

Standard 1: The student will describe the importance of earning an income and explain how to manage personal income using a budget.

Income and Taxes



Lesson Objectives

- ⇒ Identify the different kinds of payroll deductions, including taxes and benefits.
- ⇒ Explain the difference between gross and net income.
- ⇒ Compute net income.

Personal Financial Literacy

Vocabulary

Deductions: Anything subtracted from your gross income.

Exemptions: Legal allowances that reduce the amount of income taxes subtracted from your gross income.

FICA: Federal Insurance Contributions Act.

Murphy cannot wait for his mom to get home. After all, it is not every day that you get your first job! Murphy was just hired at the Stop and Shop Grocery as a sacker. They will pay him \$8 an hour. He can work up to 35 hours a week during the summer, and he can work 20 hours a week during the school year.

Murphy is so excited! Mom said he could get a motorcycle if he could find a job to make the payments.

On his way home, Murphy stopped by the Cycle Shop to check out that cool bike one more time. He even picked out the most awesome helmet in the shop. His buddies will be so jealous.

Murphy has it all figured out. 35 hours a week at \$8 an hour is \$280 ($35 \times \$8 = \280). Wow. That is \$1,120 a month ($\$280 \times 4 = \$1,120$). Mom will be proud!

What is wrong with Murphy's reasoning?

Gross income: Wages or salary before deductions for taxes and other purposes.

Medicare: Federal government program, financed by deductions from wages, that pays for certain health care expenses for older citizens.

Net income: Commonly called “take home pay”; it is your income after all deductions and exemptions.

Social Security: A federal government program that provides retirement, survivor’s, and disability benefits, funded by a tax on income, which appears on workers’ pay stubs as a deduction labeled FICA (for *Federal Insurance Contributions Act*, the enabling legislation).

Introduction



Just because the employer says you will earn \$10 an hour or \$20,000 a year does not mean that you have all of that money in your weekly or monthly paycheck. Part of your earnings will go to pay state and federal taxes, and those taxes are deducted from the amount you receive. Other payroll deductions—such as insurance, retirement or other employee benefits—are also deducted from your check.

Lesson

Have you received a paycheck and wondered where all of the money went? Or, have you heard someone in your family complain about having to pay all of those taxes? Do you know what FICA means and why we have to pay it? This lesson will help answer those questions.

Few people really enjoy paying taxes, especially when it reduces the amount of money in our paycheck. But taxes are just one kind of deduction we have from our paychecks. Other deductions may go to pay for our health insurance, contributions to our retirement account, or payments to our savings account. Regardless of where they go, all payroll deductions are listed on the payroll statement received from our employers.

It may seem unfair that we pay taxes, but citizens have been taxed almost since the beginning of time. Even in ancient Rome, people were required to pay part of their income to the government in return for goods and services received. The idea of employee benefits is more recent. While many benefits are provided by the employer,

it is very common for the employee to share the cost of those benefits. In most cases, the insurance provided by the employer is cheaper than what we would pay if we bought it on our own. Employers also provide additional payroll services, such as deductions to savings or retirement accounts, to help us prepare for future spending needs.

Whatever the reason, deductions are subtracted from our **gross income**. Gross income is our income before any deductions or exemptions. For example, if your supervisor said you would earn \$10 an hour and you worked 20 hours, your gross income would be \$200 (that's $\$10 \times 20 = \200). Your **net income** is commonly called your "take home pay;" it is your income after all deductions and exemptions.

Deductions include anything that is subtracted from that gross amount. While many deductions are voluntary, paying state and federal taxes is required. Deductions may include payments for health insurance, life insurance, meals, uniforms, employee stock purchases, union dues, and many other expenses. Most employers will also deduct personal contributions to savings accounts, college savings plans and other similar accounts. **Exemptions**, on the other hand, are legal allowances that reduce the amount of income taxes subtracted from our paycheck. Employees can have federal withholding allowances for themselves, their spouse, and their dependents. You can set those exemptions by completing a form from the Internal Revenue Service called a W-4. All employers have copies available and will have you complete one as part of the hiring process.

Payroll Taxes

FICA is basically another name for Social Security. It stands for the Federal Insurance Contributions Act and covers both Social Security and Medicare. **Social Security** and **Medicare** are federal programs providing benefits for people who are retired, disabled, or children of deceased workers. Any employer with more than one employee is required to withhold FICA taxes. Employers pay half of the tax and deduct the other half from the employee's paycheck. Employees who earn tips on their job are also required to report those tips to their employer and pay FICA on those earnings. If a person is self-employed, the individual is responsible for the entire amount.

In addition, state and federal taxes are deducted from most paychecks. The actual amount of state or federal income tax taken out each month depends on a person's income. Employers use information called "tax tables" to determine how much to deduct from each paycheck. The federal tax rates are set by Congress, while state tax rates are set by each state. State payroll taxes may vary greatly from state to state, but federal tax rates are the same regardless of where a person lives in the United States.

**COMPLETE: Paycheck Deductions – Activity 1.2.1**

Ask your teacher to review your answers before continuing with this lesson.

Conclusion

Paying taxes is part of the responsibility of earning an income. Taxes are used to support a variety of programs, such as public schools, national defense, and public welfare. While no one likes paying taxes, we all enjoy the benefits received from them. Other payroll deductions provide benefits to us and to our families. Remember, there is no such thing as a free lunch; somebody has to pay. And, payroll deductions are just one way of paying for the benefits received.

“Nothing is certain except death and taxes.”

Benjamin Franklin

Will Murphy really take home \$1,120 a month?

No. In his excitement about the new job, Murphy has totally forgotten about payroll taxes and any other payroll deductions at Stop and Shop Grocery. His calculations are the gross income, not the net.

Payroll taxes and other payroll deductions will be subtracted from his monthly earnings before he receives his check.


Name: _____ Class Period: _____

Paycheck Deductions – Activity 1.2.1

Answer the following questions using the attached pay stubs:

Earnings			Deductions			Other Deductions	
Description	Hours	Amount	Tax	Current	YTD	Meals	\$7.00
REGULAR	40	\$240.00	INCOME TAX	\$42.65	\$120.78		
OVERTIME	6	\$54.00	STATE TAX	\$8.67	\$64.98		
			FICA	\$16.25	\$115.04		
CURRENT		\$294.00					
YTD		\$3,592.00					

1. What is the name of Zooma Round's employer?
2. How much did Zooma earn before deductions?
3. What is Zooma's hourly wage?
4. List Zooma's deductions.
5. What percent was Zooma's net pay?
6. What percent was the federal tax? State tax? FICA?

		Best Bakery		Employee JENNIFER BROWN			SSN 000-999-0000	
				PAY PERIOD 8-6-__ to 8-12-__		CHECK NO. 3451		
				PAY DATE 8-15-__		NET PAY \$296.26		
Earnings			Deductions			Other Deductions		
Description	Hours	Amount	Tax	Current	YTD	Uniform	\$10.00	
REGULAR	40	\$320.00	INCOME TAX	\$30.75	\$372.01			
OVERTIME	6	\$54.00	STATE TAX	\$9.50	\$114.25			
			FICA	\$22.49	\$272.06			
			RETIREMENT	\$5.00	\$35.00			
CURRENT		\$374.00						
YTD		\$3,592.00						

7. What pay period does Jennifer Brown’s paycheck cover?

8. How much income tax has been taken out of Jennifer’s paycheck so far this year?

9. How much did Jennifer contribute to a retirement plan from this paycheck?

10. How much is Jennifer’s take-home pay?

11. What percent was Jennifer’s net pay?

12. What percent was federal tax? State tax? FICA?

Optional Activities

⇒ **Payroll Calculator**

http://www.bankrate.com/brm/calculators/tax/payroll_deductions_calculator.asp

⇒ **Basic Information on Payroll Taxes**

http://taxes.about.com/od/payroll/qt/payroll_basics.htm

⇒ **Internal Revenue Service**

<http://www.irs.gov>