



# Tax Basics

Presented by:

The Coalition for the Advancement of Financial Education, Montgomery MD

in collaboration with Montgomery County Community Action VITA, Maryland CASH

January, 2016

WITH APPRECIATION TO UNITED WAY OF CENTRAL FLORIDA



**Why did they take money from my paycheck?**

# Employment Taxes



- **Gross Earnings** = the salary you are paid
- **Net Earnings** = your “take home pay” after all deductions
- Nearly all employees have payroll taxes withheld from their paychecks
  - Social Security
  - Medicare
  - Federal Income Taxes

# What is FICA?



- Under the Federal Insurance Contributions Act (**FICA**) **12.4%** of earned income up to an annual limit must be paid into **Social Security**, and an additional **2.9%** must be paid into **Medicare**.
- Social Security pays benefits for retired workers, the disabled and dependents of both
- Medicare provides medical benefits for workers age 65 and older, spouses, retired workers

# Social Security & Medicare



- Social Security Tax (deducts 6.2% of wages/salary)
- Medicare Tax (deducts 1.45% of wages/salary)
- The 6.2 % and the 1.45% “deductions” are sent to the Internal Revenue Service and reported to the Social Security Administration
- The employer matches the 6.2% and the 1.45 % from your paycheck and sends them to the Internal Revenue Service also

# Federal Income Tax Withholdings (FITW) for employees



- Federal Income Taxes (Deductions based on IRS Form W-4 entries)
  - Pays tax due on income received
- The **employee** determines how much Federal Income Taxes will be withheld from their paycheck
- Employee fills out an IRS Form W-4

# The W-4



----- Separate here and give Form W-4 to your employer. Keep the top part for your records. -----

<b>Form W-4</b> Department of the Treasury Internal Revenue Service		<b>Employee's Withholding Allowance Certificate</b>		OMB No. 1545-0074 <b>2014</b>	
<p style="text-align: center;">▶ Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.</p>					
1 Your first name and middle initial		Last name		2 Your social security number	
Home address (number and street or rural route)			3 <input type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. Note. If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.		
City or town, state, and ZIP code			4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. ▶ <input type="checkbox"/>		
5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)				5	
6 Additional amount, if any, you want withheld from each paycheck . . . . .				6 \$	
7 I claim exemption from withholding for 2014, and I certify that I meet <b>both</b> of the following conditions for exemption.					
<ul style="list-style-type: none"> <li>• Last year I had a right to a refund of <b>all</b> federal income tax withheld because I had <b>no</b> tax liability, <b>and</b></li> <li>• This year I expect a refund of <b>all</b> federal income tax withheld because I expect to have <b>no</b> tax liability.</li> </ul> If you meet both conditions, write "Exempt" here . . . . . ▶ 7					
Under penalties of perjury, I declare that I have examined this certificate and, to the best of my knowledge and belief, it is true, correct, and complete.					
Employee's signature (This form is not valid unless you sign it.) ▶				Date ▶	
8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)			9 Office code (optional)	10 Employer identification number (EIN)	

# When to complete IRS Form W-4

- When Starting a new job
- Your situation changes (have 2 jobs, etc)
- Marital status changes
- Number of your Dependents change



## Example:



Complete the W-4s for the following two people:

### **Demetrius White (123-45-6789)**

- Age 18
- Lives at home with his parents
- Single
- Address:  
1234 Anywhere Lane  
Jacksonville, FL 32205

### **Clara Scott (987-65-4321)**

- Age 27
- Single
- Mother of 2 children
- Address:  
6789 Purple Road  
Jacksonville, FL 32218

# How withholdings work



- Demetrius earns **\$8.00** per hour and works **30 hours** per week. His total weekly pay (**Gross Pay**) before taxes is **\$240** ( $8.00 \times 30$ ).
- Deductions:
  - Social Security (6.2% of gross pay) = \$14.88
  - Medicare (1.45% of gross pay) = \$3.48
  - **Total Payroll Tax (FICA) deductions = \$18.36**
- Demetrius indicated he is a single person on his IRS Form W-4. His parents can claim him as a dependent on their 1040. He chose “1” allowance on the IRS Form W-4.
- The employer will consult an IRS table to determine the amount of FITW to withhold in addition to the payroll taxes

# IRS Employer Withholding Table



## Percentage Method Tables for Income Tax Withholding

(For Wages Paid in 2015)

TABLE 1—WEEKLY 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 \$44		\$0		Not over \$165		\$0	
Over—	But not over—	of excess over—		Over—	But not over—	of excess over—	
\$44	—\$222	\$0.00 plus 10%	—\$44	\$165	—\$520	\$0.00 plus 10%	—\$165
\$222	—\$764	\$17.80 plus 15%	—\$222	\$520	—\$1,606	\$35.50 plus 15%	—\$520
\$764	—\$1,789	\$99.10 plus 25%	—\$764	\$1,606	—\$3,073	\$198.40 plus 25%	—\$1,606
\$1,789	—\$3,685	\$355.35 plus 28%	—\$1,789	\$3,073	—\$4,597	\$565.15 plus 28%	—\$3,073
\$3,685	—\$7,958	\$886.23 plus 33%	—\$3,685	\$4,597	—\$8,079	\$991.87 plus 33%	—\$4,597
\$7,958	—\$7,990	\$2,296.32 plus 35%	—\$7,958	\$8,079	—\$9,105	\$2,140.93 plus 35%	—\$8,079
\$7,990		\$2,307.52 plus 39.6%	—\$7,990	\$9,105		\$2,500.03 plus 39.6%	—\$9,105

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 \$88		\$0		Not over \$331		\$0	
Over—	But not over—	of excess over—		Over—	But not over—	of excess over—	
\$88	—\$443	\$0.00 plus 10%	—\$88	\$331	—\$1,040	\$0.00 plus 10%	—\$331
\$443	—\$1,529	\$35.50 plus 15%	—\$443	\$1,040	—\$3,212	\$70.90 plus 15%	—\$1,040
\$1,529	—\$3,579	\$198.40 plus 25%	—\$1,529	\$3,212	—\$6,146	\$396.70 plus 25%	—\$3,212
\$3,579	—\$7,369	\$710.90 plus 28%	—\$3,579	\$6,146	—\$9,194	\$1,130.20 plus 28%	—\$6,146
\$7,369	—\$15,915	\$1,772.10 plus 33%	—\$7,369	\$9,194	—\$16,158	\$1,983.64 plus 33%	—\$9,194
\$15,915	—\$15,981	\$4,592.28 plus 35%	—\$15,915	\$16,158	—\$18,210	\$4,281.76 plus 35%	—\$16,158
\$15,981		\$4,615.38 plus 39.6%	—\$15,981	\$18,210		\$4,999.96 plus 39.6%	—\$18,210

One withholding allowance = \$76.90

# Calculate Demetrius' Withholding



1.	Total wage payment (Gross Earnings):	\$240.00
2.	One withholding allowance	\$76.90
3.	Allowances claimed on Form W-4	1
4.	Multiply line 2 by line 3	\$76.90
5.	Amount subject to withholding (subtract line 4 from line 1)	\$163.10
6.	Tax to be withheld on \$163.10 from Table 1—single person, weekly pay period	<b>\$11.91</b>

## Demetrius' "net" paycheck

- He earned \$240 for the week
- His deductions were:
  - \$18.36 for payroll taxes (FICA)
  - \$11.91 for FITW (From IRS table)
- Total deductions are **\$30.27**

**Net Pay is \$209.73**



# Sample Pay Stub



## Earnings Statement

Company Name  
0000 Nonexistent Ave.  
Nowhere, USA 00000

Pay Period: 2/17/2011 to 3/2/2011  
Pay Date: 3/2/2011

John Doe  
0000 Any St.  
Nowhere, USA 00000

Hours and Earnings			Taxes and Deductions	
Hours	Rate	Earnings	Description	Amount
80	\$27.00	\$2160.00	Federal Tax	\$296.75
			State Tax	\$97.38
			Social Security	\$81.41
			Medicare	\$28.10
<b>Gross Year-to-Date</b>	<b>Gross This Pay Period</b>	<b>Total Deductions</b>	<b>Net Pay</b>	
\$8640.00	\$2160.00	\$503.64	\$1656.36	

These are your federal income taxes. →

These are state taxes. ↗

These are your federal payroll taxes also known as FICA. ↘

# Year End



- The employer will issue an IRS Form **W-2** detailing all of the pay and all of the deductions for him for the year.
- Demetrius will report the yearly W-2 wages and FITW on a US Federal Income Tax Form 1040-EZ
- The 1040 EZ will walk him through the steps to determine if his FITW was enough to pay the taxes due on his total wages for the entire year
- Too much **FITW withheld each paycheck will generate a refund** to Demetrius
- Too little **FITW withheld each paycheck will cause Demetrius to have a balance due** that will have to be paid out of his pocket.

**It is important to fill out the W-4 correctly.**

# Non-Employees



- Individuals who perform a service for pay can be considered an **independent contractor or self employed**. Generally, these individuals use their own tools, set their own time and decide how a job will be performed.
- Yard maintenance is a good example
  - They bring their own tools
  - Pick the day and time they will stop by
  - Determine if they will edge first or mow first

## Difference between Employee and Independent Contractor/Self Employed



- Independent contractors don't have taxes withheld from payments of service
- Independent contractors must also pay taxes timely throughout the year
- Independent contractors pay double what employees pay for payroll taxes
  - They pay 12.4% in Social Security and Medicare instead of 6.2%
  - They pay 2.9% in Medicare instead of 1.45%
  - They keep all of the profits of the business.
  - They work their own schedule
  - They have the satisfaction of owning their own business

# Year End



- The payers will report all of the income paid on an IRS Form 1099-MISC and send to the independent contractor
- The independent contractor will report the income on an annual tax return, IRS 1040
- The 1040 will walk the taxpayer through the steps to determine if there is a balance due or a refund due

## In either case (Employee or Independent Contractor)



- Each pays Social Security Taxes on earned income
- Each pays Medicare Taxes on earned income
- An employer withholds, partially matches and remits to the IRS
- An Independent contractor has the sole responsibility of paying all of the taxes timely throughout the year
- Both report the earned income on a year-end tax return
- Both determine whether enough taxes were paid during the year

# VITA: FREE Volunteer Income Tax Assistance



- Montgomery MD partners offer 30+ free tax sites to help you file your taxes, with IRS certified volunteers
- Most services are from late January through April 15<sup>th</sup>
- To learn more, call 311, or go to [www.montgomerycountymd.gov/cashback](http://www.montgomerycountymd.gov/cashback)
- For free filing software, go to: [www.myfreetaxes.com](http://www.myfreetaxes.com)
- For free financial education, go to [www.mdcashacademy.org](http://www.mdcashacademy.org)