



# UNDERSTANDING YOUR PAYCHECK

## WHERE DOES MY MONEY GO?

Receiving a paycheck, especially if it is an individual's first, can be the highlight of a person's day. However, many are often shocked when they learn almost 31% of their paycheck is missing. Monetary deductions are subtracted for mandatory systematic taxes, employee sponsored medical benefits, and/or retirement benefits. **Taxes** are compulsory charges imposed on citizens by local, state, and federal governments used to fund public goods and services. The United States tax system operates on an ongoing payment system. This means as a person earns income, taxes are paid immediately on the income. There are two types of taxes: progressive and regressive. **Progressive taxes** take a larger percentage of income from high income taxpayers. The more a person earns, the more he/she pays in taxes. Examples include Federal and State taxes. **Regressive taxes** are not based on one's ability to pay. As income rises, the tax percentage remains the same or decreases. Higher income taxpayers are proportionally charged less. Examples include Medicare and Social Security.



## PAYING EMPLOYEES

There are three ways an employer may handle paying his/her employees:

1. **Paycheck**— This is the most common method. The employer physically provides the employee with his/her paycheck. The paycheck stub is attached to the paycheck to show the deductions. The employee is responsible for handling the paycheck.
2. **Direct Deposit**— Employers directly deposit the employee's paycheck into his/her authorized account. On payday, the employee receives a paycheck stub detailing the paycheck deductions. This method is more secure because there is no direct handling of the check and the employee knows exactly which day his/her paycheck will be deposited and available for use.
3. **Payroll Card**— This is the newest method. A payroll card is issued to the employee through the employer and it electronically carries the balance of the employee's net pay. In some cases, it can be used as a credit card and in most ATM machines. The company issuing the payroll card sends periodic statements which reflect the card's activity for the prior pay period and deductions.



## THE W-4

Regardless of the job, every new employee will be asked to complete a **Form W-4** also known as an Employee's Withholding Allowance Certificate. The information provided on this form determines the percentage of gross income to be withheld for taxes. Federal taxes are the largest deduction on an individual's income.

On the Form W-4, the federal government allows taxpayers to claim certain allowances. An **allowance** is used to determine the amount of federal taxes withheld from the paycheck. An employee may claim a personal allowance if no one else claims them as a dependent. A **dependent** is a person who relies on the taxpayer for financial support.

The **Internal Revenue Service** is the governmental agency responsible for collecting federal taxes, issuing regulations, and enforcing tax laws written by the United States Congress. The amount of taxes withheld from an individual's paycheck depends upon his/her income and information provided on the Form W-4.

## THE W-2

The **Form W-2** is also known as a Wage and Tax Statement. It states the amount of money earned and taxes paid throughout the previous year. The Form W-2 is used to file taxes. By January 31, a person should receive a Form W-2 from each employer for the previous year.

## THE I-9

The **Form I-9** is the Employment Eligibility Verification Form is used to verify the eligibility of individuals and to avoid hiring illegal aliens. All employees, citizens, and non-citizens must complete a Form I-9 at the time of hire. Employees must provide documentation which establishes identity and employment eligibility. Examples include a driver's license, passport, Social Security card, birth certificate, etc.



# READING A PAYCHECK STUB

<i>On-The-Go</i>				
Employee Beakens, Joe	SSN 201-92-4856	Check # 164	C	Check Amount \$1,102.98
Employee Address 293 Michael Grove Billings, MT 59102				
	Pay Type- Gross Pay	Deductions	Current	Year-to-date
B	\$1,353.33	Federal Withholding	E \$106.00	J \$636.00
		State Withholding	F \$40.82	\$244.92
		Social Security	G \$83.91	\$503.46
		Medicare	\$19.62	\$117.72
		Medical	H \$0.00	\$0.00
		401 K	I \$0.00	\$0.00
		Totals	\$250.35	\$1,502.10
<i>A Pay Period 6/11/2004-7/11/2004</i>				

A typical paycheck has two parts: the actual check and a paycheck stub. A **paycheck stub** lists the paycheck deductions as well as other important information including:

**Personal Information**—States the employee's full name, address, and social security number.

- A. **Pay Period**—The length of time for which an employee's wages are calculated usually weekly, bi-weekly, twice a month, or monthly.
- B. **Gross Pay**—The total amount of money earned during the pay period before deductions. If a person earns an hourly wage, gross pay is calculated by multiplying the number of hours worked by the wage. For example, if a person works 45 hours in a pay period earning \$6.25 per hour, his/her gross pay would be \$281.25. If a person is on **salary**, earning a set amount for a specified time period, the gross pay is the salary amount divided by the specified time period. For example, if a person earns \$24,000.00 per year, his/her gross pay would be \$2,000.00 per month.
- C. **Net Pay**—The amount of money left after all deductions have been withheld from the gross pay earned in the pay period.
- D. **Deductions**—The amount of money subtracted or deducted from the gross pay for mandatory systematic taxes, employee sponsored medical benefits, and/or retirement benefits.
- E. **Federal Withholding Tax**—The amount required by law for employers to withhold from earned wages to pay taxes. This represents the largest deduction withheld from an employee's gross income. The amount withheld depends upon two things: the amount of money earned and the information provided on the Form W-4.
- F. **State Withholding Tax**—The percentage deducted from an individual's paycheck to assist in funding government agencies within the state. The percentage of deduction depends upon the amount of gross income the employee has earned.
- G. **FICA** (Federal Insurance Contribution Act)—This tax includes two separate taxes: **Social Security** and **Medicare**. These two taxes can be combined as one line item or itemized separately on a paycheck stub.
- **Social Security**—The nation's retirement program. This tax helps provide retirement income for elderly and pays disability benefits. Social Security taxes are based upon a percentage (6.2%) of the employee's gross income. The employer matches the contribution made by the employee.
  - **Medicare**—The nation's health care program for the elderly and disabled. This tax provides hospital and medical insurance to those who qualify. Medicare taxes are based upon a percentage (1.45%) of the employee's gross income.
- H. **Medical**—The amount taken from the employee's paycheck for medical benefits. This occurs when the employer has a medical plan for employees, but does not pay full coverage for his/her benefits.
- I. **Retirement Plan**—The amount an employee contributes each pay period to a retirement plan. A specified percentage of the contribution is often matched by the employer. This may be a 401K, state, or local retirement plan.
- J. **Year-to-Date**—Totals all of the deductions which have been withheld from an individual's paycheck from January 1 to the last day of the pay period indicated on the paycheck stub.

