

Employee Withholding for Social Security Taxes

- The tax is really two taxes
 - Old-age, survivor's, and disability insurance (OASDI) tax
 - Medicare
- Each tax is calculated differently
 - OASDI puts a limit on the amount of tax that an employee must pay
 - With Medicare; all wages earned are subject to the Medicare tax

Employee Withholding for Social Security Taxes

Social Security (OASDI) Program Rates & Limits	As of 2011
Tax Rates (percent)	
Social Security (Old-Age, Survivors, and Disability Insurance)	
Employers	6.20
Employees	4.20
Medicare (Hospital Insurance)	
Employers and Employees, each	1.45
Maximum Taxable Earnings (dollars)	
Social Security	106,800
Medicare (Hospital Insurance)	No limit

Other Withholdings

- Medical insurance
- Savings plan
- Disability insurance
- Union dues
- Charitable contributions



Net Pay

Gross earnings for the current, biweekly pay period:		\$957.60
Deductions for employee withholding taxes:		
Federal income tax	\$93.00	
State income tax	76.61	
OASDI tax	59.37	
Medicare tax	13.89	
Medical insurance	<u>33.00</u>	
Total deductions		<u>274.87</u>
Net pay		<u>\$681.73</u>

Learning Objective 2

Calculating employer taxes for FICA-OASDI/Medicare, FUTA, SUTA, and workers' compensation insurance

Employer Payroll Taxes

- Social Security taxes – matches employee contribution
 - ▣ Both employer and employee pay OASDI and Medicare
- Unemployment taxes
 - ▣ Provide unemployed workers with benefits
 - ▣ Created by the same 1935 law that created Social Security
 - ▣ FUTA and SUTA

FUTA and SUTA

- FUTA taxes
 - ▣ Federal Unemployment Tax Act
 - ▣ Pay administration costs, not the benefits
- SUTA taxes
 - ▣ State Unemployment Tax Act
 - ▣ Pay the benefits to unemployed persons

FUTA and SUTA

□ FUTA taxes

- Pays 6.2% on each employee up to wage base limit of \$7,000
- Grants tax credit for SUTA tax up to a maximum of 5.4%
- Net FUTA tax rate

FUTA tax rate	6.2%
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Less: Normal FUTA tax credit	<u>5.4%</u>
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Net FUTA tax rate	<u>0.8%</u>
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FUTA and SUTA

- SUTA taxes
 - ▣ Each state determines wage base limit
- Amounts are based on the needs of the unemployment funds
- 2011 the wage base limits for states ranged from \$7,000 to \$37,300
- Rate can vary from employer to employer

Workers' Compensation Insurance

- Insures employees against losses
 - ▣ Accidental injury or death while on the job
- Paid by employer in most states
- Insurance based on total estimated gross payroll
 - ▣ To determine the amount of the premium to charge

Workers' Compensation Insurance Calculation

Beginning of the year:

Workers' compensation premium for schedulers:	
$\$50,000/\$100 = 500 \times \$1.80 =$	\$ 900.00
Workers' compensation premium for managers:	
$\$190,000/\$100 = 1,900 \times \$.22 =$	<u>418.00</u>
Total workers' compensation premium =	\$1,318.00

The difference would require additional premium or receive a credit

End of the year:

<i>Workers' compensation premium for schedulers:</i>	
$\$57,977.14/\$100 = 580 \times \$1.80 =$	\$1,044.00
<i>Workers' compensation premium for managers:</i>	
$\$220,648.16/\$100 = 2,206 \times \$.22 =$	<u>485.32</u>
<i>Total workers' compensation premium =</i>	\$1,529.32

Learning Objective 3

Preparing a payroll register

Payroll Register

- Two primary records to keep track of payroll information for a company
 - ▣ A worksheet, known as a payroll register
 - Shows all information related to an entire pay period
 - ▣ The employee earnings record
 - Used to keep track of an individual employee's payroll history

Payroll Register

Includes each employee's

- Gross earnings
- Employee withholding
- Taxes
- Net pay
- Taxable earnings
- Cumulative earnings
- Accounts to be charged
- Wage expense for that pay period

Payroll Register

TRAVELWITHUS.COM INC.
HOURLY EMPLOYEE PAYROLL REGISTER
OCTOBER 16 – 29

Employee Social Security No.	Allowances and Marital Status	Previous Earnings (YTD)	Current Earnings						Current Earnings (YTD)	
			Regular			Overtime				Gross
			Hours	Rate	Amount	Hours	Rate	Amount		
Higuera, Stephanie 123-45-6789	S-1	18 5 1 3 60	7 8	1 1 4 0	8 8 9 2 0	4	1 7 1 0	6 8 4 0	9 5 7 6 0	1 9 4 7 1 2 0
Sui, Annie 123-45-6788	S-0	2 1 2 1 0 0	8 0	1 5 1 5	1 2 1 2 0 0	4	2 2 7 3	9 0 9 0	1 3 0 2 9 0	3 4 2 3 9 0
Taylor, Harold 123-45-6787	S-2	1 9 0 4 3 7 0	7 8	1 2 1 0	9 4 3 8 0	4	1 8 1 5	7 2 6 0	1 0 1 6 4 0	2 0 0 6 0 1 0
TOTALS					3 0 4 5 0 0			2 3 1 9 0	3 2 7 6 9 0	4 2 9 5 5 2 0

TRAVELWITHUS.COM INC.
HOURLY EMPLOYEE PAYROLL REGISTER
OCTOBER 16 – 29

Employee Social Security No.	Taxable Earnings		Deductions					Net Pay	Check No.	Account Charged	
	FUTA/SUTA	OASDI	FIT	SIT	FICA		Medical Insurance			Business Scheduling Expense	Cruise Scheduling Expense
					OASDI	Medicare					
Higuera, Stephanie 123-45-6789	—	9 5 7 6 0	9 2 0 0	7 6 6 1	5 9 3 7	1 3 8 9	3 3 0 0	6 8 2 7 3	8 2 0	9 5 7 6 0	
Sui, Annie 123-45-6788	1 3 0 2 9 0	1 3 0 2 9 0	1 6 7 0 0	1 0 4 2 3	8 0 7 8	1 8 8 9	3 3 0 0	8 9 9 0 0	8 2 1		1 3 0 2 9 0
Taylor, Harold 123-45-6787	—	1 0 1 6 4 0	8 1 0 0	8 1 3 1	6 3 0 2	1 4 7 4	3 3 0 0	7 4 3 3 3	8 2 2		1 0 1 6 4 0
TOTALS	1 3 0 2 9 0	3 2 7 6 9 0	3 4 0 0 0	2 6 2 1 5	2 0 3 1 7	4 7 5 2	9 9 0 0	2 3 2 5 0 6		9 5 7 6 0	2 3 1 9 3 0

Learning Objective 4

Maintaining an employee earnings record

Individual Employee Earnings Record

- A summary of employee's earnings, withholding taxes, net pay, and cumulative earnings during each calendar year

TRAVELWITHUS.COM INC.
 EMPLOYEE EARNINGS RECORD
 Stephanie Higuera Social Security No. 123-45-6789

Pay Period	Hours		Earnings			Deductions					Net Pay	Check No.	YTD Earnings
	Regular	Overtime	Regular	Overtime	Gross	FIT	SIT	FICA		Medical Insurance			
								OASDI	Medicare				
10/2 - 10/15	80	0	91200	000	91200	8600	7296	5654	1322	3300	65027	806	1851360
10/16 - 10/29	78	4	88920	6840	95760	9200	7661	5937	1389	3300	68273	820	1947120
10/30 - 11/12	76	0	86640	000	86640	8000	6931	5372	1256	3300	61781	825	2033760
11/13 - 11/26	80	2	91200	3420	94620	9200	7570	5866	1372	3300	67312	839	2128380
11/27 - 12/10	80	4	91200	6840	98040	9800	7843	6078	1422	3300	69597	844	2226420
12/11 - 12/24	80	0	91200	000	91200	8600	7296	5654	1322	3300	64828	858	2317620
12/25 - 12/31	48	0	54720	000	54720	3200	4378	3393	793	3300	39656	863	2372340
4th Quarter Totals			595080	17100	612180	56600	48975	37954	8876	23100	436474		
YTD Totals			2314200	58140	2372340	224186	189787	147085	34399	85800	1691083		

Summary of the chapter

- The Fair Labor Standards Act states that hourly workers will receive a minimum of one and a half times their regular hourly rate of pay for all hours they work over 40 hours during a workweek.
- Salaried employees are employees who are classified as salaried according to the provisions of the Fair Labor Standards Act. These employees receive a fixed amount of pay for each pay period.

Summary of the chapter

- For the rules of the Fair Labor Standards Act to apply to an employer, the employer must be involved in interstate commerce. Most companies today are involved in interstate commerce.
- Employees and employers pay equal amounts of Social Security tax. Note that Social Security, or FICA tax, is made up of two taxes: OASDI and Medicare.

Summary of the chapter

- The OASDI tax rate for 2011 is 6.2% and the wage base limit for this year is \$106,800. Medicare has no wage base limit, so an employee and employer will pay this tax on all of an employee's earnings during the calendar year, at a rate of 1.45% for 2011.
- Federal income tax withholding amounts are listed in tax tables found in IRS Circular E, Employer's Tax Guide, also known as Publication 15.
- Gross earnings minus deductions equals net pay.

Summary of the chapter

- The two primary accounting records used to keep track of payroll amounts are the payroll register and employee earnings record. The payroll register shows gross earnings, deductions, net pay, and taxable earnings for a payroll period. The employee earnings record shows the gross earnings, deductions, and net pay for an employee for an entire calendar year.

Summary of the chapter

- The taxable earnings columns of the payroll register do not show the tax. They show the amount of earnings to be taxed for unemployment taxes, OASDI, and Medicare. The individual employee earnings records are updated soon after the payroll register is prepared.
- The payroll tax expense for an employer is made up of FICA OASDI, FICA Medicare, FUTA, and SUTA.

Summary of the chapter

- The maximum amount of credit given for state unemployment taxes paid against the FUTA tax is 5.4%. This figure is known as the normal FUTA tax credit. The normal FUTA tax credit typically results in employers paying 0.8% for FUTA tax.

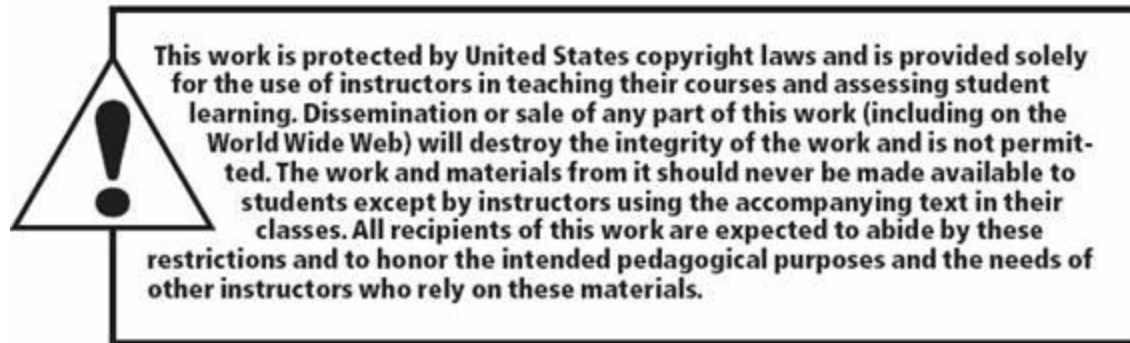
Summary of the chapter

- Employers pay workers' compensation insurance premiums based on estimated payroll. At the end of the year, estimated payroll is compared to actual payroll, and the employer either pays any additional premium or receives a credit for any overpayment of premium.

Questions



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