



Payroll Accounting

A Practical, Real-World Approach | 6th Edition

Chapter 3: Federal and State Income Tax Withholding



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Learning Objectives

- After studying this chapter, you will be able to:
 - Identify and distinguish between mandatory and voluntary deductions
 - Determine taxable earnings
 - Calculate federal income tax withholding using the wage-bracket method
 - Calculate federal income tax withholding using the percentage method
 - Understand state and local income tax withholding



Deductions From Employee Earnings

- Amounts withheld from employee's paycheck:
 - Mandatory deductions must be withheld.
 - Voluntary deductions may be requested by employee.



Mandatory Deductions

- Federal income tax withholding
- State income tax withholding
- Local income tax withholding
- Social Security tax (OASDI)
- Medicare tax (HI)
- State disability insurance tax

Voluntary Deductions

- Union dues
- Retirement plans
- Medical plans
- Cafeteria plans
 - Flexible spending accounts

Gross Pay and Taxable Pay

- Gross pay encompasses all earnings in a given period.
- Taxable pay
 - An employer must subtract tax-deferred contributions from gross pay to arrive at taxable pay.
 - Taxable pay is used for calculating mandatory deductions.
 - State and local regulations may differ from federal withholding.



Federal Income Tax Withholding

■ Pay-as-you-go system

- This was established as a result of the Current Tax Payment Act of 1943.
- Employers withhold income tax from employees and remit to the federal government.
- Certain employees may be exempt.

The Wage-Bracket Method

- Uses marital status, withholding allowances (from W-4 Form), and taxable pay

SINGLE Persons—WEEKLY Payroll Period (For Wages Paid through December 31, 2018)								
And the wages are—		And the number of withholding allowances claimed						
At least	But less than	0	1	2	3	4	5	6
The amount of income tax to be withheld								
\$ 0	\$75	\$0	\$0	\$0	\$0	\$0	\$0	\$0
75	80	1	0	0	0	0	0	0
80	85	1	0	0	0	0	0	0
85	90	2	0	0	0	0	0	0
90	95	2	0	0	0	0	0	0
95	100	3	0	0	0	0	0	0
100	105	3	0	0	0	0	0	0
105	110	4	0	0	0	0	0	0
110	115	4	0	0	0	0	0	0
115	120	5	0	0	0	0	0	0
120	125	5	0	0	0	0	0	0
125	130	6	0	0	0	0	0	0
130	135	6	0	0	0	0	0	0
135	140	7	0	0	0	0	0	0
140	145	7	0	0	0	0	0	0

The Percentage Method

■ Three-step process:

- Multiply the allowances by the figure in the allowance table.

Payroll Period	One Withholding Allowance
Weekly	\$ 79.80
Biweekly	159.60
Semimonthly	172.90
Monthly	345.80

- Subtract the allowance from taxable pay.
- Use the percentage method table to calculate tax.

(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 \$71		\$0		Not over \$222		\$0	
Over—	But not over—		of excess over—	Over—	But not over—		of excess over—
\$71	—\$254 . .	\$0.00 plus 10%	—\$71	\$222	—\$588 . .		—\$222
\$254	—\$815 . .	\$18.30 plus 12%	—\$254	\$588	—\$1,711 . .		—\$588
\$815	—\$1,658 . .	\$85.62 plus 22%	—\$815	\$1,711	—\$3,395 . .		—\$1,711



Other Federal Tax Withholding Considerations

- Certain changes may require an updated W-4 Form.
- Dealing with deceased and terminated employees:
 - After death, a portion of the employee's earnings may be paid; these payments are not subject to federal tax withholding.
 - A terminated employee is entitled to all compensation earned; earnings are subject to federal tax withholding.

Changing the W-4 Form

■ Reasons for changing:

- Marriage
- Divorce
- Birth of a child
- Job status change

■ Changes result in an adjustment of federal income tax withholding.

State Income Tax Withholding

- This is calculated based on state taxable income (which may be same as federal).
- Nine states do not collect state income tax.
- Some states levy a flat tax.
- Some states levy a graduated tax.

Local Income Tax Withholding

- Tax rates and how they are levied vary widely.
- They may differ for residents and non-residents.