FAMILY ECONOMICS & FINANCIAL EDUCATION

Understanding Your Paycheck

Methods For Paying Employees

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. By learning about paychecks, paycheck deductions, and required employment forms, a person will be able to understand the amount received on their paycheck and ensure they have been paid the correct amount from the employer.

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

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.

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.

Payroll Card

The third and newest method is by using a **payroll card**. A payroll card is a prepaid card that is offered to employees as an alternative to paper paychecks or directly depositing wages into an employee's depository institution account. Most payroll cards are **smart cards**, which have money electronically loaded onto them each pay period with funds automatically deducted from the balance 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. Once the employee's wages are credited to an account, the employee can use the card for ATM withdrawals or to make purchases.

Regardless of which method employees choose to receive their payment, it is important for the employee to understand paycheck deductions taken out of a paycheck and what they are used for.

Payroll Card Fees

There may be numerous fees associated with payroll cards. The number and amount of fees depends upon the depository institution. For example, some payroll cards offer just one ATM withdrawal per pay period free of charge, while others offer three to five withdrawals free of charge. Employers can negotiate with depository institutions to reduce the number of fees and some employers will pay all or part of the payroll card fees. Therefore, it is important for employees to obtain a list of all fees before signing up to use a payroll card.

The following are examples of fees charged by payroll card companies:

- monthly or annual fee;
- ATM fee;
- inactivity fee;
- fee after a specific number of transactions have been used;
- replacement fee if the card is lost, stolen, or destroyed;
- load fee (when funds are placed on the card account);
- point of sale (POS) fee for using the card at a point of sale terminal, or an electronic payment processor.

Funded by a grant from Take Charge America, Inc. to the Norton School of Family and Consumer Sciences Take Charge America Institute at The University of Arizona

Consumer Protection With Payroll Cards

Payroll card users are protected through **Regulation E**, or the **Electronic Fund Transfer Act**. If a payroll card is stolen or fraudulent transactions are completed, the payroll card holder is liable for only $50 if the lost or stolen card is reported to the sponsoring depository institution within 48 hours. The FBI estimates that over four million paper paychecks are stolen annually (Visa USA, Inc.). Considering there is no legal protection for consumers whose paychecks have been stolen, Regulation E provides safety and protection for payroll card holders.

Safety tips to follow when using a payroll card include memorizing the **Personal Identification Number (PIN)** and not giving it out to anyone. Also, if a payroll card is lost or stolen, it should be reported to the sponsoring depository institution immediately.

Payroll Card Benefits

There are many benefits for both employers and employees to use payroll cards.

For Employers

- lower internal costs: the costs associated with producing, handling, and distributing paychecks is eliminated.

For Employees

- Increased safety: payroll cards reduce the need to carry large amounts of cash.
- 24 hour access to funds and the ability to make online purchases easily.
- No check cashing fees each pay period which costs unbanked Americans roughly $8 billion annually (Visa USA, Inc.).
- Access to an electronic monthly statement of transactions—a great money management tool
- Option of a second card: allowances for children, send money internationally to family without additional hassle

Depository institutions benefit from the payroll card arrangement because many unbanked consumers who begin to use a payroll card become traditional depository institution account users. In addition, depository institutions profit from the fees charged to employees, employers, and merchants.

Payroll cards have no check cashing fees, which costs unbanked Americans roughly $8 billion annually (Visa USA, Inc.).

Form 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.

Form I-9

The **Form I-9** is the Employment Eligibility Verification Form used to verify the eligibility of individuals and to avoid hiring undocumented workers. 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, and birth certificate.

Taxes

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**.

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Take Charge America® Non-Profit Credit Counseling

READING A PAYCHECK STUB

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

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 or Employee Identification 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: **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.

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.

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