Understanding Your Paycheck Essentials

Starting a New Job

When an individual begins a new job, they will most likely be excited about receiving one of the benefits of that job: a paycheck. However, before an employee can receive their first paycheck, there are two forms that he/she will be required to complete: Form W-4 and Form I-9

Form W-4

The **Form W-4** is also called an Employee's Withholding Allowance Certificate. Regardless of the job, every new employee will be asked to complete a Form W-4 when they begin a new job. The information provided on the Form W-4 determines the percentage of an employee's pay that will be withheld for federal income taxes. **Taxes** are compulsory charges imposed on citizens by local, state, and federal governments. The money received from taxes is used to provide public goods and services, such as roads, schools, libraries, and police and fire departments. Citizens pay many different types of taxes in many different ways. These taxes may include income tax, sales tax, and property tax. Approximately 30% of an individual's total income is spent on taxes. However, the largest amount of taxes a person pays is on his/her income.

Employers are required by law to take income taxes directly out of employee's paycheck. Income taxes withheld from a paycheck include both state and federal income taxes (if the state has income tax). The Form W-4 lets an employer know how much of an employee's paycheck to withhold to pay federal taxes by determining the number of allowances an employee can claim. An **allowance** is used to determine the amount of federal taxes withheld from the paycheck. The number of allowances a person claims should result in the amount of federal income tax being withheld to be about equal to his/her federal income tax liability, or the amount of federal taxes the person will owe for the year. An employee may claim a personal allowance only if no one else claims the person as a dependent. A **dependent** is a person who relies on the taxpayer for financial support, like a child or nonworking adult.

Once the Form W-4 is completed by the employee, the employer will compare the form to the withholding tables prepared by the government. Based on the employee's income and their number of allowances, the employer will determine how much money to withhold from each paycheck to pay federal income taxes. Ideally, the amount of taxes withheld during the year should come close to the employee's total tax bill for the year. If the amount withheld does not cover the taxes, an employee can amend the Form W-4 for the next year's employment.

The Form W-4 may be downloaded from the Internal Revenue Service's Web site at www.irs.gov/formspubs.

Number of allowances claimed on W-4 + Amount of income = Amount of federal income tax withheld from paycheck

Form I-9

The **Form I-9** is the Employment Eligibility Verification form. The information gathered in this form is for employers to verify the eligibility of individuals for employment thereby avoiding hiring undocumented workers or others who are not eligible to work in the United States. All employees, citizens, and non-citizens must complete a Form I-9 at the time of hire. To complete this form properly, a prospective employee must provide documentation which establishes identity and employment eligibility. Examples of documentation include a passport, driver's license, U.S. Military card, social security card, etc.

The Form I-9 may be downloaded from the U.S. Citizenship and Immigration Services Web site at http://uscis.gov.

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Receiving a Paycheck

Once an employee has completed the forms necessary to receive a paycheck, he/she may have a choice of how to receive the payment. Some possible ways an employer may use to pay his/her employees is by paper paycheck, direct deposit, and/or payroll cards. An employer may offer only one or all of these payment options to their employees.

Paper Paycheck

A **paper paycheck** is one method employers can use to pay their employees. A paper paycheck will have the paycheck stub attached.

A **paycheck stub** lists important information about the paycheck and outlines the deductions made to the paycheck. This is the most common payment method, but the least secure for the employee. The employee is responsible for taking the check to the depository institution and depositing it into his/her personal account.

Advantages	Disadvantages

• Most common
• Employee may chose what action to do with the paycheck
• Deductions are clearly identified on the paycheck stub attached
	• Least secure
	  • Employee is completely responsible for paycheck
	  • Increased chance of the paycheck getting lost
	• The cost for employers to print paychecks is greater compared to direct deposit

Direct Deposit

Another method of payment is the use of **direct deposit**. Using this method, an employer deposits the employee's paycheck directly into the authorized employee's depository institution account. On payday, the employee receives only a paycheck stub, because the funds have already been deposited for the employee.

Advantages	Disadvantages
• Increased security and convenience for employee • Employee knows exactly when paycheck will be deposited • Employee can view their paycheck stub to see what deductions have been taken	• Employees must use a depository institution for this method to be available

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.

Payroll Card

A **payroll card** has money electronically loaded onto it each payday. Funds are automatically deducted from the balance of a payroll card when a purchase is made. Payroll cards function similarly to a debit card, except the funds are not linked to a checking account. The funds are directly deposited by an employer into an account at a depository institution that is linked to the payroll card. institution, so it is important for employees to obtain a list of all fees before signing up to use a payroll card.

Employees will receive a paycheck stub outlining information about the amount of their paycheck. The paycheck stub received with a payroll card may be electronic. There may be numerous fees associated with payroll cards. These fees vary depending upon the depository

• Safer than carrying large amounts of cash • Can review paycheck stub	• Employees must be careful of fees charged by payroll cards

Once the method of payment has been chosen (if applicable), the employee will receive payment after the next pay period. Employers pay their employees on a regular schedule known as a **pay period**. Most businesses pay employees either weekly, bi-weekly, twice a month (usually the 1st and the 15th), or monthly. In most businesses, the last day of the pay period is not the actual day an employee receives a paycheck. Payday is delayed a week or a full pay period to allow the business to accurately compute the employee's wages and pay them for all the time they worked in a pay period.

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READING A PAYCHECK STUB

On-The-Go				
Employee Beakens, Joe	Employee Identification 201-92-4856	Check # 164	C	Check Amount $1,102.98
Employee Address 293 Michael Grove Billings, MT 59102				
	Pay Type- Gross Income	Payroll Withholdings D	Current	Year-to-date J
	B $1,353.33	E Federal Withholding	$106.00	$636.00
		State Withholding F	$40.82	$244.92
		G Fed OASDI/EE or Social Security	$83.91	$503.46
		Red MED/EE or Medicare	$19.62	$117.72
		Medical H	$0.00	$0.00
		I 401 K	$0.00	$0.00
		Totals	$250.35	$1,502.10
A *Pay Period 6/11/2009-7/11/2009*				

Once payment has been received, it is important for an employee to know how to read a paycheck stub to determine if he/she has been paid the correct amount from the employer. The following information is included on a paycheck stub:

Personal Information—States the employee's full name, address, and Social Security or Employee Identification number.

A. Pay Period—The length of time for which an employee's wages are calculated. Most are weekly, bi-weekly, twice a month, or monthly.

B. Gross Income—The total amount of money earned during the pay period before deductions.

C. Net Income—The amount of money left after all deductions have been taken from the gross income earned in a pay period.

D. Payroll Withholdings—The amount of money subtracted or deducted from the gross income. This includes mandatory deductions to pay taxes and optional deductions to pay employee sponsored medical benefits and/or retirement benefits.

Mandatory taxes withheld from a paycheck: *Federal Withholding Tax, State Withholding Tax, and FICA*

E. Federal Withholding Tax— The amount required by law for employers to withhold from earned wages to pay federal income taxes. This represents the largest deduction taken from an employee's gross income. The amount withheld depends on 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 deducted depends on the amount of gross pay the employee has earned.

G. FICA (Federal Insurance Contribution Act)—This tax includes two separate taxes: Fed OASDI/EE or Social Security and Fed MED/EE or Medicare. These two taxes can be combined as one line item or itemized separately on a paycheck stub.

- Fed OASDI/EE or 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.
- MED/EE or 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.

Optional deductions withheld from a paycheck: *Medical and Retirement Plan*

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.