

- c. If the inflation rate this year is .7%, calculate the "adjusted" minimum wage rate to be paid next year.
- d. How much in "additional wages" will Delicious have to pay out next year at the adjusted rate?
- e. (Optional) Go to www.dol.gov/whd/minwage/america.htm and click on your state to find the current minimum wage. Calculate the weekly "minimum wage" portion of the restaurant's payroll assuming the restaurant is located in your state.
- f. (Optional) Suggest some ways that the restaurant chain or other small businesses can offset the increase in payroll and subsequent decrease in profit as a result of the minimum wage hike.

SECTION II

9

EMPLOYEE'S PAYROLL DEDUCTIONS

deductions or withholdings Funds withheld from an employee's paycheck.

mandatory deductions Deductions withheld from an employee's paycheck by law: social security, Medicare, and federal income tax.

voluntary deductions Deductions withheld from an employee's paycheck by request of the employee, such as insurance premiums, dues, loan payments, and charitable contributions.

"Hey! What happened to my paycheck?" This is the typical reaction of employees on seeing their paychecks for the first time after a raise or a promotion. As we will see, gross pay is by no means the amount of money the employee takes home.

Employers, by federal law, are required to deduct or withhold certain funds, known as **deductions or withholdings**, from an employee's paycheck. Employee payroll deductions fall into two categories: mandatory and voluntary. The three major **mandatory deductions** most workers in the United States are subject to are social security, Medicare, and federal income tax. Other mandatory deductions found only in some states are state income tax and state disability insurance.

In addition to the mandatory deductions, employees may also choose to have **voluntary deductions** taken out of their paychecks. Some examples include payments for life or health insurance premiums, union or professional organization dues, credit union savings deposits or loan payments, stock or bond purchases, and charitable contributions.

After all the deductions have been subtracted from the employee's gross earnings, the remaining amount is known as net, or take-home, pay.

$$\text{Net pay} = \text{Gross pay} - \text{Total deductions}$$

9-5

COMPUTING FICA TAXES, BOTH SOCIAL SECURITY AND MEDICARE, WITHHELD FROM AN EMPLOYEE'S PAYCHECK

Federal Insurance Contribution Act (FICA) Federal legislation enacted in 1937 during the Great Depression to provide retirement funds and hospital insurance for retired and disabled workers. Today FICA is divided into two categories, social security and Medicare.

In 1937 during the Great Depression, Congress enacted legislation known as the **Federal Insurance Contribution Act (FICA)** with the purpose of providing monthly benefits to retired and disabled workers and to the families of deceased workers. This social security tax, which is assessed to virtually every worker in the United States, is based on a certain percent of the worker's income up to a specified limit or **wage base** per year. When the tax began in 1937, the tax rate was 1% up to a wage base of \$3,000. At that time, the maximum a worker could be taxed per year for social security was \$30 ($3,000 \times .01$).

Today the FICA tax is divided into two categories. **Social security tax (OASDI)**, which stands for Old Age, Survivors, and Disability Insurance, is a retirement plan, and **Medicare tax** is for health care and hospital insurance. The social security wage base changes every year. For the most current information, consult the Internal Revenue Service, *Circular E, Employer's Tax Guide*. In 2010, the following rates and wage base were in effect for the FICA tax and should be used for all exercises in this chapter:

	Tax Rate	Wage Base
Social Security (OASDI)	6.2%	\$106,800
Medicare	1.45%	no limit

When an employee reaches the wage base for the year, he or she is no longer subject to the tax. In 2010, the maximum social security tax per year was \$6,621.60 ($106,800 \times .062$). There is no limit on the amount of Medicare tax. The 1.45% is in effect regardless of how much an employee earns.

EXAMPLE 9 CALCULATING SOCIAL SECURITY AND MEDICARE WITHHOLDINGS

What are the withholdings for social security and Medicare for an employee with gross earnings of \$650 per week? Round to the nearest cent.

SOLUTION STRATEGY

To find the withholdings, we apply the tax rates for social security (6.2%) and Medicare (1.45%) to the gross earnings for the week:

$$\text{Social security tax} = \text{Gross earnings} \times 6.2\%$$

$$\text{Social security tax} = 650 \times .062 = \underline{\$40.30}$$

$$\text{Medicare tax} = \text{Gross earnings} \times 1.45\%$$

$$\text{Medicare tax} = 650 \times .0145 = 9.425 = \underline{\$9.43}$$

TRY IT EXERCISE 9

What are the withholdings for social security and Medicare for an employee with gross earnings of \$5,000 per month?

CHECK YOUR ANSWERS WITH THE SOLUTIONS ON PAGE 299.

REACHING THE WAGE BASE LIMIT

In the pay period when an employee's year-to-date (YTD) earnings reach and surpass the wage base for social security, the tax is applied only to the portion of the earnings below the limit.

EXAMPLE 10 CALCULATING SOCIAL SECURITY WITH WAGE BASE LIMIT

Vickie Hirsh has earned \$104,900 so far this year. Her next paycheck, \$5,000, will put her earnings over the wage base limit for social security. What is the amount of Vickie's social security withholdings for that paycheck?

SOLUTION STRATEGY

To calculate Vickie's social security deduction, first determine how much more she must earn to reach the wage base of \$106,800.

wage base The amount of earnings up to which an employee must pay social security tax.

social security tax (OASDI) Old Age, Survivors, and Disability Insurance—a federal tax based on a percentage of a worker's income up to a specified limit or wage base for the purpose of providing monthly benefits to retired and disabled workers and to the families of deceased workers.

Medicare tax A federal tax used to provide health care benefits and hospital insurance to retired and disabled workers.

IN THE BUSINESS WORLD

PAYROLL TAX HOLIDAY

As part of the 2010 Tax Relief Act, the employee's portion of the Social Security tax was reduced from 6.2% to 4.2% for the tax year 2011. The wage base limit remained the same as in 2010, \$106,800.

The current FICA deduction rates and wage base are listed in the Internal Revenue Manual, *Employer's Tax Guide*.

This and other tax forms and publications can be obtained by calling the IRS at 1-800-TAX FORM or by accessing its website, www.irs.gov.



Photo by Robert Brechner

As a result of the historic healthcare reform package signed into law on March 23, 2010, the Medicare payroll tax will increase in 2013 for high-income individuals and couples.

Earnings subject to tax = Wage base - Year-to-date earnings

Earnings subject to tax = $106,800 - 104,900 = \$1,900$

Social security tax = Earnings subject to tax $\times 6.2\%$

Social security tax = $1,900 \times .062 = \underline{\underline{\$117.80}}$

TRY IT EXERCISE 10

Rick Nicotera has year-to-date earnings of \$102,300. If his next paycheck is \$6,000, what is the amount of his social security deduction?

CHECK YOUR ANSWER WITH THE SOLUTION ON PAGE 299.

9-6

CALCULATING AN EMPLOYEE'S FEDERAL INCOME TAX WITHHOLDING (FIT) BY THE PERCENTAGE METHOD

federal income tax (FIT) A graduated tax based on gross earnings, marital status, and number of exemptions that is paid by all workers earning over a certain amount in the United States.

withholding allowance, or

exemption An amount that reduces an employee's taxable income. Employees are allowed one exemption for themselves, one for their spouse if the spouse does not work, and one for each dependent child or elderly parent living with the taxpayer but not working.

percentage method An alternative method to the wage bracket tables used to calculate the amount of an employee's federal income tax withholding.

In addition to social security and Medicare tax withholdings, an employer is also responsible by federal law, for withholding an appropriate amount of **federal income tax (FIT)** from each employee's paycheck. This graduated tax allows the government a steady flow of tax revenues throughout the year. Self-employed persons must send quarterly tax payments based on estimated earnings to the Internal Revenue Service. By IRS rules, 90% of the income tax due for a given calendar year must be paid within that year to avoid penalties.

The amount of income tax withheld from an employee's paycheck is determined by his or her amount of gross earnings, marital status, and the number of **withholding allowances**, or **exemptions**, claimed. Employees are allowed one exemption for themselves, one for their spouse if the spouse does not work, and one for each dependent child or elderly parent living with the taxpayer but not working.

Each employee is required to complete a form called W-4, Employee's Withholding Allowance Certificate. The information provided on this form is used by the employer in calculating the amount of income tax withheld from the paycheck. Employees should keep track of their tax liability during the year and adjust the number of exemptions as their personal situations change (i.e., marriage, divorce, or birth of a child).

The **percentage method** for determining the amount of federal income tax withheld from an employee's paycheck is used by companies whose payroll processing is on a computerized system. The amount of tax withheld is based on the amount of gross earnings, the marital status of the employee, and the number of withholding allowances claimed.

The percentage method of calculating federal income tax requires the use of two tables. The first is the Percentage Method Amount for One Withholding Allowance Table, Exhibit 9-1. This table shows the dollar amount of one withholding allowance for the various payroll periods. The second, Exhibit 9-2, is the Tables for Percentage Method of Withholding.

EXHIBIT 9-1

Percentage Method Amount for One Withholding Allowance

Payroll Period	One Withholding Allowance
Weekly	\$ 70.19
Biweekly	140.38
Semimonthly	152.08
Monthly	304.17
Quarterly	912.50
Semiannually	1,825.00
Annually	3,650.00
Daily or miscellaneous (each day of the payroll period)	14.04

TABLE 1—WEEKLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$116 \$0

Over—	But not over—		of excess over—
\$116	—\$200	10%	—\$116
\$200	—\$693	\$8.40 plus 15%	—\$200
\$693	—\$1,302	\$82.35 plus 25%	—\$693
\$1,302	—\$1,624	\$234.60 plus 27%	—\$1,302
\$1,624	—\$1,687	\$321.54 plus 30%	—\$1,624
\$1,687	—\$3,344	\$340.44 plus 28%	—\$1,687
\$3,344	—\$7,225	\$804.40 plus 33%	—\$3,344
\$7,225		\$2,085.13 plus 35%	—\$7,225

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$264 \$0

Over—	But not over—		of excess over—
\$264	—\$471	10%	—\$264
\$471	—\$1,457	\$20.70 plus 15%	—\$471
\$1,457	—\$1,809	\$168.60 plus 25%	—\$1,457
\$1,809	—\$2,386	\$256.60 plus 27%	—\$1,809
\$2,386	—\$2,789	\$412.39 plus 25%	—\$2,386
\$2,789	—\$4,173	\$513.14 plus 28%	—\$2,789
\$4,173	—\$7,335	\$900.66 plus 33%	—\$4,173
\$7,335		\$1,944.12 plus 35%	—\$7,335

TABLE 2—BIWEEKLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$233 \$0

Over—	But not over—		of excess over—
\$233	—\$401	10%	—\$233
\$401	—\$1,387	\$16.80 plus 15%	—\$401
\$1,387	—\$2,604	\$164.70 plus 25%	—\$1,387
\$2,604	—\$3,248	\$468.95 plus 27%	—\$2,604
\$3,248	—\$3,373	\$642.83 plus 30%	—\$3,248
\$3,373	—\$6,688	\$680.33 plus 28%	—\$3,373
\$6,688	—\$14,450	\$1,608.53 plus 33%	—\$6,688
\$14,450		\$4,169.99 plus 35%	—\$14,450

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$529 \$0

Over—	But not over—		of excess over—
\$529	—\$942	10%	—\$529
\$942	—\$2,913	\$41.30 plus 15%	—\$942
\$2,913	—\$3,617	\$336.95 plus 25%	—\$2,913
\$3,617	—\$4,771	\$512.95 plus 27%	—\$3,617
\$4,771	—\$5,579	\$824.53 plus 25%	—\$4,771
\$5,579	—\$8,346	\$1,026.53 plus 28%	—\$5,579
\$8,346	—\$14,669	\$1,801.29 plus 33%	—\$8,346
\$14,669		\$3,887.88 plus 35%	—\$14,669

TABLE 3—SEMIMONTHLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$252 \$0

Over—	But not over—		of excess over—
\$252	—\$434	10%	—\$252
\$434	—\$1,502	\$18.20 plus 15%	—\$434
\$1,502	—\$2,821	\$178.40 plus 25%	—\$1,502
\$2,821	—\$3,519	\$508.15 plus 27%	—\$2,821
\$3,519	—\$3,654	\$696.61 plus 30%	—\$3,519
\$3,654	—\$7,246	\$737.11 plus 28%	—\$3,654
\$7,246	—\$15,654	\$1,742.87 plus 33%	—\$7,246
\$15,654		\$4,517.51 plus 35%	—\$15,654

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$573 \$0

Over—	But not over—		of excess over—
\$573	—\$1,021	10%	—\$573
\$1,021	—\$3,156	\$44.80 plus 15%	—\$1,021
\$3,156	—\$3,919	\$365.05 plus 25%	—\$3,156
\$3,919	—\$5,169	\$555.80 plus 27%	—\$3,919
\$5,169	—\$6,044	\$893.30 plus 25%	—\$5,169
\$6,044	—\$9,042	\$1,112.05 plus 28%	—\$6,044
\$9,042	—\$15,892	\$1,951.49 plus 33%	—\$9,042
\$15,892		\$4,211.99 plus 35%	—\$15,892

TABLE 4—MONTHLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$504 \$0

Over—	But not over—		of excess over—
\$504	—\$869	10%	—\$504
\$869	—\$3,004	\$36.50 plus 15%	—\$869
\$3,004	—\$5,642	\$356.75 plus 25%	—\$3,004
\$5,642	—\$7,038	\$1,016.25 plus 27%	—\$5,642
\$7,038	—\$7,308	\$1,393.17 plus 30%	—\$7,038
\$7,308	—\$14,492	\$1,474.17 plus 28%	—\$7,308
\$14,492	—\$31,308	\$3,485.69 plus 33%	—\$14,492
\$31,308		\$9,034.97 plus 35%	—\$31,308

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: The amount of income tax to withhold is:

Not over \$1,146 \$0

Over—	But not over—		of excess over—
\$1,146	—\$2,042	10%	—\$1,146
\$2,042	—\$6,313	\$89.60 plus 15%	—\$2,042
\$6,313	—\$7,838	\$730.25 plus 25%	—\$6,313
\$7,838	—\$10,338	\$1,111.50 plus 27%	—\$7,838
\$10,338	—\$12,088	\$1,786.50 plus 25%	—\$10,338
\$12,088	—\$18,083	\$2,224.00 plus 28%	—\$12,088
\$18,083	—\$31,783	\$3,902.60 plus 33%	—\$18,083
\$31,783		\$8,423.60 plus 35%	—\$31,783

STEPS TO CALCULATE THE INCOME TAX WITHHELD BY THE PERCENTAGE METHOD

- STEP 1.** Using the proper payroll period, multiply one withholding allowance, Exhibit 9-1, by the number of allowances claimed by the employee.
- STEP 2.** Subtract that amount from the employee's gross earnings to find the wages subject to federal income tax.
- STEP 3.** From Exhibit 9-2, locate the proper segment (Table 1, 2, 3, or 4) corresponding to the employee's payroll period. Within that segment, use the *left* side (a) for single employees and the *right* side (b) for married employees.
- STEP 4.** Locate the "Over—" and "But not over—" brackets containing the employee's taxable wages from Step 2. The tax is listed to the right as a percent or a dollar amount and a percent.

EXAMPLE 11 CALCULATING INCOME TAX WITHHOLDING

Lori Fast is a manager for Wayward Wind Travel. She is single and is paid \$750 weekly. She claims two withholding allowances. Using the percentage method, calculate the amount of income tax that should be withheld from her paycheck each week.

SOLUTION STRATEGY

From Exhibit 9-1, the amount of one withholding allowance for an employee paid weekly is \$70.19. Multiply this amount by the number of allowances claimed, two.

$$70.19 \times 2 = \$140.38$$

Subtract that amount from the gross earnings to get taxable income.

$$750.00 - 140.38 = \$609.62$$

From Exhibit 9-2, find the tax withheld from Lori's paycheck in Table 1(a). Weekly payroll period, Single person. Lori's taxable wages of \$609.62 fall in the category "Over \$200, but not over \$693." The tax, therefore, is \$8.40 plus 15% of the excess over \$200.

$$\text{Tax} = 8.40 + .15(609.62 - 200.00)$$

$$\text{Tax} = 8.40 + .15(409.62)$$

$$\text{Tax} = 8.40 + 61.44 = \underline{\underline{\$69.84}}$$

TRY IT EXERCISE 11

Jan McMillan is married, claims five exemptions, and earns \$3,670 per month. As the payroll manager of Jan's company, use the percentage method to calculate the amount of income tax that must be withheld from her paycheck.

CHECK YOUR ANSWER WITH THE SOLUTION ON PAGE 299

DETERMINING AN EMPLOYEE'S TOTAL WITHHOLDING FOR FEDERAL INCOME TAX, SOCIAL SECURITY, AND MEDICARE USING THE COMBINED WAGE BRACKET TABLES

9-7

In 2001, the IRS introduced **combined wage bracket tables** that can be used to determine the combined amount of income tax, social security, and Medicare that must be withheld from an employee's gross earnings each pay period. These tables are found in *Publication 15-A, Employer's Supplemental Tax Guide*. This publication contains a complete set of tables for both single and married people, covering weekly, biweekly, semimonthly, monthly, and even daily pay periods.

Exhibit 9-3 shows a portion of the wage bracket tables for Married Persons—Weekly Payroll Period, and Exhibit 9-4 shows a portion of the wage bracket table for Single Persons—Monthly Payroll Period. Use these tables to solve wage bracket problems in this chapter.

combined wage bracket tables IRS tables used to determine the combined amount of income tax, social security, and Medicare that must be withheld from an employee's gross earnings each pay period.

STEPS TO FIND THE TOTAL INCOME TAX, SOCIAL SECURITY, AND MEDICARE WITHHELD USING THE COMBINED WAGE BRACKET TABLE

- STEP 1.** Based on the employee's marital status and period of payment, find the corresponding table (Exhibit 9-3 or 9-4).
- STEP 2.** Note that the two left-hand columns, labeled "At least" and "But less than," are the wage brackets. Scan down these columns until you find the bracket containing the gross pay of the employee.
- STEP 3.** Scan across the row of that wage bracket to the intersection of the column containing the number of withholding allowances claimed by the employee.
- STEP 4.** The number in that column on the wage bracket row is the amount of combined tax withheld.

EXAMPLE 12 USING THE COMBINED WAGE BRACKET TABLES

Use the combined wage bracket tables to determine the amount of income tax, social security, and Medicare withheld from the monthly paycheck of Erin Lane, a single employee claiming three withholding allowances and earning \$2,975 per month.

SOLUTION STRATEGY

To find Erin Lane's monthly income tax withholding, choose the table for Single Persons—Monthly Payroll Period, Exhibit 9-4. Scanning down the "At least" and "But less than" columns, we find the wage bracket containing Erin's earnings: "At least 2,960—But less than 3,000."

Next, scan across that row from left to right to the "3" withholding allowances column. The number at that intersection, \$443.97, is the total combined tax to be withheld from Erin's paycheck.

TRY IT EXERCISE 12

Using the combined wage bracket tables, what is the total amount of income tax, social security, and Medicare that should be withheld from Brent Andrus's weekly paycheck of \$835 if he is married and claims two withholding allowances?

CHECK YOUR ANSWER WITH THE SOLUTION ON PAGE 299.

IN THE BUSINESS WORLD

All employees must have a Social Security number. Applications are available at all U.S. Post Offices or may be downloaded online at www.socialsecurity.gov.

Social Security numbers are used by the IRS as a taxpayer identification number as well as by banks, credit unions, and other financial institutions for reporting income from savings and other investments.

Information about an individual's Social Security account can be obtained by filing a Form 7004-SM—Request for Earnings and Benefits Estimate Statement. The form may be obtained by calling the Social Security Administration at 1-800-772-1213 or by transmitting your request using an online form via the Internet.

Solve the following problems using 6.2%, up to \$106,800, for social security tax and 1.45%, no wage limit, for Medicare tax.

JUMP
START
WWW

1. What are the withholdings for social security and Medicare for an employee with gross earnings of \$825 per week?

$$825 \times .062 = \underline{\$51.15} \text{ Social security}$$

$$825 \times .0145 = \underline{\$11.96} \text{ Medicare}$$

EXCEL 1

2. What are the social security and Medicare withholdings for an executive whose annual gross earnings are \$108,430?

EXCEL 2

3. Brian Hickman is an executive with Westco Distributors. His gross earnings are \$9,800 per month.

- a. What are the withholdings for social security and Medicare for Brian in his January paycheck?

- b. In what month will Brian's salary reach the social security wage base limit?

- c. What are the social security and Medicare tax withholdings for Brian in the month named in part b?

4. Kristy Dunaway has biweekly gross earnings of \$1,750. What are her total social security and Medicare tax withholdings for a whole year?

JUMP
START
WWW

As payroll manager for Freeport Enterprises, it is your task to calculate the monthly social security and Medicare withholdings for the following employees.

Employee	Year-to-Date Earnings	Current Month	Social Security	Medicare
5. Perez, J.	\$23,446	\$3,422	\$212.16	\$49.62
6. Graham, C.	\$14,800	\$1,540	_____	_____
7. Jagger, R.	\$105,200	\$4,700	_____	_____
8. Andretti, K.	\$145,000	\$12,450	_____	_____

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Use the percentage method of income tax calculation to complete the following payroll roster.

Employee	Marital Status	Withholding Allowances	Pay Period	Gross Earnings	Income Tax Withholding
9. Randolph, B.	M	2	Weekly	\$594	\$18.96
10. White, W.	S	0	Semimonthly	\$1,227	_____
11. Milian, B.	S	1	Monthly	\$4,150	_____
12. Farley, D.	M	4	Biweekly	\$1,849	_____

Use the combined wage bracket tables, Exhibits 9-3 and 9-4, to solve Exercises 13-19.

13. How much combined tax should be withheld from the paycheck of a married employee earning \$1,075 per week and claiming four withholding allowances?
14. How much combined tax should be withheld from the paycheck of a single employee earning \$3,185 per month and claiming zero withholding allowances?
15. Jeremy Dunn is single, claims two withholding allowances, and earns \$4,025 per month. Calculate the amount of Jeremy's paycheck after his employer withholds social security, Medicare, and federal income tax.

I.R.S.
AUDITS DIVISION



"I sympathize with your wife having multiple personality disorder but you can't claim each one as a dependent."

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Employee	Marital Status	Withholding Allowances	Pay Period	Gross Earnings	Combined Withholding
16. Alton, A.	S	3	Monthly	\$4,633	\$886.43
17. Emerson, P.	M	5	Weekly	\$937	_____
18. Reese, S.	M	4	Weekly	\$1,172	_____
19. Benson, K.	S	1	Monthly	\$3,128	_____

BUSINESS DECISION: TAKE HOME PAY

20. You are the payroll manager for the Canyon Ridge Resort. Mark Kelsch, the marketing director, earns a salary of \$43,200 per year, payable monthly. He is married and claims four withholding allowances. His social security number is 444-44-4444.

In addition to federal income tax, social security, and Medicare, Mark pays 2.3% state income tax, $\frac{1}{2}\%$ for state disability insurance (both based on gross earnings), \$23.74 for term life insurance, \$122.14 to the credit union, and \$40 to the United Way.

Fill out the following payroll voucher for Mark for the month of April.

Canyon Ridge Resort

Payroll Voucher

Employee: _____ Tax Filing Status: _____
SSN: _____ Withholding Allowances: _____

Full-time Pay Period From _____ To _____

Primary Withholdings:

Federal income tax	_____	_____
Social security	_____	_____
Medicare	_____	_____
State income tax	_____	_____
State disability	_____	_____

Additional Withholdings:

Gross Earnings: _____
- Total withholdings: _____

NET PAY _____

IN THE BUSINESS WORLD

During the Great Recession, there were nearly 6.4 unemployed workers for each available job at the end of November 2009, according to Labor Department data.

There were 1.7 jobless people for each opening in December 2007 when the recession began.

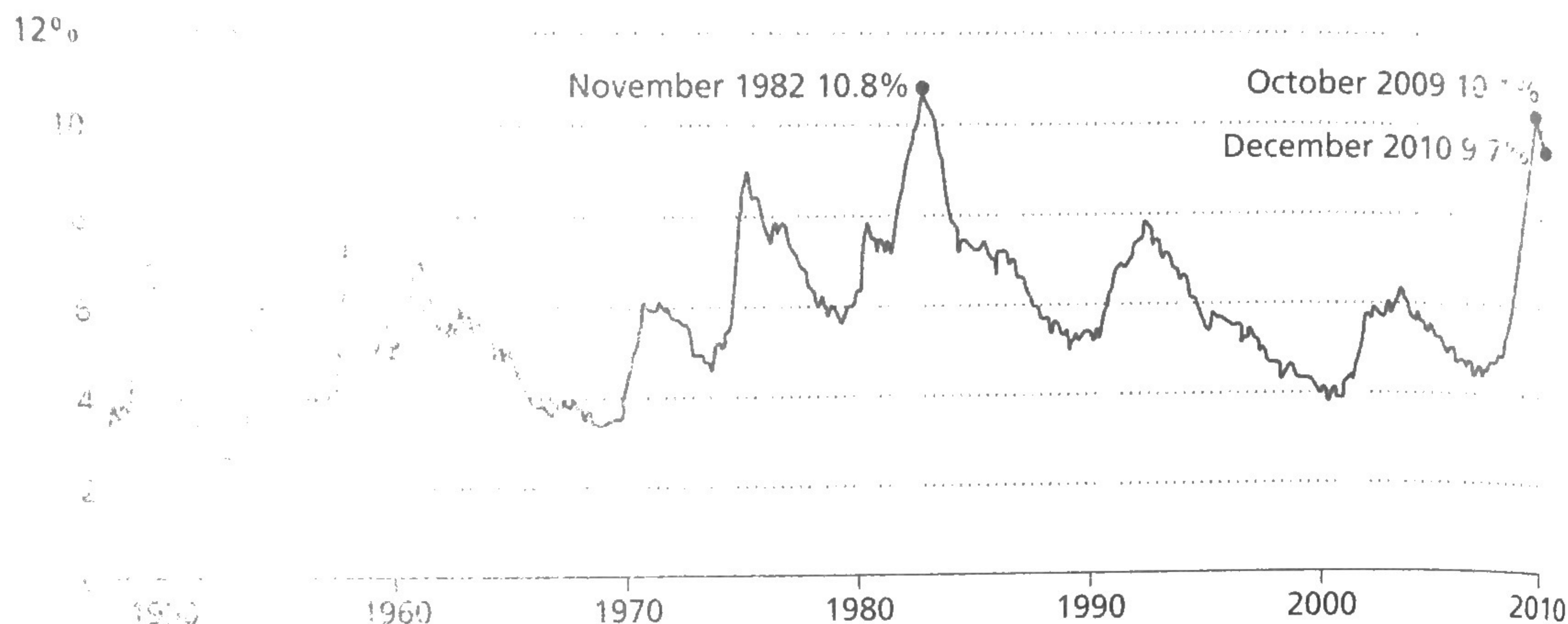
Source: The Miami Herald, Business Week, Jan. 13, 2010, page 1C.

Business

ain.com

Unemployment Peaks: The Post-World War II Jobless Rate

Recession



Sources: Labor Department, National Bureau of Economic Research

SECTION III

9

EMPLOYER'S PAYROLL EXPENSES AND SELF-EMPLOYED PERSON'S TAX RESPONSIBILITY

fringe benefits Employer-provided benefits and service packages over and above an employee's paycheck, such as pension funds, paid vacations, sick leave, and health insurance.

To this point, we have discussed payroll deductions from the employee's point of view. Now let's take a look at the payroll expenses of the employer. According to the Fair Labor Standards Act, employers are required to maintain complete and up-to-date earnings records for each employee.

Employers are responsible for the payment of four payroll taxes: social security, Medicare, state unemployment tax (SUTA), and federal unemployment tax (FUTA). In addition, most employers are responsible for a variety of **fringe benefits** that are offered to their employees. These are benefits over and above an employee's normal earnings and can be a significant expense to the employer. Some typical examples are retirement plans, stock option plans, holiday leave, sick days, health and dental insurance, and tuition reimbursement. This section deals with the calculation of these employer taxes as well as the tax responsibility of self-employed persons.

9-8

COMPUTING FICA TAX FOR EMPLOYERS AND SELF-EMPLOYMENT TAX FOR SELF-EMPLOYED PERSONS

FICA TAX FOR EMPLOYERS

Employers are required to *match* all FICA tax payments, both social security and Medicare, made by each employee. For example, if a company withheld a total of \$23,000 in FICA taxes from its employee paychecks this month, the company would be responsible for a matching share of \$23,000.

EXAMPLE 13 COMPUTING FICA TAX FOR EMPLOYEES AND THE EMPLOYER

Spectrum Engineering has 25 employees, each with gross earnings of \$250 per week.

- What are the total FICA (social security and Medicare) taxes that should be withheld from each employee's weekly paycheck?
- At the end of the first quarter (13 weeks), what were the accumulated totals of the employee's share and the matching taxes for FICA that Spectrum had sent to the IRS?

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SOLUTIONSTRATEGY

To solve for the total FICA tax due quarterly from the employees and the employer, calculate the tax due per employee per week, multiply by 25 to find the total weekly FICA for all employees, and multiply by 13 weeks to find the total quarterly amount withheld from all employees. The employer's share will be an equal amount.

- a. Social security tax = Gross earnings \times 6.2% = $250 \times .062 = \$15.50$
 Medicare tax = Gross earnings \times 1.45% = $250 \times .0145 = \$3.63$
 Total FICA tax per employee per week = $15.50 + 3.63 = \underline{\$19.13}$
- b. Total FICA tax per week = FICA tax per employee \times 25 employees
 Total FICA tax per week = $19.13 \times 25 = \$478.25$
 Total FICA tax first quarter = Total FICA tax per week \times 13 weeks
 Total FICA tax first quarter = $478.25 \times 13 = 6,217.25$
 Total FICA tax first quarter—Employee's share = $\$6,217.25$
 Total FICA tax first quarter—Employer's share = $\$6,217.25$

TRYITEXERCISE13

Big Pine Tree Service has 18 employees, 12 with gross earnings of \$350 per week and 6 with gross earnings of \$425 per week. What are the employee's share and the employer's share of the social security and Medicare tax for the first quarter of the year?

CHECK YOUR ANSWERS WITH THE SOLUTIONS ON PAGE 299.

SELF-EMPLOYMENT TAX

The self-employment tax, officially known as the Self-Employment Contributions Act (SECA) tax, is the self-employed person's version of the FICA tax. It is due on the net earnings from self-employment.

Self-employed persons are responsible for social security and Medicare taxes at twice the rate deducted for employees. Technically, they are the employee and the employer and therefore must pay both shares. For a self-employed person, the social security and Medicare tax rates are twice the normal rates, as follows:

	Tax Rate	Wage Base
Social Security	12.4% (6.2% \times 2)	\$106,800
Medicare	2.9% (1.45% \times 2)	No limit

EXAMPLE14 CALCULATING SELF-EMPLOYMENT TAX

What are the social security and Medicare taxes of a self-employed landscaper with net earnings of \$43,800 per year?

SOLUTIONSTRATEGY

To find the amount of self-employment tax due, we apply the self-employed tax rates, 12.4% for social security and 2.9% for Medicare, to the net earnings.

- Social security tax = Net earnings \times Tax rate
 Social security tax = $43,800 \times .124 = \underline{\$5,431.20}$
- Medicare tax = Net earnings \times Tax rate
 Medicare tax = $43,800 \times .029 = \underline{\$1,270.20}$