Clarity - USA payroll information guide

Taxes

Federal Withholding

To calculate US Fed Tax: Gross Pay – Amount Exempt from Federal = Taxable/Subject Wages

Once you determine the taxable amount, it is compared to the Federal Tax tables based on the employee's claimed filing status (Employee Tax Information), for Federal. If the employee is claiming a number of exemptions (i.e. Single-3), then a set amount is subtracted from the Taxable Wages BEFORE checking against the table. There is no wage limit or maximum for this tax.

The tables are located in the IRS "Circular E" (Google search), which is released every year:

http://www.irs.gov/pub/irs-pdf/p15.pdf

Example:

Semi-Monthy pay

Filing Status: M-4

Gross Amount: 5,000

Exempt deductions: 220

5,000-220 = 114,720

Four allowances @ 3900 each = 15600 (The allowance amount of 3900 may change from year to year and is different if single, married or head of household; see Circular E)

114720-15600 = 99120

Using page 45, Married persons, Annual tax table:

This falls on the line that says;

$80,800 - $154,700 . . $9,982.50 plus 25% of excess over $80,800

99120-80800 = 18320 x .25 = 4580 + 9982.50 = 14562.50/24 pay periods = 606.78 tax per pay period

The withheld Federal Tax is sent to the government by the employer. For some employers, this is done monthly, for others it's done 'semi-weekly' which is basically the following Wednesday or following Friday.

Withheld tax amounts are then reported quarterly on the Form 941 along with Social Security and Medicare taxes.

Federal Unemployment

Federal Unemployment is an employer paid tax in the US to cover the costs of unemployment payouts or loans made to individual States by the Federal government. This tax appears to be a flat percentage, but it is not. The percentage will vary from year to year and MAY vary from State to State.

Most people will know or want to know the percentage, which is usually something like 0.8% or 0.6%.

The percentage is actually derived as follows:

The total percentage is 6.0% of the first $7,000 earned for each employee.

Employers GENERALLY receive a 5.4% ', resulting in a 0.6% 'net FUTA tax rate'. Therefore, in this example, most customers will be familiar with the 0.6% tax rate and don't want to know much more.

There are circumstances, however, where the US Federal Government will reduce the credit that employers get in a particular State. This is because the State will take an unemployment loan from the government and fail to pay it back on time. The Federal government then passes the repayment on to employers in the State, reducing the 5.4% credit and therefore increasing the 0.6% net FUTA tax rate.

Example:

For 2012,

Washington State had no Credit Reduction. 6.0 – 5.4 = 0.6% FUTA rate

Arizona had it's first year of credit reduction. 6.0 – 5.1 = 0.9% FUTA rate

California had it's second year of credit recuction. 6.0 – 4.8 = 1.20% FUTA rate

Each year the Department of labor in the US releases a list of credit reductions. If the State has not paid it's loans for the previous year, the reduction is increased by 0.3% per year.

For customers, they simply need to know their rate. They may have to research to find out if their State is in credit reduction.

Totals for FUTA are reported on the federal Form 940. They included total wages as well as exempt wages (the amounts that employees make over the $7,000 limit. The employer is expected to show and calculate the amounts BY STATE if they do business in multiple States.

Social Security

Social Security tax is paid by the employer, but a portion is also withheld from employee's pay. Very few earnings are exempt from Social Security (or Medicare). Certain Foreign Students on a work permit and clergy that qualify are the main examples.

Social Security is a percentage of wages up to a certain amount. Once the amount is reached per employee, the tax is no longer collected.

Multiply wages by the percentage for the year in question (Google for the correct percentage for any given year). Traditionally, this was half employee and half employer. Usually 6.2 and 6.2 for a total of 12.4%. Once the maximum wage has been reached, stop collecting the tax.

This tax is reported on the Federal Form 941 each quarter. It is calculated by reporting wages on the form and multiplying. If it has been calculated incorrectly on payroll, this may result in the Form being out of balance.

Medicare

Medicare tax is a companion tax to Social Security. Like that tax, it is calculated as a percentage that is generally half paid by withholding from employees and half paid by the employer. The total percentage is 2.9%, resulting in 1.45% being withheld from employees, and 1.45% being paid by employers.

In 2013, this tax was altered to allow for collection of more tax from employees who make more than $200,000. In this case, an additional 0.9% is collected from employees once their wages reach $200,000, resulting in a tax percentage of 2.35%. The employer rate is unaffected and stays at 1.45%.

State Taxes

State taxes may also refer to US Territories, Guam, The US Virgin Islands, Puerto Rico and American Samoa.

State Withholding

State withholding works similar to Federal Withholding. Each State has their own method. It is USUALLY the same as Federal; the employee claims married, Single, Head of Household or other possible options, and a number of exemptions. Exempt wages or deductions are subtracted from the gross, it is multiplied to make an annual amount, and a set dollar amount per exemption claimed is subtracted. The resultant amount is then compared to a tax table and then divided by number of pay periods to get a per pay period tax.

It is advisable to use caution and research before discussing State taxes. Some States like Arizona have their own methods for calculating. Each State has it's own form and requirements for reporting State Withholding Tax. Some States do not have this tax at all (Florida, Texas, Nevada and Washington being among them).

State Unemployment

State Unemployment is generally an employer tax that is percentage based and has a maximum (wage base limit). Both factors vary from state to state, and the percentages can vary from employer to employer.

State Disability and Other

These additional taxes are typically employee, but there are a few exceptions such as New Jersey and California that tax employees directly. For this reason, setting up State taxes for customers should be done carefully, and it should be clear to them that they are responsible for verifying that everything is working according to their States' expectations.

Local taxes

Usually a very small percentage, these are set up manually and there can be more than one local tax per employee. We support number of local taxes 'automatically' - you need to define location (e.g. County, city, etc) and we will figure out amount. If tax is not listed in the list 'type' then it has to be setup manually.

Deductions

401K

A specific type of retirement plan in the US. It is exempt from Federal Tax when deducted. As with any deduction, care should be taken in the set up. There is also a special place for it on the Form Assignments (box 12, value D).

This is typically a percentage of wages, and there is a maximum per individual per year. In addition, there is often an ‘employer match’ that is defined by documents related to the 401k policy and there isn’t a specific standard. The match might be something like ‘the employee can contribute up to 6 percent, and the employer matches 50% up to 3%’. In addition, the law allows for older workers (age 55 and over) to contribute more than normal. This is referred to as a ‘catch up contribution’.

Section 125/Medical Insurance

Usually a pre tax deduction. Section 125 refers to the section of the IRS code that states that these deductions are exempt. Medical insurance can be pre tax, post tax or combinations of both. Most employers will break the deductions out, having a medical pre tax, dental pre tax, vision pre tax and maybe a medical post tax. AFLAC is often a post tax deduction.

Other Deductions

There are a number of other, specific deductions that must be dealt with. Customers should know how these work, but Clarity can handle them. Usually, it’s a question of which taxes something is subject to, are they paying out the actual dollars (earning vs. Benefit), and where it should appear on tax forms. The customer can explain how the code works and set it up accordingly with guidance.