ADP Added Value Services

Payroll Fundamentals
2017 Edition

Workbook with Answers

.

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Revised 02/14/2017

Payroll Fundamentals

Contact Us

For additional support regarding this topic, please contact: Debbie Mathewson at (714) 266-2441 or debbie.mathewson@adp.com.

Proprietary Information and Legal Disclaimer

Objectives

- ❖ Locate reference material to research payroll issues
- ❖ Determine who is considered an employee
- ❖ Review the difference between exempt and non-exempt employees
- ❖ Calculate gross pay earnings
- ❖ Review several types of deductions
- ❖ Calculate Federal Income Tax Withholding
- ❖ Calculate Social Security and Medicare Taxes
- ❖ Determine what compensation is taxable
- ❖ Calculate employee wages from gross to net
- ❖ Explain federal tax depositing and filing requirements

Introduction

Most of us take our paychecks for granted. Whether we receive a physical check or have our pay deposited directly into our checking accounts, many of us don't realize how much effort goes into creating that paycheck.

A payroll department is made up of people who have to know many different laws. These laws cover topics such as who is considered an employee, what deductions are coming out of an employee's check, which deductions have to be included for tax purposes, what taxes must be withheld, and when they have to be deposited.

The American Payroll Association (APA) offers a certification for payroll professionals who pass a rigorous 4-hour exam. This is called the Certified Payroll Professional (CPP) exam. While that exam covers a broad range of payroll topics, this course will focus on some of the basics. For those who are considering or are currently studying for the CPP exam, this course can also serve as a good foundation for what's to come.

Payroll Resources

There are several resources available to payroll associates. Throughout this class, we will be accessing some of these online resources to assist us in answering questions and calculating taxes.

IRS Publication 15 (Circular E Employers Tax Guide) - https://www.irs.gov/pub/irs-pdf/p15.pdf

IRS Publication 15-A (Employers Supplemental Tax Guide) - https://www.irs.gov/pub/irs-pdf/p15a.pdf – provides additional information on how to determine worker status

IRS Publication 15-B (Employers Tax Guide to Fringe Benefits) - https://www.irs.gov/pub/irs-pdf/p15b.pdf

Fair Labor Standards Act (FLSA) Website - http://www.dol.gov/compliance/laws/comp-flsa.htm

Fair Labor Standards Act Advisor - http://www.dol.gov/elaws/flsa.htm

American Payroll Association www.americanpayroll.org – has information on the Certified Payroll Professional exam

The Bridge Sponsored by ADP® – https://thebridge.adp.com – An online community for ADP clients which includes spaces for payroll and tax where clients can post and answer questions. Requires an ADP login and password.

ADP Tools & Resources http://www.adp.com/tools-and-resources.aspx - provides payroll and tax information, including calculation tools, payroll taxability, and reference guides. From Insights & Resources, scroll down to Tools & Resources and click the link for Compliance Resources to locate the tools below.

> **Fast Wage / Tax Facts** http://adp.com/tools-and-resources/compliance-connection/state-taxes.aspx – provides facts for all the states, including minimum wage amounts, wage withholding methods, and unemployment insurance wage limits. From the Compliance Connection area, scroll down to the States area and click the Learn More link.
>
> **Federal Tax Deposit Calendar** - http://www.adp.com/~/media/Compliance/Calendars/2017FTDCalendar_final.ashx - This is an ADP calendar used to mark all federal deposit due dates and holidays. From the Insights & Resources area of www.adp.com, scroll down to Tools & Resources, click the link for Compliance Resources, scroll down to Calendars and click the Learn More link.

Determining Who is an Employee

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15.pdf
Publication 15 – page 10

Employee Status Under Common Law

One of the most basic decisions an employer must make when hiring a worker to perform a service is whether the worker is an employee. The significance of this determination is that the employer is required to withhold and deposit income, social security, and Medicare taxes from the employee's wages and it must contribute an amount that matches the social security and Medicare tax withholdings of the employee. Under the Federal Unemployment Tax Act (FUTA), covered employers must also pay a certain percentage based on each employee's wages to support federal and state unemployment insurance programs.

Generally, employees are defined either under common law or under statutes for certain situations. While there is no uniform definition of an employee under all payroll laws, most workers can be classified as either employees or independent contractors once the common law test has been applied. Under common law rules, anyone who performs services for you is your employee if you have the right to control what will be done and how it will be done.

Statutory Employees

Statutory employees are workers who, while they are not employees under the common law, are treated as employees for certain employment tax purposes. Payments made by an employer to statutory employees are not subject to federal income tax withholding, but are subject to withholding for social security and Medicare and, in some instances, the employer must pay federal Unemployment (FUTA) tax. The following would be considered statutory employees:

Driver – delivers food, beverages, laundry, or dry cleaning for someone else

Insurance Salesperson – full-time life insurance salesperson who sells primarily for one company

Salesperson – traveling or city who works full time for one firm or person getting orders from customers

Homeworker - works at home by the guidelines of the person for whom the work is done, with materials furnished by and returned to that person

Statutory Nonemployees

Statutory nonemployees are those who by law are treated as self-employed for all federal tax purposes, including income and employment taxes. The workers who fall in this category are:

Real

Estate agents who are licensed, performing services in connection with the sale of real property.

Direct

Sellers – individuals who sell consumer products on a buy-sell or deposit-commission basis to be resold in the home or someplace other than a permanent retail establishment.

Companion Sitters – This is another type of Statutory Nonemployee. Companion sitters are individuals who furnish personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled. A person engaged in the trade or business of putting the sitters in touch with individuals who wish to employ them (that is, a companion sitting placement service) will not be treated as the employer of the sitters if that person does not receive or pay the salary or wages of the sitters and is compensated by the sitters or the persons who employ them on a fee basis. Companion sitters who are not employees of a companion sitting placement service are generally treated as self-employed for all federal tax purposes.

Example 1: Fred is an experienced plumber who agreed to perform full-time services for Acme Building Company. He performs the work in the order designated by ABC and according to their specifications. ABC supplies all Fred's materials, frequently inspects his work, pays him on a piecework basis, and carries workers' compensation insurance on him. Fred does not advertise his services or hold himself out as available to perform similar services for other companies.
What is Fred's worker classification? Employee

Example 2: Anne is a licensed cosmetologist. She does her work in a salon space at Salon Suites Inc. She determines the prices for her work, keeps all the fees charged to her clients, schedules appointments for her clients, is responsible for providing her own supplies, and pays Salon Suites a monthly rental amount. What is Anne's worker classification? Independent Contractor

Paying the Employee

Resource Alert - http://www.dol.gov/compliance/laws/comp-flsa.htm

Once a worker has been classified as an employee, there are rules about how an employee must be paid. One of the most basic payroll and employment laws is the Fair Labor Standards Act of 1938 (FLSA),

The FLSA does the following:

- Sets the minimum wage and overtime rates employees must receive for their work
- Requires recordkeeping by employers
- Places restrictions on the types of work children can do and the hours they can work
- Mandates equal pay for equal work

Exempt vs. Non-Exempt

Some employees are exempt from the overtime pay provisions of the FLSA. Exempt employees are often referred to as "salaried" employees.

For pending FLSA changes, visit https://www.dol.gov/whd/overtime/final2016/ and https://www.dol.gov/whd/overtime/final2016/litigation.htm

Below are examples of exempt employees, which are illustrative, but not all-inclusive.

Computer Professionals – must be paid at least $27.63 per hour

Administrative – their primary duty must be the office or performance of nonmanual work directly related to management – must include the exercise of discretion and independent judgment in matters of significance – must be paid at least $455 weekly

Professional – primary duty must be work requiring advanced knowledge in a field of science or advanced learning, or requiring imagination, originality, or talent – must be paid at least $455 weekly

Executive – primary duty must be management – must regularly direct the work of two or more employees – must have the authority to hire or fire – must be paid at least $455 weekly

Salesperson - Primary duty must be making sales of tangible or intangible items or obtaining orders or contracts for services or use of facilities - must customarily and regularly work away from the employer's place or places of business in performing their primary duty

Minimum Wage

The federal minimum wage rate is currently $7.25 per hour. Many states also have minimum wage laws. In states where the employee is subject to both the federal and state laws, the employee is entitled to the higher of the two minimum wages. For the purpose of this class we will be focusing on only the federal law.

Employees may be paid on a piecework, salary, or commission basis, so long as the wages at least equal the minimum hourly rate.

Workweek

In determining whether the employee has been paid the minimum wage, the employer must establish a workweek. The employee's pay cannot be averaged over any longer period to determine whether they have been paid the minimum wage. The workweek must be a regularly recurring period of 168 hours (7 consecutive 24-hour periods). It does not have to be the same as a calendar week or begin at the start of a day.

Payroll Period

While the workweek must be established to determine that the minimum wage is being paid, the payroll period is a period of service for which the employer pays wages. Some common payroll periods are:

Monthly (12 pay periods per year)

Semimonthly (24 pay periods per year)

Biweekly (26 pay periods per year)

Weekly (52 pay periods per year)

Calculating Wages

Overtime Requirements

The required overtime pay under the FLSA is 1 ½ times the employee's "regular rate of pay." In general, the regular rate of pay is an hourly pay rate determined by dividing the total regular pay actually earned for the workweek by the total number of hours worked. The FLSA requires overtime pay for hours physically worked over 40 in a workweek. Hours for which employees are paid, but during which no actual work was done, do not have to be counted when calculating the number of hours worked.

Example 1: If Jane is paid $685 biweekly and typically works a 40-hour workweek, her hourly rate would be determined as follows:

$685 ÷ 80 hours = $8.56 per hour

If Jane were to work more than 40 hours in one workweek, she would be entitled to overtime or premium pay for those hours. That premium pay could be calculated as

$8.56 x .5 = $4.28 per hour

If Jane works the following hours during a particular pay period, let's calculate her pay:

	S	M	T	W	Th	F	S	Total
Week 1	0	8	10	11	8	8	0	45
Week 2	0	9	8	10	8	8	0	43

What were the total hours that Jane worked for week 1? 45
What were the total hours that Jane worked for week 2? 43
What were the total hours that Jane worked for the entire pay period? 88

How many hours of overtime did Jane work in this pay period? 8

Now we'll take Jane's regular rate of pay and calculate the total amount of regular and premium pay that she is entitled to.

Regular rate of pay = $8.56 per hour x 88 (total hours) = $753.28
Premium pay = regular rate of pay $8.56 x .5 x 8 overtime hours = $34.24
Regular pay $753.28 + Premium pay $34.24 = $787.52 total wages for this pay period

Another way to calculate overtime is to calculate the regular hours first, then calculate the overtime hours separately and add the regular and overtime pay together:

Regular rate of pay = $8.56 per hour x 80 (regular hours) = $684.80
Overtime pay = regular rate of pay $8.56 x 8 hours x 1.5 = $102.72
Regular pay $684.80 + Overtime pay $102.72 = $787.52 total wages for this pay period

Example 2: Joe earns $7.65 per hour. His normal workweek is 40 hours from Sunday through Saturday and he typically works 8 hours a day. Joe's employer allows for paid sick time. Last week Joe worked the following schedule:

Monday	8 hours
Tuesday	Sick day
Wednesday	10 hours
Thursday	9 hours
Friday	8 hours

How many total hours did Joe work? 35
For how many hours will Joe be paid? 43
How many overtime hours is Joe entitled to? None – hours paid but not worked (sick) do not count toward overtime
Let's calculate Joe's pay for this week: 43 hours x $7.65 = $328.95

Employees Working at More Than One Rate

When an employee is paid at two or more different rates by an employer for doing two or more different jobs during the workweek, the regular rate of pay must take into account the different rates.

Example: Mike works as a researcher for 8 hours a day from Monday through Friday for $12 an hour. In the same week, he works an extra 12 hours (4 on Thursday and 8 on Saturday) as a filer for $9 an hour. His regular rate of pay would be calculated as follows:

40 hours x $12 = $480
12 hours x $9 = $108
Total pay = $588 ÷ 52 hours = $11.31 average per hour

Mike's overtime pay will have to be calculated based on the average we came up with above. Now, let's calculate his overtime pay and his total pay for this payroll period.

Overtime = 12 hours x $11.31 x .5 = $67.86

$588 (regular wages) + $67.86 (overtime premium) = $**655.86** Total wages

Pieceworkers

Some employees get paid based on how many items they produce. Under a piece-rate system, the method for determining the regular rate of pay is to add the weekly piece-rate earnings to any other earnings for the workweek and then divide the total by the number of hours worked in the workweek. The rate of pay must always equal at least the hourly minimum wage.

Example: John receives $.85 for each paper airplane he assembles, plus a $.25 bonus per airplane for each airplane over 352 he assembles in a regular 46-hour workweek. In one workweek, John assembled 420 paper airplanes.

Regular piecework earnings:	420 airplanes x $.85 = $357
Production bonus:	68 airplanes x $.25 = $17.00
Total piecework earnings:	$357 + $17.00 = $374.00
Regular rate of pay:	$374.00 ÷ 46 hours = $8.13
Total overtime premium:	$8.13 x .5 x 6 hours = $24.39
Total earnings for workweek:	$374.00 + $24.39 = $398.39

Salaried Employees

Not all salaried employees are exempt from the FLSA's overtime requirements. Only those employees whose salaries exceed a certain level and who meet the duties and responsibilities tests for exemption are classified as exempt. All other salaried employees must be paid overtime. The regular rate of pay for such employees is determined by dividing the employee's salary by the number of hours the salary is intended to compensate.

Example: Sara typically works 35 hours per week and is paid a semimonthly salary of $1,200. In a recent workweek, she worked 43 hours.

Annual Salary:	$1,200 x 24 = $28,800
Weekly Salary:	$28,800 ÷ 52 = $553.85
Regular rate of pay:	$553.85 ÷ 35 hours = $15.82
Regular pay:	$15.82 x 43 hours = $680.26
Premium pay:	$15.82 x 3 hours x .5 = $23.73
Total pay:	$703.99

What if Sara works 38 hours in one week? Would that change the amount that she's entitled to for this pay period?

No – It doesn't matter that she worked more than her agreed-upon hours. If she doesn't work more than 40 hours in one week, then according to the FLSA, she is not entitled to overtime and would only be entitled to her semimonthly salary of $1200. However, if she were to work more than 40 hours, she would be entitled to $15.82 per hour for all hours plus the overtime premium for any hours over 40.

Calculating Wages Practice

1. Susie receives an hourly wage of $12 per hour for a 35-hour workweek. In one week, in addition to her regular hours, she works an additional 7 hours on Saturday. Calculate her total earnings for this week.

   Regular rate of pay – 42 hours x $12 = $504
   Overtime pay – 2 hours x $12 x .5 = $12
   Total pay – $504 + $12 = $**516**

2. John works under the piece-rate system and he receives $2 for each toy car he produces. He also receives a bonus of $.50 for each car he produces over 300 in a workweek. In one workweek, John produces 326 toy cars in 43 hours. Calculate his earnings for this week.

   326 cars x $2 = $652
   26 cars x $.50(bonus) = $13
   Total piece-rate earnings = $665
   Regular rate of pay –$665 ÷ 43 hours = $15.47
   Overtime pay –$15.47 x 3 overtime hours x .5 = $23.21
   Total earnings –$665 + $23.21 = $**688.21**

3. An employee is paid $9 per hour plus a 10% increase for evening shifts. During the past week, the employee worked 24 hours on day shift and 24 hours on evening shift. Under FLSA, what should be the gross wages for the week?

   Day shift – 24 hours x $9 = $216
   Night shift – 24 hours x $9.90 = $237.60

   Regular rate of pay –216 + 237.60 ÷ 48 total hours = $9.45 per hour
   Overtime pay –$9.45 x 8 overtime hours x .5 = $37.80
   Total pay –$216 + $237.60 + $37.80 = $**491.40**

4. Mark is a nonexempt employee who works 35 hours per week and is paid a monthly salary of $2,500. During a certain workweek, Mark worked 43 hours. Calculate his total earnings for this week.

Annual salary:	$2,500 x 12 months = $30,000
Weekly salary:	$30,000 ÷ 52 weeks = $576.92
Regular rate of pay:	$576.92 ÷ 35 hours = $ 16.48
Regular pay:	43 hours x $16.48 = $708.64
Premium pay:	3 hours x $16.48 x .5 = $24.72
Total earnings:	$708.64 + $24.72 = $**733.36**

Payroll Deductions

Types of Deductions

There are several deductions that can come out of a paycheck. Take a few moments to write down as many deductions as you can think of:

- Medical
- 401k
- Stock plan
- Federal Income Tax
- Social Security
- Medicare
- State Income Tax
- Savings
- State Disability Insurance

Statutory vs. Voluntary Deductions

Statutory deductions are mandatory and are required by law. What are some examples from above of statutory deductions?

- Federal Income Tax
- Social Security
- Medicare

What are some examples of voluntary deductions?

- 401k
- Health Insurance/Medical
- Stock purchase plan

Calculating Federal Tax Withholding

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15.pdf
Publication 15 – page 20

Every employer that pays wages is required to deduct and withhold federal income tax from those wages. To know how much federal income tax to withhold from employees' wages, employers should have a Form W-4 on file for each employee. This form is designed to tell the employer how many withholding allowances the employee is claiming, a number that will determine the amount to withhold from the employee's wages for federal income tax. The W-4 also indicates the employee's marital status and tells the employer if the employee is claiming totally exempt from withholding.

There are several methods that can be used to calculate this withholding, but we will focus on two of the most common methods: Wage Bracket Method and Percentage Method

Wage Bracket Method

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15.pdf
Publication 15 – page 47

The wage bracket method uses IRS tables. These tables can be found starting on page 47 of Publication 15 (2017 version). There are two tables for each of the following pay periods (one for single and one for married person): weekly, biweekly, semimonthly, monthly, and daily or miscellaneous. Here are the steps used to calculate federal withholding using the wage bracket method:

1. Find the table that applies to the employee's pay period and marital status
2. Determine the employee's wages subject to federal income tax withholding.
3. Locate the wage bracket in the first two columns in which the employee's wages for the pay period can be found.
4. Move across the table to the tax amount which corresponds to the row that reflects the withholding allowances on their W-4.

Example: Sally is paid biweekly and earns $925 in taxable compensation each pay period. On her W-4, she has indicated she is married with 2 withholding allowances. Using the wage bracket method, determine the amount of federal income tax to withhold from Sally's paycheck: **$29 – found on page 53 of the Publication 15**

Percentage Method

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15.pdf
Publication 15 – page 43

Because of more numerous and complicated calculations, the percentage method of withholding is generally used by employers with automated payroll systems or by service bureaus that handle payroll processing for many different employers.

Use the following steps to figure the income tax to withhold using the percentage method:

1. Multiply one withholding allowance for your payroll period (see Table 5 on page 44 of Publication 15) by the number of allowances that the employee claimed on their W-4
2. Subtract that amount from the employee's wages
3. Determine the amount to withhold from the appropriate table on pages 45-46 of Publication 15 (**Hint**: reading this table from right to left makes this method a little easier)

Example 1: Joe is single and claims three withholding allowances on his W-4. He is paid semimonthly and his taxable earnings for this pay period are $1,500. Determine his federal income tax withholding using the percentage method.

$1,500 - $506.40 (3 withholding allowances x $168.80 for semimonthly) = $993.60 (subject wages) - $484 = $5093.60 x 15% = $76.44 + $38.80 = $**115.24**

Example 2: Jane is married and claims four allowances on her W-4. She receives an annual salary of $99,000 and is paid monthly. Calculate her federal income tax withholding using the percentage method.

$99,000 ÷ 12 (monthly payroll) = $8,250
$8,250 - $1,350.00 (IRS monthly allowance amount $337.50 x 4) =
$6,900.00 (subject wages) - $2,275 = $4,625.00 x 15% = $693.74 + $155.40 =
$**849.15**

Social Security and Medicare Taxes

Resource Alert – www.irs.gov – Type "Social Security" in search box

http://www.irs.gov/businesses/small/international/article/0,,id=104936,00.html

Employees working in the United States must pay social security and Medicare taxes. Social security coverage provides retirement benefits and medical insurance (Medicare) benefits to individuals who meet certain eligibility requirements. Employers must deduct these taxes from each wage payment as well as pay an employer portion. These taxes are collected together as Federal Insurance Contribution Act (FICA) tax.

For social security, the tax is applied only on wages up to the taxable wage base (or wage limit). For 2016, the social security wage limit is $118,500. The social security rate is 6.2%. This amount is withheld from employees and also paid by employers.

For Medicare, there is no wage limit and the rate is 1.45% for wages up to $200,000. This amount is withheld from employees and also paid by employers. In addition to this withholding rate, employers must also withhold an additional 0.9% from wages in excess of $200,000. This additional withholding is not paid by employers.

Now that we've learned about the three federal taxes withheld from employees' checks, let's look at examples where we put them all together.

Example 1: Mike is paid $900 in federal taxable wages every two weeks, is married and claims 2 withholding allowances. Using the wage bracket method for federal income tax withholding, calculate Mike's net pay.

Taxable biweekly wages:	$ 900.00
Federal income tax withheld:	$ -27.00
Social security tax withheld:	$ -55.80
Medicare tax withheld:	$ -13.05
Net pay:	$ **804.15**

Example 2: Sue earns an annual salary of $62,000, is paid weekly and on her W-4, she claims single with two withholding allowances. Using the percentage method for federal income tax withholding, calculate the net pay of her weekly paycheck.

Taxable weekly wages:	$1,192.31 ($62,000 ÷ 52 weeks)
Federal income tax withheld:	$ - 166.13 (see below)
Social security tax withheld:	$ - 73.92
Medicare tax withheld:	$ - 17.29
Net pay:	$ **934.97**

FIT $1,192.31 – 155.80 = $1,036.51 - $774 = $262.51 x 25% = $65.63 + $100.50 = $166.13

Calculating Gross to Net Practice #1

Jane is an office assistant. She earns $15.48 an hour and is paid weekly. She is a nonexempt employee. The W-4 form filed with her employer indicates her tax status as married with two withholding allowances. Using the IRS Publication 15, calculate her FIT using the wage bracket method.

Last week, Jane worked a total of 48 hours. In addition to FIT, social security, and Medicare, Jane also has deductions as follows:

- State income tax: 2.25%
- City income tax: 1.0%

Given this information, answer the following questions:

1. What is Jane's gross pay? <u>$804.96</u>
   48 hours x $15.48 = $743.04
   8 hours x $15.48 x .5 = $61.92
   $743.04 + $61.92 = $804.96

2. How much FIT is deducted from Jane's earnings? <u>$55</u>
   Using wage bracket – Married/weekly/2 allowances

3. How much social security is deducted from Jane's earnings? <u>$49.91</u>
   $804.96 x 6.2%

4. How much Medicare is deducted from Jane's earnings? <u>$11.67</u>
   $804.96 x 1.45%

5. How much SIT is deducted from Jane's earnings? <u>$18.11</u>
   $804.96 x 2.25%

6. How much is deducted for the city income tax? <u>$8.05</u>
   $804.96 x 1.0%

7. What is Jane's net pay? **<u>$662.22</u>**
   Line 1 – (Line 2 through Line 6)

Determining Taxable Compensation

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15b.pdf
Publication 15b

The Internal Revenue Code (IRC) uses the term “gross income” as the starting point for determining a taxpayer’s federal tax bill. This generally includes all compensation for services, including fees, commissions, fringe benefits, and similar items. Wages and benefits are generally included in income and subject to income and employment tax withholding, payment, and reporting requirements, unless the IRC says otherwise.

Taxable Fringe Benefits

Some examples of taxable fringe benefits are:

- Personal use of a company car
- Gift certificates
- Company paid vacation

When noncash fringe benefits or perks are provided by an employer to its employees, the amount of the benefit is defined as its fair market value, or what it would cost an individual to purchase the benefit on the open market in an “arm’s length transaction.”

The fair market value added to an employee’s earnings is known as imputed income.

Imputing Income

In most situations involving fringe benefits, taxes are not or cannot be withheld when the benefit is provided to the employee. Therefore, the taxable value of the benefit must be added to a regular wage payment.

The taxes are then calculated on the total of the imputed income added to the taxable gross earnings.

After the taxes have been calculated and deducted, the imputed income is then subtracted from the total to come up with the employee’s net pay.

Group Term Life

Under IRS regulations, employer-provided group term life insurance premiums for coverage in excess of $50,000 are considered taxable income and are subject to social security and Medicare taxes, but not FIT or FUTA.

Nontaxable Fringe Benefits

Nontaxable benefits are not subject to federal income tax withholding or social security, Medicare, or FUTA taxes. Some examples of nontaxable fringe benefits are:

- Working condition fringe benefits
- Certain moving expenses
- Qualified employee discounts
- De minimis fringes
- Dues and membership fees
- On-premises athletic facilities

Example: John earns $2,500 each pay period in taxable wages and was recently awarded an all-expenses paid vacation for reaching his sales goal. The fair market value of this vacation was $1,800. How should this be calculated?

Regular Wages	= $2,500
Imputed Income	= $1,800
Total Taxable Wages	= $4,300

After the taxes are calculated on the total taxable wages, what will happen to the imputed income amount?
It will be subtracted out before his net pay is calculated.

Voluntary Deductions

Pretax Deductions

Some deductions reduce an employee's taxable wages when pre-tax dollars are used to contribute to benefits such as health, life, and disability insurance.

Deferred Compensation Plans

The IRS allows employees to invest in qualified tax-deferred savings plans. The most common of these plans is the 401(k)

Under any qualifying 401(k) plan, employee pretax contributions are limited; and for 2017, the tax-deferred contribution limit is $18,000. For individuals age 50 or older, there is a catch-up provision, which allows them to contribute an additional $6,000.

Contributions to 401(k) are not subject to federal income tax but are still taxable for social security and Medicare. States and cities vary as to the taxability of 401(k) contributions.

Cafeteria Plans

Cafeteria plans allow employees to select from two or more benefits involving cash and qualified benefit programs. These flexible benefits allow employees to choose the benefit coverage most suitable to their needs.

Under a Cafeteria 125 plan, employees pay for flexible benefits with pretax contributions.

Under the IRS code, pretax dollars for Cafeteria 125 plans are not subject to federal income tax, social security, or Medicare taxes.

Calculating Gross to Net Practice #2

Tom is a senior manager at an accounting firm. His annual salary is $145,000. He has earned $139,423 so far this year. He is paid biweekly and his W-4 form indicates that he is married with four withholding allowances. Using the percentage method for FIT, calculate Tom's net pay for his last paycheck in December.

In addition to FIT, social security, and Medicare, consider the following items in calculating this pay:

- Tom has a pretax 401(k) contribution of 9% of his gross earnings
- Tom contributes $200 per paycheck for pre-tax health insurance
- Tom's state imposes a 3.5% income tax on taxable earnings and follows federal rules for taxable compensation
- The annual value of Tom's personal use of a company provided vehicle has been calculated at $2,475 which is being imputed on this last paycheck of the year

Given this information, answer the following questions:

1. What is Tom's biweekly salary? $5,576.92
   (annual salary ÷ 26 pay periods)

2. How much is Tom's 401(k) deduction for this pay period? $ 501.92

3. What portion of Tom's earnings is taxable for FIT and SIT? $7,350.00
   (biweekly salary – pretax 401(k) – pretax health insurance + car lease value)

4. How much FIT is withheld? $ 1,285.87
   $7,350 – 623.20 (4 withholding allowances) = $6,726.80 - $6,221 = $505.80 x 28% = $141.62 + $1,144.25 = $1,285.87

5. How much SIT is withheld? $ 257.25
   $7,350 x 3.5% = $257.25

6. What portion of Tom's earnings is taxable for social security? $ None
   He has already exceeded the $118,500 SS limit

7. How much social security tax is withheld? $ None

8. What portion of Tom's earnings is taxable for Medicare? $ 7,851.92
   (biweekly salary (no limit) – health insurance + car lease value)

9. How much Medicare will be deducted from Tom's earnings? $ 113.85

10. Using the line items on the next page, calculate Tom's net pay.

Biweekly salary		$5,576.92
Imputed car value	+	$ 2,475.00
Gross earnings	=	$8,051.92
FIT	-	$ 1,285.87
SIT	-	$ 257.25
Social Security	-	$ 0
Medicare	-	$ 113.85
Health Insurance	-	$ 200.00
401(k) contribution	-	$ 501.92
Imputed car value	-	$ 2,475.00
Net Pay	=	**$3,218.03**

Depositing and Reporting Taxes

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15.pdf
Publication 15 – Page 25

Other than paying employees, the most important function of a company's payroll department is collecting various taxes required by federal, state, and local governments. Much of this is accomplished by withholding the required amounts from employees' wages and timely paying them to the appropriate governmental unit.

The Principle of Constructive Receipt

Under federal regulations, employers must withhold federal income tax, social security tax, and Medicare tax when the employee is actually or constructively paid, not when the wages are earned and become payable. This means that the wages are considered to have been paid when they have been made available to the employee without substantial limitation or restriction.

The date when the wages have been paid is often referred to at ADP as the check date. It is this date which determines when the tax deposit will be due. But before an employer can know their due date, they must know their federal deposit frequency.

Federal Tax Deposit Rules

Employers that file Form 941 (*Employer's Quarterly Federal Tax Return)* are assigned one of two deposit frequencies by the IRS. The deposit frequency is not the same as the filing frequency for the return.

The two deposit frequencies are monthly and semiweekly. The determination of the correct frequency is based on the employer's total liability for federal income, social security, and Medicare taxes during a "lookback period." This is the 12-month period running from July 1 of the second previous year through June 30 of the previous year.

Example: For tax year 2017, the lookback period will run from July 1, 2015 through June 30, 2016.

If an employer's four quarterly Forms 941 reflect a total liability of $50,000 or less, then their assigned deposit frequency will be monthly. If their total liability exceeds $50,000, then their assigned deposit frequency will be semiweekly.

Example: Big Time Java, Inc. reported their federal tax liability as follows:

2017 Lookback Period

3rd quarter 2015 -	$13,000
4th quarter 2015 -	$15,000
1st quarter 2016 -	$13,000
2nd quarter 2016 -	$13,000
Total Liability	$54,000

What is Big Time Java's assigned deposit frequency for 2017? Semiweekly

Next Day Deposit Rule

If an employer's federal tax liability reaches $100,000 on any day during a monthly or semiweekly deposit period, the taxes must be deposited by the close of the next business day. In determining whether the $100,000 threshold is met, monthly depositors consider only those taxes accumulated during the current calendar month, not any previous months. Semiweekly depositors take into account only those taxes accumulated during the current semiweekly period.

Federal Deposit Due Dates

Once the correct deposit frequency has been determined, the employer then has to make timely deposits based on that frequency. The deposit due date will be based on the check date previously discussed under "Constructive Receipt." Below is a table to assist in determining the correct due dates based on each frequency.

Deposit Frequency	Check Date	Cutoff Date	Due Date
Monthly	1st through the 31st	Last day of the month	15th of the following month
Semiweekly	Saturday through Tuesday	Tuesday	3 banking days following cutoff date – usually Friday
	Wednesday through Friday	Friday	3 banking days following cutoff – usually Wednesday
Next Day	Any date	Same as check date	Next banking day

Example 1: Bob's Car Repair, a monthly depositor, pays wages on August 4, 11, 18, and 25. Below is a breakdown of his payroll tax liability for each of these check dates:

Aug. 4	$15,000
Aug. 11	$15,000
Aug. 18	$15,000
Aug. 25	$15,000

What is Bob's total tax liability amount for the month of August? $60,000

When will this tax liability be due? September 15

Example 2: Gina's Hair Salon, a semiweekly depositor, pays wages on Friday, May 19, 2016 with a total payroll tax liability amount of $53,000. When will Gina's tax deposit be due?
Wednesday, May 24

Impact of one-day rule on monthly depositors. If a monthly depositor accumulates at least $100,000 in tax liability on any day during a month, it not only must deposit the liability by the next day, but it also becomes a semiweekly depositor for the remainder of the current calendar year and the entire next calendar year.

Example 3: John's Hardware Store, a rapidly expanding business, is a monthly depositor for 2017. In September, he added two more stores and accumulated an employment tax liability of $103,200 with his Friday, September 8 check date. When will this tax deposit be due? Monday, September 11.
On Friday, September 15, he had another payroll with tax liability of $83,500. When will that tax deposit be due? Wednesday, September 20 – he is now a semiweekly depositor.

The Employment Tax Return – Form 941

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15.pdf
Publication 15 – Page 30

The basic employment tax return filed by employers is Form 941. The purpose of Form 941 is to provide the IRS with a report of each employer's total taxable wages paid and payroll tax liability, which can be matched against the employer's record of tax deposits and wage and tax information provided to employees on their W-2 forms. Form 941 must be filed by the last day of the month that follows the end of the quarter.

The due dates for filing the 941 are as follows:

Quarter	Quarter Ends	941 Due Date
Jan. – Mar.	March 31	April 30
Apr. – June	June 30	July 31
July – Sept.	September 30	October 31
Oct. – Dec.	December 31	January 31

Form 944 – Small employers may qualify to file Form 944 *Employer's Annual Federal Tax Return*, instead of the quarterly form 941. Employers whose annual tax liability is less than $1,000 will be notified by the IRS that they qualify to file this annual form.

Federal Unemployment Insurance (FUTA)

Resource Alert – https://www.irs.gov/pub/irs-pdf/p15.pdf
Publication 15 – Page 35

Employer contributions in the form of unemployment taxes are required by the Federal Unemployment Tax Act (FUTA). The FUTA tax is paid only by employers and is calculated as percentage of covered wages for each employee.

The FUTA Rate

The FUTA tax rate is currently 6.0% on the first $7,000 of an employee's wages. However, most employers do not pay the full rate. States also require unemployment insurance to be paid by employers and if the employer pays their state unemployment taxes in full and on time, they can receive a credit against their FUTA tax rate of up to 5.4%. This is referred to as the tentative credit. When this credit is applied, the employer would then pay .6%.

Credit Reduction

States with a high rate of unemployment and difficulty meeting their benefit obligations can borrow money from the Federal Unemployment Account to pay benefits. If loans taken out during one year are not repaid by the end of the following calendar year, the FUTA credits for employers in those states are reduced, with the extra FUTA taxes paid being applied against each state's loan balance.

The reduction schedule is 0.3% for the first year the state is a credit reduction state, another 0.3% for the second year, and an additional 0.3% for each year thereafter that the state has not repaid its loan in full.

Sometime after November 10 of each year, the credit reductions for that year are announced by the IRS and are included in Schedule A (Form 940).

Depositing and Paying the FUTA Tax

The FUTA tax must be deposited by the last day of the month following the end of the quarter. If an employer's quarterly FUTA tax is less than $500, then they do not have to make the deposit in that quarter. They can carry that liability over to the following quarter. Once the liability in a quarter reaches $500, then the deposit must be made.

Reporting FUTA Tax

Employers must report their FUTA liability annually on Form 940. The purpose of this form is to determine the employer's FUTA taxable wages for the calendar year and the FUTA tax liability on those wages after accounting for applicable state unemployment tax credits and FUTA tax deposits made during the year.

Tax Deposit Practice

http://www.adp.com/~/media/Compliance/Calendars/2017FTDCalendar_final.ashx
2017 Federal Deposit Calendar

1. ABC Corporation is a semiweekly depositor and they have a payroll tax liability of $65,000 on Thursday, December 7. When is this tax deposit due?

   Wednesday, December 7

2. Joe's Feed Store is a semiweekly depositor and they pay their employees every Friday. Based on the check dates and liability amounts below, determine when each of their tax deposits will be due.

Check Date	Liability Amount	Due Date
Friday, April 7	$48,000	Wed., April 12
Friday, April 14	$50,000	Thur., April 20
Friday, April 21	$49,000	Wed., April 26

3. Fred's Fish Emporium is a monthly depositor and they pay their employees every Friday. Based on the check dates and liability amounts below, determine when each of their tax deposits will be due.

Check Date	Liability Amount	Due Date
Friday, August 4	$55,000	Friday, September 15
Friday, August 11	$62,000	Monday, August 14
Friday, August 18	$62,000	Wednesday, August 23

4. The Burger Bungalow has reported total FUTA wages of $49,850 for 1Q17 and $43,750 for 2Q17 and they also report those wages to their State Unemployment agency.

   What is their total FUTA tax liability for 1st quarter? $299.10
   $49,850 x 0.6%
   When will this tax deposit be due? Monday, July 31
   What is their total FUTA tax liability for 2nd quarter? $262.50
   $43,750 x 0.6%
   When will this tax deposit be due? Monday, July 31

   Because this employer didn't reach $500 in liability in 1st quarter, it rolls to 2nd, gets added to that liability, and gets deposited for 2nd quarter.

Additional Practice Calculations

1. Jane is married and is paid $1,319 in taxable earnings by her employer on a biweekly basis. Jane claims 5 withholding allowances on her Form W-4 and she does not have any state income tax. Using the wage bracket method for Federal Income tax, calculate Jane's net pay for one pay period.

   Calculate Taxes
   FIT =$20 (per wage bracket method)
   SS = $81.78
   Medi = $19.13

Gross Wages	= $1,319.00
FITW	- $ 20.00
SS	- $ 81.78
Medi	- $ 19.13
Net Pay	= $**1,198.09**

2. John Daly is paid weekly and claims Married – 4 withholding allowances on his W-4. For this pay period, he works 48 hours and is paid $12.00 per hour. In addition, he receives a production bonus for having met his quota in the amount of $125.00. The employer does not pay or tax the production bonus separately. There is no state tax involved. Using the percentage method for FIT, calculate John's net pay.

Calculate wages first
48 hours x $12.00 = $576 + Production Bonus (125) = $701 (Total Wages)
Total Wages ÷ 48 hours = $14.60 Regular rate of pay
Regular rate of pay ($14.60) x 8 x .5 = $58.40 (O.T.)
Gross wages = $576 + $125 + $58.40 = **$759.40** Total Gross wages

Calculate FIT
$759.40 – ($77.90 x 4) = $447.80 - $166 = $281.80 x 10% = $28.18 FITW

Social Security $759.40 x 6.2% = $47.08
Medicare $759.40 x 1.45% = $11.01

Calculate Net Pat

Gross Wages	= $759.40
FITW	- $ 28.18
SS	- $ 47.08
Medicare	- $ 11.01
	= $ **673.13 Net Pay**

3. James earns an annual salary of $55,200 in 2017. He is single, with one allowance. He is paid semi-monthly and participates in a 401k plan at 10% of his salary and in a qualified cafeteria plan at $120 per month. There is no state income tax. Using the percentage method for FIT, calculate his net pay.

Calculate Gross Wages
$55,200 ÷ 24 pay periods = $2,300.00 gross wages per pay period

Calculate Federal Taxable Wages
$2,300.00 - $230 (401k) = $2,070.00 - $60 (cafeteria plan per pay period) = $2,010.00 Federal taxable wages

Calculate FITW
$2,010 (Fed taxable wages) - $168.80 (1 allowance) = $1,841.20 - $1,677 = $164.20 x 25% = $41.05 + $217.75 = $**258.80 FITW**

Calculate SS & Medi
$2,300.00 (Gross Wages) - $60.00 (Cafeteria plan) = $2,240
SS $2,240.00 x 6.2% = $138.88
Medi $2,240.00 x 1.45% = $32.48

Calculate Net Pay

Gross Wages	= $2,300.00
FITW	- $ 258.80
SS	- $ 138.88
Medi	- $ 32.48
401(k)	- $ 230.00
Café Plan	- $ 60.00
Net Pay	= $ **1,579.84**

4. Julia is a nonexempt employee paid $16.85 per hour every two weeks. In addition to her hourly wages, she also earned a production bonus of $125. During a recent pay period, she worked 43 hours one week and 44 hours the next week. She also contributes 3% to a 401(k) plan and $95 each pay period to her company's health insurance plan. She is married and claims two withholding allowances withholding allowances. Using the percentage method for FIT, calculate Julia's net pay.

Calculate her gross wages

$16.85 x 87 hours = $1,465.95
$1,465.95 + $125 = $1,590.95
$1,590.95 ÷ 87 hours = $18.29 (average hourly rate)
$18.29 x 7 x .5 = $64.02 (overtime)
$1,465.95 (regular) + $125 (bonus) + $64.02 (overtime) = **$1,654.97**

Calculate her federal taxable wages

$1,654.97 x 3% (401k) = $49.65 401(k)
$1,654.97 - $49.65 (401k) - $95 (health) = **$1,510.32 FIT taxable**

Calculate her FITW

$1,510.32 - $311.60 (2 withholding allowances) = $1,198.72 - $1,050.00 = $148.72 x 15% = $22.31+ $71.70 = **$94.01 FITW**

Calculate her Social Security and Medicare taxable wages

$1,654.97 - $95 (health) = **$1,559.97**

Calculate her Social Security & Medicare tax

$1,559.97 x 6.2% = $**96.72 SS**
$1,559.97 x 1.45% = $**22.62 Medi**

Calculate Net Pay

Gross Wages	=$ 1,654.97
FITW	- $ 94.01
SS	- $ 96.72
Medi	- $ 22.62
Health Insurance	- $ 95.00
401(k)	-$ 49.65
Net Pay	**= $ 1,296.97**

5. Jane earns $4,000 each pay period and is paid semimonthly. She is single and claims 2 withholding allowances. She contributes 10% to a 401k plan, $150 to a pre-tax health plan, and $250 to a credit union savings plan. In addition, Jane uses a company car for personal use, which is valued at $75 per pay period. Using the percentage method for federal income tax withholding, calculate Jane's net pay for her December 31, 2017 check date.

Calculate Federal Taxable Wages

$4,000 - $400 - $150 + $75 = $3,525

Calculate FITW

$3,525 – ($168.80 x 2) = $3,187.40 - $1,677.00 = $1,510.40 x 25% = $377.60 + $217.75 = **$595.35 FITW**

Calculate SS & Medi Taxable Wages

$4000 + 75 - $150 = $3,925.00

Calculate SS & Medi Taxes

SS - $3,925.00 x 6.2% = **$243.35 SS**
Medi - $3,925.00 x 1.45% = **$56.91 Medi**

Calculate Net Pay

Gross Wages	= $4,000.00
Car Value	+$ 75.00
FITW	- $ 595.35
SS	- $ 243.35
Medi	- $ 56.91
401(k)	- $ 400.00
Health plan	- $ 150.00
Savings	- $ 250.00
Car Allowance Imputed	- $ 75.00
Net Pay	= $ **2,304.39**