Withholding Tax Explained: Types and How It's Calculate

What Is Withholding Tax?

The term "withholding tax" refers to the money that an employer deducts from an employee's gross wages and pays directly to the government. The amount withheld is a credit against the income taxes the employee must pay during the year.

The vast majority of people who are employed in the United States are subject to tax withholding.

- Withholding tax is a set amount of income tax that an employer withholds from an employee's paycheck.
- Employer's remit withholding taxes directly to the IRS in the employee's name.
- The tax withholding is a credit against the employee's annual income tax bill.
- If too much money is withheld, an employee receives a tax refund; if too little is withheld, they may have to pay the IRS more with their tax return.

Understanding Withholding Tax

Tax withholding is a way for the U.S. government to maintain its pay-as-you-go income tax system. This means taxing individuals at the source of income rather than trying to collect income tax after wages are earned.

Here's How It Works

Whenever an employee gets paid, their employer withholds a certain percentage of their paycheck as income tax. This is then paid by the employer to the Internal Revenue Service (IRS).

The amount deducted appears on the employee's paystub and the total amount deducted annually can be found on Form W-2: Wage and Tax Statement. Employers send W-2s to their employees each year to help them file their annual income tax returns.

The amount deducted depends on a number of factors. These considerations include the amount an employee earns, filing status, any withholding allowances claimed by the employee, and whether an employee requests that additional income be withheld. If merited, any excess is paid back to the employee by the IRS as a tax refund.

The IRS suggests verifying your withholding tax early in the year and whenever any changes are made to the tax law. You should also check it whenever you have changes in your lifestyle (filing status, marriage, divorce), wages, or when tax credits and deductions are changed.

State Income Taxes

The majority of U.S. states also have state income taxes and employ tax withholding systems to collect taxes from their residents. States use a combination of the IRS W-4 Form and their own worksheets, which residents fill out to establish their withholding.

Nine states do not impose income tax on residents. They are: Alaska, Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming.

How Much Tax Should You Have Withheld?

The amount of income tax you contribute from each paycheck depends on several factors, including total annual earnings and your filing status.

You can calculate your withholding tax by using the IRS Withholding Estimator. Tax Withholding Estimator | Internal Revenue Service In order to get an accurate figure, you'll need some basic information. Be sure to have the following handy when you're filling out the online form:

- Your filing status
- Your income sources
- Any additional income sources
- The end date of your most recent pay period
- Your wages per period and the year-to-date (YTD) totals

- The amount of federal income tax per pay period and the total paid year-to-date
- Whether you take the standard deduction or itemize your deductions
- The amount of any tax credits you take

The estimator tells you how much of a refund or tax bill you can expect. You can also choose an estimated withholding amount that's suitable for you.

Who Qualifies for Exemption from Withholding?

Employees with no tax liability for the previous year and who expect no tax liability for the current year can use Form W-4 to instruct their employer not to deduct any federal income tax from their wage. This exemption is valid for a calendar year.

The Bottom Line

Payroll taxes are withheld from employee paychecks and paid by employers to fund government programs like Social Security and Medicare. This process is known as payroll tax withholding.

- Social Security: Provides retirement, disability, and survivor benefits.
- Medicare: Provides hospital insurance benefits.
- State Unemployment Tax Act (FUTA): Helps state fund unemployment compensation programs. This tax is paid by the employer on behalf of the employee.
- Federal Unemployment Tax Act (FUTA): Helps states fund unemployment compensation programs. This tax is paid by the employer on behalf of the employee.