

Lesson 6 – Paying Employees

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Welcome to this presentation.

I've a few announcements before we get started.

The information contained in this presentation is current as of the day it was presented, and shouldn't be considered official guidance.

Any stories, names, characters, and incidents portrayed in this production are fictitious. No identification with actual persons (living or deceased), places, buildings, and products is intended or should be inferred.

This program will be maintained in accordance with federal recordkeeping laws.

Now let's get started.

Our general topic's payroll taxes

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In this lesson, we'll concentrate on correctly calculating social security and Medicare taxes on wages paid to employees.

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Publication 15, Employer's Tax Guide, explains your responsibilities as an employer. A new publication is released annually. Download a current version at the beginning of each year and review "What's New" for any changes.

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Pub 15 is your main resource on employer/employee related issues. The chart on page 5 provides a brief summary of your basic responsibilities. Each item on this list has a page reference to a more detailed discussion in this publication.

Excerpts from the chart refer to:

- page 20 for the discussion on federal income tax withholding.

- page 23 for withholding of social security and Medicare taxes.
- page 24 for the discussion on deposits.

We'll focus on the second topic during this lesson.

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Your organization may have bought software to process payroll. Why should you spend the time reviewing these lessons if your software takes care of all the payroll taxes?

You should have a basic understanding of what the payroll software's computing. You're ultimately responsible for the accuracy of the employment tax returns you file.

Like most software programs, the output's dependent upon the input. You should know why you're deducting payroll taxes from employees' paychecks. An understanding of the payroll calculations will help you avoid problems and spot mistakes before the returns ever reach the IRS.

What if your computer crashed? Your employees will be upset if their paychecks are delayed.

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After reviewing this lesson, you'll know how to manually calculate the payroll tax deductions for social security and Medicare taxes.

You'll need to multiply hourly rates by hours worked to get gross wages.

Based on the W-4, you'll need to look up the correct federal income tax to be withheld. We discussed this in Lesson 5.

You'll need to compute and withhold social security and Medicare taxes.

And you'll determine net paychecks by subtracting taxes from gross wages.

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Why's social security tax withholding important?

The Federal Insurance Contributions Act (FICA) provides for a federal system of old-age, survivors, disability, and hospital insurance.

The old-age, survivors, and disability insurance portion is partially financed by the social security tax the employee has withheld from his wages.

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As an employer, you're required to withhold social security from your employees' wages. Every time you're ready to issue a payroll check, the social security tax must be deducted.

Employee wages are subject to social security regardless of the employee's age or whether he's receiving social security benefits.

The social security tax has a wage base limit. This limit is the maximum wage subject to the tax for the year and is adjusted annually for inflation.

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Not only are you required to withhold social security tax from paychecks, as the employer, you must also contribute tax on each wage payment. This is known as the "employer's share of social security tax" or the "employer contribution."

The wage base limit for social security tax also applies for the tax the employer must pay.

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Here's a chart of the wages base limits for the current and prior years.

For example, during 2016, the wage base limit was \$118,500. Once an employee's wages for the year exceed \$118,500, stop withholding social security tax from the employee. Also, stop making an employer contribution.

With the beginning of each tax year, always review Pub 15 for possible changes in wage base limits and tax rates.

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The social security tax rate has remained the same since 1990. However, a change in the law excluded wages paid to certain new employees from the employer's share of social security tax in 2010.

Another law change reduced the tax rate from employees to 4.2% for 2011 and 2012. The amounts shown here are current.

As we'll learn in Lesson 7, you must pay the social security tax withheld from employees' wages as well as the employer contribution to the U.S. Treasury.

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Let's do an example, assuming the employee and employer rates are 6.2%.

Jane earned \$2,200 this pay period. Before we issue her paycheck, we must withhold social security tax at the rate of 6.2%. Simply multiply Jane's wages by the rate of .062 and withhold \$136.40 of social security tax from her paycheck.

As the employer, you also make a social security tax contribution at the same rate. A total of \$272.80 must be paid to the U.S. Treasury on the \$2,200 wages.

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Why's Medicare tax withholding important?

As stated earlier, FICA provides for a federal system of old-age, survivors, disability, and hospital insurance.

The hospital insurance portion is partially financed by the Medicare tax that the employee has withheld from his wages.

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As an employer, you're required to withhold Medicare taxes from your employees' wages. Every time you're ready to issue a payroll check, the Medicare tax must be deducted.

Employee wages are subject to Medicare taxes regardless of the employee's age or whether he's receiving social security benefits.

Unlike social security taxes, there's no wage base limit for Medicare tax. For example, if an employee earns \$500,000 annually, you'd only withhold social security tax up to the current wage base limit. For 2016, you'd stop withholding social security tax when wages reach \$118,500. However, you must withhold Medicare tax on the entire \$500,000.

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Not only are you required to withhold Medicare tax from paychecks, as the employer, you must also contribute tax on each wage payment. There's no wage base limit for the employer for Medicare tax contributions.

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The Medicare tax rate on both the employer and the employee has been 1.45% since 1986.

As we'll learn in Lesson 7, you must pay the Medicare tax withheld from employees' wages and the employer contribution to the U.S. Treasury.

Always review new editions of Pub 15 for any changes in these tax rates.

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Let's do an example assuming both the employee and employer rates are 1.45%.

Jane earned \$2,200 this pay period. Before issuing her paycheck, you must withhold Medicare tax at the rate of 1.45%. We multiply Jane's wages by the rate and will withhold \$31.90 of Medicare tax from her paycheck.

You also make a Medicare tax contribution at the same rate. So, a total of \$63.80 must be paid to the U.S. Treasury on these \$2,200 wages.

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Here's a summary of all taxes related to Jane Blue's \$2,200 wages.

We learned how to withhold federal income tax in Lesson 5. For Jane, we withheld \$189 based on her W-4.

In this lesson, we discussed the withholding rates for social security and Medicare tax. For Jane, we withheld \$136.40 and \$31.90, respectively.

Total taxes withheld from Jane's paycheck were \$357.30.

The employer's contribution for taxes total \$168.30 - \$136.40 for social security and \$31.90 for Medicare.

The final tax liability is \$525.60. These five parts aren't available for the employer to spend. We'll learn in Lesson 7, you must send the \$525.60 to the U.S. Treasury.

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Beginning January 2013, additional withholding tax laws began. In addition to withholding Medicare tax at 1.45%, employers must withhold 0.9% "additional" Medicare tax on an individual's wages paid in excess of \$200,000 in a calendar year. This is an employee only tax. There's no employer match for the additional Medicare tax.

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To demonstrate, here's an additional Medicare tax example.

Robert's annual salary is \$222,240. He earns \$18,520 for each month.

From each paycheck, the employer must withhold Medicare tax at 1.45% so \$268.54 is withheld from all 12 paychecks.

The employer must contribute the same \$268.54 each paycheck.

As you can see in the cumulative total column, once November's reached, Robert's cumulative, or year to date, wages exceed \$200,000. For every dollar greater than \$200,000, the additional 0.9% Medicare tax applies.

As shown, \$33.48 additional Medicare tax is withheld in November. This additional tax was calculated by taking the year-to-date excess over \$200,000, (\$3,720) and multiplying it by .9%.

\$166.68 additional Medicare tax is withheld for December because December's entire wage is part of the excess over \$200,000.

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Let's try an exercise to apply what we've learned.

For Pay Period 18, please compute the employees' withholding for federal payroll taxes as well as the employer's contribution.

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Here's a spreadsheet listing our employees. Their gross wages are provided in the third column.

In Lesson 5, we looked up federal income tax withholding for our employees.

Now we'll continue with Pay Period 18 by computing social security and Medicare taxes as well as the net paycheck amounts.

First, let's compute social security tax for each employee by multiplying his gross wages by the rate of 6.2%.

Please pause to complete the exercise.

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Review the answers.

- From Lonnette's \$2,000 wage, we withhold \$124.00 in social security tax.
- From Jimmy's \$1,500 wage, withhold \$93.
- From Tiffany's \$300 we withhold \$18.60. Remember, the claim of "exemption" on her W-4 only applies to federal income tax.
- From tribal council president, vice present and secretary/treasurer, we don't withhold social security tax because Revenue Ruling 59-354 states tribal council members' pay's exempt from withholding of employment taxes.

Total social security withholding this pay period is \$235.60.

Next, compute Medicare tax for each employee by multiplying their gross wages by the rate of 1.45%.

Please pause to complete the exercise.

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Here are our answers.

- For Lonnette, we withhold \$29 in Medicare tax.
- For Jimmy, \$21.75.

- For Tiffany, we withhold \$4.35. Remember, the claim of “exemption” on her W-4 only applies to federal income tax.
- For tribal council president, vice president and secretary/treasurer, we don’t withhold Medicare tax because of Revenue Ruling 59-354.

Total Medicare tax withholding for this pay period is \$55.10.

Net checks are shown in the right-hand column.

Total payroll taxes withheld from the employees’ wages for Pay Period 18 are \$853.70. This money belongs to the employees; the employer holding it in trust. It’s not available for the employer to spend. We’ll learn in Lesson 7 when it must be sent to the U.S. Treasury.

Now let’s compute the employer’s contribution for social security and Medicare taxes. As we learned earlier, the same rates apply for the employer.

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Here are our answers:

Employer’s social security contribution for this pay period is \$235.60 while the Medicare tax contribution is \$55.10.

For 2016, the employee and employer rates were the same for each, so we can simply “match” the amounts.

Total Pay Period 18 liability is \$1,144.40. It’s not available for the employer to spend.

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Here’s an example to demonstrate the “wage base limit” for social security tax and the additional Medicare tax. For 2016, Robert’s annual salary’s \$222,240. He earns \$18,520 monthly.

First let’s look at social security tax. As shown in the cumulative total column, we reach \$118,500 in July so social security tax only applies up to \$118,500. We stop withholding and matching social security tax for Robert’s wages greater than \$118,500.

Next, we look at Medicare tax. Continuing down the cumulative total column, once we reach November, Robert's cumulative, or year to date, wages exceed \$200,000.

For every dollar greater than \$200,000, the additional 0.9% Medicare tax applies.

As shown, \$33.48 additional Medicare tax is withheld in November. The additional tax was calculated by taking the year-to-date excess over \$200,000, (\$3,720) and multiplying it by .9%.

\$166.68 additional Medicare tax is withheld for December because December's entire wage is part of the excess over \$200,000.

Last, let's look to the final column liability each payday. This is a summation of the employee's and employer's taxes for each payday. These funds aren't available for the employer to spend.

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Let's try another exercise to apply what we've learned. For Pay Period 19, please compute the employees' withholding for federal payroll taxes as well as the employer's contribution.

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Gross wages are provided in the third column.

In Lesson 5, we already looked up federal income tax withholding for our employees.

Now we'll continue with the Pay Period 19 by computing social security and Medicare taxes as well as the net paycheck amounts.

First, let's compute social security tax for each employee by multiplying his gross wages by the rate of 6.2%.

Please pause to complete the exercise.

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Here are our answers.

- From Lonnette's \$2,080 wage, we withhold \$128.96 in social security tax.
- From Jimmy's \$2,000, \$124.00 is withheld.
- From Tiffany's \$600, we withhold \$37.20. Tiffany's claim of "exemption" doesn't apply to social security tax.
- From tribal council president, vice president and secretary/treasurer, we'll not withhold social security tax because of Revenue Ruling 59-354

Total social security withholding this pay period is \$290.16.

Next, compute Medicare tax for each employee by multiplying his gross wage by the rate of 1.45%.

Please pause to complete the exercise.

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Our answers are as follows.

- For Lonnette, we withhold \$30.16 in Medicare tax.
- For Jimmy, \$29.00.
- For Tiffany, we withhold \$8.70. Tiffany's claim of "exemption" doesn't apply to Medicare tax.
- For tribal council president, vice president and secretary/treasurer, we'll not withhold Medicare tax because of Revenue Ruling 59-354.

Total Medicare tax withholding for this pay period is \$67.86.

Net checks are shown in the right-hand column.

Total payroll taxes withheld from employees' wages for Pay Period 19 is \$1,016.02. This money belongs to the employees. The employer's holding it in trust. It's not available for the employer to spend.

Last, let's compute the employer's contribution for social Security and Medicare taxes. As we learned earlier, the same rates apply for the employer.

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Our answers are shown here.

Employer's social security contribution this pay period is \$290.16, while the Medicare tax contribution's \$67.86.

Total Pay Period 19 liability is \$1,374.04. It's not available for the employer to spend.

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In summary, here's a recap of federal payroll taxes you must consider when paying employees.

- Federal income tax withholding is based on W-4 and gross wages.
- The social security and Medicare tax rates apply to the employer and employee.
- There's a wage base limit for social security tax.
- Additional Medicare tax withholding's an employee paid only tax of 0.9% on wages exceeding \$200,000.

Thank you.