Getting Paid

Advanced Level

Employment is an agreement between an employer and employee. An employer hires a person in exchange for compensation, usually in the form of wages or a salary. An employee is a person who agrees to provide certain services at a job for an employer. The agreement between an employee and employer can be verbal, implied or written in an employment contract that both parties sign.

Some employers pay their employees an hourly rate of pay or hourly wage. Jobs such as restaurant servers, cashiers, host/hostesses and cooks typically pay an hourly wage. The federal government sets a minimum hourly wage (known as the minimum wage), and employers are required to pay their employees <u>*at least*</u> that amount per hour. Some states set a higher minimum wage than the federal minimum.

> *Regardless of the type of payment you receive for a job completed, an employer is required by law to pay employees on a regular basis*

A **salary** is a fixed amount of money or compensation paid to an employee by an employer in return for work performed. Salary is commonly paid in stages at fixed intervals, for example, monthly payments of one-twelfth of the annual salary. Salaries do not depend on the specific number of hours worked. If you accept a salaried position you may find yourself working more than the standard 40 hours a week to " do whatever it takes" to complete a job successfully. And when workweeks are shortened, your pay is typically not negatively affected. Teachers, doctors, attorneys and accountants are all salaried employees.

Commission is a fee that a salesperson receives upon completion of a sale. It is a motivational system of payment designed to encourage sales staff to sell more. If you accept a job as a car salesperson, a real estate professional, or a financial planner you most likely will earn a commission when a sale has been made.

Methods of Payment

There are several systems employers use to deliver earned wages to their employees. Here are three popular ones. Your employer may let you choose the one you prefer.

Paper paycheck - Your employer pays you by authorizing a check written to you in the amount of money earned. You are then able to access your wages by cashing your paycheck and/or depositing it in a depository institution account.

Direct deposit – Your wages are deposited directly into your depository institution account. This method is more secure than a paper paycheck because there is no direct check handling. Typically the employee receives a "receipt or paystub" on payday when this payment method is used.

Payroll card - A payroll card is a reloadable debit card onto which a worker's pay is loaded. This is a good option if you don't have, can't get or don't want a traditional deposit account. When you make a purchase, funds are automatically deducted from the balance of your payroll card. You may pay fees when using a payroll card, or if you want to use the card to withdraw cash. The fees vary depending upon the depository institution, so it is important to obtain a list of all fees before using a payroll card.

Which payment method would you prefer? Why?

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You are responsible for yourself.

While you may think there is nothing wrong with getting paid in cash, you need to be aware of some serious pitfalls in this method of payment. Handling cash on payday significantly raises your risk of loss or theft. You are still responsible for paying state and federal income taxes, and setting aside enough from your pay to cover that expense. Cash payrolls do not give you the opportunity to pay into the Social Security system and will limit your ability to collect benefits later in life. And, if you become injured on the job and can no longer work, you will not have the protection of Worker's Compensation.

Gross Income – **Deductions** = **Net Income**

Payroll Deductions

Employers make several deductions from the wages you earn. Your **gross income** is the amount of money earned ***before*** payroll taxes. Your **net income** is the amount of money you are left with once all deductions have been taken from your gross income. Net income is commonly referred to as "take home pay." Some deductions are mandatory and taken from everyone's wages. Other deductions are optional and depend on employee preferences.

Your Paycheck Tax Liability

Your employer is required to withhold **income tax** and other **payroll taxes** from your paycheck. Managing the amount of your income and payroll tax withholdings on your paycheck can help you avoid paying additional taxes at the end of the year.

Income tax is the tax you pay to federal, state and local governments on the amount of money you earn. Taxable income is total income less allowable deductions. Personal characteristics such as marital status are considered deductions and influence your **tax liability** (total tax bill). Income tax is a key source of funds that the government uses to fund its activities and serve the public.

Payroll taxes are withheld or paid on your behalf by your employer. The amount of taxes deducted from your paycheck is based on the wage or salary you earn. In the United States both state and federal authorities collect some form of payroll tax.

REQUIRED INCOME AND PAYROLL TAXES

- **Federal Income Tax** – Is a tax levied by the United States Internal Revenue Service (IRS) on the annual earnings of individuals, corporations, trusts and other legal entities. Employers are required by law to withhold a percentage of your wages to pay this tax. The federal income tax represents the largest deduction taken from your gross income. The amount withheld depends on two things: the amount of money earned and the information you provide on the Form W-4.
    - The **Form W-4** is also called an Employee's Withholding Allowance Certificate.
        - The number of allowances you claim on your W-4 determines the percentage of pay withheld from your paycheck to pay your federal income tax liability.
        - The more allowances you claim, the less income tax will be withheld from your paycheck. You can claim one allowance for yourself, one for your spouse and one for each of your dependents.
        - A **dependent** is a person who relies on you, the taxpayer for financial support. A dependent may be a qualifying child or qualifying adult relative. As a general rule of thumb, you may claim an allowance for every dependent. You may change your Form W-4 at any time to have more or less federal income taxes deducted from your wages.
        - Some employees claim fewer allowances than permitted in order to be sure they don't owe additional tax at the end of the year. This is called over-withholding, and can lead to a tax refund the following year. Over-withholding has advantages and disadvantages. But, the point is that you can use income tax withholding as a financial management tool.

REQUIRED INCOME AND PAYROLL TAXES CONTINUED...

- **State Income Tax** – Is an income tax collected by most, but not all states (Florida, for instance, does not require it's residents to pay a state income tax). If you live in a state that has a state income tax your employer will deduct an amount from your wages. The amount deducted varies between states and depends on the amount of gross pay you have earned.
- **Social Security** – Employers are required by law to withhold a Social Security tax from your earned wages. Social Security is a federal government program that funds retirement accounts, financially supports citizens who have experienced profound disability, the premature death of a parent (if under the age of 18), or the premature death of a spouse in a family with children. You contribute 6.2% of your earned income to Social Security until you have reached your annual required contribution amount that varies each year.

The Form W-4 may be downloaded for free from the Internal Revenue Service's website.

- **Medicare** – Employers are required by law to withhold from your earned income this payroll tax contribution to Medicare. Medicare is a federal program whose main purpose is to help pay for health care for those over 65. You contribute 1.45% of earned income to Medicare and there is no annual limit.

How do you benefit from paying taxes?

OPTIONAL PAYROLL DEDUCTIONS

Employee benefits - Employers may offer you employee benefits in the form of products or services that add extra value for employees beyond earned wages. You may pay a portion of the cost of the benefit. This additional payment deduction, taken from your gross income, is common with health care insurance, retirement plans, and flexible spending accounts. You typically pay much less by opting into these benefits and having their costs deducted from your paycheck than if you were to privately purchase the same product.

Pay Stub

Information regarding deductions is outlined on your **pay stub**. Your "earnings statement" (pay stub) is provided by your employer and is available to you at the end of each pay period regardless of how you collect your wages. With the wide array of wage payment methods available to you from your employer, you may have to request a pay stub if one is not automatically provided. You may do this at any time during your employment.

The look of pay stubs may vary from one employer to the next, but the information provided on this document is basically the same and will include:

A. **Employee Information** – As an employee, your full name, address, and employee identification number are standard information. Depending on the employer, this section may include additional information such as your job title, department, pay rate, etc.
B. **Pay Period** – A pay period is the regular schedule by which your employer will pay you. Pay periods are typically weekly, bi-weekly or monthly and are usually determined by your employer. The last day of the pay period is not the actual day you will receive your paycheck. The pay date is delayed to allow the employer time to accurately compute your wages and pay you for all time worked in a pay period.
C. **Hours and Earnings** –These indicate how the amount of wages you earned was calculated. If you're paid an hourly wage, the amount of hours worked and pay rate will be indicated. Hours and earnings may be divided into two sections; current and year-to-date (YTD). The current section indicates the amount of wages you earned for the current pay period. The YTD section indicates the amount of wages you earned from January 1 to the last day of the current pay period.

D. **Gross Income** – This is the amount of pay you earned before deductions. This section of your pay stub may also include a YTD amount.

E. **Deductions** – This section lists all "subtractions" taken from your gross income including income taxes, payroll taxes and any additional optional deductions. Your deductions may also be reflected in a YTD amount on your pay stub.

F. **Employer Contributions** – If your employer has contributed to various employee benefits and other contributions on your behalf, that amount will be reflected in this section. Some employers opt not to disclose their employer contributions on employee pay stubs.

G. **Net Income** – This is your "take home pay." It is the amount of pay you earned after your deductions.

H. **Employee Leave Balances** - A summary of the employee's time balances (if applicable) including sick, vacation, and/or holidays.

Employee Information A				**Pay Date: 6/11/2013**
Name	Identification Number	Address	Pay Rate	Pay Period B
Joe Beakens	00112233	293 Michael Grove	$15.00	5/1 – 5/31/2013

Summary			
	Gross Income D	Total Personal Deductions	Net Income G
Current	$2,400.00	$747.00	$1,653.00
YTD	$12,000.00	$3,735.00	$8,265.00

Earnings C				
Type	Rate	Hours	Current	YTD
Regular	$15.00	160	$2,400.00	$12,000.00
Overtime	0	0	0	0

Deductions E		
Type	Personal Deduction	Employer Contribution F
Federal income tax	$249.40	0
State income tax	$100.00	0
Social Security and Medicare	$183.60	$918.00
Retirement plan	$144.00	$144.00
Health insurance	$100.00	$400.00
Workers' compensation	0	$13.80
Unemployment insurance	0	$6.26

Employee Leave Balances H					
Type	Beginning balance current	Beginning balance YTD	Used Current	Used YTD	Ending Balance
Personal	10	15	0	5	10
Sick	5	5	0	0	5

Final Note: Be Cautious About Payment in Cash

Some employers may want to pay you in cash rather than by a paper paycheck, direct deposit, or payroll card. Even though it may seem that your employer is doing you a favor by not deducting taxes and giving you more take home pay, this is probably benefiting the employer more than you. Paying employees in whole or partially in cash is a common method for an employer to evade income and employment taxes. The employer may use this method to avoid paying its share of required payroll taxes, and other responsibilities such as paying into unemployment insurance or workers' compensation funds on behalf of its employees. An employer that prefers cash payment may even retain withholding taxes and not send them to the government.

There are some cases when cash payment is normal. There are times, especially with people under the age of 18, when a person completes small odd jobs and is paid in cash, such as for mowing lawns, babysitting, etc. As long as you don't earn more than $600 for the entire year the employer usually doesn't need to make tax deductions from the wages paid. Refer to the IRS document "Filing Requirements Chart for Most Taxpayers" or ask a tax professional to determine if you should pay taxes on cash earned.

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