

## GROSS TO NET AND WHAT'S IN BETWEEN



## Agenda

- I. Overview of Payroll
- II. Tax Tables
- III. Deductions from Pay
  - I. Voluntary deductions
  - II. Involuntary deductions
- IV. Calculations
- V. Pay, Deposit, File

## GROSS TO NET AND WHAT'S IN BETWEEN

- ▶ I. Overview of Payroll
  
- ▶ Let's just start with a couple of general facts about payroll.

## GROSS TO NET AND WHAT'S IN BETWEEN

- ▶ Did you know that payroll professionals are responsible for collecting and paying over to the U.S. Treasury more than two-thirds of the operating budget of our nation?
- ▶ In the U.S. government's fiscal year 2015, payroll departments deposited 72.5% of the total IRS collections of nearly \$3.3 trillion. That's almost \$2.4 trillion collected by payroll!

## GROSS TO NET AND WHAT'S IN BETWEEN

- ▶ According to the IRS Data Book, payroll is responsible for "Individual income Tax withheld by employers" (37.6%),
- ▶ plus "Employment taxes" (34.9%),
- ▶ or a net total of 72.5% of the total IRS collections of near \$3.25 trillion.

## GROSS TO NET AND WHAT'S IN BETWEEN

- ▶ Surprising statistics, aren't they?
- ▶ You already knew you were important to your employees, who depend on you for their paychecks, and to your employer, who depends on you to maintain the bond between employer and employee.
- ▶ Don't forget that your career is a big part of what keeps the United States running.
- ▶ It's just another example of the importance of payroll.

Table 1. Collections and Refunds, by Type of Tax, Fiscal Years 2014 and 2015

Type of tax	Gross collections (\$)		Refunds (\$)		Net collections (\$)	
	2014	2015	Percentage of 2014 base		2014	2015
			(3)	(4)		
United States, total	3,064,201,358	3,262,677,258	100.0	100.0	43,272,891	3,899,404,987
Business income taxes	320,444,112	288,868,722	11.5	9.8	20,052,617	258,855,905
Corporation	226,422,281	200,025,722	8.5	7.6	1,105,555	208,920,167
Partnership	93,981,831	88,843,000	3.1	3.2	195,062	88,647,938
Excise	1,000,000,000	1,000,000,000	32.7	30.8	1,000,000,000	1,000,000,000
Individual income tax	1,442,623,565	1,761,165,859	47.1	54.0	346,456,872	1,444,729,527
Individual income tax withheld	1,146,789,692	1,241,185,768	37.4	n/a	n/a	n/a
Individual income tax payments (1)	496,444,277	519,979,529	16.2	n/a	n/a	n/a
Excise and fuel income tax	29,813,726	33,945,392	1.0	1.2	2,061,997	31,883,395
Employment taxes	479,223,287	492,228,814	15.6	15.1	3,992,989	1,914,823,417
Old Age, Survivors, Disability, and Health Insurance (OASDI), total (2)	341,071,844	356,614,535	11.1	11.0	4,942,274	1,003,876,259
Federal Unemployment Insurance (FICA)	88,079,581	94,246,185	2.8	n/a	n/a	n/a
Self-Employment Insurance Contributions Act (SECA)	13,978,256	14,278,245	n/a	n/a	n/a	n/a
Unemployment insurance	8,023,427	8,307,864	0.3	0.3	185,736	8,856,148
Internal revenues (3)	3,992,354	4,423,487	0.1	0.1	1,687	6,820,615
Estates and gift taxes	20,154,855	20,442,829	0.7	0.6	823,823	15,119,016
Customs	17,272,268	17,928,208	0.5	0.5	586,349	17,341,859
Other	2,808,317	2,087,852	0.1	0.1	36,225	2,780,498
Excise taxes (4)	1,108,076	1,220,650	0.4	0.4	346,739	70,467,263

(1) Excludes amounts credited to taxpayer accounts for tax liability in a subsequent year, as well as excise tax collected by the U.S. Customs and Border Protection and the Alcohol and Tobacco Tax and Trade Bureau.  
 (2) Includes employment-related refunds resulting from reclassification activity, refundable tax credits, and other refunds required by law. Also includes \$1.1 billion in interest, of which \$0.5 billion was paid to corporations, and \$0.5 billion was paid to all others (mixed to individual, employment, estate, gift and excise tax returns).  
 (3) Less than 0.05 percent.  
 (4) Collections of unpaid individual income tax are not reported by taxpayer separately from Old Age, Survivors, Disability, and Health Insurance (OASDI) taxes on estates and wages (under the Federal Unemployment Insurance Act or FICA) and on self-employment income (under the Self-Employment Insurance Contributions Act or SECA). The OASDI tax collection and refund data in this table are based on returns filed by the Secretary of the Treasury pursuant to the provisions of Section 201 of the Federal Security Act as amended and include all OASDI taxes. Amounts for the year for individual income tax withheld and individual income tax payments were derived by subtracting the FICA and SECA tax amounts from total employment taxes on withheld and individual income tax payments. Federal collections, and therefore, net collections estimates, were not made for the corporations.

II. Tax Tables

Federal Tax Tables

- There are two main methods for deducting federal taxes from employees.
- First is the Wage bracket method
- Go to the appropriate table, find the wage, and then move across the columns until you are under the number of allowances.

Wage Bracket Method Tables for Income Tax Withholding

Annual Income	Married Persons - Biweekly Payroll Period									
	0	1	2	3	4	5	6	7	8	9
\$1,000	...	...	...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...	...	...	...
\$18,400	...	...	...	...	...	...	...	...	...	...

Federal Tax Tables

- Since I know you can't read that chart, I have enlarged it on the next slide.
- This chart is the Married Biweekly chart.
- I have selected \$1840.00 with 3 allowances
- Be sure to watch the top column headings
- "At least" "but less than"
- For \$1840.00, the tax is \$122

And the wages are—		And the number of withholding allowances claimed is—									
At least	But less than	0	1	2	3	4	5	6	7	8	9
\$1,500	\$1,520	\$142	\$118	995	871	856	840	825	89	80	0
1,520	1,540	145	121	98	74	58	42	27	11	0	0
1,540	1,560	148	124	101	77	60	44	29	13	0	0
1,560	1,580	151	127	104	80	62	46	31	15	0	0
1,580	1,600	154	130	107	83	64	48	33	17	2	0
1,600	1,620	157	133	110	86	66	50	35	19	4	0
1,620	1,640	160	136	113	89	68	52	37	21	6	0
1,640	1,660	163	139	116	92	70	54	39	23	8	0
1,660	1,680	166	142	119	95	72	56	41	25	10	0
1,680	1,700	169	145	122	98	75	58	43	27	12	0
1,700	1,720	172	148	125	101	78	60	45	29	14	0
1,720	1,740	175	151	128	104	81	62	47	31	16	0
1,740	1,760	178	154	131	107	84	64	49	33	18	0
1,760	1,780	181	157	134	110	87	66	51	35	20	0
1,780	1,800	184	160	137	113	90	68	53	37	22	0
1,800	1,820	187	163	140	116	93	70	55	39	24	0
1,820	1,840	190	166	143	119	96	73	57	41	26	0
1,840	1,860	193	169	146	122	99	75	59	43	28	0
1,860	1,880	196	172	149	125	102	79	61	45	30	0
1,880	1,900	199	175	152	128	105	82	63	47	32	0
1,900	1,920	202	178	155	131	108	85	65	49	34	0
1,920	1,940	205	181	158	134	111	88	67	51	36	0
1,940	1,960	208	184	161	137	114	91	69	53	38	0
1,960	1,980	211	187	164	140	117	94	71	55	40	0
1,980	2,000	214	190	167	143	120	97	73	57	42	0

## Percentage Federal Withholding

- ▶ All payroll systems use the percentage withholding table.
- ▶ Actually they only load 2 tables into your system. The annual tables for single and one for married.
- ▶ The system then annualizes the amount of the gross check, taxes it and divides it back down to fit your cycle.
- ▶ That is the reason folks scream when they get extra overtime pay and the taxes are so high. The system thinks they get that amount every check.

## Federal Tax Tables

### Tables for Percentage Method of Withholding (For wages Paid after in 2016) Pub 15

Table 5. Percentage Method—2016 Amount for One Withholding Allowance

Payroll Period	One Withholding Allowance
Weekly	\$ 77.90
Biweekly	155.80
Semimonthly	168.80
Monthly	337.50
Quarterly	1,012.50
Semiannually	2,025.00
Annually	4,050.00
Daily or miscellaneous (each day of the payroll period)	15.60

## Federal Tax Tables

### Tables for Percentage Method of Withholding (For wages Paid after in 2016) Pub 15

TABLE 2—BIWEEKLY Payroll Period

(a) SINGLE person (including head of household)—			(b) MARRIED person—		
If the amount of wages (after subtracting withholding allowances) is:		The amount of income tax to withhold is:	If the amount of wages (after subtracting withholding allowances) is:		The amount of income tax to withhold is:
Not over \$87	.....	\$0	Not over \$329	.....	\$0
Over—	But not over—	of excess over—	Over—	But not over—	of excess over—
\$87	—\$443	.. \$0.00 plus 10%	\$329	—\$1,042	.. \$0.00 plus 10%
\$443	—\$1,535	.. \$35.60 plus 15%	\$1,042	—\$3,225	.. \$71.30 plus 15%
\$1,535	—\$3,592	.. \$199.40 plus 25%	\$3,225	—\$6,171	.. \$398.75 plus 25%
\$3,592	—\$7,400	.. \$713.05 plus 28%	\$6,171	—\$9,231	.. \$1,135.25 plus 28%
\$7,400	—\$15,965	.. \$1,779.89 plus 33%	\$9,231	—\$16,227	.. \$1,992.05 plus 33%
\$15,965	—\$16,050	.. \$4,612.94 plus 35%	\$16,227	—\$18,288	.. \$4,300.75 plus 35%
\$16,050	.....	.. \$4,635.69 plus 39.6%	\$18,288	.....	.. \$5,022.08 plus 39.6%

## Percentage Federal Withholding

- ▶ Let's take the same \$1840.00, biweekly, married with 3 allowances.
- ▶ First get the allowances
  - $3 \times \$155.80 = \$467.40$
  - $\$1,840.00 - \$467.40 = \$1,372.60$
  - Less the excess from the chart
    - $\$1,372.60 - \$1,042.00 = \$330.60$
    - $\$330.60 \times 15\% = \$49.59$
    - $\$49.59 + \$71.30$  (amount from chart) =  $\$120.89$
    - Wage Bracket was  $\$122.00$

So you can see percentage is more accurate.

## State Withholding Taxes

- ▶ Since this seminar covers more than one state, I decided to sort of skim this area
- ▶ State taxes are basically handled just like Federal with different charts for single and married with allowances
- ▶ It seems South Carolina and Virginia have only one selection per cycle, no single or married separation.
- ▶ North Carolina has single, married, qualifying widow and a separate one for Head of Household.

- ▶ III Deductions from pay

## Deductions from Pay

- ▶ There are two main types of deductions:
- ▶ Voluntary
  - And
- ▶ Involuntary

## Other Deductions from Pay

- ▶ We covered the required deductions (taxes).
- ▶ Now let's look at the voluntary and involuntary deductions from pay.
- ▶ Let's start with voluntary.

## Voluntary Deductions

- ▶ The most common are benefits:
    - Health insurance\*
    - Dental insurance\*
    - Vision insurance\*
    - Life insurance\*\*
    - Union dues\*\*
    - CODA (cash or deferred arrangements)\*\*\*
      - 401(k)
      - 403b
      - 457
- \*tax exempt - deducted pre tax  
\*\*post tax - deducted after taxes are established  
\*\*\*tax deferred - deducted pre tax

## Voluntary Deductions

- ▶ The main thing to remember for benefits, is which ones are pre tax and which ones are post tax. Next which ones are tax exempt and which ones are tax deferred.
- ▶ **Tax exempt** - means you will NEVER pay tax on that money and they are exempt from all taxes.
- ▶ **Tax deferred** - you are "putting off" (deferring) paying taxes and they are only deferred for federal and most states but Social Security and Medicare are required to be withheld.

## Involuntary Deductions

- ▶ Next we will touch on the deductions none of us like to handle.
- ▶ The court ordered deductions.
  1. Child Support orders
  2. Chapter 13 Bankruptcy orders
  3. **Federal Tax Levies**
  4. State tax levies
  5. Student loans
  6. Federal Administrative Garnishments
  7. Local Tax Levies
  8. Creditor Garnishments
  9. Wage Assignments

## Calculation of involuntary deductions

- ▶ When we were working with taxes, we used the "taxable" amount to calculate our withholdings.
- ▶ Now with involuntary deductions we will talk about disposable earnings.
- ▶ I made Federal Tax Levies a different color because that is the only one in the list that works on NET pay, not disposable pay.

### Calculation of involuntary deductions

- ▶ Disposable earnings are gross wages less deductions required by law.
- ▶ For the most part, that is taxes, mandatory state retirement and union dues if a condition of employment.
- ▶ Some states also include health insurance premiums as part of “required by law” deductions. **CO, CT, LA, TN, TX, WY**
- ▶ South Carolina does not allow creditor garnishments.

### ▶ IV. Calculations

### Gross to Net

- ▶ We have talked about the “Before” and the “In Between”, now let’s take it all the way through.
- ▶ Start with Gross
- ▶ Decide which deductions are pre tax or post tax to determine taxable
- ▶ Get the W4 to find:
  - Marital status
  - Number of allowances

### • Computing Gross to Net

- Three important factors – (1) rate of pay, (2) marital status with **allowances**, (3) pay frequency
- Sally earns \$2,000 semi-monthly and claims married with three allowances on her W-4. Calculate her net pay using the percentage method withholding calculation for federal income tax.
- Semi-monthly exemption allowance  
 $\$168.80 \times 3 = \$506.40$

▶ Salary	\$2,000.00	From Circular E – Allowances 3 x \$168.80 = \$506.40. Wages over \$1129 but not over \$3494; Tax is \$77.30 plus 15% of excess over \$1129
▶ Allowances	<u>- 506.40</u>	\$1,493.60 - \$1,129 =
▶ Taxable	1,493.60	\$364.60 x 15% = \$54.69 + \$77.30 = \$131.99 federal tax
▶ Federal tax	<b>131.99**</b>	
▶ FICA tax	<u>153.00</u>	FICA tax is 7.65% in total – social security portion is 6.2% and Medicare portion is 1.45%
Net Pay	\$1,715.01	
▶ **Fed Tax from Wage Bracket table =	<b>\$133.00</b>	

### FICA TAX

- ▶ For FICA, there is a split for the wage base on which to compute the tax. The social security portion (6.2%) is applicable to the first \$118,500 in wages.
- ▶ The Medicare portion (1.45%) is for all taxable wages paid in the calendar year.
- ▶ Now there is an employee additional tax of .9% on all wages greater than \$200,000. This is an **EMPLOYEE** tax only.

### Computing Gross to Net with Pre-tax Contributions

- ▶ An employee is due a regular weekly wage payment of \$650.
- ▶ The employee contributes \$15 in pre-tax contributions to a 401(k) plan and \$25 to a Section 125 health insurance plan.
- ▶ Assuming a federal income tax rate of 15%, no state tax and that the employee has no year-to-date wages at the time of the payment, what would the net pay be?

▶	Wages	\$650.00	Gross
▶	401(k)	- 15.00	Tax Deferred
▶	Health ins	- 25.00	Section 125 is
▶	Taxable	\$610.00	tax exempt for all
		<u>        </u>	taxes
▶	Fed Tax	91.50	
▶			<b>FICA Taxable</b>
▶		\$650 - 25 = \$625.00	
▶		<u>        </u>	
▶	FICA tax	47.81	47.81 401(k) is
			not taxable for
			federal tax but
			is for FICA tax
▶	Net Pay	<u>\$470.69</u>	

### D. How to Gross-up and why

- ▶ Does anyone in your company drive a company car?
- ▶ Fly on a company aircraft for personal trip?
- ▶ Have taxes prepared as part of executive perks?
- ▶ Receive life insurance in excess of \$50,000 and leave the company before it is added to income?
- ▶ Receive a gift certificate or win a trip?
- ▶ Does a supervisor want to give an employee a \$100 award and the employee actually receive \$100?

- ▶ All of these examples can create a reason to gross up a paycheck. When you gross up a check, what you are actually doing is adding the taxes onto the amount of money to force the net results.
- ▶ There is a simple formula for this process.
- ▶ Add all the taxes together then subtract the total taxes from 100%.
- ▶ Take the results of that equation and divide it into the desired net and that is the gross amount of the payment.

▶ Example: Ted wants to give Sally a \$500 award for a special project she finished ahead of schedule. Using supplemental taxes we would gross up as follows:

▶ Federal withholding	25.00%
▶ Social Security Tax	6.20%
▶ Medicare Tax	1.45%
▶ State Tax (for this example)	<u>3.40%</u>
▶ Total of taxes	36.05%

- ▶ What is her gross check?

▶	100.00%
▶ Less	<u>36.05%</u>
▶	63.95%

▶ \$500 desired net ÷ .6395 = \$781.86

▶ Proof:

▶ Federal Tax	25%	\$195.46
▶ Social Security Tax	6.2%	48.48
▶ Medicare Tax	1.45%	11.34
▶ State Tax	3.40%	<u>26.58</u>
▶ Net Check		\$500.00

- ▶ The tricky part of grossing up a payment is when the employee's check is close to the maximum Social Security wage base.
- ▶ If they have already reached the maximum, you would just leave out the 6.2% when adding the taxes together.
- ▶ but what if they were *within \$300 of the maximum* when you wanted to do the above calculation. What would you do?

- ▶ Take 6.2% of what is left to max out the wage base ( $6.2\% \times \$300 = \$18.60$ ) and add that amount to the desired net and then continue with the formula as before.
- ▶ Federal withholding 25.00%
- ▶ Medicare Tax 1.45%
- ▶ State Tax 3.40%
- ▶ Total of taxes 29.85%
- ▶ 100.00%
- ▶ Less 29.85%
- ▶ 70.15%

- ▶ Desired net \$500 plus Social Security tax of \$18.60 = \$518.60 "new" net for calculation purposes only
- ▶  $\$518.60 \div .7015 = \text{gross } \$739.27$
- ▶ Proof:
- ▶ Federal Tax 184.82
- ▶ Social Security Tax 18.60
- ▶ Medicare Tax 10.72
- ▶ State Tax 25.13
- ▶ Net Check \$500.00

## ▶ V. Pay, Deposit, File

### ▶ Withholding/Depositor Rules

- ▶ Federal income tax (FIT) and Federal Insurance Contributions Act (FICA) taxes are called Trust Funds.
- ▶ These funds are being held for the benefit of the employee and are to be paid over to the IRS.

### Withholding/Depositor Rules

As discussed earlier, federal income tax is based on income, marital status and personal allowances. The process of withholding taxes from the employees' pay and depositing those taxes with the IRS is the same as making estimated payments on behalf of the employee.

Also discussed earlier, FICA tax is based on two separate taxes. Social security and Medicare are the two pieces of the FICA tax. The employer must match the amount withheld from the employee (except for additional Medicare tax).

#### Withholding/Depositor Rules

- ▶ Now we will go into how the employer reports those taxes to the IRS.
- ▶ Each pay period a tax liability is incurred.
- ▶ The amount of that liability determines how frequently the employer must deposit those taxes with the government.
- ▶ There is a lookback period that the IRS uses to determine this frequency of each employer.
- ▶ July 1 of the 2<sup>nd</sup> preceding year to June 30 of the preceding tax year. Lookback for 2016 would be July 1, 2014 to June 30, 2015.

#### Withholding/Depositor Rules

- ▶ IRS looks at the total amount of tax liability over the lookback period and uses the following formula;
- ▶ \$50,000 or less – Monthly depositor
- ▶ \$50,000 or more – Semiweekly depositor
- ▶ Really small employers could fall into the quarterly depositor rule, which is less than \$2500 in a quarter.

#### Withholding/Depositor Rules

- ▶ **Monthly depositor** – liabilities accumulated during the month are deposited no later than the 15<sup>th</sup> of the following month. Example – January payroll tax liability is to be deposited by February 15<sup>th</sup>.
- ▶ All new businesses are monthly depositors in the beginning while they establish a lookback record.
- ▶ Once a new business accumulates \$100,000 in liability and triggers the accelerated rule, they automatically switch to a semi-weekly depositor.

#### Withholding/Depositor Rules

- ▶ **Semiweekly depositor** – tax liabilities that relate to wages paid on Wednesday, Thursday or Friday must be deposited on or before the following **Wednesday**.
- ▶ Liabilities that relate to wages paid Saturday, Sunday, Monday or Tuesday must be deposited by the following **Friday**.

#### Withholding/Depositor Rules

- ▶ If there is a holiday within this period, you are allowed to deposit the following banking day.
- ▶ Example: for a Friday payday, the following Monday is Memorial Day, that means your Wednesday deposit would be due Thursday.
- ▶ You are always allowed at least three (3) banking days for semi-weekly deposits.
- ▶ Same holds true for Monthly depositors and the 15<sup>th</sup> of the following month. They get the extra day for holidays and the 15<sup>th</sup> falling on a weekend.

#### ▶ Withholding/Depositor Rules

- ▶ **Quarterly depositor**. If an employer has a tax liability of less than \$2,500, it does not have to make deposits during the quarter.
- ▶ They remit the money quarterly when filing the form 941 using the a Form 941V.
- ▶ Paying balance due or quarterly deposits is about the only time you can use a check.



#### Withholding/Depositor Rules

- ▶ If an employer has a tax liability of \$100,000 or greater, it falls under the **Accelerated Rule** and must deposit those taxes on the next banking day.
- ▶ **Any** depositor (monthly, semi-weekly, quarterly) who accumulates a liability of \$100,000 must deposit those taxes by the next banking day.

#### Withholding/Depositor Rules

- ▶ You accumulate liability during the **same cycle**.....Wednesday, Thursday, Friday
- ▶ Or Saturday, Sunday, Monday, Tuesday
- ▶ You would NOT accumulate liability from a Friday and Monday pay day because they are in separate cycles.

#### Withholding/Depositor Rules

- ▶ Also you **never** accumulate liabilities that cross a quarter.
- ▶ Example: Wednesday, March 31<sup>st</sup> pay day \$50,000 liability. Thursday, April 1<sup>st</sup> commission pay day \$65,000 liability
- ▶ Even though they are in the Wed, Thur, Fri cycle, they have **crossed a quarter** and require two separate deposits the following Wednesday.
- ▶ One for 1<sup>st</sup> quarter and one for 2<sup>nd</sup> quarter.

#### ▶ B. Deposit Method:

- ▶ The only option is by using EFT, which is electronic funds transfer.
- ▶ The IRS has made the EFTPS (*Electronic Federal Tax Payment System*) a mandatory method for all employers.

## End of the road

- ▶ Lots of stuff between Gross and Net (the beginning and the end).
- ▶ I hope this has brought some of that together for you.
- ▶ I am available for questions any time at my email address. I am on the National Hotline but answer individual questions when received.

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