



# Income and Taxes

## Standard 1

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

## 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.

**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

**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.**

### REMINDER

*It may seem unfair that you have to pay taxes, but individuals have been taxed almost since the beginning of time.*

**Based on Murphy’s calculations, he can earn enough money to buy a used motorcycle in six months. Here’s his estimated earnings: 35 hours a week at \$8 an hour is \$280 ( $35 \times \$8 = \$280$ ). That is \$1,120 a month ( $\$280 \times 4 = \$1,120$ ).**

**What is wrong with Murphy’s plan? Will he really take home \$1,120 each month?**

## Lesson

If an employer says you will be paid \$10 an hour or \$20,000 a year, it does not mean you will have all of those earnings in your weekly or monthly paycheck. Why? Because part of your earnings will go to pay state and federal taxes or other payroll deductions such as insurance, retirement and other employee benefit offered by your employer.

It may seem unfair that you have to pay taxes, but individuals 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, however, is more recent. While many benefits are provided by the employer, it a common practice for employees to share the cost of those benefits. Employee benefits, their cost and who pays can be an important factor to consider when applying for a job. In some cases, they may add as much 40 percent to your monthly income.

Taxes and employee benefits are generally deducted from your gross income. Gross income is 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, commonly called your “take home pay”, is amount of money you actually receive after all deductions and exemptions have been met.

Deductions include anything that is subtracted from the gross amount. While many deductions are voluntary, paying state and federal taxes is required. Additional 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 any personal contributions you choose to make to your 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. Those exemptions are determined by completing a form from the Internal Revenue Service called a W-4. All employers have copies of the form and should have them available as part of the hiring process.

## **Payroll Taxes**

Taxes deducted from your gross income are often called payroll taxes. One of the most common is FICA, which 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 to 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. Those who are self-employed are responsible for paying the entire amount.

As previously mentioned, 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 and the current tax rates. Employers use "tax tables" provided by the Internal Revenue Service, a federal government agency, and state tax commissions to determine how much personal income tax to deduct from each paycheck. The federal tax rates are set by Congress, while state tax rates are set by each individual state. While state payroll tax rates vary greatly, federal tax rates are the same regardless of where a person lives in the United States. (Note: Some states do not have a personal income tax; in those states, no state taxes are deducted from individual paychecks.)

## **Conclusion**

Paying taxes is part of the responsibility of earning an income. Taxes are used to provide a variety of programs, such as public schools, national defense, and public welfare. While few people actually enjoy paying taxes, most understand the benefits received from them. Other payroll deductions provide benefits to us and to our families.

FINAL NOTE: Obviously, Murphy has forgotten about having payroll taxes and any potential expenses deducted from his paycheck. His calculations are the gross income, not the net. Murphy will need to use the net to determine how much money he is taking home each month and adjust his plans to buy that motorcycle.

This lesson was written and created by Oklahoma educators in partnership with



Name: \_\_\_\_\_ Class Period: \_\_\_\_\_

## Income and Taxes Review 1.2

Answer the following questions and give the completed lesson to your teacher to review.

1. Explain the difference between gross income and net income.
2. Identify two different types of deductions that an employer is required to subtract from a paycheck.
3. Identify two different types of optional deductions that an employer may subtract from a paycheck.
4. What is the complete name of FICA? What two payroll taxes does it include?

Name: \_\_\_\_\_ Class Period: \_\_\_\_\_

## Paycheck Deductions Activity 1.2

Answer the following questions using the attached pay stubs and give completed lesson to your teacher.

Lawns R Us						
Name: Corbin Yen		Payroll Ending: 4/3/17				
Employee No. 178945		Check No. 3399		Amount: \$223.43		
Earnings			Deductions			Other
Description	Hours	Amount	Tax	Current	YTD	Meals \$7.00
REGULAR	40	\$240.00	INCOME	\$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 Corbin Yen's employer?
2. How much did Corbin earn before deductions?
3. What is Corbin's hourly wage?
4. What are Corbin's deductions?
5. What percent was Corbin's net pay?
6. What percent was the federal tax? State tax? FICA?

<b>BEST COFFEE SHOP</b>			Employee JENNIFER BROWN SSN 000-999-0000 PAY PERIOD 8-6-17 to 8-12-17 PAY DATE 8-15-17 CHECK NO. 3451 NET PAY \$296.26			
Earnings			Deductions			Other
Description	Hours	Amount	Tax	Current	YTD	
REGULAR	40	\$ 320.00	INCOME TAX	\$30.75	\$372.01	Uniform \$10.00
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				

1. What pay period does Jennifer Brown's paycheck cover?
2. How much income tax has been taken out of Jennifer's paycheck so far this year?
3. How much did Jennifer contribute to a retirement plan from this paycheck?
4. How much is Jennifer's take-home pay?
5. What percent was Jennifer's net pay?
6. What percent was federal tax? State tax? FICA?